

Rating Action: Moody's downgrades JEA (FL) Electric Enterprise ratings to A2 for senior lien revenue bonds; outlook negative

11 Oct 2018

Approximately \$2.3 billion of revenue bonds affected

New York, October 11, 2018 -- Moody's Investors Service has downgraded JEA (FL) Electric Enterprise ratings, including the senior lien electric system revenue bonds to A2 from Aa2, subordinate lien electric system revenue bonds to A3 from Aa3, St. Johns River Power Park System (SJRPP) revenue bonds to A2 from Aa2 and Bulk Power Supply System revenue bonds (Plant Scherer revenue bonds) to A2 from Aa2. Additionally, Moody's downgraded the utility's underlying long-term rating for Variable Rate Electric System Revenue Bonds (Senior Lien) to A2 from Aa2 while affirming the associated short-term VMIG-1 rating for those bonds. Moody's also downgraded the utility's Variable Rate Electric System Revenue Bonds (Subordinate Lien) to A3/VMIG-2 from Aa3/VMIG-1. The outlook remains negative.

RATINGS RATIONALE

The rating action reflects the increasingly pressing credit risks facing JEA's future credit profile owing to the exposure to new nuclear construction through its 20-year power purchase agreement (PPA) with the Municipal Electric Authority of Georgia (MEAG Power) for 206 megawatts (MWs) of capacity from the much delayed and over-budget Vogtle nuclear project. JEA's future financial metrics, which have historically been reasonably well positioned in the Aa rating category could end up in the A rating category owing to a rising power purchase obligation through the PPA with MEAG Power for twenty years from commercial operation. These risks have been magnified by the existence of litigation between JEA and MEAG Power which raises questions about the legal status of the PPA. These actions, while arguably an attempt to mitigate the utility's exposure to an increasingly expensive contractual arrangement, calls into question JEA's willingness to abide by the take-or-pay, "hell or high water" PPA terms under the contract. We view this effort to effectively repudiate the PPA contract as being inconsistent with the Aa rating category.

The strength of the take-or-pay obligation under the PPA is the sole security for about \$1.4 billion of MEAG Power's PPA-Project J bonds issued in the public markets along with about \$337 million borrowed from the DOE to fund a portion of its 22.7% share of the Vogtle project. The PPA has been validated on three separate occasions in the Superior Court of Fulton County, Georgia wherein the court ruled the PPA-Project J bonds are deemed valid and binding obligations of MEAG Power, including the security for payment which are the revenues from the JEA take-or-pay PPA contract with MEAG Power.

JEA continues to make payments in full and on time for amounts billed by MEAG Power under the PPA and intends to do so unless and until a court invalidates the PPA. Should such a scenario occur, we believe that the outcome would expose the Florida utility to additional lawsuits from the Vogtle project's other participants and from Project J creditors, leading to further material increase in its credit risk and increased potential for rating downgrades owing to costly and protracted litigation risk.

Today's action further acknowledges the downgrade of the City of Jacksonville's G.O. to A2 from Aa2 owing in large part to our concern around their efforts to join with JEA as a co-plaintiff in the MEAG Power lawsuit which attempts to repudiate a take-or-play obligation that effectively supports a JEA debt obligation. Similar to the utility, this action calls into question the willingness to support an agreed upon obligation of their largest municipal enterprise, an action that we believe is not consistent with the Aa rating category.

Notwithstanding these factors, JEA's credit profile still exhibits positive qualities, including an unregulated rate setting process and a track record of exercising rate autonomy to achieve financial goals, maintain good liquidity and offer reasonably competitive retail rates for all customer classes.

The A2 rating for the SJRPP bonds and the Plant Scherer revenue bonds incorporate the fact that the debt service for these series of bonds are paid as an operating expense of JEA prior to the debt service on the Electric System revenue bonds and the Electric System subordinated bonds. The electric system subordinate lien rating is A3, reflecting the weaker security provisions related to the electric system subordinate lien bonds.

The VMIG-1 and VMIG-2 short-term ratings for variable rate senior lien electric system revenue bonds and subordinate lien electric system revenue bonds, respectively, reflect the short-term rating transition schedules for variable rate demand obligations supported by conditional liquidity facilities under the Moody's Rating Methodology for Variable Rate Instruments Supported by Conditional Liquidity Facilities.

RATING OUTLOOK

The negative rating outlook for Electric System, SJRPP and Bulk Power System revenue bonds primarily reflects the heightened and ongoing litigation and nuclear construction risk which we believe will persist at least during the next 12 to 18 months. The outlook also recognizes the fact that JEA faces continuing lackluster increase in demand for electricity in its service territory which contributes to a long capacity position, making its Vogtle 3&4 investment a chronic credit overhang issue.

FACTORS THAT COULD LEAD TO AN UPGRADE

- The rating is not likely to be upgraded in the near to intermediate term owing to the negative outlook and ongoing litigation and nuclear construction risk
- The outlook could stabilize if JEA withdraws its lawsuit filed against MEAG Power and or there is a non-appealable final court ruling in favor of MEAG Power's own lawsuit against the City of Jacksonville and JEA
- Also it would be credit positive if JEA introduces additional strategies to avoid the anticipated decline in its Electric Enterprise financial flexibility as the Vogtle project moves forward and payments to MEAG Power increase under the PPA and pressure the adjusted fixed obligation charge coverage ratio

FACTORS THAT COULD LEAD TO A DOWNGRADE

- Developments in the pending lawsuits that favor JEA's claims and call into further serious question JEA's willingness to continue abiding by the terms of its PPA with MEAG Power
- Further construction delays and cost overruns at the Vogtle project materially beyond the latest revised schedule and cost to complete

LEGAL SECURITY

JEA's senior lien bonds have a rate covenant that requires net revenues to cover debt service by 120% and an additional bonds test that requires net revenues to cover maximum annual debt service by 120%. A renewal and replacement account is required to be funded at least equal to 5% of gross revenues of the preceding year or 10% of net revenues of the preceding year. Senior lien bonds are also secured by a debt service reserve sized at maximum annual interest, which we consider to be a weak protection measure for bondholders.

JEA's subordinate lien bonds are payable from a subordinate lien on the net revenues of JEA's electric system. Subordinate lien bonds have a sum-sufficient rate requirement and adjusted net revenues must also be at least equal to 115% of debt service on the senior and subordinate lien bonds. There is a sum-sufficient additional bonds test. Subordinate lien bonds do not require a debt service reserve, which we consider to be a weak protection measure for bondholders.

As of FYE 2017, JEA had approximately \$167.9 million aggregate principal amount of SJRPP Revenue Bonds outstanding under its First Power Park Resolution (the First Resolution), which are referred to as "Issue Two Bonds" and approximately \$282.3 million aggregate principal amount of SJRPP Revenue Bonds outstanding under its Second Power Park Resolution (the Second Resolution), which are referred to as "Issue Three Bonds". All outstanding "Issue Two Bonds" were defeased in February 2018.

Debt service requirements for Issue Three Bonds governed by the Second Resolution are the sole responsibility of JEA. The Second Resolution permits the use of a surety bond to satisfy the debt service reserve requirement and allows for issuance of variable rate debt with payment terms other than April 1 and October 1. Under the Second Resolution, the debt service reserve is a weak level of protection for bondholders in our view since it is established at maximum annual interest. The debt service reserve under the First Resolution governing Issue Two Bonds is more protective of bondholder interests since it is based upon average annual debt service.

JEA's Bulk Power Supply System Scherer 4 Project issue is secured by a pledge of and a lien on the proceeds of the bonds; the revenues as defined in the Bulk Power Supply System resolution are all revenues derived

from ownership and operation of the project. JEA is required to make payments from the electric system as an O&M expense into the Plant Scherer Project Revenue Fund for any output, capacity, use and service of the project at least equal to 115% of the aggregate debt service. The debt service reserve account is required to be at maximum annual interest, which we view as a weak protection measure for bondholders.

PROFILE

JEA is a municipal utility whose service territory covers Jacksonville, Florida (Duval County), and parts of three adjacent counties. It is split into three enterprise funds, including the Electric Enterprise; the Water and Sewer Enterprise Fund; and the District Energy System. The Electric Enterprise is comprised of the JEA Electric System, the Bulk Power Supply System, and St. Johns River Power Park System. Jacksonville is a major ground transportation center and is also considered a significant rail hub and has one of the largest ports on the South Atlantic Seaboard. The local economy is diversified among defense, transportation and distribution, financial services, consumer goods, information services, manufacturing and insurance sectors.

METHODOLOGY

The principal methodology used in the long-term ratings was US Public Power Electric Utilities With Generation Ownership Exposure published in November 2017. The principal methodology used in the short-term ratings was Variable Rate Instruments Supported by Conditional Liquidity Facilities published in March 2017. Please see the Rating Methodologies page on www.moody.com for a copy of these methodologies.

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Kevin Rose
Lead Analyst
Project Finance
Moody's Investors Service, Inc.
7 World Trade Center
250 Greenwich Street
New York 10007
US
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Kurt Kruppenacker
Additional Contact
Project Finance
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653



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