

Adviser Edge Rating ★★★★★

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Product Summary

The Abacus Diversified Income Fund II (the Fund) invests directly in a portfolio of retail, industrial and office properties. The Fund aims to provide investors with quarterly underwritten income distributions and at least capital preservation, with a potential for capital growth at maturity. The income distributions and capital preservation are backed by the property portfolio and the subordinated loan, and underwritten by Abacus Property Group (ABP). New capital is being raised through the issue of Class C units, the conditions of which are the basis for Adviser Edge's research report.

The Fund's Responsible Entity, Abacus Funds Management Limited (Abacus) has improved a number of features of the Fund in an update on 17 November 2010 and a supplementary PDS on 31 January 2011. One of the improvements was to increase the Underwritten Distributions for Class C units, which from 1 January 2011 are set at 9% (relative to the previous 8.24%), or \$0.0675 p.a. on a \$0.75 issue price. The distribution will be indexed according to the CPI during the term of the investment beginning on 1 July 2011, preserving the purchasing power of the income. If the net income generated by the Fund's property portfolio is insufficient to meet the Underwritten Distributions, ABP will make up the shortfall by deferring the Fund's interest payments on the loan facility that ABP provided, by deferring the payment of any management fees payable to ABP under the constitution of the Fund, by a combination of interest and fee deferral, or any other way considered as appropriate by ABP. The income distributions are expected to be 100% tax deferred in FY2011. During the term of the investment, the level of tax deferral is expected to decrease. As a result of the tax deferrals during the investment term, the cost base of the investment will be reduced like other property investments. This may incur a capital gain tax for investors, even in the event that investors only receive back the initial investment amount.

The Fund also provides Underwritten Capital Return to investors at maturity between June 2016 and June 2017, which underwrites the return of 100% initial investment. In the event of a favourable market performance, investors will have the opportunity to participate in further capital gains. However, the level of capital gain is influenced by the ranking of various payments from the Fund to ABP and there is no capital gain until the Fund's net asset value increases enough to return capital

contributions back to unit-holders and repay the Abacus Loan Facility at maturity. If the net asset value of the Fund at maturity is insufficient to return the investors' capital investments, ABP will cover the shortfall by firstly writing off its \$48 million Loan Facility to the Fund, secondly by utilising the first mortgage over the unencumbered property on Sunshine Coast, and finally by injecting additional cash or/and issuing new stapled securities at the investors' discretion. As part of the improvement, the Abacus Loan Facility has been increased from \$18 million to \$48 million in order to further strengthen the robustness of the guarantee, as the amount is subordinated to the investors' capital return at maturity. Another enhancement to the Underwritten Capital Return was introduced in the supplementary PDS of January 2011, giving the Fund a first mortgage over an unencumbered property to support any shortfall at maturity. The property is 17,930m² land adjacent to the 374-room Novotel Twin Waters Resort on the Sunshine Coast, which was valued in December 2010 at \$7.6 million.

Unlike other conventional structured products in the market, this Fund does not involve the use of dynamic allocation strategies or derivatives to provide income and capital guarantees. Therefore, if the property portfolio performs poorly and fails to meet the Underwritten Distributions and Underwritten Capital Return, the guarantees rely on ABP having an adequate level of cash flows and capital to cover any shortfalls (after the subordinated loan is waived and the first mortgage is called) during the investment and at maturity.

Analysis conclusions

Adviser Edge raised its rating of the Fund to four stars following Abacus's alterations made in the updates and Supplementary PDS. The strong rating has been achieved for three main reasons.

Firstly, the Fund provides a very unique market access for investors. It is a structured product built around a property portfolio, which is uncommon in the Australian structured products market. It allows investors with a bullish view on the direct property sector to benefit while offering income and capital guarantees.

Secondly, the quantitative analysis shows that the Fund delivers attractive post-tax income returns to investors, particularly for high income earners who plan to retire in the next three to five

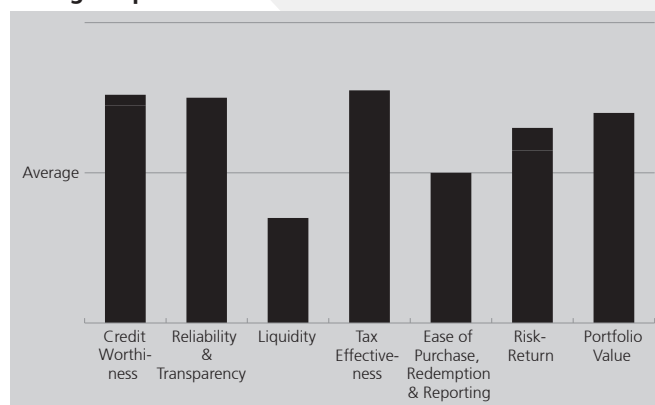
years. The strong post-tax returns are achieved as a result of contributions from the guaranteed 9% income yield, CPI indexation on the distributions, and tax deferrals. The CPI indexation provides an inflation hedge on investors' returns which currently is not addressed by any other structured products in the Australian market.

Thirdly, the property portfolio's current 9.08% capitalisation rate is considered to be above the 10-year average. If the property cycle reverses and the capitalisation rate drops, the property portfolio may significantly enhance its valuation. A strong appreciation in the value of the property portfolio can improve the chance and magnitude of capital gains to investors.

The Fund has three primary drawbacks. Firstly, the Fund has very poor liquidity during the approximately five and a half-year investment term. Although ABP may consider purchasing units back from investors in cases of investor hardship, the Fund should be considered as an illiquid investment and investors should not expect to redeem their units or sell them in the secondary market throughout the whole investment period. Secondly, the Fund may need to rely on the credit quality of and capital injections from ABP to cover the shortfalls in providing the Underwritten Distributions at the starting phase of the investment. In extreme conditions there is likely to be a strong correlation between the need for a capital injection to the Fund and a high risk of ABP not being able to meet it. ABP does not have a credit rating from the major rating agencies, although it was able to raise equity and continue to operate successfully through the GFC. ABP has also recently been able to roll over funding lines with its banks. Thirdly, although investors have the potential to receive capital gain at the end of the investment, the hurdle that the property portfolio needs to achieve to generate that capital gain is considered to be high. On top of that, investors' capital gains will be affected by other payments from the Fund to ABP.

Adviser Edge considers the product to be a hybrid of a property fund and a high-yield inflation-linked corporate bond. If the property portfolio develops profitably over the term, returns will be correlated to, but lower than a typical property fund. If the property portfolio value stagnates or rises only slightly, the guaranteed income and capital return will outperform typical property funds. In addition to this, in a very weak or falling property market the Fund will be more akin to a corporate bond, with reliance on the credit quality of ABP (after the subordinated loan is waived and first mortgage called). Advisers and investors should note that the recent improvements introduced by Abacus aimed to increase the pro forma adjusted net asset value per unit of the Fund from \$0.60 to \$0.81. Therefore, potential investors will no longer pay a substantial premium over the adjusted net assets to access the Fund and will no longer be seen as subsidising the existing Class A and B investors. These changes significantly enhance the capital security of the Fund without as heavy a reliance on ABP credit support as in the original structure of the Fund.

Rating Snapshot



Investor Suitability

Abacus Diversified Income Fund II – Product Characteristics

Asset Class	Australian Equity		International Equity		Commodity	Hedge Fund
	Foreign Exchange		Volatility	Property	Fixed income	
Borrowing	No	Partial	Full	Choice	Internal ¹	
Investment Horizon	< 1 yr	1–3 yrs	3–5 yrs	5–7 yrs	> 7 yrs	> 10 years
Market Outlook	Short term bullish	Short term bearish	Short term neutral	Long term bullish	Long term bearish	Long term neutral
Interim Cashflow	Net cash outflow		No cashflow		Net cash inflow	
Counterparty Risk	Low		Medium		High	
Market Risk*	Low growth – low risk		Medium growth – medium risk		High growth – high risk	
Self-managed Super Funds	Yes			No		

* This refers to the Fund in isolation, not the investor. The suitability to a particular investor depends on the investor's overall portfolio construction. A Low Risk product is closer to high grade fixed income, whereas a High Risk product is closer to direct equity.

¹ The fund utilises bank debts and loans from ABP to acquire property assets.

Adviser Edge considers the Fund to be suitable for those investors willing to accept the potential risk of substantial capital loss in extreme circumstances, while seeking a high and less volatile rate of return in positive to neutral market circumstances. Risk-aware investors seeking stable returns for part of their portfolio may be attracted to the guarantee on the real income yield of 9% with some capital growth potential. Advisers and investors need to

understand the credit quality of ABP combined with the additional repayment possibility of ABP stapled securities at unitholders' discretion. This will be an attractive product for long-term investors not requiring their capital for five to six years, who are able to utilise the potential tax benefits. Suitable investors will also have a positive view of property valuations over the next five to six years, and may be concerned about rising inflation.

Product Details

Legal structure

Issuer/Responsible Entity	Abacus Funds Management Limited is the Responsible Entity of the Fund and is a member of Abacus Property Group. ABP is a diversified property business listed on the S&P/ASX 200 A-REIT index. (PDS 9)
Investment Type	The Fund is an unlisted registered managed investment scheme.
Guarantor/Credit Parties	Abacus Property Group (PDS 9)
Offer Close Date	The Offer opened on 24 December 2009 and will remain open until fully subscribed, but Abacus may close the Offer at any time without notice. (PDS 39)
Maturity	Abacus intends to sell the Fund or the Fund's assets from 30 June 2016, applying the net proceeds to pay out the Fund's liabilities and returning the net proceeds to investors by 30 June 2017. (PDS 9)
Liquidity	An Investment in the Fund should be regarded as a non-liquid investment, as the Fund's withdrawal facility has been suspended. A new limited liquidity facility has been introduced for all units in the case of investor hardship. The facility will be determined by Abacus in its absolute discretion and may be terminated at any time. (PDS 11, 60)
Minimum Investment	\$5,000 and in multiples of \$1,000 thereafter. (PDS 9)

Economic features

Investment Strategy	The Fund aims to provide Underwritten Distributions and Underwritten Capital Return to investors through the backing of the diversified property portfolio and the subordinated loan, and guaranteed support from ABP. (PDS 9)
Underlying Investments	The Fund's property portfolio is comprised of 25 properties valued at \$185.4 million in total, as at 31 December 2010. The properties include retail, industrial and office buildings in New South Wales, Victoria, Queensland and Tasmania, with individual property values of less than \$25 million. (PDS 9, 22)
Capital Guarantee	New investors will receive a minimum of \$0.75 per unit at Fund termination underwritten by ABP. (PDS 43)
Capital Gain	If at the end of the Fund term the net proceeds from the sale of the Fund or its properties exceed the aggregate Underwritten Capital Return for all unit-holders, all investors will be entitled to a distribution of any further surplus up to 10% on their original Contributed Equity before ABP is entitled to be paid any deferred management fees. After payment of the deferred management fee, any excess gains are paid to investors. (PDS 10)
Tax Deferral	Distributions are expected to be 100% tax deferred in FY2011, with significant tax deferral on the distributions over the life of the Fund. The level of tax deferral will decline over the remaining term of the Fund. (PDS 10, 18)
Distributions	An initial 2011 distribution of \$0.0675 p.a. for the new units, which equates to an annualised distribution yield of 9% on a \$0.75 issue price. For each new financial year commencing July 2011, the distribution on new units will be automatically adjusted for the percentage change in the Consumer Price Index between the commencement of that financial year and the previous calculation date. Distributions will be paid quarterly, within two months of the end of the March, June, September and December quarters. (PDS 10, 18)

Fees

Ongoing Fees	<p>Fund general expenses: 0.37% p.a. of Fund's gross asset value. (PDS 47)</p> <p>Management fees: 0.7% p.a. of Fund's gross asset value. Abacus has agreed to defer the payment of its management fee until the termination of the Fund, and it will only be recovered if investors in the Fund have received back their original Contributed Equity plus a further 10% surplus in addition to their Underwritten Distributions. (PDS 11)</p>
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Investment Highlights

The Fund's property portfolio has a total land area of 216,982m² and a total lettable area of 135,436m². The portfolio's occupancy rate is currently 93% and the weighted average lease expiry by income is 3.7 years.

The weighted average capitalisation rate is 9.1%. By individual property, the lowest capitalisation rate is 8.25%, while the highest is 10.5%.

The property portfolio consists of a 51% allocation to Industrial, 45% to Office and 4% to Retail. New South Wales accounts for 38% of the total, while Victoria and Queensland properties have similar proportions at 27% and 26% respectively. Tasmania makes up the remaining 9% of the total portfolio.

The Fund's Investment mandate enables a combination of investment in direct property and indirect property investments, listed property trusts, property-based mortgages, and cash. The current target asset allocation is heavily biased towards direct property (90% to 100%), while indirect property investments and the cash allocation range between 0% and 10%. It is the intention of the property manager to concentrate on direct property investment for the remaining term of the investment.

The Fund has three different classes of units. Existing units (Class A) are the units issued prior to the current PDS, converted units (Class B) are the units issued to existing investors, who accept the offer to convert their Class A units into Class B units, and new units (Class C) are the units issued pursuant to the current PDS to new investors.

As at 31 December 2010, there are 17.4 million Class A units, 18.6 million Class B units and 8.5 million Class C units. Equity is being raised with additional issue of Class C units to repay the Abacus Working Capital Facility, with a balance at 31 December 2010 of \$46.7 million compared to \$78.8 million at 30 June 2010 before the enhancement was introduced. Abacus will now seek to issue a total of approximately 70.8 million Class C units to raise approximately \$53.1 million, comprised of \$6.4 million already raised at 31 December 2010 and a further \$46.7 million to be raised to repay the Abacus Working Capital Facility. Abacus reports that an additional \$2.0 million has been subscribed up until 28 February 2011, and a further \$4.5 million has been committed to be subscribed before 30 June 2011.

There are likely to be periods during which the Fund may not be able to generate sufficient income to meet the Underwritten Distributions to investors. This is particularly the case for the next two to three years if Class C units are fully subscribed. In these situations, ABP will cover the shortfall by deferring management fees payable by the Fund to the ABP, and as such the Fund will not be liable for this expense until the investors have received back their original contribution plus a further 10% capital gain at

maturity. ABP also intends to defer the principal and interest repayments of the Abacus Loan Facility to maturity to improve the Fund's cash position. If the above means are still inadequate, ABP will defer the interest and principal repayments of the Abacus Working Capital Facility (if any) to the extent necessary to support the Underwritten Distributions. If further support is needed ABP will make up the difference in any way it determines. ABP can recover any interest deferred on the Abacus Working Capital Facility and Abacus Loan Facility if actual cash earnings exceed the cash required to meet the Underwritten Distributions. In the worst-case scenario, ABP will inject additional cash flows into the Fund. However, the cash injections will be accounted as an additional debt to the Fund and will be repayable at maturity.

The capital protection will be underwritten by ABP for all classes of units issued, not only the new units pursuant to this Offer. According to the Underwritten Capital Return, ABP will ensure that by termination of the Fund after 30 June 2016, all investors will receive an amount equal to \$0.75 per unit less any capital distributed prior to fund termination by making a payment equal to any shortfall. If the net asset value of the Fund at maturity is insufficient to return the investors' capital investments, ABP will cover the shortfall by firstly writing off the principal of its approximately \$48 million Abacus Loan Facility to the Fund, and secondly by utilising the first mortgage over an unencumbered property, not owned by the Fund, at Twin Waters on the Sunshine Coast, and finally by injecting additional cash or/and issuing new stapled securities at the discretion of the investors. If stapled securities are issued, then the value of the stapled securities will be calculated based on the volume weighted average price of ABP stapled securities during a certain period of time preceding the date on which the ABP stapled securities will be issued to cover the shortfall.

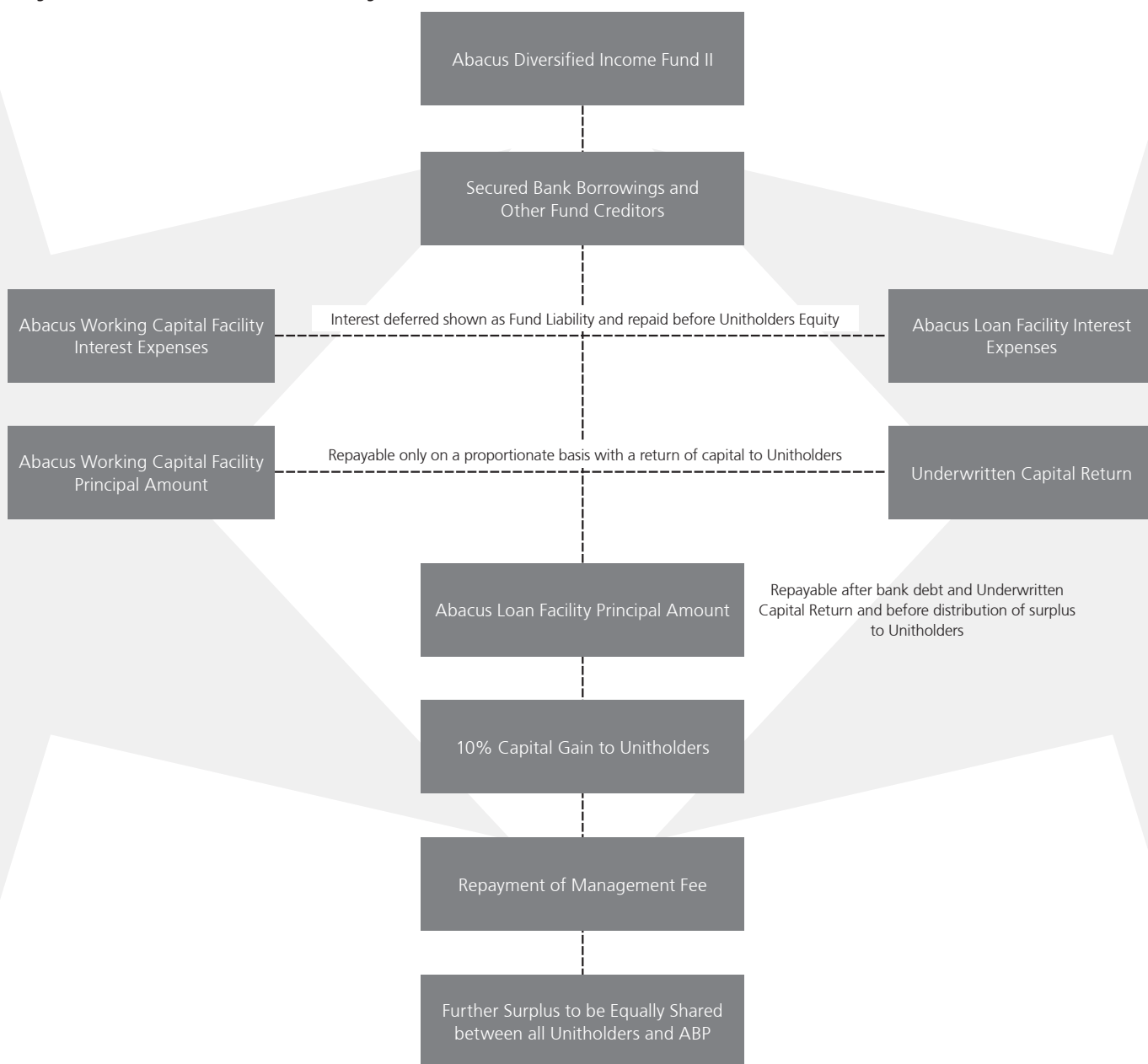
As part of the new supplementary PDS, ABP has given the Fund a first mortgage over an unencumbered property, not owned by the Fund, at Twin Waters on the Sunshine Coast. This means that the Fund can realise the value of this property if required to contribute to the Underwritten Capital Return. This land consists of 17,930m² adjacent to the 374-room Novotel Twin Waters Resort and was independently valued in December 2010 at \$7.6 million. ABP reserves the right to substitute the mortgage over the Twin Waters Land with an alternative asset of at least equal value at the time of substitution. ABP will be entitled to a release of the mortgage when the adjusted net asset value of the Fund increases to at least \$0.84 per unit across all unit classes. The value of the land may change over time. If the market value of the Twin Waters land goes down, ABP has no obligation to top up.

The Fund offers investors the opportunity to receive capital gain if the property portfolio performs well. If the net asset value of the Fund at maturity is sufficient to fully cover the investors' initial capital contributions and other liabilities except the

deferred management fee, investors will receive a capital gain up to 10% of the capital contribution. Once the investors receive back their capital contribution and 10% capital gain, ABP will be entitled to recover the deferred management fees. If the Fund still has surplus remaining after paying off the management fees, the remaining money is attributable to the investors.

As the investors' returns are mainly backed by the property portfolio, which is 100% owned by the Fund and the subordinated loan, investors will only be partially subjected to the credit risk of ABP as a result of the underwriting agreements. ABP is not rated by any credit rating agencies.

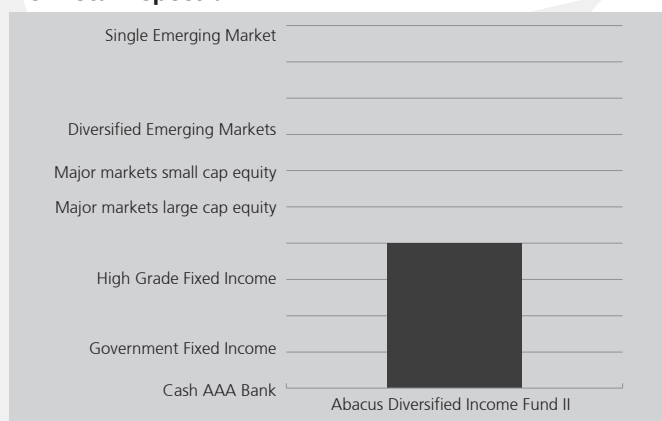
Payment Schedule at Maturity



Asset allocation

As at 31 December 2010, the Fund has a gearing ratio of 79% assuming full subscription of the Class C units and repayment of the Abacus Working Capital Facility. The gearing ratio is derived by comparing the total interest-bearing loans and borrowing excluding the Abacus Working Capital Facility (\$195.4 million – \$46.7 million) with the total assets (\$187 million). The total amount of unit-holder equity after full subscription of the new issue is expected to be approximately \$76 million, which combines the Abacus Loan Facility (\$48 million) and the additional capital (\$46.7 million), and deducts the current negative equity of \$19 million. The Fund has total bank loans of \$96 million.

Risk-return spectrum

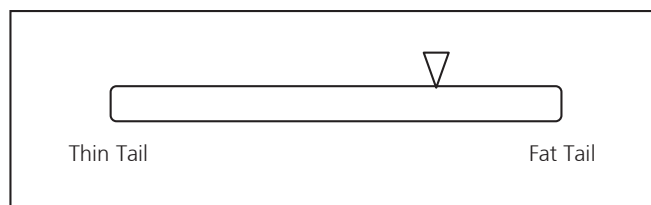


The risk-return spectrum graph shows that Fund returns in most circumstances are less risky than a direct investment in a well-diversified large capitalisation equity portfolio, and it is more similar to an investment in a medium-risk corporate fixed income security as a result of the following:

- The Fund generates a real income yield of 9% p.a.
- The income distributions and capital contributions are underwritten by ABP, which has a higher credit risk compared to other high grade corporate bond issuers
- Investors have a lower than average potential of obtaining capital gains at maturity

Advisers should acknowledge that while the Fund has lower risk than a well-diversified large capitalisation equity portfolio in normal circumstances, it has a bigger tail risk in the event that both the Fund and ABP are simultaneously affected by property market downfall.

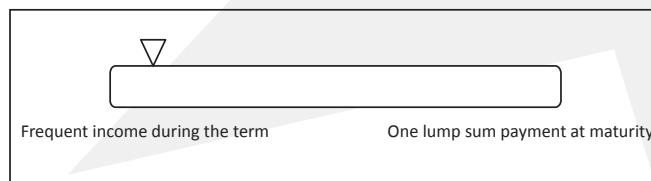
Fat tail view



In the fat tail section, Adviser Edge focuses on the downside fat tail of the Fund, which is the probability of the Fund returning between 0% and -20%. Adviser Edge believes that the Fund has an above average fat tail for non-g geared investors and a large fat tail for geared investors.

Although in normal situations investors would not incur any loss on their investment, there remains a possibility that an extreme event may cause investors to suffer quite a substantial loss. The fat tail loss would occur if the property portfolio fails to achieve an adequate level of asset value to repay the capital contribution, the \$48 million loan is insufficient to make up all the shortfall, and if ABP experiences financial difficulty in fulfilling its obligation under the underwriting agreements. Adviser Edge anticipates that the possibility of this extreme event will decrease as the market continues to stabilise and recover. However, investors should carefully assess the financial strength of the ABP in order to gain a complete understanding of the Fund's tail risk.

Frequency of cash flow



Pros

Risk and return

- The Fund's property portfolio demonstrates a sound level of diversification, with geographical exposure across four states and exposure to the three main property sectors.
- The capitalisation rates applied to the Fund's underlying assets are in line with the market.
- The pre-tax income yield of 9% p.a. is attractive, as is ABP's indexation according to CPI movements. The CPI indexation can be considered as a valuable inflation hedge option which ensures that the income will increase in line with CPI change in an inflationary environment to maintain the purchasing power of the distributions. However, the income yield will not fall if the economy experiences deflation.
- The post-tax income returns of the Fund are enhanced by the tax deferrals generated by the property portfolio. ABP anticipates that the income distributions received in FY2011 will be 100% tax deferred.
- Apart from the strong income distributions, the Fund also offers potential for investors to achieve capital gains at maturity on the back of rising commercial property value in Australia. At this stage of the commercial property cycle, this feature may be of value.
- Management fees are deferred to maturity and will not be payable unless investors receive full capital contribution back with 10% capital gain. This also further lowers investors' reliance on the credit worthiness of ABP to cover shortfalls as a result of its underwriting agreements.

Portfolio value

- The Fund offers strong diversification benefits to investors with high exposure to local and international equities in their portfolio. The Fund behaves similarly to an indexed bond during the term of the investment, offering stable and inflation-hedged incomes. It also allows investors to benefit from improvement in the commercial properties market at maturity, which tends to have lower correlation to the equity market compared to listed property securities.
- The Fund is innovative and unique, as it is uncommon to find a structured product in the current market that offers both income and capital guarantees, and performance linked to a direct property portfolio.
- The Fund's structure allows potential future capital gains to be transformed into higher income in the early years, providing a different profile compared to other property assets that investors may currently hold.

Credit worthiness

- The majority of investors' income distributions and capital return will be backed by the property portfolio; therefore, the investors will only rely on the credit worthiness of ABP to meet the Underwritten Distributions and Underwritten Capital Return if the property portfolio fails to generate sufficient incomes and capital growth and the subordinated loan is insufficient to meet the shortfall. As a result of this, investors will only be partially exposed to the credit quality of ABP.
- The increased \$48 million Abacus Loan Facility and the recently announced first mortgage over one additional property are used as a first cushion of loss, which provides investors with a greater confidence in receiving back their capital contribution at maturity before relying on financial support from ABP.
- The improvements have increased the Fund's Pro Forma adjusted NAV per unit to \$0.84 as at 30 June 2010 and \$0.81 as at 31 December 2010. An adjusted NAV of \$0.84 per unit is the required level that the Fund needs to achieve at maturity in order to return all capital contributions back to investors without requiring additional support from ABP. The improvements have removed the previous premium to net asset value which a new investor would have had to pay to enter the Fund, and are seen as a very positive step in enhancing the future prospect of the investment.
- ABP has improved its financial position through two equity raisings and the extension of debt facilities during the past two years.

Reliability and transparency

- The Fund's Property Management team is comprised of six senior staff members who collectively display a solid degree of skills and experience. The Property Management team is headed by Peter Strain who has over 25 years' experience in the property industry.
- ABP has been very supportive during the course of the initial open period of the Fund, and has displayed a willingness to improve the Fund's structure, as seen in the Supplementary PDS.

Tax features

- The Fund enhances its post-tax returns through tax deferrals resulting from property investments that attract building allowances and depreciation allowances for income tax purposes.
- The Fund may distribute fixed income on a quarterly basis. As such, the interest cost from borrowing may be tax deductible for geared investors.¹

¹ Adviser Edge does not purport to be a taxation specialist and the comments made here are of a general nature based on the knowledge of Adviser Edge from previous publicly available structured products. All investors should seek specialised and personalised taxation advice regarding the Fund. The comments throughout this product assessment assume that the investor is an Australian resident individual not carrying on a business in trading investments.



Cons

Risk and Return

- Historically, the Fund's track record has been weak. The decline in property values and increase in liabilities over the last three years have resulted in the Fund recording a negative net equity value.
- The property portfolio needs to achieve at least medium capital growth in asset value between now and maturity, before investors have the chance to participate in capital gains.
- As a result of the payment order at maturity and the current low unadjusted net asset value, the magnitude of capital gains that the investors can potentially receive will be very moderate. After the capital contributions and Abacus Loan Facility are fully paid off, the first 10% of capital growth is attributable to unitholders.

Credit worthiness

- ABP is not rated by any credit rating agencies, which makes it harder for investors and advisers to fully understand the strength of its balance sheet. Further to this, the illiquid state of the Fund makes it essential to rely on the credit strength of Abacus for five to six years.
- A guarantee of any investment is best provided from an uncorrelated source. Here, the time that the guarantee will be most needed will also be the time that the guarantor is likely to suffer weak business conditions, increasing its credit risk.

Reliability and transparency

- There is a potential conflict of interest between Abacus Property Group and the Fund in relation to related party transactions. Adviser Edge believes that an investment committee independent of the board should be established for the Fund to approve related party transactions. The extent of this conflict of interest is mitigated by the fact that the Board of Directors of ABP contains a majority of independent directors who approve related party transactions.
- There is key person's risk with Peter Strain. While the property management functions are rotated amongst the Property Management Team, Peter has overall responsibility for the properties. Peter has developed extensive knowledge and familiarity with the properties since joining the Fund in 2002.
- The Fund has a more complicated legal and payoff structure compared to most other structured products or property funds in the market.

Liquidity

- Like some unlisted property funds, the Fund has very poor liquidity as it expects to provide investors with little or no redemption facility during the investment term. Investors will have their money tied up with the investment and may be subject to additional uncertainty such as potential changes in management team and cyclical market effects. The Fund will be wound up by June 2017 unless it is voted to be extended by unitholders.

Management & People

Key Investment Staff

	Responsibility	Qualifications	Years with Fund	Investment Experience	Previous Employment
Alan Thake	Associate Director – Investments	Fellow Chartered Accountant – England	3	11	Deloitte Corporate Finance, British Waterways
Peter Strain	Director Property	GDipAppFin&Inv, Licensed valuer, Licensed real estate agent	9	26	Colliers International, ANZ Banking Group
Ellis Varejes	Chief Operating Officer	BCom, LLB, Qualified lawyer	5	25	Abbott Tout
Len Lloyd	Managing Director – Abacus Property Services	FAPO, WDA, Licensed real estate agent, Registered real estate valuer	11	40	Advance Bank, Commonwealth Development Bank
Rod de Aboitiz	Chief Financial Officer	MBA, Chartered Accountant	5	20	Rothschilds, PwC
Laurie Angeli	Senior Property Manager	Licensed valuer, Licensed real estate agent	6	20	Advance Bank, St George bank; Flight Centre
Ivano de Bortoli	Property Manager	Licensed valuer, Licensed real estate agent	4	20	Heathrow Airport, London Bor Enfield, Knight Frank
Grace Neowhouse	Property Manager		1	28	Perpetual Trustee, Advance Bank, Citibank
Rob Culf	Property Manager	Diploma in Business Valuation, Licensed real estate agent	1	25	Knight Frank, Colliers, Commonwealth Bank, Colonial, Orchard
Chris Hobbs	Property Finance Consultant	Associate Australian Society Accountants	7	30	National Australia Bank, Advance Bank
Cate Aarons	Head of Strategy	BCom, MCom in Finance	7	30	FSP
Natalie Egan	Consultant – Marketing and Technical	DipFinPlanning, DipFinAdvisory	2	16	National Australia Bank, MLC, Great Southern
Kim Kitchen	Head of Retail Distribution	Diploma in Financial Planning	15	20	Abacus Property Group
Natalia Chatalova	Analyst	BCom(Hons)	2	3	Merrill Lynch, UBS

Location of Team	Sydney	Portfolio Managers	2
Investment Offices	1	Property Managers	6

The Property Management Team and Fund Managers are directly responsible for the overall management of the Fund. Adviser Edge is satisfied that the team has the appropriate skills and experience to oversee the Fund's development and ongoing performance.

Team Summary

The Fund's investment team is based in Sydney, and travels interstate regularly to identify potential opportunities and to manage the Fund's current portfolio. Ultimately the responsibility of the Fund lies with Ellis Varejes, assisted by Alan Thake. Mr Thake is responsible for ensuring that all functions related to

the management and administration of the Fund are performed, and for integrating these activities together. Mr Thake is a Chartered Accountant and has over 11 years investment experience. More specifically Mr Thake has specialised in the property industry for most of this period.

The Fund is well supported by the Property Management team headed by Peter Strain. Mr Strain has 26 years' experience in both investment and corporate property, and is a licensed real estate agent as well as being a certified practicing valuer. Mr Strain is supported by a team of Property Managers, the members of which display a solid level of experience. Strategy direction of the property portfolio is overseen by Len Lloyd.



Significant input into the Fund is also provided by Cate Aarons and Natalie Egan. Ms Aarons is the Associate Director of Transactions, responsible for strategic analysis. Ms Egan is the Consultant of Marketing and Technical, providing marketing and distribution services to the Fund along with Kim Kitchen. All the ABP team ultimately report through to the managing director of ABP, Frank Wolf.

There is constant informal communication between members, facilitated by the close physical proximity. Also, the property management team has a formal meeting every Monday, while the executive team meets every Friday. These formal meetings serve as a forum to discuss all aspects of the Fund's operations. This includes debt, cash flow, acquisition and disposals, capital expenditures, performance, valuations, tenancy arrears and the latest property-related issues.

The Fund adopts a bottom-up strategy. While the team assesses the Fund's overall geographic and sector exposures to ensure that the Fund maintains a diversified portfolio, assets are assessed on their individual merit. The Fund does not have a formal investment committee. Asset allocation recommendations and advice are provided by the executive team, which consists of Len Lloyd, Cate Aarons, Peter Strain, Ellis Varejes and Rod de Aboitiz, and are ultimately approved by Managing Director Frank Wolf.

The Fund seeks to specialise in properties located on the east coast of Australia. Having a team based in Sydney, the Fund believes it can add more value by acquiring and managing properties on the east coast.

The Fund conducts a majority of its functions in-house, although it does outsource a number of functions that it views as cost effective to do so. The Fund outsources its registry and custody services as well as outsourcing some of the building management functions. The majority of the Fund's building management functions are performed in-house, with the Fund having a preference for in-house building managers.

Related party transactions between Abacus Property Group and the Fund are overseen by the Compliance Committee. Property acquisitions and disposals between the Fund and Abacus Property Group require the subject property or asset to be

independently valued and approved by the Board of Directors of Abacus Property Group. Furthermore, the Compliance Committee requires documentation explaining the rationale behind the property acquisition or disposal.

Adviser Edge believes that there is a potential conflict of interest between the Fund and Abacus Property Group. Adviser Edge believes that an independent investment committee (independent of the board) should be established for the Fund to approve related party transactions.

Key Staffing Changes

Adviser Edge has noted that Abacus Property Group has experienced a number of departures over the last year across its entire business. It should be noted that three of the departures were directly related to the Fund. Two Property Managers, Greg Lazarus and Mark Humphrey, left in mid-2010 and were replaced with two more experienced professionals, while the Director of Funds Management Tom Hardwick left in June 2010. These departures may have an impact on the Fund which needs to be monitored going forward. However, the Manager has advised that over the last 12 to 18 months the operational functions and strategic decision-making responsibilities were slowly transitioned to other members of the Group including Alan Thake, Cate Aarons, Gavin Lechem (recruited in 2010) and Ellis Varejes, and has consequently not required the direct replacement of Tom Hardwick.

Staff Incentives

Abacus staff members are remunerated on a structure in which employees are paid a market competitive base salary. At the end of each year, staff members are assessed against corporate objectives (not just relating to the Fund) and bonus may be paid.

Adviser Edge has reviewed the remuneration structure and feels the structure has the potential to align staff performance with the ongoing performance of the Fund.

Assets and Property

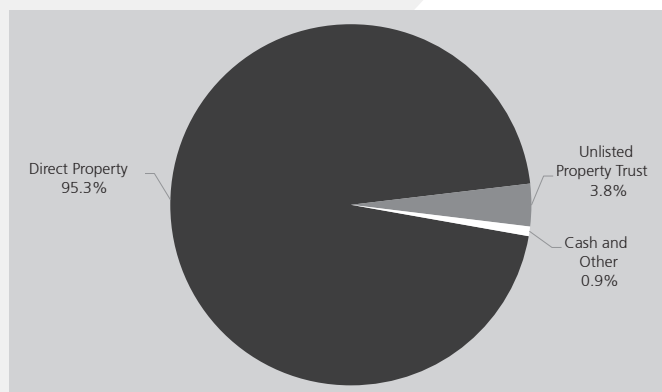
Underlying Asset Allocations – 31 December 2010*			
	Asset Value (\$m)	Current	Target
Direct Property	178.3	95.3%	90%–100%
Unlisted Property Trust	7.1	3.8%	0%–10%
Cash and Other	1.6	0.9%	0%–10%
Total Fund Value	187.0		

* Excludes trade debtors

Fund Structure

The Fund invests in a diversified portfolio of property assets, including direct property and managed trusts. While the Fund currently has no exposure to listed property trusts, the Fund has the flexibility to invest in the asset class. The Fund seeks to invest primarily in direct property assets, and will typically hold 90% to 100% of its assets in direct property.

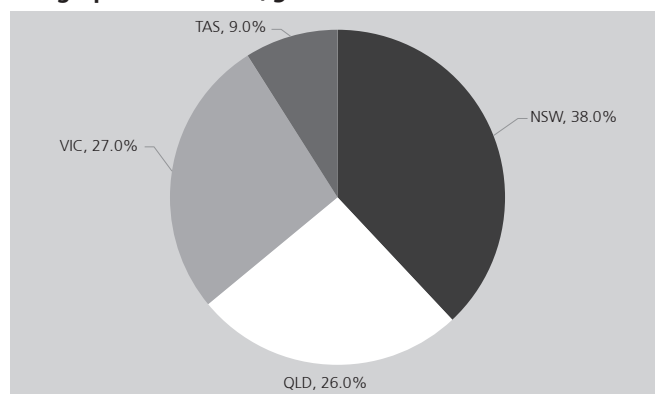
Asset allocation



As at 31 December 2010, the Fund had a total value of \$187.0 million. Investments in direct property represent the largest allocation, comprising 95.3% of the portfolio value. The Fund's exposure to internally managed unlisted property trust, the Abacus Hobart Growth Trust represents the next largest exposure at 3.8%, while the Fund's remaining exposure consists of cash and other at 0.9%. Cash levels will generally oscillate depending on the need for cash to fund potential distributions, acquisitions or capital works programs, and to maintain liquidity. There are no holdings of REITs.

Geographical Asset Allocation

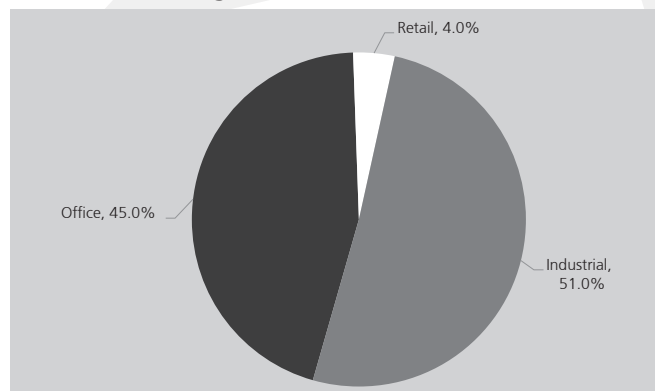
Geographic allocation, 31 December 2010



The Fund demonstrates a solid level of diversification across states, with assets in four states. As at 31 December 2010, the largest weighting within the Fund is towards New South Wales (38.0%). This weighting is followed by Victoria (27.0%) and Queensland (26.0%). The Fund also has a small exposure to Tasmania through its underlying exposure to the Abacus Hobart Growth Trust.

Sector Asset Allocation

Sector allocation, 31 December 2010



The Fund holds assets across all three major property sectors, being Industrial, Office and Retail. The majority of the Fund's assets are held in Industrial assets at 51.0%, followed by Office at 45.0% and Retail at 4.0%.

Property Summaries

Property Asset Summary as at 31 December 2010									
Address	Location	Sector	Ownership	Property Value (A\$m) ¹	Cap Rate	Occupancy	Tenancies	WALE	Area (m ²)
144-168 National Boulevard, Campbellfield	Melbourne, VIC	Industrial	100.00%	16.5	8.75%	100.0%	1	6.7	16,494
1-5 Lake Drive, Dingley	Melbourne, VIC	Industrial	100.00%	13.4	8.75%	100.0%	1	7.5	18,125
22-28 Edgeworth David Avenue, Hornsby	Sydney, NSW	Office	100.00%	11.0	9.25%	68.5%	8	4.9	3,573
27 Grant Street	Port Macquarie, NSW	Office	100.00%	11.0	10.00%	100.0%	6	2.5	3,631
Bartercard House, 121 Scarborough Street, Southport	Gold Coast, QLD	Office	100.00%	10.2	9.50%	100.0%	4	5.2	3,278
2-6 George Young Street, Regents Park	Sydney, NSW	Industrial	100.00%	9.4	8.75%	100.0%	1	5.4	7,827
12 Short Street, Southport	Gold Coast, QLD	Office	100.00%	8.3	8.50%	84.0%	13	2	2,896
4 Brunner Road, Chullora	Sydney, NSW	Industrial	100.00%	7.8	9.25%	77.4%	8	1.1	6,100
26 Production Avenue, Molendinar	Gold Coast, QLD	Industrial	100.00%	7.5	9.25%	100.0%	1	2.5	6,696
13 Boundary Road, Northmead	Sydney, NSW	Industrial	100.00%	7.3	9.00%	53.5%	6	3.6	5,687
Other Direct Property Assets (13 Properties)		Industrial, Office and Retail	100.00%	66.4	8.93%	96.5%	32	2.5	46,327
Total Direct Property Assets (23 Properties)		Industrial, Office and Retail	100.00%	168.8	9.02%	92.8%	86	3.7	120,634
Forestry House, 79-85 Melville Street*	Hobart, TAS	Office	50.00%	7.1	10.50%	100.0%*	2	10.0*	7,558
Emily Dobson House, 99 Bathurst Street	Hobart, TAS	Office	50.00%	9.5	9.00%	100.0%	4	4.6	7,244
Total Unlisted Property Trust*		Office	50.00%	16.6	9.64%	100.0%	6	6.9	14,802
Total Property Assets				185.4	9.08%	93.2%	92	3.7	135,436

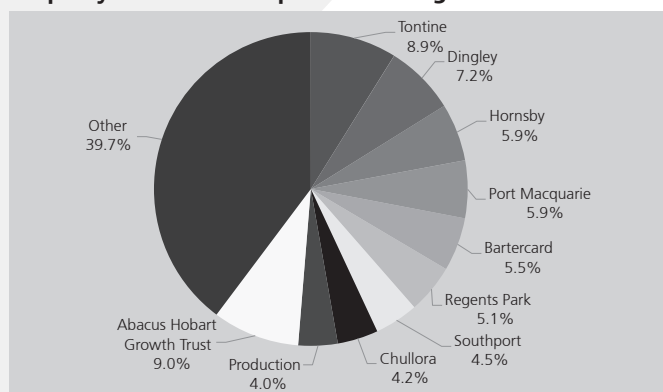
Table totals reflect sum values for dollar amounts, the tenant count and square metre. Value weighted averages are used for ownership and capitalisation rates, and square metre weighted averages used for occupancy and rental income weighted averages used WALE. ¹ Adjusted for ownership.

The Fund's portfolio is comprised of directly held assets and assets held through an investment into an unlisted property trust. The Fund's directly held assets are located in the suburban markets of Sydney, Port Macquarie, Melbourne, the Gold Coast, the Sunshine Coast and Townsville. All properties held directly by the Fund are held through sub-trusts that are 100% owned by the Fund. The Fund also has exposure to two commercial office buildings in the Hobart CBD through its investment in the Abacus Hobart Growth Trust.

The total value of property assets held by the Fund as at December 2010 was \$185.4 million. Property values range from \$0.8 million to \$16.5 million. The Fund has a weighted average capitalisation rate of 9.1% as at December 2010, softening 8 basis points from the previous year. On average the overall property values dropped 2.3% over the year to December 2010.

Adviser Edge notes that the Fund has solid geographical and sector diversification. Based on current valuations, Adviser Edge believes that the capitalisation rates applied to the underlying property assets are in line with the market.

Property investment exposures as at 31 December 2010



Based on property value, adjusted for ownership.

The Fund's five largest assets comprise 33.5% of the Fund's portfolio value and are each valued at above \$10 million. The Fund's largest two assets are industrial assets located in Melbourne, with the remaining three office assets located in the Sydney, Port Macquarie and the Gold Coast. Generally, industrial assets valued at over \$10 million experience an extended sales period compared to those valued in the sub-\$10 million sector.

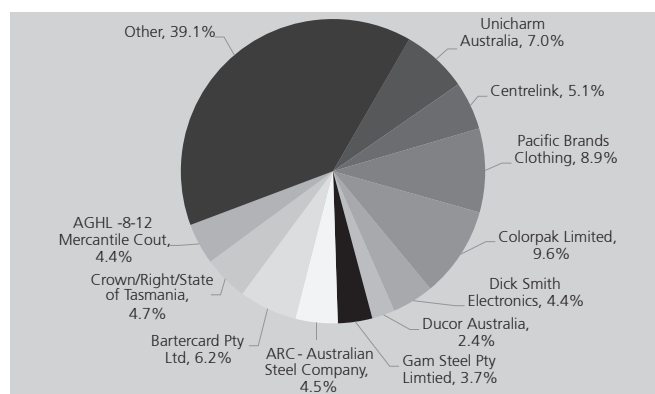
Abacus Hobart Growth Trust

Since the last review conducted by Adviser Edge, the Fund has acquired a further 21% in the Abacus Hobart Growth Trust (the Trust), and as a result the Fund currently holds a 100% interest in the Abacus Hobart Growth Trust. The Trust exercised its option to acquire a Hobart office property in 2010, which entitled the Trust to a 50% ownership in the property. At December 2010, the half interest in the property was valued at \$9.5 million. The Trust also contains an option which is expected to be exercised in

2013 at an exercise price of \$1 to acquire another office property in Hobart. Both properties are 100% leased, with a lease expiry of 6.9 years. The total net lettable area is 14,802m².

Asset Management

Tenant diversification



The Fund has 92 tenancies, which provides a high degree of diversification by tenant. The largest tenant is Colorpak, with 9.6% of base rental income. Colorpak is a listed entity, offering product packaging solutions to its clients. Colorpak fully occupies the Fund's three property assets in Melbourne (with two properties adjacent to one another) and one property asset in Sydney. Each asset leased by Colorpak is strategically leased by location to support the core operations of the business.

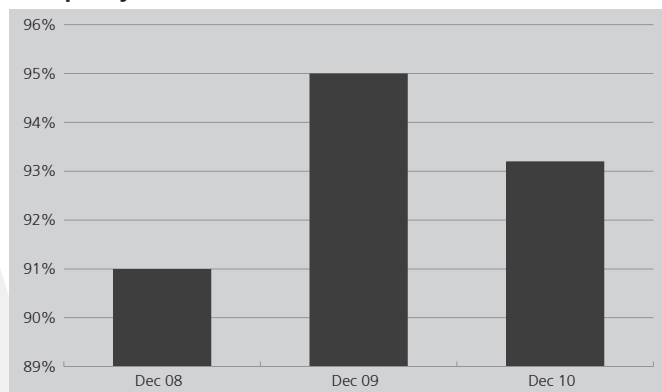
The Fund's next largest tenant is Pacific Brands, fully occupying the Fund's largest asset in Campbellfield, Melbourne, and representing 8.9% of the Fund's rental income. Pacific Brands is a listed entity and is currently undergoing a transformation program which was introduced in 2009 following the global financial crisis. As part of the transformation program, Pacific Brands reduced its workforce significantly with the company divesting, discounting and merging over 150 brands. Additionally, Pacific Brands closed a number of factories across Australia and New Zealand. In 2010, Pacific Brands divested its Dunlop Foams and Sleepmaker brands. There have been no plans by Pacific Brands to vacate the Campbellfield, property with 6.7 years still remaining on the lease. Production on the site remains substantially automated, reducing the risk of Pacific Brands relocating its facilities offshore.

Unicharm Australia, Bartercard Pty Ltd and Centrelink represent the Fund's remaining top five tenants, making up 7.0%, 6.2% and 5.1% of the Fund's rental income respectively.

The Fund's eighth largest tenant is Dick Smith, with 4.4% of rental income; Dick Smith has vacated Lot 6, 2 Endeavour St Chatswood with one year still remaining on the lease. Dick Smith, in conjunction with the Fund's Property Managers, has been in talks to find a new tenant.

The Fund has a good degree of diversification by tenant. This decreases the likelihood that income could be negatively affected by the defaults of a few key tenants.

Occupancy



Occupancy levels for the Fund have remained above 90% over the last two years. As at December 2010, the Fund recorded a 93.2% occupancy rate, a decline from the 95% occupancy experienced during the previous corresponding period. Currently, 16 of the Fund's properties are fully leased, with the remaining seven properties being partially leased due to vacancies. The Fund's Sunshine Coast and Northmead, Sydney, assets had the lowest occupancy at 46.4% and 53.5% respectively.

Property Valuers and Valuations

Properties are valued independently on an annual basis. The Fund has a policy of conducting external valuations on half of its properties in June with the remainder conducted in December. External valuations are conducted by independent, registered valuers. External pre-approved valuers include Knight Frank, Colliers International, CBRE and Savills.

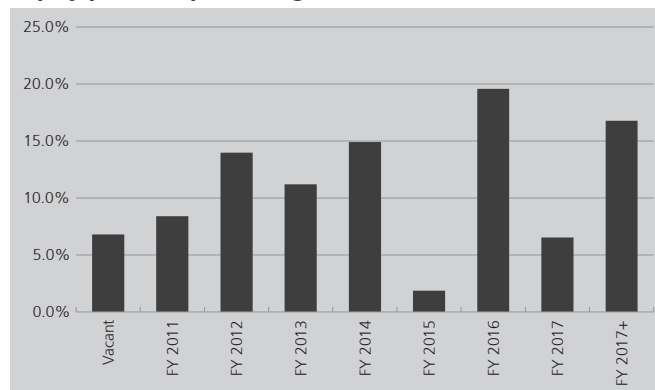
The Fund also conducts director (internal) valuations on each property. Director valuations may be applied to the book value of the property where in the opinion of the Property Portfolio Manager, the property's valuation has moved significantly outside the regular valuation cycle.

Approximately 44% of the portfolio was externally valued in December 2010. Prior to that, 5% was valued in September 2010 and 47% was externally valued in June 2010. The property subject to option was last externally valued in December 2009.

Adviser Edge is satisfied with the Fund's valuation policy and the independence of external valuers.

Lease Expiry

Expiry profile – percentage of base rental income



The Fund has a weighted average lease expiry (WALE) of 3.7 years. Taking a closer look at the year-by-year breakdown, it can be seen that the portfolio's expiry profile is spread across the next 10 years. The Fund has modest expiry risk in the short-term, with only 8.4% of leases maturing in FY2011. Leases maturing in the mid-term between FY2012 and FY2015 represent 41.9% of the portfolio, while over the longer term, 42.9% of the portfolio expires in FY2016 and beyond.

Property Acquisition and Disposal

Acquisition process

The Fund seeks to acquire properties with the following characteristics:

- A value of less than \$25 million
- Properties in the office, industrial and retail sectors
- Attractive real estate fundamentals, such as location, purchase price relative to replacement cost, underutilised land, low purchase rate per metre and good condition of improvements
- Favourable lease provisions including term, passing rent and rent review provisions
- Quality tenants, based on their financial strength and their positioning in the industry
- Opportunities to enhance returns through active management of the asset, such as restructuring of tenancies, increasing rents, upgrading and refurbishing assets, and reducing costs

While the Fund maintains a flexible approach to property acquisitions which is dependent on opportunity, the following processes will be generally followed:

- **Review and identify potential opportunities** – Opportunities may be sourced through on and off-market channels.
- **Evaluate the opportunities** – The Fund's development managers (Dean Galanos, John Bush, Cameron Laird and Philip Petersen) in conjunction with the property management team (Peter Strain, Laurie Angeli, Grace Neowhouse, Ivano de Bortoli, Rob Gult) coordinate to evaluate opportunities. Input is also provided by the executive team. Investment decision-making is supported by general economic and specific property research. This includes Reserve Bank bulletins, ABS releases, bank-sponsored research, reports by real estate groups and other industry bodies.
- **Initial due diligence performed** – The Fund's development managers conduct the initial due diligence on a proposal.
- **Structure loan and negotiate** – The Fund seeks debt financing.
- **Detailed due diligence** – The detailed due diligence process is overseen by a senior manager to ensure that all necessary checks are completed. The senior manager then signs off on the transaction.
- **Acquisition and Management** – Once approval is sought by the managing director, an offer is made. After the property is acquired, the Fund employs a team of property managers who take over responsibility for property management from the acquisition team.

Disposal process

To date, the Fund has divested one property, in June 2009. It is also expected to settle the sale of an asset on the Gold Coast in April 2011 for \$6 million.

The Fund's strategy is to acquire property assets to provide reliable income, and as such asset sales before 2016 (when the Fund is anticipated to be wound up) are expected to be infrequent. However, an asset may be sold if the asset is believed to have matured. This is, if the Manager believes that there is limited growth in income or capital value potential, or the property no longer fits the portfolio strategy.

Asset Management

The property management team is comprised of six staff members including Peter Strain, Laurie Angeli, Ivano de Bortoli, Chris Hobbs, Grace Neowhouse and Rob Culf. The Fund may manage the property directly or manage an external managing agent. The property managers have detailed processes in place for the ongoing management of properties. The Property Managers will generally visit each site at least once a year.



Summary of Quantitative Analysis

- If Class A investors convert all their units to Class B and Class C units are fully subscribed, there will be 36 million Class B units with an Underwritten Capital Return of \$1 per unit at maturity and 70.8 million Class C units with an underwritten Capital Return of \$0.75 per unit at maturity.
- The total amount of funds that would be needed to meet the Underwritten Capital Return at maturity will be approximately \$89 million.
- Assuming that the distributions will increase at an inflation rate of 3% p.a. for the next six years, the total amount of funds that would be needed to meet the Underwritten Distributions will be \$8.25 million for FY2012, \$8.50 million for FY2013, \$8.75 million for FY2014, \$9.02 million for FY2015 and \$9.29 million for FY2016.
- The Fund has a total of \$96 million bank loans as at 31 December 2010. For the six months ending 31 December 2010, the Fund has incurred \$4.3 million interest expenses on bank loans. If the drawn amounts and the borrowing costs are assumed to remain relatively stable through the investment term, the Fund is expected to incur a total interest expense of \$9 million to \$10 million p.a.
- Interest on the \$48 million Abacus Loan Facility is at a simple interest rate of 9% p.a. or \$4.32 million p.a.
- For the six months ending 31 December 2010, the Fund has a total cash flow from rental income of \$8.4 million. If the rental income is assumed to remain stable over FY2012 generating a total cash inflow of \$17 million to \$19 million, and the operating expenses plus other miscellaneous payments totals \$3 million, the Fund would not have sufficient cash after deducting expenses and interest payments to pay for all Underwritten Distributions, and will need to rely on additional support from ABP. In that case, the interest on the Abacus Loan Facility will also be needed to be deferred, increasing the balance owed to ABP.
- The cash shortfall would widen if the Fund receives less rental income due to deterioration in occupancy rate or/and incurs higher expenses from operations or new purchases.
- However, Adviser Edge does not expect the shortfall in any one year to exceed \$6 million under normal market conditions.
- For the six months ending 31 December 2010, ABP has generated total cash flows from operating activities of \$97.8 million and has \$35.6 million cash in the bank. As demonstrated by various results, ABP should be in a comfortable position to cover any shortfall in the Fund if the shortfall is mainly caused by idiosyncratic risk rather than systematic deterioration in the Australian property market.
- Adviser Edge expects that the total asset value would have to at least exceed \$200 million at maturity in order to avoid any support from ABP after writing off the \$48 million Abacus Facility Loan. This means that the valuation of the property portfolio would need to increase by more than 10% during the term or 2% p.a. Given the current level of capitalisation rates used and the long-term average of the commercial property market in Australia, this target is achievable.

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Report Date

9 March 2011