Bond Case Briefs

Municipal Finance Law Since 1971

Cuomo Long Island Power Solution Penalizes Bonds: Muni Credit.

New York Governor Andrew Cuomo's plan to fix the Long Island Power Authority, which left thousands of customers in the dark for weeks after Hurricane Sandy, isn't winning over municipal-bond investors.

On May 21, eight days after Cuomo announced the plan, tax-exempt LIPA bonds callable in nine years traded at an average yield 2.2 percentage points above top-rated bonds, data compiled by Bloomberg show. That was the most in at least three months.

Enlarge image

Sandy struck the region Oct. 29, knocking out power to 1 million LIPA customers, or 90 percent, as falling trees downed transmission lines and substations flooded. Photographer: Victor J. Blue/Bloomberg

Under the Democratic governor's proposal, which requires legislative approval, Newark, New Jersey-based Public Service Enterprise Group Inc. (PEG) will take over LIPA operations on Jan. 1, and as much as half of the authority's $7 billion of municipal debt will be refinanced. LIPA's electric rates, which are among the nation's highest, will be frozen through 2015 and state regulators will review any increases.

"To start off with saying we're not going to have any rate increases for three years when there's a lot of capital needs — the math doesn't work for me," said Howard Cure, director of muni research at New York-based Evercore Wealth Management LLC (EVR), which oversees $4.7 billion.

Knockout Blow

Sandy struck the region Oct. 29, knocking out power to 1 million LIPA customers, or 90 percent, as falling trees downed transmission lines and substations flooded. A week later, 200,000 customers still were without power.

Last week, Moody's Investors Service lowered the ratings on LIPA bonds backed by customer revenue one step to Baa1, three levels above junk, and gave the debt a negative outlook. The political and media scrutiny following Sandy will make it difficult for the utility to improve its finances and operations, particularly if those actions would require rate increases, Moody's said in a statement.

LIPA has "little if any cushion for the unforeseen events that seem to occur every year," Moody's said.

"We are disappointed by Moody's actions considering the aggressive steps LIPA" has taken to raise liquidity, Mark Gross, a spokesman for the Uniondale, New York-based nonprofit municipal electric provider, said in an e-mailed statement.

“We continue to work with federal and state government towards full and timely” Federal Emergency Management Agency reimbursement for Sandy expenses as well as funds for projects protecting against future storms, he said.

Reimbursement Request

LIPA has received $257 million of the $800 million it expects from FEMA reimbursement, Gross said.

Any delay in FEMA funds is “problematic,” said Laura Schumacher, a Moody’s analyst in New York.

LIPA has about $335 million of cash on hand, representing about 37 days of liquidity as of Dec. 31, the rating company said. Taking into account $100 million of commercial paper, the number of days of cash on hand rises to 48.

According to a commission convened by Cuomo to investigate LIPA’s handling of the storm aftermath, the key to the utility’s failings was a “dysfunctional” management structure.

The authority, which was set up in 1985, owns Long Island’s electrical lines and contracted with London-based National Grid Plc (NG/) to operate them. Under such divided management, LIPA let consultants guide spending and failed to replace aging poles or trim trees as recommended in state studies.

‘Better Way’

“LIPA has been a problem for a very long time, and it was on full display during Hurricane Sandy,” Cuomo said when he announced his plan. “We need a new and better way.”

Public Service Enterprise Group would take over LIPA’s operations, leaving it a holding company with no day-to-day responsibilities. PSEG will control capital and operating budgets, storm preparedness and response, call centers, computer systems and customer service.

To help relieve LIPA’s $7 billion debt burden, the plan calls for a new entity to issue bonds backed by a new customer charge. The securities would be structured to have higher ratings, lowering borrowing costs and generating savings.

“The state is claiming rates will go down,” Cure said. “I’m a little dubious in that the users of the utility are still paying the securitized debt.”

Cure said some investors have shown interest in LIPA bonds, and speculated that they are looking to buy securities that will be paid off in the restructuring.

Rate Independence

The proposal would remove management dysfunction while providing improved oversight, Rich Azzopardi, a Cuomo spokesman, said in an e-mailed statement.

“Rating agencies are primarily focused on LIPA’s board retaining its authority to set rates and comply with bond covenants, which our proposal does,” Azzopardi said. “This should provide great comfort to bondholders.”

The proposal would also eliminate a franchise tax of about $26 million annually that LIPA pays the state, and would cap payments LIPA makes in lieu of taxes to municipalities starting in 2015 at 2 percent per year. The Department of Public Service would review rates and capital spending.

“It’s hard to imagine politics not getting involved,” Cure said. “There’s a lot of pressure on both parties to give some rate relief.”

Most public power agencies can set rates independently, said Jeff Panger, a Standard & Poor’s analyst in New York.

“The current proposal, if it comes about, will constrain the rate-setting autonomy and flexibility that LIPA has beyond what is generally seen by other public-power entities,” he said.

LIPA’s total average electric rate of 18.2 cents per kilowatt hour is among the nation’s highest, according to a 2011 report by the Brattle Group, a consulting firm based in Cambridge, Massachusetts.

Debt Cost

One of the primary drivers is the cost of servicing $6.7 billion of debt LIPA issued in 1998 to finance the acquisition of the Long Island Lighting Co., an investor-owned utility. Lilco spent $6 billion to build the Shoreham nuclear power plant in Suffolk County from 1973 to 1984. The site never opened because of community opposition.

State Senator Michael Ranzenhofer, a Republican whose district sits between Buffalo and Rochester and who heads the chamber’s authorities committee, said he’s reviewing Cuomo’s proposal and shares the same concern as the rating companies.

“There’s the concern with LIPA being able to manage its finances and pay off its debt,” Ranzenhofer said in a May 22 telephone interview. “We need to move quickly, but also deliberatively, to make sure that the proper actions are taken.”

Columbus Issue

In the broader market, municipalities led by Columbus, Ohio, are set to offer $1.9 billion of debt in next week’s holiday-shortened calendar, the slowest period since January.

Columbus plans to offer about $369 million of general obligations to refinance higher-cost debt as municipal yields are the highest in six weeks.

At 1.88 percent, yields on benchmark 10-year munis are still below the 2.02 percent interest rate for similar-maturity Treasuries.

The ratio of the two yields, at 93 percent, has been below 100 percent on all but one day since May 2. The lower the figure, the more costly munis are compared with federal obligations.

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com