NOTICE OF GENERAL MEETING – ABACUS HOSPITALITY FUND

Notice is given that a general meeting of the shareholders of Abacus Hospitality Limited ACN 116 839 304 (**Company**) will be held concurrently and in conjunction with a general meeting of the unitholders of Abacus Hospitality Trust ARSN 123 146 798 (the **Trust)** (together, **Abacus Hospitality Fund** or the **Fund**) at:

Time: 10:00 am

Date: 5 June 2012

Place: Level 34 Australia Square, 264 – 278 George Street Sydney NSW 2000

Abacus Funds Management Limited (ACN 007 415 590) (**Responsible Entity**) is the responsible entity of the Trust.

Approval for Exit Strategy for the Fund

Resolutions

To consider and, if thought fit, to pass the following resolution as an ordinary resolution of the Company and of the Trust:

"That the continuation of the Managed Asset Sale Strategy as described in the explanatory memorandum accompanying the notice of meeting of securityholders of Abacus Hospitality Fund dated 4 May 2012 is approved."

Securityholders' meetings

The shares in the Company and the units in the Trust are stapled together to form stapled securities under the constitutions of the Company and the Trust. This means that shareholders of the Company are also unitholders of the Trust, and vice versa. The meetings of the Company and of the Trust will consequently be held concurrently.

Entitlement to vote

It has been determined that under regulation 7.11.37 of the *Corporations Regulations 2001* (Cth), for the purposes of the general meeting, shares in the Company and units in the Trust will be taken to be held by the persons who are the registered holders at 7:00 pm on 1 June 2012. Accordingly, transfers of stapled securities registered after that time will be disregarded in determining entitlements to attend and vote at the meeting.

Exercise of votes

On a poll:

- In the case of a resolution of the Company, each shareholder present in person has one vote for each share they hold. Also each person present as a proxy, attorney or duly appointed corporate representative of a shareholder, has one vote for each share held by the shareholder that the person represents; and

- In the case of a resolution of the Trust, each unitholder present in person has one vote for each dollar of the value of the units in the Trust held by the unitholder. Also, each person present as proxy, attorney or duly appointed corporate representative of a unitholder has one vote for each dollar of the value of the total units in the Trust held by the unitholder that the person represents.

Voting of jointly held securities

If any stapled securities in the Fund are jointly held, only one of the joint holders is entitled to vote at the meeting. If more than one securityholder votes in respect of a jointly held security, only the first vote is counted. If it is not practicable to determine which was first, the earliest named in the register to exercise such right (to the exclusion of those named later) prevails.

Attendance

If you plan to attend the meetings, we ask that you arrive at the venue at least 15 minutes prior to the time designated for the meetings so that we may check the number of your stapled securities and note your attendance.

Voting by corporations

In order to vote at the meetings (other than by proxy), a corporation that is a securityholder must appoint a person to act as its representative. The appointment must comply with the Corporations Act (Cth). A letter of representation must be either lodged with the registrar prior to the commencement of the meeting or the representative must bring to the meeting evidence of their appointment including any authority under which it is signed.

Voting by proxy

1 A securityholder entitled to attend and vote at the meetings may appoint a proxy to attend and vote on their behalf.

2 A proxy need not be a securityholder and can be either an individual or a body corporate. If a securityholder appoints a body corporate as a proxy, that body corporate will need to ensure that it:

- appoints an individual as its corporate representative to exercise its powers at the meetings, in accordance with section 250D of the Act; and
- provides satisfactory evidence of the appointment of its corporate representative.

3 A form of proxy is enclosed with this notice of meeting.

4 A securityholder who is entitled to cast two or more votes may appoint two proxies and may specify the proportion or number of votes each proxy is appointed to exercise. If no proportion or number is specified, each proxy may exercise half of the securityholder's votes.

5 Where more than one proxy is to be appointed or where voting intentions cannot be adequately expressed using the enclosed proxy form, an additional form of proxy is available on request from the Registry.

6 The securityholder (or securityholder's attorney) must sign the proxy form. Proxies given by a body corporate must be signed by a director, company secretary, sole director and sole company secretary or under the hand of a duly authorised officer or attorney.

7 A representative of a body corporate attending the meetings must present satisfactory evidence of their appointment to attend on its behalf, unless previously lodged with the Registry. If such evidence is not received, then the body corporate (through its representative) will not be permitted to act as a proxy.

8 The proxy form, together with any authority under which the proxy form is executed or a certified copy of that authority, must be received no later than 10:00 am on 1 June 2012 at:

Registry – Boardroom Pty Limited
GPO Box 3993
Sydney NSW 2001
Facsimile: 61 2 9290 9655

BY ORDER OF THE BOARD

Ellis Varejes
Company Secretary
4 May 2012

Proposed Exit Strategy Recommendation for Abacus Hospitality Fund

1. Purpose

The purpose of this explanatory memorandum is to outline the exit strategies available to the Fund and to make a recommendation to securityholders to approve an exit strategy.

When the Fund's first prospectus and product disclosure statement was issued in March 2007, Abacus Funds Management Ltd (**AFML**) as responsible entity (**RE** or **responsible entity)** of the Fund undertook to convene a meeting in early 2012, at which time AFML would make a recommendation to securityholders as to the appropriate exit strategies for the Fund on which securityholders would vote.

2. Background to Exit Recommendation

In the Fund Update dated May 2010 AFML undertook to review the strategic direction of the Fund. AFML completed its review and in April 2011 concluded that:

- *the hotel sector and assets owned by the Fund remain sound in the medium to long term but the Fund's asset values need time to recover; and*
- *securityholders are more likely to recover their initial investment by holding the assets until both trading performance and asset values recover.*

AFML noted that:

The carrying value of the Fund's hotel assets was significantly below replacement cost and there is little new supply in hotel assets expected due to relatively high construction costs and higher alternative uses for development land. This shortage of supply is expected to drive the recovery of both room rates and valuations in the medium term to long term. The expiry of the hotel management agreements over the next 5 years should also increase the potential sale value of the portfolio.

AFML's view at that time was that:

Based on the combination of current market conditions, the performance of the assets and the asset value drivers (being vacant possession, trading performance, supply and demand for hotel rooms, and general economic conditions) the Fund should continue as an unlisted fund beyond 2012 for up to another 5 years in order to maximise the opportunity to return as much capital to securityholders as possible.

These conclusions remain valid today. But the risk profile of the Fund has altered significantly since those statements were made, and this has led AFML to change its view as to the appropriate exit strategy for the Fund. The change in the risk profile relates specifically to insurance issues and the consequential banking implications and this is discussed in section 3 below.

3. Fund Insurance

In late 2011 the Fund experienced an adverse and changing insurance market characterised by upward pressure on premiums and significantly reduced insurer appetite for risks considered to be exposed to catastrophe perils. The Fund currently has three hotels located in areas that are viewed to be catastrophe perils by insurers. The most adversely affected hotel is Chateau on the Park, Christchurch New Zealand and the designation of catastrophe perils by the insurers is due to the Christchurch earthquake in 2011 and subsequent aftershocks. This hotel represents around 14% of the Fund's hotel asset value. The other two hotels are located in Cairns which is designated as a catastrophe peril area due to Cyclone Yasi and the Queensland floods in 2011. These two hotels represent around 35% of the Fund's hotel asset value.

For the 2011 insurance renewal premiums increased by over 250% compared to 2010, excesses increased and the availability of insurance cover was problematic in respect of Christchurch and for far north Queensland. In essence the reinsurance market has been hit badly by natural disasters over recent years not only in Australia and New Zealand but in Japan and the USA as well. Their profit recovery will take years and will be enabled only by much higher premiums, higher excesses, limit reductions and in some cases refusing cover.

The following is an extract from Marsh Pty Ltd's September 2011 insurance renewal program for the Fund (Marsh is the Fund's insurance broker):

Natural disasters have always been a feature of the Australian and New Zealand history, but the past twelve months has seen a series of large catastrophes which caused tragic loss of human life as well as large losses to the Australian and New Zealand insurance industry.

The two earthquake events in Christchurch (the second of which resulted in one of New Zealand's largest natural disasters), widespread and severe flooding in Queensland and Victoria along with the damage bill from Cyclone Yasi in North Queensland are reported to exceed AUD20 billion in insured losses.

Additionally, the total insurable losses from the earthquake and tsunami in Japan are likely to be well in excess of this amount. Whilst the insurance market structure in Japan is unique, many of the insurers and reinsurers that operate in Australasia will sustain heavy losses from this event.

Overall this has resulted in the insurance market in a state of transition, with signs of hardening of terms in particular for buyers with risks situated in Australia and New Zealand with a loss history and/or natural catastrophe exposures.

The results of the third quarter have produced mixed findings based on a number of different factors including:

- *Aggregate exposure to national catastrophe perils*
- *Adverse claims history*
- *Premium adequacy*
- *Risk retention and risk management*
- *Scope of policy coverage*
- *Market capacity*
- *Construction, occupation, protection & exposure.*

Australia

Corporate buyers with aggregate exposure to national catastrophe perils in Australia, specifically flood, cyclone, bushfire and windstorm, have experienced an increase in premium rates ranging from 7.5% to 20%, and in a number of cases loss history pushed rates significantly higher.

New Zealand

In New Zealand, we started to observe rate changes as early as last year following the first Christchurch earthquake. The second earthquake saw this trend continuing, with pricing increasing significantly and capacity not been readily available. For New Zealand risks in particular in the Canterbury region, insurers have taken a position where they are offering terms loading premium by between 0.25% and 0.30% rate on base rate. In addition to the upwards movement of premium rates, we have also seen a push for coverage restrictions across the market as insurers attempt to reduce their exposures to national catastrophe perils. Some of the impacts for New Zealand risks are:

- *Deductibles for natural catastrophe damage increasing to 5% of insured values for most regions;*
- *Significant demand for detailed natural hazard underwriting information in respect of locations to be insured;*
- *Some insurers are imposing a lower and more restrictive limit in respect of damage following a natural catastrophe.*

What this means for AHF

For the 2011-2012 renewal, it was inevitable we were going to see a tightening of the renewal premium and insurers imposing restrictions on Abacus program, due to assets being located in a diverse range of catastrophe areas (floods, cyclones and earthquake).

In February 2012 Marsh Pty Ltd provided the following update to AFML:

*Insurers are very reluctant to take on any **new** business in the Christchurch/Canterbury region but with some exceptions (such as Abacus experienced in September 2011 with Allianz) are sticking by existing clients.*

Regarding Far North Queensland (FNQ) insurers are continuing to look very closely at their portfolios aggregate exposure to catastrophe perils. Premium rates for such risks are increasing at a quicker pace than for other risk types, insurer capacity is reducing, and windstorm deductibles are increasing on these placements. Were an insurer or insurers to now withdraw from writing FNQ risks, this would exacerbate upward pressure on price from those insurers remaining in the market.

It is too early to predict what the outcome will be for Abacus at the September 2012 renewal. However based on our analysis of current market conditions, and absent a market changing catastrophe event globally or in either New Zealand or Australia between now and September, we expect that insurance will continue to be commercially available for Abacus's hotel assets and other assets for the 2012 -2013 period.

4. Exit Recommendation

There is no guarantee that insurance cover will be available in the future for the current designated catastrophe peril areas of Christchurch New Zealand and far north Queensland, particularly if there is another significant catastrophe event in those areas. Nearly 50% of the Fund's assets are in these high insurance risk designated areas. Critically, bank funding is reliant on adequate insurance cover. Compounding these risks is the fact that capital markets are constrained.

AFML's view is that the current insurance and consequential banking risks of the Fund are not compatible with the risk profile of the investors in the Fund. If insurance is not available for any of the hotels, replacement funding for the bank borrowings will need to be sourced. To obtain this replacement funding on reasonable terms without significantly adversely impacting securityholders will be very difficult given the current state of equity and debt markets. Further the asset risk would be extremely high if insurance were no longer available.

Accordingly AFML recommends a strategy which:

- provides strategic flexibility so that AFML can attempt to balance risk and potential capital upside while seeking to mitigate capital risk for AHF securityholders;
- reduces debt as a priority in order to mitigate the insurance and banking risks;
- recognises the volatility of this asset class; and
- acknowledges that regional markets are weak at the moment, but that there is potential upside due to limited supply of new hotels, vacant possession of the hotels will be available by 2016, the AUD may weaken and the economy should eventually improve.

A prudent managed asset sell down over time (the **Managed Asset Sale Strategy)** is the recommended strategy. It will mitigate insurance cover availability risks and consequential bank funding risks. This strategy could take some years to implement fully.

The strategy is consistent with AFML's responsibility to sell assets out of the Fund if AFML believes that is in the best interests of securityholders, as stated in the March 2008 prospectus and product disclosure statement for the Fund.

Initial asset sales proceeds will be applied to reduce bank debt and other senior debt described in more detail in Section 5(a) - Strategy 1 below. During this sales process the Abacus Working Capital Facility (*AWCF*) funding currently around $90 m[1] will be treated proportionately with equity. This means the AWCF will not be repaid before securityholder equity, consistent with its treatment under a fund wind up situation. (Abacus Property Group has also provided a separate $10m loan facility which will be repaid in accordance with its terms.) Any distributions of surplus capital to securityholders during this sales process will depend on lender approvals and the risk profile of the Fund at the relevant time.

[1] As at 31 December 2011.

The Managed Asset Sales Strategy is not a fire sale approach as there is no need for that. The Fund has banking arrangements in place through to June 2014 and insurance is in place for all the Fund's assets subject to annual renewal in September each year. Bank debt covenants are currently being complied with.

The recommended Managed Asset Sales Strategy is subject to better alternatives becoming available. AFML will pursue such opportunities if they arise.

5. Possible Exit Strategies

As outlined in the 2008 PDS the main exit strategies are:

- asset sales;
- continue on as an unlisted entity with a further review in approximately 5 years;
- merge the Fund with another entity; and
- listing.

AFML has examined each of these alternatives and a summary of these findings is outlined below.

(a) Strategy 1 – Sale of assets

As noted in Section 3 above this is not a proposal for an immediate sale of all the assets. The recommendation is for a Managed Asset Sale Strategy over time and this could take some years to fully implement. This strategy gives AFML the flexibility to address the current risk profile of the Fund being primarily the insurance and consequential banking risks. Initial sales proceeds will be applied to reduce bank and other senior debt which will address these risks. The AWCF will be treated as notional equity during this sales process which means that it will not be repaid ahead of securityholder equity. (The Abacus Property Group $10m facility will be repaid before unitholder equity in accordance with the terms of that facility.)

Over recent years AFML has continued to canvass the market for purchasers of the Fund's assets on both an individual and a portfolio basis. The aim has been to reduce Fund gearing due to banking pressures as a consequence of the Global Financial Crisis, while preserving investor capital. This process has resulted in the sale of hotels in Gladstone, Townsville and the Swissotel Sydney over recent years at around their original purchase price. Fund debt was reduced accordingly.

The possibility of a portfolio sale to a hotel operator or wholesale investor is less likely as the experience to date indicates that these investors do not want to co-invest with retail investors and want direct investment. Accordingly the only way to achieve a portfolio sale outcome would be by way of substantial discounting and consequential dilution for existing securityholders.

In essence the proposed Managed Asset Sale Strategy is a continuation of what has been implemented over recent years, being prudent asset sales to mitigate the relevant risk.

Indeed, AFML is currently actively seeking to sell some properties to mitigate against the risk of insurance not being available and the banking consequences if that were to eventuate.

(b) Strategy 2 - Remain unlisted for around 5 years

This strategy approximates the time frame when vacant possession of three of the hotels is available combined with the end of the term of the AWCF. The Fund's hotels are highly leveraged to increases in occupancy and room rates as well as vacant possession so that asset values can increase significantly if trading conditions improve combined with a premium for vacant possession via a reduction in the asset capitalisation rate. On this basis this strategy would theoretically result in higher net asset values than the other exit scenarios discussed in this explanatory memorandum and the analysis below highlights this.

It is extremely hard to forecast values for these properties given the volatility of this asset class and the uncertain outlook. As a guide sensitivity analysis suggests that by 30 June 2016 the following capital returns may eventuate under the following different scenarios:

- Assuming EBITDA growth rates of 4.4% pa[2] and the current portfolio cap rate of 8.95% is maintained the Fund could make a nominal return of $0.88 per security which equates to $0.51 per security in today's dollars applying a discount rate of 13%.
- A nominal return of $1.73 per security, which in discounted terms equates to $1.00 per security applying a 13% discount rate , may be returned if:
  - EBITDA growth rates average 4.4% pa and if the portfolio cap rate reduces by 340 bps from 8.95% to 5.55%; or
  - EBITDA growth rates approximately doubles to around 9% pa average and the portfolio cap rate reduces by 225 bps from 8.95% to 6.7%.
- Alternatively a nominal return of $1.26 per security may occur which in discounted terms equates to $0.73 per security applying a discount rate of 13% if EBITDA growth rates average 6% pa and the portfolio cap rate reduces by 145 bps from 8.95% to 7.5%.

These scenarios are not forecasts. AFML believes they are unlikely to eventuate.

The above analysis assumes:

- the current annual distribution rate of approximately 4.5% per annum (escalated by 4% per annum) is maintained; and
- that the capital structure remains unchanged (that is, no further equity is raised and that debt funding does not have to be reduced).

The above analysis shows that asset values for the Fund's hotel assets should increase if trading conditions improve and there is a reduction in the portfolio capitalisation rate. There are many permutations to the above sensitivity analysis. Critically, this strategy relies on a renewal of the bank debt after June 2014, no natural disasters affecting any of the hotels, continued insurance availability and at manageable cost, and investor capital being tied up for up to a further five years.

(c) Strategy 3: Merger with another fund

AHF could theoretically merge with another fund to increase Fund size and achieve economies of scale. It is unlikely that a merger partner would value the securities at any more than the current net asset value and in this environment it is more likely that a potential partner would require a discount to net asset value. There are limited merger partners in the market place and recent experience in sourcing partners has proven unsuccessful. If a merger were possible it would be most likely be substantially dilutionary to existing securityholders.

(d) Strategy 4: Listing

Given the state of the equity markets, the substantial trading discount of Australian real estate investment trusts to net tangible asset backing, the small size of the Fund's hotel portfolio and the anticipated debt reduction required for a listing, AFML's view is that this is not a feasible strategy in the current environment and, if it were possible, it would be highly dilutionary to existing investors.

AFML also considered the possibility of increasing the size of the Fund through further acquisitions. However sourcing an adequate quantum of capital and without adversely and significantly impacting securityholders is very challenging in the current environment. As noted previously equity and debt markets are constrained and third party investors interested in hospitality assets prefer to invest directly rather than via a fund structure with retail investors. This strategy is consequently not considered viable.

[2] Based on the most recent independent valuation forecasts.

6. Fund Status

Since the Fund was first launched it has been adversely impacted by the:

- Global Financial Crisis;
- European debt crisis;
- high Australian dollar;
- tightening lending criteria and limited bank appetite for hotel funding;
- February 2011 earthquake in Christchurch New Zealand which damaged the Chateau on the Park hotel and the subsequent aftershocks which caused some further damage to the hotel in December 2011 and January 2012. The hotel is currently undergoing repairs, funded by insurance, which are expected to be completed later this year. The hotel remains operational with insurance covering loss of trading earnings;
- natural disasters of Cyclone Yasi and the floods in north Queensland in 2011 which caused some minor damage to the two Cairns hotels. All repairs have been completed; and
- tightening insurance markets.

Since launching the Fund, the asset capitalisation rates have increased and as a consequence the net tangible asset value per security has reduced from the original $1.00/$1.03 entry price to approximately $0.56 as at 31 December 2011.

Hotel Profile

Hotel	**Location**	**Value as at 31 December 2011**	**Cap Rate**	**Operator**
Twin Waters	Sunshine Coast QLD	AUD 66.7m	8.75% (Nov 2011 independent valuation – CBRE)	Accor - vacant possession June 2016
Tradewinds	Cairns QLD	AUD 26.5m	9.25% (Nov 2011 independent valuation – CBRE)	Rydges - vacant possession March 2016
Esplanade	Cairns QLD	AUD 28.4m	9.50% (Jun 2011 independent valuation – CBRE)	Rydges - vacant possession Jan 2015
Diplomat	Canberra ACT	AUD 13.25m	9.50% (Dec 2011 independent valuation - Colliers)	Lease until August 2013
Chateau on the Park	Christchurch, New Zealand	NZD 28.026 m (AUD 21.3m)	8.25% (Dec 2010 independent valuation - Colliers)[3]	Owner operated
Total		**AUD $156.2m**	**WACR 8.95%**	

Cash Flow/Earnings

The Fund is servicing all bank debt interest with actual interest cover ratio at 2.70x (based on current interest rates) compared to the covenant requirement of 1.5x.

Since 1 January 2011 securityholder distributions have been based on the estimated free cash flow of the Fund, equivalent to 4.5% on an annualised basis.

[3] A recent valuation by CBRE in February 2012 has been undertaken with a value of NZ$38.5m.

Given the issues facing the Fund it is not clear at this point if distributions will continue to be maintained in the future. Based on the draft budgets for the 2013 financial year and the subdued conditions in regional hotel markets it is likely that the distribution rate will be reduced to 3.5% pa effective from the August 2013 payment.

Bank Debt Profile

As at 31 December 2011 the Fund had an actual loan to valuation ratio of 44% against a covenant requirement of 55% with maximum draw to 45% until the Christchurch hotel is repaired and the Fund demonstrates specified trading levels. Once these trading levels are achieved the LVR can be increased to 50% with a 55% LVR covenant. Bank debt is currently drawn to c$69m (facility limit c$78m).

The banks have limited appetite for hotel funding in the current environment. Given raising non bank debt capital for the Fund in this market is extremely difficult, Abacus Property Group provided funding in late 2011 of approximately $7m through the Abacus Property Group $10m facility to reduce the loan to valuation ratio to below the required 45% level. This funding from Abacus Property Group may not be available in the future.

Abacus Working Capital Facility

The repayment of this facility is at the termination date of the Fund which is March 2016 unless the Fund is wound up earlier. The recommended Managed Asset Sale Strategy will for the purposes of the AWCF be regarded as a Fund wind up and, as such, the AWCF will be subordinated to creditors of the Fund and rank proportionately with securityholder equity on any return of capital.

Fixed Interest Rate Swaps

As a consequence of the sales of three hotels over recent years, the Fund is over-hedged. This means that the Fund is paying bank interest at effectively higher rates from July 2012 because fixed interest rate positions were entered into in prior years when interest rates were expected to be higher than they are today, and when the quantum of bank debt was expected to be higher.

AFML is actively investigating cost-effective strategies to reduce this position.

Abacus Property Group Support

In addition to the funding noted above Abacus Property Group forgave $11m of the AWCF in 2011. There is no obligation for Abacus Property Group to provide additional funding support if required in the future.

7. Hotel Market Update

Recent market commentary indicates that in respect of the Australian hotel sector:

- there exists a dichotomy between CBD and regional markets with strong RevPAR and value growth in CBD markets and continuing weakness in regional markets;
- new hotel development is expected to remain subdued despite limited supply due to the large gap between valuation and construction and funding costs;
- the high Australian dollar and current global economic environment will continue to adversely impact tourism in Australia particularly in the regional markets; and
- vacant possession premiums are supported by market evidence.

8. Conclusions and Recommendation

During the 2011 calendar year the Fund experienced a changed risk profile resulting from the hardening insurance market and the designation of three of the Fund's hotels in catastrophe peril areas by insurers. Not only have premiums and excesses increased but the availability of insurance has become an issue due to the natural disasters in Christchurch New Zealand and far north Queensland. Bank funding is dependent on appropriate insurance being in place. Given these risks a debt reduction program is a priority. The recommended Managed Asset Sale Strategy will give AFML flexibility to balance risk and potential future upside and is in effect a continuation of the recent strategy of debt reduction by way of prudent asset sales. Accordingly AFML recommends that securityholders approve the Managed Asset Sale Strategy.