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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

11. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE

(a) Interest rate risk

Interest rate risk exposures

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.

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:

Note	Weighted average interest rate		Floating Interest Rate		Securities contracted to mature in:				Total
	2003	2002	2003	2002	Less than 1 year	More than 1 year but less than 5 years	2003	2002	
	%	%							
Cash assets	10(b)	4.8	4.7						
Mortgage loans	7(a)	11.2	11.7						
Investment schemes	7(b)	-	-						
					152,635,398	62,047,596	49,883,542	26,954,030	10,578,946
					69,929	767,822	-	-	89,001,626
									767,822
Total					9,034,197	10,578,946	152,705,327	62,815,418	49,883,542
									26,954,030
									213,167,815
									100,348,394

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

¹ 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. (refer Note 7(b)).

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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

11. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE (CONT)

(b) Credit risk exposure

Credit risk represents the loss that would be recognised if counterparties failed to perform as contracted. The total credit risk for recognised items including securities is therefore limited to the amount carried on the statement of financial position.

Recognised financial instruments

The Scheme minimises concentrations of 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 loan to valuation ratios not exceeding 66.67%.

The scheme is exposed to a concentration of credit risk as three individual borrowers represent \$47,993,311 (24%) of mortgage loans.

The percentage of loans secured by property in different geographical locations is as follows:

	2003	2002
Sydney CBD	10 %	18%
Within 40km of Sydney CBD	10%	27%
New South Wales – Other	31%	4%
Within 40km of Melbourne CBD	7%	1%
Victoria – Other	10%	13%
Melbourne – CBD	4%	-
Within 40km of Brisbane CBD	5%	10%
Queensland – Other	5%	23%
Canberra – Other	18%	4%
	<hr/> 100%	<hr/> 100%

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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

11. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE (CONT)

(c) Net fair values of financial assets and liabilities

The Scheme's financial assets and liabilities included in the statement of financial position are carried at amounts that approximate net fair value.

(d) 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 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 cash funds to satisfy usual levels of demand.

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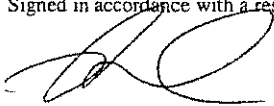
LM MORTGAGE INCOME FUND

DIRECTOR'S DECLARATION

In the opinion of the directors of LM Investment Management Limited, responsible entity of LM Mortgage Income Fund:

1. The financial statements and notes set out on pages 4 to 18 are in accordance with the Corporations Act 2001 including:
 - (a) giving a true and fair view of the financial position of the Scheme as at 30 June 2003, and of its performance, as presented by the results of its operations and its cash flows for the year ended on that date; and
 - (b) complying with Accounting Standards in Australia and the Corporations Regulations 2001.
2. There are reasonable grounds to believe that the Scheme will be able to pay its debts as and when they become due and payable.

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



Dated at Surfers Paradise this 12th day of September 2003.

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**INDEPENDENT AUDIT REPORT TO THE UNITHOLDERS OF
LM MORTGAGE INCOME FUND**

Scope

We have audited the financial report of LM Mortgage Income Fund ("the Scheme") for the year ended 30 June 2003, consisting of the statement of financial performance, statement of financial position, statement of cash flows, accompanying notes and the directors' declaration set out on pages 4 to 19. The directors of the responsible entity, LM Investment Management Limited, are responsible for the financial report. We have conducted an independent audit of this financial report in order to express an opinion on it to the unit holders of the Scheme.

Our audit has been conducted in accordance with Australian Auditing Standards to provide reasonable assurance whether the financial report is free of material misstatement. Our procedures included examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial report, and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion whether, in all material respects, the financial report is presented fairly in accordance with Accounting Standards and other mandatory professional reporting requirements in Australia and statutory requirements, so as to present a view which is consistent with our understanding of the Scheme's financial position, and performance as represented by the results of its operations and its cash flows.

The audit opinion expressed in this report has been formed on the above basis.

Audit opinion

In our opinion, the financial report of LM Mortgage Income Fund is in accordance with:

- (a) the Corporations Act 2001, including:
 - (i) giving a true and fair view of the Scheme's financial position as at 30 June 2003 and of its performance for the year ended on that date; and
 - (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and
- (b) other mandatory professional reporting requirements in Australia.

Gold Coast
12 September 2003

KPMG

KPMG

P G Steer

P G Steer
Partner

PW-34

ASIC registered agent number 388 1/2 18 March 2002

lodging party or agent name LM Investment Management Ltd.

office, level, building name or PO Box no. P.O. Box 485

street number 3 name

suburb/city Surfers Paradise state/territory QLD postcode 4217

telephone (07) 55 844 500

facsimile (07) 55 922 505

DX number

suburb/city

Australian Securities & Investments Commission

form 388

Corporations Act 2001

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

Corporations Regulations

1.0.08

Name LM MORTGAGE INCOME FUND

ACN / ARBN / ARSN/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 1/7/2003 and ends 30/6/2004 (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:

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

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

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

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

ERNST & YOUNG

office

level

building name

street number & name

suburb / city

state / territory

postcode

Business Registration number

(if applicable)

75288 172749

State / Territory registered in

date of appointment (d/m/y)

1 / 10 / 2003

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 s 298 to 300)

Auditor's report required under sections 308 and 314

Certification

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

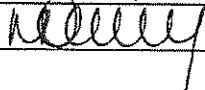
print name

LISA DARCY

capacity

DIRECTOR

sign here



date

24.9.04

* 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

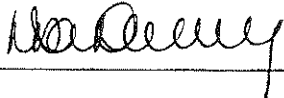
Include

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 "19" PAGES REFERRED TO IN FORM 388 - COPY OF FINANCIAL STATEMENTS AND REPORTS

A handwritten signature in black ink, appearing to read 'Lisa Darcy', is written over a horizontal line.

LISA DARCY - (DIRECTOR)

LM Mortgage Income Fund

ABN: 13 089 343 288

Annual Financial Report
30 June 2004

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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 2004 and the auditor's report thereon.

Directors

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

Name	Period of directorship
Mr Peter Charles Drake	Appointed 31 January 1997
Mr Peter Aubert	Appointed 25 March 1997; resigned 15 September 2003
Mr Geoffrey Murray Black	Appointed 31 March 1999
Mr Martyn Andrew Carne	Appointed 18 July 2002
Ms Lisa Maree Darcy	Appointed 15 September 2003
Mr Brett McMahon	Appointed 20 August 2004

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 in first registered mortgages, unlisted managed investment schemes 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.

Scheme Information

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

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

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 \$167,040,297, of which \$80,135,000 was as a result of the scheme accepting applications from a related managed investment scheme (LM Wholesale Mortgage Income Fund).

Results

The financial year ended 30 June 2004 resulted in a net profit of \$22,879,338 (2003: \$12,171,381). 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 \$22,879,338 (2003: \$12,171,381).

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

Units on issue

The Scheme issued 268,640,022 units during the financial year (2003: 179,732,862), while 101,569,725 units were redeemed (2003: 69,229,593), resulting in a balance of 377,638,198 units on issue as at 30 June 2003 (2003: 210,567,901). The Scheme had total assets of \$380,672,514 as at 30 June 2003 (2003: \$213,989,638). The basis for valuation of the Scheme's assets is disclosed in Note 1 to the financial statements.

Scheme Assets

At 30 June 2004, LM Mortgage Income Fund held assets to a total value of \$380,672,514 (2003:\$213,989,638). The basis for valuation of the assets is disclosed in Note 1 to the financial statements.

Interests of the Responsible Entity

The following fees were paid to LM Administration Pty Ltd out of scheme property during the financial year, for funds management and administrative services provided on behalf of the Responsible Entity:

	2004 \$	2003 \$
■ Management fees for the year received directly from LM Mortgage Income Fund by LM Administration Pty Ltd	4,412,570	2,234,991
■ Fees earned by LM Administration Pty Limited from other approved schemes invested in by LM Mortgage Income Fund	-	-
■ 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.	116,827	219,817

The Responsible Entity and its associates held 135,311,703 units (2003: 63,029,006) in the Scheme at year-end. The aggregate amount receivable from LM Administration Pty Limited by the Scheme at year end was \$1,935,881 (2003:\$1,139,543), in relation to prepaid management fees.

Significant changes in the 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.

Significant events after balance date

Other than the transaction below, there have been no items, transactions or events 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.

Subsequent to balance date, a related managed investment scheme, The LM Special Participation Fund has entered into an underwriting arrangement to fund interest payments on behalf of a borrower where the Scheme holds the registered first mortgage. The receivable owing to the related scheme as at September 2004 totals \$1,148,895. The security property involved consists of development land located in Camperdown, NSW, valued at \$46,500,000. The mortgage loan owed to the LM Mortgage Income Fund of \$30,225,000 has priority over the related scheme receivable. The Responsible Entity continues to monitor this loan closely and expects no loss of capital to occur.

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

Likely developments and expected results

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


Indemnities and insurance premiums for Officers or Directors

The constitution of the responsible entity requires it to indemnify all current and former officers of the Responsible Entity (but not including auditors) out of the property of the Responsible Entity against:

- (a) any liability for costs and expenses which may be incurred by that person in defending civil or criminal proceedings in which judgement is given in that persons favour, or in which the person is acquitted, or in connection with an application in relation to any proceedings in which the court grants relief to the person under the Corporations Act 2001.
- (b) a liability incurred by the person, as an officer of the Responsible Entity or of a related body corporate, to another person (other than the Responsible Entity or a related body corporate) unless the liability arises out of conduct involving a lack of good faith

During the financial period the Responsible Entity has paid an insurance premium in respect of a contract insuring each of the Directors of the Responsible Entity. The amount of the premium is, under the terms of the insurance contract, confidential. The liabilities insured include costs and expenses that may be incurred in defending civil or criminal proceedings that may be brought against the officers in their capacity as officers of the Responsible Entity. The insurance premium does not cover auditors.

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


Lisa Darcy
Director
Gold Coast

Date: 23rd September 2004

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LM MORTGAGE INCOME FUND
STATEMENT OF FINANCIAL PERFORMANCE
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2004

	Note	2004 \$	2003 \$
Investment income			
Distribution income	2(a)	-	313,870
Interest income	2(b)	29,009,477	15,376,511
Other income	2(a)	40,727	-
Total revenue		<u>29,050,204</u>	<u>15,690,381</u>
Expenses			
Management fees	8	4,412,570	2,234,991
Custodian fees	8	70,806	45,928
Advisor commissions		1,641,469	1,064,192
Other expenses	3	46,021	173,889
Total expenses		<u>6,170,866</u>	<u>3,519,000</u>
Net profit		<u>22,879,338</u>	<u>12,171,381</u>
Reconciliation of net profit			
Distributions paid and payable	6	<u>22,879,338</u>	<u>12,171,381</u>
		<u>22,879,338</u>	<u>12,171,381</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 20.

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LM MORTGAGE INCOME FUND
STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE 2004

	Note	2004 \$	2003 \$
Assets			
Cash assets	10(b)	33,563,098	9,034,197
Receivables		1,323,398	1,227,029
Prepayments	8	1,935,881	1,139,543
Investments			
Mortgage loans	7(c)	343,790,184	202,518,940
Unlisted registered managed investment schemes	7(a)	59,953	59,953
Other – related managed investment schemes	7(b)	-	9,976
Total assets		<u>380,672,514</u>	<u>213,989,638</u>
Liabilities			
Payables		746,288	134,092
Funds received in advance		-	2,011,708
Distributions payable	6	<u>2,470,649</u>	<u>1,458,557</u>
Total liabilities		<u>3,216,937</u>	<u>3,604,357</u>
Net assets		<u>377,455,577</u>	<u>210,385,281</u>
Unit holders' funds			
Units on issue	5(a)	377,638,198	210,567,901
Excess distributions	5(b)	<u>(182,620)</u>	<u>(182,620)</u>
Total unit holders' funds		<u>377,455,577</u>	<u>210,385,281</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 20.

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LM MORTGAGE INCOME FUND
STATEMENT OF CASH FLOWS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2004

	Note	2004 \$	2003 \$
Cash flows from operating activities			
Interest and distributions received		28,913,108	15,205,362
Management fees paid		(5,216,915)	(3,372,968)
Other operating cash flows		(3,149,801)	(1,743,994)
Other income received		40,727	-
Net cash provided by operating activities	10(a)	<u>20,587,119</u>	<u>10,088,400</u>
Cash flows from investing activities			
Net payments for mortgage loans		(141,271,244)	(113,517,313)
Funds received in advance		-	2,011,708
Net withdrawal from investment schemes		9,976	697,892
Net cash used in investing activities		<u>(141,261,268)</u>	<u>(110,807,713)</u>
Cash flow from unitholders' activities			
Applications		263,176,173	176,759,523
Redemptions		(101,569,725)	(69,229,593)
Distributions paid		(16,403,398)	(8,355,366)
Net cash provided by unit holders' activities		<u>145,203,050</u>	<u>99,174,564</u>
Net increase in cash held		<u>24,528,901</u>	<u>(1,544,749)</u>
Cash at the beginning of the financial year		<u>9,034,197</u>	<u>10,578,946</u>
Cash at the end of the financial year	10(b)	<u>33,563,098</u>	<u>9,034,197</u>

The statement of cash flows is to be read in conjunction with the notes to the financial statements set out on pages 7 to 20.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2004

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) Changes in accounting policies

The accounting policies are consistent with those of the prior year unless otherwise stated.

(c) 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.

(d) 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.

(e) 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 2004

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (cont)

(f) 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.

(g) 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.

(h) 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.

(i) Goods and services tax

Expenses incurred by the scheme are recognised net of the amount of GST that can be recovered from the Australian Taxation Office (ATO). Amounts recognised as receivables and payables at balance date include the amount of GST payable.

Reduced input tax credits (RITC) recoverable by the Scheme from the ATO are recognised as receivables in the Statement of Financial Position.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2004

2. INVESTMENT INCOME				2004	2003
				\$	\$
(a) Non-interest revenues					
Distribution income from:					
Unrelated managed investment schemes				-	313,870
Other income				40,727	-
				<u>40,727</u>	<u>313,870</u>
(b) Interest revenues					
	Average	2004	Average	Average	2003
	balance	Interest	rate	balance	Interest
	\$	\$	%	\$	\$
Cash assets	17,574,339	929,951	5.29	8,932,884	424,312
Mortgage loans	267,806,500	28,070,526	10.48	138,390,677	14,952,199
	<u>285,380,839</u>	<u>29,009,477</u>	<u>10.17</u>	<u>147,323,561</u>	<u>15,376,511</u>
					<u>10.61</u>
3. OTHER EXPENSES					
Audit fees				45,504	28,292
Sundry				-	12,543
Printing				-	110,185
Legal fees				-	22,869
Other				517	-
				<u>46,021</u>	<u>173,889</u>
4. AUDITORS' REMUNERATION					
Audit Services:					
Audit and review of the financial reports				33,504	21,292
Other regulatory audit services				8,000	7,000
				<u>45,504</u>	<u>28,292</u>

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 2004

5. UNITHOLDERS' FUNDS	2004		2003	
	#	\$	#	\$
(a) Units on issue				
Opening balance	210,567,901	210,567,901	100,064,632	100,064,632
Applications - cash	263,176,173	263,176,173	176,759,523	176,759,523
- reinvestments	5,463,849	5,463,849	2,973,339	2,973,339
Redemptions	(101,569,725)	(101,569,725)	(69,229,593)	(69,229,593)
Closing balance	377,638,198	377,638,198	210,567,901	210,567,901
Class A - Opening balance	152,174,591	152,174,591	100,064,632	100,064,632
Applications - cash	136,660,983	136,660,983	94,052,223	94,052,223
- reinvestments	5,463,849	5,463,849	2,973,339	2,973,339
Redemptions	(51,801,225)	(51,801,225)	(44,915,603)	(44,915,603)
Closing balance	242,498,198	242,498,198	152,174,591	152,174,591
Class B - Opening balance	58,393,310	58,393,310	-	-
Applications - cash	126,515,190	126,515,190	82,707,300	82,707,300
- reinvestments	-	-	-	-
Redemptions	(49,768,500)	(49,768,500)	(24,313,990)	(24,313,990)
Closing balance	135,140,000	135,140,000	58,393,310	58,393,310
Total closing balance	377,638,198	377,638,198	210,567,901	210,567,901

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. The distribution rate will be determined 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.

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	2004	2003
Opening balance	(182,260)	(182,620)
Transfers (to)/from statement of financial performance	-	-
Closing balance	(182,260)	(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 2004

6. DISTRIBUTIONS	2004	2003
	\$	\$
Distributions in respect of the financial year comprise:		
Total distributions paid	20,408,689	10,712,824
Total distributions payable	2,470,649	1,458,557
	<u>22,879,338</u>	<u>12,171,381</u>
As unit holders are presently entitled to the distributable income of the Scheme, no income tax is payable by the Scheme.		
7. INVESTMENTS		
(a) Unlisted registered managed investment schemes		
Related managed investment schemes at fair value (refer Note 8)	<u>59,953</u>	<u>59,953</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.		
(b) Other		
Related investment entity (refer Note 8)	<u>-</u>	<u>9,976</u>
(c) Mortgage loans		
Mortgage loans (secured by first registered mortgage over real property)	<u>343,790,184</u>	<u>202,518,940</u>
<i>Maturity analysis</i>		
Not longer than 3 months	80,051,524	86,320,878
Longer than 3 months and not longer than 6 months	22,562,465	27,207,587
Longer than 6 months and not longer than 12 months	152,928,847	39,106,933
Longer than 12 months and not longer than 18 months	13,288,002	17,675,697
Longer than 18 months but not longer than 24 months	47,491,446	11,656,057
Longer than 24 months but not longer than 36 months	27,467,900	17,636,788
Longer than 36 months but not longer than 48 months	-	2,915,000
	<u>343,790,184</u>	<u>202,518,940</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 2004

7. INVESTMENTS**(c) Mortgage loans (continued)**

As at 30 June 2004 there were four mortgage loans in default with principal outstanding of \$17,036,056. Following the sale of one of the security properties at an independent valuation to a related managed investment scheme The LM Property Performance Fund, full principal of \$7,126,904 was recovered subsequent to balance date. In addition, subsequent to year end, the total principal outstanding on the two remaining loans in default has been reduced to \$4,826,989 with an average loan to value ratio of 51%. The directors consider these loans to be fully recoverable as the Scheme holds registered first mortgages over the security properties and does not anticipate any capital loss. Accordingly, no provision for doubtful debts has been raised in relation to these mortgage loans at year-end. As at 30 June 2004, four additional mortgage loans have had interest payments underwritten by a related managed investment scheme, The LM Special Participation Fund. Details of the receivables and information in respect of those loans are set out below. The loans outstanding have priority over the related scheme receivables.

Loan principal	\$7,005,370	The security property is a residential (17 units) construction in Surry Hills NSW independently valued at \$10,639,000. Total interest payments underwritten by the related scheme as at balance date are \$316,962. In addition to this, another related scheme holds a second mortgage over this property and has advanced the sum of \$699,888. The development of the security property is now almost complete. The Responsible Entity expects the loan to be paid out via the sell-down of the property by the borrower. The loan continues to be closely monitored by the Responsible Entity, and if necessary has the right to sell the property as mortgagee in possession as required.
Loan principal	\$17,310,154	The related scheme has entered into a commercial agreement with the borrower to fund interest payments during delays in both the issuance of titles from council and the realisation of sale proceeds. Total interest payments underwritten by the related scheme as at balance date are \$726,814. The security property is a fully completed residential development at Waitara, NSW valued at \$28,140,000. Sell-down of security is now underway, and loan principal has been reduced to \$15,141,695 as at September 2004.
Loan principal	\$4,200,000	The security property is vacant land at Ferny Grove, QLD, valued at \$7,000,000. The related scheme has made interest payments totalling \$38,500. The borrowers are seeking appointment of an administrator following a meeting of creditors. Should the administrators be appointed, refinancing of the priority debt with other lenders will be sought. The Responsible Entity expects full recoverability of this loan. This loan continues to be closely monitored and the Responsible Entity has the right to sell the property as mortgagee in possession if required.
Loan principal	\$2,295,555	The security property is a residential construction at Windsor, NSW, independently valued at \$4,390,000. The related scheme has made interest payments of \$22,963. The Responsible Entity expects full recoverability of this loan.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2004

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 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 as follows:

Name	Period of directorship
Mr Peter Charles Drake	Appointed 31 January 1997
Mr Peter Aubort	Appointed 25 March 1997; resigned 15 September 2003
Mr Geoffrey Murray Black	Appointed 31 March 1999
Mr Martyn Andrew Carne	Appointed 18 July 2002
Ms Lisa Maree Darcy	Appointed 15 September 2003
Mr Brett McMahon	Appointed 20 August 2004

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.

	2004	2003
	\$	\$
LM Investment Management Limited	163,018	150,486
Associates of LM Investment Management Limited	135,148,685	62,878,520

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.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2004

8. RELATED PARTIES (continued)*Related party transactions*

During the year the scheme sold a property as mortgagee in possession at an independent valuation to a related managed investment scheme The LM Property Performance Fund, full principal of \$7,126,904 was recovered subsequent to balance date.

LM Special Participation Fund provides income assurance to investors in the Scheme. The LM Special Participation Fund agrees to underwrite interest payments to the Scheme at the discretion of the Responsible Entity, on behalf of borrowers. The LM Special Participation Fund does not guarantee the payment of all income, or return of capital. During the year, the Scheme has received underwriting payments on behalf of borrowers from a related scheme The LM Special Participation Fund totalling \$4,414,918 (2003: \$794,576) during the year.

Administration and funds management services are provided to the Scheme on behalf of the Responsible Entity by LM Administration Pty Limited. LM Administration Pty Ltd is paid a management fee for these services directly from scheme assets. In addition, LM Investment Management Limited is paid loan origination fees directly from the borrowers.

<i>Remuneration of the Responsible Entity and related entities</i>	2004	2003
	\$	\$
Total remuneration received or due and receivable:		
■ Fees for the year received directly from LM Mortgage Income Fund by LM Administration Pty Ltd	4,412,570	2,234,991
■ Fees earned by LM Administration Pty Ltd from other approved schemes invested in by LM Mortgage Income Fund.	-	-
■ 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.	46,021	173,889
Custodian's remuneration		
■ Custodian's fees paid by Responsible Entity and reimbursed by the scheme	70,806	45,928
Balances with related parties		
The aggregate amounts receivable from related parties by the Scheme at balance date are as follows:		
LM Administration Pty Ltd	1,935,881	1,139,543

These amounts are included in prepayments. No amounts are payable to related parties by the Scheme. The average monthly balance of prepayments during the year was \$1,471,564 which was non-interest bearing. Interest foregone on the above amount if calculated at the weighted average cash rate of 5.29% would have been \$77,845. If this revenue had been collected, the sum foregone would have been paid to LM Administration Pty Ltd as management fees during the year.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2004

8. RELATED PARTIES (continued)*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:

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 2004						
LM Select Mortgage Income Fund	59,953	0.75%	-	-	-	-
LMQ Mortgage Facilities	-	-	-	-	9,976	-
30 June 2003						
LM Select Mortgage Income Fund	59,953	0.75%	-	-	697,893	-
LMQ Mortgage Facilities	9,976	17.67%	-	-	-	-

These investments are on normal terms and conditions.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2004

8. RELATED PARTIES (continued)*Unit holder 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 30 June 2004	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 \$
LM Special Participation Fund	2,241,000	0.59 %	1,990,000	6,422,000	451,822
Engineering House Canberra Syndicate	-	-	-	3,553,000	75,294
Belinda J Drake	5,140	-	584,250	1,511,320	38,711
LM Managed Performance Fund	8,129,000	2.15 %	23,367,000	19,758,000	548,682
LM Wholesale Mortgage Income Fund	124,678,000	33.02 %	99,600,000	19,465,000	7,838,526
LM Property Performance Fund	92,000	0.02 %	1,558,190	4,123,500	323,193
LM Investment Management Ltd	163,018	0.04 %	12,532	-	18,003
Lisa M Darcy	3,545	-	6,500	3,018	78
Total	135,311,703	35.82%	127,118,472	54,835,838	9,294,309
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	0.44%	922,109	-	20,527
LM Managed Performance Fund	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 Ltd	150,486	0.07%	21,227	-	12,294
Total	63,029,006	29.92%	83,195,386	25,137,880	3,668,153

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.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2004

10. NOTES TO THE STATEMENT OF CASH FLOWS**(a) Reconciliation of net cash provided by operating activities to net profit**

	2004	2003
	\$	\$
Net profit	22,879,338	12,171,381
Changes in assets and liabilities during the financial year		
(Decrease)/increase in payables	(1,399,512)	(458,419)
Decrease/(increase) in prepayments and interest receivable	(892,707)	(1,624,562)
Net cash provided by operating activities	<u>20,587,119</u>	<u>10,088,400</u>

(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	<u>33,563,098</u>	<u>9,034,197</u>
---------------------------	-------------------	------------------

(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 5,463,849 units (2003: 2,973,339) as a result of reinvestment of distributions by unit holders totalling \$5,463,849 (2003: \$2,973,339). These transactions have not been included in the statement of cash flows.

11. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE**(a) Net fair values of financial assets and liabilities**

The Scheme's financial assets and liabilities included in the statement of financial position are carried at amounts that approximate net fair value.

(b) 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 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.

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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

11. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE (continued)

(c) Interest rate risk

Interest rate risk exposures

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.

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:

	Note	Weighted average interest rate	Floating Interest Rate		Securities contracted to mature in:				Total
			2004	2003	2004	2003	2004	2003	
		%							
Cash assets	10(b)	5.29	-	-	33,563,098	9,034,197	-	33,533,098	10,578,946
Mortgage loans	7(c)	10.52	-	-	255,542,836	152,635,398	88,247,349	49,883,542	202,518,940
Total			-	-	289,106,934	161,669,595	88,247,349	49,883,542	213,097,886

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

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2004

11. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE (continued)**(d) Credit risk exposure**

Credit risk represents the loss that would be recognised if counterparties failed to perform as contracted. The total credit risk for recognised items including securities is therefore limited to the amount carried on the statement of financial position.

Recognised financial instruments

The Scheme minimises concentrations of 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 loan to valuation ratios not exceeding 66.67%.

The percentage of loans secured by property in different geographical locations is as follows:

	2004	2003
Sydney CBD	2.71 %	10.00 %
Within 40km of Sydney CBD	30.92 %	10.00 %
New South Wales – Other	12.82 %	31.00 %
Melbourne – CBD	3.26 %	4.00 %
Within 40km of Melbourne CBD	9.97 %	7.00 %
Victoria – Other	8.39 %	10.00 %
Brisbane CBD	7.95 %	-
Within 40km of Brisbane CBD	7.09 %	5.00 %
Queensland – Other	1.05 %	5.00 %
Canberra – Other	14.26 %	18.00 %
NT	0.23 %	0.00 %
SA	3.85 %	0.00 %
WA	3.50 %	0.00 %
	100.00 %	100.00 %

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2004

12. IMPACT OF ADOPTING AASB EQUIVALENTS TO IASB STANDARDS

LM Investment Management Ltd and the Scheme it is trustee for have commenced transitioning their accounting policies and financial reporting from current Australian Standards to Australian equivalents of International Financial Reporting Standards (IFRS). The Trustee has allocated internal resources and with the help of expert consultants will isolate key areas that may be impacted by the transition to IFRS. As the Trustee and the scheme have a 30 June year end, priority has been given to considering the preparation of an opening balance sheet in accordance AASB equivalents to IFRS as at 1 July 2004. This will form the basis of accounting for Australian equivalents of IFRS in the future, and is required when the Trustee and the Scheme prepare their first fully IFRS compliant financial report for the year ended 30 June 2006. Based upon an initial assessment of the impact of transition to IFRS, set out below are the areas where accounting policies will change and may have an impact on the financial report. Except where stated, at this time the Trustee has not been able to reliably quantify the impacts on the financial report of the Scheme.

- Due to unitholders having the right to redeem their investment, Unitholders' Funds will no longer be classed as an equity instrument, and will be classed as debt. Based on the balance at 30 June 2004, \$337,455,577 of Unitholders' Funds will be reclassified into liabilities and distributions into expenses.
- Fair value of financial assets will be measured at current market price and will exclude disposal costs. Currently, financial assets are carried at amounts that approximate net fair value.
- Changes in accounting policies will be recognised by restating comparatives, rather than making current year adjustments via a note disclosure.

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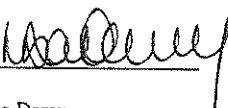
**LM MORTGAGE INCOME FUND
DIRECTOR'S DECLARATION**

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

In the opinion of the directors:

- (a) The financial statements and notes set out on pages 4 to 20 are in accordance with the *Corporations Act 2001*, including:
 - (a) giving a true and fair view of the financial position of the Scheme as at 30 June 2004, and its performance, as represented by the results of its operations and its cash flows for the year ended on that date; and
 - (b) complying with Accounting Standards in Australia and the Corporations Regulations 2001.
- (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 of LM Investment Management Limited.



Lisa Darcy
Director
Gold Coast

Date: 23rd September 2004



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PO Box 685
Port Vila
Vanuatu

■ 1 Eagle Street
Brisbane QLD 4000
Australia
Mail Address
PO Box 7878
Waterfront Place
Brisbane QLD 4001

■ Tel 617 3011 3333 (Australia)
Fax 617 3011 3100 (Australia)
DX 165 Brisbane

Independent audit report to the Unitholders of LM Mortgage Income Fund

Scope

The financial report and directors' responsibility

The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for LM Mortgage Income Fund ('the Scheme'), for the year ended 30 June 2004.

The directors of the Scheme are responsible for preparing a financial report that gives a true and fair view of the financial position and performance of the Scheme, and that complies with Accounting Standards in Australia, in accordance with the *Corporations Act 2001*. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Audit approach

We conducted an independent audit of the financial report in order to express an opinion on it to the unitholders of the Scheme. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

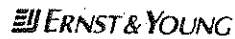
We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001*, including compliance with Accounting Standards in Australia, and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Scheme's financial position, and of its performance as represented by the results of its operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

We performed procedures to assess whether the substance of business transactions was accurately reflected in the financial report. These and our other procedures did not include consideration or judgement of the appropriateness or reasonableness of the business plans or strategies adopted by the directors and management of the Scheme.



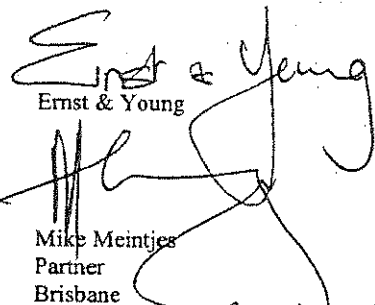
Independence

We are independent of the Scheme, and have met the independence requirements of Australian professional ethical pronouncements and the *Corporations Act 2001*.

Audit opinion

In our opinion, the financial report of LM Mortgage Income Fund is in accordance with:

- (a) the *Corporations Act 2001*, including:
 - (i) giving a true and fair view of the financial position of LM Mortgage Income Fund at 30 June 2004 and of its performance for the year ended on that date; and
 - (ii) complying with Accounting Standards in Australia and the *Corporations Regulations 2001*; and
- (b) other mandatory financial reporting requirements in Australia.


Ernst & Young
Mike Meintjes
Partner
Brisbane
Date: 23 September 2004

PW-35

ASIC registered agent number _____

lodging party or agent name LM Investment Management Ltd

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

street number & name _____

suburb/city SURREYS PARADISE state/territory QLD postcode 4217

telephone (07) 55 844 500

facsimile (07) 55 922 505

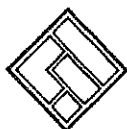
DX number _____ suburb/city _____

388 1/2 18 March 2002

AUSTRALIAN SECURITIES & INVESTMENTS COMMISSION

022294914

ASS. ☐ CASH. ☐ RUA ☐ PRODC. ☐



Australian Securities & Investments Commission

copy of financial statements and reports

form 388

Corporations Act 2001

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

Corporations Regulations

1.0.08

Name LM MORTGAGE INCOME FUND

ACN / ARBN / ARSN/PIN 089 343 288

IPC

14 SEP 2005

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 / 04 and ends 30 / 6 / 05 (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

368 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

ERNST & YOUNG

office

level

building name WATERFRONT PLACE

street number & name

1 EAGLE STREET

suburb / city

BRISBANE

state / territory

QLD

postcode 4000

Business Registration number

(if applicable) 75288172749

State / Territory registered in

date of appointment (d/m/y)

1 / 10 / 2003

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 s 298 to 300)

Auditor's report required under sections 308 and 314

Certification

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

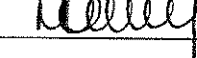
print name

LISA DARCY

capacity

DIRECTOR

sign here



date

14.9.2005

* 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

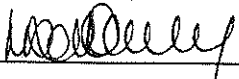
Include

- 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 "31" PAGES REFERRED TO IN FORM 388 - COPY OF FINANCIAL STATEMENTS AND REPORTS

A handwritten signature in black ink, appearing to read 'Lisa Darcy', is written over a horizontal line.

LISA DARCY - (DIRECTOR)

LM Mortgage Income Fund

ABN: 13 089 343 288

**Annual Financial Report
30 June 2005**

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LM MORTGAGE INCOME FUND RESPONSIBLE ENTITY'S REPORT

The Directors of LM Investment Management Limited (ABN 68 077 208 461) ("the Responsible Entity"), the Responsible Entity of LM Mortgage Income Fund ("the Scheme"), submit their report together with the financial report of the Scheme, for the year ended 30 June 2005 and the auditor's report thereon.

DIRECTORS

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

Name	Period of directorship
Mr Peter Charles Drake	Appointed 31 January 1997
Mr Martyn Andrew Came	Appointed 18 July 2002
Ms Lisa Maree Darcy	Appointed 15 September 2003
Mr John Dillon	Appointed 8 June 2005
Mr Geoffrey Murray Black	Appointed 31 March 1999; Resigned 20 May 2005
Mr Brett McMahon	Appointed 20 August 2004; Resigned 23 May 2005

The Directors were in office from the beginning of the financial year until the date of this report, unless otherwise stated.

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 in first registered mortgages, unlisted managed investment schemes 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.

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.

SCHEME INFORMATION

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

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

SCHEME ASSETS

At 30 June 2005, LM Mortgage Income Fund held assets totalling \$697,769,764 (2004:\$380,672,514). The basis for valuation of the assets is disclosed in Note 1 to the financial statements.

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

REVIEW OF RESULTS AND 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 \$315,038,386, of which \$142,757,881 was as a result of the scheme accepting applications from a related managed investment scheme.

Results

The financial year ended 30 June 2005 resulted in a net profit of \$39,820,485 (2004: \$22,879,338). 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 \$39,637,865 (2004: \$22,879,338).

UNIT PRICE HISTORY

Scheme name	2005 \$	2004 \$	2003 \$	2002 \$	2001 \$
As at 30 June	1.00	1.00	1.00	1.00	1.00
Year to 30 June					
High	1.00	1.00	1.00	1.00	1.00
Low	1.00	1.00	1.00	1.00	1.00

UNITS ON ISSUE

The Scheme issued 414,408,430 units during the financial year (2004: 268,640,022), while 99,370,045 units were redeemed (2004: 101,569,725), resulting in a balance of 692,676,583 units on issue as at 30 June 2005 (2004: 377,638,198).

SIGNIFICANT CHANGES IN THE 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 AND EXPECTED RESULTS

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.

SIGNIFICANT EVENTS AFTER BALANCE DATE

There have been no items, transactions or events 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.

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LM MORTGAGE INCOME FUND RESPONSIBLE ENTITY'S REPORT

FEES PAID TO THE RESPONSIBLE ENTITY AND ASSOCIATES

The following fees were paid to LM Administration Pty Ltd out of scheme property during the financial year, for funds management and administrative services provided on behalf of the Responsible Entity:

	2005	2004
	\$	\$
■ Management fees for the financial year received directly from LM Mortgage Income Fund by LM Administration Pty Ltd	7,874,560	4,412,570
■ Other expenses incurred by the Responsible Entity which are reimbursed in accordance with the provisions of the Scheme Constitution, including administration and custodian fees.	363,935	116,827

The Responsible Entity and its associates held 278,069,583 units (2004: 135,311,703) in the Scheme at year-end. The aggregate amount receivable from LM Administration Pty Limited by the Scheme at year end was \$3,354,615 (2004:\$1,935,881), in relation to prepaid management fees.

ENVIRONMENTAL REGULATION AND PERFORMANCE

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

INDEMINIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

The Constitution of the Responsible Entity requires it to indemnify all current and former officers of the Responsible Entity (but not including auditors) out of the property of the Responsible Entity against:

(a) any liability for costs and expenses which may be incurred by that person in defending civil or criminal proceedings in which judgement is given in that persons favour, or in which the person is acquitted, or in connection with an application in relation to any proceedings in which the court grants relief to the person under the Corporations Act 2001; and

(b) a liability incurred by the person, as an officer of the Responsible Entity or of a related body corporate, to another person (other than the Responsible Entity or a related body corporate) unless the liability arises out of conduct involving a lack of good faith.

During the financial year, the Responsible Entity paid an insurance premium in respect of a contract insuring each of the officers of the Responsible Entity. The amount of the premium is, under the terms of the insurance contract, confidential. The liabilities insured include costs and expenses that may be incurred in defending civil or criminal proceedings that may be brought against the officers in their capacity as officers of the Responsible Entity or related body corporates. The insurance premium does not cover auditors.



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Waterfront Place
Brisbane QLD 4001

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

In relation to our audit of the financial report of LM Mortgage Income Fund for the financial year ended 30 June 2005, 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.

A stylized signature of 'Ernst & Young' in cursive script, with the words 'Ernst & Young' printed below it in a small, sans-serif font.

A stylized signature of 'Mike Meintjes' in cursive script, with the name 'Mike Meintjes' printed below it in a small, sans-serif font.

Mike Meintjes
Partner
Brisbane
Date: 8 September 2005

Liability limited by the Accountants Scheme, approved
under the Professional Standards Act 1994 (NSW)

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

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



Lisa Darcy
Director
Gold Coast

8th September 2005

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LM MORTGAGE INCOME FUND
STATEMENT OF FINANCIAL PERFORMANCE
AND DISTRIBUTION STATEMENT
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

	Note	2005 \$	2004 \$
REVENUE AND EXPENSES FROM ORDINARY ACTIVITIES			
Investment income		836,657	-
Interest income	2(b)	49,928,757	29,009,477
Other income	2(a)	96,648	40,727
		<u>50,862,062</u>	<u>29,050,204</u>
Management fees	8	7,874,560	4,412,570
Custodian fees	8	235,055	70,806
Advisor commissions		2,692,804	1,641,469
Other expenses	3	239,158	46,021
		<u>11,041,577</u>	<u>6,170,866</u>
NET OPERATING INCOME FROM ORDINARY ACTIVITIES			
		<u>39,820,485</u>	<u>22,879,338</u>
DISTRIBUTION STATEMENT			
Distributions paid and payable	6	39,637,865	22,879,338
Undistributed Income / (Excess Distributions)	5(b)	182,620	-
		<u>39,820,485</u>	<u>22,879,338</u>

The statement of financial performance is to be read in conjunction with the notes to the financial statements set out on pages 9 to 29.

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LM MORTGAGE INCOME FUND
STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE 2005

	Note	2005 \$	2004 \$
ASSETS			
Cash assets	11(b)	46,917,105	33,563,098
Receivables	9	1,235,301	1,323,398
Prepayments	8	3,565,629	1,935,881
Investments			
Unlisted registered managed investment schemes	7(c)	59,953	59,953
Other	7(a)	33,321,273	-
Other	7(b)	612,670,503	343,790,184
TOTAL ASSETS		<u>697,769,764</u>	<u>380,672,514</u>
LIABILITIES			
Payables		976,765	746,288
Funds received in advance		34,035	-
Distributions payable	6	4,082,381	2,470,649
TOTAL LIABILITIES		<u>5,093,181</u>	<u>3,216,937</u>
NET ASSETS		<u>692,676,583</u>	<u>377,455,577</u>
UNITHOLDERS' FUNDS			
Units on issue	5(a)	692,676,583	377,638,198
Undistributed Income / (Excess distributions)	5(b)	-	(182,620)
TOTAL UNITHOLDERS' FUNDS		<u>692,676,583</u>	<u>377,455,577</u>

The statement of financial position is to be read in conjunction with the notes to the financial statements set out on pages 9 to 29.

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LM MORTGAGE INCOME FUND
STATEMENT OF CASH FLOWS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

	Note	2005 \$	2004 \$
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest and distributions received		50,517,609	28,913,108
Management fees paid		(9,293,292)	(5,216,915)
Other operating cash flows		(3,002,243)	(3,149,801)
Other income received		-	40,727
NET CASH FLOWS FROM OPERATING ACTIVITIES	12(a)	<u>38,222,074</u>	<u>20,587,119</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Net payments for mortgage loans		(268,880,318)	(141,271,244)
Net cash for other investments		(33,000,000)	-
Net withdrawal from investment schemes		-	9,976
NET CASH USED IN INVESTING ACTIVITIES		<u>(301,880,318)</u>	<u>(141,261,268)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Applications		403,970,617	263,176,173
Redemptions		(99,370,045)	(101,569,725)
Distributions paid		(27,588,320)	(16,403,398)
NET CASH FLOWS FROM FINANCING ACTIVITIES		<u>277,012,252</u>	<u>145,203,050</u>
Net increase in cash held		13,354,007	24,528,901
Cash at the beginning of the financial year		<u>33,563,098</u>	<u>9,034,197</u>
CLOSING CASH CARRIED FORWARD	12(b)	<u>46,917,105</u>	<u>33,563,098</u>

The statement of cash flows is to be read in conjunction with the notes to the financial statements set out on pages 9 to 29.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

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 Accounting

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 the Scheme Constitution, applicable 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) Changes in accounting policies

The accounting policies are consistent with those of the prior year unless otherwise stated.

(c) Portfolio Valuation

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.

(d) 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.

(e) 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 2005

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(f) Receivables

Receivables include amounts where settlement has not yet occurred. Interest is accrued at the reporting date from the time of the last payments.

(g) Payables

Payables are recognised for amounts to be paid in the future for goods and services received, whether or not billed to the Scheme, and include outstanding settlements on the purchase of investments and distributions payable.

(h) Revenue and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Scheme and the revenue can be reliably measured.

Interest income from investments in mortgage loans is brought to account as it accrues. 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 as they accrue.

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.

(i) 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.

(j) Comparative Figures

Where necessary, comparative figures have been reclassified to conform with changes in presentation in this financial report.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

(k) Goods and services tax

Expenses incurred by the scheme are recognised net of the amount of GST that can be recovered from the Australian Taxation Office (ATO). Amounts recognised as receivables and payables at balance date include the amount of GST payable.

Reduced input tax credits (RITC) recoverable by the Scheme from the ATO are recognised as receivables in the Statement of Financial Position.

(l) Taxation

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

(m) Unit Prices

Unit prices are determined in accordance with the Scheme's Constitution and are calculated by dividing the Net Fund Value by the number of units on issue.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

2. INVESTMENT INCOME				2005	2004
				\$	\$
(a) Non-interest revenues					
Distribution income from:					
Other Income				96,648	40,727
PM Capital – Enhanced Yield Fund				836,657	-
				<u>933,305</u>	<u>40,727</u>
(b) Interest revenues					
	Average	2005		2004	
	balance	Interest	Avg	Average	Interest
	\$	\$	rate	balance	\$
			%	\$	%
Cash assets	60,977,260	3,244,775	5.32	17,574,339	929,951
Mortgage loans	469,973,791	46,683,982	9.93	267,806,500	28,070,526
	<u>530,951,051</u>	<u>49,928,757</u>	<u>9.40</u>	<u>285,380,839</u>	<u>29,009,477</u>
					<u>10.17</u>
3. OTHER EXPENSES				2005	2004
				\$	\$
Audit fees				54,392	45,504
Product Disclosure Statement Production				54,817	-
Legal fees				5,639	-
Other				13,031	517
				<u>127,880</u>	<u>46,021</u>
4. AUDITORS' REMUNERATION					
Audit Services:					
Audit and review of the financial reports				44,392	37,504
Other regulatory audit services				10,000	8,000
				<u>54,392</u>	<u>45,504</u>

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 2005

5. UNITHOLDERS' FUNDS	2005		2004	
	#	\$	#	\$
(a) Units on issue				
Opening balance	377,638,198	377,638,198	210,567,901	210,567,901
Applications - cash	403,970,618	403,970,618	263,176,173	263,176,173
- reinvestments	10,437,812	10,437,812	5,463,849	5,463,849
Redemptions	(99,370,045)	(99,370,045)	(101,569,725)	(101,569,725)
Closing balance	692,676,583	692,676,583	377,638,198	377,638,198
Class A - Opening balance	242,498,198	242,498,198	152,174,591	152,174,591
Applications - cash	222,079,618	222,079,618	136,660,983	136,660,983
- reinvestments	10,437,467	10,437,467	5,463,849	5,463,849
Redemptions	(60,199,700)	(60,199,700)	(51,801,225)	(51,801,225)
Closing balance	414,815,583	414,815,583	242,498,198	242,498,198
Class B - Opening balance	135,140,000	135,140,000	58,393,310	58,393,310
Applications - cash	181,891,000	181,891,000	126,515,190	126,515,190
- reinvestments	-	-	-	-
Redemptions	(39,170,000)	(39,170,000)	(49,768,500)	(49,768,500)
Closing balance	277,861,000	277,861,000	135,140,000	135,140,000
Total closing balance	692,676,583	692,676,583	377,638,198	377,638,198

Terms and conditions on units

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. The distribution rate will be determined 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.

All unit holders are entitled to receive distributions as declared from time to time that are dependent on the period of investment in the Scheme 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.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

5. UNITHOLDERS' FUNDS

(b) Excess distributions	2005	2004
	\$	\$
Opening balance	(182,620)	(182,620)
Transfers (to)/from statement of financial performance	182,620	-
	<hr/>	<hr/>
Closing balance	-	(182,620)

Excess distributions represent a return of capital under the Constitution of the Scheme.

6. DISTRIBUTIONS

Distributions in respect of the financial year comprise:

Total distributions paid / reinvested	35,555,484	20,408,689
Total distributions payable	4,082,381	2,470,649
	<hr/>	<hr/>
	39,637,865	22,879,338

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

7. INVESTMENTS**(a) Unlisted registered managed investment schemes**

Related managed investment schemes at fair value (refer Note 9)	<hr/>	<hr/>
	59,953	59,953

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.

(b) Other

PM Capital: Enhanced Yield Fund	<hr/>	<hr/>
	33,321,273	-

At 30 June 2005, the Scheme held 29,791,035 units in the PM Capital Enhanced Yield Fund. The unit price at the 30 June 2005 was \$1.1185. The investment is at call.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

7. INVESTMENTS (cont'd)

(c) Mortgage loans	2005	2004
	\$	\$
Mortgage loans (secured by first registered mortgage over real property)	612,670,503	343,790,184
<i>Maturity analysis</i>		
Not longer than 3 months	124,063,471	80,051,524
Longer than 3 months and not longer than 6 months	74,257,003	22,562,465
Longer than 6 months and not longer than 12 months	189,040,671	152,928,847
Longer than 12 months and not longer than 18 months	104,400,746	13,288,002
Longer than 18 months but not longer than 24 months	71,235,380	47,491,446
Longer than 24 months but not longer than 36 months	15,630,223	27,467,900
Longer than 36 months but not longer than 48 months	2,702,500	-
Longer than 36 months but not longer than 48 months	31,340,509	-
	612,670,503	343,790,184

As at 30 June 2005 there were four mortgage loans with total principal outstanding of \$8,158,730 that were in arrears and being underwritten by a related scheme.

As at 30 June 2005 there were ten mortgage loans with total principal outstanding of \$65,787,754 being underwritten by a related scheme by arrangement. Of those loans, there were two with a principal outstanding of over \$5,000,000, the details of which are disclosed below. These loans are not in default and the directors consider these loans to be fully recoverable as the Scheme holds registered first mortgages over the security properties and does not anticipate any capital loss.

Loan Principal	\$30,225,000	The security property is vacant development land located in Camperdown, NSW, independently valued at \$46,500,000. The related scheme has made interest payments totalling \$3,049,085. The Responsible Entity expects full recoverability of this loan.
Loan Principal	\$8,924,382	The security property is a 30 unit development complex located at Dee Why, NSW, independently valued at \$14,610,000. The related scheme has made interest payments totalling \$411,522. The Responsible Entity expects full recoverability of this loan.

Interest due but not brought into account from borrowers as at 30 June 2005 was \$823,625 (2004:\$161,050)

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

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 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 as follows:

Name	Period of directorship
Mr Peter Charles Drake	Appointed 31 January 1997
Mr Martyn Andrew Carne	Appointed 18 July 2002
Ms Lisa Maree Darcy	Appointed 15 September 2003
Mr John Dillon	Appointed 8 June 2005
Mr Geoffrey Murray Black	Appointed 31 March 1999; Resigned 20 May 2005
Mr Brett McMahon	Appointed 20 August 2004; Resigned 23 May 2005

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.

	2005	2004
	\$	\$
LM Investment Management Limited	176,975	163,018
Associates of LM Investment Management Limited	277,892,609	135,148,685

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

8. RELATED PARTIES (cont'd)*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.

Related party transactions

LM Special Participation Fund provides income assurance to investors in the Scheme. The LM Special Participation Fund agrees to underwrite interest payments to the Scheme at the discretion of the Responsible Entity, on behalf of borrowers. The LM Special Participation Fund does not guarantee the payment of all income, or return of capital. During the year, the Scheme has received underwriting payments on behalf of borrowers from a related scheme The LM Special Participation Fund totalling \$9,014,725 (2004: \$4,414,918) during the year.

Administration and funds management services are provided to the Scheme on behalf of the Responsible Entity by LM Administration Pty Limited. LM Administration Pty Ltd is paid a management fee for these services directly from scheme assets. In addition, LM Investment Management Limited is paid loan origination fees directly from the borrowers.

Remuneration of the Responsible Entity and related entities

	2005 \$	2004 \$
Total remuneration received or due and receivable:		
■ Fees for the year received directly from LM Mortgage Income Fund by LM Administration Pty Ltd	7,874,560	4,412,570
■ Fees earned by LM Administration Pty Ltd from other approved schemes invested in by LM Mortgage Income Fund.	-	-
■ 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.	127,880	46,021
Custodian's remuneration		
■ Custodian's fees paid by Responsible Entity and reimbursed by the scheme	235,055	70,806

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

8. RELATED PARTIES (cont'd)*Remuneration of the Responsible Entity and related entities*

	2005	2004
	\$	\$
Balances with related parties		
The aggregate amounts receivable from related parties by the Scheme at balance date are as follows:		
LM Administration Pty Ltd	3,354,615	1,935,881

These amounts are included in prepayments. No amounts are payable to related parties by the Scheme. The average monthly balance of prepayments during the year was \$2,135,274 which was non-interest bearing. Interest foregone on the above amount if calculated at the weighted average cash rate of 5.32% would have been \$113,602. If this revenue had been collected, the sum foregone would have been paid to LM Administration Pty Ltd as management fees during the year.

The LM Managed Performance Fund has second mortgage borrowings on loans that are first mortgages with the LM Mortgage Income Fund. The LM Managed Performance Fund on occasion may pay development & construction costs on those related loans.

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. Details of LM Mortgage Income Fund's investments in other schemes operated by LM Investment Management Limited or its affiliates are set out below:

Scheme name	Investment at year end	Interest held in related scheme at year end	Number of Units acquired during the year	Number of Units redeemed during the year	Distribution paid or payable
30 June 2005					
LM Select Mortgage Income Fund	59,953	0.00%	-	-	-
30 June 2004					
LM Select Mortgage Income Fund	59,953	0.75%	-	-	-
LMQ Mortgage Facilities	-	-	-	9,976	-

These investments are on normal terms and conditions.

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LM MORTGAGE INCOME FUND

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

8. RELATED PARTIES (cont'd)

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 30 June 2005	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
LM Currency Protected Australian Income Fund	14,390,000	2.08%	14,750,000	360,000	444,222
LM Special Participation Fund	1,185,000	0.17 %	6,330,000	7,386,000	106,630
Belinda J Drake	30,377	-	25,236	-	1,408
LM Managed Performance Fund	2,520,000	0.36 %	14,088,000	19,697,000	572,424
LM Wholesale Mortgage Income Fund	257,000,000	37.10 %	132,322,000	-	14,455,399
LM Property Performance Fund	2,766,000	0.40 %	3,031,000	357,000	99,397
LM Investment Management Ltd	176,975	0.03 %	-	13,956	14,052
Lisa M Darcy	1,232	-	8,755	11,068	143
Total	278,069,584	40.14 %	170,554,991	27,825,024	15,693,675
30 June 2004					
LM Currency Protected Australian Income Fund	-	-	-	-	-
LM Special Participation Fund	2,241,000	0.59 %	1,990,000	6,422,000	451,822
Engineering House Canberra Syndicate	-	-	-	3,553,000	75,294
Belinda J Drake	5,140	-	584,250	1,511,320	38,711
LM Managed Performance Fund	8,129,000	2.15 %	23,367,000	19,758,000	548,682
LM Wholesale Mortgage Income Fund	124,678,000	33.02 %	99,600,000	19,465,000	7,838,526
LM Property Performance Fund	92,000	0.02 %	1,558,190	4,123,500	323,193
LM Investment Management Ltd	163,018	0.04 %	12,532	-	18,003
Lisa M Darcy	3,545	-	6,500	3,018	78
Total	135,311,703	35.82%	127,118,472	54,835,838	9,294,309

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

9. RECEIVABLES

	2005	2004
	\$	\$
Interest and distribution receivable	110,941	46,871
Mortgage interest receivable	935,087	1,276,527
GST Receivable	185,783	-
Other	3,490	-
	<hr/>	<hr/>
Closing balance	1,235,301	1,323,398

10. NOTES TO THE STATEMENT OF CASH FLOWS**(a) Reconciliation of net operating income from ordinary activities to the net cash flows from operations**

Net profit	39,820,485	22,879,338
Changes in assets and liabilities during the financial year		
(Decrease)/increase in payables	264,512	(1,399,512)
Decrease/(increase) in prepayments and interest receivable	(1,862,923)	(892,707)
	<hr/>	<hr/>
Net cash flow provided by operating activities	38,222,074	20,587,119

(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	46,917,405	33,563,098
---------------------------	------------	------------

(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 10,437,812 units (2004: 5,463,849) as a result of reinvestment of distributions by unit holders totalling \$10,437,812 (2004: \$5,463,849). These transactions have not been included in the statement of cash flows.

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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

11. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE**(a) Interest rate risk***Interest rate risk exposures*

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.

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:

Note	Weighted average interest rate	Floating Interest Rate		Securities contracted to mature in:				Total
				Less than 1 year	More than 1 year but less than 5 years	2004	2005	
Cash assets	10(b)	5.32	5.29	-	-	46,917,405	33,563,098	46,917,405
Mortgage loans	7(c)	10.20	10.52	-	-	387,361,145	255,542,836	88,247,349
				-	-	434,278,550	289,106,934	225,309,358
				-	-	434,278,550	289,106,934	88,247,349
Total				-	-	434,278,550	289,106,934	659,587,908
				-	-	434,278,550	289,106,934	377,323,283

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

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

11. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE (cont'd)**(b) Credit risk exposure**

Credit risk represents the loss that would be recognised if counterparties failed to perform as contracted. The total credit risk for recognised items including securities is therefore limited to the amount carried on the statement of financial position.

Recognised financial instruments

The Scheme minimises concentrations of 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 ratios not exceeding 75% of the mortgage securities.

The percentage of loans secured by property in different geographical locations is as follows:

	2005	2004
Sydney CBD	1.84 %	2.71 %
Within 40km of Sydney CBD	26.24 %	30.92 %
New South Wales – Other	20.66 %	12.82 %
Melbourne – CBD	0.44 %	3.26 %
Within 40km of Melbourne CBD	12.04 %	9.97 %
Victoria – Other	7.26 %	8.39 %
Brisbane CBD	0.00 %	7.95 %
Within 40km of Brisbane CBD	15.06 %	3.35 %
Queensland – Other	4.41 %	1.05 %
Canberra – Other	6.64 %	12.00 %
NT	0.13 %	0.23 %
SA	3.25 %	3.85 %
WA	2.03 %	3.50 %
	100.00 %	100.00 %

As at 30 June 2005 36.53% of mortgage loans are secured on construction/development property and (2004: 41.87%) 63.47% on commercial property (2004: 58.13%).

The Scheme's maximum credit risk exposure at balance date in relation to mortgage loan is the carrying value of these assets as indicated in the statement of financial position. No single mortgage investment exceeds 10% of the Scheme which ensures that there is no concentration of risk.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

11. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE (cont'd)

(b) Liquidity and cash flow 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 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 any unusual obligations and that liquidity is managed within the Scheme's policies and limits.

(c) Net fair values of financial assets and liabilities

The Scheme's financial assets and liabilities included in the statement of financial position are carried at amounts that approximate net fair value

12. 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.

13. SUBSEQUENT EVENTS

Since 30 June 2005 there has not been any matter or circumstance not otherwise dealt with in the financial report that has significantly affected or may significantly affect the Scheme.

14. COMMITMENTS AND CONTINGENCIES

At balance date, the total mortgage loan facility available to borrowers was \$881,046,409 (2004:\$548,324,561). Of this amount, \$265,845,982 (30.2%) has yet to be drawn down by borrowers (2004:\$203,979,992 (37.2%)).

This amount includes unused line of credit facilities extended to borrowers of \$2,469,972 (2004:\$494,432).

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

15. DIRECTOR AND EXECUTIVE DISCLOSURES

(a) Details of Specified Directors and Specified Executives

(i) Specified directors

The directors of LM Investment Management Ltd during the year were:

Name	Period of directorship
Mr Peter Charles Drake	Appointed 31 January 1997
Mr Martyn Andrew Carne	Appointed 18 July 2002
Ms Lisa Maree Darcy	Appointed 15 September 2003
Mr John Dillon	Appointed 8 June 2005
Mr Geoffrey Murray Black	Appointed 31 March 1999; Resigned 20 May 2005
Mr Brett McMahon	Appointed 20 August 2004; Resigned 23 May 2005

(ii) Specified Executives

Neither the LM Mortgage Income Fund nor LM Investment Management Ltd employ persons deemed to be specified executives of the Scheme.

(b) Remuneration of Specified Directors

(i) Remuneration Policies and Principles

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

The Executive Directors of the Board of the Directors of LM Investment Management Ltd are responsible for determining and reviewing compensation arrangements for the Directors of the Responsible Entity. The Executive directors assess the appropriateness of the nature and amount of emoluments of the Directors 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.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

15. DIRECTOR AND EXECUTIVE DISCLOSURES (contd)*(ii) 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.

(iii) Principles of Directors Remuneration Allocations

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

(iv) Remuneration of Specified Directors

Specified Directors	Salary & Fees \$	Primary Cash Bonus \$	Non Monetary Benefits \$	Post Employment Super \$	Retirement Benefits \$	Equity \$	Other \$	TOTAL \$
Drake, PC*	-	-	-	-	-	-	-	-
Darcy, LM**	10,643	-	-	938	-	-	226	11,807
Carne, M	1,978	-	-	138	-	-	-	2,116
Dillon, J	97	-	-	9	-	-	-	106
Black, G	1,720	-	-	-	-	-	-	1,720
McMahon, B	1,462	-	-	-	-	-	-	1,462
	<u>15,900</u>	-	-	<u>1,085</u>	-	-	<u>226</u>	<u>17,211</u>

* 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 an executive of the Responsible Entity, LM Darcy is 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.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

15. DIRECTOR AND EXECUTIVE DISCLOSURES (contd)

(c) Loans to Specified Directors

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

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 2005 for \$1,704,353 (MORT 2157). This transaction was approved on an arms length basis and is on normal terms and conditions.

(d) Other Transactions and Balances with Specified Directors

Other than those items disclosed in the related party note 8, the Scheme has no other transactions and balances with specified Directors.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

16. IMPACT OF ADOPTING AASB EQUIVALENTS TO IFRS

LM Investment Management Ltd and the Scheme it manages have commenced transitioning their accounting policies and financial reporting from current Australian Standards to Australian Equivalents of International Financial Reporting Standards (AIFRS). The Responsible Entity has allocated internal resources and with the help of expert consultants will isolate key areas that may be impacted by the transition to AIFRS. As the Responsible Entity and the scheme have a 30 June year end, priority has been given to considering the preparation of an opening balance sheet in accordance AASB equivalents to AIFRS as at 1 July 2004. This will form the basis of accounting for Australian equivalents of AIFRS in the future, and is required when the Responsible Entity and the Scheme prepare their first fully AIFRS compliant financial report for the year ended 30 June 2006.

Based upon an initial assessment of the impact of transition to IFRS, set out below are the areas where accounting policies are expected to change on adoption of AIFRS and our best estimate of the quantitative impact of the changes on total equity as at the date of transition and 30 June 2005 and on the net profit for the year ended 30 June 2005.

The figures disclosed are the Responsible Entity's best estimates of the quantitative impact of the changes as at the date of preparing the 30 June 2005 financial report. The actual effects of transition to AIFRS may differ from the estimates disclosed due to

- (a) ongoing work being undertaken by the AIFRS project teams;
- (b) potential amendments to AIFRSs and Interpretations thereof being issued by the standard-setters and IFRIC; and
- (c) emerging accepted practice in the interpretation and application of AIFRS and UIG Interpretations.

(a) Reconciliation of unitholders' funds under AGAAP to that under AIFRS

	Notes	30 June 2005**	1 July 2004*
		\$	\$
Total unitholders' funds under AGAAP	(i)	692,676,583	377,455,577
Derecognition of distributions paid and payable	(ii)	39,820,485	-
Reclassification of unitholders' funds	(iii)	(732,497,068)	-
Total unitholders' funds under AIFRS	(iv)	-	377,455,577

* This column represents the adjustment as at the date of transition to AIFRS.

** This column represents the cumulative adjustment as at the date of transition to AIFRS and those for the year ended 30 June 2005.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

16. IMPACT OF ADOPTING AASB EQUIVALENTS TO IFRS (cont'd)

(a) Reconciliation of unitholders' funds under AGAAP to that under AIFRS (contd)

- (i) Under AASB 132 "Financial Instruments: Disclosures and Presentation", contractual obligations are regarded as financial liabilities. As unitholders' have the ability to redeem units from the Scheme, all unitholders' funds will be classified as liabilities of the Scheme, rather than as equity. As distributions paid and payable make up a proportion of unitholders' funds, they will be classified as interest expense rather than distributions to equity holders.

It should be noted that the classification of the Scheme's units as a financial liability would not alter the underlying economic interest of the unitholders in the net assets and the net income attributable to unitholders of the Scheme.

- (ii) The Responsible Entity will apply the exemption provided in AASB 1 "First time Adoption of Australian Equivalents to International Financial Reporting Standards" which permits entities not to apply the requirements of AASB 132 "Financial Instruments: Presentation and Disclosures" and AASB 139 "Financial Instruments: Recognition and Measurement" for the financial year ended 30 June 2005. The standards will be applied from 1 July 2005.

(b) Reconciliation of net profit presented under AGAAP to that under AIFRS

	Notes	Year Ended 30 June 2005
		\$
Net profit as reported under AGAAP		39,820,485
Recognition of interest expense	(i)	(39,637,865)
Net Profit under AIFRS		<u>182,620</u>

- (i) As detailed above, all unitholders' funds will be recognised as liabilities of the Scheme, rather than as equity. Distributions paid and payable made up of unitholders' funds will be classified as interest expense in the Statement of Financial Performance.

c) Restated AIFRS Statement of Cash Flows for the year ended 30 June 2005

No material impacts are expected to the cash flows presented under AGAAP on adoption of AIFRS.

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LM MORTGAGE INCOME FUND
NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS
FOR THE FINANCIAL YEAR ENDED 30 JUNE 2005

16. IMPACT OF ADOPTING AASB EQUIVALENTS TO IFRS (contd)

d) Classification of Assets and Liabilities

Under AIFRS AASB 139 requires assets to be classified into four categories and measured according to the relevant classification. These categories are:

- Held for trading or otherwise designated at fair value through profit and loss;
- Held to maturity investments;
- Loans and receivables; and
- Available for sale financial assets.

AASB 139 requires liabilities to be measured at:

- Amortised cost using the effective interest rate method; except for
- Financial liabilities at fair value through the profit and loss.

The Scheme does not hold any assets or liabilities as held for trading.

Mortgage loans

It is anticipated that mortgage loans will be classified as loans and receivables. These will be measured at amortised cost using the effective interest rate method. Under AASB 118 and 132 fee revenue and expenses that forms an integral part of the effective interest rate is required to be deferred. Fees that form an integral part of the effective interest rate of the loan will be recognised as part of the carrying value and amortised through the effective interest rate. Management has assessed that there will be no material impact that would be recognised under AASB 132 on transition at 1 July 2005.

Investments

It is anticipated that other investments will be classified as either held to maturity investments or available for sale financial assets depending on the type of investment. Those investments that are held to maturity will be measured at amortised cost using the effective interest rate method. The investments that are classified as available for sale will be measured at a fair value basis each reporting period, with any movement in fair value being reflected through the equity reserve.

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LM MORTGAGE INCOME FUND

DIRECTOR'S DECLARATION

30 JUNE 2005

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

In the opinion of the directors:

- (a) The financial statements and notes of the Registered Scheme set out on pages 6 to 29 are in accordance with the *Corporations Act 2001*, including:
 - (a) giving a true and fair view of the financial position of the Scheme as at 30 June 2005, and its performance, as represented by the results of its operations and its cash flows for the year ended on that date; and
 - (b) complying with Accounting Standards in Australia and the Corporations Regulations 2001.
- (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

September 2005



■ 1 Eagle Street
Brisbane QLD 4000
Australia

PO Box 7878
Waterfront Place
Brisbane QLD 4001

■ Tel 61 7 3011 3333
Fax 61 7 3011 3100
DX 165 Brisbane

Independent audit report to the Unitholders of LM Mortgage Income Fund

Scope

The financial report and directors' responsibility

The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for LM Mortgage Income Fund ('the Scheme'), for the year ended 30 June 2005.

The directors of the Scheme are responsible for preparing a financial report that gives a true and fair view of the financial position and performance of the Scheme, and that complies with Accounting Standards in Australia, in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Audit approach

We conducted an independent audit of the financial report in order to express an opinion on it to the unitholders of the Scheme. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

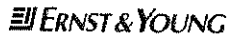
We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the Corporations Act 2001, including compliance with Accounting Standards in Australia, and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Scheme's financial position, and of its performance as represented by the results of its operations and cash flows.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

Liability limited by the Accountants Scheme, approved
under the Professional Standards Act 1994 (NSW)



We performed procedures to assess whether the substance of business transactions was accurately reflected in the financial report. These and our other procedures did not include consideration or judgement of the appropriateness or reasonableness of the business plans or strategies adopted by the directors and management of the Scheme.

Independence

We are independent of the Scheme, and have met the independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001. We have given to the directors of the Scheme a written Auditor's Independence Declaration, a copy of which is included in the Directors' Report. In addition to our audit of the financial report, we were engaged to undertake the services disclosed in the notes to the financial statements. The provision of these services has not impaired our independence.

Audit opinion

In our opinion, the financial report of LM Mortgage Income Fund is in accordance with:

- (a) the Corporations Act 2001, including:
 - (i) giving a true and fair view of the financial position of LM Mortgage Income Fund at 30 June 2005 and of its performance for the year ended on that date; and
 - (ii) complying with Accounting Standards in Australia and the Corporations Regulations 2001; and
- (b) other mandatory financial reporting requirements in Australia.

A stylized signature of 'Ernst & Young' in a cursive script, with the words 'Ernst & Young' printed below it in a small, sans-serif font.

A stylized signature of 'Mike Meintjes' in a cursive script, with the name 'Mike Meintjes' printed below it in a small, sans-serif font.

Mike Meintjes
Partner
Brisbane

Date: 8 September 2005

PW-36

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

Related forms:

Form 5137 Appointment of scheme auditor

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 details

Company name

LM MORTGAGE INCOME FUND

ACN/ABN

66 482 247 788

Lodgement details

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

Name

Sharyn Halliwell, LM Investment Management Ltd

ASIC registered agent number (if applicable)

n/a

IPC

Telephone number

(07) 55 844 500

28 AUG 2006

Postal address

PO Box 485

Surfers Paradise, QLD, 4217

Please provide an estimate of the time taken to complete this form.

hrs 6 mins

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 (Where a new auditor has been appointed to a registered scheme, Form 5137 Appointment of scheme auditor must be lodged) (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

01/07/05

to

Financial year ends

30/06/06

Date of annual general meeting (if applicable)

/ /

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 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?

3 Auditor 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

Where a new auditor has been appointed to a registered scheme, Form 5137

Appointment of scheme auditor must be lodged

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

Family name

Given name

or

Company name

ACN/ABN

or

Firm name (if applicable)

4 Continued... Details of current auditor

Office, unit, level	
WATERFRONT PLACE	
Street number and Street name	
1 EAGLE STREET	
Suburb/City	State/Territory
BRISBANE	QLD
Postcode	Country (if not Australia)
4000	
Date of appointment	
<div style="display: flex; justify-content: space-around;"> 01/10/03 </div> <div style="display: flex; justify-content: space-around; font-size: small;"> [D] [D] [M] [M] [Y] [Y] </div>	

5 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 s 298 to 300)

Auditor's report required under sections 308 and 314

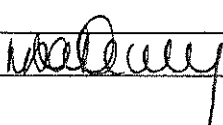
Signature

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

Name

LISA DARCY

Signature



Capacity

☒ Director

☐ Company secretary

Date signed

24/08/06

[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.

For help or more information
Telephone 03 5177 3988
Email info.enquiries@asic.gov.au
Web www.asic.gov.au

THIS IS ANNEXURE "A" OF "42" PAGES REFERRED TO IN FORM 388 – COPY OF FINANCIAL STATEMENTS AND REPORTS



LISA DARCY - (DIRECTOR)

LM MORTGAGE INCOME FUND

ABN: 66 482 247 488

Annual Report

For the year ended 30 June 2006

LM MORTGAGE INCOME FUND

ABN: 66 482 247 488

Annual Report – 30 June 2006

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The responsible entity of LM 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 MORTGAGE INCOME FUND

Directors' Report

DIRECTORS' REPORT

The directors of LM Investment Management Limited, the Responsible Entity of the LM Mortgage Income Fund, present their report together with the consolidated financial report of the LM Mortgage Income Fund ("the Scheme") and its subsidiary ("the consolidated entity"), for the year ended 30 June 2006. 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 half-year or since the end of the half-year and up to the date of this report:

Name	Period of directorship
Mr Peter Charles Drake	Appointed 31 January 1997
Mr Martyn Andrew Carne	Appointed 18 July 2002; resigned 6 June 2006
Ms Lisa Maree Darcy	Appointed 15 September 2003
Mr John Dillon	Appointed 8 June 2005
Mr Eghard van der Hoven	Appointed 22 June 2006

PRINCIPAL ACTIVITIES

During the year, the Scheme continued the principal activity of investing unitholders' funds in registered first mortgages, unlisted managed investment schemes 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 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 directly in registered first mortgage loans secured by property in Australia, unlisted managed investment schemes and cash assets.

The change in net assets attributable to the unitholders of the Scheme is presented in the Income Statement. Net profit attributable to unitholders for the year ended 30 June 2006 was \$62,376,577 (2005: \$39,820,485).

Funds under management increased by \$184,998,266 (2005: \$315,038,386) to \$877,432,931 (2005: \$692,676,583), of which \$85,139,000 was as a result of the Scheme accepting applications from related managed investment schemes (2005: \$142,757,881).

During the year, the Scheme has gained control of a newly formed company, LM MIF Investments Pty Limited incorporated to invest in unrelated investment products on behalf of the scheme. LM MIF

LM MORTGAGE INCOME FUND**Directors' Report**

Investments Pty Limited provides a regular income stream to the Scheme as a result of the Scheme providing an interest bearing loan facility to LM MIF Investments Pty Limited.

The Scheme previously had an agreement with a related scheme whereby the related scheme provided underwriting facilities by arrangement or for loans in default. This agreement was terminated in April 2006 and the Scheme now bears the full credit risk associated with loans that are in default. During the year, the Scheme purchased receivables of the LM Special Participation Fund totalling \$8,110,374 at 20 April 2006.

From 1 June 2006 the Scheme now recognises loan origination fee income from borrowers that enter into new financing arrangements with the Scheme. This income was previously recognised by the responsible entity. The Scheme reimburses the responsible entity for its administration of loan origination services.

Impact of applying Australian equivalents to International Financial Reporting Standards (AIFRS) for financial reporting

This was the first year the Scheme applied AIFRS for financial reporting purposes.

Unitholders' funds

AIFRS requires net assets attributable to unitholders to be classified and disclosed as a liability in the balance sheet. Consequently, the Scheme has recognised distributions and changes in net assets attributable to unitholders as a finance cost in the income statement.

It is the opinion of the directors that adopting AIFRS does not have unit pricing consequences, as the basis of unit price accounting is as outlined in the Scheme Constitution. The key differences between unit pricing and AIFRS Financial Reporting have been outlined below:

	30 Jun 2006	30 Jun 2005
	\$	\$
Net assets for unit pricing purposes	877,674,880	692,676,583
AIFRS reclassification of unitholders' funds to liabilities	(877,674,880)	(692,676,583)
Net assets under AIFRS	-	-

Results

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

	30 Jun 2006	30 Jun 2005
	\$	\$
Net operating income/(loss) before distributions	62,376,577	39,637,865
AIFRS financing costs:		
Distributions to unitholders	(62,376,577)	(39,455,245)
(Increase) / decrease in net assets attributable to unitholders	-	(182,620)
Net profit under AIFRS	-	-

LM MORTGAGE INCOME FUND

Directors' Report

UNITS ON ISSUE

There were 877,674,849 units on issue at 30 June 2006 (2005: 692,676,583). During the year 404,781,175 units were issued by the Scheme (2005: 414,408,430) and 219,782,909 were withdrawn (2005: 99,370,045).

SCHEME ASSETS

At 30 June 2006, the Scheme held assets to a total value of \$914,245,175 (2005: \$697,769,764). The basis for valuation of assets is disclosed in Note 2 to the financial statements.

FEES PAID TO THE RESPONSIBLE ENTITY AND ASSOCIATES

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:

	2006	2005
	\$	\$
* Management fees for the financial year received directly from LM Mortgage Income Fund by LM Administration Pty Limited	10,683,880	7,874,560
* Other expenses incurred by the Responsible Entity which are reimbursed in accordance with the provisions of the Constitution, including administration and custodian fees	794,401	363,935

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

On 22 December 2005, the Scheme gained control of a newly formed entity, LM MIF investment Pty Limited, an entity incorporated to invest in 'at call' securities on behalf of the Scheme. At the date of inception, the assets and liabilities of LM MIF Investments Pty Limited were nil. The LM MIF advances unsecured, interest bearing funds to LM MIF Investments Pty Ltd. The interest rate charged on the loan approximates the return achieved from the investments undertaken on the Scheme's behalf. The RE does not receive any fees as a result of this loan.

The Scheme previously had an agreement with a related scheme whereby the related scheme provided underwriting facilities by arrangement or for loans in default. This agreement was terminated in April 2006 and the Scheme now bears the full credit risk associated with loans that are in default.

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

The Scheme now recognises loan origination fee income from borrowers that enter into new financing arrangements with the Scheme. This income was previously recognised by the Responsible Entity.

LM MORTGAGE INCOME FUND

Directors' Report

SIGNIFICANT EVENTS AFTER THE BALANCE DATE

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.

Since 30 June 2006, mortgage loans in default totalling \$9,098,941 and mortgage loans in arrears totalling \$19,311,013 have been recovered in full.

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 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.

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. So long as 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

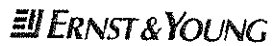
A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is set out on page 5.

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



Lisa Darcy
Director
Gold Coast

21 August 2006



■ 1 Eagle Street
Brisbane QLD 4000
Australia

■ Tel 61 7 3011 3333
Fax 61 7 3011 3100

PO Box 7878
Waterfront Place
Brisbane QLD 4001

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

In relation to our audit of the financial report of LM Mortgage Income Fund for the financial year ended 30 June 2006, 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.

A large, stylized handwritten signature in black ink, appearing to read 'Mike McIntosh', written over the printed name and date.

Mike McIntosh
Partner
21 August 2006

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LM MORTGAGE INCOME FUND

INCOME STATEMENT

For the year ended 30 June 2006

		30 June 2006		30 June 2005
		\$		\$
	Notes	Consolidated	Scheme	Scheme
Income				
Changes in the fair value of investments	3a	2,136,504	1,123,754	836,657
Interest revenue – loans and advances	3b	76,649,346	77,579,140	49,928,757
Other income	3a	3,257,617	3,257,617	96,648
Total revenue and other income		82,043,467	81,960,511	50,862,062
Expenses				
Management fees	11	10,683,880	10,683,880	7,874,560
Custodian fees		305,059	305,059	235,055
Advisor commissions		4,180,916	4,180,916	2,692,804
Impairment losses on loans and receivables	9	2,714,072	2,714,072	-
Borrowing costs		1,149,900	1,149,900	-
Legal fees		7,262	7,262	5,639
Other expenses	4	625,801	542,845	233,519
Total expenses excluding distributions to unitholders		19,666,890	19,583,934	
Net profit attributable to unitholders		62,376,577	62,376,577	11,041,577
Distributions to unitholders		(62,376,577)	(62,376,577)	(39,637,865)
Changes in net assets attributable to unitholders		-	-	182,620
Income tax expense		-	-	-
Changes in net assets attributable to unitholders after income tax expense		-	-	-

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LM MORTGAGE INCOME FUND

BALANCE SHEET

As at 30 June 2006

		30 June 2006		30 June 2005
	Note	Consolidated	Scheme	Scheme
		\$	\$	\$
ASSETS				
Cash and cash equivalents	13	32,995,697	32,645,002	46,917,105
Receivables	12	4,341,766	4,278,131	1,235,301
Prepayments		4,729,647	4,729,647	3,565,629
Investments	8	5,659,827	1	33,381,226
Loans and receivables	9	866,592,394	872,592,394	612,670,503
Total assets		914,319,331	914,245,175	697,769,764
LIABILITIES				
Payables		946,819	872,663	976,765
Funds received in advance		-	-	34,035
Interest bearing loans and advances	10	30,416,662	30,416,662	-
Distributions payable		5,281,001	5,281,001	4,082,381
TOTAL LIABILITIES EXCLUDING NET ASSETS ATTRIBUTABLE TO UNITHOLDERS		36,644,482	36,570,326	5,093,181
NET ASSETS ATTRIBUTABLE TO UNITHOLDERS		877,674,849	877,674,849	692,676,583

STATEMENT OF CHANGES IN EQUITY

For the year ended 30 June 2006

Under AIFRS, 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.

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LM MORTGAGE INCOME FUND

CASH FLOW STATEMENT

For the year ended 30 June 2006

		30 June 2006		30 June 2005
	Notes	Consolidated \$	Scheme \$	Scheme \$
Cash flows from operating activities				
Interest and distributions received		83,326,015	83,243,059	50,517,609
Management fees paid		(11,631,560)	(11,631,561)	(9,293,292)
Other operating expenses		(14,742,989)	(14,491,321)	(3,002,243)
GST (paid)/received		911,414	911,414	-
Net cash inflow/(outflow) from operating activities	13(b)	<u>57,862,878</u>	<u>58,031,591</u>	<u>38,222,074</u>
Cash flows from investing activities				
Payments for secured mortgage loans		(575,024,453)	(610,919,745)	(467,383,694)
Receipts from settlement of mortgage loans		316,057,835	357,057,835	198,503,376
Payments for purchase of investments		(7,375,912)	(75,321,273)	(33,000,000)
Receipts from sale of investments		40,321,273	48,000,000	-
Net cash inflow/(outflow) from investing activities		<u>(226,021,257)</u>	<u>(226,540,637)</u>	<u>(301,880,318)</u>
Cash flows from financing activities				
Proceeds from borrowings		30,416,662	30,416,662	-
Receipts from the issue of units		387,598,304	387,598,304	403,970,617
Distributions paid		(43,995,087)	(43,995,087)	(99,370,045)
Payment for redemption of units		(219,782,909)	(219,782,909)	(27,588,320)
Net cash inflow/(outflow) from financing activities		<u>154,236,970</u>	<u>154,236,970</u>	<u>277,012,252</u>
Net increase/(decrease) in cash and cash equivalents		<u>(13,921,409)</u>	<u>(14,272,103)</u>	<u>13,354,007</u>
Cash and cash equivalents at beginning of the year		<u>46,917,105</u>	<u>46,917,105</u>	<u>33,563,098</u>
Cash and cash equivalents at the end of the year	13(a)	<u>32,995,697</u>	<u>32,645,002</u>	<u>46,917,105</u>

LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

NOTES TO THE FINANCIAL STATEMENTS

1. CORPORATE INFORMATION

The financial report of LM Mortgage Income Fund ("the Scheme") for the year ended 30 June 2006 was authorised for issue in accordance with a resolution of the directors of the Responsible Entity on 21 August 2006.

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.

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*.

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').

This is the entity's first AIFRS consolidated annual report based on AIFRS and comparative figures for the year ended 30 June 2005 have been restated accordingly. The consolidated entity has elected not to apply the exemption under AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* from having to apply AASB 132 *Financial Instruments: Disclosure and Presentation*, and AASB 139 *Financial Instruments: Recognition and Measurement* to the comparative period.

An explanation of how the transition to AIFRSs has affected the reported financial position, financial performance and cash flows of the Scheme and the consolidated entity is provided in note 2(q). This

LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

note includes reconciliations of equity and profit or loss for comparative periods reported under Australian GAAP (AGAAP) to those reported for those periods under AIFRSs.

Australian Accounting Standards that have recently been issued or amended but are not yet effective have not been adopted for the annual reporting period ending 30 June 2006 are shown in the following tables. None of the standards issued or amended have an impact on the accounting policies adopted by the Scheme.

AASB Amendment	Affected Standard (s)	Application date of standard	Application date for entity
2004-3	AASB 1 <i>First-time adoption of AIFRS</i> AASB 101 <i>Presentation of Financial Statements</i> AASB 124 <i>Related Party Disclosures</i>	1 January 2006	1 July 2006
2005-1	AASB 139 <i>Financial Instruments: Recognition and Measurement</i>	1 January 2006	1 July 2006
2005-4	AASB 139 <i>Financial Instruments: Recognition and Measurement</i> , AASB 132 <i>Financial Instruments: Disclosure and Presentation</i> , AASB 1 <i>First-time adoption of AIFRS</i> , AASB 1023 <i>General insurance Contracts</i> and AASB 1038 <i>Life Insurance Contracts</i>	1 January 2006	1 July 2006
2005-5	AASB 1 <i>First-time adoption of AIFRS</i> and AASB 139 <i>Financial Instruments: Recognition and Measurement</i>	1 January 2006	1 July 2006
2005-6	AASB 3 <i>Business Combinations</i>	1 January 2006	1 July 2006
2005-9	AASB 4 <i>Insurance Contracts</i> , AASB 1023 <i>General insurance Contracts</i> , AASB 139 <i>Financial Instruments: Recognition and Measurement</i> and AASB 132 <i>Financial Instruments: Disclosure and Presentation</i>	1 January 2006	1 July 2006
2005-10	AASB 132 <i>Financial Instruments: Disclosure and Presentation</i> , AASB 101 <i>Presentation of Financial Statements</i> , AASB 114 <i>Segment Reporting</i> , AASB 117 <i>Leases</i> , AASB 133 <i>Earnings per Share</i> , AASB 139 <i>Financial Instruments: Recognition and Measurement</i> , AASB 1 <i>First-time adoption of AIFRS</i> , AASB 4 <i>Insurance Contracts</i> , AASB 1023 <i>General insurance Contracts</i> and AASB 1038 <i>Life Insurance Contracts</i>	1 January 2006	1 July 2006

New or revised Standard/ UIG Affected Standards	Application date of standard/ interpretation	Application date for entity
AASB 7 <i>Financial Instruments: Disclosures</i>	1 January 2007	1 July 2007
UIG 8 <i>Scope of AASB 2</i>	1 May 2006	1 July 2006

LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

c) Basis of consolidation

This consolidated financial report comprises the financial report of LM Mortgage Income Fund and its subsidiary as at 30 June 2006 ("the consolidated entity"). The financial report of the subsidiary is prepared for the same reporting period as 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. The subsidiary, "LM MIF Investments Pty Ltd" has been consolidated from the date on which control was transferred to the group. This was the 22nd December 2005. The acquisition of LM MIF Investments Pty Ltd has been accounted for using the purchase method of accounting.

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."

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

Loan Provisioning

The Scheme determines whether loans are impaired on an ongoing basis. This requires an estimation of the value of the 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.

LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

f) Income

Income is recognised to the extent that it is probable that the economic benefits will flow to the Scheme and the income 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) Borrowing 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.

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.

LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

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. Such assets 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 collectibility 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 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.

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.

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 2006 under the Scheme's Constitution.

LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

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.

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 taxable income of the Scheme. Distributable income includes capital gains arising from the disposal of investments, realised 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.

LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

o) Income Tax

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 MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

q) Impact of the adoption of AIFRS

The impacts of the adoption of AIFRS on the total unitholders' funds at the date of transition and on unitholders' funds and profit at the end of the last reporting period reported under previous AGAAP are illustrated below.

i) Reconciliation of total unitholders' funds as presented under AGAAP to equity under AIFRS:

	As at 30 June 2005	As at 1 July 2004
	\$	\$
Opening equity under previous AGAAP	692,676,583	377,455,577
Reclassification of unitholders' funds to debt	(a) (692,676,583)	(377,455,577)
Closing equity under AIFRS at 30 June 2005	-	-

ii) Reconciliation of profit for the year ended 30 June 2005 under previous AGAAP to that under AIFRS:

	As at 30 June 2005
	\$
Prior year profit as previously reported under AGAAP	39,820,485
Reclassification of unitholders' distributions to financing costs	(a) (39,637,865)
(Increase)/decrease in net assets attributable to unitholders	(a) (182,620)

Prior year profit under AIFRS

iii) Explanation of material adjustments to the Cash Flow Statement

There are no material differences between the Cash Flow Statement presented under AIFRS and the Cash Flow Statement presented under AGAAP.

(a) Under AASB 132 Financial Instruments: Disclosures and Presentation, contractual obligations are regarded as liabilities. As unitholders have the ability to redeem units from the Scheme, all net assets attributable to unitholders will be recognised as liabilities of the Scheme, rather than as equity. The classification of net assets attributable to unitholders does not alter the underlying economic interest of the unitholders in the net assets and net income attributable to unitholders of the Scheme.

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LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

3. FINANCE INCOME AND DISTRIBUTIONS TO UNITHOLDERS

(a) Non-Interest income	2006	2006	2005
	Consolidated	Scheme	Scheme
	\$	\$	\$
Changes in the fair value of investments	2,136,504	1,123,754	836,657
Other income:			
Default management fees	2,112,240	2,112,240	-
Loan origination fees	172,620	172,620	-
Penalty interest on default loans	787,241	787,241	-
Other income	215,793	215,793	96,648
	3,287,894	3,287,894	96,648

(b) Interest income

	2006					
	Consolidated			Scheme		
	Average balance \$	Income \$	Average rate %	Average balance \$	Income \$	Average rate %
Cash assets	40,199,809	2,220,819	5.52	39,754,106	2,201,005	5.54
Loans and advances	728,142,186	74,428,527	10.31	752,713,615	75,378,135	10.11
	768,341,995	76,649,346	10.08	792,467,721	77,579,140	9.88

	2005 Scheme		
	Average balance \$	Income \$	Average rate %
Cash assets	60,977,260	3,244,775	5.32
Loans and advances	469,973,791	46,683,982	9.93
	530,951,051	49,928,757	9.40

(c) Distributions to unitholders	2006	2006	2005
	Consolidated	Scheme	Scheme
	\$	\$	\$
Distributions paid	56,555,576	56,555,576	35,555,484
Distributions payable	5,821,001	5,821,001	4,082,381
	62,376,577	62,376,577	39,637,865

LM MORTGAGE INCOME FUND
Notes to the financial statements for the year ended 30 June 2006

4. OTHER EXPENSES	2006	2006	2005
	Consolidated	Scheme	Scheme
	\$	\$	\$
Loan origination expenses	172,620	172,620	-
Auditor's remuneration	90,265	90,265	54,392
Product disclosure statement production costs	57,734	57,734	54,817
Other	305,182	222,226	124,310
	<u>625,801</u>	<u>542,845</u>	<u>233,519</u>

5. AUDITOR'S REMUNERATION	2006	2006	2005
	Consolidated	Scheme	Scheme
	\$	\$	\$
Audit and review of the financial reports	75,740	75,740	44,392
Other regulatory audit services	14,525	14,525	10,000
	<u>90,625</u>	<u>90,265</u>	<u>54,392</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 2006	30 June 2005
	Scheme	Scheme
	\$	\$
Net assets attributable to unitholders		
Class A		
Opening balance	414,815,583	242,498,198
Units issued during the year	219,907,304	222,079,618
Units redeemed during the year	(129,330,909)	(60,199,700)
Units issued upon reinvestment of distributions	17,182,871	10,437,467
Closing Balance	<u>522,574,849</u>	<u>414,815,583</u>
Class B		
Opening balance	277,861,000	135,140,000
Units issued during the year	167,691,000	181,891,000
Units redeemed during the year	(90,452,000)	(39,170,000)
Units issued upon reinvestment of distributions	-	-
Closing Balance	<u>355,100,000</u>	<u>277,861,000</u>

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LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

TOTAL	30 June 2006		30 June 2005	
	#	\$	#	\$
Opening balance	692,676,583	692,676,583	377,638,198	377,455,578
Units issued during the year	387,598,304	387,598,304	403,970,618	403,970,618
Units redeemed during the year	(219,782,909)	(219,782,909)	(99,369,700)	(99,369,700)
Units issued on reinvestment of distributions	17,182,871	17,182,871	10,437,467	10,437,467
Transfers to and from the income statement				182,620
Closing Balance	877,674,849	877,674,849	692,676,583	692,676,583

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. The distribution rate will be determined 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.

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.

7. DISTRIBUTIONS TO UNITHOLDERS

	30 June 2006 \$	30 June 2006 CPU	30 June 2005 \$	30 June 2005 CPU
Distributions				
30 June	62,376,577	7.11	39,637,865	5.72

8. INVESTMENTS

		2006 Consolidated \$	2006 Scheme \$	2005 Scheme \$
Unlisted managed investment schemes	(i)	-	-	59,953
Financial assets held at fair value through profit and loss	(ii)	5,659,827	-	33,321,273
Investment in subsidiary	(iii)	-	1	-
		5,659,827	1	33,381,226

(i) The Scheme's investment in a related managed investment scheme was redeemed when the related scheme was deregistered during the period.

(ii) At 30 June 2006, the consolidated entity held 4,978,736 units in the PM Capital Enhanced Yield Fund (2005: 29,791,035). The unit price at 30 June 2006 was \$1.1368.

(iii) On 22 December 2005, the Scheme gained control of a subsidiary company, LM MIF Investments Pty Limited, a company newly incorporated in Australia on that date. The Scheme owned 100% of the issued share capital of the subsidiary of \$1 at 30 June 2006.

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LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

9. LOANS AND ADVANCES

	2006 Consolidated \$	2006 Scheme \$	2005 Scheme \$
Secured Mortgage Loans	868,300,393	868,300,393	612,670,503
Other Unsecured Loans – related party	-	6,000,000	-
Provision for impairment	(1,707,999)	(1,707,999)	-
Net loans and advances	866,592,394	872,592,394	612,670,503

(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	-	-	-
	-	6,000,000	-

(b) Maturity analysis

Less than 3 months	170,417,544	170,417,544	124,063,471
3-6 months	152,224,418	152,224,418	74,257,003
6-12 months	361,643,592	361,643,592	189,040,671
12-18 months	89,620,092	89,620,092	104,400,746
18-24 months	10,716,137	10,716,137	71,235,380
24-36 months	32,691,153	32,691,153	15,630,223
36-48 months	10,610,549	10,610,549	2,702,500
48-60 months	40,076,908	40,076,909	31,340,509
	869,108,773	869,108,773	612,670,503

(c) Concentration of risk

The loan portfolio of the Scheme does not include any loan or groups of related loans which represent 10% or more of net assets.

(d) Provisions for impairment

Until 20 April 2006, the Scheme had an arrangement with a related scheme whereby the related scheme provided underwriting facilities by arrangement or for loans in default. This arrangement no longer exists and the Scheme now bears the full credit risk associated with its secured mortgage loan portfolio and recognises penalty interest income from borrowers in default.

The impairment loss on loans and receivables expense comprises:

Specific provision	1,707,999	1,707,999	-
Collective impairment provision	-	-	-
Impairment losses recognised directly in the Income Statement	1,006,073	1,006,073	-
	2,714,072	2,714,072	-

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LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

9. LOANS AND ADVANCES (cont)	2006 Consolidated \$	2006 Scheme \$	2005 Scheme \$
<i>Specific Provision</i>			
Opening balance	-	-	-
Impairment losses provided for during year	1,707,999	1,707,999	-
Closing balance	1,707,999	1,707,999	-
<i>Collective impairment provision</i>			
Opening balance	-	-	-
Impairment losses provided for during year	-	-	-
Closing balance	-	-	-
TOTAL PROVISION	1,707,999	1,707,999	-
The collective provision for impairment is calculated by placing loans into pools with similar risk characteristics and collectively assessing for impairment.			
<i>Default loans with specific provision</i>			
Loan balance	42,661,029	42,661,029	8,158,730
Specific provision for impairment	(1,707,999)	(1,707,999)	-
Net default loans	40,953,030	40,953,030	8,158,730
<i>Loans in arrears</i>			
Loan balance	54,407,336	54,407,336	65,787,754

Restructured Loans

Four mortgage loans totalling \$59,717,035 (2005: nil) were classified as restructured loans. These loans previously in default or arrears are now performing at 30 June 2006 under revised loan terms and conditions.

Since 30 June 2006, mortgage loans in default totalling \$9,098,941 and mortgage loans in arrears totalling \$19,311,013 have been recovered in full.

LM MORTGAGE INCOME FUND**Notes to the financial statements for the year ended 30 June 2006****10. INTEREST BEARING LOANS AND ADVANCES**

	2006	2006	2005
	Consolidated	Scheme	Scheme
	\$	\$	\$
Secured bank loan	30,416,662	30,416,662	-

During the year, the Scheme entered into a committed financing agreement which provides access to \$100m for a period of 2 years, thereafter extendable at the bank's option. When drawn, the loan is secured by the assets of the Scheme.

11. RELATED PARTIES***Responsible Entity***

The Responsible Entity of LM 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 14.

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 14.

Directors' holdings of units

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

	2006	2006	2005
	Consolidated	Scheme	Scheme
	\$	\$	\$
- LM Investment Management Limited	192,138	192,138	176,975
- Directors and director related entities	-	-	31,608
- Other Associates of LM Investment Management Limited	355,100,000	355,100,000	277,861,000

LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

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.

Related party transactions

Until 20 April 2006, the LM Special Participation Fund (a related scheme) provided income assurance to investors in the Scheme by agreeing to underwrite interest payments to the Scheme at the discretion of the Responsible Entity, on behalf of borrowers. The LM Special Participation Fund did not guarantee the payment of all income, or return of capital. During the year, the Scheme received underwriting payments on behalf of borrowers from the LM Special Participation Fund totalling \$4,789,995 (2005: \$9,014,725).

At the date of this report, the LM Special Participation Fund is in the process of being wound down and deregistered.

Prior to the LM Special Participation Fund being wound down, the Scheme purchased receivables of the LM Special Participation Fund totalling \$8,110,374 at 20 April 2006.

Administration and funds management services are provided to the Scheme on behalf of the Responsible Entity by LM Administration Pty Limited, 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, LM Investment Management Limited was paid loan origination fees directly from borrowers. From 1 May 2006, loan origination fees are now recognised in the Income Statement of the Scheme. Loan origination fees received by the Scheme during the year were \$172,620 (2005: \$nil) of which \$172,620 was reimbursed by the Scheme to the responsible entity for the administration of loan origination services.

On 22 December 2005, the Scheme gained control of a newly formed entity, LM MIF investment Pty Limited, an entity incorporated to invest in 'at call' securities on behalf of the Scheme. At the date of inception, the assets and liabilities of LM MIF Investments Pty Limited were nil. The LM MIF advances unsecured, interest bearing funds to LM MIF Investments Pty Ltd. The interest rate charged on the loan approximates the return achieved from the investments undertaken on the Scheme's behalf. The RE does not receive any fees as a result of this loan.

LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

	2006 Consolidated \$	2005 Scheme \$	2005 Scheme \$
Total remuneration received or due and receivable			
■ Fees for the year paid directly by the Scheme to LM Administration Pty Ltd	10,683,880	10,683,880	7,874,560
■ Fees earned by LM Administration Pty Ltd from other approved schemes invested in by Scheme.	-	-	-
■ Other expenses including administration expenses incurred by the Responsible Entity, which are reimbursed to the Responsible Entity in accordance with the provisions of the Constitution.	489,342	489,342	127,880
Custodian's remuneration			
■ Custodian's fees paid by Responsible Entity and reimbursed by the Scheme	305,059	305,059	235,055
Balance with related parties			
Aggregate amounts receivable from related parties by the Scheme were as follows:			
■ LM Administration Pty Limited (management fees prepaid by the Scheme)(i)	3,869,587	3,869,587	3,354,615
■ LM MIF Investments Pty Limited (ii)	-	6,000,000	-
■ Australian International Investments Pty Limited (iii)	1,690,000	1,690,000	1,690,000

(i) These amounts are included in prepayments. No amounts are payable to related parties by the Scheme. The average monthly balance of prepayments during the year was \$3,504,032 which was non-interest bearing. Interest foregone on the above amount if calculated at the weighted average cash rate of 5.54% would have been \$194,123. 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 has 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 2006 for \$1,690,000 (MORT 2157). This transaction was approved on an arms length basis and is on normal terms and conditions.

The LM Managed Performance Fund has second mortgages on loans that are first mortgages of the LM Mortgage Income Fund totalling \$19,636,287 (2005: \$2,831,822). The LM Managed Performance Fund may on occasion pay development and construction costs on those related loans.

LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

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. Details of the Scheme's investment in other schemes operated by LM Investment Management Limited or its affiliates is set out below:

Scheme name	Investment at year end #	Interest held in related scheme at year end	Number of Units acquired during the year	Number of Units redeemed during the year	Distribution paid or payable
30 June 2006					
LM Select Mortgage Income Fund	-	0.00%	-	-	-
30 June 2005					
LM Select Mortgage Income Fund	59,953	0.75%	-	-	-

These investments are 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 2006					
LM Currency Protected Australian Income Fund	67,000,000	7.63%	61,395,000	8,785,000	2,546,668
LM Special Participation Fund	-	-	250,000	1,435,000	14,720
LM Managed Performance Fund	5,100,000	0.58%	20,420,000	17,840,000	871,807
LM Wholesale Mortgage Income Fund	283,000,000	32.24%	85,500,000	59,500,000	22,271,669
LM Property Performance Fund	-	-	126,000	2,892,000	84,389
LM Investment Management Ltd	192,138	0.02%	-	-	15,266
Lisa M Darcy	-	-	8,955	10,187	150
Belinda J Drake	-	-	18,503	48,880	2,307
James and Pamela Craig	314,743	0.04%	300,000	-	14,832
Harold Ward	20,041	0.00%	20,000	-	36
Total	355,626,922	40.50%	17,038,458	90,511,067	25,821,844

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LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

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 2005					
LM Currency Protected Australian Income Fund	14,390,000	2.08%	14,750,000	360,000	444,222
LM Special Participation Fund	1,185,000	0.17 %	6,330,000	7,386,000	106,630
Belinda J Drake	30,377	-	25,236	-	1,408
LM Managed Performance Fund	2,520,000	0.36 %	14,088,000	19,697,000	572,424
LM Wholesale Mortgage Income Fund	257,000,000	37.10 %	132,322,000	-	14,455,399
LM Property Performance Fund	2,766,000	0.40 %	3,031,000	357,000	99,397
LM Investment Management Ltd	176,975	0.03 %	-	13,956	14,052
Lisa M Darcy	1,232	-	8,755	11,068	143
Total	278,069,584	40.14 %	170,554,991	27,825,024	15,693,675

12. RECEIVABLES

	2006 Consolidated \$	2006 Scheme \$	2005 Scheme \$
Interest and distribution receivable	212,146	148,511	110,941
Mortgage interest receivable	1,808,959	1,808,959	935,087
Default management fee receivable	2,112,240	2,112,240	-
Penalty interest receivable	82,163	82,163	-
GST receivable	121,769	121,769	185,783
Other	4,489	4,489	3,490
	<u>4,341,766</u>	<u>4,278,131</u>	<u>1,235,301</u>

13. CASH AND CASH EQUIVALENTS

	2006 Consolidated \$	2006 Scheme \$	2005 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>32,995,697</u>	<u>32,645,002</u>	<u>46,917,105</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 \$32,995,697 (2005: \$46,917,405).

LM MORTGAGE INCOME FUND

Notes to the financial statements for the year ended 30 June 2006

	2006 Consolidated \$	2006 Scheme \$	2005 Scheme \$
(b) Reconciliation of change in net assets attributable to unitholders to net cash flows from operating activities			
Change in net assets attributable to unitholders	-	-	182,620
<i>Adjustments for:</i>			
Distributions to unitholders	62,376,577	62,376,577	39,637,865
(Increase)/decrease in interest and distribution receivable	(3,350,016)	(3,106,847)	(483,260)
(Increase)/decrease in other receivables	(1,100,004)	(1,100,004)	(1,379,662)
Increase/(decrease) in payables	(63,679)	(138,136)	264,512
Net cash flows from/(used in) operating activities	<u>57,862,878</u>	<u>58,031,591</u>	<u>38,222,074</u>

(c) Reinvestment of distributions

During the financial year, the Scheme issued 17,182,871 units (2005: 10,437,812) as a result of reinvestment of distribution by unitholders totaling \$17,182,871 (2005: \$10,437,812). These transactions have not been included in the Cash Flow Statement.

14. KEY MANAGEMENT PERSONAL DISCLOSURES**(a) 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

Non-executive directors

Mr Martyn Andrew Carne	Appointed 18 July 2002; resigned 6 June 2006
Mr John Dillon	Appointed 8 June 2005

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Notes to the financial statements for the year ended 30 June 2006

(b) 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 LM Mortgage Income Fund 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.

(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.

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(v) Remuneration of KMP

2006 Specified KMP	Salary & Fees	Primary Cash Bonus	Non Monetary Benefits	Post Employment Super	Retirement Benefits	Equity	Other	TOTAL	Total performance related
Drake, PC*	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	% -
Darcy, LM**	18,107	-	-	1,630	-	-	-	19,737	-
Brett McMahon	-	-	-	-	-	-	-	-	-
Geoff Black	-	-	-	-	-	-	-	-	-
Carme, M	3,034	-	-	273	-	-	-	3,307	-
Dillon, J	2,519	-	-	227	-	-	-	2,746	-
van der Hoven, E	284	-	-	26	-	-	-	309	-
	23,944	-	-	2,155	-	-	-	26,099	-

2005 Specified KMP	Salary & Fees	Primary Cash Bonus	Non Monetary Benefits	Post Employment Super	Retirement Benefits	Equity	Other	TOTAL	Total performance related
Drake, PC*	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	% -
Darcy, LM**	10,643	-	-	938	-	-	226	11,807	-
Brett McMahon	1,482	-	-	-	-	-	-	1,482	-
Geoff Black	1,720	-	-	-	-	-	-	1,720	-
Carme, M	1,978	-	-	138	-	-	-	2,116	-
Dillon, J	97	-	-	9	-	-	-	106	-
van der Hoven, E	-	-	-	-	-	-	-	-	-
	15,920	-	-	1,085	-	-	226	17,231	-

* 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 and E van der Hoven 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.