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Highlights

Highlights of GAO-03-784, a report to the Honorable Richard H. Baker, House of Representatives

June 2003

TENNESSEE VALLEY AUTHORITY

Information on Lease-Leaseback and Other Financing Arrangements

Why GAO Did This Study

Concern about the implications of the Tennessee Valley Authority's (TVA) debt on its future competitiveness prompted Representative Richard Baker to ask GAO to determine TVA's planned and actual use of nontraditional financing arrangements (which, to date, has consisted primarily of lease-leaseback arrangements), who is at risk under TVA's lease-leaseback arrangements, and whether TVA's accounting for the lease-leaseback arrangements complies with applicable standards and requirements.

What GAO Recommends

GAO is not recommending any actions by TVA, but does raise a matter for congressional consideration. The Congress may want to consider amending the TVA Act to clarify whether TVA's statutory debt cap should include alternative sources of financing that have the same impact on TVA's financial condition and competitive position as traditional debt financing.

TVA generally agreed with our analysis but expressed concern regarding including alternative sources of financing in its debt cap. Because we believe current law does not clearly and unambiguously address whether the amount of the lease-leaseback arrangements should be counted against the debt cap, we continue to believe the Congress may want to consider revisiting this matter.

www.gao.gov/cgi-bin/getrpt?GAO-03-784.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Linda Calbom at (202) 512-9508 or calboml@gao.gov.

What GAO Found

TVA has traditionally financed its operations with cash generated from operations, the issuance of bonds and notes, and in the past, appropriations. However, in fiscal year 2000, it began to use alternative forms of financing (primarily lease-leaseback arrangements) and is considering expanding their use. The lease-leaseback arrangements involve the refinancing of 24 combustion turbine power generators that are used during periods of peak demand for power. The lease-leaseback arrangements accounted for about $945 million of the $992 million raised by alternative financing arrangements as of May 31, 2003.

After the power generators were constructed, TVA leased them to private investors for 50 years and simultaneously leased them back for 20 years. Under these lease-leaseback arrangements, TVA received cash from the private investors, which was obtained by issuing debt in the public market and through the investors' own equity. TVA is responsible for making lease payments for 20 years, at the end of which it has the option to purchase the private investors' interest in the assets. TVA retains legal title to the assets under the arrangements but relinquishes sufficient interest in the assets so that the equity investors are entitled to certain tax benefits. The equity investors pass on some of these benefits to TVA in the form of more favorable financing rates. As a result, TVA is able to lower costs over the first 20 years of the arrangement. However, to retain use of the assets after the 20-year period, TVA would have to purchase the equity investors' remaining interest in the assets at the assets' fair market value at that time. Depending on the fair market value, TVA is at risk of incurring higher overall costs than under traditional debt financing. In large part, the determination as to who will be the net beneficiary of these arrangements and the implications to the federal treasury will hinge on the future value of the assets.

TVA's lease-leaseback arrangements have been accounted for and reported in compliance with applicable standards and requirements for financial reporting, budgetary reporting, and debt cap compliance. TVA's lease-leaseback arrangements are treated as liabilities in its financial statements and classified as debt in the President's Budget. However, they are not counted against the debt cap in the TVA Act. While the lease-leaseback arrangements are not considered debt for purposes of financial reporting and debt cap compliance, they have substantially the same economic impact on TVA's financial condition and future competitiveness as traditional debt financing.