

As required by the ASIC benchmark on liquidity, in estimating cash flows, the Manager can take into account a reasonable estimate of investor inflows and outflows based on previous experience. Withdrawals are considered with reference to the period within which investors would reasonably expect withdrawal requests to be processed, rather than the maximum period within which the Manager is able to process withdrawal requests. In order to protect all investments, the Manager has suspended withdrawals, with the exception of those approved under hardship provisions and feeder fund payments for distributions and expenses as the cashflow allows.

Lending Policies and Procedures of the Fund

Credit Committee

The Credit Committee is integral to the compliance and risk management processes utilised by the Manager with respect to the selection of registered first mortgage assets for the Fund. The Credit Committee is an internal review committee for all mortgage investments and is independent from all other departments. The Credit Committee calls for collaboration of a broad base of expertise from the property, finance, legal and accounting sectors when evaluating mortgage assets for the Fund. The formal structure and collaborative decision making process provided by the Credit Committee ensures an informed assessment and objective decision is made when selecting the first mortgage assets of the Fund.

New mortgage investment proposals are put forward by the commercial lending department for consideration with a written summary. The Credit Committee is responsible for setting the primary terms and conditions upon which subsequent approval will be based.

When mortgage investment proposals are completed in accordance with the Manager's credit standards they are required to be finally approved by the Credit Committee.

Lending Criteria of the Fund

- ▶ The Manager has determined and documented lending policies for the approval and management of mortgages. Risk management is a priority, with mortgages diversified over a number of levels including geographic location, sector, loan size, interest rate and maturity profile.
- ▶ One of the tools the Manager employs to enhance income into the Fund is to balance the assets of the mortgage portfolio between commercial loans and selective development loans.
- ▶ The type of real estate offered for security must be acceptable to the Manager. Typical mortgage securities will include commercial, industrial and residential real estate (including development loans across these sectors) secured by a registered first mortgage. A first mortgage must be registered on the primary security property. However, from time to time the Manager may subordinate the priority of a first mortgage as part of a structured exit strategy for a loan.
- ▶ The value of the security property must be established in accordance with the valuations policy of the Manager.
- ▶ The ability of the borrower to service the facility must be established to the satisfaction of the Manager.
- ▶ To the extent that they may affect the value or performance of an underlying investment the Manager may take into account labour standards, or environmental, social or ethical considerations when making, retaining or realising an investment in the Fund. The Manager has no predetermined view about how far such matters will be taken into account, and the Manager will make a determination on such issues on a case by case basis.

Lending Policies and Procedures

The Manager will be selective in its choice of mortgages and will adhere to prudent lending parameters. The Fund will follow strict lending policies and procedures as detailed below:-

- ▶ Assessment of the borrower - the Manager endeavours to meet every borrower to assess character and business acumen;
- ▶ The maximum loan amount for any one borrower generally does not exceed 10% of the scheme assets;
- ▶ All mortgages are subject to the Manager's rigorous due diligence process including approval by the Manager's Credit Committee;
- ▶ The due diligence process includes assessment of the financial capacity of the borrower and any guarantors. The assessment is carried out by review and substantiation of assets, liabilities and income by reference to information provided by the borrower and independent searches and checks;
- ▶ A first mortgage is always registered on property held as the primary security, however, from time to time the Manager may subordinate the priority of a first mortgage as part of a structured exit strategy for a loan;
- ▶ Commercial loans are loans secured by income producing property. Non-commercial loans (not secured by income producing property) include construction/development loans and pre-development land. The capacity to service commercial loans is assessed primarily by reference to income produced from the security property, however income from all sources is also considered. The capacity to service construction loans is primarily dependent on the viability of the project, the project cash flow (including interest commitments) and all factors relevant to the project including valuation of the completed product, product demand, pre-sales contracts, marketing strategies, certified project costings, credentials of the borrower, builder and key sub-contractors;
- ▶ The Manager has every security property valued by one of the Manager's panel valuers or by a valuer meeting the Manager's standards for inclusion on its panel and adhering to the Manager's valuation policies. Further details in relation to the Manager's valuation policies are outlined below under the heading "Valuation Policies";
- ▶ The Manager has a policy of diversifying mortgage securities geographically and by property type;
- ▶ The Manager has a policy of generally not exceeding the following loan to valuation ratios:-
 - 66.67% for construction and development loans; and
 - 75% for commercial loans;

However, it is the Manager's current practice to exceed those ratios wherever necessary in the process of working through a repayment solution.

The Credit Committee will consider the appropriate loan to valuation ratio based on all the factors surrounding the loan;

- ▶ The constitution of the Fund allows the Manager to lend funds provided that all mortgages are secured over property and the amount which may be advanced to a borrower does not exceed an LVR of 75% of the value of the security property on initial settlement. After a loan has settled and where the Manager considers it is in the best interests of the members of the Fund, the Manager may approve an LVR not to exceed 85% of the value of the security property. The LVR of a loan that is in default may exceed 85%. This could occur for example, where interest is being capitalised while the security property is being marketed and sold, or where the Manager determines that expenditure should be incurred to improve the security property prior to sale (the Manager considers a loan to be in default when interest payments have not been received in breach of the loan agreement, or the loan term has expired without repayment of principal);
- ▶ The following additional requirements are imposed in the case of development loans:-
 - For development/construction loans the initial drawdown for the facility is arrived at after considering both the approved loan to valuation ratio on the "as is" valuation and the "cost to complete" formula. The initial drawdown must meet the loan to valuation ratio required and also allow sufficient funds to be available in the facility to complete the development. The project feasibility must reflect the "cost to complete" formula throughout the life of the project. The concept of a "cost to complete" formula is that the lender always retains sufficient funds within the loan facility to complete the development based on its assessment of the actual cost to complete the project. The Manager engages an external consultant Quantity Surveyor for each project and receives periodic reports on the progress of the project including certification of construction claims based on work completed;
 - Additional development loan procedures are required throughout the development stages of the loan to ensure the development is adequately monitored;
 - Where applicable a tripartite agreement is made between the Manager, the borrower and the builder. This enables the Manager, in the event of default by the borrower, to deal directly with the builder.

Valuation Policies

All real property assets of the Fund are required to be valued prior to settlement of each transaction. Valuations may only be carried out by the Manager's panel valuers or by a valuer meeting the Manager's standards for inclusion on its panel and must adhere to the Manager's valuation guidelines. The Manager has determined and documented valuation review procedures for guidance on each valuation.

Members of the valuation panel are appointed and removed in accordance with the Manager's valuation panel appointment guidelines. The Manager is responsible for approving the appointment or removal of a panel valuer.

The Manager, in accordance with its valuations review guidelines is responsible for the review of all valuations. Unresolved issues arising from a review must be referred to an executive director for discussion and determination.

As an internal checking mechanism, an independent property report is obtained (where appropriate) from two real estate agents or an alternate valuers report whose normal trade area encompasses the property being valued.

Valuers selected by the Manager to perform relevant valuations on the security property are chosen based on independence, specialist industry expertise and geographic location.

The Manager only uses valuers who, where possible, are registered under one of the state/territory valuer registration regimes and who include a statement in their valuation reports on whether the valuation complies with all relevant industry standards and codes.

The Manager does not accept valuations performed on the instruction of borrowers. The Manager requires that valuations be provided on the Manager's instructions, or that valuers confirm that their valuations adhere to the Manager's requirements.

The valuer must have appropriate professional indemnity insurance.

The valuer must certify that they are independent of both the borrower and security property.

At initial settlement, the valuation relied on must not be dated more than 3 months prior to settlement.

An updated valuation will generally be required for commercial loans at 24 month intervals and construction loans at 12 months intervals. An updated valuation may also be required where a loan term is extended or a loan is otherwise varied. The requirement for an updated valuation may be waived where the Manager considers that an updated valuation would serve no useful purpose (e.g. where it is demonstrable that property values have increased or not changed in the locality of the property, where a property under construction is significantly presold, where a commercial property has long term leases in place, where a sale or refinance is imminent, where the loan to valuation ratio of the property is low or where the Manager does not consider that any purpose would be served by obtaining a valuation at the relevant time).

Development Valuations

Separate valuations (may be within the one valuation report) are required in relation to "as is" and "on completion" valuations.

Appropriate instructions must be given to the valuer having regard to the type of valuation required. In particular the instructions indicate the type of valuation required eg. "as is" or "on completion".

"As is" Valuation

The "as is" valuation is the market valuation of the property at the time of the initial drawdown. A "feasibility analysis" is undertaken including demolition, subdivision, construction, and other development costs, allowances for sales and marketing expenses, interest and an allowance for profit and risk to arrive at a base value for the land. Any such analysis is based on the premise that the development approval has or will be obtained prior to settlement of the loan. Alternatively, the valuation must contain an adjustment for any uncertainty attaching to the development approval process. The requirement for a feasibility analysis may be satisfied, if appropriate, using alternate techniques such as discounted cash flows. Additionally a cross check valuation method is employed evaluating comparable sales evidence. The loan to valuation ratio in this case must fall within the Manager's lending criteria.

"On Completion" Valuation

The "on completion" value is the market value of the property at the completion of development. The valuation methodology required is a "gross realisation" valuation based on comparable sales and/or lease evidence for the individual components e.g. houses, units, allotments etc.

The Manager will reasonably assess the appropriateness of the feasibility analysis within the valuer's report by comparison with cost estimates provided by a competent external quantity surveyor selected from the Manager's panel.

The "on completion" value is the valuation figure used in the cost to complete calculations during the development phase. The "on completion" value may be revised during the term of development to reflect changes as approved by the Manager.

Arrears Management

The Manager has documented arrears management processes which are implemented in the event that a mortgage loan goes into default. Arrears loans are managed by a team of experienced personnel. The documented processes include the following:

- ▶ Dishonoured payments or other defaults are referred to the Arrears Manager for actioning. The Arrears Manager immediately contacts the borrower to ascertain the circumstances of the default;
- ▶ If the default is short term, arrangements are made with the borrower to remedy the default;
- ▶ If the default is long term, a summary of the nature of the default is emailed to the Arrears Committee with recommendations;
- ▶ The Arrears Committee is comprised of the Executive Directors, the Portfolio Manager, the Risk Manager, the Arrears Manager and members of the Commercial Lending Department as appropriate;
- ▶ The Arrears Committee meets at least weekly. The Arrears Committee considers the recommendations for arrears loans and supervises the preparation of an arrears management plan for each arrears loan. Given the nature of loans within the loan portfolio, the Manager adopts a case by case approach to arrears management, reflected in the individual management plans for each arrears loan;
- ▶ Management plans are implemented by the Arrears Manager who maintains a separate arrears file for each arrears loan;
- ▶ Reports on arrears loans are prepared and presented at Arrears Committee meetings. Management plans are considered and updated as necessary;
- ▶ In the formulation of a management plan the Arrears Committee considers the following factors:-
 - Current value of the security property;
 - Whether an updated valuation ought to be obtained;
 - Current loan amount;
 - Current loan to valuation ratio;
 - A review of securities held;
 - A review of insurances held;
 - Issue of default notices;
 - For commercial loans:-
 - > tenancy status;
 - For construction loans:-
 - > status of construction;
 - > cost to complete;
 - > sales achieved;
 - > review of presales;
 - Current marketing and/or sales programs;
 - Credit assessment of the borrower and any guarantors;
 - Whether demands ought to be issued to any guarantors;
 - Any proposal by the borrower to remedy the default;
 - Status of any second or subsequent mortgages and status of priority arrangements;
 - Desirability of taking possession or appointing a receiver or agent for the mortgagee;
 - Compliance with statutory requirements (eg lodgement of notices, maintenance of controller accounts);
 - Any site-specific issues (eg planning, subdivision, contamination or heritage status);
 - Potential sales avenues;
 - Whether sales agent ought to be appointed/selection of agent;
- ▶ For all arrears loans, a detailed recoverability analysis is prepared and updated on a weekly basis as part of the arrears management plan;
- ▶ External consultants (valuers, lawyers, insolvency practitioners, sales consultants etc) are engaged where appropriate throughout the arrears management process;
- ▶ The Manager may from time to time foreclose on a security property as part of a realisation strategy. Foreclosure is a remedy available to a registered mortgagee by which the mortgagee becomes the absolute legal owner of the property free of any interest of the mortgagor. In the event of foreclosure, the Manager may hold, improve and/or sell the security property in order to achieve the best result for the Fund. The Manager may sell a property on which it has foreclosed to a related entity, in which case the sale price will be determined by valuation.

Arrears loans are managed in this way until the security is sold and/or all possible recovery action has been completed.

As a mechanism of capital recovery from time to time the Manager may subordinate the priority of a first mortgage as part of a structured exit strategy for a loan.

Related Parties

Broadly, the definition of "related party" includes a controlling entity, company or person of LM Investment Management Ltd ("LM"), a public company. This filters through all funds managed by LM, and any directors. This Fund has no loans to any LM directors. Investor disclosure guidelines are designed to ensure that investors are aware of any interaction with transactions between different funds or where a director or other related party, including another fund, derives a financial benefit.

As well as providing best practice disclosure of all related party transactions, the guidelines further ensure the Manager is accountable in terms of the management and monitoring of any related party transactions. It is especially important that where there is a related party somehow involved, that the transaction is evaluated from a due diligence and credit assessment process, as robustly as if it were not a related party transaction. Ongoing robust monitoring of these transactions must also be demonstrated.

The Fund may lend to related parties provided the loans are approved by the Credit Committee on commercial, arms-length terms. They must then be approved at full Board level, and are subject to review by the Board.

The Board is responsible for reviewing and approving the structure and probity of commercial dealings between the manager and any related parties and for ensuring any such transactions are approved only and after taking into consideration the Manager's Conflicts of Interests Policy. Fees issued to the account of the Fund by related parties, which are recoverable from the Fund, must be on commercial arms-length terms and are subject to review by the Board.

Following are the related party transactions within this Fund:-

- ▶ Since inception of LM Investment Management Ltd, LM Administration Pty Ltd has been engaged by LM Investment Management Ltd to provide administration services at a commercial fee. LM Administration Pty Ltd also provides administration and funds management services to the Fund and directly receives a management fee from the Fund for that service. LM Administration Pty Ltd also provides administration services at a commercial fee to Monaghan Lawyers, a law firm that provides legal services to the Fund. Peter Drake, a director of LM, is the beneficial owner of LM Administration Pty Ltd.
- ▶ John O'Sullivan, an executive director of the Manager is the beneficial owner of O'Sullivan Capital Management Ltd. O'Sullivan Capital Management Ltd has been engaged by LM Investment Management Ltd to provide marketing services in New Zealand at a commercial arms-length fee. This fee is paid by the Fund.
- ▶ The LM Managed Performance Fund, a related investment fund, has a debt owing to the Fund of \$30,336,607 at a rate of 7%pa, for the assignment of two (2) first registered mortgages. The debt is secured by a fixed and floating charge over the assets of the LM Managed Performance Fund. This loan constitutes 5.36% of the total loan portfolio.
- ▶ The LM Managed Performance Fund, a related investment fund, has guaranteed \$9,600,000 of a loan due by a Borrower to this Fund, in exchange for that Borrower making those funds available to the LM Managed Performance Fund and an associate of that fund. The interest rate on that loan is 7%pa and it equates to 1.70% of this fund's total loan portfolio.
- ▶ On 30 June 2008, the Manager assigned to the LM First Mortgage Income Fund, the rights and benefits of a debt due to the Manager from the LM Managed Performance Fund. The debt originally of \$5,100,000 is now reduced to \$1,829,700. The date for the repayment of that debt to the LM First Mortgage Income Fund has been extended to 30 June 2011. The current interest rate payable on this amount is 10%pa and the debt equates to 0.32% of the total loan portfolio.
- ▶ The Fund has made 3 loans to various related parties, which total \$19,616,038. The Manager has received establishment fees of not more than 1.5% of the total loan amount. The interest rates for these loans are commercial rates and range from 10.5% - 11%pa. These loans equate to 3.47% of the total loan portfolio.
- ▶ A loan may be repaid/exited/realised as cash through its whole or partial assignment. The Fund may assign the whole or part of a loan to other funds managed by LM as the Responsible Entity. The Fund has assigned \$5,296,500 of one of its loans to the LM Australian Income Fund - Currency Protected for a cash consideration of the same amount. When the Fund assigns part of these loans to other funds managed by LM, the Fund may subordinate its first priority mortgage. The Fund has done so in relation to the assignment to the LM Australian Income Fund - Currency Protected.

Related Party Finance

LM is the Manager of the LM Managed Performance Fund. The LM Managed Performance Fund, in its own right, has second mortgages behind loans that are first mortgages of the LM First Mortgage Income Fund. At 30 June 2010 the LM Managed Performance Fund holds 8 such second mortgages in the total amount of \$44,287,749. In each instance the LM First Mortgage Income Fund has entered into a Priority Deed to protect its own first mortgage position with the borrower as part of normal loan documentation procedures.

PORTFOLIO UPDATE AS AT 30 JUNE 2010

Assets of the LM First Mortgage Income Fund

- ▶ A diversified portfolio of Australian registered mortgages over commercial, residential, industrial, retail and vacant land; and
- ▶ Interest bearing cash investments

LM First Mortgage Income Fund Asset Allocation



- Registered First Mortgage Securities 97.01%
- Registered Second Mortgage Securities 1.60%*
- Cash & Cash Equivalents 1.39%

* As part of a structured exit strategy for a loan the Manager may subordinate the priority of a first mortgage. As at 30 June 2010 there is one loan which has been subordinated as an exit and recovery strategy. The total amount of the loan is \$9,205,380 and the combined first and second loans constitute 55% of the value of the property held as security.

Asset Allocation Guidelines	No. of Loans	Value (\$)	Actual (%)
Registered First Mortgage Securities	38	556,614,025	97.01
Registered Second Mortgage Securities	1	9,205,230	1.60
Cash & Cash Equivalents	N/A	7,957,203	1.39

LM First Mortgage Income Fund Sector Diversification



- Commercial 17.36%
- Residential 61.66%
- Industrial 14.44%
- Pending Development Land 6.54%
- Retail 0.00%

Sector Guidelines	No. of Loans	Value (\$)	Actual (%)
Commercial	10	98,242,874	17.36
Residential	22	348,874,105	61.66
Industrial	3	81,720,064	14.44
Pending Development Land	4	36,982,212	6.54
Retail	0	0	0.00

LM First Mortgage Income Fund Construction, Development and Other Mortgage Securities



- Other Mortgage Securities 79.16%
- Construction & Development Mortgage Securities 20.84%

Construction, Development and Other Guidelines	No. of Loans	Value (\$)	Actual (%)
Construction and Development Mortgage Securities	8	117,942,074	20.84
Other Mortgage Securities*	31	447,877,181	79.16

* Other Mortgage Securities includes pending development land, completed developments and commercial loans.

LM First Mortgage Income Fund Geographic Diversification



- New South Wales 28.84%
- Australian Capital Territory 1.39%
- Victoria 6.22%
- Queensland 56.01%
- Western Australia 6.92%
- Northern Territory 0.00%
- Tasmania 0.62%
- South Australia 0.00%

Sector Guidelines	No. of Loans	Value (\$)
New South Wales	14	163,198,274
Victoria	4	35,204,133
Queensland	16	316,909,913
South Australia	0	0
Australian Capital Territory	1	7,849,604
Western Australia	3	39,141,318
Northern Territory	0	0
Tasmania	1	3,516,013

LM First Mortgage Income Fund Portfolio Details as at 30 June 2010

Mortgage Portfolio Details	Actual
Total value of mortgage securities	\$565,819,255
Number of mortgages	39
Average loan size	\$14,500,000
Average loan to valuation ratio	86.56%
Total value of loans with interest built into the facility and/or capitalised	\$514,996,552
Number of loans with interest built into the facility and/or capitalised	35
Total value of undrawn loan commitments over next 24 months (progressive loan draws) funded by cashflows of the Fund	1,600,000
Number of loans with undrawn loan commitments over next 24 months (progressive loan draws) funded by cashflows of the Fund	1
Average monthly undrawn loan commitments funded by cashflows of the Fund	\$400,000

The valuation policy for the Fund's mortgage securities is written into the lending guidelines of the Fund, which are included on pages 6 and 7 of this document. They also form part of the compliance plan for the Fund, and as such the processes are included as part of the independent audit of the Fund.

The unit price of the fund remains \$1.00 as per the audited financial report to end December 2009 signed off by the Fund's auditors on and current as at 7 June 2010.^{1,3,4} The independent audit confirms that the financials represent a true and fair view of the financial position of the Fund.

Notwithstanding the value of loans capitalising interest, approximately \$135 million of loans are generating income to the Fund from business and rental activity.

As at 30 June 2010 there were 25 borrowers. 8.38% of total monies was lent to the Fund's largest borrower and 58.29% of total monies was lent to the Fund's ten largest borrowers. The Fund does not have one single borrower that exceeds 10.00% of the Fund's assets.

Loan to Valuation Ratio (LVR)

LVR	No. of Loans	Value (\$)
< 50.00%	3	10,328,345
50.01% - 60.00%	0	0
60.01% - 70.00%	3	21,512,976
70.01% - 80.00%	3	64,900,316
80.01% - 90.00%	11	171,686,063
90.01% - 100.00%	12	198,977,810
100.01% - 110.00%	7	98,213,745

The average loan to valuation across the mortgage portfolio as at 30 June, 2010 is 86.56%.

The average loan to valuation ratio of the fund has increased from sub 70% to 86.56% since the Fund closed to protect capital value and to prioritise repayment of the previous CBA line of credit facility. The unit price remains \$1.00.^{1,3,4} It is the loan to valuation ratio that has absorbed the impacts during this time, not the unit price. The conservative loan to valuation position the Fund adopts on initial setting of its loans has insulated it from the 2008 and 2009 softening in asset valuations. In addition the loan to valuation ratio has absorbed necessary capitalisation of interest and loan realisation costs which are due to the Fund and which are accruing for collection by the Fund when the borrower repays the Fund.

Where required the Fund has asserted its legal rights to take control and ensure the Fund is optimally positioned for recoverability.

In line with the Fund's investment policies certain assets within the Fund are secured by properties in various stages of ongoing development. Following the disruptions caused by the worldwide financial crisis, LM has assumed control of some assets in order to effectively manage the successful realisation of each property's development strategy. That strategy includes increasing an asset's loan to valuation ratio position above 100% where it is reasonable to do so based on overall expectations for recoverability of loan amount and interest. The most recent audited financial statements (signed on 7 June 2010) confirms the Manager's determination of full recoverability of these loan assets has been assessed on a fair and reasonable basis.

Whilst the Australian economy has continued its strong performance trends, liquidity in the "non-homeowner mortgage" sector remains tighter than has been evident in recent memory. The resultant effect has been a significant reduction in sales as raising finance for such a purchase is slow.

The most reasonable and the preferred exit and recovery strategy is to complete the ongoing development of each of these assets to position them for maximum property value on sale for recovery of original loan capital and interest due on the loans.

Comprehensive and detailed analysis of the assets supports full recoverability of Fund capital.

The audited financial report for the Fund for the period ending 31 December 2009, signed on 7 June 2010 confirms unit price of the full \$1.00.^{1,3,4}

LM First Mortgage Income Fund Mortgage Securities by Maturity Profile as at 30 June 2010

Period Maturing	No. of Loans	Value (\$)
0 – 12 months	39	565,819,255
13 – 24 months	0	0
25 – 36 months	0	0
37 – 48 months	0	0
49 – 60 months	0	0

Not all of the loans will be repaid to the Fund within 12 months. The Manager continues to drive reasonable exit strategies on the assets to realise the cashflow required to meet all Fund expenses.

LM First Mortgage Income Fund Mortgage Securities by Interest Rate Profile as at 30 June 2010

Interest Rate	No. of Loans	Value (\$)
≤ or < 7.00%	1	5,966,669
7.01% - 7.50%	0	0
7.51% - 8.00%	1	12,671,496
8.01% - 8.50%	1	15,660,418
8.51% - 9.00%	0	0
9.01% - 9.50%	3	47,845,649
9.51% - 10.00%	1	3,636,802
10.01% - 10.50%	3	37,225,657
10.51% - 11.00%	9	149,322,911
11.01% - 11.50%	7	100,174,225
11.51% - 12.00%	6	82,446,579
12.01% - 12.50%	2	58,351,434
12.50% - 13.00%	0	0
13.01% - 13.50%	5	52,517,415

The disparity between the loan rates and the current investor rates is due to the fact that currently a large portion of the loans are having interest capitalised (accumulated) to be collected when the loan repays. The average loan to valuation ratio of the Fund has increased from sub 70% to 86.56% since the Fund closed to protect capital while the CBA facility was prioritised for repayment and during the financial crisis. The unit price remains \$1.00.^{1,3,4} It is the loan to valuation ratio that has absorbed the impacts during this time, not the unit price. The conservative loan to valuation position the Fund adopts on initial setting of its loans has insulated it from some softening in asset valuations and from capitalisation of interest and loan realisation costs which are due to the Fund and are accruing for collection by the Fund when the borrower repays the Fund.

LM First Mortgage Income Fund Loans in Arrears as at 30 June 2010

Period	No. of Loans	Value (\$)
30 – 60 days	5	96,406,239
60 – 90 days	0	0
90 days and over	21	331,833,176

The Manager uses the terms "arrears" and "default" interchangeably. LM calculates its loan arrears statistic in accordance with the IFSA Standard No 18, "Best Practice Guidance for Disclosure in the Mortgage Trust Sector."

The December 2009 audited financial report (signed 7 June 2010) confirms recoverability and the unit price at \$1.00.^{1,3,4} The independent audit confirms that the financials represent a true and fair view of the financial position of the Fund.

The Manager is focused on management of the arrears loans for optimal recoverability. Please refer to page 7 for information on the Manager's arrears management processes. Arrears management is a normal and important area of management for a fund such as this where the predominant assets are loans. Arrears management focuses on recoverability. Where required the Fund has asserted its legal rights to take control and ensure the Fund is optimally positioned for recoverability.

The Manager's asset and recovery team continually assesses each individual loan in the portfolio to ensure best possible positioning for recovery of capital and interest. This is done through assessment of (i) valuations, (ii) any sales in the particular security property and (iii) general market evidence.

The effects of the "credit crunch" prevail with Australian banks and financial institutions still not readily releasing credit into the commercial and development sectors of the property market. These are the sectors over which the fund has its secured loan assets and so sales and refinance activity remains slow.

In managing optimal recoverability, some arrears assets have been identified for longer term holds for value in more favourable market conditions. Others are undergoing improvements to enhance marketability and secure appropriate sale price for the Fund over the medium term.

As a mechanism of capital recovery the Manager may subordinate the Fund's position as part of a structured exit strategy. As at 30 June 2010 there is one loan which has been subordinated as an exit and recovery strategy. The total amount of the Fund's loan is \$9,205,380 and the combined first and second loans constitute 55% of the value of the property held as security.

The Manager continues to actively manage each individual mortgage loan within the portfolio. Each asset has a specified course of action for ultimate realisation of the loan with critical timeframes.

A major focus of the past twelve months has been to ensure the timely completion of development projects within the Fund. This has been achieved with only 2 loans now to be completed.

There are currently 8 assets within the Fund which will benefit from minor further investment into the progression of each project. One of the benefits of the Deutsche Bank facility is that it enables development to recommence on these projects in order to enhance value and deliver to the market more saleable product than is currently offered by the englobed development asset. Sales of such completed end product (affordable residential property sub \$500,000) which will crystallise significant future cash flow to the Fund by way of realisation of full loan amounts and interest accrued (including that accrued during the ongoing development period). Determination of the timing of such strategies is important to the cash flow projections of the Fund which naturally help determine future investor redemptions.

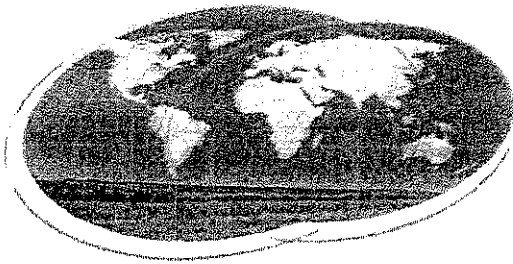
Under Australian legislation, and as regulated by the Australian Securities and Investment Commission (ASIC), fund managers of investment funds such as the LM funds must provide specific disclosures relating to fund information provided to investors, to minimise the risk of misleading or investor misunderstanding. As a responsible entity and manager of the LM income funds, LM is required to display the following disclosures relating to the content of this document.

Warning Statements/Footnotes:

- ¹ Past performance is not a reliable indicator of future performance.
- ² Interest distribution rates are variable, and will depend on income earned and expenses paid by the Fund from time to time, commission payable to advisers, and on the type of investment chosen.
- ³ Fund performance is not guaranteed and returns could be lower than expected and there is a possibility that an investor could suffer a loss and may lose some or all of their principal investment. Investment in the Fund is not a bank deposit.
- ⁴ The unit price may vary and may decrease depending on the performance and value of the assets of the Fund.
- ⁵ Investors will have limited rights to withdraw if the Fund does not satisfy the statutory liquidity test in the Corporations Act.

This product is issued by LM Investment Management Ltd (LM) ABN 68 077 208 461 Responsible Entity and AFSL No. 220281. LM requests that investors consult their financial adviser or intermediary prior to making an investment decision as well as consider this information in conjunction with the PDS.





LM First Mortgage Income Fund

ARSN 089 343 288

Update for Investors & ASIC Benchmark Disclosure 24 August 2011

This document is provided to give investors current information on the LM First Mortgage Income Fund's (Fund) compliance with ASIC Regulatory Guide 45. The requirements of ASIC's Regulatory Guide 45 - "Mortgage Schemes – Improving Disclosure for Retail Investors" was released in September 2008. Regulatory Guide 45 refers to 8 benchmarks developed by ASIC. All unlisted mortgage schemes are required to include statements in respect of each benchmark as to whether they comply or not.

Please ensure this document is read carefully, including any warning statements, before making any further decisions on current investments in the Fund.

Fund Closed to New Members

LM Investment Management Limited (the "Manager") determined that from 3 March 2009 the Fund would not accept any applications for investment from any person who was not an existing member in the Fund.

The Fund still accepts applications for investment in the Fund from any person who is an existing member in the Fund by way of rollover of investment term, including deemed applications as part of any reinvestment of distributions. The Fund continues to offer term investments, allowing investment rollovers to existing investors, based on the ongoing achievement of the Fund's objectives, strategies, continuous disclosure as detailed in this document and any disclosure of ongoing material changes. When an investor rolls over their investment they will continue to roll for their choice of investment term until they advise the Manager otherwise. Current fixed investment terms are 48, 24, 13, 12, 6, 3 and 1 month. The interest distribution rate received is based on the underlying performance of the Fund and the term and currency of investment.^{1,2,3,5} If an investor chooses to withdraw their investment at the end of their investment term, as most normal withdrawals are currently suspended, the investment will continue to earn distribution interest at a rate based on the prevailing rate of the same term as the last nominated term, until the Fund's cash flow is sufficient to make the withdrawal payment.^{1,2,3} The Fund will not be declaring or paying interest distributions for the period 1 January 2011 until 31 December 2011, at which time the distribution strategy will be reviewed dependent on performance of the Fund's assets. Any income derived from Fund assets during this period will be applied to the unit price.

Further detail on withdrawals is provided in the benchmark table on page 4 of this document.

Why the Fund Suspended Withdrawals and Closed to New Members

In order to protect the Fund from the prevailing credit and liquidity constraints in the property and financial markets, and the Fund's simultaneous obligation to repay its previous credit facility to the CBA the Manager closed the Fund to new investments and suspended withdrawals, with the exception of those approved under hardship provisions and feeder fund payments for feeder fund distributions and expenses. Feeder funds are other registered managed investment schemes that have invested directly in the LM First Mortgage Income Fund.

In July 2010 the Manager successfully refinanced the CBA facility as Step One in the Manager's ultimate strategy to reopen the Fund and resume normal operations in the future.

Strategy for the Fund

The Manager will continue to forward regular updates for investors on the 2011 Action Plan and program.



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ABN 68 677 266 461 Responsible Entity & AFSL No. 220261

ASIC Benchmark Disclosure for Investors

The information in the table below provides an updated summary of how the Fund meets or does not meet the 8 ASIC benchmarks which are required under ASIC's Regulatory Guide 45 - "Mortgage Schemes – Improving Disclosure for Retail Investors" and whether there are any material changes since the last update. We encourage you to discuss the ASIC benchmarks with your financial adviser. A full copy of Regulatory Guide 45 can be obtained from the ASIC website: www.asic.gov.au.

The Manager will, via direct communication, notify investors in the Fund of all information relevant to the Fund. Such information includes information that may be materially adverse and information that is not necessarily materially adverse but which is subject to change from time to time. This will include information that relates to the ASIC benchmarks such as information on the nature of the Fund's portfolio investments including details of loans, whether the Fund invests in other unlisted mortgage schemes and the conditions of such investment. A paper copy of any updated information will be given to investors without charge on request.

BENCHMARK NUMBER & NAME	DOES LM MEET BENCHMARK	EXPLANATION
Benchmark 1:- Liquidity (which for the purposes of this benchmark means the proportion of cash or cash equivalents in the Fund's assets)	No	<p>There have been no material changes to this benchmark since the last issue of the ASIC benchmark disclosure for the Fund. The information in this benchmark remains as follows:-</p> <p>The Manager has cash flow estimates for the Fund for the next 12 months and as such meets ASIC's liquidity benchmark guideline to have cashflow estimates for the next 3 months. As most withdrawals are suspended the Fund will have sufficient cash or cash equivalents (not including undrawn amounts under lending facilities) to meet projected cash needs over the next 3 months. The Manager's cash flow estimates for the Fund for the next 12 months contain a detailed schedule of managed loan repayments to the Fund from its existing loan portfolio. The Manager constantly monitors and reviews the Fund's cash flow estimates however any delay in the actual realisation of projected cash flow will have a flow on effect to the cashflow the Fund requires to meet its operational commitments.</p> <p>With respect to balancing the maturity of Fund assets with Fund liabilities, the Fund met this benchmark prior to its closure to new investments. As the Fund is currently closed to new investments, the Fund is reliant on income (interest payments) from existing loans and the repayment of loans to generate cash flow within the Fund. During this time it is expected that certain loans will not meet interest payment requirements on time and/or by the original maturity date. Therefore the Fund is currently unable to balance the maturity of Fund assets with Fund liabilities and withdrawal requests.</p>
Benchmark 2:- Scheme Borrowing	Yes	<p>Under the constitution the Manager may borrow against the Fund assets on terms and conditions acceptable to the Manager. The Manager has arranged a finance facility with Deutsche Bank AG ("DB") which was settled on 1 July 2010 principally to refinance the previous Commonwealth Bank line of credit.</p> <p>As at 30 June 2011 the amount owing to DB was the drawn amount of \$62,399,789. The remaining loan term is 1 year expiring on 30 June 2012, with an option, at the Manager's choice, for a 1 year extension to 30 June 2013. The interest rate of the facility is 15% (for the remaining 1 year term) and 18% (for the one year option if the option is exercised).</p> <p>The facility is secured by a fixed and floating charge over the assets of the Fund, providing DB, as secured lender, with first priority over the assets of the Fund. The amount owing to DB ranks before investors' interests in the scheme.</p> <p>The DB facility refinanced the Fund's previous Commonwealth Bank line of credit. The Fund is required to maintain a minimum \$6M cash balance within the Fund, which may be applied solely to pay taxes, insurance and statutory charges on security properties and to pay fees, costs and expenses in relation to the facility. The DB facility is not intended to be used to fund distributions or withdrawal amounts.</p> <p>The facility will be repaid via cashflow generated by the Fund and there is a minimum principal repayment of \$9,000,000 due by 31 December 2011; and where the facility is extended to 30 June 2013, \$13,500,000 by 30 June 2012. As at 30 June 2011 the Fund had already achieved its minimum principal repayment requirement for the 6 months to 31 December 2011.</p> <p>The Manager has successfully negotiated an amendment to the terms of the current Loan Agreement with DB in order that certain funds available from realisation of asset sales may be redirected from compulsory loan pre-</p>

		<p>payments to a newly created Capital Works Account. Funds allocated to the Capital Works Account are exclusively available to finance the ongoing development and improvement of existing fund assets. At this stage \$7,500,000 has been allocated for such purposes and the development of specifically identified assets, forming part of the overall recovery strategy of the Fund, has re-commenced. DB has additionally indicated that they will consider further such requests on a case by case basis as required.</p> <p>The facility agreement contains loan covenants that are usual for facilities of this nature. If a loan covenant is breached, the facility may go into default, and in those circumstances DB may elect to take recovery action. There are no loan covenant breaches at this time and the Manager does not consider that any such breaches are likely.</p>
Benchmark 3:- Portfolio Diversification	Yes	<p>Refer to pages 7 to 10 of this document under heading "Portfolio Update as at 31 May 2011" for the Fund's current portfolio diversification.</p> <p>The Manager's lending policies and procedures for the Fund remain unchanged. Whilst the Fund is not actively lending to new borrowers, it is the Manager's intention over time to lend to new borrowers and this will be determined as part of cash flow management of the fund in the best interests of all investors.</p> <p>The Fund does not currently invest in other unlisted mortgage schemes and the Fund does not have the cash to do so, but has the power to do so in the Fund constitution. The Manager's policy on investing in such schemes is to ascertain whether such an investment is desirable for the Fund in light of the circumstances at that time. The Manager will not necessarily require such a scheme to satisfy the ASIC benchmarks before the Manager invests in the scheme.</p>
Benchmark 4:- Related Party Transactions	Yes	<p>The Fund may lend to, or engage in transactions with related parties, but such loans and transactions are subject to review by the Board and can only be approved on commercial arms-length terms following approval by the Credit Committee. The Board's approval process is monitored in terms of risk management and business standards and compliance. The Fund may also invest in other managed investment schemes which are operated by the Manager. For further details refer to the paragraphs under the heading "Related Parties" on page 6 of this document.</p> <p>The Manager has a documented Conflicts Management Policy which deals with the identification, assessment and treatment of conflicts of interest and related party transactions. Board approval is required for all related party transactions.</p>
Benchmark 5:- Valuation Policy	No	<p>There have been no material changes to this benchmark since the last issue of the ASIC benchmark disclosure for the Fund. The information in this benchmark remains as follows:-</p> <p>The Manager's valuation policies set out how real property assets over which the Fund has security will be valued (that is, on an "as is" basis, and for development loans, also on an "as if complete" basis) and how often valuations are obtained. The ASIC benchmark also requires that no one valuer conducts more than 1/3 of the valuation work for the Fund. The Fund currently does not comply with this requirement because the Fund is closed and the asset base of the Fund has reduced therefore the percentage has exceeded 1/3 of the mortgage portfolio and as at 30 June 2011 34.4% of the mortgage portfolio was valued by one valuer. Valuers selected to perform relevant valuations on the security property are chosen based on independence, specialist industry expertise and geographic location. The ASIC benchmark requires the disclosure of information about the valuation of a particular property for an unlisted mortgage scheme where a loan secured against the property accounts for 5% or more of the total value of the scheme's loan book. The Manager does not provide this information due to privacy reasons and due to the commercial sensitivity of valuation information.</p>

Benchmark 6:- Lending Principles	No	<p>There have been no material changes to this benchmark since the last issue of the ASIC benchmark disclosure for the Fund. The information in this benchmark remains as follows:-</p> <p>Whilst it is the Manager's policy when settling a loan to generally not exceed a loan to valuation ratio of 66.67% on construction and development loans and 75% on commercial loans (which ratios do both comply with the ASIC benchmark), it is the Manager's current practice to exceed those ratios whenever necessary in the process of working through a repayment solution in current market conditions. The Fund's constitution allows the Manager to lend funds provided that all mortgages are secured over property and the amount which may be advanced to a borrower does not exceed an LVR of 75% of the value of the security property on initial settlement. After a loan has settled and where the Manager considers it is in the best interests of the members of the Fund, the Manager may approve an LVR not to exceed 85% of the value of the security property. The LVR of a loan that is in default may exceed 85%. Where the loan is a development loan, funds are advanced progressively in stages through the development on a "Cost to Complete" basis and the Manager engages an external consultant Quantity Surveyor for each development and receives periodic reports on the progress of the development including certification of construction claims based on work completed.</p>
Benchmark 7:- Distribution Practices	Yes	<p>The Fund will not be declaring or paying interest distributions for the period 1 January 2011 until 31 December 2011 at which time the distribution strategy will be reviewed dependent on performance of the Fund's assets. Any income derived from Fund assets during this period will be applied to the unit price.</p> <p>The Manager reviews the distribution policy of the Fund each month.</p> <p>Distributions are sourced from income earned from the assets of the Fund. Currently income is earned from the existing assets of the Fund via (i) interest payments, rental or other business income earned from assets, the Fund receives from its existing income producing loans and (ii) existing loans on which interest is being capitalised for collection on the repayment of those loans to the Fund. The interest distribution rates are variable depending on the income earned, expenses paid and other matters relevant to the Fund.</p>
Benchmark 8:- Withdrawal Arrangements	Yes	<p>There have been no material changes to this benchmark since the last issue of the ASIC benchmark disclosure for the Fund. The information in this benchmark remains as follows:-</p> <p>As stated in the Product Disclosure Statement, in certain circumstances withdrawal payments may be extended to 365 days or suspended. Withdrawals have been suspended to protect Fund assets and provide stability in current market conditions. Subject to the cashflow of the Fund, only withdrawals approved under hardship provisions and feeder fund payments for investor distributions and feeder fund expenses may be made. Investors may apply under ASIC hardship provision for withdrawal of their investment. ASIC hardship provisions are prescriptive and investors who wish to apply under these provisions must meet the hardship criteria outlined in ASIC's provisions. Investors can contact the Manager who will provide details of ASIC's hardship withdrawal provisions. If the withdrawal is allowed under ASIC hardship withdrawal provisions payment will be subject to cashflow of the Fund.</p> <p>A withdrawal notice may still be lodged. Investors must give the Manager written notice signed by the investor/s. Flexi investment investors must provide 1 business days notice, Fixed Term investments investors must provide at least 5 business days notice prior to the maturity date, and Savings Plan investors following the initial 12 month investment period must provide 1 business days notice. If an investor chooses to withdraw their investment at the end of their investment term, as most normal withdrawals are currently suspended, the investment will continue to earn interest based on the same term as the last nominated term until cash flows permit the withdrawal to be paid.</p> <p>Investors should also note the automatic rollover provisions which apply to their investments, and the time periods for notice to be given to withdraw are as outlined in this section.</p>

The amount payable to investors on withdrawal will be the issue price of their units at that time. This amount is subject to change depending on the net value of the assets of the Fund. \$144.8 million of investments in the Fund have a withdrawal pending.

\$142.8 million of investments in the Fund's feeder funds have a withdrawal pending.

Withdrawals pending across all of the funds is \$287.6 million.

Arrears Management

The Manager has documented arrears management processes which are implemented in the event that a mortgage loan goes into default. Arrears loans are managed by a team of experienced personnel. The documented processes include the following:

- > Dishonoured payments or other defaults are referred to the Arrears Manager for actioning. The Arrears Manager immediately contacts the borrower to ascertain the circumstances of the default;
- > If the default is short term, arrangements are made with the borrower to remedy the default;
- > If the default is long term, a summary of the nature of the default is emailed to the Arrears Committee with recommendations;
- > The Arrears Committee is comprised of the Executive Directors, the Portfolio Manager, the Arrears Manager and members of the Property Asset Management Department as appropriate;
- > The Arrears Committee meets at least weekly. The Arrears Committee considers the recommendations for arrears loans and supervises the preparation of an arrears management plan for each arrears loan. Given the nature of loans within the loan portfolio, the Manager adopts a case by case approach to arrears management, reflected in the individual management plans for each arrears loan;
- > Management plans are implemented by the Arrears Manager who maintains a separate arrears file for each arrears loan;
- > Reports on arrears loans are prepared and presented at Arrears Committee meetings. Management plans are considered and updated as necessary;
- > For all arrears loans, a detailed recoverability analysis is prepared and updated on a weekly basis as part of the arrears management plan;
- > External consultants (valuers, lawyers, insolvency practitioners, sales consultants etc) are engaged where appropriate throughout the arrears management process;
- > The Manager may from time to time foreclose on a security property as part of a realisation strategy. Foreclosure is a remedy available to a registered mortgagee by which the mortgagee becomes the absolute legal owner of the property free of any interest of the mortgagor. In the event of foreclosure, the Manager may hold, improve and/or sell the security property in order to achieve the best result for the Fund. The Manager may sell a property on which it has foreclosed to a related entity, in which case the sale price will be determined by valuation.

Arrears loans are managed in this way until the security is sold and/or all possible recovery action has been completed.

As a mechanism of capital recovery from time to time the Manager may subordinate the priority of a first mortgage as part of a structured exit strategy for a loan.

Development Realisation Strategies

As part of the Manager's overall recovery processes, on certain Fund assets it has adopted an approach whereby the completion of the original or revised development strategy for those assets has been determined as offering the best outcome for investors in the Fund. The outcome of this approach may achieve recovery of the outstanding loan amounts and also deliver the ability to earn future interest and revenue during the development timeframe in line with the Fund's entitlements as mortgagee.

As detailed above the Manager has agreed an amendment to the Fund's loan facility with DB in order that any funding required to achieve the outcomes noted above will have as little impact as possible on the revised liquidity offerings being made to investors.

The development programs of each project have been formulated over the last 18 months and the certainty provided by the amendment to the Fund's finance facility allows these individual strategies to be progressed. All necessary approvals have been obtained with construction activity anticipated to commence on each property. The program associated with these assets is such that, in each case, within 6-7 months from commencement of works there will be completed "saleable" assets created. At this point in time it is expected that this strategy will become cash flow positive overall as completed product revenues exceed expenditure.

The overall development strategy includes those assets held by the Fund which are secured by operating, but partly developed retirement communities. These retirement assets total around \$100,000,000 of total Fund assets. This asset type is quite unique in that they not only generate a typical "sales" type of revenue, once individual dwellings are sold or "leased for life", but they also grow an underlying business value which increases incrementally as each village grows. The Fund's security also captures the growing value of the residual business and this growing asset also secures the Fund's outstanding debt and future entitlement to interest as mortgagee.

The Manager has successfully negotiated the operational, development and sales services of established industry operators for the asset in this sector in order to provide for optimum delivery of this strategy.

In total nine of the Fund's assets have development realisation strategies. Three of those nine assets include a portion of completed saleable stock. The strategy for these three assets sees approvals currently being sought for construction of the next "Stage" of each project so that once sufficient existing stock is sold the project may progress as projected.

Related Parties

Broadly, the definition of "related party" includes a controlling entity, company or person of LM Investment Management Ltd ("LM"), a public company. This filters through all funds managed by LM, and any directors. This Fund does not have any loans to any LM directors. Investor disclosure guidelines are designed to ensure that investors are aware of any interaction with transactions between different funds or where a director or other related party, including another fund, derives a financial benefit.

As well as providing best practice disclosure of all related party transactions, the guidelines further ensure the Manager is accountable in terms of the management and monitoring of any related party transactions. It is especially important that where there is a related party somehow involved, that the transaction is evaluated from a due diligence and credit assessment process, as robustly as if it were not a related party transaction. Ongoing robust monitoring of these transactions must also be demonstrated.

The Fund may lend to related parties provided the loans are approved by the Credit Committee on commercial, arms-length terms. They must then be approved at full Board level, and are subject to review by the Board.

The Board is responsible for reviewing and approving the structure and probity of commercial dealings between the manager and any related parties and for ensuring any such transactions are approved only and after taking into consideration the Manager's Conflicts of Interests Policy. Fees issued to the account of the Fund by related parties, which are recoverable from the Fund, must be on commercial arms-length terms and are subject to review by the Board.

Following are the related party transactions within this Fund:-

- > Since inception of LM Investment Management Ltd, LM Administration Pty Ltd has been engaged by LM Investment Management Ltd to provide administration services at a commercial fee. LM Administration Pty Ltd provides administration and funds management services to the Fund and directly receives a management fee from the Fund for that service. LM Administration Pty Ltd also provides administration services at a commercial fee to Monaghan Lawyers, a law firm that provides legal services to the Fund. Peter Drake, a director of LM, is the beneficial owner of LM Administration Pty Ltd.
- > John O'Sullivan, an executive director of the Manager is the beneficial owner of O'Sullivan Capital Management Ltd. O'Sullivan Capital Management Ltd has been engaged by LM Investment Management Ltd to provide marketing services in New Zealand at a commercial arms-length fee. This fee is paid by the Fund.
- > The Fund has 2 related party loans totalling \$10,093,088 granted to entities controlled by the LM Managed Performance Fund. Both loans are performing assets for the Fund at commercial rates of 10.5%pa – 11%pa. Combined they equate to 2.19% of the total loan portfolio.

Related Party Finance

LM is the Manager of the LM Managed Performance Fund. The LM Managed Performance Fund, in its own right, has second mortgages behind loans that are first mortgages of the LM First Mortgage Income Fund. At 30 June 2011 the LM Managed Performance Fund holds 3 such second mortgages in the total amount of \$21,548,172. In each instance the LM First Mortgage Income Fund has entered into a Priority Deed to protect its own first mortgage position with the borrower as part of normal loan documentation procedures.

PORTFOLIO UPDATE AS AT 31 MAY 2011

The funds under management is actual cash held in the Fund plus mortgage securities adjusted for provisions as agreed with audited financial statements as at 31 December 2011. The provisions on the loans is a net provision which accounts for bad debts expensed between the Financial Statement period of 31 December 2010 and 31 May 2011 accounting for any disposal of assets. The Manager believes that this indicates a true and accurate reflection of the funds under management and loans as they are on the basis agreed upon with auditors and the Financial Statements.

Assets of the LM First Mortgage Income Fund

- > A diversified portfolio of Australian registered mortgages over commercial, residential, industrial, retail and vacant land; and
- > Interest bearing cash investments.

LM First Mortgage Income Fund Asset Allocation

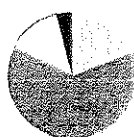


- Registered First Mortgage Securities 95.48%
- Registered Second Mortgage Securities 2.37%*
- Cash & Cash Equivalents 2.15%

* As part of a structured exit strategy for a loan the Manager may subordinate the priority of a first mortgage. As at 31 May 2011 there is one loan which has been subordinated as an exit and recovery strategy. The total amount of the loan is \$11,187,499 and the combined first and second loans constitute 38.97% of the value of the property held as security.

Asset Allocation Guidelines	No. of Loans	Value (\$)	Actual (%)
Registered First Mortgage Securities	29	449,915,576	95.48
Registered Second Mortgage Securities	1	11,187,499	2.37
Cash & Cash Equivalents	N/A	10,126,438	2.15

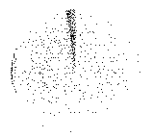
LM First Mortgage Income Fund Sector Diversification



- Commercial 18.90%
- Residential 42.65%
- Retirement 20.93%
- Industrial 13.62%
- Pending Development Land 3.90%
- Retail 0.00%

Sector Guidelines	No. of Loans	Value (\$)	Actual (%)
Commercial	8	87,149,829	18.90
Residential	9	196,649,607	42.65
Retirement	7	96,507,592	20.93
Industrial	3	62,823,106	13.62
Pending Development Land	3	17,972,941	3.90
Retail	0	0	0.00

LM First Mortgage Income Fund Construction, Development and Other Mortgage Securities



- Other Mortgage Securities 97.57%
- Construction & Development Mortgage Securities 2.43%

Construction, Development and Other Guidelines	No. of Loans	Value (\$)	Actual (%)
Construction and Development Mortgage Securities	1	11,187,499	2.43
Other Mortgage Securities*	29	449,915,576	97.57

* Other Mortgage Securities includes pending development land, completed developments and commercial loans.

LM First Mortgage Income Fund Geographic Diversification



■ New South Wales 24.21%	■ Western Australia 7.03%
■ Australian Capital Territory 1.70%	■ Northern Territory 0.00%
■ Victoria 4.66%	■ Tasmania 0.88%
■ Queensland 61.52%	■ South Australia 0.00%

Geographic Guidelines	No. of Loans	Value (\$)
New South Wales	9	111,632,366
Victoria	2	21,499,842
Queensland	14	283,673,411
South Australia	0	0
Australian Capital Territory	1	7,849,604
Western Australia	3	32,414,912
Northern Territory	0	0
Tasmania	1	4,032,940

LM First Mortgage Income Fund Portfolio Details as at 31 May 2011

Mortgage Portfolio Details	Actual
Total value of mortgage securities	\$461,103,075
Number of mortgages	30
Average loan size	\$20,047,960
Average loan to valuation ratio	91.98%
Total value of loans with interest built into the facility and/or capitalised	\$413,803,604
Number of loans with interest built into the facility and/or capitalised	27
Total value of undrawn loan commitments over next 24 months (progressive loan draws) funded by cashflows of the Fund	Nil
Number of loans with undrawn loan commitments over next 24 months (progressive loan draws) funded by cashflows of the Fund	Nil
Average monthly undrawn loan commitments funded by cashflows of the Fund	Nil

The total value of loans generating income to the Fund from business and rental activities is approximately \$154.1 million and includes some loans with interest capitalised.

As at 31 May 2011 there were 22 borrowers. 12.09% of total monies was lent to the Fund's largest borrower and 66.90% of total monies was lent to the Fund's ten largest borrowers. The Fund does not have one single borrower that exceeds 10.00% of the Fund's assets.

Loan to Valuation Ratio (LVR)

LVR	No. of Loans	Value (\$)
< 50.00%	1	11,187,499
50.01% - 60.00%	0	0
60.01% - 70.00%	2	10,093,088
70.01% - 80.00%	1	30,050,300
80.01% - 90.00%	3	21,448,846
90.01% - 100.00%	23	388,323,342

The average loan to valuation across the mortgage portfolio as at 31 May 2011 is 91.98%.

In floating the unit price, the Fund has applied a write down in its mortgage security values to reflect current market conditions. Despite this, we are pursuing recovery by all means as per the Fund's legal entitlement, and in a market in which we believe there may be upside longer term value for the Fund in "holding" the assets identified for same. See page 5 section headed "Development Realisation Strategies".

Where required the Fund has asserted its legal rights to take control and ensure the Fund is optimally positioned for recoverability.

LM First Mortgage Income Fund Mortgage Securities by Maturity Profile as at 31 May 2011

Period Maturing	No. of Loans	Value (\$)
0 - 12 months	30	461,103,075
13 - 24 months	0	0
25 - 36 months	0	0
37 - 48 months	0	0
49 - 60 months	0	0

Not all of the loans will be repaid to the Fund within 12 months. Refer to the separate progress updates of the 2011 action plan.

LM First Mortgage Income Fund Mortgage Securities by Interest Rate Profile as at 31 May 2011

Interest Rate	No. of Loans	Value (\$)
0.00%	19	297,565,730
= or < 7.00%	0	0
7.01% - 10.50%	0	0
10.51% - 11.00%	2	34,441,537
11.01% - 11.50%	4	81,212,361
11.51% - 12.00%	1	7,879,852
12.01% - 12.50%	1	7,849,604
12.50% - 15.00%	0	0
15.01% - 15.50%	1	10,348,432
16.01% - 16.50%	1	11,187,499
25.00%	1	10,618,059

You will note above that certain of the Fund's loan assets which currently are generating revenue have increased interest rates detailed above, between 16% and 25%. Whereas such assets may be categorized as either "arrears" or "performing" loans, they have been documented in such a way that the Fund may benefit, by way of increased interest earned, in the future growth in value of these particular assets. At this point in time the loans identified are secured by Retirement Sector property assets. The Manager has previously provided investors with detailed summaries of its ongoing development strategy associated with these assets and will continue to provide such updates on a regular basis.

The interest rate banding refers to the interest rate to which the Fund is legally entitled in accordance with each mortgage security loan document. The Fund will seek to recover all interest entitlement on behalf of investors but there may be instances where the Manager will cease interest accrual based on recoverability analysis. This rate does not currently include any penalty interest to which the Fund may be entitled to charge in circumstances of default.

The total value of loans generating income to the Fund from business and rental activities is approximately \$154.1 million and includes some loans with interest capitalized. The income generated by these securities will fluctuate depending on variables such as occupancy, rental period/duration and lease agreements/arrangements, business and economic conditions and seasonal periods.

LM First Mortgage Income Fund Loans in Arrears as at 21 June 2011

Period	No. of Loans	Value (\$)
30 – 60 days	0	0
60 – 90 days	1	11,926,879
90 days and over	25	398,841,147

The Manager uses the terms "arrears" and "default" interchangeably. LM calculates its loan arrears statistic in accordance with the IFSA Standard No 18, "Best Practice Guidance for Disclosure in the Mortgage Trust Sector."

The Fund has asserted its full legal rights to take control and ensure optimal positioning for recoverability. Please refer to page 5 for information on the Manager's arrears management and recovery processes.

The effects of the "credit crunch" prevail with Australian banks and financial institutions still not readily releasing credit into the commercial and development sectors of the property market. These are the sectors over which the fund has its secured loan assets and so sales and refinance activity remains slow.

In managing optimal recoverability, some arrears assets have been identified for longer term holds for value in more favourable market conditions. Others are undergoing improvements to enhance marketability and secure appropriate sale price for the Fund over the medium term.

As a mechanism of capital recovery the Manager may subordinate the Fund's position as part of a structured exit strategy. As at 31 May 2011 there is one loan which has been subordinated as an exit and recovery strategy. The total amount of the Fund's loan is \$11,187,499 and the combined first and second loans constitute 38.97% of the value of the property held as security.

The Manager continues to actively manage each individual mortgage loan within the portfolio.

Under Australian legislation, and as regulated by the Australian Securities and Investment Commission (ASIC), fund managers of investment funds such as the LM funds must provide specific disclosures relating to fund information provided to investors, to minimise the risk of misleading or investor misunderstanding. As a responsible entity and manager of the LM income funds, LM is required to display the following disclosures relating to the content of this document.

Warning Statements/Footnotes:

- 1 Past performance is not a reliable indicator of future performance.
- 2 Interest distribution rates are variable, and will depend on income earned and expenses paid by the Fund from time to time, commission payable to advisers, and on the type of investment chosen.
- 3 Fund performance is not guaranteed and returns could be lower than expected and there is a possibility that an investor could suffer a loss and may lose some or all of their principal investment. Investment in the Fund is not a bank deposit.
- 4 The unit price may vary and may increase or decrease depending on the performance and value of the assets of the Fund.
- 5 Investors will have limited rights to withdraw if the Fund does not satisfy the statutory liquidity test in the Corporations Act.

This product is issued by LM Investment Management Ltd (LM) ABN 68 077 208 461 Responsible Entity and AFSL No. 220281. LM requests that investors consult their financial adviser or intermediary prior to making an investment decision as well as consider this information in conjunction with the PDS is available by telephoning the Manager's head office on +617 5584 500.



LM Investment Management Ltd

The global provider of Australian investment solutions. GOLD COAST | SYDNEY | PERTH | HONG KONG | AUCKLAND | QUEENSTOWN | LONDON | DUBAI | JOHANNESBURG | BANGKOK
 HEAD OFFICE: Level 4 9 Beach Rd Surfers Paradise Qld 4217 Australia T +61 7 5584 4500 F +61 7 5592 2505 Freecall 1800 062 919 E mail@LMaustralia.com www.LMaustralia.com

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LM Investment Management Ltd

The global pathway to Australian investment solutions

LM First Mortgage Income Fund ARSN 059 343 288

ASIC Benchmark Disclosure for Investors

31 December, 2012

Return of Capital Process

LM Investment Management Ltd (LM, **Responsible Entity** or **we**) as responsible entity of the LM First Mortgage Income Fund (Fund) has determined that it is in the best interests of investors in the Fund to continue the sales program with an orderly sale of all the remaining assets of the Fund in a commercial manner.¹ We have been actively selling assets of the Fund since before its closure to new investors and are continuing with this to see investors' investment capital returned as quickly as commercially possible.

By March 2013, the initial distribution of capital will be paid to all investors pro-rata to their respective holdings in the Fund. From June 2013, we intend repaying capital to all investors on a periodic basis, probably each quarter, as and when liquidity is available from the sales program, after paying or making such provision that we reasonably determine for liabilities of the Fund.

LM has also determined that the Fund is not "liquid" for the purposes of the withdrawal provisions under the Corporations Act 2001.² As a consequence, we can no longer process redemption requests in accordance with the redemption provisions in the Fund's Constitution. The only way we can process redemption requests is to make a "withdrawal" offer to all investors pursuant to the Corporations Act 2001 and we currently do not intend to make such an offer. Instead we intend to return capital to investors by making pro rata periodic capital distributions as outlined above. This decision does not affect the way we process applications for financial hardship. Claims will continue to be processed in accordance with current procedures. If you think you are eligible for a payment under financial hardship please contact the Responsible Entity who will provide details of ASIC's hardship withdrawal provisions in ASIC relief received by the Fund.

ASIC Benchmark Disclosure for Investors

The Australian Securities and Investment Commission (ASIC) has issued Regulatory Guide 45 – "Mortgage Schemes – improving disclosure for retail investors" (**Regulatory Guide**). The Regulatory Guide sets out benchmarks for disclosure to investors to provide retail investors in mortgage schemes with the information they need to make an investment decision. We have set out below our current procedures and policies in relation to the Fund and have indicated whether or not these procedures and policies satisfy each of the benchmarks outlined in the Regulatory Guide.

¹ The Fund is closed to new investors and therefore a PDS is not available for this Fund.

² The Fund suspended withdrawals in May 2009.

ASIC Benchmark	Statement	Disclosure
Benchmark 1:- Liquidity	The benchmark is met	<p>The Fund is managed with a view to ensuring it has cash (or cash equivalents) sufficient to meet its projected cash needs over the next 3 months.</p> <p>The Responsible Entity has cash flow estimates for the next 12 months which are approved by the directors, updated at least every 3 months and reflect any material changes.</p> <p>Based on current cash flow estimates for the Fund, we expect the Fund to have sufficient cash to meet its projected cash needs over the next 3 months.</p> <p>LM regularly monitors the maturity of assets and liabilities of the Fund. We have currently suspended withdrawals from (and applications into) the Fund. This action has been taken to protect the best interests of all investors in the Fund and to ensure asset values are maintained.</p> <p>In addition LM has determined that the Fund is not "liquid" for the purposes of the withdrawal provisions under the Corporations Act 2001, as described above.</p> <p>LM has determined that it is in the best interests of investors to undertake a program for the orderly sale of all the assets in the Fund in a commercial manner.</p>
Benchmark 2:- Scheme Borrowing	The benchmark is met	<p>Under the constitution the Responsible Entity may borrow against the Fund assets on terms and conditions acceptable to the Responsible Entity. The Responsible Entity has arranged a finance facility with Deutsche Bank AG (DB) which was originally settled on 1 July 2010 principally to refinance the previous Commonwealth Bank line of credit.</p> <p>As at December 2012 the amount owing to DB has been reduced to the drawn amount of approximately \$29.4m.</p> <p>The current DB facility was due to expire on 30 June 2013 however LM as Responsible Entity has successfully renegotiated the loan facility with the Fund's current financier from 1 January 2013 until 30 June 2014 with an option to extend the loan for an additional 12 months. The current interest rate under the facility is 15% pa (which will increase to 18% if an event of default occurs and if the default subsists for longer than 6 months it will further increase to 20% pa). Under the facility, during the first 12 months amortisation payments of at least \$500,000 per month is required until the facility is drawn down to \$25m. Once the facility is drawn down to this level, no further amortisation or payment of principal is required under the facility. Within the following 12 months (that is, months 12-24) maturity of the \$25m facility is due on 30 June 2014. LM has an option to extend this facility for a further 12 months. This option is the sole right of the borrower and is not subject to any review or additional fees. If the option is exercised the interest rate under the facility will remain at the same as the current interest rate described above and the facility will mature on 30 June 2015.</p> <p>The revised facility will provide certainty to the Fund and its investors with regard to the maintenance of the cash flows and enable LM to commence periodic pro-rata capital distributions to investors along with the certainty of investing into the ongoing improvement of those Fund assets already identified for expenditure prior to sale. This structure will allow for the funding provided to those assets to be internal and from the Fund's own cash flows and thus not require the additional risk associated to acquiring external funding to individual assets.</p>

ASIC Benchmark	Statement	Disclosure
		<p>The facility is secured by a fixed and floating charge over the assets of the Fund, providing DB, as secured lender, with first priority over the assets of the Fund. The amount owing to DB ranks before investors' interests in the scheme.</p> <p>The facility agreement contains loan covenants that are usual for facilities of this nature. If a loan covenant is breached, the facility may go into default, and in those circumstances DB may elect to take recovery action. There are no loan covenant breaches at this time and the Responsible Entity does not consider that any such breaches are likely.</p>
Benchmark 3:- Portfolio Diversification	The benchmark is met	<p>Refer to pages 6 to 10 of this document under heading "Portfolio Update as at 31 October 2012" for the Fund's current portfolio diversification.</p> <p>The Fund is closed and is not actively lending however, the Responsible Entity's lending policies and procedures for the Fund remain unchanged.</p> <p>The Fund does not currently invest in other unlisted mortgage schemes, as the Fund is closed.</p>
Benchmark 4:- Related Party Transactions	The benchmark is met	<p>The Fund is closed and is not actively lending. The Fund has a policy of ensuring that any transaction with related parties is subject to review by the Board and only approved on arm's-length commercial terms following approval by the Credit Committee. The Board's approval process is monitored in terms of risk management and business standards and compliance and any such transactions only approved after taking into account the Responsible Entity's Conflicts of Interest Policy. Ongoing review of related party transactions is conducted regularly and monitored by the Board.</p> <p>As at 31 October 2012 the Fund has two related party loans totaling \$9,272,569 granted to entities controlled by the LM Managed Performance Fund (MPF). Both loans are performing assets for the Fund at commercial rates. Combined they equate to 2.84% of the total loan portfolio. In accordance with the Fund's policy, these loans were approved by the Credit Committee on commercial, arm's-length terms. They were approved at full Board level and are subject to review by the Board. The Fund does not have any loans to any LM directors.</p> <p>LM is the Manager of the MPF. The MPF, in its own right, has second mortgages behind loans to third party borrowers that are first mortgages of the Fund. As at 31 October 2012 the MPF holds 3 such second mortgages in the total amount of \$41,426,410. In each instance the Fund has entered into a Priority Deed to protect its own first mortgage position with the borrower as part of normal loan documentation procedures.</p> <p>Further, since inception of the Fund, LM Administration Pty Ltd (LM Admin) has been engaged by LM to provide administration services at a commercial fee. LM Admin provides administration and funds management services to the Fund and directly receives a management fee from the Fund for that service. The amount paid to LM Admin will be equal to the amount the Responsible Entity receives from the Fund for management fees. Peter Drake, a director of LM, is the beneficial owner of LM Admin.</p>

ASIC Benchmark	Statement	Disclosure
Benchmark 5:- Valuation Policy	The benchmark is not met	<p>The Fund is closed and no new lending or renewal of existing loans is occurring as the Responsible Entity is continuing with an orderly sell down of the assets. When the Fund was actively lending the Responsible Entity's valuation policies set out how real property assets over which the Fund has security will be valued (that is, on an "as is" basis, and for development loans, also on an "as if complete" basis) and how often valuations are obtained.</p> <p>Prior to the Fund's closure, it was LM's policy to seek independent valuation of the underlying security property in accordance with the Responsible Entity's valuation policies. LM determined that through the global financial crisis it would not always be in the best interests of investors to utilise independent valuations but that the assets would be valued formally twice yearly in full accordance with the Responsible Entity's statutory and general law duties, utilising a valuation methodology consistent with the Fund's constitution, the Compliance Plan and applicable accounting standards. The Fund's auditors independently review the values of each asset at a minimum of every 6 months as part of the Fund's regular audit program. In addition, LM commissioned an independent review of assets by BIS Shrapnel in 2012.</p> <p>This ASIC Benchmark also requires that no one valuer conducts more than 1/3 of the valuation work for the Fund. The Fund currently does not comply with this requirement.</p> <p>Further, this ASIC Benchmark requires the disclosure of information about the valuation of a particular property for an unlisted mortgage scheme where a loan secured against the property accounts for 5% or more of the total value of the scheme's loan book. The Responsible Entity does not provide this information due to privacy reasons and due to the commercial sensitivity of valuation information.</p>
Benchmark 6:- Lending Principles	The benchmark is not met	<p>The Fund does not meet Benchmark 6, because to meet Benchmark 6 the Fund needs to maintain (for every loan) a maximum loan-to-valuation ratio (LVR) of 70% on the basis of the latest 'as if complete' valuation where the loan relates to property development, and in all other cases a LVR of 80% on the basis of the latest market valuation.</p> <p>During the life of the loans, revaluations may be required (for reasons such as defaults and re-financing). As such, there may be times when the portfolio holds loans with an LVR greater than 80%.</p> <p>As at December 2012, all loans had a LVR greater than that specified in Benchmark 6.</p> <p>The Fund is closed and is not actively lending or renewing existing loans, however the Responsible Entity's lending policy prior to the Fund's closure was when settling a loan to generally not exceed a LVR of 66.67% on construction and development loans and 75% on commercial loans. Both of these ratios comply with the ASIC benchmark.</p>

ASIC Benchmark	Statement	Disclosure
Benchmark 7:- Distribution Practices	The benchmark is met	<p>The Fund does not currently intend making any further income distributions. LM expects to recommence the monthly income catch up that is required for the period up to 30 December 2012 for those investors who did not reinvest their income, by January 2013.</p> <p>As the Fund is currently undertaking an orderly sell down and realisation of assets, all distributions going forward will consist of capital distributions.</p> <p>The distribution reinvestment program that was previously available within the Fund is no longer offered to investors.</p>
Benchmark 8:- Withdrawal Arrangements	The benchmark is met	<p>LM has determined that the Fund is not "liquid" for the purposes of the withdrawal provisions under the Corporations Act 2001.³ As a consequence, we can no longer process redemption requests in accordance with the redemption provisions in the Fund's Constitution.</p> <p>This means that the only way we can process redemption requests is to make a "withdrawal" offer to all investors pursuant to the Corporations Act 2001 and we currently do not intend to make such an offer. Instead we intend to return capital to investors by making pro rata periodic capital distributions as outlined above.</p> <p>This decision does not affect the way we process applications for financial hardship. Investors may apply under ASIC hardship provision for withdrawal of their investment. Investors who wish to apply under these provisions must meet the hardship criteria outlined in ASIC's provisions. If you think you are eligible for a payment under financial hardship please contact the Responsible Entity who will provide details of ASIC's hardship withdrawal provisions. If the withdrawal is allowed under ASIC hardship withdrawal provisions payment will be subject to cash flow of the Fund.</p>

³ The Fund suspended withdrawals in May 2009.

Portfolio Update as at 31 October 2012

Assets of the LM First Mortgage Income Fund

- > A diversified portfolio of Australian registered mortgages over commercial, residential, industrial, retail and vacant land; and
- > Interest bearing cash investments.

LM First Mortgage Income Fund Asset Allocation

- Registered First Mortgage Securities 94.68%
- Registered Second Mortgage Securities 4.26%*
- Cash and Cash Equivalents 1.06%

* Only as part of a structured exit strategy for a loan the Responsible Entity may subordinate the priority of a first mortgage. As at 31 October 2012 there is one loan which has been subordinated as an exit and recovery strategy. The total amount of the loan is \$14,034,904 and the combined first and second loans constitute 68% of the value of the property held as security and the Responsible Entity expects to make full recovery of the loan.

Asset Allocation Guidelines	No of Loans	Value (\$)	Actual (%)
Registered First Mortgage Securities	26	312,067,855	94.68
Registered Second Mortgage Securities*	1	14,034,904	4.26
Cash & Cash Equivalents	N/A	3,502,914	1.06

LM First Mortgage Income Fund Sector Diversification

- Commercial 16.17%
- Residential 43.47%
- Retirement 35.81%
- Industrial 4.20%
- Pending Development Land 0.35%
- Retail 0.00%

Sector Guidelines	No of Loans	Value (\$)	Actual (%)
Commercial	7	52,724,436	16.17
Residential	9	141,773,539	43.47
Retirement	7	116,766,933	35.81
Industrial	3	13,691,706	4.20
Pending Development Land	1	1,146,145	0.35
Retail	0	0	0.00

LM First Mortgage Income Fund Construction, Development and Other Mortgage Securities



Other Mortgage Securities 48.36%
 Construction and Development Mortgage Securities 51.64%

Construction, Development and Other Guidelines	No of Loans	Value (\$)	Actual (%)
Construction and Development Mortgage Securities	9	168,403,884	51.64
Other Mortgage Securities*	18	157,698,875	48.36

* Other Mortgage Securities includes pending development land, completed developments and commercial loans.

The renegotiated DB facility provides the capital required toward the further staged completion of these assets during the Fund's orderly sales campaign.

LM First Mortgage Income Fund Geographic Diversification as at 31 October 2012



New South Wales 17.13% Australian Capital Territory 2.49%
 Victoria 9.19% Western Australia 6.21%
 Queensland 63.83% Northern Territory 0.00%
 South Australia 0.00% Tasmania 1.15%

Geographic Guidelines	No of Loans	Value (\$)
New South Wales	8	55,872,557
Victoria	2	29,980,623
Queensland	12	208,136,958
South Australia	0	0
Australian Capital Territory	1	8,126,424
Western Australia	3	20,236,197
Northern Territory	0	0
Tasmania	1	3,750,000

LM First Mortgage Income Fund Portfolio Details as at 31 October 2012

Mortgage Portfolio Details	Actual
Total value of mortgage securities	\$326,102,759
Number of mortgages	27
Average loan size	\$12,077,880
Average loan to valuation ratio	100%
Total value of loans with interest built into the facility and/or capitalised	\$316,830,190
Number of loans with interest built into the facility and/or capitalised	25
Total value of undrawn loan commitments over next 30 months (progressive loan draws) funded by cashflows of the Fund	Nil
Number of loans with undrawn loan commitments over next 30 months (progressive loan draws) funded by cashflows of the Fund	Nil
Average monthly undrawn loan commitments funded by cashflows of the Fund	Nil

As at 31 October 2012 there were 21 borrowers. 15.89% of total monies was lent to the Fund's largest borrower and 79% of total monies was lent to the Fund's ten largest borrowers. The Fund has one borrower that exceeds 10.00% of the Fund's assets and 9 borrowers that exceed 5% of the Fund's assets. As the assets are sold and the number of mortgages decreases it is the Responsible Entity's expectation that the exposure of the Fund to each borrower will increase.

Loan to Valuation Ratio (LVR)

LVR	No. of Loans	Value (\$)
< 50.00%	0	0
50.01% - 60.00%	0	0
60.01% - 70.00%	0	0
70.01% - 80.00%	0	0
80.01% - 90.00%	0	0
90.01% - 100.00%	27	326,102,759

The average loan to valuation across the mortgage portfolio as at 31 October 2012 is 100%. This is as a result of the Fund's closure, when due to the credit crunch and credit constraints during the global financial crisis, the majority of the Fund's borrowers were unable to meet the Fund's request for repayment of the loan at maturity, which resulted in the loans being in default. Loan to valuation ratio requirements have been exceeded as interest and recovery costs have been capitalised to the original loan amount concurrently with a softening in value of the property underlying the Fund's first mortgage. LM, utilising the strong legal position afforded by the Fund's first mortgage security over the assets, has taken control of the majority of assets on behalf Fund investors as required and is proceeding with an orderly sell down and realisation of the assets to result in pro-rata capital distributions to investors.

**LM First Mortgage Income Fund Mortgage Securities by Maturity Profile
as at 31 October 2012**

Period Maturing	No. of Loans	Value (\$)
0 – 6 months	27	326,102,759
06 – 24 months	0	0
25 – 36 months	0	0
37 – 48 months	0	0
49 – 60 months	0	0

The Responsible Entity is selling all assets in an orderly sales campaign and as the Fund is closed and not actively lending, loans are not being renewed.

**LM First Mortgage Income Fund Mortgage Securities by Interest Rate Profile
as at 31 October 2012**

Interest Rate	No. of Loans	Value (\$)
= or < 7.50%	0	0
7.51% - 8.00%	1	3,558,669
8.01% - 8.50%	2	35,726,346
8.51% - 9.00%	0	0
9.01% - 9.50%	1	4,676,670
9.51% - 10.00%	1	887,300
10.01% - 10.50%	6	130,789,240
10.51% - 11.00%	4	39,478,467
11.01% - 11.50%	3	11,385,786
11.51% - 12.00%	4	45,367,038
12.01% - 12.50%	3	36,978,339
12.50% - 13.00%	0	0
13.01% - 13.50%	1	3,220,000
16.01% - 16.50%	1	14,034,904

The interest rate banding refers to the interest rate to which the Fund is legally entitled (not including any penalty interest) in accordance with each mortgage security loan document. The Fund will seek to recover all interest entitlement on behalf of investors but the Responsible Entity has ceased interest accrual based on recoverability analysis.

LM First Mortgage Income Fund Loans in Arrears as at 31 October 2012

Period	No. of Loans	Value (\$)
30 – 60 days	0	0
60 – 90 days	0	0
90 days and over	27	326,102,759

The Responsible Entity uses the terms "arrears" and "default" interchangeably. LM calculates its loan arrears statistic in accordance with the IFSA Standard No 18, "Best Practice Guidance for Disclosure in the Mortgage Trust Sector."

Utilising the strong legal position afforded by the Fund's first mortgage security over all prior and remaining assets, LM has successfully taken control of the assets on behalf Fund investors as required following the Fund's closure, when due to the credit crunch and credit constraints the majority of the Fund's borrowers were unable to meet the Fund's request for repayment of the loan at maturity.

The Responsible Entity continues to actively manage each individual mortgage loan within the portfolio.

Warning Statements

- ¹ This information is current as at December 2012 but may be subject to change.
- ² In preparing the information contained in this ASIC Benchmark Disclosure, we did not take into account your particular investment objectives, financial situation or needs. Investors should consult their financial adviser or intermediary prior to making an investment decision.
- ³ Past performance is not a reliable indicator of future performance.
- ⁴ Fund performance is not guaranteed and returns could be lower than expected. Investment in the Fund is subject to investment risk including loss of income and principal invested. Investment in the Fund is not a bank deposit.
- ⁵ The unit price may vary and may increase or decrease depending on the performance and value of the assets of the Fund.

This information is provided by LM Investment Management Ltd (ABN 68 077 208 461 and AFSL No. 220281).

PW-32

**Australian Securities &
Investments Commission**



Form 388
Corporations Act 2001
294, 295, 298-300, 307, 308, 319, 321, 322
Corporations Regulations
1.0.08

Copy of financial statements and reports

If there is insufficient space in any section of the form, you may photocopy the relevant page(s) and submit as part of this lodgement

Company/scheme details

Company/scheme name

LM FIRST MORTGAGE INCOME FUND

ACN/ARBN/ARSN/PIN/ABN

089 343 288

Lodgement details

Who should ASIC contact if there is a query about this form?

Firm/organisation

LM INVESTMENT MANAGEMENT

Contact name/position description

GRANT FISCHER / CFO

ASIC registered agent number (if applicable)

n/a

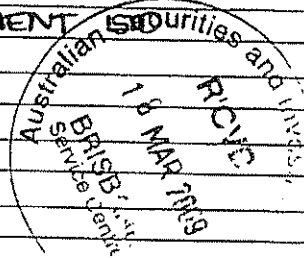
Telephone number

(07) 5584 4500

Postal address or DX address

PO BOX 485

SURFERS PARADISE Q 4217



1 Reason for lodgement of statement and reports

Tick appropriate box

- ☐ A public company or a disclosing entity which is not a registered scheme or prescribed interest undertaking (A)
- ☐ A registered scheme (B)
- ☐ Amendment of financial statements or directors' report (company) (C)
- ☐ Amendment of financial statements or directors' report (registered scheme) (D)
- ☐ A large proprietary company that is not a disclosing entity (H)
- ☐ A small proprietary company that is controlled by a foreign company for all or part of the period and where the company's profit or loss for the period is not covered by the statements lodged with ASIC by a registered foreign company, company, registered scheme, or disclosing entity (I)
- ☒ A small proprietary company that is requested by ASIC to prepare and lodge statements and reports (J)
- ☐ A prescribed interest undertaking that is a disclosing entity (K)

Dates on which financial year begins and ends

Financial year begins

01/01/07
[D] [M] [Y] [D] [M] [Y]

to

Financial year ends

30/06/08
[D] [M] [Y] [D] [M] [Y]

2 Details of large proprietary company

If the company is a large proprietary company that is not a disclosing entity, please complete the following information as at the end of the financial year for which the financial statements relate:

A What is the consolidated revenue of the large proprietary company and the entities that it controls?

B What is the value of the consolidated gross assets of the large proprietary company and the entities that it controls?

C How many employees are employed by the large proprietary company and the entities that it controls?

D How many members does the large proprietary company have?

3 Auditor's report

Were the financial statements audited?

☒ Yes

☐ No

If no, is there a class order exemption current for audit relief?

☐ Yes

☐ No

If yes, does the auditor's report (s308) for the financial year contain a statement of:

Reasons for the auditor not being satisfied as to the matters referred to in s307?

☐ Yes

☒ No

Details of the deficiency, failure or shortcoming concerning any matter referred to in s307?

☐ Yes

☒ No

4 Details of current auditor or auditors

Registered schemes must advise ASIC of the appointment of an auditor on a Form 5137 *Appointment of scheme auditor* within 14 days of the appointment of the auditor.

Auditor registration number (for individual auditor or authorised audit company)

Family name

Given name

or

Company name

ERNST + YOUNG

ACN/ABN

752 881 727 49

or

Firm name (if applicable)

4 Continued... Details of current auditor or auditors

A company may have two appointed auditors, provided that both auditors were appointed on the same date. Otherwise, an appointed auditor must resign, be removed or otherwise ceased before a subsequent appointment may be made.

Office, unit, level	
WATERFRONT PLACE	
Street number and Street name	
1 EAGLE STREET	
Suburb/City	State/Territory
BRISBANE	QLD
Postcode	Country (if not Australia)
4220	
Date of appointment	
01/10/03	
(D) (M) (Y)	
Auditor registration number (for individual auditor or authorised audit company)	
Family name	Given name
or	
Company name	
ACN/ABN	
or	
Firm name (if applicable)	
Office, unit, level	
Street number and Street name	
Suburb/City	State/Territory
Postcode	Country (if not Australia)

5 Statements and reports to be attached to this form

Financial statements for the year (as per s295(2) and accounting standards)

Income statement for the year

Balance sheet as at the end of the year

Statement of cash flows for the year

Statement of changes in equity or statement of recognised income and expense for the year

If required by accounting standards - the consolidated income statement, balance sheet, statement of cash flows and statement of changes in equity/statement of recognised income and expense

See Annexure 'A'

Notes to financial statements (as per s295(3))

Disclosures required by the regulations

Notes required by the accounting standards

Any other information necessary to give a true and fair view (see s297)

The directors' declaration about the statements and notes (as per s295(4))

The directors' report for the year, including the auditor's independence declaration (as per s298 to s300A)

Auditor's report required under s308 and s314

Concise report (if any) (s314)

Signature

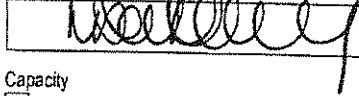
See Guide for details of signatory.

I certify that the attached documents marked () are a true copy of the original reports required to be lodged under s319 of the Corporations Act 2001.

Name

LISA DARCY

Signature



Capacity

☒ Director

☐ Company secretary

Date signed

17/03/09

[D] [D] [M] [M] [Y] [Y]

Lodgement

Send completed and signed forms to:

Australian Securities and Investments Commission,
PO Box 4000, Gippstand Mail Centre VIC 3841.

Or lodge the form electronically by visiting the ASIC website
www.asic.gov.au

For help or more information

Telephone 1300 300 630

Email info.enquiries@asic.gov.au

Web www.asic.gov.au

LM FIRST MORTGAGE INCOME FUND

ABN: 66 482 247 488

Annual Report

For the year ended 30 June 2008

LM FIRST MORTGAGE INCOME FUND

ABN: 66 482 247 488

Annual Report – 30 June 2008

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The Responsible Entity of LM First Mortgage Income Fund is LM Investment Management Ltd (ABN 68 077 208 461).
The Responsible Entity's registered office is Level 4, RSL Building, 9 Beach Road, Surfers Paradise QLD 4217.

LM FIRST MORTGAGE INCOME FUND

Directors' Report

DIRECTORS' REPORT

The directors of LM Investment Management Limited, the Responsible Entity of the LM First Mortgage Income Fund, present their report together with the consolidated financial report of the LM First Mortgage Income Fund ("the Scheme") and its subsidiary ("the consolidated entity"), for the year ended 30 June 2008. The directors' report is not part of the financial report.

DIRECTORS

The following persons held office as directors of LM Investment Management Limited, during the year or since the end of the year and up to the date of this report:

Name	Period of directorship
Mr Peter Charles Drake	Appointed 31 January 1997
Ms Lisa Maree Darcy	Appointed 15 September 2003
Mr John Dillon	Appointed 8 June 2005; resigned 28 August 2008
Mr Eghard van der Hoven	Appointed 22 June 2006
Ms Francene Mulder	Appointed 30 September 2006
Mr John Vallander Llewellyn	Appointed 1 June 2007; resigned 1 July 2008
Mr John O'Sullivan	Appointed 27 November 2007

PRINCIPAL ACTIVITIES

During the year, the Scheme continued the principal activity of investing unitholders' funds in registered first mortgages and cash investments in Australia, in accordance with the Scheme's Constitution and in accordance with the investment policy of the Scheme as outlined in the current product disclosure document.

The Scheme did not have any employees during the year.

SCHEME INFORMATION

The Scheme is an Australian registered scheme and was constituted in September 1999. The Responsible Entity of LM First Mortgage Income Fund is LM Investment Management Limited, who has been the Responsible Entity since registration of the Scheme.

The registered office and principal place of business of the Responsible Entity and the Scheme is Level 4, 9 Beach Road, Surfers Paradise, Queensland.

REVIEW OF RESULTS AND OPERATIONS

Results

During the year the Scheme continued to invest in registered first mortgage loans secured by property in Australia and cash assets.

The Scheme performed well during the year and delivered to investor's rates of interest greater than cash and a stable unit price of \$1.00. The net profit attributable to unitholders for the year ended 30 June 2008 was \$51,289,597 (2007: \$64,161,393).

During 2008, the Scheme had and continues to be impacted by events surrounding the global credit crisis. Lack of liquidity in the finance sector first saw a general slowdown in repayment of loans from those borrowers who were relying on refinances from other institutions to repay their loans to the scheme.

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Secondly, the introduction of the Australian Government Guarantee on bank deposits in Australia has also impacted the Scheme with an increase in withdrawal requests received from members following the implementation of the guarantee. Thirdly, a reflection of the credit crisis has also now resulted in the Schemes external financier requiring its loan facility to be repaid in priority to most investor redemptions.

The directors believe the Scheme will be able to meet its obligations to the financier under the current repayment plan through repayment of existing loans, however there is a risk to the unit price should the financier exercise its rights and require asset sales which are less than current valuations in order to satisfy its debt repayment schedule.

These three events in combination with the continuation of unprecedented general market conditions and the lack of liquidity within the banking sectors investment capital has seen the Scheme delay the payment of redemptions for a period of 365 days as per its constitution and in order to protect the investors.

Total assets under management were \$634,110,877 as at 30 June 2008 (2007: \$879,253,887). Investor funds under management decreased during the year by \$301,946,394 (2007: decreased by \$94,350,212) this was due to a combination of events mentioned above. Investor funds under management invested by related managed investment schemes in LM FMIF decreased by \$175,300,000 (2007: increased by \$38,950,000) to \$218,750,000 (2007: \$394,050,000).

The performance of the Scheme, as represented by the results of its operations, was as follows:

	30 June 2008	30 June 2007
	\$	\$
Net operating income/(loss) before distributions	49,797,814	64,161,393
Financing costs: Distributions to unitholders	(51,289,597)	(64,161,393)
(Increase) / decrease in net assets attributable to unitholders	-	-
Net profit/(loss)	(1,491,783)	-

UNITS ON ISSUE

There were 481,418,849 units on issue at 30 June 2008 (2007: 783,324,637). During the year 157,043,148 units were issued by the Scheme (2007: 253,296,241) and 458,948,936 were withdrawn (2007: 347,646,453).

SCHEME ASSETS

At 30 June 2008, the Scheme held assets to a total value of \$634,110,877 (2007: \$879,253,887). The basis for valuation of assets is disclosed in Note 2 to the financial statements.

FEEs PAID TO THE RESPONSIBLE ENTITY AND ASSOCIATED COMPANIES

The following fees were paid to LM Investment Management Limited and its associated companies out of Scheme property during the financial year, for funds management and administrative services provided on behalf of the Responsible Entity:

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	2008	2007
	\$	\$
• Management fees paid directly to LM Administration Pty Ltd	5,801,477	9,934,860
• Expenses incurred by the Responsible Entity and its associated entities which are reimbursed in accordance with the provisions of the Scheme's Constitution, including administration and custodian fees	-	386,755
• Expenses incurred by LM Administration Pty Ltd which are reimbursed in accordance with the provisions of the Scheme's Constitution, including administration and custodian fees	826,743	-
• Loan origination fees received by borrowers within the Scheme that were reimbursed to the Responsible Entity for the administration of loan origination services	9,410,607	3,381,487

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

In the opinion of the directors, there were no significant changes in the state of affairs of the Scheme that occurred during the financial year under review.

SIGNIFICANT EVENTS AFTER THE BALANCE DATE

Other than the matters disclosed in Note 19 of the financial report there has been no matter or circumstance that has arisen since the end of the financial year that has significantly affected or may affect the Scheme's operations in future financial years, the results of those operations of the Scheme's state of affairs in future years.

LIKELY DEVELOPMENTS AND EXPECTED RESULTS

Further information on likely developments in the operation of the Scheme and the expected results of those operations has not been included in this report because the Responsible Entity believes it would likely to result in unreasonable prejudice to the Scheme.

ENVIRONMENTAL REGULATION AND PERFORMANCE

The operations of the Scheme are not subject to any particular or significant environmental regulations under a law of the Commonwealth or a State or Territory. There have been no known significant breaches of any other environmental requirements applicable to the Scheme.

LM FIRST MORTGAGE INCOME FUND

Directors' Report

INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

No insurance premiums are paid for out of the assets of the Scheme in regards to insurance cover provided to either the officers of LM Investment Management Ltd or the auditors of the Scheme. Provided the officers of LM Investment Management Ltd act in accordance with the Scheme Constitution and the Law, the officers remain indemnified out of the assets of the Scheme against losses incurred while acting on behalf of the Scheme. The auditors of the Scheme are in no way indemnified out of the assets of the Scheme.

AUDITOR'S INDEPENDENCE DECLARATION

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is set out on page 7.

Signed in accordance with a resolution of the Directors of LM Investment Management Limited.



Lisa Darcy
Director
Gold Coast

10 March 2009



ERNST & YOUNG

1 Eagle Street
Brisbane QLD 4000 Australia
GPO Box 7878 Brisbane QLD 4001
Tel: +61 7 3011 3333
Fax: +61 7 3011 3100
www.ey.com/au

Auditor's Independence Declaration to the Directors of LM Investment Management Limited as Responsible Entity for LM First Mortgage Income Fund

In relation to our audit of the financial report of LM First Mortgage Income Fund for the financial year ended 30 June 2008, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the Corporations Act 2001 or any applicable code of professional conduct.

Ernst & Young

Ernst & Young

Paula McLuskie

Paula McLuskie
Partner
Brisbane
10 March 2009

LM FIRST MORTGAGE INCOME FUND

INCOME STATEMENT

For the year ended 30 June 2008

		30 June 2008		30 June 2007	
	Notes	Consolidated \$	Scheme \$	Consolidated \$	Scheme \$
Income					
Changes in the fair value of investments	3(a)	28,379	-	377,052	-
Interest revenue – loans and advances	3(b)	81,612,059	81,645,183	80,704,491	81,106,122
Interest revenue – cash assets	3(b)	1,504,559	1,501,881	3,449,423	3,424,562
Other income	3(a)	2,005,949	2,005,949	3,945,714	3,945,714
Total revenue and other income		85,150,946	85,153,013	88,476,680	88,476,398
Expenses					
Management fees	12	5,801,477	5,801,477	9,934,860	9,934,860
Custodian fees		157,876	157,876	185,054	185,054
Advisor commissions		2,640,504	2,640,504	3,856,517	3,856,517
Impairment losses on loans and receivables	9(d)	6,154,911	6,157,884	2,563,242	2,563,242
Finance costs		10,169,709	10,169,709	3,520,151	3,520,151
Legal fees		36,949	36,949	35,411	35,411
Other expenses	4	10,391,706	10,390,800	4,220,052	4,219,770
Total expenses excluding distributions to unitholders		35,353,132	35,355,199	24,315,287	24,315,005
Net profit attributable to unitholders		49,797,814	49,797,814	64,161,393	64,161,393
Distributions to unitholders	3(c)/7	(51,289,597)	(51,289,597)	(64,161,393)	(64,161,393)
Changes in net assets attributable to unitholders		(1,491,783)	(1,491,783)	-	-
Income tax expense		-	-	-	-
Changes in net assets attributable to unitholders after income tax expense		(1,491,783)	(1,491,783)	-	-

LM FIRST MORTGAGE INCOME FUND

BALANCE SHEET

As at 30 June 2008

		30 June 2008		30 June 2007	
		Consolidated	Scheme	Consolidated	Scheme
		\$	\$	\$	\$
	Notes				
ASSETS					
Cash and cash equivalents	14	14,643,332	14,643,332	28,593,772	28,332,244
Receivables	13	4,797,790	4,797,789	6,997,000	6,934,391
Prepayments	12	7,845,017	7,845,017	3,482,170	3,482,170
Investments	8	-	1	5,654,350	1
Loans and receivables	9	606,824,738	606,824,738	834,505,081	840,505,081
TOTAL ASSETS					
		634,110,877	634,110,877	879,232,373	879,253,887
LIABILITIES					
Payables	10	878,796	878,796	481,752	503,266
Interest bearing loans and borrowings	11	150,000,000	150,000,000	90,466,662	90,466,662
Distributions payable	3(c)	3,305,015	3,305,015	4,959,322	4,959,322
Fair value of forward exchange contracts		40,606	40,606	-	-
TOTAL LIABILITIES EXCLUDING NET ASSETS ATTRIBUTABLE TO UNITHOLDERS					
		154,224,417	154,224,417	95,907,736	95,929,250
NET ASSETS ATTRIBUTABLE TO UNITHOLDERS					
	6	479,886,460	479,886,460	783,324,637	783,324,637

STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June 2008

Net assets of the Scheme that are attributable to unitholders are classified as a liability rather than equity. As a result there was no equity at the start or end of the year. A *Statement of Changes in Net Assets Attributable to Unitholders* is disclosed in note 6.

LM FIRST MORTGAGE INCOME FUND

CASH FLOW STATEMENT

For the year ended 30 June 2008

Notes	30 June 2008		30 June 2007	
	Consolidated \$	Scheme \$	Consolidated \$	Scheme \$
Cash flows from operating activities				
Interest and distributions received	22,918,375	22,827,388	35,249,640	34,910,335
Management fees paid	(9,724,881)	(9,724,881)	(10,467,111)	(10,467,111)
Other operating expenses	(17,970,388)	(17,990,996)	(6,635,397)	(6,539,445)
Other income received	4,231,876	4,229,198	1,611,118	1,547,484
GST and withholding tax (paid)/received	729,911	729,911	(481,965)	(481,965)
Finance costs paid	(10,169,709)	(10,169,709)	(3,520,151)	(3,520,151)
Net cash inflow/(outflow) from operating activities	14(b) (9,984,816)	(10,099,089)	15,756,134	15,449,147
Cash flows from investing activities				
Payments for secured mortgage loans	(320,147,455)	(320,117,304)	(386,157,123)	(385,755,492)
Receipts from settled mortgage loans	611,498,185	611,843,835	464,782,349	464,776,872
Net cash inflow/(outflow) from investing activities	291,350,730	291,726,531	78,625,226	79,021,380
Cash flows from financing activities				
Proceeds from borrowings	59,533,338	59,533,338	60,050,000	60,050,000
Receipts from the issue of units	145,782,718	145,782,718	236,754,786	236,754,786
Distributions paid	(41,683,474)	(41,683,474)	(47,941,585)	(47,941,585)
Payment for redemption of units	(458,948,936)	(458,948,936)	(347,646,486)	(347,646,486)
Net cash inflow/(outflow) from financing activities	(295,316,354)	(295,316,354)	(98,783,285)	(98,783,285)
Net increase/(decrease) in cash and cash equivalents	(13,950,440)	(13,688,912)	(4,401,925)	(4,312,758)
Cash and cash equivalents at beginning of the year	28,593,772	28,332,244	32,995,697	32,645,002
Cash and cash equivalents at the end of the year	14(a) 14,643,332	14,643,332	28,593,772	28,332,244

LM FIRST MORTGAGE INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2008

1. CORPORATE INFORMATION

The financial report of LM First Mortgage Income Fund ("the Scheme") for the year ended 30 June 2008 was authorised for issue in accordance with a resolution of the directors of the Responsible Entity on 10 March 2009.

The Scheme is an Australian registered Scheme, constituted on 13 April 1999. The Scheme will terminate on 13 April 2080 unless terminated earlier in accordance with the provision of the Scheme Constitution (as amended).

LM Investment Management Limited, the Responsible Entity of the Scheme, is incorporated and domiciled in Australia. The registered office of the Responsible Entity is located at Level 4, 9 Beach Road, Surfers Paradise, Queensland.

The nature of the operations and principle activities of the Scheme are described in the Directors' report.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all periods presented, unless otherwise stated in the following text.

a) Basis of accounting

This financial report is a general purpose financial report that has been prepared in accordance with the Scheme Constitution, and the requirements of the Corporations Act 2001, which includes applicable Accounting Standards.

The financial statements have been prepared under the historical cost convention, except for the valuation of investments in financial assets, which have been measured at fair value or amortised cost.

The balance sheet presents assets and liabilities in decreasing order of liquidity and does not distinguish between current and non-current items, in accordance with AASB 101 – *Presentation of Financial Statements*.

Subsequent to balance date the scheme has been negatively impacted by a further tightening in credit markets.

The financial statements have been prepared on the basis the Scheme is a going concern. As detailed in Note 11, the Responsible Entity has been able to negotiate an extension to its external financing facilities until 31 July 2009, with a requirement for the full balance to be repaid in instalments, in priority to any redemptions over this period, as below:

	Tranche A	Tranche B	Total
28 February 2009	10,000,000		10,000,000
31 March 2009	17,500,000		17,500,000
30 April 2009	20,000,000		20,000,000
31 May 2009	27,500,000	15,000,000	42,500,000
30 June 2009		45,000,000	45,000,000
31 July 2009		15,000,000	15,000,000

LM FIRST MORTGAGE INCOME FUND

As at the date of this report, the Scheme has not made the repayment under the facility due on the 28 February 2009. This repayment is now overdue and the failure to make this repayment constitutes a breach under the facility. Correspondence has been received from the external financier stating that it is reviewing its options in respect of the facility, including the right to enforce its security and reserves its rights in respect of this breach.

The directors believe the Scheme will be able to meet its remaining obligations under the repayment plan through repayment of existing loans including the refinancing of existing loans with alternative financing providers; the repayment of loans from related entities; and the repayment of the prepaid management fee from LM Administration Pty Ltd.

The timing of these cash inflows is not at the discretion of the Scheme, as the Scheme is reliant on events outside the Schemes control and these events impact the Schemes ability to meet repayments of the financiers. In this event, this would require the Directors to secure continued support from the external financier or alternate sources of finance. The Directors believe that therefore there remains significant uncertainty as to the Scheme's ability to make the requirement repayments to the financiers as required within the timeframes set out in the loan agreement.

As a result of these matters there is significant uncertainty whether the Scheme will continue as a going concern, and therefore whether it will realise its assets and extinguish its liabilities in the normal course of business and at the amounts stated in the financial report. The financial report does not include any adjustments relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the Scheme not continue as a going concern.

For further information relating to the prepaid management fee refer to note 12, other receivables from related parties refer to note 12 and borrowings refer to note 11.

b) Statement of compliance

The financial report complies with Australian Accounting Standards, which include Australian equivalents to International Financial Reporting Standards ('AIFRS'). Compliance with AIFRS ensures that the financial report, comprising the financial statements and notes thereto, complies with International Financial Reporting Standards ('IFRS') as issued by the International Accounting Standards Board.

Australian Accounting Standards that have recently been issued or amended but are not yet effective have not been adopted for the annual reporting period ended 30 June 2008 are shown in the following tables. None of the standards issued or amended have an impact on the accounting policies adopted by the Scheme.

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Reference	Title	Summary	Application date of standard*	Impact on Scheme financial report	Application date for Scheme*
AASB 8 and AASB 2007-3	Operating Segments and consequential amendments to other Australian Accounting Standards	New standard replacing AASB 114 <i>Segment Reporting</i> , which adopts a management reporting approach to segment reporting.	1 January 2009	AASB 8 is a disclosure standard so will have no direct impact on the amounts included in the Scheme's financial statements. The amendments may have an impact on the Scheme's segment disclosures.	1 July 2009
AASB 101 (Revised) and AASB 2007-8	Presentation of Financial Statements and consequential amendments to other Australian Accounting Standards	Introduces a statement of comprehensive income. Other revisions include impacts on the presentation of items in the statement of changes in equity, new presentation requirements for restatements or reclassifications of items in the financial statements, changes in the presentation requirements for dividends and changes to the titles of the financial statements.	1 January 2009	These amendments are only expected to affect the presentation of the Scheme's financial report and will not have a direct impact on the measurement and recognition of amounts disclosed in the financial report. The Scheme has not determined at this stage whether to present a single statement of comprehensive income or two separate statements.	1 July 2009
AASB 127 (Revised)	Consolidated and Separate Financial Statements	Under the revised standard, a change in the ownership interest of a subsidiary (that does not result in loss of control) will be accounted for as an equity transaction.	1 July 2009	These amendments are not expected to have any impact on the Scheme's financial report.	1 July 2009

LM FIRST MORTGAGE INCOME FUND

Reference	Title	Summary	Application date of standard*	Impact on Scheme financial report	Application date for Scheme*
Amendments to International Financial Reporting Standards	Improvements to IFRSs	The improvements project is an annual project that provides a mechanism for making non-urgent, but necessary, amendments to IFRSs. The IASB has separated the amendments into two parts: Part I deals with changes the IASB identified resulting in accounting changes; Part II deals with either terminology or editorial amendments that the IASB believes will have minimal impact.	1 January 2009 except for amendments to IFRS 5, which are effective from 1 July 2009.	The Scheme has not yet determined the extent of the impact of the amendments, if any.	1 July 2009
AASB 2008-5 & AASB 2008-6	Amendments to Australian Accounting Standards arising from the Annual Improvements Project Further Amendments to Australian Accounting Standards arising from the Annual Improvements Project	The improvements project is an annual project that provides a mechanism for making non-urgent, but necessary, amendments to IFRSs. The IASB has separated the amendments into two parts: Part I deals with changes the IASB identified resulting in accounting changes; Part II deals with either terminology or editorial amendments that the IASB believes will have minimal impact.	1 January 2009 1 July 2009	The Scheme has not yet determined the extent of the impact of the amendments, if any.	1 July 2009

LM FIRST MORTGAGE INCOME FUND

Reference	Title	Summary	Application date of standard*	Impact on Scheme financial report	Application date for Scheme*
AASB 2008-7	Amendments to Australian Accounting Standards – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate	<p>The main amendments of relevance to Australian entities are those made to AASB 127 deleting the 'cost method' and requiring all dividends from a subsidiary, jointly controlled entity or associate to be recognised in profit or loss in an entity's separate financial statements (i.e., parent company accounts). The distinction between pre- and post-acquisition profits is no longer required. However, the payment of such dividends requires the entity to consider whether there is an indicator of impairment.</p> <p>AASB 127 has also been amended to effectively allow the cost of an investment in a subsidiary, in limited reorganisations, to be based on the previous carrying amount of the subsidiary (that is, share of equity) rather than its fair value (An issue sometimes known as a "dividend trap" in newcos).</p>	1 January 2009	<p>Recognising all dividends received from subsidiaries, jointly controlled entities and associates as income will likely give rise to greater income being recognised by the parent entity after adoption of these amendments.</p> <p>In addition, if the Scheme enters into any reorganisation establishing new parent entities, an assessment will need to be made to determine if the reorganisation meets the conditions imposed to be effectively accounted for on a 'carry-over basis' rather than at fair value.</p>	1 July 2009

*designates the beginning of the applicable annual reporting period unless otherwise stated

The following standards have been amended, however they do not affect the Scheme:

- AASB Int. 12 and AASB 2007-2: Service Concession Arrangements and consequential amendments to other Australian Accounting Standards
- AASB Int. 4 (Revised): Determining whether an Arrangement contains a Lease
- AASB Int. 129: Service Concession Arrangements: Disclosures
- AASB Int. 13: Customer Loyalty Programmes
- AASB Int. 14: AASB 119 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction
- AASB Int. 15: Agreement for the Construction of Real Estate

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- AASB Int. 16: Hedges of a Net Investment in a Foreign Operation
- AASB 2007-9: Amendments to Australian Accounting Standards arising from the Review of AASs 27, 29 and 31
- AASB 1004 (revised): Contributions
- AASB Int. 1038 (Revised): Contributions by Owners Made to Wholly-Owned Public Sector Entities
- AASB 1049: Whole of Government and General Government Sector Financial Reporting
- AASB 1050: Administered Items
- AASB 1051: Land Under Roads
- AASB 1052: Disaggregated Disclosures
- AASB 123 (Revised) and AASB 2007-6: Borrowing Costs and consequential amendments to other Australian Accounting Standards
- AASB 2008-1: Amendments to Australian Accounting Standard – Share-based Payments: Vesting Conditions and Cancellations
- AASB 2008-2: Amendments to Australian Accounting Standards – Puttable Financial Instruments and Obligations arising on Liquidation
- AASB 3 (Revised): Business Combinations: Business Combinations
- AASB 2008-3: Amendments to Australian Accounting Standards arising from AASB 3 and AASB 127
- AASB 2008-8: Amendments to Australian Accounting Standards – Eligible Hedged Items
- AASB 2008-9: Amendments to AASB 1049 for consistency with AASB 101
- AASB 2008-10: Amendments to Australian Accounting Standards – Reclassification of Financial Assets (Amendments to AASB 139 Financial Instruments: Recognition and Measurement and AASB 7 Financial Instruments Disclosures)
- Amendments to International Financial Reporting Standards: Eligible Hedged Items
- IFRIC 15: Agreements for the Construction of Real Estate
- IFRIC 16: Hedges of a Net Investment in a Foreign Operation

c) Basis of consolidation

This consolidated financial report comprises the financial report of LM First Mortgage Income Fund and its subsidiary as at 30 June 2008 (“the consolidated entity”). The financial report of the subsidiary is prepared for the same reporting period as the Scheme, using consistent accounting policies.

In preparing the consolidated financial statements all intercompany balances and income and expenses and profit and losses resulting from intra-group transactions have been eliminated in full. Adjustments are made to bring into line any dissimilar accounting policies that may exist.

Subsidiaries are fully consolidated from the date on which control is transferred to the group and cease to be consolidated from the date on which control is transferred out of the group.

d) Significant accounting judgements, estimates and assumptions

(i) Significant accounting judgements

In the process of applying the Group’s accounting policies, management has made judgements, apart from those involving estimations, which have had an impact on the amounts recognised in the financial statements. No judgements have been determined to be individually significant.

(ii) Significant accounting estimates and assumptions

The carrying amounts of certain assets and liabilities are often determined based on estimates and assumptions of future events. The key estimates and assumptions that have a significant risk of causing

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a material adjustment to the carrying amounts of certain assets and liabilities within the next annual reporting period are:

Allowance for impairment loss on loans and receivables

The Scheme determines whether loans are impaired on an ongoing basis. This requires an estimation of the value of future cash flows. The Scheme's policy for calculation of impairment losses is disclosed in Note 2(h)(ii).

e) Cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. For the purposes of the Cash Flow Statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

f) Revenue and income recognition

Revenue is recognised and measured at the fair value of the consideration received or receivable to the extent that it is probable that the economic benefits will flow to the Scheme and the revenue can be reliably measured. The following specific recognition criteria must also be met before income is recognised:

i) Dividend and distribution income

Dividend or distribution income is recognised when the shareholders' or unitholders' right to receive the payment is established.

ii) Interest income

Interest income is recognised as the interest accrues (using the effective interest rate method, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument) to the net carrying amount of the financial asset.

iii) Changes in the fair value of investments

Gains or losses on investments held for trading are calculated as the difference between the fair value at sale, or at year end, and the fair value at the previous valuation point. This includes both realised and unrealised gains and losses.

g) Finance costs

Interest on borrowings is recognised in the income statement in the period to which it relates. Issue costs associated with borrowings are capitalised and amortised over the term of the borrowing to which they relate using the effective interest method.

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h) Investments and other financial assets

Financial assets in the scope of AASB 139 *Financial Instruments: Recognition and Measurement* are classified as either financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale investments, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transactions costs. The consolidated entity determines the classification of its financial assets at initial recognition.

All regular way purchases and sales of financial assets are recognised on the trade date i.e. the date that the Scheme commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets under contracts that require delivery of the assets within the period established generally by regulation or convention in the marketplace.

i) Financial assets at fair value through profit or loss

Financial assets classified as held for trading are included in the category 'financial assets at fair value through profit or loss'. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on investments held for trading are recognised in profit or loss.

ii) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially measured at fair value including transaction costs directly attributable to the financial asset. After initial recognition, loans and receivables are carried at amortised cost using the effective interest method. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Loans and receivables are assessed for impairment at each reporting period. An allowance is made for doubtful debts when there is objective evidence that the consolidated entity will not be able to collect the receivables. Impairment losses are written off when identified. Losses expected as a result of future events are not recognised. If a provision for impairment has been recognised in relation to a loan, write offs for bad debts are made against the provision. If no provision for impairment has previously been recognised, write offs for bad debts are recognised as an expense in the income statement.

The amount provided for impairment of loans is determined by management of the Scheme and the Credit Committee. A provision is made of loans in arrears where the collectability of the debts is considered doubtful by estimation of expected losses in relation to loan portfolios where specific identification is impracticable.

The components of impaired assets are as follows:

"Loans in arrears" are loans and advances for which there is reasonable doubt that the Scheme will be able to collect all amounts of principal and interest in accordance with the terms of the agreement.

"Assets acquired through the enforcement of security" are assets acquired in full or partial settlement

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of a loan or similar facility through the enforcement of security arrangements.

"Restructured loans" arise when the borrower is granted a concession due to continuing difficulties in meeting the original terms and new terms are not comparable to the revised terms. These loans are removed from 'restructure loans' after a period of 12 months of performance against loan revised terms and conditions. Loans with revised terms are included in 'loans in arrears' when impairment provisions are required.

When the Responsible Entity determines interest is not recoverable on certain impaired loans, the interest is suspended and not brought into income. Should the Responsible Entity's analysis of the collectability subsequently change the interest will be brought into income at the time it is determined to be collectible.

i) Advisor Commissions

Advisor commissions may be paid to the unitholders' investment advisors and are calculated as a percentage of funds invested in the Scheme. These commissions are paid monthly in arrears and are brought to account on an accrual basis. The Scheme ceases to pay advisor commissions when the related units are redeemed.

j) Payables

Payables are carried at amortised cost and represent liabilities for goods and services provided to the consolidated entity prior to the end of the financial year that are unpaid and arise when the consolidated entity becomes obliged to make future payments in respect of the purchases of these goods and services.

Trades are recorded on trade date, and normally settled within three business days. Purchases of securities and investments that are unsettled at reporting date are included in payables.

The distribution amount payable to investors as at the reporting date is recognised separately on the balance sheet as unit holders are presently entitled to the distributable income as at 30 June 2008 under the Scheme's Constitution.

Foreign currency received from investors for investment into the Scheme is classified as a payable until it is subject to hedging by the Scheme entering into forward exchange contracts, at which time the foreign currency is invested into the Scheme and units issued.

k) Increase/decrease in net assets attributable to unitholders

Non-distributable income is transferred directly to net assets attributable to unitholders and may consist of unrealised changes in the net fair value of investments, accrued income not yet assessable; expenses accrued for which are not yet deductible, net capital losses and tax free or tax deferred income. Net capital gains on the realisation of any investments (including any adjustments for tax deferred income previously taken directly to net assets attributable to unitholders) and accrued income not yet assessable will be included in the determination of distributable income in the same year in which it becomes assessable for tax. Excess and undistributed income is also transferred directly to net assets attributable to unitholders.

LM FIRST MORTGAGE INCOME FUND

l) Distributions

In accordance with the Scheme's Constitution, the Scheme fully distributes its distributable income to unitholders. Distributions are payable monthly. Such distributions are determined by reference to the net taxable income of the Scheme. Distributable income includes capital gains arising from the disposal of investments. Unrealised gains and losses on investments that are recognised as income are transferred to net assets attributable to unitholders and are not assessable and distributable until realised. Capital losses are not distributed to unitholders but are retained to be offset against any realised capital gains.

m) Goods and services tax (GST)

The GST incurred on the costs of various services provided to the Responsible Entity by third parties such as audit fees, custodial services and investment management fees, have been passed onto the Scheme. The Scheme qualifies for Reduced Input Tax Credits (RITC's) at a rate of 75%.

Hence investment management fees, custodial fees and other expenses have been recognised in the statement of financial performance net of the amount of GST recoverable from the Australian Taxation Office (ATO). Accounts payable are inclusive of GST. The net amount of GST recoverable from the ATO is included in receivable in the balance sheet. Cash flows relating to GST are included in the cash flow statement on a gross basis.

The GST component of cash flows arising from investing and financing activities recoverable or payable to the ATO is classified as an operating cash flow.

n) Applications and redemptions

Applications received for units in the Scheme are recorded when units are issued in the Scheme. Redemptions from the Scheme are recorded when the cancellation of units redeemed occurs. Unit redemption prices are determined by reference of the net assets of the Scheme divided by the number of units on issue.

o) Taxation

Under current legislation, the Scheme is not subject to income tax provided the distributable income of the Scheme is fully distributed either by way of cash or reinvestment (ie Unitholders are presently entitled to the income of the Scheme).

The price of a unit is based upon market values of underlying assets and thus may include a share of unrealised capital gains. Should such a gain be realised, that portion of the gain that is subject to capital gains tax will be distributed so that the Scheme is not subject to capital gains tax. Realised capital losses are not distributed to unitholders but are retained in the Scheme to be offset against any realised capital gains. If realised capital gains exceed realised capital losses, the excess is distributed to unitholders.

p) Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

LM FIRST MORTGAGE INCOME FUND

3. INTEREST INCOME AND DISTRIBUTIONS TO UNITHOLDERS

a) Non-Interest income

	30 June 2008		30 June 2007	
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
Changes in the fair value of investments	28,379	-	377,052	-
Other income:				
Default management fees	1,724,208	1,724,208	3,497,077	3,497,077
Other income	281,741	281,741	448,637	448,637
	2,005,949	2,005,949	3,945,714	3,945,714

b) Interest income

	2008			2007		
	Consolidated		Average rate	Scheme		Average rate
	Average balance	Income		Average balance	Income	
	\$	\$	%	\$	\$	%
Cash assets	25,331,798	1,504,559	5.94%	25,302,766	1,501,881	5.94%
Loans and advances	722,514,861	81,612,059	11.30%	722,514,861	81,645,183	11.30%
	747,846,659	83,116,618	11.11%	747,817,627	83,147,064	11.11%

	2007			2007		
	Consolidated		Average rate	Scheme		Average rate
	Average balance	Income		Average balance	Income	
	\$	\$	%	\$	\$	%
Cash assets	61,964,147	3,449,423	5.57%	61,515,754	3,424,562	5.57%
Loans and advances	819,492,029	80,704,491	9.85%	819,992,024	81,106,122	9.89%
	881,456,176	84,153,914	9.55%	881,507,778	84,530,684	9.59%

c) Distributions to unitholders

	30 June 2008		30 June 2007	
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
Distributions paid	47,984,582	47,984,582	59,202,071	59,202,071
Distributions payable	3,305,015	3,305,015	4,959,322	4,959,322
	51,289,597	51,289,597	64,161,393	64,161,393

LM FIRST MORTGAGE INCOME FUND

4. OTHER EXPENSES

	30 June 2008		30 June 2007	
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
Loan origination expenses	9,410,607	9,410,607	3,381,487	3,381,487
Auditor's remuneration	236,001	236,001	196,441	196,441
Product disclosure statement production costs	62,972	62,972	134,413	134,413
Other expenses	682,126	681,220	507,711	507,429
	<u>10,391,706</u>	<u>10,390,800</u>	<u>4,220,052</u>	<u>4,219,770</u>

5. AUDITOR'S REMUNERATION

	30 June 2008		30 June 2007	
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
Audit and review of the financial reports	219,235	219,235	182,464	182,464
Other regulatory audit services	16,766	16,766	13,977	13,977
	<u>236,001</u>	<u>236,001</u>	<u>196,441</u>	<u>196,441</u>

These expenses have been included within 'Other Expenses' in the Income Statement.

6. CHANGES IN NET ASSETS ATTRIBUTABLE TO UNITHOLDERS

All units in the Scheme are attributed with a value of \$1. The units on issue in the Scheme and the consolidated entity are equal. Movements in number of units and net assets attributable to unitholders during the year were as follows:

	30 June 2008		30 June 2007	
	#	\$	#	\$
Net assets attributable to unitholders				
Class A				
Opening balance	389,274,637	389,274,637	522,574,849	522,574,849
Units issued during the year	47,186,284	47,186,284	65,204,786	65,204,786
Units redeemed during the year	(189,724,646)	(189,724,646)	(215,046,454)	(215,046,454)
Units issued upon reinvestment of distributions	11,259,497	11,259,497	16,541,456	16,541,456
Closing Balance	<u>257,995,772</u>	<u>257,995,772</u>	<u>389,274,637</u>	<u>389,274,637</u>
Class B				
Opening balance	394,050,000	394,050,000	355,100,000	355,100,000
Units issued during the year	93,870,624	93,870,624	171,550,000	171,550,000
Units redeemed during the year	(269,170,624)	(269,170,624)	(132,600,000)	(132,600,000)
Units issued upon reinvestment of distributions	-	-	-	-
Closing Balance	<u>218,750,000</u>	<u>218,750,000</u>	<u>394,050,000</u>	<u>394,050,000</u>

LM FIRST MORTGAGE INCOME FUND

	30 June 2008 Scheme		30 June 2007 Scheme	
	#	\$	#	\$
Class C				
Opening balance	-	-	-	-
Units issued during the year	4,725,809	4,725,809	-	-
Units redeemed during the year	(53,666)	(53,666)	-	-
Units issued upon reinvestment of distributions	934	934	-	-
Change in fair value of derivatives	-	(40,606)	-	-
Closing Balance	4,673,077	4,632,471	-	-

	30 June 2008 Scheme		30 June 2007 Scheme	
	#	\$	#	\$
TOTAL				
Opening balance	783,324,637	783,324,637	877,674,849	877,674,849
Units issued during the year	145,782,717	145,782,717	236,754,786	236,754,786
Units redeemed during the year	(458,948,936)	(458,948,936)	(347,646,453)	(347,646,453)
Units issued on reinvestment of distributions	11,260,431	11,260,431	16,541,456	16,541,456
Transfers to and from the income statement	-	(1,491,783)	-	-
Change in fair value of derivatives	-	(40,606)	-	-
Closing Balance	481,418,849	479,886,460	783,324,637	783,324,637

Class A consists of unit holders who are entitled to receive the declared distribution rate. There are a number of subclasses attached to class A.

Class B consists of related scheme unit holders. The distribution rate will be determined by the Funds Committee which is appointed by the Responsible Entity. The Responsible Entity has the discretion to waive the whole or part of the 1% trailing commission and the whole or part of its management fee for this class of unit holders.

Class C consist of unit holders who have invested in foreign currencies and are entitled to receive the declared distribution rate. There are a number of subclasses attached to class C.

All unitholders are entitled to receive distributions as declared from time to time and are entitled to one vote per unit at unitholders' meetings. In the event of winding up of the Scheme, all unitholders rank after creditors and are equally entitled to the proceeds of liquidation.

On the 3 March 2009, the manager announced that the fund will be paying any withdrawal requests up to 365 days after maturity.

LM FIRST MORTGAGE INCOME FUND

Redemptions of the Scheme are currently not suspended. At 30 June 2008 \$15,117,968 of redemptions had been requested by unitholders but not yet paid. Of the total requested redemptions \$7,303,508 related to requests occurring within thirty days of year end. \$7,814,460 had been requested more than 30 days prior to year end. Redemptions also rank behind repayment of external financing facilities as detailed in Note 2(a).

7. DISTRIBUTIONS TO UNITHOLDERS

	30 June 2008	30 June 2007
Distributions	\$	\$
Class A	24,431,419	34,369,906
Class B	26,825,153	29,791,489
Class C	33,025	-
	<u>51,289,597</u>	<u>64,161,395</u>

8. INVESTMENTS

	2008	2008	2007	2007
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
Financial assets held at fair value through profit and loss	(i) -	-	5,654,350	-
Investment in subsidiary	(ii) -	1	-	1
	<u>-</u>	<u>1</u>	<u>5,654,350</u>	<u>1</u>

i). At 30 June 2008, the consolidated entity held nil units in the PM Capital Enhanced Yield Fund (2007: 4,978,736 units). The unit price at 30 June 2007 was \$1.1357.

9. LOANS AND RECEIVABLES

	30 June 2008	30 June 2007	30 June 2007	30 June 2007
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
Secured Mortgage Loans	604,441,259	604,441,259	835,530,336	835,530,336
Other Unsecured Loans – related party	5,100,000	5,100,000	-	6,000,000
Provision for impairment	(2,716,521)	(2,716,521)	(1,025,255)	(1,025,255)
Net loans and advances	<u>606,824,738</u>	<u>606,824,738</u>	<u>834,505,081</u>	<u>840,505,081</u>
a) Aggregate amounts receivable from related parties				
Directors and director-related entities	-	-	-	-
Other related entities	-	-	-	6,000,000
Related managed investment schemes	-	-	-	-
Provision for impairment	-	-	-	-
LM Managed Performance Fund	7,008,047	7,008,047	-	-
	<u>7,008,047</u>	<u>7,008,047</u>	<u>-</u>	<u>6,000,000</u>

LM FIRST MORTGAGE INCOME FUND

9. LOANS AND RECEIVABLES

(Continued)

	30 June 2008		30 June 2007	
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
b) Maturity analysis – Secured Mortgage Loans				
Less than 3 months	207,820,725	207,820,725	201,435,919	201,435,919
3-6 months	97,953,294	97,953,294	144,628,228	144,628,228
6-12 months	143,723,462	143,723,462	54,191,912	54,191,912
12-18 months	101,817,897	101,817,897	224,938,707	224,938,707
18-24 months	24,482,446	24,482,446	49,981,868	49,981,868
24-36 months	28,643,435	28,643,435	68,573,704	68,573,704
36-48 months	-	-	51,154,823	51,154,823
48-60 months	-	-	40,625,175	40,625,175
	<u>604,441,259</u>	<u>604,441,259</u>	<u>835,530,336</u>	<u>835,530,336</u>

c) Concentration of risk

As at 30 June 2008 no individual loan was greater than 10% of net assets attributable to unit holders.

For concentration of risks relating to mortgage type and geographical location refer to note 16.

d) Provisions for impairment

The impairment loss expense relating to loans and receivables comprises:

Specific provision	3,278,509	3,278,509	1,543,070	1,543,070
Collective impairment provision	-	-	-	-
Impairment losses realized directly in the Income Statement	2,876,402	2,879,375	1,020,172	1,020,172
	<u>6,154,911</u>	<u>6,157,884</u>	<u>2,563,242</u>	<u>2,563,242</u>

	30 June 2008		30 June 2007	
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
<i>Specific Provision</i>				
Opening balance	1,025,255	1,025,225	1,707,999	1,707,999
Impairment losses provided for during year	3,278,509	3,278,509	1,543,070	1,543,070
Utilisation of provisions (loans realized)	(1,587,243)	(1,587,243)	(2,225,814)	(2,225,814)
Closing balance	<u>2,716,521</u>	<u>2,716,521</u>	<u>1,025,255</u>	<u>1,025,255</u>
<i>Collective impairment provision</i>				
Opening balance	-	-	-	-
Impairment losses provided for during year	-	-	-	-
Closing balance	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
TOTAL PROVISION	<u>2,716,521</u>	<u>2,716,521</u>	<u>1,025,255</u>	<u>1,025,255</u>

LM FIRST MORTGAGE INCOME FUND

The collective provision for impairment is calculated by placing loans into pools with similar risk characteristics and collectively assessing for impairment.

Movement in Default loans

Gross default loans opening balance	83,826,384	83,826,384	42,661,029	42,661,029
New and increased default loans	59,907,804	59,907,804	103,145,841	103,145,841
Balances written off	(754,152)	(754,152)	(1,020,709)	(1,020,709)
Returned to performing or repaid	(41,820,383)	(41,820,383)	(60,959,777)	(60,959,777)
Gross default loans closing balance	101,159,653	101,159,653	83,826,384	83,826,384
Specific provision	(2,716,521)	(2,716,521)	(1,025,254)	(1,025,254)
Net default loans	98,443,132	98,443,132	82,801,130	82,801,130

Further, the Directors of the Responsible Entity are in the process of finalising the sale of secured property in relation to default loans totalling NIL (2007: \$21,381,314) at balance date.

On 28 August 2008, it was resolved by the Board of Directors of the Responsible Entity, to transfer three mortgage loans to the value of \$33,513,345 and the related first mortgage security to the LM Managed Performance Fund (LM MPF). There is a fixed charge over these three specific secured properties plus a floating charge over the remaining assets of LM MPF to provide security to the Scheme in the event of default by the LM MPF. This loan between the Scheme and LM MPF is interest bearing at 10%, with the interest being capitalised and due to be repaid to the Scheme on 30 June 2009.

At 30 June 2008 the balance of loans that were past due but not impaired were \$63,789,822 (2007: \$77,077,546). As per the scheme's policy, loans are impaired once they exceed 90 days overdue.

At 30 June 2008 \$11,949,198 of loans were individually impaired, with a total impairment loss of \$1,616,521. These loans have been determined impaired based on loans with payments overdue by greater than 90 days.

Loans are secured by land, development property or completed construction property. The fair value of security over loans that are past due but not impaired at 30 June 2008 was \$73,192,466 (2007: \$91,850,400).

Interest on arrears loans is suspended and not brought to account if the RE considered that the amounts are not ultimately recoverable from the sale proceeds of the property. The amount of suspended interest at 30 June 2008 totalled \$3,078,983 (2007: \$1,318,418).

10. PAYABLES

	30 June 2008		30 June 2007	
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
Audit and compliance fees payable	85,750	85,750	39,250	39,250
Foreign currency awaiting investment	445,982	445,982	-	-
Other payables	347,064	347,064	442,502	464,016
	878,796	878,796	481,752	503,266

LM FIRST MORTGAGE INCOME FUND

11. INTEREST BEARING LOANS AND BORROWINGS

	30 June 2008		30 June 2007	
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
Secured bank loan	150,000,000	150,000,000	90,446,662	90,446,662

On 4 February 2009, the Directors of the Responsible Entity, LM Investment Management Limited of the Scheme and the Scheme's external financier negotiated extended terms for the \$150 million facility which matured on 30 November 2008. This revised facility expires on 31 July 2009, the facility has two tranches, Tranche A \$75 million and Tranche B \$75 million. A condition on revised facility is full repayment of the facility by 31 July 2009 in line with the agreed repayment plan, as disclosed in note 2(a).

The interest rate payable on the extended facility is BBSY + 4% per annum in relation to Tranche A and BBSY + 7.5% per annum in relation to Tranche B. In the event that the repayment is not made in accordance with the repayment plan mentioned above, the interest rate payable on Tranche A is increased to BBSY + 6% and on Tranche B it is BBSY + 9.5%. As noted in note 2(a) above, the Scheme has not made the first repayment required under the revised facility and as such is currently in breach, this has resulted in the triggering of the increased interest levels being payable on the outstanding principal detailed above.

12. RELATED PARTIES

Responsible Entity

The Responsible Entity of LM First Mortgage Income Fund is LM Investment Management Limited (ABN 68 077 208 461). Administration and funds management services are provided to the Scheme on behalf of the Responsible Entity by LM Administration Pty Ltd, an associate of the Responsible Entity. LM Administration Pty Ltd is paid a management fee directly from the Scheme.

Custodian

The Custodian of the Scheme is Trust Company of Australia Limited.

Directors

The names of each person holding the position of director of LM Investment Management Limited during the financial year are disclosed in Note 15.

Directors' remuneration

No amounts are paid by the Scheme directly to the directors of the Responsible Entity. The amount of remuneration paid by the Responsible Entity and its related parties to directors of the Responsible Entity in connection with their responsibilities for the Scheme is separately identified in Note 15.

Directors' holdings of units

The interests of LM Investment Management Limited and its associates in the Scheme at year-end are set out below.

LM FIRST MORTGAGE INCOME FUND

	30 June 2008		30 June 2007	
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
- LM Investment Management Limited	-	-	-	-
- Directors and director related entities	-	-	20,017	20,017
- Other Associates of LM Investment Management Limited	218,750,000	218,750,000	394,050,000	394,050,000

Investing activities

The Scheme may purchase and sell units in other approved schemes or investment entities operated by LM Investment Management Limited or its associates in the ordinary course of business at application and redemption prices calculated in accordance with the constitutions of those schemes. At 30 June 2008 the Scheme had no investments in other schemes operated by LM Investment Management Limited or its affiliates (2007: nil).

Other transactions with the Scheme

From time to time the directors of LM Investment Management Limited, or their director-related entities, may invest or withdraw from the Scheme. These investments or withdrawals are on the same terms and conditions as those entered into by other Scheme investors. Apart from the details disclosed in this note, no director has entered into a material contract with the Scheme since the end of the previous financial year and there were no material contracts involving directors' interests subsisting at year-end.

Administration and funds management services are provided to the Scheme on behalf of the Responsible Entity by LM Administration Pty Ltd, an associate of the Responsible Entity. LM Administration Pty Ltd is paid a management fee for these services directly from Scheme assets.

During the year, loan origination fees received by the borrowers within the Scheme were \$10,098,488 (2007: \$3,625,686) of which \$9,410,607 was reimbursed by the Scheme to the Responsible Entity for the administration of loan origination services (2007: \$3,381,487).

During the year the scheme advanced funds to a related scheme, the LM Managed Performance Fund, to finance a joint venture entered into with a borrower of the Scheme. At 30 June 2008 the balance of the loan to the related Scheme was \$7,008,047 (2007: \$4,725,000), which is secured by first mortgage of the assets of the unrelated borrower and by a guarantee from the LM Managed Performance Fund. This loan has been subject to the normal credit approval review procedures of the Scheme.

The LM Managed Performance Fund has second mortgages on loans that are first mortgages of the LM First Mortgage Income Fund totalling \$31,024,921 (2007: 18,718,980). The LM Managed Performance Fund may on occasion pay development and construction costs on those related loans. As part of the normal role as second mortgagee, the related scheme will fund interest payments from time to time within approved loan facility limits. During the 30 June 2008 year, interest payments totalling \$3,955,100 (2007: \$2,803,688) were paid from the related scheme on behalf of the borrowers.

LM FIRST MORTGAGE INCOME FUND

On 28 August 2008, it was resolved by the Board of Directors of the Responsible Entity, to transfer three mortgage loans to the value of \$33,513,345 and the related first mortgage security to the LM MPF. There is a fixed charge over these three specific secured properties plus a floating charge over the remaining assets of LM MPF to provide security to the Scheme in the event of default by the LM MPF. This loan between the Scheme and LM MPF is interest bearing at 10%, with the interest being capitalised and due to be repaid to the Scheme on 30 June 2009.

At 30 June 2008, management assigned a \$5,100,000 receivable within the Scheme from LMJM to LM Managed Performance Fund. The loan will accrue interest at 10% per annum and is for a period of 12 months, expiring on 30th June 2009.

LM FIRST MORTGAGE INCOME FUND

	30 June 2008		30 June 2007	
	Consolidated \$	Scheme \$	Consolidated \$	Scheme \$
<i>Total remuneration received or due and receivable</i>				
• Fees for the year paid directly to LM Administration Pty Ltd	5,801,477	5,801,477	9,934,860	9,934,860
• Expenses including administration expenses incurred by the Responsible Entity and its associated entities, which are reimbursed in accordance with the provisions of the Constitution.	-	-	386,755	386,755
• Expenses including administration expenses incurred by LM Administration Pty Ltd, which are reimbursed in accordance with the provisions of the Constitution.	826,743	826,743	-	-
• Loan origination fees received by borrowers within the Scheme that were reimbursed to the Responsible Entity for the administration of loan origination services	9,410,607	3,381,487	9,410,607	3,381,487
<i>Custodian's remuneration</i>				
• Custodian's fees paid by the Scheme	157,876	157,876	185,054	185,054
<i>Balance with related parties</i>				
Aggregate amounts receivable from related parties by the Scheme were as follows:				
• LM Administration Pty Ltd (management fees prepaid by the Scheme)(i)	6,716,960	6,716,960	2,793,556	2,793,556
• LM MIF Investments Pty Limited (ii)	-	-	-	6,000,000
• Australian International Investments Pty Limited (iii)	7,780,093	7,780,093	2,520,000	2,520,000
• LM Managed Performance Fund (iv)	5,100,000	5,100,000	-	-

- i). These amounts are included in prepayments of \$7,845,017 at 30 June 2008. No amounts are payable to related parties by the Scheme. The average monthly balance of prepayments during the year was \$6,632,631 (2007: \$7,204,945) which was non-interest bearing. Interest foregone on the above amount if calculated at the weighted average cash rate of 5.94% would have been \$393,978 (2007: \$401,315). If this revenue had been collected, the sum foregone would have been paid to LM Administration Pty Ltd as management fees during the year.
- ii). LM MIF Investments Pty Limited had an unsecured interest bearing loan with the Scheme. This facility was entered into on an arms length basis and is on normal terms and conditions.
- iii). Peter Charles Drake is a director and guarantor of Australian International Investment Services Pty Ltd which is a joint borrower in a loan facility outstanding to the Scheme as at 30 June 2008 for \$7,780,093 (2007: \$2,520,000). This transaction was approved on an arms length basis and is on normal terms and conditions.

LM FIRST MORTGAGE INCOME FUND

- iv). This amount relates to release of debt from LM Administration to LM MPF which was originally a prepayment of management fees from the scheme to LM administration. This transaction was approved on an arms length basis and is on normal terms and conditions.

Unitholder investing activities

Details of holdings in the Scheme by LM Investment Management Limited, its affiliates including directors and director related persons or other schemes managed by LM Investment Management Limited are set out below:

Entity	Investment at year end #	Interest held in the scheme at year end	Units issued during the year	Units redeemed during the year	Distributions paid and payable
30 June 2008					
LM Currency Protected Australian Income Fund	119,300,000	24.78%	43,500,000	85,700,000	14,041,838
LM Institutional Currency Protected Australian Income Fund	7,500,000	1.56%	14,150,000	35,400,000	2,023,890
LM Managed Performance Fund	450,000	0.09%	29,420,624	33,770,624	395,977
LM Wholesale First Mortgage Income Fund	91,500,000	19.01%	6,800,000	114,300,000	10,362,449
Harold Ward	-	-	251	20,268	251
Total	218,750,000	45.44%	93,870,875	269,190,892	26,824,405
30 June 2007					
LM Currency Protected Australian Income Fund	161,500,000	19.30%	109,400,000	14,900,000	9,244,308
LM Institutional Currency Protected Australian Income Fund	28,750,000	3.44%	32,050,000	3,300,000	916,401
LM Managed Performance Fund	4,800,000	0.57%	22,100,000	22,400,000	716,572
LM Wholesale First Mortgage Income Fund	199,000,000	23.78%	8,000,000	92,000,000	18,914,207
LM Investment Management Ltd	-	-	4,510	196,648	3,207
James and Pamela Craig	-	-	10,961	325,705	8,828
Harold Ward	20,017	0.00%	1,568	1,551	1,664
Total	394,070,017	47.09%	171,567,039	133,123,903	29,805,187

LM FIRST MORTGAGE INCOME FUND

13. RECEIVABLES

	30 June 2008		30 June 2007	
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
Interest and distribution receivable	54,641	54,641	62,609	-
Mortgage interest receivable	1,727,883	1,727,883	1,899,384	1,899,384
Penalty interest receivable	51,531	51,531	114,776	114,776
Default management fees receivable	2,702,333	2,702,333	4,834,917	4,834,917
GST receivable	84,908	84,908	85,314	85,314
Other	176,494	176,493	-	-
	<u>4,797,790</u>	<u>4,797,789</u>	<u>6,997,000</u>	<u>6,934,391</u>

14. CASH AND CASH EQUIVALENTS

	30 June 2008		30 June 2007	
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
a) Reconciliation of cash and cash equivalents				
For the purposes of the Balance Sheet and Cash Flow Statement, cash and cash equivalents comprise:				
- Cash at bank and in hand	<u>14,643,332</u>	<u>14,643,332</u>	<u>28,593,772</u>	<u>28,332,244</u>

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates.

The fair value of cash and cash equivalents is \$14,643,332 (2007: \$28,593,772).

b) Reconciliation of change in net assets attributable to unitholders to net cash flows from operating activities

	30 June 2008		30 June 2007	
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
Change in net assets attributable to unitholders	-	-	-	-
Adjustments for:				
Non cash impairment expense	6,154,911	6,157,884	2,563,242	2,563,242
Non cash interest income	(59,070,947)	(59,104,073)	(49,095,677)	(49,497,308)
Distributions to unitholders	51,289,597	51,289,597	64,161,393	64,161,393
(Increase)/decrease in interest and distribution receivable	2,481,469	2,418,863	(2,908,324)	(2,845,715)
(Increase)/decrease in other receivables	(9,745,107)	(9,745,107)	1,500,567	1,436,935
Increase/(decrease) in payables	397,044	375,530	(465,067)	(369,400)
(Over)/Under distributions	(1,491,783)	(1,491,783)		
Net cash flows from/(used in) operating activities	<u>(9,984,816)</u>	<u>(10,099,089)</u>	<u>15,756,134</u>	<u>15,449,147</u>

c) Reinvestment of distributions

During the financial year, the Scheme issued 11,260,431 units (2007: 16,541,455) as a result of reinvestment of distribution by unitholders totaling \$11,260,431 (2007: \$16,541,489). These transactions have not been included in the Cash Flow Statement.

LM FIRST MORTGAGE INCOME FUND

15. KEY MANAGEMENT PERSONNEL DISCLOSURES

(b) Details of Key Management Personnel

(i) Key Management Personnel

The Key Management Personnel ("KMP") of the Scheme were deemed to be the Directors of the Responsible Entity. The Directors of the Responsible Entity during the year were:

Executive directors

Mr Peter Charles Drake	Appointed 31 January 1997
Ms Lisa Maree Darcy	Appointed 15 September 2003
Mr Eghard van der Hoven	Appointed 22 June 2006
Ms Francene Maree Mulder	Appointed 30 September 2006

Non-executive directors

Mr John Dillon	Appointed 8 June 2005; resigned 28 August 2008
Mr John Vallander Llewellyn	Appointed 1 June 2007; resigned 1 July 2008
Mr John O'Sullivan	Appointed 28 November 2007

(c) Compensation of Key Management Personnel

(i) Compensation Policies and Principles

Remuneration of KMP is paid by LM Administration Pty Ltd, appointed by LM Investment Management Ltd as per its service agreement with that entity. The KMP do not receive any remuneration directly from the Scheme and there are no agreements in place between the KMP and the Scheme. The remuneration of KMP as disclosed below has been allocated based on the each KMP's cost of remuneration applicable to the Scheme. The principles used to allocate these costs (for disclosure purposes only) are discussed below.

(ii) Executive Directors

The Executive Directors of the Board of the Directors of LM Investment Management Ltd are responsible for determining and reviewing compensation arrangements for the KMP of the Responsible Entity. The Executive directors assess the appropriateness of the nature and amount of emoluments of the KMP on a periodic basis by reference to relevant employment market conditions with the overall objective of ensuring maximum stakeholder benefit from the retention of a high quality board. It is intended that the manner of payment chosen will be optimal for the recipient without creating undue cost for the Responsible Entity.

It is the Executive Directors' policy that employment agreements shall only be entered into with the Executive Directors of the Responsible Entity, but with no other parties.

(iii) Non-executive directors

Fees paid to non-executive directors are based on decisions made by the Executive Directors. This takes into account workload requirements and responsibilities of each Director. Fees for duties as Directors are not paid to executive Directors as their remuneration is provided as part of their normal terms and conditions.

LM FIRST MORTGAGE INCOME FUND

(iv) Principles of KMP Remuneration Allocations

For all schemes managed by the Responsible Entity, the cost of total KMP remuneration has been allocated to each scheme. The Responsible Entity has estimated the amount of time spent by each KMP performing responsibilities and duties to individual schemes, and on a percentage basis, has allocated the remuneration cost to each scheme. Where a KMP has not spent time specifically on a scheme, but rather has acted in a role as KMP of the Responsible Entity only, remuneration cost has been allocated evenly across all schemes.

LM FIRST MORTGAGE INCOME FUND

(v) Remuneration of KMP

2008 Specified KMP	Primary		Post Employment		Equity	Other	TOTAL	Total performance related %
	Salary & Fees	Cash Bonus	Super	Retirement Benefits				
	\$	\$	\$	\$	\$	\$	\$	
Drake, PC*	-	-	-	-	-	-	-	-
Darcy, LM**	47,762	-	4,299	-	-	-	52,061	-
Van der Hoven, E**	33,865	-	3,048	-	-	-	36,913	-
Mulder, F	32,142	-	2,893	-	-	-	35,035	-
Dillon, J	3,448	-	310	-	-	-	3,758	-
Llewellyn, V	3,448	-	310	-	-	-	3,758	-
O'Sullivan, J	2,058	-	185	-	-	-	2,243	-
	122,723	-	11,045	-	-	-	133,768	-

2007 Specified KMP	Primary		Post Employment		Equity	Other	TOTAL	Total performance related %
	Salary & Fees	Cash Bonus	Super	Retirement Benefits				
	\$	\$	\$	\$	\$	\$	\$	
Drake, PC*	-	-	-	-	-	-	-	-
Darcy, LM**	23,488	-	2,114	-	-	-	25,602	-
Van der Hoven, E**	17,532	-	1,578	-	-	-	19,110	-
Mulder, Francene	11,139	-	1,002	-	-	-	12,141	-
Dillon, J	2,500	-	255	-	-	-	2,755	-
Llewellyn, JV	173	-	16	-	-	-	189	-
	54,832	-	4,965	-	-	-	59,797	-

* Peter Charles Drake is the beneficial owner of 100% of the ordinary shares of the Responsible Entity. No salary and wages are paid to Peter Drake directly from the company or any of the schemes.

** As executives of the Responsible Entity, LM Darcy, E van der Hoven and F Mulder are entitled to a termination benefit that is payable on cessation of employment or a significant change in ownership of the company. No amount has been reflected in the above disclosures in relation to this potential future benefit.

Compensation by category: Key Management Personnel

	2008	2008	2007	2007
	Consolidated	Scheme	Consolidated	Scheme
	\$	\$	\$	\$
Short term	122,723	122,723	54,832	54,832
Post employment	11,045	11,045	4,965	4,965
Other long term	-	-	-	-
Termination benefits	-	-	-	-
Equity based payment	-	-	-	-
Other	-	-	-	-
	<u>133,768</u>	<u>133,768</u>	<u>59,797</u>	<u>59,797</u>

Loans to Specified KMP

The Scheme has not made, guaranteed or secured, directly or indirectly any loans to the KMP or their related entities during the period.

(d) Other Transactions and Balances with Specified KMP

Other than those items disclosed in the related party note 11, the Scheme has no other transactions and balances with specified KMP.

16. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES**a) Financial Risk Management Objectives, Policies, and Processes**

Risks arising from holding financial instruments are inherent in the Scheme's activities, and are managed through a process of ongoing identification, measurement, and monitoring. The scheme is exposed to credit risk, liquidity risk, and market risk.

Financial instruments of the Scheme comprise investments in financial assets for the purpose of generating a return on the investment made by unitholders, in addition to derivatives, cash and cash equivalents, net assets attributable to unitholders, and other financial instruments such as trade debtors and creditors, which arise directly from its operations.

The Responsible Entity is responsible for identifying and controlling the risks that arise from these financial instruments.

The risks are measured using a method that reflects the expected impact on the results and net assets attributable to unitholders of the Scheme from reasonably possible changes in the relevant risk variables. Information about these risk exposures at the reporting date, measured on this basis, is disclosed below. Information about the total fair value of financial instruments exposed to risk, as well as compliance with established investment mandate limits, is also monitored by the Responsible Entity. These mandate limits reflect the investment strategy and market environment of the Scheme, as well as the level of risk that the Scheme is willing to accept.

This information is prepared and reported to relevant parties within the Responsible Entity on a regular basis as deemed appropriate, including the fund manager, compliance manager, other key management, Risk and Investment Committees, and ultimately the Board of Directors of the Responsible Entity.

As part of its risk management strategy, the Scheme uses foreign exchange contracts to manage exposures resulting from changes in foreign currencies.

Concentrations of risk arise when a number of financial instruments or contracts are entered into with the same counterparty, or where a number of counterparties are engaged in similar business activities, or activities in the same geographic region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political, and other conditions.

In order to avoid excessive concentrations of risk, the Scheme monitors its exposure to ensure concentrations of risk remain within acceptable levels and either reduces the exposure or uses derivative instruments and collateral to manage the excessive concentrations when they arise.

b) Credit Risk

Credit risk represents the risk that the counterparty to the financial instrument will fail to discharge an obligation and cause the Scheme to incur a financial loss.

With respect to credit risk arising from the financial assets of the Scheme, other than derivatives, the Scheme's exposure to credit risk arises from default of the counterparty, with the current exposure equal to the fair value of these instruments as disclosed in the Balance Sheet. This does not represent the maximum risk exposure that could arise in the future as a result of changes in values, but best represents the current maximum exposure at the reporting date.

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values.

The Scheme minimizes credit risk by:

- undertaking credit assessment procedures on prospective borrowers
- dealing with Australian regulated banks for cash balances;
- obtaining independent valuations for all loans; and
- maintaining an average loan to valuation ratio not exceeding 75% of the mortgage securities.

At year end, 76% of the balance of mortgage loans is secured on construction/development property (2007: 66%) and 24% on commercial property (2007: 34%).

Risk concentrations of credit risk

Concentrations of credit risk are managed by counterparty and by geographical region. The percentage of loans secured by property in different geographical locations is as follows:

	2008	2007
Sydney CBD	0.00%	0.00%
Within 40km of Sydney CBD	11.03%	20.30%
New South Wales – Other	21.29%	15.37%
Melbourne – CBD	0.00%	0.00%
Within 40km of Melbourne CBD	7.22%	8.82%
Victoria – Other	2.34%	2.13%
Brisbane CBD	0.00%	0.00%
Within 40km of Brisbane CBD	2.11%	1.92%
Queensland – Other	39.80%	34.58%
Canberra – Other	1.29%	5.35%
Northern Territory	5.47%	5.18%
South Australia	0.00%	0.00%
Western Australia	9.00%	5.63%
Tasmania	0.45%	0.72%
	100.00%	100.00 %

The maximum credit risk exposure at year end in relation to mortgage loan is the carrying value of the assets as indicated in the balance sheet. No single mortgage investment exceeds 10% of the Scheme which ensure that there is no concentration of risk.

The scheme has a concentration of credit risk relating to the derivative instruments as all foreign currency swaps are entered into with the same counterparty.

Credit quality of mortgage loans

The credit quality of financial assets is managed by the Scheme using internal risk rating categories in accordance with the investment mandate of the Scheme. The scheme's exposure in each category is monitored on a daily basis. This review process allows the Responsible Entity to assess the potential loss as a result of risks and take corrective action.

The Scheme has taken possession of \$59.7M of assets during the year by taking possession of collateral it holds as security or calling on other credit enhancements such as guarantees. Assets obtained had all been sold as at 30 June 2008.

c) Liquidity risk

Liquidity risk is the risk that the Scheme may not be able to meet its obligations in relation to investment activities or funding unit holder redemptions.

The scheme invests in first mortgage commercial/industrial loans with an average loan maturity of 20 months (2007: 23 months). The nature of the investments entered into by the scheme commands that

liquidity be managed cautiously and aligned to the redemptions policy outlined within the constitution of the scheme. At 30 June 2008, the redemptions requested from unitholders was \$15,309,573 (2007:\$nil).

The Responsible Entity employs risk management strategies to ensure that the Scheme is able to meet its obligations as above. The liquidity risk associated with the need to satisfy unitholders requests for redemptions are mitigated by offering fixed term investment periods for investors and by maintaining sufficient cash funds to satisfy usual levels of demand for at-call investments.

In order to minimise liquidity risk, management assesses and monitors the liquidity requirements of both unitholder redemptions and investment activities and ensures that at all times the Scheme has adequate cash and cash equivalents to cover fund obligations and that liquidity is managed within the Scheme's policies and limits.

Maturity Analysis of Financial Liabilities

Financial liabilities of the scheme comprise trade and other payables, distributions payable, net assets attributable to unitholders, fair value of foreign exchange contracts and the secured bank loan. Trade and other payables and distributions payable have no contractual maturities but are typically settled within 30 days. Foreign exchange contracts mature within 12 months of year end.

Net assets attributable to unit holders mature over the following periods:

Period from 30 June 2008	Value
< 12 months	411,664,669
12-24 months	67,322,424
24-36 months	1,946,273
36-48 months	415,170
>48 months	29,707
Total	481,378,243

The secured bank loan (note 12) is repayable by 31 July 2009, as detailed in note 2(a). When drawn, the loan is secured by the assets of the Scheme.

d) Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates, and equity prices. Market risk is managed and monitored using sensitivity analysis, and minimised through ensuring that all investment activities are undertaken in accordance with established mandate limits and investment strategies.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair value of financial instruments. The Scheme has established limits on investments in interest bearing assets, which are monitored on a daily basis.

The Scheme's exposure to interest rate risk and the effect weighted average interest rate for classes of financial assets and financial liabilities is set out below:

CONSOLIDATED

Note	Weighted average interest rate	Floating Interest Rate		Fixed interest rate			Total
		2008	2007	Securities contracted to mature in less than 1 year	Securities contracted to mature in more than 1 year but less than 5 years	2007	
Cash assets							
Secured mortgage loans (gross)	13(b)	5.94	5.57	14,643,332	28,593,772	-	14,643,332
Unsecured loan	9	11.30	9.55	-	-	-	604,441,259
Loan facility	10	11.11	6.44	(150,000,000)	(90,416,662)	-	(150,000,000)
							(90,416,662)
Total				(135,356,668)	(61,822,890)	449,497,482	469,084,591

All other financial assets and liabilities are non-interest bearing.

SCHEME

Note	Weighted average interest rate	Floating Interest Rate		Fixed interest rate			Total
		2008	2007	Securities contracted to mature in less than 1 year	Securities contracted to mature in more than 1 year but less than 5 years	2007	
Cash assets							
Secured mortgage loans (gross)	13(b)	5.94	5.57	14,643,332	28,332,244	-	146,433,332
Unsecured loan	9	11.30	9.89	-	-	-	28,332,244
Loan facility	10	-	6.5	-	-	-	604,441,259
							835,530,336
							6,000,000
							(150,000,000)
							(90,416,662)
Total				(135,356,668)	(62,084,418)	449,497,482	469,084,591

All other financial assets and liabilities are non-interest bearing.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2007

The following table demonstrates the sensitivity of the Scheme's income statement to a reasonably possible change in interest rates, with all other variables held constant.

The sensitivity of the income statement is the effect of the assumed changes in interest rates on the interest income for one year, based on the financial instruments held at 30 June 2008.

Accounting assumptions

The basis points sensitivity is based on the historical volatility of changes in interest rates.

2008

	Change in basis points		Sensitivity of interest income (000's)	
	<i>Increase</i>	<i>Decrease</i>	<i>Increase</i>	<i>Decrease</i>
Financial instruments	50	50	3,543	3,543
	100	100	7,086	7,086

2007

	Change in basis points		Sensitivity of interest income (000's)	
	<i>Increase</i>	<i>Decrease</i>	<i>Increase</i>	<i>Decrease</i>
Financial Instruments	50	50	3,869	3,869
	100	100	7,738	7,738

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in foreign exchange rates. The Scheme enters into foreign exchange contracts principally to hedge the foreign exchange risk implicit in the value of the investor funds denominated in foreign currencies and to secure a particular exchange rate for a planned purchase or sale of investments. The term of the contracts rarely exceeds twelve months.

The fair value of forward exchange contracts held at 30 June 2008 was \$40,606 (2007: nil). The fair value adjustment to the carrying value of these contracts of \$40,606 was recognised in a derivatives reserve at 30 June 2008 (2007: nil).

The nominal Australian dollar value of forward exchange contracts held at 30 June 2008 was \$4,817,423 (2007: nil).

The table below indicates the currencies to which the Scheme had significant exposure at 30 June 2008 on its monetary assets and liabilities and forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Australian Dollar on the income statements, with all other variables held constant.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2007

Accounting Assumptions- Variability of foreign currency

The sensitivity is based on the volatility of changes in global currency.

	2008				
Currency	AUD equivalent in exposure by currency (000's)	Change in currency rate in %		Effect on net assets attributable to unitholders (000's)	
		Increase	Decrease	Increase	Decrease
CAD	106	10	10	11	11
EUR	85	10	10	9	9
GBP	1,507	10	10	151	151
JPY	155	10	10	16	16
NZD	2,179	10	10	218	218
TRY	130	10	10	13	13
USD	656	10	10	66	66

The Scheme was not subject to foreign currency risk at 30 June 2007.

Non-Australian dollar investments in the fund are hedged in the relevant currency against Australian dollar currency movements. The fund hedges a non-Australian dollar investment through the use of forward foreign exchange contracts (FFEC).

The FFECs are facilitated by a global investment bank. This form of hedging reduces currency exposure to the fund and investors. The above table is only applicable if the FEC facilitator is unable to meet its obligation and the fund therefore seeks an alternative party to re hedge the FEC.

Equity Risk

The Scheme is not subject to equity risk at 30 June 2008.

Cash Flow Hedges

Foreign Currency Contracts

The Scheme uses derivative financial instruments such as forward currency contracts to hedge its risks associated with foreign currency fluctuations. The cash flows are expected to occur between 1 and 12 months. Movement in the foreign currency contract cash flow hedge reserve is detailed below:

	2008	2007
	\$	\$
Opening Balance	-	-
Charged to Equity	40,606	-
Closing Balance	40,606	-

Included in other expenses in the profit and loss is \$1,915 of foreign currency losses due to ineffectiveness of the cash flow hedges.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2007

15. FAIR VALUES

The Scheme's financial assets and liabilities included in the Balance Sheet are carried at their fair value as disclosed by class of financial instruments or at amounts that approximate their fair values.

Refer to Note 2 for the methods and assumptions adopted in determining fair values for investments.

16. SEGMENT INFORMATION

(a) Business segment

The Scheme is organised into one business segment which operates solely in the business of investment management within Australia.

(b) Geographic segments

The Scheme operates in Australia and all directly held assets are Australian. Geographic concentrations disclosed in Note 16.

17. COMMITMENTS AND CONTINGENCIES

There are no material contingent assets and liabilities or commitments as at 30 June 2008.

18. EVENTS AFTER THE BALANCE SHEET DATE

No significant events have occurred since balance date which would impact on the financial position of the consolidated entity disclosed in the balance sheet as at 30 June 2008 or on the results and cash flows of the consolidated entity for the year ended on that date, other than those detailed below:

(a) Loans transferred to LM Managed Performance Fund (MPF)

On 28 August 2008, it was resolved by the Board of Directors to transfer three mortgage loans to the value of \$33,513,345 and the related first mortgage security to the LM MPF. There is a fixed charge over these three specific secured properties plus a floating charge over the remaining assets of LM MPF to provide security to the Scheme in the event of default by the LM MPF. This loan between the Scheme and LM MPF is interest bearing at 10%, with the interest being capitalised and due to be repaid to the Scheme on 30 June 2009. As mentioned in note 1(b), in order to meet the repayment schedule between the Scheme and the external financier, a proportion of this loan needs to be repaid by LM MPF before 31 July 2009.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2007

(b) Renegotiation of the Loan Facility

On 4 February 2009, the Responsible Entity, LM Investment Management Limited of the Scheme and the Scheme's external financier negotiated extended terms for the \$150 million facility which matured on 30 November 2008. This revised facility expires on 31 July 2009, the facility has two tranches, Tranche A \$75 million and Tranche B \$75 million. A condition on revised facility is full repayment of the facility by 31 July 2009 in line with the agreed repayment plan, as disclosed in note 2(a).

The interest rate payable on the extended facility is BBSY + 4% per annum in relation to Tranche A and BBSY + 7.5% per annum in relation to Tranche B. In the event that the repayment is not made in accordance with the repayment plan mentioned above, the interest rate payable on Tranche A is increased to BBSY + 6% and on Tranche B it is BBSY + 9.5%. As noted in note 2(a) above, the Scheme has not made the first repayment required under the revised facility and as such is currently in breach, this has resulted in the triggering of the increased interest levels being payable on the outstanding principal detailed above.

(c) Status of Scheme

On 3 March 2009, the Scheme was closed to new investors and the manager will pay withdrawal requests up to 365 days after maturity. At 9 March 2009, \$60,491,946 of redemptions has been requested by unitholders but not yet paid. Redemptions rank behind repayment of external financing facilities as detailed in Note 2(a).

LM FIRST MORTGAGE INCOME FUND
Notes to the Financial Statements for the year ended 30 June 2007

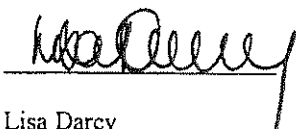
DIRECTORS' DECLARATION

In accordance with a resolution of the Directors of LM Investment Management Limited,
I state that:

- a) The financial statements and notes of the Registered Scheme set out on pages 7 to 40 are in accordance with the Corporations Act 2001, including:
 - (i) complying with Accounting Standards and the Corporation Regulations 2001; and
 - (ii) giving a true and fair view of the Scheme's financial position as at 30 June 2008, and of its performance, as represented by the results of its operations and its cash flows for the financial year ended on that date.
- b) there are reasonable grounds to believe that the Scheme will be able to pay its debts as and when they become due and payable; and
- c) the financial statements are in accordance with the provisions of the Scheme's Constitution.

On behalf of the Board

LM Investment Management Limited.



Lisa Darcy

Director

Gold Coast

10 March 2009



1 Eagle Street
Brisbane QLD 4000 Australia
GPO Box 7878 Brisbane QLD 4001
Tel: +61 7 3011 3333
Fax: +61 7 3011 3100
www.ey.com/au

Independent Auditor's Report

To the members of the LM First Mortgage Income Fund

Report on the Financial Report

We have audited the accompanying financial report of LM First Mortgage Income Fund ("the Scheme"), which comprises the balance sheet as at 30 June 2008, and the income statement, statement of changes in equity and cash flow statement for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration.

Directors' Responsibility for the Financial Report

The directors of the Responsible Entity are responsible for the preparation and fair presentation of the financial report in accordance with the Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 1(b), the directors also state that the financial report, comprising the financial statements and notes, complies with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards and International Standards on Auditing. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, we consider internal controls relevant to the entity's preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Independence

In conducting our audit we have met the independence requirements of the Corporations Act 2001. We have given to the directors of the Responsible Entity a written Auditor's Independence Declaration, a copy of which is included in the directors' report.



Ernst & Young Services Pty Limited

Auditor's Opinion

In our opinion:

the financial report of LM First Mortgage Income Fund is in accordance with the Corporations Act 2001, including:

- (i) giving a true and fair view of the financial position of LM First Mortgage Income Fund at 30 June 2008 and of its performance for the year ended on that date; and
- (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations and the Corporations Regulations 2001).

Material Uncertainty Regarding Continuation as a Going Concern

Without qualifying our opinion, we draw attention to Note 2(a) in the financial report which indicates that the Scheme's financing arrangements expired and the amount outstanding was payable on 30 November 2008. The Responsible Entity has negotiated an extension to the facility with specific repayments through to 31 July 2009. The first required payment was due on the 28 February 2009 and was not made, resulting in a breach of the facility. As a result of these matters there is significant uncertainty whether the Scheme will continue as a going concern, and therefore whether it will realise its assets and extinguish its liabilities in the normal course of business and at the amounts stated in the financial report. The financial report does not include any adjustments relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the Scheme not continue as a going concern.

Paula McLuskie

Paula McLuskie
Partner
Brisbane

10 March 2009

PW - 33

SIC registered agent number 388 1/2 18 March 2002

lodging party or agent name **LM INVESTMENT MANAGEMENT**

office level, building name or PO Box no. **PO BOX 485**

street number & name

suburb/city **SURFERS PARADISE** state/territory **QLD** postcode **4217**

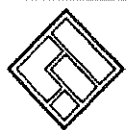
telephone **(07) 55 84 4500**

facsimile **(07) 55 922505**

DX number

Australian Securities & Investments Commission
019579759

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Australian Securities & Investments Commission

copy of financial statements and reports

form 388

15 SEP 2003

Corporations Act 2001

294, 295, 298-300, 307, 308, 319, 321, 322

Corporations Regulations

1.0.08

Name **LM Mortgage Income Fund**

ACN / ARBN (ARSIN PIN) **089 343 288**

Reason for lodgement of statements and reports

- tick the appropriate box
- ☐ A public company or a disclosing entity which is not a registered scheme or prescribed interest undertaking (A)
- ☐ A registered scheme* (B)
- ☐ Amendment of financial statements or directors' report (company) (C)
- ☐ Amendment of financial statements or directors' report (registered scheme)* (D)
- ☐ A large proprietary company that is not a disclosing entity (E)
- ☐ A small proprietary company that is controlled by a foreign company for all or part of the period and where the company's profit or loss for the period is not covered by the statements lodged with ASIC by a registered foreign company, company, registered scheme, or disclosing entity (F)
- ☐ A small proprietary company that is requested by ASIC to prepare and lodge statements and reports (J)
- ☐ A prescribed interest undertaking that is a disclosing entity (K)

Dates on which financial year begins **1/7/02** and ends **30/6/03** (d/m/y)

Date of Annual General Meeting (if applicable) / /

Details of large proprietary company

If the company is a large proprietary company that is not a disclosing entity, please complete the following information as at the end of the financial year for which the financial statements relate:

- A What is the consolidated gross operating revenue of the large proprietary company and the entities that it controls?
[]
- B What is the value of the consolidated gross assets of the large proprietary company and the entities that it controls?
[]
- C How many employees are employed by the large proprietary company and the entities that it controls?
[]
- D How many members does the large proprietary company have?.....

Auditor report

Were the financial statements audited? Yes ☒ No ☐

If yes: Does the auditor's report (section 308) for the financial year contain a statement of:

- * reasons for the auditor not being satisfied as to the matters referred to in section 307? Yes ☐ No ☒
- * details of the deficiency, failure or shortcoming concerning any matter referred to in section 307? Yes ☐ No ☒

If no: Is there a class order exemption current for audit relief? Yes ☐ No ☐

* NOTE: Where a new auditor has been appointed to a Registered Scheme, Form 5137 - Appointment of Scheme Auditor must be lodged

388 2/2 18 March 2002

Details of current auditor*

The auditor can be a person or a firm.

If a person

name (family & given names)

Auditor Registration no:

office

level

building name

street number & name

suburb / city

state / territory

postcode

date of appointment (d/m/y)

or

If a firm

name of firm

KPMG

11

CORPORATE CENTRE ONE

office

level

building name

street number & name

CNR BUNNALL RD + JAWAYER AVE

suburb / city

BUNNALL

state / territory

QLD

postcode

4217

Business Registration number (if applicable)

State / Territory registered in

date of appointment (d/m/y)

Statements and reports to be attached to this form

Financial statements for the year (as per ss295(2))

statement of financial performance for the year (profit and loss statement)

statement of financial position as at the end of the year (balance sheet)

statement of cash flows for the year

if required by accounting standards - consolidated profit & loss statement, balance sheet and statement of cash flows

Notes to financial statements (as per ss295(3))

disclosures required by the regulations

notes required by the accounting standards

any other information necessary to give a true and fair view (see s297)

The directors' declaration about the statements and notes (as per ss 295(4))

The directors' report for the year (as per ss 298 to 300)

Auditor's report required under sections 308 and 314

Certification

I certify that the attached documents marked () are a true copy of the annual reports required under Section 319.

print name

PETER DRAKE

capacity

DIRECTOR

sign here



date

12-9-03

* NOTE: Where a new auditor has been appointed to a Registered Scheme, Form 5137 - Appointment of Scheme Auditor must be lodged


Small Business (less than 20 employees), please provide an estimate of the time taken to complete this form

Include

- The time actually spent reading the instructions, working on the question and obtaining the information
- The time spent by all employees in collecting and providing this information

hrs

mins

This is annexure "A" of 26 pages referred to
in Form 388 - Copy of Financial Statements
and Reports

L. DARCY - Director

LM Mortgage Income Fund

ABN: 13 089 343 288

Annual Financial Report
30 June 2003

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LM MORTGAGE INCOME FUND

RESPONSIBLE ENTITY'S REPORT

The directors of LM Investment Management Limited ("the Responsible Entity"), the Responsible Entity of LM Mortgage Income Fund ("the Scheme"), present their report together with the financial report of the Scheme, for the year ended 30 June 2003 and the auditor's report thereon.

Responsible entity

The registered office and principal place of business of the Responsible Entity and the Scheme is Level 4, 44A Cavill Avenue, Surfers Paradise, Queensland.

LM Investment Management Limited has been the Responsible Entity since registration of the scheme in September 1999.

The directors of LM Investment Management Limited, during or since the end of the financial year, are:

Name	Period of directorship
Mr Peter C Drake	Appointed 31 January 1997
Mr Peter Aubort	Appointed 25 March 1997
Mr Geoffrey Black	Appointed 31 March 1999
Mr Martyn Andrew Carne	Appointed 19 July 2002

Principal activities

The Scheme is a registered managed investment scheme domiciled in Australia.

The Scheme's principal activity for the year was receipt of unit holders' funds and investing them in first registered mortgages generally secured by commercial properties and cash investments in Australia, in accordance with the investment policy of the Scheme as outlined in the current product disclosure document.

There have been no significant changes in the nature of those activities during the year.

The Scheme did not have any employees during the year.

Review and results of operations

During the year, the Scheme continued to invest funds directly in first registered mortgage loans, secured by commercial properties in Australia. In addition, funds under management increased by approximately \$110 million as a result of the Scheme accepting applications from a related managed investment scheme.

Results

The financial year ended 30 June 2003 resulted in a net profit of \$12,171,381 (2002: \$5,186,257). An increase in funds under management contributed to the increase in the financial result for the year.

Distributions

Distributions paid or payable by the Scheme since the end of the previous financial year were \$12,171,381 (2002: \$ 5,226,569).

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LM MORTGAGE INCOME FUND **RESPONSIBLE ENTITY'S REPORT**

Units on issue

The Scheme issued 179,732,862 units during the financial year (2002: 77,878,476), while 69,229,593 units were redeemed (2002: 21,523,728), resulting in a balance of 210,567,901 units on issue as at 30 June 2003 (2002: 100,064,632). The Scheme had total assets of \$213,989,638 as at 30 June 2003 (2002: \$101,091,971). The basis for valuation of the Scheme's assets is disclosed in Note 1 to the financial statements.

State of affairs

In the opinion of the Responsible Entity, there were no significant changes in the state of affairs of the Scheme that occurred during the financial year under review.

Likely developments

The Responsible Entity does not propose any changes to the existing business of the Scheme. The Scheme will continue to pursue its policy of raising funds and investing those funds in mortgage investments in Australia.

Environmental Regulation

The Scheme's operations are not subject to any significant environmental regulation under either Commonwealth, State or Territory legislation.

Events subsequent to balance date

There has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the Responsible Entity, to affect significantly the operations of the Scheme, the results of those operations, or the state of affairs of the Scheme, in future financial years.

Interests of the Responsible Entity

The following fees were paid to LM Investment Management Limited and its associates out of scheme property during the financial year:

	2003 \$	2002 \$
■ Responsible Entity's fees for the year received directly from LM Mortgage Income Fund	2,234,991	1,337,290
■ Responsible Entity's fees earned by the Responsible Entity from other approved schemes invested in by LM Mortgage Income Fund.	-	524,895
■ Other expenses include administration expenses incurred by the Responsible Entity which are reimbursed in accordance with the provisions of the Scheme Constitution, including Custodian fees.	219,817	40,315

The Responsible Entity and its associates held 63,029,006 units (2002: 5,741,510) in the Scheme at year-end. The aggregate amount receivable from the Responsible Entity by the Scheme at year end was \$1,139,543.

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LM MORTGAGE INCOME FUND
RESPONSIBLE ENTITY'S REPORT

Indemnities and insurance premiums for Officers or Auditors

Indemnification

Since the end of the previous financial year, the Scheme has not indemnified or made a relevant agreement for indemnifying against a liability, any person who is or has been an officer of the Responsible Entity, or an auditor of the Scheme.

Insurance premiums

During the financial year the Responsible Entity has paid premiums in respect of its officers for liability and legal expenses insurance contracts for the year ended 30 June 2003. The Responsible Entity has paid or agreed to pay in respect of the Scheme, premiums in respect of such insurance contracts for the year ended 30 June 2004. Such insurance contracts insure against certain liability (subject to specific exclusions) for persons who are or have been the Responsible Entity or executive officers of the Responsible Entity.

Details of the nature of the liabilities covered or the amount of the premium paid has not been included as such disclosure is prohibited under the terms of the contracts.

Signed in accordance with a resolution of the directors of LM Investment Management Limited.



Director

12/9/2003

Dated

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LM MORTGAGE INCOME FUND
STATEMENT OF FINANCIAL PERFORMANCE
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2003

	Note	2003 \$	2002 \$
Investment income			
Distribution income	2(a)	313,870	2,343,276
Interest income	2(b)	15,376,511	4,824,880
Total revenue		<u>15,690,381</u>	<u>7,168,156</u>
Change in net fair value of investments		-	142,661
Total investment income		<u>15,690,381</u>	<u>7,310,817</u>
Expenses			
Responsible entity fees	8	2,234,991	1,337,290
Custodian fees	8	45,928	22,015
Advisor commissions		1,064,192	746,955
Other expenses	3	173,889	18,300
Total expenses		<u>3,519,000</u>	<u>2,124,560</u>
Net profit		<u>12,171,381</u>	<u>5,186,257</u>
Reconciliation of net profit			
Distributions paid and payable	6	12,171,381	5,226,569
Excess distributions	5(b)	-	(40,312)
		<u>12,171,381</u>	<u>5,186,257</u>

The statement of financial performance is to be read in conjunction with the notes to the financial statements set out on pages 7 to 18.

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LM MORTGAGE INCOME FUND

STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2003

	Note	2003 \$	2002 \$
Assets			
Cash assets	10(b)	9,034,197	10,578,946
Receivables		1,227,029	743,577
Prepayments	8	1,139,543	-
Investments			
Mortgage loans	7(a)	202,518,940	89,001,626
Unlisted registered managed investment schemes	7(b)	59,953	757,846
Other	7(c)	9,976	9,976
Total assets		<u>213,989,638</u>	<u>101,091,971</u>
Liabilities			
Payables		134,092	609,352
Funds received in advance		2,011,708	-
Distributions payable	6	<u>1,458,557</u>	<u>600,607</u>
Total liabilities		<u>3,604,357</u>	<u>1,209,959</u>
Net assets		<u>210,385,281</u>	<u>99,882,012</u>
Unit holders' funds			
Units on issue	5(a)	210,567,901	100,064,632
Excess distributions	5(b)	<u>(182,620)</u>	<u>(182,620)</u>
Total unit holders' funds		<u>210,385,281</u>	<u>99,882,012</u>

The statement of financial position is to be read in conjunction with the notes to the financial statements set out on pages 7 to 18.

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LM MORTGAGE INCOME FUND
STATEMENT OF CASH FLOWS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2003

	Note	2003 \$	2002 \$
Cash flows from operating activities			
Interest and distributions received		15,205,362	6,654,722
Responsible Entity's and Custodian's fees paid		(3,372,968)	(1,404,756)
Other operating cash flows		(1,743,994)	(216,587)
Net cash provided by operating activities	10(a)	10,088,400	5,033,379
Cash flows from investing activities			
Net payments for mortgage loans		(113,517,313)	(89,001,626)
Funds received in advance		2,011,708	-
Net withdrawal from investment schemes		697,892	41,359,963
Net cash used in investing activities		(110,807,713)	(47,641,663)
Cash flow from unitholders' activities			
Applications		176,759,523	77,061,498
Redemptions		(69,229,593)	(21,523,728)
Distributions paid		(8,355,366)	(4,094,154)
Net cash provided by unit holders' activities		99,174,564	51,443,616
Net increase in cash held		(1,544,749)	8,835,332
Cash at the beginning of the financial year		10,578,946	1,743,614
Cash at the end of the financial year	10(b)	9,034,197	10,578,946

The statement of cash flows is to be read in conjunction with the notes to the financial statements set out on pages 7 to 18.

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LM MORTGAGE INCOME FUND

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2003

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies that have been adopted in the preparation of this financial report are:

(a) Basis of preparation

The Scheme was constituted on 24 August 1999 and will terminate on 24 August 2079 unless terminated earlier in accordance with the provision of the Constitution (as amended).

The financial report is a general purpose financial report which has been prepared in accordance with Accounting Standards, Urgent Issues Group Consensus Views, other authoritative pronouncements of the Australian Accounting Standards Board and the Corporations Act 2001.

It has been prepared on the basis of historical costs and except where stated, does not take into account changing money values or fair values of assets.

The accounting policies have been consistently applied and except where there is a change in accounting policy, are consistent with those of the previous financial year.

(b) Investments

Investments in unlisted managed investment schemes are carried at fair value. The net fair value of investments in unlisted managed investment schemes is determined as the net asset value per unit on the last day of the financial year.

(c) Cash assets

Cash assets includes deposits held at call with a bank or financial institution and highly liquid investments with short periods to maturity which are readily convertible to cash on hand at the Responsible Entity's option and are subject to insignificant risk of changes in value.

(d) Mortgage loans

Mortgage loans, which are recorded at principal amount less repayments, represent amounts advanced to other parties, which are secured by registered mortgage. The collectability of mortgage loans is assessed and a provision made for any debts which are considered doubtful, and for which insufficient security is held to ensure the full amount of the loan and any accrued interest is recoverable. The net fair value of mortgage loans approximate the carrying amount due to the variable interest rates of these loans and/or the short term to maturity.

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LM MORTGAGE INCOME FUND

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2003

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (cont)

(e) Income and expenses

Interest income from investments in mortgage loans is brought to account on an accrual basis. Distribution income from investments in related managed investment schemes is brought to account on an accrual basis. Income received in advance is deferred and brought to account equally over the relevant period. Income, which in the opinion of the Responsible Entity is non-recoverable, is written off.

Changes in the net fair value of investments are recognised as income and are determined as the difference between the fair value at year-end and the fair value as at the prior period end.

Expenses are brought to account on an accruals basis.

The Responsible Entity and Custodian are entitled under the Constitution, to be reimbursed for certain expenses incurred in administering the Scheme. The basis on which the expenses are reimbursed is defined in the Constitution. The amount reimbursed was calculated in accordance with the Constitution.

(f) Advisor Commissions

Advisor commissions are paid to unit holders' investment advisors and are calculated as a percentage of funds invested. These commissions are paid monthly in arrears and are brought to account on an accruals basis.

(g) Taxation

Under current legislation, the Scheme is not subject to income tax as the taxable income is distributed in full to the unit holders.

The Scheme fully distributes its distributable income, calculated in accordance with Scheme constitution and applicable taxation legislation, to the unit holders who are presently entitled to income under the constitution.

(h) Goods and services tax

Responsible Entity's fees, custodian fees and other expenses are recognised net of the amount of goods and services tax ("GST") recoverable from the Australian Tax Office ("ATO") as a reduced input tax credit ("RITC").

Payables are stated with the amount of GST included.

The net amount of GST recoverable from or payable to the ATO is included as current asset or liability in the statement of financial position.

Cash flows are included in the statement of cash flows on a gross basis.

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LM MORTGAGE INCOME FUND

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2003

2.	INVESTMENT INCOME			2003	2002	
				\$	\$	
(a)	Non-interest revenues					
	Distribution income from:					
	Related managed investment schemes (refer Note 8)			-	2,312,534	
	Unrelated managed investment schemes			313,870	29,745	
	Other (refer Note 8)			-	997	
				313,870	2,343,276	
(b)	Interest revenues			2003	2002	
	Average	Interest	Average	Average	Interest	Average
	balance		rate	balance		rate
	\$	\$	%	\$	\$	%
Cash assets	8,932,884	424,312	4.75	4,825,782	158,712	3.29
Mortgage loans	138,390,677	14,952,199	10.80	41,172,326	4,666,168	11.33
	147,323,561	15,376,511	10.61	45,998,108	4,824,880	10.49
3.	OTHER EXPENSES					
	Audit fees	28,292	18,300			
	Sundry	12,543	-			
	Printing	110,185	-			
	Legal fees	22,869	-			
		173,889	18,300			
4.	AUDITORS' REMUNERATION					
	Audit Services:					
	Auditors of the scheme – KPMG:					
	Audit and review of the financial reports	21,292	14,500			
	Other regulatory audit services	7,000	3,800			
		28,292	18,300			

These expenses have been included in other expenses in the statement of financial performance.

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LM MORTGAGE INCOME FUND

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2003

5. UNITHOLDERS' FUNDS	2003		2002	
	#	\$	#	\$
(a) Units on issue				
Opening balance	100,064,632	100,064,632	43,709,884	43,709,884
Applications – cash	176,759,523	176,759,523	77,061,498	77,061,498
- reinvestments	2,973,339	2,973,339	816,978	816,978
Redemptions	(69,229,593)	(69,229,593)	(21,523,728)	(21,523,728)
Closing balance	210,567,901	210,567,901	100,064,632	100,064,632
Class A - Opening balance	100,064,632	100,064,632	43,709,884	43,709,884
Applications – cash	94,052,223	94,052,223	77,061,498	77,061,498
- reinvestments	2,973,339	2,973,339	816,978	816,978
Redemptions	(44,915,603)	(44,915,603)	(21,523,728)	(21,523,728)
Closing balance	152,174,591	152,174,591	100,064,632	100,064,632
Class B – Opening balance	-	-	-	-
Applications – cash	82,707,300	82,707,300	-	-
- reinvestments	-	-	-	-
Redemptions	(24,313,990)	(24,313,990)	-	-
Closing balance	58,393,310	58,393,310	-	-
Total closing balance	210,567,901	210,567,901	100,064,632	100,064,632

Class A consists of unit holders who are entitled to receive the declared distribution rate.

Class B consists of unit holders with an investment greater than \$1,000,000 and are entitled to a bonus of .35% pa in addition to the current rate of distribution. The Responsible Entity has the discretion to waive the whole or part of the 1% trailing commission and the whole or part of its management fee for this class of unit holders.

All unit holders are entitled to received distributions as declared from time to time and are entitled to one vote per unit at unit holders' meetings.

In the event of a winding up of the scheme, all unit holders rank after creditors and are equally entitled to the proceeds of liquidation.

(b) Excess distributions	2003	2002
Opening balance	(182,620)	(142,308)
Transfers (to)/from statement of financial performance	-	(40,312)
Closing balance	(182,620)	(182,620)

Excess distributions represent a return of capital under the constitution of the scheme.

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LM MORTGAGE INCOME FUND

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2003

6. DISTRIBUTIONS

Distributions in respect of the financial year comprise:

Total distributions paid	10,712,824	4,625,962
Total distributions payable	1,458,557	600,607
	<u>12,171,381</u>	<u>5,226,569</u>

As unit holders are presently entitled to the distributable income of the Scheme, no income tax is payable by the Scheme.

	2003 \$	2002 \$
7. INVESTMENTS		
(a) Mortgage loans		
Mortgage loans	<u>202,518,940</u>	<u>89,001,626</u>
<i>Maturity analysis</i>		
Not longer than 3 months	86,320,878	10,510,534
Longer than 3 months and not longer than 6 months	27,207,587	25,552,517
Longer than 6 months and not longer than 12 months	39,106,933	25,984,545
Longer than 12 months and not longer than 18 months	17,675,697	26,954,030
Longer than 18 months but not longer than 24 months	11,656,057	-
Longer than 24 months but not longer than 36 months	17,636,788	-
Longer than 36 months but not longer than 48 months	2,915,000	-
	<u>202,518,940</u>	<u>89,001,626</u>
As at 30 June 2003 there was one mortgage loan in default with total principal of \$9,576,905 outstanding. The independent valuation of the security property completed on 27 June 2002 totalled \$15,350,000 and the loan-to-value ratio of this mortgage loan at year-end was 62%. Interest in relation to this mortgage loan has been paid by a related managed investment scheme. The directors consider this loan to be fully recoverable as the Scheme holds a registered first mortgage over the security property and do not anticipate any capital loss. Accordingly, no provision for doubtful debts has been raised in relation to this mortgage loan at year-end.		
(b) Unlisted registered managed investment schemes		
Related managed investment schemes at fair value (refer Note 8)	<u>59,953</u>	<u>757,846</u>
The Scheme's investment in a related managed investment scheme is no longer earning distributions as the related scheme is currently being wound down and only has investments in default mortgages. The directors do not anticipate any capital loss from the related managed investment scheme.		
(c) Other		
Related investment entity (refer Note 8)	<u>9,976</u>	<u>9,976</u>

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LM MORTGAGE INCOME FUND

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS FOR THE FINANCIAL YEAR ENDED 30 JUNE 2003

8. RELATED PARTIES

Responsible Entity

The Responsible Entity of LM Mortgage Income Fund is LM Investment Management Limited (ABN 68 077 208 461).

Custodian

The Custodian of the Scheme is Permanent Trustee Australia Ltd.

Directors

The names of each person holding the position of director of LM Investment Management Limited during the financial year are as follows:

Name	Period of directorship
Mr Peter C Drake	Appointed 31 January 1997
Mr Peter Aubort	Appointed 25 March 1997
Mr Geoffrey Black	Appointed 31 March 1999
Mr Martyn Carne	Appointed 19 July 2002

Directors' remuneration

No amounts are paid by the Scheme directly to the directors of the Responsible Entity. The amount of remuneration paid by the Responsible Entity and its related parties to directors of the responsible entity in connection with their responsibilities for the Scheme is not separately identified.

Directors' holdings of units

The interests of LM Investment Management Limited and its associates in the scheme at year-end are set out below.

	2003	2002
	\$	\$
LM Investment Management Limited	150,486	129,259
Associates of LM Investment Management Limited	62,878,520	5,612,251

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LM MORTGAGE INCOME FUND

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2003

8. RELATED PARTIES (cont)

Other transactions with the Scheme

From time to time directors LM Investment Management Limited, or their director-related entities, may invest or withdraw from the Scheme. These investments or withdrawals are on the same terms and conditions as those entered into by other Scheme investors.

Apart from the details disclosed in this note, no director has entered into a material contract with the Scheme since the end of the previous financial year and there were no material contracts involving directors' interests subsisting at year-end.

Related party transactions

Transactions with related parties are set out below:

<i>Responsible Entity's remuneration</i>	2003 \$	2002 \$
Total remuneration received or due and receivable:		
■ Responsible Entity's fees for the year received directly from LM Mortgage Income Fund.	2,234,991	1,337,290
■ Responsible Entity's fees earned by the Responsible Entity from other approved schemes invested in by LM Mortgage Income Fund.	-	524,895
■ Other expenses included administration expenses incurred by the Responsible Entity, which are reimbursed to the Responsible Entity in accordance with the provisions of the Constitution.	173,889	18,300
<i>Custodian's remuneration</i>		
■ Custodian's fees paid by Responsible Entity and reimbursed by the scheme	45,928	22,015

Balances with related parties

The aggregate amounts receivable from related parties by the Scheme at balance date are as follows:

LM Investment Management Ltd	1,139,543	-
------------------------------	-----------	---

These amounts are included in prepayments. No amounts are payable to related parties by the Scheme.

Investing activities

The Scheme has no investment in the Responsible Entity or its affiliates.

The Scheme may purchase and sell units in other approved schemes or investment entities operated by LM Investment Management Limited or its associates in the ordinary course of business at application and redemption prices calculated in accordance with the constitutions of those schemes. Details of LM Mortgage Income Fund's investments in other schemes operated by LM Investment Management Limited or its affiliates are set out below:

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LM MORTGAGE INCOME FUND

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2003

8. RELATED PARTIES (cont)

Scheme name	Investment at year end \$	Interest held in related scheme at year end	Change in fair value of investment \$	Funds invested during the year \$	Funds withdrawn during the year \$	Contribution to investment income \$
30 June 2003						
LM Select Mortgage Income Fund	59,953	0.75%	-	-	697,893	-
LMQ Mortgage Facilities	9,976	17.67%	-	-	-	-
30 June 2002						
LM Select Mortgage Income Fund	757,846	5.36%	142,661	13,921,090	55,138,392	2,312,534
LMQ Mortgage Facilities	9,976	17.67%	-	-	-	997

These investments are on normal terms and conditions.

Unitholder investing activities

Details of holdings in the Scheme by LM Investment Management Limited, its affiliates or other schemes managed by LM Investment Management Limited are set out below:

Entity	Investment at year end \$	Interest held in the scheme at year end	Units issued during the year	Units redeemed during the year	Distributions paid and payable \$
30 June 2003					
LM Special Participation Fund	6,673,000	3.17%	4,598,300	1,862,300	733,179
Engineering House Canberra Syndicate	3,553,000	1.69%	3,481,750	823,900	219,126
Belinda J Drake	932,210	.44%	922,109	-	20,527
LM Managed Performance Fund - Series One	4,520,000	2.14%	8,211,700	3,691,700	244,775
LM Wholesale Mortgage Income Fund	44,543,000	21.15%	62,500,000	17,957,000	2,313,417
LM Property Performance Fund	2,657,310	1.26%	3,460,300	802,990	124,835
LM Investment Management Hong Kong Ltd	150,486	.07%	21,227	-	12,294
Total	63,029,006	29.92%	83,195,386	25,137,890	3,668,153
30 June 2002					
LM Special Participation Fund	3,937,000	3.93%	3,937,000	-	1,726
G M Dwyer	-	-	-	114,062	992
Engineering House Canberra Syndicate	895,150	0.89%	1,127,734	232,584	39,250
Belinda J Drake	10,101	0.01%	16,121	6,020	101
LM Managed Performance Fund	770,000	0.77%	1,965,000	1,195,000	1,277
LM Investment Management Hong Kong Ltd	129,259	0.13%	129,259	-	11,798
E & T Aubert	-	-	-	10,000	438
Total	5,741,510	5.74%	7,175,114	1,557,666	55,582

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LM MORTGAGE INCOME FUND

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2003

9. SEGMENT INFORMATION

The scheme operates predominantly in the mortgage investment industry in Australia, with mortgages secured by commercial property. The scheme operations and customers are located within Australia.

10. NOTES TO THE STATEMENT OF CASH FLOWS

(a) Reconciliation of net cash provided by operating activities to net profit

	2003	2002
	\$	\$
Net profit	12,171,381	5,186,257
Add/(less) non-cash items		
Changes in net fair value of investments	-	(142,661)
Changes in assets and liabilities during the financial year		
(Decrease)/increase in payables	(458,419)	533,662
Decrease/(increase) in prepayments and interest receivable	(1,624,562)	(543,879)
Net cash provided by operating activities	10,088,400	5,033,379

(b) Reconciliation of cash

For the purposes of the statement of cash flows, cash includes cash on hand and at bank, and short-term deposits at call. Cash as at the end of the financial year as shown in the statement of cash flows is reconciled to the related items in the statement of financial position as follows:

Cash and cash equivalents	9,034,197	10,578,946
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(c) Sales and purchases of securities

Cash flows arising from the sales and purchases of securities are presented on a net basis in the statement of cash flows.

(d) Reinvestment of distributions

During the financial year, the scheme issued 2,973,339 units (2002: 816,978) as a result of reinvestment of distributions by unit holders totalling \$2,973,339 (2002: \$816,978). These transactions have not been included in the statement of cash flows.