BOARD AGENDA SUMMARY SHEET

Committee or Board: Finance and Audit	**Date:** December 13, 2019	**Board Meeting Date:** December 18, 2019

***For All Committee Voting Items*:**

Title of Agenda Item: Recommendation to Approve Amendments to the Board Policy on Debt and Access to the Credit Markets

Consent Agenda: ☒Yes ☐No **Accompanying Presentation:** ☐Yes ☒No

LIPA Presenter: Kenneth Kane **PSEG Long Island Presenter:** N/A

Requested Action:	The Committee is requested to adopt a resolution recommending amendments to the Board Policy on Debt and Access to the Credit Markets (the "Policy").
Summary: **(include proposed amendments to Board Policies, if applicable)**	By Resolution No. 1319, dated September 21, 2016, the Board adopted the Policy with the purpose of serving the long-term interests of LIPA's customer-owners by adopting sound financial plans in each year. The Policy was last amended by the Board by Resolution No. 1473, dated March 20, 2019. The proposed amendments relate to the: (i) fixed obligation coverage target; (ii) percent of capital spending funded by debt; and (iii) pre-funding of OPEBs. These amendments more fully set forth in the accompanying memorandum and related exhibits.

FOR CONSIDERATION
December 18, 2019

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

FROM: Thomas Falcone

SUBJECT: Recommendation to Approve Amendments to the Board Policy on Debt and Access to the Credit Markets

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Requested Action

The Finance and Audit Committee (the "Committee") of the Board of Trustees (the "Board") of the Long Island Power Authority ("LIPA") is requested to adopt a resolution recommending amendments to the Board Policy on Debt and Access to the Credit Markets (the "Policy"), which resolution is attached hereto as **Exhibit "A"**.

Background

By Resolution No. 1319, dated September 21, 2016, the Board adopted the Policy with the purpose of serving the long-term interests of LIPA's customer-owners by adopting sound financial plans in each year. The Policy was amended by the Board by Resolution No. 1354, dated March 29, 2017 and last updated by Resolution No. 1473, dated March 20, 2019.

Recommended Changes to the Policy

I. Fixed Obligation Coverage Target

The Policy currently targets 1.45x coverage of fixed-obligation coverage on debt and *capital lease* payments, in order to generate adequate cash flow to keep long-term borrowing, on average, below 64 percent of capital spending.

In 2019, the Governmental Accounting Standards Board ("GASB") issued new rules for leases effective for 2020 called Statement No. 87 - Leases. This new standard no longer differentiates between "capital" and "operating" leases and now considers all leases with a term greater than one year to be a financing arrangement, creating a corresponding asset and liability on the balance sheet.

The new accounting rules do not change LIPA's cash flow or borrowing requirements. To maintain the same level of cash flow, LIPA Staff proposes to modify its financial target in the Policy from 1.45x coverage of debt and *capital lease* payments to 1.35x coverage of annual debt and *lease payments*, using the new definition of leases as set forth in GASB 87. As demonstrated in the 2020 budget, the proposed new target produces an identical amount of dollars to cover fixed obligations as the prior 1.45x coverage ratio under the prior lease accounting rules.

II. Percent of Capital Spending Funded by Debt

Given the variability in capital spending from year to year, as well as the variability in timing of bond issuance, LIPA Staff recommends targeting a revenue funding percentage of capital spending over a multi-year planning period as opposed to implementing a strict year-by-year percentage target. Therefore, LIPA Staff proposes to modify the Policy to measure the 64% funding test on a rolling three-year average basis. In addition, further clarification is proposed within the Policy to recognize that to the extent LIPA uses cash to retire debt in advance of its due date, that is the functional equivalent of paying cash for capital expenditures.

III. Pre-funding of Other Post-Employment Benefits ("OPEBs")

Under the Amended and Restated Operations Services Agreement (the "OSA"), certain post-employment health and life insurance benefit plan expenses known as OPEBs for the employees of PSEG Long Island LLC are payable by LIPA both during the term of the OSA and after termination. To ensure funds are available for such obligations, by Resolution No. 1246, dated December 17, 2014, the Board established an OPEB Account for the purpose of providing for these future OPEB costs (the "OPEB Resolution"). The Board authorized the deposit of monies in such OPEB Account as permitted by its Investment Policy and the withdraw of funds under certain limited circumstances.

The Trustees are being requested to supersede the OPEB Resolution by incorporating such terms into the Policy. The only substantive change between the OPEB Resolution and the proposed Policy is to eliminate an annual certification that was required in the OPEB Resolution prior to making annual deposits to the OPEB Account. The amounts deposited to the OPEB Account are now pursuant to an actuarial study and are reflected in the approved Operating and Capital Budget.

All proposed changes to the Policy are more specifically shown on **Exhibit "B"**.

Recommendation

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

Attachments

Exhibit "A" Resolution
Exhibit "B" Policy (redline)
Exhibit "C" Policy (clean)

Exhibit "A"

RESOLUTION RECOMMENDING APPROVAL OF AMENDMENTS TO THE BOARD POLICY ON DEBT AND ACCESS TO THE CREDIT MARKETS

WHEREAS, the Board Policy on Debt and Access to the Credit Markets (the "Policy") was originally approved by the Board of Trustees by Resolution No. 1319, dated September 21, 2016; and amended by the Board of Trustees by Resolution No. 1354, dated March 29, 2017 and by Resolution No. 1473, dated March 20, 2019; and

WHEREAS, the Finance and Audit Committee (the "Committee") has reviewed the Policy and recommends approval of the amendments to the Policy as recommended by Staff in the accompanying memorandum.

NOW, THEREFORE, BE IT RESOLVED, that consistent with the accompanying memorandum, the Committee hereby recommends approval of amendments to the Policy.

Dated: December 18, 2019

Exhibit "B"

Board Policy:	**Debt and Access to the Credit Markets**
Policy Type:	**Operating Policies**
Monitored by:	**Finance and Audit Committee**
Board Resolution:	**#1319, approved September 21, 2016** **#1354, amended March 29, 2017** **#1473, amended March 20, 2019** **#XXX, amended December 18, 2019**

LIPA

Board Policy on Debt and Access to the Credit Markets

It is the policy of the ~~Board of Trustees of the~~ Long Island Power Authority to serve the long-term interests of ~~the Authority's customers by~~ LIPA's customer-owners. The Long Island electric grid requires substantial investments each year to maintain its reliability and resiliency. By adopting sound fiscal metrics and sustainable financial plans ~~in each year. Sound financial plans ensure the~~, LIPA ensures prudent levels of borrowing, ready access to ~~borrowing~~funds on reasonable terms ~~necessary to fund the~~for infrastructure ~~investments that maintain the reliability and resiliency of the Long Island electric system. Such financial plans contemplate prudent levels of borrowing that will accommodate efficient access to the capital markets and thereby minimize the~~ investment, and the lowest long-term cost ~~of providing electric service~~ to our customer-owners.

LIPA will achieve the lowest long-term cost to our customer-owners by adopting ~~annual~~ budgets and financial plans that ~~support bond~~meet the following objectives:

- Support credit ratings of at least A2/A; ~~from the several rating agencies by the end of 2021. Such budgets and financial plans include:~~

- Achieve fixed~~-~~-obligation coverage ratios ~~on Authority-issued debt and~~ of no less than (i) 1.35x on the combination of ~~Authority~~LIPA-issued debt and lease payments; and (ii) 1.15x on the combination of LIPA-issued debt, Utility Debt Securitization Authority-issued debt ~~of no less than:~~, and lease payments;[1]

	~~2016~~	~~2017~~	~~2018~~	~~2019~~
~~LIPA~~	~~1.20x~~	~~1.30x~~	~~1.40x~~	~~1.45x~~
~~LIPA and UDSA~~	~~1.15x~~	~~1.20x~~	~~1.25x~~	~~1.25x~~

- Generate~~generating~~ sufficient cash flow from ~~current~~ revenues to maintain the issuance of new debt as a percentage of capital spending at 64~~%~~ percent or ~~lower~~

[1] Lease payments are defined in Governmental Accounting Standard Board Statement No. 87

~~throughout the planning period~~less as measured on a three-year rolling average;

- Maintain~~maintaining~~ (i) cash on hand at each month end of at least $100 million in the Operating Fund and $150 million in the Rate Stabilization Fund and ~~overall~~(ii) cash on hand and available credit of at least 120 days of operating expenses;

- Pre-fund obligations to LIPA's Service Provider for pension costs each year in a fiscally sound manner, as measured by an actuarial services firm no less than every other year;

- Pre-fund~~ing~~ obligations to LIPA's Service Provider for ~~of Pension Fund Obligations,~~ Other Post-Employment Benefits (OPEBs) to a dedicated OPEB Account in a fiscally sound manner, as measured by an actuarial services firm no less than every other year[2];

- Pre-fund LIPA's OPEB Trust in a fiscally sound manner, as measured by an actuarial services firm no less than every other year; and

- Pre-fund LIPA's Nuclear Decommissioning Trust Fund ~~Obligations~~ in a fiscally sound manner, as measured ~~no less than every third year~~ by an actuarial services firm no less than every other year.

The Chief Executive Officer shall report annually to the Board on compliance with the key provisions of this Policy.

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Appendix: Methodology to Calculate Financial Metrics

[2] After notifying the Finance and Audit Committee, LIPA's Chief Executive Officer or Chief Financial Officer are authorized to withdraw funds from the OPEB Account if there are insufficient revenues to pay reasonable and necessary Operating Expenses or to make payments on bonds or parity obligations. The OPEB Account is therefore deemed available to make such payments, acting as a reserve fund. Any withdraws for such purposes will be repaid within twelve months.

Board Policy on Debt and Access to the Credit Markets
Appendix: Methodology to Calculate Financial Metrics

The Board Policy on Debt and Access to the Credit Markets references three ~~quantitative~~ financial ratios: Fixed Obligation Coverage; Days Cash on Hand; and the Percentage of Capital Spending Funded by Debt. This Appendix describes the calculation of each ~~of these ratios as used in the Board Policy~~ ratio.

Fixed Obligation Coverage is the ratio of funds available to pay LIPA's fixed obligations (annual debt service plus ~~capital~~ lease payments) as compared to those obligations. This ratio therefore measures the resources available from operations to make fixed scheduled payments. ~~If a utility has a~~A fixed obligation coverage ratio of 1.0x, ~~they have~~ provides for exactly enough funds from ongoing operations to pay all operating expenses and make such fixed payments, leaving no ~~such~~excess funds available for capital investments. Even a small disruption to operations ~~such as higher than anticipated expenses or a storm may~~ therefore could endanger payment of debt service and other fixed payments. A coverage ratio of 1.~~25~~35x means the utility has enough funds to pay operating expenses and fixed obligation costs, plus a margin of ~~25% over and above the fixed obligation costs~~35 percent. Higher coverage ratios reflect a greater likelihood that such fixed payments will be paid and therefore represent~~s~~ less financial risk to bond and lease holders. As such, higher coverage ratios typically merit higher bond ratings and correspondingly lower borrowing costs ~~on debt and letters of credit~~.

Coverage ~~is~~ differs~~ent~~ from most financial statistics, ~~however,~~ in that ~~coverage~~it is not ~~actually~~ paid to bond and lease holders or ~~other~~ outside parties. The funds in excess of those actually required to pay operating expenses and fixed payments remain available to LIPA to fund new infrastructure investments in lieu of issuing debt. As a result, higher coverage provides a double benefit to LIPA's customer-owners: it lowers both the cost of interest on bonds and the amount of bonds LIPA issues to build infrastructure.

LIPA's fixed obligation coverage calculation, detailed below, is intended to be similar to the way ~~that~~ rating agencies and investors calculate coverage. ~~and~~ This differs from the coverage formula used in LIPA's bond covenants[1]. The approach simplifies the review of sources and uses of cash flow and adopts most ~~of the~~ GAAP[2] conventions for measuring revenues and expenses, except in a few key areas highlighted below where GAAP figures are materially different than cash flow.

UDSA bonds are paid by an irrevocable, nonbypassable restructuring charge recovered from consumers set at an amount sufficient to pay the principal and interest payable on the bonds and other ongoing financing costs.

1 LIPA's bond covenants calculate coverage by treating tax payments and ~~capital~~ lease obligations as funds available to pay debt service obligations.
2 Generally Accepted Accounting Principles, as established by the Government Accounting Standards Board ~~(GASB)~~.

The table below summarizes LIPA's fixed obligation coverage calculation:

~~+~~	~~Operating~~	~~Note 1~~
~~+~~	~~Revenue Grant~~	~~Note 2~~
~~+~~	~~Income~~	~~Note 3~~
~~+~~	~~Investment and Miscellaneous Income~~	~~Note 4~~
~~+~~	~~(Net) Suffolk Property Tax Settlement~~	~~Note 4~~
~~=~~	~~**Total Revenue and Income**~~	~~Subtotal 1~~
~~+~~	~~Total Operating Expenses~~	~~Note 5~~
~~-~~	~~Depreciation and Amortization~~	~~Note 6~~
~~-~~	~~OPEB GAAP Operating Expense~~	~~Note 7~~
~~+~~	~~Other Interest Expense~~	~~Note 8~~
~~=~~	~~**Total Deductions from Revenue and Income**~~	~~Subtotal 2~~
~~+~~	~~Total Revenue and~~	~~Subtotal 1~~
~~-~~	~~Income Total Deductions~~	~~Subtotal 2~~
~~+~~	~~Annual Capital Lease Payments~~	~~Note 9~~
~~=~~	~~**Funds Available for LIPA + UDSA Coverage**~~	~~Subtotal 3~~
~~+~~	~~Funds Available for LIPA + UDSA~~	~~Subtotal 3~~
~~-~~	~~Coverage UDSA Debt Service~~	~~Note 10~~
~~=~~	~~**Funds Available for LIPA Fixed Obligations**~~	~~Subtotal 4~~
~~+~~	~~LIPA Debt Service~~	~~Note 10~~
~~+~~	~~Annual Capital Lease Payments~~	~~Note 9~~
~~=~~	~~**LIPA Fixed Obligations**~~	~~Subtotal 5~~
~~+~~	~~LIPA Fixed~~	~~Subtotal 5~~
~~+~~	~~Obligations UDSA~~	~~Note 10~~
~~=~~	~~**LIPA + UDSA Fixed Obligations**~~	~~Subtotal 6~~
~~+~~	~~Funds Available for LIPA Fixed~~	~~Subtotal 4~~
~~/~~	~~Obligations LIPA Fixed Obligations~~	~~Subtotal 5~~
~~=~~	~~**LIPA Coverage Ratio**~~	
~~+~~	~~Funds Available for LIPA + UDSA~~	~~Subtotal 3~~
~~/~~	~~Obligation LIPA + UDSA Fixed Obligations~~	~~Subtotal 6~~
~~=~~	~~**LIPA + UDSA Coverage Ratio**~~	

+	Operating Revenue	Note 1
+	Grant Income	Note 2
+	Investment and Miscellaneous Income (Net)	Note 3
+	Suffolk Property Tax Settlement Charges	Note 4
+	Visual Benefits Assessment Charges	Note 4
=	**Total Revenue and Income**	Subtotal 1
+	Total Operating Expenses	Note 5
+	Other Interest Costs	Note 6
	Less Non-Cash Adjustments:	
−	Depreciation and Amortization	Note 7
−	OPEB GAAP Operating Expense	Note 8
=	**Total Deductions from Revenue and Income**	Subtotal 2
+	Total Revenue and Income	Subtotal 1
−	Total Deductions	Subtotal 2
+	Annual Long-Term Lease Payments	Note 9
=	**Funds Available for LIPA + UDSA Coverage**	Subtotal 3
+	Funds Available for LIPA + UDSA Coverage	Subtotal 3
−	UDSA Debt Service	Note 10
=	**Funds Available for LIPA Fixed Obligations**	Subtotal 4
+	LIPA Debt Service	Note 10
+	Annual Long-Term Lease Payments	Note 9
=	**LIPA Fixed Obligations**	Subtotal 5
+	LIPA Fixed Obligations	Subtotal 5
+	UDSA Debt Service	Note 10
=	**LIPA + UDSA Fixed Obligations**	Subtotal 6
+	Funds Available for LIPA Fixed Obligations	Subtotal 4
/	LIPA Fixed Obligations	Subtotal 5
=	**LIPA Coverage Ratio**	
+	Funds Available for LIPA + UDSA Obligations	Subtotal 3
/	LIPA + UDSA Fixed Obligations	Subtotal 6
=	**LIPA + UDSA Coverage Ratio**	

The funds available to pay fixed obligations are ~~roughly~~generally calculated as revenue plus other sources of income minus operating expenses, excluding non-cash expenses such as depreciation ~~and,~~ amortization and OPEBs, minus other interest ~~expense~~costs. The actual results for each year are ~~included~~provided in the footnotes to ~~the Authority~~LIPA's audited financial statements. The ~~below~~ notes below describe each line item in the fixed obligation coverage calculation.

1. *Operating Revenue* ~~can be found~~is reported on ~~the Authority~~LIPA's Income Statement of Revenue, Expenses and Changes in Net Position.

2. *Grant Income* includes money received from state and federal agencies to cover specified program expenditures, such as the Regional Greenhouse Gas Initiative (RGGI) and ~~FEMA~~Federal Emergency Management Agency (FEMA) reimbursements for storm recovery. Grant income is generally recognized in the period it is received, except for the FEMA storm hardening grant, which is ~~being~~ recognized over the expected life of the assets being constructed in amounts equal to depreciation expense on those assets in each year. The amount of Grant Income is reported on ~~the Authority's Income~~LIPA's Statement of Revenue, Expenses and Changes in Net Position.

3. *Investment Income and Other Miscellaneous Income (Net)* includes the amounts reflected on the ~~Income~~ Statement of Revenue, Expenses and Changes in Net Position for investment income, excluding income earned on LIPA's Nuclear Decommissioning Trust, and the net amount of the miscellaneous other income and deductions as reported on ~~the Income~~LIPA's Statement of Revenue, Expenses and Changes in Net Position.

4. *Suffolk Property Tax Settlement and Visual Benefits Assessment* are two ~~large~~ regulatory assets that are being repaid by ~~certain~~impacted customers ~~in~~through their electric bills over ~~time~~a specified period of time. ~~The~~Such customers repay ~~both~~ principal and interest on related debt obligations. For GAAP purposes, the interest ~~payments are~~component is included in ~~Investment~~Other Income while the repayment of principal is not reflected in Operating Revenue in the year received (it was previously recognized when the regulatory assets were established). For coverage purposes, the cash receipts related to principal payments as shown on ~~the Authority~~LIPA's Cash Flow Statement are available to pay the related debt payments.

5. *Total Operating Expenses* ~~can be found on the Authority's Income~~are reported on LIPA's Statement of Revenue, Expenses and Change in Net Position and conform to GAAP.

~~5.~~6. *Other Interest Costs* represent costs that are reported as interest expense on the Statement of Revenue, Expenses and Changes in Net Position but are not part of Debt Service. The largest component of Other Interest Expense is interest rate swap payments, which are generally subordinate to bond payments. Additional costs include interest on customer deposits and bank fees. Other Interest Costs is not Debt Service, does not require coverage, and is therefore treated the same as Operating Expenses in the calculation of Funds Available for Debt Service. The amount of Other Interest Expenses is shown on the LIPA's Statement of Revenue, Expenses and Changes in Net Position.

~~6.~~7. *Depreciation and Amortization* are deducted from Operating Expenses for the coverage calculation. Instead of using accounting allocations for the recovery of capital investments and regulatory assets, the coverage calculation recognizes that these costs are ~~to be repaid to bondholders~~recovered through ~~the scheduled repayment of principal on bonds. Therefore, these amounts~~debt service and are ~~reflected in Debt Service in~~eliminated from the coverage calculation. Depreciation and Amortization ~~can be found on the Authority's Income~~are reported on LIPA's Statement~~.~~ of Revenue, Expenses, and Changes in Net Position. LIPA's key components of Depreciation and Amortization include:

- Depreciation of Utility Plant and Equipment
- Amortization of the Acquisition Adjustment ~~paid for the (~~purchase adjustment related to purchase of the Long Island Lighting Company in 1998~~)~~
- Amortization of certain regulatory assets established by the Board for specific obligations ~~to be funded by ratepayers, which are primarily the long-term obligation to fund~~related to pensions and benefits for employees who provided services to LIPA under the expired Management Services Agreement (MSA) between LIPA and National Grid (the former service provider).

~~7.~~8. *OPEB GAAP Operating Expense.* ~~Due to~~With the transition to a new service provider in 2014, ~~LIPA has few active retirees collecting~~there was a limited number of employees eligible for retirement and the cash pay-as-you-go costs for Other Post-Employment Benefits (OPEBs)~~. The cash pay-as-you-go expense for such benefits is therefore~~ was relatively small ~~relative~~compared to the GAAP ~~expense for accruing a liability to make such payments to retirees in the future. The difference between these two amounts can be found on the Authority's Cash Flow Statement.~~accrual expense. In 2014, LIPA adopted a funding plan consistent with actuarially sound principles to pre-fund future OPEB benefit expenses for employees currently working for the ~~Authority and PSEG Long Island (the~~ service provider~~)~~. This pre-funding is deposited into a separately segregated OPEB Account~~. As the accrual GAAP Operating Expense for OPEBs in any year is significantly higher than cash pay-as-you-go expense, the difference between the GAAP and cash expense~~ that is available ~~if needed to pay fixed obligations in the year. Furthermore, from a legal perspective the Authority's annual pre- funding deposits into the OPEB Account to fund future benefits are also first available~~ to make fixed obligation payments. ~~Additionally, the Board authorized that, should the need arise, the OPEB Account balance is available to make fixed obligation payments, acting in effect as a reserve fund.~~ LIPA's ratemaking model therefore recognizes the availability of these funds to make fixed obligation payments.[3] The non-cash OPEB expense is reported on LIPA's Statement of Cash Flow.

~~*Other Interest Expense* represents costs that are reported as interest expense on the income statement but are not part of Debt Service. The largest component of Other Interest Expense is interest rate swap payments, which are generally subordinate to bond payments.~~

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[3] LIPA originally contemplated a similar adjustment for the pension expense related to PSEG Long Island employees. The difference between GAAP expense and ERISA cash funding for pensions has narrowed and so this is no longer a material adjustment to the funds available to pay fixed obligations. Over time, the difference between GAAP expense and cash expense for OPEBs will also narrow and LIPA expects that this adjustment may be eliminated.

~~Additional such expense includes interest on customer deposits and bank fees. Other Interest Expense is not Debt Service, does not require coverage, and is therefore treated the same as Operating Expenses in the calculation of Funds Available for Debt Service. The amount of Other Interest Expense is shown on the Authority's Cash Flow Statement.~~

~~8.~~9. *Annual ~~Capital~~Long-Term Lease Payments.* Rating agencies ~~treat capital~~consider lease payments as a fixed obligation that operates like debt. LIPA has substantial ~~capital~~ leases related to its procurement of power supplies for generating facilities and transmission cables. According to GASB, ~~long term~~ leases ~~that meet certain criteria~~ must be recorded on ~~the Authority~~LIPA's financial statements as ~~capitalized leases.~~long-term assets and obligations. To recognize ~~capital~~long-term lease obligations in the calculation of coverage, the rating agencies add the annual ~~capital~~ lease obligation (imputed repayment of principal and interest) to both the numerator and the denominator of the fixed obligation coverage ratio. LIPA's Annual ~~Capital~~Long-Term Lease Payments are shown in the footnotes to its audited financial statements.

~~9.~~10. *Debt Service* consists of the payment of principal and interest on LIPA's long~~-~~-term and short~~-~~-term bonds. The debt service payment schedule ~~on~~for long~~-~~-term bonds is established when the bonds are issued and typically includes semi-annual ~~payment of~~ interest payments. Short~~-~~-term debt typically includes monthly or quarterly ~~payments of~~ interest payments. Repayment of principal on bonds can occur under a number of circumstances that are relevant to the determination of debt service obligations in any given year.

~~Debt that is retired per schedule is~~Scheduled debt maturities are considered ~~a~~ debt service obligations and ~~is~~are included in the debt service payments ~~on that scheduled date~~. Debt is sometimes ~~refinanced through the issuance of~~refunded with new debt, typically to obtain ~~a~~ lower ~~cost~~interest costs. Debt ~~which is refinanced~~refunded before its scheduled date is excluded from debt service requirements, and the scheduled repayments of the new debt ~~takes the place of~~replaces the scheduled repayment of the ~~retired~~refunded debt. Debt may also be called for early retirement should cash on hand be sufficient for such purposes. Such early redemption or defeasance of debt is excluded from debt service requirements. Short~~-~~-term debt can also be refunded or rolled~~-~~-over through ~~the issuance of~~issuing new debt. This happens most frequently when an existing short~~-~~-term arrangement expires or is replaced by a new line of credit on more favorable terms. In such cases, the roll-over of principal is not considered ~~to be~~ a debt service obligation at that time, as this debt was always expected to be paid by the proceeds of the roll-over and not by revenues. ~~The amount of~~ Debt Service payments ~~can be found~~are reported on ~~the Authority~~LIPA's Cash Flow Statement.

Minimum Days Cash on Hand must be at least 120 days

Days Cash on Hand is the ratio of the total cash and credit available divided by ~~the Authority~~LIPA's budgeted average daily operating expenses.

Days Cash on Hand measures ~~the Authority~~LIPA's ability to sustain its operations if revenues are delayed, reduced or interrupted for any reason. Available cash consists of cash reported on the ~~balance sheet~~Statement of Net Position and includes both unrestricted cash and funds ~~that are~~ held in a restricted account dedicated to pre-funding PSEG Long Island's operating and capital expenditures, in accordance with the terms of the Amended and Restated Operations Services Agreement. Available credit includes multiple sources such as ~~commercial paper~~, letters and lines of credit, and general revenue notes~~.~~, ~~Average~~including a revolving credit agreement. The average daily expenditure is calculated by taking LIPA's annual approved budgeted revenues minus depreciation, amortization, and interest expense (budgeted operating expenses) and dividing the net value by 365 days.

> **Percent of Capital Spending Funded by Debt not to exceed 64% measured over a three-year period**

Percent of Capital Spending Funded ~~b~~By Debt is calculated as the ratio of new money debt budgeted to be issued ~~in the year~~ divided by ~~total~~ approved capital spending. It is typically calculated both including and excluding funding derived from grants, such as FEMA. The capital spending in any year is directly observable from LIPA's financial ~~documents~~statements and represents the net increase in ~~fixed assets~~utility plant and property (plant in service plus investments in related utility assets like circuits or transformers). Similarly, LIPA's debt issuances are categorized as either refinancing of existing debt or new money debt and are ~~clearly~~ identified as to the general usage of the funds. Capital expenditures financed using short~~-~~-term debt or available cash that is later replenished by long~~-~~-term bonds are excluded from the calculation.

Given the variability in capital ~~expense~~spending from year to year, as well as the variability in timing of bond issuance, it is prudent to target a revenue funding percentage over a multi-year planning period as opposed to implementing a strict year-by-year ~~percentage~~ target. LIPA measures the 64 percent target on a rolling three-year average basis.

In certain circumstances, LIPA may choose to exercise an early redemption of existing debt with available cash on hand. These transactions reduce outstanding debt obligations that could have been used to cash-fund capital spending and effectively reduce the amount of new capital spending funded by debt. Such early redemptions are incorporated into the ratio in the year that the redemption occurs and represent an offset to the new debt that was issued in the year.

Exhibit "C"

Board Policy: **Debt and Access to the Credit Markets**

Policy Type: **Operating Policies**

Monitored by: **Finance and Audit Committee**

Board Resolution: **#1319, approved September 21, 2016**
#1354, amended March 29, 2017
#1473, amended March 20, 2019
#XXX, amended December 18, 2019

Board Policy on Debt and Access to the Credit Markets

It is the policy of the Long Island Power Authority to serve the long-term interests of LIPA's customer-owners. The Long Island electric grid requires substantial investments each year to maintain its reliability and resiliency. By adopting sound fiscal metrics and sustainable financial plans, LIPA ensures prudent levels of borrowing, ready access to funds on reasonable terms for infrastructure investment, and the lowest long-term cost to our customer-owners.

LIPA will achieve the lowest long-term cost to our customer-owners by adopting budgets and financial plans that meet the following objectives:

- Support credit ratings of at least A2/A;
- Achieve fixed-obligation coverage ratios of no less than (i) 1.35x on the combination of LIPA-issued debt and lease payments; and (ii) 1.15x on the combination of LIPA-issued debt, Utility Debt Securitization Authority-issued debt, and lease payments;[1]
- Generate sufficient cash flow from revenues to maintain the issuance of new debt as a percentage of capital spending at 64 percent or less as measured on a three-year rolling average;
- Maintain (i) cash on hand at each month end of at least $100 million in the Operating Fund and $150 million in the Rate Stabilization Fund and (ii) cash on hand and available credit of at least 120 days of operating expenses;
- Pre-fund obligations to LIPA's Service Provider for pension costs each year in a fiscally sound manner, as measured by an actuarial services firm no less than every other year;
- Pre-fund obligations to LIPA's Service Provider for Other Post-Employment Benefits (OPEBs) to a dedicated OPEB Account in a fiscally sound manner, as

[1] Lease payments are defined in Governmental Accounting Standard Board Statement No. 87

measured by an actuarial services firm no less than every other year[2];

- Pre-fund LIPA's OPEB Trust in a fiscally sound manner, as measured by an actuarial services firm no less than every other year; and

- Pre-fund LIPA's Nuclear Decommissioning Trust Fund in a fiscally sound manner, as measured by an actuarial services firm no less than every other year.

The Chief Executive Officer shall report annually to the Board on compliance with the key provisions of this Policy.

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Appendix: Methodology to Calculate Financial Metrics

[2] After notifying the Finance and Audit Committee, LIPA's Chief Executive Officer or Chief Financial Officer are authorized to withdraw funds from the OPEB Account if there are insufficient revenues to pay reasonable and necessary Operating Expenses or to make payments on bonds or parity obligations. The OPEB Account is therefore deemed available to make such payments, acting as a reserve fund. Any withdraws for such purposes will be repaid within twelve months.

Board Policy on Debt and Access to the Credit Markets
Appendix: Methodology to Calculate Financial Metrics

The Board Policy on Debt and Access to the Credit Markets references three financial ratios: Fixed Obligation Coverage; Days Cash on Hand; and the Percentage of Capital Spending Funded by Debt. This Appendix describes the calculation of each ratio.

Fixed Obligation Coverage is the ratio of funds available to pay LIPA's fixed obligations (annual debt service plus lease payments) as compared to those obligations. This ratio therefore measures the resources available from operations to make fixed scheduled payments. A fixed obligation coverage ratio of 1.0x, provides for exactly enough funds from ongoing operations to pay all operating expenses and make such fixed payments, leaving no excess funds available for capital investments. Even a small disruption to operations therefore could endanger payment of debt service and other fixed payments. A coverage ratio of 1.35x means the utility has enough funds to pay operating expenses and fixed obligation costs, plus a margin of 35 percent. Higher coverage ratios reflect a greater likelihood that such fixed payments will be paid and therefore represent less financial risk to bond and lease holders. As such, higher coverage ratios typically merit higher bond ratings and correspondingly lower borrowing costs.

Coverage differs from most financial statistics, in that it is not paid to bond and lease holders or outside parties. The funds in excess of those actually required to pay operating expenses and fixed payments remain available to LIPA to fund new infrastructure investments in lieu of issuing debt. As a result, higher coverage provides a double benefit to LIPA's customer-owners: it lowers both the cost of interest on bonds and the amount of bonds LIPA issues to build infrastructure.

LIPA's fixed obligation coverage calculation, detailed below, is intended to be similar to the way rating agencies and investors calculate coverage. This differs from the coverage formula used in LIPA's bond covenants[1]. The approach simplifies the review of sources and uses of cash flow and adopts most GAAP[2] conventions for measuring revenues and expenses, except in a few key areas highlighted below where GAAP figures are materially different than cash flow.

UDSA bonds are paid by an irrevocable, nonbypassable restructuring charge recovered from consumers set at an amount sufficient to pay the principal and interest payable on the bonds and other ongoing financing costs.

1 LIPA's bond covenants calculate coverage by treating tax payments and lease obligations as funds available to pay debt service obligations.
2 Generally Accepted Accounting Principles, as established by the Government Accounting Standards Board.

The table below summarizes LIPA's fixed obligation coverage calculation:

+	Operating Revenue	Note 1
+	Grant Income	Note 2
+	Investment and Miscellaneous Income (Net)	Note 3
+	Suffolk Property Tax Settlement Charges	Note 4
+	Visual Benefits Assessment Charges	Note 4
=	**Total Revenue and Income**	Subtotal 1
+	Total Operating Expenses	Note 5
+	Other Interest Costs	Note 6
	Less Non-Cash Adjustments:	
−	Depreciation and Amortization	Note 7
−	OPEB GAAP Operating Expense	Note 8
=	**Total Deductions from Revenue and Income**	Subtotal 2
+	Total Revenue and Income	Subtotal 1
−	Total Deductions	Subtotal 2
+	Annual Long-Term Lease Payments	Note 9
=	**Funds Available for LIPA + UDSA Coverage**	Subtotal 3
+	Funds Available for LIPA + UDSA Coverage	Subtotal 3
−	UDSA Debt Service	Note 10
=	**Funds Available for LIPA Fixed Obligations**	Subtotal 4
+	LIPA Debt Service	Note 10
+	Annual Long-Term Lease Payments	Note 9
=	**LIPA Fixed Obligations**	Subtotal 5
+	LIPA Fixed Obligations	Subtotal 5
+	UDSA Debt Service	Note 10
=	**LIPA + UDSA Fixed Obligations**	Subtotal 6
+	Funds Available for LIPA Fixed Obligations	Subtotal 4
/	LIPA Fixed Obligations	Subtotal 5
=	**LIPA Coverage Ratio**	
+	Funds Available for LIPA + UDSA Obligations	Subtotal 3
/	LIPA + UDSA Fixed Obligations	Subtotal 6
=	**LIPA + UDSA Coverage Ratio**	

The funds available to pay fixed obligations are generally calculated as revenue plus other sources of income minus operating expenses, excluding non-cash expenses such as depreciation, amortization and OPEBs, minus other interest costs. The actual results for each year are provided in the footnotes to LIPA's audited financial statements. The notes below describe each line item in the fixed obligation coverage calculation.

1. *Operating Revenue* is reported on LIPA's Income Statement of Revenue, Expenses and Changes in Net Position.

2. *Grant Income* includes money received from state and federal agencies to cover specified program expenditures, such as the Regional Greenhouse Gas Initiative (RGGI) and Federal Emergency Management Agency (FEMA) reimbursements for storm recovery. Grant income is generally recognized in the period it is received, except for the FEMA storm hardening grant, which is recognized over the expected life of the assets being constructed in amounts equal to depreciation expense on those assets in each year. The amount of Grant Income is reported on LIPA's Statement of Revenue, Expenses and Changes in Net Position.

3. *Investment Income and Other Miscellaneous Income (Net)* includes the amounts reflected on the Statement of Revenue, Expenses and Changes in Net Position for investment income, excluding income earned on LIPA′s Nuclear Decommissioning Trust, and the net amount of the miscellaneous other income and deductions as reported on LIPA′s Statement of Revenue, Expenses and Changes in Net Position.

4. *Suffolk Property Tax Settlement and Visual Benefits Assessment* are two regulatory assets that are being repaid by impacted customers through their electric bills over a specified period of time. Such customers repay principal and interest on related debt obligations. For GAAP purposes, the interest component is included in Other Income while the repayment of principal is not reflected in Operating Revenue in the year received (it was previously recognized when the regulatory assets were established). For coverage purposes, the cash receipts related to principal payments as shown on LIPA's Cash Flow Statement are available to pay the related debt payments.

5. *Total Operating Expenses* are reported on LIPA's Statement of Revenue, Expenses and Change in Net Position and conform to GAAP.

6. *Other Interest Costs* represent costs that are reported as interest expense on the Statement of Revenue, Expenses and Changes in Net Position but are not part of Debt Service. The largest component of Other Interest Expense is interest rate swap payments, which are generally subordinate to bond payments. Additional costs include interest on customer deposits and bank fees. Other Interest Costs is not Debt Service, does not require coverage, and is therefore treated the same as Operating Expenses in the calculation of Funds Available for Debt Service. The amount of Other Interest Expenses is shown on the LIPA's Statement of Revenue, Expenses and Changes in Net Position.

7. *Depreciation and Amortization* are deducted from Operating Expenses for the coverage calculation. Instead of using accounting allocations for the recovery of capital investments and regulatory assets, the coverage calculation recognizes that these costs are recovered through debt service and are eliminated from the coverage calculation. Depreciation and Amortization are reported on LIPA's Statement of Revenue, Expenses, and Changes in Net Position. LIPA's key components of Depreciation and Amortization include:
    - Depreciation of Utility Plant and Equipment;
    - Amortization of the Acquisition Adjustment (purchase adjustment related to purchase of the Long Island Lighting Company in 1998); and
    - Amortization of certain regulatory assets established by the Board for specific obligations related to pensions and benefits for employees who provided services to LIPA under the expired Management Services Agreement (MSA) between LIPA and National Grid (the former service provider).

8. *OPEB GAAP Operating Expense.* With the transition to a new service provider in 2014, there was a limited number of employees eligible for retirement and the cash pay-as-you-go costs for Other Post-Employment Benefits (OPEBs) was relatively small compared to the GAAP accrual expense. In 2014, LIPA adopted a funding plan consistent with actuarially sound principles to pre-fund future OPEB benefit expenses for employees currently working for the service provider. This pre-funding is deposited into a separately segregated OPEB Account that is available to make fixed obligation payments. LIPA's ratemaking model therefore recognizes the availability of these funds to make fixed obligation payments.[3] The non-cash OPEB expense is reported on LIPA's Statement of Cash Flow.

9. *Annual Long-Term Lease Payments.* Rating agencies consider lease payments as a fixed obligation that operates like debt. LIPA has substantial leases related to its procurement of power supplies for generating facilities and transmission cables. According to GASB, leases must be recorded on LIPA's financial statements as long-term assets and obligations. To recognize long-term lease obligations in the calculation of coverage, the rating agencies add the annual lease obligation (imputed repayment of principal and interest) to both the numerator and the denominator of the fixed obligation coverage ratio. LIPA's Annual Long-Term Lease Payments are shown in the footnotes to its audited financial statements.

10. *Debt Service* consists of the payment of principal and interest on LIPA's long-term and short-term bonds. The debt service payment schedule for long-term bonds is established when the bonds are issued and typically includes semi-annual interest payments. Short-term debt typically includes monthly or quarterly interest payments. Repayment of principal on bonds can occur under a number of circumstances that are relevant to the

[3] LIPA originally contemplated a similar adjustment for the pension expense related to PSEG Long Island employees. The difference between GAAP expense and ERISA cash funding for pensions has narrowed and so this is no longer a material adjustment to the funds available to pay fixed obligations. Over time, the difference between GAAP expense and cash expense for OPEBs will also narrow and LIPA expects that this adjustment may be eliminated.

determination of debt service obligations in any given year.

Scheduled debt maturities are considered debt service obligations and are included in the debt service payments. Debt is sometimes refunded with new debt, typically to obtain lower interest costs. Debt refunded before its scheduled date is excluded from debt service requirements, and the scheduled repayments of the new debt replaces the scheduled repayment of the refunded debt. Debt may also be called for early retirement should cash on hand be sufficient for such purposes. Such early redemption or defeasance of debt is excluded from debt service requirements. Short-term debt can also be refunded or rolled-over through issuing new debt. This happens most frequently when an existing short-term arrangement expires or is replaced by a new line of credit on more favorable terms. In such cases, the roll-over of principal is not considered a debt service obligation at that time, as this debt was always expected to be paid by the proceeds of the roll-over and not by revenues. Debt Service payments are reported on LIPA's Cash Flow Statement.

Days Cash on Hand is the ratio of the total cash and credit available divided by LIPA's budgeted average daily operating expenses.

Minimum Days Cash on Hand must be at least 120 days

Days Cash on Hand measures LIPA's ability to sustain its operations if revenues are delayed, reduced or interrupted for any reason. Available cash consists of cash reported on the Statement of Net Position and includes both unrestricted cash and funds held in a restricted account dedicated to pre-funding PSEG Long Island's operating and capital expenditures, in accordance with the terms of the Amended and Restated Operations Services Agreement. Available credit includes multiple sources such as, letters and lines of credit, and general revenue notes, including a revolving credit agreement. The average daily expenditure is calculated by taking LIPA's annual approved budgeted revenues minus depreciation, amortization, and interest expense (budgeted operating expenses) and dividing the net value by 365 days.

Percent of Capital Spending Funded by Debt not to exceed 64% measured over a three-year period

Percent of Capital Spending Funded By Debt is calculated as the ratio of new money debt budgeted to be issued divided by approved capital spending. It is typically calculated both including and excluding funding derived from grants, such as FEMA. The capital spending in any year is directly observable from LIPA's financial statements and represents the net increase in utility plant and property (plant in service plus investments in related utility assets like circuits or transformers). Similarly, LIPA's debt issuances are categorized as either refinancing of existing debt or new money debt and are identified as to the general usage of the funds. Capital expenditures financed using short-term debt or available cash that is later replenished by long-term bonds are excluded from the calculation.

Given the variability in capital spending from year to year, as well as the variability in timing of bond issuance, it is prudent to target a revenue funding percentage over a multi-year planning period as opposed to implementing a strict year-by-year target. LIPA measures the 64 percent target on a rolling three-year average basis.

In certain circumstances, LIPA may choose to exercise an early redemption of existing debt with available cash on hand. These transactions reduce outstanding debt obligations that could have been used to cash-fund capital spending and effectively reduce the amount of new capital spending funded by debt. Such early redemptions are incorporated into the ratio in the year that the redemption occurs and represent an offset to the new debt that was issued in the year.