

To: Andrew Farkas  
From: Tom Mukamal  
Cc: Frank Garrison

May 2, 2013

**Re: AYH**

As discussed, we previously agreed with Rich Kahn, Mr. Epstein's advisor, to follow up on two remaining questions. We are not aware of any other open questions. Below is a summary of where we are on these points along with some general perspective/suggestions on a productive way forward with our partner.

First, it is important to take note of the nature of the transaction as that is fundamental in providing insight into the open questions. The business deal as explained to us was that, with respect to the equity investment in AYH, both IGY and Mr. Epstein would be *pari passu* on total actual costs incurred by IGY in the acquisition and ownership of the asset up to the date of Mr. Epstein's purchase and would each own 50% of the equity. This principle is consistent with each of the purchase agreement, the operating agreement and the price reconciliation schedule provided to Mr. Kahn which you have seen. I am attaching another copy for your convenience. Please refer to the price reconciliation schedule. This schedule sets forth in detail the actual cash spent by IGY on AYH. It is this cost buildup which formed the basis of the business arrangement contained in the purchase agreement.

**1) Related Party Interest Expense incurred by AYH and paid to IGY for the period between May 29, 2007 (the "Epstein Acquisition Date") and August 28, 2007**

As you may recall, IGY financed 100% of the purchase price of AYH by drawing approximately \$26 million from an IGY credit line (the "Credit Line") from Banco Popular ("BP"). The amount(s) drawn by IGY on the Credit Line were "pushed down" via a loan by IGY to IGY Facilities and down again with a loan from IGY Facilities to IGY-AYH Holdings ("IGY-AYH") which was the entity that actually acquired AYH. Between January 18, 2007 (the "IGY Closing Date") and thru the Epstein Acquisition Date, IGY-AYH incurred \$412,125 in interest expense on the amount borrowed. An additional amount of \$330,946 of interest (the "Stub Period Interest") was incurred by IGY-AYH from and after the Epstein Acquisition Date through August 28, 2007, the date when a permanent mortgage loan on AYH was obtained (the "Permanent Financing Date"). Mr. Kahn has sought explanation around the calculation of the interest expense and particularly the Stub Period Interest.

Understanding the way the transaction occurred and the purchase price that was paid by Mr. Epstein is helpful to an analysis of this question. Note that no one that worked on this transaction in 2007 is still with IGY and thus we could not obtain answers from anyone with historical knowledge, but we were able to gain an understanding of what occurred based on what records we had available. It is clear that on the Epstein Acquisition Date, Mr. Epstein paid \$12,976,977.85 to IGY Facilities in exchange for ownership of 50% of the equity in IGY-AYH and the intercompany payable from IGY-AYH to IGY Facilities was reduced. We believe that the principle on which the business arrangement was based should have resulted in IGY Facilities converting its entire loan to IGY-AYH to equity just before or simultaneously with the Epstein purchase and selling 50% of that equity to Mr. Epstein. If the transaction had been treated this way, each of IGY Facilities and Epstein would have effectively paid for their respective interest in the property all cash and would own that equity 50/50 as of the Epstein Acquisition Date. The fact that IGY borrowed its equity under the Credit Line would not have affected anything at the IGY-AYH level. In that case, the Stub Interest should have been paid 100% by IGY to BP without any reimbursement of such interest from IGY-AYH. Not having treated the transaction as suggested resulted in Mr. Epstein being effectively allocated interest of \$165,473

(representing 50% of the Stub Interest paid by AYH) more than if the treatment had been as suggested and thus increased his purchase price for his 50% interest by that amount.

2) **\$247,000 “Gain on Sale” of 50% interest in IGY-AYH Holdings Ltd. by IGY Facilities to Mr. Epstein/Capital Account Differences.**

The 2007 IGY Ltd audit indicates that a \$247,000 book gain was recognized on the sale of a 50% interest in IGY-AYH to Mr. Epstein. By definition, that result would only occur if the sales proceeds exceeded the *book* basis by that amount. We discussed with Mr. Kahn that certain expenses incurred by IGY in connection with its acquisition of AYH do not appear to have been included in IGY’s capitalized basis. Examples include the ICG acquisition fee expense being paid by and booked at the IGY LP level (not the IGY Ltd. level), and certain travel and legal expenses not being capitalized at all. These expenses were real out-of-pocket cash expenditures made by IGY but were not included in the book basis of IGY’s investment in IGY-AYH. These items are detailed and included in the pricing reconciliation schedule.

Mr. Kahn has also asked why Mr. Epstein’s 2007 tax capital account is different than IGY’s 2007 tax capital account. Similar to the “book gain” issue it appears that IGY Facilities did not capitalize at the IGY-AYH level all of its costs and expenses incurred in connection with the purchase and ownership of AYH prior to the Epstein Acquisition Date. However, all of the purchase consideration paid by Mr. Epstein went to establish his capital account from an accounting standpoint at a different amount. **As we explained to Mr. Kahn, that difference between book capital accounts does *not* mean that IGY and Mr. Epstein did not actually invest the same amount in AYH. To the contrary, the purchase price reconciliation schedule supports the conclusion that both partners incurred 50% of the costs.**

Without a significant expansion of the scope of effort, which would include engaging IGY’s prior auditor KPMG and devoting substantial time and effort from internal IGY resources, I do not believe that we can drill down any further for details than we already have. It should also be noted that even with an expanded scope of inquiry, we may still not be able to track down seven year old time sheets, expense reports and legal bills to a level of detail which could tie each number to the penny. Obtaining additional detail however, is not relevant to the issue at hand for the reason stated above, i.e., the “gain” that appeared in the 2007 IGY audit was *not* a real economic gain based on what each party actually invested but rather merely a book gain pursuant to GAAP and doesn’t change the fact that, consistent with the business understanding at the time, each party paid the same amount of cash for its respective 50% equity interest in IGY-AYH. Similarly, the difference in the partner’s respective capital account balances is in effect a timing issue as IGY expensed acquisition and related costs for tax purposes earlier in 2007 that were capitalized by Mr. Epstein at the time of his investment. Stated another way, the business arrangement agreed to in 2007 and reflected in the purchase agreement clearly contemplates that each partner would have invested the same amount of cash and would each own 50% of the equity of the entity owning the marina. It does not contemplate any kind of accounting treatment true-up based on GAAP accruals or other accounting related adjustments. In simple terms, each party put up half the cash, albeit at different times, and received half the equity interest.

**Suggested Next Steps**

1. **Interest Adjustment** – We recommend that IGY remit to Mr. Epstein \$165,473 for the reasons stated above in 1). While the lack of personnel with historical knowledge makes inquiry harder, we think that our view on this issue is appropriate and that the equities weigh in favor of making this payment.
2. **Business Understanding** – You should have a clear discussion with Mr. Epstein to ensure that he understands the business deal and structure of the transaction as it is not clear that Mr. Kahn does. We have not heard from anyone that the business deal was intended to be other than as we have

described. The 50/50 sharing on cash invested principle is memorialized in each of the purchase agreement, the operating agreement and the price reconciliation schedule provided to Mr. Kahn. All are consistent on this point. The price reconciliation confirms that IGY and Mr. Epstein have the same dollars invested in the deal – i.e. IGY and Mr. Epstein spent exactly the same amount of money to acquire 50% of AYH (irrespective of timing of cash outlays or GAAP accounting treatment).

As a side note, the basic 50/50 principle isn't perfectly adhered to because, by virtue of side letter dated May 29, 2007 which granted Mr. Epstein rights to a 75 foot slip at no cost, he is in fact (with respect to the equity) in a slightly better position than IGY because IGY put up 50% of the money but derives economic benefits from slightly less than 50% of the property because the aforementioned slip only benefits Mr. Epstein. While this arrangement is an exception to the 50/50 principle, it was ostensibly knowingly consented to by you via the side letter.

IGY affiliates also perform services for AYH just like they do for other IGY assets and for a number of third party clients. These services are services that AYH needs provided irrespective of what entity provides them. The operational/service relationship was not and was not intended to be part of the equity investment arrangement. Separate service agreements were prepared and executed in connection with the transaction. The economic terms of the Management Agreement are outlined clearly in Section 12 of the operating agreement for IGY-AYH Holdings LLC which Mr. Epstein executed as part of the transaction. Simply put, we should very clearly be separating discussions around the equity investment arrangement and the arrangement regarding the provision of services.

3. **Independent 3<sup>rd</sup> Party Review** – Assuming that the partners agree that each understands the terms of the business deal as outlined above in #2, we would suggest that an independent 3<sup>rd</sup> party acceptable to Mr. Epstein review the transaction documents, financial history including the 2007 audit and the price reconciliation schedule. This reviewer should discuss any questions Mr. Epstein or Mr. Kahn may have and should also discuss the questions with IGY. Upon review such independent party would report to all of us what they have found and concluded.

In summary, we are confident that with the exception of the interest issue addressed in 1 above, the facts are wholly consistent with the business deal made in 2007. The detail around some of the accounting issues has been distraction and appears to have confused the fundamental issue.