S&P Global
Ratings

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Summary:

Jacksonville Electric Authority, Florida; Joint Criteria; Water/Sewer

Primary Credit Analyst:
Edward R McGlade, New York (1) 212-438-2061; edward.mcglade@spglobal.com

Secondary Contact:
Erin Boeke Burke, New York + 1 (212) 438 1515; Erin.Boeke-Burke@spglobal.com

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EXHIBIT 40

Summary:

Jacksonville Electric Authority, Florida; Joint Criteria; Water/Sewer

Credit Profile		
JEA WS		
Long Term Rating	AA+/Developing	Downgraded
JEA WS dist energy		
Long Term Rating	AA/Developing	Downgraded
JEA wtr & swr (AMBAC)		
Unenhanced Rating	AA+(SPUR)/Developing	Downgraded

Rationale

S&P Global Ratings lowered its long-term rating on Jacksonville Electric Authority (JEA), Fla.'s water and sewer system (senior-lien) revenue bonds to 'AA+' from 'AAA'. In addition, S&P Global Ratings lowered its long-term rating on the authority's water and sewer system subordinate revenue bonds to 'AA' from 'AA+'. The outlook on all bonds is developing.

This rating action affects JEA's water and sewer debt ($1.15 billion senior and $224 million subordinate).

The downgrade and developing outlook on the water and sewer system bonds reflect recent events suggesting governance instability and evidence of weak controls on the heels of the utility terminating its CEO, the departure of the CFO, and the resignation of five of the six then-sitting board members. In our view, these events are not in keeping with the former rating.

Also, in our view the absence of key executives and a board and uncertainty as to who their successors will be could frustrate strategic initiatives and the ability of the utility to move forward with its core functions. We acknowledge that the change in leadership and governance is not without effect.

The utility is operating with an interim CEO and CFO pending the city council's review of the mayor's nominees for a new board and the new board's selection of new executive officers. We believe both management and the board will need to rebuild public trust, which has eroded as a result of the failed privatization attempt and the disclosure of the initiative's high costs for consultants and severance payments. Unless addressed, this erosion of trust can translate into a loss of customer confidence and support, which could impair JEA's credit quality if it encounters resistance to rate adjustments or its implementation of strategic initiatives. JEA has a seven-member board appointed by the mayor of Jacksonville. Five members resigned effective the end of February, while one position was already vacant and one member's term is expiring. A new seven-member board has been nominated and is expected to be considered for approval at the March 10 city council meeting. If a new board is not approved by the end of February, we understand that current board members would be asked to stay on until new ones are seated. Once they are seated, JEA expects it will take up to six months to appoint a permanent CEO and CFO.

Based on publicly available information about the nominees, we observe that they have held leadership roles in business and in the community. It is not clear whether they are versed in matters relating to the governance of municipal electric, water, and sewer utilities. We will monitor the actions of the new board to assess its independence and fitness to oversee utility operations and management. We view these attributes as critical elements of credit stability. In our view, the absence of key permanent executives and a board, and uncertainty as to who their successors will be, could frustrate strategic initiatives and the ability of the utility to move forward with its core functions.

The mayor has announced that JEA will no longer pursue efforts to privatize the utility, citing "erosion of public trust" in the privatization process.

The enterprise risk assessment reflects our assessment of the utility's:

- Strong and deep service area economy in the Jacksonville metropolitan statistical area (MSA), which is characterized by average incomes and below-average unemployment;
- Very low industry risk as a monopolistic service provider of an essential public utility;
- Moderately affordable combined rates representing 2.0% of median household effective buying income (MHHEBI); and
- A revised Operational Management Assessment (OMA), where we view the system as a '3' instead of the previous '2' both scores are categorized as a good on a six-point scale with '1' being the strongest and '6' the weakest, which, in our opinion, implies overall alignment among the system's operational characteristics and that its management strategies are sufficient and well embedded, as well as very comprehensive.

The financial risk profile reflects our view of the utility's:

- Net revenues providing extremely strong all-in debt service coverage (DSC) of more than 2.52x the coverage of the past two audited years and we expect coverage will be maintained at least at such extremely strong levels for the foreseeable future;
- Very strong liquidity position with the authority reporting $64 million in unrestricted cash and cash equivalents at the end of fiscal 2019, providing about 105 days' cash on hand;
- Debt profile being moderately leveraged with a 45.4% debt-to-capitalization ratio; and
- A Financial Management Assessment (FMA) revised to good from strong, which indicates that the finance department maintains practices that are strong, well embedded, and likely sustainable. We view the system as a '3' revised from a '1' on a six-point scale with '1' being the strongest and '6' the weakest.

A net revenue pledge of water and sewer revenues secures the water and sewer revenue bonds outstanding. Capacity fees are also pledged to debt service. JEA's electric system is wholly separate from the water and sewer system; therefore, electric revenues are not pledged to the repayment of water and sewer debt service.

We consider legal provisions adequate. The system's rate covenant states pledged net revenues must provide at least 1.25x total annual debt service. In addition, the system's additional bonds test is equal to 1.25x maximum annual debt service (MADS). A debt service reserve fund equal to lessor of MADS or 125% of average annual debt service provides additional liquidity.

Enterprise risk

JEA's water and sewer system serves the greater Jacksonville MSA; the system covers a 910-square-mile area, primarily in the urban and suburban areas of the growing city of Jacksonville (Duval County) not served by private utilities, and small portions of St. John's and Nassau counties. We consider the broad and diverse Jacksonville MSA to be strong, although city income levels remain just adequate, with its MHHEBI equal to a below-average 91% of the nation.

The system's customer base is primarily residential and totaled 356,000 water and 278,000 sewer customer accounts in 2019. The customer base is diverse, with the 10 leading water and sewer users accounting for just 3.7% and 5.1% of system revenues, respectively.

JEA's water system consists of 38 treatment plants of various sizes and two re-pump facilities and can treat just under 319 million gallons per day (mgd). This provides ample capacity for the system's 117 mgd average demand, which remains roughly 14% below its consumption use permit of 136 mgd in 2018. Management anticipates that the system has sufficient water allocation from its 137 water wells to meet demand for the 20-year permit period ending in 2031. Eleven wastewater treatment plants provide capacity to treat between 123 mgd (rated average flow) to 247 mgd (rated maximum flow), which was more than sufficient to treat the average flow of 76 mgd in 2019.

We consider water and sewer rates competitive, providing additional revenue-raising flexibility. Officials indicated an average residential single-family customer uses 6,000 gallons per month or a combined bill of just $70.39, or when annualized, an affordable 2.0% of the city's MHHEBI. Officials have no current plans to raise rates.

Based on our OMA, we view JEA to be a '3' on a scale of '1' to '6', with '1' being the strongest. This indicates, in our view, that operational and organizational goals are generally well-aligned, even if some challenges exist. The good OMA includes the system's more-than-sufficient water supply and treatment capacity projected through 2036, and management's robust enterprise risk program, which we believe reflects its proactive approach to identifying and mitigating operational risks. Management's willingness to adjust utility rates is strong, although multiyear pre-approved rate increases are not standard. The score has been revised from a '2' to reflect the uncertainty within organizational effectiveness.

Financial risk

In our view, the water and sewer system's financial metrics, including its available liquidity position, have been very strong. Given the system's lack of additional debt plans, we believe JEA's very strong financial position is sustainable. Pledged net revenues (including capacity revenues in fiscal 2019) provided a very strong 2.66x all-in DSC net of an annual transfer to the city's general fund. JEA financial projections indicate maintaining all-in DSC, net of transfers out, around 2x through fiscal 2020.

The system's liquidity position, while weakening, remains a credit strength. The system maintained $64 million in unrestricted cash. When combined, the system's available cash restricted with board approval results in a liquidity position that we consider very strong at over 105 days' cash on hand in fiscal 2019. We consider the system's debt burden moderate with a debt-to-capitalization ratio equal to 45% in fiscal 2019. JEA supports $1.39 billion in total debt, including $157 million in unhedged variable-rate debt, or just 11.3% of total debt. The authority has entered into floating- to fixed-rate interest rate swap transactions to synthetically fix the interest rates on the series 2006B and 2008B variable-rate bonds. Its five-year capital improvement plan (CIP) totals a sizable $1.15 billion through fiscal 2024. However, the authority plans to fund the entire CIP with the use of internal funds, including renewal and replacement funds, capacity fees, and operating capital outlay funds. Therefore, management does not have current additional debt plans. Management indicates that the plan could change based on system growth and future environmental legislation and regulations.

Based on our FMA, we view JEA to be a '3' revised from a '1' on a scale of '1' to '6', with '1' being the strongest. The revision reflects some uncertainty surrounding the new board, potential new management, and disclosure issues that have come to light recently. An FMA of good indicates that practices are sound, well embedded, and likely sustainable. The authority maintains most of the best practices we believe critical to supporting credit quality and these are well embedded in daily operations and practices. Formal policies support many of these activities, adding to the likelihood that they will continue and transcend changes in the operating environment or personnel. JEA management maintains and fulfills various financial policies and targets related to DSC and liquidity. A policy governing coverage requires the system to maintain 1.8x coverage of total debt service, and a liquidity policy equal to at least 100 days' cash on hand. In addition, management annually updates and regularly reviews its five-year financial projections and five-year CIP, all support an FMA score of '2' and not lower for now.

Outlook

The developing outlook reflects our expectation that JEA's water and sewer system financial profile will remain very strong. We expect the system to continue to generate robust all-in DSC, allowing it to entirely cash fund its CIP as projected through fiscal 2023, which highlights its significant financial flexibility. However, uncertainty surrounding senior management and its ability to maintain or follow current policies and procedures in the water and sewer operations causes S&P Global Ratings to believe it is more likely than not that the rating will be lowered over the next two years. Conversely, should a strongly independent senior management team emerge and should the authority adhere to past policies and procedures, then it is likely that we could raise the rating to 'AAA' again, or revise the outlook to stable.

Ratings Detail (As Of February 21, 2020)		
JEA wtr and swr sys rev bnds		
Long Term Rating	AA+/Developing	Downgraded
JEA wtr and swr sys sub rev bnds		
Long Term Rating	AA/Developing	Downgraded
JEA wtr & swr subord rev bnds		
Long Term Rating	AA/Developing	Downgraded
JEA wtr & swr subord 1st crossover		
Unenhanced Rating	AA(SPUR)/Developing	Downgraded

Ratings Detail (As Of February 21, 2020) (cont.)		
JEA wtr & swr sys subord rev bnds 2010 ser A due 10/01/2020		
Long Term Rating	AA/Developing	Downgraded
JEA wtr & swr sys subord rev bnds 2010 ser B dtd 11/10/2010 due 10/01/2020 2023-2025		
Long Term Rating	AA/Developing	Downgraded
JEA wtr & swr VRDBs senior 2008B		
Long Term Rating	AA+/A-1/Developing	Downgraded
JEA wtr & swr VRDBs subord 2008B-1 & B-2		
Long Term Rating	AA/A-1+/Developing	Downgraded
JEA wtr & swr VRDBs subord 2008 A-1		
Long Term Rating	AA/A-1+/Developing	Downgraded
JEA wtr & swr VRDBs subord 2008 A-2		
Long Term Rating	AA/A-1/Developing	Downgraded
JEA wtr & swr VRDBs 2008A-1 & A-2		
Long Term Rating	AA+/A-1	Downgraded
Unenhanced Rating	AA+(SPUR)/Developing	Downgraded
JEA wtr & swr (MBIA) (National)		
Unenhanced Rating	AA+(SPUR)/Developing	Downgraded

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.