

CITY PACIFIC FIRST MORTGAGE FUND (THE FUND)

City Pacific Limited (City Pacific) has always enjoyed a very loyal investor base who have benefited over the last eleven years from the experience of the management team in delivering above average returns.

The developments during this calendar year with the global financial crisis have negatively impacted on almost all financial institutions from the biggest to the smallest and City Pacific is no exception.

City Pacific has always acted in the best interests of its unitholders – we have always stated that our unitholders are our most valuable asset and the management team will do whatever is necessary to protect those assets – our unitholders.

In light of this we would like to take this opportunity to address some additional questions which should be of benefit to you by increasing your understanding the Fund and City Pacific's role as manager of the Fund.

1. How is City Pacific managing the Fund?

City Pacific Limited is the founder and manager of the City Pacific First Mortgage Fund and has held this role for in excess of 11 years. In that time it has managed the funding of 461 loans advancing in excess of \$4.4 billion to fund projects with an end value of \$8.2 billion enabling the Fund to pay out in excess of \$435 million in distributions to unitholders.

The City Pacific First Mortgage Fund's stated strategy has been to invest in registered first mortgages over Australian properties located in areas where the property market is supported by population growth. This strategy has been evidenced by the overall performance of the Fund and the quality of the properties funded over the Fund's 11 year history.

In the last 12 months the entire Australian Property and Mortgage Fund Sector has been negatively impacted by the global credit and liquidity crisis. This impact has been evidenced by the similar actions (i.e. suspension of redemptions and in certain cases suspension or reduction of distributions) taken by Australia's leading and most experienced fund managers including funds managed by AXA, Challenger, AMP, Suncorp, Macquarie and Mirvac to name just a few.

The following quotes regarding the property fund sector appeared in a recent article from the Australian Financial Review (3 September 2008, page 36 "Redemption freezes a short-term blip"):

- "fund redemption freezes are an investor protection mechanism"
- "Ironically, it means they were good managers because they acted quickly before there were mass withdrawals on those funds – they are protecting investors"

An overview of the article and further information is attached on page 6.

Due to delays in loan repayments from borrowers caused by the ongoing global credit and liquidity crisis, forecast inflows have been delayed. This is not a reflection on the quality of the asset but rather a timing issue resulting from the impact of the global market.

City Pacific Limited is taking the prudent actions required to protect the Fund and its unitholders in line with industry best practice.

2. The Manager's Entitlement to Fees

The Manager is entitled to be paid a management fee in accordance with the Fund's Constitution. Out of the management fee it receives City Pacific pays for all of the Fund's operating costs. It takes a high level of specialised skills and experience to professionally manage the Fund and its lending activities.

It should be noted that no manager with the degree and level of qualifications required will take on this role without charging a management fee.

3. Monitoring the actions of the Manager

City Pacific and the Fund are audited by external auditors through a 31 December review and a 30 June Financial audit as well as a Compliance audit each year.

Since 2005 City Pacific has contracted an external service provider (headed by an ex-ASIC senior investigator) to undertake a Compliance Officer role and monitor City Pacific's management of the Fund on a weekly basis and ensure it is compliant with clause 4.1 of the Fund's Constitution, the PDS, the Compliance Plan, Section 601FC of the Corporations Act and City Pacific's Australian Financial Services Licence. Their findings are reported to the Compliance Committee, the Board and where necessary to ASIC.

City Pacific also communicates regularly with ASIC to ensure they are aware of the actions being taken to preserve the value of the Fund's assets and unitholders interests.

City Pacific has the professional management resources internally of project management, property development and property finance which is a combination of skill sets that many fund managers do not have. These valuable management resources ensure that City Pacific is able to appropriately manage any property should the need arise to take action against the borrower and takes the course of action which realises the most value for the property.

City Pacific's dedicated and experienced management team operate the Fund in accordance with strict operational requirements as outlined in the Fund's Constitution, the PDS, the Compliance Plan, the Corporations Act and City Pacific's Australian Financial Services Licence.

4. Access to the PDS and Constitution

The most recent PDS is dated 1 December 2007 and was withdrawn on 3 March 2008 following the deferral of redemptions. Legally the PDS must be withdrawn while the Fund is not accepting new investments.

It is not possible to have invested in the Fund without having completed an application form acknowledging that the investor has received, read and understood the PDS. The PDS is still available to all existing Fund unitholders upon request from City Pacific.

The Fund's Constitution has always and continues to be available upon request from City Pacific.

Both the PDS and Constitution are available in electronic or hard copy format upon request by existing unitholders from City Pacific.

Since the Fund deferred redemptions in March 2008 City Pacific has been reporting to ASIC on a regular basis to ensure they are aware of the actions being taken to preserve the value of the Fund's assets and unitholders interests.

5. Why does the Fund have a finance facility?

It is common practice in the mortgage fund sector to utilise debt financing. The Fund's Constitution and PDS outline that the Fund manager and the Fund have the ability to raise debt facilities. The Fund's finance facility was established in order to manage short term cash flow requirements.

The Fund's finance facility has been reduced by half down to \$120 million. This finance facility represents a ratio of 12% of debt to assets in the Fund.

The Fund's finance facility was not considered to represent a large debt ratio however the Directors consider that in light of the global credit crisis and the impact this has had on the cost of funds it was prudent to reduce this debt. In addition banks are also reassessing their lending facilities and are requesting borrowers to further reduce their loans.

The impact on mortgage and property funds has been severe and wide spread with many of the top fund managers in Australia having taken similar action to protect the underlying assets of their mortgage funds as noted in the response to Question 1. City Pacific was one of the first fund managers to take the action of protecting the assets of the Fund for its unitholders by deferring redemptions.

6. What is the impact of borrowing from outside financiers on unitholders' equity?

Additional security is held by the Fund where finance facilities are utilised as outlined in the following example:

Security position:	With finance facilities	Without finance facilities
Unitholder funds:	\$900 million	\$900 million
Finance facility:	\$200 million	Nil
Loan to value ratio:	80%	80%
Security held*:	\$1.375 billion	\$1.125 billion
Net security held**:	\$1.175 billion	\$1.125 billion

* Represents value of properties over which registered 1st mortgage is held.

** Represents security held less finance facility.

After deducting the finance facility of \$200 million the remaining security held is \$1.175 billion which is **greater** than the security held without the finance facilities.

It is important to note that the finance facility has priority of repayment to unitholder's funds.

7. Can City Pacific call in the first mortgage loans?

City Pacific has always and continues to manage the Fund's loan portfolio in a stringent manner to ensure the protection of the Fund's assets including taking whatever action is deemed necessary to ensure the prompt and full repayment of loans.

City Pacific has and continues to take action against borrowers where it is in the best interest of unitholders (i.e. to protect the value of the Fund's assets). It is best to allow projects to be completed in an orderly manner so that the full value can be achieved. Selling a half completed project will not return half of the value of the completed project. The key to realising the value of the projects being funded is to allow those developments to be completed and sold in an orderly manner.

City Pacific over the last 8 months has taken the necessary steps to:

- have borrowers that can have their loans refinanced do so in order to repay the Fund;
- have loans repaid early where possible; and
- become mortgagee in possession where it is in the best interest of the Fund.

These are commercially responsible courses of action that City Pacific has and will continue to take on behalf of the Fund. Such action requires strict management of each loan and City Pacific's lending team have the intimate knowledge of the loans and the established relationships with the borrowers to ensure this process can be effectively managed in a timely manner.

8. Are loans to related parties conducted on terms more favourable than other loans?

Related parties of City Pacific may borrow monies from the Fund and where this occurs the terms of the loan and any fees are on an arms length commercial basis, in line with loans to other unrelated parties.

Related party loans are scrutinised by the Board and subsequently reviewed by the Fund's Auditors and the externally contracted Compliance Officer to ensure that they are compliant with the lending requirements of the Fund's Constitution, the PDS, the Compliance Plan and the Fund's Lending Policy.

Complete transparency exists in relation to related party loans as the terms of these loans are detailed in the audited financial reports of both the Fund and City Pacific.

The Fund does not have any loans to Directors or Executives of City Pacific Limited.

The following table outlines the status of related party loans as at 30 June 2008:

Interest rates payable on Loans (in groups of not more than 0.5%)				
Interest rates %	All loans excluding Related Party Loans	Number of loans excluding Related Party Loans	Related Party Loans only	Number of Related Party Loans only
	\$		\$	
9.00 - 9.49	3,427,159	4	Nil	Nil
9.50 - 9.99	Nil	Nil	Nil	Nil
10.00 - 10.49	198,708	2	Nil	Nil
10.50 - 10.99	Nil	Nil	Nil	Nil
11.00 - 11.49	Nil	Nil	Nil	Nil
11.50 - 11.99	Nil	Nil	Nil	Nil
12.00 - 12.49	11,603,018	1	Nil	Nil
12.50 - 12.99	244,835,742	12	48,438,667	1
13.00 - 13.49	453,316,164	34	206,529,750	6
Total	713,380,791	53	254,968,417	7

	Loan Balance at 30 June 2008	Approved Facility	Funds advanced during period	Repayments made during period	Interest rate	% of total Loan portfolio	City Pacific Owner- ship Interest
Marina Cove Pty Ltd	76,221,017	82,161,333	85,722,241	148,850,590	13.00%	7.87%	30.6%
Lake Views Estates Pty Ltd	54,688,575	54,900,000	13,240,887	3,765,354	13.00%	5.65%	15.3%
MP Pacific Investments Pty Ltd	15,600,000	15,600,000	15,600,000	-	13.00%	1.61%	15.3%
Grande Pacific Operations Pty Ltd	24,690,863 48,438,667	24,800,000 62,200,000	12,450,863 32,483,148	- -	13.00% 12.50%	7.55%	50.0%
Sunrise Waters Pty Ltd	23,569,295	23,600,000	26,150,000	2,580,705	13.00%	2.43%	50.0%
SP Marina Pty Ltd	11,760,000	11,760,000	11,760,000	-	13.00%	1.22%	50.0%
Total	254,968,417	275,021,333	197,407,139	155,196,649		26.33%	

Good Fund Managers Take Timely Action to Protect Investors

There have been numerous reports about the actions being taken by the Managers of Australian mortgage funds. A more accurate assessment of the situation was presented in an objective article featured in the Australian Financial Review, 3 September 2008, and headlined "Redemption freezes a short-term blip." Jane Searle reported that although the wave of redemption freezes across the property fund sector were unsettling, fund managers believe investors have little reason to panic.

The report explained that poor sentiment towards property asset values had caused outflows to rise, leading to reduced liquidity in many funds. As a result fund managers have taken action to freeze funds to prevent forced asset sales at reduced prices.

The article made mention of funds that had recently frozen redemptions. These included some of Australia's leading fund managers - Macquarie Direct Property Fund, Axa's Wholesale Australian Property Fund and Challenger Hybrid Property Fund, as well as three BlackRock funds - Direct Property, Real Estate, and Combined Property Income.

Financial Lifestyle Managers financial planner Louise Parker – who has clients in frozen Macquarie and AXA funds was quoted as having said that values should come back for longer-term investors over five years.

"Ironically, it means they were good managers because they acted quickly before there were mass withdrawals on those funds - they are protecting investors," (Louise Parker.)

Property fundamentals 'sound'

BlackRock Australia managing director Maurice O'Shannassy was quoted as having said the situation was a liquidity issue rather than one linked to valuations. Also quoted was Macquarie Direct Property Fund chief executive Richard Cutler who reportedly said the fund stopped redemptions to ensure it had sufficient capital to maintain existing assets - which he described as premium quality.

Property Investment Research associate director Dugald Higgins says fund redemption freezes were an "investor protection mechanism".

"People think freezing redemptions is bad. But if you don't, we go back to the '90s when unlisted trusts just collapsed. If people want to invest in property, it's a long-term proposition - mostly about income, not for people concerned about [fluctuations] in capital values," (Dugald Higgins, The AFR, 'Redemption freezes a short-term blip' 3 September, 2008).

A further lowering of interest rates is also expected to renew confidence in the property market and the following statistics need to be considered as they outline some important fundamentals that set the Australian property market apart from the rest of the world.

Although Australia has had over 2.5% worth of mortgage rate increases since March 2005 (before the September 0.25% cut) residential property valuations have remained remarkably resilient.

BIS Shrapnel has confirmed Australia is still experiencing population growth led by the resources boom. This supports other reports that property investors are expected to come back into the market as interest rates stabilise and rental yields increase.

Net overseas migration jumped to an estimated 195,000 persons in 2007/08, and is forecast to reach a new record level of 230,000 persons in 2008/09. This population boost is creating an unprecedented demand for housing. BIS Shrapnel's building activity forecast report "Building in Australia 2008 to 2023" anticipates a 3% rise in new dwelling construction in 2008/09.

Commenting recently that house prices would not collapse as in the US, RP Data's National Research Director Tim Lawless stated "The fundamental basis of supply and demand should continue to see Australian property prices moving upwards over the medium to long term."