Los Angeles County
Metropolitan Transportation Authority

One Gateway Plaza
Los Angeles, CA 90012-2952

213.922.2000 Tel
metro.net

Metro

AUGUST 26, 2011

TO: **BOARD OF DIRECTORS**

THROUGH: **ARTHUR T. LEAHY**
CHIEF EXECUTIVE OFFICER

FROM: **TERRY MATSUMOTO**
CHIEF FINANCIAL SERVICES OFFICER AND TREASURER

SUBJECT: **NATURAL GAS HEDGING PROGRAM**

ISSUE

The Natural Gas Hedging Program (the "Hedging Program") requires that reports be provided to the Board quarterly in compliance with the Hedging Program Guidelines and to report performance of the program.

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 establish the CNG budget for the upcoming year by capping the cost in advance or otherwise reducing the effects of price increases on the budget. Budget certainty has been improved through FY11 by utilizing a hedging instrument known as a commodity swap to hedge most of the planned volume for each fiscal year.

In January 2011 the Board approved the updated CNG Hedging Program, adding commodity options and the use of cost stabilization reserves in addition to the continued use of commodity swaps. The addition of commodity options and cost stabilization reserves enhances the mix of tools we will use to hedge under various market conditions to reduce the potential for budget variances.

As of June 30, 2011, we had one "costless collar" hedge transaction outstanding, hedging 90% of our planned CNG volume for FY12. A summary of the currently outstanding hedge transactions is provided below. The positive/(negative) market values indicate the amount we would receive/(pay) on an early termination at the specified date. The rates listed in the table below reflect the hedge contract fixed rates and exclude the delivery cost and state mandated charges, which are currently $0.108 per therm.

Quarterly Summary of Outstanding Hedge Transactions
Valuation as of June 30, 2011

Period Hedged	Provider	Credit Ratings (S&P, Moody's, Fitch)	Contract Rate per Therm	Remaining Therms	Current Market Value*
FY12	Barclays Capital	AA-/Aa3/AA-	Max / Min $0.52 / $0.40	40,620,600	$387,000
Total				40,620,600	$387,000

*Monthly LIBOR rate used.

Compliance

Due to lengthy management review of the program and discussions of possible techniques to be recommended for the Board's consideration, placement of commodity swaps for FY11 was suspended. For FY11 only about 65% of the CNG volume was hedged. However, since CNG market prices remained lower than prices locked for the FY11 hedges, we realized budgetary savings on the unhedged volume.

Subsequent to the Board's approval of the updated hedging program in January 2011 and following discussions with MTA's Office of Management and Budget, it was determined that a "costless collar" strategy would be used to hedge 90% of our planned FY12 CNG volume. Bids were taken in March establishing the strike prices for the upper and lower limits that are referred to as the ceiling and the floor of the collar. With a costless collar there is no upfront cash outlay as the purchase price of the ceiling is exactly offset by the sale price of the floor.

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 $356,000 under budget as a result of a $756,000 favorable variance for unhedged therms, less an unfavorable hedge performance of $400,000. The favorable variance for unhedged therms resulted from the lower market rate per therm of $0.58 compared to the budgeted rate of $0.74. For the quarter 8,736,000 therms were hedged out of 12,880,000 actually consumed, for a realized hedge ratio of 68%. See Attachment B.

Hedge performance for the quarter was unfavorable by $400,000 because the variable rates received from the hedge were less than the monthly rates paid to the Gas Company. Hedge performance is our fixed rate payments to the hedge provider, plus actual payments for gas purchases, minus variable rate payments received from the hedge provider at the monthly index rates.

For information purposes only, if we had not hedged the CNG, the variance would have been a favorable $2,202,000, as opposed to a favorable $356,000. The difference is the result of the lower market rate of $0.57 during the quarter compared to the hedged rate of $0.78. Therefore hedging produced a cost about $1,847,000 more than if we had not hedged. The recently approved changes to the hedging program are intended to add flexibility that will allow for better participation when prices remain low or even when they move lower.

For the 4th quarter of FY11 the hedging program generally performed as intended and stabilized the actual rate per therm of gas hedged at $0.78, approximately the same as the budgeted rate of $0.74.

NEXT STEPS

- Manage program and provide reporting
- Determine the planned CNG volume for FY13 and initiate trades

ATTACHMENTS

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

Prepared by: Michael J. Smith, Assistant Treasurer
LuAnne Edwards Schurtz, Debt Manager

Attachment A

Program Compliance

Maximum Trade Maturity – The guidelines specify that hedges will settle or expire not more than 30 months from the date they are acquired. – All trade maturities are in compliance.

Maximum Trade Amount – Number of therms in CNG forecast times the Hedge Ratio divided by value for Frequency of Trades. At the time of each trade total therms hedged for the year may not exceed the Hedge Ratio. All trade amounts have been in compliance with the Hedging Program Guidelines.

Hedge Ratio - Limited to 100% of planned volume when based solely on the volume, but may be increased by up to an additional 10 percentage points as determined by staff, not to exceed 110% of planned volume - All trade amounts have been in compliance with the Hedging Program Guidelines.

Frequency of Trades: From 2 to 6 per year. – Three bids were taken for FY11. Only one bid was taken for FY12 due to the late approval of the amended hedging program guidelines relative to preparation of the MTA's annual budget.

Timing of Trades: Trades will generally be executed in advance of the budget year and have at least 28 days separation between trades.

Counterparty Credit Ratings – There have been no changes in the credit ratings of the counterparties since the last quarterly report.

Summary of Credit Ratings
(S&P/ Moody's / Fitch)

Provider	For Current Report FY11-Q3
Barclays Bank PLC	AA-/Aa3/AA-

Collateral Requirements – Requirements to post collateral are based on credit ratings of the counterparties. The threshold is $25 million for counterparties rated "A-/A3" or better. The current market values of the trades are under the $25 million threshold, so no collateral is required.

Re-Confirm Assumptions – Assumptions have been reconfirmed for factors that would affect the Gas Company's cost of gas and reduce the correlation between the Gas Company's cost and the pricing index the hedges are tied to. There have not been any changes that would cause us to change our assumptions. However, there has been a trend for the past two years where the Gas Company's rates have moved slightly higher relative to the hedge index, resulting in a small cost variance. To date, the Gas Company has not been able to provide a good explanation for this trend.

Re-Confirmation of Therms - The amount of therms was reconfirmed prior to entering into a hedge for FY12, based on the values provided by the Operations staff based on the projected service levels.

All information is as of the report date for the end of the quarter, unless otherwise specified.

Attachment B

Quarterly and Annual Summary of CNG Costs and Variances
FY 2011 Q4

	Budget	Actual	Quarterly Difference Fav/(Unfav)	Annual Difference Fav/(Unfav)
Hedged				
Therms	8,736,000	8,736,000	-	$ -
Fixed Rate Payments	$ 6,464,640	$ 5,588,856	875,784	$ 3,512,611
Cost of Gas		$ 5,018,428		
Variable Rate Payments Received		$ (3,742,176)		
Basis Variance		$ 1,276,252	(1,276,252)	$ (4,405,357)
Hedge Performance	$ 6,464,640	$ 6,865,108	$ (400,468)	$ (892,746)
Cost/Therm	$ 0.740	$ 0.786	$ (0.046)	$ (0.025)
Unhedged				
Therms	4,238,872	4,143,462	95,410	7,767
Cost of Gas	$ 3,136,765	$ 2,380,228	$ 756,538	$ 3,602,131
Cost/Therm	$ 0.740	$ 0.574	$ 0.166	$ 0.210
Total				
Therms	12,974,872	12,879,462	95,410	7,767
Cost of Gas	$ 9,601,405	$ 9,245,336	356,069	$ 2,709,385
Cost/Therm	$ 0.740	$ 0.718	$ 0.022	$ 0.052
Hedge Ratio	67.3%	67.8%		
If No Hedging				
Therms	12,974,872	12,879,462	95,410	7,767
Cost of Gas	$ 9,601,405	$ 7,398,656	$ 2,202,749	$ 10,942,182
Cost/Therm	$ 0.740	$ 0.574	$ 0.166	$ 0.210
Hedged vs. Un-hedged Difference - Fav/(Unfav)		$ (1,846,680)		

Note: All per therm amounts include $0.108 for mandated fees and delivery costs