

SUBMISSION

an investor in the City Pacific First Mortgage Fund
and the City Pacific Income Fund

Inquiry into Financial Products and Services in Australia

Parliamentary Joint Committee
on Corporations & Financial Services
Department of the Senate
Parliament House - Room SG - 64

“I BLAME THE MANAGER, I DO NOT BLAME THE MARKET”



“Bloody Stupid Me”

<http://www.news.com.au/heraldsun/story/0,21985,22030091-664,00.html>

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Introduction

I make this submission as a unit holder in each of City Pacific Limited (“CPL”)’s two funds, The First Mortgage Fund (“FMF”) and the Income Fund (“CPIF”). I believe that from a time BEFORE 1 September 2007, the manager of the FMF knew, or ought to have known, that the FMF was ill-fated and that those investors who remained in the FMF would stand to make substantial losses.

The manager would wrongly put investors’ losses down to world economics and ASIC would wrongly put investors’ losses to prudential choice. The Public Trustee of Queensland (“PTQ”) was prepared to have its title used as a lure to give false confidence to investors, yet would run for cover at the first glimpse of potential litigation, and the Commonwealth Bank of Australia (“CBA”) would enable the manager to continue along with, what I regard as, the ‘idiotic’ fundamentals of the FMF.

All the while, investors’ money would be rapidly leached from the FMF to the coffers of lenders from the fund, the majority of whom were relatives of the manager, and some to interests in which the manager intended to reap substantial commissions (eg. ‘Pacific Beach/Sands’ at Broadbeach).

The Manager engaged in multi-level transactions, mostly incorporating a second-tier lending program on the back of the ‘registered first mortgages on land in Australia’ held by the FMF. The Manager’s ‘idiotic’ fundamentals included (a) not requiring lenders to pay because it didn’t guarantee all the debt would be covered, and (b) allowing defaulting lenders to continue to borrow until their projects are completed (regardless of the economic climate).

These ‘idiotic’ fundamentals guaranteed the ‘safety’ of the second-tier transactions by not foreclosing on the first mortgages on which they lagged in priority. Defaulters were not pursued, and loans were rolled over - this ‘capitalisation’ of the interest merely added pain to investors because such actions increased the fees paid to the manager. In fact, income to both the manager and the CBA have gone up dramatically as income and investment return to investors have come to a complete halt.

The CBA controlled the affairs of the FMF in a tight-fisted way at least some time after the time when the FMF was frozen (3 March 2008), yet allowed money to be taken from the FMF and paid to CP1 in March 2009 so that such monies could be paid to itself and the manager - all the while denying unit holders the chance to recover any of their monies in the form of distributions and redemptions. I understand that the money paid to CPL itself was also paid to the CBA, so it’s my understanding that in March 2009, the CBA received nearly \$36m of the FMF’s monies instead of paying down the FMF’s debt to the CBA.

How the FMF even functioned is a surprise to me, especially given the fact that so many loans were not income producing. I would guess that at least 60% of the loans from the FMF were incapable of producing income and so the FMF appeared to me to operate in a ‘ponzi-like’ condition from some time around September 2007. The manager did extend the facility on the ‘pretence’ that the money would be used for ‘emergency’ periods such as investor redemptions but had already begun a plan of lending out as much as possible.

It seems to me that no regard was paid by the manager to the cash flow of the business and no capital contingency was provided for in the FMF.

From some time in August 2007 when Michael West of the Sydney Morning Herald (“SMH”) gave warnings to investors, CPL continued to wrongfully aver that the FMF was in a strong financial position and continue to advertise for new investment and to encourage existing investments to re-invest in the FMF. All of ASIC, CBA, KPMG, and PTQ gave no warnings as the rotten state of the FMF during the period September 2007 until 3 March 2008 (the date the fund was frozen): in fact, on 1 September 2007 the CBA increased the FMF’s facility by \$90m at such a time as I believe the FMF should have been frozen.

The Corporations Act (Cth) 2001, s. 601FC(1) (“the Act”)

Firstly, I would like to highlight the ‘perception’ of inadequacies in the administration of the law which I believe led to CPL’s blatant lack of concern for unit holders’ interests. The ‘perception’ is a pretext learnt by investors when approaching ASIC with what investors genuinely believed they have a valid complaint on which ASIC should take action and provide some degree of worthwhile feedback. I have decided to highlight various inadequacies (as I see them) throughout the text of this submission.

The Investment and Financial Service Association’s submission to the 1998 Review on the Managed Investment Act (Cth) 1998, (‘the IFSA’s Submission’) stated (on Page 9):-

“... ASIC’s role in relation to compliance is a vital part of the MIA regime for managed investments. It is not always fully appreciated that, in addition moving the regulatory regime to one based on responsibility by a single entity, MIA also instituted another, equally fundamental change, in the pivotal role it allocated to the regulator. ...”

<http://miareview.treasury.gov.au/content/publicsubmission/download/ifsa2.PDF>

I believe that it is with respect to this ‘pivotal role’ allocated to ASIC where we have suffered as investors in the CPL Funds. There has been no active involvement by ASIC and unit holders have been left without any support whatsoever.

For example, concerns were raised about many issues, and ASIC response to unit holders? Well, a ‘personalised’ letter containing a less than brief overview of the complaint (headed ‘Your Complaint’) followed by the following standardised headings” (**all of which had nothing to do with my particular complaints**) -

- ‘Your Complaint (nothing at all to do with the PARTICULAR complaint/s but rather a collective of unit holder complaints - nothing in particular mentioned)
- **Background**
- **Power to Freeze Funds**
- **Redemption of Investment - Hardship Provisions**
- **Further Assistance’**

I would however like to point out that the emphasised ‘reference’ line did in fact particularise my complaint. There was no attempt to address any particular complaint that any unit holder might have set out to particularise and adduce evidence.

Under the further heading of ‘Role of ASIC’, the regulator points out :-

“... It is important to understand the role of ASIC and to understand that ASIC is not a prudential regulator, nor do we approve products prior to their release. ASIC’s power primarily relate to ensuring that the scheme’s disclosure complies with the law. As such, ASIC has limited scope to intervene in the operations of companies simply because the projects or investments they propose may contain a certain level of risk or are not performing as expected. Risk and its relationship to the expected returns are matters for investors to assess (with or without financial advisers) and ASIC cannot direct how people invest their money. ... Further to this, ASIC is developing a number of initiatives to better equip retail investors to manage and protect their investments and wealth. ...”

It is clear that ASIC does not understand the concerns of unit holders: in fact, ASIC ignores them and sends them to a collective ‘ignored stockpile’. I might liken this to a man reporting that he’d been bashed, and the Police cautioning him for walking down the street in the area where he was bashed: ASIC did not investigate the concerns of unit holders, rather it chastised unit holders for making the investment.

I personally submitted two complaints to ASIC and have only received a reply to the last one - seems the first one has become one of the ‘great ignored’.

Generally unit holders concerns related to (1) related party transactions, and (2) security held by the FMF to support monies it had lent. There was no ‘pivotal role’ and ‘active involvement’ by ASIC, except with regard to its ‘personalised’ responses to the concerns of unit holders, the very individuals they were supposed to protect.

ASIC has been downright ignorant to believe that unit holders didn’t expect risk, and in terms of their ‘pivotal role’ and their ‘active involvement’ ASIC has been an abysmal failure.

ASIC'S concern about 'form' rather than 'substance'

The ASIF Submission envisaged (at the bottom of Page 9):-

“... ASIC Powers ASIC has extensive powers in relation to the establishment of managed investment schemes, as well as in relation to monitoring, and if necessary controlling, the management and operation of such schemes. It also has extensive powers with regard to surveillance and investigation and access to a wide range of enforcement powers. ...”

However, in the standardised, personalised letter sent to unit holders in response to their concerns, ASIC states in the penultimate paragraph :- **“As stated above, we are aware of the issues you have raised . We continue to monitor the actions of City Pacific in relation to the operation of the Fund. Please note, however that ASIC cannot comment on operational matters, and I am, therefore unable to provide further detail regarding what, if any, action ASIC may or not be taking in relation to your concerns other than the information provided on our website”.**

If there ever was a ‘shove off’ letter, it was ASIC’s letter to unit holders. In some cases (as in my case for one of my complaints) it was months late, and for some (as in my other complaint) it didn’t even come. It made no reference to the factual circumstances and evidence adduced and made no mention of CPL’s obligations - I really felt that I’d wasted my time in communicating with ASIC (one of my complaints consisted of some 15 pages).

ASIC had the power to inspect, investigate, and cause CPL to produce valuations, contracts, sureties and guarantees but did not. Rather, it looked to the ‘form’ of CPL’s interaction with the FMF.

For example, the land at the Broadbeach was purchased for \$100m in 2006 and mid-way through 2009 the debt to the Fund is over \$200m and nothing has been done to develop the site. The security and guarantees covering the loan are dubious and virtually no payments have been made on the loan. Yet, ASIC did nothing to investigate the factual circumstances - its view: well, unit holders took the risk, so nothing to concern itself about.

What if ASIC did investigate just this block of land, what would be the issues that would have been raised? Perhaps (but not limited to):-

- **Was the security adequate?**
- **Was this in fact a related party transaction?**
- **Was the transaction on commercial terms?**
- **What was the real relationship between the parties?**
- **Was there a conflict of interest in this transaction that left members of the fund at unnecessary risk?**
- **Was this a transaction into which the manager should have engaged the FMF?**

If newspaper reports are true [<http://moneymagik.com/broadbeach.php>], then unit holders collectively stand to lose well over \$100m, yet ASIC sees this loss as ‘risk and/or reward’ of our investment, and not a regulatory matter. ASIC believes that its role has been fulfilled because CPL has filled out the proper forms and ticked the right boxes - ASIC sees compliance in the FMF’s ‘form’: Investors sought to see compliance in the FMF’s ‘substance’.

Even if this transaction would be determined to be a related party transaction by ASIC, it would have been very important because it then would represent up to another 20% of the FMF lent to non-income producing endeavours in which the manager itself had sought undue rewards without regard to the risks investors in the FMF would suffer as a consequence. This issue went to cash flow, survivability, and whether or not the FMF was operating in a ‘ponzi-like’ manner or not.

Clearly, to ASIC, the loss of the \$100m would be related to ‘unit holder’ prudence, not to any other matter. But, what if it was because there was (a) inadequate security? Or (2) that the transaction was not on commercial terms? Or (3) related to a poorly managed conflict of interest? Or (4) caused the fund to be non-functioning (lack of cash flow)? Or (5) should the loan have been disclosed as a related party loan? Are these issues matters of ‘prudence’? or are they matters of ‘regulation’?

This is only but one loan that escaped ASIC’s scrutiny - I believe ASIC should have investigated this matter and all other matters with respect to loans from the FMF - I believe ASIC has failed its regulatory duty to police the Act with respect to the FMF.

Our biggest enemy has been the very regulator to which we initially turned in our hour of need.

Financial Statements - Disclosure, Surety (including Personal Guarantees and the like)

Interest Paid/Payable - As a unit holder it was impossible for me to tell exactly what interest was paid by each lender from the FMF. The 'interest payable/paid' column didn't not disclose how much of each was included in the total.

Lenders - Investors did not know how much money was lent to lenders (apart from declared related companies) and the description of the land on which the development was to take place. At first glance this might no seem important, but when one looks at the 'Pacific Sands' project at Broadbeach one will see that a loan of some \$100 was made in 2006 which has now extended to over \$200m, without any work being carried out on the site. In fact, with respect to this loan, information came predominately from the media.

Surety for loans - CPL's CEO stated (in part):-

"...**The City Pacific Mortgage Trust only lends first mortgage funds under rigid lending policies, very similar to bank lending policies. They include a requirement for a loan to valuation ratio of 80 per cent or less. ...**"

<http://news.iguana2.com/bspectator/ASX/CIY/190619>

"... **We choose only to deal directly with borrowers who meet our rigorous screening process, of whom many are repeat clients with a wealth of industry experience and a catalogue of quality products. ...**"

<http://www.citypac.com.au/citypac/documents/press/20071128%20City%20Pacific%20First%20Mortgage%20Fund.pdf>

In the Fund 'Update' of 11 June 2009, CPL stated (in part):-

"... **Security requirements which include limiting investments of the Fund to Loans primarily secured by registered first mortgages over real property and cash investments. In certain circumstances collateral security such as additional registered mortgages, fixed and floating charges and corporate and personal guarantees MAY also be taken in addition to the first mortgage. It is not necessarily a requirement that the security be income producing. ...**" {capitalisation mine}

<http://www.citypac.com.au/citypac/documents/schemes/cpfmtf/180day/20090611%20CPFMF%20Fund%20Update%20-%2011%20June%202009.pdf>

Clearly CPL's 'rigid' lending policies are not at all 'very similar' to bank lending policies as disclosed by Mr. Sullivan, in fact, charges as well as 'corporate and personal guarantees' are not mandatory as they WOULD be for a bank lender - such 'extras' were at the discretion of the manager. And what additional security do registered fixed and/or floating charges over a company represent if that company only has as its sole asset the land given up as first mortgage?

However, it seems (without access to the actual loan documents) that loans were given freely from the FMF and not on terms that a traditional lending source would consider 'prudent'. When one looks at the Fund's financials as at 30 June 2008, it was disclosed (in part) loans of:-

The 'walk-in / walk-out' loans

- **\$33,13m in Victoria had lost \$11.68m**
- **\$19.45m in Queensland had lost \$4.846m**
- **\$1.635m in Sydney had lost \$.815m**
- **\$45.16m in Melbourne had lost \$12.128m**
- **\$2.63m in Sydney had lost \$1.008m**
- **\$12.146m in Sydney had lost \$3.340m**

[http://www.citypac.com.au/citypac/documents/reports/cpfmtf/20080930_CPFMF_Annual_Financial_Report_\(30_June_2008\).pdf](http://www.citypac.com.au/citypac/documents/reports/cpfmtf/20080930_CPFMF_Annual_Financial_Report_(30_June_2008).pdf)

It doesn't strike me that these loans have been given to borrowers who 'meet (CPL's) rigorous screening process' or have been given subject to 'rigid lending policies'. [this is not a complete list - CPL was careful not to include the real BIG losses that jumped up in the mid year 2009 financials - and ASIC should have asked why the losses on the BIG loans were not disclosed in 2008, but it didn't thereby allowing CPL to continue misleading investors into thinking that these little impairments were the worst the FMF would suffer. Eg. Martha Cove, Grande Pacific, and Broadbeach impairments were not included in the list].

One has to wonder just how such loans were made? - just what was the security? As I understand it, there were no personal guarantees given, and no additional property taken as collateral for any loans, nor were there guarantees by spouses, superannuation funds or trusts associated with the lenders. This style of lending left the FMF vulnerable to the market, and vulnerable to loss - was a lack of security for lending a 'prudential' matter? Or was it a matter of 'regulation'?

Just why was the FMF permitted to lend monies (be they small amounts or large amounts) to lenders who gave insufficient surety for the loans?

The 'idiotic' Fundamentals of the FMF

On 19 August 2008, in a letter headed “Q&A”, CPL wrote to unit holders, stating in part:-

“... 3. Why do you continue to lend money to borrowers?

- **The Fund is not undertaking any new loans.**
- **The Fund has commitments to existing borrowers to fund their projects to completion.**
- **Selling a half completed project will not return half of the value of the completed project.**
- **The key to realizing the value of the projects being funded is to allow those developments to be completed and sold in an orderly manner. ...”**

“... 4. Why can't you force borrowers to repay their loans?

- **We can force the borrowers to repay their loans however this will not guarantee the full recover of the amount owed to the Fund.**
- **There are a number of loan recovery options available to the Fund and the option selected will be that which aims to secure the full repayment of the loan in the shortest period of time.**
- **The Fund has the ability to require the repayment of loans due to breaches by its borrower however a fundamental of the Fund is to co-operate with borrowers to ensure their projects are completed so that the Fund can realize the full repayment of its loans. ...”**
- **<http://www.citypac.com.au/citypac/documents/schemes/cpfmf/180day/20080819%20Questions%20and%20Answers%20-%20CPFMF%20and%20Distributions.PDF>**

When one looks in isolation at these ‘fundamentals’, then they just don’t make sense - How could it be possible to think that the ‘best outcome’ is produced from advancing money to a defaulting lender? And why would a manager think that making a lender pay regularly isn’t going to enhance the chances of getting a debt paid in full? It’s idiotic to think that these fundamentals make any sense whatsoever, but, to CPL, they made perfect sense.

CPL’s reasoning for advancing money to its defaulting relatives was under ‘cover’ of the fundamentals but in fact the reason was to protect the second mortgages its relatives had engaged in. In the ordinary course of business, a lender holding a first mortgage would not be bothered by how many other lenders entered the fray on second mortgages because ordinarily these second mortgage holders are lower in priority to the first mortgage holder, so, control of the first mortgage holder was essential for the survival of the second mortgage transactions : control of the FMF was the key to secure the second mortgage transactions carried out by the manager’s relatives.

Further, it doesn’t make sense that a first mortgage holder should be bothered whether lenders from the fund ‘complete their developments’, because that is not the concern of the FMF: the concern of the FMF should be the protection of its investments (loans) . However, the concern of the manager is that its relatives ‘complete their developments’, and they will apply the ‘fundamentals’ that best suit the situation where a lender will default and put second mortgage at risk: a regime of continuing advances to defaulters, rolling over loans with compounded accrued interest, in order that the second mortgages are not compromised, but at the expense of the first mortgage holder - the FMF.

The MP Pacific Investments fiasco (and the subsequent loan to CP1 which was eventually paid to CPL itself, and probably back to the CBA), the now risks of CP1's insolvency to the FMF (as first mortgage holder), and the potential losses at Grande Pacific and the Pacific Sands/Beach site are just a few examples of substantial potential loss to the FMF through these types of transactions.

Of course, in the case of Pacific Sands at Broadbeach, if the transaction didn’t proceed, then never mind too, just sell the land and let the FMF wear the loss. No risk to the players, just to the FMF. But to think about it, what lender would allow a loan to go on for over 3 years, to rise from \$100m to over \$200m without any further security than the original land itself, and without any development of the land?

Why didn’t ASIC investigate the reasons the FMF engaged in the loan to Foresight Acquisitions and why didn’t ASIC see this adventure by the manager as a related party transaction? (see Annexures “A” and “B” below).

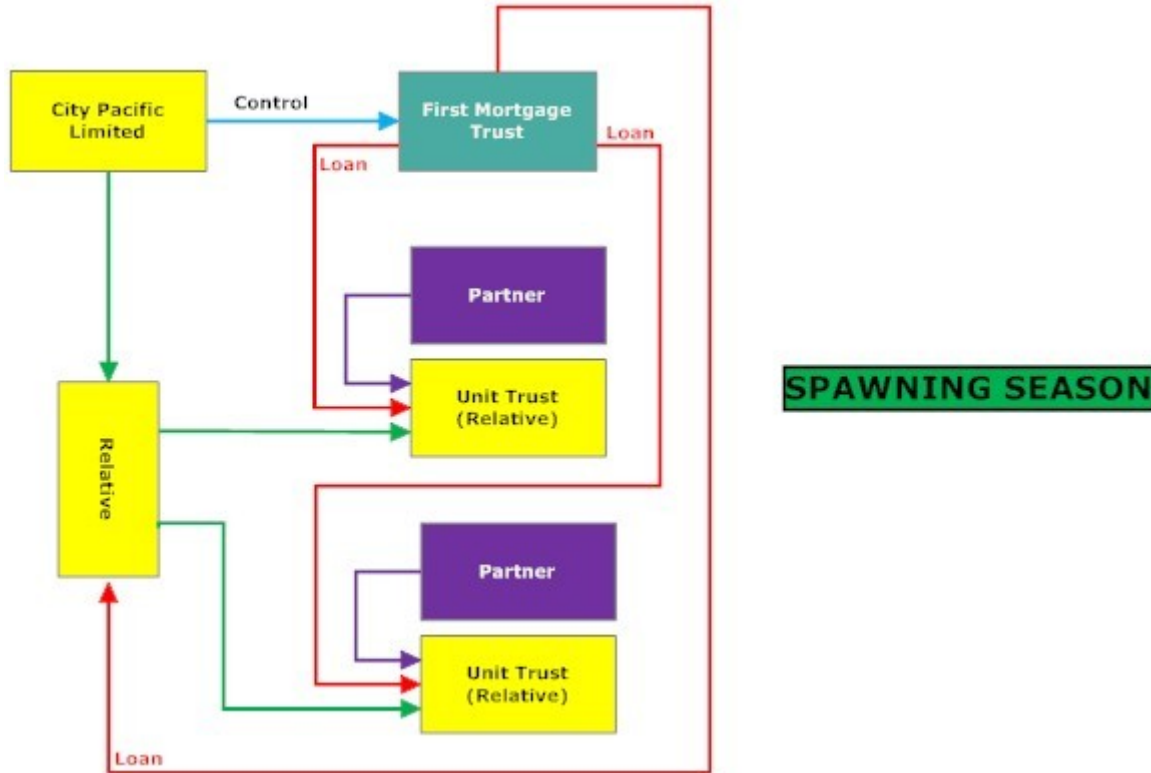
Related Party Loans

The related party loans have always been a ‘bone of contention’ with unit holders. Investors in the FMF have been substantially disadvantaged (see Annexures 1 and 2 - below) because the manager purposely went out and lent on the back of FMF loans:-

“... The company sometimes follows the fund with its own money, creating a second mortgage. “We can't end up behind a hostile lender,” Mr Sullivan said. The \$100 million was the figure at the end of the financial year, with much due to be repaid soon, he said. The company's average outstanding second mortgage balance was usually around \$25 million, he said. ...”
<http://www.news.com.au/heraldsun/story/0,21985,22257943-664,00.html>

CPL did not engage in ‘related party’ transactions as might be understood in the ordinary sense of the meaning of ‘related parties’. CPL created these ‘related parties’ as purpose-built vehicles to engage in particular transactions. Then, as a forefinger and thumb might interact, the manager caused the FMF to engage in transactions that suited the newly-born relatives and the manager perfectly.

The relatives could engage in second mortgage transactions in the secure knowledge that the first mortgage holder (the FMF) would not foreclose on its loan and thereby put the second mortgages at risk. How was this done? By application of the fund's ‘idiotic fundamentals’. Don't chase up defaulters, and continue to make monetary advances to those same defaulters in order that they complete their developments, regardless of the state of the market.



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Loans to relatives may be encapsulated as follows:-

MP Pacific Investments

- In or about September 2007 \$15m was advanced to MP Pacific Investments Pty. Ltd. (see Annexure “A”).
- Some time prior to June 2008 a capitalised loan \$15.6m was rolled over and paid to MP Pacific Investments Unit Trust.
- On 5 March 2009, a capitalised loan of \$17.8m was rolled over and paid to Marina Cove Pty. Ltd.

Table 1 – Loan: MP Pacific Investments Pty. Ltd.

Entity	as at	Loan value as at the end of period (\$)	Advances during period (\$)	Capital repaid during period (\$)	Interest paid/payable (\$)	Interest Rate %	City's ownership %
MP Pacific Investments Pty. Ltd.	31/12/07	15,000,000	15,000,000	0	606,575	12%	15.30%
MP Pacific Investments Unit Trust	30/06/08	15,600,000	15,600,000	0	696,050	13%	15.30%
MP Pacific Investments Unit Trust	31/12/08	15,000,000		600,000	2,256,985	13%	15.30%
MP Pacific Investments Unit Trust	05/03/09	0	0	0	0	0%	-
Marina Cove Pty. Ltd.	05/03/09	(+) 17,800,000	(+) 17,800,000	-	?	?	30.60%

(+) denotes amount to be Added to their existing facility with the FMF

A total of \$600,000 was paid off the loan until September 2007 - 30 December 2008 although the loan itself was rolled over and capitalised on at least two occasions. In effect, the loan to MP Pacific Investments Unit Trust was 'rolled over' to Marina Cove Pty. Ltd.

A 'convenient transaction' - In March 2009, CP1 de-tangled itself from its involvement with MP Pacific Investments Pty. Ltd. And MP Pacific Investments Unit Trust. It seems that Marina Cove Pty. Ltd. (100% owned by CP1 and the original mortgagor of the land of Martha Cove at Mornington Vic.) had entered into a second mortgage with the unit trust and the whole thing had to be unravelled. As a consequence, the money paid on the loan was allowed to remain with CP1 (Marina Cove Pty. Ltd.); the FMF lost its mortgage over the Waves Motel in northern NSW; MP Pacific Investment Unit Trust's debt to the FMF was 'paid out'; the FMF took back mortgages on land at Martha Cove (I don't know how its possible, but they purport it to be true); the FMF advanced \$17.8m to CP1 (Marina Cove Pty. Ltd.), and CP1 wrote down its debt to CPL by \$17.8m.

The bottom line here is that CPL (as manager), under the control of the CBA, allowed CP1 (Marina Cove to retain the \$17.8m in order to reduce its debt to CPL rather than the \$17.8m be retained by the FMF in order that the FMF's debt to the CBA be paid down by \$17.8m.

What more does ASIC need to see about how a manager and a bank will mistreat members of an illiquid (frozen) fund? Is this a 'regulatory' issue? Or is it merely one of our 'prudential' choice?

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Sunrise Waters Pty. Ltd.

- In or about September 2007 \$20m was advanced to Sunrise Waters Pty. Ltd.
- Some time prior to June 2008, a capitalised loan was rolled over and paid to Sunrise Waters Unit Trust.
- The loan was increased by 15% up until 30 December 2008 to \$23.6m and it's likely that no interest has been paid on the loan.

Table 2 – Loan: Sunrise Waters Pty. Ltd.

Entity	as at	Loan value as at the end of period (\$)	Advances during period (\$)	Capital repaid during period (\$)	Interest paid/payable (\$)	Interest Rate %	City's ownership %
Sunrise Waters Pty. Ltd.	31/12/07	20,369,295	2,295,000	2,580,705	973,453	12.00%	50.00%
Sunrise Waters Unit Trust	30/06/08	23,569,295	26,150,000	2,580,705	2,443,759	13.00%	50.00%
Sunrise Waters Unit Trust	31/12/08	23,573,772	4,477	0	2,561,916	13.00%	50.00%

Lake Views Estates Pty. Ltd.

- Around \$20m was advanced prior to June 2005 with the loan increasing to \$52m by 30 December 2008.
- An indeterminable amount of interest was paid on this loan.

Table 3 – Loan: Lake Views Estates Pty. Ltd.

Entity	as at	Loan value as at the end of period (\$)	Advances during period (\$)	Capital repaid during period (\$)	Interest paid/payable (\$)	Interest Rate %	City's ownership %
Lake Views Estates Pty. Ltd.	30/06/05	18,465,957	23,907,184	5,441,227	850,431	11.25%	
Lake Views Estates Pty. Ltd.	30/06/06	32,974,750	14,508,793	0	3,227,181	11.75%	
Lake Views Estates Pty. Ltd.	30/06/07	45,213,042	12,238,292	0	6,435,116	12.00%	15.30%
Lake Views Estates Pty. Ltd.	31/12/07	44,212,727	2,765,039	3,765,354	2,856,374	12.00%	15.30%
Lake Views Estates Pty. Ltd.	30/06/08	54,688,575	13,240,887	3,765,354	6,008,592	13.00%	15.30%
Lake Views Estates Pty. Ltd.	31/12/08	51,805,742	12,318	2,895,151	4,057,982	13.00%	15.30%

Grande Pacific Operations Pty. Ltd.

- Some time prior to December 2005, a loan of \$6.8m was advanced to Grande Pacific Operations Pty. Ltd. (a 50% CPL owned company).
- Some time prior to June 2006, a loan of \$12.8m loan was advanced to Grande Pacific Operations Pty. Ltd. (a 50% CPL owned company). Whether this is a capitalisation of the initial loan is not known.
- Some time prior to June 2007, the previous loan was capitalised and rolled over to Grande Pacific Limited with further advances made.
- Some time prior to June 2008, the loan was split into two ‘Syndicates’ (Syndicate 1 and Syndicate 2) with further advances made.
- By December 2008 both Syndicates owed the FMF more than \$81m with an indeterminable amount of interest being paid.

Table 4– Loan: Grande Pacific Operations Pty. Ltd.

Entity	as at	Loan value as at the end of period (\$)	Advances during period (\$)	Capital repaid during period (\$)	Interest paid/payable (\$)	Interest Rate %	City's ownership %
Grande Pacific Operations Pty. Ltd.	31/12/05	6,800,000	6,800,000	0	3,545	10.75%	50.00%
Grande Pacific Operations Pty. Ltd.	30/06/06	12,800,000	12,800,000	0	719,729	11.50%	50.00%
Grande Pacific Limited- 17/04/09 now Grande Pacific Pty. Ltd.	30/06/07	28,195,519	15,395,519	0	2,525,139	Av 12%	50.00%
Grande Pacific Syndicate 1	30/06/08	48,438,667	32,483,148	0	3,592,358	12.50%	50.00%
Grande Pacific Syndicate 1	31/12/08	56,561,338	19,075,397	10,952,726	1,208,272	12.50%	50.00%
Grande Pacific Syndicate 2	30/06/08	24,690,863	12,450,863	0	2,028,289	13.00%	50.00%
Grande Pacific Syndicate 2	31/12/08	24,703,302	12,439	0	1,939,516	13.00%	50.00%
Grande Pacific Syndicates 1 & 2 total	30/06/08	73,129,530	44,934,011	0	5,620,647	13.00%	50.00%
Grande Pacific Syndicates 1 & 2 total	31/12/08	81,264,640	19,087,836	10,952,726	3,147,788	13.00%	50.00%

Marina Cove Pty. Ltd.

Table 5 – Loan: Marina Cove Pty. Ltd.

Entity	as at	Loan value as at the end of period (\$)	Advances during period (\$)	Capital repaid during period (\$)	Interest paid/payable (\$)	Interest Rate %	City's ownership %
Marina Cove Pty. Ltd.	30/06/04	65,894,648	57,581,863	10,050,866	4,534,557	11.25%	
Marina Cove Pty. Ltd.	30/06/05	146,027,605	94,790,793	14,657,836	15,351,001	11.25%	
Marina Cove Pty. Ltd.	30/06/06	110,793,391	98,063,233	133,297,447	18,674,557	11.75%	
Marina Cove Pty. Ltd.	30/06/07	139,349,366	136,006,029	107,450,054	20,291,847	12.00%	
Marina Cove Pty. Ltd.	30/06/08	76,221,017	85,722,241	148,850,590	9,325,743	13.00%	30.60%
Marina Cove Pty. Ltd.	31/12/08	75,879,022	1,358,977	1,700,972	7,387,259	13.00%	30.60%
Marina Cove Pty. Ltd. (**)	05/03/09	93,679,022	17,800,000	0	0	?	30.60%
Marina Cove Pty. Ltd. (***)	05/03/09	111,679,022	18,000,000	0	0	?	30.60%

** denotes the \$17.8m loaned to CP1/Marina Cove (and then paid to City Pacific Limited)

*** denotes \$18m loaned to CP1/Marina Cove (and then paid to the CBA) - attracted dubious security (including 2nd mortgages)

Annexures “D” and “E” show pictures of the bleak landscape on which lenders are owed over \$300m.

The madness of the FMF ‘compromised’ first mortgage loans raised to new heights when unit holders woke to Tony Boyd’s article ‘No Mortgage Pain for City Pacific’ [‘Not happy City Pacific’- 31 March 2009]:-

“... Unit-holders in a mortgage fund managed by Gold Coast property developer City Pacific will be shocked to find that their fund is about to pay the corporate debts of a private company in the City Pacific group.

The unlisted \$980 million City Pacific First Mortgage Fund (CPFMF) will today pay an \$18 million debt owed to the Commonwealth Bank by Marina Cove Pty Ltd, a subsidiary of City Pacific associate CP1. ...

The directors claim it was in the interests of the mortgage fund to rescue Marina Cove from possible insolvency because the fund is itself heavily exposed to Marina Cove’s development site, which is called Martha Cove on the Mornington Peninsula in Victoria. ... spokesman for City Pacific said the \$18 million paid by the mortgage fund to CBA on behalf of Marina Cove Pty Ltd was actually an extension of the mortgage fund’s existing \$83 million debt facility. He said the fund was given additional first and second mortgage security in return for the increased loan.

City Pacific founder Phil Sullivan created such a complex web of incestuous corporate interests that there was bound to be a time when every possible conflict of interest would have to be managed. ...”

[http://www.businessspectator.com.au/bs.nsf/Article/City-Pacific-\\$pd20090331-QMT7Z?OpenDocument](http://www.businessspectator.com.au/bs.nsf/Article/City-Pacific-$pd20090331-QMT7Z?OpenDocument)

One has to wonder how a first mortgage had suddenly become subject to a second mortgage? But, for ASIC this wasn’t a regulatory matter either - it was a ‘prudential matter’. We invested in the FMF so it was ‘our’ risk .

‘Obscene’? yes, its ‘obscene’ that our regulator doesn’t see it as abnormal that an illiquid fund pays \$18m to CP1 (a related company of its manager) in order to protect itself against CP1 going insolvent, when the FMF held a first mortgage over CP1’s assets. So, the real question is "Does the FMF hold first mortgages over the assets of CP1?" - a question into which ASIC should have dug very deeply indeed.

The 'Folly' – the FMF takes a dive down at the Beach!

This 'development' loan at Pacific Beach/Sands deserves special mention because of the circumstances behind it. The land was purchased in or around 2006 for a sum of around \$100m, and now its up for sale expected to return no more than \$80m, but sadly for investors, the loan value on this property is over \$200m according to media sources.

In the first public statement with respect to the lender (Foresight Acquisitions Pty. Ltd. (“Foresight”)), Mr. Sullivan stated (in part):-

“... We enter into mutually beneficial arrangements, all the while considering the best interest of our shareholders and investors. Our alliance with Foresight Acquisitions is yet another example of this process in action”. ...”

http://www.citypac.com.au/citypac/documents/press/20060510_Correction%20to%20Article%20Published%20in%20The%20Australian%2009%20May.pdf

On 24 October 2007, Grocon was 'casting an eye' over the Boardbeach development:-

“... Grocon aims to satisfy its appetite for iconic projects through its CP1 links, with the company already casting its eye over the Sullivan-led City Pacific's proposed Pacific Beach project at Surfers Paradise. ...”

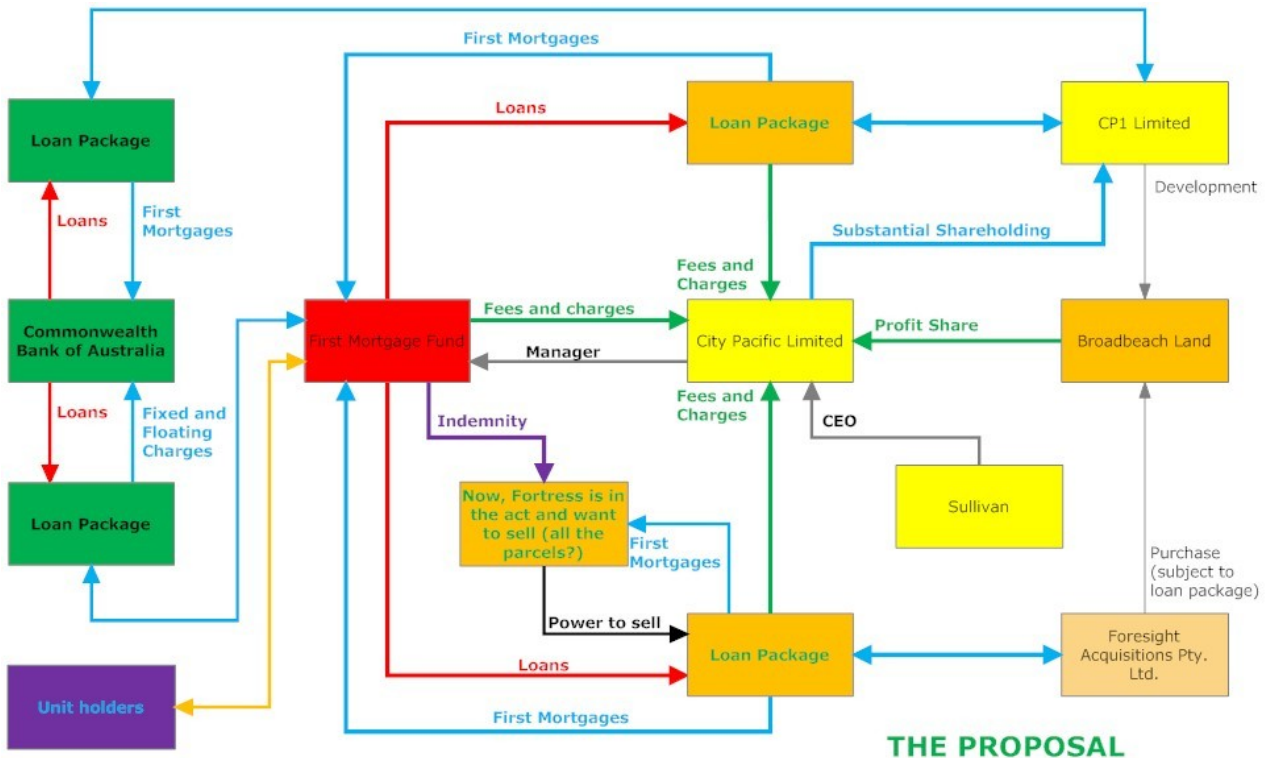
http://www.goldcoast.com.au/article/2007/10/24/4089_gold-coast-business.html

“... The initial Grollo purchase was part of a Queensland expansion strategy for Grocon, which had become preferred builder for future projects planned by CP1, among them the now-abandoned Pacific Beach on the southern edge of Surfers Paradise. ...”http://www.goldcoast.com.au/article/2009/06/03/84585_gold-coast-business.html

“... Under the purchase arrangement structured by former City Pacific chief executive Phil Sullivan, The City Pacific Mortgage Fund and the City Pacific Private Fund would fund the acquisition in return for a one-third share in development profits. ...”
<http://www.theaustralian.news.com.au/business/story/0,28124,25449996-36418,00.html>

However, I think the report was incorrect, and CPL was the one to reap the profits, not the Private Fund. CPL declared a 30% ownership in the project in its 2006 – 2007 half-year results (page 8 – under Table: Property, line 9).

http://www.citypac.com.au/citypac/documents/press/20070214_City%20Pacific%20Limited%20Half%20Year%20Presentation.pdf



This is a media article from 4 December 2007:-

“... DEMOLITION of 10 prime Surfers Paradise buildings will begin early next year to make way for the \$600 million Pacific Beach twin towers. Gold Coast City councillors approved the project yesterday, paving the way for construction to begin on the 11,355sq m site in Old Burleigh Road.

The Pacific Beach plans show two towers, a 41-storey north tower and a 36-storey east tower connected at their base by a shared lagoon. There will also be several beach villas and commercial space, including a restaurant. It is the biggest beach front development since the Sheraton Mirage and Pacific Condominiums were built by Christopher Skase in the mid-1980s.

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Negotiations by low-profile investor Craig Perry's Foresight Acquisitions and financier City Pacific Limited to secure the 10-lot prime parcel involved almost 100 property owners and the holding cost more than \$100 million to assemble. City Pacific CEO Phil Sullivan said he welcomed the council's support for the project.

"The development is on one of the largest remaining absolute beachfront sites in the area and we are confident it will appeal to end users seeking the high-quality lifestyle," he said. Investors are expected to snap up the 322 apartments worth between \$5 million and \$8 million each from next year.

Seven apartment buildings including the 14-level Oriana tower and three-level Pacific Sands will be razed along with two houses. The council has demanded a detailed demolition, construction management and staging plan. The developers will also include \$170,000 of streetscaping for Wharf Road, \$100,000 to upgrade a local park, \$500,000 of public art, a storage facility for council lifeguards and underground power lines in Old Burleigh Road...."

http://www.goldcoast.com.au/article/2007/12/04/5628_gold-coast-news.html

The 'development' got a special mention in the 'October – December 2007 Fund Update':-

"... The Development Application approval from Gold Coast City Council for Pacific Beach in December sent out a signal that the demand for luxury high-rise development is in the ascendancy. ... "We are confident it will appeal to an increasing number of people seeking the high end lifestyle that Pacific Beach offers," he said. ... The Pacific Beach towers are 41 and 36 storeys respectively with 322 apartments, plus 4 beach villas and on site alfresco dining. Construction is expected to commence this year. ..."

http://www.citypac.com.au/citypac/documents/newsletters/investors/20071231_City_Pacific_Update_-_December_2007.pdf

But by 22 February 2008, the project wasn't on the horizon any more:-

"... Major projects including ... Gainsborough Greens ... Townsville Ocean Terminal and Future Development Area ... Grande Pacific 30.6% holding in CP1 (ASX: CPK) ... 26.5% holding in Indigo Pacific Capital (ASX: IPA). ... Martha Cove ... Paradise Resort (Azzura Pacific Resort) ... Gold Coast International Hotel ..."

<http://www.citypac.com.au/citypac/documents/press/20080221%20City%20Pacific%20Announces%20Record%20Half%20Year%20Profit.pdf>

And now property was up for sale:-

"... CITY Pacific is poised to sell off some of its biggest Gold Coast property holdings as it works its way through a looming debt crisis. ... Apart from properties it owns outright on the Gold Coast, City Pacific is also financing a further \$2 billion in projects in central Surfers Paradise, including the massive Pacific Beach, being undertaken by Craig Perry's Foresight Acquisitions..."

http://www.goldcoast.com.au/article/2008/03/07/8520_gold-coast-business.html

Just how long had the site been up for sale?

The headline, "City Pacific to receive \$205 million from borrower following sale of development", suggested a big development was being sold and \$205 million would soon be flowing in the door to help pay the Commonwealth Bank, which is owed \$240 million by the end of this month. Those hoping to get back their savings from the \$900 million First Mortgage Fund would not like to have heard that this large loan to a property developer was "past due", or in default, that is.

City MD Phil Sullivan has confirmed the borrower was low-profile Gold Coast developer Craig Perry's Foresight Acquisitions. City Pacific turned over its loan books often, and Perry had strong demand to sell the beach front properties, said Sullivan. He declined to say whether the payment terms on the loan to Perry had been extended. ..."

<http://business.smh.com.au/business/fortescue-defies-the-sceptics-20080507-2bxm.html>

By June 2008 there were 'Korean buyers circling the property':-

"... CP1 chief executive Phil Sullivan this week said, while plans were progressing, the development timeline for the project had been pushed out. Another project that is being sold off is the twin-tower Pacific Beach at the southern end of Surfers Paradise.

Korean buyers are said to be circling that property, being developed by City Pacific in partnership with Craig Perry's Foresight Acquisitions, but it is clear the sale process puts that project on a longer time frame than first planned. ..."

http://www.goldcoast.com.au/article/2008/06/07/12179_gold-coast-business.html

In May 2009 the whole thing was up for sale, in part or in whole:-

"... FORTRESS Credit appears to have stepped up the pressure on City Pacific to sell a huge development site at the southern end of Surfers Paradise after the collapse of a \$205 million deal struck this time last year. ..."

http://www.goldcoast.com.au/article/2009/05/09/77215_gold-coast-business.html

The issue that is important to understand here is that nothing has been done with the site. Who was going to provide the \$600m to develop the towers? Why did the manager allow the FMF to lend \$100m to a 'low-profile' developer such as Foresight, and then allow the loan to be capitalised? What was the basis for which Fortress lent money to Foresight? What was the point of it all?

As I understand it, the proposal was put together by CP1/City Pacific, and Grocon was the preferred builder on the site. City Pacific was to receive a commission on the finished development. In fact, CPL seemed to be making commissions and fees from just about every angle possible.

In fact, I'd guess that CPL made around \$15m on this deal from which the FMF will lose over \$120m. \$15m is an estimation calculated as a management fee of 3.25% + admin & advance fees, but not including any other fees that may be related to the transaction as a whole. It seems to me that the main thing CPL had in mind was to loan out the money and take the commissions for having lent the money – once the money was out there, then it's committed – and the

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commissions just keep rolling in. Of course, its even better if the loan is capitalised, that means higher commissions.

If this land is sold for \$80m and the debt is \$210m, and City took around \$15m in commissions, and the CBA/Fortress were paid at least another \$15m in interest for the loan covering the advance to Foresight, then the FMF stands to lose around \$160m which equates to nearly 15% of the original value of the FMF.

As part of the overall deal, Grocon 'purchased' 42million shares in CP1 from CPL by way of a \$32m loan from Sandkent (a 'Sullivan' company) and it seems that part of the deal was that Grocon was just able to hand these shares to Sandkent in full satisfaction of the loan. At best the deal between Grocon and Sandkent was a very 'conditional' arrangement, but the \$100m that went to Foresight wasn't, and the debt doesn't seem to have been chased down at all, otherwise, how could it possibly have risen from \$100m to over \$208m? and why did it involve Fortress?

Why was the manager allowed to make such a loan that clearly did no more than put investors' money at risk?

The value came in acquiring the 'whole' of the block – the problem to overcome was getting all the stakeholders to sell and that is why the cost was so high, but now, they're just selling it off without regard to the very reason it was purchased as a 'whole'. Where is CPL's responsibility for their actions?

It seems to me that such a loan should never had taken place unless there was real income from the lender, together with a real commitment for a \$600m facility to develop the block, otherwise why put the fund at risk in the first place? – this 'adventure' really was a case of the manager's eyes being bigger than its pockets.

There was no risk here for CPL, no risk for the directors of Foresight, no risk for CP1, no risk for Grocon: the risk fell squarely on the investors in the FMF.

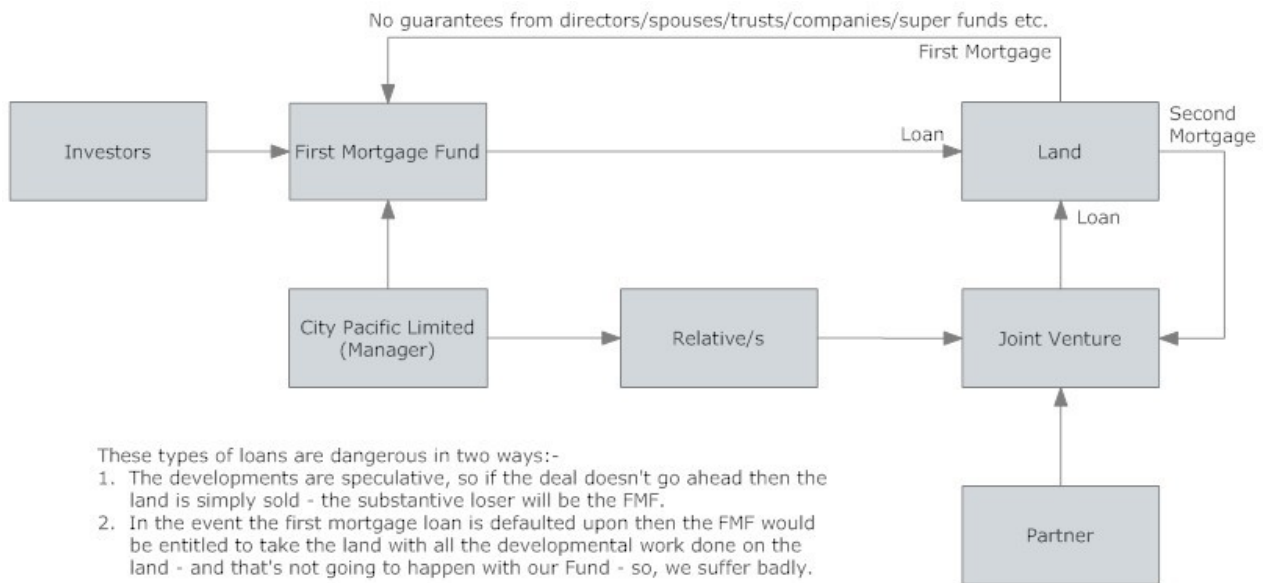
To cap it off, this type of loan had a substantial negative effect on the cash flow (as little as there was) in the FMF – the loan simply bled capital and produced nothing by way of income. [see photos as Annexure “C”]

Why didn't ASIC see this transaction as a 'related party transaction'? Why didn't CPL declare it as such?

Why didn't the manager foreclose on this loan a long time ago?

As Michael West (as always) best put it “... It might seem a little old-fashioned but if you were lending a company a lazy \$205 million you might like to know your borrower had a number in the phone book, even one of those website things. ...”
<http://business.smh.com.au/business/fortescue-defies-the-sceptics-20080507-2bxm.html>

[Please also see Annexure “F”]



Cash Flow

To my mind, the purpose of the FMF (as a managed fund) was to invest money at a higher rate of interest than the rate of interest paid to investors, and that such investments should be made in the best interests of the investors in the fund. Since the investors in the FMF would come and go (subject to the tenure of each investment) and interest needed to be paid periodically, then the manager would be required to make extremely accurate cash flow projections with respect to the FMF.

Further, the manager would be required to ensure that adequate capital reserves (contingency) would be provided for in the event of an unforeseen high rate of redemptions by investors. To this end, the manager extended the scheme's facility with the CBA to \$200m. In a letter to investors dated 21 June 2005, the CEO stated (in part):-

"... The sole purpose of this facility is to meet an unexpected level of redemption requests of 'on call' investments and to assist in managing the liquidity of the FMT. The manager does not expect under normal operating conditions that this facility will be fully drawn at any time ..."

http://www.citypac.com.au/citypac/documents/press/20050623_Letter_to_City_Pacific_Unitholders%20.pdf

Just where did the money come from that paid out redemptions and distributions? When one looks at the loan portfolio (to the extent one is able to), one sees that many loans do not in fact produce income or any significant income - For example:-

- Loan to MP Pacific Investments Pty. Ltd. (circa September 2007) à MP Pacific Investments Unit Trust à Marina Cove Pty. Ltd. Repaid only \$600k of an original \$15m + interest loan (as at March 2009 owing \$17.8m). [not including interest payable]
- Loan to Sunrise Waters Pty. Ltd. (circa September 2007) à Sunrise Waters Unit Trust. The loan increased from \$20.369m December 2007 to \$23.6 as at 30 December 2008. [not including interest payable]
- Loan to Lake Views Estates Pty. Ltd. Of \$18.5m in June 2005 increased to \$51.8m in December 2008. [not including interest payable]
- Loan to Grande Pacific Operations (\$6.8m in December 2005) à \$12.8m in June 2006 à Grande Pacific Limited \$28.2m as at June 2007 à Grande Pacific Syndicates 1 & 2 \$73.13m as at June 2008 à Grande Pacific Syndicates 1 & 2 \$81.265m as at December 2008. [not including interest payable]
- Loan to Marina Cove Pty. Ltd. (\$65.895m as at June 2004) rising to \$111.679m as at March 2009. [not including interest payable]
- Loan to Foresight Acquisitions Pty. Ltd. Of \$108m in 2006 rising to in excess of \$207m in 2009 (portion of the debt to Fortress for which the FMF is liable).
- Loan to Atkinson/Gore group for the 'saddleback ridge' estate which is understood to be nothing more than a dairy farm.

In so many cases, loans seem to have been given to one entity, then rolled over and capitalised to another entity with very little payment of either interest or capital back to the FMF. Surely, such a practice is inconsistent with the operation of a managed fund such as the FMF? Therefore the non-income producing loans account for :- \$23.6m + \$51.8 + \$81.265 + \$111.679 + \$207m + Atkinson/Gore + outstanding interest = \$375.444m + outstanding interest .

This amount, together with a facility debt of some \$240m makes interest payments alone virtually impossible, even without considering repayment of the loan principal. Of course, this is only an estimate - the point is that the substantial portion of the FMF's loans could NEVER derive enough income or capital returns to allow the FMF to function in a normal way. In fact, I believe that the FMF was 'ponzi-like' from some time around September 2007 - in a manner as disclosed in the 'NZ 2007/08 Financial review of the Ministry of Economic Development':-

"... It is our understanding that a number of the failed finance companies were in the end acting in a similar manner to ponzi schemes. In many cases, funds received for investment from new investors were used to repay the maturing loans of existing investors. In these circumstances the companies continued taking in funds many months after their position was irreversible, thus exposing investors to immediate losses ..."

[NZ 2007/08 Financial review of the Ministry of Economic Development]

http://www.parliament.nz/NR/rdonlyres/16F22058-8DD8-4541-B9A9-064848076239/100892/DBSCH_SCR_4272_6521.PDF

The Commonwealth Bank of Australia (“CBA”)

The FMF (through its manager) has had a long-standing relationship with the CBA. On or about 24 June 2005, the FMF’s facility with the CBA had been extended to \$200m in order *to manage liquidity and to account for any unexpected demand from ‘on call’ investors*.

By September 2007 the market was starting to slow and the CPL was attracting negative media coverage, including coverage from one, Michael West of the Sydney Morning Herald (“SMH”), who stated (in part) on 28 August 2007:-

“... Like many of the debenture players, City Pacific rakes in money from the mums and dads, advertises and pays commissions to financial planners for getting the business in (\$21 million last year), promotes a high yield of between 7.5 per cent and 9.25 per cent and on-lends the proceeds to property developers -- its related parties among them (one-quarter of the loan book). ... More than \$1 billion of investors' money is parked there. Risky stuff, particularly as City Pacific's bad debts blew out to \$99 million last year and retail investors are being encouraged to roll over their funds based on a PDS dated May 18, 2006. ...”

<http://www.theaustralian.news.com.au/story/0,25197,22318180-16942,00.html>

As at 30 June 2007, the four important issues were that, - (1) the market was slowing, (2) the fund had incurred significant defaulters (\$99m), (3) the FMF was in breach of a covenant related to its facility with the CBA which at that time was limited to \$170m, (4) subsequently (on 1 September 2007) the facility was raised to \$240m, and (5) negative publicity was rising out of the company’s financials.

On 30 November 2007, by deed poll, the ‘Trust’ was renamed ‘Fund’.

http://www.cpfmf.org/CPFMIFAmendConstitution_ASIC_cc.pdf

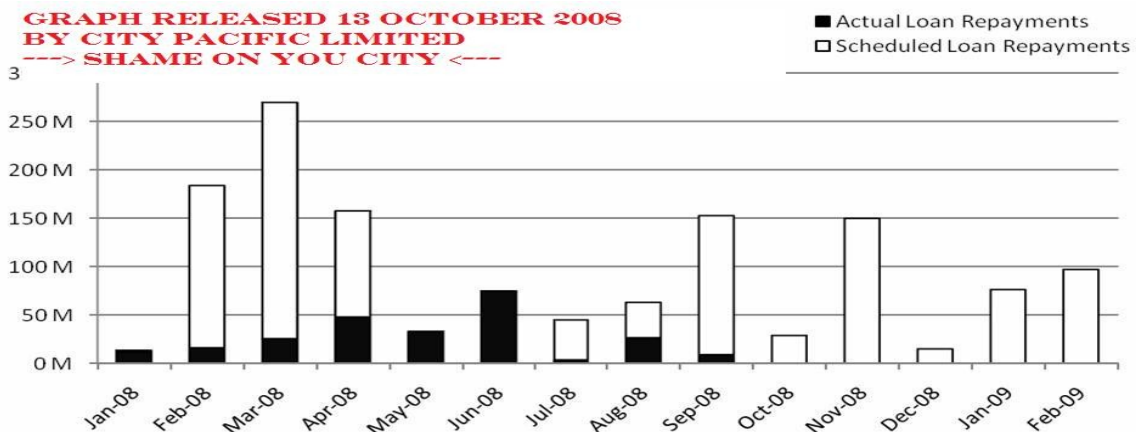
CPL stated they renamed the (now) Fund because it ‘will help make it clearer to our investors and the market that all loans in the Fund are secured by Registered First Mortgages over real property’.

<http://www.citypac.com.au/citypac/documents/press/20071128%20City%20Pacific%20First%20Mortgage%20Fund.pdf>

However, Trader, Daniel Loeb on 01 March 2008, stated (in part) “... The reality is that their mortgage funds are likely to be hiding bad debts and this is the real reason for the deconsolidation. Why would you go to this hassle if there wasn't a loss pending? All they do now is charge hefty management fees from the fund – and for what? ...”

<http://www.news.com.au/couriermail/story/0,23739,23298694-3122,00.html>

So, if we wanted to see what it was like down at CPL’s offices on the Gold Coast prior to September 2007, we would take the fact that the FMF was in breach of its facility covenants, that we had \$99m in defaulters, we had a declining market, and negative publicity had begun to hit media outlets. We could then look at the 2008 mid-term report for 31 December 2007 because that would tell us where we would go - it might be possible to draw a trend line to see just what the feeling was like down there at CPL. At the end of December the picture was bleak - \$93.5m net loss in investor numbers, while defaulters had increased, we found out on 13 October 2008 that defaulters in February 2008 would have risen to \$240m more, and in March 2008, there would be another \$160m of defaulters.



<http://www.citypac.com.au/citypac/documents/schemes/cpfmf/180day/20081013%20Letter%20to%20CPFMF%20investors%20-%2013%20October%202008.pdf> (page 3).

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There would be another \$61.15m of net investment leaving the fund. We found out that the facility had been breached during the later part of 2007.

[http://www.citypac.com.au/citypac/documents/reports/cpfmtf/20080314_CPFMF_Half-Year_Financial_Report_\(31_December_2007\).pdf](http://www.citypac.com.au/citypac/documents/reports/cpfmtf/20080314_CPFMF_Half-Year_Financial_Report_(31_December_2007).pdf)

[http://www.citypac.com.au/citypac/documents/reports/cpfmtf/20080930_CPFMF_Annual_Financial_Report_\(30_June_2008\).pdf](http://www.citypac.com.au/citypac/documents/reports/cpfmtf/20080930_CPFMF_Annual_Financial_Report_(30_June_2008).pdf)

Further, one has to keep in mind the 'idiotic' fundamentals of the FMF. That is, that developments must be completed at all costs - there is no value in making defaulters pay, so money must be advanced to defaulters to enable completion of the projects, regardless of the economic climate. (As it turned out, this fundamental was total detrimental to investors in the FMF.)

It is in these circumstances, (taking into account the 'fundamentals'), that the CBA extended the FMF's facility to \$240m: a decreasing market, increasing defaulters, negative sentiment, investors leaving the fund, and a manager running the fund without regard to proper debt collection procedures, with security on loans that the bank itself would regard as insufficient. Never mind the fact that the FMF had been in breach of its facility covenants.

There was no concern about the risk of loss, and no concern about the increase in loss caused by the leverage. The manager was allowed (by ASIC, and by the CBA) to go on its merry way lending to its heart's content. 'Emergency' had become the 'norm' in September of 2007 - the whole shooting match was starting to fall to pieces, and the CBA facilitated the manager to continue on its way without regard to unit holders interests at all.

No account was taken of the fact that so much of the loan portfolio did not produce income. In fact, it seems that cash flow wasn't a consideration at all. No concern for the lack of security (other than the land itself) to secure the various loans. How did the CBA expect the FMF to pay the bank back? Where did the CBA expect that income to come from? Over half the FMF was non-income producing, in fact \$240m was to be repaid (with interest).

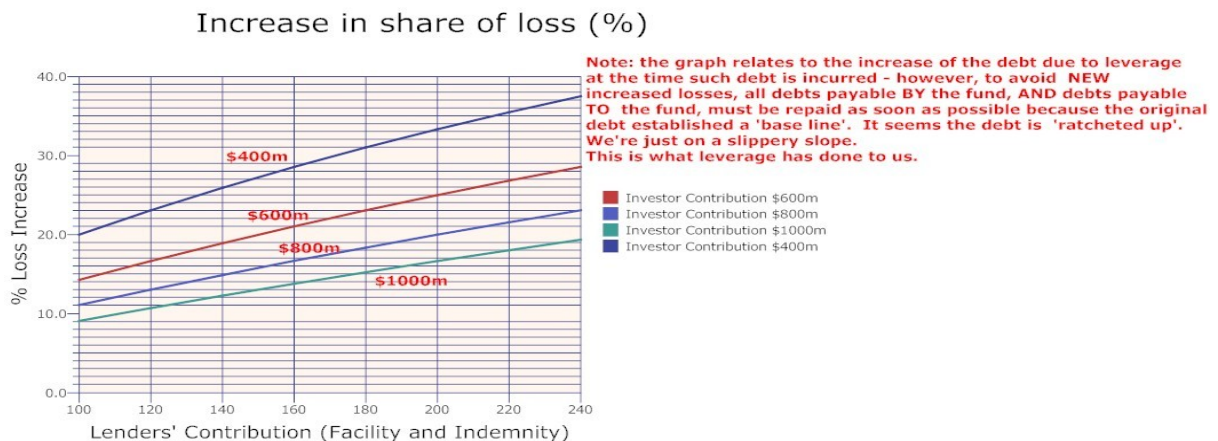
It seems that below all of the debt, negativity, 'idiotic' lending practices, defaulters, falling market, lack of surety on loans, and lack of income from the lending, there was adequate security for the CBA to grab back its \$240m plus interest if everything went wrong: the CBA was protected, but unit holders weren't.

As far as I can see there is only evidence to the contrary, that is, evidence to support the fact **THAT THE CBA SHOULD NOT HAVE EXTENDED THE FACILITY.**

So, after being 'Mr. Nice Guy', the CBA turned into a 'prudent banker' again - and demanded that the FMF reduce its facility, and to that end the manager must have scoured the earth to come across a lender of last resort, Fortress Investment Group.

Before I move on to Fortress, there are two questions that arise with respect to the CBA:

(1) *What is the CBA's liability in investors losses in the FMF (a) as a consequence of the increase in the facility to \$240m? and (b) as a consequence of the FMF's involvement with Fortress?*



If one applies the ‘but for’ test, then one would see that ‘but for’ the facilitation of the CBA, then the manager would have had no other choice but to freeze the FMF and exercise proper lending disciplines as should have rightly occurred. In my view, our losses were substantially attributed to by the CBA’s extending the facility, and then our losses were added to by the CBA forcing the manager to find an alternative source of funding in an extremely adverse market.

Fortress (as co-investor)

At first Fortress was hailed as a ‘white knight’.

“... Further to our announcement of 12 March 2008, City Pacific Limited (City Pacific) confirms that Fortress Credit Corporation (Australia) II Pty Ltd (Fortress) is the institutional co-investor in the City Pacific First Mortgage Fund (Fund). As stated previously Fortress will co-invest approximately \$100 million with the Fund in a portfolio of large first mortgage loans from the Fund at their book value. Fortress will become a joint first mortgage lender with the Fund on the portfolio of loans. City Pacific confirms that the initial \$30 million co-investment was settled on 14 March 2008.

The co-investment will release \$100 million back to the Fund which will be used to continue the investment objectives of the Fund. The Fund will continue to build value by introducing and developing long-term relationships with institutional investors and partners. ...”

<http://www.citypac.com.au/citypac/documents/press/20080318%20Fortress%20Co-investor.pdf>

But, nothing had changed, it was just a shell game.

“... *Co-lending arrangements*

On 18 March 2008, the Fund entered into a co-lending agreement with an institutional investor (Fortress Credit Corporation (Australia) II Pty Ltd). The agreement provides that the institutional investor will co-lend approximately \$100 million with the Fund in a range of first mortgages currently held by the Fund. The institutional investor acquired an interest in those mortgage loans at their book value by providing a loan facility to the borrowers.

The institutional investor became a joint first mortgage lender with first priority ahead of the Fund with the proceeds of \$100 million received by the Fund by way of loan repayments, \$20 million of which was advanced directly to the borrower by Fortress thereby reducing the Fund’s commitment. The \$100 million loan repayments were used to continue the investment objectives of the Fund.

As at 31 December 2008, the institutional investor has co-lent \$65,586,736 with the Fund on four separate loans which have different maturity dates. There are three borrowers overdue on their Loans which were due to be repaid on 30 June 2008, 31 December 2008 and 4 February 2009.. Of the four loans, the institutional investor has been repaid in full in respect of one of them and of the other three, the security properties are in the process of being marketed for sale. There is the risk to members that if these borrowers do not pay back their facilities, the institutional investor could exercise its rights as mortgagee ahead of the Fund. To date ongoing negotiation with the borrowers has occurred in conjunction with the institutional investor, City Pacific and the Fund. ...”

<http://www.citypac.com.au/citypac/documents/schemes/cpfrm/180day/20090611%20CPFMF%20Fund%20Update%20-%2011%20June%202009.pdf>

On 9 March 2009 it was disclosed that “... FORTRESS Credit appears to have stepped up the pressure on City Pacific to sell a huge development site at the southern end of Surfers Paradise after the collapse of a \$205 million deal struck this time last year. ... The site owes City Pacific and Fortress a total of \$205.7 million. It comprises 10 individual properties and was put together by Mr Perry’s Foresight Acquisitions at total cost of more than \$100 million. ...”

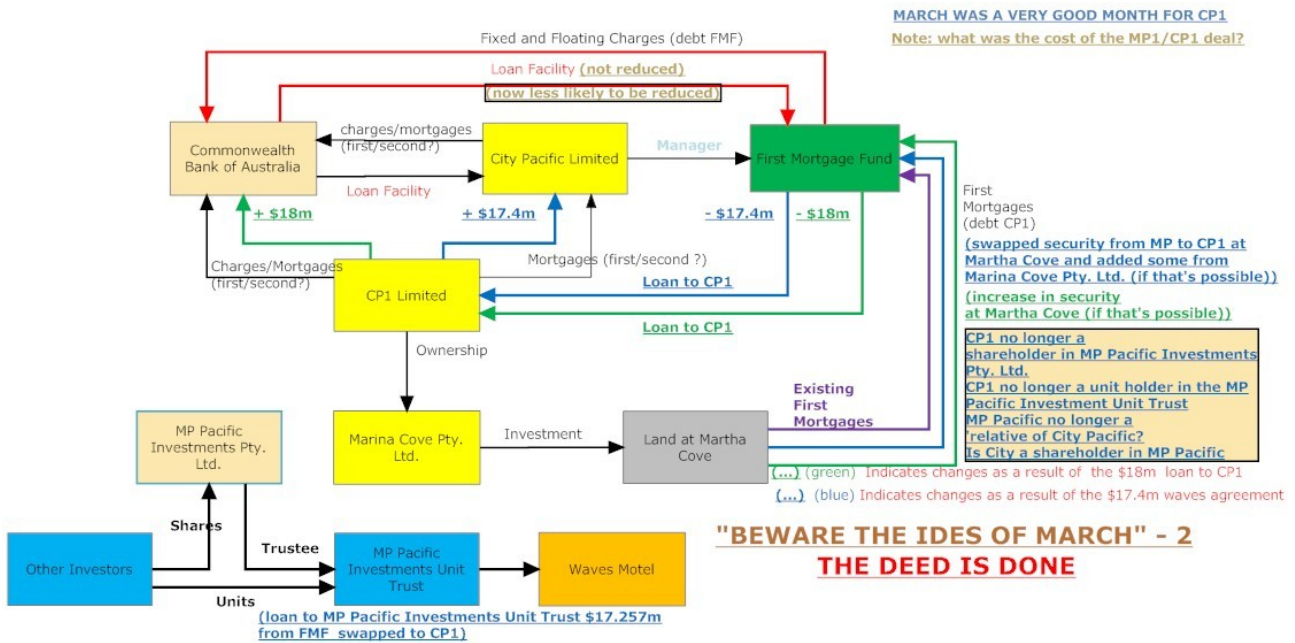
http://www.goldcoast.com.au/article/2009/05/09/77215_gold-coast-business.html

If one makes the assumption that all Fortress ‘co-lending’ with the FMF was any different to the lending in from the CBA then I suspect one would be wrong. It seems that Fortress lent to Foresight Acquisitions Pty. Ltd. (“Foresight”) because Fortress is motivating CPL to dispose of the Broadbeach property. It also seems that Foresight has not paid much in return to the FMF, nor to Fortress.

It’s at this point where the behaviour of CPL, the CBA, and Fortress all come together with the potential to do a great deal of damage to unit holders’ investments.

In March 2009, the CBA as the holder of fixed and floating charges over the FMF allowed the manager to ‘transfer’ a loan from MP Pacific Investments Unit Trust to Marina Cove Pty. Ltd. This is how the CBA and CPL would prefer us to see it, but, as previously discussed, the loan to the Unit Trust was paid out by MP Nominees (or whatever the partner company was named) in order that the FMF give up its first mortgage over the Waves Motel in Northern NSW. That money (about \$17.8m) was paid to Marina Cove Pty. Ltd. (wholly owned by CP1 Limited, a CPL relative). The FMF ended up with more worthless Marina Cove land, and CP1 paid the \$17.8m to CPL itself. Later on in the month, another amount of \$18m was advanced to Marina Cove Pty. Ltd. (or CP1 Limited) in order that CP1 repay \$18m of its

CBA facility ‘in order to protect the FMF against CP1’s insolvency to the CBA itself’. In this way, about \$36m was taken from the frozen FMF by the CBA and CPL in concert. This money was now not available to repay Fortress on the Broadbeach land, thereby allowing Fortress to press for the sale of that land.



The CBA had forced the manager to find alternative funding – the manager happened upon Fortress, and Fortress as ‘co-lender’ and pursuant to the terms of its arrangements with the FMF (as entered into by the manager), was entitled to force the sale of the land thereby causing loss to unit holders because the \$36m was unable to be paid on the FMF’s behalf: the \$36m had already been taken by the manager and the CBA in March 2009.

The FMF was an 'easy mark'

From 3 March 2008 the FMF was frozen pursuant to its Constitution (as amended). The CBA held fixed and floating charges over the assets of the FMF, and the manager held free reign over the lending practices of the FMF.

As at February 2009, the FMF owed at least \$100m to the CBA, as did CP1, and as did CPL itself: a total of some \$300m was collectively owed to the CBA by the three beforementioned entities. Of the three entities, the FMF was the only one that had the real capacity to repay its debt to the CBA.

In my opinion, the CBA was at risk of loss from CP1 and CPL, so where was the CBA to get its money? It was an easy choice – from the FMF.

It's my opinion that, in March 2009, the \$17.8m CPL authorised the fund to lend Marina Cove Pty. Ltd. (wholly owned by CP1, a CPL relative) went back to CPL and then to the CBA to satisfy portion of that entity's loan to the CBA, and CPL authorised the FMF to lend \$18m to CP1, money that went to the CBA too (under the guise that such a payment 'protected the first mortgages held by the FMF' due to insolvency by reason of CP1's debt to the CBA).

I believe these payments were allowed by the CBA (while holding control over the assets of the FMF) because the CBA itself was the beneficiary of the monies and these payments protected the CBA against loss from both of CP1 and CPL. The loser was the FMF because it was unable to repay its loan due to the fact that the manager and the CBA had used the money to protect their own interests at the expense of investors in the FMF.

I believe the CBA should repay this \$36m back to the FMF and compensate the FMF for loss of interest.

I believe this is a matter that the ASIC should have paid particular attention to.

The Custodian

"FMF investor funds are held by an independent custodian, the Public Trustee of Queensland, and invested in cash and loans secured by registered first mortgages over real property in Australia on behalf of both institutional and retail investors."
<http://www.citypac.com.au/citypac/documents/press/20080312%20City%20Pacific%20clarification%20announcement.PDF>

The Public Trustee of Queensland ("PTQ") holds itself out as a bit player in this saga, but I would submit that it is far from the truth. The PTQ allowed itself to be presented to existing and potential investors as a 'solid-rock' on which they would be able to rely. In truth, when the FMF started to show signs of trouble, the PTQ abandoned ship quite quickly and informed CPL that it no longer wished to engage in custodian work such as it was doing for the FMF.

It is true that it was the custodian, and yes, it held the records, and yes, the accounts, and of course, the 'first mortgages'. It also had note of which investments were contributing to cash flow and which ones weren't. The PTQ knew the defaulters too and it knew the level of debt over the FMF and the nature of that debt (the fixed and floating charges).

I firmly believe that the PTQ knew, or ought to have known, the true state of the FMF and should have warned investors of the risks they were facing rather than adopting the face of a pure 'custodian'. I believe that the PTQ knew or ought to have known that the FMF's cash flow was inadequate for its purpose, and further that the PTQ knew, or ought to have known, that the CPL's de-consolidation of the FMF placed investors at risk in the circumstances.

The PTQ was privy to information not available to investors in both the FMF and the CPIF.

I believe ASIC has failed investors by not investigating the role of the PTQ in matters relating to the FMF.

The Auditors (KPMG)

I am disappointed that the auditor did not warn investors as to the state of the fund at such time as CPL de-consolidated the FMF from its books. I am further disappointed that the auditor did not give a more timely warning as to the terrible state of the FMF in general.

The auditor knew, or ought to have known, the true state of the fund yet gave no warnings as to the inadequacy of cash flow within the FMF.

Just how did the auditor expect that the FMF could function given that such a large portion of the loan portfolio was directed to loans which did not produce income, or alternatively, took more and more capital to service?

Why didn't the auditor speak to the de-consolidation and the nature of the state of the FMF at the time CPL jumped on its 'life raft'? Why was it that investors had to wait until the 3 March 2008 to know that the FMF was in dire straits?

What is the 'role' of the auditor – is it to merely look at some papers here and there? Or is it to 'gauge' the health of the entity they audit? The FMF was sick for a long time but the auditors didn't give any warning as to its sickness, why? One has to ask "why was it that information available to the auditors as early as December 2007 did not trigger any action, warning, or comment by the auditors, in circumstances when only a bit of such information triggered an investor run on the fund in March 2008?"

What is the auditors duty to disclose and does it have a duty to protect the interests of investors in the entity it audits? I believe ASIC have failed investors by not investigating the role of KPMG in matters relating to the FMF.

De-consolidation

[please see Annexure “F”]

Prior to the 30 November 2007, investors in the FMF were comforted by a PDS that disclosed (among other things) that the FMF was consolidated into the accounts of CPL itself. Accountants see this as an ‘accounting treatment’, but investors, and even CPL see it very different - it was all about ‘risks and rewards’.

On 30 November 2007, by deed poll, CPL amended the name of the (then) First Mortgage Trust to the (now) First Mortgage Fund, and on 1 December 2008 CPL took the necessary steps to de-consolidate the (now) FMF. http://www.cpfmf.org/CPFMIFAmendConstitution_ASIC_cc.pdf

CPL asserted that the ‘thrust’ of the name change ‘*will help make it clearer to our investors and the market that all loans in the Fund are secured by Registered First Mortgages over real property*’.

“... City Pacific Limited (ASX: CIY), one of the largest non bank financiers in Australia, today announced that it is changing the name of its leading investment product from the City Pacific Mortgage Trust to the City Pacific First Mortgage Fund. CEO and Managing Director Phil Sullivan said the new name better describes the Fund’s activities and that there would be no changes to the Fund’s operations or the management team making the investment decisions for the Fund.

“The name change to City Pacific First Mortgage Fund will help make it clearer to our investors and the market that all loans in the Fund are secured by Registered First Mortgages over real property.”

“The City Pacific First Mortgage Fund will continue to provide our investors with regular income from its property loans delivering above average returns.”

“What won’t change is the successful timing and location formula unique to City Pacific. We will continue to finance projects in geographic locations where the property market is supported by strong population growth. This includes capitalising on opportunities which take advantage of leisure and lifestyle developments”, Mr Sullivan said....”

<http://www.citypac.com.au/citypac/documents/press/20071128%20City%20Pacific%20First%20Mortgage%20Fund.pdf>

CPL stated publicly that it was an ‘*appropriate accounting treatment given that the FMF is a separate entity*’.

“... The Directors of City Pacific consider the de-consolidation of the City Pacific First Mortgage Fund (First Mortgage Fund/ the Fund) an appropriate accounting treatment given that the First Mortgage Fund is a separate entity. This accounting treatment is standard industry practice and is consistent with the majority of Australian mortgage fund managers ...”

<http://www.citypac.com.au/citypac/documents/press/20080229%20City%20Pacific%20clarification.pdf>

The media queried the de-consolidation while explaining the consequences for the FMF.

“... Nor was there any further explanation why City Pacific de-consolidated the fund from its accounts in December, meaning it has no exposure if the fund is in financial trouble. ...”

<http://business.smh.com.au/business/city-pacific-looks-to-sell-key-assets-as-debts-mount-20080306-1xme.html>

“... Perhaps most worrying for small investors, City Pacific announced that it would reduce its exposure to two mortgage trust funds collectively holding \$963 million in assets and liabilities by no longer underwriting them. The “de-consolidation” of the First Mortgage Fund and Income Fund means they no longer appear on the balance sheet and City Pacific said it wouldn’t provide funds in the event of a loss. ...”

<http://www.news.com.au/couriermail/story/0,23739,23298694-3122,00.html>

CPL’s CEO stood by the company line.

“... We wanted the accounts to stand on their own,” Mr Sullivan said. “We wanted to make it easier for people to understand the business. There is no other motive. We don’t want to cut them loose. They are the honeypot of our business.” ...”

<http://www.news.com.au/couriermail/story/0,23739,23298694-3122,00.html>

He continued by averring the ‘security’ of the ‘registered first mortgages’ and the bundles of cash in the FMF.

“... The firm stresses that funds are secured by registered first mortgages over real properties and the First Mortgage Fund has \$47 million in cash and another \$50 million in undrawn facilities. ... “In the 10 years we have been operating we have not had one cent of capital lost. Our investors have never had to wait an additional day for their funds,” Mr Sullivan said. ...”

But others more skilled could see the reality.

“... The reality is that their mortgage funds are likely to be hiding bad debts and this is the real reason for the de-consolidation. Why would you go to this hassle if there wasn’t a loss pending? All they do now is charge hefty management fees from the fund – and for what? ...”

- Trader, Daniel Loeb 01 March 2008.

<http://www.news.com.au/couriermail/story/0,23739,23298694-3122,00.html>

‘The real reason is that their mortgage funds are likely to be hiding bad debts and this is the real reason for the de-consolidation.’ - this statement goes to the heart of the CPL’s self-interested operation of the FMF - This statement shows just how little regard CPL had for the investors who had trusted CPL to deal honestly and fairly with their investments - and this statement shows just how incompetent ASIC is at enforcement of the Act with respect to managers of managed funds.

SUBMISSION – 2009 REVIEW OF MANAGED FUNDS

While the CPL was aware that the FMF was sinking into its financial sunset, CPL was making public statements to the contrary - CPL was assuring investors that all was well in 'investment heaven'. CPL encouraged investors to reinvest and to invest more. However, City was running in the other direction, the de-consolidation was designed to protect CPL itself against the onslaught of losses to be imposed on the FMF - CPL had the inside track and knew this, but it didn't tell investors.

"... "The outlook for the year is for continued solid growth and the company is on target for at least a 10 per cent uplift as indicated at the annual general meeting in October," ..."
http://www.goldcoast.com.au/article/2007/12/19/6103_gold-coast-business.html

How could ASIC stand back and allow CPL to escape its obligations with this inside information? How could ASIC stand back and allow investors to be sucked into this void and yet allow City to escape its obligations to the FMF? Why didn't ASIC force CPL to disclose to investors the true state of the FMF? The fact that investors were leaving in droves - the fact that the property market was sinking - the fact that defaulters were going to be massive? And the fact that impairments were going to strike the FMF?

CPL knew and could avoid, we didn't know and we invested. Is this a matter of 'form' or one of 'substance'? Is this a matter of 'regulation' or one of 'prudence'?

ASIC left us to trust CPL - and as a consequence we were trapped in this web of deceit. We now stand to lose the substantial part of our investments because CPL was allowed to take steps to avoid indemnifying the FMF against loss: steps that ASIC should reverse and make the manager liable for the FMF's losses.

City continued to attempt to focus investor's minds on the name change while while misleading them as to the strengths of the FMF:-

"... As a result of the directors of City Pacific resolving that the company would no longer provide the funds with financial support in the event of a loss so as to maintain unitholder distribution rates, and both funds subsequently issuing amended Product Disclosure Statements, City Pacific no longer has exposure to the majority of the risks and rewards of either fund. ..."
<http://business.smh.com.au/business/city-pacific-bids-for-survival-20080222-1txg.html>

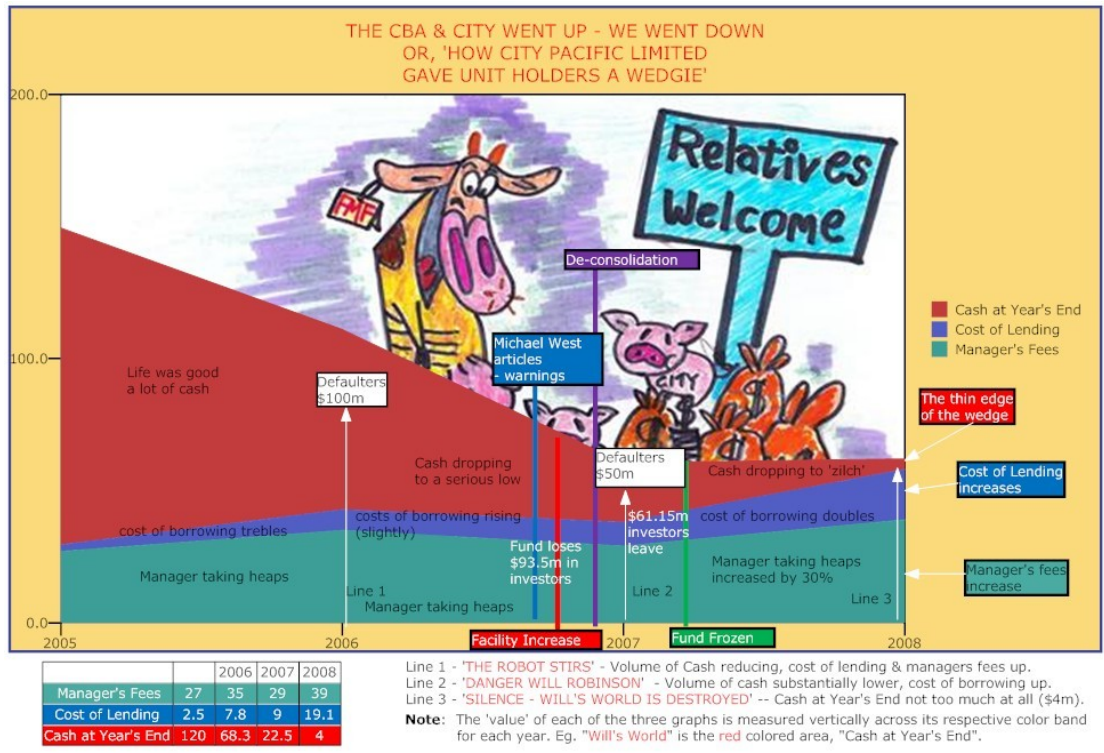
City (in its October - December 2007 Fund Update) stated (in part) "... An extensive advertising campaign is now under way after the re-badging in December of the City Pacific Mortgage Trust to the City Pacific First Mortgage Fund. We believe this name change better reflects the security offered by the fund and is one of several steps we have taken to ensure the market becomes increasingly aware of the strength of our product offerings..."
http://www.citypac.com.au/citypac/documents/newsletters/investors/20071231_City_Pacific_Update_-_December_2007.pdf
The foregoing is one of the most interesting paragraphs ever published by CPL. It discloses its 'escape plan' as a 'better reflection of the security offered by the fund' and even uses the word 'strength' in the same sentence.

If it wasn't so serious, it would be just one GREAT BIG STUPID JOKE.

A final reminder of just what a company can utter without a murmur from the regulator:

"... As we head into 2008 City Pacific has never been stronger nor better prepared for what promises to be a substantial period of growth. We expect our half yearly results due out later in February will reflect that growth with a half year profit rise from 10% to 15%. ..."
http://www.citypac.com.au/citypac/documents/newsletters/investors/20071231_City_Pacific_Update_-_December_2007.pdf

This statement was made when the FMF could not continue as a going concern as soon as the market could see some of the information the Board of City Pacific already knew.



Why the 'Frozen (Illiquid) Fund' is a Manager's 'Delight'

The 'Captive Pool of Money'

"... The Board of City Pacific has undertaken a comprehensive review of liquidity solutions for the Fund with its advisors and a determination has been made that listing the Fund on the ASX will satisfy this objective. Listing the Fund on the ASX allows unitholders to access liquidity through the sale of their units on the ASX and provides equity between the unitholders..."
<http://www.citypac.com.au/citypac/documents/press/20080924%20Proposal%20to%20list%20the%20City%20Pacific%20First%20Mortgage%20Fund.pdf>

The big problem with the managed fund business is that investors want to invest for various periods of time, but developers need financial support over what might be regarded as the long term, perhaps even as far out as 5 or 6 years for larger developments – terms for investors might be from 30 days to 3 years.

The critical element is cash flow -an issue that I believe is at the very heart of CPL's failure as a manager. In an effort to guarantee cash flow, CPL tried various mechanisms, (1) a Preferential Share Issue, and (2) Listing the FMF on the ASX. Both efforts failed due to a variety of reasons, but then come along the freezing of the fund.

CPL got what they had worked so hard to get by various devious means, their incompetence had led to the freezing of the FMF. Now they had their pool of money and they didn't have to pay a pretty penny for it. The freezing of the fund must have been a godsend for a manager whose 'fundamentals' were to continue to advance to defaulters in order to complete developments that couldn't be sold at anywhere near a reasonable price.

To cap it all off, there was no interest to pay - yet, commission to be made. In fact the commissions went up. Even though impairments reduced the value of the 'Funds Under Management' ("FUM") on which the manager's commission is calculated, the capitalised accrued gross income to the Fund rose, thereby increasing the manager's fees, although not much cash actually was paid to the FMF itself.

The winners were the lenders to the fund, the lenders from the fund, and the manager itself - the only losers were the investors themselves. The Act had entrapped us and CPL was free to do as it pleased.

As Michael West (as always) best put it “... And they are many with ASIC to boot. Just one, was our effort to warn them about City Pacific advertising on the radio a couple of months ago to get retail investors into its mortgage trusts. We didn't get much feedback from that act of do-goodery. Next thing you know, City Pacific froze redemptions on its mortgage trusts trapping investors in for the ride, a ride, mind you, from which they may or may not escape. ...”

<http://business.smh.com.au/business/failure-on-all-fronts-20080414-262u.html>

‘Why wasn’t the FMF declared illiquid prior to September 2007?’

I’ve already discussed the fact that prior to September 2007 there existed a detrimental set of circumstances - so, why wasn’t the FMF frozen at that time?

Clearly the most astute investors took notice of Mr. West’s warnings and ignored Mr. Sullivan’s assurances that the FMF was in sound financial shape, in fact, net \$93.5m investors left the fund before December 2007. The only positive aspect in relation to the FMF was Mr. Sullivan’s assurances: we didn’t get to know the truth until 13 October 2008 when the true extent of the defaulters was disclosed in an communication from CPL.

On 16 March 2006, the Manager wrote to investors in a document headed “MODIFICATION TO THE CONSTITUTION OF THE MORTGAGE TRUST” and stated (in part):-
“... For the Mortgage Trust, the modifications to the Constitution will allow City Pacific a uniform period of 180 days within which to satisfy withdrawal requests for all classes of investment. In certain circumstances, as stated in the changes to the Constitution, the uniform period may be extended to 360 days. ... “

Pursuant to Amended Clause 11.1, 11A.3, and 11B.3, the manager had at its discretion, the power to defer payments of redemption for up to 360 days.

http://www.cpfmf.org/CPFMIFAmendConstitution_ASIC_cc.pdf

The manager promised that the increase in the facility was to be used only in emergency circumstances. However, the extended facility of 1 September 2007 (which included the original increase) was used to replace the investors existing the fund: this fact was hidden from investors who believed the fund was operating normally.

I believe the manager should have frozen redemptions and distributions without extending the CBA facility.

The ‘pros’ of freezing the fund’s facility before 1 September 2007 (while not increasing the Fund’s facility)

- The manager would be forced to implement loan recovery principles,
- The manager would be unable to continue lending to defaulters,
- The FMF would be required to 'live within its means',
- The level of leverage would be reduced,
- The loss increase due to leverage would be minimized,
- The FMF would have a chance to repay its existing facility, and;
- Investor losses would be minimized.

The ‘cons’ of allowing an increase of the fund’s facility.

- The manager was allowed to continue to follow the ‘idiotic’ fundamentals,
- Investors’ losses would be increased proportionally by the increase in the fund’s leverage,
- Investors faced little chance of recovering a reasonable amount of their investments, and;
- The FMF would be unable to repay the CBA.
- Investor losses would increase because the Manager would continue to loan to defaulters and allow them complete developments, the sale of which would not recover the money lent.

The Income Fund

On 16 March 2006, CPL launched the Income Fund (“CPIF”).

“... City Pacific launches City Pacific Income Fund Leading financial services and property company City Pacific Limited today launched an income fund—the City Pacific Income Fund—to provide investors with regular income from a pool of fixed interest securities and first mortgage loans. ... Approximately 50% of the funds will be invested in stable interest investments such as bank bills and the remaining funds will be invested in a diversified portfolio of registered first mortgages. The stable interest investments will have a Standard & Poor’s credit rating of A-3 or above. ...”

One of the features of the investment was that the investment may be 'accessed at any time' with 'approximately 50% of the Fund invested in stable interest investments', the remainder was placed in the FMF.

It seems that the Fund didn't care to comply with this statement either because it chose to put the bulk of the money into the FMF, and back there in September 2007 when the FMF started to fall to pieces, neither the directors of CPL, of the auditors, or the PTQ, or ASIC gave a thought to the poor investors (including myself) in the CPIF.

Although there were months and months and months to secure the CPIF's investments in the FMF, nothing was done – this is particularly disturbing because the manager for the CPIF is the manager for the FMF. So, the Board of CPL was wearing their “FMF manager hat” perched on top of their “CPIF manager hat”.

Yes, they did nothing – they left the investors in the CPIF to ride into the economic doom of the investors in the FMF.

The real question is “Why didn't the Board of CPL act to protect the investments of the CPIF which was placed in the FMF”?

And, why didn't ASIC take particular notice of the fact that investors in the CPIF was at particular risk when the Board of CPL (as manager of the CPIF) placed the bulk of the fund's money into the FMF?

Why didn't the auditors express concern?

Why didn't the PTQ utter a concern?

Was this a 'prudential' matter, or was it a matter of 'regulation'?

Just what is the value of the Act if its not going to be policed?

'Greed' versus 'Need'

It has to be noted that as a consequence of the freezing of the FMF and CPIF that many paid a high personal price, both emotionally and financially. Some members even were left with nothing, others stood to breach contracts because of their inability to access monies invested in the funds.

I understand that in one case of a terminal illness that that family was unable to access any of its investment in the FMF (or CPIF).

I am personally sickened to think that the manager of this fund preferred to follow the 'idiotic' fundamentals of the FMF rather than consider the plight of the very people who contributed their capital to the FMF – capital which has without doubt enriched the lives of many individuals employed/engaged by the manager and its relatives.

CPL proved to be an uncaring and inconsiderate manager whose concern for self-interest transcended what I would regard as common decency.

It seemed that the law lacked the 'teeth', or ASIC lacked the 'concern' to engage with CPL to make these investors' lives a little more comfortable or bearable.

The Managed Fund Register

One of the reasons that opposition to the manager's 'reign of terror' (as some would see it), was stifled was that getting in touch with other members was difficult to achieve. It seems that the register was expensive (over \$2000 for just a few DVDs) and obfuscated by having the names indexed in a manner making it difficult to unravel, with the text contained in a secure .pdf format heavily overwritten by a strong watermark.

I am of the opinion that the manager took full advantage of a vague section of the law with regard to members obtaining a copy of the fund's register.

Summary

I believe that investors were failed by both ASIC and CPL.

By ASIC, in that ASIC failed to consider:-

- *the 'substance' of the manager's behavior,*
- *the knowledge of the PTQ with respect to the operation of the FMF,*
- *that the manager had failed to ensure adequate surety was provided to loans extended by the FMF,*
- *that transactions in which the manager had engaged might have been related party transactions but not reported as such,*
- *that the manager had engaged in related party loans which seriously compromised investors' funds,*
- *that the manager had compromised investors' funds to the extent that the FMF was required (by the manager) to pay the lender's debts (eg. \$18m went to CPI to and was paid to the CBA),*
- *that the manager continued to use investors' funds to further its own ends (eg. Loans in March 2009 - \$17.8m went to CPI and paid to CPL, and \$18m went to CPI and was paid to the CBA),*
- *that the CEO of the manager was a discharged bankrupt and was not required to make a declaration as to his past,*
- *that the disclosure by the manager in its financial statements was inadequate for investors to make informed decisions (eg. Lack of detail about lenders, amounts, repayments, as well as no distinction between 'Interest Payable' and 'Interest Paid')*
- *that the Auditors did not report that the FMF could not function as it intended to do so with respect to cash flow*
- *that the manager's de-consolidation of the FMF (in the circumstances) was illegal,*
- *that the manager's public statements as to the state of the FMF from August 2007 were misleading,*
- *that the auditors made no attempt to warn investors as to the true state of the FMF at any time from September 2007 until 3 March 2008 when the FMF was deemed frozen (illiquid),*
- *that the frozen (illiquid) fund allowed the manager, at investors' expense, to continue as if the fund was functioning normally,*
- *that the manager was able to roll over and capitalize loans when it should not have,*
- *that the manager was able to re-new loans (for defaulters) in circumstances where such defaulters should have been foreclosed on and monies returned to investors,*
- *the the CBA (as the holder of fixed and floating charges over the FMF) acted in its own best interests rather than the interests of investors (eg. The CBA had 'effective' control and allowing transactions such as the transactions in March 2009 to proceed contrary to the interests of investors),*
- *that on 1 September 2007, the manager extended the FMF's facility in circumstances whereby it should not have,*
- *that on 1 September 2007, the CBA extended the FMF's facility in circumstances whereby it should not have,*
- *that the Auditors did not warn investors that the FMF's de-consolidation was made in circumstances that investors were not aware, and;*
- *that the FMF engaged in lending arrangements with discharged bankrupts.*

I think the worst thing is that, in the light of the facts as they have unfurled, ASIC has done nothing about what has been shown to be totally misleading statements by the CEO of CPL. Further, ASIC has done nothing with respect to the issue of the 'de-consolidation' when it is clear that the FMF was in a real mess when CPL abandoned the fund and went out publicly to give investors a warm and fuzzy feeling about investing in the FMF – when investors did invest and were trapped, ASIC did nothing – ASIC allowed CPL to take to their life raft and escape the carnage that ensued – ASIC should make good this mistake.

By CPL, in that the CPL:-

- *engaged in related party transactions which compromised its capacity to put unit holders interests before the managers interests,*
- *failed to ensure adequate security for loans in a speculative market,*
- *failed to maintain a reasonable level of capital contingency,*
- *failed to pursue reasonable loan recovery principles,*
- *failed to ensure adequate cash flow.*
- *extended the FMF's facility on 1 September, 2007 in circumstances whereby it should not have,*
- *failed to act in the best interests of members of the fund by rolling over and capitalising loans (eg. Renewing loans) in circumstances whereby it should not have (eg. To defaulting lenders),*
- *engaged in at least one profit making venture with partners without declaring such venture a related transaction (eg. Pacific Sands, Broadbeach),*
- *permitted an ex-bankrupt to induce over 11,000 individuals/companies into investing over \$1b in a fund which was at best unable to function pursuant to its desired purpose,*
- *permitted the FMF to loan substantial amounts of money to a company partly administered by an ex-bankrupt,*
- *was permitted to continue lending to defaulting lenders,*
- *was permitted to follow the false doctrine that 'completion of developments (even when the develop is in default) gives the best return to a lender',*
- *was permitted to roll over and capitalise loans to defaulters in circumstances when investors in the fund were demanding the return of all or part of their investment, and*
- *permitted the FMF to act as a 'developer' and not as a 'lender'.*

Suggestions For Change

- that a manager be prohibited from engaging in related party transactions.
- that surety for loans made by managed funds should meet some minimum (high) standard which must include mandatory personal guarantees by all directors, their spouses, super funds, and family trusts (as any bank would do).
- That a managed fund hold an adequate level of capital contingency (cash) (and not by way of encumbering the assets of the managed fund)
- that a managed fund not be permitted to encumber its assets in any way whatsoever.
- That a manager must follow a standard procedure for the recovery of money owed to the managed fund.
- that disclosure in financial statements should enable investors to make an informed decision.
- that in the event a fund is frozen (illiquid) then the fund should be placed in the hands of a 'receiver' type entity which will ensure (1) that all transactions are *bona-fide*, and (2) that all acts by the manager are in investors' best interests.
- That there be a clearly defined method of allowing the members of a managed fund to collectively own assets held by the fund in the event the fund is frozen (illiquid).
- That ASIC should take a more pro-active role in regulation of managed funds.
- That ASIC should take investor complaints more seriously.
- That, in the event a manager controls more than one fund, that any of the funds be prohibited from investing in any of the others.
- That real consideration be made for investors who are in dire need of the return of at least part of their investment in special circumstances (as determined by an independent body).
- That a copy of the fund's register be available on DVD to every investor for a fee of no more than \$50.00 and that such register not be watermarked and contain only current members together with their up to date unit holdings as a single entry.

My suggestions might seem draconian but my experience tells me that if you give a manager an inch, 'he' will take a mile. I believe that managed funds are purpose-built vehicles and investors (together with the manager) need to make long term commitments to each other in order for the fund to function properly.

ASIC

It's nice for the employees of ASIC to have an office, an income, and a title – but, every now and then it'd be nice if they turned their collective mind to the plight of investors in managed trusts/funds. I think the greatest disappointment investors in the FMF/CPIF have is that they can't sue ASIC.

A Final Thought

It also seems that, apart from lack of cash flow, the hazards of related party transactions, poor debt management, and bad lending practices, the overall substantive reason the FMF failed was that the manager engaged the FMF as a developer. Instead of simply engaging the FMF as a lender holding 'first mortgages on property in Australia', the manager caused the FMF to venture into the risky world of development.

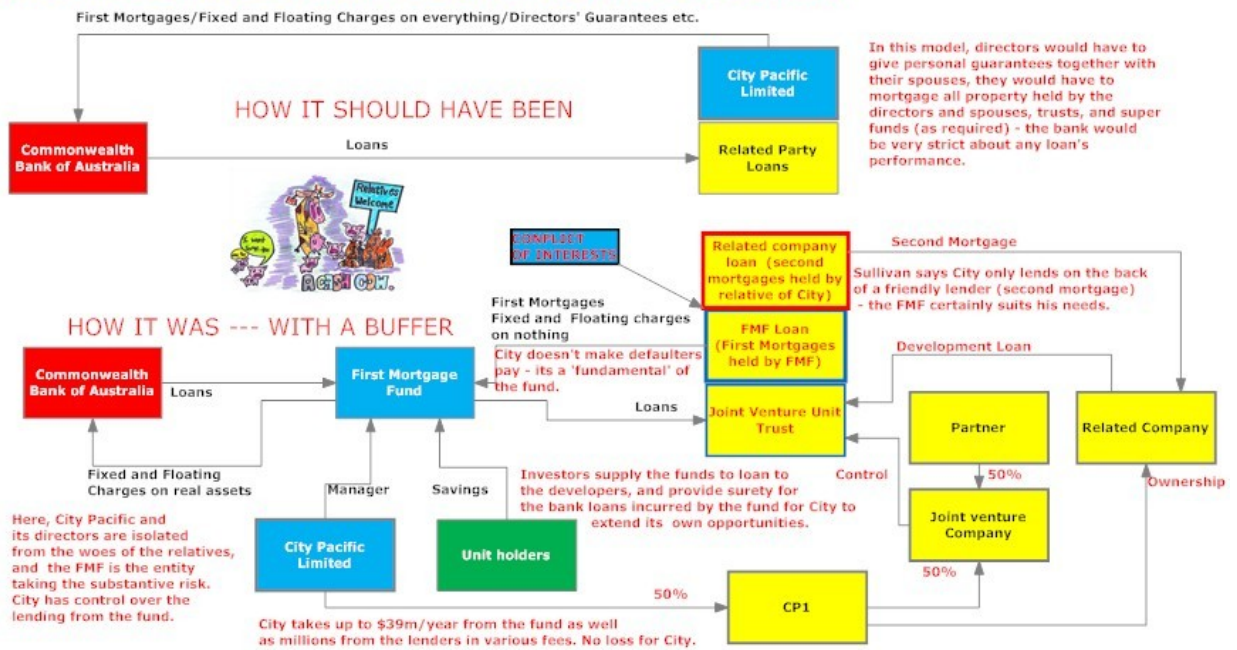
There are a lot of mortgage lenders out there who are doing well, and while some of them might have suffered losses, their losses are not comparable with those in the FMF.

While there does seem to be a problem with the valuations used by the manager, the substantive loss in the fund comes from the managers lending arrangements and its failure to actively follow established debt recovery protocols.

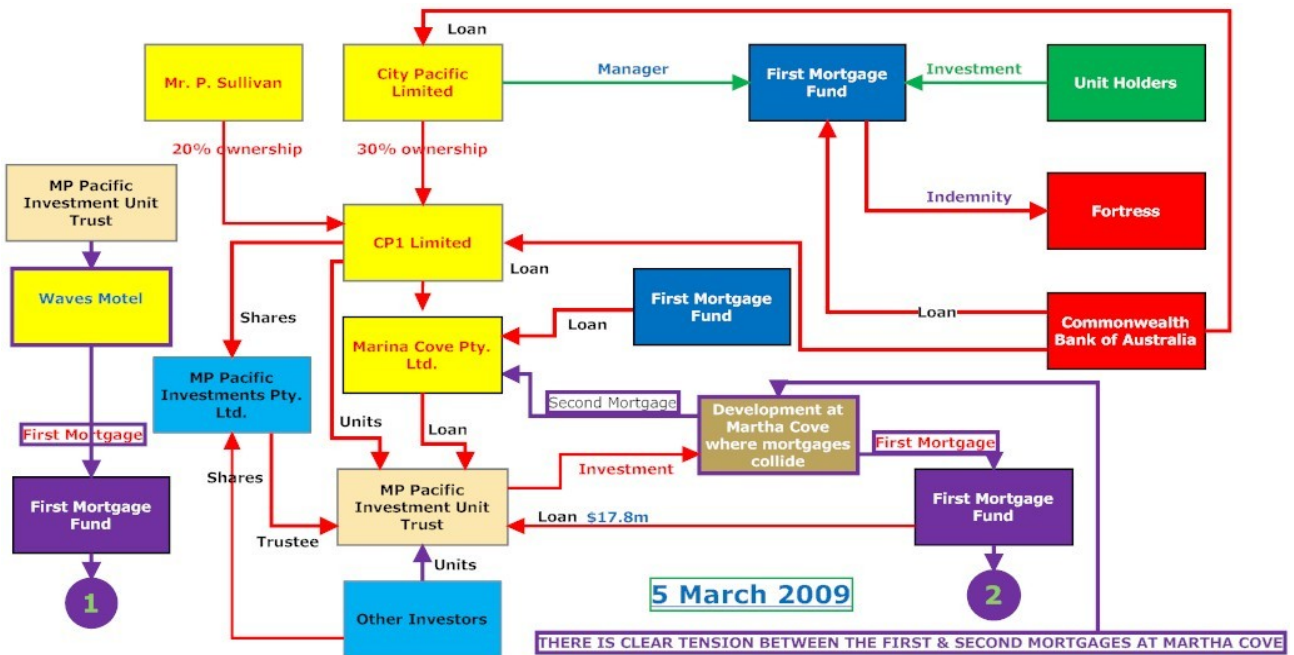
CPL would want us to believe that the Global Economic Crisis took the FMF down, but in my view, the reality is that CPL took the FMF down – the FMF was in real trouble half way through 2007 and should have been put to bed then.

Annexure “A” - A Circuit Breaker Against Insolvency

EASY ACCESS TO FINANCE - AND A CIRCUIT BREAKER AGAINST INSOLVENCY



Annexure “B” - CPL Never Goes in Behind a Hostile Lender



**'CITY PACIFIC NEVER GOES IN BEHIND A HOSTILE (FIRST MORTGAGE) LENDER'
(I believe these two first mortgage have been compromised)**

Annexure “C” - Pictures of 'Pacific Beach' at Broadbeach



Will Be Sold - (A) In One Line or (B) In Individual Titles
 (A) Whole Site - 11,335sqm*, 116 metre* beach frontage, DA Approval

Site	Land Area	Description
1	1,006sqm*	"Oriana" - 28 unit, 14 level strata title apartment building, Holiday letting + short term tenancies, 28 titles
2	4,765sqm*	"Seaview Sands" - 48 beachfront unit complex, currently tenanted, 45 titles
3	1,138sqm*	"Silvretta" - 38F Old Burleigh Road 8 unit residential complex, 8 titles
4	1,148sqm*	38D Old Burleigh Road Vacant duplex dwelling, 1 title
5	405sqm*	38B Old Burleigh Road Vacant duplex dwelling, 1 title
6	445sqm*	36 Old Burleigh Road 5 vacant units, 1 title
7	405sqm*	40 Old Burleigh Road Vacant residential dwelling, 1 title
8	405sqm*	38A Old Burleigh Road Vacant land, 1 title
9	405sqm*	"Baidorb" - 36C Old Burleigh Road 4 unit residential complex, currently vacant, 4 titles
10	417sqm*	"Seaview" - 35E Old Burleigh Road 4 residential units currently vacant, 4 titles

*ignore Site outline indicators only

For Sale by Expressions of Interest Closing 4pm Thursday 18 June 2009

CBRE CB RICHARD ELLIS
 Mark Witheriff 0439 038 100 mark.witheriff@cbre.com.au
 Andrew Jackson 0405 355 972 andrew.jackson@cbre.com.au (07) 5581 2000

MRE MURRAY REAL ESTATE
 Dan McVay 0412 872 dan@mcvayre.com.au
 Glenn Bechtel 0439 034 glenn@mcvayre.com.au (07) 3358 4222



The beach in front of the 'development' site

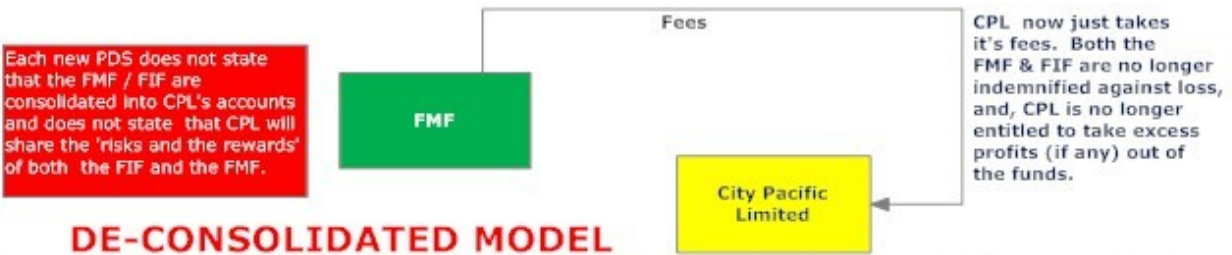
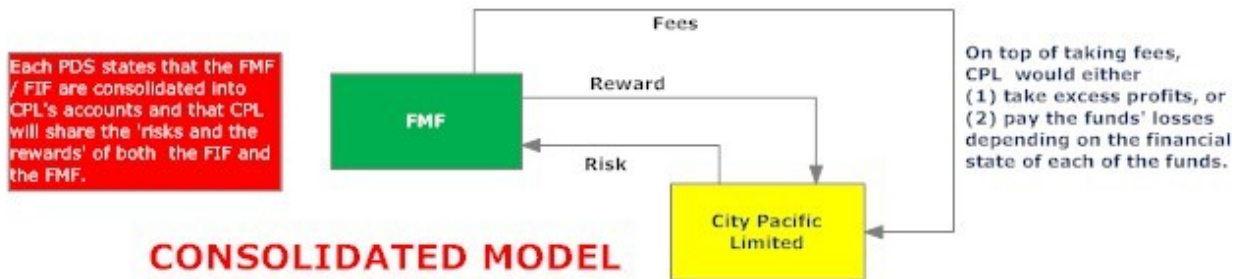
Annexure “D” - Pictures of Martha Cove 1



Annexure “E” - Pictures of Martha Cove 2

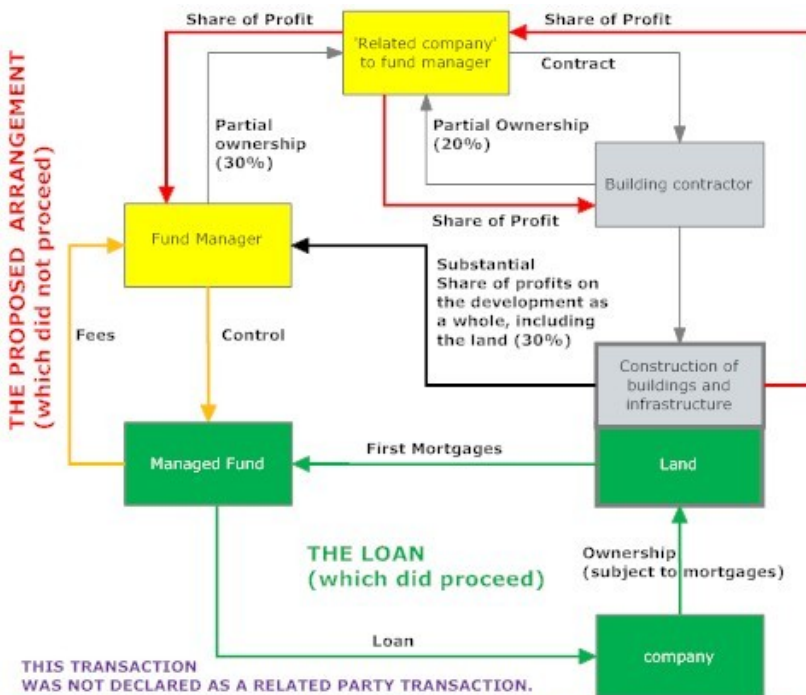


Annexure “F” - De-consolidation



Observation: the consolidations were not merely an accounting treatment, they were representations made in each PDS on which investors are entitled to rely. I believe three questions arise out of this issue - The questions are:
 (1) 'were unit holders aware of the true financial state of the Fund at such time as each PDS was withdrawn and re-issued?'.
 If the answer to (1) is 'no', then (2) 'Are the de-consolidations effective in law?'.
 If the de-consolidations are ineffective at law, then (3) 'Is CPL liable to indemnify both the FIF and FMF against loss?'

Annexure “G” - Was 'Pacific Beach' a related transaction?



In these circumstances, is the loan to 'company' (Green loop) a related party transaction (that is, a related party transaction with respect to the manager of the managed fund) when the manager has no ownership in 'company' but will take a substantial share of the profits in the land development both directly (black) and via 'related company' (red)? If you conclude that it is, then why would you think that ASIC doesn't agree?

Would it make any difference to your thinking if the Managed Fund was the FMF, the Fund Manager was CPL, the Related Company was CP1, and the land was the land at Broadbeach known as 'Pacific Beach'?

Does a proposed development on the land 'meld' the land and the development, therefore bringing about a related party transaction by 'melding' the loan between the FMF and 'company' (in green) with the fund manager and the 'related company' (the red/black profit paths)? Does the fact that a relative is the developer invoke a related party status on the transaction as a whole?



The media reports the land owes the fund/Fortress about \$210m and the land is expected to go for about \$80m - that's a \$130m loss and it doesn't include interest paid to facility providers.