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Ratings

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Summary:

Long Island Power Authority, New York; Retail Electric

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Summary:

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Credit Profile		
US$350.0 mil elec sys gen rev bnds ser 2017 due 09/01/2047		
Long Term Rating	A-/Positive	New
Long Island Pwr Auth elec sys gen rev		
Long Term Rating	A-/Positive	Outlook Revised

Rationale

S&P Global Ratings has revised its outlook to positive from stable and affirmed its 'A-' rating on the Long Island Power Authority (LIPA), N.Y.'s $3.5 billion senior-lien revenue bonds. At the same time, S&P Global Ratings assigned its 'A-' rating, with a positive outlook, to the utility's proposed $350 million series 2017 electric system general revenue bonds.

The outlook revision reflects the benefits of the basket of financial tools the New York State Department of Public Service (DPS) has created for recovering changes in a wide range of variable costs from customers, including a decoupling mechanism that tempers the exposure of energy sales and revenue to energy efficiency programs, distributed generation and weather. We believe these measures can limit the need for litigating base-rate increases, and we view the mechanisms as potentially sustaining a sound alignment among revenues, expenses and debt service. In addition, based on LIPA's November 2017 budget, we calculated that base-rate increases, cost recovery mechanisms, and the utility's use of securitizations that reduced direct debt, could strengthen fixed charge coverage (FCC) to about 1.3x from 2017-2019, compared with historical levels of about 1.1x. Our FCC calculation treats capacity charges paid to other generation owners as debt service rather than as operating expenses, because we view these payments as funding the suppliers' recovery of their investments in generation assets that they dedicate to LIPA.

Bond proceeds will fund portions of LIPA's capital program.

Uniondale, N.Y.-based LIPA pays its unsecuritized bonds' debt service from the net revenues of its retail electric system operations. As of Dec. 31, 2016, the utility reported $3.5 billion of unsecuritized long-term debt, and $405 million of short-term debt. Long-term unsecuritized debt has declined sharply from $6.6 billion at Dec. 31, 2012, largely because of a sequence of 2013-2016 securitization transactions that refunded portions of LIPA's unsecuritized debt. The utility's $370 million 2017 securitization transaction brings the total to $4.5 billion, which exhausted the legislatively authorized limit.

LIPA also records on its balance sheet $2.2 billion of capital lease obligations that reflect the net present value of its commitments to make fixed payments to its power suppliers. We treat these fixed commitments as debt service, rather than as operating expenses in our FCC calculation.

Although LIPA's financial statements consolidate the utility's unsecuritized debt and the debt of the Utility Debt Securitization Authority (UDSA)--the vehicle for issuing LIPA-related securitization bonds--those bonds' debt service is subject to a separate pledge, is not an obligation of the authority, and does not have a claim on the revenues pledged to the utility's unsecuritized debt. LIPA acts as the servicing agent for the UDSA debt and uses its retail bills to collect UDSA debt service from its customers. It remits the separately pledged revenues to the UDSA. Consequently, our financial analysis removes UDSA-related revenues and debt service from our assessment of the LIPA debt obligations, but our analysis also explores the burden of high retail rates that capture debt service on all of these obligations, together with other revenue requirements.

The rating on LIPA's unsecuritized debt reflects our opinion of the following favorable credit factors:

- LIPA benefits from the stable revenue stream that its approximately 1.1 million customers provide.
- In 2016, the utility derived 55% of its revenues from residential customers, 43% from commercial customers, and 2% from other customers, which we view as a favorable mix contributing to revenue stability.
- LIPA principally serves customers in New York's Nassau and Suffolk counties, where income levels in 2016 were 162% and 145% of the national household effective buying income, respectively, which we consider very strong.
- In 2015, the DPS recommended and the LIPA board adopted multi-year base-rate adjustments. This increased revenues by $20.1 million in 2016 and $65 million in 2017. The utility will add $64 million to base rates in 2018.
- Beyond base rates, retail rates include monthly and other periodic adjustment mechanisms for recovering changes in sales, purchased power costs, delivery costs, debt service, storm costs, payments in lieu of taxes, and other adjustments. We consider these mechanisms as supporting revenue-stream stability. Among these is a revenue-decoupling mechanism that provides for the collection of revenues deemed to have been lost to energy efficiency programs, distributed generation, weather, and changes in economic conditions. The mechanism was revised to true up annually rather than semi-annually, which we view as providing less protection to cash flows than the historically more frequent adjustments. On balance, we believe the decoupling mechanism remains a tool for supporting credit quality after the shift to less frequent reconciliations. Retail rates are competitive for the region, in our view, although they are high in absolute terms.

The rating also reflects our view of these credit risks:

- Although securitization transactions produced multi-billion-dollar debt reductions and improved debt service coverage (DSC) of unsecuritized debt, LIPA's high, fixed-payment commitments to power suppliers dilute the benefits. FCC remained adequate at 1.1x in 2015 and 2016. Using the utility's November 2017 budget, we calculate FCC will strengthen to about 1.3x through 2019.
- Because customer bills include securitization debt service, converting portions of the debt portfolio to securitized debt has not reduced customer bills.
- Legislation provides for regulatory oversight of ratemaking if requests for rate increases exceed prescribed thresholds, which might diminish LIPA's ratemaking autonomy. The rate oversight distinguishes the utility from most other public power utilities. However, the several available pass-through and decoupling mechanisms could diminish the need for base-rate adjustments that exceed the prescribed threshold.
- LIPA is voluntarily complying with a state mandate requiring New York's investor-owned utilities to source 50% of their electric production from renewable resources by 2030. We believe meeting these targets could stress the average cost of power supply, but the availability of pass-through and decoupling mechanisms directly tied to these initiatives should help maintain a sound alignment among revenues, expenses, and debt service.
- The utility has identified $1.7 billion of 2017-2019 capital needs, requiring $1.3 billion of new debt. Previously issued

debt's $248 million of amortization in those years and the 2017 debt securitization that refunded approximately $400 million of unsecuritized debt should temper the debt additions.

LIPA is among the three largest public power utilities in the U.S. by customers and revenues. It serves about 1.1 million retail customers. Unlike similar-sized peers, LIPA primarily relies on others to supply its customers' electricity needs, purchasing all but a small portion of its electricity from third parties. The utility's owned generation capacity consists of a 224-megawatt (MW), 18% interest in the Nine Mile Point 2 (NM2) nuclear plant, which represented about 4% of 2016's 5,212-MW summer peak demand. The nuclear plant is co-owned with and operated by Constellation Energy Nuclear Group LLC. The utility meets the balance of its energy needs through contracts with National Grid USA and other energy providers as well as through market purchases. The power supply agreement with National Grid expires in April 2028. It allows LIPA to purchase energy from resources other than National Grid's if they have lower costs, which is important because National Grid's resources have high production costs. Although National Grid generation units represent nearly two-thirds of LIPA's capacity, they provided only one-fifth of LIPA's 2016 power supply. The cost of reserving National Grid capacity does not abate when LIPA purchases power from others. Two underwater transmission cables provide access to the PJM Interconnection LLC and the New England independent system operator markets, which helps reduce LIPA's exposure to National Grid's high production costs.

Widespread dissatisfaction with high rates and inferior service historically have contributed to the politicization of rate-setting. LIPA's poor response in the wake of the extensive outages during 2012's Superstorm Sandy culminated in the passage of the LIPA Reform Act, a three-year rate freeze, and the utility's diminished rate-setting autonomy. DPS must review rate proposals that seek to increase revenues by more than 2.5% per year. In our view, the rate-setting construct could reduce financial flexibility. The Reform Act also transferred much of the day-to-day operating responsibilities to PSEG-Long Island (PSEG-LI), a subsidiary of New Jersey's Public Service Enterprise Group PSEG, an investor-owned, diversified energy company. Under an operating agreement that expires in 2025, LIPA pays PSEG-LI an annual fee that contains performance-based incentives. The utility's contractual obligations to PSEG-LI include substantial unfunded pension liabilities and other postemployment benefits (OPEB) relating to the PSEG employees that serve the LIPA territory.

The Reform Act directed the utility to file a 2015 rate application with DPS, which based its recommendation on DSC analysis in lieu of targeting returns on assets or equity as is common to investor owned utilities. LIPA's board ratified the DPS recommendation.

As with other regulated utilities, LIPA has not received guarantees it will achieve specific coverage metrics, but the several adjustment mechanisms the DPS established for addressing changes in prescribed variable costs, should promote sound credit quality. Among those mechanisms, the decoupling one is a significant tool.

We generally exclude nonrecurring grant income from our DSC-ratio calculation's numerator. However, the grant income LIPA reported on its income statement in recent years principally represented Federal Emergency Management Agency reimbursements for storm damage repairs that the utility expensed, and U.S. Treasury reimbursements for a portion of gross interest on Build America Bonds. Therefore, we included the grants in the numerator. We also added the income statement's recovery of carrying charges on regulatory assets. This money represents collections of debt service on bonds issued to finance a bill credit that coincided with LIPA's inception.

The utility recorded more than $781 million of unrestricted cash and investments on its balance sheet as of Dec. 31, 2016, which we view as representing a strong three-months' operating expenses. Undrawn capacity available under credit facilities brings this ratio up to about four-months' operating expenses.

Outlook

The positive outlook reflects budgetary projections that forecast strengthening financial performance as LIPA reaps the benefits of securitizations and uses a basket of adjustment mechanisms. These should facilitate the recovery of cost increases, or offset declines in revenues that flow from energy efficiency technologies, customers' embrace of distributed generation, weather's effect on sales, and other factors.

Upside scenario

We could raise the rating if the utility does not become subject to undue political pressures affecting costs, operations and credit metrics, and rate increases and pass-through mechanisms consistently boost FCC to at least the 1.3x level that the November 2017 budget suggests.

Downside scenario

We could restore the outlook to stable if capital spending needs materially add to unsecuritized debt or resistance to rate increases pressure FCC ratios.

Ratings Detail (As Of November 22, 2017)		
Long Island Pwr Auth elec sys		
Long Term Rating	A-/Positive	Outlook Revised
Long Island Pwr Auth elec sys gen rev bnds ser 2016A due 05/01/2033		
Long Term Rating	A-/Positive	Outlook Revised
Long Island Pwr Auth elec sys gen (AGM)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Long Island Pwr Auth elec sys (AGM)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Long Island Pwr Auth elec (AGM)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Long Island Pwr Auth elec (AGM)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Long Island Pwr Auth elec (ASSURED GTY)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Long Island Pwr Auth elec (BHAC)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Long Island Pwr Auth elec (BHAC) (SEC MKT)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Long Island Pwr Auth elec (BHAC) (SEC MKT)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised

Ratings Detail (As Of November 22, 2017) (cont.)		
Long Island Pwr Auth elec (CIFG)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Long Island Pwr Auth retail elec (BAM)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Long Island Pwr Auth retail elec (BAM) (SECMKT)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Long Island Pwr Auth RETELEC		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
New York St Energy Research & Dev Auth, New York		
Long Island Pwr Auth, New York		
New York St Energy Research & Dev Auth (Long Island Pwr Auth)		
Long Term Rating	A-/Positive	Outlook Revised
New York St Energy Research & Dev Auth (Long Island Lighting Co Proj) elec		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised

Many issues are enhanced by bond insurance.

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.