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Long Island Power Authority, New York; Retail Electric

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Credit Profile		
US$250.0 mil elec sys gen rev nts ser 2021 due 09/01/2025		
Long Term Rating	A/Stable	New
Long Island Pwr Auth RETELEC		
Long Term Rating	A/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'A' rating to the Long Island Power Authority (LIPA), N.Y.'s proposed $250 million electric system general revenue notes, series 2021. At the same time, S&P Global Ratings affirmed its 'A' rating on the authority's existing $4.3 billion of revenue bonds. The outlook is stable.

The authority plans to use the medium-term notes' proceeds to fund repair costs related to damage the system experienced during August 2020's Tropical Storm Isaias (Isaias). Management expects to retire the notes with a combination of reimbursements from the Federal Emergency Management Agency (FEMA) and utility rates and charges.

The rating reflects the application of our "U.S. Municipal Retail Electric And Gas Utilities: Methodology And Assumptions" criteria, published Sept. 27, 2018. The rating incorporates a negative holistic adjustment of one notch that reflects projections that include $2.7 billion of 2021-2024 capital projects, recessionary pressures, the potential costs of complying with New York State's ambitious plans to decarbonize the electric sector, and the operational uncertainties the utility faces as it revisits its contract that outsources the operations of the transmission and distribution system to address the operator's lengthy Isaias service restoration times. In addition, the rating reflects those 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 54% 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. However, following 2012's Superstorm Sandy and 2020's Isaias, the respective private contractors operating the transmission and distribution systems for LIPA during those storm events were unable to restore service within an acceptable time frame. Consequently, in fall 2020, the utility's board directed management to evaluate alternative arrangements for system operations because August's poor storm response once again raised questions about the efficacy of the outsourcing model. The alternatives under consideration include renegotiating the authority's contract with the current operator, PSEG-Long Island; replacing PSEG-Long Island with another service provider; or hiring appropriate staff to enable the utility to bring the day-to-day operations in-house. We believe that outside contractors' recurring protracted service restoration following storms highlights significant operational exposures that have the potential to negatively affect operational and financial performance.

LIPA's limited 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

Based on the utility's nuclear resource and purchases from predominantly gas-fired generation resources, we believe LIPA faces moderate environmental exposures. However, the service territory's extensive coastal exposure heightens susceptibility to storm damage attributable to climate change.

Although Energy Information Administration data show that LIPA's weighted-average retail rates were 17% above the state average in 2019, 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. Moreover, PSEG-Long Island's unsatisfactory storm response creates uncertainties. In the next few months, we expect management will decide whether to continue to outsource operations or bring them in-house. Management faces the formidable task of assessing the most cost-efficient business model for providing reliable service to Long Island's retail electric customers. We believe management will need to weigh its experience with two contractors that provided unsatisfactory restoration responses to Sandy and Isaias versus the challenge of hiring appropriate staff to operate the transmission and distribution system.

Stable Outlook

Downside scenario

We could lower the rating if changes to the outsourcing contract or the business model for day-to-day operations materially raise utility costs, without corresponding rate adjustments and reliability improvements. In addition, we could lower the rating if capital spending adds materially to unsecuritized debt and debt service. Although 2020 data suggest that COVID-19 recessionary pressures are not meaningfully affecting the revenue stream, we could lower the rating if the trend changes and the utility faces sizable delinquent and uncollectible accounts that disrupt cash flows and erode liquidity.

Upside scenario

We do not expect to raise the rating during the two-year outlook horizon because the board has directed management to reassess LIPA's business model in response to repeated service reliability issues attributable to outside system operators. Additional factors that we view as obstacles to a higher rating include utility projections of $2.7 billion of 2021-2024 capital spending, and 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 UDSA debt and uses its retail bills to collect UDSA debt service from its customers. It remits the separately pledged revenues to the UDSA. Consequently, our financial analysis removes UDSA-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 on the same bill debt service on securitized and unsecuritized debt obligations, together with other revenue requirements.

Our FCC calculation 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 2018-2019, 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 54% of revenues, with commercial customers accounting for 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

The 2013 LIPA Reform Act transferred much of the day-to-day operating responsibilities to PSEG-Long Island, which is also responsible for capital planning. Under an operating agreement that expires in 2025, LIPA pays PSEG-Long Island an annual fee that contains performance-based incentives. The utility's contractual obligations to PSEG-Long Island include unfunded pension liabilities and other postemployment benefits relating to the PSEG employees that serve the LIPA territory. The contractor's lengthy service restoration following Isaias evokes the inability of its predecessor to expeditiously restore customers' electric service following 2012's Superstorm Sandy. Customer ire following Isaias power outages triggered the board to direct management to revisit LIPA's business model.

Unsatisfactory storm restoration responses by separate contractors in 2012 and 2020 raises questions about whether management negotiated contracts with system operators that adequately incentivize operators to counter the system's susceptibility to storm damage. These episodes call into question management's capacity to drive consistently reliable electric service and also present uncertainty as to the costs the utility and its customers might bear to achieve reliability in storm-prone Long Island.

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 LIPA 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.

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. Moreover, the board recently amended the decoupling mechanism to allow the utility to defer portions of cost recovery to later periods.

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 facilitate 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 $2.7 billion of 2021-2024 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 FEMA 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 January 11, 2021)

Ratings Detail (As Of January 11, 2021) (cont.)		
Long Island Pwr Auth elec sys gen rev bnds ser 2008A dtd 10/16/2008 due 05/01/2033		
Long Term Rating	A/Stable	Affirmed
Long Island Pwr Auth RETELEC		
Long Term Rating	A/Stable	Affirmed
Long Island Pwr Auth RETELEC		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC		
Long Term Rating	A/Stable	Affirmed
Long Island Pwr Auth RETELEC (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (ASSURED GTY)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (BAM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (BAM) (SECMKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (BAM) (SECMKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (BAM) (SECMKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (BHAC)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (BHAC) (SEC MKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (BHAC) (SEC MKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (CIFG)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
New York St Energy Research & Dev Auth, New York		
Long Island Pwr Auth, New York		
New York St Energy Research & Dev Auth (Long Island Pwr Auth)		
Long Term Rating	A/Stable	Affirmed
New York St Energy Research & Dev Auth (Long Island Pwr Auth) (MBIA) (National) (SEC MKT)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Ratings Detail (As Of January 11, 2021) (cont.)

Many issues are enhanced by bond insurance.