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TO THE INVESTOR AS ADDRESSED

19 February 2014

**LM FIRST MORTGAGE INCOME FUND
(RECEIVERS AND MANAGERS APPOINTED) (RECEIVER APPOINTED)
ARSN 089 343 288
(‘the Fund’ or ‘FMIF’)**

I refer to my report dated 4 December 2013 and now provide my fourth update to investors in relation to the winding up of the Fund, as follows.

1. Repayment of indebtedness to the Secured Creditor

At the time of my previous report to investors dated 4 December 2013, the secured creditor was owed \$13m. Following the release of trust monies totalling approximately \$8m (referred to in my previous report) and other property realisations the secured creditor has been repaid in full.

Notwithstanding this, the Receivers and Managers appointed by the secured creditor have advised that they are not yet in a position to retire until the potential claim by KordaMentha as the new trustee of the LM Managed Performance Fund is resolved.

2. Potential claim by KordaMentha, the trustee of the MPF

As previously advised, KordaMentha, acting as trustee of the MPF has put me (and the Receivers and Managers appointed by the secured creditor) on notice of a potential claim against LM Investment Management Limited (Receivers and Managers Appointed) (in Liquidation) (“LMIM”) and/or the Fund in relation to potential breaches of trust.

This correspondence did not include any notice of a potential claim against the secured creditor. The claims are vague and unparticularised.

In late November 2013, KordaMentha brought an application to court against the previous trustee, LMIM to obtain access to certain books and records of the Managed Performance Fund and a court order was granted governing the process that would be adopted to allow access to same.

KordaMentha have advised me that they have completed a substantial amount of their investigations however they still require further time before deciding whether or not a claim will be brought against the previous trustee and/or the Fund.

Until this position becomes clearer, the secured creditor releases its security and the Receivers and Managers retire, I will not be in a position to recommence distributions to investors.

3. Appeal Lodged by FTI

As previously advised, the Liquidators of LMIM have appealed the court's decision that led to my appointment as Receiver of the Fund's assets and person responsible to ensure it is wound up pursuant to its constitution.

The appeal hearing was heard on 28 November 2013 however the decision has been reserved and is still awaited.

A copy of the court order setting out the decision will be placed on the website www.lmfmf.com when released.

4. Valuation of the Fund

Following my last report, a number of investors have queried why there has been such a significant downturn in the valuation of the fund and bearing in mind that the GFC occurred more than five years ago (and when the investors units were still valued at 100 cents in the dollar).

There are a number of factors that have contributed to the loss in value, including the following:

- the methodology used in the valuation of the Fund;
- interest on loans granted to borrowers not being paid and being capitalised into the loan amount resulting in an increase in the loan to value ratio;
- substantial fees being paid to the Responsible Entity of the Fund;
- the Fund borrowing money from banks to increase funding available to borrowers;
- borrowers not paying interest and defaulting on loans with interest still having to be paid to the external financier; and
- the Fund having to meet costs not paid by the defaulting borrowers in respect of operating costs of the assets and statutory obligations including rates and land tax. Some of these costs have been substantial. For example three operating businesses have had trading shortfalls of up to approximately \$5m per annum funded so that these businesses can be sold as going concerns.

Some of these issues are commented on in more detail below:



Method of valuation

As advised in my report dated 4 December 2013, the Responsible Entity has not obtained independent professional valuations of the charged properties for several years (which is a breach of the Constitution and Compliance Plan of the Fund) and instead has relied on internally produced feasibility studies of the properties.

The feasibility studies take into account the forecast development costs and sales for each property with the net cashflows derived being discounted back to a net present value.

A number of the feasibility studies are not viable with the properties having to be disposed of on an “as is” basis.

As previously advised, professional valuations were instructed by FTI and McGrathNicol after the Responsible Entity was placed into administration and it is these independent values on an “as is” basis or offers received that have been used to value the Fund.

This resulted in a downward revision in value of an unit from 59 cents as at 31 December 2012 to 17 cents as at 30 November 2013.

By way of example, one asset has reduced from approximately \$50m as at 31 December 2012 to \$13.5m as at 30 November 2013. This is because the existing planning permission is not viable for in excess of 450 units to be built on the site. Further the Fund should not be taking the risk of developing out the 400+ units to be built.

Development applications are being prepared to amend the existing approvals with a view to making the position viable and developing part of the site only with the balance of land to be sold.

A further example is where the Responsible Entity valued a property at approximately \$26m as at 31 December 2012 that only has a current market value of \$4.9m.

Again, the Responsible Entity’s valuation was based on a feasibility study that is not workable because of the risks associated with developing out the product with it being far from certain that it would produce a better outcome taking into account the current rate of sale for the product and the number of units available before any further construction could be contemplated.

Defaulting loans

A summary of the balances of defaulting loans recorded in the Fund’s audited accounts for the 2008 to 2012 financial years is provided in the table below:

	2008	2009	2010	2011	2012
	\$	\$	\$	\$	\$
Gross default loans opening balance	83,826,384	101,159,653	331,473,714	332,894,902	481,037,628
New and increase default loans	59,907,804	268,567,327	39,849,820	170,613,998	67,271,669
Balances written off	-754,152	-15,307	-1,333,416	-13,248,250	-29,304,112
Returned to performing or repaid	-41,820,383	-38,237,959	-37,095,216	-60,827,696	-61,394,886
Total default loans	101,159,653	331,473,714	332,894,902	429,432,954	457,610,299

It can clearly be seen from the above summary, the significant increases that have taken place over this period with almost all loans in default by 2012.

The balances of a number of these loans include the capitalisation of interest.

Fees paid to the Responsible Entity

There have been fees totalling in excess of \$77m paid to the Responsible Entity from 1 July 2007 to 30 June 2013, as summarised in the table below:

	2008	2009	2010	2011	2012	2013 (unaudited)	Total
	\$	\$	\$	\$	\$	\$	\$
Management fees	5,801,477	15,410,762	9,131,818	10,997,188	9,103,864	4,519,156*	54,964,265
Custodian fees	157,876	123,356	88,163	112,324	29,983	49,107	560,809
Loan management/ recovery fees	nil	nil	nil	5,381,516	4,817,414	nil	10,198,930
Loan origination fees	9,410,607	2,194,460	nil	nil	nil	nil	11,605,067
Total	15,369,960	17,618,578	9,219,981	16,491,028	13,951,261	4,568,263	77,329,071

* LMIM ceased to charge management fees in June 2013.

Interest and facility fees paid to external financiers

The Fund has borrowed up to \$150m from external financiers since 2008 with the latest facility now repaid in full.

The total interest and facility fees paid to external financiers of \$64.3m for the 2008 to 2013 financial years is detailed in the table below:

	2008	2009	2010	2011	2012	2013 (unaudited)	Total
	\$	\$	\$	\$	\$	\$	\$
Interest paid	10,021,448	12,218,376	9,965,991	13,519,294	8,143,798	4,719,566	58,588,473
Facility fees	358,949	1,863,982	2,286,887	553,495	450,000	294,095	5,807,408
Total	10,380,397	14,082,356	12,252,878	14,072,789	8,593,798	5,013,660	64,395,878

It is clear from our review of the assets remaining to be sold that it would have been in investors interests for the Responsible Entity to have realised some of these assets much earlier so that management fees (which are based on a % of funds under management), bank interest (of up to 20% per annum) and holding costs would have been much reduced.

5. Other Potential Recoveries/Legal Actions

My report of 4 December 2013 identified various matters which required additional investigation to determine whether there were any potential legal actions for dealings which occurred prior to my appointment as Receiver.

These investigations are continuing and I am in the process of obtaining further documentation and legal advices in relation to several potential claims.

Once proceedings are commenced or my investigations are complete in relation to each of the matters, I will update investors accordingly.

6. Estimated Return to Investors

Based on the professional valuations and offers received for the properties charged to the Fund, I provide an estimated return to Investors of between 13 and 18 cents in the dollar as at 31 January 2014, calculated as follows:

	Low	High
	\$000's	\$000's
Cash at Bank	11,204	11,204
Funds held in trust	1,198	1,198
Estimated selling prices of properties to be sold	65,644	92,625
<i>Less:</i>		
Selling costs (3.5% of sale price)	(2,298)	(3,242)
Land tax & rates	(695)	(695)
Other unsecured creditors	(7,936)	(8,076)
Estimated FTI Fees & legal costs (subject to approval)	(3,069)	(3,069)
Receivers and Managers' Fees (McGrathNicol)	(129)	(129)
Receiver's fees & outlays (BDO)	(595)	(595)
Estimated net amount available to investors as at 31 January 2014	63,324	89,221
Total investor units	488,787,330	488,787,330
Estimated return in the dollar	0.13	0.18

The above table does not take into account future operating costs, future Receivers fees and future rates and land tax. It also excludes any legal recoveries against borrowers, valuers or other third parties.

Please note that the distribution to Investors will take place after paying secured creditors, land tax, rates, Receivers fees and the unsecured creditors who rank ahead of Investors' interests.

7. Distributions to Investors

As mentioned earlier in my report, I am on notice from KordaMentha that the MPF potentially have a breach of trust claim against the Fund. In addition, the Receivers and Managers who were appointed to Bellpac have put me on notice not to distribute funds until the proceedings mentioned in my last report dated 4 December 2013 are resolved and also due to the MPF position, the secured creditor has not yet released its charge or retired its Receivers.

Once the Receivers and Managers have retired and funds released to me, I will be required to retain certain funds to meet the liabilities of the Fund, including contingent claims that may arise from the Bellpac litigation, the funds received for the loan/lease agreements of the aged care facilities and potentially in relation to the KordaMentha claims.

I may have to seek the directions of the court before proceeding with the next distribution.

I will update investors as to the expected timing of a distribution as these matters become clearer.



8. Audited Accounts

As previously advised, I have been in discussions with FTI and ASIC in relation to whether or not there is a need to undertake an annual audit of the Fund during the course of the winding up.

I am presently awaiting confirmation from the Australian Securities and Investments Commission that they will take no action in relation to the non-provision of the audited accounts.

In the meantime, I have met with representatives of the responsible entities of the feeder funds and confirmed to them that I will provide them with unaudited management accounts for the year ended 30 June 2013 prepared in accordance with the relevant accounting standards to assist them in their valuation of the feeder funds at that date. I will post these accounts on the website www.lmfmf.com as soon as they are finalised.

9. Ongoing Reporting to Investors

Reports will be distributed to investors in accordance with the preferred method of correspondence recorded for each investor on the Fund's database. In order to assist in reducing distribution costs, it would be appreciated if as many investors as possible could provide an email address in this respect. Please use the details in section 11 below to advise us in this regard.

My next report to investors will be issued by 30 April 2014.

10. Receiver's Remuneration and Expenses

I attach a summary of my remuneration and outlays for the period from my appointment on 8 August 2013 to 7 February 2014.

My remuneration incurred during this period totals \$487,936 plus outlays of \$52,544 plus GST.

Approval of my fees will be subject to court approval from time to time. An application to court will be prepared for the period ending 28 February 2014 and a copy of my application in this respect will be posted on the website www.lmfmf.com and investors will be notified when the application has been lodged.

11. Queries

Should unit holders require further information, please contact either Investor Relations or BDO on the details provided below.

Investor Relations

Phone: +61 7 5584 4500

Fax: +61 7 5592 2505

Email: mail@lmaustralia.com



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Yours faithfully



David Whyte
Receiver

A handwritten signature in blue ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

REMUNERATION REPORT
LM First Mortgage Income Fund (Receivers and Managers Appointed) (Receiver Appointed)
8 August 2013 to 7 February 2014

Employee	Position	Rate	Total Units	Total \$	Administration		Assets		Creditors		Investigation		Trade On		Research/Data Collection		Analysis	
					Units	\$	Units	\$	Units	\$	Units	\$	Units	\$	Units	\$	Units	\$
Whyte, David	Partner	560.00	302.70	169,512.00	43.00	24,080.00	171.50	96,040.00	2.30	1,288.00	5.50	3,080.00	80.40	45,024.00	0.00	0.00	0.00	0.00
Fielding, Andrew	Partner	560.00	1.20	672.00	1.00	560.00	0.00	0.00	0.20	112.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Beauchamp, Margaux	Executive Director	460.00	218.60	100,556.00	2.30	1,058.00	213.30	98,118.00	0.00	0.00	3.00	1,380.00	0.00	0.00	0.00	0.00	0.00	0.00
Somerville, John	Senior Manager	425.00	15.40	6,545.00	8.80	3,740.00	3.80	1,615.00	2.30	977.50	0.00	0.00	0.50	212.50	0.00	0.00	0.00	0.00
Haines, Charles	Senior Manager	425.00	154.80	65,790.00	3.20	1,360.00	27.20	11,560.00	2.90	1,232.50	118.00	50,150.00	3.50	1,487.50	0.00	0.00	0.00	0.00
Garcia, Joanne	Manager	390.00	275.10	107,289.00	25.20	9,828.00	114.00	44,460.00	55.80	21,762.00	0.30	117.00	24.30	9,477.00	7.00	2,730.00	48.50	18,915.00
Wilson, James	Manager	390.00	1.80	702.00	0.60	234.00	0.20	78.00	1.00	390.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Dharmaratne, Michael	Senior Accountant I	310.00	22.70	7,037.00	8.10	2,511.00	2.90	899.00	11.70	3,627.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Tipman, Daniel	Senior Accountant I	310.00	0.70	217.00	0.20	62.00	0.00	0.00	0.50	155.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Kennedy, Nicola	Accountant II	190.00	10.90	2,071.00	7.60	1,444.00	3.30	627.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Tantran, Rycko	Accountant II	175.00	144.20	25,235.00	0.00	0.00	85.50	14,962.50	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	58.70	10,272.50
Jackson, Nicole	Practice Assistant	150.00	5.10	765.00	5.10	765.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Richardson, Ashley	Administration Assistant	75.00	7.40	555.00	7.40	555.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Hattingh, Moira	Administration Assistant	75.00	13.20	990.00	0.60	45.00	0.00	0.00	12.60	945.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
TOTAL			1173.80	487,936.00	113.10	46,242.00	621.70	268,359.50	89.30	30,489.00	126.80	54,727.00	108.70	56,201.00	7.00	2,730.00	107.20	29,187.50
			GST	48,793.60		4,624.20		26,835.95		3,048.90		5,472.70		5,620.10		273.00		2,918.75
			TOTAL INC GST	536,729.60		50,866.20		295,195.45		33,537.90		60,199.70		61,821.10		3,003.00		32,106.25
			AVERAGE HOURLY RATE	415.69		408.86		431.65		341.42		431.60		517.03		390.00		272.27

REMUNERATION REPORT
LM First Mortgage Income Fund (Receivers and Managers Appointed) (Receiver Appointed)
8 August 2013 to 7 February 2014

Outlays		
Accommodation	339.56	
Airfares	2,152.90	
Car Hire	305.69	
General	22,011.62	
Mileage	113.40	
Parking	422.11	
Photocopy	7,371.90	
Postage	14,954.59	
Printing	1,470.30	
Search Fee	3,337.44	
Taxi fares	64.84	
SUB TOTAL	52,544.35	
GST	5,254.44	
TOTAL	57,798.79	
TOTAL INVOICE	\$ 594,528.39	