FOR CONSIDERATION
March 28, 2017

TO: The Finance and Audit Committee of the Board of Trustees

FROM: Thomas Falcone

REQUEST: Recommendation of Approval of the 2016 Financial Report of the Utility Debt Securitization Authority

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Requested Action

The Finance and Audit Committee ("Committee") of the Board of Trustees ("Board") is being requested to recommend that the Board approve the proposed financial report section of the 2016 annual report of the Utility Debt Securitization Authority (the "Authority"), prepared in accordance with Section 2800(1) of the Public Authorities Law ("PAL"), in the form attached hereto as Exhibit B.

Background

Section 2800(1) of the PAL requires the Authority to submit an annual report to the Governor, the Chairman and ranking minority member of the Senate Finance committee, the Chairman and ranking minority member of the Assembly Ways and Means committee, the State Comptroller, and the Authorities Budget Office, within ninety days after the end of the Authority's fiscal year. The annual report includes, among other things, the Authority's financial report for the fiscal year just ended. Under Section 2800(1)(a)(2) of PAL, the financial report shall include the following: audited financials; grant and subsidy programs; operating and financial risks; current bond ratings; and long-term liabilities (the "Financial Report"). Section 2800(3) of PAL requires the Financial Report to be approved by the Trustees.

Recommendation

Based upon the foregoing, it is recommended that the Committee adopt a resolution in the form of the draft resolution attached hereto as Exhibit A.

Attachments
Exhibit A Resolution
Exhibit B Financial Report of the Utility Debt Securitization Authority

EXHIBIT A

RECOMMENDATION OF APPROVAL OF 2016 FINANCIAL REPORT OF THE UTILITY DEBT SECURITIZATION AUTHORITY

WHEREAS, Section 2800(1) of the Public Authorities Law ("PAL") requires public authorities such as the Utility Debt Securitization Authority (the "Authority") to prepare an annual report; and

WHEREAS, the Authority's annual report includes, among other things, a financial report, as defined under Section 2800(1)(a)(2) of PAL (the "Financial Report"); and

WHEREAS, the Authority has prepared its Financial Report, which, pursuant to Section 2800(3) of PAL, is subject to the approval of the Trustees;

NOW, THEREFORE, BE IT RESOLVED, that the Finance and Audit Committee of the Board of Trustees hereby recommends approval by the full Board of the 2016 Financial Report of the Utility Debt Securitization Authority, in the form presented at this meeting.

Exhibit B

Utility Debt Securitization Authority
Public Authorities Reporting Information System
Summary Financial Information
December 31, 2016

UTILITY DEBT SECURITIZATION AUTHORITY
(A Component Unit of the Long Island Power Authority)
Summary Financial Information
December 31, 2016

Summary Statement of Net Position		
<u>Assets</u>		
Current Assets		
Restricted cash	$	88,572,000
Investments		-
Receivables, net		39,436,000
Other assets		259,000
Total Current Assets		**128,267,000**
Noncurrent Assets		
Restructuring property		4,359,428,000
Other assets		24,319,000
Total Noncurrent assets		**4,383,747,000**
Total Assets	**$**	**4,512,014,000**
<u>Liabilities</u>		
Current Liabilities		
Accrued liabilities		17,510,000
Bonds and notes payable		72,598,000
Total Current Liabilities		**90,108,000**
Noncurrent Liabilities		
Bonds and notes payable		4,360,731,000
Total Noncurrent Liabilities		**4,360,731,000**
Total Liabilities		**4,450,839,000**
Net Position		
Restricted		61,175,000
		61,175,000
Total Net Position		
	$	**4,512,014,000**

UTILITY DEBT SECURITIZATION AUTHORITY
(A Component Unit of the Long Island Power Authority)

Summary Statement of Revenues, Expenses and Change in Net Position
For the year ended December 31, 2016

Operating Revenues		
Charges for services	$	278,975,000
Total Operating Revenue		**278,975,000**
Operating Expenses		
Depreciation and amortization		104,566,000
Other operating expenses		4,383,000
Total Operating Expenses		**108,949,000**
Operating Income		**170,026,000**
Nonoperating Revenues		
Other nonoperating revenues		225,000
Total Nonoperating revenues		**225,000**
Nonoperating Expenses		
Interest and other financing charges		164,574,000
Other nonoperating expenses		(29,896,000)
Total nonoperating expenses		**134,678,000**
Income Before Contributions		**35,573,000**
Capital Contributions		**-**
Change in net position		**35,573,000**
Net position beginning of year		25,602,000
Other net position changes		-
Net position at end of year	**$**	**61,175,000**

UTILITY DEBT SECURITIZATION AUTHORITY

Schedule of Bonds outstanding at December 31, 2016

	Beginning balance	Additions	Maturities	Ending balance
UDSA debt:				
Series 2013T	$ 482,934,000	—		482,934,000
Series 2013TE	1,434,390,000	—	60,000,000	1,374,390,000
Series 2015TE	1,002,115,000		—	1,002,115,000
Series 2016A	—	636,770,000	—	636,770,000
Series 2016B	—	469,320,000	—	469,320,000
Subtotal	2,919,439,000	1,106,090,000	60,000,000	3,965,529,000
Net unamortized premiums	267,883,000	232,293,000	32,376,000	467,800,000
Total bonds and unamortized premiums	$ 3,187,322,000	1,338,383,000	92,376,000	4,433,329,000

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Final Editorial Review Not Completed

UTILITY DEBT SECURITIZATION AUTHORITY

(A Component Unit of the Long Island Power Authority)

Basic Financial Statements

And Required Supplementary Information

December 31, 2016 and 2015

(With Independent Auditors' Report and

Report on Internal Control and Compliance Thereon)

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UTILITY DEBT SECURITIZATION AUTHORITY
(A Component Unit of the Long Island Power Authority)

Table of Contents

UTILITY DEBT SECURITIZATION AUTHORITY
(A Component Unit of the Long Island Power Authority)

Management's Discussion and Analysis

(Unaudited)

December 31, 2016 and 2015

Overview of the Financial Statements

The management's discussion and analysis of the Utility Debt Securitization Authority's (UDSA) financial performance provides an overview of the UDSA's financial information for the years ended December 31, 2016 and 2015. The discussion and analysis should be read in conjunction with the Basic Financial Statements which follow this section. The notes to the UDSA's Basic Financial Statements provide additional information on certain components of these statements.

The UDSA's financial statements are prepared on an accrual basis in accordance with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

Management's Discussion and Analysis
Of Financial Condition and Results of Operations

Nature of Operations

The UDSA was created by Part B of Chapter 173, Laws of New York, 2013 (as amended by Chapter 58 of the Laws of New York, 2015, the "Securitization Law"). The Securitization Law allowed for the retirement of certain outstanding indebtedness of the Long Island Power Authority (Authority) through the issuance of securitized restructuring bonds (Restructuring Bonds) by the UDSA. The Securitization Law permits the Authority's Board of Trustees (Board) to adopt financing orders pursuant to which the UDSA may issue Restructuring Bonds in an amount not to exceed a $4.5 billion statutory authorized amount (inclusive of any previously issued Restructuring Bonds). The Restructuring Bonds are to be repaid by an irrevocable, nonbypassable restructuring charge on all Authority customer bills. On October 3, 2013, the Authority's Board adopted Financing Order No. 1. On June 26, 2015, the Authority's Board adopted Financing Orders No. 2, No. 3 and No. 4, which allowed the UDSA to issue additional Restructuring Bonds during 2015 and 2016. All such financing orders are substantively the same and each permits the UDSA to issue Restructuring Bonds in an aggregate amount not to exceed the amount authorized by the Securitization Law. Each such financing order authorized Restructuring Bonds secured by a separate restructuring charge created pursuant to that financing order. Through the end of 2016, a total of $4.13 billion of UDSA Restructuring Bonds have been issued, with $369 million of statutory capacity remaining. A new financing order will be required to use the remaining capacity.

Below is a summary of the results of each Financing Order:

- *Financing Order No. 1.* On December 18, 2013, the UDSA issued $2.022 billion of 2013 Restructuring Bonds. The UDSA used the proceeds of the 2013 Restructuring Bonds to purchase the 2013 Restructuring Property, including the 2013 Restructuring Charge. The 2013 Restructuring Property was pledged by the UDSA to the payment of the 2013 Restructuring Bonds. The refunding produced an approximate $132 million of net present value savings. The 2013 Restructuring Bonds have an average life of 14.2 years and an all in cost of 4.22%.

- *Financing Order No. 2.* On October 27, 2015, the UDSA issued $1.002 billion of 2015 Restructuring Bonds. The UDSA used the proceeds of the 2015 Restructuring Bonds to purchase 2015 Restructuring Property, including the 2015 Restructuring Charge. The 2015

Restructuring Property was pledged by the UDSA to the payment of the 2015 Restructuring Bonds. The refunding produced an approximate $128 million of net present value savings. The 2015 Restructuring Bonds have an average life of 15.6 years and an all in cost of 3.40%.

- *Financing Order No. 3.* On April 7, 2016, the UDSA issued $636.8 million of 2016A Restructuring Bonds. The UDSA used the proceeds of the 2016A Restructuring Bonds to purchase 2016A Restructuring Property, including 2016A Restructuring Charge. The 2016A Restructuring Property was pledged by the UDSA to the payment of the 2016A Restructuring Bonds. The refunding produced an approximate $115.2 million of net present value savings. The 2016A Restructuring Bonds have an average life of 11.8 years and an all in cost of 2.70%.

- *Financing Order No. 4.* On September 8, 2016, the UDSA issued $469.3 million of 2016B Restructuring Bonds. The UDSA used the proceeds of the 2016B Restructuring Bonds to purchase 2016B Restructuring Property, including the 2016B Restructuring Charge. The 2016B Restructuring Property was pledged by the UDSA to the payment of the 2016B Restructuring Bonds. The refunding produced an approximate $71.6 million of net present value savings. The 2016B Restructuring Bonds have an average life of 6.9 years and an all in cost of 2.01%.

For a further discussion of the UDSA, see the notes to Basic Financial Statements.

UTILITY DEBT SECURITIZATION AUTHORITY
(A Component Unit of the Long Island Power Authority)

Management's Discussion and Analysis

(Unaudited)

December 31, 2016 and 2015

Financial Condition Overview

The UDSA's Statements of Net Position as of December 31, 2016, 2015, and 2014 are summarized below:

		(Amounts in thousands)		
		2016	**2015**	**2014**
Assets				
Current assets	$	128,267	51,041	61,143
Noncurrent assets		4,383,747	3,174,571	2,032,101
Total assets		4,512,014	3,225,612	2,093,244
Liabilities and Net Position				
Current liabilities		90,108	72,688	18,644
Noncurrent liabilities		4,360,731	3,127,322	2,019,340
Net position - restricted		61,175	25,602	55,260
Total liabilities and net position	$	4,512,014	3,225,612	2,093,244

2016 Compared to 2015

The primary changes in the UDSA's statement of financial condition as of December 31, 2016 and 2015 were as follows:

Assets

Current assets increased by $77 million compared to 2015 due primarily to increased cash and investment balances of $55 million and increased accounts receivable balances resulting from the two additional Financing Orders issued in 2016, which imposed two additional Restructuring Charges on utility customer bills.

Noncurrent assets increased by $1.2 billion compared to 2015 due to the issuance of the additional Restructuring Property under Financing Orders No. 3 and No. 4 (discussed in note 1 to the Basic Financial Statements).

Total Liabilities and Net Position

Current liabilities increased by $17 million compared to 2015 due primarily to higher scheduled maturities payable within one year as a result of the issuance of the 2016 Restructuring Bonds.

Noncurrent liabilities increased by $1.2 billion compared to 2015 due primarily to the issuance of the 2016A and 2016B Restructuring Bonds, totaling $783 million and $555 million, including premium, respectively (discussed in note 3 to the Basic Financial Statements).

2015 Compared to 2014

The primary changes in the UDSA's statement of financial condition as of December 31, 2015 and 2014 were as follows:

Assets

Current assets decreased by $10 million compared to 2014 due primarily to the lower accounts receivable balance. The Financing Order No. 1 Restructuring Charge, imposed on utility customer bills, decreased as a direct result of the lower 2015 debt service payments on Series 2013 Restructuring Bonds.

Noncurrent assets increased by $1.1 billion compared to 2014 due to the issuance of the additional Restructuring Property under Financing Order No. 2 (discussed in note 1 to the Basic Financial Statements).

Total Liabilities and Net Position

Current liabilities increased by $54 million compared to 2014 due to higher scheduled maturities due within one year. Also contributing to the increase is higher accrued interest resulting from the October 2015 issuance of the 2015 Restructuring Bonds.

Noncurrent liabilities increased by $1.1 billion compared to 2014 due to the issuance of the 2015 Restructuring Bonds totaling $1.002 billion plus premium (discussed in note 3 to the Basic Financial Statements).

UTILITY DEBT SECURITIZATION AUTHORITY
(A Component Unit of the Long Island Power Authority)

Management's Discussion and Analysis

(Unaudited)

December 31, 2016 and 2015

Results of Operations

The UDSA's Statements of Revenues, Expenses and Changes in Net Position for the years ended December 31, 2016, 2015 and 2014 are summarized as follows:

		(Amounts in thousands) 2016	2015	2014
Operating revenues	$	278,975	73,158	233,437
Operating expenses		108,949	18,108	96,730
Operating income		170,026	55,050	136,707
Interest charges and credits		(134,678)	(84,741)	(78,680)
Other income		225	33	4
Change in net position		35,573	(29,658)	58,031
Restriced net position – beginning of year		25,602	55,260	(2,771)
Restricted net position – end of year	$	61,175	25,602	55,260

2016 to 2015

Net Position

The net position and changes in net position reflect the timing differences between the accrual-based accounting required under generally accepted accounting principles and the ratemaking treatment followed by the UDSA. The UDSA's Restructuring Charge is set at an amount sufficient to recover the debt service payments and other cash operating expenses that the UDSA incurs in any given year, which may differ from the accrued revenues and expenses recognized. As shown below, the relevant information from the Statement of Cash Flows demonstrates the UDSA has been recovering a stable and consistent amount of revenue sufficient to meet all debt service obligations. The under or over recovery of net cash from current operations offsets any excess or underage in the previous year.

		(Amounts in thousands) 2016	2015	2014
Net cash provided by operating activities	$	254,698	92,213	192,092
Interest and other interest paid		(162,193)	(86,286)	(90,029)
Redemption of long-term debt		(60,000)	(15,000)	(90,000)
Net cash provided in (used in) current year	$	32,505	(9,073)	12,063

Operating revenues

Revenues increased by $206 million compared to 2015 due primarily to the two additional Financing Orders issued in 2016 plus the increase in the Restructuring Charge for Financing Order No. 1.

Operating expenses

Operating expenses increased by $91 million compared to 2015 due primarily to the higher amortization of Financing Orders No. 2, 3 and 4 Restructuring Property, which is amortized annually based on the total principal payments due plus premium amortization on the Restructuring Bonds.

Interest charges and credits

Interest charges and credits increased by $50 million compared to 2015 due to the issuance of the 2016A and 2016B Restructuring Bonds.

2015 to 2014

Operating revenues

Revenues decreased by $160 million compared to 2014 due primarily to the decrease in the Financing Order No. 1 Restructuring Charge from $0.013518 per KWh in 2014 to $0.003914 per KWh in 2015. The Restructuring Charge is directly related to 2013 Restructuring Bonds' scheduled debt service payments. Also, contributing to the decrease was the timing of the accrual for unbilled revenue.

Operating expenses

Operating expenses decreased by $79 million compared to 2014 due primarily to lower amortization of the Financing Order No. 1 Restructuring Property, which is amortized annually based on the total principal payments due plus premium amortization on the Restructuring Bonds. The UDSA's debt principal payments due in 2015 decreased by $75 million compared to 2014.

Interest charges and credits

Interest charges and credits increased by $6 million compared to 2014 due primarily to the October 2015 issuance of the 2015 Series Bonds, which resulted in two months of interest expense.

Cash and Liquidity

Included in current assets are the UDSA's restricted cash accounts totaling approximately $88.6 million, $33.5 million and $22.5 million at December 31, 2016, 2015 and 2014, respectively. The higher balance in 2016 compared to 2015 is due to the additional reserves required for the 2016 bond issuance (discussed in note 1 to the Basic Financial Statements).

UTILITY DEBT SECURITIZATION AUTHORITY
(A Component Unit of the Long Island Power Authority)

Management’s Discussion and Analysis

(Unaudited)

December 31, 2016 and 2015

Bond Ratings

Below are the UDSA’s securities as rated by Moody’s Investors Service (Moody’s), Standard and Poor’s Global Ratings (S&P), and Fitch Ratings (Fitch):

	Investment ratings		
	Moody’s	**S&P**	**Fitch**
UDSA Restructuring Bonds Series 2013	Aaa (sf)	AAA (sf)	AAA (sf)
UDSA Restructuring Bonds Series 2015	Aaa (sf)	AAA (sf)	AAA (sf)
UDSA Restructuring Bonds Series 2016A	Aaa (sf)	AAA (sf)	AAA (sf)
UDSA Restructuring Bonds Series 2016B	Aaa (sf)	AAA (sf)	AAA (sf)

Contacting the Utility Debt Securitization Authority

This financial report is designed to provide the UDSA’s bondholders, and other interested parties, with a general overview of the UDSA’s finances and to demonstrate its accountability for the funds it receives. If you have any questions about this report or need additional information, contact the Utility Debt Securitization Authority, in care of the Long Island Power Authority, at 333 Earle Ovington Blvd., Suite 403, Uniondale, New York 11553, or visit the UDSA’s website at www.lipower.org/UDSA.

Independent Auditors' Report

The Board of Trustees
Utility Debt Securitization Authority:

Report on the Financial Statements

We have audited the accompanying basic financial statements of the Utility Debt Securitization Authority (UDSA), a component unit of the Long Island Power Authority and the State of New York, which comprise the statements of net position as of December 31, 2016 and 2015, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these basic financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these basic financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the basic financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the basic financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the basic financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion on the Financial Statements

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the UDSA as of December 31, 2016 and 2015, and its changes in net position, and cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis and Required Supplementary Information be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2017 on our consideration of the UDSA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the UDSA's internal control over financial reporting and compliance.

(signed) KPMG LLP

New York, NY
March 28, 2017

UTILITY DEBT SECURITIZATION AUTHORITY

(A Component Unit of the Long Island Power Authority)

Statements of Net Position

December 31, 2016 and 2015

(Amounts in thousands)

		2016	2015
Assets			
Current assets:			
Restricted cash and cash equivalents	$	88,572	33,518
Accounts receivable (net of uncollectible accounts of $156 and $33)		39,436	17,201
Prepaid assets		259	322
Total current assets		128,267	51,041
Noncurrent assets:			
Restructuring property (net of accumulated amortization)		4,359,428	3,155,559
Regulatory asset - unamortized debt issuance costs		24,319	19,012
Total noncurrent assets		4,383,747	3,174,571
Total assets	$	4,512,014	3,225,612
Liabilities and Net Position			
Current liabilities:			
Current maturities of long-term debt	$	72,598	60,000
Accrued interest		14,693	12,257
Accrued expenses		2,817	431
Total current liabilities		90,108	72,688
Noncurrent liabilities:			
Long-term debt, including unamortized premium		4,360,731	3,127,322
Net position - restricted		61,175	25,602
Total liabilities and net position	$	4,512,014	3,225,612

See accompanying notes to financial statements.

UTILITY DEBT SECURITIZATION AUTHORITY

(A Component Unit of the Long Island Power Authority)

Statements of Revenues, Expenses, and Changes in Net Position

Years ended December 31, 2016 and 2015

(Amounts in thousands)

		2016	2015
Operating revenue	$	278,975	73,158
Operating expenses:			
Amortization of restructuring property		104,566	15,672
Provision for uncollectible accounts		1,713	846
Servicing, administrative and other fees		2,670	1,590
Total operating expenses		108,949	18,108
Operating income		170,026	55,050
Other income		225	33
		170,251	55,083
Interest charges:			
Interest expense		164,574	94,948
Other interest expense		316	20
Amortization of restructuring bond premium and issuance costs, net		(30,212)	(10,227)
Total interest charges		134,678	84,741
Change in net position		35,573	(29,658)
Net position, beginning of year		25,602	55,260
Net position, end of period	$	61,175	25,602

See accompanying notes to financial statements.

UTILITY DEBT SECURITIZATION AUTHORITY

(A Component Unit of the Long Island Power Authority)

Statements of Cash Flows

Years ended December 31, 2016 and 2015

(Amounts in thousands)

		2016	2015
Cash flows from operating activities:			
Operating revenues received	$	255,027	93,449
Paid to suppliers:			
General and administrative fees		(329)	(1,236)
Net cash provided by operating activities		254,698	92,213
Cash flows from investing activities:			
Restructuring property		(1,308,434)	(1,152,277)
Earnings received		225	34
Net cash used in investing activities		(1,308,209)	(1,152,243)
Cash flows from financing activities:			
Proceeds from issuance of restructuring bonds		1,338,384	1,179,662
Redemption of long-term debt		(60,000)	(15,000)
Interest paid		(162,139)	(86,286)
Other interest costs		(54)	—
Bond issuance costs		(7,626)	(7,311)
Net cash provided by financing activities		1,108,565	1,071,065
Net increase in restricted cash and cash equivalents		55,054	11,035
Restricted cash and cash equivalents, beginning of year		33,518	22,483
Restricted cash and cash equivalents, end of period	$	88,572	33,518

Reconciliation of operating income to net restricted cash provided by operating activities:

Operating income	$	170,026	55,050
Adjustments to reconcile operating income to net restricted cash provided by operating activities:			
Amortization of restructuring property		104,566	15,672
Changes in operating assets and liabilities:			
Prepaid assets and accrued expenses		2,341	354
Accounts receivable		(22,235)	21,137
Net restricted cash provided by operating activities	$	254,698	92,213

See accompanying notes to financial statements.

UTILITY DEBT SECURITIZATION AUTHORITY
(A Component Unit of the Long Island Power Authority)

Notes to Basic Financial Statements

December 31, 2016 and 2015

(amounts in thousands, unless otherwise stated)

(1) Summary of Significant Accounting Policies

(a) General

The Utility Debt Securitization Authority (UDSA) is a special purpose corporate municipal instrumentality, body corporate and politic, political subdivision and public benefit corporation of the State of New York, created by Part B of Chapter 173, Laws of New York, 2013 (as amended by Chapter 58 of the Laws of New York, 2015, the "Securitization Law").

The Securitization Law provided the legislative foundation for the issuance of restructuring bonds (Restructuring Bonds) by the UDSA. The issuance of Restructuring Bonds allows the Long Island Power Authority (Authority) to retire a portion of its outstanding indebtedness in order to provide savings to the Authority's utility customers on a net present value basis. The Authority is the owner of the electric transmission and distribution system located in the Counties of Nassau and Suffolk (with certain limited exceptions) and a portion of Queens County known as the Rockaways (Service Area), and is responsible for facilitating the supply of electricity to customers within the Service Area.

(b) Financial Reporting Entity

The Securitization Law prohibits the UDSA from engaging in any other activity except as specifically authorized by a financing order and provides that the UDSA is not authorized to be a debtor under Chapter 9 or any other provision of the Bankruptcy Code.

The financial statements of the UDSA have been prepared in conformity with accounting principles generally accepted in the United States of America applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The operations of the UDSA are presented as a proprietary fund following the accrual basis of accounting in order to recognize the flow of economic resources. Revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred. The basic financial statements and its accompanying notes cover the years ended December 31, 2016 and 2015.

Under GASB Statement No. 61, *The Financial Reporting Entity*, the UDSA is considered a blended component unit of the Authority. The assets, liabilities, and results of operations are consolidated with the operations of the Authority for financial reporting purposes.

(c) Use of Estimates

The accompanying financial statements were prepared in conformity with U.S. generally accepted accounting principles, which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(d) Accounting for the Effects of Rate Regulation

The UDSA is subject to the provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. GASB Statement No. 62 addresses accounting rules for regulated operations. This statement recognizes the economic ability of regulators, through the ratemaking process, to create future economic benefits and obligations affecting rate-regulated companies. Accordingly, the UDSA records these future economic benefits and obligations as regulatory assets or regulatory liabilities, respectively.

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, requires that debt issuance costs be expensed in the current financial period. As the UDSA charge provides recovery for debt issuance costs on a systematic basis over the life of the debt, the UDSA has classified these costs as a regulatory asset, in accordance with GASB Statement No. 62, to be collected over the life of the debt issuance to which they relate.

(e) Accounts Receivable

The UDSA receivables include amounts due from the customers served by the Authority and the accrual of unbilled revenue to be received in the subsequent year. The Authority accrues unbilled revenues by estimating unbilled consumption at the customer meter. Unbilled revenue for the UDSA totaled $15 million and $11 million as of December 31, 2016 and 2015, respectively.

Accounts receivable are classified as current assets and are reported net of an allowance for uncollectible amounts

(f) Restructuring Property

The Financing Orders, as adopted by the Authority's Board, authorized the creation of Restructuring Property and the issuance of Restructuring Bonds by the UDSA to provide funds for the purchase of Restructuring Property from the Authority. The Authority was authorized to use the proceeds from the sale of Restructuring Property to purchase, redeem, repay, or defease certain of its outstanding debt. Restructuring Property is defined as the right, title, and interest: (a) in and to rates and charges to recover from customers the debt service requirements on the Restructuring Bonds (referred to as Restructuring Charges); (b) in and to all revenues, collections, claims, payments, money, or proceeds of or arising from the Restructuring Charges, regardless of whether such revenues, collections, claims, payments, money, or proceeds are imposed, billed, received, collected, or maintained together with or commingled with other revenues, collections, claims, payments, money, or proceeds; and (c) in and to all rights to obtain adjustments to the Restructuring Charges. These nonbypassable consumption based Restructuring Charges are billed to all existing and future retail electric customers taking electric transmission or distribution service within the Service Area from the Authority or any of its successors or assignees. Restructuring Charges are established on behalf of the UDSA, and are not subject to oversight by the Public Service Commission, the Department of Public Service or any other regulatory body, including the Authority's Board. The Authority has lowered its rates to reflect the savings from the securitization and modified its rate structure to create restructuring offset charges, which are amounts equal to and opposite the Restructuring Charges, so that customer bills are less than they would have been absent the sale of Restructuring Bonds. The securitization offset charges will be adjusted along with changes to the Restructuring Charges, subject to true-up adjustments as discussed in note 3.

(amounts in thousands, unless otherwise stated)

The Restructuring Property is amortized annually based on principal payments due on the Restructuring Bonds. Also, included in the annual amortization is an amount equal to the bond premium amortization which is recorded using the effective interest rate method.

Below is a summary of the Financing Orders issued:

Financing Order	Date Issued		Initial Amount Issued	Restructuring Charge Rate Effective Date
Financing Order No. 1	December 18, 2013	$	2,022,324	March 1, 2014
Financing Order No. 2	October 27, 2015		1,002,115	January 1, 2016
Financing Order No. 3	April 7, 2016		636,770	April 7, 2016
Financing Order No. 4	September 8, 2016		469,320	September 8, 2016
		$	4,130,529	

(g) Revenues

The UDSA records revenue for Restructuring Charges under the accrual method of accounting in accordance with the imposed charges.

(h) Income Taxes

The UDSA is a political subdivision of the State of New York (State) and, therefore, is exempt from federal, state, and local income taxes.

(i) Recent Accounting Pronouncements

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units—an amendment of GASB Statement No. 14.* This Statement will change how certain component units incorporated as not-for-profit corporations should be presented in the financial statements of the primary state or local government. Specifically, such component units must be “blended into the primary state or local government’s financial statements in a manner similar to a department or activity of the primary government.” This Statement is effective for reporting periods beginning after June 15, 2016 and will not have a significant impact on the financial position or results of operations of the UDSA.

(2) Restricted Cash and Cash Equivalents

Restricted cash and cash equivalents consist of funds held in the UDSA’s restricted bank accounts to pay the principal, interest, and other expenses associated with the Restructuring Bonds. The UDSA has specific investment guidelines to address the legal and contractual requirement such that investment maturities are managed to meet the restructuring bonds debt service obligations.

The Trustee, under the indenture for each series of Restructuring Bonds, must maintain a segregated trust account for each series of Restructuring Bonds known as the Collection Account. The Collection Account for the bonds consists of four subaccounts: a General Subaccount, an Excess Funds Subaccount, Reserve Subaccounts, and an Upfront Financing Costs Subaccount. For administrative purposes, the subaccounts may be established by the Trustee as separate accounts, which will be recognized collectively as the Collection Account.

The Trustee shall have sole dominion and exclusive control over all money in each Collection Account and shall apply such money as provided in the Indenture. Each account shall remain at all times with a securities intermediary. Only the Trustee shall have access to the Collection Accounts for the purpose of making deposits to and withdrawals from such account. Funds in the Collection Accounts shall not be commingled with any other monies.

Reserve Accounts

The Reserve Subaccount related to the Series 2013 Restructuring Bonds was established at a reserve level of 0.5% of the initial principal amount of the Restructuring Bonds originally issued. Accordingly, the balance in the Series 2013 Reserve Subaccount totaled $10 million as of December 31, 2016 and 2015, respectively.

The Reserve Subaccount related to the Series 2015 Restructuring Bonds was established with two subaccounts - the Operating Reserve Subaccount and the Debt Service Reserve Subaccount. The Operating Reserve Subaccount was established at a reserve level of 0.5% of the initial principal amount of the Restructuring Bonds originally issued. The Debt Service Reserve Subaccount was established at a reserve level of 1.50% of the aggregate principal amount of the 2015 Restructuring Bonds then outstanding less the minimum principal amount due on any subsequent scheduled payment date. Accordingly, the balance in the Series 2015 Reserve Subaccounts totaled $20 million as of December 31, 2016 and 2015, respectively.

The Reserve Subaccount related to the Series 2016A and 2016B Restructuring Bonds were also established with two subaccounts - the Operating Reserve Subaccount and the Debt Service Reserve Subaccount. The Operating Reserve Subaccount was established at a reserve level of 0.5% of the initial principal amount of the Restructuring Bonds originally issued. The Debt Service Reserve Subaccount was established at a reserve level of 1.50% of the aggregate principal amount of the Restructuring Bonds then outstanding less the minimum principal amount due on any subsequent scheduled payment date. Accordingly, the balance in the Series 2016A Reserve Subaccounts totaled $13 million and the 2016B Reserve Subaccounts totaled $9 million as of December 31, 2016.

Risks

Credit Risk: The UDSA's permissible investments include (i) demand deposits and certificates of deposit, (ii) direct obligations of, or obligations guaranteed by the United States of America, (iii) commercial paper having a rating of not less than A-1, P-1, F1 at the time of the commitment, (iv) money market funds which have the highest rating available, (v) repurchase obligations that are a direct obligation of or obligation guaranteed by the United States of America, and (vi) repurchase obligations meeting the minimum ratings criteria set forth in the investment guidelines.

(amounts in thousands, unless otherwise stated)

Concentration of Credit Risk: The UDSA's investment policies have established limits such that no more than 5% of the investment portfolio may be invested in the securities of any one issuer except as follows: (i) U.S. Treasury Obligations; (ii) demand deposits, time deposits, or certificates of deposit and bankers' acceptance of eligible institution (as defined in investment guidelines) (iii) repurchase obligations with respect to any security that is a direct obligation of, or obligations guaranteed by, the United States of America; (iv) repurchase obligations with an eligible institution; and (v) money market funds which have the highest rating available. To the extent that more than 35% of the UDSA's total invested funds are invested with any single eligible institution, other than the Bond Trustee, the UDSA Board shall be notified. As of December 31, 2016, the UDSA money-market mutual fund was 100% invested in U.S. government obligations.

Custodial Credit Risk: The UDSA believes that custodial credit risk is minimal, as it is the UDSA's policy and practice, as stipulated in its investment guidelines, that its investments be held by only eligible institutions with investment grade credit ratings.

Interest Rate Risk: The UDSA's investment guidelines state that investments must mature on or before the business day preceding the debt service payment dates of the restructuring bonds and therefore, all investments are generally maturities of a short nature. As such, the UDSA presents its funds held in its money-market mutual funds as cash equivalents.

Below is a summary of the UDSA's restricted cash and cash equivalents as of December 31, 2016 and 2015:

Deposit/investment type		**2016 Fair value**	**Percent of portfolio**
Money-market mutual fund	$	88,572	100%
Cash		-	0%
Total	$	88,572	100%

Deposit/investment type		**2015 Fair value**	**Percent of portfolio**
Money-market mutual fund	$	13,431	40%
Uncollateralized deposits		20,087	60%
Total	$	33,518	100%

(amounts in thousands, unless otherwise stated)

(3) Long-Term Debt

The Financing Orders adopted by the Authority's Board authorize the issuance of Restructuring Bonds by the UDSA to provide funds for the purchase of Restructuring Property from the Authority.

The Restructuring Bonds are consolidated on the Authority's financial statements, however they are not direct obligations of the Authority, PSEG Long Island (the Authority's service provider), or any of their affiliates. The Restructuring Bonds are also not a debt and do not constitute a pledge of the faith and credit or taxing power of the State or of any county, municipality, or any other political subdivision, agency, or instrumentality of the State other than the UDSA.

Each Restructuring Property (2013, 2015, 2016A and 2016B) secures only their respective Restructuring Bonds and does not secure Restructuring Bonds of any of the other Series. In each restructuring transaction, the Authority used the net proceeds from the sale of the Restructuring Property to retire debt and other obligations of the Authority producing net present value savings to the Authority's customers.

Interest payments on all the Restructuring Bonds are paid semiannually every June 15^{th} and December 15^{th}. Restructuring Charges are set to collect amounts sufficient to pay principal of, and interest on the bonds on a timely basis and any ongoing financing costs.

Below is the UDSA's schedule of capitalization for the period ended December 31:

	Year of maturity	**Interest rate**		**2016**	**2015**
UDSA Restructuring Bonds:					
Series 2013T	2019–2023	2.04%-3.44%	$	482,934	482,934
Series 2013TE	2016–2039	5.00%		1,374,390	1,434,390
Series 2015	2021–2035	3.00%-5.00%		1,002,115	1,002,115
Series 2016A	2023–2033	5.00%		636,770	-
Series 2016B	2017–2033	4.00%-5.00%		469,320	-
Total Par Outstanding				3,965,529	2,919,439
Unamortized premium				467,800	267,883
Less current maturities				(72,598)	(60,000)
Total long-term debt			$	4,360,731	3,127,322

(amounts in thousands, unless otherwise stated)

The debt service requirements for the UDSA's bonds as of December 31, 2016 are as follows:

Due		Principal	Interest		Annual debt service Requirements
2017	$	72,598	192,213	$	264,811
2018		122,803	182,220		305,023
2019		130,761	177,906		308,667
2020		122,622	174,542		297,164
2021		157,174	169,942		327,116
2022–2026		945,861	727,424		1,673,285
2027–2031		1,141,690	478,740		1,620,430
2032–2036		903,750	192,604		1,096,354
2037–2040		368,270	35,332		403,602
Total	$	3,965,529	2,330,923	$	6,296,452

The Restructuring Bonds are subject to sinking fund requirements beginning in 2017.

(4) Significant Agreements and Related-Party Transactions

The Authority acts as the initial Servicer of the applicable Restructuring Property pursuant to the terms of a Servicing Agreement with the UDSA executed in connection with each issuance of Restructuring Bonds. Under the Servicing Agreement entered into by the Authority and the UDSA, concurrently with the issuance of the Restructuring Bonds, the Authority, as Servicer, is required to manage and administer the UDSA bondable Restructuring Property and to collect the Restructuring Charges on the UDSA's behalf. However, pursuant to the Authority's Amended and Restated Operation Services Agreement, PSEG Long Island, among other things, performs the billing and collections, meter reading, and forecasting required of the Servicer under the Servicing Agreement. The Authority is responsible for taking all necessary action in connection with true-up adjustments (described below) and certain reporting requirements.

The Restructuring Charges will be adjusted (true-up adjustment) at least annually and, if determined by the Servicer in connection with a midyear review process to be necessary, semiannually or more frequently, to ensure that the expected collections of the Restructuring Charges are adequate to timely pay all scheduled payments of principal and interest on the Restructuring Bonds and all other ongoing financing costs when due.

During 2016 and 2015, the UDSA reset its Restructuring Charge on all its Restructuring Bonds during the midyear review.

Under the Financing Orders, the Authority withholds from the Restructuring Charge collections an annual servicing fee equal to 0.05% of the initial principal amount of the Restructuring Bonds originally issued.

(5) Subsequent Events

In connection with the preparation of the financial statements, management has evaluated subsequent events from December 31, 2016 through March 28, 2017, which was the date the financial statements were available for issuance, and concluded that no additional disclosures or adjustments to the financial statements were necessary.

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Board of Trustees
Utility Debt Securitization Authority:

We have audited, in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the basic financial statements of the Utility Debt Securitization Authority (UDSA), which comprise the statements of net position as of December 31, 2016 and 2015, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the basic financial statements, and have issued our report thereon dated March 28, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the basic financial statements as of and for the year ended December 31, 2016, we considered the UDSA's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the UDSA's internal control. Accordingly, we do not express an opinion on the effectiveness of the UDSA's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such, that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weakness. However material weakness may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the UDSA's basic financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the UDSA's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the UDSA's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

(signed) KPMG LLP

New York, NY
March 28, 2017