

Special Committee on the Potential Sale of JEA AGENDA

Thursday, March 22, 2018
3:30 PM
Council Chambers 1st Floor, City Hall

Tape No. _____

Carol Owens, Chief of Legislative Services

John R. Crescimbeni, Chair
Danny Becton
Anna Lopez Brosche
Garrett Dennis
Joyce Morgan

Legislative Assistant: Staci Lopez
Legislative Assistant: Mia Richardson
Research Asst.: Jeff Clements
Council Auditors Office: Kyle Billy
Council Auditors Office: Phillip Peterson
Office of General Counsel: Peggy Sidman

Meeting Convened:
Meeting Adjourned:

1. **Call Meeting to Order**
2. **Introductions**
3. **Reports from the Council Auditor — Kyle Billy**
 - **Franchise fee and utility service tax components**
 - **Schedule of future JEA contributions to the City of Jacksonville**
 - **Ten year review of JEA revenue/expenses and debt retirement**
 - **Potential sale of JEA: things to consider**
4. **Update on selection of independent adviser/consultant: scope of services/qualifications — Council President Anna Lopez Brosche**
5. **Update on status of subpoena — Peggy Sidman, Jon Phillips**
6. **Public Comment**
7. **Announcements**
8. **Adjourn**

*Note: Other Items may be added at the discretion of the chair. **RULE 4.505 DISRUPTION OF MEETING** No member of the audience shall applaud nor make any noise or remarks that are audible to the Committee that would indicate approval or disapproval of anything being discussed.*

****The next special committee meeting date will be at 2:00 PM on March 29, 2018. ****



Council Auditor's Office

The Potential Sale of JEA: Things to Consider

March 22, 2018

Special Report #807

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



March 22, 2018

Special Report #807

Honorable Members of the City Council
 City of Jacksonville

We are providing this special report in accordance with Ordinance Code Section 102.102. This report does not represent an audit or attestation conducted pursuant to government auditing standards. We wish to emphasize that we are not experts in utility valuation. However, we believe our report provides useful information that should be considered in any discussion of the potential sale of JEA.

INTRODUCTION

What is JEA’s value? JEA recently contracted with Public Financial Management (PFM) to prepare a report that included potential JEA value ranges. That report titled “The Future of JEA: Opportunities and Considerations” was released on February 14, 2018.¹ It estimated that the sales price for JEA could range from a low of \$7.5 billion to a high of \$11 billion. We utilized these gross numbers as a starting point for determining the net sale proceeds that would be available to the City of Jacksonville (see chart below) should they materialize.

	Minimum	Maximum
Gross Value ¹	7,500,000,000	11,000,000,000
Less:		
JEA Long-Term Debt ¹	(3,900,000,000)	(3,900,000,000)
Plant Vogtle Obligation ¹	(1,200,000,000)	(1,200,000,000)
GEPP Pension UAAL (1)	(541,025,000)	(541,025,000)
Interest Rate Swap termination cost ¹	(100,000,000)	(100,000,000)
JEA OPEB UAAL (1)(2)	(34,526,000)	(34,526,000)
Environmental Liabilities	(21,654,000)	(21,654,000)
Net Proceeds to the City (3)	\$1,702,795,000	\$5,202,795,000

(1) UAAL=Unfunded Actuarial Accrued Liability

(2) OPEB=Other Post-Employment Benefits

(3) Net Proceeds have not been reduced by fees and expenses associated with the sale.

In the chart above, we can see that the net proceeds to the City from selling JEA could range from a low of \$1,702,795,000 to a high of \$5,202,795,000. However, these numbers alone do not answer the question of JEA’s value and numbers alone do not answer the question as to whether the City should sell JEA. What else needs to be considered?

¹ https://www.jea.com/About/Investor_Relations/Financial_Reports/JEA_Valuation_PFM_Report.aspx

JEA'S CONTRIBUTION TO THE CITY GENERAL FUND

Although JEA does not pay property taxes, JEA has contributed to the City General Fund each year since consolidation in 1968. In the late 1970s, a formula was created to allow the City and JEA to budget with certainty the amount of the contribution. For the most part, the formula has been reviewed and modified every five years. The original formula was based on sales, and consequently, the contribution increased or decreased with sales. The formula has been modified many times since then to include a floor or various minimum increases. Under the current formula which is in effect until September 30, 2021, JEA will pay the City of Jacksonville \$116,619,815 in Fiscal Year 2017/18. The formula requires a minimum increase of one percent each year over the base year amount of \$114,187,538 from Fiscal Year 2015/16. The calculation is written into the JEA charter. While other City revenues may come in more or less than budgeted, the contribution from JEA is one revenue that the City knows it can count on.

REPLACING JEA'S CONTRIBUTION TO THE CITY GENERAL FUND

If JEA is sold, the City will no longer receive the JEA contribution, thus creating a hole in the City budget. The ad valorem taxes paid by a private utility will fill part of the hole, but not all of it. Assuming that a private utility would pay \$60 million in ad valorem taxes (calculated on all JEA real property and all JEA tangible personal property except for St. Johns River Power Park and the downtown headquarters tower), this would leave a hole of approximately \$57 million in the budget. There are multiple options to fill the budget hole. We have provided three options as examples.

Option #1: A portion of the sale proceeds could be used to pay off the City's General Fund supported debt, which is approximately \$850 million and would save approximately \$90 million per year in debt service, thus filling the hole by reducing required expenditures. This option would reduce the net proceeds available to the City to a range of \$850 million to \$4.35 billion.

Option #2: A portion of the sale proceeds could be used to pay down the City's pension debt. We estimate that if the City paid down the police and fire pension debt by \$1.1 billion, it would reduce the City's required pension payment by approximately \$75 million per year, thus filling the hole by reducing required expenditures. This option would reduce the net proceeds available to the City to a range of \$600 million to \$4.1 billion. (An actuary could run various scenarios and advise the City on projected outcomes.)

Option #3: A portion of the sale proceeds could be permanently set aside to generate a revenue stream equal to the approximate difference between the JEA contribution and the ad valorem taxes estimated to be paid by an Investor Owned Utility (IOU). (\$2 billion invested in 30-year U.S. Treasury bonds at 3.0% would generate \$60 million annually.) This option would reduce the net proceeds available to the City to an approximate range of \$0 to \$3.2 billion. However, setting aside \$2 billion in a trust fund could have unintended consequences. In 2017, House Bill 7063 was filed and died in the Government Accountability Committee.² The bill would have prohibited certain local governments from enacting, extending, or increasing taxes unless the government did not have excess unencumbered fund balances. A county would not have been able to levy a millage rate above its rolled-back rate unless it spent down those excess fund balances.

² <https://www.flscnate.gov/Session/Bill/2017/07063>

Not an Option: While there are likely many other options that could be considered to fill the budget hole that would be created by the loss of the JEA contribution, there is one thing that is not an option. Proceeds from the sale of JEA should not be used directly to fill the hole. (See Recommendation #1)

ADDITIONAL JEA CONTRIBUTIONS TO THE CITY

In any meaningful discussion of JEA's value to the City, there are additional factors that must be considered. These "additional factors" are contributions that JEA 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 major contributions made by JEA to the City through the years.

1. In 1996, the Environmental Protection Agency (EPA) issued an administrative order to the City of Jacksonville because of sanitary sewer overflows due to poor sewer infrastructure. On June 1, 1997, the City Water/Sewer utility was transferred to JEA. In 1998, JEA started the "Groundworks Program" to dedicate resources to the Water and Sewer system, which improved so much that the EPA lifted the administrative order in the same year.³ Over \$3,618,940,436 has been invested by JEA in capital improvements to the Water and Sewer system to date.⁴
2. Prior to JEA taking over the water and sewer system from the City Public Utilities Department on June 1, 1997, the water and sewer utility was not making a contribution to the City General Fund. Since JEA took over the water and sewer system, it has made a contribution to the City General Fund each year.⁵
3. At the time the City financed the River City Renaissance project in the 1990s, the City's practice was to use fixed-rate bonds. JEA suggested that the City use variable-rate debt for the financing to achieve significant interest savings. Because of concerns with how high the variable interest rate might go, JEA guaranteed the maximum amount of interest that the City would pay on \$242,000,000 in variable-rate debt.⁶
4. In 2001, JEA expanded its water and sewer territory with the full support of the City Council. All nineteen Council Members sponsored Ordinance 2001-880-E, which approved the financing and appropriated the funds for JEA to purchase United Water, increasing JEA's service territory and adding approximately 36,000 customers. JEA lowered water and sewer rates for almost all of the former United Water customers.⁷ As JEA expanded, its contribution to the City General Fund increased.
5. JEA partnered with the City for a Joint Projects Agreement so that utility and drainage projects could be accomplished at the same time thereby avoiding overlapping construction costs and multiple traffic disruptions.⁸ This coordination was especially helpful during the Better Jacksonville Plan.
6. JEA performed the project management function for the \$75 million septic tank remediation project that was part of the Better Jacksonville Plan.⁹
7. JEA has an Economic Development Program Rider with two rate programs to attract new business to Jacksonville. Currently, Sysco International Food Group Inc., Dresser Equipment Group Inc., and Hans Mill Corporation are part of the program.
8. JEA spent approximately \$53,000,000 on electric, water and sewer infrastructure at Cecil Field to assist the City in creating Cecil Commerce Center.

³ JEA Annual Report 1998

⁴ Number provided by JEA's Financial Planning & Analysis Department

⁵ JEA Annual Report 1998

⁶ JEA Annual Report 2001

⁷ <https://www.prnewswire.com/news-releases/jea-and-united-water-complete-219-million-transaction-74688952.html>

⁸ JEA Annual Report 1999

⁹ <http://www.coj.net/Departments/Better-Jacksonville-Plan/Docs/bjpreport20011023.aspx>

9. JEA spent approximately \$20,000,000 to purchase over 5,000 acres of preservation land to complement the City's Preservation Project.
10. In conjunction with the Better Jacksonville Plan, JEA constructed a chilled water plant at Hogan's Creek to serve the new arena and baseball field and another plant downtown to serve the new courthouse and the new Main Library. The downtown plant now also serves the JEA Plaza, the State Attorney Office building, the City Hall Annex, and the Library Garage. JEA has since constructed another plant in Springfield to serve the University of Florida College of Medicine, the Proton Beam Facility, and the Shands Healthcare campus.¹⁰
11. 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 could both use. The First Coast Radio System was a City-wide 800MHz trunked radio system used by JEA, the City, the Sheriff's Office, and the Fire & Rescue Department. JEA financed the \$20,795,159 cost of the system and billed the using agencies for their monthly operating charges as well as a capital recovery charge. With the newly installed P-25 radio system, JEA houses the transmitters and receivers at no cost to the City. The system also provides service to the five surrounding counties.
12. JEA has several community partnerships and community involvement programs that enable and encourage their employees to contribute to a better community. Examples include internships through Duval County Public Schools and Florida State College at Jacksonville, participation with Junior Achievement of North Florida to teach elementary and high school students about business, economics and entrepreneurship, and involvement with local charity fundraising efforts to further the charity's cause.¹¹
13. JEA spent \$1,150,000 to fund the initial construction of the JEA Science Theatre at the Museum of Science and History and an additional \$775,000 to fund the renovation of the theater years later.
14. JEA is performing and financing (estimated cost of approximately \$10 million) the City's LED (Light Emitting Diode) streetlight conversion.
15. Pursuant to the 2016 interagency agreement between the City and JEA,
 - A. JEA contributed \$15,000,000 to be used in conjunction with a \$15,000,000 match from the City for water and sewer infrastructure.
 - B. JEA transferred 30.34 metric tons of Total Nitrogen Water Quality Credits to the City because the expected reductions generated by the septic-tank phase out program were not sufficient for the City to meet the Total Nitrogen Load Reduction Goal of 50% by July 31, 2015. Per the agreement, JEA shall provide these credits (valued at \$2,086,767 per year) to the City for no compensation through December 31, 2023 to assist the City in meeting its Basin Management Action Plan (BMAP) load reduction goal. Per the Florida Department of Environmental Protection, if the City sold JEA, the City would get to keep the BMAP credits already received, but any future credit transfers would have to be transacted between the City and the new owner of the utility.
 - C. JEA committed to contributing a maximum annual amount of \$1,000,000 for sewer projects that the City undertakes to meet its environmental obligations. Related to those sewer projects, JEA committed to pay the sewer capacity fees up to an annual cap of \$650,000.
16. JEA agreed to provide the City Solid Waste Division a discounted rate on landfill leachate disposal through Fiscal Year 2018/19, while the City explores alternative methods of disposal.
17. The City of Jacksonville, the Duval County School Board, the United States Navy, and the United States Marine Corps save money on their electric bills because they qualify for JEA's General Service Extra Large Demand rate rider. The rider provides a reduction in overall costs by combining accounts that would otherwise be required to be billed separately at a higher rate.

¹⁰ https://www.jea.com/About/Careers/District_Energy_System_Overview_Presentation/

¹¹ https://www.jea.com/in_our_community/community_investment/

18. In 2013, the Northeast Florida Regional Council released an Economic Impact Analysis for JEA. The study estimated the economic impact and value of JEA to Duval County in 2012. The annual impact of JEA on Gross County Product (GCP) indicated:
- o JEA contributed between \$860 - \$910 million to GCP
 - o JEA contribution was 1.4% - 1.5% of Duval County GCP
 - o JEA directly and indirectly impacted 4,500 - 4,700 jobs
 - o JEA impacted Earnings/Personal Income \$206 - \$310 million
- Only the tangible impacts were quantified in the analysis.

OTHER CONSIDERATIONS

1. As a municipally owned utility, JEA is eligible for Federal Emergency Management Agency (FEMA) funds. Since 2004, JEA has been reimbursed 81.9% or \$13,829,366 of storm damage costs by FEMA and the State (costs for Hurricanes Matthew and Irma are not included because as of the report date, no reimbursements have been received for Hurricanes Matthew or Irma). Investor Owned Utilities are not eligible for FEMA reimbursement so the costs of natural disasters are passed on to customers. As of January 2018, FPL (Florida Power and Light) customers were paying two different storm cost recovery charges. On a typical 1,000 kWh monthly FPL bill, \$3.36 was being collected for a period of twelve months until February of 2018 for Hurricane Matthew. In addition, \$1.20 is being collected to repay the bonds issued for the 2004 and 2005 hurricane restoration efforts and to partially replenish the storm damage reserve for future storms.¹² This charge has been collected since 2007. Note that FPL has only one residential rate for their entire service area which means that storm charges are assessed to all of their customers regardless of the geographic location of the damage or the customer.
2. The JEA contribution is a pledged revenue for the City's Capital Project bonds. The City has approximately \$108 million of these bonds outstanding as of 9/30/17. Of course, the City could defease these bonds with the proceeds from the sale of JEA if there are sufficient proceeds to do so.
3. The JEA contribution is a pledged revenue for all of the Jacksonville Port Authority's (JPA) outstanding bonds. Pursuant to Municipal Code Section 106.218, the pledge amount is calculated annually by multiplying ¼ mill times the gross kilowatt hours of electricity sold by JEA for the prior 12 months. Although the obligation will remain with the City if JEA is sold, the factor that is used to calculate the pledged revenue will have to be revised. The outstanding amount of JPA bonds as of 9/30/17 was \$182,269,000. The bondholders will have to consent to a revised calculation prior to, or concurrent with the sale to avoid impairment of the bonds.¹³ From FY 1996/97 to FY 2016/17, \$63,584,846 of revenue from JEA was pledged to JPA for debt service. For FY 2017/18, the amount pledged from the JEA assessment is \$3,062,125.
4. JEA has an interlocal agreement with Nassau and St. Johns Counties that allows either county the first right of refusal to purchase the JEA water and sewer facilities in their respective county in the event of a change of majority ownership of JEA. There is also a clause that states that if the facilities are purchased and then resold within five years, the net profit must be split 50/50 between JEA and the County.
5. According to the American Public Power Association 2017/18 Directory and Statistical Report, public utilities gave back 5.6% of their electric operating revenues to their communities in 2014. In comparison, IOUs only paid 4.2% of operating revenues in taxes and fees to State and local governments. For that same time period, JEA paid 6.1% of operating revenues to the City. In 2017, JEA paid 6.7%.

¹² <https://www.fpl.com/rates/pdf/electric-tariff-section8.pdf>

¹³ Per JPA bond counsel, Foley & Lardner

6. The City Council currently has the capability to question and influence JEA's annual proposed budgets and planned capital project expenditures for the electric, water/sewer, and district energy systems. This ability to influence where or when improvements occur would likely not exist under an Investor Owned Utility.
7. JEA's contribution to the City has a guaranteed floor or minimum. Returns on the invested sale proceeds from JEA would be dependent upon market conditions.
8. JEA currently contributes to the cost of providing City services. Specific examples that would otherwise be offset by a General Fund contribution are the Office of Inspector General (\$85,000) and the Office of Ethics, Compliance & Oversight (\$5,000). JEA also utilizes the services of Fleet Management and participates in the City's workers' compensation and general and auto liability insurance pooling with the Risk Management Division. These areas could be affected if JEA's participation was removed.
9. If JEA's utilities are split, (for example if Electric is sold, but Water/Sewer is retained) they will not be as efficient operating separately as they are together. The electric, water/sewer, and district energy utilities are deeply intertwined. In Fiscal Year 2017/18 for example, the electric utility is budgeted to perform \$48 million of water/sewer work. Work performed by one utility for another is charged to the correct utility, however if the utilities were separated, the efficiencies would be lost and the work would likely cost more.
10. JEA maintains its company headquarters downtown and was preparing just a few months ago to build a new headquarters building in the heart of downtown. JEA has approximately 2,000 employees. Most of these jobs are well paid with benefits. If JEA were a company thinking of moving its headquarters and 2,000 jobs to Jacksonville, the Office of Economic Development would likely ask the City Council to approve millions of dollars of incentives to lure them here.
11. The City of Jacksonville receives JEA contribution on utility sales outside of Jacksonville. For example, water and sewer customers in Nassau and St. Johns Counties contribute to the City of Jacksonville General Fund every month when they pay their bill.
12. Private Utilities will likely not pay as much in ad valorem taxes as one might think. It is common practice for private sector businesses to challenge their property assessments. For example, we checked with the Value Adjustment Board in Miami-Dade County and found that Florida Power and Light (FPL) filed petitions challenging its assessments in 2013, 2014, and 2015, all of which were later withdrawn. We checked with the Value Adjustment Board in Palm Beach County Florida and found that FPL had filed petitions in 2014, 2015, 2016, and 2017. In 2014 and 2016, FPL withdrew its petition with no change in assessment. In 2015, FPL withdrew its petition, but received a reduction in its assessment from \$1,710,880 to \$342,176. In 2017, FPL did not appear at the hearing and the petition was denied.
 In another example, in 2012, a tax dispute arose between Duke Energy and Citrus County. After fifteen months, Citrus County agreed to a settlement. Citrus officials said they agreed to settle because of rising legal bills in their battle with Duke.¹⁴
13. Local Control: While it might be a stretch to say that local control is priceless, it does have considerable value. Possible bidders for JEA might include FPL based in Juno Beach, Florida, Duke Florida (owned by Duke Energy which is based in Charlotte, North Carolina), and TECO (owned by Emera which is based in Halifax, Nova Scotia, Canada). Would these companies based in other cities, states, and another country make Jacksonville a priority on a day to day basis or after a natural disaster? Would they work closely with the City on infrastructure projects? The CEO would certainly not be just across the street.

¹⁴ <http://www.tampabay.com/news/business/energy/settlement-favors-duke-energy-in-tax-dispute-with-citrus-county/2171118>

14. The City must assume that if JEA is sold, the City will not be able to get JEA back if it later has seller's remorse. Jacksonville Port Authority once owned all of Blount Island, but sold the eastern 900 acres to Offshore Power Systems in the early 1970s for use in a large economic development project. Think how things would be different if JPA still owned all of Blount Island. JPA may not have developed the Dames Point Terminal. JPA might have a cruise ship terminal east of the Dames Point Bridge. The length of JPA's dredging project would be shorter and less expensive if it only had to accommodate Blount Island.
15. Even if the sale proceeds pay for JEA's share of the UAAL, an actuary will have to determine the effect on the General Employees Pension Plan if the JEA employees are removed from the pension plan. The models used in pension reform did not contemplate the sale of JEA. The models contemplated that those JEA employees hired by September 30, 2017 would be part of the pension plan with an employee and employer share being paid into the pension plan every pay period for decades into the future. The impact to the pension plan might be favorable or unfavorable, but the actuary will have to determine this. (See Recommendation #2)
16. JEA and the City could spend considerable sums of money working on a deal that might never close. Two recent examples follow:
 - A. In 2016, NextEra Energy, the parent of Florida Power & Light, canceled its \$2.63 billion bid to purchase Hawaiian Electric Industries after the deal was rejected by Hawaiian state regulators.^{15 16}
 - B. In 2017, utility regulators in Texas rejected an \$18.7 billion bid by NextEra Energy to buy Oncor Electric Delivery Co., the state's largest regulated utility.¹⁷To reiterate, it is entirely possible that bids could be obtained, a term sheet could be agreed on, millions of dollars could be spent on attorneys, consultants, financial advisors, and investment bankers, but for regulatory or other reasons, the deal does not close. In its February 14, 2018 report, PFM stated that "A sale of all or a portion of JEA's assets will represent one of the largest, most complex transactions ever attempted in the municipal utility market."¹⁸ Where will the funds come from to pay all these costs? If the deal does not close, those millions that were spent may not be recoverable. (See Recommendation #3)
17. The sale could take years to close. For example, the sale of Vero Beach's electric utility to Florida Power and Light (FPL) was first approved by voters in 2011. In October of 2017 (6 years later) the Vero Beach City Council approved the sale, but it is still not final. It must still be approved by several other groups including the Florida Public Service Commission (FPSC).¹⁹ If the sale does not go through, the City of Vero Beach will be responsible for the majority of the costs associated with the sale.²⁰

¹⁵ <http://www.miamiherald.com/news/business/article90362237.html>

¹⁶ <https://www.hawaiianelectric.com/nextera-energy-and-hawaiian-electric-industries-announce-termination-of-merger-agreement>

¹⁷ <http://www.sun-sentinel.com/business/fl-bz-nextera-oncor-deal-rejected-20170413-story.html>

¹⁸ https://www.jea.com/About/Investor_Relations/Financial_Reports/JEA_Valuation_PFM_Report.aspx

¹⁹ <https://www.tcpalm.com/story/news/local/shaping-our-future/growth/2017/10/24/vero-beach-oks-selling-electric-system-fpltakes-action-fpl-185-million-offer-buy-city-electric-syste/791924001/>

²⁰ http://www.covb.org/vertical/sites/%7B898790A2-F88A-48AE-A9B3-666AAE67AD40%7D/uploads/FPL_LETTER_OF_INTENT_May_16_2017.pdf

18. Eight Council Members will be leaving the City Council due to term limits. It is possible that the current Council could vote to move forward with a sale, but the next Council may not approve the deal.
19. It is possible that a private equity firm could purchase and operate JEA. Private equity firms buy companies with capital from investors (cash) and borrowed money (debt/bonds). If the borrowed money greatly exceeds the cash, it is called a leveraged buy-out (LBO). One of the issues with an LBO is that the purchased company will end up with the debt on its books after the purchase. In one of the largest LBOs in history, utility company TXU Corp was purchased by a group of private equity firms which left TXU (now known as Energy Future Holdings) with more than \$40 billion in debt. In 2014, Energy Future Holdings filed for Chapter 11 bankruptcy protections because it could not make scheduled debt payments.²¹
20. If the City sells JEA, it will not have JEA to oversee any future capital projects involving the undergrounding of electric lines or the extension of water and sewer lines.

BENEFITS TO THE CITY OF SELLING JEA

1. The City could potentially receive a large sum of money without increasing debt or raising taxes. These funds could be used to pay down or pay off City debt, pay for the pension UAAL, construct infrastructure, and/or provide funding for large projects (e.g. a new convention center, downtown development, or an entertainment zone).
2. Ad valorem taxes and stormwater fees would be collected on former JEA property.
3. The Duval County School Board (DCSB) would receive additional ad valorem taxes, although the amount DCSB would receive is limited. We estimate that DCSB would receive approximately \$8 million per year for capital purposes only. It does not appear that the DCSB would receive any additional operating funds because an increase in local funds would be offset by a decrease in state funds. (See Attachment 1)

BENEFITS TO THE CITY OF KEEPING JEA

1. An annual, predictable monetary contribution to the City General Fund.
2. Local control of Electric and Water/Sewer Utilities.
3. A corporate headquarters located in downtown Jacksonville.
4. Thousands of high paying jobs with benefits.
5. Rates are set by the JEA Board, whereas rates for an IOU are set by the Public Service Commission in Tallahassee.
6. After a hurricane or storm that causes large quantities of electrical outages, JEA makes it a priority to restore electrical service to JEA sewer infrastructure, thereby reducing the potential ripple effects of the storm.

²¹ <http://www.star-telegram.com/news/business/article3855518.html>

RECOMMENDATIONS

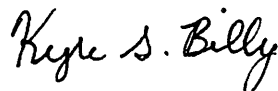
Recommendations if the City decides to sell JEA

1. Proceeds from the sale of JEA should never be used for operating expenses. They should be set aside to generate a future income stream and/or used for one-time expenditures such as paying down debt or used for needed capital expenditures. (Note: The City needs to be cognizant of the increased operating costs that would be associated with any capital expenditures.)
2. As part of the City's due diligence, it should engage its actuary to determine the effect on the general employees pension plan if JEA were sold.
3. Include a requirement in the purchase agreement that if the deal does not go through for any reason other than the City of Jacksonville turning it down, the buyer must reimburse the City of Jacksonville and JEA for all expenses incurred in the attempted sale.

Recommendation if the City decides to Keep JEA

4. A task force should be created to determine what, if any, changes could be made to JEA that would help JEA to increase its financial contribution to the City and/or help the City accomplish other goals such as extending water and sewer infrastructure. (Note: From 2010 through 2017, JEA paid down \$400 million in debt beyond its normal debt service. Paying down that much additional debt in that period of time shows fiscal discipline, however, it also begs the question as to whether those funds could have been used in other ways to benefit the City.) The task force could explore ideas such as those listed below and many others not contemplated here.
 - a. Could JEA become a natural gas utility creating an additional revenue stream and additional City contribution? (For example, Tallahassee operates electric, water, sewer, and natural gas utilities.)
 - b. Could JEA sell or lease rooftop solar to its customers?
 - c. Could/should JEA take over the City Stormwater Utility?
 - d. What other ways could JEA generate additional revenue?
 - e. Could JEA make a larger financial contribution to the City General Fund?
 - f. Should the City contribution include sales of reclaimed water?
 - g. What amount of electric line undergrounding and extension of water and sewer lines should be pursued and included in JEA's capital improvement budget each year?

Respectfully submitted,



Kyle S. Billy, CPA
Council Auditor

Council Auditor's Office
The Potential Sale of JEA: Things to Consider
DCSB Impact

The Duval County School Board (DCSB) would receive additional ad valorem taxes, although the amount DCSB would receive is limited. We estimate that DCSB would receive approximately \$8 million per year for capital purposes, pursuant to the Local Capital Improvement Millage. Note that the DCSB would probably not receive additional operating revenue from the sale of JEA. Based on the way the Florida Education Finance Program (FEFP) formula works, increases in revenue from the Required Local Effort or the Discretionary Local Effort would likely be offset by a corresponding decrease in State funds. The Local Capital Improvement Millage however, is not part of the FEFP calculation. This information was confirmed with the Florida Department of Education.

Duval County Gross Taxable Value used to calculate DCSB 2017/18 Taxes	\$ 64,320,200,875 (A)
Exemption Value of JEA Property as of 1/1/17	5,582,321,552
Total Duval County Taxable Value Including JEA	\$ 69,902,522,427 (B)

DCSB 2017/2018 Budgeted Ad Valorem Revenue Under Two Scenarios

Funding Sources	Millage Rates (C)	Scenario 1	Scenario 2	Difference
		JEA City Owned (A) x (C)	JEA Investor Owned (B) x (C)	
Required Local Effort Taxes ¹	4.2370	\$ 261,623,703	\$ 284,329,908	\$ 22,706,205
Discretionary Local Effort ²	0.7480	\$ 46,187,050	\$ 50,195,603	\$ 4,008,553
Total Local Funding		\$ 307,810,753	\$ 334,525,511	\$26,714,758
State Funding ³		\$ 637,616,380	\$ 610,901,622	\$ (26,714,758)
Total Local and State Funding		\$ 945,427,133	\$ 945,427,133	\$ -
Local Capital Improvement ⁴	1.5000	\$ 92,621,089	\$ 100,659,632	\$ 8,038,543

Footnotes:

- 1 - This funding is used for school district operations. The millage rate is set by the Department of Education.
- 2 - This funding is used for school district operations. The DCSB sets the Discretionary Local Effort millage rate; however, the 0.7480 millage rate is the maximum millage rate allowed by the Florida Legislature.
- 3 - This funding is derived by the State from a complex formula based on a number of factors (e.g. number of students, the Florida Price Level index by school district, discretionary millage compression supplement, etc.)
- 4 - This funding is to be used for capital improvements only. The DCSB sets the Local Capital Improvement millage rate; however, the 1.5000 millage rate is the maximum millage rate allowed for capital improvements.

This methodology has been confirmed with the Florida Department of Education regarding State and local funding for the DCSB both currently and under the assumption of adding JEA property to the tax roll. It also assumes that an Investor Owned Utility would take advantage of the 4% early payment discount on property taxes.



Council Auditor's Office

The Potential Sale of JEA: Things to Consider

March 22, 2018

Special Report #807

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



March 22, 2018

Special Report #807

Honorable Members of the City Council
 City of Jacksonville

We are providing this special report in accordance with Ordinance Code Section 102.102. This report does not represent an audit or attestation conducted pursuant to government auditing standards. We wish to emphasize that we are not experts in utility valuation. However, we believe our report provides useful information that should be considered in any discussion of the potential sale of JEA.

INTRODUCTION

What is JEA's value? JEA recently contracted with Public Financial Management (PFM) to prepare a report that included potential JEA value ranges. That report titled "The Future of JEA: Opportunities and Considerations" was released on February 14, 2018.¹ It estimated that the sales price for JEA could range from a low of \$7.5 billion to a high of \$11 billion. We utilized these gross numbers as a starting point for determining the net sale proceeds that would be available to the City of Jacksonville (see chart below) should they materialize.

	Minimum	Maximum
Gross Value ¹	7,500,000,000	11,000,000,000
Less:		
JEA Long-Term Debt ¹	(3,900,000,000)	(3,900,000,000)
Plant Vogtle Obligation ¹	(1,200,000,000)	(1,200,000,000)
GEPP Pension UAAL (1)	(541,025,000)	(541,025,000)
Interest Rate Swap termination cost ¹	(100,000,000)	(100,000,000)
JEA OPEB UAAL (1)(2)	(34,526,000)	(34,526,000)
Environmental Liabilities	(21,654,000)	(21,654,000)
Net Proceeds to the City (3)	\$1,702,795,000	\$5,202,795,000

(1) UAAL=Unfunded Actuarial Accrued Liability

(2) OPEB=Other Post-Employment Benefits

(3) Net Proceeds have not been reduced by fees and expenses associated with the sale.

In the chart above, we can see that the net proceeds to the City from selling JEA could range from a low of \$1,702,795,000 to a high of \$5,202,795,000. However, these numbers alone do not answer the question of JEA's value and numbers alone do not answer the question as to whether the City should sell JEA. What else needs to be considered?

¹ https://www.jea.com/About/Investor_Relations/Financial_Reports/JEA_Valuation_PFM_Report.aspx

JEA'S CONTRIBUTION TO THE CITY GENERAL FUND

Although JEA does not pay property taxes, JEA has contributed to the City General Fund each year since consolidation in 1968. In the late 1970s, a formula was created to allow the City and JEA to budget with certainty the amount of the contribution. For the most part, the formula has been reviewed and modified every five years. The original formula was based on sales, and consequently, the contribution increased or decreased with sales. The formula has been modified many times since then to include a floor or various minimum increases. Under the current formula which is in effect until September 30, 2021, JEA will pay the City of Jacksonville \$116,619,815 in Fiscal Year 2017/18. The formula requires a minimum increase of one percent each year over the base year amount of \$114,187,538 from Fiscal Year 2015/16. The calculation is written into the JEA charter. While other City revenues may come in more or less than budgeted, the contribution from JEA is one revenue that the City knows it can count on.

REPLACING JEA'S CONTRIBUTION TO THE CITY GENERAL FUND

If JEA is sold, the City will no longer receive the JEA contribution, thus creating a hole in the City budget. The ad valorem taxes paid by a private utility will fill part of the hole, but not all of it. Assuming that a private utility would pay \$60 million in ad valorem taxes (calculated on all JEA real property and all JEA tangible personal property except for St. Johns River Power Park and the downtown headquarters tower), this would leave a hole of approximately \$57 million in the budget. There are multiple options to fill the budget hole. We have provided three options as examples.

Option #1: A portion of the sale proceeds could be used to pay off the City's General Fund supported debt, which is approximately \$850 million and would save approximately \$90 million per year in debt service, thus filling the hole by reducing required expenditures. This option would reduce the net proceeds available to the City to a range of \$850 million to \$4.35 billion.

Option #2: A portion of the sale proceeds could be used to pay down the City's pension debt. We estimate that if the City paid down the police and fire pension debt by \$1.1 billion, it would reduce the City's required pension payment by approximately \$75 million per year, thus filling the hole by reducing required expenditures. This option would reduce the net proceeds available to the City to a range of \$600 million to \$4.1 billion. (An actuary could run various scenarios and advise the City on projected outcomes.)

Option #3: A portion of the sale proceeds could be permanently set aside to generate a revenue stream equal to the approximate difference between the JEA contribution and the ad valorem taxes estimated to be paid by an Investor Owned Utility (IOU). (\$2 billion invested in 30-year U.S. Treasury bonds at 3.0% would generate \$60 million annually.) This option would reduce the net proceeds available to the City to an approximate range of \$0 to \$3.2 billion. However, setting aside \$2 billion in a trust fund could have unintended consequences. In 2017, House Bill 7063 was filed and died in the Government Accountability Committee.² The bill would have prohibited certain local governments from enacting, extending, or increasing taxes unless the government did not have excess unencumbered fund balances. A county would not have been able to levy a millage rate above its rolled-back rate unless it spent down those excess fund balances.

² <https://www.flsenate.gov/Session/Bill/2017/07063>

Not an Option: While there are likely many other options that could be considered to fill the budget hole that would be created by the loss of the JEA contribution, there is one thing that is not an option. Proceeds from the sale of JEA should not be used directly to fill the hole. (See **Recommendation #1**)

ADDITIONAL JEA CONTRIBUTIONS TO THE CITY

In any meaningful discussion of JEA's value to the City, there are additional factors that must be considered. These "additional factors" are contributions that JEA 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 major contributions made by JEA to the City through the years.

1. In 1996, the Environmental Protection Agency (EPA) issued an administrative order to the City of Jacksonville because of sanitary sewer overflows due to poor sewer infrastructure. On June 1, 1997, the City Water/Sewer utility was transferred to JEA. In 1998, JEA started the "Groundworks Program" to dedicate resources to the Water and Sewer system, which improved so much that the EPA lifted the administrative order in the same year.³ Over \$3,618,940,436 has been invested by JEA in capital improvements to the Water and Sewer system to date.⁴
2. Prior to JEA taking over the water and sewer system from the City Public Utilities Department on June 1, 1997, the water and sewer utility was not making a contribution to the City General Fund. Since JEA took over the water and sewer system, it has made a contribution to the City General Fund each year.⁵
3. At the time the City financed the River City Renaissance project in the 1990s, the City's practice was to use fixed-rate bonds. JEA suggested that the City use variable-rate debt for the financing to achieve significant interest savings. Because of concerns with how high the variable interest rate might go, JEA guaranteed the maximum amount of interest that the City would pay on \$242,000,000 in variable-rate debt.⁶
4. In 2001, JEA expanded its water and sewer territory with the full support of the City Council. All nineteen Council Members sponsored Ordinance 2001-880-E, which approved the financing and appropriated the funds for JEA to purchase United Water, increasing JEA's service territory and adding approximately 36,000 customers. JEA lowered water and sewer rates for almost all of the former United Water customers.⁷ As JEA expanded, its contribution to the City General Fund increased.
5. JEA partnered with the City for a Joint Projects Agreement so that utility and drainage projects could be accomplished at the same time thereby avoiding overlapping construction costs and multiple traffic disruptions.⁸ This coordination was especially helpful during the Better Jacksonville Plan.
6. JEA performed the project management function for the \$75 million septic tank remediation project that was part of the Better Jacksonville Plan.⁹
7. JEA has an Economic Development Program Rider with two rate programs to attract new business to Jacksonville. Currently, Sysco International Food Group Inc., Dresser Equipment Group Inc., and Hans Mill Corporation are part of the program.
8. JEA spent approximately \$53,000,000 on electric, water and sewer infrastructure at Cecil Field to assist the City in creating Cecil Commerce Center.

³ JEA Annual Report 1998

⁴ Number provided by JEA's Financial Planning & Analysis Department

⁵ JEA Annual Report 1998

⁶ JEA Annual Report 2001

⁷ <https://www.prnewswire.com/news-releases/jea-and-united-water-complete-219-million-transaction-74688952.html>

⁸ JEA Annual Report 1999

⁹ <http://www.coj.net/Departments/Better-Jacksonville-Plan/Docs/bjpreport20011023.aspx>

9. JEA spent approximately \$20,000,000 to purchase over 5,000 acres of preservation land to complement the City's Preservation Project.
10. In conjunction with the Better Jacksonville Plan, JEA constructed a chilled water plant at Hogan's Creek to serve the new arena and baseball field and another plant downtown to serve the new courthouse and the new Main Library. The downtown plant now also serves the JEA Plaza, the State Attorney Office building, the City Hall Annex, and the Library Garage. JEA has since constructed another plant in Springfield to serve the University of Florida College of Medicine, the Proton Beam Facility, and the Shands Healthcare campus.¹⁰
11. 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 could both use. The First Coast Radio System was a City-wide 800MHz trunked radio system used by JEA, the City, the Sheriff's Office, and the Fire & Rescue Department. JEA financed the \$20,795,159 cost of the system and billed the using agencies for their monthly operating charges as well as a capital recovery charge. With the newly installed P-25 radio system, JEA houses the transmitters and receivers at no cost to the City. The system also provides service to the five surrounding counties.
12. JEA has several community partnerships and community involvement programs that enable and encourage their employees to contribute to a better community. Examples include internships through Duval County Public Schools and Florida State College at Jacksonville, participation with Junior Achievement of North Florida to teach elementary and high school students about business, economics and entrepreneurship, and involvement with local charity fundraising efforts to further the charity's cause.¹¹
13. JEA spent \$1,150,000 to fund the initial construction of the JEA Science Theatre at the Museum of Science and History and an additional \$775,000 to fund the renovation of the theater years later.
14. JEA is performing and financing (estimated cost of approximately \$10 million) the City's LED (Light Emitting Diode) streetlight conversion.
15. Pursuant to the 2016 interagency agreement between the City and JEA,
 - A. JEA contributed \$15,000,000 to be used in conjunction with a \$15,000,000 match from the City for water and sewer infrastructure.
 - B. JEA transferred 30.34 metric tons of Total Nitrogen Water Quality Credits to the City because the expected reductions generated by the septic-tank phase out program were not sufficient for the City to meet the Total Nitrogen Load Reduction Goal of 50% by July 31, 2015. Per the agreement, JEA shall provide these credits (valued at \$2,086,767 per year) to the City for no compensation through December 31, 2023 to assist the City in meeting its Basin Management Action Plan (BMAP) load reduction goal. Per the Florida Department of Environmental Protection, if the City sold JEA, the City would get to keep the BMAP credits already received, but any future credit transfers would have to be transacted between the City and the new owner of the utility.
 - C. JEA committed to contributing a maximum annual amount of \$1,000,000 for sewer projects that the City undertakes to meet its environmental obligations. Related to those sewer projects, JEA committed to pay the sewer capacity fees up to an annual cap of \$650,000.
16. JEA agreed to provide the City Solid Waste Division a discounted rate on landfill leachate disposal through Fiscal Year 2018/19, while the City explores alternative methods of disposal.
17. The City of Jacksonville, the Duval County School Board, the United States Navy, and the United States Marine Corps save money on their electric bills because they qualify for JEA's General Service Extra Large Demand rate rider. The rider provides a reduction in overall costs by combining accounts that would otherwise be required to be billed separately at a higher rate.

¹⁰ https://www.jea.com/About/Careers/District_Energy_System_Overview_Presentation/

¹¹ https://www.jea.com/in_our_community/community_investment/

18. In 2013, the Northeast Florida Regional Council released an Economic Impact Analysis for JEA. The study estimated the economic impact and value of JEA to Duval County in 2012. The annual impact of JEA on Gross County Product (GCP) indicated:
- o JEA contributed between \$860 - \$910 million to GCP
 - o JEA contribution was 1.4% - 1.5% of Duval County GCP
 - o JEA directly and indirectly impacted 4,500 - 4,700 jobs
 - o JEA impacted Earnings/Personal Income \$206 - \$310 million
- Only the tangible impacts were quantified in the analysis.

OTHER CONSIDERATIONS

1. As a municipally owned utility, JEA is eligible for Federal Emergency Management Agency (FEMA) funds. Since 2004, JEA has been reimbursed 81.9% or \$13,829,366 of storm damage costs by FEMA and the State (costs for Hurricanes Matthew and Irma are not included because as of the report date, no reimbursements have been received for Hurricanes Matthew or Irma). Investor Owned Utilities are not eligible for FEMA reimbursement so the costs of natural disasters are passed on to customers. As of January 2018, FPL (Florida Power and Light) customers were paying two different storm cost recovery charges. On a typical 1,000 kWh monthly FPL bill, \$3.36 was being collected for a period of twelve months until February of 2018 for Hurricane Matthew. In addition, \$1.20 is being collected to repay the bonds issued for the 2004 and 2005 hurricane restoration efforts and to partially replenish the storm damage reserve for future storms.¹² This charge has been collected since 2007. Note that FPL has only one residential rate for their entire service area which means that storm charges are assessed to all of their customers regardless of the geographic location of the damage or the customer.
2. The JEA contribution is a pledged revenue for the City's Capital Project bonds. The City has approximately \$108 million of these bonds outstanding as of 9/30/17. Of course, the City could defease these bonds with the proceeds from the sale of JEA if there are sufficient proceeds to do so.
3. The JEA contribution is a pledged revenue for all of the Jacksonville Port Authority's (JPA) outstanding bonds. Pursuant to Municipal Code Section 106.218, the pledge amount is calculated annually by multiplying ¼ mill times the gross kilowatt hours of electricity sold by JEA for the prior 12 months. Although the obligation will remain with the City if JEA is sold, the factor that is used to calculate the pledged revenue will have to be revised. The outstanding amount of JPA bonds as of 9/30/17 was \$182,269,000. The bondholders will have to consent to a revised calculation prior to, or concurrent with the sale to avoid impairment of the bonds.¹³ From FY 1996/97 to FY 2016/17, \$63,584,846 of revenue from JEA was pledged to JPA for debt service. For FY 2017/18, the amount pledged from the JEA assessment is \$3,062,125.
4. JEA has an interlocal agreement with Nassau and St. Johns Counties that allows either county the first right of refusal to purchase the JEA water and sewer facilities in their respective county in the event of a change of majority ownership of JEA. There is also a clause that states that if the facilities are purchased and then resold within five years, the net profit must be split 50/50 between JEA and the County.
5. According to the American Public Power Association 2017/18 Directory and Statistical Report, public utilities gave back 5.6% of their electric operating revenues to their communities in 2014. In comparison, IOUs only paid 4.2% of operating revenues in taxes and fees to State and local governments. For that same time period, JEA paid 6.1% of operating revenues to the City. In 2017, JEA paid 6.7%.

¹² <https://www.fpl.com/rates/pdf/electric-tariff-section8.pdf>

¹³ Per JPA bond counsel, Foley & Lardner

6. The City Council currently has the capability to question and influence JEA's annual proposed budgets and planned capital project expenditures for the electric, water/sewer, and district energy systems. This ability to influence where or when improvements occur would likely not exist under an Investor Owned Utility.
7. JEA's contribution to the City has a guaranteed floor or minimum. Returns on the invested sale proceeds from JEA would be dependent upon market conditions.
8. JEA currently contributes to the cost of providing City services. Specific examples that would otherwise be offset by a General Fund contribution are the Office of Inspector General (\$85,000) and the Office of Ethics, Compliance & Oversight (\$5,000). JEA also utilizes the services of Fleet Management and participates in the City's workers' compensation and general and auto liability insurance pooling with the Risk Management Division. These areas could be affected if JEA's participation was removed.
9. If JEA's utilities are split, (for example if Electric is sold, but Water/Sewer is retained) they will not be as efficient operating separately as they are together. The electric, water/sewer, and district energy utilities are deeply intertwined. In Fiscal Year 2017/18 for example, the electric utility is budgeted to perform \$48 million of water/sewer work. Work performed by one utility for another is charged to the correct utility, however if the utilities were separated, the efficiencies would be lost and the work would likely cost more.
10. JEA maintains its company headquarters downtown and was preparing just a few months ago to build a new headquarters building in the heart of downtown. JEA has approximately 2,000 employees. Most of these jobs are well paid with benefits. If JEA were a company thinking of moving its headquarters and 2,000 jobs to Jacksonville, the Office of Economic Development would likely ask the City Council to approve millions of dollars of incentives to lure them here.
11. The City of Jacksonville receives JEA contribution on utility sales outside of Jacksonville. For example, water and sewer customers in Nassau and St. Johns Counties contribute to the City of Jacksonville General Fund every month when they pay their bill.
12. Private Utilities will likely not pay as much in ad valorem taxes as one might think. It is common practice for private sector businesses to challenge their property assessments. For example, we checked with the Value Adjustment Board in Miami-Dade County and found that Florida Power and Light (FPL) filed petitions challenging its assessments in 2013, 2014, and 2015, all of which were later withdrawn. We checked with the Value Adjustment Board in Palm Beach County Florida and found that FPL had filed petitions in 2014, 2015, 2016, and 2017. In 2014 and 2016, FPL withdrew its petition with no change in assessment. In 2015, FPL withdrew its petition, but received a reduction in its assessment from \$1,710,880 to \$342,176. In 2017, FPL did not appear at the hearing and the petition was denied.
 In another example, in 2012, a tax dispute arose between Duke Energy and Citrus County. After fifteen months, Citrus County agreed to a settlement. Citrus officials said they agreed to settle because of rising legal bills in their battle with Duke.¹⁴
13. Local Control: While it might be a stretch to say that local control is priceless, it does have considerable value. Possible bidders for JEA might include FPL based in Juno Beach, Florida, Duke Florida (owned by Duke Energy which is based in Charlotte, North Carolina), and TECO (owned by Emera which is based in Halifax, Nova Scotia, Canada). Would these companies based in other cities, states, and another country make Jacksonville a priority on a day to day basis or after a natural disaster? Would they work closely with the City on infrastructure projects? The CEO would certainly not be just across the street.

¹⁴ <http://www.tampabay.com/news/business/energy/settlement-favors-duke-energy-in-tax-dispute-with-citrus-county/2171118>

14. The City must assume that if JEA is sold, the City will not be able to get JEA back if it later has seller's remorse. Jacksonville Port Authority once owned all of Blount Island, but sold the eastern 900 acres to Offshore Power Systems in the early 1970s for use in a large economic development project. Think how things would be different if JPA still owned all of Blount Island. JPA may not have developed the Dames Point Terminal. JPA might have a cruise ship terminal east of the Dames Point Bridge. The length of JPA's dredging project would be shorter and less expensive if it only had to accommodate Blount Island.
15. Even if the sale proceeds pay for JEA's share of the UAAL, an actuary will have to determine the effect on the General Employees Pension Plan if the JEA employees are removed from the pension plan. The models used in pension reform did not contemplate the sale of JEA. The models contemplated that those JEA employees hired by September 30, 2017 would be part of the pension plan with an employee and employer share being paid into the pension plan every pay period for decades into the future. The impact to the pension plan might be favorable or unfavorable, but the actuary will have to determine this. **(See Recommendation #2)**
16. JEA and the City could spend considerable sums of money working on a deal that might never close. Two recent examples follow:
 - A. In 2016, NextEra Energy, the parent of Florida Power & Light, canceled its \$2.63 billion bid to purchase Hawaiian Electric Industries after the deal was rejected by Hawaiian state regulators.^{15 16}
 - B. In 2017, utility regulators in Texas rejected an \$18.7 billion bid by NextEra Energy to buy Oncor Electric Delivery Co., the state's largest regulated utility.¹⁷To reiterate, it is entirely possible that bids could be obtained, a term sheet could be agreed on, millions of dollars could be spent on attorneys, consultants, financial advisors, and investment bankers, but for regulatory or other reasons, the deal does not close. In its February 14, 2018 report, PFM stated that "A sale of all or a portion of JEA's assets will represent one of the largest, most complex transactions ever attempted in the municipal utility market."¹⁸ Where will the funds come from to pay all these costs? If the deal does not close, those millions that were spent may not be recoverable. **(See Recommendation #3)**
17. The sale could take years to close. For example, the sale of Vero Beach's electric utility to Florida Power and Light (FPL) was first approved by voters in 2011. In October of 2017 (6 years later) the Vero Beach City Council approved the sale, but it is still not final. It must still be approved by several other groups including the Florida Public Service Commission (FPSC).¹⁹ If the sale does not go through, the City of Vero Beach will be responsible for the majority of the costs associated with the sale.²⁰

¹⁵ <http://www.miamiherald.com/news/business/article90362237.html>

¹⁶ <https://www.hawaiianelectric.com/nextera-energy-and-hawaiian-electric-industries-announce-termination-of-merger-agreement>

¹⁷ <http://www.sun-sentinel.com/business/fl-bz-nextera-oncor-deal-rejected-20170413-story.html>

¹⁸ https://www.jea.com/About/Investor_Relations/Financial_Reports/JEA_Valuation_PFM_Report.aspx

¹⁹ <https://www.tcpalm.com/story/news/local/shaping-our-future/growth/2017/10/24/vero-beach-oks-selling-electric-system-fpltakes-action-fpl-185-million-offer-buy-city-electric-syste/791924001/>

²⁰ http://www.covb.org/vertical/sites/%7B898790A2-F88A-48AE-A9B3-666AAE67AD40%7D/uploads/FPL_LETTER_OF_INTENT_May_16_2017.pdf

18. Eight Council Members will be leaving the City Council due to term limits. It is possible that the current Council could vote to move forward with a sale, but the next Council may not approve the deal.
19. It is possible that a private equity firm could purchase and operate JEA. Private equity firms buy companies with capital from investors (cash) and borrowed money (debt/bonds). If the borrowed money greatly exceeds the cash, it is called a leveraged buy-out (LBO). One of the issues with an LBO is that the purchased company will end up with the debt on its books after the purchase. In one of the largest LBOs in history, utility company TXU Corp was purchased by a group of private equity firms which left TXU (now known as Energy Future Holdings) with more than \$40 billion in debt. In 2014, Energy Future Holdings filed for Chapter 11 bankruptcy protections because it could not make scheduled debt payments.²¹
20. If the City sells JEA, it will not have JEA to oversee any future capital projects involving the undergrounding of electric lines or the extension of water and sewer lines.

BENEFITS TO THE CITY OF SELLING JEA

1. The City could potentially receive a large sum of money without increasing debt or raising taxes. These funds could be used to pay down or pay off City debt, pay for the pension UAAL, construct infrastructure, and/or provide funding for large projects (e.g. a new convention center, downtown development, or an entertainment zone).
2. Ad valorem taxes and stormwater fees would be collected on former JEA property.
3. The Duval County School Board (DCSB) would receive additional ad valorem taxes, although the amount DCSB would receive is limited. We estimate that DCSB would receive approximately \$8 million per year for capital purposes only. It does not appear that the DCSB would receive any additional operating funds because an increase in local funds would be offset by a decrease in state funds. (See Attachment 1)

BENEFITS TO THE CITY OF KEEPING JEA

1. An annual, predictable monetary contribution to the City General Fund.
2. Local control of Electric and Water/Sewer Utilities.
3. A corporate headquarters located in downtown Jacksonville.
4. Thousands of high paying jobs with benefits.
5. Rates are set by the JEA Board, whereas rates for an IOU are set by the Public Service Commission in Tallahassee.
6. After a hurricane or storm that causes large quantities of electrical outages, JEA makes it a priority to restore electrical service to JEA sewer infrastructure, thereby reducing the potential ripple effects of the storm.

²¹ <http://www.star-telegram.com/news/business/article3855518.html>

RECOMMENDATIONS

Recommendations if the City decides to sell JEA

1. Proceeds from the sale of JEA should never be used for operating expenses. They should be set aside to generate a future income stream and/or used for one-time expenditures such as paying down debt or used for needed capital expenditures. (Note: The City needs to be cognizant of the increased operating costs that would be associated with any capital expenditures.)
2. As part of the City's due diligence, it should engage its actuary to determine the effect on the general employees pension plan if JEA were sold.
3. Include a requirement in the purchase agreement that if the deal does not go through for any reason other than the City of Jacksonville turning it down, the buyer must reimburse the City of Jacksonville and JEA for all expenses incurred in the attempted sale.

Recommendation if the City decides to Keep JEA

4. A task force should be created to determine what, if any, changes could be made to JEA that would help JEA to increase its financial contribution to the City and/or help the City accomplish other goals such as extending water and sewer infrastructure. (Note: From 2010 through 2017, JEA paid down \$400 million in debt beyond its normal debt service. Paying down that much additional debt in that period of time shows fiscal discipline, however, it also begs the question as to whether those funds could have been used in other ways to benefit the City.) The task force could explore ideas such as those listed below and many others not contemplated here.
 - a. Could JEA become a natural gas utility creating an additional revenue stream and additional City contribution? (For example, Tallahassee operates electric, water, sewer, and natural gas utilities.)
 - b. Could JEA sell or lease rooftop solar to its customers?
 - c. Could/should JEA take over the City Stormwater Utility?
 - d. What other ways could JEA generate additional revenue?
 - e. Could JEA make a larger financial contribution to the City General Fund?
 - f. Should the City contribution include sales of reclaimed water?
 - g. What amount of electric line undergrounding and extension of water and sewer lines should be pursued and included in JEA's capital improvement budget each year?

Respectfully submitted,

Kyle S. Billy

Kyle S. Billy, CPA
Council Auditor

Council Auditor's Office
The Potential Sale of JEA: Things to Consider
DCSB Impact

The Duval County School Board (DCSB) would receive additional ad valorem taxes, although the amount DCSB would receive is limited. We estimate that DCSB would receive approximately \$8 million per year for capital purposes, pursuant to the Local Capital Improvement Millage. Note that the DCSB would probably not receive additional operating revenue from the sale of JEA. Based on the way the Florida Education Finance Program (FEFP) formula works, increases in revenue from the Required Local Effort or the Discretionary Local Effort would likely be offset by a corresponding decrease in State funds. The Local Capital Improvement Millage however, is not part of the FEFP calculation. This information was confirmed with the Florida Department of Education.

Duval County Gross Taxable Value used to calculate DCSB 2017/18 Taxes	\$ 64,320,200,875 (A)
Exemption Value of JEA Property as of 1/1/17	<u>5,582,321,552</u>
Total Duval County Taxable Value Including JEA	<u>\$ 69,902,522,427 (B)</u>

DCSB 2017/2018 Budgeted Ad Valorem Revenue Under Two Scenarios

Funding Sources	Millage Rates (C)	Scenario 1	Scenario 2	Difference
		JEA City Owned (A) x (C)	JEA Investor Owned (B) x (C)	
Required Local Effort Taxes ¹	4.2370	\$ 261,623,703	\$ 284,329,908	\$ 22,706,205
Discretionary Local Effort ²	0.7480	\$ 46,187,050	\$ 50,195,603	\$ 4,008,553
Total Local Funding		\$ 307,810,753	\$ 334,525,511	\$26,714,758
State Funding ³		\$ 637,616,380	\$ 610,901,622	\$(26,714,758)
Total Local and State Funding		\$ 945,427,133	\$ 945,427,133	\$ -
Local Capital Improvement ⁴	1.5000	\$ 92,621,089	\$ 100,659,632	\$ 8,038,543

Footnotes:

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- 2 - This funding is used for school district operations. The DCSB sets the Discretionary Local Effort millage rate; however, the 0.7480 millage rate is the maximum millage rate allowed by the Florida Legislature.
- 3 - This funding is derived by the State from a complex formula based on a number of factors (e.g. number of students, the Florida Price Level index by school district, discretionary millage compression supplement, etc.)
- 4 - This funding is to be used for capital improvements only. The DCSB sets the Local Capital Improvement millage rate; however, the 1.5000 millage rate is the maximum millage rate allowed for capital improvements.

This methodology has been confirmed with the Florida Department of Education regarding State and local funding for the DCSB both currently and under the assumption of adding JEA property to the tax roll. It also assumes that an Investor Owned Utility would take advantage of the 4% early payment discount on property taxes.

Council Auditor's Office

Application of Franchise Fee and Public Service Tax (Utility Service Tax)

Franchise Fee - an amount equal to 3% of electric revenues (not to exceed \$2.4 million per customer per fiscal year) and all water and sewer revenues. The franchise fee is limited to revenues derived within Duval County (not including USDs 2-5) and is not applied to reclaimed water or district energy services.

Public Service Tax (Utility Service Tax) - an amount of 10% imposed and levied on each purchase of electricity, metered or bottled gas (natural, liquefied petroleum gas or manufactured), and water service in the corporate limits of the City. For electric service, the tax is only applied against the portion of the fuel adjustment charge that was in place prior to October 1, 1973.

Electric Service Bill		
Bill Components	Is Franchise Fee charged on Bill Component?	Is Utility Service Tax charged on Bill Component?
Basic Monthly Charge	✓	✓
Energy Charge	✓	✓
Fuel Cost	✓	✓
Environmental Charge	✓	✓
City of Jacksonville Franchise Fee		✓
Gross Receipts Tax		✓
Public Service Tax (Utility Service Tax)		

Water Service Bill		
Bill Components	Is Franchise Fee charged on Bill Component?	Is Utility Service Tax charged on Bill Component?
Basic Monthly Charge	✓	✓
Water Consumption Charge	✓	✓
Environmental Charge	✓	✓
City of Jacksonville Franchise Fee		✓
Public Service Tax (Utility Service Tax)		

Sewer Service Bill		
Bill Components	Is Franchise Fee charged on Bill Component?	Is Utility Service Tax charged on Bill Component?
Basic Monthly Charge	✓	
Sewer Usage Charge	✓	
Environmental Charge	✓	
City of Jacksonville Franchise Fee		
Public Service Tax (Utility Service Tax)		

Reclaimed Water Service Bill		
Bill Components	Is Franchise Fee charged on Bill Component?	Is Utility Service Tax charged on Bill Component?
Basic Monthly Charge		✓
Public Service Tax (Utility Service Tax)		

District Energy Service Bill		
Bill Components	Is Franchise Fee charged on Bill Component?	Is Utility Service Tax charged on Bill Component?
Demand Charge		
Consumption Charge		

**Council Auditor's Office
JEA Contribution Information**

History of JEA Contributions to the City

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Electric Contribution	73,846,764	76,094,124	79,007,252	81,921,688	83,037,710	83,969,075	87,318,021	90,108,598	91,720,182	92,270,692
Water Contribution	20,340,780	20,593,422	20,180,276	19,765,852	21,149,828	22,718,463	21,869,517	21,578,940	22,467,356	23,552,258
Totals	94,187,544	96,687,546	99,187,528	101,687,540	104,187,538	106,687,538	109,187,538	111,687,538	114,187,538	115,822,950

Current Formula for Calculation of JEA Contributions - Article 21.07(C) JEA Charter

Effective October 1, 2016, consistent with the provisions of this section 21.07(c), JEA shall pay the city combined assessment for the electric system and the water and sewer system. The combined assessment for the electric system and the water and sewer system shall equal, but not exceed the greater of (A) the sum of (i) the amount calculated by multiplying 7.468 mills by the gross kilowatt-hours delivered by JEA to retail users of electricity in JEA's service area and to wholesale customers under firm contracts having an original term of more than one year (other than sales of energy to Florida Power and Light Company from JEA's St. Johns River Power Park System) during the twelve-month period ending on April 30 of the fiscal year immediately preceding the fiscal year for which such assessment is applicable plus (ii) the amount calculated by multiplying 389.20 mills by the number of K-Gals (1=1000 gallons) potable water and sewer service, excluding reclaimed water service, provided to consumers during the twelve-month period ending on April 30 of the fiscal year immediately preceding the fiscal year for which such assessment is applicable or (B) a minimum calculated amount which increases by 1% per year from fiscal year 2016-2017 through fiscal year 2020-2021 using the fiscal year 2015-16 combined assessment of \$114,187,538 as the base year. The amounts applicable to clause (B) above are: for fiscal year 2016-2017 - \$115,329,413; for fiscal year 2017-2018 - \$116,482,708; for fiscal year 2018-2019 - \$117,647,535; for fiscal year 2019-2020 - \$118,824,010; and for fiscal year 2020-2021 - \$120,012,250.

The following two pages show the detailed calculation presented at JEA's budget hearing of how the JEA contribution is determined and then compared to the identified floor from Article 21.07(C) of the JEA Charter.

**CALCULATION OF JEA ELECTRIC CONTRIBUTION
FOR FISCAL YEAR 2017-2018**

**CITY WATER/SEWER CONTRIBUTION FORMULA
FOR FISCAL YEAR 2017-2018**

	Total	Less Interchange	Net kWh
Month	kWh Sales (1)	kWh Sales (2)	Sales
May 2016	953,860,830	1,014,000	952,846,830
June	1,187,678,293	27,295,000	1,160,383,293
July	1,289,228,317	4,194,000	1,285,034,317
August	1,322,732,224	16,818,000	1,305,914,224
September	1,312,328,044	56,878,000	1,255,450,044
October	1,087,642,427	45,558,000	1,042,084,427
November	878,412,157	26,434,000	851,978,157
December	887,333,577	7,449,000	879,884,577
January 2017	957,813,362	11,339,000	946,474,362
February	815,852,726	5,813,000	810,039,726
March	863,809,753	5,719,000	858,090,753
April	918,433,823	18,115,000	900,318,823
Totals	12,475,125,533	226,626,000	12,248,499,533
		(3)	0.007468
			<u><u>\$ 91,471,795</u></u>

	Water Consumption	Sewer Consumption	Adjustments Total	Total Net Consumption
MONTH	kGals (1)	kGals (1)	kGals (2)	kGals
May 2016	3,307,729	2,167,549	(138,060)	5,337,218
June	3,663,119	2,379,591	(148,110)	5,894,600
July	3,696,744	2,371,763	(158,413)	5,910,094
August	3,781,184	2,376,493	(178,795)	5,978,883
September	3,653,920	2,339,033	(171,116)	5,821,838
October	3,131,673	2,095,904	(133,424)	5,094,153
November	3,063,516	2,023,264	(133,927)	4,952,853
December	3,281,733	2,199,082	(159,777)	5,321,038
January 2017	3,059,853	2,155,173	(121,653)	5,093,372
February	2,682,345	1,875,600	(123,646)	4,434,298
March	3,141,915	2,156,949	(143,492)	5,155,371
April	3,510,812	2,297,649	(187,533)	5,620,928
Totals	39,974,542	26,438,050	(1,797,945)	64,614,647
			(3)	<u><u>0.3892000</u></u>
				<u><u>\$ 25,148,020</u></u>

Notes:

- (1) kWh sales information is based on JEA's CMFTR124 monthly reports.
- (2) Interchange, the sale of electricity to other utilities, is not included in the contribution formula.
- (3) The current City contribution formula is based on multiplying 7.468 mills times total electric kWh sales less interchange sales for the twelve months (12) ending April 30th of each year.

Pursuant to Ordinance § 106.218, one quarter of a mill or \$3,062,125 has been dedicated to the JPA for port expansion.

Notes:

- (1) Consumption information taken from JEA's CMFTR124 monthly reports.
- (2) Total Adjustments include Summer Discount, Water Large (large industrial customer), Sewer LTD (wholesale sewer rate) and Water Reuse Consumption.
- (3) The current City contribution is based on multiplying 389.20 mills times total water/sewer kGal sales less reuse sales for the twelve (12) months ending April 30th of the prior year.

JEA Contribution Calculation

A Millage Calculation

Electric	\$	91,471,795	78.44%
Water		25,148,020	21.56%
	\$	<u>116,619,815</u>	

B Floor (per Ordinance plus 1%)

FY 2015/16	\$	114,187,538	Base Year
FY 2016/17	\$	115,329,413	
FY 2017/18	\$	116,482,708	

Conclusion

The millage calculation of \$116,619,815 is greater than the minimum payment of \$116,482,708 therefore, the millage in the amount of \$116,619,815 is the JEA contribution for FY17/18.

Recommended Budget FY 17/18

Electric	\$	91,471,795	78.44%
Water		25,148,020	21.56%
	\$	<u><u>116,619,815</u></u>	

Notes:

A Calculated as 7.468 mills times gross kilowatt-hours delivered by JEA to users of electricity in JEA's service area (less interchange sales) plus the amount calculated by multiplying 389.20 mills by the number of kGals (1,000 gallons) of potable water and sewer service (excluding reclaimed water sales) provided to consumers during the twelve (12) month period ending April 30th of the previous year.

B Notwithstanding the contribution cap calculated in Part A above, JEA shall pay the City each fiscal year, from 2016/2017 through 2020/2021, an additional amount if necessary, to ensure a minimum annual increase of 1% using the fiscal year 2015-2016 combined assessment of \$114,187,538 as the base year.

Although the annual transfer of available revenue from JEA to the City is based upon formulas that are applied specifically to the respective utility systems operated by JEA, JEA's Charter allows it to utilize any of its revenues regardless of source to satisfy its total annual obligation to the City.

JEA's Charter does not currently require a contribution from the District Energy System (Chilled Water).

Council Auditor's Office
Budgeted JEA Contributions and Millage Rate History

FISCAL YEAR	MILLAGE FOR ELECTRIC (Per Ordinances)	MILLAGE FOR WATER (Per Ordinances)	BUDGETED ELECTRIC CITY CONTRIBUTIONS (Budget Ordinances)	BUDGETED WATER CITY CONTRIBUTIONS (Budget Ordinances)	TOTAL CONTRIBUTIONS	DOLLAR AMOUNT CHANGE
Per JEA's Charter, from FY 1968/69 through FY 1977/78, JEA was required to contribute annually to the City of Jacksonville, a percentage not to exceed 30% of defined gross revenues.						
1978/79 ¹	4.50	N/A	25,731,850		25,731,850	
1979/80	4.50	N/A	26,259,521		26,259,521	527,671
1980/81	4.50	N/A	25,430,587		25,430,587	(828,934)
1981/82	4.50	N/A	25,907,300		25,907,300	476,713
1982/83	4.50	N/A	25,803,338		25,803,338	(103,962)
1983/84 ²	4.76	N/A	27,819,985		27,819,985	2,016,647
1984/85	4.76	N/A	28,884,837		28,884,837	1,064,852
1985/86	4.76	N/A	29,457,186		29,457,186	572,349
1986/87	4.76	N/A	31,124,554		31,124,554	1,667,368
1987/88	4.76	N/A	33,778,052		33,778,052	2,653,498
1988/89 ³	5.00	N/A	37,490,966		37,490,966	3,712,914
1989/90	5.00	N/A	37,759,359		37,759,359	268,393
1990/91	5.00	N/A	40,063,483		40,063,483	2,304,124
1991/92	5.00	N/A	41,529,616		41,529,616	1,466,133
1992/93	5.00	N/A	42,323,106		42,323,106	793,490
1993/94 ⁴	5.25	N/A	43,261,617		43,261,617	938,511
1994/95	5.25	N/A	48,570,887		48,570,887	5,309,270
1995/96	5.25	N/A	48,798,841		48,798,841	227,954
1996/97 ⁵	5.25	1.75	52,800,571	3,035,682	55,836,253	7,037,412
1997/98 ⁶	5.25	1.75	52,039,278	9,528,923	61,568,201	5,731,948
1998/99 ⁶	5.50	1.75	57,056,117	9,437,643	66,493,760	4,925,559
1999/2000	5.50	1.75	60,898,145	10,536,135	71,434,280	4,940,520
2000/2001	5.50	1.75	62,589,668	11,048,610	73,638,278	2,203,998
2001/2002	5.50	1.75	65,489,556	11,116,676	76,606,232	2,967,954
2002/2003	5.50	1.75	67,039,278	11,456,781	78,496,059	1,889,827
2003/2004 ⁷	5.513	2.149	70,039,278	13,148,260	83,187,538	4,691,479
2004/2005	5.513	2.149	68,676,620	17,260,918	85,937,538	2,750,000
2005/2006	5.513	2.149	71,030,754	17,656,784	88,687,538	2,750,000
2006/2007	5.513	2.149	73,100,458	18,337,080	91,437,538	2,750,000
2007/2008	5.513	2.149	73,846,762	20,340,776	94,187,538	2,750,000
2008/2009 ⁸	5.513	2.149	76,094,120	20,593,418	96,687,538	2,500,000
2009/2010	5.513	2.149	79,007,260	20,180,278	99,187,538	2,500,000
2010/2011	5.513	2.149	81,921,684	19,765,854	101,687,538	2,500,000
2011/2012	5.513	2.149	83,037,710	21,149,828	104,187,538	2,500,000
2012/2013	5.513	2.149	83,969,075	22,718,463	106,687,538	2,500,000
2013/2014	5.513	2.149	87,318,021	21,869,517	109,187,538	2,500,000
2014/2015	5.513	2.149	90,108,598	21,578,940	111,687,538	2,500,000
2015/2016	5.513	2.149	91,720,182	22,467,356	114,187,538	2,500,000
2016/2017	7.468	389.200	92,270,692	23,552,258	115,822,950	1,635,412
2017/2018 ⁹	7.468	389.200	91,471,795	25,148,020	116,619,815	796,865
TOTALS			\$ 2,251,520,707	\$ 371,928,200	\$ 2,623,448,907	

Footnotes:

- 1 - Ord 78-351-185 Amended Ch. 128 of the Ord Code and set the JEA calculation rate at 4.50 mills multiplied by the gross kilowatt hours sold by the authority during the 12 month period ending on May 31 of the current fiscal year.
- 2 - Ord 83-591-400 Repealed the 1970 Ordinance Code and included with this legislation was the increase of the JEA contribution from 4.50 mills to 4.76 mills multiplied by the gross kilowatt hours sold by the authority during the 12 month period ending on May 31 of the fiscal year.
- 3 - Ord 88-1061-532 Amended Section 106.202 of the Ordinance Code and increased the contribution calculation rate from 4.76 mills to 5.0 mills multiplied by the gross kilowatt hours sold by the authority during the 12 month period ending on May 31 of the fiscal year.
- 4 - Ord 93-82-1385 Amending, revising, repealing and renumbering Article 21, the JEA Charter. This Ordinance increased the contribution calculation from 5.0 mills to 5.25 mills multiplied by the gross kilowatt hours sold by the authority during the 12 month period ending on May 31 of the fiscal year.
- 5 - Ord 97-12-E and Ord 97-229-E Amended Article 21 (JEA Charter) by authorizing JEA to take over the Water and Sewer and setting the assessment calculation rate of 1.75 mills. The takeover occurred on June 1, 1997 and per the CAFR for the year ending September 30, 1997 the General Fund received the \$3,035,682.
- 6 - Ord 98-253-E Amended Article 21 (JEA Charter) and increased the assessment calculation from 5.25 mills to 5.50 mills multiplied by the gross kilowatt hours delivered or such amount, if necessary, which will reflect an increase on an annual basis of \$3,000,000 per year using the FY 1998 assessment as the base year for such additional amount. Also, as seen in the 1997/1998 FY line, there was a contribution of \$9,528,923 from JEA's assumption of the City's Water and Sewer System on June 1, 1997. This was also noted in the FY 1997/98 Budget Ordinance and the CAFR for the FY Ending September 30, 1998.
- 7 - Ord 2003-1320-E Amended Article 21 (JEA Charter) and increased the assessment calculation from 5.50 mills to 5.513 mills multiplied by gross kilowatt-hours delivered by JEA and also increased the water and sewer assessment from 1.75 mills to 2.149 mills multiplied by the number of cubic feet of potable water and cubic feet of sewer service excluding reclaimed water service provided to customers during the 12 month period ending on April 30th of the current fiscal year (the same with electric). Also, JEA was to pay the city each fiscal year from Fiscal Year 2004-2005 through Fiscal Year 2007-2008 an additional amount necessary to ensure a minimum annual increase of \$2,750,000.
- 8 - Ord 2007-1132-E Amended Article 21 (JEA Charter) by decreasing the minimum annual increase from \$2,750,000 to \$2,500,000
- 9 - Ord 2014-764-E Amended Article 21 (JEA Charter) by setting a new millage formula and a base level contribution that increases 1% each year for five years. The annual contribution is the greater of the millage calculation or the annual increase from the base level amount for the applicable year.



OFFICE OF THE CITY COUNCIL

117 WEST DUVAL STREET, SUITE 425
4TH FLOOR, CITY HALL
JACKSONVILLE, FLORIDA 32202

Brosche-Crescimbeni Noticed Meeting Minutes
Scope of Services for Advisor to Special Committee on Potential Sale of JEA
March 19, 2018
1:00 p.m.

Topic: Scope of services and qualifications for advisor to the Special Committee on Possible Sale of JEA

Location: City Council Conference Room A, 4th floor, City Hall – St. James Building, 117 West Duval Street

In attendance: Council Members Anna Lopez Brosche, John Crescimbeni, Lori Boyer (arr. 1:14)

Also: Philip Peterson – Council Auditor’s Office; Peggy Sidman and John Sawyer – Office of General Counsel; Jeff Clements – Council Research Division; Dr. Sherry Magill – Jessie Ball duPont Fund

Meeting Convened: 1:00 p.m.

Chairwoman Brosche called the meeting to order and the attendees introduced themselves for the record. She reported that she had forwarded the scope of services and qualifications for a City Council consultant to advise on JEA potential sale issues to Dr. Sherry Magill, President of the Jessie Ball duPont Fund.

Ms. Magill explained the Jessie Ball duPont Fund’s grant eligibility criteria and application requirements. The City of Jacksonville is the only government agency eligible to receive funding from the Fund as a result of having been a beneficiary of Ms. duPont’s beneficence during her lifetime. She offered the Fund’s financial assistance for a consultant because of the importance of the topic to the city. The Fund would need a letter from the Council requesting financial assistance to study a particular issue and could fund a consultant in one of two ways – either by means of an RFP to solicit interested consultants or by funding a consultant already selected by the City. She noted that the University of Florida has a Public Utility Research Center that might be a useful source of expertise. The duPont Fund has a committee that approves grant requests and she offered to convene that body by teleconference to expeditiously review the City’s request and approve a scope of service and a grant amount.

Ms. Brosche said that the special committee felt that it needed an expert in the field of utilities to be available as an independent expert to cross-check and verify what the committee is told by various speakers who appear at meetings. The committee has not compiled a set of questions or a topic that it wants researched. In response to a question about whether a representative of the committee could make contact with potential consultants to determine who might be qualified and interested before sending out an RFP, John Sawyer of the Office of General Counsel advised against that method if an RFP is to be issued so as to avoid any perception of unfair advantage. Mr. Crescimbeni said that he has received

several indications of interest from a variety of people offering their assistance in the process, some more apparently qualified than others.

Ms. Magill said that the Pew Charitable Trusts in Philadelphia and the Arnold Foundation of Texas have supported City studies in the past. Ms. Magill also said that the duPont Fund could respond to an RFP issued by the City for potential funders of such an outside expert who would be present at the committee's meetings and available to comment as issues arise and perhaps perform research on behalf of the committee as needs arise. This would be somewhat unusual for the Fund, not having a specific research question from the outset, but would be consistent with its intention to support the City in its exploration of a very important public policy issue. Ms. Magill said that it will be very important for the City Council to be satisfied that the consultant is appropriately qualified and has sufficient expertise to handle the work envisioned. The Fund typically pre-screens potential respondents to determine who is qualified and available before issuing an RFP.

Ms. Magill said that the duPont Fund does not have an opinion or position on the potential sale of the JEA and will not take a stand on the issue, but is willing to fund research to assist the City Council in making a decision in the best interests of the citizens on the most important public policy issue in Jacksonville's history of consolidated government. Ms. Magill said that the Fund could commission a study itself, but would prefer that ownership of the result would be in the hands of the City. It is important that the end result be what the City needs to make its decision. President Brosche said that it appears the work of the Special Committee will generate more and more questions as its work progresses, so the task will likely evolve over time. Ms. Magill said that the duPont Fund could provide funding in two ways – either by means of a grant (only to eligible recipients previously funded by Ms. duPont or by the fund) or by means of a research contract. She said the Fund supports some of America's finest universities and could utilize those contacts to find a qualified expert. Mr. Crescimbeni suggested that the Fund run the pre-qualification process and identify a set of qualified experts, from which the City would make a choice. He prefers a method that utilizes the duPont Fund's ability to perform due diligence activities outside of the constraints of the City's procurement processes.

Ms. Brosche distributed and reviewed a list of four potential procurement options provided by Greg Pease, Chief of the Procurement Division.

Ms. Magill offered to approach the Public Utility Research Center at the University of Florida to gauge their interest in undertaking the task and to invite Ted Kury, Director of Energy Studies for the Center, to attend a future special committee meeting to discuss the project and the Center's potential interest. She will also do some further internet research on potential academic institutes that might have relevant expertise and may be interested in participating. Mr. Crescimbeni suggested contacting the Florida Association of Counties, Florida League of Cities and Florida Municipal Attorneys Association.

Meeting Adjourned: 1:50 p.m.

Minutes: Jeff Clements, Council Research
3.19.18 Posted 3:00 p.m.

Tapes: Brosche/Crescimbeni noticed meeting on JEA advisor scope of services – LSD
3.19.18



OFFICE OF THE CITY COUNCIL

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E-MAIL: CLBROWN@COJ.NET

SUBPOENA DUCES TECUM

RE: Special Committee on the Potential Sale of JEA

TO: Paul McElroy, Managing Director and Chief Executive Officer of JEA
c/o JEA
21 West Church Street
Jacksonville, Florida 32202

General Statement: The subject matter of the inquiry will be matters concerning the potential sale of JEA, including but not limited to inquiries related to the Public Financial Management, Inc. (PFM) report dated February 14, 2018.

YOU ARE HEREBY COMMANDED to appear before the City Council Special Committee on the Potential Sale of JEA at its scheduled meeting on Thursday, March 29, 2018, at 2:00 p.m., at 117 West Duval Street, Council Chambers, 1st Floor, City Hall, Jacksonville, Florida, to testify and to speak the truth in the above matter and to have with you at that time and place, for inspection and copying, all documents within your possession, custody or control relating to the following:

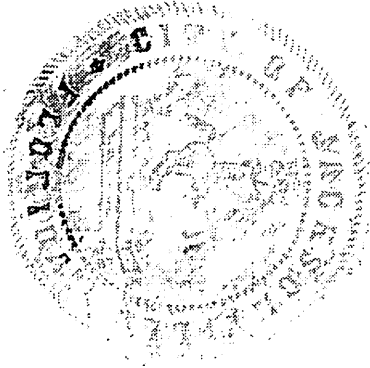
Documents that relate to philanthropic/volunteer hours from 2013 through 2017 provided by JEA, as a corporate entity, or through its JEA employees, including but not limited to any documents that relate to the value of such philanthropic/volunteerism hours, the community impact of such hours, any requirements by JEA of charitable giving or volunteerism by JEA for its employees; programs or policies to encourage such charitable giving or volunteerism, or any other documentation that relate to the value of the Community Impact of charitable giving, volunteerism support, or other community-related goals as described under "Key Value Drivers for Sales Price" beginning on pages 14-15 of the PFM report, a copy of which is attached hereto;

Documents concerning JEA's strategic plan to offset the recent revenue decline trend, including but not limited to the power point entitled "Materials to assist the City Council Special Committee on the Potential Sale of JEA" dated March 15, 2018;

Documents concerning JEA report on hurricane damages from Matthew and Irma and FEMA reimbursements;

This subpoena duces tecum is issued under the authority of Sections 5.09 and 18.01, Charter of the City of Jacksonville, and Chapter 134, Jacksonville Ordinance Code. This subpoena is continuing in nature and unless you are released from the subpoena your testimony will continue at the next meeting after your appearance. If you are not served at least seven (7) days prior to the above Special Committee on the Potential Sale of JEA meeting, you are required to appear at the next Special Committee on the Potential Sale of JEA meeting that is scheduled for Thursday, April 5, 2018 at 3:30 p.m. in Council Chambers, 1st Floor, City Hall, Jacksonville, Florida.

WITNESS my hand and the Seal of the City of Jacksonville, Florida this 20th day of March, 2018.



A handwritten signature in black ink, reading "Cheryl L. Brown". The signature is written in a cursive style and is positioned above a horizontal line.

Cheryl L. Brown, Council Secretary
Jacksonville City Council

Enterprise Value as a Multiple of EBITDA or Cash Flow:

A pro-forma projection is used to determine the expected EBITDA if JEA were a private utility. The EBITDA number is multiplied by a factor determined by industry comparable public equity trading values and recent utility M&A transactions to determine the appropriate enterprise value.

Enterprise Value as a Multiple of Assets in Rate Base:

A pro-forma projection is used to determine the expected Public Service Commission approved rate base assets if JEA were a private utility. JEA's NPP&E serves as a good proxy for an estimate of the assets for which the FPSC would allow capital cost recovery to a private, regulated utility. The amount of rate base is multiplied by a factor determined by industry comparable public equity trading values and recent utility M&A transactions to determine the appropriate enterprise value.

These multiples and ratios of Earnings, EBITDA and Rate Base are typically used to measure and compare various transactions. They often provide a "scorecard" comparison, as opposed to serving as the primary determinate of the price a buyer will pay for an asset.

Potential asset buyers will examine these metrics and compare them to their own business objectives and projections. Some buyers will examine a potential acquisition on a stand-alone basis – looking to see that the expected economic results deliver a sufficient return on funds invested in the new business. Other buyers will expect to incorporate the new business into an existing operation. These buyers will want to see that returns for their investors are higher for the combined business than for their existing business. But the focus will clearly be first and foremost on achieving investment returns and economic success for shareholders/investors.

At various times in the past, the City has analyzed the value of JEA. Since the last time this analysis was completed in 2012, there are several factors that have worked together to improve the overall potential market value of JEA's utility assets. Buyers are willing to pay higher multiples of Earnings, EBITDA, and NPP&E. At the same time, the JEA management team has reduced JEA's overall debt and improved the operation of the utility, including its relationship with its customers, thus substantially improving the value of the enterprise.

Key Value Drivers for Sales Price

As mentioned earlier, simply focusing on obtaining the highest possible up-front price for a utility asset, may lead to outcomes that are not optimal for the long-term customers of the utility if it is sold. New owners are likely to make changes that will impact utility customers and the City. Some of these changes may be necessary to generate earnings required to justify a high purchase price for JEA. In nearly every system sale, the seller or state regulators impose conditions on the sale that are designed to protect ratepayers, employees and the community from excessive change and unintended consequences of a new ownership structure.

Listed below are examples of common asset sale conditions or objectives that are designed to protect ratepayers:

- **Guaranteed employment:** acquisitions commonly provide employment guarantees for existing employees for a period of time to be negotiated among the parties.
- **Utility Rate Guarantees:** Acquirers will often agree to keep rates the same or lower for some period of time following the acquisition. Rate regulation for a buyer of JEA's assets will ultimately transition to the Florida Public Service Commission. The pricing and duration of rate constraints may have a significant impact on acquisition price.
- **Headquarters Location:** The sale process can include certain requirements around maintaining a physical presence in a community, including the location of corporate headquarters.
- **Community Impact:** Requirements for charitable giving, volunteerism support, or other community-related goals can be included in the constraints established up front as part of the sale process.

While these types of conditions, and others, are common in utility asset sales, conditions that are too onerous on the buyer could serve to limit the price paid for a utility asset. Any decisions related to a sale of JEA should include discussion and decisions on these items to ensure that there are not unintended consequences of a sale that adversely impact the community.

Overview of JEA's Balance Sheet

Like JEA's operations, JEA's financial statements are divided according to the three utility systems and their respective funds – the Electric Enterprise Fund, the Water and Sewer Fund, and the District Energy System (DES). The Electric Enterprise Fund is comprised of the JEA Electric System, Bulk Power Supply System (Scherer), and St. Johns River Power Park System (SJRPP). JEA maintains separate accounting records for the Electric System, the Bulk Power Supply System and its ownership interest in SJRPP. For purposes of financial reporting, however, JEA prepares combined financial statements that include the Electric System, the Bulk Power Supply System, JEA's interest in the Power Park, the Water and Sewer System and the District Energy System. The financial statements consist of the related statements of net position, statements of revenues, expenses, and changes in net position, and statements of cash flows covering the fiscal year period October 1 – September 30.

JEA's statement of net position, more commonly referred to as a balance sheet, contains relevant financial metrics that would be important to the analysis of an asset sale. JEA's outstanding debt would have to be retired if its utility assets are sold. Portions of cash and cash equivalents on hand can be used to satisfy portions of the long-term debt obligations. Both assets and liabilities would be factored into the net transaction price. Net capital assets are another indicator of value although these are historical amounts and might not represent current replacement or market values for JEA's invested infrastructure assets.

Table #2: JEA Balance Sheet Metrics

As of 9/30/17 (\$'000)	Cash and Equivalents	Long-Term Debt	Net Capital Assets
Electric System ¹	\$803,000	(\$2,328,000)	\$2,687,000
Water/Sewer	\$448,000	(\$1,625,000)	\$2,616,000
DES	\$7,000	(\$36,000)	\$36,000
TOTALS	\$1,258,000	(\$3,989,000)	\$5,339,000

¹ Excludes SJRPP – shutdown January 2018