

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

Consolidated Results of Operations

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

Change in Net assets

The Authority generated a net deficit of \$31 million for the nine months ended September 30, 2005 compared to an excess of revenue over expenses of \$16 million in 2004.

Revenue

Revenue for the nine months ended September 30, 2005, increased approximately \$275 million. The increase is attributable to higher recoveries of excess fuel costs totaling approximately \$226 million, load growth and sales mix totaling approximately \$45 million, the positive effects of weather estimated to be \$33 million, and higher other miscellaneous revenue of approximately \$3 million primarily due to service fees initiated during 2005. These increases were partially offset by the migration of commercial customers to LI Choice totaling approximately \$27 million (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.

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 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 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 FPPCA will be reduced or increased accordingly. As a result of continuing increases in fuel and purchased power costs, the Authority increased the FPPCA 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. In 2005, the Authority increased the FPPCA by 1.9% annually, effective June 8, 2005, as a result of the increasing fuel and purchased power costs.

Due to the mid-February implementation date of the FPPCA in 2004, LIPA deferred approximately \$36 million of excess fuel costs, \$16 million of which remained deferred at this time last year. (All deferred fuel costs were fully recovered over the remainder of 2004). Through September 2005, no such deferrals were recorded.

After eliminating the effects of the deferral resulting from the timing of the FPPCA implementation date, fuel and purchased power costs for the nine months ended September 30, 2005, increased approximately \$279 million as compared to the same period in 2004. This increase is primarily attributable to increased commodity costs totaling \$202 million and higher sales volumes totaling approximately \$58 million. In 2005, the Authority partially offset fuel and purchased power costs by applying customer credits totaling \$17 million. In the similar period of 2004, customer credits totaled \$36 million.

Operations and maintenance ("O&M")

O&M decreased approximately \$3 million for the nine month period September 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 \$6 million, the absence of any 2005 costs associated with renting temporary emergency stand-by generators whereas in 2004 LIPA incurred approximately \$14 million, and in 2004, LIPA incurred \$2 million related to the settlement of the Cross Sound Cable dispute.

These decreases were partially offset by higher PSA costs totaling approximately \$13 million (due primarily to agreed upon increased capacity charges totaling \$9 million and the 2004 Utility Plant true-up totaling approximately \$4 million), higher clean energy expenses totaling approximately \$4 million and higher costs related to NMP2 and customer accounts expenses each totaling approximately \$1 million.

General and administrative

General and administrative expenses increased approximately \$3 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 \$5 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 \$6 million due to higher earnings on investment balances which includes amounts held as collateral from various counterparties, totaling approximately \$7 million, higher sales of emissions credits totaling approximately \$4 million, partially offset by lower interest income related to New York Independent System Operator (NYISO) prior months re-bills totaling approximately \$5 million.

Interest charges

Interest charges increased approximately \$11 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, and interest on amounts held as collateral from various counterparties.

Consolidated Balance Sheet
(Thousands of Dollars)

	September 30, 2005 (unaudited)	December 31, 2004 (audited)
Current assets:		
Cash and cash equivalents	\$ 698,312	\$ 335,068
Investments	21,938	77,900
Accounts receivable (less allowance for doubtful accounts of \$19,485 and \$19,635, respectively)	414,820	274,184
Other accounts receivable	20,080	11,344
Fuel inventory	86,572	66,948
Material and supplies inventory	7,160	7,128
Interest receivable	140	300
Prepayments and other current assets	18,323	9,732
Total Current Assets	1,267,345	782,604
Noncurrent assets:		
Utility plant and property and equipment, net	3,948,299	3,540,103
Promissory Notes Receivable-KeySpan Energy	155,425	155,425
Nonutility Property and Other Investments	604,733	120,213
Deferred loss - financial derivatives	101,815	86,177
Deferred Charges	87,201	93,972
Regulatory Assets		
Shoreham settlement	568,664	572,101
Fuel and purchased power costs	299,284	327,931
Total Regulatory Assets	867,948	900,032
Acquisition Adjustment (net of accumulated amortization of \$987,402 and \$902,891, respectively)	3,108,109	3,192,620
Total assets	\$ 10,140,875	\$ 8,871,146
Current liabilities:		
Short-term debt	\$ 100,000	\$ 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	335,200	275,054
Accrued payments in lieu of taxes	33,242	38,082
Accrued interest	77,685	44,465
Counterparty collateral	408,140	-
Customer deposits	22,977	24,721
Total current liabilities	1,276,244	765,504
Noncurrent liabilities:		
Long-term debt	6,785,279	6,865,277
Capital lease obligation	1,140,096	772,800
Asset retirement obligation	71,394	68,320
Deferred credits	87,021	85,323
Deferred credits - financial derivatives	239,251	228,126
Deferred gain - financial derivatives	6,640	10,410
Regulatory liability-fuel derivatives	510,545	23,675
Claims, damages and storm reserves	23,566	20,091
Total noncurrent liabilities	8,863,792	8,074,022
Net assets		
Invested in capital assets net of related debt	(609,335)	(634,292)
Unrestricted	610,174	665,912
Total net (deficit) assets	839	31,620
Total liabilities and net (deficit) assets	\$ 10,140,875	\$ 8,871,146

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

	Nine Months Ended September 30,	
	2005 (unaudited)	2004 (unaudited)
Operating revenues - electric sales	\$ 2,441,262	\$ 2,166,510
Operating expenses:		
Operations - fuel and purchased power		
Fuel and purchased power costs	1,315,714	1,037,287
Recovery of 2003 Excess Fuel Costs	29,217	28,142
Fuel and purchased power expenses - deferral	-	(25,601)
	1,344,931	1,039,828
Operations and maintenance	545,337	548,479
General and administrative	31,989	28,527
Depreciation and amortization	176,732	171,813
Payments in lieu of taxes	167,484	160,040
	2,266,473	1,948,687
Operating Income	174,789	217,823
Nonoperating revenues and expenses:		
Other income, net		
Investment income	11,476	4,812
Carrying charges on regulatory asset	24,218	23,577
Other	6,811	7,971
Total other income, net	42,505	36,360
Change in net assets before interest charges and (credits)	217,294	254,183
Interest charges and (credits):		
Interest on long-term debt, net	235,476	222,065
Other interest	14,251	16,848
Allowance for borrowed funds used during construction	(1,652)	(1,553)
Total interest charges	248,075	237,360
Change in net (deficit) assets	(30,781)	16,823
Net assets		
Total net assets, beginning of year	31,620	11,620
Total net assets, end of period	\$ 839	\$ 28,443

Statement of Cash Flows
(Thousands of Dollars)

	Nine Months Ended September 30,	
	2005 (unaudited)	2004 (unaudited)
Cash flows from operating activities:		
Received from customers for the system sales, net of refunds	\$ 2,356,550	\$ 2,111,735
Other operating revenues received	20,407	8,469
Paid to suppliers and employees		
Operations and maintenance	(602,561)	(636,200)
Fuel and purchased power	(1,233,573)	(1,066,075)
Payments in lieu of taxes	(245,512)	(239,135)
Margin calls on fuel derivative transactions, net	408,140	-
Net cash provided by operating activities	<u>703,451</u>	<u>178,794</u>
Investing activities:		
Net sales of investment securities	55,962	57,982
Earnings received on investments	10,230	3,629
Other	5,790	6,669
Net cash provided by investing activities	<u>71,982</u>	<u>68,280</u>
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(133,781)	(144,694)
Swaption proceeds		35,000
Proceeds from the issuance of commercial paper notes and bonds		248,512
Bond issuance costs		(4,586)
Interest paid, net	(194,608)	(177,550)
Redemption of long-term debt	(83,800)	(97,915)
Net cash used in capital and related financing activities	<u>(412,189)</u>	<u>(141,233)</u>
Net increase in cash and cash equivalents	363,244	149,159
Cash and cash equivalents at beginning of period	335,068	105,841
Cash and cash equivalents at end of period	<u>\$ 698,312</u>	<u>\$ 255,000</u>
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 174,789	\$ 217,823
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	176,732	171,813
Nuclear fuel burned	4,451	4,717
Shoreham surcharge recovery (credits)	27,655	26,915
Provision for claims and damages	10,361	5,252
Accretion of asset retirement obligation	3,074	2,901
Other	4,449	(38,113)
Changes in operating assets and liabilities:		
Accounts receivable, net	(149,362)	(120,813)
Fuel and Material & supplies inventory	(19,656)	(12,720)
Fuel and purchased power costs recovered related to prior periods	29,217	28,142
Excess fuel and purchased power costs deferred	-	(25,601)
Counterparty collateral	408,140	-
Accounts payable and accrued expenses and other	33,601	(81,522)
Net cash provided by (used in) operating activities	<u>\$ 703,451</u>	<u>\$ 178,794</u>