

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE CONSOLIDATED RESULTS OF OPERATIONS
FOR THE SIX MONTHS ENDED JUNE 30, 2005**

Consolidated Results of Operations

The accompanying consolidated financial information reflects the operating results of the Authority and LIPA for the six months ended June 30, 2005 and 2004.

Change in Net assets

The Authority generated a net deficit of \$107 million for the six months ended June 30, 2005 compared to a net deficit of \$78 million in 2004.

Revenue

Despite a decrease in sales of approximately 1% when compared to the similar period in 2004, revenue for the six months ended June 30, 2005, increased approximately \$136 million. The increase is attributable to higher recoveries of excess fuel costs totaling approximately \$162 million and load growth and sales mix totaling approximately \$10 million, partially offset by the negative effects of weather estimated to be \$11 million, the migration of commercial customers to LI Choice totaling approximately \$21 (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 \$5 million. Other miscellaneous revenue also increased approximately \$1 million over the similar period last year.

Fuel and Purchased Power Costs

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment (“FPPCA”). The FPPCA surcharge was modified by the Board in 2004 to allow LIPA to recover in the period incurred fuel and purchased power costs beyond those included in base rates (“Excess Fuel Costs”). 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, the Authority increased the surcharge in 2004 by an annual rate of 4.5% in February, and 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 \$58 million of excess fuel costs incurred through June 2004 (which were fully recovered over the remainder of 2004). Through June 2005, no such deferrals were recorded. In 2005, the Authority increased the surcharge by 1.9% annually, effective June 8, 2005, to ensure reaching the \$20 million net income target.

After eliminating the effects of the deferral resulting from the timing of the FPPCA implementation date, fuel and purchased power costs for the first six months of 2005 increased approximately \$98 million as compared to the same period in 2004. This increase is primarily attributable to increased commodity costs totaling \$80 million partially offset by a period over period decline in sales totaling approximately \$18 million. In addition, in 2004, fuel and purchased power costs included a one-time credit of \$36 million.

Operations and maintenance ("O&M")

O&M decreased approximately \$7 million for the six month period June 30, 2005, compared to the similar period in 2004 due primarily to lower MSA costs (resulting primarily from higher capital spending in 2005) totaling approximately \$10 million, the absence of any 2005 costs associated with renting temporary emergency stand-by generators whereas in 2004 LIPA incurred approximately \$5 million through June 30, 2005 and, in 2004, LIPA incurred the cost of \$2 million related to the settlement of the Cross Sound Cable dispute.

These decreases were partially offset by higher PSA costs totaling approximately \$8 million (due primarily to agreed upon increased capacity charges totaling \$4 million and the 2004 Utility Plant true-up totaling approximately \$4 million) and higher clean energy expenses totaling approximately \$2 million.

General and administrative

General and administrative expenses increased approximately \$5 million due to the timing of costs associated with the strategic assessment to evaluate LIPA's long-term organizational and business options, other various consulting costs and increased salary and benefit expenses.

Depreciation and amortization

Depreciation and amortization increased approximately \$3 million due to higher utility plant balances in 2005 when compared to 2004.

Payments in lieu of taxes

Payments in lieu of taxes increased approximately \$7 million due to increased property and school taxes.

Other income

Other income increased approximately \$4 million due primarily to higher earnings on investment balances.

Interest charges

Interest charges increased approximately \$7 million due to increased interest expense on long term debt due primarily to higher interest rates on variable rate debt combined with slightly higher average debt balances outstanding in 2005 when compared to 2004.

Consolidated Balance Sheet
(Thousands of Dollars)

	June 30, 2005 (unaudited)	December 31, 2004 (audited)
Current assets:		
Cash and cash equivalents	\$ 430,533	\$ 335,068
Investments	14,983	77,900
Accounts receivable (less allowance for doubtful accounts of \$19,485 and \$19,635, respectively)	263,017	274,184
Other accounts receivable	14,040	11,344
Fuel inventory	66,485	66,948
Material and supplies inventory	7,362	7,128
Interest receivable	307	300
Prepayments and other current assets	23,522	9,732
Total Current Assets	820,249	782,604
Noncurrent assets:		
Utility plant and property and equipment, net	3,569,508	3,540,103
Promissory Notes Receivable-KeySpan Energy	155,425	155,425
Nonutility Property and Other Investments	286,462	120,213
Deferred loss - financial derivatives	141,197	86,177
Deferred Charges	87,805	93,972
Regulatory Assets		
Shoreham settlement	572,486	572,101
Fuel and purchased power costs	101,797	304,256
Total Regulatory Assets	674,283	876,357
Acquisition Adjustment (net of accumulated amortization of \$959,232 and \$902,891, respectively)	3,136,279	3,192,620
Total assets	\$ 8,871,208	\$ 8,847,471
Current liabilities:		
Short-term debt	\$ 150,000	\$ 100,000
Current maturities of long-term debt	207,355	193,630
Current portion of capital lease obligation	91,645	89,552
Accounts payable and accrued expenses	307,174	275,054
Accrued payments in lieu of taxes	19,694	38,082
Accrued interest	43,730	44,465
Counterparty collateral	106,600	-
Customer deposits	24,851	24,721
Total current liabilities	951,049	765,504
Noncurrent liabilities:		
Long-term debt	6,779,735	6,865,277
Capital lease obligation	749,701	772,800
Asset retirement obligation	70,369	68,320
Deferred credits	86,104	85,323
Deferred credits - financial derivatives	280,138	228,126
Deferred gain - financial derivatives	10,221	10,410
Claims, damages and storm reserves	19,103	20,091
Total noncurrent liabilities	7,995,371	8,050,347
Total net (deficit) assets	(75,212)	31,620
Total liabilities and net (deficit) assets	\$ 8,871,208	\$ 8,847,471

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

	Six Months Ended June 30,	
	2005 (unaudited)	2004 (unaudited)
Operating revenues - electric sales	\$ 1,366,844	\$ 1,230,622
Operating expenses:		
Operations - fuel and purchased power		
Fuel and purchased power costs	714,816	616,431
Recovery of 2003 Excess Fuel Costs	17,429	17,768
Fuel and purchased power expenses - deferral	-	(58,046)
	732,245	576,153
Operations and maintenance	358,979	366,381
General and administrative	22,140	17,336
Depreciation and amortization	116,975	114,285
Payments in lieu of taxes	108,026	101,394
Total Operating Expenses	1,338,365	1,175,549
Operating Income	28,479	55,073
Nonoperating revenues and expenses:		
Other income, net		
Investment income	6,346	3,228
Carrying charges on regulatory asset	16,114	15,601
Other	7,558	7,345
Total other income, net	30,018	26,174
Change in net assets before interest charges and (credits)	58,497	81,247
Interest charges and (credits):		
Interest on long-term debt, net	156,544	148,264
Other interest	9,693	11,466
Allowance for borrowed funds used during construction	(908)	(911)
Total interest charges	165,329	158,819
Change in net assets	(106,832)	(77,572)
Net (deficit) assets		
Total net assets, beginning of year	31,620	11,620
Total net (deficit) assets, end of period	\$ (75,212)	\$ (65,952)

Statement of Cash Flows
(Thousands of Dollars)

Six Months
Ended
June 30,

	2005	2004
	(unaudited)	(unaudited)
Cash flows from operating activities:		
Received from customers for the system sales, net of refunds	\$ 1,408,624	\$ 1,251,334
Other operating revenues received	11,838	8,057
Paid to suppliers and employees		
Operations and maintenance	(404,814)	(414,323)
Fuel and purchased power	(648,657)	(659,723)
Payments in lieu of taxes	(168,548)	(167,789)
Margin calls on fuel derivative transactions, net	106,600	-
Net cash provided by (used in) operating activities	305,043	17,556
Investing activities:		
Net purchases (sales) of investment securities		56,946
Earnings received on investments	5,350	2,453
Other	2,309	6,452
Net cash provided by investing activities	7,659	65,851
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(93,252)	(102,517)
Swaption proceeds	-	35,000
Proceeds from the issuance of commercial paper	50,000	100,000
Interest paid, net	(153,102)	(144,547)
Redemption of long-term debt	(83,800)	(97,915)
Net cash (used in) provided by capital and related financing activities	(280,154)	(209,979)
Net increase (decrease) in cash and cash equivalents	32,548	(126,572)
Cash and cash equivalents at beginning of period	335,068	219,095
Cash and cash equivalents at end of period	\$ 367,616	\$ 92,523
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 28,479	\$ 55,073
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	116,975	114,285
Nuclear fuel burned	2,933	2,538
Shoreham surcharge recovery (credits)	15,729	16,047
Provision for claims and damages	3,575	3,500
Accretion of asset retirement obligation	2,049	1,934
Other	2,874	(39,275)
Changes in operating assets and liabilities:		
Accounts receivable, net	8,621	(12,505)
Fuel and Material & supplies inventory	229	(10,859)
Fuel and purchased power costs recovered related to prior periods	17,429	17,768
Excess fuel and purchased power costs deferred	-	(58,046)
Counterparty collateral	106,600	-
Accounts payable and accrued expenses	(450)	(72,904)
Net cash provided by (used in) operating activities	\$ 305,043	\$ 17,556