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**From:** McElroy, Paul E. - Managing Director CEO  
**Sent:** Wednesday, February 7, 2018 3:34 PM  
**To:** 'afzahn@gmail.com'  
**Cc:** McElroy, Paul E. - Managing Director CEO  
**Subject:** FW: JEA Draft Report  
**Attachments:** JEA Draft Report.pdf

Aaron,

The below email, along with the attached draft report was sent to Board Members just a few minutes ago.

Thank you  
Paul

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**From:** McElroy, Paul E. - Managing Director CEO  
**Sent:** Wednesday, February 7, 2018 3:17 PM  
**To:** 'Alan Howard' <ahoward@milamhoward.com>; 'Newbill32218@yahoo.com' <Newbill32218@yahoo.com>; 'Cumber, Husein' <Husein.Cumber@feci.com>; Flanagan, Kelly (flanagank@nfl.jaguars.com) <flanagank@nfl.jaguars.com>; 'april.green@bethelite.org' <april.green@bethelite.org>  
**Cc:** Charleroy, Melissa M. - Executive Assistant <charmm@jea.com>  
**Subject:** JEA Draft Report

Board Members,

In response to the request by the Chairman in December to study the privatization question and report back to the Board within 60-90 days, JEA engaged Public Financial Management to study the question and provide an independent report. Their work is not yet complete. However, JEA received a public records request for a draft of the report. In compliance with Florida's Sunshine Laws, JEA is providing the draft to members of the media and other community stakeholders and wanted our Board Members to also be informed about this release of information. Work on the study and draft is incomplete and remains ongoing. Information contained in this draft is subject to change, could be added to or subtracted from, and should in no way be construed to represent a final work product.

Paul McElroy

# The Future of JEA: Opportunities and Considerations

DRAFT

Michael Mace

PUBLIC FINANCIAL MANAGEMENT

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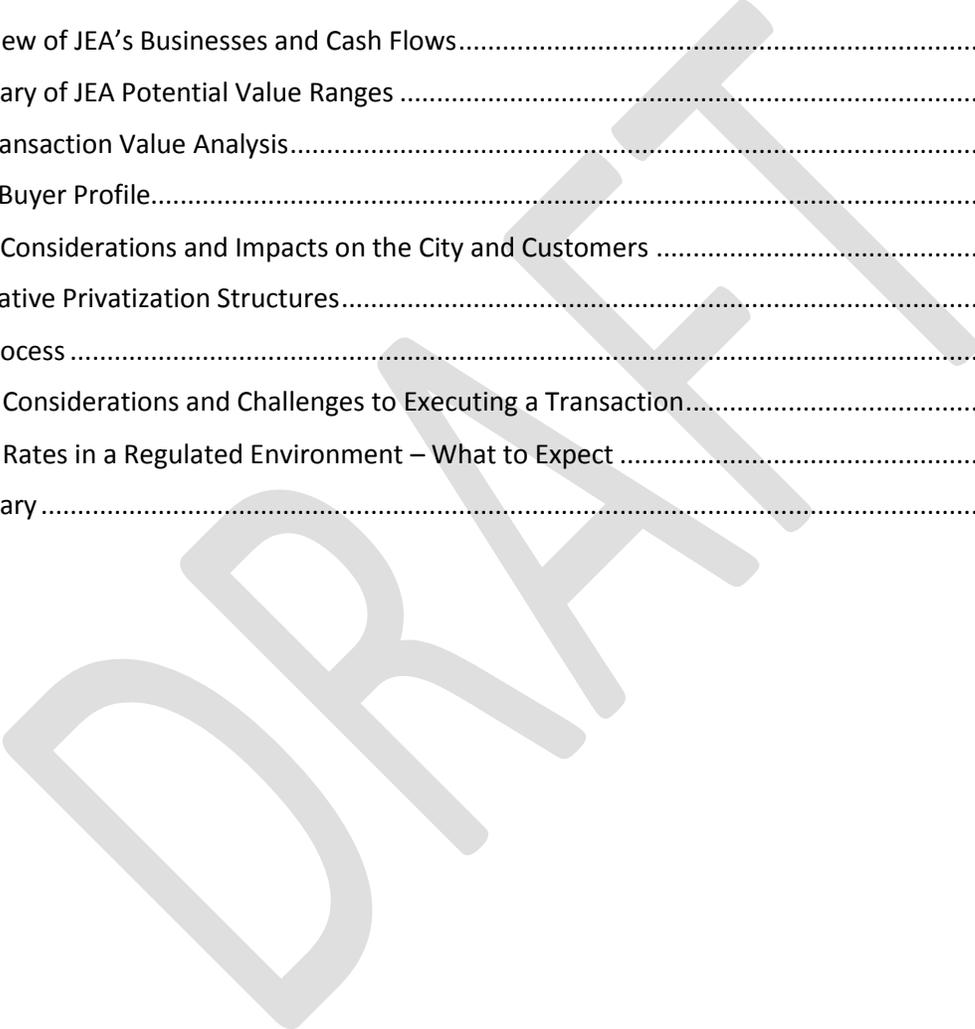
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## Introduction

On November 28, 2017, in his final meeting as a Director of the JEA Board, Mr. Thomas Petway posed the following questions...

“Would the customers of JEA and the people of Jacksonville be better served in the private marketplace?”  
“Should JEA and the city of Jacksonville consider the financial benefits that would come from the privatization of JEA?” **CONFIRM QUOTES**

This topic has been raised and studied in the past. The conclusions of prior studies were that the City and the ratepayers would be better served by having JEA remain in place as a municipally-owned utility. But as Mr. Petway accurately stated at the November meeting, the utility market is vastly different than when JEA was formed in 1967. Further, the utility market is quite different than it was just five years ago when this topic was last studied.

The outlook for the future of the utility industry, and specifically for the electric utility industry, is as uncertain as it has ever been. Continued advances in technology will impact both energy demand and energy supply. Technology has led to tremendous leaps forward in energy efficiency, resulting in reduced energy demand; while potential growth in electric vehicle adoption could replace that demand in the upcoming decade. On the supply side, we have seen coal go out of favor due to environmental concerns, and nuclear due to cost concerns; while natural gas-fired and renewable generation costs have declined dramatically. The prospects for continued change can be argued to make the utility industry more volatile and riskier than it has been in the past.

The rapidly changing nature of the utility industry supports the need for the City and JEA to reevaluate questions that have been asked and answered in the past. As a result of Mr. Petway’s questions and suggestions, JEA’s new Board Chair Mr. Alan Howard made the following request of JEA’s CEO, Mr. Paul McElroy... “...take up that challenge, evaluate our prospective position in the marketplace, and report back on what the private market value of JEA may be so the citizens of Jacksonville and the mayor and other constituencies — City Council — can evaluate that opportunity.”

JEA’s management team was given the directive to study this issue, and report back to the Board. One of the steps taken by JEA to respond to this directive by the Board was to commission Public Financial Management (“PFM”) to prepare a report that addressed a number of topics that are relevant to any decision that JEA and/or the City might make regarding the City’s continued ownership, or possible sale, of JEA. The goal of the PFM Report (or “Report”) is not to make a recommendation on whether to retain JEA, sell JEA or seek some other relationship between JEA, the City and JEA’s ratepayers. Rather, the goal of the Report is to inform the Board, the City and the Public as to several important considerations that must be evaluated in order to make any decisions regarding JEA’s future. The Report does contain a range of potential values that the City might derive from a sale of JEA. It also includes a discussion of the key drivers of JEA’s potential market value, and it covers the required application of a portion of the sale proceeds that would reduce the gross sale proceeds to a net amount that would be available to the City. There are many other considerations that City leaders evaluate that go beyond the question of “What is JEA Worth?”. The price a buyer might pay for JEA (or that separate buyers might pay separately for JEA’s Electric, Water & Sewer, and District Energy Systems) is but one input to a more complex equation that arrives at the net long-term impact of a JEA asset sale on both the City and on JEA’s ratepayer “owners”.

The goal of this Report is to raise and address the other inputs to this complex equation, and to assist the reader in prioritizing both the quantitative and non-quantitative considerations relevant to a decision to retain JEA; or to proceed to the next step in the complex process of deriving the highest possible value of JEA for the City and the ratepayers.

The readers of this Report should consider the qualifications and background of the firm providing the Report. For a brief introduction to PFM, we are the country's largest, independent, full-service financial and investment advisor to the governmental and not-for-profit sectors. PFM has served as JEA's financial advisor since 2002. PFM is independent in that it is not associated with any investment or commercial bank. The firm does not underwrite or trade municipal securities for its own account. PFM is not affiliated with and does not provide financial advisory services to private, for-profit utilities. PFM does not serve as a broker in asset sales and would not serve in this role should JEA sell any or all of its assets. PFM has particular expertise in providing financial advice to large municipal utility systems across the country. In the public power sector, PFM serves as financial advisor to well over half of the 50 largest public power systems in the United States. PFM is also the leading financial advisor to large governmental water and wastewater systems. PFM has assisted several of our clients in the evaluation of large asset sales and acquisitions. In some cases, these analyses have covered the sale of all of a utility's assets. In a limited number of cases, the outcome of the process was a sizable asset sale or privatization arrangement.

Sales of municipal utility systems have historically been quite rare. There are significant economic factors that have long favored municipal ownership. In the past, PFM's role in the analysis of a potential municipal utility system sale has often been to explain and quantify these economic factors. For JEA, its access to low-cost tax-exempt debt, and its non-profit, cost-of-service business model provided considerable cost savings relative to for-profit utilities that: (1) had higher cost debt, (2) even higher cost equity, and (3) paid taxes on net income. The utility industry had long been a very capital intensive business, and JEA's distinct capital cost advantages delivered considerable value for JEA's customers. The evaluation of municipal ownership or sale was often focused on capital cost advantages and their impact on current and projected utility rates. Not surprisingly, the projected rate differentials between municipal versus for-profit ownership led to a clear advantage for continued municipal ownership of large utility assets.

However, in recent years there have been considerable changes in both the capital markets and in the utility industry that justify a new look at the old math that had always favored municipal ownership. In addition, there have been changes in JEA's business outlook and financial structure that have made JEA more appealing to potential purchasers of utility assets. These changes necessitate a very different approach to this exercise than that of simply going through an explanation of capital cost and philosophical differences between public power and Investor Owned Utilities ("IOUs").

This Report will provide an updated view of the potential value of JEA to an acquirer. This value reflects the changes discussed above as well as other market dynamics. The Report will also discuss: (1) information related to JEA's utility systems, (2) a comparison of municipal and for-profit ownership, (3) utility valuation methodologies and approaches, (4) potential sale processes and timeline, (5) complexities of the privatization process, and (6) the potential risks to, and impacts on the City from an asset sale.

As mentioned, the goal of this Report is not to recommend either selling or retaining JEA. It is to inform the Board and other community decision makers, and assist them in assessing the value of JEA. Throughout the Report, there is discussion of the City selling or retaining JEA. At no point in this Report does PFM assume a preferred outcome for any decision regarding JEA's future. While it may be possible

for isolated sections, or selected text of the Report to be read out of context, and be interpreted as expressing a view regarding the potential or preferred outcome of JEA's and the City's evaluation process, PFM is not expressing any opinion or assumptions as to the outcome of the evaluation process on the part of either JEA or the City.

## JEA Asset Summary

JEA is a not-for-profit, community-owned utility created by the City of Jacksonville to serve Duval County and surrounding communities. It is located in Jacksonville, Florida, and serves approximately 464,000 electric, 346,000 water and 269,000 sewer customers in Northeast Florida. JEA is an independent agency of the City of Jacksonville. JEA's businesses are divided into three main systems: electric, water/sewer, and district energy. JEA provides reliable utility services to business and residential customers at an affordable cost, while remaining in compliance with environmental regulations.

JEA provides excellent customer service as measured by J.D. Power. By focusing on the customer experience, JEA improved its customer ratings over the past six years, and is now ranked in or near the top quartile in both business and residential customer satisfaction in the J.D. Power survey. JEA ranks #2 in business customer satisfaction in the state of Florida.

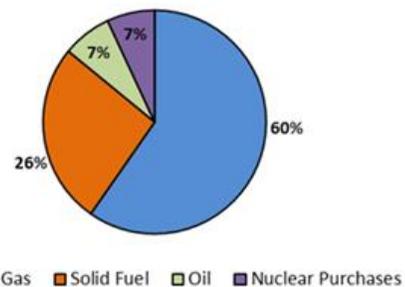
JEA's Northeast Florida service territory is strong and diverse with little to no significant customer concentrations. Current median household income in the territory is roughly 85-90% of the national average. Real GDP growth for Jacksonville is on par with US real GDP growth. JEA's average monthly bills as a percentage of its ratepayers' household income are below the national average [CHECK]. JEA's rates for both the electric and water/sewer systems are below the medians in the State of Florida. JEA's competitive rate structure supports the regions ability to capture significant new growth opportunities into the future.

### Electric System:

The electric department of the City of Jacksonville was made an independent authority of the City in 1968 as a result of City Consolidation. JEA now serves most of Duval County and limited areas in Clay and St. Johns Counties. JEA serves the City of Atlantic Beach, the Town of Baldwin and the Town of Orange Park through electric franchise agreements.

The JEA Electric System consists of generating facilities located on four plant sites within the City of Jacksonville, and an interest in a generating unit in central Georgia. In January 2018, JEA shutdown the St Johns River Power Park ("SJRPP") a plant co-owned with FPL. JEA also purchases power from several solar installations in Duval County and a landfill facility. JEA has been authorized to purchase up to 300MW of additional solar output from field sites in and around the City of Jacksonville. JEA entered into a 20-year purchase power agreement to receive 206MW of nuclear capacity and energy from Plant Vogtle Units 3 & 4, which is under construction in Southern Georgia.

**JEA Generation Capacity <sup>1</sup>**



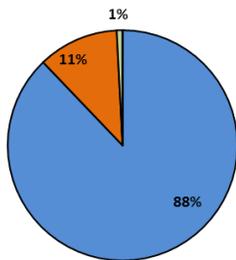
1. Based on 2017 JEA Ten Year Site Plan of Available Capacity after Vogtle Units 3 & 4 in operation

JEA owns and maintains 745 circuit miles of transmission lines and 6,800 miles of distribution lines. The T&D system consists of over 70 substations and 200 high voltage transformers, 340 distribution feeder circuit lines, over 100,000 lower voltage transformers and over 200,000 electric poles. The T&D system is approximately 44% overhead and 56% underground.

JEA’s electric system has been in operation since 1895 with a record of outstanding reliability and performance. JEA is one of only 184 of the nation’s more than 2,000 public power utilities to earn the Reliable Public Power Provider (RP3®) designation from the American Public Power Association for providing consumers with the highest degree of reliable and safe electric service.

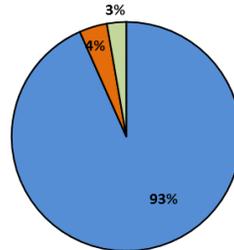
JEA’s 464,000 electric system customers are in an area covering 900 square miles within three counties (Duval, Clay, St Johns) and six municipal tax jurisdictions (Cities of Jacksonville, Baldwin, Atlantic Beach, Orange Park, Unincorporated Clay County, Unincorporated St Johns County).

**JEA Number of Electric Accounts**



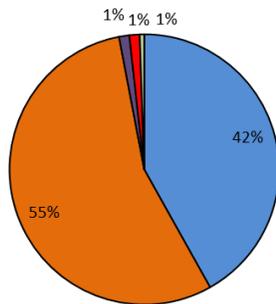
Residential Commercial & Industrial Public Street Lighting

**JEA Electric Accounts by Area**



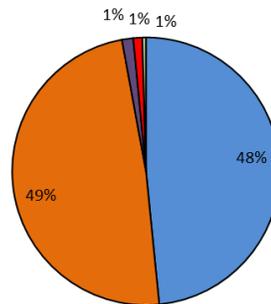
City of Jax Unincorporated St Johns County Other

**JEA Electric System Sales (MWh)**



Residential Commercial & Industrial Sales for Resale - Territorial Public Street Lighting Sales for Resale - Off System

**JEA Electric System Revenue**



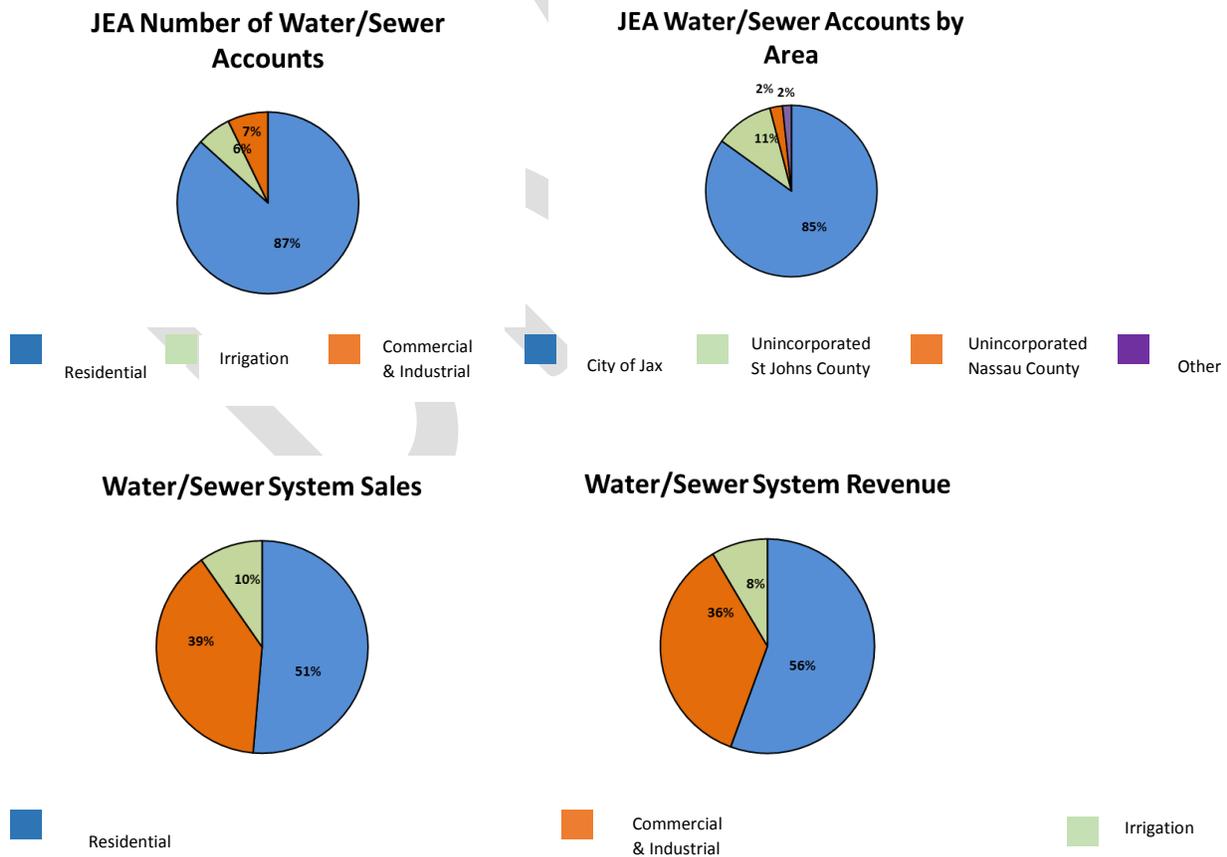
Water and Sewer System:

The water and sewer department of the City was transferred by Ordinance to JEA in 1997. At the time, the utility needed significant system upgrades and the City Council found it hard to raise rates to the degree needed to cover the cost of the upgrades. There had been an ongoing effort in the City to acquire

smaller water and sewer utilities to be able to provide similar service levels and rates as those offered by the City. JEA continued that effort by acquiring most of the remaining larger private utilities within the service districts in the county (Ortega Utilities, United Water, Florida Water). JEA also expanded service into northern St. Johns County with the approval of City Council and the St. Johns County government. Through a series of approvals and acquisitions, JEA purchased JCP Utilities (Julington Creek Plantation), and later acquired the St. Johns and Nassau customers from Florida Water and United Water. JEA also made a similar purchase of existing customers and expanded service territory in Nassau County through its acquisition of United Water. JEA serves minor portions of Clay County in the northern Oakleaf Plantation area. The cities of Atlantic Beach, Baldwin and Jacksonville Beach serve their cities as well as Neptune Beach for water and wastewater service. There are a few remaining private utilities in the City of Jacksonville.

The JEA Water and Sewer System consists of 137 permitted wells, 37 water treatment plants with over 300MGD of system water capacity and 4,700 miles of water pipes. The Sewer system consists of 11 wastewater treatment facilities with a 241MGD peak capacity, 1,300 pump stations and 4,000 miles of pipe. JEA also owns over 300 miles of pipe delivering reclaimed water from ten reclaimed water facilities.

JEA's 346,000 water customers and 269,000 wastewater customers are in a service territory spanning four counties (Duval, Clay, St Johns, Nassau) and includes two major wholesale water customers. JEA also supplies reclaimed water to 11,000 customers.



Unlike many water and wastewater utilities, JEA has kept its system up to date by funding an appropriate capital investment program including: pipe replacements, system hardening, and constructing adequate capacity. While the need for large capital investments to update a neglected system is a common driver behind evaluating water and wastewater privatization, this is not the case for JEA.

#### District Energy System:

The District Energy System was established in 2004 and provides chilled water to customers for air-conditioning. JEA owns four chilled water plants and facilities which generate and distribute chilled water to buildings located within the respective districts served by the plants and certain ancillary equipment. The biggest customers of the district energy system are city owned facilities such as the baseball park, the arena, the Duval County Courthouse, the library and other government buildings. JEA also has contracts with private entities to serve institutional buildings such as UF Health Jacksonville.

## Overview of Municipal Ownership vs. For-Profit Ownership

Utility services in the United State are provided by three general types of utility enterprises: (1) for-profit, IOUs, (2) non-profit, governmentally-owned or affiliated utilities, and (3) non-profit, consumer-owned cooperative utilities. In the electric utility sector, most of the country is served by the IOU market, with only about 15% of the population served by public power utilities such as JEA. In the water/sewer sector, municipal utilities serve over 80% of the country's population [CHECK]. From an economic perspective, each of the three utility structures shares the goal of meeting the needs of their "owners". Municipal utilities are owned by governmental entities, and operated to maximize value to the local ratepayer citizens. Municipal utilities operate on a cost of service basis, in that ratepayers are charged only for the costs required to deliver service. There is no requirement to charge ratepayers for profits and shareholder returns, nor must a municipal utility include provisions for federal and state income taxes in their rate structure. IOUs have an obligation to their shareholders to deliver profits and achieve targeted equity returns. IOUs also have to pay taxes on net income and property taxes.

The IOU structure clearly carries the added cost of delivering equity returns to its shareholders. These higher returns often come with higher risk for the shareholder. In some cases, equity owners absorb costs that would have been passed on to customers in the municipal ownership structure. There are numerous instances where IOU shareholders have absorbed the costs that regulators did not allow to be passed on to ratepayers. Under a municipal utility structure, there is no shareholder "buffer" to absorb losses as an alternative to passing costs on to ratepayers.

Most utilities, IOU and municipal, generally have near monopoly status in their service territories. For municipal utilities, the cost-of-service business model precludes them from charging rates in excess of those required to recover their costs. Municipal utilities are also locally-governed by either an independent Board or elected governing body; which leaves the utility answerable to local ratepayer interests. For IOUs, ratepayer interests are protected by state regulation that governs the IOU rate setting process in order to ensure that IOUs earn only a "reasonable" return for their shareholders. IOUs are allowed to earn profits, pay shareholders, and recover enough to pay taxes. The regulatory structure is

in place to ensure that IOUs are not exercising monopoly pricing power in a way that allows for excessive shareholder returns at the expense of ratepayers.

The following table provides a comparison of the municipal utility and IOU ownership structure along a number of criteria:

	<b>Municipal Utility</b>	<b>Investor Owned Utility</b>
<b>Ownership</b>	Local government body and customers of the utility, usually limited to the service area	Shareholders or investors, typically external to the service territory
<b>Structure/Management</b>	Not-for-profit public entity managed locally by elected or appointed board members and public employees	Private company. Shareholder elected board appoints management team of private sector employees. Both may be external to the service territory.
<b>Rate Setting &amp; Regulation</b>	Customer rates are set by utility's governing body/board or city council in a public forum. Florida Public Service Commission (FPSC) regulates rate structure. Little or no regulation of wholesale rates. Costs for all plant investment are immediately recoverable in rates.	Customer rates are set and regulated by FPSC through a public process that includes some customer participation. Some regulation of wholesale rates. Customers represented by Florida Office of Public Counsel. Generally, plant costs cannot be recovered in rate base until plant is used and useful.
<b>Mission/Goals</b>	Optimize benefits for local customer owners and local communities	Optimize return on investment for shareholders
<b>Financing</b>	Tax-free bond sales, bank borrowing, and retained earnings	Equity sales, bond sales, bank borrowing and retained earnings
<b>Investment in Capital Assets</b>	Own and operate assets or purchase service through contracts. FPSC must certify need for facility investment. Can be jointly owned.	Own and operate assets or purchase service through contracts. Can be jointly owned.
<b>Profit/Net Revenue</b>	Rates are set to recover costs and earn additional return to maintain bond ratings and invest in new facilities. Can provide return to local government owner	Utility rates are set to recover costs and earn a reasonable return as profits for investors in return for the risk they bear for investing in new facilities
<b>Size/heterogeneity</b>	Munis differ greatly in size and number of customers served. Local or regional geography and customer mix.	Large in size and number of customers, complex geographic and customer mix.

<b>Taxes and Contribution</b>	Typically pay a payment in lieu of taxes or contribution to local government	Pay state and federal income tax and local property taxes
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## Introduction to Utility Enterprise Valuation

In recent years there have been a significant number of large transactions involving the sales and purchases of utility assets. These transactions have primarily involved energy assets and enterprises, such as integrated electric utilities, electric transmission companies, generating assets, natural gas pipelines and natural gas distribution companies. There have been only a limited number of transactions involving large water and wastewater assets.

Given the large number of publicly-traded energy companies, and the material number of mergers and acquisitions of energy assets, there is sufficient public data and history that enables analysts to value what JEA's electric system may be worth to the private sector. There is not nearly the amount of market and price guidance for water/sewer utility assets. We can look to the energy sector for guidance on the value of JEA's water/sewer utility. We can also estimate the water/sewer system value from stock prices and multiples of the publicly-owned water utilities. There are commonalities between the energy and water/sewer asset classes, such that asset prices in the energy sector provide helpful guidance for prices that might be paid for water/wastewater assets. The values for the limited water/wastewater transactions that have been executed, along with certain "non-electric" energy transactions, indicate that the values for water/wastewater assets could be higher in terms of metric multiples than the values for same-sized electric utility assets.

Following is a summary of selected "headline" asset sales in the energy sector that have occurred in recent years:

Acquiror / Target															Recent Precedent Average	
Announcement Date	1/3/18	10/16/17	8/21/17	7/19/17	7/10/17	1/25/17	4/26/16	2/9/16	2/9/16	2/1/16	10/26/15	9/4/15	8/24/15	7/12/15	2/26/15	NA
Premium	38%	NA	NA	24%	0%	28%	NA	50%	33%	23%	42%	48%	38%	NA	25%	32%
Offer price per share	\$53.71	NA	NA	\$53.00	\$53.13	\$88.25	NA	\$34.00	\$44.90	\$25.00	\$60.00	\$27.55	\$66.00	NA	\$52.75	NA
Diluted shares outs.	147.6	NA	NA	64.4	143.0	51.5	NA	43.9	155.0	176.4	81.7	237.7	120.2	NA	57.2	NA
Equity purchase price	\$7.9	\$1.7	\$11.8	\$3.4	\$7.6	\$4.5	\$0.3	\$1.5	\$6.9	\$4.4	\$4.9	\$6.5	\$7.9	\$0.9	\$3.0	NA
Corporate adjustments	6.7	-	6.9	1.9	4.0	1.8	0.1	0.9	4.4	1.6	1.8	3.9	4.1	1.0	1.7	NA
Enterprise purchase price	\$14.6	\$1.7	\$18.7	\$5.3	\$11.6	\$6.3	\$0.3	\$2.4	\$11.3	\$6.0	\$6.7	\$10.4	\$12.0	\$1.9	\$4.7	NA
Implied multiples:																
LTM EBITDA	9.3x	16.6x	10.5x	11.8x	11.0x	13.9x	11.3x	10.9x	13.8x	9.6x	14.9x	11.6x	9.8x	14.8x	11.5x	12.1x
NTM EBITDA	10.9x	NA	10.1x	12.1x	10.6x	12.2x	NA	10.2x	12.9x	9.5x	12.9x	10.9x	10.1x	12.2x	10.2x	11.1x
LTM EPS / net income	12.6x <sup>(1)</sup>	NA	27.9x	24.2x	21.5x	26.7x	25.9x	26.4x	22.0x	19.4x	30.5x	28.4x	24.4x	36.9x	23.3x	25.0x
NTM EPS / net income	18.2x <sup>(2)</sup>	NA	25.6x	27.9x	20.9x	25.5x	NA	22.8x	21.4x	19.1x	29.1x	23.9x	21.8x	30.0x	21.9x	23.7x
Rate base	1.54x <sup>(3)</sup>	2.33x	1.70x	1.71x	1.79x	2.47x	2.18x	1.64x	2.02x	2.23x	2.46x	1.74x	1.95x	2.10x	2.09x	2.00x

**REFINE TABLE TO SUBSET OF MOST RELEVANT EXAMPLES AND LINE ITEMS**

Asset prices in these transactions are generally expressed in terms of their values as multiples of Earnings, Earnings Before Interest, Taxes, Depreciation and Amortization (“EBITDA”), or Net Property, Plant and Equipment (“NPP&E”) which is a proxy for the utility’s rate base and determines the return on capital an IOU would be allowed to earn by regulators. One of the most commonly followed metrics for stock prices and company valuations is the Price to Earnings Ratio. The following chart provides an historical view of this metric:

## Historical P/E Ratio: Integrated Utilities



### UTILIZE MID CAP ONLY AND EXAMINE LONGER LOOK BACK PERIOD

As the above chart clearly demonstrates, there has been a pronounced upward trend in the valuations and prices paid for utility assets in recent years. The fact that multiples have increased means that stockholders and asset purchasers are paying more now than ever for utility assets. These high prices are not isolated to the utility market. Buyers of all types of commercial enterprises are willing to pay high multiples of earnings and attach high value to expected future cash flow. The stock prices and asset acquisition prices paid today are a function of both the amount of expected future earnings of a business, and the present value of those earnings to the buyer. The present value is determined by applying a discount rate or capital cost to the future expected earnings. These capital costs, and thus net present value discount rates, are near all-time lows for most potential buyers of utility assets. Most buyers would source their acquisition funding through a combination of debt and equity. Debt funding costs are still very low, in spite of a recent moderate increases in some interest rate indices. The cost of equity funding is at an all-time low – especially for what are considered relatively low risk utility investments. Stock market indices have been steadily setting new all-time highs for the past several months. High stock prices mean low equity costs for companies issuing stock, or using stock as a currency for acquisitions. Interestingly, while the market cost of equity has declined considerably for many large regulated utility companies, their allowable returns on their regulated utility investments have remained relatively stable over time. This means that a regulated utility can fund an acquisition in the market with a combination of debt and equity that has a combined cost that is lower than at any time in history. That utility can then earn a regulated return on the portion of that purchase that is allowed into rate base. This allowable

return on equity will be materially higher than the utility's actual cost of equity. This means the acquiring utility can pay a price that is well in excess of the portion of the asset price that might be allowed in its regulated rate base, and still provide a market-based return to its shareholders.

As discussed later in this Report, there are various categories of potential buyers of utility assets. One category includes existing regulated electric utilities and energy companies – known as “Strategic Buyers”. These Strategic Buyers have strong economic incentives to acquire additional utility assets. One of the strongest incentives is to satisfy shareholders’ desire for growth in earnings. As is well known throughout the utility industry, technology advances and environmental concerns have led to declines in energy use by most consumer classes. When combined with a generally sluggish economy for the past decade, many utilities have seen sales decline significantly in recent years. This is not appealing to shareholders. For some utilities, the only way to generate material growth is through acquisitions. These Strategic Buyers are: (1) motivated to grow/buy, (2) have record low funding costs, and (3) continue to be able to earn attractive regulated returns for the portions of the acquisition price that is allowed into the rate base. These factors combine to create a motivated buyer base that has been paying higher than ever multiples of Earnings, EBITDA and NPP&E.

In addition to being able to pay a higher price than ever for a given cash flow or earnings stream, buyers are also interested in assets for which there is potential to grow cash flow and earnings. Some buyers might look at JEA’s cost structure and asset base, and have expectations of increasing revenues and/or decreasing cost in order to improve the cash flow return on JEA’s assets. The combination of low capital costs and the potential to increase cash flow, should make JEA an attractive acquisition candidate for many potential buyers.

As a cautionary note, for some potential buyers, “increasing revenues” can mean higher utility rates; and “decreasing cost” can mean reducing the labor force and a lower economic profile in the City. Conditions can be imposed upon buyers to limit the adverse impacts on both ratepayers and employees. The degree of these conditions can affect the amount a buyer will be willing to pay. Buyer conditions and stakeholder protections can be used to balance the desire to generate the highest value while continuing to address the long-term best interests of ratepayers and citizens. The Report will address the tensions between up-front value and long-term impacts.

Potential new owners may also place significant value on JEA’s physical assets, as well as their strategic location that is near the geographic center of one of the stronger economic growth regions in the Country. JEA has: (1) diverse, flexible generating resources, (2) land suitable for future resource development, (3) strategically located transmission lines, and (4) similarly attractive gas transportation assets. It would be reasonable for a buyer to look at these assets and assume they might be deployed more efficiently by an entrepreneurial, for-profit owner.

The combination of near-record stock prices and acquisition multiples, with JEA’s perceived potential for significant operational and strategic synergies, make JEA an extremely interesting target for any utility seeking to provide value to its owners. JEA is also attractive to non-utility investors that could borrow and leverage to produce very low funding costs, and invest those dollars to earn a higher regulated return on the portion of their investment that is allowed into rate base, such that the higher allowed return on this portion of the investment translates to a market-based return on the higher amount of their overall acquisition price.

## Traditional Valuation Methodologies

One of the fundamental conditions that must be present in order to motivate a for-profit enterprise to purchase or acquire another business is that the transaction must provide the acquirer with the expectation that the transaction will be economically beneficial for its owners/shareholders. The transaction benefit is often described as being “accretive to shareholders” – namely the acquirer’s shareholders. In the private sector, which would include most entities that would have an interest in acquiring JEA, there are several methods by which potential buyers examine an acquisition to determine if the purchase would be beneficial to the buyer. These valuation methods generally compare the potential purchase price to measures of future cash flow (or net present value of cash flow), earnings, asset base or other financial metrics. Following are descriptions of several key valuation metrics for utility mergers and acquisition transactions:

### Discounted Cash Flow and Discount Rate:

Discounted cash flow analysis is a classic financial analysis used to value an organization. The analysis starts with a projection of JEA’s free cash flow, to which a Weighted Average Cost of Capital (“WACC”) is applied as a discount rate to determine the present value of the enterprise.

### Purchase Price as a Multiple of Earnings:

A pro-forma earnings projection is used to determine the expected net income if JEA were a private utility. This earnings number is multiplied by a factor determined by industry comparable public equity trading values and recent utility M&A transactions to determine the equity value of an enterprise. This value is then combined with the debt balance in the pro-forma capital structure to determine the enterprise value.

### Enterprise Value as a Multiple of EBITDA:

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. 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.

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 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.

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 prices 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 Businesses and Cash Flows

Like JEA's operations, JEA's financials are broken into three enterprise 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, also contains relevant financial metrics. Cash and cash equivalents on hand (less current liabilities) can be used to satisfy portions of long-term debt obligations. Both assets and liabilities are 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 values for JEA’s invested infrastructure assets.

As of 9/30/17 (\$'000)	Cash and Equivalents	Net Working Capital <sup>2</sup>	Long-Term Debt	Net Capital Assets
Electric System <sup>1</sup>	\$802,772	(\$93,326)	(\$2,328,211)	\$2,687,232
Water/Sewer	\$447,743	(\$55,752)	(\$1,625,187)	\$2,615,950
DES	\$7,035	(\$2,477)	(\$36,446)	\$36,180
<b>TOTALS</b>				

1 Excludes SJRPP – shutdown January 2018

2 Net working capital consists of accounts receivable, materials, and inventories less current liabilities

Other relevant JEA financial indicators are provided below to illustrate some of the measures that are important components to the valuations and prices paid by potential buyers. Recent transactions provide benchmarks which may be applied to JEA’s financial metrics. These benchmarks provide indicative value ranges for JEA’s assets. Ultimate price will be determined as a result of a competitive process and following an in-depth due diligence effort by potential buyers.

### JEA INDICATIVE METRICS

## Summary of JEA Potential Value Ranges

Recent utility stock prices and utility mergers and acquisitions provide an **indicative** value range for JEA’s key assets. The following table provides a range for utility transaction metrics and multiples that have been seen in recent years. Ranges are provided for several metrics associated with the valuation methodologies discussed previously. It is important to note that these metrics and ranges are for transactions among for-profit, non-governmental entities. None of the transactions that provide data for the table are sourced from sales of governmental assets. Data points for asset sales of large governmental utilities comparable to JEA simply do not exist.

### Ranges and Indicative Transaction Metrics:

TABLE

When we apply the range of observed multiples shown in the table above to the JEA metrics provided earlier, we arrive at the **indicative** value ranges for JEA as listed below:

TABLE

One of the first and most important things we observe from the table above is that the implied value ranges are VERY wide. The lowest implied valuation is \$\_\_\_ billion, and the highest implied valuation is \$\_\_\_ billion – a difference of \$\_\_\_ billion. It is also clear that the upper end of the potential value ranges provide very large valuation numbers. The market and transaction data points that contribute to the value multiple ranges in Table #\_\_ are sourced from a wide variety of transactions, and market conditions. It would be overly optimistic to assume that the high end of the price range is the most appropriate starting point for JEA price discussions. JEA, as a large governmental asset, would be a more complex and difficult transaction than the majority of those that make up the data ranges. Later in the Report, we discuss the complications and considerations associated with a JEA asset sale, and their impact on potential buyer interest and value. Complexity and uncertainty may reduce buyer interest and push potential valuations away from the high end of the ranges.

There are a great number of factors that would drive JEA’s value toward the higher or lower of any of the ranges listed above, some of which would be in the control of the City as the seller.

Another very important qualifier to the valuation ranges above it that these are implied values for the **gross transaction value**. That is the gross or total price that might be paid. If JEA were sold and received gross proceeds of \$\_\_\_ billion - \$\_\_\_ billion, JEA would then have to apply these proceeds, together with any cash and investments remaining at JEA, to retire its liabilities. JEA has cash and investments totaling roughly \$\_\_\_ billion on its balance sheet. A portion of these may go to a buyer – for example, capital funds or operating reserves assumed to be required for business continuity. But a large portion, such as debt service reserves, would likely stay with JEA and be available to offset remaining JEA liabilities.

The following section of the Report discusses the application of the gross proceeds, along with the deployment of remaining cash and investments to JEA liabilities, to arrive at the range of net proceeds to the City.

## Net Transaction Value Analysis

The ranges of gross transaction proceeds provided above provide a first step in calculating the potential net impact for the City of a JEA sale. There are several JEA liabilities that will have to be accounted for before any funds can be released to the City. Following is a discussion of these liabilities.

### JEA Debt

With the sale of JEA, the City would be removing the revenue source that was expected to service JEA’s \$4 billion in debt outstanding. In order to honor its contract with its bondholders, JEA would be required to retire all of its debt in order to accomplish an asset sale. Some of JEA’s debt, mostly its short-term debt, can be retired by simply paying the bondholder the face amount of the bonds they own. Most of the debt, like the majority of municipal bonds, have specific provisions by which the bonds can be retired prior to their final maturity and due date. The typical long-term municipal bond can be paid back to (or “called” from) the investor prior to its final maturity date. Bonds cannot be called or paid off before this call date. However, the issuer is typically allowed to deposit investments in an escrow account to pay the principal and interest on the bond until the call date. This is known as “defeasing” bonds. The defeased bonds are still owned by the investors, but they are no longer the legal liability of the issuer. JEA will be able to retire its longer debt by allocating a portion of the gross transaction proceeds to the purchase of US Treasury

investments that will pay principal and interest on any bonds that cannot immediately be paid off. The earning rate on the Treasury escrow investments will be lower than the interest rate on the defeased JEA bonds. This will lead the cost of the escrow investments to exceed the par amount of the defeased bonds. Based on current market conditions for escrow investment securities, and the amount of JEA debt that remains outstanding, PFM has calculated an overall JEA debt retirement cost of approximately \$4.1 billion as of 10/1/2018.

Summary of Approximate Debt Retirement Components and Costs as of 10/1/2018

System	Electric and SJRPP	Water	District Energy
Total defeasance cost	\$2.47 Billion	\$1.6 Billion	\$36 Million

ADD DETAIL TO DEBT COMPOSITION

**Other JEA liabilities**

Certain other liabilities are expected to be funded from gross proceeds as illustrated in the table below:

Liability	Description	Amount
Interest Rate Swaps	Mark to market on certain interest rate hedge agreements	\$100 million electric \$30 million water
Purchased Power Settlement	TBD	TBD

**Likely Buyer Profiles**

The potential buyers of JEA’s assets can be divided into two general categories – Strategic Buyers and Financial Buyers. Strategic Buyers include those that already participate in some way in the utility business. They include regulated utilities, Independent energy companies, and investment companies with existing utility assets. For the most part, these would be entities that have experience with many of the components of JEA’s business, including: running a retail utility and managing a fleet of utility assets. Many of these Strategic Buyers will also have experience providing service in a territory that is overseen by a state level public utility regulator. Some of these potential buyers may already provide service that is subject to regulation by the FPSC. These Strategic Buyers would look to integrate JEA’s assets into their existing asset base, and likely derive cost synergies based on their existing operations. These buyers would view JEA as a very long term investment.

Financial Buyers would be those whose primary focus in acquiring JEA would be as a financial investment, perhaps one that might be sold after some period of time. The Financial Buyers would include: large investment funds, pension funds, private equity firms, infrastructure funds, etc. These buyers would likely keep JEA as a stand-alone entity, seeking to maximize earnings but not necessarily through synergies with their other investments. Minimum holding periods may be negotiated to prevent a buyer from selling the assets prior to the expiration of any conditions or protections negotiated by the City.

## Other Considerations and Impacts on the City and Customers

Estimates of JEA's market value, gross sale proceeds and the City's net proceeds provide important input for any decision to pursue a new path for JEA and the City. However, the potential up-front net proceeds available to the City represent only one of many outcomes and impacts from a sale of JEA. There are several other far-reaching impacts in addition to the up-front price and net proceeds.

### **Customer Impacts – Rates and Service Levels**

The discussion of future utility rates under an asset sale scenario is not simply a comparison of JEA's current rates to potential future rates if JEA is sold. In order to assess the customer rate impact of a sale, it is necessary to develop long-term projections of customer rates under continued City ownership of JEA. A thorough analysis of the customer impact requires comprehensive rate projections under a sale and a non-sale scenario. The sale scenario requires analysis of potential rate conditions that the City may decide to impose on potential buyers, and on the rate structure once ratemaking transitions to a FPSC regulatory environment. While it is impossible to predict the industry, economic, technological and demographic conditions that will prevail over the long run, an effort should be made to develop the best possible pro forma projections for both a sale scenario and a non-sale scenario. Over the next five to ten years, the cash flow dynamics and capital needs of the electric system would suggest that the FPSC rate regulatory structure would allow a new owner limited opportunity raise electric rate. In fact, it is likely that electric rates could be lower after a sale of the system. For the water and sewer system, if future capital improvements are required, the FPSC could approve rate increases needed by a new owner to recover their capital improvement. Based on the cash flow and capital needs of the water and sewer system, it is possible that higher rates may be needed in the foreseeable future. The projected incremental rate impact between JEA ownership and new ownership is likely to be the most important non-price consideration in the complex decision regarding JEA's future.

### **Local Employment and Economic Impacts**

In almost every acquisition of a major utility company, there is an expectation that the new combined enterprise will experience synergies and efficiencies that allow for cost reductions. There is no reason to expect that JEA's case would be different. As mentioned, the City could place conditions on the buyer that they not reduce employment levels for some period of time. Commitments from acquirers to maintain employment and/or economic presence in a community are common in utility acquisitions.

### **Operational Efficiencies and Economic Benefits**

The City and JEA have partnered on many beneficial initiatives and projects in the past, and the City could continue to partner with a new owner subject to the terms and conditions of the sale. Listed below are select recent examples of the value of the partnership to the Jacksonville community:

- The City and JEA are currently partnering on the latest septic tank phase out program including program funding and JEA providing project management and outreach.
- JEA acquired approximately 5,000 acres of land as buffers or adjacent to JEA facilities in parallel with the City's Preservation Project as part of BJP.
- The City and JEA partnered on the Water and Sewer Expansion Authority creation and dissolution from 2003 to 2011.

- JEA partnered with the City on the transition of Cecil Commerce Center (formerly Cecil Field) including planning for the transition.
- JEA and the City partnered on the LED streetlight conversion program which is an initiative to convert all streetlights City wide to LED fixtures.
- JEA's operational efficiencies and advancements in the wastewater system provide nitrogen reduction credits to the City which are critical to meeting its reduction goals.
- JEA provides multiple services to the City including treatment of the City's leachate, processing and review of the City's wireless facility attachment applications, and chilled water to several City facilities.
- The City and JEA coordinate continually on projects that involve multiple agencies for upgrades, widenings, expansions, maintenance and repairs.

JEA's economic development policy is designed to support the economic growth of northeast Florida through active participation in both local and regional economic development efforts in coordination with various City departments. JEA's policy objectives include commitments to competitive rate offerings, service reliability, and business support resources that meet or exceed the needs of its business customers. Such objectives support community goals to grow existing businesses and attract new business.

Many Florida utilities are supportive of economic development initiatives and partnerships; and offer rates programs that may be criteria specific or are designed to encourage growth within certain industries. The extent to which an acquiring utility would participate in future economic development initiatives and partnerships can be among the conditions imposed upon a buyer.

#### **Potential Residual Costs and Liabilities**

The ownership and operation of a large utility carries a significant degree of business risk. The environmental risks and liabilities associated with both electric and water/sewer systems have received national attention in recent years. A purchaser would want a detailed environmental assessment and conduct an environmental audit to fully understand the environmental risks associated with the acquisition. The City will also need to conduct an environmental risk assessment associated with any residual environmental liability that may not be transferable pursuant to certain environmental laws.

#### **Renewables and Energy Policy**

JEA's clean and renewable energy goals have been developed in response to JEA's solicitation of and reaction to its customers' desire for affordable pursuit of an environmentally responsible energy portfolio. If JEA is sold, these decisions are more likely to be determined by State and Federal legislation.

#### **Eligibility for Federal and State Assistance – FEMA Grants**

As a municipal government entity, the City and JEA are eligible for various forms of Federal and State assistance for events such as natural disasters, environmental mishaps and other potentially unexpected and costly occurrences. The availability of assistance like FEMA disaster grants would no longer be available to offset costs related to natural disaster recovery.

#### **Tax and Revenue Impacts**

Currently the City of Jacksonville has three primary funding sources from JEA into the General Fund:

- JEA Contribution. JEA contribution is a payment to the City in lieu of taxes. The current formula for the annual contribution is based on a millage per units sold, including a floor formula of one percent growth from the FY16 contribution. The contribution in FY18 is expected to be \$116.6 million.
- Franchise Fee. The JEA franchise fee was implemented in 2008 as an additional revenue source for the City. It is unique among municipal utilities but more common where communities are served by investor-owned utilities. The current JEA franchise fee is 3% of certain revenues and is expected to be \$39.5 million in FY18.
- Public Service Taxes. This tax, provided for under Florida state law, is equal to 10% of a portion of utility purchases (generally, electric and water but excluding most fuel and sewer charges). It is commonly levied in service territories served by both municipal and investor-owned utilities and is expected to be \$88.5 million in FY18.

#### **Property Taxes vs. City Contribution**

As a municipal utility, JEA does not pay property taxes on its land and assets; as an alternative JEA pays an annual contribution in lieu of taxes. Should a private entity take the place of JEA, the taxable assessed value of property in Duval County could increase by approximately 10% (the addition of ~\$5bn net capital assets on the City's ~\$50bn taxable base). Based on current millage rates, this increase in assessed value will equate to approximately \$101 million of additional property taxes receipts<sup>1</sup>, of which \$63.5 million would go the City of Jacksonville General Fund. Most of the remainder would go toward funding public schools.

#### **Franchise Fee**

While JEA's 3% Franchise Fee is unique among municipal utilities, it is more commonly assessed on investor-owned utilities in amounts up to 6%. [CHECK] The City could establish the new franchise fee at a level that is designed to preserve revenue to the City, and avoid having the franchise fee be a driver of higher rates.

#### **Public Service Taxes**

Public Service Taxes are common on both municipal and investor-owned utilities and the calculation of tax to the City would be similar in either case.

Prior to any asset sale, the City would need to conduct a comprehensive analysis on the tax and revenue changes arising from a new ownership structure – both on the City and on neighboring communities. It should be possible to “immunize” local government finance against adverse impacts from selling JEA if the proper conditions are imposed on potential buyers.

## Alternative Privatization Structures

“Privatization” can encompass a variety of structures resulting in private sector involvement in the utility's operation. Privatization structures could include:

- A sale of generation assets only. Under this option, JEA would sell its electric system generation assets but retain its transmission, distribution, customer relationships, and entire water & sewer system. This type of privatization is typically coupled with a Power Purchase Agreement, whereby JEA sells its generation to a third party who, in return, agrees to supply all of JEA's power supply needs for a contractual period of time at a contractual price.

Under a generation asset sale, the value received is highly dependent on the terms and conditions of the Power Purchase Agreement. Proceeds could be applied against JEA's outstanding electric system debt to cushion any financial impact on JEA customers.

Example of generation privatization: North Carolina Eastern Municipal Power Agency (2015)

- Operations and Maintenance contract. Under this option, JEA would continue to exist as a legal entity with a skeleton staff primarily responsible for contract management, financial reporting, and long-term strategic decision-making. All utility operations are contracted to a third party who is responsible for the day-to-day operation of the utility.

The value derived from an O&M contract (near-complete outsourcing) could be derived from a difference in contract price versus insourced total operating expenses. This value is not clear at this time. Outsourcing can also be accomplished for a subset of utility operations rather than for the entire utility, and these opportunities are periodically analyzed by JEA.

Example of O&M privatization: Long Island Power Authority (2011)

- Enterprise sale. Under this option, the entire JEA enterprise – electric enterprise, water/sewer enterprise, district energy system, or all three – is sold to a third party. After regulatory approvals are received and all outstanding debt obligations of JEA are redeemed, proceeds are transferred to the City of Jacksonville and the ownership and operation of the utility(s) is transferred to the third party acquirer. This can result in an operation that is ultimately folded into an acquirer's operation, or some independence in operation may result, including retaining a corporate headquarters located in Jacksonville.

This option and the concession described below will be the primary focus for an analysis of JEA.

Examples of utility privatizations: City of Vero Beach (pending)

- Concession agreement. Under a concession agreement, the City gives a third party the right to operate utility assets for a specified period of time, typically very long term (30-50 years). This commercial structure is more common for water & sewer utilities than for electric utilities. The risks and benefits of a concession are similar to an enterprise sale with a key difference: at the end of the term of the concession agreement, ownership of the utility reverts to the City. Concession agreements can encompass all assets of a system or just a subset of assets, for example, just vertical assets of the Water & Sewer System.

The value of the concession agreement is established similar to the value of an enterprise sale.

Example of utility concession: City of Rialto

- IPO Option. The City could choose to convert JEA to a corporation and recapitalize the business through an Initial Public Offering. This would have the effect of maintaining an independent investor owned utility headquartered in Jacksonville. This structure presents a number of complexities that would need to be solved. Typically, in an IPO the owners would only offer a portion of the stock on the market and retain a significant portion of ownership in the company. While under Florida law the City could not hold the remaining equity after an IPO, it could theoretically make a contribution of JEA stock to the pension funds and lower the required ongoing pension contributions. Alternatively, the City could explore setting up a public trust to hold the stock for the benefit of the community on a perpetual basis. Either option is likely to net less proceeds to the City from the privatization than a sale of the enterprise, although some benefits of local ownership could be preserved.
- Recapitalization of JEA. Rather than a sale, it is possible for JEA to re-leverage its balance sheet, allowing the City to extract substantial value from JEA's equity position. JEA's credit rating would likely be downgraded, reflecting the increased debt position. This leverage could be structured to allow for stable rates over the near term but would require future rate increases to repay this borrowing. Although it is unlikely to lead to as large a capital transfer to the City as an outright sale of the enterprise, this recapitalization would allow the City to retain local control over the utility.

## The Process

Utility asset sale processes proceed generally through six phases:

Phase 1 - Commitment to the Process: In order for a sale process to move forward, it will be essential to develop consensus and commitment to evaluate the option of a sale. That does not mean a commitment to sell; but rather to provide the comfort and guidance to potential buyers that if they undertake considerable due diligence, commit to spend billions of dollars, and achieve the City's economic objectives, that their efforts will likely not be in vain. This commitment is essential to generating the greatest level of interest among buyers, and will be important to maximizing value.

Phase 2 – Documentation and Disclosure: Develop documentation around the utilities' operation, legal issues, financial disclosures, and other materials are fully prepared. This preliminary documentation process should be comparable to that involved in a JEA bond sale.

Phase 3 – Preparing for the Sale: Engage advisors, prepare sale process, resolve legal, regulatory, and other issues prior to proceeding. This phase will include a resolution of the issues discussed later in this section. During this phase, the determination will be made around whether it is optimal to proceed with a single sale process for the enterprise as a whole or to engage in separate processes for each utility system.

Phase 4 – Indications of Interest: During this phase, the seller receives reactions and indications from the acquirers most likely to participate in the next phase of the process. This includes a comprehensive management presentation to potential buyers, and discussions/meetings to determine interest and financial and execution wherewithal. Following this phase, the seller and its advisor will narrow down the acquirers to participate in the second phase of the bid process.

Phase 5 – Due diligence and final bids: The potential acquiring companies undertake a significant due diligence effort and submit final bids. Bids are scored against pre-determined criteria to recommend a successful acquirer(s) and the acquisition contract is negotiated.

Phase 6 – Regulatory approvals: Completion of a process can be lengthy (in excess of a year). Approvals will be required from the Jacksonville City Council, Federal Energy Regulatory Commission, North American Electric Reliability Corporation, the FPSC, and other regulatory agencies.

Phases #2 through #5 could take roughly 5-9 months. Phases #1 and #5 are more difficult to predict, and could add more than six months to the front end of the process, and possibly a year for the final approval stage.

## Major Considerations and Challenges to Executing a Transaction

A privatization of the JEA enterprise would likely represent the largest and most complex municipal privatization in the United States. Privatizations are complex undertaking and often take years to complete. Below is a discussion of several of the execution complexities that will likely be encountered under a privatization scenario. No issues have been identified to date which will prevent a privatization altogether, but each of these will have to be carefully considered and mitigated if a privatization moves forward.

### **Operational**

JEA must ensure continuity of operations through a potential change in ownership. This includes managing the workforce through change while maintaining focus on safety, service and reliability to the community.

### **Employees**

Any acquisition, sale or privatization process is typically challenging for employees. There will be uncertainty from the time a potential sale is initially made public until the final resolution of the process. This process can take well over a year, and employees will focus on the terms of the transaction, negotiated by the parties, that affect their future job security. Employees may pursue other employment options in search of more security. It may be difficult to fill positions during a sale process.

### **Regulatory**

JEA currently operates under a municipal utility regulatory and rate setting construct. If a privatization were to occur, the transition to the FPSC regulatory structure would have to be carefully managed to ensure compliance both before and after privatization with all applicable regulations, including operational, security, technology, environmental, and financial.

### **Contracts and legal**

There are a number of outstanding contracts and property rights that would be affected by a privatization of JEA. These include power purchase agreements, interlocal agreements, and real estate easements. A

privatization would necessitate a complete review of all outstanding agreements. We have identified several specific items that would need to be addressed as indicated below.

#### Plant Vogtle Power Purchase Agreement

JEA entered into a 20 year power purchase agreement with the Municipal Energy Authority of Georgia (“MEAG”). The contract obligates JEA to pay for all incurred costs associated with JEA’s share of the capacity and energy output over the 20 year period. As written, this contract does not contain a provision discussing change in control of either party to the contract. A change in control may require a complex restructuring of the contract or identification of an alternate vehicle to allow the sale process to comply with the tax covenants contained in the contract. All possible solutions identified require substantial legal and economic due diligence.

#### Interlocal agreements

JEA has active interlocal agreements with Nassau and St. Johns Counties that grant JEA the right to provide water and sewer service to current and future customers in specified areas. Each of these agreements have a change of control provision that gives each county the option to purchase the portion of JEA’s water and sewer assets in each county if there is a change of control for JEA.

#### Property issues

JEA has thousands of property rights contracts, many of which contain complexities around ownership, transfer rights, and division of property rights should a privatization occur.

#### St. Johns River Power Park Shutdown

JEA is in the process of dismantling and remediating the St Johns River Power Park site under the terms of an Asset Transfer and Contract Termination Agreement (“ATA”) between JEA and Florida Power & Light Company. This work will remain ongoing through 2020.

#### **Transaction Execution and Costs**

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. JEA and the City will require experienced financial, legal and technical advisors that specialize in utility assets sales. Obtaining the best advice is essential to maximizing value for the City and for ratepayers. The complex, protracted nature of this assignment will lead to professional fees that are much higher than for typical municipal financing assignments undertaken by JEA or the City. These fees often become the subject of much attention – even though expert advice is essential to the sale process and can generate value to the City that is well in excess of these fees.

## Summary

It is very likely that the sale of JEA, in whole or in part, can produce substantial up-front net proceeds to the City – even after all of JEA’s liabilities have been accounted for. Current market conditions can be expected to provide for a greater net value of JEA to the City than at any time in the past. The sale of JEA would be an enormously complex undertaking. It would have quantifiable impacts on future taxes and payments received by the City and other governmental jurisdictions. It would have economic impacts on

JEA's employees and on the City. Many of these impacts can be managed through conditions that the City can decide to impose on the sale process and potential buyers. There would also be a number a qualitative differences between having a utility with a local presence and under local control, versus having a utility that is privately held. While local control and presence are appealing, there is also a fundamental question of whether it is prudent for the City to remain in the utility business. It is a business that is changing rapidly due to technology and market forces. It may be more prudent to leave this business to larger, more nimble companies that have the ability to absorb risk and uncertainty.

Jacksonville's leaders will have to evaluate and weigh the quantifiable and qualitative impacts to make the best decision for JEA ratepayers and for the City. In the past, it could be expected that the sale of JEA would not produce enough proceeds to satisfy JEA's liabilities and still leave sufficient net proceeds to compensate the City for future economic and qualitative differences under a new ownership structure. Because of recent changes to the utility market and to JEA, those old expectation are no longer valid. A more thorough, updated valuation of JEA, and perhaps an exploratory sale process could lead to a new answer to the old question of whether the City should sell JEA.

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