S&P Global Ratings

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Long Island Power Authority, New York; Retail Electric

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Credit Profile		
US$400.0 mil elec sys gen rev bnds ser 2023E due 09/01/2049		
Long Term Rating	A/Stable	New
US$180.585 mil elec sys gen rev bnds ser 2023F due 09/01/2033		
Long Term Rating	A/Stable	New
Long Island Pwr Auth RETELEC		
Long Term Rating	A/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'A' rating to the Long Island Power Authority (LIPA or the authority), N.Y.'s proposed $580.585 million electric system general revenue bonds, series 2023E and 2023F.
- At the same time, S&P Global Ratings affirmed its 'A' rating on the authority's existing revenue bonds, of which $5.3 billion were outstanding at Dec. 31, 2022.
- The outlook is stable.

Security

The proposed bonds are secured by a net revenue pledge of LIPA's electric system.

The authority pays debt service on its revenue bonds outstanding from the revenues remaining after paying the operating expenses of the electric system. We assigned our rating on the revenue bonds outstanding by applying our "U.S. Municipal Retail Electric And Gas Utilities: Methodology And Assumptions" criteria, published Sept. 27, 2018. In addition, we have applied those provisions of our "U.S. Municipal Water, Sewer, And Solid Waste Utilities: Rating Methodology And Assumptions" criteria, published April 14, 2022, which delineates S&P Global Ratings' methodology for assessing the impact of securitized debt.

At Dec. 31, 2022, LIPA had $3.1 billion of securitized debt outstanding, issued by its component unit, the Utility Debt Securitization Authority (UDSA). LIPA expects to issue additional UDSA-securitized debt in the near future. The UDSA debt is secured by an irrevocable, non-by-passable consumption-based charge, and is not secured by the trust estate that secures LIPA's electric revenue bonds.

Credit overview

The authority provides electric service to about 1.2 million customers in Nassau and Suffolk counties, and a portion of Queens County known as the Rockaways. LIPA is a political subdivision of the State of New York, governed by a board of trustees appointed by the governor and legislative leadership.

LIPA outsources the management of its operations to a for-profit, investor-owned utility--currently, the Public Service Enterprise Group Long Island (PSEGLI), a subsidiary of the Public Service Enterprise Group (PSEG). PSEGLI receives from LIPA a management fee and passes through the operating costs of the ServCo subsidiary, which handles the day-to-day operations of the utility. The contract with PSEGLI expires Dec. 31, 2025.

Following dissatisfaction with its management services performance in the aftermath of Tropical Storm Isaias in 2020, LIPA tied an enhanced portion of the fee paid to PSEGLI to certain key performance metrics. We understand that LIPA believes that these metrics have not been fully met. While the level of the fee at risk is not meaningful from a credit perspective, we believe that it does raise the question of whether LIPA believes that it is receiving the expected value of service, in consideration of the management fee that it pays.

The New York State Legislative Commission on the Future of the Long Island Power Authority (the commission) issued a draft report in April 2023 outlining specific actions, legislation, and timeline necessary to restructure LIPA from the current model (third-party management and operations handled by ServCo) into an authority with management services and ServCo employees directly employed by LIPA. The commission has stated that the final report and accompanying legislation--to be issued by November 2023--will include recommendations for governance structure and transitioning of ServCo employees to LIPA, issues that were omitted in the draft report. Should the legislature fail to enact the legislation, LIPA would need to pivot quickly to a new third-party management contract, either with PSEGLI or some other management services provider. As no concrete actions have been adopted to date, our rating does not reflect the hypothetical risks associated with the management models under consideration, although it does reflect the governance uncertainty post-expiration.

The rating on LIPA also reflects our view of the following credit considerations:

- A large, predominantly residential, and affluent customer base contributes to revenue stability and predictability. However, despite above-average incomes, high retail rates limit rate-raising flexibility, although rates are competitive with those of other large power providers in the region.
- Although LIPA's board retains final rate-setting power, the authority is required to submit any proposed rate increase that would raise revenue by more than 2.5% for review to the New York State Department of Public Service. However, credit risk is mitigated--but not eliminated--by myriad pass-through and decoupling mechanisms that reduce the likelihood that more sizable rate increases will be needed. The mechanisms provide automatic recovery of power costs as well as the cost of complying with the Climate Leadership and Community Protection Act (CLCPA), and decouple budget-to actual revenue variances for any reason, including economic conditions such as write-offs.
- LIPA faces operational and governance uncertainty as the state legislature reconsiders the outsourcing of management of the operations of the transmission and distribution (T&D) system to PSEGLI, under the contract that expires in 2025.
- LIPA's power supply is in the process of transitioning as it complies with New York State's ambitious decarbonization plan, the CLCPA. LIPA currently has 17% of its power needs met through zero emission resources (utility-scale solar [2%] and nuclear generation owned by LIPA or purchased under contract [15%], while behind-the-meter solar equates to another 2%), but anticipates that wind and solar will be sufficient to reduce LIPA's carbon emissions 72% by 2030 (from 2010 levels). However, we note that achieving this will be influenced by the progress of renewable buildout on Long Island and off the coast of Long Island, which in our view is very uncertain. Nevertheless, LIPA's risks are largely the same as all other utilities in New York and LIPA will maintain the flexibility to adjust its plans to match the rate of buildout.

- Fixed cost coverage (FCC), which averaged 1.22x over the past three years, is supportive of the current rating. Based on LIPA's financial forecast, we calculate FCC of 1.2x-1.3x over the next five years.
- Liquidity is sound, with unrestricted cash (net of collateral holdings) and undrawn capacity on credit lines measuring 145 days of operating expenses in 2022.
- LIPA's T&D system is highly leveraged (debt is 92% of total capitalization), and its capital needs are sizable (almost $4 billion over 2023-2027; with 64% expected to be debt financed), and it faces longer-term costs to comply with the state's decarbonization plan.

Environmental, social, and governance

We believe that environmental risk has a moderately negative influence on the rating. LIPA's power supply is in transition, in step with the rest of New York State. LIPA expects to issue a new integrated resource plan later in 2023 that will include options to address expiring contracts while complying with the CLCPA. Moving LIPA toward a zero-emissions electric system in compliance with the CLCPA will mean both adding new clean energy sources and retiring older fossil-fueled power plants, which we believe introduces energy transition risk, although we note other New York utilities also face this risk. In addition, we note that the service territory's extensive coastal exposure heightens susceptibility to storm damage and rising tides attributable to climate change.

We view social risk as also having a moderately negative influence on the rating. Although LIPA's weighted-average retail rates were 19% above the state average in 2021, income levels temper the social risks associated with this rate disparity. While we understand that LIPA's retail rates are competitive for the region, they are high in absolute terms, which we believe constrains rate-raising flexibility. We also believe that macro-economic factors add to LIPA's social risk. In our opinion, unsustainably strong business and consumer economic activity is driving inflation, and will likely lead to higher interest rates, and ultimately an economic slowdown. However, although S&P Global Economics sees an economic weakening on the horizon, we no longer foresee imminent recession risk. (See "Economic Outlook U.S. Q3 2023: A Sticky Slowdown Means Higher For Longer," published June 26, 2023, on RatingsDirect.) Consequently, we continue to monitor the strength and stability of public power utilities' revenue streams for evidence of delinquent payments or other revenue erosion because elevated consumer prices and interest rates will likely continue whittling discretionary incomes.

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, although we note this threshold has not been breached over the past five years. In addition, we believe that several pass-through and decoupling mechanisms diminish the potential need to exceed the threshold. However, governance risk is elevated given the unsatisfactory storm responses by two contractors, and more recently by LIPA's belief that PSEGLI failed to fully meet the performance standards established under the recently revised contract. In our view, this raises questions about controls under outsourcing arrangements. While our view of LIPA's governance risk does not currently factor in potential changes to the authority's operating model as outlined in the commission's draft report, we acknowledge the potential that further adjustments to management oversight will be considered during the state's 2024 legislative session.

Outlook

The stable outlook reflects credit-supportive pass-through mechanisms that have promoted cost recovery across economic cycles, helping LIPA to maintain consistent FCC and liquidity metrics. The outlook is also supported by strong income levels, which suggest modest rate-raising flexibility despite already high rates. Although there is uncertainty regarding LIPA's future management model, the outlook does not currently reflect the commission's draft recommendations.

Downside scenario

We could lower the rating if our forward-looking view of FCC, liquidity, or debt suggests deterioration, or if rate-raising flexibility is compromised. In our view, this would most likely result from energy transition pressures as LIPA seeks to comply with the CLCPA. In addition, we could lower the rating if the unsettled future of LIPA's management becomes an impediment to strategic planning.

Upside scenario

We do not expect to raise the rating during the two-year outlook because we believe the utility faces meaningful operational and financial exposures, including unresolved questions about whether LIPA or others will manage day-to-day operations, a sizable capital program, and the uncertain costs of decarbonization.

Credit Opinion

An uncertain future for LIPA's management model

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, from inception, New York State directed LIPA to outsource its day-to-day operations and capital planning to a private company viewed as having expertise that would translate into reliable service. However, following Superstorm Sandy (2012) and Tropical Storm Isaias (2020), the respective private contractors operating the T&D systems for LIPA were unable to restore service within a time frame acceptable to the authority. Consequently, in fall 2020, the utility's board directed management to evaluate alternative arrangements for system operations, citing questions about the effectiveness of the outsourcing model.

As part of its response to Isaias' protracted outages, LIPA amended and restated its contract with system operator PSEGLI. The revision imposed higher performance standards on PSEGLI, including more substantial financial penalties for substandard performance.

On May 15, 2023, LIPA issued a report stating that PSEGLI fully met just 69% of key performance metrics, with the most notable shortcomings in the areas of customer service and information technology. Based on LIPA's evaluation, PSEGLI qualified for about $15 million of the $21 million of variable compensation it was eligible to receive in 2022. PSEGLI also received about $57 million in fixed fees. (In addition, PSEG subsidiaries and affiliated companies were paid $44 million for power supply, fuel management, and information technology systems and services.)

Meanwhile, the state's legislative commission has issued a draft report outlining specific actions, legislation, and timeline necessary to restructure LIPA from the current model (third-party management and ServCo operations), bringing management of operations in-house in a manner similar to that of other public power utilities.

The report suggests a number of options that might be considered in changing the management model, which could save ratepayers $48 million- to $78 million per year, after one-time transition costs. However, we note that no changes have been adopted to date, and there is a lack of clarity on what actions and governance structure might be adopted, as well as how LIPA might deploy potential operational savings.

Hearings on the draft report are expected to be held in September 2023. A final report and draft legislation are expected to be issued by Nov. 1, 2023, and presented to the state legislature during the ensuing legislative session, commencing January 2024.

A deep and diverse service area underpins creditworthiness

Among the three largest public power utilities in the U.S., the authority serves about 1.2 million retail customers in Nassau and Suffolk counties where income levels are about 160% and 143% of the national household effective buying income, respectively. In our view, well-above average incomes support rate-raising flexibility, although this has historically been challenged by ratepayer perception of service delivery shortcomings in the aftermath of Superstorm Sandy. The utility derives 53% of its revenues from residential customers and the balance from commercial and governmental customers. We view the sizable revenue contributions from residential customers and the absence of substantial industrial loads as contributing to revenue stability.

Post-pandemic delinquencies are not expected to affect the rating

Customers' delinquent payments in 2022 reached $210 million (about $25 million less than in 2021, but $95 million higher than in 2019, prior to the pandemic).

New York State's moratorium on disconnects has expired, and LIPA resumed disconnects in March 2023. Tapping into a state program, LIPA used about $10 million in state money and $15 million in internal funds to forgive arrears accumulated through May 1, 2022, for eligible low-income customers (the phase 1 forgiveness program).

LIPA subsequently adopted a phase 2 forgiveness program to eliminate arears through May 1, 2022, for remaining residential customers, capped at $2,000 per account, and extended its disconnect moratorium though March 1, 2023. LIPA estimates the phase 2 program affected about 44,000 customers, and cost the authority $42 million in bill credits, captured via LIPA's delivery service adjustment mechanism. LIPA has also extended the elimination of arrears to about 880 small commercial accounts at a modest additional cost.

A primarily outsourced, but flexible power supply

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 9% of 2022's retail energy requirements. The nuclear plant is co-owned with and operated by Constellation Energy Nuclear Group LLC, and has an operating license that expires in 2046. LIPA also purchases (under contract) about 6% of its energy needs from Exelon's Fitzpatrick nuclear plant.

Contractual agreements with National Grid USA and other energy providers, as well as economy market purchases, serve all needs beyond NM2. Importantly, the National Grid contract allows LIPA to purchase energy from resources other than National Grid's if they have lower costs, which we believe will be increasingly important as LIPA seeks to comply with the CLCPA. While the cost of reserving National Grid capacity does not abate when LIPA purchases power from others, LIPA can direct National Grid to remove generation and related capacity charges from the power supply agreement. National Grid provided 23% of LIPA's 2022 power supply, compared with 32% in 2021, as opportunities for economy purchases increased. The power supply agreement with National Grid expires in April 2028.

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.

Decarbonization goals could pressure rates, but cost recovery mechanisms should mitigate financial risk

In June 2019, New York enacted the CLCPA, directing the state's utilities to source 70% of their electricity from renewable resources by 2030 and 100% of their electricity from carbon-free resources by 2040. LIPA is voluntarily complying with this mandate.

Renewable and other carbon-free resources accounted for just 17% of LIPA's power supply in 2022 (behind-the-meter solar accounts for another 2%), but the introduction of offshore wind--beginning with the South Fork wind farm later in 2023--will add substantial amounts of renewable energy directly to LIPA's grid, although the cost of that wind will be shared pro rata by all customer in the state, and subject to completion risk.

Achieving the state-wide goals is envisioned through the addition of 9,000 MW of offshore wind by 2035; 6,000 MW of solar by 2025 (10,000MW by 2030); and 6,000 MW of battery storage by 2030.

We understand that the offshore wind and energy storage components will be undertaken by the New York State Energy Research and Development Authority on behalf of the state's utilities, with LIPA bearing 12.5% of the cost, which are not fully known at this time. LIPA would also be responsible for 1,310 MW of the state's distributed solar goal (behind-the-meter and feed-in tariffs) by 2030 and is almost 70% of the way toward meeting that goal.

We view the state's plan as aggressive in scale and proposed timeline. Moreover, achieving these goals will require substantial investment in transmission, and we note that transmission and offshore wind projects have historically faced significant opposition, resulting in project delays and/or cancellation. We also note the sizable amount and high cost of land needed to site the solar additions will tend to cause most of the future development to occur outside of LIPA's service territory. Importantly, however, the costs of complying with the CLCPA will be recovered via LIPA's power supply charge, and not subject to 2.5% revenue increase limitation, although they will likely impose further rate pressure.

Transitioning to a zero-emissions electric system means that LIPA will need to both add these new clean sources of energy and (via direction to National Grid) retire older, fossil-fueled power plants. Five combustion turbines are already slated to be retired in 2025. LIPA anticipates releasing its integrated resource plan later this year, providing options to meet these renewable targets and identifying the order, amount, and timing of additional fossil-fueled power plant retirements.

LIPA's almost $4 billion five-year capital plan ($862 million capital budget for 2023) includes about three-quarters of spending for T&D projects. LIPA anticipates debt financing 64% of the cost. 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.

Long Island Power Authority, New York--key credit metrics			
	--Fiscal year ended Dec. 31--		
	2022	**2021**	**2020**
Operational metrics			
Electric customer accounts	1,151,583	1,147,562	1,142,640
% of electric retail revenues from residential customers	53	55	54
Top 10 electric customers' revenues as % of total electric operating revenue	6	6	6
Service area median household effective buying income as % of U.S.	143	143	141
Weighted average retail electric rate as % of state	119	119	117
Financial metrics			
Gross revenues ($000s)	3,988,862	3,639,065	3,675,147
Total operating expenses less depreciation and amortization ($000s)	3,521,796	3,204,128	3,220,109
Debt service ($000s)	266,834	230,381	255,145
Debt service coverage (x)	1.8	1.9	1.8
Fixed-charge coverage (x)	1.2	1.2	1.2
Total available liquidity ($000s)*	1,399,890	1,455,497	1,400,761
Days' liquidity	145	166	159
Total on-balance-sheet debt ($000s)	7,571,605	7,915,452	7,647,890
Debt-to-capitalization (%)	92	93	93

*Total available liquidity includes available committed credit line balances, where applicable. Debt service coverage--Revenues minus expenses divided by debt service. Fixed-charge coverage--Sum of revenues minus expenses minus total net transfers out plus capacity payments (or their proxy), divided by the sum of debt service plus capacity payments (or their proxy). N.A.--Not available.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of July 20, 2023)		
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 (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

Ratings Detail (As Of July 20, 2023) (cont.)		
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 (CIFG)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.