FOR CONSIDERATION
May 10, 2023

TO: The Board of Trustees

FROM: Thomas Falcone

SUBJECT: Approval of the Annual Report on the Board Policy on Fiscal Sustainability

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Requested Action

The Board of Trustees (the "Board") of the Long Island Power Authority ("LIPA") is requested to adopt a resolution finding that LIPA has complied with the Board Policy on Fiscal Sustainability (the "Policy") and approving the annual report for the Policy, which resolution is attached as **Exhibit "A"**.

Background

In September 2016, the Board adopted the Policy, previously known as the Board Policy on Debt and Access to the Credit Markets, with the purpose of serving the long-term interests of LIPA's customers by adopting sound financial plans each year. Sound financial plans ensure ready access to borrowing on reasonable terms necessary to fund the infrastructure investments that maintain the reliability and resiliency of the Long Island electric system. Such financial plans contemplate prudent levels of borrowing that will accommodate efficient access to the capital markets and thereby minimize the long-term cost of providing electric service to LIPA's customer-owners.

The last annual report to the Board was presented in March 2022. After the March 2022 meeting, a working group of Trustees, together with the Board's governance consultant Leading Resources, Inc., participated in various meetings to develop and draft amendments to the Policy. In September 2022, the Board adopted amendments to the Policy, including renaming the Policy to the Board Policy on Fiscal Sustainability consistent with the Board's Purpose and Vision.

Compliance with the Policy

LIPA Staff recommends that, for the reasons set forth below, the Board find that LIPA has complied with the Policy for the period since the last annual review. The Policy provides that "LIPA's vision for fiscal sustainability is to meet the Board's policy goals to provide clean, reliable, and affordable energy through strategies that prudently manage and safeguard LIPA's assets and result in the lowest long-term cost to customers. To achieve our vision for fiscal sustainability, LIPA will:

"Decrease LIPA's leverage and cost of capital by:"

- "Achieving AA-category credit ratings via reducing LIPA's debt-to-assets ratio from 92 percent to 70 percent or less by 2030."
  - In 2022, LIPA's three ratings were reaffirmed at A2, A, A, from Moody's, S&P Global, and Fitch Ratings, respectively. Fitch maintained a "positive" outlook to

its rating.

  - New debt as a percentage of capital spending for the three-year rolling average for the period ended December 31, 2022 was approximately 66%. By limiting new borrowing while paying down existing debt and fixed obligations (i.e. leases), LIPA remains on path to achieve the Board's stated objective of a debt-to-asset ratio of 70 percent or less by 2030.

- "maximizing grants and low-cost funding sources; minimizing costs through securitization of debt and tax-exempt financing."
  - LIPA received approximately $276 million from the Federal Emergency Management Administration ("FEMA") for reimbursement of costs associated with repairs to its transmission and distribution ("T&D") system that were damaged as a result of Tropical Storm Isaias.
  - LIPA received $7.6 million from FEMA for reimbursement of costs associated with damage to the T&D system from Hurricane Ida.
  - LIPA was awarded a competitive grant by FEMA under the Tropical Storm Isaias disaster declaration to fund a $3.5 million project to harden three transmission expressway crossings.
  - LIPA submitted to FEMA proposals totaling approximately $426 million seeking mitigation funding to storm harden its T&D system as provided for under the Tropical Storm Isaias disaster declaration. The application remains pending.
  - LIPA submitted to the Department of Energy ("DOE") a proposal seeking a federal grant for $250 million towards $500 million of T&D investments to enhance interconnection capacity for Distributed Energy Resources. LIPA was notified on February 24 of an initial determination of support by DOE and invited to submit a full grant application in May 2023.
  - LIPA partnered with Stony Brook University to apply for a $20 million DOE grant related to the implementation of certain projects in LIPA's 5-year Strategic Roadmap.
  - The Utility Debt Securitization Authority ("UDSA"), LIPA's component unit, issued approximately $841 million to refund LIPA and UDSA outstanding indebtedness through the issuance of securitization bonds generating net present value savings of $42 million. In addition, UDSA issued its first Green Bonds totaling $95 million to support LIPA's resiliency investments.

- "pre-funding long-term liabilities on an actuarially sound basis including (1) pension costs, (2) Other Post-Employment Benefits ("OPEBs"); and (3) the Nuclear Decommissioning Trust Fund."
  - As measured by an actuarial services firm, during 2022, LIPA funded $30 million to the PSEG Long Island pension plan trust account. As of December 31, 2022, the PSEG Long Island pension plan trust account had assets valued at $370 million compared to a benefit obligation of $452 million.
  - LIPA funded $36.3 million to the LIPA OPEB account in 2022. LIPA's OPEB account, to prefund the OPEB benefits of PSEG Long Island employees, had assets valued at $523 million compared to a benefit obligation of $455 million. The funding levels have been reviewed by an actuarial services firm within the last two

years.
  - The LIPA OPEB Trust for LIPA employees had assets valued at $25 million compared to benefit obligations of $24 million.
  - The NMP2 Nuclear Decommissioning Trust Funds (NDTF) had assets valued at $155 million compared to a liability of $102 million. LIPA funded $0.3 million to the NDTF in 2022. The NDTF funding levels have been reviewed by an actuarial services firm within the last two years.

- "maintaining fixed-obligation coverage ratios of no less than 1.40x on LIPA-issued debt and lease payments, and 1.20x on the combination of LIPA-issued debt, UDSA-issued debt, and lease payments."
  - For the period ended December 31, 2022, LIPA achieved coverage ratios of 1.45x for LIPA-issued debt and lease payments and 1.29x for LIPA and UDSA-issued debt and lease payments.
  - The 2023 Budget is set to meet a 1.40x fixed-obligation coverage ratio.

- "minimizing LIPA's need for coverage while maintaining fiscal sustainability by budgeting reasonable amounts and using reconciliation mechanisms for hard-to-predict cost categories (e.g. storms)."
  - LIPA's Revenue Decoupling Mechanism ("RDM") ensures that only LIPA's budgeted and Board-approved revenues for delivery service are collected from customers in each customer class by comparing actual revenues with authorized revenues. The RDM credits (or collects) any differences to (or from) customers in the following year. For 2022, LIPA's residential customers will be provided a credit of $65 million in 2023 rates, and its commercial customers will be charged $12 million.
  - LIPA's Delivery Service Adjustment ("DSA") provides cost recovery or refunding of overcollection for certain items that vary due to external factors, including debt service, storm restoration expenditures, non-storm emergency costs, bad debt expense, and PSEG Long Island pension and OPEBs. For 2022, LIPA's customers will be provided a credit of $2 million in 2023 rates.

- "Maintain cash on hand and available credit sufficient to fund business operations in emergencies, as measured by month-end balances of at least: (i) $100 million in the Operating Fund and $150 million in the Rate Stabilization Fund, and (ii) 150 days of operating expenses."

  - Cash on hand at the end of each month exceeded the target of $100 million in the Operating Fund and $150 million in the Rate Stabilization Fund. As of December 31, 2022, the Operating and the Rate Stabilization funds totaled $296 million and $157 million, respectively.
  - During 2022, cash on hand and available credit exceeded the target of at least 150 days available for operating expenses. As of December 31, 2022, 309 days of operating expenses were available in cash and credit.

- "Develop budgets and financial plans that maximize customer value and aggressively manage costs."

- LIPA's 2023 Budget sets rates and charges to provide clean, reliable, and affordable energy through strategies that prudently manage and safeguard LIPA's assets and result in the lowest long-term cost to customers. LIPA's 2023 Budget was approved in December 2022.
- Pursuant to the Strategic Roadmap (link) approved by the Board in March 2023, LIPA is establishing a business process optimization practice to systematically look for continuous improvement opportunities. Several projects were undertaken in the LIPA's Work Plan and Performance Metrics to enhance operations and financial reporting that will assist in assuring value for customers' money, as detailed in those documents.
- Within the 2023 Budget, nearly $1.1 billion of ongoing cost savings equals 26 percent of electric bills, or about $46 per month for a typical residential customer. These savings include:

Operating Lean	$ Millions
Discontinued investments in combined cycle plants	$353
LIPA Reform Act 2% Tax Cap	$340
Commodity Hedging (based on current prices)	$147
Renegotiating expiring power purchase agreements	$49
Smart Meter savings	$45
Power plant property tax savings	$40
Refinancing existing debt	$40
Investing in cost-effective energy efficiency	$22
Reduction to wholesale market and off-island transmission	$16
Operating savings and improved productivity	$13
Power supply pension and retirement savings	$8
TOTAL	$1,073 MILLION

- "Provide operating managers with financial reporting that drives sound business decisions and the best use of limited resources."
  - Monthly, LIPA's financial reporting managers provide analysis of budgeted costs versus actual spending to LIPA's operating departments to aid in their analysis of PSEG Long Island's resource management, ensuring the most cost-effective and efficient processes are utilized. Significant variations are identified and investigated timely.
  - Pursuant to the Strategic Roadmap (link) approved by the Board in March 2023, LIPA will be further enhancing budgeting and reporting by strengthening processes for Capital Project review and approval; enhancing both LIPA and PSEG Long Island's financial analysis and fiscal management capabilities; and establishing integrated operational and financial performance reporting framework, among

other items.

- "Provide LIPA's customers and investors with timely, transparent, accurate, and useful information to evaluate LIPA's financial performance and plans."
  - LIPA's annual Budget (link) was approved by LIPA's Board on December 14, 2022, and made available on LIPA's website. The Budget includes a letter from LIPA's CEO that explains major initiatives and expenditures for the prior year and coming year in plain English and the main drivers of the budget and electric rates.
  - LIPA's annual audited Financial Statements (link) were approved by LIPA's Board on March 29, 2023, and made available on LIPA's website and the Electronic Municipal Market Access ("EMMA") platform for bondholders.
  - LIPA undertakes substantial quarterly and annual reporting obligations to make available its plans and evaluate its performance relative to plan, including the Strategic Plan (link), Work Plans (link), Performance Metrics (link), and Quarterly and Annual Performance Reports (link), among other items.
  - LIPA maintains Fact Sheets and videos on topics of significant interest to the public (e.g. Time of Day Rates (link), the clean energy transition (link)) to explain the topics in plain English.
  - LIPA's Transparency Plan (link) summarizes other initiatives to make its operations and decisions transparent to customers, investors, and stakeholders.

Enterprise Risk Management Discussion

The Board has adopted a Policy on Enterprise Risk Management ("ERM"). Enterprise risks are brought to the Board's attention throughout the year. One such enterprise risk is related to liquidity. Specifically, the risk identified is, "Insufficient liquidity to cover obligations greater than 60 days (i.e., loss of revenue stream) results in the inability to make debt service payments, pay UDSA Bondholders, and cover operating expenses."

This risk is rated as a medium-level risk and is mitigated by LIPA's ability to access capital markets, borrow from rate stabilization funds, a revolving line of credit or in the commercial paper market. In August 2022 all three rating agencies reaffirmed their credit ratings for LIPA helping to further mitigate this risk by providing confidence in LIPA's ability to access capital markets.

Based on the credit ratings and the ability to access capital markets, we believe this risk is being adequately managed. LIPA's liquidity remains strong, well above the 150-day minimum required by the Policy as noted above.

Annual Review of the Policy

LIPA Staff has reviewed the Policy and suggests no amendments at this time.

Recommendation

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

Attachments

Exhibit "A" Resolution

Exhibit "A"

RESOLUTION APPROVING THE REPORT TO THE BOARD OF TRUSTEES ON THE BOARD POLICY ON FISCAL SUSTAINABILITY

WHEREAS, the Board Policy on Fiscal Sustainability (the "Policy"), previously known as the Debt and Access to the Credit Markets, was originally approved by the Board of Trustees by Resolution No. 1319, dated September 21, 2016; and

WHEREAS, the last annual report to the Board was presented in March 2022; and

WHEREAS, the Board has conducted an annual review of the Policy and affirms that the Policy has been complied with.

NOW, THEREFORE, BE IT RESOLVED, that consistent with the accompanying memorandum, the Board hereby finds that LIPA has complied with Policy for the period since the last annual review and approves the annual report to the Board.

Dated: May 10, 2023