FitchRatings

RATING ACTION COMMENTARY

Fitch Rates LIPA Electric System Rev Bonds 'A'; Outlook Positive

Mon 24 Jul, 2023 - 12:09 PM ET

Fitch Ratings - New York - 24 Jul 2023: Fitch Ratings has assigned an 'A' rating to the following Long Island Power Authority, NY (LIPA or the authority) bonds:

--Approximately $400 million electric system general revenue bonds series 2023E;

--Approximately $185 million electric system general revenue bonds series 2023F;

--Approximately $128 million electric system variable-rate demand general revenue bonds series 2023D (underlying rating);

In addition, Fitch has assigned a 'A' bank bond rating to the series 2023D bonds. The bank bond rating is assigned to the 2023D bonds but will only become applicable if the bonds cannot be remarketed and are purchased by the bank providing the liquidity facility.

Proceeds from the series 2023E bonds will be used to fund system improvements and pay the costs of issuance. Proceeds from the series 2023F will be used to refinance existing debt and to pay the costs of issuance. The series 2023E bonds will be sold with a fixed rate and amortize through 2049. The series 2023F bonds will be sold with a fixed rate with various maturities through 2033. These bonds are expected to price the week of July 31st. The series 2023D bonds are expected to be remarketed in August.

Fitch has also affirmed the following LIPA ratings at 'A':

--Issuer Default Rating (IDR);

--Approximately $4.5 billion senior-lien electric system revenue and refunding bonds.

The Rating Outlook is Positive.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Long Island Power Authority (NY)	LT IDR	A Rating Outlook Positive	Affirmed	A Rating Outlook Positive
Long Island Power Authority (NY) /Electric System Revenues/1 LT	LT	A Rating Outlook Positive	Affirmed	A Rating Outlook Positive

VIEW ADDITIONAL RATING DETAILS

The Positive Outlook reflects LIPA's improving leverage ratio and Fitch's expectation that the gradual but consistent deleveraging trend that began in 2015 will continue through 2027. Leverage, measured by net adjusted debt-to-adjusted funds available for debt service (FADS), improved to 8.1x at YE 2022 from 8.8x four years prior. The improvement is attributable, in part, to LIPA's strategy of budgeting to achieve higher fixed obligation coverage.

Going forward, leverage ratios are expected to trend below 8.0x in 2023/2024, consistent with a higher rating, as performance continues to benefit from LIPA's revenue-decoupling mechanism (RDM), as well as modest but consistent rate increases designed to achieve higher fixed charge coverage.

LIPA's very strong service area, more disciplined approach to rate setting and authorized RDM should sustain its very strong revenue defensibility and overall performance even through periods of stress, further supporting its financial profile. LIPA's operating cost burden remains comparatively high within the sector. However, ongoing efforts to moderate costs and operating risk, and improve the terms of its operating services agreement (OSA) with system operator PSEG Long Island (PSEGLI), have been reasonably successful in recent years, and are factored in the rating.

The adoption of a public power model, whereby LIPA would directly operate the system upon termination of the OSA in 2025, is still under consideration. An upgrade of the rating is unlikely prior to a final decision related to management of the authority's assets, which is expected prior to the end of calendar 2023.

SECURITY

The series 2023D, 2023E and 2023F bonds are senior-lien obligations of LIPA secured by the net revenues of the electric system, after payment of O&M expenses.

KEY RATING DRIVERS

Revenue Defensibility - 'aa'

Very Strong and Mature Service Area

LIPA's revenue defensibility assessment reflects the revenue stability provided by its exclusive role as the transmission and distribution utility serving Long Island, and the exceptionally strong profile of the service area. The assessment also factors in LIPA's legal ability to determine rates, its ability to recover 80% of costs through rate mechanisms and offset variation in energy sales through a revenue-decoupling mechanism (RDM) that adjusts for any difference between actual and budgeted revenues, and its affordable cost of electric service.

Rate increases above 2.5% are subject to regulatory review by the New York State Department of Public Service. However, this is not viewed as a credit risk given LIPA's other adjustable rate mechanisms. The authority has not proposed a rate increase of more than 2.5% since the initial rate plan since 2015.

Operating Risk - 'bbb'

Above Average Operating Costs

Operating risk is assessed as midrange, reflecting operating costs that are well above the national average and have ranged between 15 and 20 cents/kWh over the last five years. LIPA's relatively high operating cost burden reflects legacy acquisition costs, challenges related to serving LIPA's island geography and high payments in lieu of taxes (PILOTs). Most recently, operating costs increased to 19.2 cents per kilowatt hour (kwh) in 2022 from 17.2 cents per kwh in 2021 as a result of rising natural gas prices and power supply costs.

LIPA's power supply portfolio is well diversified and comprised of purchased capacity from units located on Long Island and elsewhere. Natural gas is the predominant fuel source for the vast majority of contracted capacity, supplemented by smaller amounts of nuclear, solar, hydro, oil-fired and refuse capacity. Capital spending is elevated at roughly $4.0 billion over the next five years.

Financial Profile - 'a'

Improved Cash Flow Supports Lower Leverage

Lower leverage of 8.1x and stable coverage of full obligations of 1.25x in 2022 reflect a series of base rate increases and the resulting improvement in FADS, together with increasing cash on hand. Unrestricted cash totaled $1.34 billion at the end of 2022, or 180 days. Liquidity facilities provide additional liquidity totaling 324 days on hand.

Fitch's scenario analysis indicates that leverage is expected to continue trending lower, declining below 8x in both the base and stress scenarios, which is consistent with the financial profile assessment and rating outlook. Liquidity is expected to remain robust and coverage in historical ranges. Fitch's key financial ratios and analysis includes consideration of LIPA's approximately $3.8 billion in outstanding securitization bonds.

Asymmetric Additional Risk Considerations

There are no asymmetric additional risk considerations factored in the rating.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--Failure to achieve leverage approaching 7.0x in Fitch's base and stress cases would likely result in a revision of the Outlook to Stable;

--Failure to sustain leverage below 9.0x in Fitch's base or stress cases would likely result in a downgrade;

--Failure to implement planned rate increases;

--Higher than anticipated capex and related borrowings;

--A determination that any proposed change in the management of LIPA's assets introduces additional operating or financial risk.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--A sustained reduction in leverage, approaching 7.0x in Fitch's base and stress cases;

--A determination that any proposed change in the management of LIPA's assets does not introduce additional operating or financial risk.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

PROFILE

LIPA owns one of the largest municipal electric distribution systems in the U.S., serving about three million people located throughout New York's Nassau and Suffolk counties and the Rockaway section of New York City. LIPA owns the electric transmission and distribution system located throughout its service territory. However, operation and maintenance of the system, and significant responsibilities for power supply are contracted for with external service providers.

LIPA and PSEGLI amended their existing OSA in April 2022 to place a greater share of PSEGLI's compensation at risk based on performance, introduce a wider array of metrics to evaluate performance, strengthen accountability, facilitate long-term planning and separate systems dedicated to LIPA. The amendments further eliminated PSEGLI's eight-year extension option leaving the termination date at Dec. 31, 2025.

A legislative commission is evaluating a model that would bring the utility's transmission and distribution assets under Authority management upon expiration of the OSA. The commission issued a draft report in April 2023 laying out options and considerations for governance, regulatory oversight, transparency and resource planning. Additional hearings are scheduled for the fall and a final report, along with a draft bill, are expected to be released in November 2023. LIPA believes that a transition could be completed in 12 months. If the model is not pursued, LIPA will rebid the OSA before YE 2023.

The majority of LIPA's generating capacity is provided pursuant to a power supply agreement (PSA) with National Grid plc (BBB-/Stable). The PSA, which extends through April 2028, provides LIPA with access to approximately 3,700MW of on-island generating capacity currently owned by National Grid. LIPA also maintains an ownership interest in the Nine Mile Point 2 (NMP2) nuclear facility. The remainder of LIPA's capacity and the majority of its energy supply are met through a portfolio of purchased power agreements, including off-island and market purchases. Power supply and fuel management services are provided by PSEG Energy Resources & Trade LLC, a PSEG affiliate.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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APPLICABLE CRITERIA

U.S. Public Power Rating Criteria (pub. 03 Mar 2023) (including rating assumption sensitivity)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Apr 2023) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST Econometric API - Fitch Analytical Stress Test Model, v3.0.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

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Long Island Power Authority (NY)	EU Endorsed, UK Endorsed

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