Long Island Power Authority, New York; Retail Electric

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Credit Profile

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<th>Status</th>
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<tr>
<td>US$257.0 mil elec sys gen rev bnds ser 2020A due 09/01/2038</td>
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<tr>
<td>US$250.0 mil elec sys gen rev bnds (mandatory tender bnds) ser 2020B due 09/01/2050</td>
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<tr>
<td>Long Island Pwr Auth RETELEC</td>
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Rating Action

S&P Global Ratings assigned its 'A' rating to the following series of Long Island Power Authority (LIPA), N.Y., proposed bonds:

- $257 million electric system general revenue bonds, series 2020A;
- $250 million electric system general revenue bonds, series 2020B (mandatory tender bonds); and
- $121 million electric system general revenue bonds, series 2020C (federally taxable).

Although the 2020B bonds are subject to mandatory tender at the end of each term mode, at the option of management, or on any mode change date, we conclude the mandatory tender provisions will not impair liquidity because LIPA’s obligation to purchase tendered bonds is contingent on its securing remarketing proceeds sufficient to fund the purchase of all tendered bonds.

The outlook is stable.

At the same time, S&P Global Ratings affirmed its 'A' rating on the authority's existing $4.3 billion of revenue bonds.

Bond proceeds will refund portions of existing debt and fund portions of LIPA's capital program.

The long-term ratings reflect the application of our "U.S. Municipal Retail Electric And Gas Utilities: Methodology And Assumptions" criteria, published Sept. 27, 2018. The ratings incorporate a negative holistic adjustment of one notch that reflects projections that include $3.5 billion of 2020-2024 capital projects, recessionary pressures, and the potential costs of complying with New York State's ambitious plans to decarbonize the electric sector. In addition, the ratings reflect the provisions of our "U.S. Public Finance Waterworks, Sanitary Sewer, And Drainage Utility Systems: Rating Methodology And Assumptions" criteria, published Jan. 19, 2016, delineating S&P Global Ratings' methodology for assessing the impact of securitized debt.
Credit overview
LIPA is a corporate municipal instrumentality and political subdivision of New York State. The authority is among the three largest public power utilities in the U.S. by customers and revenues. It serves more than 1.1 million retail customers. The utility derives 56% of its revenues from residential customers and the balance from commercial and governmental customers. LIPA principally serves customers in Nassau and Suffolk counties, where income levels are about 50% above the national household effective buying income.

Unlike similar-sized peers, LIPA primarily relies on others to supply its customers' electricity needs, purchasing all but a small portion of its electricity from third parties. Moreover, New York State directed LIPA to outsource day-to-day operations and capital planning to a private company viewed as better able to provide reliable service.

LIPA's owned generation capacity consists of a 224-megawatt (MW), 18% interest in the Nine Mile Point 2 (NM2) nuclear plant, which equaled about 4% of 2019's 5,269 MW peak demand. The nuclear plant is co-owned with and operated by Constellation Energy Nuclear Group LLC. Contractual agreements with National Grid USA and other energy providers, as well as market purchases, serve all needs beyond NM2. The power supply agreement with National Grid expires in April 2028. It allows LIPA to purchase energy from resources other than National Grid's if they have lower costs, which is important because National Grid's resources have high production costs. National Grid provided 18% of LIPA's 2019 power supply, compared with 25% in 2015. The cost of reserving this capacity does not abate when LIPA purchases power from others, but LIPA can direct National Grid to remove generation from the power supply agreement. Underwater transmission cables provide access to the PJM and New England independent system operator markets, which helps reduce LIPA's exposure to National Grid's high production costs.

The stable outlook reflects very strong fixed charge coverage (FCC), the availability of robust pass-through mechanisms for recovering rising costs, and favorable service area demographics that can support the utility's high rates and mitigate recessionary pressures.

Environmental, social, and governance factors
We believe the utility faces moderate environmental exposures according to our environmental, social, and governance risk factors (ESG), and as the national focus on reducing greenhouse gas emissions advances.

Although Energy Information Administration data show that LIPA's weighted-average retail rates were 15% above the state average in 2018, we believe that service territory income levels temper the social risks associated with this rate disparity, but also observe historical resistance to rate adjustments. Recessionary pressures associated with the pandemic also have the potential to limit financial flexibility, whether due to high unemployment or commercial customers that are unable to operate at pre-pandemic levels.

We associate governance risk with the utility because of the requirement that LIPA must litigate rate adjustments that seek to increase aggregate revenues by more than 2.5% per year. In addition, LIPA has had contentious dealings with some of the taxing jurisdictions to which it makes payments in lieu of taxes. The utility through its agent, PSEG-Long Island (PSEG-LI), a subsidiary of New Jersey's Public Service Enterprise Group, an investor-owned, diversified energy company, continues to make progress in remediating its predecessor's reliability issues that contributed to the state's mandate that LIPA relinquish day-to-day operations to PSEG-LI.
Stable Outlook

Downside scenario
We could lower the rating if COVID-19-related recessionary pressures meaningfully disrupt the revenue stream. In addition, we could lower the rating if capital spending adds materially to unsecuritized debt and debt service, or resistance to rate increases weakens financial performance.

Upside scenario
We do not expect to raise the rating during the two-year outlook horizon because the utility projects $3.5 billion of 2020-2024 capital spending and faces the uncertainties of the effect of the pandemic and recession on energy sales and collections. We also believe the utility could face upward cost pressures as it migrates away from carbon-based generation fuels and responds to the specter of distributed generation technologies.

Credit Opinion
LIPA reported $4.6 billion of short- and long-term debt as of Dec. 31, 2019. This debt balance is net of the $4.5 billion of debt it securitized to improve the financial cushion available to its unsecuritized bondholders. Although LIPA’s financial statements consolidate the utility's unsecuritized debt and the debt of the Utility Debt Securitization Authority (UDSA)—the vehicle for issuing LIPA-related securitization bonds—those bonds' debt service is subject to a separate pledge, is not an obligation of the authority, and does not have a claim on the revenues pledged to the utility's unsecuritized debt. LIPA acts as the servicing agent for the USDA debt and uses its retail bills to collect USDA debt service from its customers. It remits the separately pledged revenues to the USDA. Consequently, our financial analysis removes USDA-related revenues and debt service from our assessment of the LIPA debt obligations, but our analysis also explores the burden of high retail rates that capture debt service on securitized and unsecuritized debt obligations, together with other revenue requirements.

Our FCC treats capacity payments to other generation suppliers as debt service in lieu of an operating expense because we view those payments as funding the suppliers' recovery of their capital investments in the generation they dedicate to LIPA. FCC was 1.5x in 2018 and 2019, which we consider very strong.

Enterprise Risk Profile: Very Strong

Economic fundamentals: Extremely strong
LIPA principally serves customers in Nassau and Suffolk counties, where income levels are about 160% and 140% of the national household effective buying income, respectively, which we consider to be extremely strong. LIPA benefits from the stable revenue stream that more than 1.1 million customers provide. Residential customers provide about 56% of revenues, with commercial customers providing 42%, which we view as a favorable mix contributing to revenue stability. However, health and safety restrictions relating to the COVID-19 pandemic could compromise the stability of revenues from commercial establishments, particularly if businesses are unable to resume operations at pre-pandemic levels.
Market position: Strong
Retail rates are competitive for the region, in our view, although they are high in absolute terms. Nevertheless, income levels contribute to affordability.

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

Operational Management Assessment (OMA): Strong
New York's Department of Public Service (DPS) must review rate proposals that seek to increase aggregate revenues by more than 2.5% per year. In our view, the rate-setting construct could reduce financial flexibility. The potential for rate oversight distinguishes the utility from most other public power utilities. However, the several available pass-through and decoupling mechanisms could diminish the need for base-rate adjustments that exceed the threshold.

The 2013 LIPA Reform Act transferred much of the day-to-day operating responsibilities to PSEG-LI, which is also responsible for capital planning. Under an operating agreement that expires in 2025, LIPA pays PSEG-LI an annual fee that contains performance-based incentives. The utility's contractual obligations to PSEG-LI include unfunded pension liabilities and other postemployment benefits (OPEB) relating to the PSEG employees that serve the LIPA territory.

Like other regulated utilities, LIPA has not received guarantees it will achieve specific coverage metrics, but the several adjustment mechanisms the DPS included in its rate recommendation for addressing changes in prescribed variable costs, should promote sound credit quality. The decoupling mechanism is a significant tool but not an absolute guarantee for insulating financial performance from variable electric sales and revenues.

In June 2019, New York enacted the Climate Leadership and Community Protection Act, directing the state's utilities to produce 100% of their electricity from carbon-free resources by 2040. We believe meeting these targets could stress the average cost of power supply, but the availability of pass-through and decoupling mechanisms directly tied to these initiatives should help maintain a sound alignment among revenues, expenses, and debt service.

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

Financial Risk Profile: Strong
Debt and liabilities: Highly vulnerable
As of Dec. 31, 2019, the utility reported $4.6 billion of unsecuritized debt. By comparison, its 2019 net position was only $519 million, translating into what we consider an extremely high debt-to-capitalization ratio of 90%. This level is particularly acute for a utility that outsources almost all of its energy supply.

LIPA has identified $3.5 billion of 2020-2024 capital needs. Although the utility did not provide a projected balance sheet, we calculate that the amortization of portions of previously issued debt will temper debt additions and the
utility's unsecuritized debt could reach $5.5 billion in 2024.

**Coverage metrics: Very strong**

Securitization transactions produced multi-billion-dollar debt reductions and improved debt service coverage (DSC) of unsecuritized debt, which was almost 1.8x in 2018 and 2019. LIPA's high, fixed-payment commitments to power suppliers dilute some of the benefits of the securitizations; however, FCC remains very strong. We calculated FCC of 1.5x in 2018-2019.

We generally exclude nonrecurring grant income from our DSC ratio calculation's numerator. However, the grant income LIPA reported on its income statement in recent years principally represented Federal Emergency Management Agency reimbursements for storm damage repairs that the utility expensed, U.S. Treasury reimbursements for a portion of gross interest on Build America Bonds, and recurring energy-efficiency grants from the Regional Greenhouse Gas Initiative. Therefore, we included the grants in the numerator. We also added the income statement’s recovery of carrying charges on regulatory assets. This money represents collections of debt service on bonds issued to finance a bill credit that coincided with LIPA's inception.

**Liquidity and reserves: Very strong**

The utility recorded $1.1 billion of unrestricted cash and investments on its balance sheet as of Dec. 31, 2019, which we view as representing a strong five-months' operating expenses. Undrawn capacity available under credit facilities brings this ratio up to six months' operating expenses.

In addition, the utility maintains rate-stabilization funds subsumed within restricted assets. The audited financial statements do not delineate the balances held as rate-stabilization reserves.

**Related Research**

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

### Ratings Detail (As Of July 28, 2020)

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**New York St Energy Research & Dev Auth, New York**

Long Island Pwr Auth, New York

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Many issues are enhanced by bond insurance.