

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE CONSOLIDATED RESULTS OF OPERATIONS
FOR THE SIX MONTHS ENDED JUNE 30, 2007**

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, 2007 and 2006.

Change in Net Assets

The Authority generated revenue over expenses of approximately \$5 million for the six months ended June 30, 2007 and compared with approximately \$107 million for the six months ended June 30, 2006.

Revenue

Revenue for the six months ended June 30, 2007, decreased approximately \$46 million when compared to the similar period of 2006. The decrease is attributable to lower recoveries of power supply costs (discussed below) totaling approximately \$85 million, partially offset by the positive effects of weather estimated to be \$14 million, increased load growth totaling approximately \$18 million and higher average pricing totaling approximately \$7 million.

Fuel and Purchased Power Costs

LIPA's tariff includes a fuel recovery provision—the Fuel and Purchased Power Cost Adjustment ("FPPCA") that provides for the recovery of fuel and purchased power costs in the period incurred, in amounts sufficient to allow the Authority to earn a financial target of \$75 million with a variance of \$50 million above or below such amount in each year. Should fuel and purchased power prices change such that LIPA would exceed or fail to meet its financial target, the FPPCA would be reduced or increased accordingly. In no event, however, can LIPA recover an amount that exceeds its fuel and purchased power costs incurred.

As a result of lower than anticipated fuel and purchased power costs, the Authority decreased the FPPCA in January 2006 by \$24 million annually. In October 2006, the FPPCA was decreased by an additional \$161 million annual amount followed by an additional \$71 million annual reduction in February 2007.

Fuel and purchased power costs for the six months ended June 30, 2007, increased approximately \$56 million as compared to the same period in 2006. This increase was due to higher commodity costs totaling approximately \$89 million and higher sales volumes totaling approximately \$23 million. This increase was partially offset by the net change in the regulatory liability related to fuel cost recovery totaling approximately \$56 million as the Authority returned approximately \$90 million from the 2006 deferral, offset by the recognition of a regulatory liability of approximately \$34 million for 2007 fuel cost recovery.

Operations and Maintenance

Operations and maintenance expense increased \$13 million due primarily to increased storm accruals totaling approximately \$4 million, increased clean energy expenses totaling \$3 million, increased PSA costs totaling approximately \$4 million and a litigation settlement paid during 2007 totaling \$2 million.

General and administrative

General and administrative expenses decreased approximately \$2 million due to an insurance reimbursement of legal fees.

Depreciation and Amortization

Depreciation and amortization increased approximately \$1 million due to increased depreciation expense as a result of higher utility plant balances in 2007 when compared to 2006.

Other Income

Other income increased approximately \$7 million due to higher investment earnings resulting from higher investment balances coupled with higher interest rates.

Interest Charges

Total interest charges decreased approximately \$7 million due primarily to the lack of counterparty collateral held by LIPA on its fuel derivatives in 2007 and higher allowance for borrowed funds used during construction.

Other Significant Events

In 2006, LIPA entered into a 20 year agreement with, Neptune Regional Transmission System, LLC to purchase 660 MW of capacity over an undersea high voltage cable running between Sayerville, NJ and Levittown, NY. The cable was declared commercially operational on June 29, 2007, and capitalized in accordance with SFAS No. 13, Accounting for Leases.

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

	Six Months Ended June 30,	
	2007 (unaudited)	2006 (unaudited)
Operating revenues - electric sales	\$ 1,609,324	\$ 1,655,532
Operating expenses:		
Operations - fuel and purchased power		
Fuel and purchased power costs	941,511	900,913
Recovery of 2003 Excess Fuel Costs	17,192	16,736
Refund of 2006 Excess Recovery of Fuel Costs	(90,888)	-
	<u>867,815</u>	<u>917,649</u>
Operations and maintenance	366,029	352,761
General and administrative	18,376	20,840
Depreciation and amortization	122,630	121,315
Payments in lieu of taxes	110,840	110,469
	<u>1,485,690</u>	<u>1,523,034</u>
Total Operating Expenses	<u>1,485,690</u>	<u>1,523,034</u>
Operating Income	<u>123,634</u>	<u>132,498</u>
Nonoperating revenues and expenses:		
Other income, net		
Investment income	18,853	11,686
Carrying charges on regulatory asset	16,196	16,310
Other	6,080	5,896
Total other income, net	<u>41,129</u>	<u>33,892</u>
Change in net assets before interest charges and (credits)	<u>164,763</u>	<u>166,390</u>
Interest charges and (credits):		
Interest on long-term debt, net	157,478	157,979
Other interest	6,385	10,551
Allowance for borrowed funds used during construction	(4,332)	(2,377)
Total interest charges	<u>159,531</u>	<u>166,153</u>
Change in net assets	5,232	237
Net assets		
Total net assets, beginning of year	<u>169,790</u>	<u>51,620</u>
Total net assets, end of period	<u>\$ 175,022</u>	<u>\$ 51,857</u>

Consolidated Balance Sheet
(Thousands of Dollars)

	June 30, 2007 (unaudited)	December 31, 2006 (audited)
Current assets:		
Cash and cash equivalents	\$ 400,064	\$ 501,244
Investments	142,111	208,755
Accounts receivable (less allowance for doubtful accounts of \$19,485)	264,412	269,477
Other accounts receivable	12,198	9,615
Fuel inventory	135,998	138,175
Material and supplies inventory	6,808	6,871
Interest receivable	508	460
Prepayments and other current assets	31,575	27,400
Total Current Assets	<u>993,674</u>	<u>1,161,997</u>
Noncurrent assets:		
Utility plant and property and equipment, net	5,301,653	4,118,775
Promissory Notes Receivable-KeySpan Energy	155,425	155,425
Nonutility Property and Other Investments	124,878	69,129
Deferred loss - financial derivatives	9,520	46,187
Deferred Charges	<u>86,036</u>	<u>89,643</u>
Regulatory Assets		
Shoreham settlement	566,004	565,392
Fuel and purchased power costs	<u>238,058</u>	<u>295,928</u>
Total Regulatory Assets	<u>804,062</u>	<u>861,320</u>
Acquisition Adjustment (net of accumulated amortization of \$1,184,593 and \$1,128,253 respectively)	<u>2,910,918</u>	<u>2,967,258</u>
Total assets	<u>\$ 10,386,166</u>	<u>\$ 9,469,734</u>
Current liabilities:		
Short-term debt	\$ 100,000	\$ 100,000
Current maturities of long-term debt	249,735	218,605
Current portion of capital lease obligation	202,558	121,380
Accounts payable and accrued expenses	328,562	286,738
Regulatory liability-fuel and purchased power costs	196,130	197,918
Accrued payments in lieu of taxes	15,175	43,462
Accrued interest	45,049	42,771
Customer deposits	<u>26,271</u>	<u>25,137</u>
Total current liabilities	<u>1,163,480</u>	<u>1,036,011</u>
Noncurrent liabilities:		
Long-term debt	6,651,687	6,806,290
Capital lease obligation	2,062,194	1,044,240
Asset retirement obligation	90,002	85,086
Deferred credits	76,042	74,367
Deferred credits - derivatives	117,036	209,973
Deferred gain - derivatives	22,910	12,338
Claims, damages and storm reserves	<u>27,793</u>	<u>31,639</u>
Total noncurrent liabilities	<u>9,047,664</u>	<u>8,263,933</u>
Net assets		
Invested in capital assets net of related debt	(271,615)	(417,837)
Unrestricted	<u>446,637</u>	<u>587,627</u>
Total net assets	<u>175,022</u>	<u>169,790</u>
Total liabilities and net assets	<u>\$ 10,386,166</u>	<u>\$ 9,469,734</u>

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

	Six Months Ended June 30,	
	2007 (unaudited)	2006 (unaudited)
Cash flows from operating activities:		
Received from customers for the system sales, net of refunds	\$ 1,636,560	\$ 1,723,477
Other operating revenues received	19,716	22,595
Paid to suppliers and employees		
Operations and maintenance	(386,860)	(419,469)
Fuel and purchased power	(833,111)	(820,299)
Payments in lieu of taxes	(193,777)	(175,540)
Margin calls on fuel derivative transactions, net	-	(173,020)
Net cash provided by operating activities	242,528	157,744
Investing activities:		
Net (purchases) sales of investment securities	66,644	(13,052)
Earnings received on investments	17,709	10,825
Other	4,482	5,085
Net cash provided by investing activities	88,835	2,858
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(148,473)	(125,871)
Proceeds from the issuance of commercial paper notes and bonds	-	1,019,544
Bond issuance costs	(430)	(12,498)
Interest paid, net	(148,815)	(145,027)
Redemption of long-term debt	(134,825)	(978,634)
Net cash used in capital and related financing activities	(432,543)	(242,486)
Net decrease in cash and cash equivalents	(101,180)	(81,884)
Cash and cash equivalents at beginning of period	501,244	454,414
Cash and cash equivalents at end of period	\$ 400,064	\$ 372,530
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 123,634	\$ 132,498
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	122,630	121,315
Nuclear fuel burned	2,768	2,511
Shoreham surcharge recovery (credits)	15,584	15,614
Provision for claims and damages	13,026	9,126
Accretion of asset retirement obligation	2,541	2,312
Other	1,566	2,169
Changes in operating assets and liabilities:		
Accounts receivable, net	2,482	61,354
Fuel and Material & supplies inventory	2,240	(29,928)
Fuel and purchased power costs, net	(38,868)	123,018
Counterparty collateral	-	(173,020)
Accounts payable and accrued expenses and other	(5,075)	(109,225)
Net cash provided by operating activities	\$ 242,528	\$ 157,744

*Restated to be consistent with current year presentation.