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Los Angeles County
Metropolitan Transportation Authority

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September 17, 2018

TO: BOARD OF DIRECTORS

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

FROM: NALINI AHUJA *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 and fiscal year ended June 30, 2018.

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 did not enter into any hedges for fiscal year 2018, this report presents the actual cost of our CNG in comparison to what was budgeted for the quarter and for the fiscal year. 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.

For the quarter ending June 30, 2018, CNG costs were approximately \$1.9 million under budget as actual usage was approximately 1.0 million therms below budget primarily due to operating fewer miles than budgeted. The actual average gas price was below the budget per therm at \$0.385 vs. the budgeted amount of \$0.510 (see Attachment B).

For the fiscal year ending June 30, 2018, CNG costs were approximately \$4.2 million under budget as actual usage was approximately 3.6 million therms below budget primarily due to operating fewer miles than budgeted. The actual average gas price was lower than budget per therm at \$0.457 vs. the budgeted amount of \$0.510 (see Attachment C).

Since the end of the third quarter, inventories increased going from 20.4% less than the five year average to 18.6% less than the five year average inventory. The number of drilling rigs exploring for natural gas decreased from 194 to 187 and prices increased slightly during the quarter. The current market environment (as of September 6th) presents the potential to hedge the remaining nine months of FY 2019 at an index gas cost of around \$0.2469 per therm (plus the current additional cost of \$0.1803 per therm in SoCal Gas Company charges), for a total expected cost of about \$0.4272 per therm for the remainder of fiscal year 2019, compared to the FY19 budgeted cost of \$0.4500 per therm.

Beginning August 1, 2017 Metro began a one year pilot program with Clean Energy as a Biomethane Gas Provider. Under the terms of the contract, Clean Energy provides CNG for a single bus division as a pilot program at a \$0.005 per therm discount to the SoCal Border Index. For the quarter ended June 30, 2018, Metro procured CNG through Clean Energy at a cost roughly \$52,000 lower than if it had purchased from its other supplier SoCal Gas Company; for the entire fiscal year ended June 30, 2018 CNG procured through Clean Energy was \$186,000 lower. At the July 2018 Board Meeting, the Board chose to exercise the four year option of the original contract with Clean Energy allowing the possibility of expanding these savings to the remaining bus divisions in the future. Extending the strategy to the remaining divisions will have no material effect on the economic results of natural gas hedging in the future. However, with this new strategy the gas commodity will be invoiced by the Biomethane Gas Provider(s), separate from SoCal Gas Company's transmission charges enabling a clearer view of the effects of hedging on cost.

NEXT STEPS

- Enter into hedges for FY 2019 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
- C. Annual Summary of CNG Costs and Variances

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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 June 30, 2018 there are no hedges in place.

Hedge Ratio - Limited to 100% of planned volume –There were no hedges in place for FY17 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.

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|---------------------|---|
| • 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 Terms - The amount of terms will be reconfirmed with Operations prior to entering into new hedges.

All information is as of June 30, 2018, unless otherwise specified.

ATTACHMENT B

**Quarterly Summary of CNG Costs and Variances
FY 2018 QTR4**

Performance vs. Budget	<u>Price per Therm</u>	<u>Volume in Therms</u>	<u>Total Cost</u>
Budget	\$ 0.5100	11,889,094	\$ 6,063,438
Actual therms consumed	<u>\$ 0.3851</u>	<u>10,845,443</u>	<u>\$ 4,177,103</u>
Variance to Budget excluding hedge: Fav (Unfav)	\$ 0.1249	1,043,651	\$ 1,886,335
<u>Variance Analysis:</u>			
Actual volume vs budget variance fav (unfav)	\$ 0.5100	1,043,651	\$ 532,262
Actual price vs budget variance fav (unfav)	\$ 0.1249	10,845,443	<u>\$ 1,354,073</u>
Variance to Budget excluding hedge: Fav (Unfav)			\$ 1,886,335
Therms Hedged and net receipts (payments) for hedge (a)		-	\$ -
% of budgeted therms hedged		0.00%	
Total variance to budget (No hedges entered)			<u>\$ 1,886,335</u>
Total cost of gas including hedge (No hedges entered)	\$ 0.3851		\$ 4,177,103
Actual cost as a percentage of budget			68.9%

(a) No hedges were in place for 4th quarter FY18.

ATTACHMENT C

**Annual Summary of CNG Costs and Variances
FY 2018**

Performance vs. Budget	<u>Price per Therm</u>	<u>Volume in Therms</u>	<u>Total Cost</u>
Budget	\$ 0.5100	47,556,376	\$ 24,253,752
Actual therms consumed	<u>\$ 0.4571</u>	<u>43,957,621</u>	<u>\$ 20,092,829</u>
Variance to Budget excluding hedge: Fav (Unfav)	\$ 0.0529	3,598,755	\$ 4,160,923
<u>Variance Analysis:</u>			
Actual volume vs budget variance fav (unfav)	\$ 0.5100	3,598,755	\$ 1,835,365
Actual price vs budget variance fav (unfav)	\$ 0.0529	43,957,621	<u>\$ 2,325,558</u>
Variance to Budget excluding hedge: Fav (Unfav)			\$ 4,160,923
Therms Hedged and net receipts (payments) for hedge (a)		-	\$ -
% of budgeted therms hedged		0.00%	
Total variance to budget including hedge			<u>\$ 4,160,923</u>
Total cost of gas including hedge	\$ 0.457		\$ 20,092,829
Actual cost as a percentage of budget			82.8%

(a) No hedges were in place for FY18.