S&P Global Ratings

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Long Island Power Authority, New York; Retail Electric

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Long Island Power Authority, New York; Retail Electric

Credit Profile		
US$430.0 mil elec sys gen rev bnds ser 2018 due 12/31/2039		
Long Term Rating	A-/Positive	New
Long Island Pwr Auth elec sys gen rev		
Long Term Rating	A-/Positive	Affirmed

Rationale

S&P Global Ratings has assigned its 'A-' rating to the Long Island Power Authority (LIPA), N.Y.'s proposed $430 million series 2018 electric system general revenue bonds. At the same time, S&P Global Ratings has affirmed its 'A-' rating on the utility's $3.76 billion senior-lien revenue bonds. The outlook is positive.

The long-term ratings reflect the application of our "U.S. Municipal Retail Electric And Gas Utilities: Methodology And Assumptions" criteria, published Sept. 27, 2018.

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

The ratings reflect our opinion of the authority's very strong enterprise risk profile. We base our view on the utility service territory's extremely strong economic fundamentals and strong market position, which reflects a positive adjustment to the utility's market position score.

We also concluded that the operational and management assessment is strong, based on the utility's ability to serve customers from a diverse mix of contracted and market generation assets, depending on their economics. In addition, the operational and management assessment reflects the benefits of a basket of financial tools that facilitate passing along to customers the changes it could experience in a wide range of variable costs, including a decoupling mechanism that tempers the exposure of energy sales and revenue to energy efficiency programs, distributed generation, and weather.

We consider the electric utility sector's industry risk assessment to be extremely strong relative to other industries and sectors.

Tempering these strengths is our view that this highly leveraged utility's financial profile is only adequate. We believe its debt and liabilities translate into a highly vulnerable posture. Significant fixed financial obligations for power purchases add to the utility's leverage and erode fixed charge coverage (FCC) metrics. 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. FCC was 1.16x in 2017 and 1.12x and 1.13x in 2016 and 2015. We consider liquidity to be very strong based on $828 million of unrestricted cash and investments at year-end 2017. Nearly $340 million of capacity available under credit lines bolsters liquidity.

Outlook

The positive outlook reflects expectations of strengthening of fixed charge coverage in 2018 and 2019. However, we observe that debt service requirements in 2018 and 2019 will be lower than recent years' annual debt service. Because LIPA projects its debt service requirements will climb beyond 2019, we could raise the rating if financial metrics strengthen to produce a strong financial profile assessment relative to higher debt and debt service requirements.

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 levels that produce a strong financial profile assessment.

Downside scenario

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

Utility Description And Credit Overview

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, 2017, the utility reported $3.4 billion of unsecuritized long-term debt, and $360 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 $4.5 billion of 2013-2017 securitization transactions that refunded portions of LIPA's unsecuritized debt. The utility has exhausted the legislatively authorized limit on its securitizations.

LIPA also records on its balance sheet $2.0 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.

LIPA is among the three largest public power utilities in the U.S. by customers and revenues. It serves about 1.1million 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 2017's 4,945-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-sixth of LIPA's 2017 power supply. The cost of reserving National Grid capacity does not abate when LIPA purchases energy 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.

Enterprise Risk Profile: Very Strong

Economic fundamentals: Extremely strong

LIPA principally serves customers in New York's Nassau and Suffolk counties, where income levels in 2017 were 162% and 147% of the national household effective buying income, respectively, which we consider to be extremely strong. LIPA benefits from the stable revenue stream that its approximately 1.1 million customers provide. In 2017, the utility derived 54% of its revenues from residential customers, 44% from commercial customers, and 2% from other customers, which we view as a favorable mix contributing to revenue stability.

Market position: Strong

Retail rates are competitive for the region, in our view, although they are high in absolute terms. Nevertheless, income levels contribute to affordability.

Because customer bills include securitization debt service, converting portions of the debt portfolio to securitized debt has not reduced customer bills, which can influence ratemaking flexibility.

Operational Management Assessment (OMA): Strong

Widespread dissatisfaction with inferior service, despite high rates, historically 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. New York's Department of Public Service must review rate proposals that seek to increase aggregate revenues by more than 2.5% per year. In our view, the rate-setting construct could reduce financial flexibility. In our opinion, 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 threshold.

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. PSEG-LI is also responsible for capital planning. 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 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.

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 added $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.

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.

Industry risk: Extremely strong

Consistent with "Methodology: Industry Risk," published Nov. 19, 2013, we consider industry risk for municipal retail electric and gas utilities covered under these criteria very low, and therefore extremely strong compared with other industries and sectors.

Financial Risk Profile: Very Strong

Debt and liabilities: Highly vulnerable

As of Dec. 31, 2017, the utility reported $3.4 billion of unsecuritized long-term debt, and $360 million of short-term debt. By comparison, its 2017 net position was only $472 million.

The utility has identified $3.2 billion of 2018-2022 capital needs, requiring $1.9 billion of new debt. Previously issued debt's $1.2 billion of amortization in those years will temper debt additions, but our calculations indicate that 2022 debt balances will be 27% higher than 2017's.

Coverage metrics: Adequate

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 was adequate in our opinion at 1.13x in 2015, 1.12x in 2016 and 1.16x in 2017. Using the utility's 2018, budget, we calculate FCC will strengthen to about 1.3x in 2018 and 2019 based, in part, on those years' lower debt service requirements.

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, U.S. Treasury reimbursements for a portion of gross interest on Build America Bonds, and recurring energy efficiency grants from the Regional Greenhouse Gas Initiative. 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.

Liquidity and reserves: Very strong

The utility recorded more than $828 million of unrestricted cash and investments on its balance sheet as of Dec. 31, 2017, 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.

Ratings Detail (As Of October 8, 2018)		
Long Island Pwr Auth elec sys		
Long Term Rating	A-/Positive	Affirmed
Long Island Pwr Auth elec sys gen rev bnds ser 2016A due 05/01/2033		
Long Term Rating	A-/Positive	Affirmed
Long Island Pwr Auth elec sys gen (AGM)		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
Long Island Pwr Auth elec sys (AGM)		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
Long Island Pwr Auth elec (AGM)		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
Long Island Pwr Auth elec (AGM)		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
Long Island Pwr Auth elec (ASSURED GTY)		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
Long Island Pwr Auth elec (BHAC)		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
Long Island Pwr Auth elec (BHAC) (SEC MKT)		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
Long Island Pwr Auth elec (BHAC) (SEC MKT)		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed

Ratings Detail (As Of October 8, 2018) (cont.)		
Long Island Pwr Auth elec (CIFG)		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
Long Island Pwr Auth retail elec (BAM)		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
Long Island Pwr Auth retail elec (BAM) (SECMKT)		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
Long Island Pwr Auth retail elec (BAM) (SECMKT)		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
Long Island Pwr Auth RETELEC		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed
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	Affirmed
New York St Energy Research & Dev Auth (Long Island Lighting Co Proj) elec		
Unenhanced Rating	A-(SPUR)/Positive	Affirmed

Many issues are enhanced by bond insurance.