January 28, 2014

MEMORANDUM TO THE TRUSTEES

FROM THE PRESIDENT and CHIEF EXECUTIVE OFFICER

SUBJECT: Funding Plan for Strategic Initiatives and Energy Efficiency Investments

SUMMARY

The Trustees are requested to approve the dedication of certain funds presently held in the Capital Project Reserve ("CPR") to meet a portion of the costs of major renewals, replacements, repairs, additions, betterments and other investments associated with the Authority's strategic initiatives, capital plan and energy efficiency investments.

BACKGROUND

NYPA's Mission is to provide clean, low-cost, and reliable energy consistent with its commitment to the environment and safety, while promoting economic development and job development, energy efficiency, renewables and innovation, for the benefit of its customers and all New Yorkers. Through this mission, NYPA:

- Invests in energy infrastructure in New York State
- Provides low-cost power to businesses, government and other consumers
- Promotes economic development and job creation through its power resources
- Supports energy efficiency improvements and the development of new technologies

NYPA's corresponding Financial Goal is to preserve its financial strength to ensure access to low-cost capital in order to undertake the initiatives necessary to carry out its mission.

Throughout its history, NYPA has been able to respond effectively to many of the urgent, energy-related challenges that faced New York State by maintaining ready-access to the capital markets. Central to this access is the Authority's credit rating, one of the key measures by which investors judge the safety of their investment. NYPA's solid financial position has been recognized in the financial community with AA/Aa/AA- ratings from Fitch, Moody's, and Standard and Poor's, respectively.

Maintaining a AA rating has been demonstrated to be of critical importance. The disturbances in the credit markets in 2007-08 showed that lesser rated public authorities and municipals had to pull back on planned debt issuances due to soft demand and higher costs. It was reported at the time that the A- rated Miami-Dade County, Florida deferred a $540 million bond offering for its airport. Chicago cancelled a $950 million offering and the A rated District of Columbia was reported as cancelling a $350 million bond offering for its schools. At this same time, NYPA's Series 2007 Bonds were being marketed with such attractive rates that it was able to add to the planned $339 million offering (related to the Niagara and St. Lawrence relicensing and upgrades costs) another $264 million to defease at a lower cost a large portion of the Series 2002 Bonds issued in support of the 500 MW Plant's construction. NYPA's high credit rating allowed for this refunding opportunity which saved its customers nearly $10 million at a time when other issuers were pulling back from the market due to higher costs.

In order to maintain its AA rating, NYPA has targeted, among other measures, an earnings level that would set itself at or above the median coverage ratio for like entities. Fitch Ratings annually publishes its Public Power Peer Review in which it reports on financial metrics for various public power systems by ratings category. Over the last several years, Fitch reported that the median for AA rated wholesale public power entities was in the 1.7X to 2.1X range. Among its various ratings' factors, Moody's established a target of at least 2.0X for its AA rating category. With this in mind, the Trustees set forth in their Policy Statement dated May 24, 2011, that a debt service coverage ratio of 2.0 shall be used as a reference point in considering any such payments or transfer of funds outside of NYPA for other authorized lawful corporate purposes.

DISCUSSION

NYPA's net revenues have traditionally been reinvested in support of its mission and the State's energy infrastructure. Beginning in the mid-1990s, facing the on-set of deregulation, the Authority adopted a focused strategy to properly position itself for the competitive energy market. This multifaceted program included, among other things, reinvesting in and modernizing its operating facilities and reducing its cost structure by paying down debt associated with its generation and transmission facilities.

As recently reported to the Finance Committee, since 1997, the Authority has lowered its debt burden by over $1.3 billion (more than 40%) after having issued more than $2 billion in new project debt. This new project debt supported the construction of the Small Clean Power Plants, the 500 megawatt combined cycle plant and investments of more than $500 million to upgrade and modernize the Niagara and St. Lawrence hydroelectric facilities.

Over the last 5 years, NYPA's on-going core capital requirements would typically run $150 - $200 million per year. A similar amount was planned for investment in energy efficiency measures, so the total demand for funding resources averaged about $345 million per year. Today, the Authority's 5-year Plan calls for $2.4 billion – or about $480 million per year – to be invested in the various Authority facilities and in support of the Authority's energy efficiency efforts. This represents a 40% increase as compared to the past 5 years.

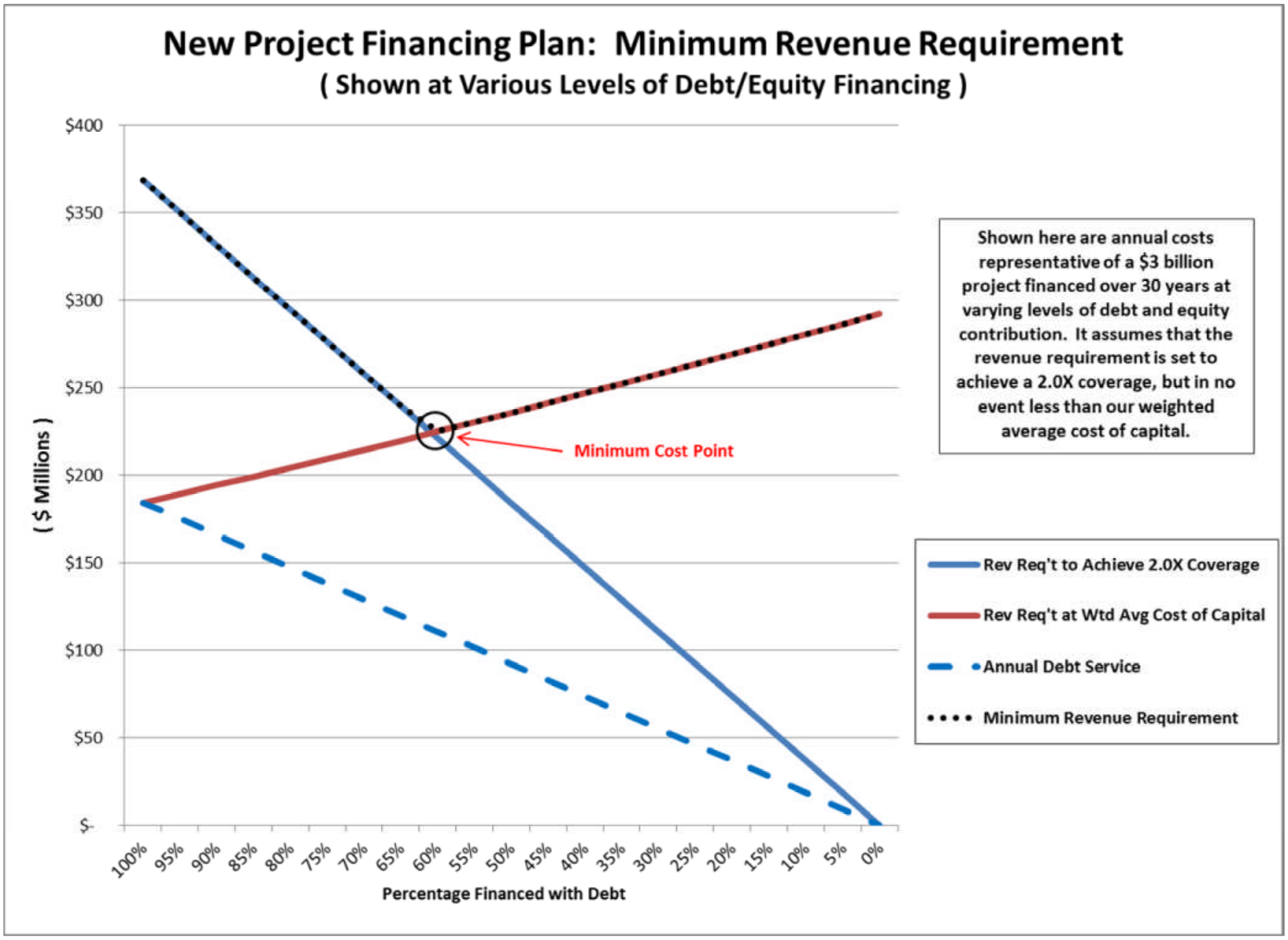
The Authority's Energy Services program is seeking to invest nearly $1.2 billion during this period with a large percentage of this attributed to the $800 million Build Smart New York initiative. Moreover, of the $1.2 billion planned for the Authority's facilities, a significant portion is slated for the life extension and modernization ("LEM") work at the Lewiston Pumped Storage Plant ($460 million in total) and Transmission LEM work ($726 million in total), both previously approved by the Trustees. In addition to its planned capital and energy efficiency investments, other major capital projects may result from the Authority's on-going strategic planning process. While it is early in the study stages, nevertheless, the Authority may identify additional opportunities to provide benefits to the people of the state.

With the Authority's currently outstanding debt levels of $1.7 billion, to add as much as $2.4 billion or more in additional debt financing could very well overburden the Authority financially. Here, a second financial metric of significance is considered. The Authority's debt as a percentage of capitalization is a low 31%. (Moody's, by comparison, benchmarks it AA ratings category with a level of at or below 50%). With 100% debt financing, the debt as a percentage of capitalization metric exceeds 50%.

In order to maintain the Authority's financial metrics at acceptable levels (and thereby maintain its AA credit rating), the Financial Plan calls for these investments to be funded with part debt and part internal funding sources (i.e., equity). As noted, it was being projected that the Authority's capital and energy efficiency requirements were going to significantly increase. In recognition of this expected growth in investments, combined with the conclusion of the accelerated debt retirement program, the Authority began to set aside funds to help support some of these major new investment(s) in energy infrastructure. At present, the Authority has a little over $840 million in its Capital Project Reserve for this purpose.

In addition to protecting the Authority's financial standing and making necessary investments financeable, significant savings are available to NYPA's customers through the use of NYPA equity. For an illustrative example, if an assumed $3 billion investment was to be 100% debt financed over 30 years, the annual debt service costs would be about $185 million per year. In order for the Authority to maintain its 2.0X coverage, it would need to set rates to collect twice that or about $370 million per year. If, on the other hand, NYPA was to use its reserves for one-third of this investment, annual debt service declines to less than $125 million per year and the required rates would be set to recover $245 million per year. This represents a savings of $125 million per year for the customer.

As demonstrated in the chart below, at approximately two-thirds debt and one-third equity, the minimum cost point is achieved by drawing a balance between NYPA's weighted average cost of capital and its goal to maintain coverage at or above the median for comparable AA rated wholesale public power organizations. Any points to the right of the minimum cost point on the "2.0X Coverage Line" would represent an under collection on the part of NYPA in that it is less than the Authority's weighted average cost of capital taking into account the opportunity cost associated with NYPA's reserve funds. Conversely, any points to the left of the minimum cost point on the "2.0X Coverage Line" would represent an over collection on the part of NYPA in that it is greater than the Authority's weighted average cost of capital. Through the deployment of this CPR, the Authority maintains access to low-cost capital markets and can deliver tremendous savings to its customers thereby furthering its mission.



Based on the foregoing it is recommended that the Trustees formally approve the dedication of funds presently held in the CPR to meet a portion of the costs of the following projects in the following amounts:

Project	Dedicated CPR	Total Project Cost
Transmission LEM	$ 200 million	$ 726 million
Lewiston Plant LEM:	$ 125 million	$ 460 million
Build Smart New York:	$ 300 million	$ 800 million
Other Strategic Initiatives:	$ 150 million	----------
Total:	$ 800 million	-----------

FISCAL INFORMATION

Dedication of the CPR funds in support of the aforementioned strategic initiatives, capital plan and energy efficiency investments were anticipated and such funds are presently on deposit for this purpose in the Operating Fund. Until required, the monies will remain invested in the Authority's Operating Fund in accordance with the Authority's Investment Guidelines and will be available, if necessary, to meet any operating expenses or debt service payments.

RECOMMENDATION

The Executive Vice President and Chief Financial Officer recommends that the Trustees approve the dedication of $800 million of funds presently held in the Capital Project Reserve to meet a portion of the costs of major renewals, replacements, repairs, additions, betterments and other investments associated with the Authority's strategic initiatives, capital plan and energy efficiency investments as set forth above.

For the reasons stated, I recommend the approval of the above-requested action by adoption of a resolution in the form of the attached draft resolution.

Gil C. Quiniones
President and Chief Executive Officer

Att.
Funding Plan – CPR

R E S O L U T I O N

RESOLVED, That the Trustees hereby approved the dedication of $800 million of funds presently held in the Capital Project Reserve in the Operating Fund to meet a portion of the costs of major renewals, replacements, repairs, additions, betterments and other investments associated with the Authority's strategic initiatives, capital plan and energy efficiency investments, as set forth in the attached memorandum of the President and Chief Executive Officer; and be it further

RESOLVED, That the Chairman, the Vice Chair, the President and Chief Executive Officer, the Chief Operating Officer, the Executive Vice President and General Counsel, the Executive Vice President and Chief Financial Officer, the Corporate Secretary, the Treasurer and all other officers of the Authority be, and each of them hereby is, authorized and directed, for and in the name and on behalf of the Authority, to do any and all things and take any and all actions and execute and deliver any and all certificates, agreements and other documents that they, or any of them, may deem necessary or advisable to effectuate the foregoing resolution, subject to approval as to the form thereof by the Executive Vice President and General Counsel.