10 October 2008

Dear Investor,

Since writing to you in our June quarterly publication *Outlook* global market confidence has weakened sharply, with a number of major financial institutions faltering and financial turmoil intensifying. In this letter we explain how market conditions are expected to impact your investment in Orchard's unlisted property funds and the steps we are taking to protect your capital in these challenging times, including moving to an annual payment for distributions.

Global financial market crisis

Recent events in the US have exacerbated the credit freeze that has paralysed business and financial markets around the world. Last month international financial markets took a significant turn for the worse with large scale business failures and heightened market instability. Uncertainty regarding the investment outlook has continued to drive substantial daily swings in share markets around the globe, adding to investor concerns.

As the financial rout deepens, many are predicting a recession in the US and other major economies. Most notably the International Monetary Fund has described the continuing credit crisis as "the most dangerous shock to the financial sector since the 1930's[1]". This warning came as US Congress passed a $US700 billion bank rescue package in a desperate bid to reassure financial markets.

While the crisis of confidence in the US continues the impact on financial markets across the globe intensifies with the contagion hitting Europe, Japan and even China. According to the latest AMP Capital research report the US, Europe, UK and Japan are all "on the brink of recession, if not in it" and we have seen China's growth rate already slow from 12% last year to around 9%[2].

Official actions in a number of countries have been aimed at restoring stability and improving liquidity, however it is widely acknowledged markets are going to prove challenging for some time ahead.

Impact on the Australian economy

The Australian economy is not immune to the financial market fallout with clear signs of an economic slowdown already emerging. Weakened business and consumer sentiment will continue to weigh on domestic demand and property markets in the year ahead. ANZ Economics and Markets Research expects economic growth (measured by real Gross Domestic Product) to slow to just 2.1% in 2008/09, down from 3.9% in 2007/08[3].

On 7 October the Reserve Bank of Australia (RBA) responded to the severe international financial conditions and shocked financial markets by slashing interest rates by 100 basis points to an official rate of 6%.

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[1] Bloomberg, "America in midst of 'full-blown crisis': International Monetary Fund", 4 October 2008
[2] AMP Capital, "The continuing roller-coaster ride in financial markets", 2 October 2008
[3] ANZ Economics and Markets Research, "Property Outlook – September 2008"

In its accompanying statement, the RBA painted a sombre economic outlook, commenting that "The recent deterioration in prospects for global growth, together with much more difficult market conditions even for creditworthy borrowers, now present the risk that demand and output could be significantly weaker than earlier expected"[4].

This economic slowdown is not confined to Australia, with the RBA also pointing to evidence of slowing economic growth in Australia's trading partners in Asia.

Impact on the Australian property market

Volatility in global credit markets continues to have a strong negative impact on property markets and we continue to operate in an increasingly challenging environment.

The credit crisis has resulted in the availability of capital being heavily reduced and the cost of funding rising in 2008 which has taken its toll across all asset classes, including property.

- Office markets have experienced an easing of yields this year, despite fundamentals in CBD office markets remaining tight. The difficult global economic environment, tighter financing conditions and heightened caution in most investment sectors are set to continue to impact on this market well into 2009.
- Retail property yields are also expected to ease going forward, with weak retail spending and an increased number of forced/distressed sales weighing heavily on the market.
- For industrial property, the combination of weak sentiment, easing economic growth, rising business overheads and increased funding costs have seen prospects for further demand for industrial space already begin to diminish[5].

The continued tightening of credit coupled with the confusion in property and financial markets are set to increase uncertainty about the value of the underlying assets in property funds. In this environment, we reasonably expect asset values to decline. In the short to medium term falling asset values will place increased pressure on property funds to reduce debt levels, in line with falling property values, to maintain bank loan-to-value ratios (LVRs).

A particularly challenging time is expected over the next 12 to 24 months for property markets with a sustained decline in asset values as forced sellers and opportunistic buyers dominate the market.

What are we doing to manage your Orchard investment?

At Orchard we remain committed to reducing risks in the current market. To prepare for the deteriorating conditions ahead, we have taken the following steps to protect the capital of each fund:

1. Changing the Orchard distribution payment frequency from quarterly, instead opting for an annualised distribution payment in July 2009, payment of which will ultimately depend on the financial condition of each fund. This change will apply to all Orchard unlisted funds, effective immediately. This means that you will not receive a quarterly distribution payment for the September 2008 quarter. While we understand the impact this decision may have on your personal circumstance in the short term, we believe this is the most prudent and sustainable approach to managing the funds in light of volatile market conditions;
2. Deferring all non essential capital expenditure; and
3. Renegotiating debt facilities to spread expiry risk and concentration risk with any single financier.

[4] Reserve Bank of Australia, Policy Statement October 2008
[5] ANZ Economics and Markets Research, "Property Outlook – September 2008"

This prudent approach has been adopted to help ensure all funds continue to meet their contracted obligations, are not forced to sell assets and minimise interest costs. In this extraordinary environment our strategy is focused on the preservation of capital value namely through debt reduction, as this will help improve each fund's position in the long term.

What are the material risks each fund faces?

Our next quarterly report *Outlook* will contain a fund-by-fund analysis of all material risks. We will also include detailed information about the strategies to address each of these risks and position the funds strongly for the future. The report will be made available to you in late October.

Further information

We remain committed to acting in the best interests of all investors and keeping you informed. We are confident that the decisive action we are taking at this difficult time will optimise the prospects for all funds over the longer term.

If you have any questions or require further information, please speak to your financial adviser or call Orchard Investor Services on 1800 008 494.

Yours sincerely,

David Hinde
Chief Executive Officer