

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

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, 2007 and 2006.

Change in Net Assets

The Authority generated revenue over expenses of approximately \$161 million for the nine months ended September 30, 2007 compared with approximately \$158 million for the nine months ended September 30, 2006.

Revenue

Revenue for the nine months ended September 30, 2007 decreased approximately \$128 million when compared to the similar period of 2006. The decrease is attributable to lower recoveries of power supply costs (discussed below) totaling approximately \$155 million and the negative effects of weather estimated to be \$7 million. These decreases were partially offset by the positive effects of load growth and sales mix estimated to be \$34 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 nine months ended September 30, 2007 decreased approximately \$148 million as compared to the same period in 2006. The decrease was primarily the result of the net change in the regulatory liability related to fuel cost recovery totaling approximately \$229 million, partially offset by higher commodity costs totaling approximately \$60 million and higher sales volumes totaling approximately \$21 million. The \$229 million decrease in the regulatory liability is the result of returning to the customer approximately \$150 million of the 2006 deferral and the lower current year excess fuel cost deferral totaling \$79 million when compared to the nine months ended September 30, 2006.

Operations and Maintenance

Operations and maintenance expense increased \$18 million due primarily to increased PSA costs totaling approximately \$9 million as a result of higher property taxes and capacity charges, increased clean energy expenses totaling \$5 million, increased MSA costs totaling approximately \$3

million due to a prior year true-up recorded in the current period, increased storm accruals totaling approximately \$1 million, and a litigation settlement paid during 2007 totaling \$2 million. These increases were partially offset by lower NMP2 costs totaling approximately \$2 million.

General and Administrative

General and administrative expenses decreased approximately \$2 million due to an insurance reimbursement of prior year's legal fees totaling \$1 million and lower current year legal fees totaling approximately \$2 million. These reductions were partially offset by the Authority's adoption of Governmental Accounting Standard No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions" (GASB 45) whereby the Authority recorded a \$1 million expense in the current period related to the costs of providing health benefits to employees upon retirement. Prior to adoption of this pronouncement, the Authority recorded such expenses when paid.

Depreciation and Amortization

Depreciation and amortization increased approximately \$3 million as a result of higher utility plant balances in 2007 when compared to 2006.

Prior Service Cost- OPEBs

As noted above, the Authority adopted the provisions of GASB No. 45 which, in addition to requiring the recognition of a current period expense for providing health benefits to employees upon their retirement, required the recognition of the amount incurred in the periods prior to the adoption of this pronouncement of approximately \$11 million.

Other Income, Net

Other income increased approximately \$3 million. LIPA realized higher investment earnings totaling approximately \$7 million resulting from higher investment balances coupled with higher interest rates. In addition, LIPA earned higher sales of emissions allowance credits of approximately \$1 million. These increases were partially offset by \$5 million for the cost of the community benefits package associated with the Caithness generating station.

Interest Charges

Total interest charges decreased approximately \$9 million due primarily to the lack of counterparty collateral held by LIPA on its fuel derivatives in 2007 (which in 2006 totaled approximately \$4 million) and higher allowance for borrowed funds used during construction totaling approximately \$2 million. The remaining decrease is due to the lower debt outstanding in 2007 compared to 2006 partially offset by increased interest on variable rate bonds.

Other Accounts Receivable

The balance of this account increased by \$81 million as a result of LIPA recognizing amounts due from KeySpan upon receipt of approval by the New York State Comptroller of the Amended and Restated Management Services Agreement. KeySpan paid LIPA these monies on October 2, 2007. Please see Item II of Other Significant Events below.

Other Long Term Receivables

The balance of this account increased approximately \$64 million as a result of LIPA recognizing the net present value of synergy savings due from National Grid resulting from the purchase of KeySpan by National Grid. LIPA also recognized a receivable of approximately \$23 related to the reimbursement of costs to construct the Interconnection facilities related to the Neptune cable, which is to be paid over a period of 20 years. Please see Items I and II of Other Significant Events below.

Deferred Credits

The balance of this account increased primarily due to the recognition of the amounts to be received by LIPA from KeySpan/National Grid (the \$76 million related to the Amended MSA, and the \$69 million of synergy savings), the final disposition of which remains undetermined. Please see Item II of Other Significant Events below.

Other Significant Events

- I. 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.
- II. In August 2007, the Authority received approval from the New York State Comptroller of the Amended and Restated Management Services Agreement (Amended MSA), the Generation Purchase Option entered into with KeySpan in January 2006 (collectively, the 2006 KeySpan Agreements). In addition, the Comptroller also approved the agreements the Authority reached with National Grid, including the Agreement and Waiver, the Amendment to the Amended MSA and the second Generation Purchase Option Agreement, all of which became effective upon the completion of the National Grid/KeySpan merger (collectively, the National Grid Agreements) on August 24, 2007. In October 2007, the Authority received approximately \$69 million from KeySpan/National Grid in conjunction with the 2006 KeySpan Agreements, approximately \$7 million related to the National Grid Agreements and approximately \$5 million of synergy savings related to the National Grid Agreements. The Authority will also receive an additional \$64 million in synergy savings on a net present value basis. The Authority's management is currently evaluating the potential uses for these funds and will provide its recommendation later this year to the Board of Trustees who will ultimately decide how these funds will be used.
- III. Other Postemployment Benefits ("OPEBs")

As the Authority provides healthcare benefits for retirees as a participating employer in the New York State Health Insurance Program (NYSHIP), the Authority is required to adopt the provisions of Governmental Accounting Standards Board (GASB) No. 45—*Accounting and Financial Reporting for Employers for Postemployment Benefits Other Than Pensions*, which became effective in 2007. The Authority's actuarial consultants performed a valuation based on employee data supplied to them by the Authority. The adoption of this standard resulted in the recognition of an \$11 million charge for such employee benefits related to the Authority's current year obligation, plus a transition obligation for prior service costs. The Authority currently estimates its annual obligation to be approximately \$1.3 million in 2008.

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

	Nine Months Ended September 30,	
	2007 (unaudited)	2006 (unaudited)
Operating revenues - electric sales	\$ 2,726,901	\$ 2,854,453
Operating expenses:		
Operations - fuel and purchased power		
Fuel and purchased power costs	1,528,943	1,527,186
Recovery of 2003 Excess Fuel Costs	27,969	27,571
Refund of 2006 Excess Recovery of Fuel Costs	(150,015)	-
	1,406,897	1,554,757
Operations and maintenance	585,101	567,222
General and administrative	27,773	29,521
Depreciation and amortization	184,702	181,620
Payments in lieu of taxes	170,481	170,593
Prior service cost-OPEB's	10,009	-
Total Operating Expenses	2,384,963	2,503,713
Operating Income	341,938	350,740
Nonoperating revenues and expenses:		
Other income, net		
Investment income	27,582	20,790
Carrying charges on regulatory asset	24,176	24,363
Other	7,304	10,855
Total other income, net	59,062	56,008
Change in net assets before interest charges and (credits)	401,000	406,748
Interest charges and (credits):		
Interest on long-term debt, net	235,999	238,843
Other interest	9,879	14,190
Allowance for borrowed funds used during construction	(6,216)	(3,948)
Total interest charges	239,662	249,085
Change in net assets	161,338	157,663
Net assets		
Total net assets, beginning of year	169,790	51,620
Total net assets, end of period	\$ 331,128	\$ 209,283

Consolidated Balance Sheet
(Thousands of Dollars)

	September 30, 2007 (unaudited)	December 31, 2006 (audited)
Current assets:		
Cash and cash equivalents	\$ 484,721	\$ 501,244
Investments	216,490	208,755
Accounts receivable (less allowance for doubtful accounts of \$19,485)	387,166	269,477
Other accounts receivable	103,043	9,615
Fuel inventory	123,521	138,175
Material and supplies inventory	6,809	6,871
Interest receivable	727	460
Prepayments and other current assets	18,981	27,400
Total Current Assets	<u>1,341,458</u>	<u>1,161,997</u>
Noncurrent assets:		
Utility plant and property and equipment, net	5,281,359	4,118,775
Promissory Notes Receivable-KeySpan Energy	155,425	155,425
Nonutility Property and Other Investments	117,910	69,129
Other long - term receivables	85,987	-
Deferred loss - financial derivatives	38,187	46,187
Deferred Charges	84,199	89,643
Regulatory Assets		
Shoreham settlement	562,425	565,392
Fuel and purchased power costs	227,280	295,928
Total Regulatory Assets	<u>789,705</u>	<u>861,320</u>
Acquisition Adjustment (net of accumulated amortization of \$1,212,763 and \$1,128,253 respectively)	2,882,748	2,967,258
Total assets	<u>\$ 10,776,978</u>	<u>\$ 9,469,734</u>
Current liabilities:		
Short-term debt	\$ 100,000	\$ 100,000
Current maturities of long-term debt	222,560	218,605
Current portion of capital lease obligation	219,378	121,380
Accounts payable and accrued expenses	401,448	286,738
Regulatory liability-fuel and purchased power costs	160,388	197,918
Accrued payments in lieu of taxes	26,105	43,462
Accrued interest	67,308	42,771
Customer deposits	27,510	25,137
Total current liabilities	<u>1,224,697</u>	<u>1,036,011</u>
Noncurrent liabilities:		
Long-term debt	6,684,061	6,806,290
Capital lease obligation	2,023,479	1,044,240
Asset retirement obligation	92,848	85,086
Deferred credits	221,661	74,367
Deferred credits - derivatives	154,789	209,973
Deferred gain - derivatives	14,016	12,338
Claims, damages and storm reserves	30,299	31,639
Total noncurrent liabilities	<u>9,221,153</u>	<u>8,263,933</u>
Net assets		
Invested in capital assets net of related debt	(299,219)	(417,837)
Unrestricted	630,347	587,627
Total net assets	<u>331,128</u>	<u>169,790</u>
Total liabilities and net assets	<u>\$ 10,776,978</u>	<u>\$ 9,469,734</u>

Statement of Cash Flows
(Thousands of Dollars)

	Nine Months Ended September 30,	
	2007 (unaudited)	2006 (unaudited)
Cash flows from operating activities:		
Received from customers for the system sales, net of refunds	\$ 2,646,582	\$ 2,826,006
Other operating revenues received	33,930	27,418
Paid to suppliers and employees		
Operations and maintenance	(562,657)	(596,666)
Fuel and purchased power	(1,346,043)	(1,353,701)
Payments in lieu of taxes	(266,850)	(262,060)
Margin calls on fuel derivative transactions, net	-	(232,424)
Net cash provided by operating activities	504,962	408,573
Investing activities:		
Net purchases of investment securities	(7,735)	(169,842)
Earnings received on investments	25,889	19,188
Other	11,168	9,965
Net cash provided by (used in) investing activities	29,322	(140,689)
Cash flows from capital and related financing activities:		
Capital and nuclear fuel expenditures	(207,116)	(203,194)
Proceeds from the issuance of commercial paper notes and bonds	-	2,118,973
Bond issuance costs	(430)	(24,042)
Interest paid, net	(207,846)	(186,132)
Redemption of long-term debt	(135,415)	(1,871,312)
Net cash used in capital and related financing activities	(550,807)	(165,707)
Net (decrease) increase in cash and cash equivalents	(16,523)	102,177
Cash and cash equivalents at beginning of period	501,244	454,414
Cash and cash equivalents at end of period	\$ 484,721	\$ 556,591
Reconciliation to net cash provided by operating activities:		
Operating income	\$ 351,947	\$ 350,740
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	184,702	181,620
Nuclear fuel burned	4,229	4,242
Shoreham surcharge recovery (credits)	27,143	27,589
Provision for claims and damages	19,539	18,713
Accretion of asset retirement obligation	3,811	3,498
Other	2,348	2,951
Changes in operating assets and liabilities:		
Accounts receivable, net	(128,539)	(54,316)
Fuel and Material & supplies inventory	14,716	(42,993)
Regulatory asset - Fuel and purchased power costs	(53,431)	176,181
Counterparty collateral	-	(232,424)
Accounts payable and accrued expenses and other	88,506	(27,228)
Net cash provided by operating activities	\$ 514,971	\$ 408,573