OFFICE OF THE COUNCIL AUDITOR
Suite 200, St. James Building

September 13, 2007 Special Report #637

Council President Daniel Davis
Jacksonville City Council District 12
117 W. Duval Street
City Hall, Suite 425
Jacksonville, FL 32202

Dear Council President Davis,

In response to your letter dated July 25, 2007, my office has quantified the value of JEA's net assets and JEA's cash flows. We are providing this special written report in accordance with Ordinance Code Section 102.102. This report does not represent an audit or attestation conducted pursuant to Government Auditing Standards. As seen below, the value of JEA's net assets at July 31, 2007 was $1,518,871,000 per JEA's monthly financial statements.

	Electric System	Water/Sewer System	District Energy System	Total JEA
Value of JEA's Net Assets				
Current Assets	$ 373,289,000	$ 110,868,000	$ 1,121,000	$ 485,278,000
Restricted Assets	453,425,000	100,515,000	2,451,000	556,391,000
Other Non-current Assets	260,763,000	22,184,000	302,000	283,249,000
Capital Assets (net of depreciation)	3,494,298,000	2,679,780,000	49,128,000	6,223,206,000
Total Assets	$4,581,775,000	$2,913,347,000	$ 53,002,000	$7,548,124,000
Current Liabilities	$ 155,803,000	$ 9,742,000	$ 15,000	$ 165,560,000
Liabilities Payable from Restricted Assets	262,950,000	51,866,000	212,000	315,028,000
Other Non-current Liabilities	112,940,000	8,109,000	-	121,049,000
Long-term Debt	3,636,795,000	1,737,571,000	53,250,000	5,427,616,000
Total Liabilities	$4,168,488,000	$1,807,288,000	$ 53,477,000	$6,029,253,000
Net Assets as of July 31, 2007	$ 413,287,000	$1,106,059,000	$ (475,000)	**$1,518,871,000**
(per JEA unaudited financial statements)				

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Regarding the value of JEA's cash flows, we calculated the value from two different perspectives. First, what is the value of JEA's cash flows to the City of Jacksonville? Second, what would the value of JEA's cash flows be to an Investor Owned Utility (IOU)? These are two entirely different numbers. We calculated the net present value of JEA's projected contributions to the City general fund for the next 30 years. We also calculated the net present value of JEA's projected cash flows to an IOU (assuming an IOU purchased JEA) for the next 30 years.

Each of these projections is based on various assumptions which we list below. While we believe that our assumptions are reasonable, assumptions are educated guesses about the future which may differ from actual experience. We wish to emphasize that we are not experts in utility valuation and we did not engage or consult any independent experts in utility valuation to assist in calculating our estimates. This was a limited exercise which we believe provides useful estimates and information for discussion purposes.

Value of JEA's Cash Flows to the City

We estimate the value of JEA's cash flows to the City to be worth $2,001,136,744 based on the following assumptions:

1. The appropriate interest rate for discounting the projected cash flows is 6.35% consisting of a risk free rate of 4.85% and a risk premium of 1.5%. The risk free rate of return is the rate of return on an investment having no risk of default, equal to the real rate of return plus expected inflation. The risk premium is the difference between the required rate of return on an investment with risk and the rate of return on a risk-free investment, such as U.S. Treasury bills.
2. The electric contribution to the City general fund will grow at 2.50% per year for the next 30 years, the same rate that JEA electric sales have grown (measured on a quantity sold basis) on average for the past five years.
3. The water/sewer contribution to the City general fund will grow at 7.94% per year for the next 30 years, the same rate that JEA water/sewer sales have grown (measured on a volume sold basis) on average for the past five years.

Value of JEA to an Investor Owned Utility

We estimate the value of JEA's cash flows to an IOU to be $3,145,943,326 based on the following assumptions:

1. The appropriate interest rate for discounting the projected cash flows is 11.75%, which is the likely return on equity allowed by the Florida Public Service Commission.
2. Electric sales will grow at 2.50% per year for the next 30 years, the same rate that JEA electric sales have grown (measured on a quantity sold basis) on average for the past five years.
3. Water/sewer sales will grow at 7.94% per year for the next 30 years, the same rate that JEA water/sewer sales have grown (measured on a volume sold basis) on average for the past five years.
4. The IOU would raise rates as soon as possible. Electric rates would be raised to $112.18 per megawatt hour, which represents a blended rate that is equivalent to that being charged by Florida Power & Light (vs. a JEA blended rate of $80.65 per megawatt hour). Water/Sewer rates would be raised 28%, the rate differential between JEA and United Water at the time JEA purchased United Water's Florida operations in December 2001.

5. The IOU would be required to refund all of JEA's tax-exempt debt with taxable debt as part of the purchase transaction. The IOU's average interest rate on outstanding debt would be two percent higher than JEA's average interest rate.
6. The IOU would save $31,955,382 per year by laying off 369 JEA employees. The savings represent the salaries and benefits for all JEA support personnel who are not directly involved in operations. The savings are allocated 72% to electric and 28% to water/sewer.
7. The IOU would not pay a contribution to the City general fund, but would pay ad valorem taxes.
8. The IOU would pay state corporate income taxes at a rate of 5.5% and federal corporate income taxes at an effective rate of 24%.
9. Electric fuel revenues equal fuel expense.
10. District Energy System revenue and expense are immaterial to this calculation.

Additional JEA Contributions

In any meaningful discussion of JEA value to the City, there are additional factors that must be considered. These "additional factors" are contributions that JEA makes or has made to the City and the citizens of Jacksonville above and beyond the annual monetary contribution to the City general fund. We have compiled a list of what we consider to be the top five additional contributions made by JEA during the past ten years.

1. JEA's low electric rates have saved the citizens of Jacksonville over two billion dollars during the past ten years, compared to what the citizens would likely have paid if JEA had been an investor owned utility.
2. JEA spent approximately $53 million on electric, water, and sewer infrastructure at Cecil Field to assist the City and JAA in creating Cecil Commerce Center.
3. JEA spent approximately $26 million to purchase over 5,000 acres of preservation land to complement the City's Preservation Project.
4. Rather than the City and JEA each constructing their own radio systems, JEA coordinated the design and construction of a radio system that the City and JEA can both use. The First Coast Radio System is a City-wide 800MHz trunked radio system used by JEA and the City including the Sheriff's Office and the Fire & Rescue Department. JEA financed the $20,795,159 cost of the system and bills the using agencies for their monthly operating charges as well as a capital recovery charge.
5. JEA constructed chilled water plants to serve the City sports complex, the proposed new courthouse, the Main Library, and Shands Jacksonville.

Benefits of Privatization

The City and the School Board could be expected to benefit from the sale of JEA to an IOU as discussed below. As with any sale transaction, the value of JEA to an IOU assumes that a buyer exists that is willing and able to purchase JEA.

1. The City would receive an infusion of cash from the sale that could be invested to provide a permanent revenue stream for the City general fund. For example, $3 billion would generate $140,400,000 per year assuming the proceeds were invested and earned 4.68% (current 20-year treasury bond yield) or $268,800,000 per year assuming the

proceeds earned 8.96% (the average rate earned by the General Employees pension plan during the past ten years). To determine the net financial benefit to the City general fund, this additional investment income must be netted with the additional ad valorem taxes which the City would receive from the IOU (approximately $52 million for 2007 at the currently proposed millage rate), the loss of the JEA contribution to the City general fund ($94,187,538 for FY 07/08), and an increase in the City's utility bills of approximately $7.5 million per year.

2. The Duval County School Board would receive ad valorem taxes from the IOU. Taxes paid to the School Board for 2007 would be approximately $48 million using the currently proposed school board millage rate. To determine the net benefit to the School Board, the ad valorem taxes received must be netted against an approximate $7.6 million increase in the School Board's utility bills.
3. The City would be removed from involvement or responsibility for public utilities.

<u>Conclusion</u>

We estimate the value of JEA to the City to be a minimum of $2.0 billion not taking into consideration "Additional JEA Contributions" such as those listed above. We estimate that the value of JEA could be as high as $3.1 billion to an investor owned utility or utilities assuming that a willing and able buyer exists. The difference between the two values is largely due to the assumption that an IOU would raise rates in order to cover its costs and generate its required return on equity, which is a higher rate of return than that generated by JEA which only attempts to cover its costs, with the contribution to the City general fund essentially being the City's return on equity.

Sincerely,

Kirk A. Sherman, CPA
Council Auditor