



Cayman Islands

**SPECIAL REPORT OF
*THE AUDITOR GENERAL***

ON

***THE REVIEW OF THE DEBT FINANCING
ARRANGEMENTS FOR BOATSWAIN'S BEACH***

Cayman Islands Audit Office

June 2007

REVIEW OF DEBT FINANCING ARRANGEMENTS FOR BOATSWAIN'S BEACH

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REVIEW OF DEBT FINANCING ARRANGEMENTS FOR BOATSWAIN'S BEACH

Executive Summary

1.01 The funding of the Boatswain's Beach addition to the Turtle Farm has been a source of discussion for some time. In late 2006, the Minister of Tourism, Environment, Investment and Commerce and the Leader of the Opposition made calls for the Office of the Auditor General to review the financing arrangements of the project. This report documents the results and conclusions of that investigation.

1.02 The financing of the Boatswain's Beach project is more complicated than most financial transactions, as there were actually two attempts to arrange financing. The first attempt to finance the project was signed and then stopped at the last moment and then another financing package was arranged.

1.03 The first attempt at financing was based on the premise that the Boatswain's Beach project would be incorporated as a Special Purpose Entity (SPE). A main feature of this SPE arrangement would have been that the debt for the Boatswain's Beach project would not have been recorded as Government debt. Under this SPE model, a financial agreement was made to secure US\$36,000,000 in debt through the services of GC Ventures Corp. Ltd. (GC Ventures) and QuadCapital Advisors LLC (QuadCapital). A Financial Advisory Service Agreement (FASA) for this debt arrangement was signed between GC Ventures and the Turtle Farm in May 2003.

1.04 In November 2003, government officials representing the shareholders of the Turtle Farm requested that the first source of financing not be finalized. After some negotiations, a second agreement was signed between the Turtle Farm and William Blair & Company, LLC (William Blair). This resulted in the final financing package of US\$44,600,000. This financing package was completed in March 2004.

1.05 Various organizations were paid funds based either on the first FASA or the second agreement with William Blair. The total costs of financing the Boatswain's Beach project were in excess of US\$2,800,000 and were paid to the following entities:

	US\$
➤ GC Ventures Corp. Ltd	\$594,948.83
➤ Live Oaks Capital Ltd.	384,895.30
➤ QuadCapital Advisors, LLC	403,655.07
➤ William Blair & Company, LLC	<u>\$1,439,065.01</u>
Total	\$2,822,564.21



1.06 In my opinion, the total amount paid for financing costs was far in excess of amounts paid in other government financing arrangements of the same time period. As such, I do not believe that the Turtle Farm received good value for the amount of the funds spent.

1.07 I have reviewed the individual amounts for each of the companies noted above and provided detailed comments regarding each element of the financing arrangement. I encourage readers to peruse each section for a clearer understanding of how I drew my conclusions in each case. However the main observations of the financing arrangements are as follows:

- ❖ I believe that the first financing arrangement summarized by the FASA was one that made no financial sense to the Turtle Farm. As such, the Board of Directors of the Turtle Farm failed in its fiduciary duty to the residents of the Cayman Islands in approving such a deal. It is my opinion that this deal was so disadvantageous to the residents of the Cayman Islands that it should never have been signed.
- ❖ I have concluded that there was little or no benefit derived from the payment of over \$970,000 to GC Ventures and Live Oaks Capital and that the Board of Directors of the Turtle Farm received little in exchange for the payments of such large amounts of money.
- ❖ The main payment to QuadCapital was a result of the decision to take another financing route. It was a legal obligation that the Turtle Farm incurred as a result of the decision to obtain alternate financing. I applaud the decision in late November to make alternate financing arrangements as it clearly saved the Turtle Farm millions of dollars in interest costs. However, if the Board of Directors had undertaken its fiduciary responsibility more diligently in early 2003, this penalty payment would never have been made.
- ❖ The financial arrangement with William Blair involved a high fixed fee as well as an incentive fee. As such, it paid out much more in financing fees than other types of financing transactions. In my opinion, the total amount paid was much higher than similar transactions.

1.08 It is difficult to quantify with any exact precision the amount of financing fees that should have been paid for this project. However, based on my review, it is my opinion that as much as \$1,650,000 of the \$2,800,000 represented little or no value to the residents of the Cayman Islands.

Report Clearance.

1.09 It is the policy of the Office of the Auditor General that all reports be discussed with the client. The client is then entitled, but not obligated, to prepare a management response to any or all of the report. This management response is then included in the body of the report presented to the Legislative Assembly.



1.10 In the case of the financing arrangements of the Boatswain's Beach project, I discussed with the Managing Director which body should be responsible for the issuance of a management response. It was agreed that it would be most appropriate for the Board of Directors of the Turtle Farm to issue this response.

1.11 I meet with the Board twice, on 04 May 2007, and 16 May 2007, to discuss the draft report. At those meetings, some suggestions were made and the report was revised to reflect some concerns by the Board members present.

1.12 On 01 June 2007, I received an e-mail from the Chairman of the Board of Directors. In this e-mail, the Chairman stated that the Board was "*not able to offer a consolidated response to your Report on the CTF Bond Financing arrangements as this activity pre-dated the appointment of the majority of existing Board Members in August 2005.*"

1.13 As a result, there is no management response to this report.

Acknowledgements

1.14 A report of this complexity is a difficult thing to do. There was a mountain of documents to review and many questions to answer. The burden of providing these documents and the answers to my many questions fell on the Managing Director, Mr. Ken Hydes. Despite a serious medical condition, Mr. Hydes was exemplary in assisting me and my Office in preparing my Report. I believe that Mr. Hydes assistance in providing the information used in preparing this report is an example of the highest level of co-operation between my Office and the client. I am most grateful for his assistance.

Don Duguay

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15 June 2007



A History of the Financial Arrangements for Boatswain's Beach

2.01 The first mention of the financing of the Boatswain's Beach project was at a meeting of the Board of Directors of the Cayman Islands Turtle Farm on 05 February 2003. At this time, a presentation regarding financing was made to the Board by Prospect Ventures Inc. (PVI). PVI was represented at this meeting by Mr. Suresh Prasad and Mr. David Berry. The presentation outlined possible options for financing the project. A 25 year fixed rate fully amortizing structured financing was recommended at this meeting.

2.02 Based upon interviews with the Managing Director of the Turtle Farm, Mr. Ken Hydes, PVI was recommended to the Board by Mr. Danny Owens, the architect of the development project.

2.03 The financing proposal was discussed at the Board of Directors meetings on 05 February and 05 March 2003. On 11 April 2003, a paper by the then Minister of Tourism, Development and Commerce, Mr. McKeeva Bush, was discussed at the Executive Council of the Cayman Islands. At this meeting, EXCO was informed that the Board of Directors had accepted an offer from GC Ventures for the financing of the Boatswain's Beach project. EXCO then authorized the Board of Directors of the Turtle Farm to enter into the proposed financing arrangement with GC Ventures.

2.04 On 09 May 2003, the Turtle Farm entered into a Financial Advisory Services Agreement (FASA). Other investors noted in the agreement were:

- QuadCapital Advisors LLC
- William Blair & Company, LLC
- Nesbitt Burns

2.05 The FASA outlined the costs of financing the development of the Turtle Farm through a Special Purpose Entity (SPE).

2.06 At a meeting of the Board of Directors on 30 May 2003, the Board of Directors was informed that EXCO had approved the financing arrangements and that the Financial Advisory Services Agreement had been signed on 09 May 2003.

The Financial Advisory Service Agreement

2.07 The financing requirements for this first attempt at financing the Boatswain's Beach project were fairly complex. However, the essence was that the Turtle Farm would not be directly responsible for the debt of the Boatswain's Beach project. The project would be facilitated by the creation of a SPE. This SPE, which would be owned by the Turtle Farm and the Government, would build and develop the Boatswain's Beach facility. The Turtle Farm would then lease the property from the SPE over the next 25 years and would obtain the ownership of the property at the end of the lease for a nominal amount.



2.08 If the SPE arrangement had been executed as contemplated, the debt of the Boatswain's Beach project would not appear on the balance sheet of the Turtle Farm and by extension the consolidated balance sheet of the Cayman Islands Government. This "off balance sheet" approach appeared to be a prime motivation for the project to be funded in this manner.

2.09 The Financial Advisory Service Agreement contemplated several fees. These will be discussed in a later section.

The first financing arrangements were never completed

2.10 The exact details of the FASA were never finalized as the government decided to go with another financing arrangement. However, in a letter to the Turtle Farm dated 29 May 2003, QuadCapital noted that the financing arrangement would be for US\$36 million (+ or – 5 million) and that the interest rate would be the 10 year US interest rate plus 2.69%. At that date, the interest rate would have been 6.36%.

2.11 The financing arrangements were next discussed at a meeting of the Board of Directors on 20 October 2003. At this meeting, which was attended by representatives from GC Ventures, William Blair and QuadCapital, it was mentioned that the financing was ready. During the subsequent discussion, it was revealed that it was proposed that the financing would be for approximately US\$36 million with a repayment term of 23 years. It was expected that the interest rate on the bonds would be 7.4%.

2.12 On 05 November 2003, these terms were presented to Cabinet in a paper from the Minister of Tourism, Environment, Development and Commerce. As a result of this paper, the Cabinet approved the formation of the charitable trust that would be the SPE that would own the process and asked His Excellency the Governor to execute a bondable lease to rent the facility from the Trust.

2.13 However, the charitable Trust was never formed as this financing arrangement was not completed.

A revised financing arrangement is made

2.14 On 24 November 2003, a series of meetings were held with Government officials. As a result of these discussions, it was agreed that the previous financing agreement would not be finalized. Rather, officials of the Turtle Farm were advised that financing was to be obtained through a direct bond placement. The results of these discussions meant that the financing would be a direct obligation of the Turtle Farm and would therefore be part of the liabilities portion of the balance sheet of the Turtle Farm. These liabilities would be guaranteed by the Government of the Cayman Islands. It also meant that there would be no need to finalize the creation of the SPE.

2.15 By a resolution of the Board of Directors in December 2003, the Turtle Farm was directed to complete a direct bond financing agreement as described above.



2.16 Based on this direction, the Turtle Farm entered into an agreement with William Blair on 15 December 2003 for a bond placement of US\$45 million.

2.17 The agreement was signed on 12 March 2004 and the Turtle Farm received the net proceeds of the placement soon after.

Financial Fees Paid for Boatswain’s Beach Project

3.01 Financial fees were paid to various entities under the two agreements. The first agreement was the FASA signed between GC Ventures and the Cayman Turtle Farm (1983) Ltd. on 09 May 2003. This agreement contemplated the “off balance sheet” arrangement noted above where a SPE would be created. In November 2003, the government decided to finance the Turtle Farm through a direct bond placement. To facilitate this, the second financial agreement between the Turtle Farm and William Blair was signed on 15 December 2003. These two agreements formed the contractual basis for all payment of financing costs.

Actual payments

3.02 As a result of the two agreements noted above, the final amounts paid to the various parties involved in the financing of the Boatswain’s Beach project are as follows:

	US\$
G.C. Ventures Corp. Ltd.	\$ 594,948.83
Live Oaks Capital Ltd.	384,895.30
Prospect Ventures Inc.	4,167.89
QuadCapital Advisors, LLC	403,655.07
William Blair & Company	<u>1,439,065.01</u>
Total financing fees	\$2,826,732.10

Financial arrangements of the Financial Advisory Services Agreement (FASA)

3.03 As mentioned above, an agreement was signed between the Turtle Farm and GC Ventures on 09 May 2003. This agreement was premised on the assumption that a SPE would be created to own the Boatswain’s Beach project. This entity would then lease the facility to the Turtle Farm.



3.04 The FASA stated that the amount that would be borrowed would be based on an initial budgetary plan of US\$36 million. In consideration of its efforts, the agreement entitled GC Ventures and QuadCapital to the following expenses and fees:

- A refundable advance of CI \$16,000 to GC Ventures for out of pocket expenses refundable from the advisory fee noted below.
- A non-refundable application fee of US \$10,000 to QuadCapital.
- A deposit of US \$40,000 payable to QuadCapital for expenses.
- A good faith deposit of 2% to QuadCapital. Fifty percent (50%) of this deposit was due on the signing of an indicative commitment with the balance due on the final offer. This deposit would be returned if the financing was arranged but the good faith deposit would be forfeited if the investors are prepared to close but the client chooses not to close. The first portion of the good faith deposit (US\$360,000) was paid to QuadCapital.
- An advisory fee of two and a half percent (2.50%) payable to GC Ventures on completion of the financing. This fee covered all of the underwriting commissions of the investors.

Financial arrangement with William Blair

3.05 After the government had decided to forgo the SPE financing and obtain direct bond financing for the Boatswain's Beach project, the Turtle Farm entered into an arrangement with William Blair on 15 December 2003. This arrangement had the following fees and expenses:

- A “*minimum*” fee equal to 1.00% of the proceeds from the funding.
- An incentive fee to be paid if the final interest rate on the funding was less than contemplated in the agreement.
- Retainer and expense deposits totalling US\$250,000.

3.06 The incentive fee was a unique feature of this agreement and resulted in a significant portion of the ultimate fees paid. The agreement between William Blair and the Turtle Farm contemplated that the interest rate for the financing would be approximately 5.9%. The calculation for this interest rate was the 10 year average life US Treasury yield (which was 4.40% on 15 December 2003) and 150 basis points or 1.5%.

3.07 The agreement stated that if the final spread was less than 150 basis points, William Blair would receive 50% of the present economic benefit of the reduced spread.



Table 1: Summary: Financing Costs Paid US\$				
Company	Description	FASA	Second Agreement	Total
GC Ventures	Final settlement	\$348,000		
	Bond placement fee	223,000		
	Expenses deposit (refundable)	19,048		
	Government financing fees	4,901		
	<i>Subtotal</i>	594,949		
Live Oaks	Final advisory commission	223,000		
	Final settlement	110,000		
	Expenses	51,895		
	<i>Subtotal</i>	384,895		
QuadCapital	Good faith deposit	360,000		
	Expenses	33,655		
	Application fee	10,000		
	<i>Subtotal</i>	403,655		
Prospect Ventures	Expenses	4,168		
William Blair	Incentive fee		\$957,000	
	Minimum fee		446,000	
	Expenses		36,065	
Total		\$1,387,667	\$1,439,065	\$2,826,732



Financing Payments

Payments to GC Ventures.

4.01 As previously mentioned, the total payments to GC Ventures was US\$594,948.83. This was made up of the following:

	US\$
• Two months expenses deposit (CI \$16,000)	\$ 19,047.62
• Government financing fees	4,901.21
• Fee from Bond Placement	223,000.00
• Final settlement	<u>348,000.00</u>
	\$594,948.83

4.02 The first major amount paid to GC Ventures was the payment of US\$223,000. This payment was made on 19 March 2004 and is equal to ½ of 1% of the US\$44.6 million bond issued by William Blair. An equivalent amount was paid to Live Oaks Capital on the same date. My discussions with officials with William Blair indicate that these amounts were paid directly to these two companies at the direction of Turtle Farm officials out of the \$44.6 million.

4.03 After the direct funding arrangement was completed, the Turtle Farm entered into discussions with GC Ventures as to the value of the work done by GC Ventures on behalf of the Turtle Farm. In an invoice dated 25 May 2004, GC Ventures billed the Turtle Farm for a total of US\$571,000 for the work done on the financing arrangement. This was calculated as 1,524 hours at a rate of \$375 per hour. The final payment of \$348,000 on 30 June 2004 was the difference between this calculation and the \$223,000 paid in March 2004 to GC Ventures.

4.04 It should be stressed that the major payments were **negotiated** amounts between GC Ventures and the Turtle Farm. The financing that this total fee was based on was never put into place and it seems reasonable, in my opinion, that the full amount contemplated in the FASA would not be paid. However, GC Ventures did have some entitlement to fees based on its agreement with the Turtle Farm from the FASA. Therefore, in my opinion the key question is whether this final amount paid was reasonable or excessive.

The fees paid to GC Ventures were excessive

4.05 After reviewing the files, it is my opinion that the amount claimed by GC Ventures and paid by the Turtle Farm is grossly excessive and that the residents of the Cayman Islands received little or no value for these payments. During my review of the files of the Turtle Farm relating to the financing of the Boatswain's Beach project, I discovered two pieces of correspondence that strongly influenced my opinion on this matter.



4.06 The first piece was the minutes of the Extraordinary General Meeting of the Shareholders of the Turtle Farm on 27 February 2004. The shareholder of the Turtle Farm, which is 100% owned by the Government of the Cayman Islands, was represented by Mr. Kearney Gomez, the Hon. George McCarthy and the Hon. James Ryan. At this meeting, the shareholders placed on record their concern on the “*excessive fees*” paid to all parties to the original transaction. During this meeting, it was noted that the fees had been renegotiated and that the following fees were payable:

“\$0.4 million to GC Ventures/Live Oaks Capital (for setting up the deal)...”

4.07 However, \$571,000 in direct fees was paid to GC Ventures with an additional amount of \$333,000 paid to Live Oaks for a total of \$904,000. I note that far from being a reduction in fees, the final amount was slightly more than the 2.5% fee (or \$900,000) contemplated in the FASA. I have not been provided with a reason as to why this substantially increased amount of fees has been paid.

4.08 The second piece of correspondence found in the file was a memo to Mr. Ken Hydes from Mr. Carson J. Wynne. Mr. Wynne was originally a director of GC Ventures but submitted his resignation from GC Ventures effective 02 August 2003. As such, Mr. Wynne was party to the efforts made to that date by GC Ventures relating to the Turtle Farm financing.

4.09 In his memo of 22 March 2004, Mr. Wynne claims that he personally spent 1242.5 hours on Phase 1 (the portion of the financing saga where an SPE was contemplated) and 437.5 hours in Phase 2 (the bond placement). However he goes on to say that:

*“FYI Suresh and David spent **zero hours in Phase 2** and I would think that it reasonable to assume that they could legitimately claim 60-100 total hours in Phase 1, combined for the two of them. Even that might be overly generous. ... they will claim (and quite legitimately) that they did some background work with LGB but I do believe that in total this would amount to more than 30 hours (sic) given the scarcity of LGB’s time.”*

4.10 These statements lead me to believe that the payments to GC Ventures were grossly excessive. Mr. Wynne makes the same conclusion at the end of his memo in the following extract:

*“As a parting thought, I would strongly advise you Ken to ensure that the corporate records of CTF reflect payment (if any) to GC Ventures for hours expended **solely** on Phase 1, as there is a great degree of animosity towards them from QuadCapital, William Blair and ourselves for the 11 months of wasted time and lack of delivery going down the wrong road. WB feels their total “value” would be in the order of \$25,000 in normal commercial circumstances in North America, to which QC would concur. The bottom line is that they performed no valuable role in either phase of the financing,*



measured in North American finance terms. They claim to have an intimacy with LG that was integral to the project which we know to be totally untrue and in fact caused great trepidation in Cabinet, with Attorney General and with the FS.”

Role of GC Ventures in the financing of the Turtle Farm

4.11 In attempting to complete my work evaluating the final amount paid to GC Ventures, I have asked the question, “What exactly was the role of GC Ventures in the acquisition of financing for the Boatswain’s Beach project?” I have directed this very question to Mr. Ken Hydes of the Turtle Farm. He told me that GC Ventures was the group that introduced the Board of Directors to the financiers (i.e. QuadCapital and William Blair). They were also involved in meetings concerned with the setting up of an SPE in the spring to fall of 2003.

4.12 My discussions with the ultimate deliverer of the bond, William Blair, revealed that GC Ventures had no direct involvement with the bond placement and were not known to the company prior to meeting them during the financing exercise.

4.13 Given the above, it appears to me that GC Ventures did little more than introduce the Board of Directors to the financiers and then attended meetings where the details of the financing were worked out. They seemed to have no direct involvement with the detailed workings of the bond arrangement and I think that it would be fair to say that the process would have continued in an equivalent manner even if they had not been involved beyond making introductions. In short, in my opinion this company added very little value to the financing process.

4.14 I believe that given the process and the limited role that GC Ventures played in the procurement of financing the Boatswain’s Beach project, the fee paid to them cannot be justified. In my opinion, the Board of Directors of the Turtle Farm was seriously remiss in their fiduciary duties by signing a financial advisory service agreement with them in the first place. Even if they felt that GC Ventures had provided a valuable service, the fee of 2.5% of the value of the financing seems grossly excessive. In conclusion, I believe that the residents of the Cayman Islands received little or no value for the almost US\$595,000 paid directly to GC Ventures.

The use of “Advisors” for financing transactions

4.15 From the start of my investigation, I have been concerned that the Turtle Farm chose to have “advisors” to assist them in this deal. The key question that I asked at the start of my investigation, and one that still has been not been resolved, is **why** advisors were needed at all. If Governments or Statutory Authorities need financing, the possible sources of funds are usually known to them. There is usually no need for advisors. This is the only instance that I am aware of where advisors were used for financing of a government project.



4.16 Others may argue that advisors were needed to assist in setting up the complex mechanisms for a SPE. Certainly, the Turtle Farm would need legal and accounting advice to ensure that the process would have been done properly. In fact, it did so and additional fees were paid to lawyers and accountants to set up an SPE and ensure that it had been done properly. Readers should note that I have not reviewed these expenses (which totalled approximately \$189,000) as technically they were not part of the financing charges and such fees are a normal part of all financing transactions.

4.17 However, it appears to me that the “advisors” in this case were merely the go betweens between the people providing the technical advice and the Board. While there may have been some value in such a role, I do not believe that it justifies the large fees paid to them.

4.18 In summary, I can see no substantive need for “advisors” at all for this transaction. While I can understand why firms such as GC Ventures would make a proposal to a Board of Directors to be involved in financing deals, I am at a loss as to why the Board of Directors of the Turtle and Farm, and ultimately the Cabinet, would feel the need to pay for this service.

Could the Turtle Farm have forced more favorable terms on GC Ventures?

4.19 I am sure that some readers of this report will reply that having signed the original agreement with GC Ventures the Turtle Farm had little choice but to make the payments to them. I do not believe, given the wording of the FASA, that this is the case.

4.20 In making such a determination, I felt it useful to look in detail at the exact wording of the advisory fee and whether GC Ventures had met its obligations.

4.21 The Advisor Appointment and Compensation was discussed in Section 3 of the FASA. I have taken the liberty of reproducing that section below.

3.1 The Client agrees to appoint the Advisor/Consultant for the named parties in Appendix “B” for the purposes of facilitating the Financing and the Advisor agrees to accept such appointment in connection with the Financing. In the event that the Financing is provided to the Client, in that said funds are made immediately available in liquid or other acceptable form, to the Client by the Investors, the Client agrees to pay to the Advisor on the date upon which the Financing is completed, by way of a deduction of proceeds on Closing, an advisory fee of two and one-half per cent (2,50%) (the “Fee”) of the amount of the Financing less the Refundable Advance indicated in Paragraph 2.1 hereof which amount shall be deducted from the said 2.5%.

3.2 The Fee shall be payable regardless of whether the Financing is completed during the term of this agreement or not providing that the Financing is completed within Twelve (12) months of the date of this agreement and involves a named party introduced to the Client by



the Advisor as identified in Appendix "B". The Fee shall cover all underwriting commissions of the Investors.

3.3 *If there shall be a dispute between the parties as to the amount or the method of calculating the Fee or any component of same, or any other dispute as it relates to the provisions hereof, such dispute shall be resolved in accordance with the Arbitration Law of the Cayman Islands.*

4.22 I note that William Blair, the company that provided the final bond funds, was one of the companies noted in Appendix "B" of the agreement. In addition, this financing was done within 12 months of the signing of the FASA.

4.23 Therefore, it may appear that GC Ventures was entitled to the advisory fee based on its agreement. However, under Section 1 of the FASA, the following stipulation was made:

The Client hereby appoints the Advisor on a "best-efforts basis" to facilitate the Financing with the right to procure a long-term Credit Tenant Financing special-purpose real estate financing commitment, senior note issuance and/or bond issuance by private placement and/or term sheet materially in accordance with the March 14, 2003 term sheet from QuadCapital attached hereto as Appendix "A" (the "Indicative Commitment") from the sources or their affiliates which the Advisor deems appropriate, and subject to the approval of the Client including (collectively, the "Investors"):

1. *QuadCapital Advisors LLC*
2. *William Blair & Company*
3. *Nesbitt Burns*

4.24 Based on my interpretation of the FASA, there are two major concerns with the payments that were made under it. The first is that the 2.5% fee that was discussed in Section 3.2 of the FASA notes that the fee "*shall cover all the underwriting commissions of the Investors.*" However, I note that GC Ventures, and through them Live Oaks, were paid over \$900,000 US **and** William Blair received over \$1.4 million separately for underwriting costs. In total, over \$2.3 million was ultimately paid out to GC Ventures and William Blair; a massive increase from the \$900,000 fee noted in the FASA or the \$1,115,000 calculated based on the final numbers of the final bond placement.

4.25 Using the numbers from the original FASA, GC Ventures would have been owed a total of US\$900,000 (2.5% of \$36,000,000). Of this amount, an underwriting fee would have been owed to the ultimate provider of the financing. The size of the underwriting fee was never explicitly stated but I believe that the fees would have been approximately one percent (1%) based on the subsequent agreement signed by William Blair. If this percentage was accurate, GC Ventures/Live Oaks would have owed the financiers \$360,000 and would have retained \$540,000 as a final amount under the FASA.



4.26 Another way of looking at the same issue is to calculate what GC Ventures and Live Oaks were entitled to net of underwriting fees based on the final bond arrangement. A calculation of 2.5% of the bond issue of \$44,600,000 is \$1,115,000. This would have been the entire fee payable. Out of this amount, the underwriting fee would have to be paid. Therefore, GC Ventures and Live Oaks would have owed William Blair at least the minimum fee of \$446,000 that was ultimately paid to them. This would have left the net proceeds for GC Ventures and Live Oaks at \$669,000. Yet, they were ultimately paid \$904,000 or \$235,000 more than what they would have been entitled to under the most generous interpretation of the FASA and \$364,000 if the terms of the FASA were applied.

Based on Bond Issue	\$44,600,000		Based on FASA	\$36,000,000
Fee Entitlement 2.5%	\$1,115,000		Fee Entitlement 2.5%	\$900,000
Amount Owed	GC Ventures \$669,000		Amount Owed	GC Ventures \$540,000
	Financiers \$446,000			Financiers \$360,000
Actual Payments	GC Ventures/Live Oaks \$904,000		Actual Payments	GC Ventures/Live Oaks \$904,000
Overpayment	GC Ventures/Live Oaks \$235,000		Overpayment	GC Ventures/Live Oaks \$364,000

4.27 In several documents, Turtle Farm management has made statements to the effect that they have reduced the final fee paid to GC Ventures and Live Oaks. I find this a puzzling statement. In taking the example above, I believe that these two companies have been overpaid by \$235,000 even if the position most favourable to them was taken. This is a far cry from any reduction claimed by the management of the Turtle Farm.



4.28 Secondly, in my interpretation of the agreement, GC Ventures is entitled to the advisory fee only if the final agreement is “*materially in accordance*” with the term sheet. In my opinion, the final agreement was **not** materially in accordance with the fact sheet for the following reasons:

1. The fact sheet amount was \$36,000,000. The final bond placement was \$44,600,000.
2. The term for the fact sheet was 25.5 years while the term for the final bond placement was 15 years.
3. The interest rate on the fact sheet was 6.75% while the interest rate for the final bond placement was 4.85%.

4.29 In essence, all of the important components of a loan were different than the one contemplated in the FASA. I therefore conclude that, as a matter of strict interpretation of the agreement, GC Ventures was not entitled to its advisory fee. Although the ultimate provider of the funds was one of the companies named in the FASA, I believe that the final agreement was not materially in accordance with the fact sheet as stated in the agreement.

4.30 However, I should also state that it would seem to be patently unfair to deny **any** payment to GC Ventures even if it could be justified from a strict interpretation of the agreement itself. It is clear that some efforts had been made by that company in securing the original funding. In addition, it was the decision of the government themselves that caused the original funding to be abandoned. Therefore, I conclude that it was reasonable, given the fact that the FASA had been signed by the Turtle Farm, to make **some** payment to GC Venture to reimburse them for their time.

4.31 However, I find the details of the final payment troubling. There is only a rudimentary accounting for hours spent. The total amount, over 1500 hours, seems very high. This is especially true in light of the comments of Mr. Carson Wynne. Also the rate of \$375 per hour seems excessive. If we assume that the two principals of GC Ventures were the ones who worked on this project, they were each given over \$285,000 for work that was done between May 2003 and December 2003, a period of eight months. Even if one assumes that they worked exclusively (which they did not according to their invoice), this would equate to an annual salary of over \$400,000 each.

4.32 Finally, I note that the \$19,047.62 was a refundable deposit. As yet, it has not been reimbursed to the Turtle Farm in accordance with Section 3.1 of the FASA. I recommend to the management of the Turtle Farm that this amount be recovered from GC Ventures as soon as possible.

4.33 It was also noted that GC Ventures signed a general release recognizing that they had no additional claims to compensation after they received the final disbursement of US\$348,000.



Payments to Live Oaks

4.34 The total payment to Live Oaks was US \$384,895.30. This was made up of:

Financial Advisory Expenses	\$ 51,895.30
Final Advisory Commission	223,000.00
Final Settlement	<u>110,000.00</u>
Total	\$384,895.30

4.35 This large amount of money was paid out even though there is no contractual obligation to this company in any of the documents relating to the financing of the Boatswain's Beach project. Live Oaks is not mentioned in the FASA nor could I find a contract between them and the Turtle Farm. When I questioned Mr. Ken Hydes about the legitimacy of the payments he sent a letter to Live Oaks. In this letter, Mr. Hydes wrote:

"Expenses were paid to Live Oaks. Under what arrangement or agreement were these expenses paid?"

4.36 Mr. John T. Fenoglio, President of Live Oaks Capital, responded to my Office on February 14, 2007 with the following reply:

"In accordance with the request from Kenneth Hydes, please be informed that Live Oaks expenses were reimbursed in accordance with instructions from Kenneth Hydes."

4.37 Readers will note that this does not answer the question as to why this company received any money from the Turtle Farm.

4.38 An understanding, at least partially, can be obtained from some of the documents reviewed during my investigation of the financing arrangements of Boatswain's Beach. The \$110,000 was paid to Live Oaks under a general release signed on the 19 May 2004. This release, which was signed by John Fenoglio, states in part that the payment is:

"..arising from the Releasor's entitlement pursuant to the Financial Advisory and Services Agreement dated effective May 8, 2003 to which the Releasor was a party pursuant to a fee entitlement and sharing agreement dated effective December 17, 2003 with GC Ventures Corp. Limited in respect to the US\$44.6 million financing completed on or about March 12, 2004."

4.39 Readers should note that I asked the management of the Boatswain's Beach project for a copy of the agreement between GC Ventures and Live Oaks. They stated that they paid the amounts above as directed by GC Ventures even though they did not have a copy of the fee entitlement and sharing agreement. As part of the investigation relating to the financing, Turtle Farm management did obtain the



agreement. The agreement does state that Live Oaks Capital is entitled to 50% of all GC Ventures fees under the FASA. Therefore, the obligation for payment to Live Oaks derives from the fact that GC Ventures decided, for whatever reason, to pay part of its fee to Live Oaks. I am not in a position to say why GC Ventures would have made such an arrangement.

4.40 As a result, I do believe it is fair to say that the portion paid to Live Oaks should be added to GC Ventures payments in determining the total value ultimately paid to GC Ventures. Using this assumption, I believe that GC Ventures were ultimately paid \$979,844.13 either through direct payments or payments directed to their partner Live Oaks. Of this amount, \$594,948.83 was paid directly to GC Ventures and another \$384,895.30 was paid to their “partner” Live Oaks Capital.

4.41 In paragraph 4.05, I concluded that I believed that the residents of the Cayman Islands received little or no value for the almost US\$595,000 paid directly to GC Ventures. Given the above, I believe that in addition to the \$595,000 received directly by GC Ventures, it caused another almost \$385,000 to be paid to Live Oaks. Needless to say, I also conclude that this amount was of limited or no value.

4.42 In addition, I find it incomprehensible why these payments were made to Live Oaks by the Turtle Farm. Live Oaks was never a party to any agreement signed by the Turtle Farm and therefore the Turtle Farm was under no legal obligation to make payments directly to them. Even if it is true that GC Ventures had entered into some fee splitting arrangement with Live Oaks (a situation that the Turtle Farm had no proof at the time), the only proper course of business would be for the Turtle Farm to make any and all payments to GC Ventures. Then, GC Ventures could have paid any amount that it wished to Live Oaks.

4.43 GC Ventures “justified” the vast majority of its payment (US\$571,000) by providing the Turtle Farm with an hourly accounting of its work. I have previously mentioned that I do not believe that this constituted good value for money but at least there was some justification about how the payment was calculated. However, there is no similar calculation for the funds paid to Live Oaks. In fact, I have found in my review not a single piece of paper that would justify the amount paid to Live Oaks. When questioned about the matter, officials from the Turtle Farm had no response. The only action taken was to write to Live Oaks and ask them to justify their payments. Readers will note the curt response above which is in truth no response at all.

4.44 There were three components to the payments made to Live Oaks. The first were for expenses totalling \$51,895.30. These were based on invoices sent to the Turtle Farm from Live Oaks. I am at a loss to understand why any of these amounts were paid. There was no contractual obligation between the Turtle Farm and Live Oaks. At best, Live Oaks worked as a partner with GC Ventures. In no way was the Turtle Farm responsible for these expenses and in my opinion they should not have been paid.



4.45 The second component of the payment to Live Oaks was the \$223,000 paid to it upon the settlement of the bond proceeds. As previously noted, the bond placer, William Blair, was directed to make a payment of that amount to each of GC Ventures and Live Oaks. Readers will note that the total amount paid to GC Ventures and Live Oaks equated to 1% of the total value of the Bond. The Turtle Farm stated that the \$223,000 was paid to GC Ventures as part of the ultimate settlement of \$571,000. Even though I have previously concluded that the \$571,000 should not have been paid, at least I can understand how the calculation was made. However, if the \$571,000 was the total and final amount that should have been paid to GC Ventures, how then can the \$223,000 that was paid to Live Oaks be justified? Live Oaks had no contractual obligations with the Turtle Farm. Rather, its rights to payment (if any) came from a fees splitting arrangement that the Turtle Farm has never seen at the time of payment! Therefore, this \$223,000 payment seems to have no basis either in contractual obligation or as part of the negotiated agreement with GC Venture. I believe that this payment should not have been made and that the management of the Turtle Farm failed in its fiduciary responsibility to the residents of the Cayman Islands when it authorized this payment. In short, I do not see any justification for this payment.

4.46 But even this payment of \$223,000 was not the one that is the most unusual. The final payment to Live Oaks was the payment of US\$110,000 based on the general release signed by Live Oaks. The simple question I ask is, “release from what?” Again Live Oaks had **no** contractual obligation with the Turtle Farm. It had some arrangement with GC Ventures but this was of no legal consequence to the Turtle Farm. Despite this, the Turtle Farm paid Live Oaks to release the Turtle Farm from any future claims by Live Oaks. Furthermore, since I have already calculated that GC Ventures and Live Oaks had been paid more than they would have been entitled to under the most liberal interpretation of the FASA, I am bewildered as to how this additional payment was even contemplated let alone paid.

4.47 In my opinion, this payment was totally without merit and should not have been paid. The Turtle Farm paid US\$110,000 to be released from claims from an organization that it had no contractual basis with and who had, along with their partner GC Ventures, been already paid more than they were entitled to according to their agreement. A large amount of money was paid in my opinion for something that had absolutely no value. In addition, there was no justification of the amount of US\$110,000. I found no documentation of any discussion or analysis by the Turtle Farm as to why this payment was made. It literally seems as if Live Oaks told the Turtle Farm that it would release it from future claims if they paid US\$110,000 and the Turtle Farm agreed. In my opinion, there was no basis to make this payment and the management of the Turtle Farm failed in its fiduciary obligations to the people of the Cayman Islands when it made this payment.



Payments to QuadCapital

4.48 The total amount of payments to QuadCapital under the FASA signed in May 2003 was US\$403,655.07, made up of:

An application fee	\$ 10,000
An expense deposit	40,000
A good faith deposit	<u>360,000</u>
Sub-total	\$410,000
Minus unused expense deposit	<u>6,344.93</u>
Total paid	\$403,655.07*

* The difference between this calculation and the amount paid is \$195.01 and is due to currency difference in paying in CI dollars and converting to US dollars.

4.49 These payments resulted from the FASA signed in May 2003.

4.50 It should be noted that if the original financing arrangement had gone through as originally planned, there would have been no expense under the good faith deposit clause. The FASA had originally contemplated a 2% good will payment. This good will payment would have been paid in two instalments:

- 1% (US\$360,000) which was paid on the execution of the indicative commitment i.e. 29 May 2003.
- An additional 1% which was to be paid on the issuance of a final offer of financing. The final offer document was never completed and therefore this second portion of the good faith deposit was never paid.

4.51 Clause 2.24 of the FASA stated that... *If due to no fault of its own the Investors are prepared to close but the Client chooses not to close the Good Faith Deposit shall be forfeited as liquidated damages.*

4.52 As a result of this clause, QuadCapital retained the \$360,000 portion of the good faith deposit already paid by the Turtle Farm, when the Turtle Farm decided to choose another source of financing. This amount was a direct cost of the decision not to proceed on the original funding basis. If the government had proceeded as originally planned, this deposit would have been returned to them.

4.53 As such, the payment of the \$360,000 was a consequence of the decision to choose a different form of financing. In the next section, I will review whether the decision to forego this SPE financing arrangement for a direct bond placement was a good one.



Was the original financing a good deal?

4.54 It has been argued that the amount in the “spread” (the number of basis points above the Treasury rate) was due to the fact that the borrowing would have been done by an SPE and not the government. This makes some sense as an SPE would require a greater spread than one made directly to the government as there would be more perceived risk to the investors. However, the key question here is not whether **some** increase in the spread was justified but **how much** that increase should be? The original SPE arrangement called for an interest rate that was 269 basis points (2.69%) above the Treasury rate. The agreement with William Blair contemplated a “nominal” rate of 150 basis points (1.5%) and ultimately obtained a rate of 78 (.78%) basis points above the Treasury rate. The difference between the SPE spread and the final amount was almost 2% here. Such a difference seems unjustified given that the SPE would be wholly owned by the Turtle Farm and the Government of the Cayman Islands and would have ultimately been supported by an agreement with the Turtle Farm (and ultimately the Government of the Cayman Islands) to a lease that would have insured the repayment of the loan. In short, the SPE would have been assured a stream of money guaranteed by the Government of the Cayman Islands. While I acknowledge that this is not the same as an outright ownership of the debt by the Cayman Islands, it seems that such an increase in risk does not justify the expense of an extra 2% in interest annually.

4.55 Therefore, it is my opinion that the loan arrangement contemplated by the FASA was not a good deal for the Cayman government. Given the other problems noticed regarding fees I cannot understand how this deal was allowed to proceed as far as it did as the terms seemed to be quite unfavourable to the government. Of course, if the deal had not been signed originally, then the government would not have been responsible for the US\$360,000 paid to QuadCapital when the FASA deal ultimately fell through. I believe that this cost to the government would have been avoided if a proper and comprehensive analysis of the original financing deal had been completed.

Payments to William Blair

4.56 William Blair received a total of US\$1,439,065 in financing fees. This was made up of the following:

Expenses	\$ 36,065
Retainer and expenses deposit	250,000
Incentive and minimum fee	<u>1,153,000</u>
Total	\$1,439,065

4.57 These fees were in accordance with the engagement agreement signed between William Blair and the Turtle Farm on 15 December 2003.

4.58 The retainer and expenses deposit was made up of a retainer of \$225,000 and an expense deposit of \$25,000.



4.59 The Turtle Farm borrowed US\$ 46,600,000 from William Blair in March 2004. The final interest rate on the bond placement fees was 4.85%.

4.60 William Blair was compensated in two ways for its participation in the bond issue. It was entitled to a minimum fee of 1% (US \$446,000) of the ultimate proceeds. In addition it was entitled to an incentive fee. The incentive fee was described as follows:

“If Blair shall provide a Financing proposal that is at a spread less than the 150 basis points mentioned above, Blair shall share 50% of the present value economic benefit of the reduced spread to the Company in the form of an Incentive fee that is in addition to the Minimum Fee above. For example, if the spread is 140 basis points, Blair will earn an Incentive Fee equal to the present value benefit of five (5) basis points of the Financing or approximately US\$150,000 based on a US \$45,000,000 15 year final maturity and a 10 year average life financing;”

4.61 When questioned about the details of how this payment was calculated, officials of the Turtle Farm could not provide an explanation. I was forced to communicate directly with William Blair directly to determine how the payments to that company were made.

4.62 The final financing was arranged at 78 basis points spread. This meant that the incentive fee was calculated at 72 basis points “saved”. The 10 year T-Bill rate at 12 March 2004 was 4.07%. Through a spreadsheet obtained from William Blair comparing the payments at 5.57% (T+150) and the final interest rate of the bond (4.85% or T+78), the value of the incentive fee owed to William Blair was calculated to be \$1,178,032.36. This meant that in addition to the minimum fee of \$446,000 that was contemplated in another section of the agreement, William Blair was entitled to a total of \$1,624,032.36 in accordance with the 15 December 2003 agreement.

4.63 Readers will note that William Blair was paid \$1,403,000 in fees. The difference between this figure and the actual amount owed (\$1,624,032.36) is \$221,032.36. This difference was explained in a letter addressed to my Office on February 16, 2007 which stated,

“The simple yet fundamental reason for the differential was William Blair believed it was adequately compensated for its efforts and wished to provide the residents of the Cayman Islands a gesture of “good faith.”

Was the arrangement with William Blair a fair one?

4.64 In reviewing the components of the payments to William Blair it is important to look at each of the two key components; the payment of the minimum fee (1%) and the incentive fee.



4.65 The minimum fee is common on many financing arrangements and it is not unusual to see a fixed fee for financing deals of this size. In addition, the use of an incentive fee is not unheard of in such a deal. Therefore on the face of it, the fees in the arrangement do not seem unusual.

4.66 However, in reviewing the arrangement with William Blair, I believe the two key questions are:

1. Is the 1% minimum fee reasonable in this case? and;
2. Should there be an incentive clause? If so, at what rate should the bar be placed so that an interest rate below that amount should constitute an “saving?” In theory, the bar should be set so the “savings” constitute a real benefit from what would have been found “normally.”

4.67 So were the fees paid in this case excessive? The following examples of other government financing around the same time period were used by this Office in determining if the fees paid to William Blair were reasonable or excessive.

4.68 The first loan was one that the government negotiated on 08 April 2003. In this loan, the government borrowed \$163.2 Million for 15 years from a private placement. The interest rate on these borrowings was 5.30% which were 135 basis points above the 10 year treasury rate of 08 April 2003. The total fees paid including expenses was \$885,551 or .54% of the funds borrowed. Of the \$885,551 of total expenses, the joint fee of \$571,000 was split between two companies who acted as agents for the government. This fee was equal to .35% of the total amount borrowed. The remaining amount (\$314,551) was for legal fees and transaction costs. There was no incentive fee.

4.69 The second loan was one made to the National Housing and Community Development Trust on 28 October 2004. At that time, the Trust borrowed US\$14,500,000 at a rate of 5.238%. The term was 20 years and the loan was guaranteed by the Government of the Cayman Islands. The interest rate was 115 basis points above the 10 year Treasury rate at that date and was 51 basis points above the 20 year rate. The total fees paid were \$184,185 or 1.27% of the total funds. The fee for this transaction was 1% or \$145,000. The remainder of the fees were for lawyer costs and transaction costs. There was no incentive fee.

4.70 I believe that these comparisons are valid in that in both cases the government borrowed money in a private placement. In the first case, the government borrowed approximately four times the size of the borrowing for the Turtle Farm. In the second example, the borrowing was only one third the size of the borrowing of the Turtle Farm. I believe both examples are useful in making some conclusions regarding whether the Turtle Farm received good value for the fees paid.



The Minimum Fee

4.71 The first point of conclusion relates to the minimum fee paid. The placement fee paid in the case of the government borrowing was \$571,000 or .35% of the amount borrowed. In the case of the borrowing by the Trust, the placement fee was \$145,000 or 1% of the amount borrowed. This is consistent with information that I have received independently that the placement fee can be as high as 1% but usually decreases as the size of the loan increases.

4.72 In the Turtle Farm, the placement fee was 1% of the amount borrowed or \$446,000.

Date	Entity	Amount Borrowed US\$	Placement fee as a percent of funds borrowed	Negotiated Rate (based on 10 year Treasury Bill)
08-Apr-03	Government	\$163,200,000	0.35%	+ 1.35
12-Mar-04	Turtle Farm	44,600,000	1.00%	+ 1.50
28-Oct-04	NHCDT	14,500,000	1.00%	+ 1.15

4.73 Given these facts, it is my conclusion that the amount paid to William Blair for a placement fee was reasonable but at the high end of such transactions. Given that the Government had paid a 1% fee for a much smaller loan and only .35% for a much larger loan, I would have expected negotiators for the Turtle Farm to have requested a rate lower than 1%. If we use the two points noted above, and used them to extrapolate a value for a loan the size of the Turtle Farm's, a value of .85% would be obtained. If the placement fee had been set at such a rate, the Government would have saved over \$65,000.

The Incentive Fee

4.74 The situation is even clearer in the case of the incentive fee. In both the Government's borrowing of \$163.2 million and the Trust's borrowing of \$14.5 million, there was no incentive fee. In the case of the Turtle Farm, in addition to the large amount of the fixed fee, there was an incentive fee that generated another almost \$1.2 million in fees. Therefore, it seems clear to me that compared to the Government's borrowing of \$163.2 million and the Trust's borrowing of \$14.5 million, the Turtle Farm's borrowing of \$44.6 million was extremely generous in relating to fees generated by the agent.

4.75 One other point that can be discerned from the comparison above is the rate at which the incentive fee kicks in. In the agreement with William Blair, the incentive fee starts at 150 basis points. However, the Government had borrowed funds at 135 basis points in April 2003. In 2004, the Trust borrowed funds at 115 basis points above the ten year rate and only 51 basis points above the 20 year rate. As mentioned



above, I do not agree that **any** incentive fee was appropriate in that other government borrowing had been done without such a fee. However, it could be argued that an incentive fee may be appropriate if it would result in additional government savings. However to do so, the rate at where the incentive should **start** should be at the lowest level that government could have borrowed otherwise. Given the two examples above where the Government borrowed money at between 115 and 135 basis points, I believe that the rate should have been set in that area if an incentive fee was to have been used. If the incentive fee had been set at 120 basis points, the Government could have reduced the incentive fee by 15/72 or 20.8%. This would have equated to a savings of approximately \$500,000.

4.76 The final point that should be made before coming to a conclusion relating to the fees paid to William Blair was their statement that they did not charge all that they were entitled to under the agreement. In the final analysis, the company did not charge over \$220,000 that it was entitled to as a gesture of good faith. I applaud such generosity and am grateful that the financing fees were not even higher than they actually ended up being.

Conclusions relating to the payments to William Blair

4.77 The payments to William Blair were made up of two components, the minimum fee and the incentive fee. In my opinion, the minimum fee was at the high end of fees paid for other similar government financing transactions. As such, I believe it could have and should have been negotiated for a smaller amount. However, I have deeper concerns about the incentive fee. This has not been a consideration in other financial agreements and given the high amount of the minimum fee, I believe that William Blair was already adequately compensated for its efforts. Given its minimum fee, it should have been providing its client, the Turtle Farm, with financing as cheaply as possible. However, even if an incentive fee was contemplated, I believe that the bar of 150 basis points was much too high and should have been reduced substantially.



Did the Government Receive Good Value from the Final Financing Deal?

5.01 It has been argued by the Turtle Farm that in spite of the high costs of financing, the ultimate deal for financing was a good one in that the interest rate obtained was lower than any other government financing of the same time period. It is certainly true that the final interest rate (4.85%) was lower than other agreements and this will result in lower interest costs over the years.

5.02 However, I do not believe that this can be the final answer to the question of whether this was a good deal for the government. A good interest rate was obtained and should be acknowledged. However, the more relevant question to my mind would be, “did the Government have to pay **so much** to get such a deal?”

5.03 To get an overall perspective it is necessary to consider the following facts:

- Under the SPE vehicle of financing the development of the Turtle Farm, funding would have been done on a “spread” of 269 basis points or 2.69% above the US 10 year Treasury average. Using the rate used in the final arrangement with William Blair (4.07%) the rate of the agreement if signed then would have been 6.76%.
- If the direct bond placement had gone ahead at the “normal” spread of 150 basis points as contemplated in the William Blair agreement, the bond agreement would have been signed at a rate of 5.57%.
- The final agreement was for an interest rate of 4.85%.

5.04 Therefore, a preliminary analysis would indicate that the switch from a SPE type of funding to the direct bond structure was quite advantageous to the Turtle Farm. The difference in rates was 1.91% annually. On the loan balance of US\$44,600,000, this resulted in a saving of over \$7.5 million in interest over the life of the loan.

5.05 Therefore, I believe that the decision that was made in November 2003 to stop the processing of the SPE financing and obtain a direct bond placement was a good one and one that saved millions of dollars in financing charges. As such, I applaud the officials who made the decision at that time. However, it is important to note that it is my opinion that such a decision should never have had to have been made if the Board had done some due diligence before signing the original FASA. If the deal had been reviewed objectively, I believe that no one would have come to a conclusion that paying an unproven firm 2.5% of US\$36,000,000 for arranging a loan that would have been 269 basis points over the Treasury rate made any kind of financial sense. There was already evidence that money could be borrowed substantially cheaper. In my opinion, it seems incomprehensible how a large payment to a firm that was only guaranteeing a **higher** interest rate could be justified. In short, I am at a loss to understand how the original FASA was ever signed in the first place; it represents poor financial value and contemplates large advisory fees for very little effort. In my



opinion the original FASA should never have been signed and if it had not then a large part of the fees that were ultimately been paid would not have been paid.

5.06 Another way to look at whether this financing was a good deal is to compare it to other government funding at approximately the same time.

5.07 It appears from any objective analysis that the interest rate obtained for the Boatswain's Beach financing was an excellent one. The final rate as noted was 4.85% which was 72 basis points above the ten year Treasury rate at that time. This compares extremely well with the other two government financing arrangements noted in the same time frame. The Trust funding had an interest rate of 5.238% which was 115 basis points above the 10 year Treasury rate at that time. However, it should be noted that the Trust financing was for 20 years instead of the 15 year rate for the Turtle Farm and that the Trust's interest rate was only 51 basis points above the relevant 20 year Treasury rate.

5.08 The interest rate for the Turtle Farm's financing also compares favourably to the Government's borrowing of April 2003. In that much larger placement, the Government obtained an interest rate of 5.30% which was 135 basis points above the 10 year Treasury rate at the time.

5.09 So by any objective measurement, the final interest rate obtained by the Turtle Farm was a good one.

5.10 However, it does not mean that the fees paid were reasonable.

5.11 The Turtle Farm, or any government organization, should try to obtain financing as cheaply as possible. To do so, it should spend extra money if the end result would be to save even more. There is no doubt that the final conclusion was that the Turtle Farm ultimately got a very good deal on the ultimate financing package. However, the key question that needs to be addressed is whether the money spent in placement fees ensured the Turtle Farm those favourable rates.

5.12 In my opinion, it did not. I see no effect of the payments to GC Ventures and Live Oaks that helped in securing a good interest rate. Their role, in my opinion, only related to the SPE financing and they were not involved in any way with the ultimate bond placement.

5.13 In addition, I view the payment to QuadCapital to be contractually obligated but again of no consequence to the final interest rate. If, as previously stated, the original FASA had been scrutinized more thoroughly, the agreement should not have been signed and the Turtle Farm would not have to pay a fee to break the agreement.



5.14 As previously noted, I believe that the payments to William Blair were high given the fees paid in other financing transactions. However, it must be acknowledged that the arrangement did result in a very low rate of interest. This may have been due to the use of an incentive agreement. I have no problem with the concept of an incentive agreement but in this particular case, I believe that the “bar” chosen was too generous and resulted in more fees than could be justified.

5.15 In conclusion, I believe that the Government did get a good deal when arranging this financing. The final terms compare favourably to other borrowings of the times. However, I do not believe that the Government needed to pay the fees that it did to get such a good deal. I believe that the Government could have received such terms with much less payments.



Conclusions Relating to the Financing Expenses

6.01 I realize that the discussions above are very difficult to follow as they involve large sums paid to numerous parties. I have had to be precise in calculating the amounts paid and to whom and when they were paid. However in the final analysis, I have come to the following conclusions:

- **Payments to GC Ventures:** The total amount paid was approximately US\$595,000. I could find little value for the money spent here. The company provided little services for the fees generated and in the words of one of the previous owners generated less than \$25,000 of value added. On that basis, I believe that the Turtle Farm overspent \$570,000 in making payments to this company.
- **Payments to Live Oaks:** Payments to this company totalled approximately \$385,000. I have found no contractual obligation for any of these payments and conclude that the total amount should not have been paid and yielded no value to residents of the Cayman Islands.
- **Payments to QuadCapital:** Payments to this company totalled approximately \$404,000. Of this amount, \$360,000 was incurred to break the original financing arrangement. In my opinion, this could have been avoided with some due diligence and as such the payment of \$360,000 represents no value to the residents of the Cayman Islands.
- **Payments to William Blair:** Payments to this company totalled approximately \$1.4 million. Of this amount, \$446,000 was related to a fixed fee. This seems high compared to other government borrowings. The incentive fee generated \$1.178 million (although \$250,000 was forgone by the company as a good will gesture). In total, I believe that the fees paid to this company were at best \$340,000 too high.

6.02 So in the final analysis, of the \$2.8 million relating to the financing of the Turtle Farm, I believe that over \$1.65 million was of little value to the residents of the Cayman Islands.

6.03 I am sure that most residents of the Cayman Islands will find such wanton disregard to the use of their funds to be appalling. I would agree with them. In the course of almost 30 years of government auditing, I have difficulty thinking of any situation which showed such a cavalier attitude to the expenditure of such sums. Agreements were signed which clearly were not in the best interest of the residents of the Cayman Islands. Numerous firms were paid vast sums that were either a gross exaggeration of the value of their services or well beyond what would normally be spent in a similar situation. In some cases, there appeared to be no value at all for large sums spent. In other cases, moneys were paid without a clean understanding of how the sums had been calculated or even without documentation that the money was owed to the people it was paid to.



6.04 I believe that the entire handling of the financing arrangements for the Boatswain's Beach project was handled in a very cavalier manner and with little regard for financial probity.

