# LIPA
Long Island Power Authority

*(A Component Unit of the State of New York)*

Consolidated Financial Statements and
Required Supplementary Information

December 31, 2019 and 2018

*(With Independent
Auditors' Reports
Thereon)*

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KPMG LLP
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Melville, NY 11747-4302

## Independent Auditors' Report

Board of Trustees
Long Island Power Authority:

*Report on the Financial Statements*

We have audited the accompanying consolidated financial statements of the business-type activities of the Long Island Power Authority (LIPA), a component unit of the State of New York, as of and for the years ended December 31, 2019 and 2018, and the related notes to the consolidated financial statements, which collectively comprise LIPA's consolidated financial statements as listed in the table of contents.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

*Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing* Standard issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Long Island Power Authority and its blended component unit as of December 31, 2019 and 2018, and the respective changes in their net position and, where applicable, their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

*Other Matters*

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis on pages 3 through 20 and Required Supplementary Information on page 86 be presented to supplement the consolidated financial statements. Such information, although not a part of the consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the consolidated financial statements, and other knowledge we obtained during our audits of the consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Other Reporting Required by Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2020 on our consideration of LIPA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of LIPA's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering LIPA's internal control over financial reporting and compliance.

KPMG LLP

Melville, New York
March 27, 2020

*(Amounts in thousands, unless otherwise stated)*

## Introduction

The Long Island Power Authority (LIPA) is a component unit of New York State (State). LIPA became the retail supplier of electric service in the Counties of Nassau and Suffolk (with certain limited exceptions) and a portion of Queens County known as the Rockaways (Service Area), on May 28, 1998 by acquiring the transmission and distribution (T&D) system of the Long Island Lighting Company (LILCO) as a wholly owned subsidiary of LIPA. As part of the acquisition, LIPA also acquired an undivided 18% interest in the Nine Mile Point Unit 2 (NMP2) generating facility, located in upstate New York, which is operated and managed by Exelon Corporation. LIPA provides electric delivery service in the Service Area, which includes approximately 1.1 million customers. The population of the Service Area is approximately 2.9 million.

LIPA was established as a corporate municipal instrumentality of the State of New York (State), constituting a political subdivision of the State, created by Chapter 517 of the Laws of 1986 (the LIPA Act). As such, it is a component unit of the State and is included in the State's annual financial statements.

LIPA is also subject to the LIPA Reform Act, codified as Chapter 173, Laws of New York (Reform Act), which created the Securitization Law and established the Utility Debt Securitization Authority (UDSA). The Securitization Law's purpose was to provide a legislative foundation for the UDSA's issuance of restructuring bonds to allow LIPA to retire a portion of its outstanding indebtedness, providing savings to LIPA's customers on a net present value basis. The restructuring bonds are repaid by an irrevocable, non-bypassable restructuring charge on all LIPA's customers. The UDSA has a governing body separate from that of LIPA and has no commercial operations. The UDSA is included as a blended component unit of LIPA.

The Securitization Law allowed the UDSA to issue restructuring bonds totaling approximately $4.5 billion, the proceeds of which refunded LIPA bonds and generated total net present value debt service savings of $492 million for LIPA's customers.

LIPA has operating agreements to provide the majority of services necessary to provide electric service in the Service Area. The primary operating agreement is the Amended and Restated Operations Services Agreement (OSA) with PSEG Long Island LLC (PSEG Long Island).

PSEG Long Island commenced operating LIPA's electric T&D system on January 1, 2014 under the PSEG Long Island brand name and provides day-to-day T&D system operating functions as well as certain administrative support functions. PSEG Long Island acts as agent in performing many of its obligations and in return receives (a) reimbursement for pass-through operating expenditures, (b) a fixed management fee and (c) an incentive fee contingent on meeting certain performance metrics.

LIPA also has a contract with PSEG Energy Resources and Trade LLC (PSEG ER&T) to provide services related to fuel and power supply management and certain commodity activities. Separately from its contract with PSEG ER&T, LIPA maintains power purchase agreements with various third-party power generators.

LIPA's Board of Trustees (Board) approves LIPA's annual consolidated budget, expenditures and the electric rates. The Reform Act, in addition to establishing the UDSA, established a rate review process that required LIPA and PSEG Long Island to submit for review to the New York State Department of Public Service (DPS) a three-year rate proposal for electric rates for the 2016-2018 period. Subsequent to the rate proposal period, LIPA and PSEG Long Island are only required to submit a proposed rate increase for DPS review and recommendation if it would increase the rates and charges by an amount that would increase LIPA's annual revenues by more than 2.5%. The DPS is required to review and make its recommendations to LIPA's Board within 240 days of such filing. LIPA's Board retains final rate-setting power. LIPA's annual base rate increase has not exceeded the 2.5% threshold since the three-year rate plan expired in 2018; and, therefore no such rate proposal has been submitted to the DPS although LIPA provides DPS with its budgets and rate adjustments.

## Overview of the Consolidated Financial Statements

LIPA is engaged in business type activities and follows financial reporting for enterprise funds. LIPA's financial statements are prepared on an accrual basis in accordance with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

The annual financial report for LIPA includes management's discussion and analysis and the Consolidated Financial Statements. The Consolidated Financial Statements consist of the Statements of Net Position, the Statements of Revenue, Expenses and Changes in Net Position, and the Statements of Cash Flows. Following the consolidated financial statements is LIPA's Required Supplemental Information.

The management's discussion and analysis provides an overview of LIPA's financial information for the years ended December 31, 2019 and 2018, with comparative information as of and for the year ended December 31, 2017. The management's discussion and analysis should be read in conjunction with the Consolidated Financial Statements and the accompanying notes (Notes), which follow this section. The Notes are an integral part of LIPA's Consolidated Financial Statements and provide additional information on certain components of these statements.

The Consolidated Statements of Net Position provide information about the nature and amount of resources and obligations at a specific point in time.

The Consolidated Statements of Revenues, Expenses and Changes in Net Position report all of LIPA's revenues and expenses for the periods shown.

The Consolidated Statements of Cash Flows report the cash provided and used by operating activities, as well as other cash sources, such as investment income and debt financing, and other cash uses such as payments for debt service and capital additions.

The Notes to Consolidated Financial Statements provide additional detailed information to support the Consolidated Financial Statements.

The Required Supplemental Information includes unaudited information required by GASB to accompany the Consolidated Financial Statements and relates to LIPA's participation in the New York State and Local Employees' Retirement System.

*(Amounts in thousands, unless otherwise stated)*

LIPA's Consolidated Statements of Net Position as of December 31, 2019, 2018, and 2017 are summarized below:

| | | 2019 | 2018 | 2017 |
|---|---|---|---|---|
| Assets and deferred outflows of resources: | | | | |
| Capital assets | $ | 8,773,962 | 8,383,338 | 8,088,014 |
| Current assets | | 2,347,045 | 2,101,253 | 1,922,648 |
| Regulatory assets | | 1,150,374 | 1,090,570 | 1,329,148 |
| Other noncurrent assets | | 1,138,162 | 1,235,843 | 1,542,921 |
| Deferred outflows of resources | | 222,548 | 247,313 | 275,026 |
| Total assets and deferred outflows of resources | | 13,632,091 | 13,058,317 | 13,157,757 |
| Liabilities and deferred inflows of resources: | | | | |
| Long-term debt, net of current portion | | 8,494,325 | 8,233,016 | 7,978,731 |
| Current liabilities | | 1,252,605 | 1,080,086 | 1,266,128 |
| Regulatory liabilities | | 34,240 | 61,556 | 14,910 |
| Other noncurrent liabilities | | 2,791,414 | 2,668,763 | 2,884,844 |
| Deferred inflows of resources | | 540,639 | 520,046 | 540,956 |
| Total liabilities and deferred inflows of resources | | 13,113,223 | 12,563,467 | 12,685,569 |
| Total net position | | 518,868 | 494,850 | 472,188 |
| Total liabilities, deferred inflows of resources and net position | $ | 13,632,091 | 13,058,317 | 13,157,757 |

## Assets and Deferred Outflows of Resources

### *2019 Compared to 2018*

Assets and deferred outflows of resources increased by $574 million compared to 2018 due to increases of $391 million in capital assets, $246 million in current assets, and $60 million in regulatory assets. These increases were partially offset by decreases of $98 million in other noncurrent assets and $25 million in deferred outflows of resources.

Capital assets increased $391 million compared to 2018 primarily due to higher investment in reliability capital projects, as well as certain storm hardening projects. These capital additions were partially offset by asset retirements, annual depreciation expense and the scheduled amortization of capital lease obligations.

Current assets increased $246 million compared to 2018 primarily due to increased investment balances from the unspent proceeds received on the issuance of the Electric System General Revenue Bonds, Series 2019A and Series 2019B, in anticipation of various capital projects that were deferred until 2020. LIPA also posted increased counterparty collateral due to lower gas prices. These increases were partially offset by lower accounts receivable balances resulting from lower revenue driven by lower Power Supply Charges.

Regulatory assets increased $60 million primarily due to an increase of $104 million in the OSA-Employee Retirement Benefits regulatory asset resulting from an updated actuarial study and an increase of $5 million to the Power Supply Charge recoverable. These increases were partially offset by the scheduled annual recovery or amortizations of regulatory assets totaling $41 million, and a decrease in the Delivery Service Adjustment (DSA) of $8 million. For a full discussion of the regulatory assets and liabilities, see Note 5 to LIPA's Consolidated Financial Statements.

Other noncurrent assets decreased $98 million primarily due to the $102 million decrease in restricted cash and cash equivalents and restricted investments due to expenditures for storm hardening capital projects and $111 million of scheduled amortization of the Acquisition Adjustment, partially offset by increases of $103 million due to the deferred mark-to-market valuation of certain of LIPA's financial and commodity derivative instruments.

Deferred outflow of resources decreased $25 million primarily due to the scheduled amortization of previously deferred costs associated with refunding of higher cost debt.

### *2018 Compared to 2017*

Assets and deferred outflows of resources decreased $99 million compared to 2017 due to decreases of $238 million in regulatory assets, $307 million in other noncurrent assets, and $28 million in deferred outflows of resources. These decreases were partially offset by increases of $295 million in capital assets and $179 million in current assets.

Capital assets increased $295 million compared to 2017 primarily due to higher investment in reliability capital projects, as well as certain storm hardening projects. These capital additions were partially offset by asset retirements and annual depreciation expense.

Current assets increased $179 million compared to 2017 primarily due to increased investment account balances and increased accounts receivable resulting from higher revenues due to a warmer than normal summer.

Regulatory assets decreased $238 million primarily due to a decrease of $139 million in the OSA–Employee Retirement Benefits regulatory asset resulting from an updated actuarial study, the resolution of outstanding issues with LIPA's prior service provider allowing for a reduction to an existing regulatory asset of $42 million, and scheduled annual recovery or amortizations of regulatory assets totaling $77 million. These decreases were partially offset by an increase in the DSA of $20 million. For a full discussion of the regulatory assets and liabilities, see Note 5 to LIPA's Consolidated Financial Statements.

Other noncurrent assets decreased $307 million primarily due to the $172 million decrease in restricted cash and cash equivalents due to expenditures for storm hardening capital projects and $111 million of scheduled amortization of the Acquisition Adjustment.

Deferred outflow of resources decreased $28 million primarily due to the improvement in the mark-to-market valuation of LIPA's effective commodity derivative instruments.

## Liabilities and Deferred Inflows of Resources

### *2019 Compared to 2018*

Liabilities and deferred inflows of resources increased $550 million due to increases of $173 million in current liabilities, $261 million in long-term debt, $123 million in non-current liabilities and $21 million in deferred inflows of resources. These increases were partially offset by a decrease of $27 million in regulatory liabilities.

Long-term debt, net of current portion, increased $261 million. LIPA issued $502 million Electric System General Revenue Bonds Series 2019, which together with the $40 million of premium received on the bonds, funded capital projects. These increases were partially offset by the $228 million of current debt maturities classified as current liabilities and the scheduled amortization of premium totaling $61 million.

Current liabilities increased $173 million primarily due to a $58 million increase in short-term debt to support the higher collateral posted by LIPA on its commodity positions, a $36 million increase in current maturities of long-term debt and a $56 million negative mark-to-market position of its commodity derivative instruments. The remaining increase is due to the timing of various employee benefit accruals.

Regulatory liabilities decreased $27 million primarily due to lower deferrals resulting from the Revenue Decoupling Mechanism (RDM). The RDM compares actual revenues with authorized revenues and credits (or collects) any differences to (or from) customers. It is intended to cover all sources of variances in delivery service revenues including revenue variances caused by warmer or cooler than normal weather. In 2019, LIPA experienced a cooler summer when compared to 2018. This decrease was partially offset by the Board authorized deferral to a regulatory liability of $15 million of unspent funds related to the Utility 2.0 program. This regulatory credit is to fund future expenditures for energy efficiency programs filed under the Utility 2.0 program.

Other noncurrent liabilities increased $123 million primarily due to a $187 million increase in the PSEG Long Island's workforce retirement benefit obligations resulting from an updated actuarial valuation, and a $55 million increase in the deferred mark-to-market valuation on certain of LIPA's derivative instruments. This increase was partially offset by the $122 million scheduled amortization of the capital lease obligations.

Deferred inflows of resources increased $21 million primarily due to increased mark-to-market valuations on certain investment accounts.

### *2018 Compared to 2017*

Liabilities and deferred inflows of resources decreased $122 million due to decreases of $186 million in current liabilities, $216 million in noncurrent liabilities, and $21 million in deferred inflows of resources. These decreases were partially offset by increases of $254 million in long-term debt and $47 million in regulatory liabilities.

Long-term debt, net of current portion, increased $254 million. LIPA issued $430 million Electric System General Revenue Bonds Series 2018, which together with the $52 million of premium received on the bonds, funded capital projects. These increases were partially offset by $192 million of current debt maturities classified as current liabilities.

Current liabilities decreased $186 million primarily due to the $126 million decrease in outstanding short-term debt with the remaining decrease due to lower accounts payable and various lower accruals.

Regulatory liabilities increased $47 million due to the RDM whereby any revenue variances caused by warmer than normal weather is returned to the customers.

Other noncurrent liabilities decreased $216 million primarily due to the amortization of the capital lease obligations of approximately $141 million, a $22 million improvement in the deferred mark-to-market valuation on LIPA's interest derivative instruments, and a $62 million decrease in the PSEG Long Island's workforce retirement benefit obligations resulting from an updated actuarial valuation. These decreases were partially offset by the increase in miscellaneous reserves.

Deferred inflows of resources decreased $21 million primarily due to increased mark-to-market valuations on certain investment accounts.

*(Amounts in thousands, unless otherwise stated)*

## Results of Operations

LIPA's Consolidated Statements of Revenues, Expenses and Changes in Net position for the years ended December 31, 2019, 2018 and 2017 are summarized as follows:

| | | 2019 | 2018 | 2017 |
|---|---|---|---|---|
| Electric revenues (net of uncollectible expense) | $ | 3,516,355 | 3,560,065 | 3,458,320 |
| Operating expenses | | (3,237,837) | (3,285,096) | (3,190,824) |
| Interest charges, net | | (363,673) | (352,383) | (336,071) |
| Total expenses | | (3,601,510) | (3,637,479) | (3,526,895) |
| Revenue less operating and interest charges, net | | (85,155) | (77,414) | (68,575) |
| Grant income | | 35,916 | 43,238 | 42,058 |
| Other income | | 73,257 | 56,838 | 43,639 |
| Total other income, net | | 109,173 | 100,076 | 85,697 |
| Change in net position | | 24,018 | 22,662 | 17,122 |
| Net position, beginning of year | | 494,850 | 472,188 | 455,066 |
| Net position, end of year | $ | 518,868 | 494,850 | 472,188 |

## Operating Revenues

### *2019 Compared to 2018*

Electric operating revenues, net of uncollectible expense, for 2019 totaled $3.52 billion, a decrease of $44 million compared to 2018 due to decreases in (i) the power supply costs of $85 million; (ii) the Delivery Service Adjustment of $30 million; and (iii) the Utility 2.0 program revenues of $15 million. These decreases were partially offset by increases in (i) the base delivery revenues of $78 million; (ii) the Distributed Energy Resources revenues of $7 million; and (iii) miscellaneous revenue of $1 million.

### *2018 Compared to 2017*

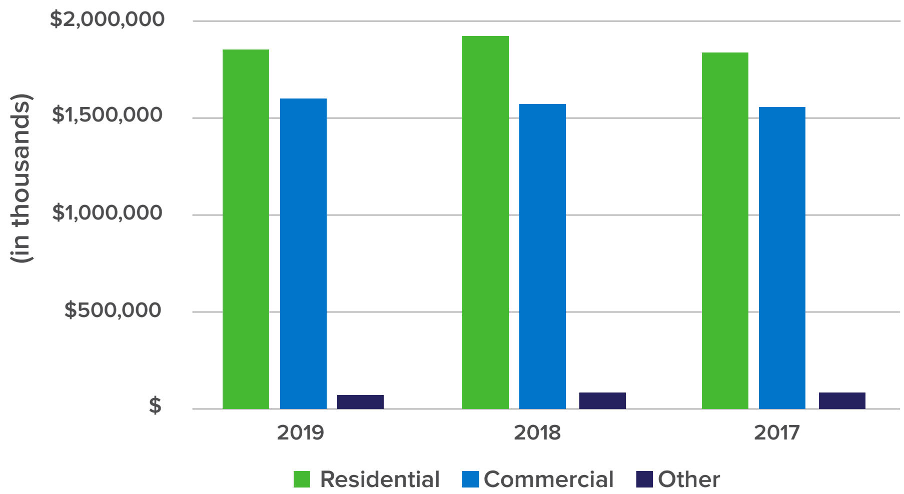
Electric operating revenues, net of uncollectible expense, for 2018 totaled $3.56 billion, an increase of $102 million compared to 2017 due to an increase in base delivery rates totaling $48 million and higher power supply costs totaling $43 million. Other factors, such as the DSA deferral and other miscellaneous revenues, caused the remaining increase in revenues.

*(Amounts in thousands, unless otherwise stated)*

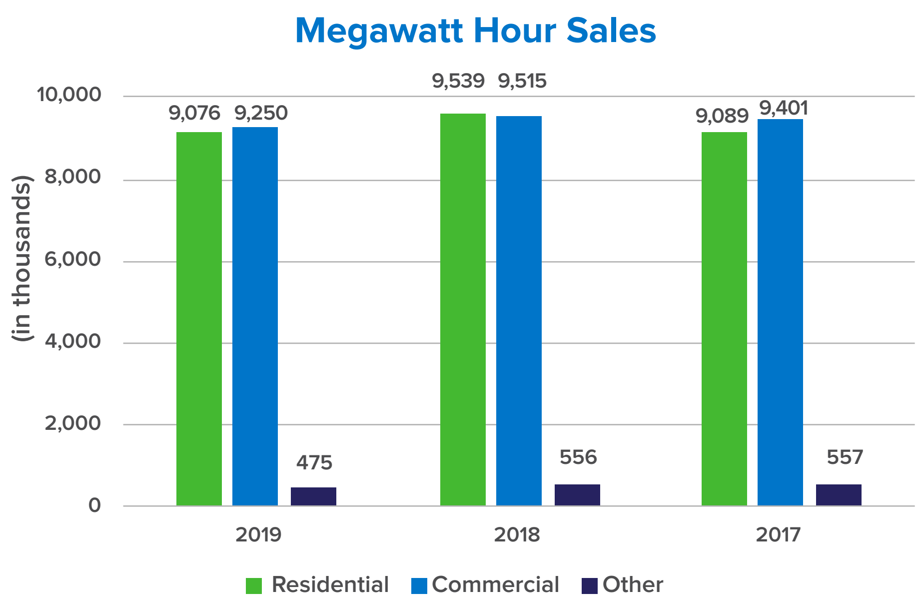
The following table and chart represent revenue for the years ended December 31, 2019, 2018 and 2017 by customer class (residential, commercial and other).

| **Revenues from sales of electricity** | | **2019** | **2018** | **2017** |
|---|---|---|---|---|
| Residential | $ | 1,850,891 | 1,910,427 | 1,831,400 |
| Commercial | | 1,582,981 | 1,555,927 | 1,534,273 |
| Other | | 82,483 | 93,711 | 92,647 |
| Total | $ | 3,516,355 | 3,560,065 | 3,458,320 |

## Revenues from Sales of Electricity by Customer Class



The following chart shows megawatt hour (MWh) sales for the years ended December 31, 2019, 2018 and 2017 by customer class (residential, commercial and other). The largest customer in the Service Area (the Long Island Rail Road) accounted for less than 2% of total sales and less than 2% of revenue, which is included in "Other" sales. In addition, the ten largest customers in the Service Area accounted for approximately 7% of total sales and less than 6% of revenue.

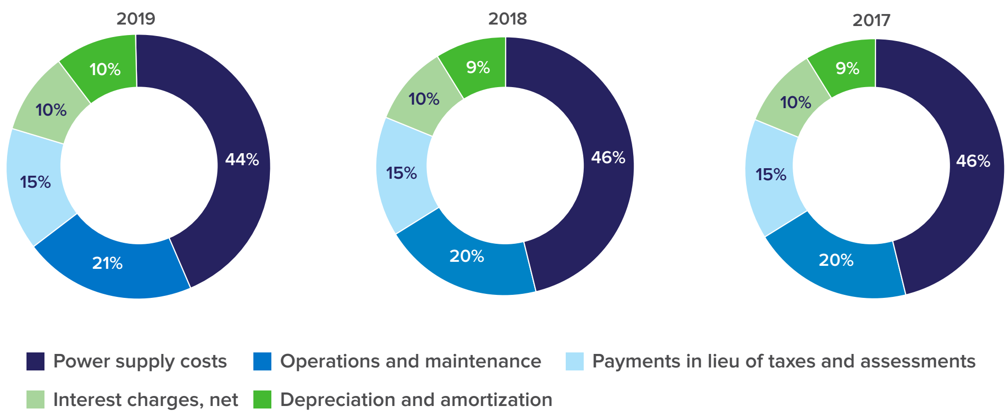


*(Amounts in thousands, unless otherwise stated)*

## Operating and Interest Charges

For the years ended December 31, 2019, 2018 and 2017, LIPA's expenses were comprised of (i) power supply costs; (ii) operations and maintenance expenses; (iii) payments in lieu of taxes, other taxes and assessments (including property taxes on generating assets under contract); (iv) interest charges, net; and (v) depreciation and amortization, as shown below:

| Operating and Interest Charges | | 2019 | 2018 | 2017 |
|---|---|---|---|---|
| Power supply costs | $ | 1,585,662 | 1,675,640 | 1,631,475 |
| Operations and maintenance | | 739,086 | 734,945 | 713,873 |
| Payments in lieu of taxes and assessments | | 550,745 | 542,651 | 536,721 |
| Interest charges, net | | 363,673 | 352,383 | 336,071 |
| Depreciation and amortization | | 362,344 | 331,860 | 308,755 |
| Total | $ | 3,601,510 | 3,637,479 | 3,526,895 |



### *2019 Compared to 2018*

For the year ended December 31, 2019, operating and interest charges totaled $3.60 billion, a decrease of $36 million compared to 2018. The decrease is primarily due to lower power supply costs of $90 million, offset by increases in (i) operating and maintenance costs of $4 million; (ii) payments in lieu of taxes and assessments of $8 million; (iii) interest charges, net of $11 million; and (iv) depreciation expense of $30 million.

### *2018 Compared to 2017*

For the year ended December 31, 2018, operating and interest charges totaled $3.64 billion, an increase of $110 million compared to 2017. The increase is primarily due to higher: (i) power supply costs of $44 million; (ii) operating and maintenance costs of $21 million primarily attributed to higher storm restoration costs (iii) payments in lieu of taxes and assessments of $6 million; (iv) interest charges, net of $16 million; and (v) depreciation expense of $23 million.

## Capital Asset and Financing Activities

The approved 2020 capital budget projects expenditures of approximately $820 million for various capital improvements. The capital budget anticipates funding no more than 64% of capital expenditures with long-term tax-exempt bonds in order to comply with LIPA's Board financial policy, which seeks to limit debt-funded capital expenditures. LIPA measures the 64% target on a rolling three-year average due to the variability in capital project planning.

During 2019 and 2018, LIPA had approximately $686 million and $640 million, respectively, in capital improvements, of which less than 64% was funded with the issuance of tax-exempt debt.

LIPA and UDSA paid scheduled debt maturities totaling $192 million and $193 million in 2019 and 2018, respectively. LIPA also called for early redemption $14 million of its taxable Electric System General Revenue Bonds, Series 2014B with cash from operations in 2019.

As tax-exempt advance refunding transactions are no longer permitted under Federal tax law, during 2019, LIPA executed a forward-starting interest rate swap to secure low interest rates for the future refunding of its Electric System General Revenue Bonds, Series 2012A and 2012B, callable in 2022 with a coupon rate of 5.0%. LIPA secured an interest rate of 1.857% associated with the $251 million Series 2012A Bonds, and 1.315% associated with the $164 million Series 2012B Bonds. Based on interest rate assumptions at the time of the transaction, the forward-starting swaps will generate net present value savings of approximately $103 million.

*(Amounts in thousands, unless otherwise stated)*

A summary of the financing activity for LIPA and the UDSA for the years ended December 31, 2019 and 2018 is shown below:

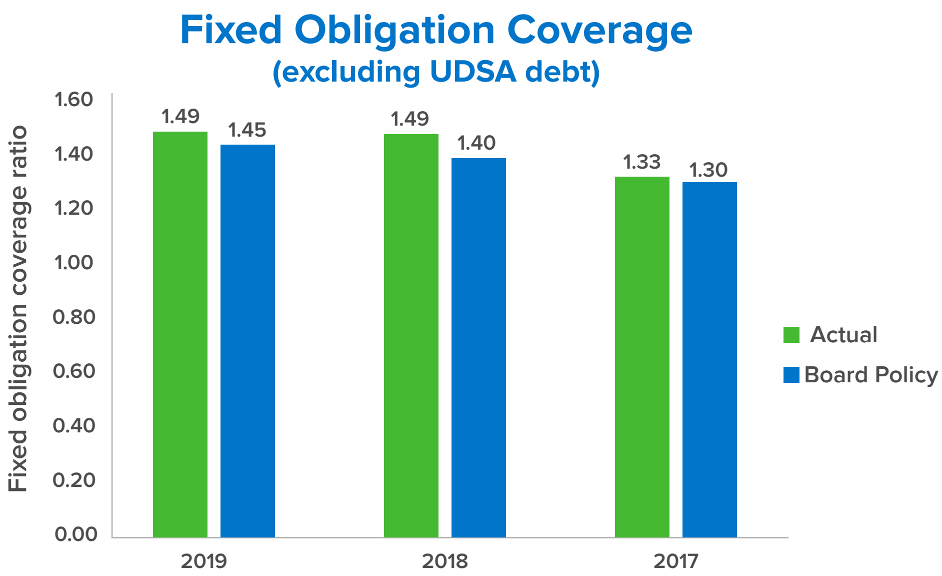
| | | Bonds to fund capital projects | Remarketing of floating-rate bonds |
|---|---|---|---|
| **2019:** | | | |
| 2019A General Revenue Bonds | $ | 218,175 | — |
| 2019B General Revenue Bonds | | 284,250 | — |
| **2018:** | | | |
| 2018 General Revenue Bonds | $ | 430,000 | — |
| 2014C General Revenue Bonds | | — | 150,000 |
| 2015C General Revenue Bonds | | — | 149,000 |

For a full discussion on LIPA's debt activities, see Note 12 to the Consolidated Financial Statements.

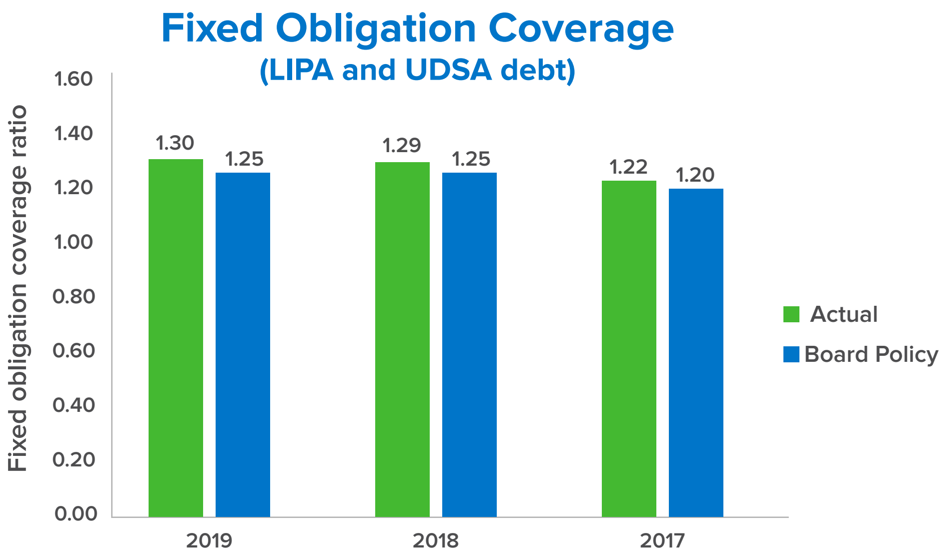
## Fixed Obligation Coverage Ratios

LIPA utilizes the "public power model" of budgeting and rate setting, using fixed obligation coverage ratios to determine revenue requirements. LIPA's methodology for calculating its fixed obligation coverage ratios excludes certain specified non-cash items from expenses.

As shown in the chart below, LIPA budgeted to achieve fixed obligation coverage targets (including capital leases) on LIPA issued debt of a minimum of 1.45x, 1.40x, and 1.30x, in 2019, 2018, and 2017, respectively. LIPA exceeded its targets for the years ended December 31, 2019, 2018, and 2017 with fixed obligation coverage ratios of 1.49x, 1.49x, and 1.33x, respectively.



As shown in the chart below, with the UDSA restructuring bonds included, LIPA's fixed obligation coverage ratio was targeted to achieve a minimum of 1.25x in 2019 and 2018, and 1.20x in 2017. The fixed obligation coverage ratios, inclusive of the UDSA restructuring bonds, for the years ended December 31, 2019, 2018, and 2017 were 1.30x, 1.29x, and 1.22x, respectively.




Effective in 2020, LIPA modified its financial policy related to fixed obligation coverage as a result of the impact of GASB 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, with a corresponding asset and liability on the Consolidated Statements of Net Position.

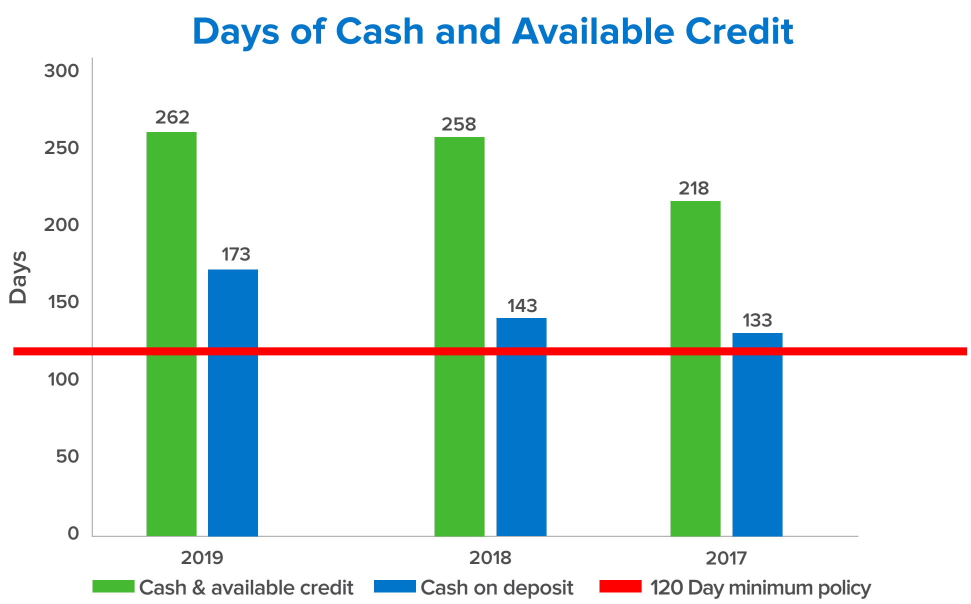
To supply electricity to its customers, LIPA enters into long-term power supply agreements for power plants and regional transmission cables. Although these power plants and cables are not owned by LIPA, under these new accounting rules, LIPA must recognize a financing arrangement asset and a corresponding liability in its Consolidated Statements of Net Position. The new accounting guidance does not change payments under these contracts but increases assets and liabilities, which will impact LIPA's fixed obligation coverage ratio in the 2020 budget, and beyond.

LIPA's financial policy targeted a 1.45x fixed obligation coverage ratio for 2019 and beyond to provide adequate cash flow to limit borrowing to no more than 64% of capital spending. To maintain the same level of cash flow in 2020, LIPA's financial policy has been updated to modify its financial target from 1.45x coverage of debt and capital lease payments to 1.35x coverage of debt and capital lease payments, using the new definition of leases. This new target will generate the same cash flow to cover fixed obligations as the prior lease accounting rules and the prior coverage target.

For a full discussion of the fixed obligation coverage ratio calculation, see Note 12(g) to the Consolidated Financial Statements.

## Liquidity and Capital Resources

LIPA's Board financial policy includes a requirement, among others, to maintain a minimum month-end balance of at least $100 million in the Operating Fund and $150 million in the Rate Stabilization Fund and overall cash on hand and available credit of at least 120 days of operating expenses. As of December 31, 2019, 2018, and 2017, LIPA's available sources of liquidity for operating purposes and capital program funding achieved the policy target with 262 days, 258 days and 218 days of cash and available credit, respectively. This represents cash, cash equivalents, investments and available credit totaling approximately $2.1 billion as of December 31, 2019.



(Amounts in thousands, unless otherwise stated)

The table below summarizes LIPA's operating liquidity and available credit capacity:

| | | 2019 | 2018 | 2017 |
|---|---|---|---|---|
| **Operating liquidity** | | | | |
| Unrestricted cash, cash equivalents & investments | $ | 743,307 | 679,940 | 633,531 |
| OPEB Account cash, cash equivalents & investments | | 386,262 | 271,879 | 194,699 |
| PSEG Long Island Working Capital requirements | | 248,499 | 198,611 | 211,972 |
| Total operating liquidity | | 1,378,068 | 1,150,430 | 1,040,202 |
| **Available credit** | | | | |
| General Revenue Notes – Revolving Credit Facility | | 198,000 | 345,000 | 337,180 |
| General Revenue Notes – Commercial Paper | | 510,000 | 570,500 | 277,500 |
| Subordinated General Revenue Notes – Commercial Paper | | — | — | 50,000 |
| Total available credit | | 708,000 | 915,500 | 664,680 |
| Total cash, cash equivalents, investments & available credit | $ | **2,086,068** | **2,065,930** | **1,704,882** |
| **Restricted cash, cash equivalents and investments** | | | | |
| FEMA Grant Proceeds | | 1,732 | 103,820 | 275,783 |
| UDSA | | 109,049 | 124,597 | 109,167 |
| Total restricted cash, cash equivalents and investments | $ | 110,781 | 228,417 | 384,950 |

### *Funds included in available cash, cash equivalents and investments*

LIPA's available liquidity balances include accounts dedicated to pre-funding PSEG Long Island's working capital needs totaling approximately $248 million, $199 million, and $212 million as of December 31, 2019, 2018, and 2017, respectively. This represents approximately 31 days cash as of December 31, 2019. These accounts are owned by LIPA and are available only for LIPA's operating and capital costs. The funds are restricted due to the contractual obligation to pre-fund the accounts from which PSEG Long Island, who acts as agent for LIPA, pays expenses related to operating LIPA's electric system; however, LIPA considers these funds to be part of its working capital as these funds are available to meet its operating and capital needs.

LIPA's available liquidity balances also includes an unrestricted OPEB Account established to pre-fund certain future post-employment retirement obligations of the PSEG Long Island employees. The balance in the unrestricted OPEB Account is intended to fund the PSEG Long Island employee retiree contractual obligation. However, in the event that revenues are insufficient to pay reasonable and necessary operating expenses, or to make payments on bonds or parity obligations, these funds are available; as such they are considered unrestricted cash, cash equivalents and investments. As of December 31, 2019, 2018, and 2017, the unrestricted OPEB Account had approximately $386 million, $272 million, and $195 million on deposit, respectively. This represents approximately 49 days cash as of December 31, 2019.

### *Available credit*

LIPA maintains a short-term borrowing program to provide resources to meet interim working capital needs, fund its capital program between long-term debt offerings, and meet any cash flow requirements from severe weather events. Among other factors, LIPA's operating and capital needs vary during the year given the summer peaking and seasonal nature of its sales. At December 31, 2019, the maximum outstanding total short-term borrowings may not exceed $1.0 billion; however, in December 2019, the Board authorized a $200 million increase allowing for a maximum of $1.2 billion to provide for interim funding associated with costs of storm hardening system improvements that are expected to be reimbursed by the Federal Emergency Management Agency (FEMA). As various approvals are pending to effectuate the Board approved increase, these borrowing programs are shown as part of LIPA's available credit at the current $1.0 billion maximum.

The outstanding balance of LIPA's short-term borrowings totaled $292 million and $235 million as of December 31, 2019 and 2018, respectively. The short-term borrowing programs are supported by bank agreements with various expiration dates from 2020 through 2022. Management expects to renew or replace these bank agreements as needed prior to their expiration. LIPA believes it will have sufficient liquidity throughout 2020 to meet its planned operating, maintenance and capital programs.

### *Restricted cash, cash equivalents and investments*

LIPA's restricted cash, cash equivalents and investments as of December 31, 2019, 2018 and 2017 was $111 million, $228 million, and $385 million, respectively, of which approximately $2 million, $104 million, and $276 million, respectively, was advance funding provided by FEMA for storm restoration and storm hardening capital projects. The storm hardening projects are intended to strengthen the Long Island electrical grid against the effects of severe weather.

The remaining balance of restricted cash and cash equivalents is related to UDSA debt service payments and required debt service and operating reserves of $109 million, $125 million, and $109 million as of December 31, 2019, 2018 and 2017, respectively. Restricted funds are not included in the days cash calculation.

## Operational Highlights

The New York State Climate Leadership and Community Protection Act (CLCPA) was passed by the Legislature and signed by Governor Andrew M. Cuomo in July 2019. New York's CLCPA is an ambitious and comprehensive climate law that requires New York to reduce economy-wide greenhouse emissions 40% by 2030 and 85% by 2050. The law creates a Climate Action Council to create a plan to achieve these goals, including certain minimum targets for the electric power sector.

To achieve these goals LIPA seeks to provide carbon-free energy by 2040 through expenditures for energy efficiency, solar, energy storage, and offshore wind. LIPA's 2020 operating budget includes approximately $148 million for utility-scale renewable projects, approximately $89 million for energy efficiency and distributed energy programs, approximately $41 million for residential and commercial solar and distributed energy systems, approximately $8 million for the Utility 2.0 programs and approximately $5 million for new utility-owned LED lighting. LIPA's Utility 2.0 plan focuses on programs that improve energy efficiency, utilize new technology such as smart meters, to address emerging resource and system needs, and encourages beneficial electrification, through the adoption of electric vehicles and heat pumps.

With LIPA's transition to a more sustainable electric grid, LIPA's third-party contracted fossil-fueled power generating plants operate less each year. Under a power supply agreement with National Grid, LIPA contracts to receive approximately 3,700 megawatts of capacity (and related energy) from National Grid's legacy oil and gas fired generating plants located on Long Island, which were formally owned by LILCO. Under this agreement, LIPA is responsible for the property taxes on these generating plants. As a result of the decreased demand for these generating plants, LIPA has sought to reduce its property tax bills on such plants. In 2018, LIPA negotiated a compromise with the Town of Brookhaven and the Village of Port Jefferson on the Port Jefferson power plant. In 2019, LIPA reached a tentative agreement with Nassau County for the E.F. Barrett and the Glenwood Landing power plants. LIPA continues to seek a fair assessment on the Northport power plant from the Town of Huntington.

In 2019, the Department of Environmental Conservation (DEC) issued new regulations for Nitrogen Oxide (NOx) air emissions from older peaking plants and directed all generation owners to submit compliance plans by March 2, 2020. National Grid as owner of the plants, in consultation with LIPA, reviewed the emissions from the plants, which are used primarily during peak demand periods during the summer, and decided to retire two smaller plants. National Grid will retire peaking units in Glenwood Landing (15 megawatts), and West Babylon (52 megawatts). All other peaking units are, or will be, in compliance with the DEC regulations by May 2023. LIPA continues to have excess generation capacity. Additional retirements are likely at the conclusion of studies to evaluate the cost effectiveness, including tax burdens and reliability benefits of various units.

Furthermore, to continue LIPA's commitment to the investments necessary to provide reliable electric service to customers, LIPA's 2020 capital budget of approximately $820 million includes: (i) approximately $225 million to fund new projects to meet increasing load including the Nassau Hub, Belmont Racetrack and other regulatory driven projects; (ii) approximately $101 million for regulatory driven projects including installation of a new 138kV underground cable from East Garden City to Valley Stream; (iii) approximately $43 million of technology improvements; (iv) approximately $67 million to fund the Utility 2.0 programs; and (v) approximately $37 million to fund the first year of a $200 million multi-year storm hardening program.

*(Amounts in thousands, unless otherwise stated)*

Included in the capital budget is PSEG Long Island's meter replacement program with state-of-the-art smart meters budgeted at a total cost of $196 million, and $264 million for circuit repairs and equipment replacements. All of these efforts have greatly improved customer satisfaction which has improved by 34% since 2013. PSEG Long Island is also ranked in the top 25% of national utilities for reliability, with a 37% improvement in customer outages and a 35% improvement in momentary customer interruptions since 2016.

## Risk Management

LIPA has a dedicated Enterprise Risk Management group to identify operating and other risks within each business unit and assist management in ongoing risk identification, monitoring and mitigation.

LIPA has a Power Supply Risk Management Committee (PRMC) to identify and manage commodity risk and has an Enterprise Risk Management Committee (ERMC) to identify and manage interest rate risk it is exposed to during the conduct of its operations. As part of risk management, LIPA established a power supply risk management hedging program to mitigate a portion of the exposure to fluctuations in commodity prices on behalf of its customers. LIPA also hedges its interest rate exposure through certain interest rate derivative instruments that are approved by the ERMC based on the Board policy established for interest rate exchange agreements.

## Bond Ratings

LIPA's financial policy sought to increase LIPA's credit ratings to A2 by Moody's Investors Service (Moody's), A by Standard and Poor Global Ratings (S&P), and A by Fitch Ratings (Fitch). In 2019, LIPA achieved its target by receiving upgrades as the table below illustrates:

| Rating Agency | 2019 | 2018 |
|---|---|---|
| **Moody's** | A2 (Stable) | A3 (Positive) |
| **S&P** | A (Stable) | A- (Positive) |
| **Fitch** | A (Stable) | A- (Stable) |

The UDSA bonds are rated Aaa (sf) by Moody's and AAA (sf) by S&P and Fitch.

Certain bonds and notes of LIPA are supported by either a bank letter of credit or are insured against default.

## Contacting the Long Island Power Authority

This financial report is designed to provide LIPA's bondholders, customers, and other interested parties with a general overview of LIPA's finances and to demonstrate its accountability for the funds it receives. If you have any questions about this report or need additional information, contact LIPA at 333 Earle Ovington Blvd., Suite 403, Uniondale, New York 11553, or visit LIPA's website at www.lipower.org.

# LONG ISLAND POWER AUTHORITY

*(A Component Unit of the State of New York)*

Consolidated Statements of Net Position

December 31, 2019 and 2018

*(Amounts in thousands)*

| **Assets and Deferred Outflows of Resources** | | **2019** | **2018** |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | $ | 166,436 | 327,800 |
| Restricted cash – working capital requirements | | 248,499 | 198,611 |
| Restricted cash | | 109,049 | 124,597 |
| Investments | | 963,133 | 624,019 |
| Counterparty collateral – posted by LIPA | | 116,409 | 7,320 |
| Accounts receivable (less allowance for doubtful accounts of $27,821 and $28,185 at December 31, 2019 and 2018, respectively) | | 458,475 | 531,607 |
| Other receivables | | 56,321 | 74,625 |
| Fuel inventory | | 119,507 | 99,117 |
| Material and supplies inventory | | 57,785 | 50,574 |
| Commodity derivative instruments | | — | 17,282 |
| Regulatory assets to be recovered within one year | | 155,171 | 150,517 |
| Prepayments and other current assets | | 51,431 | 45,701 |
| Total current assets | | 2,502,216 | 2,251,770 |
| Noncurrent assets: | | | |
| Restricted cash and cash equivalents | | 1,714 | 11,607 |
| Restricted investments | | 18 | 92,213 |
| Utility plant and property and equipment, net | | 8,773,962 | 8,383,338 |
| Nuclear decommissioning trust fund | | 144,346 | 125,219 |
| Other long-term receivables | | 25,276 | 31,089 |
| Unrealized charges | | 197,546 | 94,464 |
| Financial derivative instruments | | 2,625 | 3,240 |
| Regulatory assets for future recovery | | 995,203 | 940,053 |
| Acquisition adjustment (net of accumulated amortization) | | 766,637 | 878,011 |
| Total noncurrent assets | | 10,907,327 | 10,559,234 |
| Deferred outflows of resources: | | | |
| Deferred defeasance costs on debt refunding | | 212,680 | 241,552 |
| OPEB expense | | 242 | 1,679 |
| Pension expense | | 1,251 | 1,594 |
| Accumulated decrease in fair value of commodity derivatives | | 8,375 | — |
| Accumulated decrease in fair value of OPEB Account | | — | 2,488 |
| Total deferred outflows of resources | | 222,548 | 247,313 |
| Total assets and deferred outflows of resources | $ | 13,632,091 | 13,058,317 |

See accompanying Notes to Consolidated Financial Statements.

# LONG ISLAND POWER AUTHORITY

*(A Component Unit of the State of New York)*

Consolidated Statements of Net Position

December 31, 2019 and 2018

*(Amounts in thousands)*

| **Liabilities, Deferred Inflows of Resources and Net Position** | | **2019** | **2018** |
|---|---|---|---|
| Current liabilities: | | | |
| Short-term debt | $ | 292,000 | 234,500 |
| Current maturities of long-term debt | | 101,860 | 61,430 |
| Current maturities of UDSA debt | | 126,057 | 130,761 |
| Current portion of capital lease obligations | | 171,170 | 168,430 |
| Accounts payable and accrued expenses | | 402,937 | 376,177 |
| Regulatory liabilities payable in one year | | 34,240 | 61,556 |
| Commodity derivative instruments | | 56,287 | — |
| Accrued payments in lieu of taxes | | 8,236 | 10,550 |
| Accrued interest | | 55,264 | 48,638 |
| Unrealized credits | | — | 10,250 |
| Customer deposits | | 38,794 | 39,350 |
| Total current liabilities | | 1,286,845 | 1,141,642 |
| Noncurrent liabilities: | | | |
| Long-term debt, net | | 4,207,551 | 3,775,406 |
| Long-term UDSA debt, net | | 4,286,774 | 4,457,610 |
| Capital lease obligations, net | | 1,581,061 | 1,702,801 |
| Borrowings | | 67,084 | 72,256 |
| Operations Services Agreement-employee retirement benefits | | 796,509 | 609,176 |
| Financial derivative instruments | | 125,794 | 106,058 |
| Commodity derivative instruments | | 35,763 | — |
| Asset retirement obligation | | 67,293 | 67,483 |
| Long-term liabilities and unrealized credits | | 49,713 | 43,142 |
| Claims and damages | | 68,197 | 67,847 |
| Total noncurrent liabilities | | 11,285,739 | 10,901,779 |
| Deferred inflows of resources: | | | |
| Regulatory credits - grants | | 482,710 | 498,322 |
| Accumulated increase in fair value of financial derivatives | | 2,625 | 3,240 |
| Accumulated increase in fair value of commodity derivatives | | — | 9,124 |
| OPEB expense | | 3,336 | 3,534 |
| Pension expense | | 506 | 1,609 |
| Accumulated increase in fair value of NMP2 Trust and OPEB Account | | 51,462 | 4,217 |
| Total deferred inflows of resources | | 540,639 | 520,046 |
| Net position: | | | |
| Net investment in capital assets | | 204,756 | 77,241 |
| Restricted | | 100,967 | 116,384 |
| Unrestricted | | 213,145 | 301,225 |
| Total net position | | 518,868 | 494,850 |
| Total liabilities, deferred inflows of resources and net position | $ | 13,632,091 | 13,058,317 |

See accompanying Notes to Consolidated Financial Statements.

# LONG ISLAND POWER AUTHORITY

*(A Component Unit of the State of New York)*

Consolidated Statements of Revenues, Expenses, and Changes in Net Position

Years ended December 31, 2019 and 2018

*(Amounts in thousands)*

| | | 2019 | 2018 |
|---|---|---|---|
| Operating revenues – electric sales (net of uncollectible expense) | $ | 3,516,355 | 3,560,065 |
| Operating expenses: | | | |
| Operations – power supply charge | | 1,585,662 | 1,675,640 |
| Operations – power supply charge – property taxes | | 214,245 | 209,960 |
| Operations and maintenance | | 623,499 | 615,859 |
| Storm restoration | | 86,549 | 90,463 |
| General and administrative | | 29,038 | 28,623 |
| Depreciation and amortization | | 362,344 | 331,860 |
| Payments in lieu of taxes and assessments | | 336,500 | 332,691 |
| Total operating expenses | | 3,237,837 | 3,285,096 |
| Operating income | | 278,518 | 274,969 |
| Nonoperating revenues and expenses: | | | |
| Other income, net: | | | |
| Investment income, net | | 48,276 | 25,562 |
| Grant income | | 35,916 | 43,238 |
| Carrying charges on regulatory assets | | 22,682 | 24,078 |
| Other | | 2,299 | 7,198 |
| Total other income, net | | 109,173 | 100,076 |
| Interest charges and (credits): | | | |
| Interest on debt | | 373,314 | 361,283 |
| Other interest | | 26,045 | 27,131 |
| Other interest amortizations | | (35,686) | (30,156) |
| Allowance for borrowed funds used during construction | | — | (5,875) |
| Total interest charges and (credits), net | | 363,673 | 352,383 |
| Change in net position | | 24,018 | 22,662 |
| Net position, beginning of year | | 494,850 | 472,188 |
| Net position, end of year | $ | 518,868 | 494,850 |

See accompanying Notes to Consolidated Financial Statements.

# LONG ISLAND POWER AUTHORITY

*(A Component Unit of the State of New York)*

Consolidated Statements of Cash Flows

Years ended December 31, 2019 and 2018

*(Amounts in thousands)*

| | | 2019 | 2018 |
|---|---|---|---|
| Cash flows from operating activities: | | | |
| Operating revenues received | $ | 3,775,979 | 3,791,800 |
| Paid to suppliers and employees: | | | |
| Operations and maintenance | | (508,501) | (528,153) |
| Operations – power supply charge | | (1,804,951) | (1,829,765) |
| Operations – power supply charge – property tax related | | (214,245) | (209,960) |
| Payments in lieu of taxes | | (459,185) | (454,529) |
| Collateral on commodity derivative transactions, net | | (109,364) | 12,185 |
| PSEG Long Island pension funding | | (28,000) | (40,000) |
| Net cash provided by operating activities | | 651,733 | 741,578 |
| Cash flows from investing activities: | | | |
| Earnings received on investments | | 33,684 | 23,010 |
| Sale of restricted investment securities | | 92,195 | 180,600 |
| Purchase of investment securities | | (224,731) | (144,074) |
| Purchase of investment securities - OPEB Account | | (65,725) | (94,069) |
| Other | | — | 450 |
| Net cash used in investing activities | | (164,577) | (34,083) |
| Cash flows from noncapital financing related activities: | | | |
| Grant proceeds | | 40,017 | 38,458 |
| Proceeds from credit facility draws and commercial paper program | | 652,000 | 840,000 |
| Redemption of credit facility draws and commercial paper program | | (594,500) | (965,820) |
| Net cash provided by (used in) noncapital financing related activities | | 97,517 | (87,362) |
| Cash flows from capital and related financing activities: | | | |
| Capital expenditures | | (685,851) | (639,993) |
| Proceeds from the issuance of long-term debt | | 540,481 | 482,317 |
| Debt issuance costs | | (1,256) | (2,777) |
| Other interest costs | | (22,255) | (24,239) |
| Interest paid – LIPA | | (150,139) | (127,799) |
| Redemption of long-term debt – LIPA | | (75,430) | (69,880) |
| Interest paid – UDSA | | (196,379) | (201,925) |
| Redemption of long-term debt – UDSA | | (130,761) | (122,803) |
| Net cash used in capital and related financing activities | | (721,590) | (707,099) |
| Net decrease in cash and cash equivalents | | (136,917) | (86,966) |
| Cash and cash equivalents at beginning of year | | 662,615 | 749,581 |
| Cash and cash equivalents at end of year | $ | 525,698 | 662,615 |
| Reconciliation to net cash provided by operating activities: | | | |
| Operating income | $ | 278,518 | 274,969 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | | |
| Depreciation and amortization | | 362,344 | 331,860 |
| Other post-employment benefit non-cash expense | | 42,894 | 48,100 |
| Nuclear fuel burned | | 9,387 | 10,716 |
| Shoreham and VBA surcharges | | 45,848 | 49,289 |
| Accretion of asset retirement obligation | | 3,206 | 1,196 |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable, net | | 115,891 | (72,021) |
| Regulatory assets and liabilities | | (163,719) | 204,921 |
| Fuel and material and supplies inventory | | (27,601) | (3,285) |
| Accounts payable, accrued expenses and other | | (15,035) | (104,167) |
| Net cash provided by operating activities | $ | 651,733 | 741,578 |

See accompanying Notes to Consolidated Financial Statements.

## (1) Nature of Operations

The Long Island Power Authority (LIPA) is the owner of the electric transmission and distribution (T&D) system located in the Counties of Nassau and Suffolk (with certain limited exceptions) and a portion of Queens County known as the Rockaways (Service Area), and is responsible for supplying electricity to customers within the Service Area. LIPA also owns an undivided 18% interest in the Nine Mile Point Unit 2 (NMP2) generating facility, located in upstate New York, which is operated and managed by Exelon Corporation (Exelon).

LIPA was established as a corporate municipal instrumentality of the State of New York (State), constituting a political subdivision of the State, created by Chapter 517 of the Laws of 1986 (the LIPA Act). As such, it is a component unit of the State and is included in the State's annual financial statements.

LIPA is subject to the LIPA Reform Act (Reform Act) which was passed and codified as Chapter 173, Laws of New York on June 21, 2013 by the New York State Assembly and Senate. The Reform Act is divided into two parts, Part A and Part B.

Part A of the Reform Act addressed the reorganization of LIPA and changed its operating responsibilities and the relationship with its service provider, and Part B, referred to as the Securitization Law, created the Utility Debt Securitization Authority (UDSA). The Securitization Law provided a legislative foundation for the UDSA to issue restructuring bonds to allow LIPA to retire a portion of its outstanding indebtedness, providing debt service savings to LIPA's customers on a net present value basis. The restructuring bonds are repaid by irrevocable, non-bypassable restructuring charges on all LIPA's customers. The UDSA has a governing body separate from that of LIPA and has no commercial operations.

For a further discussion on the UDSA, see Note 4.

LIPA has operating agreements with service providers to provide the majority of services necessary to serve LIPA's customers and has power purchase agreements to meet its power supply needs. Below is a summary of LIPA's primary operating agreements:

Amended and Restated Operations Services Agreement (OSA): Effective January 1, 2014, PSEG Long Island LLC (PSEG Long Island), a wholly owned subsidiary of Public Service Enterprise Group (PSEG), fully dedicated to LIPA's Long Island operations, provides operations, maintenance and related services for the T&D system under the OSA. The OSA expires December 31, 2025 and includes a provision that if PSEG Long Island achieves certain levels of performance during the first 10 years of the 12 year term, the parties will negotiate an eight-year extension on substantially similar terms and conditions. PSEG Long Island is paid a management fee and may earn incentive compensation related to specified performance metrics. During the years ended December 31, 2019 and 2018, PSEG Long Island was paid a management fee totaling approximately $65 million and $64 million, respectively. For 2018, PSEG Long Island was paid an incentive fee totaling approximately $9.7 million. For 2019, PSEG Long Island may earn an incentive fee up to approximately $9.8 million, which will be determined by June 2020.

Essentially all costs of operating and maintaining LIPA's T&D system incurred by PSEG Long Island are passed through to and paid for by LIPA.

Amended and Restated Power Supply Agreement (A&R PSA): National Grid provides capacity and energy to LIPA from its oil and gas fired generating plants located on Long Island under the A&R PSA.

The A&R PSA provides for the purchase of approximately 3,700 megawatts of capacity (and related energy to the extent needed) from these generating plants. The A&R PSA commenced May 28, 2013 and expires April 30, 2028. For a further discussion on the A&R PSA, see Note 15.

In addition, LIPA is party to several power purchase agreements with other third-party generators for approximately 1,800 megawatts of capacity and related products.

Fuel Management Agreement and Power Supply Management Agreement: PSEG Energy Resources and Trade LLC (PSEG ER&T) provides fuel management services for both the National Grid generating facilities under contract by LIPA and the other units in LIPA's energy supply portfolio. Certain other services related to power supply management and commodity activities are also provided by PSEG ER&T. During the years ended December 31, 2019 and 2018, PSEG ER&T was paid a management fee totaling approximately $19 million and $18 million, respectively. The agreements with PSEG ER&T expire December 31, 2025 and are subject to extension.

## (2) Summary of Significant Accounting Policies

### *(a) Reporting Entity*

LIPA complies with all applicable pronouncements of the Governmental Accounting Standards Board (GASB). In accordance with GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASB Statement No. 62), the operations of LIPA are presented as an enterprise fund following the accrual basis of accounting in order to recognize the flow of economic resources.

LIPA's reporting entity is comprised of itself and (i) its operating subsidiary the Long Island Lighting Company (LILCO), a wholly owned subsidiary of the Long Island Power Authority, doing business as LIPA and Power Supply Long Island; and (ii) the UDSA. All significant transactions between LIPA, LILCO and UDSA have been eliminated.

During 2017, LIPA established a legally separate trust under Section 115 of the Internal Revenue Code known as the Long Island Power Authority OPEB Trust (OPEB Trust) to fund LIPA's Other Post-Employment Benefit Plan (OPEB) which provides health care benefits to LIPA's qualified retired employees.

### *(b) Estimates*

The accompanying financial statements were prepared in conformity with U.S. generally accepted accounting principles, which require management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the reporting period as well as the reported amounts of assets and liabilities, including disclosure of contingent assets and liabilities, through the date of the financial statements. Actual results could differ from those estimates.

### (c) Reclassifications and Immaterial Adjustment of Prior Period Presentation

The presentation of restricted cash has been adjusted on the statement of cash flows for the year ended December 31, 2018. Cash and cash equivalents at the beginning of the year has been increased by $324 million to include restricted cash and cash equivalents. The adjustment is not considered material to any previously issued financial statements, however, has been corrected in the 2018 for comparative purposes.

In addition, certain other amounts in the 2018 Consolidated Financial Statements have been reclassified in order to conform to the 2019 Consolidated Financial Statements presentation.

### (d) Cash, Cash Equivalents and Investments (including Restricted)

Cash and cash equivalents, and restricted cash and cash equivalents, include all highly liquid financial instruments with a maturity of three months or less when purchased.

Funds held by LIPA are administered in accordance with LIPA's investment policies pursuant to Section 2925 of the New York State Public Authorities Law. These policies comply with the New York State Comptroller's investment guidelines for public authorities. Investments' carrying values are reported at fair market value.

Certain amounts have been restricted for specific purposes. For a further discussion, see Note 11.

### (e) Counterparty Collateral

LIPA and certain of its counterparties require collateral posting for mark-to-market valuations that exceed established credit limits. At December 31, 2019 and 2018, LIPA was required to post $116 million and $7 million, respectively, of collateral to various counterparties, which is recorded as a current asset.

### (f) Material and Supplies Inventory

The material and supplies inventory supports the operations and maintenance of the T&D system. The inventory is accounted for on a weighted average cost basis of accounting.

LIPA also owns 18% of the material and supplies inventory needed to support the operation of the NMP2 nuclear power station. As of December 31, 2019 and 2018, the value of the NMP2 inventory totaled approximately $13 million and $11 million, respectively.

### (g) Other Receivables and Other Long-Term Receivables

The current portion of other receivables is comprised primarily of non-electric billings such as insurance damage claims and mutual aid assistance.

The long-term portion of other receivables is comprised primarily of the net present value of reimbursable costs to construct the interconnection facilities related to the Neptune cable, which is to be paid to LIPA over a 20-year period that commenced in 2007.

### (h) Unrealized Charges

Unrealized charges consist primarily of the ineffective balance of interest rate and commodity derivative instruments.

### *(i) Acquisition Adjustment*

The Acquisition Adjustment, an intangible asset, represents the difference between the purchase price paid and the net assets acquired from LILCO. The Acquisition Adjustment is being amortized on a straight-line basis through 2026 totaling approximately $111 million annually.

### *(j) Capital Lease Obligations*

Capital lease obligations represent the net present value of various contracts including capacity and/or energy of certain generation and transmission facilities, fleet vehicles and certain office facilities. Upon satisfying the capitalization criteria, the net present value of the contract payments is included in both Utility Plant and Capital Lease Obligations.

The capacity and energy contracts are recognized in power supply expense in an amount equal to the contract payment of the capital leases, as allowed through the rate-making process. The value of the asset and the obligation is reduced each month to properly reflect the remaining net present value of the asset and obligation. The fleet vehicle and office facility leases are recognized in operating expense in an amount equal to the contract payment of the agreement.

### *(k) Fuel Inventory*

LIPA owns the fuel oil used in the generation of electricity at the facilities under contract. Fuel inventory represents the value of low sulfur diesel and other liquid fuels that LIPA had on hand at each year-end. Fuel inventory is valued using the weighted average cost method. At the time of consumption, an expense is recorded at the weighted average cost.

### *(l) Borrowings*

Borrowings represent the unamortized balance of cash premiums received at the time of entering into certain financial derivative instruments. LIPA is amortizing such premiums over the life of the instrument in accordance with GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB Statement No. 53).

### *(m) Commodity and Financial Derivative Instruments*

Commodity and financial derivative instruments represent the amount LIPA believes it would receive or be required to pay in order to terminate its commodity and financial derivative instruments which approximates fair value.

### *(n) Long-Term Liabilities and Unrealized Credits*

Long-term liabilities and unrealized credits consist primarily of the impacts of any changes resulting from updated asset retirement studies and deferred ineffective mark-to-market values on derivative instrument transactions.

### *(o) Claims and Damages*

Losses arising from claims including workers' compensation claims, property damage, and general liability claims are partially self-insured. Reserves for these claims and damages are established if it is probable that a loss has been incurred and the amount can be reasonably estimated.

(Amounts in thousands, unless otherwise stated)

### *(p) Revenues*

Operating revenues are comprised of cycle billings for electric service rendered to customers based on meter reads and the accrual of revenues for electric service rendered to customers not billed at year-end. LIPA accrues unbilled revenues by estimating unbilled consumption at the customer meter. Unbilled revenues totaled $181 million and $197 million as of December 31, 2019 and 2018, respectively.

LIPA recognizes an estimate for uncollectible accounts for its receivables related to electric service based upon its historical experience with collections. LIPA records bad debts for its estimated uncollectible accounts related to electric service as a reduction to related operating revenues in the Consolidated Statements of Revenues, Expenses and Changes in Net Position.

### *(q) Depreciation and Amortization*

The provisions for depreciation for utility plant result from the application of straight-line rates determined by age life studies of assets in service. The rates are applied to groups of depreciable properties. The average composite depreciation rates were 2.84% and 2.36% for 2019 and 2018, respectively. Property and equipment is being depreciated over its estimated useful life using the straight-line method.

Separately, capital lease assets and leasehold improvements are being amortized over the lesser of the life of the assets or the term of the lease, using the straight-line method.

The following estimated useful lives are used for utility property:

| Category | Useful life |
|---|---|
| Generation – nuclear | 46–54 years |
| Transmission and distribution | 40–75 years |
| Common | 5–55 years |
| Nuclear fuel in process and in reactor | 6 years |
| Generation assets under capital lease | 10–25 years |

### *(r) Asset Retirement Obligations (ARO)*

GASB issued Statement No. 83, *Certain Asset Retirement Obligations* (GASB Statement No. 83) which states that if a legal obligation for future asset retirement exists for tangible capital assets, a liability is required to be recognized. LIPA, as an 18% owner of NMP2, has a legal obligation imposed by the U.S. Nuclear Regulatory Commission to decommission the plant. LIPA funds its share of the decommissioning costs of the nuclear power plant based on an actuarial study. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and method of settlement.

GASB Statement No. 83 also provides an exception to the initial and subsequent measurement of the ARO if the governmental agency owns a minority share (less than 50%) in an undivided interest arrangement with joint ownership of a tangible capital asset when the majority owner reports under the Financial Accounting Standards Board (FASB). The exception allows governments to report their minority share of an ARO liability using the measurements provided by the FASB reporting entity without adjustment.

(Amounts in thousands, unless otherwise stated)

Exelon, NMP2's majority shareholder, is a FASB reporting entity and as such LIPA estimated its ARO in accordance with FASB Accounting Standards Codification (ASC) 410, Asset Retirement and Environmental Obligations (FASB ASC 410). LIPA recorded its 18% share based on information provided by Exelon which updated its analysis of the NMP2 ARO during 2019. The NMP2 plant has a remaining license term to 2046. The ARO is continually reviewed for adequacy and any necessary changes are updated annually.

LIPA also has a legal obligation to remove certain of its contracted undersea cables in its transmission agreements. Removal of undersea cables pose many potential environmental issues and removal of such cables are rarely completed. Since the timing and extent of any potential asset retirement is unknown, the fair value of any obligations associated with such removal cannot be reasonably estimated.

A summary of LIPA's ARO activity for the years ended December 31, 2019 and 2018 is included below:

| | | 2019 | 2018 |
|---|---|---|---|
| Asset retirement obligation: | | | |
| Beginning balance | $ | 67,483 | 67,787 |
| Change due to updates | | (3,396) | (3,912) |
| Accretion expense | | 3,206 | 3,608 |
| Balance at December 31 | $ | 67,293 | 67,483 |

### (s) *Long-Lived Assets*

Long-lived assets and purchased intangibles subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that there is a significant unexpected decline in the service utility of a capital asset. There were no impairment charges recognized in both 2019 and 2018.

### (t) *Payments-in-Lieu-of-Taxes*

LIPA makes payments-in-lieu-of-taxes (PILOTs) for certain taxes previously paid by LILCO, including gross income, property, and Metropolitan Transportation Authority. In addition, LIPA has entered into various PILOT arrangements for property it owns, upon which generation has been built.

### (u) *Allowance for Borrowed Funds Used During Construction*

The allowance for borrowed funds used during construction (AFUDC) is the net cost of borrowed funds used for construction purposes. Prior to 2019, AFUDC was computed monthly on a portion of construction work in progress, and shown as a net reduction in interest expense. The AFUDC rate for the year ended December 31, 2018 was 4.44%.

Effective January 1, 2019, with the early implementation of GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, interest cost incurred before the end of a construction period are no longer included in the historical cost of a capital asset.

### *(v) Income Taxes*

LIPA is a political subdivision of the State and, therefore, is exempt from Federal, state, and local income taxes.

### *(w) Fair Value Measurements*

GASB Statement No. 72, *Fair Value Measurement and Application* (GASB Statement No. 72), establishes general principles for measuring fair value and standards of accounting and financial reporting for assets and liabilities measured at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available; for others, this information might not be available.

The fair value hierarchy categorizes the inputs to valuation techniques used to measure fair value into three levels as described below:

Level 1 – measurements that use quoted prices (unadjusted) for identical assets or liabilities in active markets that LIPA has the ability to access at the measurement date.

Level 2 – measurements other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly.

Level 3 – measurements that use unobservable inputs for an asset or liability. In some valuations, the inputs used may fall into different levels of hierarchy. In these cases, the financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For a further discussion on the fair value hierarchy levels of LIPA's derivatives and investments, see Notes 8 and 11.

### *(x) Recent Accounting Pronouncements*

GASB issued Statement No. 83, *Certain Asset Retirement Obligations* (GASB Statement No. 83). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this statement. Recognition occurs when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates the government to perform the asset retirement activities. If a liability for an ARO has been incurred by a government but is not yet recognized because it is not reasonably estimable, the government should disclose that fact and the reasons. This statement was implemented by LIPA in 2019 and did not have a material impact on the consolidated financial statements.

GASB Statement No. 84, *Fiduciary Activities*, addresses criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria is generally on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and post-employment benefit arrangements that are fiduciary activities. This statement was implemented by LIPA in 2019 and did not have a material impact on the consolidated financial statements.

GASB Statement No. 87, *Leases* (GASB Statement No. 87), addresses the recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a model for lease accounting based on the principle that leases are financings of the right to use an underlying asset. The requirements of this statement are effective for reporting periods beginning after December 15, 2019.

GASB Statement No. 88*, Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements* improves the information that is disclosed in notes to financial statements related to debt, including direct borrowings and direct placements. This statement was implemented by LIPA in 2019. The adoption of this statement did not have a material impact on the consolidated financial statements; however, it did impact disclosures related to LIPA's long-term debt in Note 12.

GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period* requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund. Although the requirements of this statement were effective for reporting periods beginning after December 15, 2019, LIPA adopted and implemented the requirements of this statement in 2019. This statement did not have a material impact on the consolidated financial statements.

GASB Statement No. 91, *Conduit Debt Obligations* (GASB Statement No. 91), provides a single method of reporting conduit debt obligations by issuers associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This statement clarifies the definition of a conduit debt obligation, establishes that a conduit debt obligation is not a liability of the issuer, establishes standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations and improves required note disclosures. The requirements of this statement are effective for reporting periods beginning after December 15, 2020.

LIPA is currently evaluating the impact of statements effective for future periods (GASB Statements No. 87 and 91) on the accompanying consolidated financial statements.

## (3) Rate Matters

LIPA is empowered by the LIPA Act to set rates for electric service in its Service Area without being required to obtain the approval of the New York State Department of Public Service (DPS) or any other State regulatory body. The LIPA Act requires that any bond resolution of LIPA contain a covenant that it will at all times maintain rates, fees, or charges sufficient to pay the costs of: operation and maintenance of facilities owned or operated by LIPA; PILOTs; renewals, replacements, and capital additions; and the principal of, and interest on, any obligations issued pursuant to such resolution as the same become due and payable. In addition, LIPA must establish or maintain reserves or other funds, or accounts required or established by or pursuant to the terms of such resolution.

In 2013, the LIPA Reform Act established a rate review process that required LIPA and PSEG Long Island submit for review to DPS a three-year rate proposal for rates and charges that took effect on January 1, 2016. Subsequent to the rate proposal period, LIPA and PSEG Long Island are only required to submit a proposed rate increase for DPS review if it would increase the rates and charges by an amount that would increase LIPA's annual revenues by more than 2.5%. LIPA's Board of Trustees (Board) retains final rate-setting power. LIPA's annual base rate increase has not exceeded the 2.5% threshold since the three-year rate plan expired at the end of 2018; and, therefore no such rate proposal has been submitted to the DPS although LIPA provides DPS with its budgets and rate adjustments.

LIPA has a cost reconciliation mechanism, referred to as the Delivery Service Adjustment (DSA), to reconcile certain specified budgeted costs to actual costs in each year. The DSA provides cost recovery or refunding for certain items that vary due to external factors, including: debt service (variances in interest rates and capital expenditures) and storm restoration expenditures (variances from the budget for storm restoration expenses). For debt service, any differences between the actual payments and the amount included in the approved budget and approved delivery rates is charged or refunded to customers, including an allowance for fixed obligation coverage at the factor specified in the Board's Policy. For storm restoration expenditures, if actual storm restoration costs to be recovered from customers is lower than the budgeted costs, such balances will be managed as a regulatory storm reserve to offset future storm expenditures. If actual storm restoration costs are higher than the budgeted costs, one-third of that balance will be recovered in the subsequent recovery period and the remaining two-thirds will be eligible for recovery during a future recovery period and remain as a regulatory asset.

The DSA is calculated through the end of September each year, which allows for the bill impact to be known in advance of the annual budget approval. Any adjustments are reviewed by DPS and implemented on January 1st for recovery (or refund) over the following 12 months.

LIPA also has a Revenue Decoupling Mechanism (RDM). All six of the investor-owned New York State electric utilities also have RDMs within their tariffs for delivery service. Mechanically, RDMs function by comparing actual delivery service revenues with authorized delivery service revenues and crediting (or collecting) any differences to (or from) customers. RDMs are intended to cover all sources of variances in delivery service revenues including, among other things, any net lost revenues attributable to the implementation of energy efficiency or net metering programs, any revenue variances caused by warmer or cooler than normal weather, and revenue variations that result from changes in economic conditions. LIPA's RDM has an additional, forward-looking component. In any year in which the electric sales forecast being used to set rates is more than one year old (such as during a multi-year rate plan), LIPA's tariff provides that an estimate of the coming rate year's delivery revenue variance may also be included in the RDM.

*(Amounts in thousands, unless otherwise stated)*

In addition to the items discussed above, LIPA's tariff also includes: (i) a Power Supply Charge to allow for adjustments to customers' bills to reflect changes in the cost of fuel, purchased power and related costs; (ii) a PILOTs recovery rider to allow rate adjustments to accommodate changes in revenue-based PILOTs; (iii) a rider providing for the recovery of costs associated with the Shoreham Property Tax Settlement; (iv) a rider to recover the costs of LIPA's distributed energy resources and energy efficiency programs; (v) a rider providing for the collection of the New York State assessment imposed by the New York State Legislature; and (vi) a visual benefit assessment for certain customers in the Town of Southampton.

## (4) Component Unit – Utility Debt Securitization Authority

The Reform Act created the Securitization Law, which established the UDSA to permit the issuance of restructuring bonds to allow LIPA to retire a portion of its outstanding indebtedness in order to provide debt service savings to LIPA's customers as measured on a net present value basis. The Securitization Law, as amended, allowed for a total issuance of up to $4.5 billion of UDSA restructuring bonds. In 2017, all such authorization was exhausted.

Each issuance of restructuring bonds is separately secured by distinct collateral pursuant to a new financing order. Each such financing order authorizes restructuring bonds to be repaid pursuant to that financing order by an irrevocable contract right to impose, bill, and collect a non-bypassable consumption-based Restructuring Charge from all existing and future retail customers taking electric transmission or distribution service within the Service Area from LIPA or any of its successors or assignees.

LIPA's Board adopted Financing Orders which allowed the UDSA to issue restructuring bonds. All such financing orders are substantively the same, and each financing order permits the UDSA to issue restructuring bonds in an aggregate amount not to exceed the amount authorized by the Securitization Law. The issuance of the 2017 Restructuring Bonds utilized the available capacity of restructuring bonds permitted to be issued by the Securitization Law. Below is a summary of each financing order and amounts issued:

| Financing Order | Date Issued | Initial Amount Issued | Net Present Value Savings | Restructuring Charge Rate Effective Date |
|---|---|---|---|---|
| Financing Order No. 1 | December 18, 2013 | $ 2,022,324 | 131,609 | March 1, 2014 |
| Financing Order No. 2 | October 27, 2015 | 1,002,115 | 127,978 | January 1, 2016 |
| Financing Order No. 3 | April 7, 2016 | 636,770 | 115,238 | April 7, 2016 |
| Financing Order No. 4 | September 8, 2016 | 469,320 | 71,647 | September 8, 2016 |
| Financing Order No. 5 | November 21, 2017 | 369,465 | 45,387 | January 1, 2018 |
| | | $ 4,499,994 | 491,859 | |

To pass through the benefits of securitization to customers, LIPA modified its rate structure to create restructuring offset charges, which are in an amount equal to and opposite the Restructuring Charges; the net result is that the customer bill is less than it would have been absent the sale of restructuring bonds. The restructuring offset charges are adjusted coincident with changes to the Restructuring Charges to maintain that equality.

As discussed in Note 2, UDSA is a component unit of LIPA and all of the activities and balances of the UDSA are blended into and reported as part of LIPA. See Note 17 for consolidating condensed information.

*(Amounts in thousands, unless otherwise stated)*

## (5) Regulatory Accounting

LIPA's Board has approved various regulatory mechanisms that result in timing differences between the recognition of revenues and expenses for rate-making purposes and treatment under generally accepted accounting principles for non-regulated entities. These actions result in regulatory assets and liabilities, which are summarized in the table below:

| | | 2019 | 2018 |
|---|---|---|---|
| Regulatory assets to be recovered within one year: | | | |
| OSA – employee retirement benefits | $ | 54,006 | 54,006 |
| Shoreham property tax settlement | | 47,336 | 46,233 |
| Delivery service adjustment | | 23,607 | 28,845 |
| Employee benefit plan settlement | | 15,634 | 15,634 |
| Power supply charge recoverable | | 8,957 | — |
| Debt issuance costs | | 3,209 | 3,209 |
| New York State assessment | | 1,393 | 1,681 |
| Southampton visual benefit assessment | | 1,029 | 909 |
| | $ | 155,171 | 150,517 |
| Regulatory assets for future recovery: | | | |
| OSA – employee retirement benefits | | 401,663 | 297,206 |
| Shoreham property tax settlement | | 353,130 | 376,918 |
| Employee benefit plan settlement | | 78,169 | 93,803 |
| Delivery service adjustment | | 76,040 | 78,529 |
| Power supply charge recoverable | | 44,766 | 48,551 |
| Debt issuance costs | | 26,575 | 29,591 |
| Unfunded actuarially determined reserves | | 8,018 | 8,018 |
| Southampton visual benefit assessment | | 6,842 | 7,437 |
| | $ | 995,203 | 940,053 |
| Regulatory liabilities payable within one year: | | | |
| Utility 2.0 | | 15,613 | — |
| Revenue decoupling mechanism | | 12,875 | 47,644 |
| Delivery service adjustment | | 5,737 | — |
| Distributed energy resources | | 15 | 534 |
| Power supply charge refundable | | — | 13,378 |
| | $ | 34,240 | 61,556 |
| Regulatory credits: | | | |
| Grants | | 482,710 | 498,322 |
| | $ | 482,710 | 498,322 |

### *(a) OSA – Employee Retirement Benefits*

LIPA is responsible for reimbursing PSEG Long Island for retirement benefit costs associated with the PSEG Long Island workforce. The retirement benefit plans are owned, sponsored by, and the legal obligation of PSEG Long Island. However, in most cases, PSEG Long Island employee compensation costs are a contractual cost of LIPA under the OSA, including the cost for these retirement benefits (and any required pre-funding of such benefits).

The PSEG Long Island workforce includes both electric-serving employees hired under the expired Management Services Agreement (MSA) with National Grid (referred to as transitioned employees) and PSEG Long Island employees hired since the beginning of the OSA on January 1, 2014. PSEG Long Island recognizes the assets and liabilities associated with the retirement benefit plans; however, they also recognize a receivable from LIPA for the unfunded portion of any liabilities resulting from LIPA's contractual obligation to fund these employee costs.

The balance of the OSA – Employee Retirement Benefits regulatory asset represents costs and liabilities which have been incurred but not yet collected in electric rates. This amount will be different from LIPA's liability to PSEG Long Island due to differences between funding and recovery levels.

A significant portion of this contractual liability resulted from the transitioned employees being protected against benefit losses from change in service providers. The PSEG Long Island retirement plans ensure that transitioned employees earn a retirement benefit that, when combined with their accrued National Grid benefits, are equal to the benefit they would have received had the transitioned employees remained with National Grid. This provision created a prior-service cost liability totaling $442 million at the beginning of the OSA on January 1, 2014.

Retirement benefit obligations are future cash outlays that will be incurred as the PSEG Long Island employees receive retirement benefits and therefore are estimates of such costs. Differences between amounts collected from customers and amounts owed to PSEG Long Island for these benefits may arise from changes in asset values, plan amendments, interest rates, and actuarial assumptions, among other factors, which will be reflected in the balance of the regulatory asset.

LIPA contributes to a PSEG Long Island sponsored pension trust on an ongoing basis to pre-fund pension obligations. Additionally, LIPA sets aside funds in an OPEB Account based upon periodic actuarial studies to ensure that sufficient funds are available to meet future healthcare and other post-employment benefit obligations.

### *(b) Shoreham Property Tax Settlement (Settlement)*

In January 2000, LIPA reached an agreement with Suffolk County, the Town of Brookhaven, the Shoreham-Wading River Central School District, the Wading River Fire District and the Shoreham-Wading River Library District (which was succeeded by the North Shore Library District) (collectively, the Suffolk Taxing Jurisdictions) and Nassau County regarding the over assessment of the Shoreham Nuclear Power Station. Under the terms of the agreement, LIPA issued $457.5 million of rebates and credits to customers over a five-year period. In order to fund such rebates and credits, LIPA used proceeds from its Capital Appreciation Bonds, Series 1998A Electric System General Revenue Bonds totaling $146 million and Series 2000A Electric System General Revenue Bonds totaling $325 million.

As provided under the Settlement, beginning in June 2003, Suffolk County electric customers' bills include a surcharge (the Suffolk Surcharge) to be collected over the succeeding approximate 25-year period to repay the debt service and issuance costs on the bonds issued by LIPA to fund the Settlement as well as the cost of pre-funding certain rebates and credits.

As rates are established at a level sufficient to recover all such costs identified above, LIPA recorded a regulatory asset. The balance remaining represents rebates and credits issued to LIPA's customers, costs of administering the program, plus annual debt service costs on the bonds identified above, less surcharges collected since 2003.

### *(c) Employee Benefit Plan Settlement*

The MSA between LIPA and National Grid provided, among other things, that upon termination of the MSA, when a third-party succeeded National Grid as the service provider, the successor would assume the rights and obligations of National Grid regarding certain employee benefit plan liabilities. The OSA with PSEG Long Island, however, did not require PSEG Long Island to assume the employee benefit plan assets and liabilities related to the MSA, which were co-mingled with those of other National Grid employees.

LIPA and National Grid and its affiliates signed an Employee Benefit Plan Settlement in 2013 resolving the parties' respective employee benefit plan funding obligations for National Grid's electric-serving employees. LIPA's Board approved recovery of such costs from customers over a 10-year period, the remaining term of the OSA, as virtually all former employees of National Grid covered by these plans have been transitioned to PSEG Long Island and continue to serve our customers.

During 2018, LIPA received Board approval to reduce the employee benefit plan settlement regulatory asset by $42 million for the amounts resulting from the final reconciliation of billings from LIPA's former service provider, which were significantly lower than initial estimated amounts.

As of December 31, 2019 and 2018, the employee benefit plan settlement balance totaled $94 million and $109 million, respectively.

### *(d) Delivery Service Adjustment*

The DSA provides cost recovery or refunding for certain items that vary due to external factors, including: debt service (variances in interest rates and capital expenditures) and storm restoration expenditures (variances from the amounts budgeted for storm restoration expenses). The DSA is calculated through the end of September each year, and as of September 30, 2019, a $23 million regulatory asset was incorporated into the 2020 budget and electric rates. As of September 30, 2018, a regulatory asset totaling $24 million was incorporated into the 2019 budget and electric rates.

The remaining DSA recoverable balance is a result of the storm recovery rider component of the DSA. As discussed in Note 3, Rate Matters, storm restoration costs above the annual budgeted amount is amortized for recovery over a three-year period. One-third is factored into the subsequent year's DSA and the remaining balance is carried forward for recovery in future years. The carryover as of December 31, 2019 and 2018 totaled approximately $76 million and $79 million, respectively.

### *(e) Revenue Decoupling Mechanism*

The RDM ensures that only approved revenues for delivery service are collected from customers. The RDM compares actual revenues with authorized revenues and credits (or collects) any differences to (or from) customers. It is intended to cover all sources of variances in delivery service revenues including, among other things, any net lost revenues attributable to the implementation of energy efficiency or net metering programs, any revenue variances caused by warmer or cooler than normal weather, and revenue variations that result from changes in economic conditions.

The RDM is applied to delivery rates on a percentage basis and is reset at the beginning of each year to include the prior year surplus or shortfall between actual and authorized revenues for delivery service. In years when a multi-year rate plan is in effect, the RDM also utilizes such realized prior year surplus or shortfall to update delivery rates for the current year so as to minimize future variances between actual and authorized revenues. In no event may LIPA recover an amount that exceeds authorized delivery revenues.

The cumulative balance as of December 31, 2019 was approximately $13 million due to customers and is set to be returned in 2020. The RDM balance as of December 31, 2018 was approximately $48 million due to customers and was credited in 2019 rates.

### *(f) Debt Issuance Costs*

LIPA established a regulatory asset for debt issuance costs incurred prior to 2018. The regulatory asset will be amortized as a component of LIPA's revenue requirement on a systematic basis over the life of the debt to which they relate.

### *(g) Power Supply Costs Recoverable or Refundable*

LIPA's tariff includes a Power Supply Charge with a monthly reconciliation of power supply costs. For the year ended December 31, 2019, actual power supply costs exceeded amounts recovered in the Power Supply Charge, resulting in the recognition of a regulatory asset totaling $2 million, which will be collected from customers in 2020. For the year ended December 31, 2018, actual power supply costs were below amounts recovered in the Power Supply Charge, resulting in the recognition of a regulatory liability totaling $13 million, which was returned to customers in 2019.

Also recoverable through the Power Supply Charge are deferred transition costs associated with the transfer of the power supply management contract to PSEG ER&T. Collection of these costs totaling $19 million are being recovered over an eleven-year period, as approved by LIPA's Board, that began January 1, 2015, and expiring December 31, 2025. As of December 31, 2019 and 2018, the remaining balance of such costs totaled $10 million and $12 million, respectively.

Amounts incurred related to various energy projects, the amortization of which are charged to power supply costs over the period of benefit (i.e., the life of the power purchase agreement) are also recoverable as a component of the Power Supply Charge. As of December 31, 2019 and 2018, the balance was $26 million and $28 million, respectively.

Unfunded actuarially determined potential costs relating to generation are a deferred component of the Power Supply Charge and total $13 million. Such amounts will not be reflected in the Power Supply Charge until settlement costs are paid.

### *(h) Southampton Visual Benefit Assessment*

LIPA has recorded the incremental costs to bury a portion of a transmission cable routed through the Town of Southampton as a regulatory asset, which is being recovered from certain customers of the Town in a visual benefit district over a period of 20 years that began in 2009.

### *(i) Regulatory Credits – Grants*

LIPA has received grants for storm restoration and storm hardening. LIPA's Board authorized the deferral of grant income as a regulatory credit. This regulatory credit will be amortized over the same time period as the depreciation expense on the associated capital assets for storm hardening.

### *(j) Distributed Energy Resources*

The Distributed Energy Resources (DER) charge recovers costs of LIPA's energy efficiency and distributed energy resource programs. The costs of such programs are authorized by LIPA's Board annually in its approved budget and billed to customers through the DER charge based on energy usage.

### *(k) Unfunded Actuarially Determined Reserves*

Unfunded actuarially determined reserves are amounts recorded for non-cash reserves that are deferred until settlement costs are paid, at which time they are recovered in rates. Such estimates were calculated by an actuary based on experience and are updated every three years. The next study is scheduled to be updated in 2020.

### *(l) Utility 2.0*

LIPA's annual Utility 2.0 plan funds new technologies, pilot programs, smart meters, and distributed energy projects. Utility 2.0 actual project costs are reconciled to funding levels set in rates on an annual basis. In December 2019, LIPA's Board approved regulatory accounting treatment to align revenue recognition with the timing of Utility 2.0 plan expenses.

## (6) Deferred Outflows and Deferred Inflows of Resources

Certain assets and liabilities are reported as deferred outflows of resources (expenses or expenditures) and deferred inflows of resources (revenues) as follows:

### *(a) Deferred Defeasance Costs on Debt Refunding*

Deferred defeasance costs on refunded debt represent the difference between the reacquisition price and the carrying amount of the refunded debt. These deferred costs are amortized as a component of interest expense over the shorter of the life of the old or new debt.

### *(b) Changes in Fair Value of Derivative Instruments*

The accumulated changes in the mark-to-market valuation of a hedging derivative instrument deemed effective are reported as deferred inflows or deferred outflows of resources on the Consolidated Statements of Net Position.

As LIPA follows GASB Statement No. 62, any changes in ineffective investment derivative instruments are reported as unrealized charges, as LIPA's Board has authorized the deferral of these unrealized gains or losses until realized, which corresponds to the period when they are recovered in rates.

### *(c) Changes in Fair Market Value of NMP2 Decommissioning Trust and OPEB Account*

LIPA maintains a Trust for the decommissioning of NMP2. Separately, LIPA maintains an OPEB Account to set aside funds to meet future PSEG Long Island retirement benefit costs. These funds are reported at their fair market value and any unrealized gains or losses are recognized as a component of deferred inflows or deferred outflows of resources in accordance with LIPA's ratemaking process.

### *(d) Pension and OPEB*

In accordance with GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27* (GASB Statement No. 68), LIPA reports as deferred inflows or deferred outflows of resources the differences between expected and actual experience, projected and actual investment earnings on pension plan investments, contributions and the proportionate share of contributions, and changes in LIPA's contributions to the pension system subsequent to the measurement date.

In accordance with GASB Statement No. 75, *Accounting and Financial Reporting for Post-employment Benefits Other Than Pensions*, (GASB Statement No. 75), LIPA reports the changes in LIPA's net OPEB liability that have not been included in OPEB expense as deferred inflows or deferred outflows of resources. Amounts included would result from changes of assumptions, the net difference between projected and actual earnings on the OPEB Trust and LIPA's contributions subsequent to the measurement date.

## (7) Federal Emergency Management Agency (FEMA) Grants

In 2012, Superstorm Sandy caused significant damage to LIPA's Service Area resulting in the declaration of a federal major disaster area and making LIPA eligible for FEMA grants. LIPA and FEMA signed a Letter of Undertaking (LOU) that provides for a Public Assistance (PA) grant authorized under Section 428 of the Stafford Act (428 Grant Agreement) for a total eligible reimbursement of $1.29 billion (90% of $1.43 billion contained in the LOU). LIPA also signed a Community Development Block Grant (CDBG) to compensate for the non-federal match of certain declared weather events including Superstorm Sandy, Hurricane Irene, and Snowstorm Nemo.

LIPA received funding resulting from Superstorm Sandy costs totaling approximately $1.11 billion under the FEMA 428 Grant Agreement, and $90 million under CDBG. A portion of the FEMA 428 Grant Agreement included funding for future storm hardening and mitigation efforts. LIPA maintains a restricted segregated account for any unused portion of the grant proceeds. As of December 31, 2019 and 2018, this segregated grant account totaled approximately $2 million and $104 million, respectively. The remaining amounts owed to LIPA under the LOU are expected to be received after the projects are completed.

## (8) Derivative Instruments

LIPA uses derivative instruments in its normal course of business to limit some of the volatility associated with interest rate changes and market price fluctuations in the purchase of fuel oil, natural gas and electricity. LIPA does not use derivative instruments for trading or speculative purposes. These contracts are evaluated pursuant to GASB Statement No. 53 to determine whether they meet the definition of derivative instruments, and whether they effectively hedge the expected cash flows associated with interest rate and commodity price risk exposures. The fair values of LIPA's derivatives are reported on the Consolidated Statements of Net Position as either Commodity Derivative Instruments or Financial Derivative Instruments.

LIPA applies hedge accounting for derivative instruments that are deemed effective under GASB Statement No. 53. Under hedge accounting, changes in the fair value of such hedging derivative instruments are a component of deferred inflows or deferred outflows of resources on the Consolidated Statements of Net Position until the contract is settled or hedge accounting is terminated. Derivative instruments that do not meet the definition of a hedging derivative instrument are economic hedges, intended to mitigate exposure to fluctuations in interest rates or commodity prices and are referred to as investment derivative instruments. Changes in the fair value of investment derivative instruments are deferred until settled or terminated in accordance with LIPA's ratemaking process.

All settlement payments or receipts for hedging and interest rate derivative instruments are recorded as either power supply expense for commodity derivative instruments or interest expense for interest rate derivative instruments on the Statements of Revenues, Expenses and Changes in Net Position in the period settled.

LIPA's interest rate and commodity derivative contracts are valued in accordance with GASB Statement No. 72, which establishes a fair value hierarchy: Level 1, Level 2 and Level 3 (as discussed in Note 2 (w)). Interest rate derivative contracts are based on the present value of cash flows using the income approach and the interest rate derivative contracts are classified as Level 2 (as defined in Note 2), as their valuation relies primarily on observable inputs.

*(Amounts in thousands, unless otherwise stated)*

LIPA's commodity derivative contracts are transacted both over-the-counter and through clearing exchanges and the valuations are based upon price quotes from exchanges and third-party brokers. The impacts of credit and non-performance risk by either LIPA or its counterparty were not material to the financial statements as all LIPA's counterparties are highly-rated, as noted in the credit risk discussion below.

In accordance with GASB Statement No. 72, LIPA determines the level of fair value hierarchy based on the lowest level input that is significant to the fair value measurement in its entirety. The following table presents LIPA's derivative instruments measured and recorded at fair value on the Consolidated Statements of Net Position on a recurring basis and their level within the fair value hierarchy:

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | **Level 1** | **Level 2** | **Level 3** | **Level 1** | **Level 2** | **Level 3** |
| Derivative assets: | | | | | | |
| Financial derivatives | $ — | 2,625 | — | — | 3,240 | — |
| Commodity derivatives | — | — | — | 18,637 | — | — |
| Derivative liabilities: | | | | | | |
| Financial derivatives | — | (192,878) | — | — | (178,314) | — |
| Commodity derivatives | (89,456) | (2,594) | — | — | (1,355) | — |
| | $ (89,456) | (192,847) | — | 18,637 | (176,429) | — |

(Amounts in thousands, unless otherwise stated)

LIPA's derivative instruments are as follows:

| Derivative instrument description | Fair value December 31, 2019 | Net change in fair value | Fair value December 31, 2018 | Type of hedge | Financial statement classification for changes in fair value |
|---|---|---|---|---|---|
| Hedging derivative instruments: | | | | | |
| Financial derivatives: | | | | | |
| Total return swap | $ 900 | (369) | 1,269 | Cash flow | Deferred inflows |
| Total return swap | 1,322 | (649) | 1,971 | Cash flow | Deferred inflows |
| Forward-starting swap | 533 | 533 | — | Cash flow | Deferred inflows |
| Forward-starting swap | (130) | (130) | — | Cash flow | Deferred inflows |
| Total | $ 2,625 | (615) | 3,240 | | |
| Commodity derivatives: | | | | | |
| Natural gas basis swaps | (8,375) | (17,499) | 9,124 | Cash flow | Deferred inflows/(outflows) |
| Total | $ (8,375) | (17,499) | 9,124 | | |
| Investment derivative instruments: | | | | | |
| Financial derivatives: | | | | | |
| Synthetic fixed-A | $ (186,219) | (18,946) | (167,273) | N/A | Unrealized charges |
| Basis swap-A | (3,329) | 2,192 | (5,521) | N/A | Unrealized charges |
| Basis swap-B | (1,665) | 1,095 | (2,760) | N/A | Unrealized charges |
| Basis swap-C | (1,665) | 1,095 | (2,760) | N/A | Unrealized charges |
| Total | $ (192,878) | (14,564) | (178,314) | | |
| Commodity derivatives: | | | | | |
| Power – financial basis | (2,594) | (1,239) | (1,355) | N/A | Unrealized charges |
| Purchased power swaps | (26,781) | (41,114) | 14,333 | N/A | Unrealized charges |
| Natural gas swaps | (54,300) | (49,480) | (4,820) | N/A | Unrealized charges |
| Total | $ (83,675) | (91,833) | 8,158 | | |

The terms of LIPA's commodity derivative instruments as of December 31, 2019 and 2018 are summarized in the table below:

| Derivative Instrument | Amount (in thousands) | Units | Beginning Period | Ending Period | LIPA Pays Per Unit | LIPA Receives |
|---|---|---|---|---|---|---|
| **2019:** | | | | | | |
| Natural Gas Swaps | 183,203 | Dthms | 1/1/2020 | 12/1/2023 | $ 2.35 to $ 2.92 | Natural Gas at Henry Hub |
| Natural Gas Basis Swaps | 35,623 | Dthms | 1/1/2020 | 3/1/2022 | $ (0.38) to $ 5.67 | Gas Basis between Henry Hub & Transco Z6, NY |
| Purchased Power Swaps | 12,019 | Mwhs | 1/1/2020 | 12/1/2023 | $ 20.00 to $ 45.95 | Power at PJM West |
| Purchased Power Basis | 3,698 | Mwhs | 1/1/2020 | 12/1/2021 | $ (4.65) to $ 4.80 | Power Basis between PJM West to JCPL |
| **2018:** | | | | | | |
| Natural Gas Swaps | 171,223 | Dthms | 1/1/2019 | 12/1/2023 | $ 2.47 to $ 3.15 | Natural Gas at Henry Hub |
| Natural Gas Basis Swaps | 26,930 | Dthms | 1/1/2019 | 3/1/2021 | $ (0.38) to $ 5.80 | Gas Basis between Henry Hub & Transco Z6, NY |
| Purchased Power Swaps | 9,407 | Mwhs | 1/1/2019 | 12/1/2023 | $ 22.50 to $ 46.50 | Power at PJM West |
| Purchased Power Basis | 3,840 | Mwhs | 1/1/2019 | 12/1/2021 | $ (4.80) to $ 7.35 | Power Basis between PJM West to JCPL |

The terms of LIPA's interest rate derivative instruments as of December 31, 2019 are summarized in the table below:

| Financial derivative | Effective date | Termination date | LIPA pays | LIPA receives | Original notional | Upfront cash payment |
|---|---|---|---|---|---|---|
| Synthetic fixed-A | 6/1/2003 | 12/1/2029 | 5.120 % | 69.47% of 1-month LIBOR | $ 587,225 | $ 106,400 |
| Basis swap-A | 7/1/2004 | 8/15/2033 | SIFMA | 70.50% of 1-month LIBOR | 502,090 | 17,500 |
| Basis swap-B | 7/1/2004 | 8/15/2033 | SIFMA | 70.50% of 1-month LIBOR | 251,045 | 8,750 |
| Basis swap-C | 7/1/2004 | 8/15/2033 | SIFMA | 70.50% of 1-month LIBOR | 251,045 | 8,750 |
| Total return swap | 6/29/2015 | 6/29/2020 | 69.4% 1-month LIBOR+.40% | MMD +1.10% [a] | 200,000 | — |
| Total return swap | 9/15/2016 | 9/1/2021 | 69.4% 1-month LIBOR+.30% | MMD +1.05% [a] | 175,000 | — |
| Forward-starting swap | 9/1/2022 | 9/1/2042 | 1.8571% | 70.00% of 1-month LIBOR | 251,510 | — |
| Forward-starting swap | 9/1/2022 | 9/1/2029 | 1.3150% | 70.00% of 1-month LIBOR | 164,860 | — |

[a] Based on lowest long-term rating of LIPA

LIPA has outstanding Electric System General Revenue Bonds, Series 2015A Municipal Market Data (MMD) Floating Rate Notes (FRNs) totaling $200 million and Electric System General Revenue Bonds, Series 2016A MMD FRNs totaling $175 million.

Immediately following direct placement of these FRNs, LIPA entered into five-year basis agreements whereby the counterparty agreed to pay LIPA an amount equal to the floating MMD FRN coupon, and LIPA agreed to pay the counterparty 69.4% of one-month London Interbank Offered Rate (LIBOR) plus basis points as specified in the table above. At the five-year expiration or the early termination of the agreements, the counterparty pays LIPA 90% of any increase in the market value of the MMD FRN and LIPA pays the counterparty 100% of any decrease in the market value of the MMD FRN, provided however, that if LIPA exercises its right to call or remarket the MMD FRN, the value of either agreement will be zero and neither party will have a payment obligation.

In December 2019, LIPA entered into two forward-starting interest rate swap transactions. The swaps become effective on September 1, 2022 and were executed in anticipation of issuing bonds to refund LIPA's Electric System General Revenue Bonds, Series 2012A and 2012B, which are callable in 2022. LIPA agreed to pay each counterparty the fixed interest rates in the table above in exchange for receiving 70% of 1-month LIBOR. LIPA has the ability to terminate each swap at par beginning on September 1, 2027 and monthly thereafter.

LIPA is exposed to the following risks related to derivative instruments as defined by GASB Statement No. 53:

### *(a) Termination Risk*

Termination risk is the risk that a derivative could be terminated by a counterparty prior to its scheduled maturity due to a contractual event with LIPA owing a termination payment. As long as LIPA fulfills its obligations under the contracts, the counterparties do not have the right to terminate these agreements. LIPA believes that termination risk is low because the counterparties may terminate the agreements only upon the occurrence of specific events such as payment defaults, other defaults which remain uncured for 30 days after notice, bankruptcy or insolvency of LIPA (or similar events), or a downgrade of LIPA's and its insurers', if any, credit rating below investment grade. If, at the time of termination, the mark-to-market valuation of the derivative was a liability of LIPA, LIPA could be required to pay that amount to the counterparty. Termination risk associated with all of LIPA's derivatives is limited to the fair market value.

### *(b) Basis Risk*

LIPA is exposed to basis risk on certain of its interest rate swaps because the variable-rate payments received by LIPA, and those paid either pursuant to the terms of the swap or on the associated variable rate debt, may differ. The terms of the interest rate swap transactions are summarized in the table above.

LIPA is exposed to basis risk on a portion of its commodity swaps when the commodity swap payment received is based upon a reference price in a market (e.g., natural gas priced at Henry Hub) that differs from the market in which the hedged item is expected to be bought (natural gas priced at New York City gate). If the correlation between these market prices should change substantially, LIPA may incur costs as a result of the hedging derivative instrument's inability to offset the price of the related commodity.

### *(c) Collateral Posting*

Under certain conditions, LIPA may be required to post collateral related to its interest rate derivative instruments. Under the terms of its interest rate derivative agreements, collateral may be required if LIPA's credit ratings, and in the case of insured swaps, the credit ratings of any related interest rate derivative insurer, fall below minimum levels as provided in each agreement, and LIPA fails to provide alternative credit enhancements. Collateral for its financial derivatives, if required, would approximate fair value. LIPA has never been required to post collateral for its interest rate derivative instruments.

LIPA has collateral requirements with commodity derivative counterparties in the Credit Support Annexes (CSA) of International Swap Deal Agreements (ISDA). Collateral is required to be posted with the counterparty when the negative fair value of the commodity derivative instrument exceeds the unsecured line of credit established with each counterparty as listed in the counterparty table below. In the event of collateral being posted, the value will equal the difference between the fair value and the amount of the unsecured line of credit. For exchange broker cleared derivative transactions, there is an initial margin requirement on day one of a trade that is calibrated to cover the expected cost of closing out the position in the event of a default. Collateral postings between the exchange clearing broker and LIPA each day thereafter are based on the fair value of the derivative instrument.

### *(d) Credit Risk*

Credit risk is the risk that the counterparty (or its guarantor) will default on its obligations under the agreement. LIPA has sought to limit counterparty risk by contracting only with highly rated counterparties or requiring guarantees of the counterparty's obligations. LIPA also makes use of exchange cleared transactions for a portion of its commodity derivatives. The exchange uses a central clearing counterparty structure along with risk based margin requirements that limits credit risk exposure.

Below is a table with the credit ratings issued by Moody's Investors Service (Moody's) and Standard and Poor Global Ratings (S&P) and unsecured line of credit limits of LIPA's counterparties as of December 31, 2019:

| Counterparty | As of December 31, 2019 Moody's | S&P | Counterparty's unsecured line of credit *(in millions)* |
|---|---|---|---|
| **Interest Rate Derivative Instruments:** | | | |
| JPMorgan Chase & Co.[1] | A2 | A- | $ — |
| Citibank, N.A. New York | Aa3 | A+ | — |
| Merrill Lynch Capital Services, Inc. [2] | A2 | A- | — |
| UBS AG, Stamford Branch | Aa3 | A+ | — |
| Wells Fargo Bank, N.A. | Aa2 | A+ | — |

*1 The original counterparty was Bear Stearns Capital Markets Inc.*

*2 Ratings reflect the rating of Bank of America Corp.*

| Counterparty | Moody's | S&P | Counterparty's unsecured line of credit *(in millions)* |
|---|---|---|---|
| **Commodity Derivative Instruments:** | | | |
| BP Energy Company * | A2 | A- | 10.0 |
| Citigroup Energy, Inc. * | A3 | BBB+ | 10.0 |
| Consolidated Edison Energy, Inc. * | Baa1 | BBB+ | 4.0 |
| Exelon Generation Company, LLC | Baa2 | BBB+ | 10.0 |
| J. Aron & Company * | A3 | BBB+ | 40.0 |
| JPMorgan Chase Bank, N.A. | Aa2 | A+ | 35.0 |
| Macquarie Energy LLC * | A2 | A+ | 10.0 |
| Merrill Lynch Commodities, Inc. * | A2 | A- | 20.0 |
| Mitsui Bussan Commodities Ltd. * | A3 | A | 12.5 |
| Morgan Stanley Capital Group Inc. * | A3 | BBB+ | 10.0 |
| Next Era Power Marketing * | Baa1 | BBB+ | 5.0 |
| Pacific Summit Energy LLC * | Baa1 | A- | 10.0 |
| Societe Generale | A1 | A | 25.0 |
| The Bank of Nova Scotia | Aa2 | A+ | 25.0 |

** Rating reflects the rating of the parent company guarantor*

(Amounts in thousands, unless otherwise stated)

## (9) Utility Plant and Property and Equipment

Additions to and replacements of utility plant are capitalized at original cost, which includes material, labor, and indirect costs associated with an addition or replacement. The cost of renewals and betterments relating to units of property is added to utility plant. The cost of property replaced, retired, or otherwise disposed of is deducted from utility plant and, generally, together with dismantling costs less any salvage, are charged to accumulated depreciation. The cost of repairs and minor renewals are charged to operations and maintenance expense. Group properties, such as poles, meters, and wire, are accounted for on an average unit cost basis by year of installation.

The following schedule summarizes LIPA's utility plant and property and equipment as of December 31, 2019:

| | | Beginning balances | Additions | Transfers/ Disposals | Ending balances |
|---|---|---|---|---|---|
| Utility plant | $ | 8,044,824 | 521,144 | (85,400) | 8,480,568 |
| Utility plant assets under capital lease | | 58,302 | 52,125 | (1,003) | 109,424 |
| Office equipment, furniture, and leasehold improvements | | 2,090 | 1,482 | — | 3,572 |
| Long lived assets – asset retirement cost | | 15,542 | — | (15,542) | — |
| Accumulated depreciation | | (2,114,724) | (242,543) | 154,252 | (2,203,015) |
| Total utility plant – net | | 6,006,034 | 332,208 | 52,307 | 6,390,549 |
| Generation and transmission assets under capital lease | | 3,196,383 | — | — | 3,196,383 |
| Accumulated depreciation | | (1,371,718) | (163,836) | — | (1,535,554) |
| Total generation and transmission assets under capital lease – net | | 1,824,665 | (163,836) | — | 1,660,829 |
| Construction work in progress | | 540,111 | 693,537 | (521,145) | 712,503 |
| Retirement work in progress | | 12,528 | 49,949 | (52,396) | 10,081 |
| | | 552,639 | 743,486 | (573,541) | 722,584 |
| Totals | $ | 8,383,338 | 911,858 | (521,234) | 8,773,962 |

(Amounts in thousands, unless otherwise stated)

The following schedule summarizes LIPA's utility plant and property and equipment as of December 31, 2018:

| | | Beginning balances | Additions | Transfers/ Disposals | Ending balances |
|---|---|---|---|---|---|
| Utility plant | $ | 7,621,220 | 519,977 | (96,373) | 8,044,824 |
| Utility plant assets under capital lease | | 30,706 | 27,844 | (248) | 58,302 |
| Office equipment, furniture, and leasehold improvements | | 17,825 | 358 | (16,093) | 2,090 |
| Long lived assets – asset retirement cost | | 15,542 | | | 15,542 |
| Accumulated depreciation | | (2,055,931) | (201,335) | 142,542 | (2,114,724) |
| Total utility plant – net | | 5,629,362 | 346,844 | 29,828 | 6,006,034 |
| Generation and transmission assets under capital lease | | 3,488,869 | — | (292,486) | 3,196,383 |
| Accumulated depreciation | | (1,491,528) | (172,676) | 292,486 | (1,371,718) |
| Total generation and transmission assets under capital lease – net | | 1,997,341 | (172,676) | — | 1,824,665 |
| Construction work in progress | | 453,839 | 606,249 | (519,977) | 540,111 |
| Retirement work in progress | | 7,472 | 39,304 | (34,248) | 12,528 |
| | | 461,311 | 645,553 | (554,225) | 552,639 |
| Totals | $ | 8,088,014 | 819,721 | (524,397) | 8,383,338 |

## (10) Nine Mile Point Nuclear Power Station, Unit 2

LIPA owns an undivided 18% interest in NMP2 in Oswego County, New York. The other 82% is owned by Constellation Energy Nuclear Group (CENG), a joint venture of Exelon and EDF, a large electric-power company headquartered in France. The unit is operated by Exelon.

NMP2 has a rated net capacity of approximately 1,300 megawatts. LIPA is entitled to 18% of the unit's capacity and energy and is obligated to pay 18% of its operating and maintenance costs, nuclear fuel costs, and costs of capital additions. LIPA's net capital investment in NMP2, excluding nuclear fuel, was approximately $537 million and $540 million as of December 31, 2019 and 2018, respectively.

### *Nuclear Plant Decommissioning*

The operating license for NMP2 expires on October 31, 2046.

As of December 31, 2019, and 2018, LIPA's share of the estimated costs for decommissioning of the unit and restoration of the site is approximately $64 million and $63 million, respectively, and is included in the Consolidated Statements of Net Position as a component of the Asset Retirement Obligation. LIPA maintains a nuclear decommissioning trust fund (NDTF) for its share of the decommissioning costs. As of December 31, 2019, and 2018, the NDTF had approximately $144 million and $125 million, respectively. LIPA believes that deposits to the fund, which are based on actuarial estimates, and the assumed investment returns of these funds during the term of the operating license, will be sufficient to meet its obligations.

### *Liability for Nuclear Accidents*

The Federal Price-Anderson Act (Act) currently requires owners of nuclear power plants to obtain $450 million in private insurance coverage for off-site liability coverage for each reactor site (not each reactor). Exelon maintains this coverage for the Nine Mile Point site, and LIPA reimburses Exelon for its proportionate share of the cost. The Act further stipulates that in the event off-site damages exceed the amount of private insurance coverage, each reactor licensee is retroactively liable for a prorated share of the excess. This liability is limited to $131 million per reactor, payable at no more than approximately $20 million per reactor per incident per year. LIPA's maximum liability under this provision is approximately $24 million, payable at approximately $4 million per incident per year.

## (11) Cash, Cash Equivalents and Investments

The majority of LIPA's cash, cash equivalents and investments are either managed by an external investment manager or invested in mutual funds. LIPA's investment of funds is administered in accordance with the applicable provisions of State law, the Bond Resolution, certain banking agreements and LIPA's investment policy.

### ***(a) Unrestricted cash, cash equivalents and investments***

As of December 31, 2019, and 2018, LIPA had unrestricted cash, cash equivalents and investments totaling approximately $1.13 billion and $952 million, respectively. The unrestricted funds primarily consist of the: Operating Fund, Construction Fund, Rate Stabilization Fund, and OPEB Account.

*(Amounts in thousands, unless otherwise stated)*

In the event that LIPA determines there are insufficient revenues to pay reasonable and necessary operating expenses or to make payments on bonds or parity obligations, after notifying the Finance and Audit Committee of LIPA's Board, LIPA may release funds from the OPEB Account for such purposes. As such, the OPEB Account is unrestricted.

Deposits made to LIPA's unrestricted OPEB Account are to fund LIPA's contractual obligations to employees of PSEG Long Island for certain post-employment benefits. LIPA has invested such funds, pursuant to LIPA's investment policy, in domestic and international stock mutual funds (65%), as well as inflation protected and bond market institutional mutual funds (35%). As of December 31, 2019, and 2018, the OPEB Account balance totaled approximately $386 million and $272 million, respectively. The following tables summarize LIPA's unrestricted cash, cash equivalents and investments as of December 31, 2019 and 2018. The credit ratings listed are from Moody's, S&P and Fitch and the rating shown is the lowest rated obligation within each investment type.

| Deposit/investment type | Credit Rating (if applicable) | Percent of portfolio | 2019 Fair value | Cash and cash equivalents | Investments |
|---|---|---|---|---|---|
| Operating Fund, Construction Fund, Rate Stabilization Fund and Other operating accounts: | | | | | |
| Cash and collateralized deposits | | 1 % | $ 5,796 | 5,796 | — |
| Discount notes and bonds: | | | | | |
| Certificates of deposit | AA-/A-1/Aa2/P-1/AA/F1 | — | 2,760 | — | 2,760 |
| Commercial paper | A-1/P-1/F1 | 29 | 218,875 | — | 218,875 |
| Corporate | BBB+/Baa1/BBB+ | 18 | 132,099 | 4,262 | 127,837 |
| Federal agencies | AA+/Aaa | 10 | 70,389 | 8,977 | 61,412 |
| Foreign government bonds | AAA/A-1+/Aaa/P-1/AAA/F1+ | 3 | 25,449 | — | 25,449 |
| Municipal bonds | AA/Aa1/AA | — | 2,854 | — | 2,854 |
| Treasury bills, notes and zero-coupon bonds | AA+/Aaa | 19 | 137,684 | — | 137,684 |
| Money-market mutual funds | | 20 | 147,401 | 147,401 | — |
| Subtotal | | 100 % | 743,307 | 166,436 | 576,871 |
| OPEB Account | | | | | |
| Mutual funds – equities | | 65 % | 251,309 | — | 251,309 |
| Mutual funds – fixed income | | 35 | 134,953 | — | 134,953 |
| Subtotal | | 100 % | 386,262 | — | 386,262 |
| Total | | | $ 1,129,569 | 166,436 | 963,133 |

(Amounts in thousands, unless otherwise stated)

| Deposit/investment type | Credit rating (if applicable) | Percent of portfolio | | 2018 Fair value | Cash and cash equivalents | Investments |
|---|---|---|---|---|---|---|
| Operating Fund, Construction Fund, Rate Stabilization Fund and Other operating accounts: | | | | | | |
| Cash and collateralized deposits | | 2 | % | $ 13,310 | 13,310 | — |
| Discount notes and bonds: | | | | | | |
| Certificates of deposit | A/A-1/A1/P-1/A+/F-1 | 9 | | 60,784 | 18,214 | 42,570 |
| Commercial paper | A-1/P-1/F-1 | 6 | | 39,268 | 13,474 | 25,794 |
| Corporate | BBB+/A-1/Baa1/P-1/BBB+/F-1+ | 13 | | 95,662 | 2,307 | 93,355 |
| Federal agencies | AA+/A-1+/Aaa/P-1 | 7 | | 47,605 | 14,343 | 33,262 |
| Foreign government bonds | AAA/Aaa/AAA | 3 | | 19,029 | — | 19,029 |
| Municipal bonds | AA-/Aa3/AA- | 1 | | 3,343 | — | 3,343 |
| Treasury bills and notes | AA+/A-1+/Aaa/P-1 | 39 | | 265,064 | 130,277 | 134,787 |
| Money-market mutual funds | | 20 | | 135,875 | 135,875 | — |
| Subtotal | | 100 | % | 679,940 | 327,800 | 352,140 |
| OPEB Account: | | | | | | |
| Mutual funds – equities | | 65 | % | 176,947 | — | 176,947 |
| Mutual funds – fixed income | | 35 | | 94,932 | — | 94,932 |
| Subtotal | | 100 | % | 271,879 | — | 271,879 |
| Total | | | | $ 951,819 | 327,800 | 624,019 |

### (b) Restricted cash, cash equivalents and investments

LIPA's restricted cash, cash equivalents and investments consist of: the Working Capital Requirements Account, the FEMA Grant Proceeds Fund, and the UDSA Collection and Reserve Accounts.

#### *Restricted Cash for Working Capital Requirements*

In accordance with the OSA, LIPA is required to advance fund an account available to PSEG Long Island to pay for operating and capital expenditures that PSEG Long Island incurs as LIPA's agent in the management of LIPA's T&D system. LIPA is required to maintain three months of anticipated T&D operating and capital costs in this account. These accounts totaled $248 million and $199 million, as of December 31, 2019 and 2018, respectively, and were held in a collateralized demand deposit account. These funds are determined to be restricted due to the contractual obligation of LIPA to pre-fund the accounts but are considered by LIPA to be part of its working capital.

#### *FEMA Grant Proceeds*

LIPA received, in advance, approximately $502 million from FEMA which is restricted for storm hardening work on certain LIPA assets. As of December 31, 2019, approximately $2 million remains as long-term cash, cash equivalents and investments. LIPA funds are expended by PSEG Long Island for approved projects, and LIPA reimburses itself for approved projects expenditures. LIPA has segregated FEMA funds for future use as required by the FEMA 428 grant agreement.

*(Amounts in thousands, unless otherwise stated)*

### *UDSA*

Restructuring charges are held by the Bond Trustee (Trustee) in Collection Accounts to satisfy debt service on the Restructuring Bonds. The Collection Accounts for the bonds consists of four subaccounts: General Subaccount, Excess Funds Subaccount, Reserve Subaccount, and Upfront Financing Costs Subaccount. The Collection Accounts (other than the Upfront Financing Costs Subaccount) secure the Restructuring Bonds.

Restricted cash held by the Trustee, as of December 31, 2019 and 2018 includes $51 million and $66 million, in the General Subaccounts, respectively, and $58 million in the Reserve Subaccounts.

The UDSA has separate investment guidelines that are specifically designed to address its legal and contractual requirements. These guidelines mandate that such investments be matched to meet bond and interest payments.

The following tables summarize LIPA's restricted cash, cash equivalents and investments as of December 31, 2019 and 2018. The credit ratings listed are from Moody's, S&P and Fitch and the ratings shown are the lowest rated obligation within each investment type.

| Deposit/investment type | Credit rating (if applicable) | Percent of portfolio | 2019 Fair value | Cash and cash equivalents | Investments |
|---|---|---|---|---|---|
| Restricted Working Capital Account and FEMA Grant Proceeds: | | | | | |
| Cash and collateralized deposits | | 99 % | $ 248,499 | 248,499 | — |
| Discount notes and bonds: | | | | | |
| Corporate | AAA/AAA | — | 18 | — | 18 |
| Money-market mutual funds | | 1 | 1,714 | 1,714 | — |
| Total | | 100 % | $ 250,231 | 250,213 | 18 |
| UDSA: | | | | | |
| Money-market mutual funds | | 100 % | $ 109,049 | 109,049 | — |

| Deposit/investment type | Credit rating (if applicable) | Percent of portfolio | 2018 Fair value | Cash and cash equivalents | Investments |
|---|---|---|---|---|---|
| Restricted Working Capital Account and FEMA Grant Proceeds: | | | | | |
| Cash and collateralized deposits | | 66 % | $ 198,611 | 198,611 | — |
| Discount notes and bonds: | | | | | |
| Certificates of deposit | A/A-1/A1/P-1/A+/F-1 | 7 | 21,593 | 4,837 | 16,756 |
| Commercial paper | A-1/P-1/F-1 | 8 | 23,849 | — | 23,849 |
| Corporate | BBB+/A-1/Baa1/P-1/BBB+/F-1+ | 10 | 31,617 | — | 31,617 |
| Treasury notes | AA+/A-1+/Aaa/P-1 | 9 | 26,761 | 6,770 | 19,991 |
| Total | | 100 % | $ 302,431 | 210,218 | 92,213 |
| UDSA: | | | | | |
| Money-market mutual funds | | 100 % | $ 124,597 | 124,597 | — |

### *(c) Risks*

LIPA's investment policy places a limit on investments by sector and issuer and addresses various risks, as described below. LIPA's Board may also specifically authorize, as it deems appropriate, other investments that are consistent with LIPA's investment objective. LIPA regularly reviews and revises its investment policy.

*Credit Risk:* The risk that an issuer of a security will not fulfill its obligation to the investor. LIPA mitigates this risk by limiting investments to those carrying either the highest short-term rating or: (i) the two highest long-term ratings for supranationals and collateralized investment agreements; (ii) the three highest long-term ratings for corporates, municipals, and certificates of deposit; (iii) the highest long-term rating for asset backed securities. Money-market funds must have the highest fund rating by all nationally recognized statistical rating organizations that rate the fund. Counterparties of repurchase agreements must be rated in the highest short-term rating category, and floating-rate notes should reflect the appropriate sector rating requirements.

*Concentration of Credit Risk:* The risk of loss attributed to the magnitude of an entity's investment in a sector single issuer. LIPA's investment policy has established limits such that no more than 5%, across all sectors of the investment portfolio, may be invested in the securities of any one non-governmental issuer, and no more than 40% may be invested in the securities of any one Federal Agency. Additionally, issuer limitations exist across other sectors of the portfolio as follows: (i) 10% for supranationals; (ii) 20% for repurchase agreements; and (iii) 25% for money-market funds.

*Custodial Credit Risk:* For deposits and investments, the risk that in the event of failure of a financial institution or counterparty, LIPA will not be able to recover its deposits, investments, or collateral securities that are in possession of another party. LIPA minimizes this risk by: (i) collateralizing its demand deposits and time deposits; (ii) utilizing financial institutions that are low risk, highly rated by rating agencies; and (iii) having investments held by designated custodians in the name of LIPA.

As of December 31, 2019, and 2018, approximately $254 million and $211 million, respectively, in deposits were uninsured. LIPA has, through a pledge, assignment and custodial agreement with its bank, collateralized 102% of the collective funds on deposit. LIPA has highly rated money-market funds of approximately $258 million and $262 million which were uninsured at December 31, 2019 and 2018, respectively.

*Interest Rate Risk:* The risk of a decline in the value of an investment resulting from interest rate fluctuations. Interest rate risk is commonly associated with investments in fixed-income products. LIPA's investment portfolio is structured to ensure sufficient liquidity is available, and as such, LIPA's investment policy has established maximum maturities by sector. The portfolio may not exceed 5.5 years or a 5.5 year average life with certain exceptions as follows: (i) Federal Agency securities have a maximum maturity of 10 years; (ii) certificates of deposit may not exceed 3 years; (iii) bankers acceptances and commercial paper may not exceed 270 and 180 days, respectively; and (iv) repurchase agreements have a maximum maturity of 90 days. Additionally, there are no maturity limitations for investments in money-market or mutual funds.

In order to meet the OPEB Account objectives of funding future retirement benefit obligations while balancing long-term risk and return and providing reasonable diversification, the OPEB Account allocates its assets in domestic and international equity mutual funds and fixed-income mutual funds. The equity funds replicate broad-based, low cost market index strategies. The fixed-income mutual funds replicate the Barclays U.S. Treasury Inflation Protected Securities Index or the Barclay's Capital U.S. Float Adjusted Aggregate Bond Market Index.

LIPA's OPEB Account investment policy has established fund targets as follows: (i) domestic equity mutual funds at 40%; (ii) international equity mutual funds at 25%; (iii) fixed-income investment mutual funds at 20%; and (iv) fixed-income investments – inflation protected securities mutual funds at 15%, with quarterly rebalancing when an asset class falls outside of a 5% range of its asset weighting.

### *(d) Nuclear Decommissioning Trust Fund (NDTF)*

LIPA maintains a separate investment policy applicable to the long-term investments in the NDTF, which are held to meet LIPA's obligation with respect to the eventual decommissioning of LIPA's 18% interest in the NMP2 nuclear facility. LIPA's policy is to periodically conduct an actuarial study to determine the appropriate level of funding for the NDTF and to maintain an appropriate investment policy so that the value in the trust in 2046 (the year in which decommissioning activities are scheduled to begin), will be sufficient to meet decommissioning obligations.

To meet LIPA's objectives of funding future liabilities for the nuclear decommissioning obligations of LIPA's 18% share of NMP2, while balancing long-term risk and return and providing reasonable diversification, the NDTF is invested in domestic and international equity mutual funds and fixed-income mutual funds. The equity funds replicate broad-based, low cost market index strategies. The fixed-income mutual funds replicate the Barclays U.S. Treasury Inflation Protected Securities Index or the Barclay's Capital U.S. Float Adjusted Aggregate Bond Market Index.

LIPA's NDTF investment policy has established fund targets as follows: (i) domestic equity mutual funds at 35%; (ii) international equity mutual funds at 20%; (iii) fixed-income investments mutual funds at 25%; and (iv) fixed-income investments — inflation protected securities mutual funds at 20%, with quarterly rebalancing when an asset class falls outside of a 5% range of its asset weighting.

*Credit Risk:* Prior to investing in mutual funds as described above, the NDTF guidelines sought to minimize credit risk by limiting permissible fixed-income investments to obligations of the U.S. government and its agencies; corporate or other obligations with a BBB-/Baa3 or better rating; mortgage obligations rated AA/Aa or better; commercial paper with a rating of A-1/P-1; certificates of deposit; Yankee certificates of deposit and bankers acceptances of domestic banks with a minimum rating of A-/A3 and minimum short-term ratings, if applicable, of A-1/P-1, short term money-market investment accounts that conform to the aforementioned permissible investments.

*Interest Rate Risk:* Due to the long-term nature of the NDTF, prior to investing in mutual funds as described above, the fixed-income portion of the portfolio was managed to track the Barclay's Capital U.S. Float Adjusted Aggregate Bond Market Index. The portfolio's duration was required to fall within a range of 20% below the duration of the index and 10% above the duration of the index.

(Amounts in thousands, unless otherwise stated)

The NDTF had the following investments as of December 31:

| Investment type | Percent of portfolio | | 2019 Fair value |
|---|---|---|---|
| Mutual funds – domestic equities | 58 % | $ | 83,147 |
| Mutual funds – fixed-income | 42 | | 61,199 |
| Total | 100 % | $ | 144,346 |

| Investment type | Percent of portfolio | | 2018 Fair value |
|---|---|---|---|
| Discount notes and bonds: | | | |
| Corporate | 14 % | $ | 17,072 |
| Federal agencies | 14 | | 17,109 |
| Treasury notes and bonds | 30 | | 37,358 |
| Mutual funds – domestic equities | 41 | | 52,482 |
| Money-market mutual funds | 1 | | 1,198 |
| Total | 100 % | $ | 125,219 |

(Amounts in thousands, unless otherwise stated)

### (e) Fair Value of Investments

The following table presents LIPA's unrestricted and restricted investments and NDTF, measured and recorded at fair value on the Consolidated Statements of Net Position and their level within the fair value hierarchy (as previously defined in Note 2):

| Investment type | | 2019 Fair Value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|---|
| Unrestricted and restricted investments | | | | | |
| Discount notes: | | | | | |
| Certificates of deposit | $ | 2,760 | — | 2,760 | — |
| Commercial paper | | 218,875 | — | 218,875 | — |
| Corporate | | 127,855 | — | 127,855 | — |
| Federal agencies | | 61,412 | — | 61,412 | — |
| Foreign government bonds | | 25,449 | — | 25,449 | — |
| Municipal bonds | | 2,854 | — | 2,854 | — |
| Treasury bills and notes | | 137,684 | 133,732 | 3,952 | — |
| Money-market mutual funds | | 386,262 | 386,262 | — | — |
| Total | $ | 963,151 | 519,994 | 443,157 | — |
| NDTF: | | | | | |
| Mutual funds – domestic equities | $ | 83,147 | 83,147 | — | — |
| Mutual funds – fixed-income | | 61,199 | 61,199 | — | — |
| Total | $ | 144,346 | 144,346 | — | — |

(Amounts in thousands, unless otherwise stated)

| Investment type | | 2018 Fair Value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|---|
| Unrestricted and restricted investments | | | | | |
| Discount notes: | | | | | |
| Certificates of deposit | $ | 59,326 | — | 59,326 | — |
| Commercial paper | | 49,643 | — | 49,643 | — |
| Corporate | | 124,972 | — | 124,972 | — |
| Federal agencies | | 33,262 | — | 33,262 | — |
| Foreign government bonds | | 19,029 | — | 19,029 | — |
| Municipal bonds | | 3,343 | — | 3,343 | — |
| Treasury bills and notes | | 154,778 | 154,778 | — | — |
| Money-market mutual funds | | 271,879 | 271,879 | — | — |
| Total | $ | 716,232 | 426,657 | 289,575 | — |
| NDTF: | | | | | |
| Discount notes: | | | | | |
| Corporate | $ | 17,072 | — | 17,072 | — |
| Federal agencies | | 17,109 | — | 17,109 | — |
| Treasury notes and bonds | | 37,358 | 37,358 | — | — |
| Mutual funds – domestic equities | | 52,482 | 52,482 | — | — |
| Money-market mutual funds | | 1,198 | 1,198 | — | — |
| Total | $ | 125,219 | 91,038 | 34,181 | — |

### *(f) OPEB Trust*

LIPA created a legally separate Section 115 Trust (OPEB Trust) to fund its eligible employee and retiree OPEB obligation. Based on the funding analysis of an actuarial study, LIPA, in 2017, transferred approximately $19 million from the OPEB Account to the OPEB Trust. Additionally, LIPA funded approximately $1 million and $2 million in 2019 and 2018, respectively, to the OPEB Trust, thereby funding approximately 105% and 89% of its net OPEB liability, respectively.

The OPEB Trust is restricted to funding LIPA's employee and retiree OPEB obligations.

(Amounts in thousands, unless otherwise stated)

## (12) Long-Term and Short-Term Debt

### *(a) Electric System General Revenue Bonds and Subordinated Revenue Bonds*

LIPA financed the cost of acquiring the T&D system from LILCO with Electric System General Revenue Bonds. Ongoing capital improvements are funded through the issuance of debt, except where grants or excess cash flow provide the ability to cash fund such expenditures. LIPA and LILCO, which is now a subsidiary of LIPA, entered into a Financing Agreement, whereby LILCO transferred to LIPA all of its right, title and interest in and to the revenues generated from the operation of the T&D system, including the right to collect and receive the same.

All of LIPA's bonds are secured by a Trust Estate as pledged under LIPA's Bond Resolution (the Resolution). The Trust Estate consists principally of the revenues generated by the operation of the T&D system and has been pledged to LIPA. Below is a summary of LIPA's bond transactions completed during the years ended December 31:

**2019**

| | | | | |
|---|---|---|---|---|
| Revenue Obligations: | 2019A General Revenue Bonds | Par Amount: | $ | 218,175 |
| Purpose: | Fund system improvements and pay issuance costs | Date Closed: | | September 26, 2019 |
| Revenue Obligations: | 2019B General Revenue Bonds | Par Amount: | $ | 284,250 |
| Purpose: | Fund system improvements and pay issuance costs | Date Closed: | | September 26, 2019 |

**2018**

| | | | | |
|---|---|---|---|---|
| Revenue Obligations: | 2018 General Revenue Bonds | Par Amount: | $ | 430,000 |
| Purpose: | Fund system improvements and pay issuance costs | Date Closed: | | October 30, 2018 |
| Revenue Obligations: | 2014C General Revenue Bonds | Par Amount: | $ | 150,000 |
| Purpose: | Remarket floating-rate notes | Date Closed: | | September 12, 2018 |
| Revenue Obligations: | 2015C General Revenue Bonds | Par Amount: | $ | 149,000 |
| Purpose: | Remarket floating-rate notes | Date Closed: | | September 12, 2018 |

### *(b) Component Unit Bonds – UDSA*

LIPA's Board adopted Financing Orders authorizing the issuance of Restructuring Bonds by the UDSA to allow LIPA to retire a portion of its outstanding indebtedness and to provide savings to LIPA's customers as measured on a net present value basis. The Restructuring Bonds are not obligations of LIPA. There were no additional UDSA bond transactions completed in 2019 and 2018.

*(Amounts in thousands, unless otherwise stated)*

LIPA's long-term debt as of December 31, 2019 consisted of the following:

| | | Beginning balance | Accretion/ additions | Maturities | Repaid/ Refundings | Ending balance | Years of Maturity | Interest Rate (%) | |
|---|---|---|---|---|---|---|---|---|---|
| General revenue bonds/notes: | | | | | | | | | |
| Series 1998A | $ | 91,569 | 4,891 | 5,365 | — | 91,095 | 2020-2028 | 5.30 | (a) |
| Series 2000A | | 302,651 | 16,945 | 34,935 | — | 284,661 | 2020-2029 | 5.86-5.95 | (a) |
| Series 2003C | | 36,645 | — | — | — | 36,645 | 2029 | 5.25 | |
| Series 2010B | | 210,000 | — | — | — | 210,000 | 2020-2041 | 4.85-5.85 | (c) |
| Series 2011A | | 18,315 | — | — | — | 18,315 | 2020-2021 | 5.00 | (b) |
| Series 2012A | | 250,000 | — | — | — | 250,000 | 2037-2042 | 5.00 | (b) |
| Series 2012B | | 179,035 | — | — | — | 179,035 | 2021-2029 | 5.00 | (b) |
| Series 2014A | | 413,070 | — | — | — | 413,070 | 2034-2044 | 4.00-5.00 | (b) |
| Series 2014B | | 146,435 | — | 18,950 | 14,000 | 113,485 | 2020-2026 | 3.11-4.13 | (b) |
| Series 2014C FRN | | 150,000 | — | — | — | 150,000 | 2030-2033 | 1.95 | (b)(d) |
| Series 2015B | | 117,230 | — | 2,180 | — | 115,050 | 2020-2045 | 3.00-5.00 | |
| Series 2015C FRN | | 149,000 | — | — | — | 149,000 | 2030-2033 | 1.95 | (b)(d) |
| Series 2016B | | 378,515 | — | — | — | 378,515 | 2020-2046 | 5.00 | |
| Series 2017 | | 350,000 | — | — | — | 350,000 | 2021-2047 | 5.00 | |
| Series 2018 | | 430,000 | — | — | — | 430,000 | 2022-2039 | 2.25-5.00 | |
| Series 2019A | | — | 218,175 | — | — | 218,175 | 2020-2039 | 3.00-5.00 | |
| Series 2019B | | — | 284,250 | — | — | 284,250 | 2049 | 1.65 | |
| Direct placement notes: | | | | | | | | | |
| Series 2015A1 FRN | | 51,000 | — | — | — | 51,000 | 2033 | 2.76 | (b)(d) |
| Series 2015A2 FRN | | 149,000 | — | — | — | 149,000 | 2029 | 2.60 | (b)(d) |
| Series 2016A FRN | | 175,000 | — | — | — | 175,000 | 2033 | 2.77 | (b)(d) |
| Subtotal | | 3,597,465 | 524,261 | 61,430 | 14,000 | 4,046,296 | | | |
| UDSA restructuring bonds: | | | | | | | | | |
| Series 2013T | | 423,353 | — | 130,761 | — | 292,592 | 2020-2023 | 2.55-3.44 | |
| Series 2013TE | | 1,374,390 | — | — | — | 1,374,390 | 2023-2039 | 5.00 | |
| Series 2015 | | 1,002,115 | — | — | — | 1,002,115 | 2021-2035 | 3.00-5.00 | |
| Series 2016A | | 636,770 | — | — | — | 636,770 | 2023-2033 | 5.00 | |
| Series 2016B | | 333,500 | — | — | — | 333,500 | 2020-2033 | 4.00-5.00 | |
| Series 2017 | | 369,465 | — | — | — | 369,465 | 2020-2039 | 5.00 | |
| Subtotal | | 4,139,593 | — | 130,761 | — | 4,008,832 | | | |
| | | 7,737,058 | 524,261 | 192,191 | 14,000 | 8,055,128 | | | |
| Plus: Net premium | | 688,149 | 40,156 | 61,191 | — | 667,114 | | | |
| Less: Current maturities | | (192,191) | | | | (227,917) | | | |
| Total Long-term debt | $ | 8,233,016 | | | | 8,494,325 | | | |

(a) Capital Appreciation Bonds
(b) Certain bonds of this series are subject to interest rate exchange agreements
(c) Taxable Build America Bonds subject to federal subsidy, rate shown is pre-subsidy level
(d) Variable rate (rate presented as of December 31, 2019)

*(Amounts in thousands, unless otherwise stated)*

LIPA's long-term debt as of December 31, 2018 consisted of the following:

| | | Beginning balance | Accretion/ additions | Maturities | Repaid/ Refundings | Ending balance | Years of Maturity | Interest Rate (%) | |
|---|---|---|---|---|---|---|---|---|---|
| General revenue bonds/notes: | | | | | | | | | |
| Series 1998A | $ | 98,010 | 5,209 | 11,650 | — | 91,569 | 2019-2028 | 5.28-5.30 | (a) |
| Series 2000A | | 319,189 | 17,922 | 34,460 | — | 302,651 | 2019-2029 | 5.83-5.95 | (a) |
| Series 2003C | | 36,645 | — | — | — | 36,645 | 2029 | 5.25 | |
| Series 2010B | | 210,000 | — | — | — | 210,000 | 2020-2041 | 4.85-5.85 | (c) |
| Series 2011A | | 18,315 | — | — | — | 18,315 | 2019-2038 | 5.00 | (b) |
| Series 2012A | | 250,000 | — | — | — | 250,000 | 2037-2042 | 5.00 | (b) |
| Series 2012B | | 179,035 | — | — | — | 179,035 | 2021-2029 | 5.00 | (b) |
| Series 2014A | | 413,070 | — | — | — | 413,070 | 2034-2044 | 4.00-5.00 | (b) |
| Series 2014B | | 164,950 | — | 18,515 | — | 146,435 | 2019-2026 | 2.76-4.13 | (b) |
| Series 2014C FRN | | 150,000 | — | — | — | 150,000 | 2030-2033 | 2.39 | (b)(d) |
| Series 2015B | | 117,230 | — | — | — | 117,230 | 2019-2045 | 3.00-5.00 | |
| Series 2015C FRN | | 149,000 | — | — | — | 149,000 | 2033 | 2.39 | (b)(d) |
| Series 2016B | | 383,770 | — | 5,255 | — | 378,515 | 2020-2046 | 5.00 | |
| Series 2017 | | 350,000 | — | — | — | 350,000 | 2021-2047 | 5.00 | |
| Series 2018 | | — | 430,000 | — | — | 430,000 | 2022-2039 | 2.25-5.00 | |
| Direct placement notes: | | | | | | | | | |
| Series 2015A1 FRN | | 51,000 | — | — | — | 51,000 | 2033 | 3.96 | (b)(d) |
| Series 2015A2 FRN | | 149,000 | — | — | — | 149,000 | 2029 | 3.73 | (b)(d) |
| Series 2016A FRN | | 175,000 | — | — | — | 175,000 | 2033 | 3.96 | (b)(d) |
| Subtotal | | 3,214,214 | 453,131 | 69,880 | — | 3,597,465 | | | |
| UDSA restructuring bonds: | | | | | | | | | |
| Series 2013T | | 469,786 | — | 46,433 | — | 423,353 | 2019-2023 | 2.04-3.44 | |
| Series 2013TE | | 1,374,390 | — | — | — | 1,374,390 | 2023-2039 | 5.00 | |
| Series 2015 | | 1,002,115 | — | — | — | 1,002,115 | 2021-2035 | 3.00-5.00 | |
| Series 2016A | | 636,770 | — | — | — | 636,770 | 2023-2033 | 5.00 | |
| Series 2016B | | 409,870 | — | 76,370 | — | 333,500 | 2020-2033 | 4.00-5.00 | |
| Series 2017 | | 369,465 | — | — | — | 369,465 | 2020-2039 | 5.00 | |
| Subtotal | | 4,262,396 | — | 122,803 | — | 4,139,593 | | | |
| | | 7,476,610 | 453,131 | 192,683 | — | 7,737,058 | | | |
| Plus: Net premium | | 694,804 | 52,317 | 58,972 | — | 688,149 | | | |
| Less: Current maturities | | (192,683) | | | | (192,191) | | | |
| Total Long-term debt | $ | 7,978,731 | | | | 8,233,016 | | | |

(a) Capital Appreciation Bonds
(b) Certain bonds of this series are subject to interest rate exchange agreements
(c) Taxable Build America Bonds subject to federal subsidy, rate shown is pre-subsidy level
(d) Variable rate (rate presented as of December 31, 2018)

*(Amounts in thousands, unless otherwise stated)*

The debt service requirements for LIPA's consolidated bonds (excluding short-term debt such as general revenue notes and revolving credit facility but including the UDSA Restructuring Bonds) as of December 31, 2019 are as follows:

| Due | | Principal* | Interest | Net swap payments (receipts) | Total |
|---|---|---|---|---|---|
| 2020 | $ | 227,917 | 345,419 | 18,848 | 592,184 |
| 2021 | | 279,379 | 339,103 | 18,854 | 637,336 |
| 2022 | | 300,741 | 328,909 | 18,851 | 648,501 |
| 2023 | | 322,060 | 317,179 | 18,851 | 658,090 |
| 2024 | | 343,740 | 304,283 | 18,848 | 666,871 |
| 2025–2029 | | 1,938,105 | 1,294,321 | 73,526 | 3,305,952 |
| 2030–2034 | | 2,133,140 | 855,831 | (7,102) | 2,981,869 |
| 2035–2039 | | 1,688,275 | 442,124 | — | 2,130,399 |
| 2040–2044 | | 717,310 | 121,459 | — | 838,769 |
| 2045–2049 | | 222,010 | 15,192 | — | 237,202 |
| Total | $ | 8,172,677 | 4,363,820 | 160,676 | 12,697,173 |

* Future interest on capital appreciation bonds are included in principal maturities.

Future debt service on the variable-rate bonds and the floating-rate portion of floating-to-fixed rate swaps is calculated using the relevant indices, including applicable spreads, as of December 31, 2019. Such rates, as shown in the long-term debt summary table, are assumed constant through maturity. For bonds subject to floating-to-fixed rate swap agreements, the "net swap payments" represent the fixed rate swap payment net of the assumed variable rate swap receipts for each agreement.

Terms by which interest rates change for variable rate debt are as follows:

The 2014C FRN Bonds bear interest at 70% of one-month LIBOR, plus the per annum spread of 65 basis points. The rate is determined on the second London Banking Day prior to the first business day of each month.

The 2015A-1 FRN Bonds bear interest at the sum of the prevailing 18-year AAA MMD general obligation index and the applicable spread of 100 basis points. The MMD FRN rate resets on the first business day of each month.

The 2015A-2 FRN Bonds bear interest at the sum of the prevailing 14-year AAA MMD general obligation index and the applicable spread of 100 basis points. The MMD FRN rate resets on the first business day of each month.

The 2015C FRN Bonds bear interest at 70% of one-month LIBOR, plus the per annum spread of 88 basis points. The rate is determined on the second London Banking Day prior to the first business day of each month.

The 2016A FRN Bonds bear interest at the sum of the prevailing 17-year AAA MMD general obligation index and the applicable spread of 105 basis points. The MMD FRN rate resets on the first business day of each month.

(Amounts in thousands, unless otherwise stated)

### (c) Callable Bonds

LIPA has approximately $3.3 billion of Electric Revenue Bonds that become callable from 2020 through 2028. The UDSA has approximately $2.9 billion of Restructuring Bonds that become callable from 2023 through 2027.

### (d) Interest Rate Swap Agreements

LIPA has entered into several interest rate swap agreements with various counterparties to modify the interest rate on outstanding debt. For a further discussion, see Note 8.

### (e) Short-Term Debt

LIPA's short-term borrowing program provides resources to meet interim working capital needs, cash flow requirements due to the seasonality of sales, and cash flow requirements from unforeseen circumstances such as severe weather events. LIPA was authorized to issue short-term borrowings up to $1.0 billion; however, in December 2019, the Board authorized a $200 million increase to provide for interim funding associated with costs of storm hardening system improvements, which are expected to be reimbursed by FEMA as provided for in the 428 Grant Agreement.

LIPA's short-term borrowing program is supported by various bank agreements expiring from 2020 through 2022. LIPA is negotiating renewal and/or replacement facilities that will increase the total maximum authorized par amount to $1.2 billion and extend expirations. The $1.2 billion program is expected to be fully implemented prior to May of 2020. The table below reflects the $1.0 billion program as LIPA is pursuing various approvals to effectuate the Board-approved increase.

LIPA's short-term debt as of December 31, 2019 consisted of the following instruments:

| | | Maximum Authorized Par Amount | Beginning Balance | Additions | Payments | Ending Balance | Supporting Letter of Credit Expiration Date |
|---|---|---|---|---|---|---|---|
| General revenue notes: | | | | | | | |
| Series 2013A | Revolving Credit Agreement | $ – | 5,000 | – | 5,000 | – | 3/22/2019 |
| Series 2019A | Revolving Credit Agreement | 200,000 | – | 2,000 | – | 2,000 | 3/15/2022 |
| Series 2015 CP 1AB | Commercial Paper | 200,000 | – | 350,000 | 285,000 | 65,000 | 6/29/2021 |
| Series 2015 CP 2AB | Commercial Paper | 100,000 | – | 95,000 | 50,000 | 45,000 | 3/11/2022 |
| Series 2015 CP 3AB | Commercial Paper | 100,000 | – | 25,000 | 25,000 | – | 5/01/2020 |
| Series 2015 CP 4AB | Commercial Paper | 200,000 | 150,000 | – | 50,000 | 100,000 | 3/12/2022 |
| Series 2015 CP 5AB | Commercial Paper | 100,000 | – | 180,000 | 100,000 | 80,000 | 3/12/2021 |
| Series 2015 CP 6AB | Commercial Paper | 100,000 | 79,500 | – | 79,500 | – | 3/14/2022 |
| | Total short-term debt | $ 1,000,000 | 234,500 | 652,000 | 594,500 | 292,000 | |

*(Amounts in thousands, unless otherwise stated)*

LIPA's short-term debt as of December 31, 2018 consisted of the following instruments:

| | | Maximum Authorized Par Amount | Beginning Balance | Additions | Payments | Ending Balance | Supporting Letter of Credit Expiration Date |
|---|---|---|---|---|---|---|---|
| General revenue notes: | | | | | | | |
| Series 2013A | Revolving Credit Agreement | $ 350,000 | 12,820 | 280,000 | 287,820 | 5,000 | 3/22/2019 |
| Series 2015 CP 1AB | Commercial Paper | 200,000 | 67,500 | 80,000 | 147,500 | — | 6/29/2021 |
| Series 2015 CP 2AB | Commercial Paper | 100,000 | 30,000 | 80,000 | 110,000 | — | 3/11/2022 |
| Series 2015 CP 3AB | Commercial Paper | 100,000 | — | — | — | — | 5/01/2020 |
| Series 2015 CP 4AB | Commercial Paper | 200,000 | — | 200,000 | 50,000 | 150,000 | 3/12/2021 |
| Series 2015 CP 5AB | Commercial Paper | 100,000 | — | 100,000 | 100,000 | — | 3/12/2021 |
| Series 2015 CP 6AB | Commercial Paper | 100,000 | — | 100,000 | 20,500 | 79,500 | 3/14/2022 |
| Subordinated revenue notes: | | | | | | | |
| Series 2014 CP 1AB | Commercial Paper | — | 150,000 | — | 150,000 | — | NA |
| Series 2014 CP 2AB | Commercial Paper | — | 100,000 | — | 100,000 | — | NA |
| | Total short-term debt | $ 1,150,000 | 360,320 | 840,000 | 965,820 | 234,500 | |

### (f) *Covenants*

LIPA's General Resolution, bond agreements with purchasers of LIPA's direct placement notes and bank agreements supporting its short-term borrowing program, generally include certain covenants, events of default and remedies including, in some cases, acceleration of the related obligations. In addition, the bond agreements and bank agreements generally include different and/or additional covenants from the General Resolution such as, among others; (i) a requirement that LIPA maintain an amount not less than $150 million in the Rate Stabilization Fund; and (ii) a more rigorous rate covenant. Complete copies of LIPA's financing documents for its long-term and short-term borrowings, the bond agreements, bank agreements and related offering documents have been filed with the Municipal Securities Rulemaking Board's EMMA website. Such documents can also be found on LIPA's website (https://www.lipower.org/investors/).

### *(g) Fixed Obligation Coverage Ratio*

LIPA follows the "public power model" of rate-setting which makes use of a fixed obligation coverage ratio to determine revenue requirements. LIPA's methodology for calculating the fixed obligation coverage ratio excludes certain specified non-cash items from expenses. Depreciation expense, amortization of the Acquisition Adjustment and other regulatory assets, including the PSEG Long Island accrual expense for future OPEB benefit cost obligations, are excluded from the coverage calculation. The revenue section of this calculation includes revenues received from certain customers used to satisfy regulatory assets that were established when LIPA issued debt to fund these projects. For calculating the coverage ratios, such cash receipts are available to meet LIPA's fixed obligation requirements as they are a component of cash flow, but are excluded from revenues for accrual accounting purposes.

Certain interest related costs, such as interest rate derivative costs, letters of credit and remarketing fees, bond administration costs, and interest related to customer deposits, are treated as ordinary operating expenses without coverage. LIPA and the UDSA principal and interest payments, including interest payments on LIPA's short-term borrowing program and payments on capital leases, are included for coverage.

Effective in 2020, LIPA modified its financial policy related to fixed obligation coverage as a result of the impact of GASB Statement No. 87. This new standard no longer differentiates between capital and operating leases and effective January 1, 2020, considers all leases with a term greater than one year to be a financing arrangement, with a corresponding asset and liability of the Consolidated Statements on Net Position.

To supply electricity to its customers, LIPA enters into long-term power supply agreements for power plants and regional transmission cables. Although these power plants and cables are not owned by LIPA, under these new accounting rules, LIPA must recognize a financing arrangement asset and a corresponding liability in its Consolidated Statements of Net Position. The new accounting guidance does not change payments under these contracts but increases assets and liabilities, which will impact LIPA's fixed obligation coverage ratio in the 2020 budget, and beyond.

LIPA's financial policy targeted a 1.45x fixed obligation coverage ratio for 2019 and beyond to provide adequate cash flow to limit borrowing to no more than 64% of capital spending. To maintain the same level of cash flow in 2020, LIPA's financial policy has been updated to modify its financial target from 1.45x coverage of debt and capital lease payments to 1.35x coverage of debt and capital lease payments, using the new definition of leases. This new target effective for 2020 will generate the same cash flow to cover fixed obligations as the prior lease accounting rules.

*(Amounts in thousands, unless otherwise stated)*

LIPA's calculation of its fixed obligation coverage ratio, for the years ended December 31, 2019 and 2018, is shown below for informational purposes:

| | | 2019 | 2018 | |
|---|---|---|---|---|
| Operating revenues | $ | 3,516,355 | 3,560,065 | (1) |
| Other income | | 86,491 | 75,998 | (1) |
| Shoreham Settlement & VBA regulatory asset receipts | | 45,848 | 49,289 | (2) |
| Total revenues and income | | 3,648,694 | 3,685,352 | |
| Operating expenses | | (3,237,837) | (3,285,096) | (1) |
| Add non cash expenses/(deduct cash funding): | | | | |
| Depreciation and amortizations | | 362,344 | 331,860 | (1) |
| Capital lease allowance | | 263,457 | 281,081 | (3) |
| OPEB accrual expense | | 42,894 | 48,100 | (2) (4) |
| Other interest expense | | (22,255) | (24,239) | (2) |
| Total expenses | | (2,591,397) | (2,648,294) | |
| **Funds available for debt service** | **$** | **1,057,297** | **1,037,058** | |
| Principal – LIPA | | 75,430 | 69,880 | (2) |
| Interest – LIPA | | 150,139 | 127,799 | (2) |
| Principal – UDSA | | 130,761 | 122,803 | (2) |
| Interest – UDSA | | 196,379 | 201,925 | (2) |
| Capital lease obligation | | 263,457 | 281,081 | (3) |
| **Total fixed obligation debt service** | **$** | **816,166** | **803,488** | |
| **Fixed Obligation Coverage Ratios:** | | | | |
| Excluding UDSA | | 1.49 | 1.49 | (5) |
| Including UDSA | | 1.30 | 1.29 | |
| **Board Approved Coverage Targets:** | | | | |
| **Excluding UDSA** | | 1.45 | 1.40 | |
| **Including UDSA** | | 1.25 | 1.25 | |

Notes:

(1) See Statements of Revenues, Expenses and Changes in Net Position

(2) See Statements of Cash Flows

(3) See note 12 (h) (below)

(4) The public power model, adopted by LIPA's Board, adds back the

PSEG Long Island OPEB accrual operating expense as cash available to pay debt service. There are no mandatory pre-funding requirements for these OPEB expenses. LIPA voluntarily sets aside funds for OPEB obligations in an OPEB Account after payment of all operating expenses and debt service each year. See note 11 for more detail.

(5) 2019 – Excluding UDSA equal to ($1,057,297 less ($327,140))/($816,166 less ($327,140))
2018 – Excluding UDSA equal to ($1,037,058 less ($324,728))/($803,488 less ($324,728))

(Amounts in thousands, unless otherwise stated)

### (h) Changes in noncurrent liabilities

LIPA's other long-term liabilities as of December 31, 2019 were comprised of the following:

| | | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|---|
| Long-term liabilities and unrealized credits | $ | 43,142 | 87,591 | (81,020) | 49,713 |
| Borrowings | | 72,256 | — | (5,172) | 67,084 |
| Claims and damages | | 67,847 | 7,160 | (6,810) | 68,197 |
| Capital lease obligations | | 1,702,801 | 141,717 | (263,457) | 1,581,061 |
| Total other long-term liabilities | $ | 1,886,046 | 236,468 | (356,459) | 1,766,055 |

LIPA's other long-term liabilities as of December 31, 2018 were comprised of the following:

| | | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|---|
| Long-term liabilities and unrealized credits | $ | 39,559 | 13,333 | (9,750) | 43,142 |
| Borrowings | | 77,307 | — | (5,051) | 72,256 |
| Claims and damages | | 57,676 | 18,261 | (8,090) | 67,847 |
| Capital lease obligations | | 1,843,515 | 140,367 | (281,081) | 1,702,801 |
| Total other long-term liabilities | $ | 2,018,057 | 171,961 | (303,972) | 1,886,046 |

## (13) OSA – Employee Retirement Benefits Obligations

PSEG Long Island employee pension and OPEB obligations are legal obligations of PSEG Long Island, and the employees covered by these plans are PSEG Long Island employees. However, the cost to employ PSEG Long Island's workforce, including employee pension and other post-employment benefits, are a "pass through expenditure" and contractual liability of LIPA.

When transitioning National Grid employees to PSEG Long Island, to ensure the National Grid workforce serving LIPA was protected against benefit losses from the transition, the PSEG Long Island benefit plans credited National Grid transitioned employees for service prior to the OSA for purposes such as eligibility, participation, vesting, company match levels, subsidies (including any type of early retirement subsidy) and attainment of retirement dates. In addition, those employees who immediately prior to the OSA effective date could have become eligible to participate in the National Grid post-employment health and life insurance benefit plans, are entitled to receive substantially equivalent post-employment health and life insurance benefits from PSEG Long Island. This arrangement created a prior service cost obligation totaling $126 million for pensions and $316 million for OPEBs as of January 1, 2014. The following table provides a roll-forward of the changes to the benefit obligations and the fair value of the plan assets during each of the years ended December 31, 2019 and 2018.

*(Amounts in thousands, unless otherwise stated)*

The table also provides the funded status of the PSEG Long Island plans and the amounts recognized as the long-term contractual liability on the Consolidated Statements of Net Position at the end of both years.

| | | Pension benefits | | Post-employment benefits | |
|---|---|---|---|---|---|
| | | **2019** | **2018** | **2019** | **2018** |
| Benefit obligation at beginning of year | $ | 321,500 | 320,522 | 500,352 | 541,558 |
| Service cost | | 26,356 | 29,856 | 15,900 | 18,628 |
| Interest cost | | 13,866 | 11,754 | 21,918 | 19,906 |
| Actuarial loss (gain) | | 95,443 | (38,001) | 96,417 | (73,755) |
| Benefits paid | | (3,910) | (2,631) | (6,205) | (5,985) |
| Plan amendment | | — | — | (2,877) | — |
| Benefit obligation at end of year | | 453,255 | 321,500 | 625,505 | 500,352 |
| Fair value of assets at beginning of year | | 212,676 | 191,219 | — | — |
| Actual return on plan assets | | 45,485 | (15,912) | — | — |
| Employer contribution | | 28,000 | 40,000 | 6,205 | 5,985 |
| Gross benefits paid | | (3,910) | (2,631) | (6,205) | (5,985) |
| Fair value of assets at end of year | | 282,251 | 212,676 | — | — |
| LIPA unfunded obligation | $ | (171,004) | (108,824) | (625,505) | (500,352) |

The table does not reflect the balance of LIPA's OPEB Account, which was established to pre-fund the contractual liability for post-employment benefits.

LIPA's Board authorized the creation of an OPEB Account to allow LIPA to segregate funds to meet future OPEB obligations for PSEG Long Island employees. As of December 31, 2019 and 2018, LIPA had on deposit in the OPEB Account approximately $386 million and $272 million, respectively. For a further discussion, see Note 11.

(Amounts in thousands, unless otherwise stated)

The contractual liability related to pension and post-employment benefits increased during 2019 due to the update of certain assumptions regarding the census data, claims costs, excise taxes, and the discount rate. These changes resulted in a net actuarial loss of approximately $95 million for pension benefits and approximately $96 million for post-employment benefits as follows:

| | | Pension benefits | Post-employment benefits |
|---|---|---|---|
| Updated census data | $ | 6.0 | 0.3 |
| Updated assumptions | | 0.1 | (15.7) |
| Updated medical trend | | N/A | 7.2 |
| Removal of excise tax | | N/A | (19.2) |
| Impact of adopting granular method | | 1.2 | 0.9 |
| Discount rate changes (see table below) | | 88.1 | 122.9 |
| Total loss (gain) | $ | 95.4 | 96.4 |

The actuarial valuations related to pension and post-employment benefits involve estimates and assumptions regarding the probability of events in the future. Below are the weighted average assumptions used to calculate actuarial present values of benefit obligations as of December 31, 2019 and 2018:

| | Pension benefits | | Post-employment benefits | |
|---|---|---|---|---|
| | 2019 | 2018 | 2019 | 2018 |
| Discount rate | 3.52 % | 4.60 % | 3.60 % | 4.67 % |
| Rate of compensation increase | 3.25 % | 3.25 % | 3.25 % | 3.25 % |

*Pension Plan Assets*

During 2019 and 2018, LIPA provided $28 million and $40 million, respectively, to PSEG Long Island for deposit in its pension plan trust fund. The trust is sponsored, overseen and managed by the PSEG Thrift & Pension Investment Committee. The benefit plan assets are maintained separately and are not commingled with other PSEG plans. The benefit plan assets are not LIPA assets and, therefore, are not reflected on the Consolidated Statements of Net Position. These assets, however, reduce LIPA's contractual obligation to PSEG Long Island for the benefit obligations of the PSEG Long Island employees. The following table outlines the PSEG Long Island pension assets as of December 31, 2019 and 2018:

| | | 2019 | | 2018 | |
|---|---|---|---|---|---|
| Investment type | | Amount | Allocation | Amount | Allocation |
| Equity | $ | 201,855 | 71.5% | 140,700 | 66.2% |
| Fixed-income | | 79,878 | 28.3 | 71,428 | 33.6 |
| Other | | 518 | 0.2 | 548 | 0.2 |
| Total | $ | 282,251 | 100.0% | 212,676 | 100.0% |

## (14) LIPA Employee Benefits

All full-time LIPA employees must participate in one of two employee retirement plans offered by LIPA, either: (i) the New York State and Local Retirement System (the Retirement System); or (ii) the New York State Voluntary Defined Contribution Plan (VDC). Employees in part-time positions have the option of enrolling in the Retirement System.

### (a) Pension Plans

*(i) Plan Description*

The Retirement System is a cost-sharing multiple-employer defined benefit retirement system. The net position of the Retirement System is held in the New York State Common Retirement Fund (the Fund), which was established to hold all net assets and record changes in fiduciary net position allocated to the Retirement System. The Comptroller of the State of New York serves as the trustee of the Fund and is the administrative head of the Retirement System. Retirement System benefits are established under the provisions of the New York State Retirement and Social Security Law (NYSRSSL). Once a public employer elects to participate in the Retirement System, the election is irrevocable. The New York State Constitution provides that pension membership is a contractual relationship and plan benefits cannot be diminished or impaired. Benefits can be changed for future members only by enactment of a State statute. The Retirement System is included in the State's financial report as a pension trust fund. That report, including information with regard to benefits provided, may be found at www.osc.state.ny.us/retire/publications/index.php or obtained by writing to the New York State and Local Retirement System, 110 State Street, Albany, NY 12244.

*(ii) Benefits*

The Retirement System provides retirement benefits as well as death and disability benefits and uses a tier concept to distinguish membership classes (i.e. Tiers 1 through 6) with Tier membership based on the date an employee joins the Retirement System. The Retirement System is noncontributory for Tier 1 and 2 employees who joined on or prior to July 26, 1976. Tiers 3 and 4 employees, who joined between July 27, 1976 and December 31, 2009, are required to contribute 3% of their gross earnings toward their retirement benefits until the employee either accrues ten years of service credit or has been a member of the Retirement System for ten years after their date of membership. Employees who joined the Retirement System after January 1, 2010 are Tier 5 employees and contribute 3% of their salary during their entire length of service. Employees who joined the Retirement System on or after April 1, 2012 are Tier 6 employees and must contribute for their entire length of service. Tier 6 contribution rates vary based on annual compensation. During the first three years of membership, the Tier 6 employee contribution rate is based on the employee's annual wage. After this three-year period, the employee's contribution rate will be based on actual earnings in the two years prior. The contribution rate varies between 3% and 6% depending on an employee's actual salary.

Members in Tiers 1, 2, 3, and 4 become vested in the pension plan after five years of credited service and members in Tiers 5 and 6 after ten years of credited service. All members are generally eligible to receive benefits at age 55. The benefit is generally 1.67% of final average salary (FAS), times the number of years of service, for members who retire with less than 20 years of service. The benefit calculation for Tiers 1 and 2 members with greater than 20 years of service credit, or Tiers 3 through 5 members between 20 and 30 years of service credit is calculated using 2% of FAS for each year of service. Tier 3 through 5 members are eligible for an additional 1.5% of FAS applied to each year of service over 30 years. The benefit for Tier 6 members with more than 20 years of service is 1.75% of FAS for 20 years of service plus 2% of FAS for each year of service credit in excess of 20 years. The Retirement System provides an annual automatic cost of living adjustment to members or surviving spouses based on certain eligibility criteria.

*(iii) Post-Employment Benefit Increases*

A cost-of-living adjustment is provided annually to: (i) all pensioners who have attained age 62 and have been retired for five years; (ii) all pensioners who have attained age 55 and have been retired for ten years; (iii) all disability pensioners, regardless of age, who have been retired for five years; (iv) Retirement System recipients of an accidental death benefit, regardless of age, who have been receiving such benefit for five years; and (v) the spouse of a deceased retiree receiving a lifetime benefit under an option elected by the retiree at retirement. An eligible spouse is entitled to one-half the cost-of-living adjustment amount that would have been paid to the retiree when the retiree would have met the eligibility criteria.

*(iv) Employers Contributions*

Under the authority of the NYSRSSL, the Comptroller annually certifies the actuarially determined rates expressly used in computing the employers' contributions based on salaries paid during the Retirement Systems' fiscal year ending March 31. LIPA's contributions for the year ended December 31, 2019, 2018 and 2017, were equal to 100% of the contributions required, and were $0.57 million, $0.61 million, and $0.56 million, respectively.

*(v) Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions*

At December 31, 2019 and 2018, LIPA reported a liability of $0.73 million and $0.31 million, respectively, for its proportionate share of the Retirement System net pension liability. The total pension liability, as reported by the Retirement System, as of March 31, 2019 was determined using an actuarial valuation as of April 1, 2018, with update procedures used to roll-forward the total pension liability to March 31, 2019. LIPA's proportionate share of the net pension liability was based on a projection of LIPA's long-term share of contributions to the pension plan relative to the projected contributions of all participating members, actuarially determined.

At December 31, 2019 and 2018, LIPA's proportionate share was 0.01% of the Retirement System net pension liability.

*(Amounts in thousands, unless otherwise stated)*

For the year ended December 31, 2019 and 2018, LIPA recognized pension expense of $0.23 million and $0.76 million, respectively. As of December 31, 2019 and 2018, LIPA reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | **Deferred Outflows of Resources** | **Deferred Inflows of Resources** | **Deferred Outflows of Resources** | **Deferred Inflows of Resources** |
| Difference between expected and actual expense | $ 144 | 49 | 111 | 91 |
| Net difference between projected and actual earnings on investments | — | 188 | 450 | 889 |
| Changes in assumptions | 184 | — | 206 | — |
| Net difference between LIPA's contributions and proportionate share of contributions | 354 | 269 | 218 | 629 |
| LIPA's contributions subsequent to the measurement date | 569 | — | 609 | — |
| | $ 1,251 | 506 | 1,594 | 1,609 |

The net amount of LIPA's balances of deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

| | |
|---|---|
| Plan years ended December 31: | |
| 2020 | 6 |
| 2021 | (44) |
| 2022 | 67 |
| 2023 | 147 |
| | $ 176 |

*(Amounts in thousands, unless otherwise stated)*

*(vi) Actuarial Assumptions*

The total pension liability as of the measurement date was determined by using an actuarial valuation as of April 1, 2018, with update procedures used to roll-forward the total pension liability to the measurement date. The actuarial valuation used the following assumptions:

| | |
|---|---|
| Measurement date: | March 31, 2019 |
| Actuarial valuation date: | April 1, 2018 |
| Actuarial cost method: | Aggregate Cost Method |
| Inflation: | 2.50 % |
| Salary scale: | 4.20 % |
| Investment rate of return, including inflation (compounded annually, net of expenses): | 7.00 % |
| Cost of living adjustments, annually: | 1.30 % |
| Decrement tables: | April 1, 2010 – March 31, 2015 Retirement System's Experience |
| Mortality improvement: | Society of Actuaries Scale MP-2014 |

For December 31, 2018, the total pension liability as of the measurement date was determined by using an actuarial valuation as of April 1, 2017, with update procedures used to roll-forward the total pension liability to the measurement date. The actuarial valuation used the following assumptions:

| | |
|---|---|
| Measurement date: | March 31, 2018 |
| Actuarial valuation date: | April 1, 2017 |
| Actuarial cost method: | Aggregate Cost Method |
| Inflation: | 2.50 % |
| Salary scale: | 3.80 % |
| Investment rate of return, including inflation (compounded annually, net of expenses): | 7.00 % |
| Cost of living adjustments, annually: | 1.30 % |
| Decrement tables: | April 1, 2010 – March 31, 2015 Retirement System's Experience |
| Mortality improvement: | Society of Actuaries Scale MP-2014 |

The long-term expected rate of return on pension plan investments was determined in accordance with Actuarial Standard of Practice (ASOP) No. 27, Selection of Economic Assumptions for Measuring Pension Obligations. ASOP No. 27 provides guidance on the selection of an appropriate assumed investment rate of return. Consideration was given to expected future real rates of return (expected returns, net of pension plan investment expense and inflation) for equities and fixed income as well as historical investment data and pension plan performance.

*(Amounts in thousands, unless otherwise stated)*

Best estimates of arithmetic real rates of return for each major asset class are summarized below:

| Asset class | Long-term expected real rate of return (%) |
|---|---|
| Domestic equity | 4.55 |
| International equity | 6.35 |
| Private equity | 7.50 |
| Real estate | 5.55 |
| Absolute return strategies | 3.75 |
| Opportunistic portfolio | 5.68 |
| Real assets | 5.29 |
| Bonds and mortgages | 1.31 |
| Cash | (0.25) |
| Inflation-indexed bonds | 1.25 |

*(vii) Discount Rate*

The discount rate used to calculate the total pension liability was 7.0%. The projection of cash flows used to determine the discount rate assumes that contributions from pension plan members will be made at the current contribution rates and that contributions from employers will be made at statutorily required rates, actuarially determined. Based upon those assumptions, the Retirement System's fiduciary net position was projected to be available to make all projected future benefit payments of current pension plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

*(viii) Sensitivity of the Net Pension Liability to the Discount Rate Assumption*

The following represents the current-period net pension liability (asset) of LIPA's proportionate share of the net pension liability, as of December 31, 2019, calculated using the current-period discount rate assumption of 7.0%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.0%) or 1-percentage-point higher (8.0%) than the current assumption:

| | | 1% Decrease (6.0%) | Assumption (7.0%) | 1% Increase (8.0%) |
|---|---|---|---|---|
| LIPA's proportionate share of the net pension liability (asset) | $ | 3.2 million | 0.73 million | (1.3) million |

(Amounts in thousands, unless otherwise stated)

The following represents the sensitivity to the net pension liability (asset) of LIPA's proportionate share as of December 31, 2018, calculated using the discount rate assumption of 7.0%:

| | | 1% Decrease (6.0%) | Assumption (7.0%) | 1% Increase (8.0%) |
|---|---|---|---|---|
| LIPA's proportionate share of the net pension liability (asset) | $ | 2.3 million | 0.3 million | (1.4) million |

### (b) New York State Voluntary Defined Contribution Plan

LIPA offers certain full-time employees participation in a Voluntary Defined Contribution Plan (VDC), which is an alternative to the State's Retirement System. The VDC option is available to all unrepresented State, New York City, and local public employees who are hired on or after July 1, 2013 and are paid at a rate of $75,000 or more on an annual basis. For those employees choosing this option, LIPA is required to contribute 8% of their gross salary and the employee contributes between 3% and 6% depending on salary.

### (c) Deferred Compensation Savings Plan

LIPA also offers all employees a deferred compensation plan created in accordance with the Internal Revenue Code, Section 457. This plan permits participants to defer a portion of their salaries until future years. Amounts deferred under the plan are not available to employees or beneficiaries until termination, retirement, death or an unforeseeable emergency. An independent trustee is also responsible for the administration of this plan.

### (d) Other Post-Employment Benefits

Other Post-Employment Benefits (OPEB) are a form of employee compensation that are recognized in the same period in which the compensated service is provided by the employees. OPEB includes post-employment healthcare benefits (including medical, dental, vision, hearing and other health-related benefits) and other forms of post-employment benefits (including life insurance, disability and long-term care).

LIPA is a participating employer in the New York State Health Insurance Program (NYSHIP), which is an agent multiple-employer plan administered by the New York State Department of Civil Service. Through NYSHIP, LIPA provides certain health care for eligible retired employees and their dependents. Participation in the NYSHIP program provides for employees and/or their dependents to continue eligibility for these benefits in retirement. Employees with membership in the NYSLRS are eligible for retiree health insurance if the employee has at least one year of full-time service with LIPA, and satisfied the requirements for retiring as a member of the Retirement System. Employees enrolled in the VDC are eligible for retiree health insurance if the employee has five years of full-time service with LIPA and meets the age requirement of the Retirement System tier in effect at the time the employee last entered service.

NYSHIP does not issue a stand-alone financial report and NYSHIP's agent activities are included within the financial statements of the State.

LIPA's OPEB liability totaled approximately $22 million and $21 million as of December 31, 2019 and 2018, respectively. LIPA's OPEB Trust, a legally separate Section 115 trust approved by LIPA's Board to accumulate resources for its OPEB obligation, totaled approximately $23 million and $21 million as December 31, 2019 and 2018, respectively, for a total respective funding of 104.9% and 89.2%. Contributions to the OPEB Trust are based on an actuarial valuation.

## (15) Commitments and Contingencies

### *(a) Power Purchase Agreements*

*Amended and Restated Power Supply Agreement*

The A&R PSA, which became effective on May 28, 2013, is the successor agreement to the original PSA between National Grid and LIPA. The A&R PSA provides for the sale to LIPA by National Grid of all the capacity, energy and, ancillary services from the oil and gas fired generating plants on Long Island formerly owned by LILCO. Sales are at cost, based on wholesale rates regulated by the Federal Energy Regulatory Commission (FERC). The rates may be modified in accordance with the terms of the A&R PSA for: (i) agreed upon labor and expense indices applied to the base year; (ii) a return of and return on net capital additions, which require approval by LIPA; and (iii) certain reasonably incurred expenses that are outside of the control of National Grid. The annual capacity charge in 2019 and 2018 was approximately $441 million and $443 million, respectively. The variable charge under both the PSA and A&R PSA is constant at $0.90 per megawatt hour of electric energy generated by the plants.

The A&R PSA has provisions for penalties in the event that annual guarantees for heat rate and unforced capacity are not met. No penalties were assessed in either 2019 or 2018.

The capacity charge of the A&R PSA is adjusted each year for the actuarially required contributions for the pension and OPEB (P&OPEB) benefits of the employees that work at these National Grid power plants. The actuarially required contributions are reflected in annual filings by National Grid with FERC. As of the most recent estimate provided by National Grid's actuary dated March 2019, the P&OPEB obligations are underfunded by approximately $60 million. This underfunding is a component in the development of the actuarially required contributions in each year. LIPA does not expect to have a material liability for P&OPEB obligations under the A&R PSA upon termination of the contract.

The A&R PSA does not meet the criteria for capitalization and is accounted for as an operating lease.

*Other Power Purchase and Transmission Agreements*

LIPA has entered into power purchase agreements (PPAs) with several private companies to develop and operate generating units at sites throughout Long Island. Generally, the PPAs provide for LIPA to purchase 100% of the capacity (and associated energy and ancillary services as needed), for the term of each contract, which vary in term duration. LIPA also has various long-term agreements for capacity and/or energy from facilities via undersea cables.

LIPA also has two contracts for five megawatt storage batteries, which store energy for use primarily to meet daily and seasonal peak loads on the South Fork of Long Island.

(Amounts in thousands, unless otherwise stated)

Certain of these facilities have been accounted for as a capital lease obligations on the Consolidated Statements of Net Position and those facilities that did not meet the criteria for capitalization are being accounted for as operating leases.

*Gas Transportation Agreements*

LIPA has natural gas transportation agreements for the delivery of gas to its contracted gas power generating facilities. Certain of these agreements have minimum obligations which are included in the table below. LIPA also has natural gas physical supply contracts which have no fixed costs associated with them.

At December 31, 2019, the approximate minimum obligations for the power purchase agreement commitments discussed above are included in the table below and all such costs are recoverable through the Power Supply Charge.

| | | Capital leases | Operating leases | A&R PSA commitment | Gas transportation |
|---|---|---|---|---|---|
| 2020 | $ | 263,118 | 99,404 | 456,490 | 5,251 |
| 2021 | | 253,544 | 65,883 | 464,049 | 5,251 |
| 2022 | | 254,920 | 64,772 | 471,210 | 5,251 |
| 2023 | | 256,122 | 61,392 | 476,925 | 4,751 |
| 2024 | | 257,719 | 50,919 | 481,946 | 4,251 |
| 2025 through 2029 | | 848,196 | 273,991 | 1,647,113 | 19,130 |
| 2030 through 2034 | | 96,079 | 36,857 | — | — |
| 2035 through 2039 | | 21,981 | — | — | — |

(Amounts in thousands, unless otherwise stated)

*Other Energy Projects*

LIPA has several contracts to purchase renewable energy and energy from waste facilities. These contracts do not have minimum obligations and LIPA only pays if the energy is delivered. For the years ended December 31, 2019 and 2018, LIPA paid approximately $124 million and $114 million for energy related to these contracts.

LIPA also approved a 20-year power purchase agreement for a 130-megawatt offshore wind farm to be installed off the coast of Long Island that is expected to be commercially operational by December 2022. LIPA will only pay for energy when delivered without taking construction risk and has no financial commitment until the wind farm is commercially operational.

As provided by LIPA's tariff, the cost of all the facilities noted above are includable and recoverable through the Power Supply Charge.

### (b) Other Long-Term Agreements

LIPA leases office space and certain fleet vehicles with various terms and expiration dates. The following table presents the approximate minimum obligations for such agreements which are recoverable through operations and maintenance costs:

| | | Other Long-Term Agreements |
|---|---|---|
| 2020 | $ | 18,903 |
| 2021 | | 18,053 |
| 2022 | | 16,978 |
| 2023 | | 16,205 |
| 2024 | | 12,915 |
| 2025 through 2029 | | 41,358 |

### (c) Insurance Programs

LIPA's insurance program is comprised of a combination of policies, from major insurance companies, self-insurance, and contractual transfer of liability, including naming LIPA as an additional named insured and indemnification.

LIPA has purchased Workers' Compensation insurance from the New York State Insurance Fund to provide coverage for claims arising from employee accidents or injuries. In addition, LIPA carries Employment Practices Liability Insurance from a major insurance company and LIPA's office property and liability coverage is administered by the New York State Office of General Services Bureau of Risk & Insurance Management through a master policy the State procures for various State entities, including LIPA. Liability related to construction projects and similar risks is transferred through contractual indemnification and compliance with insurance requirements. LIPA also has insurance coverage on its interest in NMP2 as disclosed in Note 10.

LIPA has commercially available excess general liability, property and cyber insurance for claims above its self-insurance provisions. For general liability, including automobile liability, LIPA is self-insured up to $3.0 million per occurrence. For property damage and extra expense combined, LIPA is self-insured up to $1.5 million per occurrence. For property damage or loss due to a named windstorm and flood, 2% of the value at risk is self-insured per occurrence with a minimum of $1.5 million and up to a maximum self-insured level of $7.5 million. For cyber-related events, including an event relating to LIPA's information technology system, LIPA is self-insured for up to $10,000 per event. Similarly, LIPA's Service Provider, PSEG Long Island, also maintains cyber insurance covering events related to information technology and operating systems where LIPA is an additional named insured.

LIPA has no general property insurance for damage to its poles and wires and is self-insured.

## (16) Legal Proceedings

### *(a) PSEG Long Island*

PSEG Long Island's liability for third-party claims in performing its obligations to operate and maintain LIPA's T&D system is generally limited to the aggregate loss and expense between $2.5 million and $5 million in any contract year other than for loss and expense attributable to PSEG Long Island's gross negligence or willful misconduct, for which there is no limitation on PSEG Long Island's liability. PSEG Long Island is not responsible for any liabilities that occurred prior to January 1, 2014.

### *(b) Superstorm Sandy*

Four purported class action suits were filed against LIPA and National Grid related to Superstorm Sandy that contain common allegations of wrongdoing and/or gross negligence relating to LIPA's and National Grid's preparedness and response to the storm. These actions seek monetary damages, fees and other relief. Twelve more individual actions have been filed on behalf of the owners of approximately 100 properties in the Breezy Point, Belle Harbor and Rockaway Park neighborhoods of the Rockaway Peninsula, in the Queens portion of the Service Area. These suits allege generally that the failure to de-energize the electrical system in the Rockaways in advance of the tidal surges experienced during the storm resulted in fires that caused various types of property damage, ranging from all or partial loss of plaintiffs' customers' homes. In February 2018, the Court of Appeals, New York State's highest court, affirmed lower court rulings that LIPA is not entitled at this point to dismissal of the fire cases. In June 2018, the court in the class action litigation granted plaintiffs' motion to certify a class consisting of residential customers who lost power for more than three days and who did not require an electrical inspection before service could be restored. LIPA has appealed that ruling.

The class action cases, and the fire cases are being defended, and although the amounts sought in damages are material, the outcome of these matters cannot be predicted with certainty at this time. LIPA does not believe that they will have a material impact on the operating results or financial condition of LIPA.

### *(c) Environmental*

National Grid and LIPA are parties to Liabilities Undertaking and Indemnification Agreements which, when taken together, provide, generally, that environmental liabilities will be divided between National Grid and LIPA on the basis of whether they relate to assets transferred to National Grid or retained by LIPA as part of the 1998 LIPA/LILCO Merger (Merger). In addition, to clarify and supplement these agreements, National Grid and LIPA also entered into an agreement to allocate between them certain liabilities, including environmental liabilities, arising from events occurring prior to the Merger and relating to the business and operations to be conducted by LIPA after the Merger (the Retained Business) and to the business and operations to be conducted by National Grid after the Merger (the Transferred Business).

National Grid is responsible for all liabilities arising from all manufactured gas plant operations on Long Island (MGP Sites), including those currently or formerly operated by National Grid or any of its predecessors, whether or not such MGP Sites were related to the Transferred Business or the Retained Business. In addition, National Grid is responsible for all environmental liabilities traceable to the Transferred Business and certain scheduled environmental liabilities. Environmental liabilities that arise from the non-nuclear generating business (a Transferred Business) may be recoverable by National Grid as part of the capacity charge under the A&R PSA. LIPA is responsible for all environmental liabilities traceable to the Retained Business and certain scheduled environmental liabilities.

Environmental liabilities, other than those related to MGP sites that existed as of the date of the Merger that are untraceable, including untraceable liabilities that arise out of common and/or shared services, have been allocated to LIPA and National Grid, as provided for in the Merger.

The A&R PSA addresses the terms by which LIPA will continue to purchase electricity from certain National Grid facilities. Generally, National Grid's liabilities under this contract are limited to losses due to gross negligence or willful misconduct or violations of environmental laws not consistent with prudent utility practices.

### *(d) Environmental Matters Retained by LIPA*

*Superfund Sites* – Under Section 107(a) of the federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA, also commonly referred to as Superfund), parties that generated or arranged for disposal of hazardous substances are liable for costs incurred by the Environmental Protection Agency (EPA) or others that are responding to a release or threat of release of hazardous substances.

*Metal Bank* – Cottman Avenue is a National Priorities List site with PCB contamination on the Delaware River in Philadelphia, Pennsylvania. EPA sued a number of potentially responsible parties (PRPs) and subsequently settled with all defendants, among them a number of utility companies – including LILCO – alleged to have sent used transformers to the site during the 1960s and 1970s. The remediation has been completed and monitoring at the site continues. LIPA's contribution toward the settlement and monitoring costs has not been material. One feature of the long-term remedy began to fail within two years of construction, and the EPA required the PRP group to repair it. The repair costs were not material to LIPA. In December 2016, the PRP group filed suit against the remedial design consultant that designed the remedy and approved changes to its design during construction. The results of the litigation and any recovery that may be secured by the PRP Group are uncertain.

The U.S. Department of Interior, the National Oceanic and Atmospheric Administration and the Pennsylvania Fish and Boat Commission and Departments of Environmental Protection and Conservation and Natural Resources notified the PRP group that they have claims for damages to natural resources allegedly impacted by releases of hazardous substances to and from the Cottman site. While disputing the liability, the PRP group engaged in settlement discussions with these agencies and, at the end of 2018, reached a tentative agreement to resolve their claims. LIPA believes that the potential settlement would not have a material impact on the operating results or financial condition of LIPA.

### *(e) Asbestos Proceedings*

Litigation is pending in New York State Court against LIPA, LILCO, National Grid and various other defendants involving thousands of plaintiffs seeking damages for personal injuries or wrongful death allegedly caused by exposure to asbestos. The cases for which LIPA may have financial responsibility involve employees of various contractors and subcontractors engaged in the construction or renovation of certain power plants formerly owned by LILCO. These cases include extraordinarily large damage claims, which have historically proven to be excessive. The actual aggregate amount paid to plaintiffs alleging exposure to asbestos at these power plants over the years has not been material to LIPA. Due to the nature of how these cases are litigated, it is difficult to determine how many of the remaining cases that have been filed (or of those that will be filed in the future) involve plaintiffs who were exposed to asbestos at any of these power plants. Based upon experience, it does not appear that currently pending or future claims involving plaintiffs who allege exposure to asbestos at any of these power plants will have a material impact on the operating results or financial condition of LIPA.

*(Amounts in thousands, unless otherwise stated)*

## (17) Component Unit Consolidating Condensed Statements

UDSA is a component unit of LIPA and all of the activities and balances of the UDSA are blended into and reported as part of LIPA. The consolidating condensed information for December 31, 2019 is below:

**Consolidating Condensed Statement of Net Position**
**December 31, 2019**

| | | LIPA | UDSA | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Assets and deferred outflows of resources: | | | | | |
| Current assets | $ | 2,348,341 | 154,162 | (287) | 2,502,216 |
| Utility plant and property and equipment, net | | 8,773,962 | — | — | 8,773,962 |
| Noncurrent assets | | 2,113,452 | 4,351,860 | (4,331,947) | 2,133,365 |
| Deferred outflows of resources | | 222,548 | — | — | 222,548 |
| Total assets and deferred outflows of resources | $ | 13,458,303 | 4,506,022 | (4,332,234) | 13,632,091 |
| Liabilities, deferred inflows of resources and net position: | | | | | |
| Current liabilities | $ | 1,152,706 | 134,426 | (287) | 1,286,845 |
| Long-term debt, including unamortized premium | | 4,207,551 | 4,286,774 | — | 8,494,325 |
| Noncurrent liabilities | | 7,123,361 | — | (4,331,947) | 2,791,414 |
| Deferred inflows of resources | | 540,639 | — | — | 540,639 |
| Net position | | 434,046 | 84,822 | — | 518,868 |
| Total liabilities, deferred inflows of resources and net position | $ | 13,458,303 | 4,506,022 | (4,332,234) | 13,632,091 |

**Consolidating Condensed Statement of Revenues, Expenses, and Changes in Net Position**
**For the year ended December 31, 2019**

| | | LIPA | UDSA | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Operating revenues | $ | 3,211,705 | 307,400 | (2,750) | 3,516,355 |
| Operating expenses | | 3,068,130 | 172,457 | (2,750) | 3,237,837 |
| Operating income | | 143,575 | 134,943 | — | 278,518 |
| Nonoperating revenue and expenses | | 105,361 | 3,812 | — | 109,173 |
| Interest charges and (credits): | | | | | |
| Interest on debt | | 177,066 | 196,248 | — | 373,314 |
| Other interest and amortizations | | 32,478 | (42,119) | — | (9,641) |
| Total interest charges and (credits) | | 209,544 | 154,129 | — | 363,673 |
| Change in net position | | 39,392 | (15,374) | — | 24,018 |
| Beginning net position | | 394,654 | 100,196 | — | 494,850 |
| Ending net position | $ | 434,046 | 84,822 | — | 518,868 |

**Consolidating Condensed Statement of Cash Flows**
**For the year ended December 31, 2019**

| | | LIPA | UDSA | Eliminations | Total |
|---|---|---|---|---|---|
| Net cash provided by operating activities | $ | 343,561 | 308,172 | — | 651,733 |
| Net cash (used in) provided by investing activities | | (168,389) | 3,812 | — | (164,577) |
| Net cash provided by noncapital related activities | | 97,517 | — | — | 97,517 |
| Net cash used in capital and related financing activities | | (394,058) | (327,532) | — | (721,590) |
| Net decrease in cash and cash equivalents | | (121,369) | (15,548) | — | (136,917) |
| Cash and cash equivalents at beginning of year | | 538,018 | 124,597 | — | 662,615 |
| Cash and cash equivalents at end of year | $ | 416,649 | 109,049 | — | 525,698 |

(Amounts in thousands, unless otherwise stated)

The consolidating condensed information for December 31, 2018 is below:

**Consolidating Condensed Statement of Net Position**
**December 31, 2018**

| | | LIPA | UDSA | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Assets and deferred outflows of resources: | | | | | |
| Current assets | $ | 2,077,975 | 173,837 | (42) | 2,251,770 |
| Utility plant and property and equipment, net | | 8,383,338 | — | — | 8,383,338 |
| Noncurrent assets | | 2,153,715 | 4,523,469 | (4,501,288) | 2,175,896 |
| Deferred outflows of resources | | 247,313 | — | — | 247,313 |
| Total assets and deferred outflows of resources | $ | 12,862,341 | 4,697,306 | (4,501,330) | 13,058,317 |
| Liabilities, deferred inflows of resources and net position: | | | | | |
| Current liabilities | $ | 1,002,184 | 139,500 | (42) | 1,141,642 |
| Long-term debt, including unamortized premium | | 3,775,406 | 4,457,610 | — | 8,233,016 |
| Noncurrent liabilities | | 7,170,051 | — | (4,501,288) | 2,668,763 |
| Deferred inflows of resources | | 520,046 | — | — | 520,046 |
| Net position | | 394,654 | 100,196 | — | 494,850 |
| Total liabilities, deferred inflows of resources and net position | $ | 12,862,341 | 4,697,306 | (4,501,330) | 13,058,317 |

**Consolidating Condensed Statement of Revenues, Expenses, and Changes in Net Position**
**For the year ended December 31, 2018**

| | | LIPA | UDSA | Eliminations | Consolidated |
|---|---|---|---|---|---|
| Operating revenues | $ | 3,226,465 | 336,350 | (2,750) | 3,560,065 |
| Operating expenses | | 3,114,467 | 173,379 | (2,750) | 3,285,096 |
| Operating income | | 111,998 | 162,971 | — | 274,969 |
| Nonoperating revenue and expenses | | 97,124 | 2,952 | — | 100,076 |
| Interest charges and (credits): | | | | | |
| Interest on long-term debt and short-term debt | | 160,788 | 200,495 | — | 361,283 |
| Other interest and amortizations | | 34,434 | (43,334) | — | (8,900) |
| Total interest charges and (credits) | | 195,222 | 157,161 | — | 352,383 |
| Change in net position | | 13,900 | 8,762 | — | 22,662 |
| Beginning net position | | 380,754 | 91,434 | — | 472,188 |
| Ending net position | $ | 394,654 | 100,196 | — | 494,850 |

**Consolidating Condensed Statement of Cash Flows**
**For the year ended December 31, 2018**

| | | LIPA | UDSA | Eliminations | Total |
|---|---|---|---|---|---|
| Net cash provided by operating activities | $ | 404,087 | 337,491 | — | 741,578 |
| Net cash (used in) provided by investing activities | | (37,035) | 2,952 | — | (34,083) |
| Net cash used in noncapital related activities | | (87,362) | — | — | (87,362) |
| Net cash used in capital and related financing activities | | (382,086) | (325,013) | — | (707,099) |
| Net (decrease) increase in cash and cash equivalents | | (102,396) | 15,430 | — | (86,966) |
| Cash and cash equivalents at beginning of year | | 640,414 | 109,167 | — | 749,581 |
| Cash and cash equivalents at end of year | $ | 538,018 | 124,597 | — | 662,615 |

## (18) Subsequent Events

In connection with the preparation of the consolidated financial statements, management has evaluated subsequent events from January 1, 2020 through March 27, 2020, which was the date consolidated financial statements were available for issuance and concluded that no additional disclosures or adjustments to the consolidated financial statements were necessary.

# LONG ISLAND POWER AUTHORITY

*(A Component Unit of the State of New York)*

Required Supplementary Information

(Unaudited)

*(Amounts not in thousands)*

**Schedule of Proportionate Share of the Net Pension Liability**
**New York State and Local Employees' Retirement System**

| As of measurement date March 31, | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|---|
| Proportionate percentage of net pension liability | 0.0103343% | 0.0096075% | 0.0099883% | 0.0106679% | 0.0280362% | 0.0280362% |
| Proportionate share of the net pension liability | $ 732,219 | $ 310,076 | $ 938,526 | $ 1,712,234 | $ 947,131 | $ 1,266,916 |
| LIPA's covered-employee payroll | $ 3,883,794 | $ 4,088,041 | $ 3,782,636 | $ 3,511,480 | $ 8,246,620 | $ 11,057,226 |
| LIPA's proportionate share of the net pension liability as a percentage of its covered-employee payroll | 18.85% | 7.58% | 24.81% | 48.76% | 11.49% | 11.46% |
| Plan fiduciary net position as a percentage of the total pension liability | 96.27% | 98.24% | 94.70% | 90.70% | 97.95% | 97.20% |

**Schedule of Contributions**
**New York State and Local Employees' Retirement System**

| As of December 31, | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|---|
| Statutorily required contribution | $ 568,817 | $ 608,517 | $ 558,890 | $ 198,948 | $ 850,124 | $ 2,023,685 |
| Contributions in relation to statutorily required contributions | $ 568,817 | $ 608,517 | $ 558,890 | $ 198,948 | $ 850,124 | $ 2,023,685 |
| Contribution deficiency (excess) | — | — | — | — | — | — |
| LIPA's covered-employee payroll (as of March 31,) | $ 3,883,794 | $ 4,088,041 | $ 3,782,636 | $ 3,511,480 | $ 8,246,620 | $ 11,057,226 |
| Contributions as a percentage of covered payroll | 14.65% | 14.89% | 14.78% | 5.67% | 10.31% | 18.30% |

*This schedule is presented to illustrate the requirement to show information for 10 years.*
*However, until a full 10-year trend is compiled, LIPA has presented information for those years for which information is available.*

See accompanying independent auditors' report.

KPMG LLP
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1305 Walt Whitman Road
Melville, NY 11747-4302

# Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Board of Trustees
Long Island Power Authority:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated financial statements of the business-type activities of the Long Island Power Authority (LIPA), a component unit of the State of New York, as of and for the year ended December 31, 2019, and the related notes to the consolidated financial statements, which collectively comprise LIPA's basic financial statements, and have issued our report thereon dated March 27, 2020.

*Internal Control Over Financial Reporting*

In planning and performing our audit of the consolidated financial statements, we considered LIPA's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of LIPA's internal control. Accordingly, we do not express an opinion on the effectiveness of LIPA's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

*Compliance and Other Matters*

As part of obtaining reasonable assurance about whether LIPA's consolidated financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of consolidated financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

KPMG

*Purpose of this Report*

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of LIPA's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering LIPA's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Melville, New York
March 27, 2020

LIPA

Long Island Power Authority