

FITCH RATES LONG ISLAND POWER AUTHORITY, NY'S SER 2017 ELECTRIC SYSTEM GEN REVS 'A-'; OUTLOOK STABLE

Fitch Ratings-New York-22 November 2017: Fitch Ratings has assigned an 'A-' rating to the Long Island Power Authority, NY's (LIPA) issuance of \$350 million, series 2017 electric system general revenue bonds.

Bond proceeds will be used to fund capital expenditures and pay costs of issuance. The fixed rate, 2017 bonds are scheduled to price Nov. 30, 2017 with serially maturing bonds due Sept. 1, 2021-2037, and term bonds due Sept. 1, 2042 and 2047.

Fitch has also affirmed the 'A-' ratings on the following LIPA debt and commercial paper bank notes (as of Dec. 31, 2016):

- \$3.5 billion, senior lien electric system revenue and refunding bonds;
- implied electric system revenue subordinate obligations;
- \$200 million CP notes series 2014 -1A and 1B (bank notes);
- \$100 million CP notes series 2014 CP-2A and 2B (bank notes).

The Rating Outlook is Stable.

The CP bank note rating is assigned to LIPA's series 2014 commercial paper notes but will only become applicable if the notes cannot be remarketed and are purchased by the bank providing the corresponding letters of credit.

LIPA's debt rating takes into account the \$4.5 billion in currently outstanding securitization bonds, issued by the Utility Debt Securitization Authority (UDSA) to retire a portion of LIPA's existing debt. Revenues collected by LIPA to pay debt service on the securitization bonds (a non-bypassable consumption based surcharge) are not subject to the lien of the general or subordinated general resolutions.

SECURITY

The electric system general revenue bonds are senior lien obligations of LIPA secured by the net revenues of the electric system, after payment of operating and maintenance expenses. LIPA's subordinate lien general revenue obligations are also secured by the net revenues of the electric system, but are subordinate to payments on LIPA's outstanding \$3.5 billion in senior lien electric revenue bonds and floating rate notes. The subordinate lien long-term rating is implied as there are no bonds currently outstanding.

KEY RATING DRIVERS

SOLID UTILITY FUNDAMENTALS: LIPA is one of the nation's largest municipal electric distribution systems, serving 1.1 million retail customers. The authority benefits from a flexible power supply mix, an affluent and well-diversified customer base and cost recovery mechanisms that stabilize cash flow. A series of comprehensive operating agreements with capable external service providers further support operations.

REGULATORY OVERSIGHT: LIPA operates within the regulatory oversight of the New York State Department of Public Service (DPS), pursuant to the 2013 LIPA Reform Act. Fitch

views many of the legislated provisions of the LIPA Reform Act as supportive of credit quality. However, added regulatory oversight could affect LIPA's financial and rate flexibility over time.

CONSTRUCTIVE REGULATORY FRAMEWORK: The recommendations submitted by the DPS to date have been reasonable and included LIPA's initial three-year rate plan, annual distribution rate updates, and support for LIPA's public power model and power supply strategy. Although the initial rate recommendations and the staged updates (2016-2017) of the rates have reduced LIPA's revenue increases, the DPS continues to support LIPA's sound long-term financial goals, policies, and varied cost recovery mechanisms.

RATE PRESSURES PERSIST: While electric rates have become more competitive regionally, political and consumer rate pressures persist as LIPA's average residential revenue per kilowatt hour (kwh) remains high relative to the rest of the nation at approximately 18.9 cents/kwh for 2016.

HIGH DEBT LEVELS: As of Sept. 30, 2017, LIPA's debt levels, including capital lease and securitization obligations, remain high totaling \$10.4 billion, and net debt to adjusted funds available for debt service at 9.6x is well above the peer utility median of 6.5x. While Fitch recognizes the benefits of the separately secured \$4.5 billion in securitized debt, the repayment profile remains an obligation and burden of current ratepayers. Positively, LIPA's three-year rate plan aims to reduce debt financing of future capex which will moderate future borrowings.

ADEQUATE LIQUIDITY: For fiscal year end 2016, LIPA's internal liquidity was adequate at 92 days operating cash, although below the rating category median of 137 days. Positively, days liquidity, which incorporates available external bank lines, rises to 202 days, in-line with their peers.

RATING SENSITIVITIES

IMPROVED OPERATING STABILITY: A sustained trend of improved operating and financial performance, in particular a material decline in leverage, at the Long Island Power Authority, sufficient to offset political and consumer-driven rate pressures, could result in consideration of a positive rating action over the long-term.

CREDIT PROFILE

LIPA owns one of the largest municipal electric distribution systems in the U.S., serving a population of about 3 million people located throughout Nassau and Suffolk counties, and the Rockaways section of New York City. The service area economy continues to exhibit well above average wealth and income levels. Unemployment in Nassau and Suffolk Counties (general obligation debt rated 'A'/Outlook Stable and 'A-'/Outlook Stable, respectively) are in-line or below that of the state and nation. LIPA's retail rate competitiveness and service reliability continue on an improving trend since 2013.

LIPA owns the electric transmission and distribution (T&D) system located in its service territory. However, since its inception in 1998, operation and maintenance of the T&D system has been contracted for with external providers. Maintenance of the T&D system is currently contracted with PSEGLI, a subsidiary of Public Service Enterprise Group (PSEG, Issuer Default Rating 'BBB+'/'Negative Outlook'), pursuant to an amended and restated operating services agreement that extends to Dec. 31, 2025. PSEGLI is paid a management fee and can earn performance incentives.

LIPA's power supply agreement (PSA) remains with National Grid, plc, to provide capacity and energy from its oil and gas-fired generating units on Long Island. The PSA provides LIPA

with access to approximately 3,700 MW of on-island generation owned by National Grid. This agreement is in place through May 2028.

UPDATED POWER SUPPLY PLAN

LIPA completed its integrated resource plan (IRP) in 2017, which concluded that LIPA's long-term (2030) power supply requirements have considerably declined, by 1,700 MW. This decline reflects projected load growth that is anticipated to be more than offset by energy efficiency initiatives and renewable energy resources. LIPA's load and energy sales growth are projected to decline by approximately 1% by 2021, as the authority aims to meet the state's cleaner energy goals. NYS has set a renewable target of 50% by 2030. While LIPA is not directly subject to this mandate, the authority strives to meet the state's objectives. LIPA projects it will not need new baseload generation until 2030.

SUMMARY FINANCIAL PERFORMANCE

LIPA's operating cash flow weakened over the past four fiscal years, largely due to the authority's self-imposed three-year base rate freeze (2013-2015), storm costs, and lower kwh sales. Fitch calculated funds available for debt service (FADS), which Fitch adjusts for non-cash storm cost accruals, capitalized lease payments and payments in lieu of taxes, has declined from \$1.48 billion in FY2012 to \$1.24 billion in FY2016. Annual debt service, including the capitalized lease payment, has remained relatively flat at approximately \$890 million, but with the declining FADS has resulted in tightened debt service coverage from 1.61x in fiscal 2012 to 1.39x in 2016. Similarly, Fitch's coverage of full obligations which conservatively incorporates the authority's PILOT payments and a fixed portion of purchased power expense as fixed obligation, has fallen from 1.21x in 2012 to 1.02x in 2016, below the Fitch median for comparably rated retail systems (1.37x). The coverage of full obligations excludes grant income and refunded debt maturities in each fiscal year.

LIPA's leverage remains high relative to their peers. Total debt obligations have risen gradually over time and stand at \$10.6 billion at year-end 2016, including the authority's electric system revenue bonds, capitalized lease obligations (\$2.2 billion) and securitized restructuring bonds (\$4.5 billion). While Fitch recognizes the cost benefit and non-recourse nature of the securitized bonds, the repayment profile remains an obligation of the same LIPA customers. Net debt to adjusted FADS, which measures net debt (including off-balance sheet obligations) relative to the margins available to service the debt, is 9.6x, which is high compared to their peer median of 6.5x. Positively, LIPA's is targeting debt financing 64% or less of capex, or \$1.3 billion through 2019, aimed at moderating future borrowings.

LIPA's financial metrics should improve in 2017-2018 as the remaining distribution rate increases are implemented, and debt service and other cost savings are recognized. Additionally, LIPA has received DPS support to utilize a revenue decoupling mechanism (similar to corporate counterparts in the state) to mitigate the impact of the declining kwh sales as cleaner energy initiatives are implemented. Annual revenues are projected to rise by a total of \$176.9 million through 2018. LIPA's current three-year rate plan extends through 2018. LIPA does not anticipate another three-year revenue requirement review by the DPS until post-2019.

LIBERAL BOND COVENANTS

Bond covenants are fairly liberal, with a sum sufficient rate covenant, no debt service reserve fund, and no historical or projected debt service coverage test for the issuance of additional bonds. However, the Authority's bank LOC reimbursement agreements require LIPA to maintain a rate stabilization fund, the balance of which is not less than \$150 million, or the equivalent of roughly half of the 2016 debt service for the senior lien bonds.

Contact:

Primary Analyst
Lina Santoro
Analytical Consultant
+1-212-908-0522
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Dennis Pidherny
Managing Director
+1-212-908-0738

Committee Chairperson
Kathy Masterson
Senior Director
+1-512 215-3730

Media Relations: Sandro Scenga, New York, Tel: +1 212-908-0278, Email:
sandro.scenga@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria

Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017)

<https://www.fitchratings.com/site/re/898969>

U.S. Public Power Rating Criteria (pub. 18 May 2015)

<https://www.fitchratings.com/site/re/864007>

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2017 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or

a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001