Long Island Power Authority, New York; Retail Electric

Primary Credit Analyst:
Jeffrey M Panger, New York (1) 212-438-2076; jeff.panger@standardandpoors.com

Secondary Contact:
David N Bodek, New York (1) 212-438-7969; david.bodek@standardandpoors.com

Table Of Contents

Rationale

Outlook

The Securitization Financing Has Not Reduced Customer Bills

Legislatively Imposed Rate Oversight And A Rate Freeze Could Reduce Financial Flexibility

The Securitization Marginally Help Financial Metrics But Does Not Counter Other Credit Exposures

Whether The Transfer Of Operations To A New Company Will Improve Performance Is Uncertain

Related Criteria And Research
Long Island Power Authority, New York; Retail Electric

Credit Profile

<table>
<thead>
<tr>
<th>Bond Description</th>
<th>Long Term Rating</th>
<th>Unenhanced Rating</th>
<th>Notes</th>
</tr>
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Rationale

Standard & Poor's Ratings Services has assigned its 'A-' rating to the Long Island Power Authority (LIPA), N.Y.'s proposed electric system general revenue bonds, series 2015A. At the same time, Standard & Poor's affirmed its 'A-' rating on the authority's $5.5 billion of unsecuritized bonds. The outlook is negative.

Bond proceeds will refinance variable-rate bonds outstanding, and are floating-rate notes, bearing interest at a spread above the Municipal Market Data Rate, to a maximum of 15%. There are monthly coupon resets and mandatory tenders on any mode change date. In the event of a failed remarketing, the interest rate will be ratcheted to 12%. A failed remarketing does not constitute an event of default, and does not trigger acceleration.

The utility uses its net revenues to pay its direct debt's debt service. As of Sept. 30, 2014, the utility had $5.55 billion of direct debt, excluding the $2 billion of securitization debt the Utility Debt Securitization Authority issued in December 2013 to refinance a portion of the utility's $7 billion of presecuritization debt.

LIPA serves the transmission and distribution needs of a broad and affluent customer base whose residential customers account for slightly more than half of operating revenues. We view this as a credit strength.

We believe these concerns temper the authority's credit strengths:

- Although ostensibly a transmission and distribution utility, LIPA secures its customers' energy and capacity needs under contracts that created substantial fixed financial obligations. Our analysis focuses on fixed charge coverage: we make adjustments that treat LIPA's recurring payments in lieu of taxes (PILOT) as operating expenses and we treat the capacity and lease payments underlying the utility's outsourced generation capacity requirements as having debt service attributes rather than as operating expenses. Fixed charge coverage rose to 1.2x in 2013, but was 1.1x in 2014. These results are generally in line with the 1.1x from 2009-2011 and 1.0x in 2012. We view historical fixed cost coverage levels as thin for the ratings, and meaningfully below direct debt coverage, which was 2.3x in 2014.

- LIPA has voluntarily submitted to the state's request that it freeze its base rates in 2014 and 2015. Although the
utility benefits from pass-through mechanisms for several of its variable operating costs, we believe that freezing base rates could reduce the financial flexibility that we consider important to responding to changing costs and preserving credit quality, particularly as the authority adds debt and offsets some of the securitization’s debt reductions.

- Legislation directed LIPA to file a rate case for review by the New York Department of Public Service (DPS). The rate case is subject to full evidentiary hearings. The requirement to file the rate case distinguishes LIPA from most public power utilities that have autonomous ratemaking authority and the capacity to respond to changes in their business climate expeditiously.
- In January 2015, LIPA filed its rate case, seeking a 2% per year increase in delivery rates for fiscal years 2016-2018. DPS expects to review the case by Sept. 28. The three-year tenor of the rate case’s scope might limit financial flexibility if circumstances change and the utility is reluctant to file or the regulator opposes entertaining another rate case during those years.
- Because LIPA has not filed any rate cases since its 1998 inception, the introduction of regulatory oversight adds uncertainty to the assessment of its credit quality. Regulatory oversight of the utility’s rates will not be tested until the DPS reviews the 2015 rate filing, adding uncertainty to projecting the utility’s financial performance.
- Although the authority’s $2 billion securitization financing reduced direct debt, LIPA projects that customer bills will not be lower as a result because they will include the securitization bonds’ debt service charges. We believe that this could perpetuate customers’ and politicians’ rancor regarding the authority’s rates and constrain financial flexibility.

The business profile score is ‘5’ on a scale of ‘1’ to ‘10’, with one being the strongest score attainable. The business profile reflects our view of LIPA’s untested regulatory oversight and rates that are above average but comparable with those of other regional providers.

The authority is among the three largest public power utilities in the U.S., serving about 1.1 million retail customers. Unlike similar-size peers, LIPA relies on others to supply its customers’ electricity needs. The utility purchases all but a small portion of its electricity from third-parties. LIPA’s owned generation capacity consists of a 234-megawatt, 18% interest in the Nine Mile Point 2 (NM2) nuclear plant, which provides about 8% of energy needs. Constellation Energy Nuclear Group LLC co-owns and operates the plant. Contractual agreements with National Grid USA and other energy providers, as well as market purchases, serve all needs beyond NM2. The authority’s contractual agreement with National Grid extends to 2028, and provides approximately 3,700 megawatts (MW) of capacity. The agreement also allows LIPA to purchase energy from resources other than National Grid’s if they have lower costs, which is important because National Grid’s resources have high production costs. The authority purchases about 2,100 MW of capacity from sources other than National Grid.

LIPA has seven transmission interconnections, (five are underwater and two underground), and these provide connections to PJM, New England and New York. Although interconnections help reduce the authority’s exposure to National Grid’s production costs, the cost of reserving National Grid capacity does not abate when LIPA purchases power from others.
Outlook

The negative outlook reflects our view that although the securitization has reduced direct debt obligations and has, at least marginally, improved debt service coverage and leverage ratios for the unsecuritized debt, the agreement to submit to a rate freeze, the absence of postsecuritization bill reductions, the uncertainties associated with untested regulatory oversight of rates could limit the authority's financial flexibility and erode credit metrics for the unsecuritized debt. Moreover, fixed charge coverage remains thin for the rating. We will monitor the upcoming rate proceedings, capital spending, and financing needs to assess their implications for financial performance and the ratings.

The Securitization Financing Has Not Reduced Customer Bills

In December 2013, LIPA refunded more than one-quarter of its debt through a legislatively directed securitization. The Utility Debt Securitization Authority (UDSA), a special-purpose entity created for the transaction, sold $2.0 billion of bonds that retired a portion of the $7 billion of debt the authority reported as of Dec. 31, 2012. The enabling legislation's stated rationale for a securitization cited the potential for reducing borrowing costs and creating customer savings.

The securitization bonds are not LIPA obligations. Securitization bondholders do not have a claim on the authority's revenues and the unsecuritized revenue bond bondholders do not have a claim on the funds pledged to the securitization bonds. Irrevocable, nonbypassable consumption-based charges secure the securitization bonds.

LIPA's customer bills will include UDSA's debt service requirements. LIPA projects that combining securitization charges with its other charges will maintain bills at current levels and customers will not see savings compared to presecuritization bills.

Average consumer rates are about 20 cents per kilowatt-hour, which we believe are high in absolute terms. Also, Energy Information Administration data show that LIPA's 2013 residential rates were about 10% above the state's average and its commercial rates about 21% higher.

Because customers and politicians already perceived bills as high before the securitization, we view the absence of a postsecuritization rate reduction as potentially perpetuating customers' and politicians' negative views of the utility, which could limit financial flexibility should it need to raise rates.

Legislatively Imposed Rate Oversight And A Rate Freeze Could Reduce Financial Flexibility

Legislative provisions from 2013 impose regulatory oversight of LIPA's ratemaking that, in our view, has the potential to reduce the authority's financial flexibility and affect the rating on the utility.

The legislation directed LIPA to make a rate filing in 2015 for review by the New York DPS in full evidentiary hearings.
The authority filed its rate case Jan. 30, seeking a 2% per year increase in delivery rates covering fiscal years 2016-2018. DPS expects to complete its review by Sept. 28.

The legislation requires full evidentiary hearings for "any [subsequent] rate proposal that would increase … the aggregate revenues of the authority by more than two and one-half percent … on an annual basis." LIPA's board can challenge a DPS rate recommendation, but the legislation requires that it do so only through adversarial hearings in which the board "present[s] the basis for its determination." The authority can challenge the board's rejection of a DPS rate recommendation in court.

Although the utility believes it retains ratemaking authority pending the transition to DPS rate oversight, it acquiesced to the state's request that it agree to submit to a base-rate freeze through 2014, and rates did not change unchanged in 2015.

The authority continues to make monthly adjustments to the power supply charge component of its rates, which we view as preserving an important element of its financial flexibility. During the rate freeze, the question has remained as to whether the utility possesses sufficient financial flexibility to address capital spending needs, additional debt, and inflationary pressures on wages and other costs that it recovers in base rates and are outside the power cost adjustment mechanism. Fiscal 2014 results appear to suggest that LIPA has been able to address these spending needs while maintaining stable financial metrics.

On a positive note for the utility, the legislation limits the annual increases in PILOTs it makes to municipalities to 2% per year. PILOTs rose 43% from 2008 to 2013, reaching $342 million. However, the legislation provides for the utility and its ratepayers to shoulder the costs of DPS oversight which could dilute the PILOT relief.

The Securitization Marginally Help Financial Metrics But Does Not Counter Other Credit Exposures

We believe that financial metrics have historically been only adequate for the rating, with debt-to-capitalization ratios of about 97% in 2010-2012, prior to the securitization, and fixed charge coverage of 1.1x in 2010 and 2011, 1.0x in 2012, 1.2x in 2013, and 1.1x in 2014. LIPA's financing documents provide that PILOTs are post-debt service obligations. However, we view recurring PILOTs as having the attributes of operating expenses. In addition, our coverage analysis treats fixed capacity payments to generation suppliers as debt service rather than operating expenses. However, direct debt service coverage (before transfers and without giving effect to fixed capacity payments) improved to 2.3x in 2014 from 2.0x in 2013.

We have viewed the utility's use of monthly adjustment mechanisms that allowed timely recovery of changes in some variable costs and the service area's demographics as having compensated for thin fixed charge debt service coverage and high leverage. Although direct debt service coverage and leverage ratios improved following the securitization, we will monitor whether rate oversight and debt additions bears this out.

Standard & Poor's generally excludes nonrecurring grant income from its debt service coverage ratio calculation's numerator. However, part of the grant income that LIPA reported on its income statement in recent years principally
represented Federal Emergency Management Agency (FEMA) reimbursements for storm damage repairs that the
authority expensed and U.S. Treasury reimbursements for a portion of gross interest on Build America Bonds.
Therefore, we included the grants in the coverage ratio's numerator. We also added the income statement's recovery
of carrying charges on regulatory assets to the numerator. This money represents collections of debt service on bonds
issued to finance a bill credit that coincided with the authority's inception.

The utility maintains what we view as sound liquidity, with unrestricted cash and investments of $782 million as of
Dec. 31, 2014. The utility also had prefunded about $148 million of the system operator's operating expenses.

Providing additional liquidity is a $500 million revolving credit agreement (RCA) and authorization to issue up to $600
million in commercial paper (CP). At fiscal year-end 2014 (Dec. 31), a $65 million draw on the RCA and $215 million in
CP were outstanding.

In addition to nonsecuritized long-term direct debt, the utility reported $2.4 billion of capital lease obligations on its
balance sheet as of Dec. 31. These obligations are the present value of capacity payment commitments to energy
suppliers. Debt-to-capitalization measures 96%, which we view to be especially high for a distribution utility.

**Whether The Transfer Of Operations To A New Company Will Improve Performance Is Uncertain**

The 2013 LIPA legislation transferred much of the day-to-day oversight of operations to PSEG Long Island, a
subsidiary of New Jersey's Public Service Enterprise Group (PSEG). It remains uncertain whether the transition from
National Grid USA's operational oversight to management by PSEG will improve politicians' and ratepayers' negative
perceptions of high rates. Both National Grid and PSEG are investor-owned companies.

The legislation sets three days as the baseline for restoring service following emergency or storm events. If this goal is
not met, the system operator, PSEG, must provide the DPS with an assessment of its pre-event preparedness and
post-event restoration efforts. As LIPA pursues the storm-hardening measures that the governor and legislators called
for in the wake of 2012's lengthy storm outages, the availability of ratemaking flexibility could be critical to supporting
capital investments and preserving financial metrics. FEMA funding should temper this exposure.

**Related Criteria And Research**

**Related Criteria**
- USPF Criteria: Methodology: Definitions And Related Analytic Practices For Covenant And Payment Provisions In
  U.S. Public Finance Revenue Obligations, Nov. 29, 2011

**Related Research**
- U.S. State And Local Government Credit Conditions Forecast, April 2, 2015

_Ratings Detail (As Of May 12, 2015)_

_WWW.STANDARDANDPOORS.COM/RATINGSDIRECT_
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**Long Island Pwr Auth elec**

**New York St Energy Research & Dev Auth, New York**

Long Island Pwr Auth, New York

New York St Energy Research & Dev Auth (Long Island Pwr Auth)

**Long Term Rating** A-/Negative Affirmed

New York St Energy Research & Dev Auth (Long Island Pwr Auth) (MBIA) (National)

**Unenhanced Rating** A-(SPUR)/Negative Affirmed

**New York St Energy Research & Dev Auth (Long Island Lighting Co Proj) elec**
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Many issues are enhanced by bond insurance.