Spring 2000

TVA Bonds: A Marketing Plan

Kelly Anne Love

University of Tennessee - Knoxville

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Appendix D - UNIVERSITY HONORS PROGRAM
SENIOR PROJECT - APPROVAL

Name: Kelly Love
College: Business Admin. Department: Finance
Faculty Mentor: Suzan Murphy
PROJECT TITLE: TVA Bonds: A marketing Plan

I have reviewed this completed senior honors thesis with this student and certify that it is a project commensurate with honors level undergraduate research in this field.

Signed: Suzan Murphy, Faculty Mentor
Date: 5-11-00

Comments (Optional):
UNIVERSITY HONORS PROGRAM

SENIOR PROJECT - PROSPECTUS

Name: Kelly Love

College: Business Administration
Department: Finance

Faculty Mentor: Susan Murphy

PROJECT TITLE: The marketing of TVA Bonds

PROJECT DESCRIPTION (Attach not more than one additional page, if necessary):

I will research TVA bonds in terms of frequency of issuance, interest rates, ratings, etc. Based on this information, I will develop profiles of the ideal institutional and individual investors. I will then compare these profiles to who the current investors are and develop a marketing plan for TVA Bonds.

Projected completion date: _____________________________________

Signed: _____________________________

I have discussed this research proposal with this student and agree to serve in an advisory role, as faculty mentor, and to certify the acceptability of the completed project.

Signed: _____________________________, Faculty Mentor

Date: 2-23-00

Return this completed form to The University Honors Program, F101 Melrose Hall, 974-7875, not later than the beginning of your last year in residence.
TVA Bonds
A Marketing Plan

Kelly A. Love
May 11, 2000

Suzan Murphy, Faculty Advisor
Abstract

TVA was created in 1933 for power production, flood control, and navigation in the Tennessee Valley. In 1959, TVA asked for permission to issue bonds because of political interference with its congressional appropriations. From that date forward, TVA's power system became self-financing.

TVA bonds are owned by individuals and institutions both in the US and abroad. Investors in ten states hold 49% of the US individual investment in TVA bonds. Institutions such as money managers, pension funds, insurance companies, and government institutions own TVA bonds as well. The investor base is quite varied.

The ideal individual investor is one of three people: one who needs a fixed income investment, one who lives in a state with a high tax rate, or one who needs little default risk. The ideal institutional investor is one who needs a low default risk but wants a better yield than the US Treasury bonds.

There are several important factors at work in deciding which states to target with additional marketing efforts. First, because TVA bonds are exempt from state and municipal taxes, TVA could target states with high tax rates. Second, deregulation has been a major issue in the electric-utility industry for a decade. TVA favors federal legislation because state-by-state laws can not cover TVA. The agency needs the support of investors in states that would be most likely to support federal legislation: states with no current deregulation activity and those with ongoing investigations. Third, TVA needs to develop large investor bases in states that have representatives on committees that are important to its operations. In addition, recruiting investors in the Tennessee Valley is crucial. All of these people have influence over matters pertaining to TVA.
With these focal states, TVA should do three things. First, it should plan domestic roadshows in these states in order to get TVA's name and message out to investment banker and institutional investors there. Second, investment bankers and brokers could be invited to participate in conference calls so that they can learn more about TVA. Third, TVA should initiate contact with ideal institutional investors who are not already owners of TVA bonds. Fourth, TVA should tell investment bankers exactly what kinds of individuals and institutions it wants to be put in contact with. Fifth, TVA needs to work toward having more foreign government and central bank investment so that it has some political insurance if the US Government were to take adverse action toward it.
Introduction

After graduation, I will begin working for the Tennessee Valley Authority in the Investor Relations Department. An important function of this team is to interact with TVA bondholders, investment bankers, and analysts. During the last year, my work as an intern has exposed me to the current marketing efforts employed to attract and retain investors. Beyond global roadshows and an annual meeting for financial analysts and investors, not many activities are dedicated to attracting new investors, and none are targeted in a way that is advantageous to potential investors or to TVA. In an effort to improve this, I have created a marketing plan for TVA bonds based on who the current investors are and who should be investing in them.

Background

In the depths of the Great Depression, Franklin Roosevelt searched for innovative solutions to try to stimulate the economy. One of his ideas was the creation of “a corporation clothed with the power of government but possessed of the flexibility and initiative of a private enterprise.” The result was the creation of the Tennessee Valley Authority on May 18, 1933, by the TVA Act. Its primary responsibilities were to provide flood control, navigation, and electric power in the Valley, but it also helped with malaria prevention, reforestation, and erosion control.

During the 1930s, the Tennessee Valley was in poor shape. TVA improved the region by developing fertilizers, teaching farmers how to improve crop yields, replanting forests, controlling forest fires, and improving wildlife and fish habitats. However, the
most dramatic change in the Valley came from the introduction of electric lights and modern appliances, which was made possible by the electricity generated by TVA dams. Electricity drew much needed industries into the region. During the 1940s, TVA power was critical to wartime industries such as aluminum production. TVA also engaged in one of the largest hydropower construction programs ever. During the 1950s, TVA became the nation’s largest electricity supplier, but the demand for electricity was still more than it could supply. The agency needed additional appropriations from Congress in order to build coal-fired plants to fill the demand. Because of political conflicts, the appropriations were denied, and TVA sought the power to issue bonds. In 1959, the TVA power system became self-financing. During the 1960s, there was unprecedented economic growth in the Tennessee Valley, and TVA electric rates were among the lowest in the nation. Believing that the Valley would continue to grow, TVA began building nuclear plants that would be a new source of power. During the 1970s and 1980s, fuel costs were rising and the average cost of electricity increased fivefold. In order to be competitive, TVA improved its efficiency and productivity while cutting costs. During the 1990s, TVA prepared for competition in a deregulated electric-utility industry. It cut operating costs, reduced its workforce, increased generating capacity, stopped building nuclear plants, and developed a plan to meet the future energy needs of the Tennessee Valley. TVA is currently continuing to strengthen its position as an industry leader in price, reliability, efficiency, and environmental stewardship.¹

TVA’s operating goals include supplying low-cost, reliable power, supporting a thriving river system, and stimulating economic growth. TVA’s 10-year Business Plan is the document that outlines how TVA will achieve these goals and remain competitive in
a deregulated environment. Because a large part of the 10-year Plan deals with competing at the average cost of power and because debt reduction is essential to this goal, it is important to study TVA’s current financing, look at the competition it faces in the bond market, and examine how TVA can better market its bonds.²

TVA’s financing goal is to offer unique investment opportunities that provide exceptional value for both the investor and TVA. Its financing objectives include obtaining cost-effective financing rates, being customer-driven, broadening the investor base, lengthening the average maturity, maintaining flexibility through optionality, and building on the TVA yield curve.³

The competition TVA faces in the bond market is quite different than the competition it faces in the electric-utility industry. In the industry, companies such as Southern Company, Duke Energy, and Cinergy are considered competitors of TVA. However, the entities that TVA competes with in the bond market are known as government-sponsored enterprises (GSEs). This group includes Fannie Mae, Farm Credit, Freddie Mac, Sallie Mae and others. The bonds issued by all of these firms are considered legal investments for banks, and their bonds are exempt from SEC registration. All but Farm Credit have the authority to borrow from the US Treasury. All have AAA-rated bonds. However, only TVA borrows on the budget of the US Government, has the power of eminent domain, has Directors appointed by the President, and is fully-owned by the US Government. None of these entities has an explicit guarantee by the US Government to bail it out in case of default.⁴(See Appendix A)
**TVA’s Debt Portfolio**

TVA’s debt portfolio is quite diversified. 63% of the bond issues are domestic, while 37% are global. 62% of the bonds are non-callable. The maturities range from less than one year up through 50 years. In addition to normal callable and non-callable debt, TVA has also issued some unique structures. For example, Put Bonds, QIDS, VIPs, and PARRS are all unique structures within TVA’s bond issues.\(^5\)(See Appendix B)

TVA’s bonds have some distinct strengths. First, TVA is wholly owned by the US Government, which gives its bonds an implicit guarantee against default. Second, TVA’s power bonds receive the highest rating given by Standard and Poor’s and Moody’s: AAA/Aaa. Third, TVA is required by law to charge rates sufficient to ensure full payment of its annual debt service. This makes it almost certain that TVA will not default on its bonds. Fourth, the TVA Act requires that TVA apply a specified amount of its net power proceeds to investment in power assets or to reduction of its capital obligations during each successive five-year period. Fifth, TVA bonds may only be issued to provide capital for TVA’s power program or to refund existing indebtedness. Sixth, TVA bonds are exempt from state and municipal taxes. Even though TVA bonds have all of these strengths, the public does not seem to be fully aware of them. Analysts and investment bankers have just begun to learn about these strengths from the fairly new Investor Relations Team at TVA. This team has begun to market TVA bonds to the public, but there is still much ground to be covered.\(^6\)

**Current Investors**

Before one can develop a marketing plan for TVA bonds, it is helpful to know who the current investors are. TVA bondholders are institutions and individuals located
both in the United States and abroad. By number, domestic individual investors represent 91% of the investor base. International individuals represent 5%, domestic institutions represent 3%, and international institutions represent 1%. (See Appendix C) By dollar holdings, domestic individuals represent only 28% of the investment in TVA bonds; international individuals, 2%; domestic institutions, 48%; and international institutions, 22%. Dollar holdings is probably a better measure of investment, but the disparity between the two measures is interesting. 7 (See Appendix D)

Geographically, TVA investors are all over the world. European investors represent 48% of the investment in TVA’s global bonds. These investors are primarily located in the United Kingdom. Investment in other European countries is very limited. Asian investors represent 12% of the investment in these bonds, and a great majority of those investors are located in Japan. (See Appendix E) Institutional investors in TVA global bonds can be divided into several groups: money managers, banks/trusts, insurance companies, government institutions, pension funds, and corporations. Money managers and banks/trusts represent 59% of this investment. (See Appendix F) Although this data is based on global bonds, it can be applied to domestic bond issues as well. The percentages would probably be different, but the general categories of investors would be the same. Within the United States, individual investors in ten states represent 49% of the investment in TVA bonds: California, New York, Florida, Pennsylvania, Illinois, Ohio, New Jersey, North Carolina, Michigan, and Texas. (See Appendix G) Incidentally, Tennessee investors rank eleventh on this list of dollar holdings by individuals. 8
Profiles

Before creating marketing plan, it is also necessary to determine who the ideal individual and institutional investors are so that they can be targeted in some fashion. The ideal individual investor could be one of three types of people. First, it could be an older person who needs the stability of a fixed income investment. Second, it could be a person who wants a tax-free investment because he/she lives in a state with a high income tax rate. Third, it could be a person who is looking for a high quality investment with little default risk.

The ideal institutional investor is basically one that is looking for an investment with a low default risk but wants a better rate of return that what is available with a US Treasury bond. The list of the current types of institutional investors accurately depicts the types of institutions that would ideally be interested in TVA as an investment. However, that list probably understates how valuable a high quality investment, such as TVA bonds, would be to insurance companies, pension funds, and government institutions.

Important Factors

Before putting together a comprehensive marketing plan, it is necessary to examine the profiles of the ideal individual and institutional investors in conjunction with several important factors, including taxes, laws, and politics.

State Tax Rates

Each state is permitted to set its own income tax rate in addition to the federal income tax rate. Because TVA bonds are exempt from state income taxes, it is useful to
examine which states have higher tax rates. This would be an important factor for individuals in their decision to purchase TVA bonds.

Seven states do not have an income tax. Six states have a low income tax rate, between 1% and 4.99%. Quite a few states have a moderate income tax rate between 5% and 7%. Thirteen states and the District of Columbia have income tax rates higher than 7%: California, Hawaii, Idaho, Iowa, Maine, Minnesota, Montana, New Mexico, North Carolina, North Dakota, Oregon, Rhode Island, and Vermont. (See Appendix H) People living in those thirteen states and the District of Columbia would probably like to have an investment that is tax-free so that they could escape paying these high rates on each investment.°

**Deregulation**

The beginning of competition is an important issue in the electric-utility industry. Some states have already begun to pass laws and/or regulatory orders that are the beginning of the deregulation in those states. Basically, deregulation means that local power companies, such as Knoxville Utilities Board, would be able to choose from which distributor they buy their power. For TVA, the problem is that it serves parts of seven states. State laws can not regulate the entire TVA service area; on the contrary, even if each state passed deregulation legislation, something would still have to be decided about TVA by the US Congress. Therefore, it is advantageous to TVA for federal deregulation legislation to be passed. The states that have already passed deregulation laws or regulatory orders would be less likely to support federal legislation. States that have either no activity or are engaged in ongoing investigations would be more likely to
support such legislation, so TVA would do well to target those states in order to gain political influence there.10(See Appendix I)

**Congressional Representation**

There are five congressional committees and subcommittees that deal with TVA in some way. Their decisions affect TVA both directly and indirectly at times. Any influence TVA could garner with these Representatives might be helpful if the agency wanted to affect any potential legislation. Having a large investor base in the Congressmen’s home states would be a good way to ensure that they will not do anything to harm TVA’s position. The influential Congressmen are from the following states: Rhode Island, Montana, Pennsylvania, Minnesota, New Mexico, California, Indiana, Nevada, Alaska, and Texas.11(See Appendix J)

In addition, it is certainly necessary to ensure that each state in the Tennessee Valley has an ample number of investors. Not only does it help to have the support of the people TVA serves, but it also means that the Valley Congressional Delegation will have to be committed to blocking anti-TVA legislation. The states in the Tennessee Valley are Tennessee, Kentucky, Virginia, North Carolina, Georgia, Alabama, and Mississippi.

**The Marketing Plan**

To determine which states to target, it is necessary to compare which states are priorities on each factor: state tax rates, deregulation, congressional representation, and investor concentration in ten states. It is helpful to consider the top ten dollar holdings states because that is where the money is currently invested. Investors in those states are
already interested in the current issues, so there is more potential in those states for future investment.

In ranking the states, it is necessary to decide which factors are more important than others. Investor presence in the ten states, although significant, is the least important of these factors because marketing in those states would expand the investor base but in a random fashion. Each state on that list received a scoring of one. Tax rates are more important than this but not as important as the other two factors. Marketing to the public based on tax rates is a way to expand the investor base in a more targeted fashion, but it is more advantageous to TVA to market in a way that is politically effective as well. States with tax rates over seven percent received a scoring of two. States that have no current activity or ongoing investigations dealing with deregulation received a scoring of four. This is significantly more important to TVA because of the political influence that the agency should strive for in each of these states. Likewise, states with congressional representation relevant to TVA received a higher scoring of six because of the potential impact these Congressmen could have on TVA. These scorings are based on relative importance, so the scorings reflect the overall importance of each factor in TVA’s marketing plan.

Using this scoring system, totaling the scores for each state in each category creates a ranking of the states. Based on the list of scores, there is no nature break, but looking at the congressional representation column helps to cut the list into a more manageable number for the purposes of targeting. The following states should be targeted: Alabama, California, Georgia, Indiana, Kentucky, Minnesota, Mississippi, Montana, New Mexico, North Carolina, Pennsylvania, Rhode Island, Tennessee, and
Texas. (See Appendix K) The only states with relevant congressional representation that do not appear on this list are those that are scored only on that factor. Should this list need to be separated into two tiers of importance, California, Montana, New Mexico, Rhode Island, Pennsylvania, and Texas could be given a somewhat lower priority. However, if it is at all financially feasible, all 14 states should be targeted.

**Marketing Strategies**

In order to reach out to investors in these states, there are several things that TVA should begin doing. TVA should, of course, continue with its current strategies, but it is necessary to supplement those with the following suggestions.

First, domestic roadshows to the target states are an excellent option. This would involve visiting the major cities in these states and conducting informational meetings with brokers, analysts, and investment bankers. These meetings could occur over lunch with just financial people, or they could involve bringing institutional and individual investors together for a presentation of some sort about TVA and its investment options. Either way, this would be a good way to get investment bankers and investors interested in TVA bonds. Although this is an expensive option because of flight costs and such, it is almost the only way to get in touch with individual investors and investment bankers in these states, particularly those outside the Tennessee Valley.

Second, another possible strategy to reach these investors and investment bankers is conference calls. Basically, TVA would invite investment bankers and brokers in the target states to listen in on a group presentation over the telephone. They would then be allowed to ask any questions they had about the material and TVA bonds. This would definitely be a less expensive way to reach people in all of the target states, but it might
not be as reliable. Although many people would be invited to participate in the
conference call, it could not be guaranteed that all would do so. However, even if all of
them did not participate, those that did would be better informed and better able to recruit
investors for TVA bonds.

Third, TVA should research institutions and contact those that fit the profile of the ideal investor. By taking the initiative, TVA is certain to get better results. TVA would be able to go to an institution, state exactly why it will benefit from investing in TVA bonds, and develop an extremely convincing argument. The people who invest for institutions would probably be very receptive to such a presentation.

Fourth, TVA should tell investment bankers exactly what kind of people and institutions with which it wants to have meetings. TVA is best suited to know who would benefit from investing in TVA bonds. Some investment bankers are still learning about TVA bonds themselves, so they are not necessarily in a good position to judge their advantages. By telling them exactly what to do, TVA should get better results than if things were left to chance. In addition, TVA could use this method to point investment bankers in the direction of people and institutions that would not only appreciate TVA bonds but also provide some sort of political advantage to TVA.

The fifth marketing strategy is critical. TVA needs to pursue more foreign government and central bank investment in various countries. Not only will this help to diversify the investor base even more, but it will also give TVA leverage with the US Government and Congress. These powerful foreign governments and institutions would think the US Government was crazy if it bankrupted TVA or took any other action to overtly harm it. Although this strategy sounds entirely politically motivated, it is also a
way to get the TVA name out to governments and institutions that may not know about it. There are so many unstable governments all over the world that would benefit from an extremely stable investment like TVA bonds.

With these five strategies at work in the targeted selection of states and abroad, TVA should be able to expand its investor base, which is one of its financing objectives. However, this expansion will be to TVA’s benefit rather than in a random fashion. Investors who appreciate the advantages of TVA bonds will have more exposure to them, and TVA will be able to claim a larger amount of political influence on issues that are critical to TVA’s success. Essentially, everybody’s needs will be met.

1 TVA web site
2 “8-99 IR.ppt”
3 Ibid
4 Ibid
5 Ibid
6 Ibid
7 “TVA Investor Information Notebook.ppt”
8 Ibid
9 Federation of Tax Administrators
10 Energy Information Administration
11 “TVA Investor Information Notebook.ppt”
Bibliography


Appendices
Appendix A

Government-sponsored Enterprises
<table>
<thead>
<tr>
<th></th>
<th>TVA</th>
<th>FNMA</th>
<th>Farm Credit</th>
<th>FHLB</th>
<th>FHLMC</th>
<th>SLMA</th>
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<td>1932</td>
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<td>1972</td>
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<td>Aaa/AAA</td>
<td>Aaa/AAA</td>
<td>Aaa/AAA</td>
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<td><strong>Power of Eminent Domain</strong></td>
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<td>Mortgages</td>
<td>Agricultural loans</td>
<td>Bank loans and other financial services</td>
<td>Mortgages</td>
<td>Educational loans</td>
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A Comparison of U.S. Government-Sponsored Enterprises
Appendix B

Debt Portfolio
Diversification of Debt Portfolio

Domestic vs Global

- Domestic: 37%
- Global: 63%

Callable vs Non-Callable

- Callable: 38%
- Non-callable: 62%

Debt Maturities

- Short-term Debt: 14%
- 1 - 10 Years: 9%
- 10 - 30 Years: 35%
- 30 - 50 Years: 42%

Debt Structures

- Other Callable: 4%
- Other Non-Callable: 1%
- Put Bonds: 9%
- QIDS: 4%
- VIPS: 4%
- PARRS: 29%
Appendix C

Number of Investors by Percentage
Total Number of Investors By Percentage

- International Institutional: 1%
- Domestic Institutional: 2%
- International Individual: 6%
- Domestic Individual: 91%
Appendix D

Investors by Dollar Holdings
Investor Dollar Holdings By Percentage

- Domestic Institutional: 52%
- Domestic Individual: 24%
- International Institutional: 20%
- International Individual: 4%
Appendix E

Global Investment
Geographic Region

Investment in TVA Global Bonds by
Appendix F

Investor Types
Investment in TVA Global Bonds by Investor Type

- Money Manager: 39%
- Bank/Trust: 20%
- Insurance: 15%
- Government Institution: 10%
- Retail: 8%
- Pension Fund: 6%
- Corporate: 2%
Appendix G

Investor Concentration in the US
US Investor Concentration
10 States Represent 49% of US Individual Investment

Millions of dollars

North Carolina $238
New Jersey $244
Ohio $249
Illinois $308
Texas $215
Michigan $223
Pennsylvania $333
Florida $430
California $649
New York $468
Appendix H

State Tax Rates
State Individual Tax Rates

State Tax Rates

- Higher than 7%
- 5% to 7%
- 1% to 4.99%
- No State Income Tax

State Income Tax is limited to Dividends and Interest Income Only

Source: Federation of Tax Administrators, January 1999
Appendix I

Deregulation Status
Deregulation Status

- Restructuring Legislation Enacted
- Comprehensive Regulatory Order Issued
- Legislation/Orders Pending
- Commission or Legislative Investigation Ongoing
- No Activity

Map of the United States indicating the status of deregulation in different states.
Appendix J

Congressional Representation
Appendix K

Ranking of States
## Congressional Representation

<table>
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<tr>
<th>Committee</th>
<th>Person</th>
<th>Role</th>
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<th>No. of Investors</th>
<th>Total Holdings (in millions)</th>
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<td><strong>Energy and Water Development Subcommittee</strong></td>
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## Congressional Representation

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