PW-39

Australian Securities & Investments Commission

AUSTRALIAN SECURITIES & INVESTMENTS COMMISSION
027353931

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

Investments Commission ... 0 OCT 2010 ... Centre

Copy of financial statements and reports

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

Company/scheme details

Company/scheme name
LM First Mortgage Income Fund

ACN/ARBN/ARSN/PIN/ABN
089 343 288

Lodgement details

An image of this form will be available as part of the public register.

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

ASIC registered agent number (if applicable)

Firm/organisation
LM Investment Management Ltd

Contact name/position description
Kelly Roetman / Financial Controller

Telephone number (during business hours)
(07) 55 844 500

Email address (optional)

Postal address
PO Box 485

Suburb/City
Surfers Paradise

State/Territory
QLD

Postcode
4217

1 Reason for lodgement of statement and reports

Tick appropriate box.

- [ ] A public company or a disclosing entity which is not a registered scheme or prescribed interest undertaking (A)
- [x] A registered scheme (B)
- [ ] Amendment of financial statements or directors' report (company) (C)
- [ ] Amendment of financial statements or directors' report (registered scheme) (D)
- [ ] A large proprietary company that is not a disclosing entity (H)
- [ ] A small proprietary company that is controlled by a foreign company for all or part of the period and where the company's profit or loss for the period is not covered by the statements lodged with ASIC by a registered foreign company, company, registered scheme, or disclosing entity (I)
- [ ] A small proprietary company that is requested by ASIC to prepare and lodge statements and reports (J)
- [ ] A prescribed interest undertaking that is a disclosing entity (only for financial year ending 01/07/2010 or earlier) (K)

See Guide for definition of large and small proprietary companies.

Dates on which financial year begins and ends

Financial year begins 01/07/09 [D D] [M M] [Y Y] to Financial year ends 30/06/10 [D D] [M M] [Y Y]

2 Details of large proprietary company

See Guide for definition of large and small proprietary companies.

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

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

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

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

D How many members does the large proprietary company have?

3 Auditor's report

Were the financial statements audited?

[X] Yes
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 [X] No
Details of the deficiency, failure or shortcoming concerning any matter referred to in s307?
[ ] Yes [X] No

[ ] No
If no, is there a class order exemption current for audit relief?
[ ] Yes [ ] No

4 Details of current auditor or auditors

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

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

Family name

Given name

or

Company name
Ernst & Young

ACN/ABN
752 881 727 49

or

Firm name (if applicable)

4 Continued... Details of current auditor or auditors

Office, unit, level
Water front Place

Street number and Street name
1 Eagle Street

Suburb/City
Brisbane

State/Territory
QLD

Postcode
4000

Country (if not Australia)

Date of appointment
01/10/03
[D D] [M M] [Y Y]

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

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

Family name

Given name

or

Company name

ACN/ABN

or

Firm name (if applicable)

Office, unit, level

Street number and Street name

Suburb/City

State/Territory

Postcode

Country (if not Australia

5 Statements and reports to be attached to this form

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

- Statement of comprehensive income, may also include a separate income statement for the year
- Statement of financial position as at the end of the year
- Statement of cash flows for the year
- Statement of changes in equity
- If required by accounting standards — the consolidation statements of comprehensive income/Income statement, financial position, cash flows and changes in equity.

Notes to financial statements (see s295(3))

- Disclosures required by the regulations
- Notes required by the accounting standards
- Any other information necessary to give a true and fair view (see s297)

The signed directors' declaration about the statements and notes (see s295(4))

The signed directors' report for the year, including the copy of the auditor's independence declaration (s298 to s300A)

Signed auditor's report required under s308 and s314

Concise report (if any) (see s314)

Signature

See Guide for details of signatory.

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

Name
Lisa Darcy

Signature

Capacity
[X] Director
[ ] Company secretary

Date signed
0 6 / 1 0 / 1 0
[D D] [M M] [Y Y]

Lodgement

Send completed and signed forms to:
Australian Securities and Investments Commission,
PO Box 4000, Gippsland Mail Centre VIC 3841.

Or lodge the form electronically by:

- visiting the ASIC website www.asic.gov.au
- using Standard Business Reporting enabled software. See www.sbr.gov.au for more details.

For help or more information
Telephone 1300 300 630
Email info.enquiries@asic.gov.au
Web www.asic.gov.au

LM FIRST MORTGAGE INCOME FUND

ABN: 66 482 247 488

Annual Report

For the year ended 30 June 2010

LM FIRST MORTGAGE INCOME FUND

ABN: 66 482 247 488

Annual Report – 30 June 2010

Contents

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

LM FIRST MORTGAGE INCOME FUND

Directors' Report

DIRECTORS' REPORT

The directors of LM Investment Management Limited, the Responsible Entity of the LM First Mortgage Income Fund, present their report of the LM First Mortgage Income Fund ("the Scheme") for the year ended 30 June 2010. The directors' report is not part of the financial report.

DIRECTORS

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

Name	**Period of directorship**
Mr Peter Charles Drake	Appointed 31 January 1997
Ms Lisa Maree Darcy	Appointed 15 September 2003
Mr Eghard van der Hoven	Appointed 22 June 2006
Ms Francene Mulder	Appointed 30 September 2006
Mr John O'Sullivan	Appointed 27 November 2007
Mr Simon Tickner	Appointed 16 December 2008

PRINCIPAL ACTIVITIES

During the year, the Scheme continued the principal activity of investing unitholders' funds in registered first mortgages 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 and ASIC Benchmark Disclosure and Update.

The Scheme did not have any employees during the year.

SCHEME INFORMATION

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

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

REVIEW OF RESULTS AND OPERATIONS

Results

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

The Responsible Entity determined from 3 March 2009 that the Scheme would not accept any applications for investment from any person who was not an existing member of the Scheme. The Scheme still accepts applications for investment from any person who is an existing member of the Scheme by way of rollover of investment term, including deemed applications as part of any reinvestment of distributions.

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

LM FIRST MORTGAGE INCOME FUND

Directors' Report

REVIEW OF RESULTS AND OPERATIONS (Continued)

The Scheme was established in 1999, and has met its objective during its eleven years of operation by maintaining a stable unit price of $1.00 and delivering forecast distributions which continued to accrue to investor's accounts during the year.

This result is particularly pleasing given the difficult circumstances surrounding the onerous repayment terms of the funds external financing agreement with the Commonwealth Bank of Australia.

The prime objective of the Scheme is to deliver income to investors whilst maintaining capital value of investment in the Scheme. The priority is to protect all investors and all fund capital.

The global financial crisis and following tightness in credit markets has influenced timing in relation to the expected realisation of first mortgage assets due to borrower difficulties in obtaining finance and the accompanied slowdown in sales of property assets. Therefore the manager has determined that the fund remains closed to new investor applications and investor redemptions with the exception of approved hardship withdrawals.

Subsequent to year end, the directors were able to successfully refinance the existing facility with the Commonwealth Bank of Australia. This was the first important step in realising the ultimate strategy for the Scheme.

The new financing facility with Deutsche Bank, Sydney allows the realisation of assets in a more timely and composed manner and the repayment of the facility is linked to the sales of assets rather than a fixed monthly repayment amount (refer to note 10 on page 28 for further details on this new facility).

The second step in the strategy for the Scheme is to announce a managed redemption plan for those investors with a redemption request lodged. At the same time the directors must ensure that they protect those investors who wish to remain invested in the Scheme. The directors are currently considering all options regarding this redemption plan.

Finally, the directors final step in the strategy is to re-open the fund for new investors, this will be achieved via allocating an agreed percentage of funds from realisation of assets to recommence new lending and take advantage of the many opportunities which exist for commercial lending in the Australian property market. This in turn will enable the fund to deliver higher returns and once again attract new investors in the Scheme.

The implementation of this strategy is ultimately dependant on the resumption of normal credit conditions in the Australian Property Market and the return to a more traditional quantum of lending by Australian bank and non bank participants in the commercial property sector.

The manager has significant resources in house dedicated to the asset realisation programme and each individual first mortgage asset has a managed exit strategy. All completed property assets are currently available for sale and the manager expects to continue to realise proceeds from these assets in an orderly fashion over the coming twelve months and beyond.

This will allow over time the Scheme to continue its principal activity of investing in new registered first mortgages and cash within the Australian property market and provide investors with rates of return with the appropriate risk return margin over cash with a stable unit price.

Net profits before distributions to unitholders for the year ended 30 June 2010 was $23,642,517 (2009: $39,577,872).

LM FIRST MORTGAGE INCOME FUND

Directors' Report

REVIEW OF RESULTS AND OPERATIONS (Continued)

Distributions to unitholders during the year totalled $24,770,380 (2009: $39,271,910).

Total assets under management were $575,065,155 as at 30 June 2010 (2009: $630,789,449). Investor funds under management decreased during the year by $7,328,655 (2009: increased by $14,588,808). Investor funds under management invested by related managed investment schemes in LM FMIF decreased by $6,929,699 (2009: increased by $12,471,300) to $223,613,698 (2009: $230,543,397).

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

	30 June 2010	30 June 2009
	$	$
Net operating income/(loss) before distributions	23,642,517	39,577,872
Financing costs: Distributions to unitholders	(24,770,380)	(39,271,910)
(Increase) / decrease in net assets attributable to unitholders	1,127,863	(305,962)
Net profit/(loss)	-	-

UNITHOLDER FUNDS

There were $487,146,613 units on issue at 30 June 2010 (2009: $494,475,268). During the year $20,893,238 of units were issued by the Scheme (2009: $95,766,741) and $26,070,292 of units were withdrawn (2009: $81,524,501).

SCHEME ASSETS

At 30 June 2010, the Scheme held assets to a total value of $575,065,155 (2009: $630,789,449). The basis for valuation of assets is disclosed in Note 2 to the financial statements.

FEES PAID TO THE RESPONSIBLE ENTITY AND ASSOCIATED COMPANIES

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

	2010	2009
	$	$
• Management fees paid or payable directly to LM Administration Pty Ltd	-	10,310,762
• Management fees paid or payable directly to LM Investment Management Pty Ltd	8,995,455	5,100,000
• Expenses incurred by the Responsible Entity and its associated entities which are reimbursed in accordance with the provisions of the Scheme's Constitution, including administration and custodian fees	-	-
• Expenses incurred by LM Administration Pty Ltd which are reimbursed in accordance with the provisions of the Scheme's Constitution, including administration and custodian fees	879,091	960,259
• Loan origination fees received from borrowers within the Scheme that were reimbursed to the Responsible Entity for the administration of loan origination services	-	2,194,460

LM FIRST MORTGAGE INCOME FUND

Directors' Report

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

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

SIGNIFICANT EVENTS AFTER THE STATEMENT OF FINANCIAL POSITION DATE

Other than the matters disclosed in Note 18 of the financial report there has been no matter or circumstance that has arisen since the end of the financial year that has significantly affected, or may affect, the Scheme's operations in future financial years, the results of those operations of the Scheme's state of affairs in future years.

LIKELY DEVELOPMENTS AND EXPECTED RESULTS

Further information on likely developments in the operation of the Scheme and the expected results of those operations has not been included in this report because the Responsible Entity believes it would likely 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 Limited or the auditors of the Scheme. Provided the officers of LM Investment Management Limited act in accordance with the Scheme Constitution and the Law, the officers remain indemnified out of the assets of the Scheme against losses incurred while acting on behalf of the Scheme. The auditors of the Scheme are in no way indemnified out of the assets of the Scheme.

AUDITOR'S INDEPENDENCE DECLARATION

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

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

Lisa Darcy
Director
Gold Coast

6 October 2010

ERNST & YOUNG

1 Eagle Street
Brisbane QLD 4000 Australia
GPO Box 7878 Brisbane QLD 4001

Tel: +61 7 3011 3333
Fax: +61 7 3011 3100
www.ey.com/au

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

In relation to our audit of the financial report of LM First Mortgage Income Fund, for the financial year ended 30 June 2010, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.

Ernst & Young

Ernst & Young

P McLuskie

Paula McLuskie
Partner
Brisbane
6 October 2010

LM FIRST MORTGAGE INCOME FUND

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2010

	Notes	30 June 2010 $	30 June 2009 $
Income			
Interest revenue – mortgage loans		54,533,895	68,475,219
Interest revenue – cash assets		100,695	238,603
Realised foreign exchange gain on investor funds		1,056,978	-
Unrealised foreign exchange gain on foreign exchange contracts		17,451	-
Other income	3(a)	-	10,898,863
Total revenue and other income		55,709,019	79,612,685
Expenses			
Management fees	11	8,995,455	15,410,762
Finance costs	4(a)	12,252,878	14,082,356
Custodian fees		88,163	123,356
Advisor commissions		2,133,181	2,167,826
Impairment losses on mortgage loans	8(d)	6,582,816	5,056,938
Unrealised foreign exchange losses on investor fund		25,725	91,131
Realised loss on foreign exchange contracts		1,180,181	-
Legal fees		58,174	69,789
Other expenses	4(b)	749,929	3,032,655
Total expenses excluding distributions to unitholders		32,066,502	40,034,813
Net profit before distributions to unitholders		23,642,517	39,577,872
Distributions paid to unitholders	3(b)	(24,770,380)	(39,271,910)
Net profit/(loss) after distributions to unitholders		(1,127,863)	305,962
Other comprehensive income		-	-
Changes in net assets attributable to unitholders		(1,127,863)	305,962
Income tax expense		-	-
Changes in net assets attributable to unitholders after income tax expense		(1,127,863)	305,962

LM FIRST MORTGAGE INCOME FUND
STATEMENT OF FINANCIAL POSITION
As at 30 June 2010

	Note	30 June 2010 $	30 June 2009 $
ASSETS			
Cash and cash equivalents	13(a)	1,976,709	1,154,822
Receivables	12	1,668,542	17,296,353
Prepayments	11	8,401,148	6,269,970
Investments	7	1	1
Fair value of forward exchange contracts		17,451	22,344
Loans and receivables	8	563,001,304	606,045,959
TOTAL ASSETS		575,065,155	630,789,449
LIABILITIES			
Payables	9	2,481,791	1,051,369
Interest bearing loans and borrowings	10	81,014,217	133,000,000
Distributions payable	3(b)	4,422,534	2,234,098
Fair value of forward exchange contracts		-	28,714
Total liabilities excluding net assets attributable to unitholders		87,918,542	136,314,181
NET ASSETS	6	487,146,613	494,475,268
Represented by:			
Net assets attributable to unitholders (calculated in accordance with IFRS)		487,146,613	494,475,268

LM FIRST MORTGAGE INCOME FUND

STATEMENT OF CHANGES IN NET ASSETS ATTRIBUTABLE TO UNITHOLDERS

For the year ended 30 June 2010

	2010 $	2009 $
TOTAL		
Opening balance	494,475,268	479,886,460
Units issued during the year	17,525,140	88,028,697
Units redeemed during the year	(26,070,292)	(81,524,501)
Units issued on reinvestment of distributions	3,368,098	7,738,044
Transfers to and from the statement of comprehensive income	(1,127,863)	305,962
Change in fair value of derivatives	-	40,606
Foreign exchange (gain)/loss on investor funds	(1,023,738)	-
Closing Balance	487,146,613	494,475,268

LM FIRST MORTGAGE INCOME FUND
STATEMENT OF CASH FLOWS
For the year ended 30 June 2010

	Notes	30 June 2010 $	30 June 2009 $
Cash flows from operating activities			
Interest and distributions received		8,508,222	14,989,628
Management fees paid		(12,000,000)	(14,693,802)
Other operating expenses		(2,474,764)	(3,247,801)
Other income received		2,124,736	17,833
GST and withholding tax (paid)/received		(2,098,179)	291,402
Finance costs paid		(11,619,561)	(13,869,073)
Net cash inflow/(outflow) from operating activities	13(b)	(17,559,546)	(16,511,813)
Cash flows from investing activities			
Payments for secured mortgage loans		(15,461,041)	(117,016,006)
Receipts from settled mortgage loans		114,763,275	163,133,558
Net cash inflow/(outflow) from investing activities		99,302,234	46,117,552
Cash flows from financing activities			
Proceeds from / (repayments) of borrowings		(51,985,783)	(17,000,000)
Cash paid on realisation of foreign exchange contracts		(1,180,181)	-
Receipts from the issue of units		3,606,995	88,028,697
Distributions paid		(5,291,540)	(32,598,445)
Payment for redemption of units		(26,070,292)	(81,524,501)
Net cash inflow/(outflow) from financing activities		(80,920,801)	(43,094,249)
Net increase/(decrease) in cash and cash equivalents		821,887	(13,488,510)
Cash and cash equivalents at beginning of the year		1,154,822	14,643,332
Cash and cash equivalents at the end of the year	13(a)	1,976,709	1,154,822

LM FIRST MORTGAGE INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2010

1. CORPORATE INFORMATION

The financial report of LM First Mortgage Income Fund ("the Scheme") for the year ended 30 June 2010 was authorised for issue in accordance with a resolution of the directors of the Responsible Entity on 6 October 2010.

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

a) Basis of accounting

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

The financial statements have been prepared under the historical cost convention, except for financial assets and financial liabilities held at fair value through profit or loss, that have been measured at fair value.

The statement of financial position 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*. All balances are expected to be recovered or settled within twelve months, except for loans and receivables and net assets attributable to unitholders. The amount expected to be recovered or settled within twelve months in relation to the balances cannot be reliably determined.

The financial report is presented in Australia Dollars ($).

The financial report complies with Australian Accounting Standards, which included International Financial Reporting Standards ('IFRS').

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

a) Basis of accounting (Continued)

Going Concern

The financial statements have been prepared on the basis the Scheme is a going concern. Since the year end the Responsible Entity has entered into a new facility with another external financier on behalf of the Scheme and the existing facility as at 30 June 2010 was fully repaid. This new facility agreement provides a revised facility of $90 million for two years with an option to extend for an additional year, of which $81 million was drawn on the 1 July 2010.

The new facility agreement requires the Scheme to make minimum repayments in priority to any redemptions, except for hardship provisions and feeder fund payments for investor distributions and fund expenses. In addition, where the Scheme realises assets or receives cash in settlement of secured loans it must repay to the external financier an agreed amount that varies based on each secured loan.

There remains significant uncertainty in the financial and property markets that may impact the timing of future cash flows. The directors believe the Scheme will be able to meet its obligations under the repayment plan through repayment of existing loans including the refinancing of existing loans with alternative financing providers; the repayment of loans from related entities; the repayment of the prepaid management fees from LM Administration Pty Ltd; or the continued support from the external financier.

The directors expect that in meeting the repayment obligations the Scheme will be in a position to secure additional funding or redraw on the new facility to complete development projects valued on an "on completion basis".

The Responsible Entity is also considering options for a managed redemption plan for those investors with a redemption request lodged. The directors must also ensure that they protect those investors who wish to remain invested in the Scheme.

On this basis the directors believe the Scheme is a going concern and hence the financial report does not include any adjustments relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the Scheme not continue as a going concern.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

b) Accounting Standards not previously applied

The accounting policies have been consistently applied by the Scheme and are consistent with those applied in the 30 June 2009 Annual Financial Report, except for the adoption of AASB 101: *Presentation of Financial Statements.*

The Scheme has adopted the following new and revised Australian Accounting Standard issued by the Australian Accounting and Standards Board which is mandatory to apply to the current period. Disclosures required by this Standard that are deemed material have been included in this financial report on the basis that they represent a significant change in information from that previously made available.

i) *Presentation of Financial Statements*

AASB 101 prescribes the contents and structure of the financial statements. Changes reflected in this financial report include:

- Items of income and expense not recognised in profit or loss are now disclosed as components "other comprehensive" and
- Other financial statements are renamed in accordance with the Standard

c) New standards and other interpretations not yet adopted

The following are Australian Accounting Standards and Interpretations that have recently been issued and have not been adopted for the annual reporting period ending 30 June 2010.

AASB 9: *Financial Instruments* includes requirements for the classification and measurement of financial assets. These requirements improve and simplify the approach for the classification and measurement of financial assets compared with the requirements of AASB 139. The Scheme has not yet determined the extent of the impact of AASB 9, however, application will occur from 1 July 2013.

AASB 9: *Financial Instruments* is the only new standard that will materially impact the Scheme once adopted. There are no other impending new accounting standards that will result in any material change in relation to amount recognised in the financial statements.

d) Basis of consolidation

This financial report of June 2010 comprises the financial report of LM First Mortgage Income Fund and its subsidiary as at at that time ("the consolidated entity"). The financial report of the subsidiary is prepared for the same reporting period as the Scheme, using consistent accounting policies.

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

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

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

d) Basis of consolidation (Continued)

The Scheme owns 100% of the issued share capital of $1 of LM MIF Investments Pty Limited at 30 June 2010. This company is in the process of being wound up and has not traded during the period. On this basis consolidated financial statements were not prepared for the year ended 30 June 2010.

e) Significant accounting judgements, estimates and assumptions

(i) Significant accounting judgements

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

(ii) Significant accounting estimates and assumptions

The carrying amounts of certain assets and liabilities are often determined based on estimates and assumptions of future events. The key estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of certain assets and liabilities within the next annual reporting period are:

a. Allowance for impairment loss on loans and receivables

The Scheme determines whether loans are impaired on an ongoing basis. This requires an estimation of the value of future cash flows through a "on completion" valuation or the property based on an 'as is' valuation.

b. Fair value of financial instruments

When the fair value of financial assets and financial liabilities recorded in the Statement of Financial Position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values.

The judgments include considerations of liquidity and model inputs such as credit risk (both own and counterparty's), correlation and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments. The models are calibrated regularly and tested for validity using prices from any observable current market transactions in the same instrument (without modification or repackaging) or based on any available observable market data.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

f) 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 Statement of Cash Flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

g) Distribution income

Distribution income is recognised when the unitholders' right to receive the payment is established.

h) 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.

i) *Default management fees*

Income from default management fees is recognised in line with the executed agreement with the borrower when an event of default occurs.

j) 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.

k) Fees, Commissions and other expenses

Except where included in the effective interest calculation (for financial instruments carried at amortised cost), fees and commissions are recognised on an accrual basis. Audit and compliance fees are included with 'other expenses' and are recorded on an accrual basis.

l) Finance costs

Interest on borrowings is recognised in the statement of comprehensive income 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.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

m) Financial Instruments

Financial instruments in the scope of AASB 139 *Financial Instruments: Recognition and Measurement* are classified as either financial assets and financial liabilities at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale investments or other financial liabilities 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 Scheme 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) Fair value of financial assets and liabilities through profit and loss

Financial assets held for trading included forward exchange contracts. These assets are acquired principally for the purpose of mitigating the risk of movements in the value of non-Australian Dollar investor funds and facilitating forecasting of future cash flows. During the period, all derivatives are classified as held for trading. Derivative financial instruments entered into by the Scheme do not meet the hedge accounting criteria as defined by AASB139. Consequently, hedge accounting is not applied by the Scheme in the 2010 financial year.

ii) Loans and receivables

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

Loans and receivables are assessed for impairment at each reporting period. An allowance is made for credit losses when there is objective evidence that the Scheme will not be able to collect the loans and 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 statement of comprehensive income.

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

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

m) Financial Instruments (Continued)

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.

Where possible, the Fund seeks to restructure loans to have loans fully performing, however the fund will take possession of the collateral where necessary. The renegotiation may involve extending payment terms and arrangement of new loan conditions. Once the terms have been renegotiated any impairment is measured the same way as performing loans. The renegotiated loans continue to be assessed individually and collectively for impairment.

ii) Loans and receivables (Continued)

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

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

n) 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.

o) Payables

Payables are carried at amortised cost and represent liabilities for goods and services provided to the Scheme prior to the end of the financial year that are unpaid and arise when the Scheme 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 statement of financial position as unitholders are presently entitled to the distributable income as at 30 June 2010 under the Scheme's Constitution.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

p) 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.

q) Distributions

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

r) 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 comprehensive income 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 statement of financial position. 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.

s) 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.

Applications received in foreign currency denominations are initially recorded in the functional currency by applying the exchange rates ruling at the date of the transaction. Foreign currency denominated unitholder funds are translated into the Schemes functional currency at balance date, using the spot rate prevailing at that date. Gains and losses arising from foreign exchange translation are recorded in the Statement of Comprehensive Income in the period in which they arise.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

t) Taxation

Under current legislation, the Scheme is not subject to income tax provided the distributable income of the Scheme is fully distributed either by way of cash or reinvestment (i.e. 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.

u) 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.

v) Capital Management

The Responsible Entity manages the Scheme's net assets attributable to unitholders as capital, not withstanding net assets attributable to unitholders is classified as a liability. The amount of net assets attributable to unitholders can change significantly on a daily basis as the Scheme is subject to daily applications and redemptions at the discretion of unitholders.

The Responsible Entity monitors the level of daily applications and redemptions relative to the liquid assets in the Scheme.

The Scheme is not subject to any externally imposed capital requirements.

w) Derivative financial instruments

The Scheme uses derivative financial instruments such as forward currency contracts to hedge its risks associated with foreign currency fluctuations. Derivatives are recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Any gains or losses arising from changes in the fair value of derivatives, except for those that qualify as cash flow hedges, are taken directly to net profit or loss for the year.

The fair value of forward currency contracts is calculated by reference to valuations provided by the financial institutions with which the forward exchange contracts are held.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

x) Foreign currency translations

The Scheme's transactions in foreign currencies comprise applications and withdrawals of foreign currency unitholder funds and payment of distributions. Transactions in foreign currencies are initially recorded in the functional currency by applying the exchange rates ruling at the date of the transaction. Monetary assets and liability denominated in foreign currencies are retranslated at the rate of exchange prevailing at the balance sheet date, and exchange rate gains and losses recognised in the Statement of Comprehensive Income.

y) Determination of Fair Value

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair value for financial instruments traded in active markets at the reporting date is based on their quoted price or binding dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not traded in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include: using recent arm's length market transactions; reference to the current market value of another instrument that is substantially the same; discounted cash flow analysis and option pricing models making as much use of available and supportable market data as possible.

Refer to Note 16 to the financial statements for the methods and assumptions applied in determining fair value for each class of financial instrument.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

3. INCOME AND DISTRIBUTIONS TO UNITHOLDERS

a) Non-Interest income

	2010	2009
	$	$
Changes in the fair value of investments	-	-
Other income:		
Default management fees	-	10,751,114
Foreign exchange gains	-	26,553
Other income	-	121,196
	-	10,898,863

b) Distributions to unitholders

	2010	2009
	$	$
Distributions paid	20,347,846	37,037,812
Distributions payable	4,422,534	2,234,098
	24,770,380	39,271,910

c) Distributions paid and payable

Class A	9,869,689	16,473,735
Class B	14,416,030	22,159,255
Class C	484,661	638,920
	24,770,380	39,271,910

As at 30 June 2010, $2,127,691 (2009: $485,702) of distributions payable related to distributions that were requested to be paid under the Scheme's Constitution prior to 30 June 2010.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

4. EXPENSES

	2010 $	2009 $
a) Finance costs		
Interest on bank loans	9,965,991	12,218,376
Facility fees	2,286,887	1,863,982
	12,252,878	14,082,356
b) Other expenses		
Loan origination expenses	-	2,194,460
Auditor's remuneration	401,984	478,744
Other expenses	347,945	359,451
	749,929	3,032,655

5. AUDITOR'S REMUNERATION

	2010 $	2009 $
Audit and review of the financial reports	370,680	461,757
Other regulatory audit services	31,304	16,987
	401,984	478,744

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

6. CHANGES IN NET ASSETS ATTRIBUTABLE TO UNITHOLDERS

Movements in the net assets attributable to unitholders during the year were as follows:

	2010 $	2009 $
Net assets attributable to unitholders		
Class A		
Opening balance	252,479,887	257,196,248
Units issued during the year	660,314	5,022,455
Units redeemed during the year	(2,489,991)	(16,932,807)
Units issued upon reinvestment of distributions	3,062,822	7,193,991
Closing Balance	253,713,032	252,479,887
Class B		
Opening balance	230,543,397	218,072,097
Units issued during the year	16,282,761	75,347,798
Units redeemed during the year	(23,212,460)	(62,877,663)
Units issued upon reinvestment of distributions	-	1,165
Closing Balance	223,613,698	230,543,397

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

6. CHANGES IN NET ASSETS ATTRIBUTABLE TO UNITHOLDERS (Continued)

	2010 $	2009 $
Class C		
Opening balance	11,146,022	4,618,115
Units issued during the year	582,065	7,658,444
Units redeemed during the year	(367,841)	(1,714,031)
Units issued upon reinvestment of distributions	305,276	542,888
Foreign exchange (gain)/loss on investor funds	(1,023,738)	40,606
Closing Balance	10,641,784	11,146,022
Movement in changes net assets attributable to unitholders	(821,901)	305,962
Total assets attributable to unitholders	487,146,613	494,475,268

Class A consists of unitholders who are entitled to receive the declared distribution rate. There are a number of subclasses attached to class A. These consist of the following products with varying terms:

- Flexi Account investment option;
- Fixed Term Investment option; and
- LM Savings Plan investment option.

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

Class C consist of unitholders who have invested in foreign currencies and are entitled to receive the declared distribution rate. The class C product is Non-Australian Dollar Currency Hedged Fixed Term Investment Option. This consists of various terms and currency products.

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.

Status of investment in fund

During the 2009 year, the Responsible Entity closed the Scheme to new investors and suspended withdrawals, with the exception of those approved under hardship provisions and feeder fund payments for distributions and expenses. Feeder funds are other registered managed investment schemes that have invested directly in the LM First Mortgage Income Fund. Redemptions are generally to be paid within 365 days of the investment maturity term, however, redemptions have been suspended, per the constitution, as the Responsible Entity considers the suspension of withdrawals to be in the best interest of the members of the Scheme.

At 30 June 2010, $308,295,443 (2009: $236,270,945) of redemptions had been requested by unitholders but not yet paid. Of the total requested redemptions $448,589 (2009: $5,984,668) related to requests occurring within thirty days of year end. $153,007,642 (2009: $106,607,043) had been requested more than 30 days prior to year end. Redemptions also rank behind repayment of external financing facilities as detailed in Note 2(a). Of the above, $154,839,212 (2009: $123,679,234) of redemptions had been requested by unitholders of the feeder funds.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

7. INVESTMENTS

	2010	2009
	$	$
Investment in subsidiary	1	1
	1	1

The Scheme owns 100% of the issued share capital of $1 of LM MIF Investments Pty Limited at 30 June 2009. This company is in the process of being wound up and has not traded during the period. On this basis consolidated financial statements were not prepared for the year ended 30 June 2010.

8. LOANS AND RECEIVABLES

	2010	2009
	$	$
Secured mortgage loans	556,766,225	595,631,265
Secured mortgage loans – 2nd priority	9,205,379	7,981,694
Other unsecured loans – related party	1,829,700	5,100,000
Provision for impairment	(4,800,000)	(2,667,000)
Net loans and advances	563,001,304	606,045,959

Secured mortgage loans of $9,205,379 (2009: $7,981,694) have second priority over the security held. The first priority is held by another party whom is entitled to $5,000,000 (2009: $5,000,000) of the security.

a) Aggregate amounts receivable from related parties

	2010	2009
	$	$
Directors and director-related entities - secured	7,849,604	7,669,590
Related managed investment schemes - secured	31,731,087	35,465,182
Related managed investment schemes - unsecured	1,829,700	5,100,000
	41,410,391	48,234,772

b) Maturity analysis – Secured Mortgage Loans

	2010	2009
	$	$
Less than 3 months	474,335,296	408,431,218
3-6 months	80,149,902	59,866,162
6-12 months	11,486,406	37,901,770
12-18 months	-	96,289,380
18-24 months	-	1,124,429
24-36 months	-	-
	565,971,604	603,612,959

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

8. LOANS AND RECEIVABLES (Continued)

b) Maturity analysis – Secured Mortgage Loans (Continued)

The above maturity analysis is the contractual maturity of the secured loans. However, the secured construction loans will be realised through cash flows which will occur within 5 years. The carrying values of these loans at 30 June 2010 were $164,828,848.

c) Concentration of risk

As at 30 June 2010 no individual loan was greater than 10% of net assets attributable to unitholders. (2009: nil)

For concentration of risks relating to mortgage type and geographical location refer to Note 15.

d) Provisions for impairment

The impairment loss expense relating to loans and receivables comprises:

	2010	2009
	$	$
Specific provision	3,560,000	1,540,000
Collective impairment provision	-	-
Loans written off directly in the statement of comprehensive income	4,449,816	5,106,459
Provision utilized during the period	(1,427,000)	(1,589,521)
	6,582,816	5,056,938

	2010	2009
	$	$
Specific Provision		
Opening balance	2,667,000	2,716,521
Impairment losses provided for during year	3,560,000	1,540,000
Utilisation of provisions (loans realised)	(1,427,000)	(1,589,521)
Closing balance	4,800,000	2,667,000
Collective impairment provision		
Opening balance	-	-
Impairment losses provided for during year	-	-
Closing balance	-	-
TOTAL PROVISION	4,800,000	2,667,000

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

8. LOANS AND RECEIVABLES (Continued)

d) Provisions for impairment (Continued)

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

	2010 $	2009 $
Movement in Default loans		
Gross default loans opening balance	331,473,714	101,159,653
New and increased default loans	39,849,820	268,567,327
Balances written off	(1,333,416)	(15,307)
Returned to performing or repaid	(37,095,216)	(38,237,959)
Gross default loans closing balance	332,894,902	331,473,714
Specific provision	(3,493,000)	(2,667,000)
Net default loans	329,401,902	328,806,714

At 30 June 2010, the balance of loans that were past due but not impaired was $248,106,127 (2009: $304,553,260). As per the Scheme's policy, loans are past due once they exceed 90 days overdue.

At 30 June 2010, $84,785,951 of loans were individually impaired, with a total impairment loss of $4,800,000.

Loans are secured by land, development property or completed construction property. The fair value of security over loans that are past due but not impaired at 30 June 2010 was $326,365,696 (2009: $389,017,914).

As at 30 June 2010 the Scheme was mortgage in possession of security relating to loans in default of $332.9 million (2009: $331.5 million) and had taken possession of assets offered as collateral security valued at $401 million (2009: $415.4 million).

Interest on arrears loans is suspended and not brought to account if the Responsible Entity considered that the amounts are not ultimately recoverable from the sale proceeds of the property. The amount of suspended interest at 30 June 2010 totalled $20,031,170 (2009: $6,532,157).

9. PAYABLES

	2010 $	2009 $
Foreign currency awaiting investment	195	2,242
Other payables	2,481,596	1,049,127
	2,481,791	1,051,369

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

10. INTEREST BEARING LOANS AND BORROWINGS

	2010 $	2009 $
Secured bank loan	81,014,217	133,000,000

On 4 September 2009, the Directors of the Responsible Entity of the Scheme, LM Investment Management Limited, and the Scheme's external financier negotiated extended terms for the $150 million facility that had matured. This facility agreement provided a revised facility of $128 million, being the balance of the loan at that date, with a requirement for repayments to be made quarterly with the full principal balance to be repaid by or on 30 June 2010, in priority to any redemptions.

The facility agreement required the Scheme to repay 60% of all net proceeds to the external financer, being the cash received from the realisation of assets with minimum cumulative quarterly repayment amount as detailed below:

	Minimum quarterly repayment	Reduced commitment and principal outstanding
30 November 2009	15,000,000	113,000,000
28 February 2010	15,000,000	98,000,000
31 May 2010	15,000,000	83,000,000
30 June 2010	Any remaining balance	0

The interest rate payable on the facility was BBSY + 4.50% per annum. In the event that the repayment was not made in accordance with the repayment plan above, the interest rate payable was increased to BBSY + 6.50%.

As detailed in Note 2(a), on the 1 July 2010 the Directors of the Responsible Entity of the Scheme, LM Investment Management Limited, entered into a new facility with another external financier and the facility described above was fully repaid.

The new bank agreement provides a $90 million facility for two years with an option to extend for an additional year with interest at 15% per annum increasing to 18% if the loan term is extended. In the event that the repayment is not made in accordance with the repayment plan mentioned below, the interest rate payable is increased to BBSY +5.0%.

The Scheme is also required to hold a minimum cash balance of $6 million under this facility.

The facility agreement requires the Scheme to make minimum repayments as detailed below. These minimum repayments must be made in priority to any redemptions, except for hardship provisions and feeder fund payments for investor distributions and fund expenses.

	Minimum repayment
31 December 2010	7,000,000
30 June 2011	11,000,000
31 December 2010	11,000,000
30 June 2012	$13,500,000 if facility extended or any remaining balance

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

10. INTEREST BEARING LOANS AND BORROWINGS (Continued)

In additional, where the Scheme realises assets or receives cash in settlement of secured loans it must repay to the external financier an agreed amount that varies based on each secured loan.

Where the Scheme has repaid excess of the minimum repayments required, the facility allows the Scheme to redraw funds to complete agreed development projects or establish new loans subject to prior approval from the external financier.

As at the date of this report, the Scheme is in compliance with all loan covenants in the facility agreement and the current balance of the facility at the date of this Report is $83,607,533.

The facility is secured by a fixed and floating charge over the assets of the Fund, providing Deutsche Bank, as secured lender with first priority over the assets of the Fund.

11. RELATED PARTIES

Responsible Entity

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

On 1 February 2009, the Scheme's arrangement in relation to management fees was amended. The basis of the management fee calculation remains unchanged however the revised agreement provides that LM Investment Management Limited is required to be paid up to $1 million per month for administration and fund management services, with any monthly management fee in excess of $1 million to be paid to LM Administration Pty Limited for administration services provided on behalf of LM Investment Management Limited.

Custodian

The Custodian of the Scheme is LM Investment Management 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.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

11. RELATED PARTIES (Continued)

Directors' holdings of units

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

	2010 $	2009 $
- LM Investment Management Limited	-	-
- Directors and director related entities	-	-
- Other Associates of LM Investment Management Limited	223,613,698	230,543,397

Investing activities

The Scheme may purchase and sell units in other approved schemes or investment entities operated by LM Investment Management Limited or its associates in the ordinary course of business at application and redemption prices calculated in accordance with the constitutions of those schemes. At 30 June 2010 the Scheme had no investments in other schemes operated by LM Investment Management Limited or its affiliates (2009: nil).

Other transactions with the Scheme

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

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 Limited is paid a management fee for these services directly from Scheme assets. On 1 February 2009 the Scheme's arrangement in relation to management fees was amended. The basis of the management fee calculation remains unchanged however the revised agreement provides that LM Investment Management Limited is required to be paid up to $1 million per month for administration and fund management services, with any monthly management fee in excess of $1 million to be paid to LM Administration Pty Limited for administration services provided on behalf of LM Investment Management Limited.

During the year, management fees of $8,995,455 (2009: $15,410,762) were paid or payable by the Scheme. Of these fees $8,995,455 (2009: $5,100,000) was paid or payable to LM Investment Management Limited and $0 (2009: $10,310,762) was paid or payable to LM Administration Pty Limited.

During the year, loan origination fees received from borrowers within the Scheme were $2,769,913 (2009: $4,366,378) of which nil (2009: $2,194,460) was reimbursed by the Scheme to the Responsible Entity for the administration of loan origination services.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

11. RELATED PARTIES (Continued)

Other transactions with the Scheme (Continued)

On 28 August 2008, it was resolved by the Board of Directors of the Responsible Entity, to transfer three mortgage loans to the value of $33,513,345 and the related first mortgage security to the LM Managed Performance Fund (LM MPF). There is a fixed charge over these two specific secured properties plus a floating charge over the remaining assets of LM MPF to provide security to the Scheme in the event of default by the LM MPF. This loan between the Scheme and LM MPF is interest bearing at 10%, with the interest being paid to 30 June 2010. Since 2009, LM MPF has sold one of the properties and repaid $3.9 million to the Scheme. Subsequent to the year end, the Credit Committee has agreed to extend the repayment term of the loan to 28 August 2011 and reduce the interest rate to 7%.

The Scheme has advanced funds to a related scheme, the LM Managed Performance Fund, to finance a joint venture entered into with a borrower of the Scheme. At 30 June 2010, the balance of the loan to the related Scheme was $9,563,238 (2009: $9,563,238), which is secured by first mortgage of the assets of the unrelated borrower and by a guarantee from the LM Managed Performance Fund. This loan has been subject to the normal credit approval review procedures of the Scheme and is a fully serviced loan with interest being paid monthly.

The LM MPF has second mortgages on loans that are first mortgages of the LM First Mortgage Income Fund totalling $53,631,982 (2009: $46,905,578). The LM MPF may on occasion pay development and construction costs on those related loans. As part of the normal role as second mortgagee, the related scheme will fund interest payments from time to time within approved loan facility limits. During the 30 June 2010 year, interest payments totalling $413,722 (2009: $1,903,971) were paid from the related scheme on behalf of the borrowers.

At 30 June 2008, management assigned a $5,100,000 receivable within the Scheme from LM Investment Management Limited to LM MPF. Originally, the receivable was to accrue interest at 10% and expire on 30 June 2009. Since 30 June 2009, the Board of Directors of the Responsible Entity has agreed to extend the repayment term of this receivable to 30 June 2010. The balance at 30 June 2010 was $1,829,700, however has been repaid subsequent to year end.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

11. RELATED PARTIES (Continued)

Other transactions with the Scheme (Continued)

	2010 $	2009 $
Responsible Entity remuneration received or due and receivable		
• Management fees for the year paid or payable directly from LM Administration Pty Limited	-	10,310,762
• Management fees for the year paid or payable from LM Investment Management Limited.	8,995,455	5,100,000
• Expenses including administration expenses incurred by the Responsible Entity and its associated entities, which are reimbursed in accordance with the provisions of the Constitution.	-	-
• Expenses including administration expenses incurred by LM Administration Pty Limited, which are reimbursed in accordance with the provisions of the Constitution.	879,091	960,259
• Loan origination fees received by borrowers within the Scheme that were reimbursed to the Responsible Entity for the administration of loan origination services	-	2,194,460
Custodian's remuneration		
• Custodian's fees paid by the Scheme	88,163	123,356

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

11. RELATED PARTIES (Continued)

Other transactions with the Scheme (Continued)

Balance with related parties	2010	2009
Aggregate amounts receivable from related parties by the Scheme were as follows:		
• LM Administration Pty Limited (management fees prepaid by the Scheme)*(i)*	8,200,000	6,000,000
• Australian International Investments Pty Limited *(ii)*	7,849,604	7,669,589
• LM Managed Performance Fund *(iii)*	31,357,590	41,745,359
• LM Currency Protected Australian Income Fund *(iv)*	-	100,000
Aggregate amounts payable to related parties from the Scheme were as follows:		
• John O'Sullivan *(v)*	66,984	17,794

i). These amounts are included in prepayments of $8,401,148 at 30 June 2010 (2009: $6,269,970). No amounts are payable to related parties by the Scheme. The average monthly balance of prepayments during the year was $6,183,333(2009: $7,973,684) which was non-interest bearing. Interest foregone on the above amount if calculated at the weighted average cash rate of 3.57% (2009: 4.75%) would have been $220,745 (2009: $378,750). If this revenue had been collected, the sum foregone would have been paid to LM Administration Pty Limited as management fees or reduction in change in net assets attributable to unitholders during the year.

The prepaid management fee increased due to the directors resolving to absorb an additional provision for impairment loss through a reduction of management fee charged, this resulted in an increase in prepaid management fee. This prepaid management fee will be recovered through LM Administration Pty Limited's Agreement to offset future payable management fees or through guarantee from Peter Charles Drake.

ii). Peter Charles Drake is a director and guarantor of Australian International Investment Services Pty Limited which is a joint borrower in a secured loan facility outstanding to the Scheme as at 30 June 2010 for $7,849,604 (2009: $7,669,589). This transaction was approved on an arm's length basis and is on normal terms and conditions.

iii). This amount relates to the assignment of debt of $1,829,700 (2009: $5,100,000) from LM Administration Pty Limited to LM MPF which was originally a prepayment of management fees from the Scheme to LM Administration Pty Limited. Plus the loans and receivable balance at 30 June 2010 of $29,527,890 (2009: $36,645,359).

iv). This amount relates to payments for margin calls on behalf of LM Currency Protected Australian Income Fund. This transaction was paid on normal terms and at arm's length.

v). John O'Sullivan is the beneficial owner of O'Sullivan Capital Management Limited, which has been engaged by LM Investment Management Limited to provide marketing services in New Zealand. For the year ended 30 June 2010, $121,541 (2009: $112,134) in adviser marketing commission has been earned, with $66,984 (2009:17,794) remaining payable. This engagement is on normal commercial terms and at arm's length.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

11. RELATED PARTIES (Continued)

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 2010					
LM Currency Protected Australian Income Fund	118,040,000	24.12%	10,282,468	18,917,468	8,971,025
LM Institutional Currency Protected Australian Income Fund	9,780,000	2.00%	1,237,550	1,526,550	675,503
LM Managed Performance Fund	-	-	-	-	-
LM Wholesale First Mortgage Income Fund	96,476,500	19.71%	4,767,643	2,768,443	4,769,522
LM Australian Income Fund	-	-	-	-	-
Dhani Darcy	226	0.00%	10	-	-
Total	224,296,726	45.83%	16,287,671	23,212,461	14,416,050

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 2009					
LM Currency Protected Australian Income Fund	126,675,000	25.56%	38,774,376	31,399,376	12,847,979
LM Institutional Currency Protected Australian Income Fund	10,069,000	2.03%	7,545,535	4,976,535	1,051,556
LM Managed Performance Fund	-	-	16,450,507	16,900,507	123,644
LM Wholesale First Mortgage Income Fund	94,477,300	19.06%	12,023,535	9,046,235	8,132,510
LM Australian Income Fund	-	0%	555,000	555,000	3,565
Dhani Darcy	-	0%	216	216	19
Total	**231,221,300**	**46.65%**	**75,349,169**	**62,877,869**	**22,159,273**

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

12. RECEIVABLES

	2010	2009
	$	$
Interest and distribution receivable	-	-
Mortgage interest receivable	1,285,212	1,599,427
Mortgage interest receivable – related party	-	3,132,014
Penalty interest receivable	174,998	192,525
Default management fees receivable	-	11,995,827
GST receivable	176,815	163,315
Other	31,517	213,245
	1,668,542	17,296,353

During the year, the penalty interest receivable was capitalised onto the secured mortgage loan balance. Refer Note 8 Loans and Receivables.

13. CASH AND CASH EQUIVALENTS

a) Reconciliation of cash and cash equivalents

For the purposes of the Statement of Financial Position and Statement of Cash Flows, cash and cash equivalents comprise:

	2010	2009
	$	$
- Cash at bank and in hand	1,976,709	1,154,822

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 $1,976,709 (2009: $1,154,822).

As at 30 June 2010 $388,736 (2009: $580,941) of cash at bank was held in foreign exchange margin accounts and therefore was not available for use by the Scheme.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

13. CASH AND CASH EQUIVALENTS (Continued)

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

	2010	2009
	$	$
Change in net assets attributable to unitholders	(1,127,863)	305,962
Adjustments for:		
Non cash impairment expense	6,582,816	5,056,938
Non cash interest income	(50,847,584)	(50,395,681)
Distributions to unitholders	24,770,380	39,271,910
Gains/loss on foreign exchange contracts	1,162,730	-
Gains/loss on investor funds	(1,031,253)	-
(Increase)/decrease in interest receivable	331,742	(3,257,517)
(Increase)/decrease in other receivables	1,169,064	(8,654,940)
Increase/(decrease) in payables	1,430,422	1,161,515
Net cash flows from/(used in) operating activities	(17,559,546)	16,511,813

c) Reinvestment of distributions

During the financial year, the Scheme issued $3,368,098 of units (2009: $7,738,044) as a result of reinvestment of distributions by unitholders. These transactions have not been included in the Statement of Cash Flows.

14. KEY MANAGEMENT PERSONNEL 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
Ms Francene Maree Mulder	Appointed 30 September 2006
Mr Simon Tickner	Appointed 16 December 2008
Non-executive directors	
Mr John O'Sullivan	Appointed 28 November 2007

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

14. KEY MANAGEMENT PERSONNEL DISCLOSURES (Continued)

(b) Compensation of Key Management Personnel

(i) Compensation Policies and Principles

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

(ii) Executive Directors

The Executive Directors of the Board of the Directors of LM Investment Management Limited 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.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

14. KEY MANAGEMENT PERSONNEL DISCLOSURES (Continued)

(v) *Remuneration of KMP allocated to this fund*

2010 Specified KMP	Salary & Fees	Primary Cash Bonus	Non Monetary Benefits	Post Employment Super	Post Employment Retirement Benefits	Equity	Other	TOTAL	Total performance related
	$	$	$	$	$	$	$	$	%
Drake, PC*	-	-	-	-	-	-	-	-	-
Darcy, LM**	46,501	27,654	-	5,535	-	-	-	79,690	-
Van der Hoven, E**	34,910	15,929	-	4,178	-	-	-	55,017	-
Mulder, F**	29,770	17,357	-	3,857	-	-	-	50,984	-
Tickner, S	33,088	15,929	-	4,023	-	-	-	53,040	-
O'Sullivan, J	7,143	0	-	0	-	-	-	7,143	-
	151,412	**76,869**	-	**17,593**	-	-	-	**245,874**	-

2009 Specified KMP	Salary & Fees	Primary Cash Bonus	Non Monetary Benefits	Post Employment Super	Post Employment Retirement Benefits	Equity	Other	TOTAL	Total performance related
	$	$	$	$	$	$	$	$	%
Drake, PC*	-	-	-	-	-	-	-	-	-
Darcy, LM**	25,727	2,642	-	2,066	-	-	-	30,435	-
Van der Hoven, E**	18,828	1,996	-	1,649	-	-	-	22,473	-
Mulder, F**	16,096	1,996	-	1,644	-	-	-	19,736	-
Tickner, S	13,875	1,346		1,321				16,542	
O'Sullivan, J	3,846	-	-	-	-	-	-	3,846	-
	78,372	**7,980**	-	**6,680**	-	-	-	**93,032**	-

* Peter Charles Drake is the beneficial owner of 100% of the ordinary shares of the Responsible Entity. No salary and wages are paid to Peter Drake directly from the company or any of the schemes. ** As executives of the Responsible Entity, LM Darcy, E van der Hoven and F Mulder are entitled to a termination benefit that is payable on cessation of employment or a significant change in ownership of the company. No amount has been reflected in the above disclosures in relation to this potential future benefit.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

14. KEY MANAGEMENT PERSONNEL DISCLOSURES (Continued)

Compensation by category: Key Management Personnel

	2010	2009
	$	$
Short term	228,281	86,352
Post employment	17,593	6,680
Other long term	-	-
Termination benefits	-	-
Equity based payment	-	-
Other	-	-
	245,874	93,032

Loans to Specified KMP

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

(c) Other Transactions and Balances with Specified KMP

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

15. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

a) Financial Risk Management Objectives, Policies, and Processes

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

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

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

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

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

15. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

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

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

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

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

b) Credit Risk

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

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

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

The Scheme minimizes credit risk by:

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

As at year end, 61% (2009: 59%) of the mortgage loans were secured by a combination of completed development projects (industrial 14% (2009: 13%) and residential 41% (2009: 38%) and land 6% (2009: 8%)), 18% (2009: 26%) were secured by commercial property and 21% (2009: 15%) of the mortgage loans were secured on construction and development projects in the residential sector.

The carrying amount of renegotiated loans which would have been past due or impaired at 30 June 2010 was $64,366,100.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

15. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Risk concentrations of credit risk

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

	2010	2009
Within 40km of Sydney CBD	2.53%	9.64%
New South Wales – Other	26.30%	22.33%
Within 40km of Melbourne CBD	3.56%	6.33%
Victoria – Other	2.68%	0.71%
Queensland – Other	55.99%	52.09%
Canberra – Other	1.39%	1.35%
Western Australia	6.92%	7.02%
Tasmania	0.63%	0.53%
	100.00%	100.00%

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

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

Credit quality of mortgage loans

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

As at 30 June 2010 the Scheme was mortgage in possession of security relating to loans in default of $332.9 million (2009: $331.5 million) and had taken possession of assets offered as collateral security valued at $401 million (2009: $$415.4million).

c) Liquidity risk

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

The nature of the investments entered into by the Scheme commands that liquidity be managed cautiously and aligned to the redemptions policy outlined within the constitution of the Scheme. At 30 June 2010, the redemptions requested from unitholders but not paid was $153,456,231 (2009: $112,591,711). An additional $156,019,147 (2009: 123,679,234) of redemptions had been requested by unitholders of the feeder funds – refer to Note 6.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

15. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

c) Liquidity risk (Continued)

During the 2009 year, the Responsible Entity closed the Scheme to new investors and suspended withdrawals, with the exception of those approved under hardship provisions and feeder fund payments for distributions and expenses. Feeder funds are other registered managed investment schemes that have invested directly in the LM First Mortgage Income Fund. Redemptions are generally to be paid within 365 days of the investment maturity term, however, redemptions have been suspended, per the constitution, as the Responsible Entity considers the suspension of withdrawals to be in the best interest of the members of the Scheme.

At 5 October 2010, $160,271,420 of redemptions had been requested by unitholders but not yet paid. Redemptions also rank behind repayment of external financing facilities as detailed in Note 2(a).

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

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

Maturity Analysis of Financial Liabilities

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

Net assets attributable to unitholders mature over the following periods:

Period from 30 June 2010	Value
Due and payable*	155,401,717
< 12 months	418,343,610
12-24 months	33,132,319
24-36 months	1,660,387
36-48 months	284,348
>48 months	147,673
Total	608,970,054

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

15. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

* This balance represents redemptions requested but not paid at 30 June 2010 of $155,401,717 (2009: $112,591,711).

The secured bank loan is repayable by 30 June 2012, as detailed in Note 2(a) and 10. When drawn, the loan is secured by the assets of the Scheme.

d) Market risk

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

Interest rate risk

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

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

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

15. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

SCHEME

	Note	Weighted average interest rate		Floating Interest Rate		Fixed interest rate: Securities contracted to mature in less than 1 year		Fixed interest rate: Securities contracted to mature in more than 1 year but less than 5 years		Total	
		2010 %	2009 %	2010	2009	2010	2009	2010	2009	2010	2009
Cash and cash equivelants	13(a)	3.57	4.75	1,976,709	1,154,822	-	-	-	-	1,976,709	1,154,822
Secured mortgage loans (gross)	8	9.36	9.52	-	-	565,971,604	506,199,148		97,414,080	565,971,604	603,612,957
Unsecured loan	8	10.0	10.0	-	-	1,829,700	5,100,000	-	-	1,829,700	5,100,000
Loan facility	10	9.39	8.36	(81,014,217)	(133,000,000)	-	-	-	-	(81,014,217)	(133,000,000)
Total				(79,037,508)	(131,845,178)	567,801,304	511,299,148	-	97,414,080	488,763,796	474,184,591

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

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

15. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

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

The sensitivity of the Statement of Comprehensive Income is the effect of the assumed changes in interest rates on the interest income for one year, based on the financial instruments held at 30 June 20010.

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

2010

	Change in basis points		Sensitivity of interest income ($000's)	
	Increase	*Decrease*	*Increase*	*Decrease*
	50	50	2,825	2,825
Financial Instruments	100	100	5,650	5,650

2009

	Change in basis points		Sensitivity of interest income ($000's)	
	Increase	*Decrease*	*Increase*	*Decrease*
	50	50	3,124	3,124
Financial instruments	100	100	6,247	6,247

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

The fair value of forward exchange contracts held at 30 June 2010 was $17,451 (2009: $6,370).

The nominal Australian dollar value of forward exchange contracts held at 30 June 2010 was $10,266,314 (2009: $11,253,138).

The table below indicates the currencies to which the Scheme had significant exposure at 30 June 2010 on its monetary assets and liabilities and forecast cash flows. The analysis calculates the effect of a reasonably possible movement of the currency rate against the Australian Dollar on the Statement of Comprehensive Income, with all other variables held constant.

Foreign currency
Investments in the fund are hedged in the relevant currency against Australian dollar currency movements. The fund manages foreign currency risk through the use of forward foreign exchange contracts (FFEC).

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

15. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

The FFECs are facilitated by several banking firms. This reduces currency exposure to the fund and investors. The below table is only applicable if the FFEC facilitator is unable to meet its obligation and the fund therefore seeks an alternative party to transact the FFEC.

Accounting Assumptions- Variability of foreign currency
The sensitivity is based on the volatility of changes in global currency.

Currency	2010				
	AUD equivalent in exposure by currency (000's)	Change in currency rate in %		Effect on net assets attributable to unitholders (000's)	
		Increase	*Decrease*	*Increase*	*Decrease*
CAD	14	10	10	1	2
EUR	1,432	10	10	130	159
GBP	2,139	10	10	194	238
HKD	8	10	10	1	1
JPY	140	10	10	13	16
NZD	4,720	10	10	445	505
SGD	212	10	10	19	24
THB	33	10	10	3	4
TRY	187	10	10	17	21
USD	1,381	10	10	126	153

Currency	2009				
	AUD equivalent in exposure by currency (000's)	Change in currency rate in %		Effect on net assets attributable to unitholders (000's)	
		Increase	*Decrease*	*Increase*	*Decrease*
EUR	1,716	10	10	172	172
GBP	2,725	10	10	273	273
NZD	4,523	10	10	452	452
TRY	301	10	10	30	30
USD	1,556	10	10	156	156
HKD	182	10	10	18	18
SGD	217	10	10	22	22
THB	33	10	10	3	3

Equity Risk
The Scheme is not subject to equity risk at 30 June 2010.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

16. FAIR VALUES OF FINANCIAL INSTRUMENTS

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

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

Disclosed below is the fair value of the Scheme's financial instruments.

The following methods and assumptions are used to determine the net fair values of financial assets and liabilities.

Fair value: The Scheme uses various methods in estimating the fair value of a financial instrument. The methods comprise:
Level 1 – the fair value is calculated using quoted prices in active markets;
Level 2 – the fair value is estimated using inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices);
Level 3 – the fair value is estimated using inputs for the asset or liability that are not based on observable market data.

	Fair Value				**Carrying Amount**
2010	**Level 1 $**	**Level 2 $**	**Level 3 $**	**Total $**	**$**
Financial Assets					
Forward currency contracts	-	17,451	-	**17,451**	**17,451**
Total Financial Assets	-	17,451	-	**17,451**	**17,451**
Financial Liabilities					
Forward currency contracts	-	-	-	-	-
Total Financial Liabilities	-	-	-	-	-

The fair values of currency exchange contracts (forwards and swaps) are calculated by reference to current exchange rates for contracts with similar maturity and risk profiles.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2010

17. COMMITMENTS AND CONTINGENCIES

There are no material contingent assets and liabilities or commitments as at 30 June 2010

18. EVENTS AFTER THE STATEMENT OF FINANCIAL POSITION DATE

No significant events have occurred since balance date which would impact on the financial position of the Scheme disclosed in the balance sheet as at 30 June 2010 or on the results and cash flows of the Scheme for the year ended on that date, other than those detailed below:

(a) Negotiation of new loan facility

On 1 July 2010, the Directors of the Responsible Entity, LM Investment Management Limited, of the Scheme entered into a new loan facility another external financier and fully repaid the existing external financier. The new bank agreement provides a $90 million facility for two years with an option to extend for an additional year. A condition of the new loan facility is repayment of the facility in line with the agreed repayment plan, as disclosed in Note 2(a).

The interest rate payable on the new facility is 15% per annum. In the event that the repayment is not made in accordance with the repayment plan mentioned above, the interest rate payable is increased to BBSY +5.0%.

(b) Status of distributions payable

As at 30 June 2010, $2,127,691 of distributions payable related to distributions that were required to be paid under the Scheme's Constitution prior to 30 June 2010. As at 5 October 2010, these distributions remain payable. In addition $1,627,770 of distributions payable as at 5 October 2010 that were required to be paid under the Scheme's Constitution remain payable.

LM FIRST MORTGAGE INCOME FUND

DIRECTORS' DECLARATION

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

a) The financial statements and notes of the Registered Scheme set out on pages 8 to 48 are in accordance with the *Corporations Act 2001*, including:

(i) complying with Accounting Standards and the Corporation Regulations 2001; and

(ii) giving a true and fair view of the Scheme's financial position as at 30 June 2010, and of its performance, as represented by the results of its operations and its cash flows for the financial year ended on that date.

(iii) the financial statements and notes to the financial statements are prepared in compliance with the International Financial Reporting Standards as made by the International Accounting Standards Board.

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
6 October 2010

ERNST & YOUNG

1 Eagle Street
Brisbane QLD 4000 Australia
GPO Box 7878 Brisbane QLD 4001

Tel: +61 7 3011 3333
Fax: +61 7 3011 3100
www.ey.com/au

Independent auditor's report to the unitholders of LM First Mortgage Income Fund

Report on the Financial Report

We have audited the accompanying financial report of LM First Mortgage Income Fund ('the Scheme'), which comprises the statement of financial position as at 30 June 2010, and the statement of comprehensive income, statement of changes in net assets attributable to unitholders and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration.

Directors' Responsibility for the Financial Report

The directors of the responsible entity of the Scheme are responsible for the preparation and fair presentation of the financial report in accordance with the Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Act 2001*. This responsibility includes establishing and maintaining internal controls relevant to the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 2, the directors also state that the financial report, comprising the financial statements and notes, complies with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Auditor's Responsibility

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

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

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

Independence

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

ERNST & YOUNG

Auditor's Opinion

In our opinion:

1. the financial report of LM First Mortgage Income Fund is in accordance with the *Corporations Act 2001*, including:
   (i) giving a true and fair view of the financial position of LM First Mortgage Income Fund at 30 June 2010 and of its performance for the year ended on that date; and
   (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*.

2. the financial report also complies with International Financial Reporting Standards as issued by the International Accounting Standards Board..

Ernst & Young

Ernst & Young

P McLuskie

Paula McLuskie
Partner
Brisbane
6 October 2010

AUSTRALIAN SECURITIES & INVESTMENTS COMMISSION
020500688

Australian Securities & Investments Commission

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

Copy of financial statements and reports

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

Company/scheme details

Company/scheme name
LM FIRST MORTGAGE INCOME FUND

ACN/ARBN/ARSN/PIN/ABN
089 343 288

Lodgement details

An image of this form will be available as part of the public register.

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

ASIC registered agent number (if applicable)

Firm/organisation
LM INVESTMENT MANAGEMENT LIMITED

Contact name/position description
GRANT FISCHER / CFO

Telephone number (during business hours)
(07) 55 84 4700

Email address (optional)

Postal address
PO BOX 485

Suburb/City
SURFERS PARADISE

State/Territory
QLD

Postcode
4217

Australian Securities & Investments Commission Service Centre 5 SEP 2011

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)
- [x] A registered scheme (B)
- [ ] Amendment of financial statements or directors' report (company) (C)
- [ ] Amendment of financial statements or directors' report (registered scheme) (D)

See Guide for definition of large and small proprietary companies.

- [ ] 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 (only for financial year ending 01/07/2010 or earlier) (K)

Dates on which financial year begins and ends

Financial year begins 01/07/10 [D D] [M M] [Y Y] to Financial year ends 30/06/11 [D D] [M M] [Y Y]

2 Details of large proprietary company

See Guide for definition of large and small proprietary companies.

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

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

[ ]

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

[ ]

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

[ ]

D How many members does the large proprietary company have?

[ ]

3 Auditor's report

Were the financial statements audited?

☑ Yes

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

☐ No

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

☐ Yes ☐ No

4 Details of current auditor or auditors

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

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

[ ]

Family name [ ] Given name [ ]

or

Company name

ERNST + YOUNG

ACN/ABN

752 881 72749

or

Firm name (if applicable)

[ ]

4 Continued... Details of current auditor or auditors

Office, unit, level
WATER FRONT PLACE

Street number and Street name
1 EAGLE ST

Suburb/City
BRISBANE

State/Territory
QLD

Postcode
4000

Country (if not Australia)

Date of appointment
[D D]/[M M]/[Y Y]

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

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

Family name

Given name

or

Company name

ACN/ABN

or

Firm name (if applicable)

Office, unit, level

Street number and Street name

Suburb/City

State/Territory

Postcode

Country (if not Australia

5 Statements and reports to be attached to this form

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

- Statement of comprehensive income, may also include a separate income statement for the year
- Statement of financial position as at the end of the year
- Statement of cash flows for the year
- Statement of changes in equity
- If required by accounting standards — the consolidation statements of comprehensive income/income statement, financial position, cash flows and changes in equity.

Notes to financial statements (see s295(3))

- Disclosures required by the regulations
- Notes required by the accounting standards
- Any other information necessary to give a true and fair view (see s297)

The signed directors' declaration about the statements and notes (see s295(4))

The signed directors' report for the year, including the copy of the auditor's independence declaration (s298 to s300A)

Signed auditor's report required under s308 and s314

Concise report (if any) (see s314)

Signature

See Guide for details of signatory.

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

Name

LISA DARCY

Signature

Capacity

[x] Director

[ ] Company secretary

Date signed

1 6 / 0 9 / 1 1
[D D] [M M] [Y Y]

Lodgement

Send completed and signed forms to:
Australian Securities and Investments Commission,
PO Box 4000, Gippsland Mail Centre VIC 3841.

Or lodge the form electronically by:

- visiting the ASIC website www.asic.gov.au
- using Standard Business Reporting enabled software. See www.sbr.gov.au for more details.

For help or more information

Telephone 1300 300 630
Email info.enquiries@asic.gov.au
Web www.asic.gov.au

LM FIRST MORTGAGE INCOME FUND

ABN: 66 482 247 488

Annual Report

For the year ended 30 June 2011

LM FIRST MORTGAGE INCOME FUND

ABN: 66 482 247 488

Annual Report – 30 June 2011

Contents

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

LM FIRST MORTGAGE INCOME FUND

Directors' Report

DIRECTORS' REPORT

The directors of LM Investment Management Limited, the Responsible Entity of the LM First Mortgage Income Fund, present their report of the LM First Mortgage Income Fund ("the Scheme") for the year ended 30 June 2011. The directors' report is not part of the financial report.

DIRECTORS

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

Name	Period of directorship
Mr Peter Charles Drake	Appointed 31 January 1997
Ms Lisa Maree Darcy	Appointed 15 September 2003
Mr Eghard van der Hoven	Appointed 22 June 2006
Ms Francene Mulder	Appointed 30 September 2006
Mr John O'Sullivan	Appointed 27 November 2007
Mr Simon Tickner	Appointed 16 December 2008

PRINCIPAL ACTIVITIES

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

There were no significant changes in the nature of the Scheme's activities during the year.

The Scheme did not have any employees during the year.

SCHEME INFORMATION

The Scheme is an Australian registered scheme and was constituted on 13 April 1999. The Responsible Entity of LM First Mortgage Income Fund is LM Investment Management Limited, who has been the Responsible Entity since registration of the Scheme.

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

REVIEW OF RESULTS AND OPERATIONS

Results

During the year, the Scheme continued to invest in existing registered first mortgage loans secured by property in Australia.

The Responsible Entity determined from 3 March 2009 that the Scheme would not accept any applications for investment from any person who was not an existing member of the Scheme. The Scheme still accepts applications for investment from any person who is an existing member of the Scheme by way of rollover of investment term, including deemed applications as part of any reinvestment of distributions.

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

LM FIRST MORTGAGE INCOME FUND

Directors' Report

REVIEW OF RESULTS AND OPERATIONS (Continued)

The resultant tightness in credit markets following the global financial crisis ("GFC") continues to influence timing in relation to the expected realisation of first mortgage assets due to borrower difficulties in obtaining finance and the accompanied slowdown in sales of property assets. Therefore the manager has determined that the Scheme remains closed to new investor applications and investor redemptions with the exception of approved hardship withdrawals.

On 1 July 2010, the directors were able to successfully refinance the Scheme's previous facility with the Commonwealth Bank of Australia. This was the first important milestone in realising the ultimate strategy for the Scheme.

The new financing facility with Deutsche Bank, allows the realisation of assets in a more timely and composed manner and the repayment of the facility is linked to the sales of assets rather than a fixed monthly repayment amount. In addition to this, the directors have renegotiated, in June 2011, a more favourable repayment schedule in order to maximise the available cash in the Scheme, which will greatly assist the Scheme achieve its four step action plan which is detailed below.

The strategy for the Scheme over the course of the GFC was to focus on the preservation of the unit price.

Following feedback from investors and advisers, during the year, the Responsible Entity announced a revised liquidity strategy to accelerate the rates of sales of identified assets. This was in order to commence the four step action plan below:

1. Catch up on payments of declared distributions and other Scheme expenses;
2. Announce a managed redemptions plan;
3. Re-lending into the current market in order to enhance returns; and
4. Re-open the Scheme to new investors.

As mentioned above, the Responsible Entity announced a liquidity strategy that identified certain completed assets which were to be actively marketed and sold. The cash proceeds from the sales campaign are to be applied to the four step action plan. Other specific assets were selected to remain in the Scheme as in the opinion of the directors they represent opportunities for growth over the medium to longer term. Subsequent to balance date, the Scheme has commenced step one and has now made two payments towards the catch-up program relating to distributions accrued for February and March 2010.

The Australian property market has performed well in comparison to other developed countries during the course of the GFC (in particular the affordable residential sectors), however some sectors of the market remain affected by the continued lack of credit in the marketplace, hence seeing a slowness continue in the rate of sales and some discounting apply in order for property sellers to realise cash.

During the course of the accelerated sales and marketing campaign, the manager accepted sales prices which have resulted in the fluctuation of the unit price. After assessment of this market evidence, the directors are of the opinion that some additional provisions were required in the accounts in order to reflect these values.

Importantly, these additional provisions do not represent actual bad debts which have been written off but the Responsible Entity's expectation as to the market value of the underlying securities held by the Scheme. Included within this additional provision is actual debts written off during the year of $13.25 million (3.10% of the loan balance at 30 June 2011). The market will ultimately determine the value of the extent of the provision required to be utilised once the properties have been sold and settled. The assets which have been retained by the Scheme may provide outperformance over the medium to longer term (particularly those in the retirement sector) and in fact see the reversal of some of these provisions.

LM FIRST MORTGAGE INCOME FUND

Directors' Report

REVIEW OF RESULTS AND OPERATIONS (Continued)

The unit price of the Scheme as at 16 September 2011 is 80 cents (2010: $1.00) due to a total provision raised for realised and unrealised losses of 20 cents per unit.

It should be noted that as at the date of this report only 5 cents of the total 20 cents has been realised, the additional provision of 15 cents has been provided and considers the Responsible Entity's expectation as to the current market value of the securities held by the Scheme. Should market conditions improve this additional provision may not be fully utilised by the Scheme.

The manager has significant resources in-house dedicated to the overall asset realisation programme and each individual first mortgage asset has a managed exit strategy. All non-construction assets are currently available for sale and the manager expects to continue to realise proceeds from these assets in an orderly fashion over the coming twelve months and beyond.

The Directors believe that this should allow, over time, the Scheme to continue its principal activity of investing in new registered first mortgages and cash within the Australian property market and provide investors with rates of return with the appropriate risk return margin over cash with a stable unit price.

The change in net assets attributable to the unitholders of the Scheme is presented in the Statement of Comprehensive Income. Net loss attributable to unitholders for the year ended 30 June 2011 was $77,418,896 (2010: profit of $23,507,438).

Distributions to unitholders declared during the year totalled $14,295,925 (2010: $24,770,380).

Total assets under management were $454,724,799 as at 30 June 2011 (2010: $575,066,439). Investor funds under management decreased during the year by $104,824,211 (2010: decreased by $7,328,655). Funds under management invested by related managed investment schemes in LM FMIF decreased by $13,222,693 (2010: decreased by $6,929,699) to $210,378,005 (2010: $223,613,698).

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

	30 June 2011	30 June 2010
	$	$
Net operating income/(loss) before distributions	(77,418,896)	23,507,438
Financing costs: Distributions to unitholders	(14,295,925)	(24,770,380)
(Increase) / decrease in net assets attributable to unitholders	91,714,821	1,262,942
Net profit/(loss)	-	-

UNITHOLDER FUNDS

There were 476,355,743 units on issue at 30 June 2011 (2010: 487,146,613). During the year 12,180,254 of units were issued by the Scheme (2010: 20,893,238) and 24,218,932 of units were withdrawn (2010: 26,070,292).

SCHEME ASSETS

At 30 June 2011, the Scheme held assets to a total value of $454,724,799 (2010: $575,066,439). The basis for valuation of assets is disclosed in Note 2 to the financial statements.

LM FIRST MORTGAGE INCOME.FUND

Directors' Report

FEES PAID TO THE RESPONSIBLE ENTITY AND ASSOCIATED COMPANIES

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

	2011	2010
	$	$
• Management fees paid or payable directly to LM Administration Pty Ltd	10,997,188	8,995,455
• Expenses incurred by the Responsible Entity and its associated entities which are reimbursed in accordance with the provisions of the Scheme's Constitution, including administration and custodian fees	791,164	879,091
• Loan management fees paid to the Responsible Entity for loan management and receivership services provided by the Responsible Entity on behalf of the Scheme in replacement of appointing external receivers. These fees are charged directly to the borrower to facilitate future possible recovery.	5,381,516	-

SIGNIFICANT CHANGES IN THE STATE OF AFFAIRS

In the opinion of the directors, there were no significant changes in the state of affairs of the Scheme that occurred during the financial year under review that are not otherwise disclosed in this report.

SIGNIFICANT EVENTS AFTER THE STATEMENT OF FINANCIAL POSITION DATE

Other than the matters disclosed in Note 18 of the financial report there has been no matter or circumstance that has arisen since the end of the financial year that has significantly affected, or may affect, the Scheme's operations in future financial years, the results of those operations of the Scheme's state of affairs in future years.

LIKELY DEVELOPMENTS AND EXPECTED RESULTS

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

LM FIRST MORTGAGE INCOME FUND

Directors' Report

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 Limited or the auditors of the Scheme. Provided the officers of LM Investment Management Limited 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 8.

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

Lisa Darcy
Director
Gold Coast

16 September 2011

ERNST & YOUNG

1 Eagle Street
Brisbane QLD 4000 Australia
GPO Box 7878 Brisbane QLD 4001

Tel: +61 7 3011 3333
Fax: +61 7 3011 3100
www.ey.com/au

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

In relation to our audit of the financial report of LM First Mortgage Income Fund, for the financial year ended 30 June 2011, to the best of my knowledge and belief, there have been no contraventions of the auditor independence requirements of the *Corporations Act 2001* or any applicable code of professional conduct.

Ernst & Young

Ernst & Young

P McLuskie

Paula McLuskie
Partner
Brisbane
16 September 2011

LM FIRST MORTGAGE INCOME FUND

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 30 June 2011

	Notes	30 June 2011 $	30 June 2010 $
Income			
Interest revenue – mortgage loans		35,604,341	54,533,895
Interest revenue – cash assets		162,848	100,695
Realised foreign exchange gain on investor funds		37,375	1,056,978
Unrealised foreign exchange gain on investor funds		1,134,069	-
Unrealised foreign exchange gain on foreign exchange contracts		16,240	17,451
Total revenue and other income		36,954,873	55,709,019
Expenses			
Management fees	11	10,997,188	9,131,818
Finance costs	4(a)	14,072,789	12,252,878
Custodian fees		112,324	88,163
Advisor commissions		2,090,475	2,133,181
Impairment losses on mortgage loans	8(d)	84,873,703	6,582,816
Unrealised foreign exchange losses on investor fund		-	25,725
Realised loss on foreign exchange contracts		1,338,500	1,180,181
Legal fees		407,260	58,174
Other expenses	4(b)	481,530	748,645
Total expenses excluding distributions to unitholders		114,373,769	32,201,581
Net profit/(loss) before distributions to unitholders		(77,418,896)	23,507,438
Distributions paid/payable to unitholders	3(a)	(14,295,925)	(24,770,380)
Net profit/(loss) after distributions to unitholders		(91,714,821)	(1,262,942)
Other comprehensive income		-	-
Changes in net assets attributable to unitholders		(91,714,821)	(1,262,942)
Income tax expense		-	-
Changes in net assets attributable to unitholders after income tax expense		(91,714,821)	(1,262,942)

LM FIRST MORTGAGE INCOME FUND

STATEMENT OF FINANCIAL POSITION

As at 30 June 2011

	Note	30 June 2011 $	30 June 2010 $
ASSETS			
Cash and cash equivalents	13(a)	18,475,447	1,976,709
Receivables	12	1,753,449	1,669,826
Prepayments	11	8,656,894	8,401,148
Investments	7	-	1
Fair value of forward exchange contracts		33,691	17,451
Loans and receivables	8	425,805,318	563,001,304
TOTAL ASSETS		454,724,799	575,066,439
LIABILITIES			
Payables	9	3,702,723	2,618,154
Interest bearing loans and borrowings	10	62,399,788	81,014,217
Distributions payable	3(a)	6,434,965	4,422,534
Total liabilities excluding net assets attributable to unitholders		72,537,476	88,054,905
NET ASSETS	6	382,187,323	487,011,534
Represented by:			
Net assets attributable to unitholders (calculated in accordance with IFRS)		382,187,323	487,011,534

LM FIRST MORTGAGE INCOME FUND

STATEMENT OF CHANGES IN NET ASSETS ATTRIBUTABLE TO UNITHOLDERS

For the year ended 30 June 2011

TOTAL	2011 $	2010 $
Opening balance	487,011,534	494,475,268
Units issued during the year	81,549	17,525,140
Units redeemed during the year	(24,184,932)	(26,070,292)
Units issued on reinvestment of distributions	12,098,705	3,368,098
Transfers to and from the statement of comprehensive income	(91,714,821)	(1,262,942)
Foreign exchange (gain)/loss on investor funds	(1,104,712)	(1,023,738)
Closing Balance	382,187,323	487,011,534

LM FIRST MORTGAGE INCOME FUND

STATEMENT OF CASH FLOWS

For the year ended 30 June 2011

	Notes	30 June 2011 $	30 June 2010 $
Cash flows from operating activities			
Interest and distributions received		5,006,959	8,508,222
Management fees paid		-	(12,000,000)
Other operating expenses		(614,903)	(2,474,764)
Other income received		-	2,124,736
GST and withholding tax (paid)/received		-	(2,098,179)
Finance costs paid		(15,144,105)	(11,619,561)
Net cash inflow/(outflow) from operating activities	13(b)	(10,752,049)	(17,559,546)
Cash flows from investing activities			
Payments for secured mortgage loans		(15,897,472)	(15,461,041)
Receipts from settled mortgage loans		62,313,149	114,763,275
Net cash inflow/(outflow) from investing activities		46,415,677	99,302,234
Cash flows from financing activities			
Repayment of borrowings		(81,014,217)	(51,985,783)
Proceeds from new facility		89,100,000	-
Repayment of new facility		(26,700,212)	-
Cash paid on realisation of foreign exchange contracts		-	(1,180,181)
Receipts from the issue of units		70,000	3,606,995
Distributions paid		-	(5,291,540)
Payment for redemption of units		(620,461)	(26,070,292)
Net cash inflow/(outflow) from financing activities		(19,164,890)	(80,920,801)
Net increase/(decrease) in cash and cash equivalents		16,498,738	821,887
Cash and cash equivalents at beginning of the year		1,976,709	1,154,822
Cash and cash equivalents at the end of the year	13(a)	18,475,447	1,976,709

LM FIRST MORTGAGE INCOME FUND

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011

1. CORPORATE INFORMATION

The financial report of LM First Mortgage Income Fund ("the Scheme") for the year ended 30 June 2011 was authorised for issue in accordance with a resolution of the directors of the Responsible Entity on 16 September 2011.

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

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

The nature of the operations and principal activities of the Scheme are described in the Directors' Report.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

a) Basis of accounting

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

The financial statements have been prepared under the historical cost convention, except for financial assets and financial liabilities held at fair value through profit or loss, that have been measured at fair value.

The statement of financial position 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*. All balances are expected to be recovered or settled within twelve months, except for loans and receivables and net assets attributable to unitholders. The amount expected to be recovered or settled within twelve months in relation to the balances cannot be reliably determined.

The financial report is presented in Australian Dollars ($).

Statement of Compliance

The financial statements have been prepared in accordance with the Australian Accounting Standards as issued by the Australian Accounting Standards Board and International Financial Reporting Standards as issued by the International Accounting Standards Board.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

a) Basis of accounting (Continued)

Going Concern

The financial statements have been prepared on the basis the Scheme is a going concern. During the year, Responsible Entity entered into a facility with an external financier on behalf of the Scheme that provides a facility of $90 million for two years with an option to extend for an additional year, of which $63 million was drawn on 30 June 2011.

The facility agreement requires the Scheme to make minimum repayments in priority to any redemptions, except for hardship provisions and feeder fund payments for investor distributions and fund expenses. In addition, where the Scheme realises assets or receives cash in settlement of secured loans it must repay to the external financier an agreed amount that varies based on each secured loan.

During the year, the directors of the Responsible Entity agreed an amendment to the facility that provides for $7.5 million of repayments from the settlement of secured loans made in June 2011 to be available to complete development projects. As at the date of this report $7.5 million of these funds remain available to the Scheme. See note 10 for details of the facility.

As a result of disruptions following the global financial crisis, there is significant volatility in the financial and property markets, and there has been uncertainty as to the Scheme's ability to access funding. This resulted in the Responsible Entity closing the Scheme in 2009 to new investors and suspending withdrawals, with the exception of those withdrawals approved under hardship provisions and feeder fund payments for distributions and expenses allowed under the facility agreement. From 1 January 2011 distributions were also suspended.

Since the year end the Scheme has commenced paying outstanding distributions and the Responsible Entity is considering options for a managed redemption plan for those investors with a redemption request lodged. The directors must also ensure that they protect those investors who wish to remain invested in the Scheme. The payment of redemptions is dependent on the ability of the Scheme to realise its loans and receivables, the timing of which in the current market remains uncertain. This uncertainty may impact the timing of payment of redemption requests from unitholders.

The directors believe the Scheme will be able to meet its obligations to unitholders and that the Scheme will be able to realise its loans and receivables in the normal course of business as a going concern at the amounts stated. On this basis the directors believe the Scheme is a going concern and hence the financial report does not include any adjustments relating to the recoverability and classification of recorded asset amounts or to the amounts and classification of liabilities that might be necessary should the Scheme not continue as a going concern.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

b) New accounting standards and interpretations

Australian Accounting Standards and Interpretations that have recently been issued or amended but are not yet effective have not been adopted by the Scheme for the annual reporting period ended 30 June 2011. The impact of these standards and interpretations has been assessed and to the extent applicable to the Scheme are discussed below. Standards and Interpretations that are not expected to have a material impact on the Scheme have not been included.

AASB 9 *Financial Instruments* and related amendment AASB 2009-11

AASB 9 applies to annual reporting periods beginning on or after 1 January 2013 and will therefore apply to the Scheme from 1 July 2013. The Scheme does not intend to early adopt AASB 9 as permitted by the standard, and the actual impact on initial application will depend on certain elections as disclosed below.

AASB 9 requires all financial instruments to be measured at fair value unless the criteria for amortised cost are met. The application of the standard is not expected to change the measurement basis of any of the Scheme's current financial instruments, however, AASB 9 allows the Scheme to elect to present gains and losses on equity securities through other comprehensive income, which may impact the presentation of these gains and losses. The impact of the standard may also change if the nature of the Scheme's activities or investments changes prior to initial application.

c) Significant accounting judgements, estimates and assumptions

(i) Significant accounting judgements

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

(ii) Significant accounting estimates and assumptions

The carrying amounts of certain assets and liabilities are often determined based on estimates and assumptions of future events. The key estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of certain assets and liabilities within the next annual reporting period are:

a. Allowance for impairment loss on loans and receivables

The Scheme determines whether loans are impaired on an ongoing basis. This requires an estimation of the value of future cash flows through a "on completion" valuation or the property based on an "as is" valuation.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

c) **Significant accounting judgements, estimates and assumptions (continued)**

b. Fair value of financial instruments

When the fair value of financial assets and financial liabilities recorded in the Statement of Financial Position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values.

The judgments include considerations of liquidity and model inputs such as credit risk (both own and counterparty's), correlation and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments. The models are calibrated regularly and tested for validity using prices from any observable current market transactions in the same instrument (without modification or repackaging) or based on any available observable market data.

d) **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 Statement of Cash Flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

e) **Distribution income**

Distribution income is recognised when the unitholders' right to receive the payment is established.

f) **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.

g) **Default management fees**

Income from default management fees is recognised in line with the executed agreement with the borrower when an event of default occurs.

h) **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.

i) **Fees, commissions and other expenses**

Except where included in the effective interest calculation (for financial instruments carried at amortised cost), fees and commissions are recognised on an accrual basis. Audit and compliance fees are included with 'other expenses' and are recorded on an accrual basis.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

j) Finance costs

Interest on borrowings is recognised in the statement of comprehensive income 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.

k) Financial Instruments

Financial instruments in the scope of AASB 139 *Financial Instruments: Recognition and Measurement* are classified as either financial assets and financial liabilities at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale investments or other financial liabilities 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 Scheme 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) Fair value of financial assets and liabilities through profit and loss

Financial assets held for trading included forward exchange contracts. These assets are acquired principally for the purpose of mitigating the risk of movements in the value of non-Australian Dollar investor funds and facilitating forecasting of future cash flows. During the period, all derivatives are classified as held for trading. Derivative financial instruments entered into by the Scheme do not meet the hedge accounting criteria as defined by AASB139. Consequently, hedge accounting is not applied by the Scheme in the 2011 financial year.

ii) Loans and receivables

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

Loans and receivables are assessed for impairment at each reporting period. An allowance is made for credit losses when there is objective evidence that the Scheme will not be able to collect the loans and 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 statement of comprehensive income.

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

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

k) **Financial Instruments (Continued)**

ii) Loans and receivables (Continued)

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.

Where possible, the Fund seeks to restructure loans to have loans fully performing, however the fund will take possession of the collateral where necessary. The renegotiation may involve extending payment terms and arrangement of new loan conditions. Once the terms have been renegotiated any impairment is measured the same way as performing loans. The renegotiated loans continue to be assessed individually and collectively for impairment.

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

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

l) **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.

m) **Payables**

Payables are carried at amortised cost and represent liabilities for goods and services provided to the Scheme prior to the end of the financial year that are unpaid and arise when the Scheme 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 statement of financial position as unitholders are presently entitled to the distributable income as at 30 June 2011 under the Scheme's Constitution.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

n) 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.

o) Distributions

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

p) 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 comprehensive income 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 statement of financial position. Cash flows relating to GST are included in the Statement of Cash Flows 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.

q) 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.

Applications received in foreign currency denominations are initially recorded in the functional currency by applying the exchange rates ruling at the date of the transaction. Foreign currency denominated unitholder funds are translated into the Schemes functional currency at balance date, using the spot rate prevailing at that date. Gains and losses arising from foreign exchange translation are recorded in the Statement of Comprehensive Income in the period in which they arise.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

r) Taxation

Under current legislation, the Scheme is not subject to income tax provided the distributable income of the Scheme is fully distributed either by way of cash or reinvestment (i.e. 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.

s) 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.

t) Capital management

The Responsible Entity manages the Scheme's net assets attributable to unitholders as capital, not withstanding net assets attributable to unitholders is classified as a liability. The amount of net assets attributable to unitholders can change significantly on a daily basis as the Scheme is subject to daily applications and redemptions at the discretion of unitholders.

The Responsible Entity monitors the level of daily applications and redemptions relative to the liquid assets in the Scheme.

The Scheme is not subject to any externally imposed capital requirements.

u) Derivative financial instruments

The Scheme uses derivative financial instruments such as forward currency contracts to hedge its risks associated with foreign currency fluctuations. Derivatives are recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

Any gains or losses arising from changes in the fair value of derivatives, except for those that qualify as cash flow hedges, are taken directly to net profit or loss for the year.

The fair value of forward currency contracts is calculated by reference to valuations provided by the financial institutions with which the forward exchange contracts are held.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

v) Foreign currency translations

The Scheme's transactions in foreign currencies comprise applications and withdrawals of foreign currency unitholder funds and payment of distributions. Transactions in foreign currencies are initially recorded in the functional currency by applying the exchange rates ruling at the date of the transaction. Monetary assets and liability denominated in foreign currencies are retranslated at the rate of exchange prevailing at the balance sheet date, and exchange rate gains and losses recognised in the Statement of Comprehensive Income.

w) Determination of Fair Value

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair value for financial instruments traded in active markets at the reporting date is based on their quoted price or binding dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs.

For all other financial instruments not traded in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include: using recent arm's length market transactions; reference to the current market value of another instrument that is substantially the same; discounted cash flow analysis and option pricing models making as much use of available and supportable market data as possible.

Refer to Note 16 to the financial statements for the methods and assumptions applied in determining fair value for each class of financial instrument.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

3. INCOME AND DISTRIBUTIONS TO UNITHOLDERS

a) Distributions to unitholders

	2011	2010
	$	$
Distributions paid/reinvested	7,860,960	20,347,846
Distributions payable	6,434,965	4,422,534
	14,295,925	24,770,380

b) Distributions paid and payable

Class A	5,304,007	9,869,689
Class B	8,836,041	14,416,030
Class C	155,877	484,661
	14,295,925	24,770,380

As at 30 June 2011, $6,289,306 (2010: $2,127,691) of distributions payable related to distributions that were requested to be paid under the Scheme's Constitution prior to 30 June 2011. Distributions have been suspended from 1 January 2011. Subsequent to balance date, $1,039,826 of distributions have been paid relating to February and March 2010.

4. EXPENSES

	2011	2010
	$	$
a) Finance costs		
Interest on bank loans	13,519,294	9,965,991
Facility fees	553,495	2,286,887
	14,072,789	12,252,878
b) Other expenses		
Auditor's remuneration	415,880	401,984
Other expenses	65,650	347,945
	481,530	749,929

5. AUDITOR'S REMUNERATION

	2011	2010
	$	$
Audit and review of the financial reports	388,480	370,680
Other regulatory audit services	27,400	31,304
	415,880	401,984

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

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

6. CHANGES IN NET ASSETS ATTRIBUTABLE TO UNITHOLDERS

Movements in the net assets attributable to unitholders during the year were as follows:

	2011 $	2010 $
Net assets attributable to unitholders		
Class A		
Opening balance	253,713,032	252,479,887
Units issued during the year	11,549	660,314
Units redeemed during the year	(547,888)	(2,489,991)
Units issued upon reinvestment of distributions	1,656,038	3,062,822
Closing Balance	254,832,731	253,713,032
Class B		
Opening balance	223,613,698	230,543,397
Units issued during the year	70,000	16,282,761
Units redeemed during the year	(23,610,149)	(23,212,460)
Units issued upon reinvestment of distributions	10,317,456	-
Closing Balance	210,391,005	223,613,698
Class C		
Opening balance	10,641,784	11,146,022
Units issued during the year	-	582,065
Units redeemed during the year	(26,895)	(367,841)
Units issued upon reinvestment of distributions	125,211	305,276
Foreign exchange (gain)/loss on investor funds	(1,104,712)	(1,023,738)
Closing Balance	9,635,388	10,641,784
Movement in changes net assets attributable to unitholders	(92,671,801)	(956,980)
Total assets attributable to unitholders	382,187,323	487,011,534

Class A consists of unitholders who are entitled to receive the declared distribution rate. There are a number of subclasses attached to class A. These consist of the following products with varying terms:

- Flexi Account investment option;
- Fixed Term Investment option; and
- LM Savings Plan investment option.

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

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

6. CHANGES IN NET ASSETS ATTRIBUTABLE TO UNITHOLDERS (Continued)

Class C consist of unitholders who have invested in foreign currencies and are entitled to receive the declared distribution rate. The class C product is Non-Australian Dollar Currency Hedged Fixed Term Investment Option. This consists of various terms and currency products.

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.

Status of investment in fund

During the 2009 year, the Responsible Entity closed the Scheme to new investors and suspended withdrawals, with the exception of those approved under hardship provisions and feeder fund payments for distributions and expenses. Feeder funds are other registered managed investment schemes that have invested directly in the LM First Mortgage Income Fund. Redemptions are generally to be paid within 365 days of the investment maturity term, however, redemptions have been suspended, per the constitution, as the Responsible Entity considers the suspension of withdrawals to be in the best interest of the members of the Scheme.

At 30 June 2011, $291,228,754 (2010: $308,295,443) of redemptions had been requested by unitholders but not yet paid. Of the total requested redemptions $870,215 (2010: $448,589) related to requests occurring within thirty days of year end. $143,311,487 (2010: $153,007,642) had been requested more than 30 days prior to year end. Redemptions also rank behind repayment of external financing facilities as detailed in Note 2(a). Of the above, $147,917,267 (2010: $154,839,212) of redemptions had been requested by unitholders of the feeder funds.

From 1 January 2011, the decision was made to suspend distributions of the Scheme and its feeder funds. Since year end, $1,039,826 of distribution has been paid, relating to distributions accrued for February and March 2010.

7. INVESTMENTS

	2011	2010
	$	$
Investment in subsidiary	-	1
	-	1

The Scheme owned 100% of the issued share capital of $1 of LM MIF Investments Pty Limited. This company was wound up during the period.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

8. LOANS AND RECEIVABLES

	2011	2010
	$	$
Secured mortgage loans	490,865,724	556,766,225
Secured mortgage loans – 2nd priority	11,365,047	9,205,379
Other unsecured loans – related party	-	1,829,700
Provision for impairment	(76,425,453)	(4,800,000)
Net loans and advances	425,805,318	563,001,304

Secured mortgage loans of $11,365,047 (2010: $9,205,379) have second priority over the security held. The first priority is held by another party that is entitled to $5,000,000 (2010: $5,000,000) of the security.

a) Aggregate amounts receivable from related parties

	2011	2010
	$	$
Directors and director-related entities - secured	7,849,604	7,849,604
Related managed investment schemes – secured	2,243,485	31,731,087
Related managed investment schemes – unsecured	-	1,829,700
	10,093,089	41,410,391

b) Maturity analysis – Secured Mortgage Loans

	2011	2010
	$	$
Less than 3 months	282,809,146	474,335,296
3-6 months	-	80,149,902
6-12 months	7,849,604	11,486,406
12-18 months	11,365,047	-
18-24 months	-	-
24-36 months	-	-
	302,023,797	565,971,604

The above maturity analysis is the contractual maturity of secured non-construction loans. Secured construction loans will be realised through cash flows which in years one and two will be reinvested to meet construction costs, and which are expected to realise a net cash inflow in three to five years. The carrying value of these loans at 30 June 2011 was $200,207,424.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

8. LOANS AND RECEIVABLES (Continued)

c) Concentration of risk

There are four counterparties with which the Scheme's credit exposure exceeds 10% of the net assets attributable to unitholders as at 30 June 2011. The total value of loans, before taking into account collateral or other credit enhancements, is $190,025,272 (2010: $178,910,561).

For concentration of risks relating to mortgage type and geographical location refer to Note 15.

d) Provisions for impairment

The impairment loss expense relating to loans and receivables comprises:

	2011 $	2010 $
Specific provision		
Opening balance	4,800,000	2,667,000
Impairment losses provided for during the year	84,360,301	3,560,000
Impairment losses realised during the year	(12,734,848)	(1,427,000)
Closing balance	76,425,453	4,800,000
Collective provision		
Opening balance	-	-
Impairment losses provided for during the year	-	-
Closing balance	-	-
Total Provision for impairment	76,425,453	4,800,000
Changes to operating profit/(loss) before tax for impairment losses on loans and receivables comprises:		
Specific provision	71,625,453	2,133,000
Collective provision	-	-
Impairment losses recognised directly in Statement of Comprehensive Income	13,248,250	4,449,816
	84,873,703	6,582,816

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

8. LOANS AND RECEIVABLES (Continued)

d) Provisions for impairment (Continued)

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

	2011 $	2010 $
Movement in Default loans		
Gross default loans opening balance	332,894,902	331,473,714
New and increased default loans	170,613,998	39,849,820
Balances written off	(13,248,250)	(1,333,416)
Returned to performing or repaid	(60,827,696)	(37,095,216)
Gross default loans closing balance	429,432,954	332,894,902
Specific provision	(76,425,453)	(3,493,000)
Net default loans	353,007,501	329,401,902

At 30 June 2011, the balance of loans that were past due but not impaired was $157,695,871 (2010: $248,106,127). As per the Scheme's policy, loans are past due once they exceed 90 days overdue.

At 30 June 2011, $323,137,094 of loans were individually impaired, with a total impairment loss of $76,425,453.

Loans are secured by land, development property or completed construction property. The fair value of security over loans that are past due but not impaired at 30 June 2011 was $170,064,593 (2010: $326,365,696).

Interest on arrears loans is suspended and not brought to account when the Responsible Entity considered that the amounts are not ultimately recoverable from the sale proceeds of the property. The amount of suspended interest at 30 June 2011 totalled $87,077,591 (2010: $20,031,170).

9. PAYABLES

	2011 $	2010 $
Foreign currency awaiting investment	-	195
Other payables	3,702,723	2,617,959
	3,702,723	2,618,154

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

10. INTEREST BEARING LOANS AND BORROWINGS

	2011 $	2010 $
Secured bank loan	62,399,788	81,014,217

On 1 July 2010, the Directors of the Responsible Entity of the Scheme, LM Investment Management Limited, entered into a new facility with another external financier.

The existing bank agreement provides a $90 million facility for two years with an option to extend for an additional year with interest at 15% per annum increasing to 18% if the loan term is extended. In the event that the repayment is not made in accordance with the repayment plan mentioned below, the interest rate payable is increased to BBSY +5.0%.

The Scheme is also required to hold a minimum cash balance of $6 million under this facility.

The facility agreement requires the Scheme to make minimum repayments as detailed below. These minimum repayments must be made in priority to any redemptions, except for hardship provisions and feeder fund payments for investor distributions and fund expenses.

	Minimum repayment
31 December 2011	$11,000,000
30 June 2012	$13,500,000 if facility extended or any remaining balance

In addition, where the Scheme realises assets or receives cash in settlement of secured loans it must repay to the external financier an agreed amount that varies based on each secured loan.

Where the Scheme has made repayments in excess of the minimum repayments required, the facility allows the Scheme to redraw funds to complete agreed development projects or establish new loans subject to prior approval from the external financier.

The facility is secured by a fixed and floating charge over the assets of the Scheme, providing Deutsche Bank, as secured lender with first priority over the assets of the Scheme.

As at the date of this report, the Scheme is in compliance with all loan covenants in the facility agreement and the current balance of the facility at the date of this report is $59,791,622. The Scheme's financing facilities contain various financial covenants. During the financial period certain of those covenants (including the minimum cash balance) were breached. The Scheme's bank provided the Scheme with temporary waivers of those covenants to ensure that there was no event of default triggered under the facilities. However, from 1 February 2011 to 3 May 2011 the Scheme paid penalty interest at 18%. Since 4 May 2011, the Scheme has been paying interest at 15% (refer to Note 2).

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

11. RELATED PARTIES

Responsible Entity

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

The Scheme's arrangement in relation to management fees is such that LM Investment Management Limited is required to be paid up to $1 million per month for administration and fund management services, with any monthly management fee in excess of $1 million to be paid to LM Administration Pty Limited for administration services provided on behalf of LM Investment Management Limited.

Custodian

The Custodian of the Scheme is LM Investment Management 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.

	2011 $	2010 $
- LM Investment Management Limited	-	-
- Directors and director related entities	-	-
- Other Associates of LM Investment Management Limited	167,378,018	223,613,698

Investing activities

The Scheme may purchase and sell units in other approved schemes or investment entities operated by LM Investment Management Limited or its associates in the ordinary course of business at application and redemption prices calculated in accordance with the constitutions of those schemes. At 30 June 2011 the Scheme had no investments in other schemes operated by LM Investment Management Limited or its affiliates (2010: nil).

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

11. RELATED PARTIES (Continued)

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. All transaction was approved on an arm's length basis and is on normal terms and conditions.

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 Limited is paid a management fee for these services directly from Scheme assets. The Scheme's arrangement in relation to management fees is such that LM Investment Management Limited is required to be paid up to $1 million per month for administration and fund management services, with any monthly management fee in excess of $1 million to be paid to LM Administration Pty Limited for administration services provided on behalf of LM Investment Management Limited.

During the year, management fees of $10,997,188 (2010: $9,131,818) were paid or payable by the Scheme. Of these fees, $10,997,188 (2010: $$9,131,818) was paid or payable to LM Administration Pty Limited.

During the year, loan origination fees received from borrowers within the Scheme was nil (2010: $2,769,913). These fees are charged when new borrowings are undertaken or existing borrowings are rolled over to non-default conditions.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

11. RELATED PARTIES (Continued)

Other transactions with the Scheme (Continued)

On 28 August 2008, it was resolved by the Board of Directors of the Responsible Entity, to transfer three mortgage loans to the value of $33,513,345 and the related first mortgage security to a related scheme, LM Managed Performance Fund ('LM MPF'). There is a fixed charge over these two specific secured properties plus a floating charge over the remaining assets of LM MPF to provide security to the Scheme in the event of default by the LM MPF. This loan between the Scheme and LM MPF is interest bearing at 7%, with the interest being capitalised. On 30 May 2011, this receivable was successfully repaid in full by LM MPF.

The Scheme has advanced funds to LM MPF to finance a joint venture entered into with a borrower of the Scheme. At 30 June 2011, the balance of the loan LM MPF Scheme was fully paid (2010: $9,563,238), which is secured by first mortgage of the assets of the unrelated borrower and by a guarantee from the LM MPF. This loan had been subject to the normal credit approval review procedures of the Scheme and was a fully serviced loan with interest being paid monthly.

The LM MPF has second mortgages on loans that are first mortgages of the Scheme totalling $46,158,276 (2010: $53,631,982). LM MPF may on occasion pay development and construction costs on those related loans. As part of its role as second mortgagee, LM MPF will fund interest payments from time to time within approved loan facility limits. During the 30 June 2011 year, interest payments totalling $915,954 (2010: $413,722) were paid by LM MPF on behalf of borrowers.

At 30 June 2008, management assigned a $5,100,000 receivable within the Scheme from LM Investment Management Limited to LM MPF. The loan accrued interest at 10% per annum and was repaid in full on 31 August 2010.

	2011 $	2010 $
Responsible Entity remuneration received or due and receivable		
• Management fees for the year paid or payable directly from LM Administration Pty Limited	10,997,188	9,131,818
• Expenses including administration expenses incurred by the Responsible Entity and its associated entities, which are reimbursed in accordance with the provisions of the Constitution.	791,164	879,091
• Loan management fees paid to the Responsible Entity for loan management and controllership services provided by the Responsible Entity on behalf of the Scheme in replacement of appointing external receivers. These fees are charged directly to the borrowers to facilitate possible future recovery.	5,381,516	-
Custodian's remuneration		
• Custodian's fees paid by the Scheme	112,324	88,163

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

11. RELATED PARTIES (Continued)

Other transactions with the Scheme (Continued)

Balance with related parties	2011	2010
Aggregate amounts receivable from related parties by the Scheme were as follows:		
• LM Administration Pty Limited (management fees prepaid by the Scheme)*(i)*	8,200,000	8,200,000
• Australian International Investments Pty Limited *(ii)*	7,849,604	7,849,604
• LM Managed Performance Fund *(iii)*	-	31,357,590
Aggregate amounts payable to related parties from the Scheme were as follows:		
• John O'Sullivan *(iv)*	162,609	66,984

i). These amounts are included in prepayments of $8,200,000 at 30 June 2011 (2010: $8,200,000). No amounts are payable to related parties by the Scheme. The average monthly balance of prepayments during the year was $8,200,000 (2010: $6,183,333) which was non-interest bearing. Interest foregone on the above amount if calculated at the weighted average cash rate of 4.02% (2010: 3.57%) would have been $329,640 (2010: $220,745). If this revenue had been collected, the sum foregone would have been paid to LM Administration Pty Limited as management fees or reduction in change in net assets attributable to unitholders during the year.

This prepaid management fee will be recovered through LM Administration Pty Limited's Agreement to offset future payable management fees or through guarantee from a director, Peter Charles Drake.

ii). Peter Charles Drake is a director and guarantor of Australian International Investment Services Pty Limited which is a joint borrower in a secured loan facility outstanding to the Scheme as at 30 June 2011 for $7,849,604 (2010: $7,849,604). This transaction was approved on an arm's length basis and is on normal terms and conditions.

iii). During August 2008, three mortgage loans were assigned from the Scheme to LM Managed Performance Fund ('LM MPF') as LM MPF's mandate was more appropriate to take over the future development on behalf of the original borrowers. This assignment was done on commercial terms and conditions on an arm's length basis. This loan between the Scheme and LM MPF is interest bearing at 7%. The amount of interest being charged on the loan during the period was $1,030,712.

LM MPF has successfully settled the full value of these loans as at 30 June 2011 (2010: $29,527,890).

LM MPF has settled the amount, including interest charged during the period through:

1) Cash settlement of $1,251,039;

2) payments of the Scheme's fund expenses, management fees and net settlements on foreign currency trades on behalf of the Scheme totalling $13,166,399;

3) payments on behalf of the feeder funds have been settled by the feeder funds through redemption of their investment in the Scheme (see table below);

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

11. RELATED PARTIES (Continued)

Other transactions with the Scheme (Continued)

4) payments on behalf of the Scheme in relation to loan management fees paid to the Responsible Entity for loan management and receivership services provided the Responsible Entity on behalf of the Scheme in replacement of appointing external receivers totalling $3,284,002. These are reflected with the loans and advances balance; and

5) payments on behalf of the Scheme in relation to loan redraws totalling $765,738. These are reflected within the loans and advances balance.

The payments made on behalf of the Scheme relating to fund expenses and management fees have been reflected in the Scheme's Statement of Comprehensive Income.

The payments made by LM MPF on behalf of the feeder funds have been settled by the feeder funds through redemption of their investment in the Scheme. These redemptions of units in the Scheme were not settled in cash, but as a reduction in the Scheme's receivable.

The Scheme's external financier has approved this arrangement to settle the Scheme's receivable from LM MPF.

Scheme	Amount
LM Currency Protected Australian Income Fund	$10,878,396
LM Institutional Currency Protected Australian Income Fund	$1,433,117
LM Wholesale First Mortgage Income Fund	$67,296
Total	**$12,378,809**

iv). John O'Sullivan is the beneficial owner of O'Sullivan Capital Management Limited, which has been engaged by LM Investment Management Limited to provide marketing services in New Zealand. For the year ended 30 June 2011, $95,645 (2010: $121,541) in adviser marketing commission has been earned, with $162,609 (2010: $66,984) remaining payable. This engagement is on normal commercial terms and at arm's length.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

11. RELATED PARTIES (Continued)

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 2011					
LM Currency Protected Australian Income Fund	84,319,198	22.21%	7,264,994	19,905,996	5,945,879
LM Institutional Currency Protected Australian Income Fund	6,377,442	1.68%	520,651	2,328,849	430,529
LM Wholesale First Mortgage Income Fund	76,681,193	20.20%	2,953,480	3,578,488	2,459,271
Dhani Darcy	185	0.00%	5	-	-
Total	167,378,018	44.09%	10,739,130	25,813,333	8,835,679

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 2010					
LM Currency Protected Australian Income Fund	118,040,000	24.12%	10,282,468	18,917,468	8,971,025
LM Institutional Currency Protected Australian Income Fund	9,780,000	2.00%	1,237,550	1,526,550	675,503
LM Wholesale First Mortgage Income Fund	96,476,500	19.71%	4,767,643	2,768,443	4,769,522
Dhani Darcy	226	0.00%	10	-	-
Total	224,296,726	45.83%	16,287,671	23,212,461	14,416,050

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

12. RECEIVABLES

	2011 $	2010 $
Mortgage interest receivable	929,706	1,285,212
Penalty interest receivable	132,446	174,998
GST receivable	674,721	176,815
Other	16,576	32,801
	1,753,449	1,669,826

During the year, the penalty interest receivable was capitalised onto the secured mortgage loan balance. Refer Note 8 Loans and Receivables.

13. CASH AND CASH EQUIVALENTS

a) Reconciliation of cash and cash equivalents

For the purposes of the Statement of Financial Position and Statement of Cash Flows, cash and cash equivalents comprise:

	2011 $	2010 $
- Cash at bank and in hand	18,475,447	1,976,709

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 $18,475,447 (2010: $1,976,709).

As at 30 June 2011, $351,071 (2010: $388,736) of cash at bank was held in foreign exchange margin accounts and was not available for use by the Scheme.

The Scheme's borrowing agreement requires the Scheme to hold a minimum cash balance of $6 million across two bank accounts, one of which is a restricted account. The Scheme's financier is required authorise cash outflows from the restricted account (into which loan settlement proceeds are received) and in the event that the minimum cash balance is breached, the financier is required to authorise all cash outflows, including those from the unrestricted account which receipts interest from borrowers.

At the date of this report, the Scheme is in compliance with this requirement.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

13. CASH AND CASH EQUIVALENTS (Continued)

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

	2011 $	2010 $
Change in net assets attributable to unitholders	(90,886,748)	(1,262,942)
Adjustments for:		
Non-cash impairment expense	83,974,954	6,582,816
Non-cash interest income	(31,158,288)	(50,847,584)
Distributions to unitholders	14,295,925	24,770,380
(Gains)/loss on foreign exchange contracts	(1,134,069)	1,162,730
(Gains)/loss on investor funds	1,338,500	(1,031,253)
(Increase)/decrease in interest receivable	398,057	331,742
(Increase)/decrease in other receivables	10,065,637	1,167,780
Increase/(decrease) in payables	2,353,983	1,566,785
Net cash flows from/(used in) operating activities	(10,752,049)	(17,559,546)

c) **Reinvestment of distributions**

During the financial year, the Scheme issued $12,098,705 (2010: $3,368,098) as a result of reinvestment of distributions by unitholders. These transactions have not been included in the Statement of Cash Flows.

d) **Financing and investing activities - non-cash settlement of related party receivables**

During the financial year, the Scheme received full settlement of its receivable from a related entity LM Managed Performance Fund ("LM MPF"). LM MPF settled the amount owing to the Scheme by directly paying the Scheme's fund expenses, management fees and net settlements on foreign currency trades. These payments have been reflected as a reduction of the loan receivable from LM MPF and are therefore excluded from the Statement of Cash Flows.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

14. KEY MANAGEMENT PERSONNEL 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
Ms Francene Maree Mulder	Appointed 30 September 2006
Mr Simon Tickner	Appointed 16 December 2008
Non-executive directors	
Mr John O'Sullivan	Appointed 28 November 2007

(b) Compensation of Key Management Personnel

(i) Compensation Policies and Principles

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

(ii) Executive Directors

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

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

(iii) Non- executive directors

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

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

14. KEY MANAGEMENT PERSONNEL DISCLOSURES

(iv) Principles of KMP Remuneration Allocations

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

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

14. KEY MANAGEMENT PERSONNEL DISCLOSURES (Continued)

(i) *Remuneration of KMP allocated to this fund*

2011 Specified KMP	Primary Salary & Fees	Primary Cash Bonus	Non Monetary Benefits	Post Employment Super	Post Employment Retirement Benefits	Equity	Other	TOTAL	Total performance related
	$	$	$	$	$	$	$	$	%
Drake, PC*	-	-	-	-	-	-	-	-	-
Darcy, LM**	54,525	42,500	-	4,817	-	-	-	101,842	-
Van der Hoven, E**	40,678	21,635	-	3,621	-	-	-	65,934	-
Mulder, F**	35,052	21,635	-	3,096	-	-	-	59,783	-
Tickner, S	38,564	21,635	-	3,440	-	-	-	63,639	-
O'Sullivan, J	43,543	-	-	-	-	-	-	43,543	-
	212,362	107,405	-	14,974	-	-	-	334,741	-

2010 Specified KMP	Primary Salary & Fees	Primary Cash Bonus	Non Monetary Benefits	Post Employment Super	Post Employment Retirement Benefits	Equity	Other	TOTAL	Total performance related
	$	$	$	$	$	$	$	$	%
Drake, PC*	-	-	-	-	-	-	-	-	-
Darcy, LM**	46,501	27,654	-	5,535	-	-	-	79,690	-
Van der Hoven, E**	34,910	15,929	-	4,178	-	-	-	55,017	-
Mulder, F**	29,770	17,357	-	3,857	-	-	-	50,984	-
Tickner, S	33,088	15,929	-	4,023	-	-	-	53,040	-
O'Sullivan, J	7,143	-	-	-	-	-	-	7,143	-
	151,412	76,869	-	17,593	-	-	-	245,874	-

* Peter Charles Drake is the beneficial owner of 100% of the ordinary shares of the Responsible Entity. No salary and wages are paid to Peter Drake directly from the company or any of the schemes. ** As executives of the Responsible Entity, LM Darcy, E van der Hoven and F Mulder are entitled to a termination benefit that is payable on cessation of employment or a significant change in ownership of the company. No amount has been reflected in the above disclosures in relation to this potential future benefit.

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

14. KEY MANAGEMENT PERSONNEL DISCLOSURES (Continued)

Compensation by category: Key Management Personnel

	2011	2010
	$	$
Short term	319,767	228,281
Post employment	14,974	17,593
Other long term	-	-
Termination benefits	-	-
Equity based payment	-	-
Other	-	-
	334,741	245,874

Loans to Specified KMP

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

(c) Other Transactions and Balances with Specified KMP

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

15. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

a) Financial Risk Management Objectives, Policies, and Processes

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

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

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

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

LM FIRST MORTGAGE INCOME FUND

Notes to the Financial Statements for the year ended 30 June 2011

15. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

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

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

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

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

b) Credit Risk

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

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

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

The Scheme minimises credit risk by:
- undertaking credit assessment procedures on prospective borrowers;
- dealing with Australian regulated banks for cash balances; and
- obtaining independent valuations for all loans.

As at year end, 80.85% (2010: 61%) of the mortgage loans were secured by a combination of completed development projects (industrial 8.05% (2010: 14%) and residential 33.12% (2010: 41%) and land 3.62% (2010: 6%)), 19.15% (2010: 18%) were secured by commercial property and 36.05% (2010: 21%) of the mortgage loans were secured on construction and development projects in the residential and retirement sectors.

The carrying amount of renegotiated loans which would have been past due or impaired at 30 June 2011 was $21,465,636.