FitchRatings

RATING ACTION COMMENTARY

Fitch Rates LIPA Electric System Rev Bonds 'A+'; Outlook Stable

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Fitch Ratings - New York - 19 Jul 2024: Fitch Ratings has assigned an 'A+' rating to the following Long Island Power Authority, NY (LIPA) bonds:

--Approximately $737 million electric system general revenue bonds series 2024A;

--Approximately $285 million electric system general revenue bonds series 2024B (fixed rate mandatory tender bonds);

Proceeds from the series 2024A and 2024B bonds will be used to fund system improvements, refund certain outstanding bonds and pay the costs of issuance. The series 2024A bonds will be sold with a fixed rate and amortize through 2054. The series 2024B bonds will be issued as multi-modal bonds and initially sold with a fixed interest rate through the mandatory tender date. The bonds are expected to be priced the week of Aug. 5, 2024.

Fitch has also upgraded the following LIPA ratings to 'A+' from 'A':

--Issuer Default Rating (IDR);

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

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT ⬍	RATING ⬍	PRIOR ⬍

Long Island Power Authority (NY)	LT IDR	A+ Rating Outlook Stable	Upgrade	A Rating Outlook Positive
Long Island Power Authority (NY) /Electric System Revenues/1 LT	LT	A+ Rating Outlook Stable	Upgrade	A Rating Outlook Positive

VIEW ADDITIONAL RATING DETAILS

The upgrade to 'A+' reflects LIPA's improved leverage ratio and Fitch Ratings' expectation that the gradual but consistent deleveraging trend that began in 2015 will continue through 2028. Leverage, measured by net adjusted debt to adjusted funds available for debt service (FADS), improved to 7.8x at YE 2023 from 8.8x five years prior. The improvement is in part attributable to LIPA's strategy of budgeting to achieve higher fixed-obligation coverage.

Fitch expects leverage ratios to trend toward 7.0x through 2028, consistent with the upgraded rating, as performance continues to benefit from LIPA's revenue-decoupling mechanism (RDM), timely cost recovery and modest but consistent rate increases designed to achieve higher fixed-charge coverage.

LIPA's very strong service area, 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 pursuant to an updated operating services agreement (OSA) with system operator PSEG Long Island (PSEGLI) are reasonably successful and factored in the rating.

A legislative commission's plan for LIPA to adopt a public power model, whereby LIPA would directly operate the utility system upon termination of the OSA in 2025, appears to have stalled in the New York State legislature. The authority expects to continue outsourcing operation of the system after the expiration of the current OSA at YE 2025, eliminating any near-term risk of change in management structure. While the recent departure of several members of the authority's senior management team, including LIPA's CEO, is a concern, the authority has indicated its intent to preserve its strategic objectives and policies on fiscal sustainability.

SECURITY

The series 2024A and 2024B 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'

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 LIPA's legal ability to determine rates and its affordable cost of electric service, as well as its ability to recover roughly 80% of costs through rate mechanisms, and offset variability in energy sales through its RDM that adjusts for any difference between actual and budgeted revenues.

Rate increases over 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 in 2015.

Operating Risk - 'bbb'

Operating risk is assessed as midrange, reflecting operating costs well above the national average, and ranging between 15 cents/kWh 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 fell to 16.6 cents/kWh in 2023 from 19.2 cents/kWh in 2022 as a result of lower natural gas prices and power supply costs.

LIPA's power supply portfolio is well diversified and comprises purchased capacity from units located on Long Island and elsewhere that comfortably meet the area's peak demand. 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.

Plans to add sizable amounts of contracted off-shore wind, and solar capacity, are expected to diversify the authority's portfolio further and comply with New York State's clean energy goals. Capital spending is elevated at roughly $4.8 billion over the next five years, and will focus on improving system resilience and reliability, and supporting modest load growth.

Financial Profile - 'a'

Lower leverage of 7.8x and stable coverage of full obligations of 1.23x in 2023 reflect a series of base rate increases and the resulting improvement in FADS, together with strong and stable cash on hand. Unrestricted cash totaled $1.33 billion at the end of 2023, or 229 days. Liquidity facilities provide additional liquidity totaling 377 days on hand.

Fitch's scenario analysis indicates leverage is expected to continue trending below 8.0x, and eventually closer to 7.0x, which is consistent with the financial profile assessment and the upgraded rating. While leverage ratios could push higher in stress scenarios involving significantly lower sales, any weakness is expected to be temporary given LIPA's flexibility under the RDM to recover lost revenue.

Fitch expects liquidity to remain robust and coverage to be within historical ranges in its rating case scenario. Fitch's key financial ratios and analysis include consideration of LIPA's approximately $3.5 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 sustain leverage approximating 8.0x in Fitch's rating case scenario;

--Failure to adhere to stated policies related to financial sustainability, including fixed charge coverage targets;

--Failure to implement rate increases consistent with its financial budget;

--Any change in management structure, strategic objectives or financial policies, or failure to procure adequate service provider arrangements, that increases operating or financial risk, and/or weakens credit quality.

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

--A sustained reduction in leverage below 7.0x in Fitch's rating case scenario;

--Demonstrated operating stability and strong performance across the system's external service providers.

PROFILE

LIPA owns one of the largest municipal electric distribution systems in the U.S., serving approximately three million people 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, system O&M and significant responsibilities for power supply are contracted 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.

LIPA intends to preserve the continuity of its business model and recently issued a request for proposal to identify the future service provider for the OSA and power supply management and fuel management services. The authority expects to complete the selection process in mid-2025 to allow for a transition (if necessary), and ensure continuous service.

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 3,900MW of on-island generating capacity 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 Sector, Revenue-Supported Entities Rating Criteria (pub. 12 Jan 2024) (including rating assumption sensitivity)

U.S. Public Power Rating Criteria (pub. 08 Mar 2024) (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

Endorsement Policy

ENDORSEMENT STATUS

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