



**LM Mortgage Income Fund**

**ABN: 13 089 343 288**

**Annual Financial Report  
30 June 2004**

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

The directors of LM Investment Management Limited ("the Responsible Entity"), the Responsible Entity of LM Mortgage Income Fund ("the Scheme"), present their report together with the financial report of the Scheme, for the year ended 30 June 2004 and the auditor's report thereon.

**Directors**

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

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

**Principal activities**

The Scheme is a registered managed investment scheme domiciled in Australia. The Scheme's principal activity for the year was receipt of unit holders' funds and investing in first registered mortgages, unlisted managed investment schemes and cash investments in Australia, in accordance with the investment policy of the Scheme as outlined in the current product disclosure document.

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

The Scheme did not have any employees during the year.

**Scheme Information**

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

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

**Review and results of operations**

During the year, the Scheme continued to invest funds directly in first registered mortgage loans, secured by commercial properties in Australia. In addition, funds under management increased by \$167,040,297, of which \$80,135,000 was as a result of the scheme accepting applications from a related managed investment scheme (LM Wholesale Mortgage Income Fund).

**Results**

The financial year ended 30 June 2004 resulted in a net profit of \$22,879,338 (2003: \$12,171,381). An increase in funds under management contributed to the increase in the financial result for the year.

**Distributions**

Distributions paid or payable by the Scheme since the end of the previous financial year were \$22,879,338 (2003: \$12,171,381).

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RESPONSIBLE ENTITY'S REPORT**

**Units on issue**

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

**Scheme Assets**

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

**Interests of the Responsible Entity**

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

	<b>2004</b>	<b>2003</b>
	<b>\$</b>	<b>\$</b>
■ Management fees for the year received directly from LM Mortgage Income Fund by LM Administration Pty Ltd	4,412,570	2,234,991
■ Fees earned by LM Administration Pty Limited from other approved schemes invested in by LM Mortgage Income Fund	-	-
■ Other expenses include administration expenses incurred by the Responsible Entity which are reimbursed in accordance with the provisions of the Scheme Constitution, including Custodian fees.	116,827	219,817

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

**Significant changes in the state of affairs**

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

**Significant events after balance date**

Other than the transaction below, there have been no items, transactions or events of a material and unusual nature likely, in the opinion of the Responsible Entity, to affect significantly the operations of the Scheme, the results of those operations, or the state of affairs of the Scheme, in future financial years.

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

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

**Likely developments and expected results**

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

**Environmental Regulation**

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


**Indemnities and insurance premiums for Officers or Directors**

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

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

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

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

  
Lisa Darcy  
Director  
Gold Coast

Date: 23rd September 2004

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

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

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

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

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

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

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

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

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

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

**1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES**

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

**(a) Basis of preparation**

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

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

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

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

**(b) Changes in accounting policies**

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

**(c) Investments**

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

**(d) Cash assets**

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

**(e) Mortgage loans**

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

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

**1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES (cont)**

**(f) Income and expenses**

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

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

Expenses are brought to account on an accruals basis.

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

**(g) Advisor Commissions**

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

**(h) Taxation**

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

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

**(i) Goods and services tax**

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

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

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

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

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

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

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

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

Class B consists of unit holders with an investment greater than \$1,000,000. The distribution rate will be determined by the Responsible Entity. The Responsible Entity has the discretion to waive the whole or part of the 1% trailing commission and the whole or part of its management fee for this class of unit holders.

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

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

<b>(b) Excess distributions</b>	<b>2004</b>	<b>2003</b>
Opening balance	(182,260)	(182,620)
Transfers (to)/from statement of financial performance	<u>-</u>	<u>-</u>
Closing balance	<u>(182,260)</u>	<u>(182,620)</u>

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

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

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

LM MORTGAGE INCOME FUND

NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED 30 JUNE 2004

7. INVESTMENTS

(c) Mortgage loans (continued)

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

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

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

**8. RELATED PARTIES**

*Responsible Entity*

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

*Custodian*

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

*Directors*

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

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

*Directors' remuneration*

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

*Directors' holdings of units*

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

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

*Other transactions with the Scheme*

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

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

**8. RELATED PARTIES (continued)**

*Related party transactions*

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

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

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

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

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

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

**8. RELATED PARTIES (continued)**

*Investing activities*

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

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

Scheme name	Investment at year end \$	Interest held in related scheme at year end	Change in fair value of investment \$	Funds invested during the year \$	Funds withdrawn during the year \$	Contribution to investment income \$
<b>30 June 2004</b>						
LM Select Mortgage Income Fund	59,953	0.75%	-	-	-	-
LMQ Mortgage Facilities	-	-	-	-	9,976	-
<b>30 June 2003</b>						
LM Select Mortgage Income Fund	59,953	0.75%	-	-	697,893	-
LMQ Mortgage Facilities	9,976	17.67%	-	-	-	-

These investments are on normal terms and conditions.

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

**8. RELATED PARTIES (continued)**

*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:

<b>Entity</b>	<b>Investment at year end</b>	<b>Interest held in the scheme at year end</b>	<b>Units issued during the year</b>	<b>Units redeemed during the year</b>	<b>Distributions paid and payable</b>
<b>30 June 2004</b>	<b>\$</b>				<b>\$</b>
LM Special Participation Fund	2,241,000	0.59 %	1,990,000	6,422,000	451,822
Engineering House Canberra Syndicate	-	-	-	3,553,000	75,294
Belinda J Drake	5,140	-	584,250	1,511,320	38,711
LM Managed Performance Fund	8,129,000	2.15 %	23,367,000	19,758,000	548,682
LM Wholesale Mortgage Income Fund	124,678,000	33.02 %	99,600,000	19,465,000	7,838,526
LM Property Performance Fund	92,000	0.02 %	1,558,190	4,123,500	323,193
LM Investment Management Ltd	163,018	0.04 %	12,532	-	18,003
Lisa M Darcy	3,545	-	6,500	3,018	78
<b>Total</b>	<b>135,311,703</b>	<b>35.82%</b>	<b>127,118,472</b>	<b>54,835,838</b>	<b>9,294,309</b>
<b>30 June 2003</b>					
LM Special Participation Fund	6,673,000	3.17%	4,598,300	1,862,300	733,179
Engineering House Canberra Syndicate	3,553,000	1.69%	3,481,750	823,900	219,126
Belinda J Drake	932,210	0.44%	922,109	-	20,527
LM Managed Performance Fund	4,520,000	2.14%	8,211,700	3,691,700	244,775
LM Wholesale Mortgage Income Fund	44,543,000	21.15%	62,500,000	17,957,000	2,313,417
LM Property Performance Fund	2,657,310	1.26%	3,460,300	802,990	124,835
LM Investment Management Ltd	150,486	0.07%	21,227	-	12,294
<b>Total</b>	<b>63,029,006</b>	<b>29.92%</b>	<b>83,195,386</b>	<b>25,137,880</b>	<b>3,668,153</b>

**9. SEGMENT INFORMATION**

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

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

**10. NOTES TO THE STATEMENT OF CASH FLOWS**

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

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

**(b) Reconciliation of cash**

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

Cash and cash equivalents	<u>33,563,098</u>	<u>9,034,197</u>
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**(c) Sales and purchases of securities**

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

**(d) Reinvestment of distributions**

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

**11. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE**

**(a) Net fair values of financial assets and liabilities**

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

**(b) Liquidity Risk**

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

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

**LM MORTGAGE INCOME FUND**  
**NOTES TO AND FORMING PART OF THE FINANCIAL STATEMENTS**  
**FOR THE FINANCIAL YEAR ENDED 30 June 2003**

**11. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE (continued)**

**(c) Interest rate risk**

*Interest rate risk exposures*

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

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

Note	Weighted average interest rate		Floating Interest Rate		Securities contracted to mature in:		Total			
	2004 %	2003 %	2004	2003	Less than 1 year	More than 1 year but less than 5 years				
Cash assets	10(b) 5.29	4.8	-	-	33,563,098	9,034,197	-	33,533,098	10,578,946	
Mortgage loans	7(c) 10.52	11.2	-	-	255,542,836	152,635,398	88,247,349	49,883,542	343,790,185	202,518,940
<b>Total</b>			-	-	289,106,934	161,669,595	88,247,349	49,883,542	377,323,283	213,097,886

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

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

**11. ADDITIONAL FINANCIAL INSTRUMENTS DISCLOSURE (continued)**

**(d) Credit risk exposure**

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

*Recognised financial instruments*

The Scheme minimises concentrations of credit risk by:

- undertaking credit assessment procedures on prospective borrowers;
- dealing with Australian regulated banks for cash balances;
- obtaining independent valuations for all loans; and
- maintaining loan to valuation ratios not exceeding 66.67%.

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

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

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

**12. IMPACT OF ADOPTING AASB EQUIVALENTS TO IASB STANDARDS**

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

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

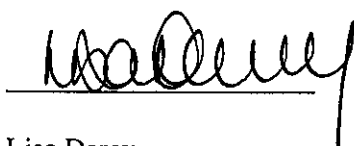
**LM MORTGAGE INCOME FUND  
DIRECTOR'S DECLARATION**

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

In the opinion of the directors:

- (a) The financial statements and notes set out on pages 4 to 20 are in accordance with the *Corporations Act 2001*, including:
  - (a) giving a true and fair view of the financial position of the Scheme as at 30 June 2004, and its performance, as represented by the results of its operations and its cash flows for the year ended on that date; and
  - (b) complying with Accounting Standards in Australia and the Corporations Regulations 2001.
- (b) there are reasonable grounds to believe that the Scheme will be able to pay its debts as and when they become due and payable; and
- (c) the financial statements are in accordance with the provisions of the Scheme's constitution.

On behalf of the Board of LM Investment Management Limited.



Lisa Darcy  
Director  
Gold Coast

Date: 23rd September 2004

## Independent audit report to the Unitholders of LM Mortgage Income Fund

### Scope

#### *The financial report and directors' responsibility*

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

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

#### *Audit approach*

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

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

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

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

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

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

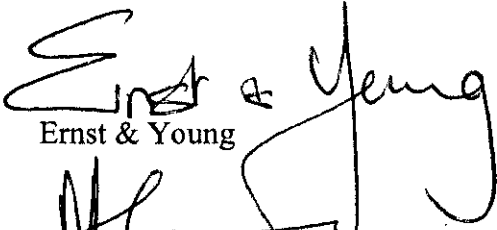
**Independence**

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

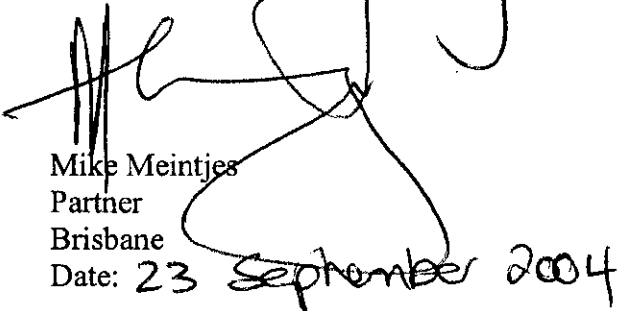
**Audit opinion**

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

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



Ernst & Young



Mike Meintjes  
Partner  
Brisbane

Date: 23 September 2004