

CEO'S ADDRESS

Presented by Andrew Griffin

Pacific First Mortgage Fund - Meeting of Unitholders

1 September 2010 Brisbane

The State of the Mortgage Fund Market

Since being appointed to manage your Fund, we have invested a huge amount of resources in ascertaining the state of the Fund and its assets. With the benefit of this knowledge, we are now in a position to speak frankly with you in relation to the Fund. The fact is your investment has been decimated by the global financial crisis as well as City Pacific's gross mismanagement.

So today, whilst I will give you an insight into the state of the Fund, and how it has been mismanaged in the past, I also want to focus on what we can do in the future to try to recover past losses.

To commence, it is important to understand how your Fund differs from many other first mortgage funds.

Unlike all mainstream mortgage funds City Pacific marketed the Fund directly to the public as offering high returns backed by first mortgages. They spurned marketing the Fund through professional advisor networks which meant they were able to avoid any need to have the fund rated by independent ratings agencies such as Mercer, Morningstar, Standard & Poor, Lonsec or van Eyk. As such, City Pacific avoided the independent scrutiny of both the ratings agencies and the advisor networks. An independent scrutiny embraced by all mainstream mortgage funds as a valuable marketing tool but avoided by City Pacific for fear of exposure.

City Pacific was then largely left unchecked in investing the Fund in risky assets, marketing the Fund on the basis of unrealized, illusory returns, administering the Fund without adhering to proper lending practices and exploiting the Fund for the benefit of City Pacific's own balance sheet through a series of related party deals.

I say the returns were "illusory" because:

- They were a result of accounting treatment. To be precise nearly \$150m, or 17% of the original value of the Fund, was actually interest owed by developers that had no ability to pay that interest. That \$150m was never a real asset of your Fund. The effect of this was that the 'true' value of your units was already down by 17% to 83 cents;
- And secondly, the distributions that resulted from the 'accounting income' were largely funded not by income earned from the loans but from new **money invested in your fund by new investors**. This is the very definition of a Ponsi, or pyramid, scheme. Funding existing investor's distributions with new investor's money. The distribution of new capital this way depressed the value of your units even further.

Another problem I mentioned resulting from the lack of third party scrutiny was that City Pacific was able to significantly deviate from responsible lending practices. This 'deviation' resulted in a variety of negligent and potentially fraudulent practices including a preponderance of loans being made to "related" parties, loans being made without due and proper consideration, loans being made against arbitrarily inflated values and loans that were defective or by virtue of poor documentation, simply unenforceable.

I will refer to a couple of loans for your information to illustrate points throughout this course of this address. The first is Asset 23, pictured below.



Asset 23, which comprises a total of 900ha on the Gold Coast hinterland, was acquired by the borrower in several stages until the entire property holding was amalgamated in late 2005. The Fund had lent \$17m at this stage at 50% gearing (i.e. the borrower contributed 50% equity and the Fund provided 50% by way of debt). The property was revalued in March 2006 and, based on some ridiculous assumptions that some future rezoning would occur (needless to say it never did), the valuation doubled to \$65m. The Fund also allowed an increase in gearing to 80% ... for non income producing vacant rural land ... and subsequently lent another \$38m to the borrower. The total loan was now \$55m. None of this money was used to improve the property. It remained a large rural landholding. We have no idea what the borrower did with the \$38m. But we do know that this borrower had other loans from the Fund that were failing. But rather than take action, which would have meant, telling Unitholders that there were significant impairments in the mortgage portfolio, City Pacific "rectified" this problem with another revaluation of Asset 23 in June 2008. Surprise, surprise, based on even more outrageous assumptions of rezoning (needless to say they too never happened) the value doubled again to \$130m. This enabled City Pacific to 'pretend' that their borrower was not in any default. Un-repaid loans from that borrower went on to cause significant losses to the Fund that could have been stopped earlier and if so, the bulk of these losses avoided. **To be precise losses from this borrower were nearly \$165m, or 19% of the original value of the Fund!**

To be clear, the reduction in the value of your units that was hidden from you by clever accounting treatment and a single dodgy revaluation exceed \$315m, or 36 cents per share.

Why was it hidden? Why did they not stop it? Because once this became known there would be no more new investment in the Fund the cash flow would stop and City Pacific as a developer (ASX listed) would collapse. The Unitholders were not important. Your only role was to be City Pacific's 'iron lung'. You unknowingly kept them alive. **As a thank you City Pacific stripped the last remaining cash out of the Fund with a \$50m loan to itself** in March 2009. I cannot imagine what would have happened if they were still the manager of your Fund.

So your Fund has a very different profile to other mortgage funds. And whilst other funds were challenged by falling values post the GFC, your Fund was decimated. **Your Fund's remaining assets comprise large and complex loans unsupported by the borrowers who generally have fled the country, gone into receivership or administration or declared themselves bankrupt.** The remaining mortgage securities were, and remain, highly speculative, incomplete and fraught with problems. I will, however, address the assets of the Fund shortly.

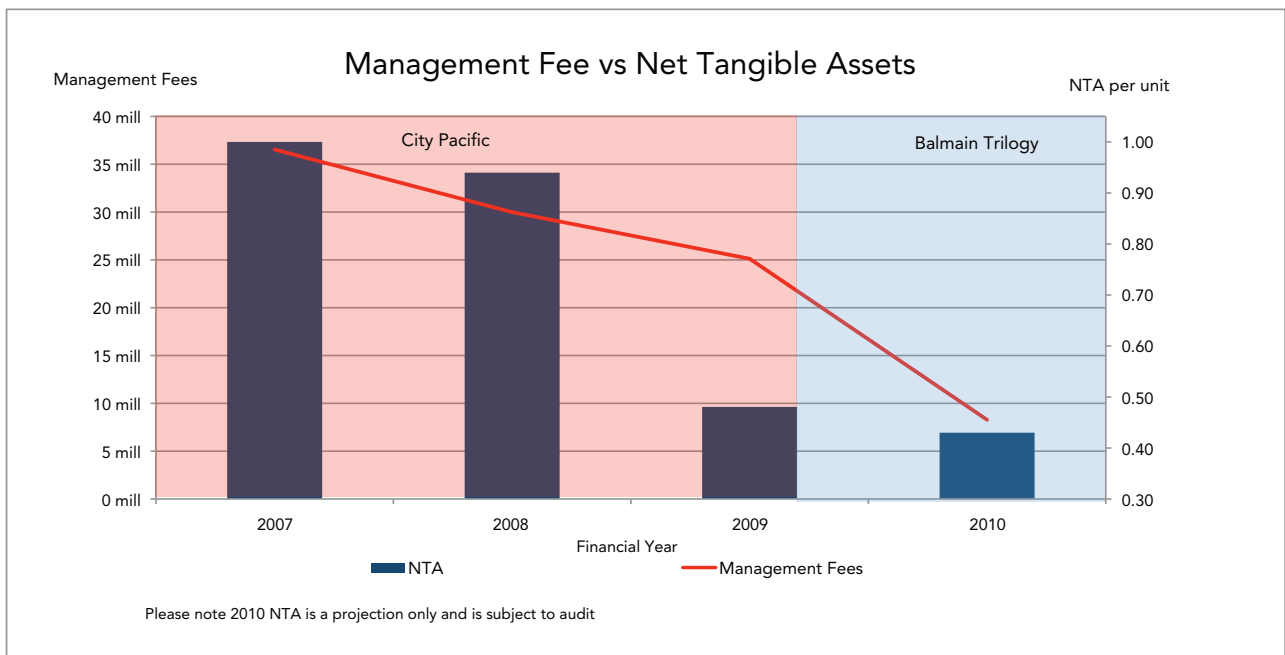
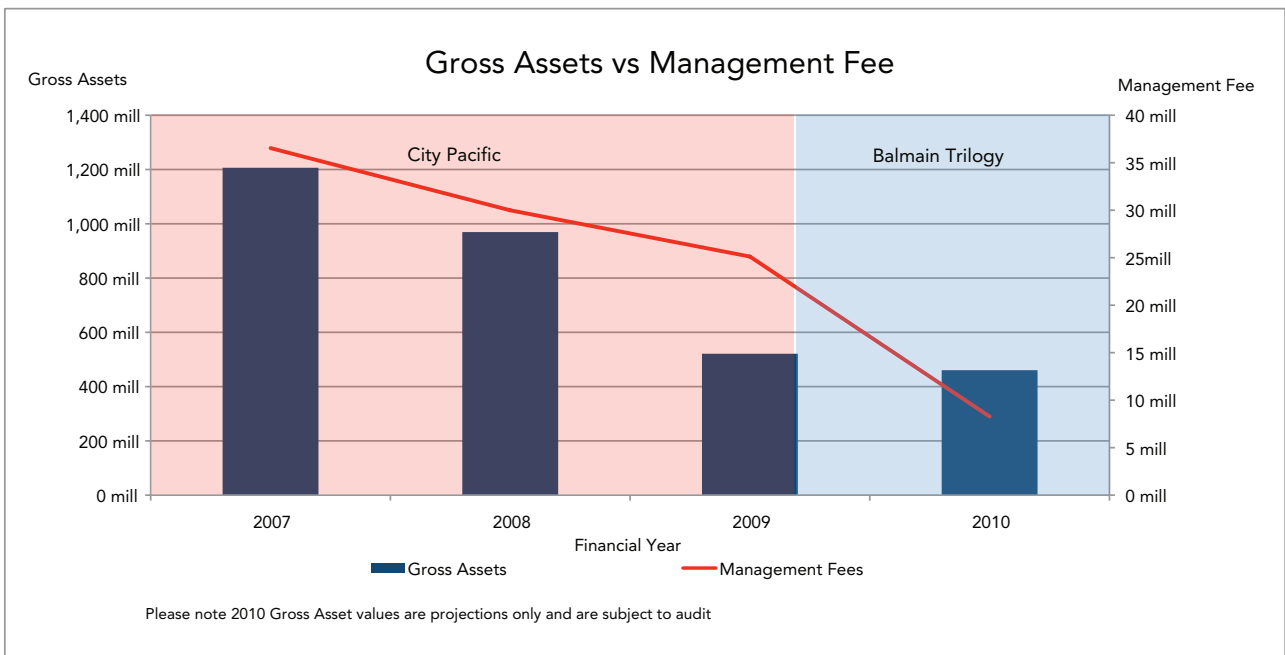
So it would appear, on the face of it, to be a very simple process for Balmain Trilogy to follow as manager of your fund. Nail up some "For Sale" signs and get you your money back, or what's left of it, as quickly as possible. But we also know that most of you want us to maximize your recovery, even if it takes longer. It is who achieve these goals ...both speed of recovery and amount of recovery... that is the very essence of the New Strategy.

I would like to make it clear for the record that our sole aim as your manager is to recover as much of your original investment as we can as fast as we can. If anyone doubts our commitment I would like to remind you of what we have achieved in our first year.

What Have We Achieved

- Steadily realised those Fund assets where a fair market value could be obtained and **recovered \$135m for the fund in the first 10 months;**
- **Reduced the Fund's finance facility with the CBA from \$91.8 million to \$30 million** and now have their consent to a further 2 year term and their **consent to commence unlimited redemptions to Unitholders;**
- **Increased the Fund's cash position from \$9 million to \$42.2 million as at 30 June 2010** which enables us to make the **first payment to Unitholders of \$35m in October** this year.
- **Reduction in management fees from \$30m in 2008 and \$25m in 2009 to \$8.3m in 2010 – a 67% reduction** - see charts below;
- **Reduction in related party loans from \$200m in 2008 and \$80m in 2009 to nil in 2010;**
- **Established an Investor Committee, appointed by an independent auditor, which has provided valuable feed back to Balmain Trilogy over the last 12 months;**
- **Provided an unprecedented level of information in respect of the assets to Unitholders,** tempered only by the very real need to protect Balmain Trilogy's ability to realize the value of the assets. We do not want every developer in Australia to know our hand before it is played!;
- **Completed an extensive legal and asset review of all Fund to establish work-out strategies for each of the assets and draft statements of claim against entities that have caused the Fund harm;**
- **Appointed an independent custodian (Trust Company) and an independent registrar (Computershare)** to ensure Unitholder protection;
- We have **taken control of all of the warts-and-all assets of the Fund to ensure appropriate remediation** prior to sales or development commencing;
- **Vigorously pursued borrowers and guarantors** including related parties of the previous manager (City Pacific Limited) for amounts owed to the Fund;

- We have **micro-managed the process of procurement of re-zonings and development approvals** on the vast number of rural landholdings which comprise the Fund's assets;
- **Rectified significant legal and/or physical defects in the assets of Fund** including rectification of defective mortgages;
- **Identified specific Fund assets that can be developed** to significantly increase value of the Fund;



Asset Review

So let me turn to the assets of the Fund.

The first ever loan-by-loan Asset Review of a mortgage fund was published by Balmain Trilogy in December 2009. **The review projected total recoveries of \$108m by 30 June 2010. In fact, as I mentioned earlier, Balmain Trilogy achieved total recoveries of \$135m during 2010, being 25% more than originally projected.**

The Explanatory Memorandum sets out a short form status for each of the Fund Assets. I do not intend to go through each asset however if you have any questions about specific assets please feel free to ask during question time.

I will, however, give you a couple of examples of the type of work that Balmain Trilogy has been undertaking in respect of achieving the \$135m in recoveries last year. You will see that the work carried out by Balmain Trilogy significantly exceeds that expected of a mortgage fund manager and is more accurately described as that of a property development manager.

Firstly:

Asset 22

When we took over from City Pacific, the security comprised a partially completed residential unit complex - see photos below. The building was under significant distress with exposed structural supports and significant flood damage to the basement. **With not a single contractor on site, it was later confirmed that the building had been left derelict for over two years and the Fund had taken no action whatsoever.** Balmain Trilogy initially sought offers to sell the building 'as is'. Following a marketing campaign the best offer was at \$13m which we believed was inappropriate. Over the course of the next 6 months, Balmain Trilogy evaluated and rectified the structural integrity of the asset, removed 1.7 million litres of water from the basement, connected the services to the building and rectified the roof and drainage to prevent further water penetration to the basement. The asset had at least been readied for continued construction.

Next, Balmain Trilogy, without the assistance of any real estate agent, identified a potential quasi government purchaser for the completed building. The purchaser agreed to acquiring the finished property and to pay the Fund \$20m, with 70% paid upfront and the balance on completion. The purchaser was also paying for the \$15m cost to complete the building. Balmain Trilogy also procured an improved development approval to take the number of units from 106 to 114 which enabled the purchase price to be adjusted upwards even further. The purchase agreement has been executed, 70% of the money banked, and completion, and the balance of the money, is due in the next six months.

The total net recovery for the Fund will exceed \$20m without the Fund having to commit one dollar of development expenditure or being exposed to any risk from the development.

The net result was that Balmain Trilogy's *development management* of Asset 22 was able to improve the net recovery available to Unitholders by over \$7m when compared with the "sell now" alternative.



Asset 11

This asset comprised a partially complete 14 level residential building consisting of 52 units in the heart of Brisbane - see photos below. **As with Asset 22 the site had remained dormant for over 18 months as City Pacific simply did not have enough staff to properly manage any of the Fund's assets.** During that period **the building suffered significant water damage from flooding caused by a defective roof slab. The units themselves were not 'fitted-out', no strata plan had been prepared and the borrower was in significant arrears on all statutory obligations.** A marketing campaign produced offers in the order of \$20m. Again Balmain Trilogy felt that whilst this offer was a fair market price for the asset as it was, Balmain Trilogy could do better. We simply do not like handing profit margins to developers.

So ignoring the potential sale Balmain Trilogy completed the building works, rectified the damage to the building, fitted-out the units, addressed the statutory arrears and commenced an aggressive marketing campaign to sell the completed units to investors. Within 2 months of commencing the marketing campaign the strata was registered and 80% of the units were sold and settled. Whilst the Fund had to occur additional development expenditure of \$2m to complete the building works and get the strata plan registered **the net recovery to the Fund, with only 1 lot left to sell, will exceed \$28.7m. This is a net improvement of \$6.7m in recoveries available to Unitholders.**



In summary Balmain Trilogy's development management services procured recoveries for the Fund in respect of Assets 11 & 22 that exceeded the alternative "sale" option by \$16m even after allowing for development expenditure of just \$2m.

THAT is development management in a nutshell, extracting additional value for you the Unitholders, with minimal potential liability incurred by the Fund. It is not simply appointing a builder or an agent or "nailing up a fore sale sign". It is doing what all successful property developers do ... working out optimal value-add strategies, maximizing development potential, lobbying Councils and State Governments, procuring rezoning and optimal development approvals ... IT IS WHAT WE DO.

We sincerely believe that Balmain Trilogy can produce similar results in respect of a number of assets of the Fund; however the workload involved will far exceed that required for Assets 22 and 11.

An example of one asset which we prefer for development is Fund Asset No. 34.

Asset 34

Asset No. 34 comprises a loan secured by a 40 ha 'potential' residential subdivision located in Carrara on the Gold Coast - see photograph below. The property has a 1km frontage to the Nerang River and is close to prestige housing estates including Royal Pines and Emerald Lakes. It currently has an impaired value of \$21m.

The history of the loan is interesting. A developer (purchaser) acquired Asset 34 with the intention of creating a residential subdivision of 303 lots. However Asset 34 required a significant quantity of land-fill to raise the level of the land above the flood plain level otherwise it could not be developed. Unfortunately the vendor of Asset 34 controlled the rights to the only available land-fill which was sitting on the adjoining site!

The rub is as follows. The foolish new developer was a City Pacific Joint Venture. As you sadly might expect the CPL JV borrowed money for the purchase of the **submerged** Asset 34 from your Fund. **The Fund also had advanced money to the original owner on a separate property. When the watery problem with Asset 34 came to light, a plan was 'hatched' that the original owner would 'sell' the CPL JV the rights to the land-fill in consideration for favourable loan terms from your Fund!!**

What was the benefit to the Fund from this – nil!

And the cost to the Fund – significant ... about \$2.6m

What was the benefit to the CPL JV – significant ... they now had a usable site

And the cost to the CPL JV - nil!

This was a typical CPL "deal" with your Fund but fortunately Balmain Trilogy managed to prevent this deal from proceeding following our appointment."

The current situation consequently provides a perfect example of the varying roles that Balmain Trilogy could adopt:

Firstly we could sell Asset 34 now ... with all of its issues unresolved (i.e. no final development consent, no land-fill solution). This would take approximately 6 months and would likely result in a recovery of the impaired value i.e. no upside from its written down value. **This would effectively be the consequence of a 'wind-up' of the Fund;**

Secondly we could remediate the land-fill issue, finalise the interim development consent and then sell the site. This would take longer, say 12-18 months, but the sale price would be considerably higher and the recovery to Unitholders would be significantly above the current impaired value;

Thirdly the final option, where Balmain Trilogy rectifies the land-fill issue, procures an enhanced development consent for approximately 400 housing lots, and proceeds with the staged development of Asset 34 and the eventual sale of completed housing lots to home buyers and builders. This could yield a significantly enhanced recovery for the Fund, perhaps 2 or 3 times the value of selling it now.



As at today the value of the Funds development assets are approximately \$150m. Whilst we are not guaranteeing that we can double this amount as perhaps could be achieved in respect of Asset 34 we do believe that we can add significantly to Unitholder recoveries from the careful, planned and risk averse development of these assets.

The question for you to consider today is whether you want these assets to be developed in this way. That is your choice ... today.

What is our thought process and motivation

Originally Balmain Trilogy's intention was to remediate the fund, remove the problems and take new investment into the fund and potentially grow it into a much larger fund. Unfortunately, due to the state of the Fund, it became readily apparent that this could not happen.

It was also clear that some of the assets, Martha Cove and Asset 34 in particular, were capable (if properly developed) of returning some of the losses in the Fund back to Unitholders. Consequently, through developing some of the Fund's assets, we could conceivably return Unitholders a significantly improved return of capital from those developments being successful.

Whilst Balmain Trilogy was prepared to considerably broaden the scope of its funds management services to your Fund without seeking any further compensation as we did with Assets 11 and 22, it is important to note that Balmain Trilogy has not been appointed as a specialist development manager to the Fund, and has not been remunerated for providing those services to date. However going forward, we believe that to expect Balmain Trilogy to manage significant developments like Martha Cove and Asset 34 for no fee is both unreasonable and uneconomic for all parties if those parties have reasonable commercial expectations.

As part of the New Strategy, we propose to expand our services to include development management.

We are ideally placed to provide those services given our extensive experience in managing non-performing loans, in development and our specific knowledge of the Fund's assets. The Balmain Group currently administers over \$7bn in commercial mortgage assets. As a fund manager we have re-opened a mortgage fund that we acquired (from Mariner) and, outside of the mortgage funds management sector, we also manage commercial mortgage assets on behalf of such institutions as NAB, AXA, CBA and Bendigo Bank. Balmain's executives, myself included, have run both publicly listed development companies and major private development companies that have undertaken and successfully completed the type of development work that the Fund requires.

The New Strategy involved a fee arrangement which reduced our base fee to 1% and incorporated a performance fee which ensured a proper alignment of the interests of Balmain Trilogy and Unitholders. The performance fee was an arm's length fee and considered by the independent expert to be fair and reasonable. Unfortunately, Unitholders have been misled into believing this fee could be up to \$80 million. This is entirely untrue and cannot be substantiated on any reasonable basis. This is evidenced by our preparedness to cap our entire performance fee at \$30 million, being less than the base fee that City Pacific earned in 2008.

So let's revisit the terms of the proposed performance fee:

- the base fee drops by 33% from 1.5% to 1.0%. If we cannot deliver returns in excess of the indexed value of the Fund we earn less. We believe this is proper alignment;
- we do not get paid any part of the performance fee until 50% of the indexed value of the fund, or approximately \$210m is actually returned in cash to Unitholders. **We cannot use revaluations to increase value ... we have to actually pay it to Unitholders;** and,
- **we only get paid 50% of the performance fee until 75% of the indexed value of the fund, or approximately \$320m, is returned in cash to Unitholders.**

Under the New Strategy, we proposed an arrangement whereby the Fund could use our development management skills to try and recover some lost value. This lost value will not be recovered by the passing of time, general improvement in market values or dumb luck. It will only come from sensible and effective development strategies applied to selective assets of your Fund.

Under the New Strategy, we wished to provide Unitholders with choice. The choice to leave the Fund quickly or to remain invested in the Fund to enjoy the potential benefits of any successes that Balmain Trilogy can generate in respect of development of assets and improved returns to Unitholders.

But how can we provide this choice?

I can speak with detailed knowledge of two investors (both holding in excess of \$1m units) one of whom (Mr A) wants to get out of the Fund ASAP (at virtually any price) and one (Mr B) who knows Balmain well and wants to "hang in there" to see what additional value Balmain Trilogy can manage to create from the Funds assets.

Does Balmain Trilogy wind-up the Fund to keep Mr A happy (fire-sale, fast return of the proceeds, etc)? Or does Balmain Trilogy develop some of the assets of the Fund to keep Mr B happy? Or maybe some middle ground where neither of them is happy.

Well we simply **do not want to make that choice for Unitholders**. If we did we would either:

1. have to explain to Mr A that BT will be developing some of the assets and so he will not see the fast returns of capital that he wants; or conversely,
2. we would have to explain to Mr B that we are winding-up the Fund and we will not be seeking to recover lost value by developing some of the assets; or, depressingly,
3. explain to both that we were doing what neither of them wanted but it was in between the two and was the least disliked 2nd best option (we call this the compromise or Green solution).

What we want is for Unitholders to make their own choice. And the only possible means by which Balmain Trilogy can provide this critical, individual choice to Unitholders is for the Fund to adopt a development strategy – to provide the opportunity for value increase - but to allow Unitholders to redeem units at different speeds ... specifically faster or slower.

This way Mr A is free to accept all redemption offers and exit the Fund at an accelerated rate (whilst not quite as quickly as an exit from fire sales but at a significantly increased price), whilst Mr B can refuse all redemption offers and “hang in there” knowing that Balmain Trilogy is trying to add value in the longer term. Is it fair that Mr B might get more money than Mr A by staying in the Fund longer? How can it not be ... both Mr A and Mr B had the same choice to either accelerate or delay their exit from the Fund, it is up to them how they decide.

However Mr A and Mr B can only redeem disproportionately if the redemption programme is based on the Issue Price of the units. Only a Current Value Redemption facility allows Mr A to redeem units faster than Mr B without causing a significant loss to Mr B.

And whilst I have now mentioned those “words” (Current Value redemption) that have been seized upon by a minority action group that seems unable to understand the complexities of redemption theory, let me clear up some myths:

1. **The type of redemption facility adopted by the Fund does not affect Balmain Trilogy’s management fees;**
2. **The type of redemption facility does not change the \$ redeemed to Unitholders**, just which Unitholders receive the redemptions. Under neither scenario can Balmain Trilogy leave unneeded ‘cash’ in the Fund so as to prop up the management fees all available liquidity will be returned to Unitholders;
3. **A Current Value redemption does not create a loss**, the loss **has already occurred in the diminution in the value of the assets** (as a result of the actions of the previous manager); and,
4. **The maintenance of \$1.00 redemptions does not ‘increase’ the value of the Fund, that only changes as asset values are improved;**
5. **The maintenance of \$1.00 redemptions only serves to tie every Unitholder by the hip to every other Unitholder and rob them off their individual choice to accelerate or delay their exit from the Fund;**
6. Balmain Trilogy is indifferent to which redemption facility is used by the Fund but, as a fiduciary, we categorically recommend that redemptions occur at current value otherwise Unitholders will be deprived of what we believe is their inalienable right to choose their level of investment in the fund independently from the choices of other Unitholders.

What is your choice today?

You would all be aware that Resolution 1 requires a 75% majority of units voted at this meeting.

I can advise you that, on the closing of the proxies, a total of 7,400 Unitholders had voted. This is 61% of the Unitholders of the Fund. Of the 7,400 Unitholders that voted, 6,000 or 81% have voted in favour of Resolution 1.

I can also advise you that, on the closing of the proxies, a total of 587m units were voted. This is 66% of the units in the Fund. Of the 587m units that were voted, 386m or 66% have voted in favour of Resolution 1.

As you are all aware Resolution 1 requires a 75% majority of units hence, notwithstanding the support of 81% of voting Unitholders and 66% of all votes cast, it appears likely that the ghost of Phil Sullivan and his old band of supporters may have prevented the optimal outcome for the Fund which is clearly supported by a majority of Unitholders and units.

This, however, is by no means a failure. We always knew that a 75% majority in respect of any vote for anything is a significant hurdle to carry, especially in the face of 'opposition' no matter how misguided, deceptive or misleading that opposition may be.

Consequently it is important for you to know that, whatever the outcome of the final voting on Resolution 1 ... carried or rejected ... Unitholders will still benefit from Balmain Trilogy's professional and committed management of the Fund. There will be no "slacking off" of our performance and we will continue to act solely in the best interests of Unitholders to recover the highest possible value from the assets as quickly as possible. Further I personally and Balmain Trilogy as a company, both warrant that, irrespective of the outcome of the vote in respect of Resolution 1:

- **Balmain Trilogy is targeting to repay \$295m, or 71% of the current assets of the Fund, to Unitholders prior to October 2012.**
- **Payments to Unitholders will still commence in the amount of \$35m in October 2010 in some form;**
- **Balmain Trilogy will NOT hang on to any excess liquidity and will return any excess liquidity to Unitholders promptly and regularly;**
- Balmain Trilogy will continue to act in the best interests of all Unitholders in maximizing the value of recoveries and **no fire-sales will occur;**
- **Balmain Trilogy will not 'slaughter' assets such as Asset 34 or Martha Cove.** Even if the Resolutions are not passed, Trilogy and Balmain Trilogy will continue to act in the best interests of Unitholders and if that means developing assets, then Trilogy will appoint a development manager where it considers it to be in the best interests of Unitholders; and
- **Balmain Trilogy will improve communications to all Unitholders.**

Closing

In closing Balmain Trilogy has always sort to engage with Unitholders in a proactive and constructive manner. For example, in developing the New Strategy, we consulted with a broad range of Unitholders (as evidenced by over 81% of Unitholders who voted by proxy being in favour of the New Strategy).

Unfortunately, it appears as though the result of this meeting has been influenced by the lies and deception that has been perpetrated on the Fund's members by certain individuals. Whilst their motives are entirely unclear to us, in our opinion, their actions have caused significant damage to you, the Unitholders, and I can only stress that they will cause further damage if they continue to act in the same manner.

It is also important for you to note that none of these individuals has sought to discuss any of their concerns with either the Investor Committee or Balmain Trilogy or Trilogy. They have never bothered to verify any of their outrageous allegations with proper dialogue. Sniping from the side is always easier than proper discussion and consideration.

Should any member have any issue with our management we respectfully request that they meet with us and go through their issues, as many hundreds of Unitholders have, to understand the complexities that burden the fund before continually requisitioning meetings at great cost to the fund with resolutions that are redundant and lacking in any commonsense.

We have not failed to successfully demonstrate our bona fides to the fund's bankers, the independent expert, the auditors and the investment committee. We have not failed to gain the support of 81% of all Unitholders. We will not fail any examination of our conduct.

We are committed to serving the members of the Fund and we take great pride in scrupulously complying with our fiduciary obligations to the Unitholders.

In good faith we helped you remove City Pacific as manager, at considerable expense to ourselves with no guarantee that we would jointly be successful in removing City Pacific, and we have done nothing other than act in your collective best interests for the last year. We will continue to do so.

Thank you for your consideration.