



## Fitch Rates Long Island Power Auth, NY's Ser 2018 Electric System Gen Revs 'A-'; Outlook Stable

Fitch Ratings-New York-05 October 2018: Fitch Ratings has assigned an 'A-' rating to the Long Island Power Authority, NY's (LIPA) issuance of approximately \$430 million, series 2018 electric system general revenue bonds.

Bond proceeds will fund capital expenditures and pay costs of issuance. The fixed rate, 2018 bonds are scheduled to price Oct. 16, 2018.

Fitch has also affirmed the 'A-' ratings on the following LIPA debt and CP bank notes (as of Dec. 31, 2017):

- \$3.2 billion, senior lien electric system revenue and refunding bonds;
- implied electric system revenue subordinate obligations;
- \$200 million maximum authorized CP notes series 2014-1A and 1B (bank note rating);
- \$100 million maximum authorized CP notes series 2014 CP-2A and 2B (bank note rating).

The Rating Outlook is Stable.

The CP bank note rating is assigned to LIPA's series 2014 CP notes but will only become applicable if the notes cannot be remarketed and are purchased by the bank providing the corresponding letters of credit.

### SECURITY

The electric system general revenue bonds are senior lien obligations of LIPA secured by the net revenues of the electric system, after payment of operating and maintenance expenses and prior to payment of subordinate lien obligations (which includes the CP notes). The subordinate lien long-term rating is implied as there are no bonds currently outstanding.

### KEY RATING DRIVERS

**SOLID UTILITY FUNDAMENTALS:** LIPA is one of the nation's largest municipal electric distribution systems, serving 1.1 million retail customers. The authority benefits from sound utility fundamentals including a flexible power supply mix, an affluent and well-diversified customer base, and cost recovery mechanisms that cover a large portion of variable and fixed costs. A series of comprehensive operating agreements with capable external service providers further support operations.

**UNIQUE BUSINESS MODEL:** The LIPA Reform Act (2013) broadened the responsibilities of the utility's system operator (PSEG Long Island) and expanded the state regulatory oversight of LIPA by the Department Public Service (DPS), a staff arm of the New York Public Service Commission (NYPSC). Fitch views many of the legislated provisions as supportive of credit quality, however, added regulatory oversight could affect LIPA's financial and rate flexibility over time.

**RATE PLAN PENDING:** LIPA's DPS-reviewed three-year rate plan expires this year and budgeted rates for 2019 are expected to be announced in November. LIPA's financial performance has improved over the plan period due, in part, to the constructive and supportive recommendations of the DPS and the adoption of sound long-term financial goals, policies, and varied cost recovery mechanisms. Further financial improvement and deleveraging are likely to hinge on approved rate plans for 2019 and beyond.

**HIGH BUT DECLINING LEVERAGE:** LIPA's leverage has declined in recent years reflecting improved cash flow, but remains high for the rating category. Fitch-calculated debt to funds available for debt service (FADS; includes securitization debt) has declined to 8.0x in 2017 from 9.0x in 2014, while net debt to adjusted FADS has declined to 9.4x from 10.9x. Rating category medians totaled 5.7x and 6.4x, respectively. While Fitch recognizes the benefits of LIPA's separately secured \$4.3 billion in securitized debt, the repayment profile remains an obligation and burden of current ratepayers.

**RATE PRESSURES REMAIN:** Despite electric rates that have become regionally more competitive, political and consumer rate pressures persist as LIPA's average residential revenue per kwh remains high relative to the rest of the nation.

**ADEQUATE LIQUIDITY:** LIPA's operating cash balances remain adequate at 72 days, although moderately below the 2017

rating category median of 168 days. Favorably, total liquidity on hand amounts to a solid 251 days, stronger than the peer median of 235 days.

## RATING SENSITIVITIES

**IMPROVED OPERATING STABILITY AND DELEVERAGING:** A continuance of the Long Island Power Authority's improved operating and financial stability, supportive rate setting, and a reduction in leverage, sufficient to offset political and consumer-driven rate pressures could result in consideration of positive rating action.

## CREDIT PROFILE

LIPA owns one of the largest municipal electric distribution systems in the U.S., serving a population of about 2.9 million located throughout Nassau and Suffolk counties, and the Rockaways section of New York City. LIPA has provided electric service in the area since May 28, 1998.

LIPA's service area economy remains strong, with continued well-above average wealth and income indices. Unemployment figures, for Nassau and Suffolk Counties, remain in-line with or better than the state and nation. Fitch rates Suffolk County's general obligations debt 'A-/Outlook Stable; and Nassau County debt at 'A'/Outlook Stable.

LIPA owns the electric transmission and distribution (T&D) system in its service area; however, operation and maintenance of the T&D system and significant responsibilities for power supply are contracted for with external providers. Currently, T&D system services are provided by PSEG Long Island (PSEGLI; a subsidiary of Public Service Enterprise Group [Issuer Default Rating of BBB+/Stable]), pursuant to an amended and restated operating services agreement (OSA). The OSA, which took effect on Jan. 1, 2014 and runs through Dec. 31, 2025, is extendable pursuant to PSEGLI meeting certain performance criteria. Positively, LIPA continues to outperform its New York counterparts in electric system reliability (excluding major storm outages).

LIPA relies heavily on purchased resources to meet its energy demand and capacity requirements. Most of the authority's available capacity remains rooted in its legacy power supply agreement (PSA) with National Grid, which was initially signed in 1998 and renewed in May 2013 through 2028. Although available capacity under the agreement has declined slightly in recent years as a result of unit retirements, the agreement still provides important access to 3,700 MW of on-island gas/oil-fired resources - approximately 65% of the authority's total capacity requirements.

The authority has worked to diversify its power supply mix, adding up to 1,900 MW of purchased capacity from independent generating units located on Long Island and elsewhere. Access to off-island resources, in particular, has increased significantly in recent years as a result of new interconnections, which are capable of supplying up to 40% of LIPA's peak energy requirements. Declining wholesale market prices and expanded access to regional energy markets have moderated the cost of LIPA's energy supply in recent years by allowing the authority to displace more expensive generation from its PSA resources in favor of more economic energy purchases from independent power producers and short-term purchases in the NYISO, ISO-NE and PJM markets. Purchases pursuant to the PSA have steadily declined from 51% of requirements in 2005 to 16% in 2017, whereas purchases from other suppliers, including short-term purchases, now account for 63% of requirements.

PSEGLI conducted an integrated resource plan in mid-2017 that affirmed that LIPA does not need to add baseload generating capacity through at least 2035, due in part to the greater adoption of energy efficiency and rooftop solar. Also in 2017, the LIPA board adopted a policy that would require the utility to meet its share of New York State's 50% renewable energy goal. Longer term resource planning will likely involve the addition of 800 MWs of new renewable energy generation by 2030 to cover incremental needs, as well as replace existing capacity earmarked for retirement.

Despite limited generation needs, LIPA's five year capital budget includes \$3.27 billion of capital expenditures, which is above historical levels. The increased investment in the electric system reflects LIPA's remaining FEMA-funded initiatives related to strengthening system resiliency, reliability and storm hardening, as well as transmission system reinforcements and additions. Favorably, LIPA expects to debt finance less than 64% of the planned expenditures. FEMA grants will provide \$279 million (9%); LIPA cash from operations \$987 million (or 30%); and the rest is projected debt financing of about \$2 billion through 2021.

## RATE PLAN PENDING

The DPS concluded its initial review of LIPA's three-year rate plan in September 2015, and LIPA's board approved the rate plan in December 2015. Overall, Fitch viewed the DPS's recommendations as constructive. Although the recommendations reduced LIPA's original three-year revenue request, the DPS positively endorsed several rate adjustment mechanisms to offset variability in some of LIPA's largest expense items, including debt service, storm damage, energy efficiency, PILOTs, and fuel and purchased power costs. Revised rates for 2019 are expected to be announced in November. The authority does not expect to propose an increase of more than 2.5% for 2019 or 2020.

Although they remain nominally high, LIPA's retail rates have become increasingly competitive on a regional basis. Improving power supply economics and the benefits of public power ownership (including tax-exempt financing and access to grants from FEMA and the State) have moderated power costs, resulting in residential bills that are only 3% higher than in 2008. By comparison, residential rates at neighboring systems have risen steadily and now exceed LIPA's in most cases.

#### SOUND FINANCIAL PERFORMANCE

LIPA's Fitch-calculated cash flow and coverage metrics have modestly improved since 2014, but remain weak relative to peer medians. Debt service coverage rose to 1.51x in 2017, up from 1.46x in 2014. The improvement in LIPA's FADS reflects higher revenue requirements approved as part of the current three-year rate plan, as well as the effect of certain non-cash charges. As FADS has grown, annual debt service favorably remained relatively flat. Similarly, coverage of LIPA's full obligations, which conservatively incorporates the authority's sizable PILOT payments and a fixed portion of purchased power expense as fixed obligation, improved to 1.11x in 2017 from 1.04x in 2013.

LIPA's debt rating takes into account the \$4.3 billion in outstanding securitization bonds, issued by the Utility Debt Securitization Authority (UDSA) to refund a portion of LIPA's senior debt. Revenues collected by LIPA to pay debt service on the securitization bonds (a non-bypassable consumption based surcharge) are not subject to the lien of the general or subordinated general resolutions.

LIPA's leverage has also improved given stronger operating cash flow. Debt to FADS modestly declined to 8.0x (FY2017) from 9.0x (FY2014), and net adjusted debt to adjusted FADS improved to 9.4x from 10.9x. LIPA's total debt obligations have stabilized in recent years and totaled \$10.6 billion at year-end 2017, including the authority's electric system revenue bonds, capitalized lease obligations and securitized restructuring bonds issued by UDSA.

LIPA's unrestricted cash and liquidity have steadily increased over the last five years following the funding and reimbursement challenges related to Hurricane Irene and Superstorm Sandy. Cash and investments have grown from 55 days to 139 days since 2013, despite a base rate freeze in 2015 and a large number of storms in 2016. Prospectively, LIPA intends to maintain solid liquidity of at least \$250 million, or the equivalent of at least 120 days operating cash.

LIPA's projected financial performance should continue to improve through 2022, given a manageable five-year capital plan, and modest system growth and distribution rate increases. Operating stability is supported by the authority's ability to mitigate a large portion of cost volatility through varied adjustment mechanisms adopted in recent years.

Total debt outstanding is projected to modestly decline over the five year horizon, as anticipated new debt issuance to fund capital expenditures is offset by scheduled debt and capital lease principal payments of about the same amount. While total debt will not materially improve by 2022, strengthening FADS and a modest increase in cash on hand could favorably drive net adjusted debt to FADS lower through the forecast period, from 9.4x (2017) to about 8.0x (2022).

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In addition to the sources of information identified in Fitch's Revenue-Supported Rating Criteria, this action was additionally informed by information from Lumesis.

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#### **Applicable Criteria**

Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018) (<https://www.fitchratings.com/site/re/10020113>)  
U.S. Public Power Rating Criteria (pub. 18 May 2015) (<https://www.fitchratings.com/site/re/864007>)

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