
LM Managed Performance Fund (the 'Fund' or 'MPF')

23 May 2015 | Update to Unitholders No. 16

This is our sixteenth Update to Unitholders.

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1 Overview

1.1 Purpose of update

The purpose of this update is to provide information to Unitholders in relation to recent developments in the winding up of the MPF. This includes the following:

- Update on the progress of recovery action and litigation including:
 - Barly Wood & Lifestyle court proceedings
 - potential claims, including: AIIIS, auditor action, and prepaid management fees
 - recovery of the Lygon Street loan
 - withholding tax remitted to the Australian Taxation Office (ATO).
- Defence of claims against the MPF by the LM First Mortgage Income Fund (FMIF)
- Timing for amendments to the investor database
- LM Investor Victim Centre (LMIVC) initiative
- Fund management matters.

All values in this document are in Australian Dollars.

1.2 Prior update reports

This update to Unitholders should be read in conjunction with prior update reports issued by the Trustee, particularly Update to Unitholders No. 15 which was released on 3 December 2015.

1.3 Summary of work undertaken/key developments

The focus of the Trustee remains on ongoing litigation with the objective of increasing recoveries for unitholders. Key developments during last six months are summarised as follows:

- The Barly Wood and Lifestyle matter has required further refinements to the claim over the last five months to clarify the nature of the claim against LMIM and the FMIF and the basis of recovery resulting from the claim. The complexities of this process is described in further detail in section 2.1 of this report. The next hearing on this matter is set for 31 May 2016 and relates to an application filed by the second defendant, FMIF to strike out (dismiss) the claim of the MPF against them. If the FMIF are successful in their application, this will likely bring to a close the MPF's claim against the FMIF, it is our intention to defend this application and carry on with our claim in this matter.

- Statement of claim for the AIIIS matter has been filed with the Courts but is yet to be formally served on the FMIF or LMIM who are the defendants in the matter. The Trustee has 12 months from the date of filing this claim with the Courts to serve this claim on the defendants and we will continue to assess the most appropriate timing to progress the matter which will require the Trustee to make two applications to the Court:
 1. For leave to proceed under section 96 of the Trust Act, this in effect seeks the Court's view on the validity of the claim before engaging in the costs of litigation.
 2. To make application under section 500 of the Corporations Act which is required because one of the defendants being LMIM is a company in liquidation and litigation cannot be commenced against such a company without the Courts consent to do so.
- The Trustee has commenced correspondence with the former auditor of the Fund in order to obtain copies of audit files with a view to assessing whether there is an actionable claim against the former auditor. There are a number of steps in assessing such a claim and it is likely that sufficient information may take a number of months to obtain before a final decision can be made on the likelihood of success in such proceedings.
- The Trustee has been in discussions with its tax advisor in relation to a potential refund from the ATO for withholding tax paid in respect of unitholder distribution. Significant analysis and preparation of management accounts has been undertaken in order to progress a claim for refund. These discussions are progressing well and we believe that we will be in a position to outline our position to the ATO in the next two months.
- We have been formally advised by the Receiver of the FMIF that he intends on mediating their claim against the Directors of LMIM, LMIM itself and the Fund in early July 2016. In line with the litigation timetable for this claim, the Trustee has also commenced the disclosure process in relation to this matter.

The current recovery actions being pursued (as detailed below) are considered by the Trustee to be the best prospects of realisation for the Unitholders. As outlined in previous updates, any future return to Unitholders is contingent upon the success of these actions.

The key risk facing the Fund at present remains to be the claim being pursued by the Receiver of LM Investment Management Limited (Receivers and Managers Appointed) as responsible entity of the LM First Mortgage Income Fund (FMIF), against a number of parties including the MPF. Should the Trustee be wholly unsuccessful in defending this claim, there will not be any distribution to Unitholders of the MPF. For this reason, the Trustee considers it paramount that resources of the Fund be utilised for the defence of this claim.

2 Recovery action and litigation

A summary of current recovery action and litigation is provided as follows:

| Matter/Loan | Status | | Claim Amount/Expected Recovery (\$) |
|--------------------------------|---------------------------|--|-------------------------------------|
| Barly Wood & Lifestyle | Current proceedings | Full claim amounts (subject to deductions) | 9,731,663 and 19,551,801 |
| AIIIS | | Full claim amount (subject to deductions) | 15,759,919 |
| Auditor action | Preparation | | Not yet confirmed |
| Directors & Officers insurance | Preparation | | Not yet confirmed |
| Lygon Street | Property sales continuing | | Approx. - \$1,500,000 |
| Prepaid management fees | Preparation | | Not yet confirmed |
| ATO – withholding tax paid | Preparation | | Not yet confirmed |

The Trustee does not presently anticipate any recoveries other than those outlined above. Further, any recoveries from the above matters are subject to successful outcomes from ongoing litigation. Information regarding each of these claims is outlined in the following sections.

2.1 Barly Wood & Lifestyle

Background of the matter

In August 2008, LM Investment Management Limited (LMIM) entered into an agreement with FMIF which involved the assignment of a number of loans from FMIF to LMIM. This transaction included the FMIF loans to Barly Wood Pty Ltd (Barly Wood) and The Lifestyle Investment Company Pty Ltd (Lifestyle). The Trustee claims that LMIM breached a number of duties owed to the MPF in the course of these transactions. The facts of each case are very similar and are detailed at a high level in Update to Unitholders No. 15 which was released on 3 December 2015.

Current status of both the Barly Wood and Lifestyle claims

The following table summarises the steps required in order to pursue these claims, and the current status:

| Step | Status | |
|---|------------|--|
| Filing of statement of claim | Complete | Filed with the Courts in August 2014. |
| Application for directions to proceed under section 96 of the Trusts Act | Complete | Application was filed on 29 May 2015 and was heard in the Supreme Court of Queensland on 26 August 2015. The Trustee was successful in its application for directions that it is justified in proceeding with this matter. |
| Application for leave to proceed under section 500 of the Corporations Act 2001 | Complete | Leave granted. |
| Serving of statement of claim upon solicitors for LMIM | Complete | |
| Hearing regarding who will conduct the defence of the action as between LMIM and FMIF's Receiver, David Whyte | Complete | This matter was heard in the Supreme Court on 7 December 2015. Outcome of the hearing is detailed below. |
| Hearing of strike out application | Incomplete | Application is due to be heard by the Court on 31 May 2016. |
| Filing of defence | Incomplete | Expected to be undertaken by the defendant following the 31 May 2016 hearing. |
| Discovery process | Incomplete | Expected to be undertaken in late 2016. |
| Hearing | Incomplete | Unitholders will be advised once date is set. |

Recent developments

The following summarises the developments in this matter since 3 December 2015.

Defence of the matter

The original defendant in this matter was LMIM, however, due to the trustee relationship between LMIM and FMIF and that FMIF obtained the benefit of the assignment transaction, FMIF may be liable for the payment of damages to the Fund should the Trustee be successful in the action. For this reason FMIF had made an application to the Courts for leave to defend the matter. This application was heard on 7 December 2015 by the Honourable Justice Jackson.

Following the hearing, orders were made to the following effect:

- David Whyte as Receiver of the property of the FMIF be added as the second defendant in the proceeding.
- LMIM is not required to file any defence these proceedings.

- The Trustee was approved to interrogate the LM server for information about or concerning the affairs of the FMIF, solely for the purpose of these proceedings.
- The Trustee was to file second further amended statements of claim by 4pm on 29 February 2016.

Further investigations as to consideration

Following Court approval being granted, the Trustee has undertaken further investigations of FMIF data contained on the LM server in order to clarify the method of payment of consideration to FMIF. Payment was not made in full by way of direct payment to FMIF, rather there were in excess of 450 payments, many of which were made to third parties on behalf of FMIF, in effect the payment of liabilities of the FMIF on its behalf.

Subsequent amended statements of claim

Second further amended statements of claim were prepared and filed with the Courts on 29 February 2016.

Following lodgement and review by the defendant, FMIF, FMIF lodged additional statements of complaint through their solicitors. Based on the nature of their complaints and the change of key defendant from LMIM for FMIF in the matters, the Trustee considered it appropriate to prepare and file a third further amended statements of claim in order to clarify the points which had been the subject of FMIF complaint against the MPF claim. These were filed and served on 19 April 2016.

Strike out application

On 27 April 2016, the Trustee received notice that a strike out application, which is an application made to the Court to dismiss a claim, had been filed by the second defendant (FMIF) in relation to these proceedings. This application is due to be heard by the Court on 31 May 2016 at 10am.

As outlined earlier, whilst the Trustee intends on defending the application to strike out, should the FMIF be wholly successful in their application, this would bring to an end these proceedings and the MPF would be unlikely to have a basis to continue with this claim.

Litigation funding

Due to the expected significant costs of litigation and the ongoing demands on the cash reserves of the Fund, the Trustee entered into a litigation funding agreement for the Barly Wood and Lifestyle matters to support litigation efforts and ensure preservation of claims.

Unitholders should be advised that if the Trustee is successful in its claims for Barly Wood and Lifestyle, a portion of the return to MPF will be paid to IMF Bentham under the litigation funding agreement.

2.2 AIIS

Background of the matter

In January 2005, the MPF entered into a loan agreement with Australian International Investment Services Pty Ltd (AIIS) where it took a first ranking security position. Subsequently, a deed of priority was entered into where the first ranking security was in effect transferred to FMIF. The Trustee is of the view that LMIM breached a number of duties owed to the MPF in the course of these transactions.

It is not expected that the MPF will receive any recovery of the outstanding loan based on the sale price of the property and the amount outstanding to FMIF pursuant to its first ranking security. The expected loss to the MPF in this transaction is approximately \$18.8 million.

Recent developments

The statement of claim was filed in the Supreme Court on Wednesday, 16 December 2015. The Trustee is yet to serve the statement of claim on the defendant and is in the process of determining whether to proceed with obtaining leave to proceed under section 96 of the Trust Act and section 500 of the Corporations Act. It

is likely that the Trustee will reserve this decision until greater clarity is obtained on other litigation matters in order to preserve the cash holdings of the Fund.

2.3 Auditor action

Background of the matter

Williams Partners Independent Audit Specialists (WPIAS) provided audit services to the Fund in 2011 and 2012. The Trustee considers that there is a possible claim against WPIAS relating to audit services provided.

Recent developments

Upon receipt of the LM group books and records, the Trustee has commenced an in depth review into the services provided by WPIAS including the scope of their review in 2011 and 2012, the documents they examined and the overall outcome of the audit.

In order to progress these investigations and determine whether the Trustee has any actionable claim against WPIAS, the audit files of WPIAS would need to be reviewed by the Trustee and its legal advisors.

Requests have been sent to WPIAS for access to the audit files. To date, provision of these files has not been forthcoming. Should WPIAS refuse to comply with the Trustee's request for access to the audit files, the Trustee will strongly consider applying for the issue of application summonses under the Corporations Act 2001 and the issue of orders for the production of documents by WPIAS.

As outlined in previous updates to investors, the Trustee have also made requests of ASIC to produce these documents but have been able to do so for reasons of privacy and privilege.

2.4 Lygon Street

Background of the matter

Upon appointment of the Trustee, MPF held a second ranking mortgage over the property 457-459 Lygon Street, Brunswick East, Victoria. At the time of appointment, preliminary earthworks were being undertaken.

Following review, the Trustee determined that the best opportunity for a full recovery of monies loaned by the MPF (being approximately \$0.9 million) was to assist in ensuring that the development was funded through to completion. MPF's remaining funding obligations at 8 May 2013 were assumed by AIF in exchange for a new deed of priority being entered into and a release from any breach of trust claims in relation to the development. As a result of these negotiations, the development is now complete.

Recent developments

We continue to work with the borrower to facilitate a full repayment of MPF borrowings which, inclusive of interest, exceeds \$1.5 million. The borrower has not achieved a refinance of the facility to date and is pursuing an asset sell-down strategy.

Currently 33 of the 40 residential lots have sold and settled. We have been advised by the borrower that all but two of the remaining lots are now under contract. The Fund's security also extends to two retail lots which are being marketed for sale by the borrower.

Over the coming weeks we will be working with the AIF who hold both a first and second security position, and the borrower to formulate a strategy to work through the sale and settlement of the residential and retail units in order to maximise the return to the Fund.

2.5 Prepaid management fees

As outlined in previous updates to Unitholders, at the time of Administrators being appointed to LMIM there was an amount of \$12.3 million which had prepaid to LM Administration Pty Ltd (LMA) for management fees.

Further investigation and analysis has been undertaken by the Trustee to determine whether to pursue a claim against various parties with respect to a potential breach of trust claim regarding the prepaid management fees. The results of these investigations indicate the following:

- During the period 1 July 2008 and 12 April 2013, \$52 million was paid from the MPF to LMA in respect of management fees.
- An amount of \$27 million was expensed in management fees during the same period.
- After other repayments and adjustments, the balance of the prepaid management fees account at 12 April 2013 was \$12.3 million.

The Trustee will keep Unitholders updated in relation to the progress of any claim for prepaid management fees.

We are currently in the process of finalising the statement of claim for filing with the Courts on this matter.

2.6 Withholding tax remitted to the ATO

The Trustee has been working with a tax advisor in relation to approximately \$4 million which was paid to the Australian Taxation Office as withholding tax for unitholder distributions in the period from July 2011 to March 2013. It is the view of the Trustee that the distributions made during this period were not distributions of profit. Proper assessment of the carrying values of mortgage loans during the year ended 30 June 2012 should have resulted in additional provisions being raised which would have caused a loss in the Fund. Based on this view, some or all of these withholding tax payments may be refundable from the ATO.

In order to progress this matter, the Trustee has prepared restated management accounts for the year ended 30 June 2012 and has prepared management accounts for the years ended 30 June 2013, 30 June 2014 and 30 June 2015. Investigative work has also been undertaken regarding distribution reinvestments and unitholder composition.

It is expected that the ATO will be approached in relation to this claim for refund of withholding tax payments within the next 2 months.

3 Claims against the MPF

3.1 Defence of FMIF claim against the Fund

Background of the matter

On 23 December 2014, LMIM as responsible entity of the FMIF commenced proceedings in the Supreme Court of Queensland against six current or former directors (Directors) of LMIM, LMIM itself and the Trustee of the MPF. FMIF alleges that the Directors breached duties owed to LMIM and FMIF in relation to the distribution of proceeds of the settlement of a legal action. The FMIF further alleges that LMIM was knowingly involved in those breaches and that the proceeds of the breaches were paid to the MPF. FMIF seeks to recover, from the Directors, LMIM and the MPF, \$15,546,147.85 plus interest on this sum and legal costs.

Unitholders should note that if the Trustee is wholly unsuccessful in its defence of this claim, it is possible that all remaining cash holdings of the MPF will be distributed to the FMIF forcing the MPF to obtain Court Orders to cease the winding up of the Fund and close it as soon as practicable.

Recent developments

The plaintiff has previously indicated a willingness to attempt to settle this matter through mediation. Orders were made by the Court on 28 April 2016 that mediation is to be conducted by no later than 31 July 2016. It has recently been proposed by the plaintiff that the mediation be conducted in early July 2016. The Trustee is currently developing its strategy in relation to this mediation.

The disclosure process is continuing and the Trustee is in the process of completing its disclosure which is required to be submitted by 26 May 2016.

4 Timing for amendments to the investor database

Prior to the former trustee being placed into Voluntary Administration, the investor database was maintained by LMA. For this reason, the Fund itself did not have a system for management of the investor database and there has been a freeze on changes to the investor database since the appointment of the Trustee on 12 April 2013.

Due to a number of requests for Unitholders, the Trustee has been working on developing the most efficient way of facilitating changes to Unitholder details. The Trustee has determined that the most effective and efficient way of managing this process would be through engaging a third party registry service. The Trustee has made enquiries into the costs involved with this process and estimates a minimum ongoing monthly cost of approximately \$6,000.

It is the Trustee's view that the above is reflective of the lowest cost of carrying out the investor database update through any means.

The Trustee has made the decision to continue the freeze on changes to the investor database at this stage for the following reasons:

- The monthly cost would represent a minimum of approximately \$72,000 per year in additional costs to the Fund, and would likely be significantly higher.
- There is still a high degree of uncertainty regarding timeframe for conclusion of the winding up due to ongoing litigation. Once the investor database update process is commenced, it would need to run until finalisation of the winding up; resulting in the monthly cost being incurred until conclusion which could have a material impact on any potential return to investors.
- Any return to investors remains dependent on the outcome of litigation. The investor database update process will become redundant if there is no distribution made to unitholders at the conclusion of the winding up.
- In the interests of preserving the remaining value of the Fund so that recovery actions may be pursued.

The Trustee will continue to review this decision and before making any distribution from the Fund (subject to sufficient funds being held), will provide Unitholders with the opportunity to change certain details associated with their unit holdings. It is highly likely that once the Trustee is in a position to commence this process, that it will be facilitated through a third party registry service.

5 LM Investor Victim Centre initiative

We have been approached by an investor group called the LMIVC for co-operation and support of a wide ranging initiative addressing corrective and recovery actions outside of the immediate scope of the Trustee. Whilst the Trustee does not express any view in relation to the LMIVC or the intention or validity of this initiative, we have agreed to share the below link on their behalf for your consideration. Please see the below link: https://sites.google.com/site/lminvestorvictimcentre/home/wr_corrective_and_recovery_actions.

6 Fund Management

6.1 Return of monies to Unitholders

In line with previous updates and comments above, the Trustee advises that the likelihood of a return to Unitholders is dependent on the outcome of recovery actions and litigation outlined above. In particular, Unitholders should be aware that the claim by the FMIF against the MPF puts at serious risk the potential of any return to MPF Unitholders. It is emphasised that a distribution, if one is to be made, will not be made until substantially all possible recovery actions and litigation is complete. Unitholders should be aware that if litigation is unsuccessful there is unlikely to be a return to Unitholders.

6.2 Investor communication

The Trustee will continue to communicate to Unitholders significant changes to the status of the Fund or any recovery actions.

In the interim, Unitholders are able to obtain further information by:

- accessing the KordaMentha website at <http://www.kordamentha.com/creditor-information/australia/109>
- if you are unable to find the answer to your query in any of our Updates or Frequently Asked Questions listing then you may email lminvestors@kordamentha.com; (In order to manage the ongoing management costs of the Fund, due to the high volume of enquires made via email the Trustee will only review and respond to emails on a fortnightly basis).

Please note that the Trustee makes every attempt to answer your enquiries on a regular basis however due to the number of queries received and our focus on managing costs of the Fund there may be some delay in responding to your individual requests. We appreciate your patience whilst we manage the large volume of emails and telephone calls received during this time.

Yours sincerely

KordaMentha
Trustee of the Fund