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Metro

December 13, 2017

TO: **BOARD OF DIRECTORS**

THROUGH: **PHILLIP A. WASHINGTON**
CHIEF EXECUTIVE OFFICER

PAW

FROM: **NALINI AHUJA**
CHIEF FINANCIAL OFFICER

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 September 30, 2017.

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. As Metro has not entered into any hedges for fiscal year 2018 at this time, this report presents the actual cost of our CNG in comparison to what was budgeted for the quarter. Operations related variances are presented in order to provide an overall perspective for CNG costs.

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

Infrastructure costs associated with pipelines and storage facilities contributed to significant increases in transportation related fees for CNG starting in fiscal year 2016. The hedging agreements related to the wholesale base cost of natural gas do not cover these infrastructure costs thereby reducing the efficiency and benefit of the hedge. Although we have observed a decrease in the fees, at current levels the surcharges would reduce the gas cost savings expected to offset payments for the hedge. Hence, staff decided against hedging the CNG costs in fiscal year 2018 at this time.

For the quarter ending September 30, 2017, CNG costs were approximately $270,000 under budget as actual usage was approximately 450,000 therms below budget primarily due to operating fewer miles than budgeted. The actual average gas price was very close to budget at $0.506 per therm vs. the budgeted amount of $0.510 (see Attachment B).

Since the end of the first quarter, inventories have decreased with respect to the five year average, rig count has decreased slightly from 189 to 176 and prices have increased. This current market environment presents the potential to hedge the balance of FY 2018 (January – June) at an index gas cost of around $0.2787 per therm (plus the current additional cost of $0.2234 per therm in SoCal Gas Company charges), for a total expected cost of about $0.5060 per therm for the last six months of fiscal year 2018, compared to the FY18 budgeted cost of $0.5100 per therm. For FY 2019, prices can currently be hedged at $0.5030 per therm given the assumptions for pricing in FY 2018 above.

At the May 2017 Regular Board Meeting, Metro entered into a five year indefinite delivery/indefinite quantity contract with Clean Energy as a Biomethane Gas Provider. Under the terms of the contract, for the first year Clean Energy will provide CNG for a single bus division as a pilot program at a $0.005/therm discount to the SoCal Border Index beginning August 1, 2017. Pending the results of the pilot, the contract gives the option to extend the pilot to the remaining divisions for four additional years. This development and the possibility of extending this contract to the remaining divisions for an additional four years will have no material effect on the economic results of natural gas hedging in the future. However, under the new contract, the gas commodity will be invoiced by Clean Energy, separate from SoCal Gas Company's transmission charges enabling a clearer view of the effects of hedging on cost. For the quarter ended September 30, 2017, Metro procured CNG through Clean Energy at a cost roughly $40,000 lower than if it had purchased from its other supplier SoCal Gas Company.

NEXT STEPS

- Enter into hedges for FY 2018 as warranted
- Continue to monitor the lowering of surcharge/tariffs with SoCal Gas and the CPUC
- Continue to monitor the effects of the Contract with Clean Energy

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. – As of September 30, 2017 there are no hedges in place.

Hedge Ratio - Limited to 100% of planned volume –There are no hedges in place for FY18 therefore we are 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; there are no hedges in place therefore we are 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 September 30, 2017, unless otherwise specified.

ATTACHMENT B

Quarterly Summary of CNG Costs and Variances
FY 2018 QTR1

Performance vs. Budget	Price per Therm		Volume in Therms	Total Cost	
Budget	$	0.5100	11,889,094	$	6,063,438
Actual therms consumed	$	0.5063	11,442,792	$	5,793,514
Variance to Budget excluding hedge: Fav (Unfav)	**$**	**0.0037**	**446,302**	**$**	**269,924**
Variance Analysis:					
Actual volume vs budget variance fav (unfav)	$	0.5100	446,302	$	227,614
Actual price vs budget variance fav (unfav)	$	0.0037	11,442,792	$	42,310
Variance to Budget excluding hedge: Fav (Unfav)				**$**	**269,924**
Therms Hedged and net receipts (payments) for hedge (a)			-	$	-
% of budgeted therms hedged			0.00%		
Total variance to budget (No hedges entered)				**$**	**269,924**
Total cost of gas including hedge (No hedges entered)	**$**	**0.5063**		**$**	**5,793,514**
Actual cost as a percentage of budget					95.5%

(a) No hedges were in place for 1st quarter FY18.