

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE CONSOLIDATED RESULTS OF OPERATIONS
FOR THE SIX MONTHS ENDED JUNE 30, 2006**

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, 2006 and 2005.

Change in Net assets

The Authority generated revenue over expenses of \$107 million for the six months ended June 30, 2006 compared with expenses over revenue of \$107 million for the six months ended 2005.

Revenue

Revenue for the six months ended June 30, 2006, increased approximately \$289 million. The increase is attributable to higher recoveries of excess fuel costs totaling approximately \$295 million, higher average pricing of approximately \$12 million, offset by decreased load and sales mix totaling approximately \$4 million and the negative effects of weather estimated to be \$14 million.

Fuel and Purchased Power Costs

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment ("FPPCA"). The FPPCA was modified in 2003 by the Board 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 was designed to recover a sufficient amount of Excess Fuel Costs to allow the Authority to earn \$20 million of excess revenue over expenses each year as a reserve. If fuel prices change such that LIPA would exceed or fail to meet that financial target, the FPPCA would be reduced or increased accordingly. As a result of continuing increases in fuel and purchased power costs, the Authority increased the FPPCA in 2005 1.9% annually, effective June 8, and an additional 5.5% annually, effective October 8. In December 2005 the Authority proposed a modification to the FPPCA to allow the Authority to achieve \$75 million of excess revenue over expenses each year with a variance of \$50 million above or below such amount in each year. This modification was approved by the Board of Trustees in April 2006 after public hearings held in March and April regarding this modification. Also in connection with the adoption of the 2006 Operating Budget in December 2005, the Authority decreased the FPPCA by 1% annually effective January 1, 2006.

Fuel and purchased power costs for the six months ended June 30, 2006, increased approximately \$79 million as compared to the same period in 2005. This increase is primarily attributable to increased commodity costs totaling \$91 million partially offset by lower sales volumes totaling approximately \$12 million.

Operations and maintenance

Operations and maintenance decreased approximately \$6 million due to lower MSA expenses totaling approximately \$26 million, due in part to the newly negotiated annual fee, which through June contributed approximately \$8 million to this decrease. The remaining change is due to the timing and type of work performed under the agreement. This decrease was partially offset by increased PSA capacity costs totaling \$9 million, higher storm cost accruals totaling approximately \$6 million, higher clean energy expenses totaling approximately \$2 million and higher bad debt expense totaling approximately \$3 million.

General and administrative

General and administrative expenses decreased approximately \$1 million due to lower consulting costs, primarily as a result of costs incurred in 2005 related to the strategic assessment to evaluate LIPA's long-term organizational and business options.

Depreciation and amortization

Depreciation and amortization increased approximately \$4 million due to higher utility plant balances in 2006 when compared to 2005.

Payments in lieu of taxes

Payments in lieu of taxes increased approximately \$2 million due primarily to increased revenue taxes (due to higher fuel cost recoveries).

Other income

Other income increased approximately \$4 million due primarily to higher earnings of approximately \$5 million on investment balances offset by lower sales of emissions credits totaling approximately \$1 million.

Interest charges

Interest charges increased approximately \$1 million due primarily to higher rates on variable rate debt.

Other Significant Events

I. 2006 Financing

In March 2006, the Authority issued Series 2006A Electric System General Revenue Bonds, totaling approximately \$853 million to refund approximately \$844 million par value of Series 1998 bonds. This refunding produced approximately \$49 million net present value savings. The 2006A bonds have an average life of 16.5 years and an all in cost of 4.6%. The Authority also issued Series 2006B Electric System General Revenue Bonds, totaling approximately \$97 million to reimburse LIPA's treasury for or to fund capital expenditures for system improvements. The 2006B bonds have an average life of 29 years and an all in cost of 4.8%.

In July 2006, the Authority issued Series 2006 C Electric System General Revenue Bonds, totaling approximately \$198 million to reimburse LIPA's treasury for or to fund capital expenditures for system improvements. The Series 2006 C bonds have an average life of 29 years and an all-in cost of approximately 4.9%. The Authority also issued Series 2006 D Electric System General Revenue Bonds totaling approximately \$335 million to refund approximately \$328 million of existing Authority debt including portions of Series 1998A, Series 1998B, Series 2001A and Series 2003C Bonds. The refunding will produce debt service savings of approximately \$11.6 million on a net present value basis. The average life of the Series 2006 D Bonds is approximately 11 years with an all-in cost of approximately 4.5.

II. Voluntary filing with New York State Public Service Commission (PSC)

On May 3, 2006, the Authority voluntarily filed two petitions seeking PSC review of LIPA's FPPCA surcharge including the appropriateness of its charges to customers and seeking a confirmation that LIPA is treating fuel and purchased power costs properly and similar to other New York electric companies. The first petition sought a declaratory ruling regarding the PSC's interpretation of its rule on escalation clauses, that the PSC allows utilities to automatically recover increased fuel and purchased power and other costs through escalation clauses. The second petition asked the PSC to confirm the appropriateness of the actual costs that LIPA recovers through its fuel and purchased power cost adjustment clause. With respect to the first petition, the PSC, on June 20, 2006, issued a Declaratory Ruling which confirmed that the PSC permits the use of adjustment clauses to allow utilities to adjust their rates to reflect changes in fuel and other costs. With respect to the second petition, the PSC issued an Order declining the Authority's request that it review the appropriateness of LIPA's recovery of fuel and purchased power costs through the FPPCA. The PSC noted that LIPA is not subject to PSC jurisdiction except in very limited circumstances unrelated to ratemaking, and LIPA's rates, services and practices are not governed by, and need not comply with, the provisions of the Public Service Law and the PSC's regulations. In a separate letter to the Authority, the Chairman of the PSC offered technical assistance to the Authority in procuring and overseeing an independent consultant to perform a review of the FPPCA, should the Authority choose to pursue that option. The Authority expects to work with the Department of Public Service to retain an independent consultant to conduct such a review.

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

	Six Months Ended June 30,	
	2006 (unaudited)	2005 (unaudited)
Operating revenues - electric sales	\$ 1,655,532	\$ 1,366,844
Operating expenses:		
Operations - fuel and purchased power		
Fuel and purchased power costs	794,631	714,816
Recovery of 2003 Excess Fuel Costs	16,736	17,429
	<u>811,367</u>	<u>732,245</u>
Operations and maintenance	352,761	358,979
General and administrative	20,840	22,140
Depreciation and amortization	121,315	116,975
Payments in lieu of taxes	110,469	108,026
Total Operating Expenses	<u>1,416,752</u>	<u>1,338,365</u>
Operating Income	<u>238,780</u>	<u>28,479</u>
 Nonoperating revenues and expenses:		
Other income, net		
Investment income	11,686	6,346
Carrying charges on regulatory asset	16,310	16,114
Other	5,896	7,558
Total other income, net	<u>33,892</u>	<u>30,018</u>
 Change in net assets before interest charges and (credits)	 <u>272,672</u>	 <u>58,497</u>
 Interest charges and (credits):		
Interest on long-term debt, net	157,979	156,544
Other interest	10,551	9,693
Allowance for borrowed funds used during construction	(2,377)	(908)
Total interest charges	<u>166,153</u>	<u>165,329</u>
 Change in net assets	 106,519	 (106,832)
 Net assets		
Total net assets, beginning of year	<u>51,620</u>	<u>31,620</u>
Total net assets (deficit), end of period	<u>\$ 158,139</u>	<u>\$ (75,212)</u>

Consolidated Balance Sheet
(Thousands of Dollars)

	June 30, 2006 (unaudited)	December 31, 2005 (audited)
Current assets:		
Cash and cash equivalents	\$ 372,530	\$ 454,414
Investments	29,518	16,466
Accounts receivable (less allowance for doubtful accounts of \$19,485)	292,436	343,673
Other accounts receivable	13,785	23,902
Fuel inventory	134,982	104,652
Material and supplies inventory	6,963	7,365
Interest receivable	416	153
Prepayments and other current assets	39,609	21,273
Total Current Assets	890,239	971,898
Noncurrent assets:		
Utility plant and property and equipment, net	4,037,929	4,004,646
Promissory Notes Receivable-KeySpan Energy	155,425	155,425
Nonutility Property and Other Investments	281,262	464,334
Deferred loss - financial derivatives	15,062	88,778
Deferred Charges	89,573	85,050
Regulatory Assets		
Shoreham settlement	569,012	568,316
Fuel and purchased power costs	274,460	291,197
Total Regulatory Assets	843,472	859,513
Acquisition Adjustment (net of accumulated amortization of \$1,071,912 and \$1,015,572, respectively)	3,023,599	3,079,939
Total assets	\$ 9,336,561	\$ 9,709,583
Current liabilities:		
Short-term debt	\$ 100,000	\$ 100,000
Current maturities of long-term debt	304,430	202,325
Current portion of capital lease obligation	121,830	121,813
Accounts payable and accrued expenses	267,421	332,008
Accrued payments in lieu of taxes	29,398	43,552
Accrued interest	43,872	44,780
Counterparty collateral	59,404	232,424
Customer deposits	23,796	23,224
Total current liabilities	950,151	1,100,126
Noncurrent liabilities:		
Long-term debt	6,642,742	6,686,136
Capital lease obligation	1,070,649	1,097,055
Asset retirement obligation	82,684	81,463
Deferred credits	72,606	68,601
Deferred credits - financial derivatives	137,842	222,996
Deferred gain - financial derivatives	11,877	6,339
Regulatory liability-fuel derivatives	187,874	368,666
Claims, damages and storm reserves	21,997	26,581
Total noncurrent liabilities	8,228,271	8,557,837
Net assets		
Invested in capital assets net of related debt	(539,744)	(475,991)
Unrestricted	697,883	527,611
Total net assets	158,139	51,620
Total liabilities and net assets	5 \$ 9,336,561	\$ 9,709,583

Statement of Cash Flows
(Thousands of Dollars)

Six Months
Ended
June 30,

	2006 (unaudited)	2005 (unaudited)
Cash flows from operating activities:		
Received from customers for the system sales, net of refunds	\$ 1,723,477	\$ 1,408,624
Other operating revenues received	22,595	11,838
Paid to suppliers and employees		
Operations and maintenance	(419,469)	(404,814)
Fuel and purchased power	(820,299)	(648,657)
Payments in lieu of taxes	(175,540)	(168,548)
Margin calls on fuel derivative transactions, net	(173,020)	106,600
Net cash provided by operating activities	157,744	305,043
Investing activities:		
Net (purchases) sale of investment securities	(13,052)	62,917
Earnings received on investments	10,825	5,350
Other	5,085	2,309
Net cash provided by investing activities	2,858	70,576
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(125,871)	(93,252)
Proceeds from the issuance of commercial paper notes and bonds	1,019,544	50,000
Bond issuance costs	(12,498)	-
Interest paid, net	(145,027)	(153,102)
Redemption of long-term debt	(978,634)	(83,800)
Net cash used in capital and related financing activities	(242,486)	(280,154)
Net (decrease) increase in cash and cash equivalents	(81,884)	95,465
Cash and cash equivalents at beginning of period	454,414	335,068
Cash and cash equivalents at end of period	\$ 372,530	\$ 430,533
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 238,780	\$ 28,479
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	121,315	116,975
Nuclear fuel burned	2,511	2,933
Shoreham surcharge recovery (credits)	15,614	15,729
Provision for claims and damages	9,126	3,575
Accretion of asset retirement obligation	2,312	2,049
Other	2,169	2,874
Changes in operating assets and liabilities:		
Accounts receivable, net	61,354	8,621
Fuel and Material & supplies inventory	(29,928)	229
Fuel and purchased power costs recovered related to prior periods	16,736	17,429
Counterparty collateral	(173,020)	106,600
Accounts payable and accrued expenses	(109,225)	(450)
Net cash provided by operating activities	\$ 157,744	\$ 305,043