

ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

**In re: Applications For An Amendment
Of Certificate For An Extension
Of Territory And For an Original
Water And Wastewater Certificate
(for a utility in existence and charging
for service)**

Docket No. 992040-WS

**In re: Application by Nocatee Utility
Corporation for Original Certificates for
Water & Wastewater Service in Duval
and St. Johns Counties, Florida**

Docket No. 990696-WS

REBUTTAL TESTIMONY OF

JIM L. BOWEN

ON BEHALF OF INTERCOASTAL UTILITIES, INC.

DOCUMENT NUMBER-DATE

06773 JUN-28

FPSC-RECORDS/REPORTING

1 of the bank to provide financing for the expansion of Intercoastal's service
2 territory, which letter is attached hereto as Exhibit "JLB-3". I have also
3 referenced the financial analysis and the revised financial analysis prepared
4 by Mr. Mike Burton for this case. I have also reviewed the filings of Ms.
5 Deborah Swain in this case. I also rely upon my knowledge of Intercoastal
6 and my working relationship with Jax Utilities Management and my general
7 knowledge of the water and wastewater industry from the perspective of my
8 own expertise.

9 **Q. Please discuss your relationship with Intercoastal Utilities, Inc.**

10 A. I have provided tax, accounting and consulting services to Intercoastal
11 Utilities, Inc. since 1987.

12 **Q. What is the purpose of your testimony?**

13 A. The purpose of my testimony is to provide information related to the
14 application filed by Intercoastal Utilities, Inc. to serve the territory West of
15 the Intercoastal Waterway which includes the Nocatee development. I will
16 make specific comments related to the Intervenor Direct Testimony of
17 Deborah D. Swain.

18 **Q. What comments do you wish to make about Ms. Swain's testimony?**

19 A. Ms. Swain made several comments about the financial statements of
20 Intercoastal for the year ended August 31, 1998. Ms. Swain used outdated
21 information that did not include the additional rates that were recently
22 approved and, therefore, cannot possibly be a reasonable basis for evaluating
23 the utility's ability to pay debt service in the future. The financial statements
24 changed significantly in the subsequent year due to the plant expansion and
25 related increase in rates effective November 1, 1998. The financial

1 statements for the year ended August 31, 1999 were reviewed by Smoak,
2 Davis & Nixon LLP who issued its report dated November 12, 1999 (see
3 Exhibit JLB-1). These financial statements reflect operating income of
4 \$641,931 and net income of \$181,370 for the year ended August 31,
5 1999. The retained earnings deficit was reduced to \$1,383,100 at August
6 31, 1999. The statement of cash flows reflects net cash provided from
7 operating activities of \$314,807 for the year ended August 31, 1999.
8 (Operating activities includes interest expense but does not include
9 repayment of debt and acquisition of utility plant). Repayment of debt was
10 \$67,080 for the year and was projected to vary from \$116,181 to
11 \$196,391 for the years ended 2000 through 2003. The construction loan
12 is scheduled to mature on January 15, 2004 and the company plans to
13 refinance the balance due on that date.

14 Ms. Swain indicated that the financial statements for the year ended August
15 31, 1998 reflected a sharp increase in the scheduled principal payments
16 during the year ended 2003. However, this was not a regular scheduled
17 payment but was the original maturity of the construction loan which was
18 amended and restated in January, 1999 and is now scheduled to mature on
19 January 15, 2004. It is normal for this type of loan to provide for principal
20 payments which would amortize the loan over a longer period than the actual
21 loan period. Therefore, the loan has a balloon payment due on the maturity
22 date which will be refinanced.

23 Ms. Swain indicated that Intercoastal had to increase wastewater rates in
24 part to pay for new debt. She said that it is unclear if the rate increase is
25 adequate to pay for the new debt. The financial statements for the year

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ended August 31, 1999 appear to support the fact that the utility has adequate operating income to cover its debt service. The limited proceeding rate case provided additional revenue to cover the direct costs of the plant expansion including depreciation, property taxes, rate case expense and a return on investment. The return on investment provides funds to pay interest and recovery of depreciation provides funds to repay the debt. Therefore the sole purpose of the limited proceeding was to provide adequate additional revenue to cover direct costs of the plant expansion including debt service. Ms. Swain said that negative equity and the highly leveraged position of the utility indicates a high financial risk and raises questions regarding the continued financial viability of the utility in light of its plans to finance its expansion entirely through debt. However, many utilities and other businesses leverage their operations with significant debt. A utility has the ability to request rate proceedings which allow a recovery of its costs including debt service. The utility's decision to use debt instead of equity benefits the customers. The cost of equity as determined in the Commission's most recent leverage formula (Order No. PSC-99-1224-PAA-WS issued on June 21, 1999) calls for a minimum return on equity of 8.93% even at the 100% equity level. An utility capitalized at 40% equity or lower would be entitled to a return on equity of 10.12%. However, Intercoastal has been able to finance construction of water and wastewater facilities at a debt cost substantially lower than 10.12% and to deduct the interest payment for tax purposes. Therefore, the utility's decision to use debt instead of equity is beneficial to the customers through reduced rates.

Q. Do you anticipate that Intercoastal will be able to secure the financing or

1 otherwise attract the capital necessary to effectuate its application if its
2 application is granted by the Commission?

3 A. Based on my knowledge of the utility industry and specifically Intercoastal,
4 I would anticipate that Intercoastal will be able to attract the capital
5 necessary to follow through on the representations in its application. My
6 opinion in that regard is based upon the information that I referenced within
7 my testimony including, but not limited to, the financial strength of the major
8 stockholders of the utility and a letter from First Union National Bank of
9 Florida dated June 1, 2000 which documents an intent on the part of the
10 bank to provide financing for the expansion of Intercoastal's service territory.
11 Also, Intercoastal has secured its debt in the past with the guarantees of
12 certain major stockholders. I have been provided with copies of the most
13 recent financial statements of five major stockholders who own 56.75% of
14 the stock in Intercoastal. There are fourteen other stockholders who own
15 the balance of the stock. These financial statements are the representation
16 of the five major stockholders and have not been audited. Therefore, I do
17 not give an opinion or any other form of assurance on these financial
18 statements. Financial institutions and the Florida Public Service Commission
19 often rely on unaudited financial statements prepared by stockholders as a
20 general indication of their net worth and ability to attract capital. Four of the
21 financial statements are personal financial statements which have not
22 provided for estimated income taxes on the differences between the
23 estimated current values of assets and their tax bases as required by
24 generally accepted accounting principles for personal financial statements
25 and the effect of these omissions has not been determined. The maximum

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current individual income tax rate is 39.6%. However the long-term capital gain rate of 20% is likely to apply to certain assets held for investment. The total combined net worth of the five major stockholders as reflected in their financial statements was \$33,700,000. These five major stockholders should be able to attract capital and obtain significant credit for the utility based on their net worth and business experience.

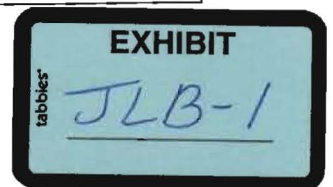
Ms. Swain said that it did not appear that Intercoastal could pay for the increased debt based on the projections in Mr. Burton's Exhibit 21. MB-1. She said that the utility is unable to pay its interest out of operating income in any year shown. However, a cash flow projection for the years 2000 through 2005 taken from information included in Mr. Burton's Exhibit MB-1 shows that the utility would have positive net cash flow after interest and debt payments when you add back expenses which do not use cash flow (depreciation and amortization) and you consider cash CIAC collections (See Exhibit JLB-2).

Q. Does this conclude your testimony?

A. Yes, it does.

INTERCOASTAL UTILITIES, INC.
FINANCIAL REPORT
AUGUST 31, 1999

SMOAK, DAVIS & NIXON LLP
CERTIFIED PUBLIC ACCOUNTANTS
1514 NIRA STREET
JACKSONVILLE, FLORIDA 32207



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SMOAK, DAVIS & NIXON LLP

CERTIFIED PUBLIC ACCOUNTANTS

1514 NIRA STREET

JACKSONVILLE, FLORIDA 32207

R. LAVON BURNAM, C.P.A.
JIM L. BOWEN, C.P.A.
JEFFREY L. SHELTON, C.P.A.
EDWARD P. SCHMITZER, C.P.A., P.A.
CALVIN K. STEPHENS, C.P.A., P.A.

(904) 396-5831
(904) 399-8985 FAX
WWW.SDNLFP.COM

PAUL R. SMOAK, C.P.A.
(1889-1965)
JEWELL A. DAVIS, C.P.A.
(1897-1982)
FRANCIS C. NIXON, C.P.A.
(1907-1980)

To the Board of Directors
Intercoastal Utilities, Inc.
Jacksonville, Florida

Accountant's Review Report

We have reviewed the accompanying balance sheets of Intercoastal Utilities, Inc. as of August 31, 1999 and 1998, and the related statements of income, retained earnings (deficit), and cash flows for the years then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of Intercoastal Utilities, Inc.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

Smoak, Davis & Nixon LLP

November 12, 1999

INTERCOASTAL UTILITIES, INC.

BALANCE SHEETS

August 31, 1999 and 1998

ASSETS	<u>1999</u>	<u>1998</u>
UTILITY PLANT (Note 1)		
Water - franchises	34,630	34,630
Water - structures and improvements	50,170	48,170
Water - distribution and treatment plant	6,602,165	6,211,343
Water - utility plant acquisition adjustment	187,303	187,303
Sewer - franchises	34,630	34,630
Sewer - structures and improvements	170,906	169,108
Sewer - collection and treatment plant	10,583,598	10,180,718
Sewer - utility plant acquisition adjustment	243,854	243,854
General plant	27,350	27,350
Construction in progress	<u>3,490,110</u>	<u>622,056</u>
	21,424,716	17,759,162
Less accumulated depreciation	<u>4,943,654</u>	<u>4,393,839</u>
	<u>16,481,062</u>	<u>13,365,323</u>
CURRENT ASSETS		
Cash	37,356	87,183
Cash investment	<u>21,122</u>	<u>20,894</u>
Total cash and cash investments (Note 1)	58,478	108,077
Customer accounts receivable (net of allowance for bad debts of \$1,000) (Note 1)	502,426	369,552
Other receivables	250	5,783
Prepaid expenses	17,372	11,265
Prepaid and refundable income taxes	-0-	54,282
	<u>578,526</u>	<u>548,959</u>
OTHER ASSETS		
Deferred income taxes (Note 2)	1,640,423	1,750,252
Deferred rate case expense	176,443	88,203
Unamortized loan costs	33,580	41,250
Other assets	675	149,637
	<u>1,851,121</u>	<u>2,029,342</u>
	<u>18,910,709</u>	<u>15,943,624</u>

SEE ACCOUNTANT'S REVIEW REPORT

The Notes to Financial Statements are an integral part of these statements.

LIABILITIES AND STOCKHOLDERS' EQUITY	<u>1999</u>	<u>1998</u>
STOCKHOLDERS' EQUITY		
Common stock, par value \$10 per share, 300 shares authorized, issued and outstanding	3,000	3,000
Additional paid-in capital	66,623	66,623
Retained earnings (deficit)	<u>(1,383,100)</u>	<u>(1,564,470)</u>
	<u>(1,313,477)</u>	<u>(1,494,847)</u>
LONG-TERM DEBT (Note 3)	<u>5,928,618</u>	<u>3,546,103</u>
CURRENT LIABILITIES		
Current portion of long-term debt (Note 3)	116,181	136,203
Accounts payable	130,349	180,524
Accrued property taxes	136,400	136,426
Accrued interest	12,361	6,456
Other accrued expenses	4,084	4,066
	<u>399,375</u>	<u>463,675</u>
OTHER LIABILITIES AND DEFERRED CREDITS		
Advances from developers (Note 4)	270,263	341,821
Deferred contributed income taxes (Note 6)	2,419,862	2,495,180
Deferred investment tax credits (Note 1)	4,083	4,486
	<u>2,694,208</u>	<u>2,841,487</u>
CONTRIBUTIONS IN AID OF CONSTRUCTION (Note 1)	<u>11,201,985</u>	<u>10,587,206</u>
	<u>18,910,709</u>	<u>15,943,624</u>

INTERCOASTAL UTILITIES, INC.

STATEMENTS OF INCOME

Years Ended August 31, 1999 and 1998

	<u>1999</u>	<u>1998</u>
Operating revenues:		
Water	965,687	845,920
Sewer	<u>1,813,363</u>	<u>1,246,494</u>
	<u>2,779,050</u>	<u>2,092,414</u>
Operating expenses:		
Operations and maintenance	1,153,763	1,091,782
Administrative and general	577,284	554,053
Taxes, other than income taxes	205,259	196,825
Depreciation	143,446	147,077
Amortization of acquisition adjustment	10,935	10,935
Amortization of rate case expense	<u>46,432</u>	<u>-0-</u>
	<u>2,137,119</u>	<u>2,000,672</u>
Operating income	641,931	91,742
Interest income	8,973	12,689
Interest expense	(257,202)	(290,468)
Deferred expenses - sale of utility assets	(178,702)	-0-
Other income (expense)	<u>478</u>	<u>(565)</u>
Income (loss) before income taxes	215,478	(186,602)
Provision for income taxes (benefit) (Note 2)	<u>34,108</u>	<u>(46,976)</u>
Net income (loss)	<u><u>181,370</u></u>	<u><u>(139,626)</u></u>

SEE ACCOUNTANT'S REVIEW REPORT

The Notes to Financial Statements are an integral part of these statements.

INTERCOASTAL UTILITIES, INC.
STATEMENTS OF RETAINED EARNINGS (DEFICIT)
Years Ended August 31, 1999 and 1998

	<u>1999</u>	<u>1998</u>
Balance, beginning	(1,564,470)	(1,424,844)
Net income (loss)	<u>181,370</u>	<u>(139,626)</u>
Balance, ending	<u>(1,383,100)</u>	<u>(1,564,470)</u>

SEE ACCOUNTANT'S REVIEW REPORT

The Notes to Financial Statements are an integral part of these statements.

INTERCOASTAL UTILITIES, INC.

STATEMENTS OF CASH FLOWS

Years Ended August 31, 1999 and 1998

	1999	1998
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	181,370	(139,626)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Deferred income taxes	109,829	83,027
Deferred investment tax credits	(403)	(403)
Amortization of contributed income taxes	(75,318)	(75,318)
Amortization of acquisition adjustment	10,935	10,935
Amortization of rate case expense	46,432	-0-
Amortization of loan costs	10,370	13,186
Depreciation	143,446	147,077
Change in assets and liabilities:		
Accounts receivable	(132,874)	(79,380)
Other receivables	5,533	(2,992)
Prepaid expenses	(6,107)	(729)
Prepaid and refundable income taxes	54,282	44,601
Other assets	11,590	(286,765)
Accounts payable	(50,175)	176,960
Accrued expenses	5,897	15,982
Net cash provided by (used in) operating activities	<u>314,807</u>	<u>(93,445)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of utility plant	(3,201,358)	(618,870)
Contributions in aid of construction	546,017	490,916
Advances from developers	(71,558)	34,405
Net cash provided by (used in) investing activities	<u>(2,726,899)</u>	<u>(93,549)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt	2,429,573	174,500
Repayment of long-term debt	(67,080)	(110,697)
Net cash provided by (used in) financing activities	<u>2,362,493</u>	<u>63,803</u>
Net increase (decrease) in cash	(49,599)	(123,191)
Cash at beginning of year	<u>108,077</u>	<u>231,268</u>
Cash at end of year	<u>58,478</u>	<u>108,077</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOWS INFORMATION		
Cash paid during the year for:		
Interest expense (net of amount capitalized)	240,927	292,327
Income taxes (net of refunds)	(54,282)	(98,883)
SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Utility property contributed by developers	464,196	1,055,699
Utility property acquired with long-term debt	-0-	190,030

SEE ACCOUNTANT'S REVIEW REPORT

The Notes to Financial Statements are an integral part of these statements.

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Business and Significant Accounting Policies

The company provides water and sewer services to certain designated areas in St. Johns County, Florida.

Cash:

Cash includes all cash balances and highly liquid investments with a maturity of three months or less. The company places its temporary cash investments with high credit quality financial institutions. At times such investments may be in excess of the FDIC insurance limit.

Customer Accounts Receivable:

Customers are billed for water and sewer services monthly or quarterly in advance at the minimum rates, plus water and sewer usage charges and service charges applicable for the previous month or quarter. Customer accounts receivable are stated at their face value less an allowance for doubtful accounts.

Utility Plant and Contributions in Aid of Construction:

Utility plant is recorded at original cost. Contributions in aid of construction are recognized when developers contribute utility plant or contribute funds to construct or reimburse for the cost of utility plant. Depreciation is calculated on the straight-line method. Depreciation applicable to contributed utility plant is charged to the contributions in aid of construction account rather than to depreciation expense.

Rate Case and Loan Costs:

Rate case costs are amortized to expense over four years beginning with the period when the new rates go into effect. Loan costs are amortized to expense over the life of the loan.

Investment Credit:

The investment credit permitted by Section 38 of the Internal Revenue Code is accounted for by the deferral method, and is therefore taken into income over the life of the related property.

Accounting Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

SEE ACCOUNTANT'S REVIEW REPORT

NOTES TO FINANCIAL STATEMENTS

Note 1. (Continued)

Derivative Financial Instruments:

The company uses interest rate swap agreements to manage interest rate exposure of specific debt instruments. The differential to be paid or received is accrued as interest rates change and is recognized in interest expense over the life of the agreements.

Note 2. Income Taxes

Income taxes are summarized as follows:

	<u>1999</u>	<u>1998</u>
Current - tax returns	-0-	-0-
Refund - loss carryback claim	-0-	(54,282)
Deferred investment tax credits	(403)	(403)
Deferred income taxes	109,829	83,027
Amortization of contributed income taxes	<u>(75,318)</u>	<u>(75,318)</u>
Provision for income taxes	<u>34,108</u>	<u>(46,976)</u>

Legislation enacted in 1996 repealed the income tax on contributions in aid of construction received after June 12, 1996. The company has no tax basis in contributed property after that date.

The company has a federal alternative minimum tax credit carryover of \$108,273 at August 31, 1999. The company also has a net operating loss carryover of \$562,858 at August 31, 1999.

Deferred income taxes are recognized due to temporary differences between financial statement income and taxable income. Significant temporary differences are as follows:

- (1) Depreciation is calculated by the straight-line method in the financial statements and by accelerated methods in the tax returns.
- (2) Contributions in aid of construction and contributed income taxes are amortized over the life of related utility plant in the financial statements. These contributions were recognized as taxable income when received in the tax returns for all contributions received after 1986 and prior to June 12, 1996. Tax depreciation is allowed on contributed property which was included in taxable income.
- (3) Alternative minimum tax credit carryovers are available to use in future income tax returns.

SEE ACCOUNTANT'S REVIEW REPORT

NOTES TO FINANCIAL STATEMENTS

Note 3. Long-Term Debt

Long-term debt and related current portion consist of the following:

	1999	1998
<p><u>Bank Note Payable</u> - The bank debt was refinanced on November 18, 1997 and provides for additional funds for plant expansion (total loan available of \$4,500,000). The note provides for monthly interest payments at libor plus 1.75% (7.01875% at 8-31-99) and monthly principal payments of \$4,170 for June, 1998 through November, 1998 and \$8,877 for December, 1998. The note was amended and restated in January, 1999 to provide for monthly interest payments and principal payments which vary from \$5,712 to \$12,783 required from February 15, 2000 to December 15, 2003 with maturity on January 15, 2004. The company has an interest rate swap agreement which converts the interest rate to a fixed rate of 7.275% effective January 15, 1999. The note is secured by a mortgage and security agreement on the utility property and is guaranteed by certain stockholders.</p>	3,835,445	1,427,259
<p><u>Developer Notes Payable</u> - The notes were issued to various developers to purchase certain water distribution and sewer collection lines and facilities. The notes provide for monthly interest payments which range from 6.33% to 7.94% and a twenty year amortization of principal which commences after five years or when 80% of the lots within each development are connected.</p>	1,622,490	1,649,303
<p><u>Related Party Developer Note Payable</u> - The note provides for monthly payments of \$5,525 for twenty years which includes principal and interest at 7.94% and matures in 2015.</p>	586,864	605,744
	6,044,799	3,682,306
<p>Less current portion of long-term debt</p>	116,181	136,203
	5,928,618	3,546,103

SEE ACCOUNTANT'S REVIEW REPORT

NOTES TO FINANCIAL STATEMENTS

Note 3. (Continued)

Principal payments on long-term debt in the succeeding five years, based on terms in effect at year end, are due as follows:

Year ending August 31, 2000	116,181
2001	165,848
2002	181,791
2003	196,391
2004	3,527,406
Subsequent Years	<u>1,857,182</u>
	<u>6,044,799</u>

The company had interest expense of \$257,202 net of amount capitalized of \$96,585 for the year ended August 31, 1999. The company had interest expense of \$290,468 without any capitalized interest for the year ended August 31, 1998.

Note 4. Advances from Developers

Certain developers have advanced funds to the company in order to reserve capacity for water and sewer service. These advances are recognized as contributions in aid of construction when the developer requests that connections be made to the company's system.

Note 5. Related Party Transactions

The company has a management agreement with a related party that is a subsidiary of a stockholder. Management fees were \$100,000 in 1999 and \$100,000 in 1998.

The management company also charged Intercoastal \$1,054,081 in 1999 and \$1,099,162 in 1998 for certain operating expenses and \$2,839,727 in 1999 and \$587,919 in 1998 for costs which were capitalized.

The company has a balance payable to the management company included in accounts payable of \$43,389 at August 31, 1999 and \$115,830 at August 31, 1998.

Note 6. Deferred Contributed Income Taxes

The company collected contributed income taxes from developers to reimburse for income taxes on contributions in aid of construction (CIAC). The company amortizes the contributed income taxes over the life of the related CIAC.

Contributed property received after June 12, 1996 is no longer subject to income taxes due to legislation enacted in 1996. Therefore, contributed income taxes will not be collected on contributions after that date.

SEE ACCOUNTANT'S REVIEW REPORT

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NOTES TO FINANCIAL STATEMENTS

Note 7. Rate Case

The company had a limited proceeding rate case which increased its wastewater rates by 40.93% effective November 1, 1998. The percentage increase will be reduced to 37.32% in approximately four years after recovery of rate case expenses. The limited proceeding relates to the wastewater treatment plant expansion which is estimated to cost approximately \$3,075,000. The company intends to file a full rate case within 18 months of the final order, at which time the plant expansion will be in operation.

The St. Johns County Water and Sewer Authority has engaged a consultant to analyze the company's financial statements and rates for the 1998 calendar year reporting period. The final report on the analysis has not been completed.

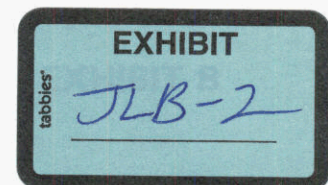
Note 8. Fair Value of Financial Instruments:

All financial instruments are held for purposes other than trading. The estimated fair value of all nonderivative financial instruments approximate their carrying amounts in the balance sheets. The estimated fair value of the interest rate swap agreement was the unrealized gain of \$156,111 at August 31, 1999. The estimated fair value of the interest rate swap agreement was based on a quote obtained from a financial institution that deals in this type of instrument.

SEE ACCOUNTANT'S REVIEW REPORT

**INTERCOASTAL UTILITIES, INC.
PRO-FORMA PROJECTION OF CASH FLOW
COMPILED FROM BURTON EXHIBIT MB-1
YEARS 2000 THROUGH 2005**

	Net Income Before Interest	Depreciation and Amortization	Cash CIAC Collected	Subtotal Cash Flow	Interest	Debt Payments	Net Cash Flow
2000	212,845	353,551	221,053	787,449	(604,884)	(199,411)	(16,846)
2001	354,890	367,209	240,948	963,047	(594,080)	(223,325)	145,642
2002	321,088	521,927	863,270	1,706,285	(1,354,356)	(551,420)	(199,491)
2003	725,575	692,863	886,908	2,305,346	(1,316,155)	(589,257)	399,934
2004	719,544	678,635	912,671	2,310,850	(1,273,219)	(636,656)	400,975
2005	719,064	662,912	940,754	2,322,730	(1,229,438)	(680,437)	412,855
	3,053,006	3,277,097	4,065,604	10,395,707	(6,372,132)	(2,880,506)	1,143,069



Post Office Box 2080
Jacksonville, Florida 32231-0010
904 361-2265



June 1, 2000

H. R. James, President
Intercoastal Utilities, Inc.
6215 Wilson Boulevard
Jacksonville, Florida 32210

Dear Mr. James:

We have considered the plans of Intercoastal Utilities, Inc. to extend its territorial authority for provision of water and wastewater services to approximately 25,00 acres of land situated west of its current service area. Based on our longstanding relationship with the utility's principals, our confidence in Intercoastal's managerial and technical capabilities to perpetuate its operations, this expanded service program appears practical and attainable.

First Union is prepared to assist Intercoastal in bringing this program to fruition; specifically, to favorably consider providing funds for the initial creation and future expansion of the service facilities, at competitive market rates. A firm commitment, on behalf of First Union, would be subject to appropriate regulatory approvals and our satisfaction with updates of necessary financial information as the service planning advances.

As further evidence of First Union's interest in financing such an expansion, we have reviewed the financial statements of six of the approximately 16 shareholders on Intercoastal, who collectively produce a net worth of over \$30 million. In light of this financial capacity, the expertise and in-depth knowledge of the management team and the excellent credit relationship we currently have with Intercoastal Utilities, we feel confident of our ability to provide the necessary financing upon the receipt of the appropriate regulatory approvals and a financial analysis of the expanded service area. Terms would be consistent with the present financing we are providing Intercoastal.

Sincerely,

J. Andrew Hogshead
Vice President

JAH/slb

