

ECONOMIC OUTLOOK

New Zealand holds firm amidst global uncertainty

If I had to use one word to describe the global economic markets at the moment it would be 'volatile'. The volatility is the result of uncertainty and the uncertainty is largely due to the debt crisis in Europe and to a lesser extent the political procrastination that recently occurred in the United States.

The debt crisis in Europe, which at the time of writing this article is no closer to being resolved, stems from several nations being too highly indebted. The risk of default and downstream risks, in particular, on European banks, and the potential for social unrest, has European politicians and bankers scrambling and markets reeling.

In the United States, the upper limit on the amount which the US Treasury can borrow (the debt ceiling) was increased to a staggering US\$15 trillion in early August after a protracted and intense debate. This equates to almost US\$50,000 for every citizen. Four days later, Standard & Poor's downgraded the United States' credit rating, taking away its treasured AAA rating (the US is now rated AA+ (Outlook Negative) - the same as New Zealand).

Strong sovereigns, particularly in the United States and Europe, is something we have taken as a given and change like this has shocked the financial markets worldwide. It is a reflection of the new world we live in, where volatility and uncertainty is the norm. It is mirrored in share markets, commodity markets, foreign exchange markets and interest rates.

The chart below shows the performance of the US share market through the Dow Jones Industrial Average over the last five years. During this period the Dow Jones has fallen almost 5%. Whilst I am a fan of equity markets

generally as an asset class, it is clear why fixed interest investments and capital protection via term deposits are so in vogue at the moment.

New Zealand economy resilient

Despite global uncertainty, the New Zealand economy has remained somewhat resilient. There are several reasons for the relative strength of the New Zealand economy, including:

- New Zealand products are in demand at present - being food, protein and (currently) tourism, which has meant New Zealand dollar commodity prices have been relatively buoyant.

- New Zealand is less reliant on the United States and Europe as we have increasingly hitched our wagon to the growing Asian economies. Consequently, increasing demand from Asia for our products will help us achieve the necessary 'export led recovery'.

- The labour market in New Zealand is also in relatively good shape, with some spare capacity to accommodate growth without stimulating inflation.

The comparative strength of the New Zealand economy is reflected in the high value of the New Zealand dollar relative to our trading partners and is close to historic highs.

While the New Zealand economy is travelling relatively well, the risks of a global slowdown have increased, and the expected stimulus from the rebuild of Christchurch has been delayed. Two factors the Reserve Bank Governor cited in deciding to revise down expectations of future interest rate changes.

Given the situation globally, the New Zealand economy is exposed to the risk of:

- lower growth by our trading partners, which could potentially impact on New Zealand dollar commodity prices;

- a higher New Zealand dollar reducing the competitiveness of exporters;

- higher funding costs for banks that fund themselves in offshore markets, which could see banks increase lending rates in New Zealand to recover these costs;

- at its extreme, there is potential for increased protectionism in some countries limiting access to certain markets.

We need not be exposed to the extent we are, and our current plight is amplified by our poor savings record as a nation and our dependence on foreign capital and investment flows. We would be better insulated if we had greater control and ownership of core services such as banking and finance and also funds management.

In periods of volatility, having greater control over the allocation of capital and availability of credit is imperative. Sadly, much of New Zealand's financial services are predominantly owned offshore.

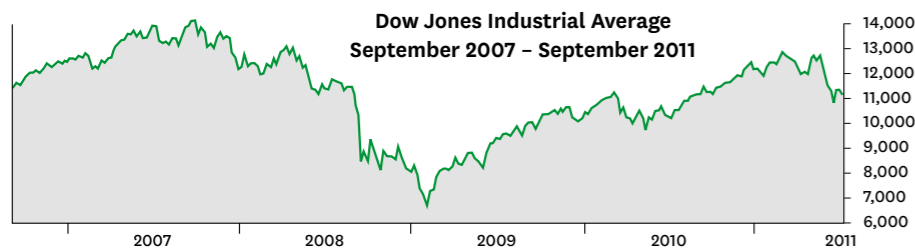
What does this all mean for interest rates?

Interest rates are likely to remain lower for longer. Future interest rate rises remain contingent upon greater stability in offshore markets and the Reserve Bank being confident the New Zealand economy is showing evidence of a robust, sustainable and long term recovery.

Should the New Zealand dollar remain strong then this will likely limit or delay any interest rate rises.

Craig Stephen
Group Treasurer

The views expressed in this article are those of Craig Stephen and are general in nature and not intended to be financial advice.



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100% FOR NEW ZEALAND

We like home-grown - and that goes for financial services too.

We are 100% New Zealand operated and managed, with a parent company listed on the NZSX, and use our presence in communities across the country to meet the needs of small-to-medium sized businesses, farmers and families.

IMPORTANT INFORMATION

All deposits are issued by Heartland Building Society. Minimum term deposit investment \$1,000. Heartland Building Society has a BBB- (Outlook Negative) credit rating from Standard & Poor's. Standard & Poor's credit ratings are statements of opinion, not statements of fact or recommendations to buy, hold or sell any securities. Ratings may be changed, withdrawn or suspended by Standard & Poor's at any time. Heartland Building Society is a subsidiary of Heartland New Zealand Limited (HNZ). HNZ's shares are tradable on the NZSX. However, NZX Limited accepts no responsibility for any statement in this newsletter.

The NZSX is a registered market operated by NZX Limited, which is a registered exchange, regulated under the Securities Markets Act. HNZ does not guarantee the obligations of Heartland Building Society in relation to deposits. MARAC Finance Limited (MARAC) and PGG Wrightson Finance (PWF) are wholly owned subsidiaries of Heartland Building Society. MARAC and PWF guarantee all deposits issued by Heartland Building Society. The guarantee is unlimited and unsecured. For further details about our deposits or credit rating, see Heartland Building Society's Investment Statement, available at www.heartland.co.nz or by calling 0800 85 20 20.



At Heartland Building Society (Heartland), our depositors are an important part of our business. During September, I had the pleasure of meeting many of our depositors during a series of forums that were held around the country - it was great to meet so many people who share Heartland's vision.

The forums gave us the opportunity to provide an update on the Heartland business along with details of our inaugural annual result. You can read about the result, including our pleasing net profit after tax of \$7.7m, on page 3.

Heartland is focused on having a balanced portfolio with lending spread between small-to-medium sized businesses, farmers and families - reflecting New Zealand's economy. On page 2 you can read about Heartland's acquisition of PGG Wrightson Finance, which has given Heartland a foothold in the agriculture sector and provides a platform for growth in this essential area of New Zealand's economy. I would like to welcome PGG Wrightson Finance investors to Heartland.

There are a number of lessons which can be taken out of the Global Financial Crisis, one of which is 'local is good'. This is a key part of Heartland's philosophy - investing in New Zealand communities where we raise funds. All of our lending and funding is New Zealand based, which means that our core business is not directly exposed to events in offshore markets. Heartland's Group Treasurer, Craig Stephen, has written an interesting article on the global and domestic economic outlook on page 4.

Finally, at Heartland we believe we have a responsibility to communicate with our depositors. If you have any questions, suggestions, or would like a copy of our Investment Statement, please feel free to contact any of the Heartland Investment Team or me directly on 0800 85 20 20.

Andrew Ford
National Retail Funding Manager

HEARTLAND'S RURAL BUSINESS EXPANDS

Heartland's Rural division provides critically important finance to farmers, including working and seasonal capital, livestock finance, and plant and machinery finance. Our offer focuses on providing finance for working assets as well as mortgage based lending for land purchase and farm development.

A key part of our rural strategy is based around Heartland's acquisition of PGG Wrightson

Finance (PWF) and the formation of a strategic alliance with PGG Wrightson Limited (PGW) to use the PGW brand to offer the wider suite of Heartland rural products to PGW customers.

The PWF acquisition, which was completed on 31 August 2011, is highly complementary to the existing Heartland business and will significantly increase our footprint in the economically important rural sector.

The acquisition rounds out our asset portfolio across the business, household and rural sectors and will act as an engine for growth.

For the PWF team and our valued customers, it will be business as usual, with the additional size and scale benefits of being part of Heartland.

Will Purvis
Head of Rural



YOUR INVESTMENT – HELPING NEW ZEALAND PROSPER

INVESTING IN YOUR LOCAL COMMUNITY

As a Heartland Building Society (Heartland) investor, your deposit is used to fund small-to-medium sized local businesses, farmers and families in your community – and helps drive the productive sector of the New Zealand economy. One such business that Heartland is proud to support is Mid-Canterbury based All Farm Engineering Limited – owned by local couple Robert and Valeska Wilson.

On a lifestyle block in the one-pub, one-garage Mid-Canterbury town of Hinds, Robert Wilson has built a million-dollar business on the strength of a piece of advice from his father.

“When I was a young lad, my father told me to establish a relationship with a bank¹, so that one day, when I wanted to buy a house, they’d know who I was,” Robert says.

“That’s the best piece of advice a father could give a son.”

Robert tested his father’s theory with CBS Canterbury (now part of Heartland) when he bought his first house at 29. Two years later, he and wife Valeska went back to CBS Canterbury to borrow money to build a workshop on their lifestyle block at Hinds.

And they’ve gone back numerous times since to help capitalise on opportunities in the Mid-Canterbury region which Robert describes as a ‘dairy Mecca’.

All Farm Engineering Limited started as an engineering and maintenance business, but it is now diversified into excavation, machinery for making silage, effluent system consultation and installation of water meters.

The business services farms in a 20km radius of the Wilsons’ workshop. The business put a cap on new customers four years ago and continues to maintain a strong revenue model and excellent staff.

Through all those years, Robert, now 40 and a father of four, has maintained a solid and trusting relationship with CBS Canterbury’s Ashburton Branch Manager Andrew Wilson (no relation).

“Our business grew and grew and grew,” Robert says, “and CBS Canterbury grew with us. It was very easy. They are brilliant.”

All Farm Engineering Limited is just one of a variety of local New Zealand businesses that your deposit with Heartland helps to fund².

1. Heartland is not a registered bank.
2. For a current copy of Heartland’s Investment Statement call 0800 85 20 20.



Robert Wilson, All Farm Engineering Limited

SOLID FIRST PROFIT RESULT FOR HEARTLAND

In the financial year to 30 June 2011 Heartland Building Society Group (Heartland)¹ achieved a number of significant milestones, most notable of which was bringing together CBS Canterbury, MARAC and Southern Cross Building Society to form Heartland.

We are proud of what we have achieved over the last year, which would not have been possible without our loyal depositors. Heartland has now established the foundation for sustained growth which will make a positive lasting contribution to New Zealand communities.

Highlights for the Year

We are pleased to report that in the financial year ending 30 June 2011, Heartland produced a net profit after tax (NPAT) of \$7.7 million. This is despite substantial one-off costs of \$6.6 million relating to the merger and integration costs. Some other highlights for the year include:

- Heartland’s shareholder funds (equity) increased to \$294 million²
- Liquidity of \$547 million was held at 30 June 2011³
- Heartland’s parent company, NZX listed Heartland New Zealand Limited (HNZ), also produced a solid result with a NPAT of \$7.1 million⁴.

Looking forward

The building blocks are now in place for Heartland to grow within our target market segments – small-to-medium sized businesses, farmers and families. We believe

what makes Heartland different from other financial service organisations is our service ethos. We don’t believe one size fits all and we value long-term relationships that are responsive to customers’ changing needs.

On 31 August 2011, Heartland acquired PGG Wrightson Finance⁵, which is highly complementary to the existing Heartland business and will significantly increase our footprint in the economically important rural sector. For further details on the PGG Wrightson Finance acquisition refer to the article on Heartland’s rural business on page 2.

The financial results and strategic progress achieved during the year are encouraging as we prepare for the next phase of our evolution into a leading financial services organisation that is in touch with New Zealand and focused on working to support the productive sector.

We are fortunate in having a proud legacy to draw on and energy and inspiration to create a fresh offer that appeals to New Zealanders. They too will know that while we have a new name we are an old friend, true to our origins of building prosperity for Kiwis like them.

Depositor Forums

We invited all our depositors to a series of forums throughout the country to provide an update on Heartland, our financial performance and outlook for the future. Our depositors are a critical part of our business, and we believe it is essential that we communicate clearly and often with you. As such, we were delighted with how many of you made it along to the September

forums, and the interest and commitment you continue to show to our business. Given the success of these forums, and the series we ran in November last year, we intend to conduct them regularly.

If you were unable to attend one of the September forums and would like to find out more about Heartland’s annual result, you will find a copy of the annual result presentation in the ‘Latest News’ section of our website www.heartland.co.nz. If you have any questions about our annual results or would like a copy of our Investment Statement please feel free to call the Heartland Investment Team on 0800 85 20 20. We are here to help.

Sean Kam
Chief Financial Officer

1. For the purposes of this article, the Heartland Building Society Group comprises Heartland Building Society and its subsidiaries as at 30 June 2011. It does not include PGG Wrightson Finance which was acquired on 31 August 2011. For more information about the Heartland Group see our Investment Statement or Prospectus.
2. This amount is taken from the most recent audited Statement of Financial Position of Heartland dated 30 June 2011 and has been calculated as at this date. The Statement of Financial Position (and the amounts taken from it) is included in Heartland’s audited financial statements for the period ending 30 June 2011. As such, these statements do not include any adjustments for the acquisition of PGG Wrightson Finance on 31 August 2011.
3. Liquidity comprises of cash, committed undrawn bank facilities and unutilised securitisation facilities. This amount does not include any adjustment for the acquisition of PGG Wrightson Finance on 31 August 2011.
4. HNZ does not guarantee the obligations of Heartland in relation to the Heartland deposits. HNZ shares are tradable on the NZSX. However, NZX Limited accepts no responsibility for any statement in this newsletter. The NZSX is a registered market operated by NZX Limited, which is a registered exchange, regulated under the Securities Markets Act.
5. PGG Wrightson Finance became a wholly owned subsidiary of Heartland on 31 August 2011. PGG Wrightson Finance guarantees all deposits issued by Heartland. The guarantee is unlimited and unsecured.

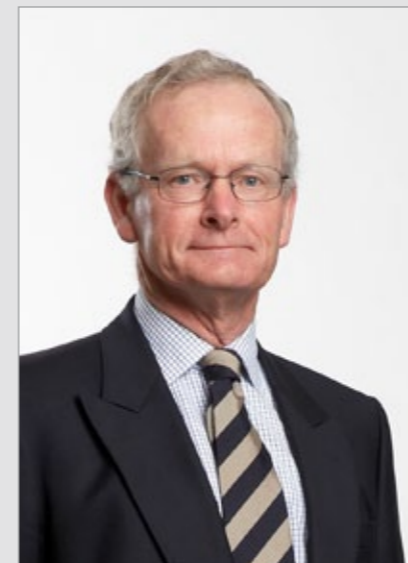
A Tribute to Richard Elworthy

It was with great sadness that we farewelled Richard Elworthy, former Managing Director of Pyne Gould Corporation (PGC) and Chairman of MARAC, who passed away in August.

Richard joined Pyne Gould Guinness in 1969. In 1987 he was appointed Group Financial Controller of PGC and Managing Director in 1991. He retired as Managing Director in June 2005, but remained on the PGC board to 2009.

Richard was instrumental in creating the platform for Heartland Building Society and was admired for his commercial acumen, eye for detail and chairmanship.

He was greatly respected by all who knew him and worked with him, and will be surely missed.



Richard Elworthy