

UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF NEW YORK

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SECURITIES AND EXCHANGE COMMISSION :

*Plaintiff,* :

vs. :

Case No. 1:10-CV-457  
(GLS/CFH)

McGINN, SMITH & CO., INC., :  
McGINN, SMITH ADVISORS, LLC, :  
McGINN, SMITH CAPITAL HOLDINGS CORP., :  
FIRST ADVISORY INCOME NOTES, LLC, :  
FIRST EXCELSIOR INCOME NOTES, LLC, :  
FIRST INDEPENDENT INCOME NOTES, LLC, :  
THIRD ALBANY INCOME NOTES, LLC, :  
TIMOTHY M. McGINN, AND :  
DAVID L. SMITH, GEOFFREY R. SMITH, :  
Individually and as Trustee of the David L. and :  
Lynn A. Smith Irrevocable Trust U/A 8/04/04, :  
LAUREN T. SMITH, and NANCY McGINN, :

*Defendants,* :

LYNN A. SMITH and :  
NANCY McGINN, :

*Relief Defendants, and* :

GEOFFREY R. SMITH, Trustee of the :  
David L. and Lynn A. Smith Irrevocable :  
Trust U/A 8/04/04, :

*Intervenor.* :

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**RECEIVER'S REPORT REGARDING SMITH TRUST  
SACANDAGA PROPERTY AS DIRECTED BY  
MEMORANDUM-DECISION AND ORDER DATED  
SEPTEMBER 11, 2013 (DOCKET NO. 592)**

This report ("Report") is filed by the Receiver, William J. Brown, Esq., pursuant to the Court's direction in the Memorandum-Decision and Order dated September 11, 2013 ("MDO") (Docket No. 592 at pages 10 - 11).

The Report is organized into six sections:

- (a) Summary of Report;
- (b) Background;
- (c) Process Employed in the Preparation of the Report;
- (d) Budgets and Appraisal;
- (e) Answers to the Five Topics Requested by the Court at Pages 10-11 of the MDO; and
- (f) Conclusion.

The attached Exhibits contain additional narrative and reports. Exhibits B, C, D and E have been filed with the Court under seal pursuant to Court Order. The confidential Exhibits have been delivered to the Securities and Exchange Commission, the Smith Trust trustee, and counsel for the Smith Trust.

A draft version of this Report was made available on October 8, 2013 to the SEC, the Smith Trust trustee, and counsel for the Smith Trust to permit them to comment or provide corrections prior to the Report being finalized and filed with the Court. The Receiver received comments from all parties, some of which have been incorporated into the Report.

#### **Summary of Report**

The Receiver has concluded following extensive review of the circumstances, the real property currently owned by the David L. and Lynn A. Smith Irrevocable Trust ("Smith Trust") on Sacandaga Lake (collectively, "Property"), and the Smith Trust bank accounts, that in order for the Receiver to be able to reach a recommendation with respect to the Property, he must

first determine whose interests are to be protected and considered. The Receiver believes that the paramount interest is to first protect the interests of the defrauded McGinn Smith investors and secondarily to “consider” (to the extent possible) the “Smith Interests”<sup>1</sup> without differentiation of who among the Smith Interests may have a greater or lesser interest. Assuming the Smith Interests have an interest to be protected or considered, the Receiver concludes that a sale of the Property is the best course of action for the reasons stated in this Report.

### **Background**

The purpose of this Report and the scope of the Receiver’s involvement are stated in the MDO.

By way of further background, when Lynn Smith failed to disgorge the \$944,848 and the \$51,232 as required by this Court’s July 20, 2011 Order (Docket No. 342), the Receiver made a written information request to counsel for the Smith Trust and Lynn A. Smith in order to begin an evaluation process to obtain the maximum potential value for the Property in accordance with this Court’s Order. A copy of that information request is attached as **Exhibit A**. The Receiver and two real estate agents inspected the Property on October 19, 2011. Subsequently, the Trust obtained a stay of any sale pending appeal which consequently deferred the Receiver’s decision on how to proceed. In the interim, the Receiver has visited the Property on three occasions and approved the payment of expenses to preserve the Property.

The Property consists of three parcels of real property aggregating approximately 1.41 acres. Two of the parcels are improved by three seasonal residences (one main house and

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<sup>1</sup> “Smith Interests” is a term used in the Report to collectively refer to the interests of Lynn A. Smith (former owner of the Property and relief defendant), Geoffrey and Lauren Smith (purported beneficiaries of the Smith Trust), and the Smith Trust which is the current owner of the Property and cash totaling approximately \$1,948,316 which is controlled by the Receiver plus several other investments (collectively, “Smith Trust Assets”), all of which is subject to the Court’s Freeze Order.

two cottages).<sup>2</sup> The main house is located on Sacandaga Lake with a year to year 45 foot lake access permit issued by the Hudson River - Blue River Regulatory District (“HRRD”). The two cottages are on one parcel on the rear portion of the site and have no independent beach access since they do not have a HRRD lake access permit. The lack of permit potentially impacts the market value of the cottages if sold independent of the main house, and obtaining a permit is not likely for the cottages. But, if such a permit was obtained, it would further reduce the main house beach frontage to the detriment of the main house. There is an existing ten foot wide lake access permit granted to a neighboring residence which allows that residence the right to use an adjacent ten foot strip of the Property’s beach. These narrow ten foot lake access permits for non-lakeside property owners are not considered desirable by lakeside property buyers. The lake shore is owned by New York State and is at least partly the reason for the permit access system. None of the structures on the Property are currently suitable for winter occupancy.

On September 26, 2013, the Receiver was informed by the Smith Interests for the first time that the “dock, furniture, tools, machines and artwork” at the Property do not belong to the Smith Trust, the owner of the real property. This creates a potential complication for any rental scenario as discussed later in the Report, but see footnote 7 below.

A more specific description of the Property along with maps and photos are contained in the Summary Appraisal Report (“Appraisal”) attached as **Exhibit D** at pages 16-24.

The Property was purportedly acquired by Lynn A. Smith from her father. In July 2010, Mrs. Smith conveyed the Property via three deeds to the Smith Trust for \$600,000 plus closing costs. Those deeds are attached to the Appraisal at pages 48 - 63. Since the Court’s stay was re-imposed, the Receiver, working through and with the Smith Interests, has paid utility,

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<sup>2</sup> While a survey has been requested from the Smith Interests numerous times since September 7, 2011, the Receiver was informed in late September 2013 that no survey existed.

insurance and tax bills and approved and paid for certain repairs to the Property requested by the Smith Interests. Those costs have been paid with cash from the Smith Trust cash (described in footnote 1) and are listed in the Non-Rental Budget and the Rental Budget attached as **Exhibit B**.

**Process Employed in the Preparation of the Report**

To prepare this Report, the Receiver relied upon his review of his 2011 due diligence materials which included information from the Smith Interests, public information from local governments and government web sites such as town assessor records, information received from prior but different real estate broker communications, the Receiver's two prior site visits (on October 19, 2011 and on July 25, 2013 to inspect the need for certain repairs), the Receiver's site visit on September 18, 2013 with a different real estate broker and an appraiser, various communications with the Smith Trust trustee, David Smith, and Lynn Smith, and the Receiver's experience in dealing with the Property since September 7, 2011.

Additionally, the Receiver retained an MAI appraiser<sup>3</sup> to appraise the Property and contacted a local real estate broker<sup>4</sup> who has extensive sales experience on Sacandaga Lake and also lives on the same lake. Those two professionals accompanied the Receiver on a September 18, 2013 site visit to the Property during which they were able to inspect the Property and the interior and exterior of all three houses on the Property and ask questions of the former owner, Lynn A. Smith.

The appraisal firm has delivered its 68 page Appraisal which is attached as Exhibit D. The Appraisal values each parcel independently. The real estate broker has given the Receiver his conclusions and recommendations as to the potential sale or rental<sup>5</sup> of the Property

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<sup>3</sup> Conti Appraisal & Consulting, LLC.

<sup>4</sup> Christian C. Klueg of CMK & Associates Real Estate.

<sup>5</sup> The broker's advice was provided prior to the Receiver being informed that the dock, furniture, tools, machines and artwork were not owned by the Smith Trust and might not be available for use if the Property were rented.

and those are reflected in the answers to Topics 1 and 2 below and in Exhibit C. The broker views the Property as being capable of sale in a number of different ways including as one parcel, or one cottage to a neighbor who may want more land, or one cottage coupled with the main house, or both cottages and the vacant land separately. Thus, the broker presents a range of value recognizing that the cottages are likely to take more time to sell (if sold separate from the main house) given their limitations. Any sale would require careful consideration of sufficient parking for each structure and road access. A survey would be necessary to make this determination.

The Receiver and his staff also prepared two budgets -- a "Non-Rental" and a "Rental" budget for the Property based on actual expenses to date and projected expenses based on experience to date and the Receiver's investigation as to what projected income and expenses are likely to be going forward under a non-rental and a rental scenario. The Non-Rental budget assumes the Property is not rented, and the Rental Budget assumes it is. A discussion of the Budgets is set forth below.

### **Budgets and Appraisals**

The Non-Rental budget reveals based on actual experience to date that there is a minimum annual cost of \$18,081 per year in utility, real property tax, and insurance expenses alone without providing for the cost of summer lawn maintenance (\$1,000), winter snow maintenance (plowing and roofs) (\$3,000)<sup>6</sup>, beach preparation (\$250), repairs (\$750), and the cost to open and close the properties (\$600). The additional costs would bring the annual expense or net negative cash flow total to \$23,681.

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<sup>6</sup> The Receiver has been informed that snowplowing and removal of roof snow has not been done historically. Especially given the absence from the area of Geoffrey and David Smith and for fire protection and other reasons, the Receiver intends to engage a snow plow service this winter.

In 2013, there were capital expenses of \$6,597 for drainage and roof repairs. It is reasonable to expect that capital costs will continue annually including staining of the main house exterior and exterior window repairs in 2014. The Receiver has estimated \$3,000 in 2014 for capital expenses, yielding a total net negative cash flow of \$26,681 for 2014.

The Rental budget uses the same historical expense base and adds to that the increased costs of insurance (to add rental coverage), utilities, interior cleaning before and after each rental, rental supplies such as replacement of broken items, cleaning products, towels and sheets, cable TV and internet, and rental management. As a result, assuming the Property could be rented for ten summer weeks at \$2,500 per week (without consideration of likely vacancy or discounts), the projected net negative cash flow in 2014 is (\$9,233) if rented versus (\$26,681) in the non-rental scenario.<sup>7</sup> A rental period of fourteen weeks as the Smith Interests suggest is not likely due to weather, black fly season, and schools still being in session. See *Black Flies Put Bite on Tourism*, The Philadelphia Inquirer (June 7, 1993) attached as **Exhibit B**.

The Receiver believes there is a greater chance for the rental scenario net loss to increase rather than decrease because the Rental budget is as optimistic as the Receiver could make it based on his due diligence. Furthermore, the Property has not been recently rented by the Smith Interests, so there is no meaningful historical evidence of the ability to rent it or the terms on which it could be accomplished.

Sacandaga Lake is not a “destination” lake like Lake George which has a prominent and active rental market with new renters each year and rental agents. The Receiver was consistently informed that if he could find renters on Sacandaga Lake, the net rental income

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<sup>7</sup> Following their receipt of a draft of the Report, the Smith Interests “expressed a willingness” to cause the following Property costs to be paid: cleaning, beach preparation, repairs-general, and open/close of Property which the Receiver’s budget values at a total of \$5,200 per year. If accomplished, the projected net negative cash flow in 2014 would be (\$3,033) if rented and (\$24,081) if not rented. The Smith Interests also expressed their willingness “to waive all potential liability of personal property” and make it available at no cost if the Property were rented.

would likely cover the cost of the real property taxes but not more. On Sacandaga Lake, it appears that most homeowners use websites such as homeaway.com to locate renters since there is not an established rental brokerage market. The Receiver is not in a position, nor should he be, to directly engage in the property leasing business. The Smith Interests have not offered to be the rental agent even assuming that would be acceptable to the Court or the Receiver.

**Answers to the Five Topics Requested by the Court at Pages 10-11 of the MDO**

Topic 1.      Market Value of the Property - The summary market values of the Property are set forth on **Exhibit C**. The Appraisal is attached as **Exhibit D**. The expected holding period if the Property were marketed for sale would range from 6 months to 12 months.

The July 2010 Property conveyance by Lynn Smith to the Smith Trust was not an arms-length transaction. There are no other recent arms-length sales affecting the Property.

The Smith Interests claim to have based their \$600,000 purchase price on the sale of an adjoining property and a Property Profile and Market Analysis prepared by Leah Slocum of Realty USA in Delmar, New York. The Receiver has reviewed that report and does not find the “comparables” appropriate since most are described as “new”, “newly remodeled” or “updated”, none of which applies to the Property. Additionally, the Slocum report presents lakefront homes which have two to three times the beachfront enjoyed by the Property which is a significant value point. A copy of the Slocum report is attached as **Exhibit E**.

Topic 2.      Expectations that the market for the Property will improve in the foreseeable future - While there is more demand and more sales volume in the Sacandaga Lake market recently, the market prices on Sacandaga Lake are described as “stable” and not seen as materially rising or declining in any appreciable manner in the near future. The following chart provided by the broker is illustrative of this conclusion:



|                   | 2011      | 2012      | 2013      |
|-------------------|-----------|-----------|-----------|
| Sales:            | 71        | 94        | 113       |
| Avg. Days on Mkt: | 121       | 138       | 151       |
| Avg Sales Price:  | \$273,000 | \$296,000 | \$292,000 |

These statistics are for Sacandaga Lake properties which are lakeside or with lake access and which closed (sold) between May 1, 2011 and October 7, 2011, May 1, 2012 and October 7, 2012, and May 1, 2013 and October 7, 2013. The “average days on market” statistics can be deceiving because property listings often expire and are then relisted with the same or different broker. The relisting starts a new “days on market” calculation. There are currently about 40 Sacandaga lakefront properties on the active market listed for sale between \$250,000 and \$999,999. There are approximately 200 cottages for sale on the lake in the \$100,000 to \$250,000 price range.

Thus, the broker believes and the Receiver agrees that the likelihood of a successful sale has increased for a Sacandaga Lake property which is properly priced. The Receiver does not expect any increase in market value to offset the annual cost of continuing to hold the Property pending the outcome of the SEC action in this court which the Receiver estimates will take at least another 24 months given likely appeals. In other words, the cost of holding the Property is a net loss (resulting in a reduction of currently held Smith Trust cash) even if the Property were rented for a portion of the year. See the Budgets attached as Exhibit B and the Receiver’s discussion in Topic 4 below.

Topic 3. Whether the property is being maintained and whether additional debts are being incurred - It appears that the Property was reasonably well-maintained prior to the commencement of the business and legal issues of the Smith Interests. It is now beginning to

show signs of wear as evidenced by the need late this summer to replace the roof on the white cottage and replace a section of an underground drainage culvert to avoid storm water running down the middle of the Property and possibly flooding two of the buildings. Additionally, the exterior of the main house needs to be re-stained and there is woodwork on one or more of the houses that is rotting around the windows which needs to be replaced. Other likely repairs will arise especially given the age of the buildings and the harsh winter climate at the Adirondack lake shore.

The Property, while in a nice location is subject to serious weather conditions which take their toll on the exterior elements of the property. If the Property was not attended to, its condition would deteriorate rapidly. Up until this summer, it is believed that some combination of Geoffrey Smith and/or David Smith took care of many of the exterior maintenance issues at the Property. Presently, neither of them are available to continue to do that since one now lives out of state and the other is incarcerated.

Under the existing court orders, the Receiver views it his responsibility to at least maintain the status quo at the Property to the extent he is aware of the need for work to be done. If the Property were not to be sold for some period of time, the Receiver's burden and the cost to maintain the Property will only increase as evidenced by the budgets attached as Exhibit B.

Topic 4.      Whether the equity in the property will be preserved - In reviewing both the Rental budget and the Non-Rental budget attached as Exhibit B, under no circumstances will the current equity in the Property (including Smith Trust cash) be preserved even if the value of the Property does not depreciate.

The Receiver pays ongoing Property expenses from Smith Trust bank accounts at Kinderhook Bank which were previously frozen by Court Order. In 2012, for example, the Receiver authorized Property preservation payments of \$25,298.79, and \$35,625.28 from

January 1, 2013 through October 1, 2013. At best, a rental of the Property pays for the annual real estate taxes, but the costs of rental and the consequences thereof cause an additional depletion of Smith Trust frozen cash. One could argue that simply maintaining the Property and not renting it would be a more prudent approach than renting the Property which is likely to result under almost any scenario in further expenses to repair and other risks of loss the Property after summer rentals and to maintain it in the condition to obtain a satisfactory rental price. A successful sale or sales best preserves equity for the defrauded investors or the Smith Interests. The equity in the Property and the Smith Trust Assets are what they are today.

Topic 5. Whether the value of the Property will appreciate significantly to compensate for the expenses being incurred - The value of the Property is not likely to appreciate in any material amount to compensate for the rental or non-rental expenses to be incurred. See answers to Topics 1 and 2 above. The town assessor did not increase the Property's assessment following the transfer of the Property from Lynn Smith's name to the Trust in the weeks between the Court lifting the stay and re-imposing the stay.

### **Conclusion**

There is no economic justification to continue current ownership of the Property. It would also be contrary to the Receiver's duties to maximize recoveries for the defrauded investors.

The Receiver would not rent the Property for the reasons described in this Report including the potential inability or difficulty to retain a responsible rental agent in the Sacandaga Lake market, the risk of increased damage and wear and tear to the Property, and the complications associated with the claimed ownership of the furniture, equipment and artwork by Mrs. Smith. The possible rental income is offset in the Receiver's view with the obligation to hold the Property for a continued period of time, with the risks associated with that decision, and

the depletion of cash from the Smith Trust accounts. The Smith Interests have not produced a full season tenant with adequate monetary security previously or now.

The Receiver would list the Property for sale while interest rates are reasonably low and while maintaining the Property in a status quo condition. The exact methodology of a real property listing (including access to the Property) would be developed to maximize the value of the Property. Offering the Property for sale at a price of \$600,000 or more attracts a different type of buyer and not as plentiful a buyer as compared to properties selling in the \$400,000 to \$500,000 range. Thus, the Receiver would explore both the sale of the main house separate from or with the two cottages, or selling one of the cottages or the vacant land to an adjoining neighbor who may want the additional land. Winter is not necessarily a poor time to list the Property for sale. Serious buyers want to find a property to purchase by Spring. Informed buyers want to see a property when the lake level is at its lowest (which is now) so that they can assess the beach.

In any event, it is reasonable to expect that there would be at least another 6 to 12 months to hold these Properties, incurring the costs thereof. Given the location of the Property, on the lake and exposed to the weather, with the risk of vandalism or fire, the Receiver does not believe it prudent for him to retain the Properties for any extended period of time.

Dated: Buffalo, New York  
October 10, 2013

PHILLIPS LYTTLE LLP

By /s/ William J. Brown  
William J. Brown (Bar Roll #601330)  
Attorneys for Receiver  
Omni Plaza  
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Albany, New York 12207  
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and

3400 HSBC Center  
Buffalo, New York 14203  
Telephone No.: (716) 847-8400

## **Exhibit A**

**William J. Brown, as Receiver  
of McGinn, Smith & Co., Inc., et al.**

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Tel: 716.847.7089

3400 HSBC Center  
Buffalo, NY 14203  
inquiry@mcginnsmithreceiver.com

September 7, 2011

**Via E-mail**

James D. Featherstonhaugh, Esq.  
Featherstonhaugh Wiley Clyne & Cordo  
99 Pine Street  
Albany, NY 12207-2776

Re: Lynn Smith – Sanctions Order

Dear Jim:

I am following up on my conversation last Wednesday with you regarding Lynn Smith's decision not to disgorge the \$944,848 and the \$51,232 as required under Judge Homer's July 20, 2011 Order (Docket No. 342).

Accordingly, I intend to proceed with the process to obtain the maximum possible return on the Great Sacandaga Lake property. In that regard, I request the following initial information to be received by me by September 12, 2011:

1. A copy of the Deed(s) to the property;
2. The abstract(s) of title for the property;
3. A copy of the current insurance policy covering the property;
4. A current tax bill for the property;
5. Survey of the property;
6. A description of the improvements on the property (I understand that there is more than one building on the property);
7. Instructions on how to obtain access to the property;
8. A description as to the status of winterizing the property or preparing it for the winter season and the steps usually taken in that regard;
9. Whether any security alarm systems exist on the property and if activated;
10. Any information regarding recent sales or rentals in the area;

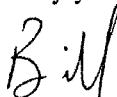
James D. Featherstonhaugh, Esq.  
William D. Dreyer, Esq.  
September 7, 2011  
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11. Any information regarding parties interested in purchasing the property;
12. Recommendations concerning brokers to list or rent the property;
13. Any information regarding factors which would serve to enhance the value of the property or diminish the value of the property such as potential condemnations, efforts by others to acquire the property for development or other rights, etc. (I am unfamiliar with the property so, while this question may seem odd, I want to make sure I cover all bases and gather as much information as I can to understand the property);
14. A copy of all utility bills for the property and the status of utility service to the property; and
15. Any other information which you believe would be useful to me in my role with respect to the property.

I am willing to take the information in batches so that information that is readily available can be forwarded promptly.

My intention is to visit the property within the next 7-10 days once I have received and reviewed the majority of the information from you.

Sincerely yours,



William J. Brown  
Receiver

cc (via e-mail): David Stoelting, Esq.  
Kevin McGrath, Esq.

**Exhibit B**

**Budgets and The Philadelphia Inquirer Article**

**Confidential - Filed Under Seal**



**Exhibit C**

**Market Values and Discussion**

**Confidential - Filed Under Seal**

**Exhibit D**

**Summary Appraisal**

**Confidential - Filed Under Seal**

**Exhibit E**

**Leah Slocum Property Profile and Market Analysis  
prepared for Smith Interests**

**Confidential - Filed Under Seal**