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NOVEMBER 18, 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. Beginning with FY12 we began using a "costless collar" strategy to facilitate better participation when rates are lower.

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 September 30, 2011, we had two "costless collar" hedge transactions outstanding, hedging 90% of our planned CNG volume for FY12 and about 20% of the FY13 volume. Three more hedges will be entered into to bring the FY13 hedged volume to 90% of planned volume. 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 cap and floor 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 September 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-	Ceiling / Floor $0.52 / $0.40	30,414,400	($672,000)
FY13	RBC Capital	AA-/Aa1/AA	Ceiling / Floor $0.542 / $0.445	9,125,000	(234,000)
Total				39,539,400	($903,959)

*Monthly LIBOR rate used.

Compliance

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 and FY13 CNG volumes. Bids were taken in March establishing the FY12 hedge strike prices for the upper and lower limits, referred to as the ceiling and the floor of the collar. The first hedge for FY13 was bid in July. 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 $465,000 under budget as a result of paying a rate lower than the budgeted rate. The favorable cost variance includes the effects of an unfavorable 8% overrun on the amount of therms consumed. For the quarter 10,212,000 therms were hedged out of 12,791,000 actually consumed, for a realized hedge ratio of 79.8%. See Attachment B.

For information purposes only, if we had not hedged the CNG, the variance would have been the same. Because the market prices during the quarter were between the ceiling and floor of the collar, no settlement payments were paid or received. Therefore hedging had no cost impact on the cost of CNG for the quarter.

For the 1st quarter of FY12 the hedging program performed as intended and allowed us to participate at favorable market prices that are above the floor and below the ceiling established by the costless collar.

NEXT STEPS

- Manage program and provide reporting
- Execute additional hedges for FY13

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 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. – As previously disclosed to the Board, as a result of delays due to reassessment of the hedging program, only one trade was made to hedge FY12. FY13 will be hedged using four trades.

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

Provider	Credit Ratings (S&P/ Moody's / Fitch)
Barclays Bank PLC	AA-/Aa3/AA-
RBC Capital	AA-/Aa1/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 several 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 Summary of CNG Costs and Variances
FY 2012 Q1

		Budget	Actual	Difference Fav/(Unfav)
Hedged				
	Therms	10,212,000	10,212,000	-
	Cost of Gas		$ 5,781,191	
	Hedge Settlements		$ -	
	Hedge Performance	$ 6,637,800	$ 5,781,191	$ 856,609
	Cost/Therm	$ 0.650	$ 0.566	$ 0.084
Unhedged				
	Therms	1,644,746	2,579,200	(934,454)
	Cost of Gas	$ 1,069,085	$ 1,460,130	$ (391,045)
	Cost/Therm	$ 0.650	$ 0.566	$ 0.084
Total				
	Therms	11,856,746	12,791,200	(934,454)
	Cost of Gas	$ 7,706,885	$ 7,241,321	465,564
	Cost/Therm	$ 0.650	$ 0.566	$ 0.084
	Hedge Ratio	86.1%	79.8%	
If No Hedging				
	Therms	11,856,746	12,791,200	(934,454)
	Cost of Gas	$ 7,706,885	$ 7,241,321	$ 465,564
	Cost/Therm	$ 0.650	$ 0.566	$ 0.084
	Hedged vs. Un-hedged Difference - Fav/(Unfav)		0	

Note: All per therm amounts include $0.104 for mandated fees and delivery costs