FOR CONSIDERATION
December 19, 2018

TO: The Finance and Audit Committee of the Board of Trustees

FROM: Thomas Falcone

SUBJECT: Recommendation for Approval of the Authority's 2019 Budget and Amendment of 2018 Budget

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Requested Action

The Finance and Audit Committee (the "Committee") of the Board of Trustees is requested to adopt a Resolution recommending (i) approval of the proposed 2019 Operating and Capital Budgets (the "Budget") which sets forth the revenue, grant, other income, and expenditure forecasts for the year ending December 31, 2019, and (ii) amending the 2018 Operating and Capital Budgets, as described below and specified in **Exhibit "A**".

Background on 2019 Operating and Capital Budgets

The proposed 2019 Budget totals $4.468 billion, including an Operating Budget of $3.599 billion and a Capital Budget of $869 million. The proposed 2019 Operating Budget funds delivery and power supply costs, taxes and debt service. The Capital Budget funds long-life infrastructure investments such as transmission, substations, poles and wires. In addition, the Operating and Capital Budgets fund investments in various information technology projects, services and commodities needed to support system operations.

The proposed 2019 Budget is consistent with the financial policy adopted by the Board of Trustees in December 2015 to reduce the Authority's borrowing and interest cost and raise the Authority's credit ratings over five years. That policy established a fixed obligation coverage target of 1.45x for LIPA fixed obligation payments for 2019. Staff projects that the 2019 Budget will achieve a coverage ratio of 1.45x in 2019.

In addition, the Budget meets the Board's financial policy for borrowing, with new debt funding less than 64% of capital spending. For 2019, staff projects LIPA will fund 62% of the $869 million Capital Budget from debt issues, inclusive of FEMA projects, achieving the Board's fiscal goal. Excluding the $138.2 million of FEMA financed projects, staff forecasts 73% would be financed with debt. The 2019 Capital Budget includes a deferral of certain specified 2018 capital projects totaling $56.1 million into 2019.

The monthly electric bill for the average residential customer is projected to be $154.94 in 2019, which is $3.67 per month or 2% below the 2018 budgeted level. The primary drivers of the decrease are lower Power Supply Costs and credits resulting from the Revenue Decoupling Mechanism. These decreases offset increases in infrastructure investments, storm restoration costs, and energy efficiency investments, as described in greater detail in the Budget.

Changes from the Proposed Budget

The 2019 Budget presented herein reflects minor adjustments to the Proposed Budget presented to the Trustees on November 14, 2018. Adjustments include (1) an update to capitalized lease costs that was offset by other adjustments, resulting in no change to total Delivery Revenue Requirements; and (2) an update to the Distributed Energy Resources rider ("DER") totaling $420,000 for Direct Current Fast Charging ("DCFC") incentives for electric vehicles, consistent with the Consensus Proposal filed in the New York Department of Public Service's electric vehicle proceeding subsequent to the submission of LIPA's Proposed Budget.[1] The objective of the DCFC incentives is to spur investment in DCFC stations by mitigating the impact of demand charges on station owners during the next several years of low expected station utilization.

Power Supply Charge and Allocation of Intra-Year Power Supply Capacity Costs

In December 2015, the Trustees approved a regulatory asset to allow for a greater share of the recovery of certain fixed generation capacity costs in the Power Supply Charge ("PSC") from customers during the summer months consistent with when the generation capacity is needed rather than recovering these fixed costs equally through the year. Staff believes this accurately reflects cost causation in electric rates. The December 2015 approval by the Trustees specified that the schedule of deferrals and amortization of such costs in future years would be presented in future budgets. There is no net impact on an annual basis from the reallocation of these costs within the year, with allocations by month from plus $30 million to minus $28.5 million, as shown in the table below.

	Reallocation of the Proposed Fixed Capacity Costs in the Power Supply Charge
January	($28,500,000)
February	($28,500,000)
March	($11,000,000)
April	($9,000,000)
May	($4,000,000)
June	$11,000,000
July	$30,000,000
August	$30,000,000
September	$22,000,000
October	($1,000,000)
November	($4,500,000)
December	($6,500,000)
Annual	$0 Million

[1] Case No. 18-00561, Proceeding on Motion of the Commission Regarding Electric Vehicle Supply Equipment and Infrastructure (consensus proposal filed November 21, 2018). In its recommendation on PSEG Long Island's 2018 Utility 2.0 Plan, the Department of Public Service recommended adoption of DCFC incentives consistent with this proceeding.

The annual PSC is projected to decrease from $1.877 billion in 2018 to $1.793 billion in 2019 for a savings of $84 million. The primary drivers of the decline include lower projected energy sales, lower commodity prices, reduced gas transportation costs, and reduced generation capacity payments. In addition to the cost of fuels consumed in generation and purchased power, the Authority's share of costs charged by the regional energy markets, payments to energy service companies, Zero Emission Credits associated with the adoption by the NYS Public Service Commission of the Clean Energy Standard, as well as other agreements, hedging, and renewable energy costs are included in the PSC.

LIPA staff also seeks authorization to implement a recommendation made by PSEG Long Island to book regulatory assets for "Unusual Events" that would cause volatility (at the level described in the following paragraph) in the PSC. An Unusual Event is defined to mean an unexpected or unpredictable occurrence outside the control of the utility which results in a significant increase or decrease in power supply cost as compared to the projected level of power supply costs used to establish the PSC in a month. Unusual Events include, among others: sustained abnormal extremes in weather (e.g. a polar vortex); a major disruption in fuel supply; or the extended forced outage of a major electric facility (e.g., a transmission cable or power plant); and a change in law, regulation, or standard contract provision.

As proposed, a regulatory asset may be needed if, as a result of the occurrence of an Unusual Event, any month's Deferred Fuel Balance and/or current month's projected fuel costs rise to a level that would result in a change of more than 0.50 ₵/kWh in the immediately succeeding month's PSC as compared to the current month's PSC. The recovery of that portion of the deferred fuel balance or current month's projected recovery position attributable to the Unusual Event may be amortized so as to limit the month-over-month change in the PSC to no more than 0.50 ₵/kWh. In no event however shall the amortization period exceed four months.

Operating Expense

Total operating expenses are projected to increase from $719.8 million in 2018 to $765.2 million in 2019 for an increase of $45.4 million. Operating Expenses include PSEG Long Island Operating Expenses, PSEG Long Island Managed Expenses and LIPA Operating Expenses.

PSEG Long Island Operating Expenses include: T&D, Customer Service, Power Markets, Renewable Energy programs and costs associated with the annual Utility 2.0 Plan. PSEG Long Island Operating Expenses must remain within 102% of amounts budgeted for PSEG Long Island to receive its incentive compensation.

PSEG Long Island Managed Expenses are costs managed by PSEG Long Island, but not measured for incentive compensation as some of these expenses are not within their control. These include storm preparation and restoration, depreciation, uncollectible receivables and PILOTs.

LIPA Operating Expenses include PSEG Long Island's management fee, Authority staff salaries and professional consultant fees.

The increase in expenses is associated with a higher budget for storm related costs, the addition of new and expanded Utility 2.0 programs, including funding associated with Advanced Metering Infrastructure (AMI) meters, and a carryover of $0.7 million from 2018 to 2019 of funds associated with the 2018 Utility 2.0 Super Saver program.

Accounting Treatment Related to the Resolution of Superstorm Sandy Estimates

Included in the LIPA 2019 Operating Budget is the reduced amortization expense related to the resolution of Superstorm Sandy costs. In 2012, Superstorm Sandy caused costly and extensive damage to LIPA's transmission and distribution system. LIPA recognized the cost of such damage based on best available estimates in accordance with generally accepted accounting principles. Actual costs, including proper supporting documentation, were substantially delayed due to the inability of LIPA's former service provider to produce bills due to the implementation of a new accounting system.

During 2018, LIPA paid its final invoice related to these delayed billings. The initial estimates were higher than actual costs. Rather than lower the amount recognized by LIPA six years ago and distort current results, the Authority is afforded regulatory accounting treatment under GASB No. 62 and is, therefore, recommending netting this one-time adjustment of $42 million against an existing regulatory asset consistent with actions approved by the Board in the past. This action will reduce the existing regulatory asset amortization by approximately $6.0 million annually.

As LIPA follows the Public Power Model, this transaction does not impact the Authority's expenditures or the level of electric rates but does provide a less complex and more informative view of LIPA's net position and going forward financial condition to stakeholders, rating agencies, and investors. This accounting treatment is a preferred treatment for LIPA as its delivery rates are set to produce cash flows sufficient to cover debt service obligations rather than a traditional rate base/rate of return formulation of revenue requirements.

PILOTs, Taxes and Other Assessments

PILOTs, Taxes and Other Assessments are projected to increase from $544.8 million in 2018 to $546.3 million in 2019. PILOTs are both revenue-based and property-based. Property-based PILOTs are on Authority-owned properties and the LIPA Reform Act established a 2% annual cap on increases. In addition, the Authority incurs real property taxes associated with generating assets under contract through the National Grid Power Supply Agreement, among other agreements. The Authority continues to challenge these property taxes which are significantly over-assessed.

Annual Budget and Rate Updates

Under the New York Public Authorities Law as amended by the LIPA Reform Act (P.A.L. § 1020 et seq.), the Authority and PSEG Long Island are required to submit a proposed rate increase to the New York Department of Public Service (the "DPS") for review if it would increase the rates and charges by an amount that would increase the Authority's annual revenues by more than 2.5% of the prior year's total annual revenues. The proposed budget and associated rate adjustments would increase the Authority's 2019 revenues by less than this threshold.

In March 2015, the Authority adopted a "Revenue Decoupling Mechanism," which functions by comparing actual revenues with revenues authorized in the approved budget, and crediting (or collecting) any differences due to (or from) customers in the following year. In addition to recovering the variance between the prior year's budgeted and actual revenues, the RDM also recovers an estimate of such variance for the coming year (the "forward-looking component"). The forward-looking component is estimated based on the prior year's actual variance. This method produces reasonable estimates if the variance between budgeted and actual revenues remains similar from year to year in a multi-year sales forecast, such as the one adopted as part of the Authority's Three-Year Rate Case for 2016, 2017 and 2018.

The Authority used its most recent forecast of electricity sales to propose rates for 2019 sufficient to achieve the Authority's revenue requirements. Using an updated sales forecast for 2019 should result in a smaller variance because more recent information is available (producing a more accurate forecast). As a result, the forward-looking component of the RDM is not needed in any year in which an updated sales forecast is used to calculate rates and failure to recognize this could result in greater than necessary RDM revenue collection in the upcoming year. For this reason, Staff recommends that the RDM be modified such that the forward-looking component may be suspended in any year in which an updated sales forecast is used to calculate rates.

2019 Utility 2.0 Plan

The 2019 Proposed Budget includes $69.7 million in Capital funding and $16.4 million in Operating funding for Utility 2.0 initiatives. The Utility 2.0 plan is consistent with the DPS recommendation (attached as **Exhibit "C"**). The Utility 2.0 Program provides for full deployment of AMI meters, an expanded Super Savers program, a new Behind-the-Meter Storage program, and a new electric vehicle charging station incentive program.

Energy and Nature Center

The proposed Capital Budget includes $9.0 million for the planning, design and construction of a new Energy and Nature Center at Jones Beach pursuant to a Memorandum of Agreement between LIPA and the New York States Office of Parks and Recreation and Historic Preservation ("Parks"). The Energy and Nature Center ("Center") at Jones Beach will be a public-private partnership that LIPA and Parks will jointly fund. The partnership will jointly oversee the design, construction and operations of the Center, in addition to engaging in public outreach during all phases of planning, design and construction.

The Energy and Nature Center at Jones Beach will set an example of sustainable and resilient design, and through a variety of hands-on exhibits and programs, visitors to the Center will gain an understanding of Long Island's various ecosystems and learn how to use energy wisely and create a more resilient and sustainable future. The Center will be an interactive facility for visitors of all ages to become stewards of the environment and smart energy consumers with construction to begin later in 2019 and opening late-2020 early 2021.

Information Technology

LIPA's proposed Operating and Capital Budgets include $8.4 million for Information Technology ("IT") professional services and commodities that are expected to be procured using contracts negotiated by the New York State Office of the General Services ("NYS-OGS") and Federal Supply Schedules (General Service Administration or "GSA").

IT professional services include management support and expert assistance outside the scopes of service for LIPA's current IT consulting services contracts. These services would be billed on a fixed hourly labor rate or at a fixed-cost, at or below the rates negotiated by the NYS-OGS or the GSA, as applicable, on an as-needed basis to support various IT system implementation initiatives as well as operational and oversight functions. Over the next three years, such anticipated professional services include system design and architecture in order to support LIPA IT infrastructure upgrades, a data portability roadmap and Intranet initiatives, system integration and implementation of an IT helpdesk, inventory management, a new enterprise resource planning system ("ERP"), Cloud migration, cybersecurity planning and implementation, IT strategic planning, business process improvement initiatives related to various IT systems implementations, quality assurance of various IT initiatives within LIPA and independent verification and validation of IT system implementations managed by PSEG Long Island.

Commodities to be procured include hardware, software licenses, software/cloud subscription, system hosting, telephony, telecom, audiovisual support and services on an as-needed basis in the ordinary course of business and continued maintenance of the existing hardware and software.

Amendment of the 2018 Operating and Capital Budgets

PSEG Long Island's 2018 approved Operating Budget is being reduced by $0.7 million to account for the carryover of funds related to the Utility 2.0 Super Saver program from 2018 to 2019.

PSEG Long Island is reducing its approved 2018 Capital Budget by $58.6 million. This reflects the carryover of $56.1 million in Capital projects from 2018 to 2019, including $41.8 million in Load Growth projects such as the Ruland Road New 69 KV Circuit and the Canal to Southampton New 69 KV Transmission Circuit. In addition, 2018 Utility 2.0 funding is reduced by $2.5 million, to reflect a correction to the budget of $4.8 million and accelerated meter deployment of $2.3 million.

Public Comment on the 2019 Operating and Capital Budgets

The Authority held two public comment sessions on the 2019 Budget, one in Nassau County and one in Suffolk County, both on November 16, 2018. No public comments were received at the public hearings.

The Authority also accepted written and emailed comments. Three comments were received from individual customers. Two customers had read a November newspaper article on the 2019 Budget and wrote in opposition to any increase in delivery rates. One customer sought further information on the Budget than was provided in the article. The requested information was provided by Authority staff. This customer also expressed opposition to any increase in delivery rates.

The DPS received the Authority’s Annual Budget and Rate Update filing and Utility 2.0 filing as described above.

Recommendation

Based upon the foregoing, I recommend approval of the above requested action by adoption of a resolution in the form of the draft resolution attached hereto.

Attachments

Exhibit “A”	Resolution
Exhibit “B”	Proposed 2019 Operating and Capital Budgets
Exhibit “C”	DPS Utility 2.0 Recommendation
Exhibit “D”	Tariff redline reflecting rate adjustments and RDM modification

Exhibit "A"

RECOMMENDING APPROVAL OF THE 2019 OPERATING AND CAPITAL BUDGETS AND AMENDMENT OF THE 2018 BUDGETS

WHEREAS, the Long Island Power Authority ("Authority"), through its wholly owned subsidiary, LIPA, owns the electric transmission and distribution system serving the counties of Nassau and Suffolk and a small portion of the County of Queens known as the Rockaways; and

WHEREAS, the Board of Trustees is required to approve annual budgets for the operations of the Authority and for capital improvements; and

WHEREAS, the proposed budget incorporates Operating and Capital budgets for the operation and maintenance of the transmission and distribution system, customer services, business services and energy efficiency and renewable energy programs which are predicated on improving storm response and restoration, customer satisfaction, and reliability and storm hardening; and

WHEREAS, under the New York Public Authorities Law as amended by the LIPA Reform Act (P.A.L. § 1020 et seq.), the Authority and PSEG Long Island are required to submit a proposed rate increase to the New York Department of Public Service for review if it would increase the rates and charges by an amount that would increase the Authority's annual revenues by more than 2.5% of the prior year's total annual revenues. The proposed budget and associated rate adjustments would increase the Authority's 2019 revenues by less than this threshold. Therefore, the proposed budget contains Rate updates consistent with the Authority's Mission, Board Policies, and the LIPA Reform Act; and

WHEREAS, the Authority released its proposed 2019 Operating and Capital Budgets on November 14, 2018 and held two public comment sessions on November 16, 2018; and

WHEREAS, the memorandum accompanying this resolution includes a schedule of deferrals and amortizations of certain generation capacity costs within the months of the year to affect the more accurate reflection of cost causation in electric rates within each month of the year; and

WHEREAS, the proposed budget includes $9 million for the planning, design and construction of a new energy and nature education center at Jones Beach in partnership with the NYS Department of Parks and Recreation, which will require the Chief Executive Officer or his designee(s) to execute the Memorandum of Agreement as described in the accompanying Memorandum; and

NOW, THEREFORE, BE IT RESOLVED, that consistent with the accompanying memorandum, the Finance and Audit Committee (the "Committee") of the Board of Trustees hereby recommends approval of the proposed 2019 Operating and Capital Budgets and associated rate and RDM adjustments, which are attached hereto; and

BE IT FURTHER RESOLVED, that the the Committee hereby recommends that the Authority amend its approved 2018 Capital Budget to reduce expenditures by $58.6 million to defer these expenditures to 2019 and correct the Utility 2.0 funding; and

BE IT FURTHER RESOLVED, that the Committee hereby recommends that that the Authority amends its approved 2018 Operating Budget to reduce by $0.7 million to defer these expenditures to 2019; and

BE IT FURTHER RESOLVED, that the Committee hereby recommends that that the Authority establish a regulatory asset as described in the accompanying memorandum for Unusual Events that would result in a change of more than 0.50 ₵/kWh in the immediately succeeding month's PSC as compared to the current month's PSC allowing for recovery over a period not to exceed four months; and

BE IT FURTHER RESOLVED, that the Committee hereby recommends that the Authority transfer accounting impacts due to the resolution of Superstorm Sandy estimates against a regulatory asset and reduce its annual amortization over the remaining life; and

BE IT FURTHER RESOLVED, that the Committee hereby recommends that that the Authority finance the requirements of the 2019 and 2020 Capital Budgets, as adjusted from time to time, through a combination of internally- generated funds and the issuance of tax-exempt or taxable debt of the Authority and authorizes the Officers of the Authority to evidence such intent by appropriate certifications; and

BE IT FURTHER RESOLVED, that the Committee hereby recommends that the Chief Executive Officer and his designees be authorized to carry out all actions deemed necessary or convenient to implement this resolution.

Dated: December 19, 2018