

Premium Income Fund

Investor Update: 31 December 2009



Issue 3, 2009

Welcome to the Investor Update for the Premium Income Fund. This update outlines key details about the Fund's activities for the period September 2009 to December 2009.

2009 was a challenging year. The Fund has experienced difficulties in finalising transactions at market value for the 11 security properties which were prepared for sale and taken to market during the year due to difficult market conditions.

My team was pleased to complete negotiations with Harbour Street Development Pty Ltd in relation to the Wollongong property. The sale of this property represents a very positive outcome for the Fund. Cash will be available to the Fund following completion of building works and sale of the 75 apartments, which is expected to occur during 2010.

It is anticipated that the net proceeds from the sale of the apartments will enable a cash payment to be made to Unitholders of the Premium Income Fund during 2010.

My team continues to focus on finding ways to maximise the value of the underlying assets of the Fund for the benefit of all Unitholders.

Kind regards

Jenny Hutson
Managing Director
Wellington Capital Limited

Investor Updates are mailed to Unitholders for the periods ending April, August and December, and include a restatement of information released to the market by way of NSX releases made in the period to assist the Fund's many Unitholders who do not have internet or email access.

Key events – September to December 2009:

- Construction at Wollongong development recommenced in late November. 55 out of 75 apartments have been presold and are scheduled to settle in 2010 on completion of this part of the project.
- Construction at Port Macquarie development is practically complete and is expected to gain its certificate of occupancy during February 2010. A marketing campaign for the 26 apartments has commenced.
- One out of four properties in possession at Townsville has been sold for 30% more than the amount offered in mid 2009.
- ASIC commenced legal proceedings against former directors and officers of MFS Limited and MFS Investment Management Limited and the companies themselves in relation to the finance facility drawdown of the Premium Income Fund.

Housing Market Commentary

Following substantial decreases in the second half of 2008, property prices recovered over the first half of 2009. High interest rates had initially created a sharp decline in turnover, and the Reserve Bank of Australia (RBA) sought to dampen inflationary pressures emerging from strong economic growth. The Global Financial Crisis led to a sharp and rapid shift in economic conditions, with interest rates cut heavily in response. The 425 basis point reduction in the cash rate by the RBA (and 380 basis point decline in the standard variable rate) between September 2008 and April 2009 alleviated the pressure on many households, while also bringing housing affordability back to its most attractive level for almost a decade across most state capitals.

Improved affordability and the introduction of the Federal Government's First Home Owner's Grant Boost Scheme (FHOGBS) in October 2008 (as well as various other State Government incentives) has driven a surge in first home buyer demand at the more affordable end of the market. This has had the effect of stabilising the falls in house prices that were coming through in the second half of 2008. The FHOGBS provided the impetus for movement of renters to owner occupation, and this is likely to continue after the incentive has expired, albeit at a more moderate rate.

The lead times in ramping up construction means that new dwelling activity will be below underlying demand in the short term, particularly in the apartment sector, where the tight credit environment has meant that developers have found it difficult to obtain finance to proceed—even in projects that would otherwise be financially viable. The shortfall in supply will continue to underpin tight vacancy rates and further rental growth, which should ensure that the owner occupation versus rent equation continues to remain attractive in the current low interest rate environment.

The surge in first home buyer demand is now slowly permeating through to greater demand from upgraders who are trading over to their next dwelling after selling to the buoyant first home buyer market. In addition, the strong rental environment and stabilisation of prices is also beginning to attract investors back into the market. Activity from these two groups should continue to gather momentum through the remainder of 2009, being the main driver of demand from the start of 2010 and offsetting some of the decline in first home buyer demand after the FHOGBS expires. Nevertheless, the weakened economic environment is expected to continue to dampen price growth in 2009/10, as further negative influences on the national economy maintain concerns about the employment outlook.

In addition, household income overall is being undermined by the reduction in working hours, even though the peak unemployment rate may not now reach the levels initially feared at the start of the year. Price growth is consequently forecast to be limited in 2009/10, before accelerating into 2010/11 and 2011/12 as economic growth begins to gather momentum. Price growth will be driven by low interest rates.

After raising the cash rate by 25 basis points in each of October, November and December 2009, the RBA is expected to pause



before lifting rates again in the second half of 2010. With few positive influences on economic growth expected in 2009/10, it is anticipated that the RBA will be keen to encourage an upturn in residential construction to help drive the economy. Stronger rate rises are expected in 2010/11 and in 2011/12, as the RBA restores the cash rate from the current highly stimulatory level to a more neutral setting. Price growth is forecast to ultimately slow from 2012/13, as further rises to interest rates, in response to lower unemployment and emerging inflationary pressures, begin to impact on affordability and demand.

Australian Housing Outlook, Bis Shrapnel 2009

Cash Payments

The Board is very conscious of, and concerned about, the economic hardship that the Fund's current position is causing for Unitholders.

The Fund's next priority is to return a 3 cent payment to Unitholders. It is anticipated that this payment will be made during 2010 after the sale of the apartments in the Wollongong project. After that payment is made, the Fund will focus on the rebuilding of unit value. This will be achieved through a combination of further development of selected existing assets, selected realisations and with measured new investments aimed at rebalancing the asset class allocations of the Fund.

It remains unlikely that the Fund will be able to return to a situation where regular distributions are a feature of the Fund.

Management Fees

No management fees have been paid to or accrued by Wellington Capital Limited as responsible entity of the Premium Income Fund.

An undertaking was provided to the Supreme Court of Queensland and the Australian Securities and Investments Commission in September 2008 that the responsible entity will only charge a management fee of 0.7% per annum on funds under management after Unitholders are in receipt of the cash payments totalling 3 cents per unit.

31 December 2009 Financial Report (half-yearly report)

The Fund's 31 December 2009 Financial Report (half-yearly report) is due to be released to the market by mid March 2010. A copy of the report will be released to the National Stock Exchange and will be available on the Fund's website.

Unitholders who do not have internet access and wish to receive a hard copy should contact the Wellington Hotline to arrange for a printed copy to be mailed.

Fund Portfolio

Strategy maintained

The recovery strategy for the Fund continues to be implemented in accordance with that outlined in the previous update.

Following this strategy, Wellington has secured strong operational deals on the properties in possession at Wollongong and Port Macquarie, which has enabled construction to recommence on both projects.

Asset realisations

As previously advised, the 2009 portfolio sale campaign did not yield a tremendous result in the short term. Three out of thirteen (eleven in one campaign and two individually) marketed properties were sold and settled during 2009.

These sales were significant in that the net return to the Fund allowed the Fund to implement its strategy to secure strong operational deals which will maximise the longer term value of other parts of the Fund's portfolio.

Wollongong

Wellington Capital Limited as responsible entity for the Premium Income Fund in its capacity as mortgagee in possession of 60 – 62 Harbour Street, Wollongong has sold the partially complete asset, hotel and apartment complex to Harbour Street Development Pty Ltd for \$38 million (plus GST).

This sale will see the Premium Income Fund realise its carrying value for the asset over time. Cash will be available to the Fund following completion of building works and sale of the 75 apartments which form part of the project. Completion of building works and completion of sales are expected to occur during 2010.

Jenny Hutson, Managing Director of Wellington Capital said 'Our team has been in negotiations with various parties in relation to this asset all year. This property was taken to auction in May 2009 and there was significant interest in the project from a range of parties. The sale to Harbour Street Development Pty Ltd represents a very positive outcome for the Premium Income Fund.'

It is anticipated that the net proceeds from the sale of the apartments will enable a cash payment to be made to Unitholders of the Premium Income Fund during 2010.

The partially complete complex is well progressed. Sales of the apartments are being conducted through local Wollongong agents.





Port Macquarie

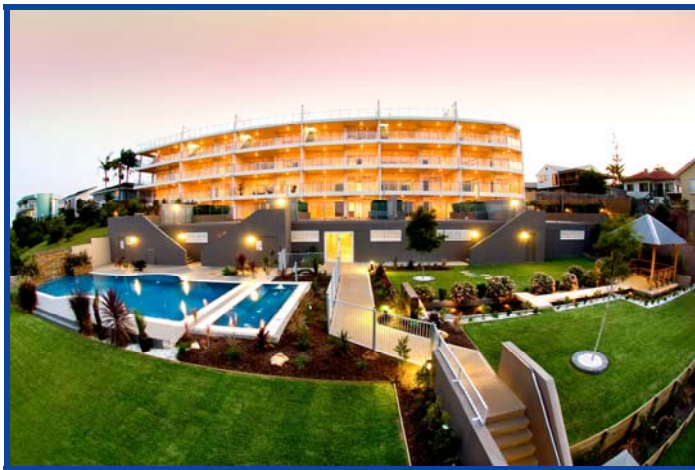
The Fund's previous update advised that a builder and developer has partnered with the Fund to complete and sell this asset.

The building is now practically complete and it is expected to gain certificate of occupancy during February 2010.

A sales process has been conducted via three prominent agents and interest has been strong in this quality product.



Port Macquarie | August 2009



Port Macquarie | December 2009

Octaviar Update

Public Trustee of Queensland – Application against Administrators of Octaviar Limited (In Administration) and Octaviar Administration Pty Ltd (In Administration) Supreme Court of Queensland

On 9 September 2009, the Supreme Court of Queensland ordered:

- ✿ the removal of John Greig and Nicholas Harwood as Provisional Liquidators of Octaviar Administration Pty Ltd and Administrators of Octaviar Limited;
- ✿ Octaviar Administration Pty Ltd and Octaviar Limited each be wound up; and
- ✿ Kate Barnet and William Fletcher of Bentleys Corporate Recovery be appointed as Liquidator of each of Octaviar Administration Pty Ltd and Octaviar Limited.

The Premium Income Fund remains an unsecured creditor of each of Octaviar Limited and Octaviar Administration Pty Ltd.

Public examinations of the officers of Octaviar Limited (In Liquidation) and Octaviar Administration Pty Ltd (In Liquidation) are due to be undertaken by the Liquidators in early 2010.

Litigation Update

Australian Securities and Investments Commission (ASIC) v King & Ors – Supreme Court Proceedings 12122 of 2009

Management Investments Limited, the former responsible entity of the Premium Income Fund has been served with proceedings instituted by the Australian Securities and Investment Commission (ASIC) seeking declarations against:

- ✿ Michael King
- ✿ Craig White
- ✿ Guy Hutchings
- ✿ David Anderson
- ✿ Marilyn Watts
- ✿ Octaviar Administration Pty Ltd (In Liquidation);
- ✿ Octaviar Castle Pty Ltd; and
- ✿ Management Investments Limited as former responsible entity of the Premium Income Fund (formerly known as MFS Investment Management Limited), in relation to the draw down of the Premium Income Fund's finance facility in November 2007 and December 2007.

The proceedings seek declarations of contraventions, pecuniary penalties, compensation and disqualifications from managing corporations pursuant to the *Corporations Act 2001* (Cth).

The proceedings allege that:

- ✿ in November 2007, officers of the former responsible entity caused the Premium Income Fund to transfer \$130 million to MFS Administration Pty Ltd so that MFS Administration could use those funds to pay financial obligations of other MFS Ltd subsidiaries, including \$103 million owed to Fortress Credit Corporation (Australia) Pty Ltd by MFS Castle Pty Ltd;
- ✿ in December 2007, officers of the former responsible entity caused the Premium Income Fund to transfer \$17.5 million to MFS Pacific Finance Ltd, a New Zealand registered company (now known as OPI Pacific Finance Ltd (Receivers and Managers Appointed)); and
- ✿ that in about January 2008, officers of the former responsible entity and the fund manager created and used false documents relating to the use of the \$147.5 million.

As a result of the funds being transferred, the proceedings allege that the Premium Income Fund suffered a loss of \$147.5 million.

ASIC has made a market release setting out the declarations sought against each Respondent in the proceeding. This market release is available from the Fund's website or ASIC's website.

A directions hearing of the Application was heard on 7 December 2009 before Justice Ann Lyons in the Supreme Court of Queensland. Orders as to the orderly conduct of the proceedings were made, including that a defence be filed by the First Respondent, Management Investments Limited being the former responsible entity of the Premium Income Fund, by 30 April 2010.

Further announcements will be made as the proceedings progress.



Class Action – Mercedes Holdings Pty Ltd & Ors v KPMG & Ors – Federal Court Proceedings NSD324 of 2009

On 26 June 2009, Wellington Capital Limited as responsible entity of the Premium Income Fund advised the market that following negotiations with the Applicants' legal representative these proceedings have by mutual agreement been discontinued against the former responsible entity of the Premium Income Fund with no order as to costs.

A copy of the agreement is available from the Fund's website, or on request from the Wellington Hotline.

The former responsible entity has not been discontinued as a Respondent in the proceedings.

A Notice of Motion was filed by the former responsible entity in accordance with the Court timetable which was set out by Justice Perram in the Federal Court in Sydney on 30 October 2009. The Notice of Motion seeks to have the former responsible entity (currently the Third Respondent) discontinued as a party to the class action.

The Notice of Motion to have the former responsible entity discontinued as a party to the class action was due to be heard from 16 December 2009.

The Court was unable to deal with the Notice of Motion filed by the former responsible entity seeking to have the former responsible entity (currently the Third Respondent) discontinued as a party to the class action due to timing restrictions.

As the Federal Court year ended on 18 December 2009, the Notice of Motion has been set down to be heard on 18 February 2010.

Further updates will be provided as the matter progresses.

Bond Street Custodians – Federal Court Proceedings

Bond Street Custodians Limited filed a claim against Wellington Investment Management Limited as responsible entity of the Wholesale Premium Income Fund on 16 October 2008 in relation to a redemption request for 16.254 million units in the Wholesale Premium Income Fund which was lodged on 21 January 2008, shortly prior to the suspension of redemptions.

A directions hearing of this matter took place on 8 December 2009 before Justice Perram in the Federal Court in Sydney.

The current hearing date for this matter has been vacated as a result of the Plaintiff, Bond Street Custodians Limited, seeking to file a notice of motion in relation to amendment and/or discovery against the Defendant, the former responsible entity of the Premium Income Fund.

Further directions in this matter will be heard on 10 February 2010.

Further updates will be provided as the matter progresses.

Investor Advisory Committee

Report of meeting of committee members

"The Investor Advisory Committee has met for its first meeting of members with the Fund's management team. It was noted that a large amount of correspondence from fellow Unitholders had been received by email and post, and that many Unitholders had expressed disappointment that they had not received prompt individual responses. This correspondence was tabled and discussed with the Fund's management team.

Much of the correspondence received by the Investor Advisory Committee seeks information that is not publicly available. Whilst the committee is able to meet with the Fund's management team, they are unable to provide us with information that is not available to all Unitholders.

Of particular interest was the ASIC proceedings which were commenced in November 2009. As a committee we will be watching those proceedings with interest, as we are sure all Unitholders will be. We have been advised that the statement of claim sets out in clear detail the events that ASIC claim to have happened around the draw down of the Royal Bank of Scotland loan in November 2007.

On a more positive note, the Wollongong project appears to be progressing well, and the Fund's management team explained to us that completion and sale of the apartments in this complex would allow the promised 3 cent cash payment to be made to Unitholders – a payment which we are sure will be welcomed.

We will continue to table your correspondence at our meetings with the Fund's management team and report back to you in the investor updates."

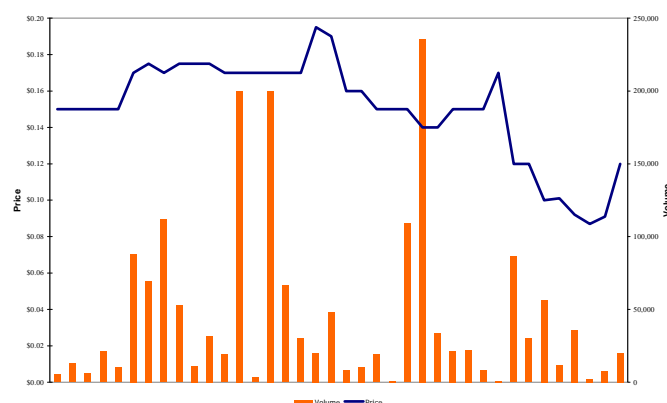
National Stock Exchange Update

Trading in the Premium Income Fund (NSX: PIN) commenced on 16 October 2008.

A summary of trading activity from 1 September 2009 to 31 December 2009 is set out below:

High	Low	Volume (01/09/2009 – 31/12/2009)
19.5 cents	10 cents	1,727,600

Trading summary (NSX:PIN) 1 September 2009 to 31 December 2009



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Premium Income Fund

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