HEARTLAND BANK

Disclosure Statement

For the six months ended 31 December 2012

CONTENTS

GENERAL INFORMATION

This Disclosure Statement has been issued by Heartland Bank Limited for the six months ended 31 December 2012 in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order (No 2) 2012 (Order).

Words and phrases defined by the Order have the same meanings when used in this Disclosure Statement.

Name and address for service

The name of the Registered Bank is Heartland Bank Limited (Bank). The Bank was incorporated under the Companies Act 1993 on 31 January 2013. The Banking Group consists of the Bank and all of its controlled entities. All controlled entities are incorporated in New Zealand.

The Bank was formerly known as Heartland Building Society. Heartland Building Society was established in January 2011, as a result of the merger of Canterbury Building Society (CBS), MARAC Finance Limited (MARAC) and Southern Cross Building Society (SCBS) and was incorporated under the Building Societies Act 1965.

The Bank's address for service is 75 Riccarton Road, Riccarton, Christchurch.

GUARANTEE ARRANGEMENTS

The bank has the following guarantees as at the date this disclosure statement is signed:

Guarantee of Bank's obligations

MARAC, VPS Parnell Limited, VPS Properties Limited and PGG Wrightson Finance Limited (PWF), all members of the Banking Group, each guarantee the obligations of the Bank under a Standby Cash Advances Facility Agreement dated 15 December 2010 (as amended from time to time) to Bank of New Zealand and Westpac New Zealand Limited. The guarantee does not have an expiry date.

MARAC's address for service is Heartland House, 35 Teed Street, Newmarket, Auckland. The address for service of VPS Parnell Limited, VPS Properties Limited and PWF is 75 Riccarton Road, Riccarton, Christchurch. Neither MARAC, VPS Parnell Limited, VPS Properties Limited or PWF have a credit rating applicable to their long term senior unsecured obligations. Further details can also be obtained by referring to the Bank's Disclosure Statement for the year ended 30 June 2012, which is available at www.heartland.co.nz.

Cross Guarantees

The Guaranteeing Group, which includes the Bank, MARAC, VPS Parnell Limited, VPS Properties Limited and PWF, have entered into an All Obligations Cross Guarantee and Indemnity Deed Poll dated 15 December 2010. Each member of the Guaranteeing Group guarantees all of each other’s obligations to Bank of New Zealand and Westpac New Zealand Limited. The cross guarantee does not have an expiry date. Further details can also be obtained by referring to the Bank's Disclosure Statement for the year ended 30 June 2012, which is available at www.heartland.co.nz.

DIRECTORS

Michelle Anne Smith resigned as a Director with effect from 1 February 2013.

Richard Arthur Wilks was appointed as a Director with effect from 1 February 2013.

There have been no other changes to the Directors since the 30 June 2012 Disclosure Statement was signed.

CONDITIONS OF REGISTRATION

There have been no changes to the Conditions of Registration imposed on the Bank by the Reserve Bank of New Zealand (RBNZ) pursuant to section 74 of the Reserve Bank of New Zealand Act 1989 between the date of registration, 17 December 2012, and 31 December 2012, the reporting date for this Disclosure Statement. The 30 June 2012 Disclosure Statement details all of the Conditions of Registration imposed on the Bank.

After 31 December 2012, the following Conditions of registration cease to apply:

1. That the banking group complies with the following requirements:
(a) the total capital ratio of the banking group is not less than 12 percent;
(b) the tier one capital ratio of the banking group is not less than 12 percent; and
(c) the capital of the banking group is not less than $30 million.

For the purposes of this condition of registration, capital, the total capital ratio and the tier one capital ratio must be calculated in accordance with the Reserve Bank of New Zealand document entitled “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated October 2010.

1A. That—
(a) the bank has an internal capital adequacy assessment process (“ICAAP”) that accords with the requirements set out in the document “Guidelines on a bank’s internal capital adequacy assessment process (“ICAAP”)” (BS12) dated December 2007;
(b) under its ICAAP, the bank identifies and measures its “other material risks” defined as all material risks of the banking group that are not explicitly captured in the calculation of tier one and total capital ratios under the requirements set out in the document “Capital Adequacy Framework (Standardised Approach)” (BS2A) dated October 2010; and
(c) the bank determines an internal capital allocation for each identified and measured “other material risk”.

The Bank converted to a company on 31 January 2013, meeting condition 15 pertaining to Heartland Building Society converting to a company under Part 7A of the Building Societies Act 1965 by 15 February 2013.

AUDITOR

KPMG
KPMG Centre
18 Viaduct Harbour Avenue
Auckland

PENDING PROCEEDINGS OR ARBITRATION

There are no pending legal proceedings or arbitrations concerning any member of the Banking Group at the date of this Disclosure Statement that may have a material adverse effect on the Banking Group or the Bank.

CREDIT RATING

As at the date of signing this Disclosure Statement, the Bank's credit rating issued by Standard & Poor's (Australia) Pty Limited (S&P) was BBB- stable. This BBB- credit rating was issued on 6 December 2011 and is applicable to long term unsecured obligations payable in New Zealand, in New Zealand dollars. The rating is not subject to any qualifications. The rating of BBB- stable was reaffirmed by S&P on 17 December 2012.

OTHER MATERIAL MATTERS

There are no other material matters relating to the business or affairs of the Bank or the Banking Group which would, if disclosed in this Disclosure Statement, materially affect the decision of a person to subscribe for debt securities of which the Bank or any member of the Banking Group is the issuer.

DIRECTORS' STATEMENTS

Each Director of the Bank states that he or she believes, after due enquiry, that:

1. As at the date on which the Disclosure Statement is signed:
   (a) the Disclosure Statement contains all the information that is required by the Order; and
   (b) the Disclosure Statement is not false or misleading;
2. From the date of registration to the date on which this Disclosure Statement is signed:
   (a) the Bank complied with all conditions of the registration;
   (b) credit exposures to connected persons were not contrary to the interests of the Banking Group; and
   (c) the Bank had systems in place to monitor and control adequately the Banking Group's material risks, including credit risk, concentration of credit risk, interest rate risk, currency risk, equity risk, liquidity risk, operational risk and other business risks, and that those systems were being properly applied.

This Disclosure Statement is dated 25 February 2013 and has been signed by all of the Directors.

B. R. Irvine (Chair - Board of Directors)

J. K. Greenslade

E. J. Harvey

G. T. Ricketts

G. R. Leech

C. R. Mace

G. R. Kennedy

R. A. Wilks

INTERIM STATEMENT OF COMPREHENSIVE INCOME

For the six months ended 31 December 2012

	NOTE	Unaudited 6 mths to Dec 2012 $000	Audited 6 mths to Dec 2011 $000	Audited 12 mths to Jun 2012 $000
Interest income	5	103,264	101,769	205,131
Interest expense	5	56,520	62,647	121,502
Net interest income		**46,744**	**39,122**	**83,629**
Operating lease income		7,712	7,463	15,064
Operating lease expenses		5,029	4,803	9,954
Net operating lease income		**2,683**	**2,660**	**5,110**
Lending and credit fee income		795	958	1,889
Other income		1,611	2,257	4,330
Net operating income		**51,833**	**44,997**	**94,958**
Selling and administration expenses	6	31,300	34,919	64,181
Profit before impaired asset expense and income tax		**20,533**	**10,078**	**30,777**
Impaired asset expense	7	5,254	3,788	5,642
Decrease in fair value of investment properties		-	-	3,900
Profit before income tax		**15,279**	**6,290**	**21,235**
Income tax expense / (benefit)		4,361	(3,932)	(2,974)
Profit for the period		**10,918**	**10,222**	**24,209**
Other comprehensive income				
Cash flow hedges:				
Effective portion of changes in fair value, net of income tax		274	(595)	378
Reserves:				
Net change in available for sale reserve, net of income tax		46	(104)	(103)
Net change in defined benefit reserve, net of income tax		203	(236)	(435)
Other comprehensive income / (loss) for the period, net of income tax		**523**	**(935)**	**(160)**
Total comprehensive income for the period		**11,441**	**9,287**	**24,049**

All comprehensive income for the period is attributable to owners of the Banking Group.

The notes on pages 8 to 22 are an integral part of these interim financial statements.

INTERIM STATEMENT OF CHANGES IN EQUITY

For the six months ended 31 December 2012

	NOTE	Share Capital $000	Available for sale Reserve $000	Defined benefit Reserve $000	Hedging Reserve $000	Retained Earnings $000	Total Equity $000
Unaudited - Dec 2012							
Balance at 1 July 2012		**189,774**	**8**	**(421)**	**(1,010)**	**182,942**	**371,293**
Total comprehensive income for the period							
Profit for the period		-	-	-	-	10,918	10,918
Total other comprehensive income		-	46	203	274	-	523
Total comprehensive income for the period		**-**	**46**	**203**	**274**	**10,918**	**11,441**
Contributions by and distributions to owners							
Dividends to equity holders	8	-	-	-	-	(7,831)	(7,831)
Total transactions with owners		**-**	**-**	**-**	**-**	**(7,831)**	**(7,831)**
Balance at 31 December 2012		**189,774**	**54**	**(218)**	**(736)**	**186,029**	**374,903**
Audited - Dec 2011							
Balance at 1 July 2011		**134,774**	**111**	**14**	**(1,388)**	**160,330**	**293,841**
Total comprehensive income for the period							
Profit for the period		-	-	-	-	10,222	10,222
Total other comprehensive loss, net of income tax		-	(104)	(236)	(595)	-	(935)
Total comprehensive (loss) / income for the period		**-**	**(104)**	**(236)**	**(595)**	**10,222**	**9,287**
Contributions by and distributions to owners							
Issue of share capital		55,000	-	-	-	-	55,000
Dividends to equity holders	8	-	-	-	-	(1,597)	(1,597)
Total transactions with owners		**55,000**	**-**	**-**	**-**	**(1,597)**	**53,403**
Balance at 31 December 2011		**189,774**	**7**	**(222)**	**(1,983)**	**168,955**	**356,531**
Audited - Jun 2012							
Balance at 1 July 2011		**134,774**	**111**	**14**	**(1,388)**	**160,330**	**293,841**
Total comprehensive income for the year							
Profit for the year		-	-	-	-	24,209	24,209
Total other comprehensive (loss) / income, net of income tax		-	(103)	(435)	378	-	(160)
Total comprehensive (loss) / income for the year		**-**	**(103)**	**(435)**	**378**	**24,209**	**24,049**
Contributions by and distributions to owners							
Issue of share capital		55,000	-	-	-	-	55,000
Dividends to equity holders	8	-	-	-	-	(1,597)	(1,597)
Total transactions with owners		**55,000**	**-**	**-**	**-**	**(1,597)**	**53,403**
Balance at 30 June 2012		**189,774**	**8**	**(421)**	**(1,010)**	**182,942**	**371,293**

The notes on pages 8 to 22 are an integral part of these interim financial statements.

INTERIM STATEMENT OF FINANCIAL POSITION

As at 31 December 2012

	NOTE	Unaudited Dec 2012 $000	Audited Dec 2011 $000	Audited Jun 2012 $000
Assets				
Cash and cash equivalents		122,998	118,564	89,220
Investments		24,406	24,309	24,327
Due from related parties	9	286	272	276
Investment properties		55,316	58,083	55,504
Finance receivables	10	2,044,793	2,075,211	2,078,276
Operating lease vehicles		34,359	35,333	34,550
Current tax asset		1,598	1,763	5,272
Other assets		18,438	23,298	15,857
Intangible assets		22,986	21,981	22,997
Property, plant and equipment		10,071	10,031	10,067
Deferred tax asset		8,146	7,640	8,143
Total assets		**2,343,397**	**2,376,485**	**2,344,489**
Liabilities				
Borrowings	11	1,935,116	1,985,551	1,939,489
Due to related parties	9	-	104	193
Trade and other payables		33,378	34,299	33,514
Total liabilities		**1,968,494**	**2,019,954**	**1,973,196**
Equity				
Share capital		189,774	189,774	189,774
Retained earnings and reserves		185,129	166,757	181,519
Total equity		**374,903**	**356,531**	**371,293**
Total equity and liabilities		**2,343,397**	**2,376,485**	**2,344,489**
Total interest earning and discount bearing assets		2,192,708	2,220,115	2,193,238
Total interest and discount bearing liabilities		1,935,880	1,987,713	1,940,948

The notes on pages 8 to 22 are an integral part of these interim financial statements.

INTERIM STATEMENT OF CASH FLOWS

For the six months ended 31 December 2012

	NOTE	Unaudited 6 mths to Dec 2012 $000	Audited 6 mths to Dec 2011 $000	Audited 12 mths to Jun 2012 $000
Cash flows from operating activities				
Interest received		99,194	97,875	197,136
Operating lease income received		6,529	6,392	13,099
Proceeds from sale of operating lease vehicles		4,683	4,952	7,932
Lending, credit fees and other income received		2,406	3,215	6,219
Net decrease in finance receivables		32,192	-	-
Total cash provided from operating activities		**145,004**	**112,434**	**224,386**
Payments to suppliers and employees		33,463	33,978	66,940
Interest paid		54,048	63,483	121,742
Purchase of operating lease vehicles		8,082	10,794	16,905
Net increase in finance receivables		-	24,453	20,547
Taxation paid		815	-	23
Total cash applied to operating activities		**96,408**	**132,708**	**226,157**
Net cash flows from / (applied to) operating activities	12	**48,596**	**(20,274)**	**(1,771)**
Cash flows from investing activities				
Sale of investment properties		188	-	832
Total cash provided from investing activities		**188**	**-**	**832**
Purchase of office fit-out, equipment and intangible assets		859	1,261	3,191
Purchase of investments		79	6,478	6,496
Purchase of subsidiary		-	24,898	24,898
Purchase of investment properties		-	-	937
Total cash applied to investing activities		**938**	**32,637**	**35,522**
Net cash flows applied to investing activities		**(750)**	**(32,637)**	**(34,690)**
Cash flows from financing activities				
Issue of share capital		-	55,000	55,000
Total cash provided from financing activities		**-**	**55,000**	**55,000**
Dividends paid		7,831	1,597	1,597
Net decrease in borrowings		6,237	210,605	256,399
Total cash applied to financing activities		**14,068**	**212,202**	**257,996**
Net cash flows applied to financing activities		**(14,068)**	**(157,202)**	**(202,996)**
Net increase / (decrease) in cash held		**33,778**	**(210,113)**	**(239,457)**
Opening cash and cash equivalents		89,220	267,034	267,034
Cash impact of acquisition of subsidiary		-	61,643	61,643
Closing cash and cash equivalents		**122,998**	**118,564**	**89,220**

The notes on pages 8 to 22 are an integral part of these interim financial statements.

NOTES TO THE INTERIM FINANCIAL STATEMENTS

For the six months ended 31 December 2012

1 Reporting entity

The interim financial statements presented are the consolidated interim financial statements of the Banking Group comprising of the Bank and its subsidiaries.

The significant subsidiaries of the Bank included in the Banking Group are MARAC, PWF, VPS Parnell Limited and VPS Properties Limited. The Banking Group also includes Heartland ABCP Trust 1 and CBS Warehouse A Trust (collectively the Trusts), which are special purpose vehicles holding securitised loans purchased from MARAC and the Bank.

The Bank acquired PWF on 31 August 2011, as a result comparatives for the year ended 30 June 2012 and the six months ended 31 December 2011 only include the PWF result from the date of acquisition.

2 Basis of preparation

The interim financial statements presented here are for the following periods:

- 6 month period ended 31 December 2012 - Unaudited
- 6 month period 31 December 2011 - Audited
- 12 month period ended 30 June 2012 - Audited

(a) Statement of compliance

The condensed interim financial statements of the Banking Group incorporated in this Disclosure Statement have been prepared in accordance with Generally Accepted Accounting Practice in New Zealand (NZ GAAP) and NZ IAS 34 Interim Financial Reporting. They do not include all of the information required for full annual financial statements and should be read in conjunction with the Disclosure Statement for the year ended 30 June 2012. The Banking Group is also in compliance with IAS 34 Interim Financial Statements.

The Banking and all the entities within the Banking Group are profit-oriented entities. The Bank is a reporting entity and an issuer for the purposes of the Financial Reporting Act 1993 and its interim financial statements comply with that Act.

(b) Basis of measurement

The interim financial statements have been prepared on a going concern basis in accordance with historical cost, unless stated otherwise.

(c) Comparative information

Certain comparatives have been restated to comply with current period presentation.

3 Significant accounting policies

The accounting policies applied by the Banking Group in these consolidated interim financial statements are the same as those applied by the Banking Group in its consolidated financial statements as at and for the year ended 30 June 2012.

4 Segmental analysis

Segment information is presented in respect of the Banking Group's operating segments which are those used for the Banking Group's management and internal reporting structure.

All income received is from external sources, except those transactions with related parties, refer to Note 9 - Related party transactions and balances. Certain selling and administration expenses, such as premises, IT and support centre costs are not allocated to operating segments and are included in Other.

Operating segments

The Banking Group operates predominantly within New Zealand and comprises the following main operating segments:

Retail and Consumer	Providing a comprehensive range of financial services to New Zealand businesses and families, including term, transactional and savings based deposit accounts together with residential mortgage lending, motor vehicle finance and asset finance.
Business	Providing term debt, plant and equipment finance, commercial mortgage lending and working capital solutions for small-to-medium sized New Zealand businesses.
Rural	Specialist financial services to the farming sector primarily offering livestock finance, rural mortgage lending, seasonal and working capital financing, as well as leasing solutions to farmers.
Non-core Property	Funding assets of the non-core property division.

The Banking Group's operating segments are different than the industry categories detailed in Note 16 - Asset quality. The operating segments are primarily categorised by sales channel, whereas Note 16 - Asset quality is based on credit risk concentrations.

4 Segmental analysis (continued)

	Retail & Consumer $000	Business $000	Rural $000	Non-core Property $000	Other $000	Total $000
Unaudited - 6 months ended 31 December 2012						
Interest income	45,371	26,388	23,545	4,605	3,355	103,264
Interest expense	24,228	13,895	12,084	4,156	2,157	56,520
Net interest income	**21,143**	**12,493**	**11,461**	**449**	**1,198**	**46,744**
Net operating lease income	2,664	19	-	-	-	2,683
Net other income	284	91	22	1,503	506	2,406
Net operating income	**24,091**	**12,603**	**11,483**	**1,952**	**1,704**	**51,833**
Depreciation and amortisation expense	-	-	-	-	866	866
Other selling and administration expenses	6,061	2,887	3,046	3,248	15,192	30,434
Selling and administration expenses	**6,061**	**2,887**	**3,046**	**3,248**	**16,058**	**31,300**
Profit / (loss) before impaired asset expense and income	**18,030**	**9,716**	**8,437**	**(1,296)**	**(14,354)**	**20,533**
Impaired asset expense	756	817	(299)	3,980	-	5,254
Profit / (loss) before income tax	**17,274**	**8,899**	**8,736**	**(5,276)**	**(14,354)**	**15,279**
Income tax expense	-	-	-	-	4,361	4,361
Profit / (loss) for the period	**17,274**	**8,899**	**8,736**	**(5,276)**	**(18,715)**	**10,918**
Total assets	980,183	530,496	480,572	143,217	208,929	**2,343,397**
Total liabilities	-	-	-	-	1,968,494	**1,968,494**
Total equity	-	-	-	-	374,903	**374,903**
Audited - 6 months ended 31 December 2011						
Interest income	47,920	24,788	17,703	7,217	4,141	101,769
Interest expense	29,377	14,858	9,850	5,664	2,898	62,647
Net interest income	**18,543**	**9,930**	**7,853**	**1,553**	**1,243**	**39,122**
Net operating lease income	2,651	9	-	-	-	2,660
Net other income	566	13	33	2,145	458	3,215
Net operating income	**21,760**	**9,952**	**7,886**	**3,698**	**1,701**	**44,997**
Depreciation and amortisation expense	-	-	-	-	952	952
Other selling and administration expenses	6,478	2,723	2,698	3,240	18,828	33,967
Selling and administration expenses	**6,478**	**2,723**	**2,698**	**3,240**	**19,780**	**34,919**
Profit / (loss) before impaired asset expense and income	**15,282**	**7,229**	**5,188**	**458**	**(18,079)**	**10,078**
Impaired asset expense	365	1,745	54	1,624	-	3,788
Profit / (loss) before income tax	**14,917**	**5,484**	**5,134**	**(1,166)**	**(18,079)**	**6,290**
Income tax benefit	-	-	-	-	(3,932)	(3,932)
Profit / (loss) for the period	**14,917**	**5,484**	**5,134**	**(1,166)**	**(14,147)**	**10,222**
Total assets	1,014,138	518,502	466,401	169,587	207,857	**2,376,485**
Total liabilities	-	-	-	-	2,019,954	**2,019,954**
Total equity	-	-	-	-	356,531	**356,531**

4 Segmental analysis (continued)

	Retail & Consumer $000	Business $000	Rural $000	Non-core Property $000	Other $000	Total $000
Audited - 12 months ended 30 June 2012						
Interest income	94,606	49,867	41,391	12,630	6,637	205,131
Interest expense	55,572	28,911	22,340	10,370	4,309	121,502
Net interest income	**39,034**	**20,956**	**19,051**	**2,260**	**2,328**	**83,629**
Net operating lease income	5,097	13	-	-	-	5,110
Net other income	927	57	66	4,104	1,065	6,219
Net operating income	**45,058**	**21,026**	**19,117**	**6,364**	**3,393**	**94,958**
Depreciation and amortisation expense	-	-	-	-	1,830	1,830
Other selling and administration expenses	11,475	5,273	5,837	6,350	33,416	62,351
Selling and administration expenses	**11,475**	**5,273**	**5,837**	**6,350**	**35,246**	**64,181**
Profit / (loss) before impaired asset expense and income	**33,583**	**15,753**	**13,280**	**14**	**(31,853)**	**30,777**
Impaired asset expense	1,991	2,445	689	517	-	5,642
Decrease in fair value of investment properties	-	-	-	3,900	-	3,900
Profit / (loss) before income tax	**31,592**	**13,308**	**12,591**	**(4,403)**	**(31,853)**	**21,235**
Income tax benefit	-	-	-	-	(2,974)	(2,974)
Profit / (loss) for the year	**31,592**	**13,308**	**12,591**	**(4,403)**	**(28,879)**	**24,209**
Total assets	989,352	540,228	478,582	160,168	176,159	**2,344,489**
Total liabilities	-	-	-	-	1,973,196	**1,973,196**
Total equity	-	-	-	-	371,293	**371,293**

5 Net interest income

	Unaudited 6 mths to Dec 2012 $000	Audited 6 mths to Dec 2011 $000	Audited 12 mths to Jun 2012 $000
Interest income			
Cash and cash equivalents	1,582	3,641	5,132
Finance receivables	100,532	98,128	199,526
Derivatives held for risk management:			
• Net interest income on cash flow hedges	1,150	-	473
Total interest income	**103,264**	**101,769**	**205,131**
Interest expense			
Retail deposits and debenture stock	46,689	52,010	100,769
Bank and securitised borrowings	9,831	10,634	20,733
Derivatives held for risk management:			
• Net interest expense on cash flow hedges	-	3	-
Total interest expense	**56,520**	**62,647**	**121,502**
Net interest income	**46,744**	**39,122**	**83,629**

Included within the Banking Group's interest income on finance receivables is $1,380,000 (December 2011: $1,594,000; June 2012: $2,674,000) on individually impaired assets.

6 Selling and administration expenses

	Unaudited 6 mths to Dec 2012 $000	Audited 6 mths to Dec 2011 $000	Audited 12 mths to Jun 2012 $000
Personnel expenses	16,673	18,530	34,186
Directors' fees	96	87	175
Superannuation	201	240	475
Audit fees	221	176	516
Audit related fees	30	26	35
Amortisation - intangible assets	512	569	1,075
Depreciation - property, plant and equipment	354	383	755
Operating lease expense as a lessee	822	834	1,648
Legal and professional fees	1,573	2,939	5,397
Other operating expenses	10,818	11,135	19,919
Total selling and administration expenses	**31,300**	**34,919**	**64,181**

Audit related fees include professional fees in connection with trustee reporting, review of prospectus documentation for various Group entities, accounting advice and review work completed.

Heartland New Zealand has paid some Director's fees on behalf of the Banking Group.

7 Impaired asset expense

	NOTE	Unaudited 6 mths to Dec 2012 $000	Audited 6 mths to Dec 2011 $000	Audited 12 mths to Jun 2012 $000
Individually impaired assets expense	16(d)	3,611	3,385	6,921
Collectively impaired assets expense / (benefit)	16(d)	1,643	403	(1,279)
Total impaired asset expense		**5,254**	**3,788**	**5,642**

8 Dividends

During the period, dividends of $2,000,000 on 4 October 2012 and $5,830,560 on 11 December 2012 were paid to BSHL No. 1 Limited (December 2011: $1,597,000; June 2012: $1,597,000).

9 Related party transactions and balances

The Bank's immediate parent is BSHL No. 1 Limited, which is a wholly owned subsidiary of the Bank's ultimate parent Heartland New Zealand Limited (HNZ).

The Banking Group provided administrative assistance to MARAC Insurance Limited (a 50% joint venture interest between HNZ and the New Zealand Automobile Association) and Heartland Cash and Term PIE Fund, and received insurance commission from MARAC Insurance Limited.

Heartland Cash and Term PIE Fund's investments in the Bank are detailed in Note 13 - Special purpose entities.

All transactions were conducted on normal commercial terms and conditions, except that no interest is charged on intragroup balances.

	Unaudited 6 mths to Dec 2012 $000	Audited 6 mths to Dec 2011 $000	Audited 12 mths to Jun 2012 $000
Transactions with related parties			
Lending and credit fee income	176	237	368
Other income	180	168	328
Total transactions with other related parties	**356**	**405**	**696**

	Unaudited Dec 2012 $000	Audited Dec 2011 $000	Audited Jun 2012 $000
Due from related parties			
BSHL No. 1 Limited	200	200	200
Heartland New Zealand Limited	86	72	76
Total due from related parties	**286**	**272**	**276**
Due to related parties			
Heartland New Zealand Limited	-	-	193
Other related parties	-	104	-
Total due to related parties	**-**	**104**	**193**

10 Finance receivables

(a) Total finance receivables

	Unaudited Dec 2012 $000	Audited Dec 2011 $000	Audited Jun 2012 $000
Non-securitised			
Gross finance receivables	1,795,562	1,817,639	1,828,201
Less allowance for impairment	26,801	28,668	26,693
Total non-securitised finance receivables	**1,768,761**	**1,788,971**	**1,801,508**
Securitised			
Gross finance receivables	276,708	286,952	277,501
Less allowance for impairment	676	712	733
Total securitised finance receivables	**276,032**	**286,240**	**276,768**
Total gross finance receivables	2,072,270	2,104,591	2,105,702
Total allowance for impairment	27,477	29,380	27,426
Total finance receivables	**2,044,793**	**2,075,211**	**2,078,276**

10 Finance receivables (continued)

(b) Analysis of finance receivables	Unaudited Dec 2012 $000	Audited Dec 2011 $000	Audited Jun 2012 $000
Neither at least 90 days past due or impaired	1,964,610	1,987,483	1,987,787
At least 90 days past due	49,173	62,597	52,004
Individually impaired	49,418	45,082	56,825
Restructured assets	9,069	9,429	9,086
Provision for impairment	(27,477)	(29,380)	(27,426)
Total finance receivables	**2,044,793**	**2,075,211**	**2,078,276**

Refer to Note 16 - Asset quality for further analysis of finance receivables by credit risk concentration.

11 Borrowings

	Unaudited Dec 2012 $000	Audited Dec 2011 $000	Audited Jun 2012 $000
Bank borrowings	-	50,075	50,010
Deposits	1,670,756	1,671,069	1,625,120
Securitised borrowings	264,360	264,407	264,359
Total borrowings	**1,935,116**	**1,985,551**	**1,939,489**

Refer to Note 18 - Concentrations of funding for further analysis of borrowings.

(a) Bank facilities	Maturity	Unaudited Dec 2012 $000	Audited Dec 2011 $000	Audited Jun 2012 $000
Heartland ABCP Trust 1	07 Aug 13	400,000	300,000	300,000
CBS Warehouse A Trust	22 Jan 14	150,000	175,000	150,000
Heartland Bank Limited	30 Sep 13	50,000	200,000	200,000
Total bank facilities		**600,000**	**675,000**	**650,000**

Bank facilities and deposits (which include NZDX bonds) rank equally and are unsecured. Investors in Heartland ABCP Trust 1 rank equally with each other and are secured over the securitised assets of that Trust. Investors in the CBS Warehouse A Trust rank equally with each other and are secured over the securitised assets of that Trust.

12 Reconciliation of profit after tax to net cash flows from operating activities

	Unaudited 6 mths to Dec 2012 $000	Audited 6 mths to Dec 2011 $000	Audited 12 mths to Jun 2012 $000
Profit for the period	**10,918**	**10,222**	**24,209**
Add / (less) non-cash items:			
Depreciation and amortisation expense	866	952	1,830
Change in fair value of investment properties	-	-	3,900
Impaired asset expense	5,254	3,788	5,642
Deferred tax benefit	(3)	(2,475)	(2,978)
Derivative financial instruments revaluation	795	(992)	(219)
Accruals	(340)	822	529
Total non-cash items	**6,572**	**2,095**	**8,704**
Add / (less) movements in working capital items:			
Other assets	(1,699)	(4,041)	2,695
Current tax	3,674	(3,166)	(6,675)
Other liabilities	(1,086)	1,689	212
Total movements in working capital items	**889**	**(5,518)**	**(3,768)**
Net cash flows from operating activities before movements in finance receivables and operating lease vehicles	**18,379**	**6,799**	**29,145**
Movements in operating lease vehicles	191	(2,606)	(1,823)
Movements in finance receivables	30,026	(24,467)	(29,093)
Net cash flows from / (applied to) operating activities	**48,596**	**(20,274)**	**(1,771)**

13 Special purpose entities

Heartland Cash and Term PIE Fund

The Banking Group controls the operations of Heartland Cash and Term PIE Fund, a portfolio investment entity that invests in the Bank's deposits. Investments of Heartland Cash and Term PIE Fund are represented as follows:

	Unaudited Dec 2012 $000	Audited Dec 2011 $000	Audited Jun 2012 $000
Deposits	21,136	8,203	12,347

Heartland ABCP Trust 1 and CBS Warehouse A Trust Securitisation

The Banking Group has securitised a pool of receivables comprising residential, commercial and motor vehicle loans to the Trusts. The Banking Group substantially retains the credit risks and rewards associated with the securitised assets, and continues to recognise these assets and associated borrowings on the Statement of Financial Position. Despite this presentation in the interim financial statements, the loans sold to the Trusts are set aside for the benefit of investors in the Trusts and are represented as follows:

	Unaudited Dec 2012 $000	Audited Dec 2011 $000	Audited Jun 2012 $000
Cash and cash equivalents - Securitised	16,574	9,039	15,579
Finance receivables - Securitised	276,032	286,240	276,768
Borrowings - Securitised	(264,360)	(264,407)	(264,359)

14 Risk management policies

There have been no material changes since the signing of the 30 June 2012 Disclosure Statement in the Banking Group's policies for managing risk, or material exposures to any new types of risk.

15 Credit risk

Credit risk is the risk of financial loss to the Banking Group caused by the failure of a customer to meet their contractual obligations that arise from the Banking Group's lending activities. Credit risk carries the greatest risk of resulting in a material adjustment to the carrying amounts of the Banking Group's assets within the next financial year.

To manage this risk the Risk Committee, a committee of the Board of Directors (Board), has been delegated the task of overseeing a formal credit risk management strategy. The Risk Committee reviews the Banking Group's credit risk exposures to ensure consistency with the Banking Group's credit policies to manage all aspects of credit risk.

The tables below represent the maximum credit risk exposure, without taking account of any collateral held. The exposures set out below are based on net carrying amounts as reported in the Interim Statement of Financial Position.

(a) Maximum exposure to credit risk	**Unaudited Dec 2012 $000**
Finance receivables	2,044,793
Cash and cash equivalents	122,998
Investments	24,406
Due from related parties	286
Derivative financial assets	1,155
Other financial assets	7,740
Total on balance sheet credit exposures	**2,201,378**

(b) Concentration of credit risk by geographic region	**Unaudited Dec 2012 $000**
Auckland	600,084
Wellington	180,848
Rest of North Island	523,957
Canterbury	563,327
Rest of South Island	325,136
Total financial assets	**2,193,352**
Other financial assets	7,740
Due from related parties	286
Total on balance sheet credit exposures	**2,201,378**

15 Credit risk (continued)

(c) Concentration of credit risk by industry sector

	Unaudited Dec 2012 $000
Agriculture	517,534
Forestry and Fishing	20,435
Mining	14,003
Manufacturing	68,818
Finance	151,608
Wholesale trade	56,481
Retail trade	121,627
Insurance	5,708
Households	651,805
Property and Business services	284,775
Transport and storage	28,679
Education and Health	5,370
Communications	12,501
Culture and recreation	10,466
Electricity, gas, and water	2,432
Personal services	3,486
Other	245,650
Total on balance sheet credit exposures	**2,201,378**

(d) Credit exposure to individual counterparties

At 31 December 2012 the Banking Group did not have any period end or peak end-of-day credit exposures over 10% of equity to individual counterparties (not being members of groups of closely related counterparties) or groups of closely related counterparties (excluding central government of any country with a long-term credit rating of A- or A3 or above, or its equivalent, or any bank with a long-term credit rating of A- or A3 or above, or its equivalent, and connected persons).

The peak aggregate end-of-day credit exposures is determined by taking the maximum end-of-day aggregate amount of credit exposure over the period. The amount is then divided by the Banking Group's equity as at the end of the quarter. Credit exposures disclosed are based on actual exposures. The credit rating is applicable to an entity's long term senior unsecured obligations payable in New Zealand, in New Zealand dollars.

(e) Other assets under administration

Other assets under administration are any loans, not being individually impaired or 90 days or more past due, where the customer is in any form of voluntary or involuntary administration, including receivership, liquidation, bankruptcy or statutory management. As at 31 December 2012, the Banking Group did not have any assets under administration.

16 Asset Quality

Asset quality of finance receivables

The disclosures below are categorised by the following credit risk concentrations:

Corporate

Rural Lending to the farming sector primarily offering livestock financing, rural mortgage lending, seasonal and working capital financing, as well as leasing solutions to farmers. Includes lending to individuals and small to medium enterprises.

Property Property asset lending including non-core property.

Other All other lending that does not fall into another category.

Residential Lending secured by a first ranking mortgage over a residential property used primarily for residential purposes either by the mortgagor or a tenant of the mortgagor.

All Other Consumer lending to individuals.

(a) Finance Receivables by credit risk concentration

	Corporate			Residential	All Other	Total
	Rural $000	Property $000	Other $000	$000	$000	$000
Unaudited - Dec 2012						
Neither at least 90 days past due or impaired	528,108	40,145	750,360	276,559	369,438	1,964,610
At least 90 days past due	10,703	25,910	8,838	387	3,335	49,173
Individually impaired	496	44,945	1,772	2,205	-	49,418
Restructured	6	5,652	1,189	-	2,222	9,069
Provision for impairment	(1,343)	(19,258)	(4,417)	(853)	(1,606)	(27,477)
Total finance receivables	**537,970**	**97,394**	**757,742**	**278,298**	**373,389**	**2,044,793**

16 Asset Quality (continued)

(b) Past due but not impaired

	Corporate Rural	Corporate Property	Corporate Other	Residential	All Other	Total
	$000	$000	$000	$000	$000	$000
Unaudited - Dec 2012						
Less than 30 days past due	3,773	443	11,717	2,161	8,207	26,301
At least 30 and less than 60 days past due	9,696	879	5,734	1,673	2,404	20,386
At least 60 and less than 90 days past due	4,851	2,075	541	95	1,416	8,978
At least 90 days past due	10,703	25,910	8,838	387	3,335	49,173
Total past due but not impaired	**29,023**	**29,307**	**26,830**	**4,316**	**15,362**	**104,838**

(c) Individually impaired assets

	Corporate Rural	Corporate Property	Corporate Other	Residential	All Other	Total
	$000	$000	$000	$000	$000	$000
Unaudited - Dec 2012						
Opening	1,060	50,860	2,275	2,630	-	56,825
Additions	408	6,523	477	133	-	7,541
Deletions	(670)	(9,804)	-	(395)	-	(10,869)
Write offs	(302)	(2,634)	(980)	(163)	-	(4,079)
Closing gross individually impaired assets	**496**	**44,945**	**1,772**	**2,205**	**-**	**49,418**
Less: individual allowance for impairment	321	16,719	585	765	-	18,390
Total net impaired assets	**175**	**28,226**	**1,187**	**1,440**	**-**	**31,028**

(d) Provision for impaired assets

	Corporate Rural	Corporate Property	Corporate Other	Residential	All Other	Total
	$000	$000	$000	$000	$000	$000
Unaudited - Dec 2012						
Provision for individually impaired assets						
Opening individual impairment	696	16,917	1,086	695	-	19,394
Impairment loss for the period						
- (credit)/charge for the period	(88)	3,045	394	260	-	3,611
- recoveries	25	-	103	-	-	128
- write offs	(302)	(2,634)	(980)	(163)	-	(4,079)
- effect of discounting	(10)	(609)	(18)	(27)	-	(664)
Closing individual impairment	**321**	**16,719**	**585**	**765**	**-**	**18,390**
Provision for collectively impaired assets						
Opening collective impairment	1,823	960	3,315	79	1,855	8,032
Impairment loss for the period						
- (credit)/charge for the period	(801)	1,579	651	16	198	1,643
- recoveries	3	-	112	-	42	157
- write offs	(3)	-	(246)	(7)	(489)	(745)
Closing collective impairment	**1,022**	**2,539**	**3,832**	**88**	**1,606**	**9,087**
Total provision for impairment	**1,343**	**19,258**	**4,417**	**853**	**1,606**	**27,477**

Real Estate Credit Limited Management Agreement (RECL Agreement)

On 5 January 2011, MARAC entered into the RECL Agreement with Real Estate Credit Limited (RECL) under which RECL assumed the risk of loss on certain non-core property loans for a 5 year period (ending 5 January 2016). The maximum amount payable by RECL in respect of loss (including interest accruing on loss payments until the due date for payment) is limited to $30 million and payment is due at the end of the 5 year period ($2.0 million has been paid to date). The RECL Agreement covers MARAC non-core property loans with a net book value of $84 million as at 31 December 2012 (December 2011: $88 million; June 2012: $94 million).

In determining the charge for the year, the RECL Agreement has been taken into consideration. In assessing the requirements for provisions, the Banking Group has identified loans for which a loss is expected to be covered by the RECL Agreement of $28.0 million as at 31 December 2012 (December 2011: $16.6 million; June 2012: $28.5 million). Claims of $28.0 million are expected to be made under the RECL Agreement in relation to these loans, and to this extent, the RECL Agreement is fully utilised.

Further information about the RECL Agreement is included in the Bank's Disclosure Statement for the year ended 30 June 2012.

17 Liquidity risk

Liquidity risk is the risk that the Banking Group may encounter difficulty in raising funds at short notice to meet its commitments and arises from any mismatch of the maturity of financial assets and liabilities. Responsibility for liquidity management is delegated to the Asset and Liability Committee (ALCO), with the Risk Committee providing oversight.

The Banking Group manages liquidity and funding risk by:
- weekly liquidity reporting and scenario analysis to quantify the Banking Group's current and forecast position.
- maintaining a diverse and stable funding base.
- retaining borrowing facilities committed to the Banking Group by registered banks.
- holding a portfolio of liquid assets.
- ensuring the liquidity management framework is compliant with local regulatory requirements.

(a) Liquid assets

The Bank holds the following financial assets for the purpose of managing liquidity risk:	Unaudited Dec 2012 $000
Cash and cash equivalents	122,998
Investment securities	24,406
Undrawn committed bank facilities	335,000
Total liquidity	**482,404**

(b) Contractual liquidity profile of financial assets and liabilities

The following table shows the cash flows on the Banking Group's financial liabilities and unrecognised loan commitments on the basis of their earliest possible contractual maturity. In the following table, total financial assets does not include unrecognised loan commitments and total financial liabilities does not include undrawn committed bank facilities.

The table includes estimates as to the average interest rate applicable for each asset or liability class during the contractual term.

	On Demand $000	0-6 Months $000	6-12 Months $000	1-2 Years $000	2-5 Years $000	5+ Years $000	Total $000
Unaudited - Dec 2012							
Financial assets							
Cash and cash equivalents	122,998	-	-	-	-	-	122,998
Investments	-	491	491	982	24,818	-	26,782
Finance receivables	-	643,436	270,260	359,077	480,776	502,438	2,255,987
Finance receivables - securitised	-	54,504	54,289	85,569	86,194	98,811	379,367
Derivative financial assets	1,155	-	-	-	-	-	1,155
Other financial assets	-	8,026	-	-	-	-	8,026
Total financial assets	**124,153**	**706,457**	**325,040**	**445,628**	**591,788**	**601,249**	**2,794,315**
Financial liabilities							
Borrowings	282,700	708,493	556,074	120,386	56,107	-	1,723,760
Borrowings - securitised	-	5,266	3,800	265,813	-	-	274,879
Derivative financial liabilities	764	-	-	-	-	-	764
Other financial liabilities	-	15,258	-	-	-	-	15,258
Total financial liabilities	**283,464**	**729,017**	**559,874**	**386,199**	**56,107**	**-**	**2,014,661**
Net financial (liabilities) / assets	**(159,311)**	**(22,560)**	**(234,834)**	**59,429**	**535,681**	**601,249**	**779,654**
Unrecognised loan commitments	106,242	-	-	-	-	-	106,242
Undrawn committed bank facilities	335,000	-	-	-	-	-	335,000

The undrawn committed bank facilities totalling $335.0 million are available to be drawn down on demand. To the extent drawn, $260.0 million is contractually repayable in 6-12 months' time and $75.0 million is contractually repayable in 1-2 years' time upon facility expiry.

17 Liquidity risk (continued)

(c) Expected maturity profile of financial assets and liabilities

The following table shows management's expected maturities of existing financial assets and financial liabilities.

Expected maturities of financial assets are based on management's best estimate having regard to current market conditions and past experience. The expected maturities of securitised borrowings are based on the expected maturities of securitised receivables and historical deposit and debenture reinvestment levels have been applied to other borrowings. Other financial liabilities reflect contractual maturities.

The table does not reflect a forward looking view of how the Banking Group expects actual financial assets and liabilities to perform in the future, as it does not include new lending and borrowing.

	On Demand $000	0-6 Months $000	6-12 Months $000	1-2 Years $000	2-5 Years $000	5+ Years $000	Total $000
Unaudited - Dec 2012							
Financial assets							
Cash and cash equivalents	122,998	-	-	-	-	-	122,998
Investments	-	491	491	982	24,818	-	26,782
Finance receivables	-	646,194	319,983	382,463	589,439	57,091	1,995,170
Finance receivables - securitised	-	68,962	60,381	82,184	112,370	-	323,897
Derivative financial asset	1,155	-	-	-	-	-	1,155
Other financial assets	-	8,026	-	-	-	-	8,026
Total financial assets	**124,153**	**723,673**	**380,855**	**465,629**	**726,627**	**57,091**	**2,478,028**
Financial liabilities							
Borrowings	2,827	220,373	338,204	339,578	554,264	386,528	1,841,774
Borrowings - securitised	-	5,266	3,800	9,067	27,224	265,000	310,357
Derivative financial liabilities	764	-	-	-	-	-	764
Other financial liabilities	-	15,258	-	-	-	-	15,258
Total financial liabilities	**3,591**	**240,897**	**342,004**	**348,645**	**581,488**	**651,528**	**2,168,153**
Net financial assets / (liabilities)	**120,562**	**482,776**	**38,851**	**116,984**	**145,139**	**(594,437)**	**309,875**
Unrecognised loan commitments	106,242	-	-	-	-	-	106,242
Undrawn committed bank facilities	335,000	-	-	-	-	-	335,000

18 Concentrations of funding

(a) Concentration of funding by industry

	Unaudited Dec 2012 $000
Finance	264,360
Households	1,563,108
Listed bond	107,648
Total borrowings	**1,935,116**

(b) Concentration of funding by geographical area

	Unaudited Dec 2012 $000
Auckland	391,557
Wellington	265,038
Rest of North Island	337,095
Canterbury	693,564
Rest of South Island	165,007
Overseas	82,855
Total borrowings	**1,935,116**

19 Interest rate risk

Interest rate risk is the risk that market interest rates will change and impact on the Banking Group's financial results by affecting the margin between interest earning assets and interest bearing liabilities. The Banking Group monitors market interest rates on a daily basis and regularly reviews interest rate exposure. Interest rate risk is mitigated by management's frequent monitoring of the interest rate repricing profiles of borrowings and finance receivables, and where appropriate, the establishment of derivative instruments.

Contractual repricing analysis

The interest rate risk profile of financial assets and liabilities that follows has been prepared on the basis of maturity or next repricing date, whichever is earlier.

	0-3 Months	3-6 Months	6-12 Months	1-2 Years	2+ Years	Non-interest bearing	Total
	$000	$000	$000	$000	$000	$000	$000
Unaudited - Dec 2012							
Financial assets							
Cash and cash equivalents	121,009	-	-	-	1,989	-	122,998
Investments	24,406	-	-	-	-	-	24,406
Due from related parties	-	-	-	-	-	286	286
Finance receivables	1,199,102	96,609	168,654	164,945	138,807	644	1,768,761
Finance receivables - securitised	94,926	27,717	50,167	64,673	38,549	-	276,032
Other financial assets	1,155	-	-	-	-	7,740	8,895
Total financial assets	**1,440,598**	**124,326**	**218,821**	**229,618**	**179,345**	**8,670**	**2,201,378**
Financial liabilities							
Borrowings	689,143	286,921	539,346	109,767	45,579	-	1,670,756
Borrowings - securitised	264,360	-	-	-	-	-	264,360
Other financial liabilities	764	-	-	-	-	15,258	16,022
Total financial liabilities	**954,267**	**286,921**	**539,346**	**109,767**	**45,579**	**15,258**	**1,951,138**
Effect of derivatives held for risk management	(135,207)	(5,289)	32,563	141,114	(33,181)	-	-
Net financial assets / (liabilities)	**351,124**	**(167,884)**	**(287,962)**	**260,965**	**100,585**	**(6,588)**	**250,240**

20 Capital adequacy

The Banking Group is subject to regulation by the RBNZ. The RBNZ has set minimum regulatory capital requirements for banks that are consistent with the internationally agreed framework developed by the Basel Committee on Banking Supervision. These requirements define what is acceptable as capital and provide for methods of measuring the risks incurred by the Banking Group.

The Banking Group must comply with RBNZ minimum capital adequacy ratios as determined in its Conditions of Registration which require capital adequacy ratios to be calculated under the Basel II framework in accordance with the Capital Adequacy Framework (Standardised Approach) BS2A. Basel II consists of three pillars. Pillar One covers the capital requirements for credit, operational, and market (including interest rate) risks. Pillar Two covers all other material risks not already included in Pillar One and the requirement for an internal capital adequacy process; and Pillar Three relates to market disclosure.

The capital adequacy tables set out on the following pages summarise the composition of regulatory capital and the capital adequacy ratios for the Banking Group for the six months ended 31 December 2012.

Internal Capital Adequacy Assessment Process ('ICAAP')

The Banking Group has an ICAAP which complies with the requirements set out in BS12 and is in accordance with its Conditions of Registration. The Board has overall responsibility for ensuring the Banking Group has adequate overall capital in relation to its risk profile and establishes minimum internal capital levels and limits above the regulatory minimum.

The documented process ensures that the Banking Group has sufficient available capital to meet minimum capital requirements, even in stressed events. It describes the risk profile of the Banking Group and the risk appetite and tolerances under which it operates, and assesses the level of capital held against the material risks of the bank (both Pillar One and Pillar Two).

The ICAAP identifies the additional capital required to be held against other material risks, being concentration risk, strategic / business risk, reputational risk, regulatory risk and model risk. See Note 20(i) for further details.

20 Capital adequacy (continued)

(a) Bank Capital Summary

	Unaudited Dec 2012 $000
Tier One Capital	
Issued and fully paid up ordinary share capital	189,774
Perpetual fully paid up non-cumulative preference shares	-
Revenue and similar reserves	182,942
Current year's audited retained earnings	3,087
Tier One minority interests	-
Less deductions from Tier One Capital	
Intangible assets	(22,986)
Net future tax benefits	(8,146)
Total Tier One Capital	**344,671**
Tier Two Capital	
Upper Tier Two Capital	-
Lower Tier Two Capital	-
Total Tier Two Capital	**-**
Total Tier One and Tier Two Capital	**344,671**
Less deductions from capital	-
Total Capital	**344,671**

Capital structure

Ordinary shares

In accordance with BS2A, ordinary share capital is classified as Tier One Capital. The ordinary shares have no par value. Each ordinary share of the Bank carries the right to vote on a poll at meetings of shareholders, the right to an equal share in dividends authorised by the Board and the right to an equal share in the distribution of the surplus assets of the Bank in the event of liquidation.

Reserves

Available-for-sale reserve — The available-for-sale reserve comprises the changes in the fair value of available-for-sale securities, net of tax. These changes are recognised in profit or loss as other income when the asset is either derecognised or impaired.

Hedging reserve — The hedging reserve comprises the fair value gains and losses associated with the effective portion of designated cash flow hedging instruments.

Defined benefit reserve — The defined benefit plan reserve represents the excess of the fair value of the assets of the defined benefit superannuation plan over the net present value of the defined benefit obligations.

Retained earnings — The accumulated comprehensive income that has been retained in the Banking Group.

(b) Credit risk

	Total exposure $000	Risk weighting %	Risk weighted exposure $000	Minimum Pillar One capital requirement $000
Unaudited - Dec 2012				
On balance sheet exposures				
Cash	440	0%	-	-
Bank deposits	24,406	20%	4,881	390
Banks	122,558	20%	24,512	1,961
Zero coupon bond	9,309	20%	1,862	149
Residential mortgages not past due - Welcome home loans < 90% loan to value ratio	20,356	35%	7,125	570
Residential mortgages not past due - Welcome home loans > 90% LVR	47,558	50%	23,779	1,902
Residential mortgages not past due < 80% LVR	189,634	35%	66,372	5,310
Residential mortgages not past due 80 < 90% LVR	10,728	50%	5,364	429
Residential mortgages not past due 90 < 100% LVR	3,296	75%	2,472	198
Residential mortgages not past due 100%+ LVR	5,286	100%	5,286	423
Past due residential mortgages	1,559	100%	1,559	125
Other past due assets - provision 20%+	11,265	100%	11,265	901
Other past due assets - provision < 20%	65,365	150%	98,048	7,844
Corporates and other assets	1,800,505	100%	1,800,505	144,040
Non risk weighted assets	31,132	n/a	-	-
Total on balance sheet exposures	**2,343,397**		**2,053,030**	**164,242**

20 Capital adequacy (continued)

(b) Credit risk (continued)

	Total exposure	Credit conversion Factor	Credit equivalent amount	Risk weighting	Risk weighted exposure	Minimum Pillar One capital require-ment
	$000	$000	$000	%	$000	$000
Off balance sheet exposures						
Direct credit substitute	1,379	100%	1,379	100%	1,379	110
Performance-related contingency	6,979	50%	3,490	100%	3,490	279
Other commitments where original maturity is more than one year	85,724	50%	42,862	100%	42,862	3,429
Other commitments where original maturity is less than or equal to one year	20,518	20%	4,104	100%	4,104	328
Market related contracts: [1]						
Interest rate contracts	236,742	n/a	884	20%	177	14
Total off balance sheet exposures	**351,342**		**52,719**		**52,012**	**4,160**
Total credit risk (on and off balance sheet)	**2,694,739**				**2,105,042**	**168,402**

(c) Residential mortgages by loan-to-valuation ratio

	On balance sheet exposures	Off balance sheet exposures [2]	Total exposures
	$000	$000	$000
Unaudited - Dec 2012			
LVR range			
Does not exceed 80%	194,107	4,359	198,466
Exceeds 80% and not 90%	26,611	19	26,630
Exceeds 90%	57,699	255	57,954
Total exposures	**278,417**	**4,633**	**283,050**

At 31 December 2012, of the balance of "Exceeds 90%" above, $47.6 million relates to Welcome Home loans, whose credit risk is mitigated by the Crown.

(d) Reconciliation of mortgage related amounts

	Unaudited Dec 2012 $000
Loans and advances - loans with residential mortgages (see Note 16(a))	278,298
Plus: Residential mortgages classified as Property in Note 16(a)	119
On-balance sheet residential mortgage exposures subject to the standardised approach	**278,417**
Off balance sheet mortgage exposures subject to the standardised approach	4,633
Total residential exposures subject to the standardised approach	**283,050**

(e) Credit risk mitigation

As at 31 December 2012 the Banking Group has $67.9 million of Welcome Home Loans, whose credit risk is mitigated by the Crown. Other than this the Banking Group does not have any exposures covered by eligible collateral, guarantees and credit derivatives.

The Banking Group has entered into arrangements to mitigate a risk of loss. This includes a management agreement with RECL in respect of certain non-core property loans and a Deed of Guarantee and Indemnity in relation to the Recourse Loans acquired in PWF.

(f) Operational Risk

Unaudited - Dec 2012	Implied risk weighted exposure $000	Total operational risk capital requirement $000
Operational risk	148,308	11,865

Operational risk has been calculated based on the previous 12 quarters of the Banking Group. As the Bank commenced operations on 5 January 2011, quarterly data prior to merger has been calculated as a combination of CBS, SCBS and MARAC.

[1] The credit equivalent amount for market related contracts was calculated using the current exposure method.

[2] Off balance sheet exposures means unutilised limits.

20 Capital adequacy (continued)

(g) Market risk

Unaudited - Dec 2012		Implied risk weighted exposure $000	Aggregate capital charge $000
Market risk end-period capital charge	Interest rate risk only	61,047	4,884
Market risk peak end-of-day capital charge	Interest rate risk only	62,754	5,020

Peak end of day aggregate capital charge at the end of the period is derived by following the risk methodology for measuring capital requirements within Part 10 of the Standardised Approach. Peak end of day aggregate capital charge is derived by determining the maximum end of month capital charge over the reporting period. Based on the portfolio of the Banking Group's risk exposures, it is considered by management that the difference between end of month aggregate capital charge and end of day aggregate capital charge is insignificant.

(h) Total capital requirements

Unaudited - Dec 2012	Total exposure $000	Risk weighted exposure or implied risk weighted exposure $000	Capital requirement $000
Credit risk	2,694,739	2,105,042	168,402
Operational risk	n/a	148,308	11,865
Market risk	n/a	61,047	4,884
Total	**n/a**	**2,314,397**	**185,151**

Basel II Capital Ratios	Unaudited Dec 2012 %	Unaudited Dec 2011 %
Regulatory capital ratios		
Tier One Capital expressed as a percentage of total risk weighted exposures	14.89%	14.10%
Minimum Tier One Capital as per Conditions of Registration	12.00%	12.00%
Total Capital expressed as a percentage of total risk weighted exposures	14.89%	14.10%
Minimum Total Capital as per Conditions of Registration	12.00%	12.00%
Solo capital adequacy *		
Tier One Capital expressed as a percentage of total risk weighted exposures	16.52%	15.80%
Minimum Tier One Capital as per Conditions of Registration	12.00%	12.00%
Total Capital expressed as a percentage of total risk weighted exposures	16.52%	15.80%
Minimum Total Capital as per Conditions of Registration	12.00%	12.00%

* For the purposes of calculating capital adequacy on a solo basis, subsidiaries which are both wholly owned and wholly funded by the Bank are to be consolidated with the Bank. Therefore, capital adequacy on a solo basis is calculated based on the Bank and its subsidiaries excluding Heartland ABCP Trust 1 and CBS Warehouse A Trust Securitisation.

(i) Other material risks

The ICAAP has identified the capital required to be held against other material risks (being concentration risk, strategic / business risk, reputational risk, regulatory risk and model risk). The Board has determined that the regulatory minimum capital of 12% as per the Conditions of Registration is sufficient to cover these other material risks. As a result, there is no additional internal capital allocation for other material risks.

21 Insurance business, securitisation, funds management, other fiduciary activities

Insurance business

The Banking Group does not conduct any insurance business.

Marketing and distribution of insurance products

The Banking Group markets and distributes term life insurance and general insurance covering risks such as redundancy, bankruptcy or suspension of employment. The insurance products are underwritten by MARAC Insurance Limited. There have been no material changes since 30 June 2012 in the Banking Group's marketing and distribution of insurance products.

Securitisation, funds management and other fiduciary activities

Since 30 June 2012, the reporting date of the previous Disclosure Statement, there have been no material changes to the Bank's involvement in securitisation, funds management and other fiduciary activities.

22 Contingent liabilities and commitments

	Unaudited Dec 2012 $000	Audited Dec 2011 $000	Audited Jun 2012 $000
Letters of credit, guarantee commitments and performance bonds	8,358	2,530	13,404
Total contingent liabilities	**8,358**	**2,530**	**13,404**

The Banking Group also has contingent commitments to fund at future dates as set out in Note 17 - Liquidity risk.

23 Events after the reporting date

On 31 January 2013, in accordance with Part 7A of the Building Societies Act 1965, Heartland Building Society (HBS) converted to a limited liability company named Heartland Bank Limited registered under the Companies Act 1993.

As a result of the conversion:

- All shareholders of HBS on 31 January 2013 became shareholders of Heartland Bank Limited and received one fully paid ordinary share in Heartland Bank Limited for every one share in HBS held by the shareholder.
- All of the property, rights and liabilities of HBS automatically vested in Heartland Bank Limited and all contracts and licences held by HBS shall become binding and enforceable in favour of Heartland Bank Limited.

There have been no other material events after the reporting date that would affect the interpretation of the interim financial statements or the performance of the Banking Group.

Independent auditor’s review report

To the shareholder of Heartland Bank Limited

We have reviewed pages 4 to 22 of the half-year disclosure statement of Heartland Bank Limited (the “Bank”) and its controlled entities (the “Banking Group”), which includes interim financial statements prepared and disclosed in accordance with the Registered Bank Disclosure Statements (New Zealand Incorporated Registered Banks) Order (No 2) 2012 (the “Order”) and supplementary information prescribed in schedules 5, 7, 9, 13, 16 and 18 of the Order.

The interim financial statements and supplementary information provide information about the past financial performance and cash flows of the Banking Group and its financial position as at 31 December 2012.

Directors’ responsibilities

The directors are responsible for the preparation and presentation of the half-year disclosure statement, which includes interim financial statements prepared in accordance with Clause 25 of the Order and which give a true and fair view of the financial position of the Banking Group as at 31 December 2012 and its financial performance and cash flows for the six month period ended on that date.

The directors are also responsible for such internal controls as they determine are necessary to enable the preparation of the half-year disclosure statement that is free from material misstatement whether due to fraud or error.

They are also responsible for the preparation of supplementary information in the half-year disclosure statement which fairly states the matters to which it relates in accordance with schedules 3, 5, 7, 9, 13, 16 and 18 of the Order.

Reviewer’s responsibilities

Our responsibility is to express an independent opinion on the half-year disclosure statement, which includes interim financial statements disclosed in accordance with Clause 25 of the Order, and supplementary information disclosed in accordance with schedules 5, 7, 9, 13, 16 and 18 of the Order, as presented to us by the directors, and report our opinion to you.

We are responsible for reviewing the interim financial statements (excluding the supplementary information) in order to report to you whether, in our opinion, on the basis of the procedures described below, anything has come to our attention that would cause us to believe that the interim financial statements have not been prepared, in all material respects, in accordance with NZ IAS 34 *Interim Financial Reporting* and do not present a true and fair view of the financial position of the Banking Group as at 31 December 2012 and its financial performance and cash flows for the six month period ended on that date.

We are responsible for reviewing the supplementary information (excluding the supplementary information relating to capital adequacy) in order to report to you whether, in our opinion, on the basis of the procedures described below, anything has come to our attention that would cause us to believe that the supplementary information does not fairly state the matters to which it relates in accordance with schedules 5, 7, 13, 16 and 18 of the Order.

We are responsible for reviewing the supplementary information relating to capital adequacy in order to state whether, on the basis of the procedures described below, anything has come to our attention that cause us to believe that the information disclosed in accordance with schedule 9 is not in all material respects prepared in accordance with the Bank's conditions of registration and disclosed in accordance with schedule 9 of the Order.

We have performed our review in accordance with the review engagement standard RS-1 issued by the External Reporting Board and the review engagement guideline RG-1 issued by the New Zealand Institute of Chartered Accountants. A review is limited primarily to enquiries of Banking Group personnel and analytical review procedures applied to the financial data and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Our firm has also provided other services to the Banking Group in relation to general accounting services. Subject to certain restrictions, partners and employees of our firm may also deal with the Banking Group on normal terms within the ordinary course of trading activities of the business of the Banking Group. These matters have not impaired our independence as auditor of the Banking Group. The firm has no other relationship with, or interest in, the Banking Group.

Review opinion

We have examined the interim financial statements and supplementary information and based on our review nothing has come to our attention that causes us to believe that:

a) the interim financial statements on pages 4 to 22 (excluding the supplementary information disclosed in accordance with schedules 5, 7, 9, 13, 16 and 18 of the Order) have not been prepared, in all material respects, in accordance with NZ IAS 34 *Interim Financial Reporting* and do not present a true and fair view of the financial position of the Banking Group as at 31 December 2012 and its financial performance and cash flows for the six month period ended on that date;

b) the supplementary information (excluding supplementary information relating to capital adequacy) disclosed in accordance with schedules 5, 7, 13, 16 and 18 of the Order, does not fairly state the matters to which it relates in accordance with those schedules; and

c) the supplementary information relating to capital adequacy disclosed in accordance with schedule 9 of the Order, is not, in all material respects prepared in accordance with the Bank's conditions of registration and disclosed in accordance with schedule 9 of the Order.

Our review was completed on 25 February 2013 and our opinion is expressed as at that date.

KPMG

Auckland