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Ratings

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Long Island Power Authority, New York; Joint Criteria; Retail Electric

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US$737.305 mil elec sys gen rev bnds ser 2024A due 09/01/2054		
Long Term Rating	A/Stable	New
US$285.22 mil elec sys gen rev bnds ser 2024B due 09/01/2054		
Long Term Rating	A/Stable	New

Credit Highlights

- S&P Global Ratings assigned its 'A' ratings to the Long Island Power Authority (LIPA or the authority), N.Y.'s proposed $737.05 million tax-exempt electric system general revenue bonds, series 2024A, and $285.22 million taxable electric system general revenue bonds, series 2024B.
- At the same time, S&P Global Ratings affirmed its 'A' rating on the authority's existing revenue bonds, ($5.2 billion outstanding at Dec. 31, 2023), and its 'AA+/A-1' rating on the authority's series 2023D bonds ($128 million outstanding).
- The outlook is stable.

Security

The proposed and existing revenue bonds are secured by a net revenue pledge of LIPA's electric system. The series 2023D bonds are jointly supported by LIPA's net revenue pledge and a letter of credit from Barclays Bank, PLC. The authority pays debt service on its revenue bonds and joint support debt from the revenues remaining after paying the operating expenses of the electric system.

The series 2024A bonds will be issued as fixed rate obligations, with new money and refunding components. The series 2024B refunding bonds are being issued as multimodal "soft put" bonds, initially bearing interest at a fixed rate, subject to mandatory tenders at the end of each term mode interest rate period, at the option of LIPA, and on any mode change date. We do not consider the soft put to be a contingent liability for LIPA; in the event that LIPA is unable to fully remarket the tendered bonds, the bonds will remain with existing bondholders, and no event of default will occur, although the bonds would then carry a higher interest rate (between 6% and 8%) until they can be remarketed or refunded.

We assigned our rating to 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" criteria, published April 14, 2022, which delineates S&P Global Ratings' methodology for assessing the impact of securitized debt. (As of Dec. 31, 2023, LIPA had $3.7 billion of securitized debt outstanding, issued by its component unit, the Utility Debt Securitization Authority (UDSA). The UDSA debt is secured by an irrevocable, non-bypassable 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 PSEG Long Island (PSEGLI), a subsidiary of the Public Service Enterprise Group, under a contract that expires Dec. 31, 2025. PSEGLI receives from LIPA a management fee and passes through the operating costs of its ServCo subsidiary, which handles the day-to-day operations of the utility (see Credit Opinion for further detail).

The New York State Legislature went through a multiyear process where it evaluated alternative governance models for LIPA with a stated goal of moving toward a traditional public power model where LIPA, not a third party, would manage the operations of the utility. That process resulted in a bill introduced in the New York State Assembly, but the bill failed to advance through the legislative process. Since LIPA's management contract with PSEG Long Island expires at the end of 2025, LIPA moved ahead with a competitive request for proposal (RFP) for a new 10-year, third-party management contract. Responses are due in September 2024, with selection and state approvals to be completed by June 2025, leaving a six-month transition period before the new contract would need to take effect, Jan. 1, 2026.

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

- A large, predominantly residential, and affluent customer base, contributing to revenue stability and predictability. However, despite above-average incomes, high retail rates limit rate-raising flexibility, although they are competitive with those of other large power providers in the region.
- Fixed cost coverage (FCC) has been stable and supportive of the rating, averaging 1.23x in the past three years. Based on LIPA's financial forecast, we expect FCC will remain at this level in the next five years.
- Liquidity is sound, with unrestricted cash and undrawn capacity on credit lines measuring 192 days of operating expenses in 2023.

The rating also reflects our view of the following credit risks:

- LIPA faces operational and governance uncertainty. Its day-to-day operations are managed by the PSEGLI, under a contract that expires Dec. 31, 2025. A bill seeking to change LIPA's governance model was not advanced during the state's 2024 legislative session, and the CEO, COO, and CFO subsequently resigned. Although these positions have since been filled (and in the CEO's case, on an interim basis) by executives with solid backgrounds and experience, the impact of the management transition remains unclear--particularly as it relates to planning, oversight of PSEGLI, and the new contract with a (potentially new) third-party operator.
- LIPA's power supply is also transitioning, as the utility seeks to comply with New York State's ambitious decarbonization mandate, the Climate Leadership and Community Protection Act (CLCPA). The CLCPA directs 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. We believe that achieving this will be very challenging as it will depend on the progress of renewable buildout both onshore and offshore of Long Island, which we view as very uncertain, as well as new technologies that have yet to be developed. Nevertheless, we note that these risks are largely the same for LIPA as for other utilities in New York.

- Although LIPA's board retains final rate-setting power, the authority is required to submit any proposed base 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 CLCPA, and decouples budget-to actual revenue variances for any reason, including economic conditions such as write-offs. The authority's 2024 budget anticipated that these pass-throughs would contribute to a 12% year-over-year increase to the typical residential ratepayer bill for 2024.
- LIPA's transmission and distribution (T&D) system is highly leveraged. Excluding the separately secured UDSA debt, the authority has $5.6 billion of debt and lease obligations outstanding, measuring 90% of total capitalization. Capital needs are sizable (almost $4.8 billion over 2024-2028, with nearly 60% expected to be debt financed). While we anticipate debt to capitalization will gradually decline over the next five years, we expect that LIPA will remain highly leveraged.

Environmental, social, and governance

We believe that environmental risks exert a negative influence on the rating. The utility's power supply is in transition, in step with the rest of New York State. 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 other New York utilities face this risk as well. In addition, the service territory's extensive coastal exposure heightens susceptibility to storm damage and rising tides attributable to climate change. LIPA has incurred more than $700 million in storm costs since 2015. A substantial portion of these costs were covered by FEMA reimbursements, which together with mitigation grants also provided by FEMA were used to fund storm hardening, reliability, and resiliency capex--and possibly contributing to substantially lower storm costs incurred in the two most recent years.

We view social risk as also having a moderately negative influence on the rating. Although LIPA's weighted-average retail rate was 12% above the state average in 2022, well-above average incomes temper rate affordability risk. Nevertheless, while we understand that LIPA's retail rates are competitive for large downstate utilities in New York and throughout the region, they are high in absolute terms, and we believe that this modestly constrains rate-raising flexibility.

We continue to monitor the strength and stability of electric utilities' revenue streams for evidence of delinquent payments or other revenue erosion. Inflation as measured by the Consumer Price Index has remained above 3% in recent months, and S&P Global Economics forecasts elevated interest rates persisting at least until December. (See "Economic Outlook U.S. Q3 2024: Milder Growth Ahead," published June 24, 2024, on RatingsDirect). In addition, Bureau of Labor Statistics data shows that electricity price inflation continues to outpace the overall CPI. The combination of material increases in delinquent consumer, credit card, and auto loans, along with the resumption of student loan payments and drawdowns of household savings garnered during the pandemic, will likely compound the financial pressures facing electricity consumers.

We associate governance risk with the utility because of the requirement that LIPA must litigate rate adjustments that seek to increase base rate revenue by more than 2.5% per year. This threshold has not been breached in the past six years, and we believe that several pass-through and decoupling mechanisms diminish the potential need to exceed the threshold.

In our view, governance risk is also elevated, given the uncertainty related to the expiring operating contract with PSEGLI, the recent resignations of key executives, and unsatisfactory contractor responses following extreme weather events, which raises questions about controls under outsourcing arrangements.

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 high income levels, which suggest modest rate-raising flexibility despite already high rates.

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 there are significant further changes to LIPA's senior leadership, possibly suggesting internal turmoil and compounding risks related to LIPA's ongoing operational management, both of which could become an impediment to executing on strategic plans.

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 third-party management of day-to-day operations, a sizable capital program, and the uncertain costs of decarbonization.

Credit Opinion

A deep and diverse service area underpins creditworthiness

One of 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.

A unique business model, with day-to-day- operations outsourced under a contract that expires in 2025, introducing credit risk.

LIPA outsources the management of its operations to a for-profit, investor-owned utility. Day-to-day operations are managed by PSEGLI, under an Operations and Service Agreement (OSA) that went into effect in 2014 and expires Dec. 31, 2025.

ServCo, a subsidiary of PSEGLI, provides substantially all operational services under the OSA, via its 2,600 employees, which include the remaining legacy Long Island Lighting Co. and National Grid employees that transitioned employment to ServCo upon effectiveness of the 2014 OSA. Salaries and benefits of the ServCo employees are pass-through expenditures to LIPA. LIPA's power supply and fuel procurement are managed by a PSEG affiliate.

LIPA's responsibilities include policymaking, planning and oversight, rate setting, legal, IT, and financing responsibilities for the transmission and distribution system.

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. 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. As PSEGLI fully met just 69% of key performance metrics, (with the most notable shortcomings in the areas of customer service and IT), LIPA withheld a portion of PSEGLI's compensation in 2023.

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.

However, after the New York State Assembly decided not to enact legislation to convert LIPA's business model from third-party operation and management to in-house operation and management, LIPA issued an RFP for a new 10-year OSA. In our view, LIPA is facing a tight timeframe to bid out a new OSA as it seeks changes to the OSA, shifting certain risks from LIPA's ratepayers to a prospective third-party operator. We also believe that there is uncertainty as to whether PSEGLI and other qualified operators will submit bids, and at what cost.

A primarily outsourced, flexible power supply

LIPA's power supply comes from its 18% ownership stake (229 MW) in Nine Mile Point Nuclear Unit 2 (NMP2), which provides a nominal 10% of the utility's energy supply; a power supply agreement with "Genco," a subsidiary of investor-owned National Grid (3,513 MW); and purchased power contracts (2,070 MW) with on- and off-island generators.

In 2023, NMP2 provided about 10% of LIPA'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 and other energy providers, as well as economy market purchases, serve all needs beyond NMP2. Of importance, the National Grid contract allows LIPA to purchase energy from sources other than National Grid if they have lower costs, which we believe will be increasingly important as LIPA seeks to comply with the CLCPA. Although 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 22% of LIPA's 2023 power supply, compared with 32% in 2021, as opportunities for economy purchases increased. The power supply agreement with National Grid expires in April 2028.

LIPA's 2023 integrated resource plan envisioned the retirement of seven gas-fired units (up to 1,332 MW). These units are currently running at very low capacity factors and would be replaced with resources designed to meet the requirements of the CLCPA. However, their retirement remains dependent on the offshore wind project achieving commercial operation.

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 State 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 account for about 20% of LIPA's power supply, but offshore wind faces completion risk if it is to add substantial amounts of renewable energy into the grid with cost shared pro rata by all customers in the state.

Achieving the statewide 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 of the decarbonization plan 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 is not fully known at this time. LIPA would also be responsible for 1,200 MW of the state's distributed solar goal (behind-the-meter and feed-in tariffs) by 2030.

In our view, the offshore wind component is the most challenging part of the CLCPA, and will require significant expansion of transmission capability. Toward this end, the New York Independent System Operator (NYISO) selected Propel NY Energy transmission project to facilitate delivery of bi-directional energy between Long Island and the rest of the state (via Westchester County and New York City. The project will add 90 miles of new underground and submarine transmission lines with four new stations, and is viewed as a key to delivering offshore wind into the NYISO grid.

We view the state's decarbonization plan as aggressive in scale and proposed timeline. Moreover, achieving these goals will require substantial investment in transmission, and transmission and offshore wind projects have historically faced significant opposition, resulting in project delays and/or cancellation. Moreover, achieving the 2040 goal while simultaneously meeting projected demand growth and ensuring reliability (for example, countering renewable intermittency with dispatchable carbon-free resources) will likely depend on technological advancement. Of importance, however, the costs of complying with the CLCPA will be recovered via LIPA's power supply charge and will not be 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. Four 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 $4.8 billion five-year capital plan ($905 million capital budget for 2024) includes about three-quarters of spending for T&D projects. The authority anticipates debt financing about two-thirds 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.

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 25, 2024)		
Long Island Pwr Auth RETELEC		
Long Term Rating	A/Stable	Affirmed
Long Island Power Authority elec sys gen rev bnds		
Long Term Rating	AA+/A-1	Affirmed
Unenhanced Rating	A(SPUR)/Stable	Affirmed
Long Island Pwr Auth RETELEC (AGM)		
Unenhanced Rating	A(SPUR)/Stable	Affirmed
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
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

Ratings Detail (As Of July 25, 2024) (cont.)

Many issues are enhanced by bond insurance.

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