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JUNE 15, 2016

TO: BOARD OF DIRECTORS

THROUGH: PHILLIP A. WASHINGTON
CHIEF EXECUTIVE OFFICER

FROM: NALINI AHUJA
EXECUTIVE DIRECTOR, FINANCE AND BUDGET

SUBJECT: NATURAL GAS HEDGING PROGRAM

ISSUE

The Natural Gas Hedging Program (the "Hedging Program") requires that we report compliance with the Hedging Program Guidelines and program performance to the Board on a quarterly basis. This report is provided for the quarter ended March 31, 2016.

DISCUSSION

The purpose of this report is to present the status of compliance and performance for the hedged portion of our compressed natural gas ("CNG") budget. Operations related variances are presented in order to provide an overall perspective for CNG costs.

The objective of the Hedging Program is to improve budget certainty for fuel costs and to help determine the CNG budget for the upcoming year by establishing a portion of the cost in advance or otherwise reducing the effects of price volatility on the budget. The Hedging Program allows us to use commodity swaps, commodity options and cost stabilization reserves.

During fiscal 2016, the natural gas hedging program used financial swaps where the index price used to value the swaps is based on the wholesale price of natural gas at the California-Arizona border on a monthly basis. Swaps effectively "lock-in" our cost for a volume of natural gas that is equivalent to the volume of the swap. When prices end up being higher than the swap price, we pay more to the natural gas supplier and receive a payment from the swap to offset the higher cost of natural gas. When prices end up being lower than the swap price, we pay less to the natural gas supplier and make a payment to the swap to offset the lower cost of gas. In the third quarter of fiscal 2016, we had three swaps in place for fiscal 2016.

Quarterly Summary of Outstanding Hedge Transactions
Valuation as of March 31, 2016

Period Hedged	Provider	Credit Ratings (S&P, Moody's, Fitch)	Contract Fixed Rate per Therm	Market* Rate per Therm as of 03/31/2016	Remaining Therms Hedged	Current Market Value
FY16	Citibank	A/A1/A+	$0.3872	$0.1739	2,100,000	$-447,930
FY16	RBC	AA-/Aa3/AA	$0.3349	$0.1739	2,100,000	$-338,100
FY16	RBC	AA-/Aa3/AA	$0.3055	$0.1739	2,100,000	$-276,360
Total				-	6,300,000	$-1,062,390

*Market price derived by adding henry hub natural gas futures prices to SoCal Basis swap prices as reported by Bloomberg.

Compliance

As of the date of this report the Hedging Program is in compliance with all the specified limitations and requirements. The individual compliance items are listed on Attachment A.

Performance

For the quarter, CNG costs were approximately $252,000 over budget, including the $805,560 cost of the hedge, and the actual usage was lower than budgeted by approximately 1.06 million therms. The actual average gas price of $0.493 was slightly lower than the per therm budget price of $0.496. See Attachment B. When the hedges were placed, the total cost of CNG net of the hedge was expected to be lower than actual cost. Other charges from the supplier, unrelated to the wholesale cost of natural gas (pipeline transportation, etc.) increased unexpectedly and have remained above original expectations and historical norms.

The natural gas market continues to be very well supplied and benchmark prices have decreased to twenty year lows. As of May 20, 2016, natural gas inventories in the U.S. were 26.5% larger than one year ago and 37.4% larger than the five year average for this time of year. Inventories for the end of the heating season were at all-time high levels. Plentiful inventories cause prices to remain low, which is the current market condition. A warmer than expected winter kept inventories elevated and prices down. The forward pricing curve continues to be positively sloped where forward prices are higher than spot prices. The difference between spot and forward prices represents the cost of storage for the natural gas and when inventories are large, this cost is greater. In response to low prices, natural gas exploration and production has decreased significantly. The number of operating natural gas drilling rigs in the United States has decreased from 936 in October of 2011 to 87 as of May 27, 2016. This is a 90.7% decrease in the development of new sources of natural gas in the United States. One year ago the number of rigs was 225 indicating a 61.3% reduction in natural gas drilling activity over the past twelve months. This low level of activity has been supportive of price since mid-March despite the record high inventories. Lower drilling activity implies lower production levels in the future, which indicates lower inventories and higher prices. LNG exports from the United States have begun, which will increase global demand for U.S. natural gas and will have a positive influence on price.

Currently, 53% of expected natural gas consumption for the remainder of FY 2016 has been hedged. Given current market conditions and because approximately 75% of projected FY 2016 consumption has already been consumed, budget risk for FY 2016 has decreased. Thus, no additional hedging is recommended for FY 2016. The current market environment presents an opportunity to begin hedging FY 2017 at a relatively low assumed index gas cost of $0.2811 plus an additional expected cost of $0.2272 in SoCal Gas Company charges, for a total expected cost of about $0.5083 per therm. FY 2017 can be hedged currently at a SoCal Border Index price (wholesale price of gas at California Arizona Border, which does not include transportation and other supplier costs) that is lower than any average fiscal year price over the past 17 years. The Aliso Canyon gas leak does not affect our hedging performance or results. Metro's natural gas hedges use financial swaps that are independent of SoCal Gas Company and are based upon the wholesale price of natural gas at the California Arizona Border.

NEXT STEPS

- Enter into hedges for fiscal 2017 as warranted.

ATTACHMENTS

A. Program Compliance
B. Quarterly Summary of CNG Costs and Variances

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ATTACHMENT A

Program Compliance

Maximum Trade Maturity – The guidelines specify that the maximum trade maturity for hedges is 30 months forward to coincide with the last business day of the fiscal year being hedged. – Hedges are less than 30 months forward.

Hedge Ratio - Limited to 100% of planned volume –FY16 hedges are less than 100%, in compliance with the Hedging Program Guidelines.

Counterparty Credit Criteria – Requirements to post collateral are based on credit ratings of the counterparties and volume of hedges; in compliance.

• Aa3/AA- or better	No collateral required
• A3/A- or better	$25 million limit without collateral
• Baa1/BBB+	$15 million limit without collateral
• Baa2/BBB	$10 million limit without collateral
• Baa3/BBB-	$ 2.5 million limit without collateral

Re-Confirm Assumptions –Before entering into new hedges we will reconfirm assumptions with our hedging advisor.

Re-Confirmation of Therms - The amount of therms will be reconfirmed with Operations prior to entering into new hedges.

All information is as of March 31, 2016, unless otherwise specified.

ATTACHMENT B

Quarterly Summary of CNG Costs and Variances
FY 2016 QTR 3

Performance vs. Budget	Price per Therm	Volume in Therms	Total Cost
Budget	$ 0.4960	11,796,579	$ 5,851,103
Actual therms consumed	$ 0.4935	10,735,074	$ 5,297,443
Variance to Budget excluding hedge: Fav (Unfav)	**$ 0.0025**	**1,061,505**	**$ 553,660**
Variance Analysis:			
Actual volume vs budget variance fav (unfav)	$ 0.4960	1,061,505	$ 526,506
Actual price vs budget variance fav (unfav)	$ 0.0025	10,735,074	$ 27,154
Variance to Budget excluding hedge: Fav (unfav)			**$ 553,660**
Therms Hedged and net receipts (payments) for hedge (a)		6,300,000	$ (805,560)
% of budgeted therms hedged		53.41%	
Total variance to budget including hedge			**$ (251,900)**
Total cost of gas including hedge	**$ 0.569**		**$ 6,103,003**
Actual cost as a percentage of budget			104.3%

(a) Three hedges were in place for 3rd quarter FY16.