

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE CONSOLIDATED RESULTS OF OPERATIONS
FOR THE THREE MONTHS ENDED MARCH 31, 2005**

Consolidated Results of Operations

The accompanying consolidated financial information reflects the operating results of the Authority and LIPA for the three months ended March 31, 2005 and 2004.

Change in Net assets

The Authority generated a net deficit of \$64 million for the three months ended March 31, 2005 compared to a net deficit of \$81 million in 2004.

Revenue

Despite a decrease in sales of approximately 1% when compared to the similar period in 2004, revenue for the three months ended March 31, 2005, increased approximately \$73 million. The increase is attributable to higher recoveries of excess fuel costs totaling approximately \$86 million and load growth and sales mix totaling approximately \$6 million, partially offset by the negative effects of weather estimated to be \$5 million, the migration of commercial customers to LI Choice totaling approximately \$10 (an equivalent amount of fuel costs are also avoided as a result of this migration, thus, there is no impact on earnings), and the impact of having one less day of sales in 2005 as 2004 was a leap year, estimated to be approximately \$4 million.

Fuel and Purchased Power Costs

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment ("FPPCA"). Effective with the Board's mid-February 2004 adoption of the 2004 budget, the FPPCA surcharge was modified to allow LIPA to recover from customers amounts incurred for fuel and purchased power beyond those included in base rates ("Excess Fuel Costs") in the period incurred. As a result of this modification, the FPPCA surcharge is designed to recover a sufficient amount of fuel and purchased power costs to allow the Authority to earn \$20 million of excess revenue over expenses each year. If fuel prices change such that LIPA would exceed or fail to meet that financial target, the surcharge will be reduced or increased accordingly. As a result of continuing increases in fuel and purchased power costs in 2004, the Authority increased the surcharge by an annual rate of 4.5% in February, by an additional annual rate of 5.0% and 1.0% in June and October, respectively.

Due to the mid-February implementation date of the FPPCA surcharge in 2004, LIPA deferred approximately \$37 million of excess fuel costs incurred through March 2004 (which were fully recovered over the remainder of 2004). Such deferral was not necessary in 2005 as the fuel surcharges implemented in 2004 is estimated to be sufficient to allow LIPA to meet its net income target of \$20 million in 2005.

After eliminating the effects of the deferral resulting from the timing of the FPPCA implementation date, fuel and purchased power costs in 2005 increased approximately \$26 million due to increased commodity costs. This increase was mitigated by approximately \$10 million due to the decline in sales.

Operations and maintenance ("O&M")

O&M decreased approximately \$5 million for the three month period March 31, 2005, compared to the similar period in 2004 due primarily to lower MSA costs (resulting from higher capital spending in 2005) totaling approximately \$8 million. This decrease was partially offset by higher Nine Mile Point 2 expenses totaling approximately \$1 million and higher PSA costs totaling approximately \$2 million.

General and administrative

General and administrative expenses increased approximately \$1 million due primarily to costs associated with the strategic assessment to evaluate LIPA's long-term organizational and business options.

Payments in lieu of taxes

Payments in lieu of taxes increased approximately \$4 million due to increased property taxes.

Other Income

Other income decreased approximately \$1 million due primarily as a result of lower emissions credit income.

**Consolidated Statement of Revenues, Expenses and
Changes in Net Assets (Deficit)
(Thousands of Dollars)**

	Three Months Ended March 31,	
	2005 (unaudited)	2004 (unaudited)
Operating revenues - electric sales	\$ 672,207	\$ 599,159
Operating expenses:		
Operations - fuel and purchased power		
Fuel and purchased power costs	352,240	336,166
Recovery of 2003 Excess Fuel Costs	9,165	8,978
Fuel and purchased power expenses - deferral	-	(36,615)
	<u>361,405</u>	<u>308,529</u>
Operations and maintenance	183,215	188,657
General and administrative	10,122	9,345
Depreciation and amortization	58,328	57,035
Payments in lieu of taxes	54,390	50,285
	<u>667,460</u>	<u>613,851</u>
Operating Income	<u>4,747</u>	<u>(14,692)</u>
Nonoperating revenues and expenses:		
Other income, net		
Investment income	2,908	1,946
Carrying charges on regulatory asset	8,047	7,765
Other	816	3,651
Total other income, net	<u>11,771</u>	<u>13,362</u>
Change in net assets before interest charges and (credits)	<u>16,518</u>	<u>(1,330)</u>
Interest charges and (credits):		
Interest on long-term debt, net	75,989	74,032
Other interest	5,231	6,252
Allowance for borrowed funds used during construction	(421)	(990)
Total interest charges	<u>80,799</u>	<u>79,294</u>
Change in net assets	(64,281)	(80,624)
Net (deficit) assets		
Total net assets, beginning of year	<u>31,620</u>	<u>11,620</u>
Total net (deficit) assets, end of period	<u>\$ (32,661)</u>	<u>\$ (69,004)</u>

Consolidated Balance Sheet
(Thousands of Dollars)

	March 31, 2005 (unaudited)	December 31, 2004 (audited)
Current assets:		
Cash and cash equivalents	\$ 402,747	\$ 335,068
Investments	44,914	77,900
Accounts receivable (less allowance for doubtful accounts of \$19,485 and \$19,635, respectively)	248,383	274,184
Other accounts receivable	9,618	11,344
Fuel inventory	85,774	66,948
Material and supplies inventory	7,214	7,128
Interest receivable	242	300
Prepayments and other current assets	9,793	9,732
Total Current Assets	808,685	782,604
Noncurrent assets:		
Utility plant and property and equipment, net	3,543,094	3,540,103
Promissory Notes Receivable-KeySpan Energy	155,425	155,425
Nonutility Property and Other Investments	273,478	120,213
Deferred loss - financial derivatives	80,088	86,177
Deferred Charges	90,766	93,972
Regulatory Assets		
Shoreham settlement	571,993	572,101
Fuel and purchased power costs	139,693	304,256
Total Regulatory Assets	711,686	876,357
Acquisition Adjustment (net of accumulated amortization of \$931,061 and \$902,891, respectively)	3,164,450	3,192,620
Total assets	\$ 8,827,672	\$ 8,847,471
Current liabilities:		
Short-term debt	\$ 100,000	\$ 100,000
Current maturities of long-term debt	193,630	193,630
Current portion of capital lease obligation	89,249	89,552
Accounts payable and accrued expenses	314,371	275,054
Accrued payments in lieu of taxes	22,125	38,082
Accrued interest	78,337	44,465
Customer deposits	24,860	24,721
Total current liabilities	822,572	765,504
Noncurrent liabilities:		
Long-term debt	6,871,614	6,865,277
Capital lease obligation	762,701	772,800
Asset retirement obligation	69,344	68,320
Deferred credits	86,371	85,323
Deferred credits - financial derivatives	220,532	228,126
Deferred gain - financial derivatives	7,448	10,410
Claims, damages and storm reserves	19,751	20,091
Total noncurrent liabilities	8,037,761	8,050,347
Net assets		
Total net (deficit) assets	(32,661)	31,620
Total liabilities and net (deficit) assets	\$ 8,827,672	\$ 8,847,471

**Statement of Cash Flows
(Thousands of Dollars)**

**Three Months
Ended
March 31,**

	2005 (unaudited)	2004 (unaudited)
Cash flows from operating activities:		
Received from customers for the system sales, net of refunds	\$ 715,356	\$ 640,219
Other operating revenues received	5,363	2,939
Paid to suppliers and employees		
Operations and maintenance	(214,123)	(213,756)
Fuel and purchased power	(352,695)	(350,444)
Payments in lieu of taxes	(91,031)	(94,147)
Margin calls on fuel derivative transactions, net	51,356	-
Net cash provided by (used in) operating activities	<u>114,226</u>	<u>(15,189)</u>
Investing activities:		
Net purchases (sales) of investment securities	32,986	7,222
Earnings received on investments	2,373	1,512
Other	1,531	3,311
Net cash provided by investing activities	<u>36,890</u>	<u>12,045</u>
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(44,593)	(44,660)
Proceeds from the issuance of bonds, net of issuance costs	-	100,000
Interest paid, net	(38,844)	(32,282)
Net cash (used in) provided by capital and related financing activities	<u>(83,437)</u>	<u>23,058</u>
Net increase in cash and cash equivalents	67,679	19,914
Cash and cash equivalents at beginning of period	335,068	219,095
Cash and cash equivalents at end of period	<u>\$ 402,747</u>	<u>\$ 239,009</u>
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 4,747	\$ (14,692)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	58,328	57,035
Nuclear fuel burned	1,462	949
Shoreham surcharge recovery (credits)	8,155	8,339
Provision for claims and damages	1,788	1,749
Accretion of asset retirement obligation	1,024	967
Other	2,177	(1,692)
Changes in operating assets and liabilities:		
Accounts receivable, net	27,527	20,446
Fuel and Material & supplies inventory	(18,912)	(4,556)
Fuel and purchased power costs recovered related to prior periods	9,165	8,978
Excess fuel and purchased power costs deferred	-	(36,615)
Accounts payable and accrued expenses	18,765	(56,097)
Net cash provided by (used in) operating activities	<u>\$ 114,226</u>	<u>\$ (15,189)</u>