



**Memorandum from the Office of the Inspector General**

September 8, 2008

Anda A. Ray, WT 11A-K

**FINAL REPORT – INSPECTION 2008-11878 – REVIEW OF TISHOMINGO COUNTY DEVELOPMENT FOUNDATION TERM RECREATIONAL EASEMENT**

Based on concerns expressed to the Office of the Inspector General (OIG), we initiated an inspection of TVA's easement with the Tishomingo County Development Foundation (TCDF). The objective of the review was to determine whether easement payments were made in accordance with the agreement. Under terms of the easement, TCDF was to develop, construct, operate, and maintain commercial resort facilities with all necessary appurtenances thereto. TVA was to be paid a fee for use of the property based on the greater of (1) a percentage of annual gross revenues or (2) a guaranteed minimum payment specified in the easement. Subsequent to the execution of the easement between TVA and TCDF, TCDF leased the easement area to a third party, Pickwick Pines Marina Incorporated (PPM).

In summary, we found that while TCDF was not in compliance with amended easement payment provisions, the payment provisions were recently amended again to provide PPM an opportunity to develop and operate the marina. Specifically, the 2005, 2006, and 2007 payments had been made as originally agreed or in accordance with an amended agreement. The 2008 payment of \$121,000 required by the original amendment, initially due by January 31, 2008, had not been made; however, TVA recently restructured the payment schedule to allow the \$121,000 payment to be amortized into future annual lease payments. We also noted that the minimum investment provision of the easement has not been met. On August 6, 2008, TCDF sent PPM a notice of default. The letter states PPM has 30 days to remedy defaults, or the lease will be terminated.

**BACKGROUND**

On April 1, 2005, TVA granted TCDF a 40-year term easement (i.e., TVA contract No. 180739) for TVA Tract No. XPR-460RE located in Tishomingo County, Mississippi. Under the conditions of the easement, TCDF was:

- To develop, construct, operate, and maintain commercial resort facilities with all necessary appurtenances thereto, in accordance with plans approved in advance and in writing by TVA.

- To pay TVA as the annual payment (1) the greater of 4 percent of all annual gross revenues, with the exception of revenues from the sale of boats, plus 1 percent of annual boat sales or (2) a guaranteed minimum payment specified by the easement. The minimum annual payment as set forth in the payment schedule is to be paid in advance by January 31 of each calendar year with any additional payment amounts due based on revenues to be paid by January 31 of the following year. The minimum yearly payments required by the agreement were as follows:
  - Year 1--\$9,417.81 (\$12,500 prorated from the effective date on a 365-day basis)
  - Year 2--\$25,000
  - Year 3 through year 5--\$48,000
  - Year 6 through year 10--\$50,400
  - Year 11 through year 15--\$52,920
  - Year 16 through year 20--\$55,566
  - Year 21 through year 25--\$58,344
  - Year 26 through year 30--\$61,261
  - Year 31 through year 35--\$64,324
  - Year 36 through year 40--\$67,540
- Provided a conditional option to renew for an additional 40-year term.

On April 13, 2005, TCDF entered into a 40-year lease agreement with PPM for the same property. PPM was to develop the leased premises immediately upon execution of the lease and continue with such development as expeditiously as reasonably possible. TCDF is to be paid an annual lease payment based on percentage of gross revenue with a required minimum payment.

#### **OBJECTIVE, SCOPE, AND METHODOLOGY**

The objective of our review was to determine whether easement payments were made in accordance with payment terms. To achieve our objective, we:

- Reviewed the easement and applicable contract term modifications to determine easement payment terms.
- Conducted interviews with TVA Office of Environment and Research personnel to obtain information about the easement and status of payments.
- Obtained supporting documentation for easement payments to determine whether easement payments have been made in accordance with the contract provisions.

The scope of the inspection included easement payments made to TVA by TCDF through June 30, 2008.

This inspection was conducted in accordance with the "Quality Standards for Inspections."

**FINDINGS**

Our review found that TCDF was not in compliance with amended payment provisions, but the payment terms have recently been restructured providing TCDF/PPM an opportunity to develop and operate the marina. Specifically, the 2005 payment was made as originally agreed. In 2006 and 2007, payments were made in accordance with an amended agreement that allowed the lessee to make lower payments for those years and defer significant amounts to the future. The required 2008 payment of \$121,000 due in accordance with the amendment, which would include the deferred amounts from 2006 and 2007, was initially due by January 31, 2008, but extensions regarding this payment were granted through April 21, 2008. On June 29, 2008, an amendment structured by TVA was signed which allowed the \$121,000 payment to be amortized into future annual lease payments. In addition, the minimum investment provision of the easement has not been complied with.

**First Amendment to Payment Terms**

Under the original terms of the easement, the first annual easement payment of \$9,417.81 was due upon execution of the agreement. For 2006 and 2007, the minimum payments due were \$25,000 and \$48,000, respectively. The easement payment terms were amended on May 10, 2006, to defer the annual payments for 2006 and 2007. The new payment terms required (1) two interest-only payments of \$1,250 for 2006 and \$3,650 for 2007 and (2) a lump sum payment of \$121,000 to be paid by January 31, 2008.<sup>1</sup> According to the explanation contained in documentation reviewed, these amendments were made in consideration of delays in construction which had affected the financial condition of the third-party developer of the property, PPM.

Supporting documentation pertaining to payments shows that TVA received the initial minimum payment of \$9,417.81 and the two interest payments. However, the \$121,000 lump-sum payment reflecting the annual minimum payments for 2006 through 2008 has not been received by TVA (see Table 1).

**Table 1: Payment Information for Years 2005, 2006, and 2007**

Year	Original Payment Schedule	Amended Payment Schedule	Payment Amount and Date
2005	\$9,417.81 due upon easement execution	N/A	\$9,417.81 on April 18, 2005
2006	\$25,000 due January 31, 2006	\$1,250 due upon execution of modification	\$1,250 on June 26, 2006
2007	\$48,000 due January 31, 2007	\$3,650 due December 31, 2006	\$3,650 on December 26, 2006
2008	\$48,000 due January 31, 2008	\$121,000 due January 31, 2008	TVA has not received

Source: OIG analysis based on information contained in the easement, easement amendments, and payment documentation.

<sup>1</sup> The \$121,000 payment amount reflected the sum of the 2006, \$25,000 deferred minimum payment; the 2007, \$48,000 deferred minimum payment; and the \$48,000, 2008 minimum payment amount due.

**Recent Amendment to Payment Terms**

On January 11, 2008, TCDF requested further modification to the payment terms and submitted a recommended payment schedule. TCDF's letter recommended to TVA that "the lease payments be amended to more accurately reflect the actual start date of construction. The recommendation consists of shifting the start date two years and adjusting the lease payments accordingly." Subsequent to the letter, the following events occurred:

- On February 1, 2008, TVA notified TCDF that the \$121,000 lump-sum payment due on January 31, 2008, would now be due on February 29, 2008, because TVA needed additional time to consider TCDF's request regarding further modification to the payment schedule.
- On March 26, 2008, TVA again extended the due date to April 21, 2008, to provide additional consideration time.
- On June 18, 2008, TVA proposed to amend the minimum payment schedule under the TCDF easement. The \$121,000 currently due would be re-amortized over the remaining life of the easement resulting in a higher minimum payment each year. Specifically:
  - For 2008, TVA would receive two equal payments of \$26,300 due on September 15 and December 15 of 2008.
  - For 2009 through 2044, the payment to TVA would be (1) the greater of 4 percent of all annual gross revenues, with the exception of revenues from the sale of boats, plus 1 percent of annual boat sales or (2) a guaranteed minimum payment specified in Table 2 below.
  - For 2009, TCDF will make the minimum payment in four equal payments due no later than March 15, June 15, September 15, and December 15 of 2009.
  - For 2010 through 2044, the minimum payment is due on or before January 31 of each year, and any additional amount due based on annual gross revenues for that year shall be paid by January 31 of the succeeding year.

<b>Table 2: Proposed Minimum Payment Schedule</b>	
2008	\$52,600 in two equal payments of \$26,300 due on September 15 and December 15 of 2008
2009	\$52,600
2010-2014	\$55,200
2015-2019	\$58,000
2020-2024	\$60,900
2025-2029	\$63,900
2030-2034	\$67,100
2035-2039	\$70,500
2040-2044	\$74,000

Source: OIG analysis based on information contained in proposed easement amendment.

TCDF, along with PPM, recently agreed to the proposed amendment from TVA thereby modifying easement payment terms. As a result, the \$121,000 payment is no longer due to TVA. The payment for 2008 is to be \$52,600 paid in two equal payments of \$26,300 due September 15 and December 15 of 2008.

**ADDITIONAL INFORMATION**

While amendments have been made to payment terms, the minimum investment provisions of the easement have also been modified to extend required performance dates. According to the most recent amendment, TCDF shall have invested a minimum of \$1,000,000 for development of the site by June 30, 2008. Additionally, TCDF is to have completed and in operation prior to December 31, 2008, (1) a restaurant, (2) six rental cabins, and (3) at least 100 slips in an operating marina. According to TVA personnel, the minimum investment provision of the easement has not been met. On August 6, 2008, TCDF sent PPM a notice of default. The default letter states PPM has not complied with minimum investment and development provisions of the lease, and PPM has 30 days to remedy defaults, or the lease will be terminated.

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This report does not include any recommendations. Accordingly, no response is necessary.

Information contained in this report may be subject to public disclosure. Please advise us of any sensitive information in this report that you recommend be withheld.

If you have any questions or wish to discuss our observations, please contact Stephanie L. O'Daniel, Auditor, at (423) 751-8507 or Gregory C. Jaynes, Deputy Assistant Inspector General, Inspections, at (423) 751-7821. We appreciate the courtesy and cooperation received from your staff during the inspection.



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