

TACIR

The Tennessee Advisory Commission
on Intergovernmental Relations

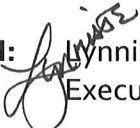


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226 Capitol Boulevard Bldg., Suite 508
Nashville, Tennessee 37243-0760
Phone: (615) 741-3012
Fax: (615) 532-2443
www.tn.gov/tacir

MEMORANDUM

TO: Commission Members

FROM:  Wynnis Roehrich-Patrick
Executive Director

DATE: 5 February 2013

SUBJECT: TVA PILOTS: Electric Generation and Transmission Cooperatives and Related Issues—Annual Update for Commission Approval

The Electric Generation and Transmission Cooperative Act (Public Chapter 475, Acts of 2009) directed TACIR to

- consider whether the current wholesale power supply arrangements between the Tennessee Valley Authority and municipal utilities and electric cooperatives are likely to change in the future in a way that could affect payments in lieu of taxes from the Tennessee Valley Authority to the state and to its local governments;
- report written findings to the Commerce, Labor and Agriculture Committee of the Senate; the Commerce Committee of the House of Representatives; the Finance Committee of the Senate; and the Finance Committee of the House of Representatives; and
- include recommendations, if any, on adjustments to the state tax system that would keep the state and local governments whole from such future changes.

The following year, the General Assembly passed Public Chapter 1035, Acts of 2010, based partly on TACIR's June 2010 report, *The Electric Generation and Transmission Cooperative Act of 2009 and Its Possible Impact on the Tennessee Valley Authority's Payments in Lieu of Taxes*. Public Chapter 1035 made the study an annual requirement.

The attached report is submitted for your approval as TACIR's 2013 report to the General Assembly.

Tennessee Valley Authority's Payments in Lieu of Taxes Annual Report to the Tennessee General Assembly

The Tennessee Advisory Commission on Intergovernmental Relations (TACIR) was tasked by the Electric Generation and Transmission Cooperative Act of 2009 (Section 4 of Public Chapter 475, Acts of 2009) with monitoring changes in the wholesale distribution of electric power by the Tennessee Valley Authority (TVA) and its distributors for possible effects on the Authority's payments in lieu of taxes (PILOTs) to the states in the Valley region. The Commission's report was to "include recommendations, if any, on adjustments to the state tax system that would keep the state and local governments whole from such future changes." After considering a number of options, including those developed by TACIR staff,¹ the Tennessee General Assembly passed Public Chapter 1035, Acts of 2010, requiring payments equivalent to TVA's Tennessee PILOT from any other entity providing wholesale electric current for resale within the state, such as the electric generation and transmission cooperatives authorized in 2009. Public Chapter 1035 was designed to ensure that revenue from power sales in the TVA region would not depend on who produced that power or who sold it. The Act also renewed the requirement that TACIR monitor the effects of the 2009 act and report to the General Assembly annually. This is the Commission's report for the 2013 legislative session.

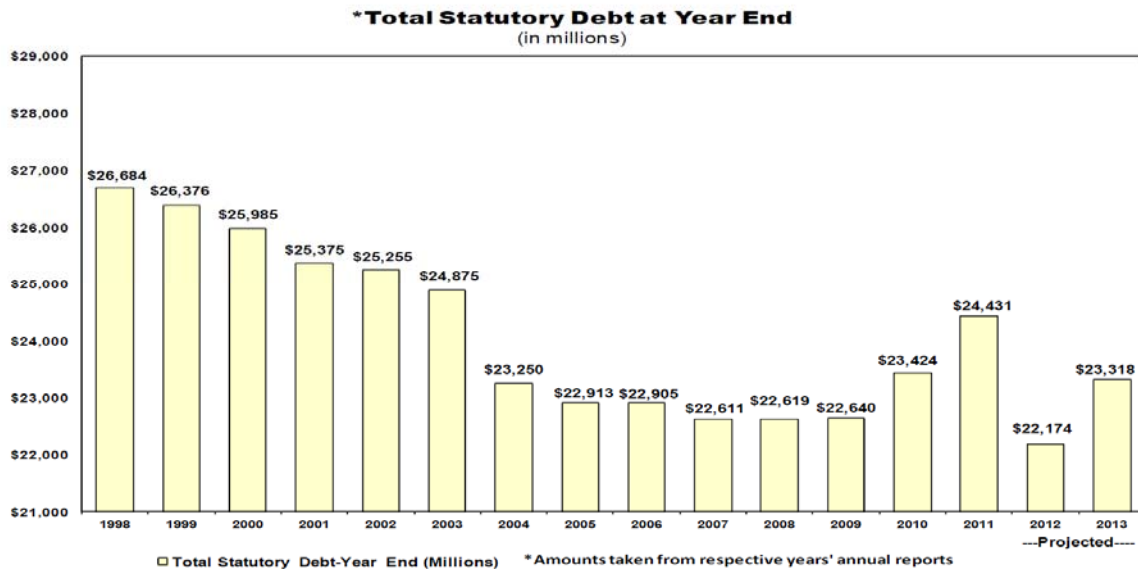
In federal fiscal year 2011-12, TVA's total payments in lieu of taxes in the region amounted to \$579 million of which \$354.3 million was paid to the state of Tennessee. On November 19, 2012, the TVA Board authorized estimated payments of \$536 million in federal fiscal year 2012-13.² The decline in estimated payments of \$43 million comes as a result of the loss of the U.S. Enrichment Corporation of Paducah, Kentucky, its largest customer, to competition as well as the continuing slowdown in economic activity stemming from the recession and other factors.³ The decline in estimated total PILOTs to the counties amounts to slightly more than \$1 million in the distribution to county governments, \$462,062 to the 350 municipalities, and approximately \$2 million to the state and its agencies. In most cases, the loss to counties and cities of funds amounts to only a few thousand dollars. The largest estimated loss will be incurred by Shelby County, nearly \$76,500. See appendix A for an explanation of Tennessee's allocation formula and appendix B for the distribution to local governments within the state by county since federal fiscal year 2005-06. While any loss of funding will be painful, these estimated payments serve as a reminder that the TVA funds are not guaranteed, but in the 13 years since federal fiscal year 2000-01 there has been only one other year in which payments were less than the previous year.

¹ TACIR's June 2010 report, *The Electric Generation and Transmission Cooperative Act of 2009 and Its Possible Impact on the Tennessee Valley Authority's Payments in Lieu of Taxes*, is available online at http://www.tn.gov/tacir/PDF_FILES/Taxes/electric_generation_cooperative_act.pdf.

² See appendix A for an explanation of TVA's formula for allocating its payments in lieu of taxes among the recipient states.

³ All of TVA's customers, including distributors and large direct customers have the option of not renewing their contracts with TVA. In other words, TVA is subject to competition from other producers of electricity though those competitors may not establish generating operations in the TVA service region.

One concern for the future of the distribution of the PILOT in the TVA region and among Tennessee’s counties is the effect of financing arrangements for new TVA generating capacity. In order to stay within the \$30 billion debt ceiling imposed on it by the Congress in 1980, TVA has resorted to new financing methods that could affect the distribution of PILOT funds and negatively affect county and city funds. The following graph shows the level of TVA’s debt since 1998.⁴



One technique that TVA has used to stay within its financial constraints is the leasing of some generating facilities. About the same time the Electric Generation and Transmission Cooperative Act was passed in 2009, TVA entered into an agreement with a group of its distributors organized as the Seven States Power Corporation, a non-profit company. Seven States purchased an interest in a generation plant in Southaven, Mississippi, while agreeing that TVA would continue to operate the plant.⁵ Under this sale-and-lease-back arrangement, all sales of electricity produced at Southaven are through TVA and, therefore, accounted for as TVA revenues and subject to the PILOT allocation to states. Although the fact that TVA doesn’t own the Southaven plant doesn’t affect the PILOT allocation across states, it does affect the PILOT distribution to the state of Mississippi. The following statement was included in TVA’s latest budget proposal: “TVA may seek to enter into similar arrangements for other assets in the future, potentially including assets under construction. While such leasing transactions allow TVA to diversify its asset financing program, financing an asset by using the proceeds of leasing transactions is typically more costly to TVA than financing an asset with the proceeds of Bonds.”⁶ Leasing arrangements such as this do not change the total amount of the PILOT under the TVA formula. Section 15d(g) of the 1933 Act says that

⁴ Tennessee Valley Authority 2013 *Budget Proposal and Management Agenda*, Submitted to Congress February 2012.

⁵ More information about the plant can be found on TVA’s website at <http://www.tva.com/sites/southaven.htm>.

⁶ Tennessee Valley Authority 2013 *Budget Proposal and Management Agenda*, p. 61.

. . . [p]ower generating and related facilities operated by the Corporation under lease and lease-purchase agreements shall constitute power property held by the Corporation within the meaning of section 13 of this Act . . .

This provision causes facilities operated by TVA under leases to be included in the calculation of the value of power-producing property under Section 13, which means that the value of TVA property in the state where this is done does not change.

Second, however, the amount of the TVA PILOT that goes through any particular state's own allocation formula would decrease to the extent that the new plant owners must pay taxes to the state or local governments. Section 15d(g) of the TVA Act goes on to say that

. . . that portion of the payment due for any fiscal year under said section 13 to a State where such facilities are located which is determined or estimated by the Board to result from holding such facilities or selling electric energy generated thereby shall be reduced by the amount of any taxes or tax equivalents applicable to such fiscal year paid by the owners or others on account of said facilities to said State and to local taxing jurisdictions therein.

To understand the effect of this second provision, consider the Southaven plant and the Caledonia plant in Mississippi, which has a similar sale-and-lease-back arrangement.⁷ Because of the change in ownership status, the plants are subject to state and local taxes. Consequently, Mississippi's allocation was reduced by \$5.5 million in 2011 and by \$5.9 million in 2012. This works much like the \$3+ million in direct payments TVA makes to counties in Tennessee. Direct payments are taken off the top of TVA's PILOTs to each state, reducing the amount allocated through the state's statutory formula. The amount allocated through Tennessee's formula, including the amount retained by the state in its general fund, would be reduced by any taxes paid on account of any plant operated through a sale-and-lease-back arrangement, if that were to occur. If that were to happen, Tennessee might want to modify its allocation formula to offset the direct payments of taxes by, for example, reducing the allocation to any particular jurisdiction by the amount of the reimbursement TVA made to the plant owners. It is possible, of course, that the reimbursement amount could be greater than the allocation through the state formula to those jurisdictions, so considerable thought would need to go into making such a change.

Fortunately, TVA has chosen a different strategy to raise funds for generating expansions in Tennessee without approaching its debt ceiling. Thus far, arrangements in Tennessee have been lease-and-lease-back agreements. An example is the natural gas combined cycle plant built in 2010 in East Tennessee next to the John Sevier fossil plant and leased to a private company in January 2012. The company paid TVA \$1 billion for the lease and leased the plant

⁷ More information about the plant can be found on TVA's website at <http://www.tva.com/sites/caledonia.htm>.

back to TVA for 30 years. It is managed by TVA employees.⁸ This lease arrangement changes neither the ownership of the property nor TVA revenues and so has no effect on the PILOT across states or within Tennessee.

What could affect the PILOT funds received by Tennessee and its local governments is a shifting of generating operations between states. As a consequence of meeting the demands of economic growth in the TVA service region while staying under its debt limit, TVA's financing has already shifted production from Tennessee to other states. To the extent that these changes shift the balance of property held by TVA from Tennessee to other states, the balance of PILOT distributions will shift from Tennessee to those other states because half of the PILOTs are distributed across the states based on the value of TVA property in each state. The other half is based on TVA sales in each state as explained in appendix A. Staff will continue to monitor and report developments in the region that may affect TVA's payments in lieu of taxes.

⁸ More information about the plant can be found on TVA's website at http://www.tva.com/sites/johnsevier_cc.htm.

Appendix A

The TVA Act of 1933 (TVA Act) specifically directs that 5% of the agency’s “gross proceeds” be paid as payments in lieu of taxes (PILOTs) to states and local governments where the authority owns and operates property. (48 Stat. 58-59, 16 U.S.C. § 831.) TVA interprets “gross proceeds” as their operating revenues from the sale of power to municipalities, cooperatives, and industries. The TVA Act of 1933 specifically excludes sales to federal agencies from the PILOT calculation. Payments to each state are based on the amount of TVA-owned property and sales in each state. Tennessee’s share based on those two factors has been close to 60% of the total each year.

Each state determines its own method of distributing the payments. The following chart shows the formula used by the state of Tennessee in distributing the funds among the state government, its agencies, counties, and cities.

Figure 1. Tennessee Valley Authority (Tennessee State Revenue Sharing Act)
Title 67, Chapter 9, Part 1

From the Allocation of TVA Payments in Lieu of Taxes to Tennessee
(after direct payments to counties and 1977-78 base payment to state, counties and cities)

	Basis of Apportionment <i>(§ 67-9-101)</i>	Proration to Counties & Municipalities <i>(§ 67-9-102)</i>
Paid to areas with TVA construction <i>(remainder allocated to CTAS, TACIR and Four Lakes Regional Development Authority)</i>	3%	
Retained by the State	48.5%	
Paid to Local Governments	48.5%	
<i>Counties—70% of Local Share</i>		
<ul style="list-style-type: none"> • <i>Based on Percent of State Population</i> • <i>Based on Percent of State Land</i> • <i>Based on County’s Percent of TVA Acreage in Tennessee</i> 		<div style="text-align: right;">30%</div> <div style="text-align: right;"><i>(14.55% of total)</i></div> <div style="text-align: right;">30%</div> <div style="text-align: right;"><i>(14.55% of total)</i></div> <div style="text-align: right;">10%</div> <div style="text-align: right;"><i>(4.85% of total)</i></div>
<i>Municipalities—30% of Local Share Based on Percent of State Population</i>		<div style="text-align: right;">30%</div> <div style="text-align: right;"><i>(14.55% of total)</i></div>
Total Allocated by State	100%	

Appendix B

Distribution of Local Governments Share of TVA Payments in Lieu of Taxes to Tennessee by County and by Federal Fiscal Year

County	Federal Fiscal Year							
	2012-13	2011-12	2010-11	2009-10	2008-09	2007-08	2006-07	2005-06
Anderson	1,612,474	1,628,776	1,546,731	1,530,703	1,314,022	1,264,144	1,136,604	1,011,991
Bedford	1,044,012	1,056,269	928,091	904,031	779,922	746,413	662,317	576,279
Benton	1,755,601	1,775,511	1,681,941	1,517,412	1,442,886	1,381,308	1,234,153	1,083,631
Bledsoe	509,186	514,938	488,189	477,252	416,329	397,406	352,388	306,681
Blount	1,902,219	1,924,220	1,720,504	1,670,991	1,469,911	1,408,062	1,254,818	1,097,083
Bradley	1,525,662	1,543,148	1,409,576	1,379,503	1,202,726	1,152,858	1,025,104	893,955
Campbell	1,464,224	1,481,115	1,419,222	1,330,092	1,218,230	1,165,806	1,038,223	907,628
Cannon	399,644	404,089	378,669	370,868	324,388	310,268	276,359	241,845
Carroll	934,214	945,114	919,599	898,812	783,134	748,628	663,697	577,155
Carter	1,002,246	1,013,851	985,421	916,689	846,956	810,483	720,811	628,861
Cheatham	706,189	714,497	672,918	657,544	568,149	543,425	482,114	411,158
Chester	471,165	476,654	447,516	437,532	381,080	364,221	322,869	278,335
Claiborne	1,055,841	1,067,925	1,005,104	1,043,505	852,128	814,961	724,986	633,595
Clay	292,135	295,482	280,844	274,408	239,076	228,117	201,963	175,388
Cocke	829,079	837,865	802,617	769,762	693,734	665,717	597,930	528,742
Coffee	1,272,598	1,287,786	1,205,926	1,208,728	1,027,692	983,871	873,418	760,079
Crockett	433,569	438,635	421,062	411,576	358,650	342,862	303,986	264,300
Cumberland	1,174,558	1,188,144	1,085,577	1,060,129	924,213	882,238	781,890	673,484
Davidson	9,737,876	9,857,677	9,109,391	8,909,996	7,765,289	7,465,046	6,651,425	5,801,860
Decatur	659,153	666,300	635,778	705,947	558,590	535,451	479,834	423,125
Dekalb	479,344	484,917	451,121	440,125	383,465	366,270	324,618	282,169
Dickson	1,046,532	1,058,985	1,105,916	1,081,262	942,012	901,814	687,067	597,013
Dyer	1,001,748	1,013,575	974,517	952,787	829,748	794,029	704,528	612,921
Fayette	1,102,420	1,115,231	956,031	934,144	813,964	774,736	685,389	593,656
Fentress	637,697	644,989	604,177	590,374	514,328	490,683	434,377	377,188
Franklin	1,301,487	1,316,032	1,218,982	1,184,818	1,160,125	1,111,709	993,377	872,333
Gibson	1,256,188	1,271,095	1,236,146	1,208,214	1,053,062	999,209	886,901	765,738
Giles	917,126	927,692	890,192	870,163	763,906	730,014	647,692	563,634

Federal Fiscal Year

County	2012-13	2011-12	2010-11	2009-10	2008-09	2007-08	2006-07	2005-06
Grainger	1,043,560	1,050,893	989,955	739,988	846,697	811,506	728,098	642,761
Greene	1,329,007	1,344,413	1,270,687	1,274,741	1,082,604	1,035,565	919,862	801,458
Grundy	529,652	535,768	523,944	512,053	446,719	427,160	379,106	330,355
Hamblen	1,218,349	1,232,604	1,142,260	959,300	979,728	939,737	835,636	732,324
Hamilton	6,098,974	6,172,624	5,754,066	5,546,120	4,894,971	4,703,799	4,195,702	3,670,393
Hancock	280,346	283,556	268,835	262,636	228,857	218,373	193,335	167,903
Hardeman	976,214	987,554	954,558	933,506	812,591	776,436	687,622	597,655
Hardin	1,177,192	1,187,235	1,135,469	1,088,295	960,132	918,799	818,886	717,023
Hawkins	1,531,038	1,546,157	1,464,669	1,375,747	1,270,664	1,222,847	1,105,242	984,740
Haywood	783,048	792,173	769,923	762,294	653,785	620,516	550,063	476,380
Henderson	936,962	947,875	888,775	1,000,835	761,380	727,351	644,808	564,655
Henry	1,795,581	1,816,108	1,716,553	1,713,028	1,569,655	1,501,946	1,338,781	1,171,898
Hickman	821,298	830,502	779,087	761,575	665,766	636,043	565,098	493,003
Houston	443,290	448,314	425,780	359,101	363,697	348,069	310,236	271,624
Humphreys	1,636,165	1,654,292	1,563,621	1,518,908	1,330,349	1,275,198	1,142,587	1,007,089
Jackson	390,453	394,904	370,982	362,476	316,013	301,394	266,760	231,596
Jefferson	1,167,182	1,178,881	1,100,969	944,124	972,846	938,125	844,633	757,970
Johnson	517,897	523,533	498,339	457,791	428,963	410,723	367,148	322,751
Knox	5,769,066	5,837,663	5,435,205	5,289,180	4,642,629	4,458,980	3,978,176	3,466,593
Lake	289,031	292,448	283,627	277,303	241,455	231,099	205,043	178,399
Lauderdale	788,035	797,242	762,742	745,933	649,492	620,936	550,573	478,796
Lawrence	1,035,219	1,047,224	1,003,987	985,404	858,738	820,833	728,001	633,271
Lewis	403,211	407,831	384,929	376,182	328,224	313,593	278,180	242,129
Lincoln	869,002	878,955	834,588	815,762	711,595	679,360	602,531	524,256
Loudon	1,307,471	1,319,761	1,193,007	1,123,479	1,056,045	1,021,211	935,784	848,138
Macon	1,110,996	1,123,206	1,077,334	1,052,597	928,946	892,169	800,224	705,984
Madison	838,463	848,197	804,257	785,950	685,183	654,650	580,154	504,104
Marion	510,748	516,665	479,105	468,533	407,878	389,543	345,175	299,926
Marshall	1,957,030	1,980,137	1,838,804	1,801,689	1,565,431	1,501,182	1,334,277	1,160,258
Maury	1,309,542	1,323,829	1,267,621	991,365	1,073,859	1,032,109	930,334	817,925
McMinn	737,308	745,872	684,901	669,673	583,749	558,770	496,678	433,180
McNairy	1,694,719	1,714,838	1,589,555	1,531,460	1,346,018	1,290,090	1,130,173	985,516

Federal Fiscal Year

County	2012-13	2011-12	2010-11	2009-10	2008-09	2007-08	2006-07	2005-06
Meigs	795,382	804,234	757,527	642,063	650,204	622,868	557,729	490,892
Monroe	1,728,087	1,743,348	1,636,875	1,621,473	1,446,589	1,390,172	1,245,580	1,106,963
Montgomery	3,158,261	3,196,991	2,576,722	2,519,488	2,194,835	2,107,103	1,874,242	1,633,845
Moore	209,067	211,398	189,002	195,675	179,440	171,505	152,606	133,368
Morgan	681,840	689,573	644,138	629,993	549,014	523,818	464,071	403,390
Obion	949,761	960,920	931,426	910,212	793,081	758,599	672,861	585,229
Overton	616,735	623,821	584,016	570,459	497,172	474,538	420,265	365,038
Perry	679,322	686,830	650,000	726,472	558,881	534,781	477,297	418,823
Pickett	199,085	201,361	191,688	187,295	163,179	155,694	137,835	119,696
Polk	813,018	820,491	784,199	751,206	696,898	672,455	613,658	554,518
Putnam	1,296,743	1,310,933	1,173,191	1,147,114	999,852	955,593	846,005	736,615
Rhea	1,268,335	1,282,041	1,200,368	1,114,935	1,030,404	989,679	890,850	788,550
Roane	1,841,038	1,860,550	1,779,170	1,603,339	1,501,136	1,443,990	1,303,815	1,160,097
Robertson	1,342,154	1,358,223	1,206,268	1,177,943	1,026,430	978,071	866,584	753,479
Rutherford	4,390,376	4,440,698	3,681,619	3,603,201	3,138,392	2,781,745	2,477,463	2,135,359
Scott	737,442	743,544	700,638	684,694	596,513	569,545	502,670	436,675
Sequatchie	417,931	422,676	386,703	378,254	330,562	311,278	276,836	241,653
Sevier	1,522,126	1,539,836	1,342,506	1,308,489	1,146,365	1,096,627	974,249	848,919
Shelby	16,305,442	16,473,058	16,573,904	16,216,026	14,145,153	13,572,845	12,017,904	10,463,207
Smith	532,889	538,770	508,982	513,511	434,436	416,043	370,016	324,830
Stewart	2,783,072	2,803,160	2,610,620	3,903,632	2,200,830	2,107,633	1,885,803	1,658,846
Sullivan	2,639,729	2,657,038	2,544,472	2,358,764	2,133,626	2,046,476	1,823,947	1,593,293
Sumner	2,888,191	2,923,276	2,511,060	2,498,314	2,135,026	2,041,963	1,809,973	1,559,712
Tipton	1,172,206	1,186,126	1,084,468	1,056,559	920,581	853,637	757,817	658,641
Trousdale	236,822	239,297	227,458	236,575	197,263	189,576	170,856	166,895
Unicoi	412,845	417,738	397,477	388,460	338,572	324,107	287,694	250,371
Union	1,122,959	1,135,172	1,066,487	909,172	924,464	887,291	798,003	706,565
Van Buren	348,452	352,368	334,438	311,515	287,932	275,109	244,428	213,271
Warren	913,707	923,943	878,360	889,895	755,900	724,548	647,271	568,217
Washington	1,911,069	1,933,933	1,741,382	1,697,525	1,481,624	1,420,759	1,262,470	1,099,707
Wayne	915,764	926,288	878,398	858,398	748,451	714,464	632,729	549,730
Weakley	1,025,635	1,037,682	991,520	973,192	844,222	805,093	712,152	619,511

County	Federal Fiscal Year							
	2012-13	2011-12	2010-11	2009-10	2008-09	2007-08	2006-07	2005-06
White	641,267	646,911	626,744	581,624	522,293	499,131	428,886	373,765
Williamson	3,342,568	3,383,257	2,760,804	2,704,902	2,356,853	2,197,451	1,884,691	1,613,173
Wilson	1,909,968	1,922,483	1,726,323	1,689,916	1,472,200	1,339,366	1,191,067	1,003,905
Total	\$139,569,523	\$141,109,734	\$131,718,846	\$128,784,681	\$112,690,747	\$107,611,415	\$95,618,062	\$83,496,630