FITCH RATINGS LONG ISLAND POWER AUTHORITY'S $799M BONDS AT 'A-'; OUTLOOK NEGATIVE

Fitch Ratings-New York-25 November 2014: Fitch Ratings assigns an 'A-' rating to the following senior lien electric system general revenue bonds of the Long Island Power Authority (LIPA):

--Series 2014A, federally tax-exempt, fixed rate bonds;
--Series 2014B, federally taxable, fixed rate bonds;
--Series 2014C, floating rate notes, four-year term;

Additionally, Fitch affirms $4.9 billion of outstanding parity lien electric system general revenue bonds.

The Rating Outlook remains Negative.

LIPA's debt rating takes into account the $2 billion in outstanding securitization bonds, issued by the Utility Debt Securitization Authority (UDSA) in December 2013 to retire a portion of LIPA's existing debt. Revenues collected by LIPA to pay debt service on the securitization bonds (a non-bypassable consumption based surcharge) are not subject to the lien of the general or subordinated general resolutions.

SECURITY

The electric system general revenue bonds are senior lien obligations of LIPA secured by the net revenues of the electric system, prior to payment of subordinate lien obligations.

KEY RATING DRIVERS

OPERATIONS TRANSFORMED BY LEGISLATION: The current rating and Negative Outlook reflect Fitch's concern over the LIPA Reform Act (the Act) enacted in 2013, which broadened the operating responsibilities of the new system-operator (PSEG Long Island) and expanded the rate regulatory oversight of LIPA. Fitch expects the results of the initial three-year base rate proceeding required in 2015 to be instructive toward future financial goals and policies, as well as prospective rate pressures.

SOLID UTILITY FUNDAMENTALS: LIPA's rating reflects solid utility fundamentals including an improved power supply mix, an affluent well-diversified customer base, and approved rate mechanism to stabilize sizeable fuel and purchased power related cash flow. These strengths remain unaffected by the recent legislation and restructuring initiatives.

STORM COST RECOVERY NEARLY COMPLETE: The recovery of Hurricane Sandy damage costs has progressed as expected, and has not materially compromised LIPA's liquidity. LIPA's final storm costs totaled $704 million, of which $579 million has been fully reimbursed by FEMA (90% reimbursement level less amounts to be recovered via insurance and state grants). Operating cash balances are adequate, but remain low for the rating category at $391.7 million, as of Sept. 30, 2014, or roughly 59 days operating cash.

WEAK DEBT METRICS: The authority remains considerably levered with $10.2 billion of debt (including capital leases and securitized bonds) and equity capitalization at just 3.6%. Debt per
customer is elevated at $9,173 for fiscal 2013, compared to the 'A-' peer median of $3,403. Excluding non-recourse securitization bonds, equity capitalization moderately improves.

RATING SENSITIVITIES

ADOPTION OF ROBUST FINANCIAL POLICIES: The adoption of rate-setting and financial policies that are supportive of credit quality consistent with the rating would be viewed positively and could stabilize the Outlook.

RESTRICTIVE REGULATORY AND/OR POLITICAL OVERSIGHT: Any proposed changes to LIPA's business model and/or expanded regulatory oversight that limit the adequacy and timeliness of necessary rate increases would result in a downgrade.

CREDIT PROFILE

LIPA is one of the largest municipal electric distribution systems in the U.S., serving a population base of more than 3 million people located throughout Nassau and Suffolk counties (general obligations' rated 'A'/Stable Outlook for both) and the Rockaways section of Queens in New York City. The service area economy continues to exhibit above average wealth and income levels. LIPA's customer base is well diversified and desirable as residential users account for 52% of revenues.

Operations and management services related to the LIPA transmission and distribution system, which had been provided by a subsidiary of National Grid plc, has shifted to PSEG-LI, a subsidiary of Public Service Enterprise Group (Issuer Default Rating 'BBB+/Outlook Stable). Following a request for proposals, Public Service Enterprise Group (PSEG) was selected as the new system service provider for 12 years, as of Jan. 1, 2014.

RESTRUCTURING LEGISLATION ENACTED

Following Hurricane Sandy and its aftermath, LIPA faced staunch criticism from customers, local politicians and the governor's office regarding the utility's response, and timeliness in restoring power. The intense criticism opened the way for the passage of restructuring legislation in July 2013. The Reform Act was intended to (i) restructure the relationship between LIPA and the system service provider, such that PSEGLI would assume broader control of all utility operations, (ii) establish a new office of the Department of Public Service (DPS) with responsibility to oversee and make recommendations regarding LIPA's rates and operations, (iii) and authorize the sale of securitized bonds that would be used to refinance a portion of LIPA's outstanding debt and lower debt service costs.

Fitch views a number of the restructuring initiatives positively however the broader oversight role of the DPS is a concern. Although the role is intended to be advisory, the nature of the department's advice, and how obligated the LIPA board will feel to implement DPS recommendations, is uncertain at this time.

Under the terms of the Act the DPS is required to review LIPA's rates for 2016-2018, and to review revenue increases that exceed 2.5% after 2018. Concerns about the timeliness of the review process are somewhat mitigated by LIPA's authority to increase revenues prior to the DPS recommendation. LIPA's must submit its initial rate request to the DPS for review by Feb. 1, 2015. The outcome of LIPA's first three-year rate review with the DPS will be a key rating is stabilizing the authority's Outlook.

MAJOR REIMBURSEMENT OF STORM COSTS COMPLETE
LIPA's final total for Superstorm Sandy costs is $704 million, down from initial estimates of $806 million. As of Nov. 17, 2014, the Authority has received its full reimbursement from FEMA of $579 million, more timely receipts than in prior major storms. FEMA has further granted an additional $730 million to LIPA to storm harden the system. These additional funds will be received over the next three years, as LIPA upgrades the system.

LIPA's available liquid resources remain sufficient. The authority arranged for a $500 million three-year working capital line of credit from a syndicate of banks in 2013 to bolster liquidity. LIPA recently added a new $300 million commercial paper program, fully supported by bank credit facilities. The new program is replacing the existing program expiring at the end of January. As of Sept. 30, 2014, LIPA's days operating liquidity was satisfactory at 59 days (or 66 days treating PILOT as below the line operating expense). LIPA is planning on expanding its CP program to a maximum of $625 million in early 2015.

LEVERAGE REMAINS HIGH

Total debt at year end 2013 was $10.2 billion, including the securitization debt and capital lease obligations. Without the securitization debt, total debt falls to $8.2 billion. Year end 2013 ratios for debt per customer ($9,173) and debt-to-total capitalization (96.4%) were well above the medians for 'A-' rated retail systems ($3,403 and 51%, respectively). Excluding securitization debt, the authority's debt-to-capitalization will moderately improve.

LIPA's existing annual debt service will fall by about $16 million (due to interest savings related to the securitization), providing some cushion for the authority to keep base rates flat through 2015 as projected. LIPA's operating expenses will also decline into 2015 due to lower labor, professional and other fees.

The Outlook remains Negative due to LIPA's uncertain post-restructuring rate-setting policy. Also, the effect of the projected costs savings on financial margins remains unclear. Fitch expects greater clarity on these issues in 2015, as the authority submits its three-year rate proposal to the DPS for review.

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In addition to the sources of information identified in Fitch's U.S. Public Power Rating Criteria this action was informed by information from CreditScope.

Applicable Criteria and Related Research:
--'U.S. Public Power Peer Study -- June 2014' (June 13, 2014);
--'U.S. Public Power Peer Study Addendum -- June 2014' (June 13, 2014);
--'U.S. Public Power Rating Criteria' (March 18, 2014).

Applicable Criteria and Related Research:
U.S. Public Power Peer Study -- June 2014
U.S. Public Power Peer Study Addendum - June 2014
U.S. Public Power Rating Criteria

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