



Natural Gas Commodity Prepay

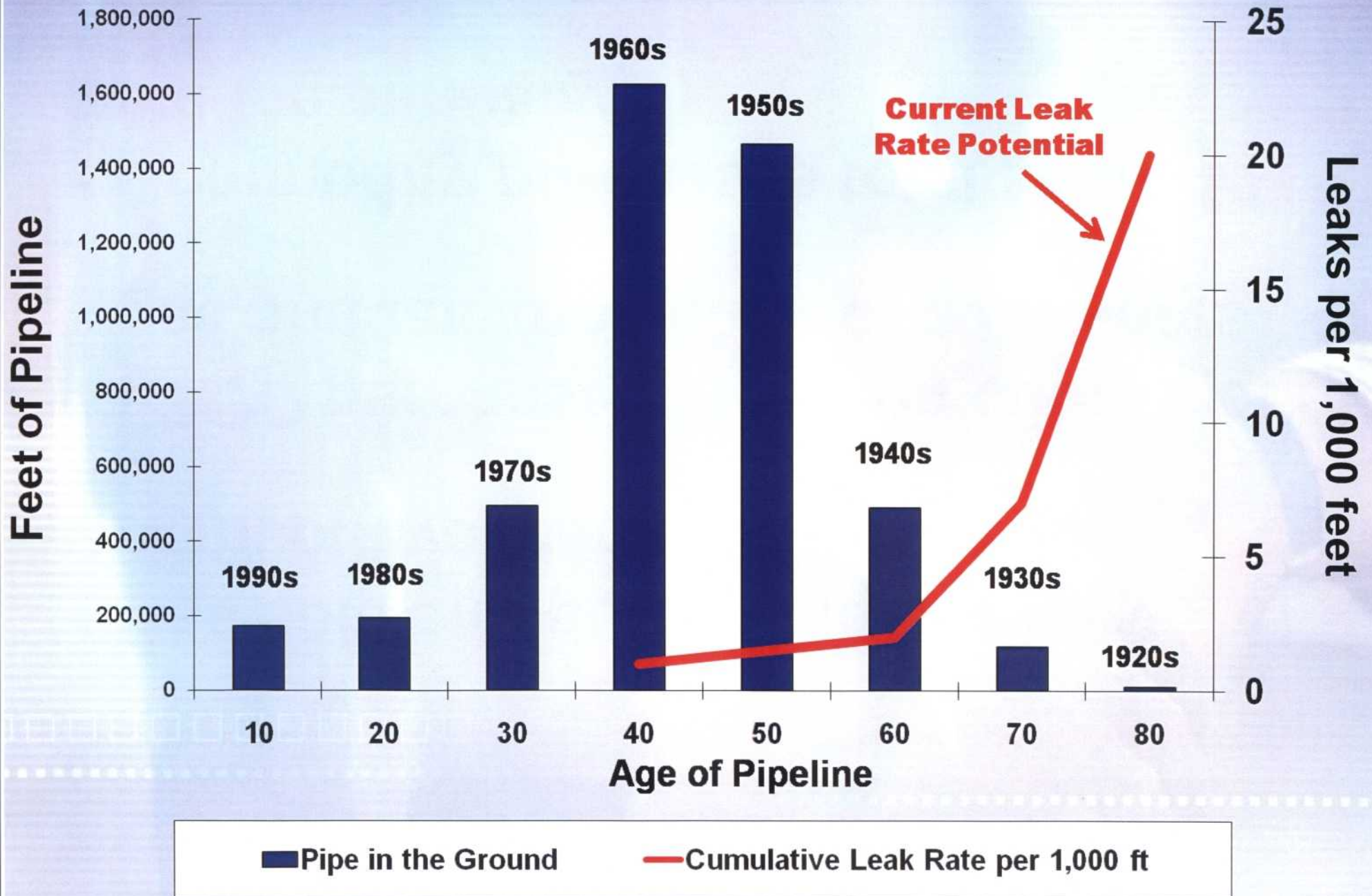
***City Council Workshop
July 17, 2007***

Pipeline Infrastructure Needs

Aging Gas Pipeline Infrastructure

- Majority of LBGO pipeline system was installed between 40 to 60 years ago
- Gas leaks rise significantly in pipeline 60 years or older, causing safety concerns
- Funding in excess of \$200 million needed for major long-term pipeline replacement over the next 2-3 decades

Pipeline Infrastructure Needs



Gas Commodity Purchases

- Gas sold and purchased in a very competitive market
- LBGO purchases 10 billion cubic feet of gas annually on behalf of customers
- Commodity purchases total about **\$90 million annually**

Gas Commodity Benchmarks

City Charter requires pricing comparable to surrounding gas utilities

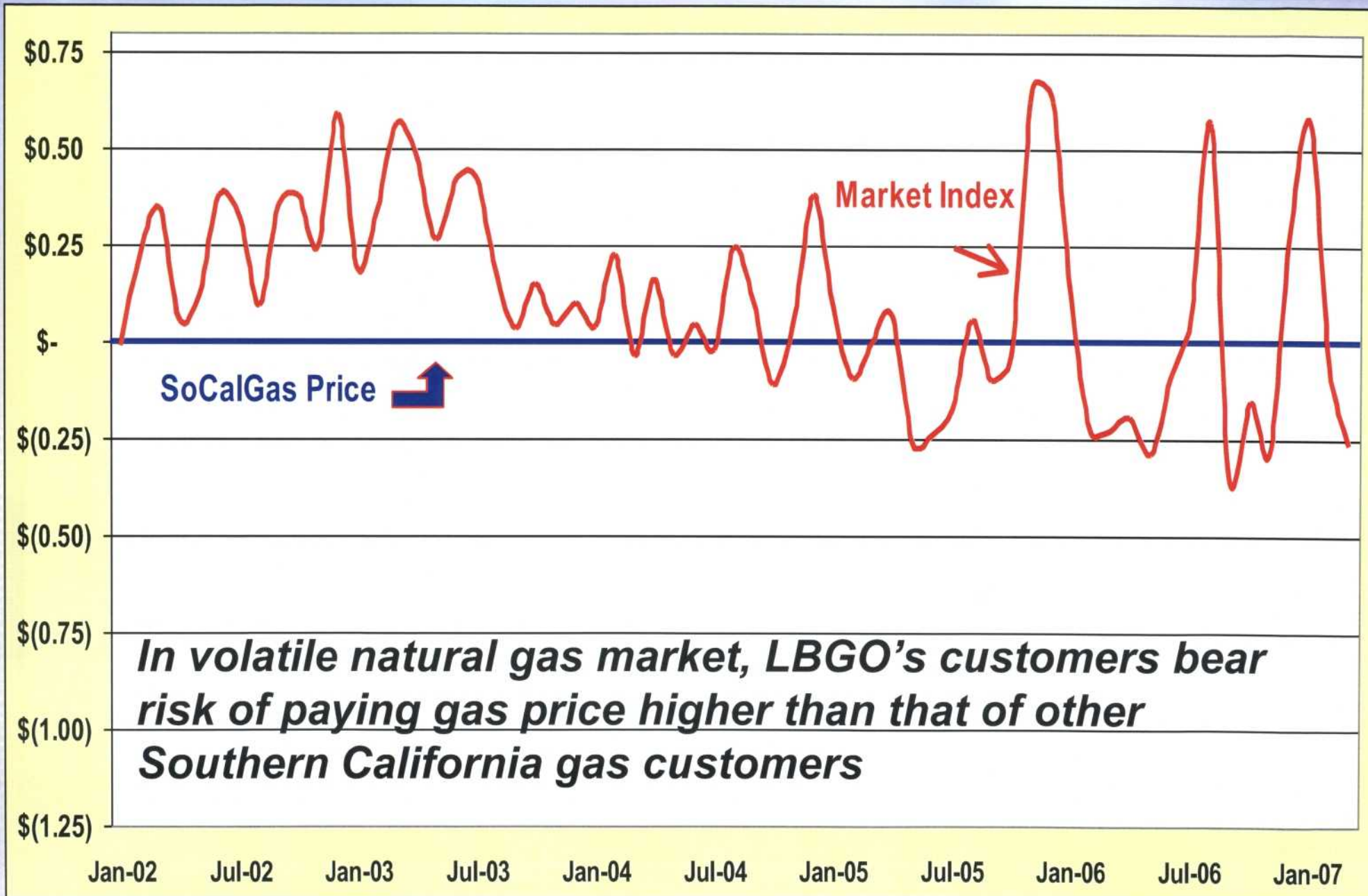
SoCALGAS PRICE

- **Commodity price charged to virtually all other ratepayers in Southern California**

BORDER INDEX

- **Market price of gas sold to California gas buyers**
- **Financially traded index**

Gas Supply Risks





**Natural Gas
Commodity
Prepay as a**

Solution!

What is a Gas Prepay?

A municipal natural gas buyer makes an upfront payment to a gas supplier in exchange for future long-term gas supply deliveries

- **The prepayment is funded through the issuance of tax-exempt bonds**
- **Savings are created by the difference between the tax-exempt funding cost and the supplier's taxable discount rate**



Background: Prepay Transactions

- **IRS clarified acceptable prepay structures in 2003**
- **Support provided in Energy Policy Act of 2005**
- **In 2006, 11 gas pre-pay transactions completed, involving nearly \$10 billion of tax-exempt debt**
- **In 2007, 16 transactions completed/in process, including deals involving CA muni utilities in Los Angeles, Sacramento, Burbank, Anaheim, Pasadena, Glendale, Roseville**
- **Prepay structures have evolved to minimize risk and increase price savings**

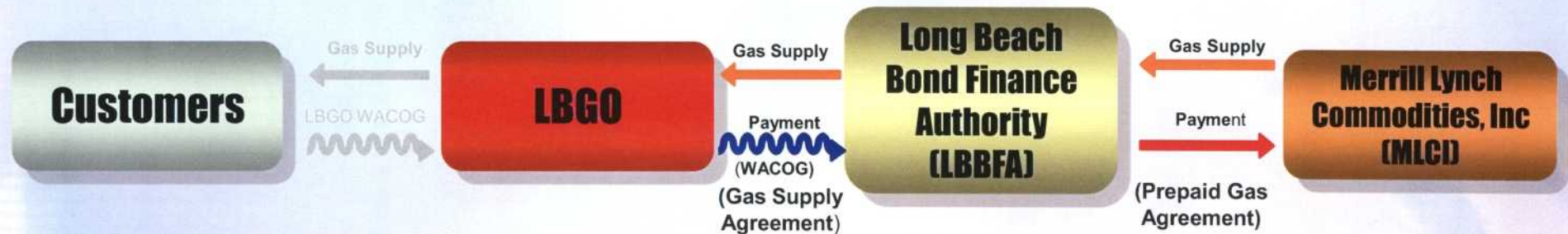
Background: Prepay Transactions

- In February 2007, the City issued an RFP
- There were nine RFP respondents. The City interviewed 5 of the parties:
 - Citigroup
 - Goldman Sachs
 - JP Morgan
 - Merrill Lynch
 - UBS
- Merrill Lynch was selected as it offered the best overall value and risk mitigation package

Prepay Structure: How the Deal Works

1. Form a JPA as Conduit Issuer

2. Enter Long Term Supply Contract



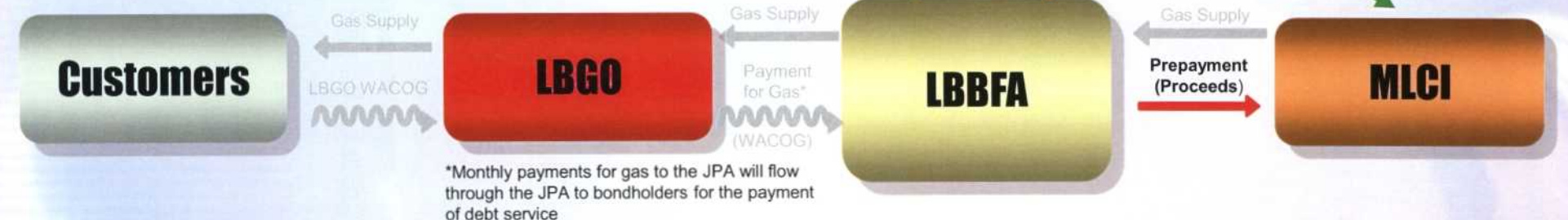
- The City will use the Long Beach Bond Finance Authority as the conduit issuer for purpose of issuing bonds and contracting with gas commodity provider
- LBBFA will contract for a 30-year gas supply at a fixed price, and will simultaneously contract with LBGO for the delivery of the natural gas

Prepay Structure: How the Deal Works

1. Form a JPA as Conduit Issuer

2. Enter Long Term Supply Contract

3. Issue Bonds for Prepayment



4. Lock in Discounted Fixed Price

- By prepaying, LBGO will buy gas at a fixed discount off the market price
- If MLCI defaults, payment obligation to bondholders shifts to ML as bonds are non-recourse to the City. ML would then make a termination payment to the City equal to unrealized savings. LBGO would revert to buying market gas.

Prepay Structure: How the Deal Works

1. Form a JPA as Conduit Issuer

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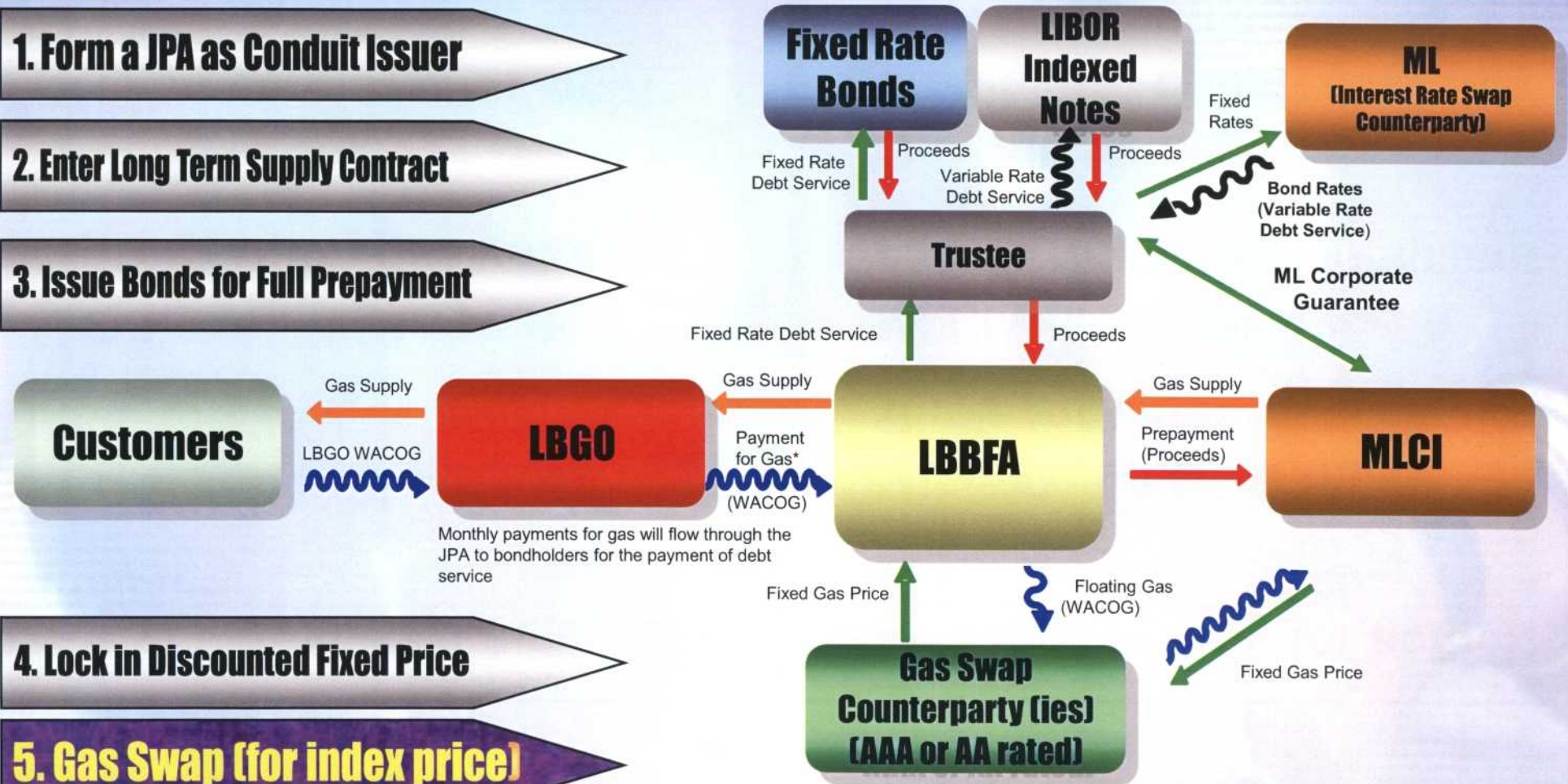
3. Issue Bonds for Full Prepayment

4. Lock in Discounted Fixed Price

5. Gas Swap (for index price)

6. Lock-in Discounted Index Price

7. Natural Gas Delivered

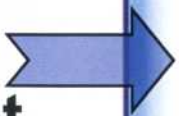
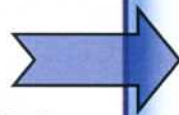
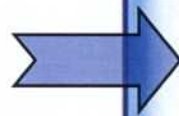
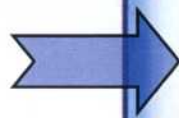


- The gas swap, required by federal tax law, converts the discounted fixed price to a discounted index price
- The gas swap also eliminates risk that would exist with a fixed price supply

Favorable Risk Allocation

Risk

- MLCI defaults on gas delivery
- Expected savings lost due to MLCI default
- LBGO unable to accept agreed upon gas volumes
- Rating agencies treatment of prepay debt
- Gas swap counterparty fails to perform



Mitigation

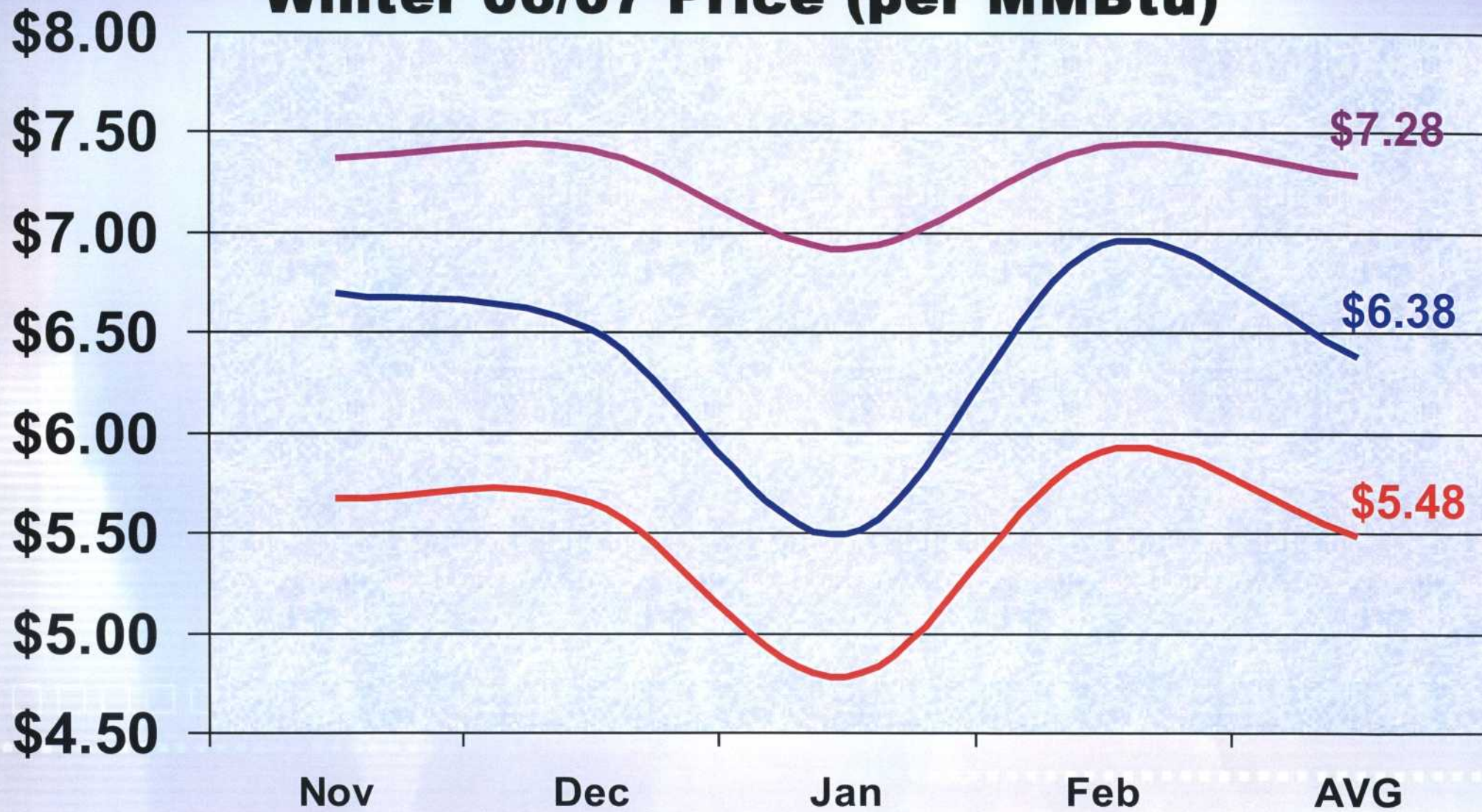
- ✓ LBGO pays only for actual gas delivered
- ✓ ML makes LBGO financially whole for unrealized savings
- ✓ MLCI will remarket gas to ensure regulatory compliance
- ✓ Conduit insulates City's credit, not counted as City debt by rating agencies
- ✓ Guarantor bears the risk

Terms Under Negotiation

- **Conduit Issuer:** Long Beach Bond Finance Authority
- **Underwriter/Supplier:** Merrill Lynch (proposed)
- **Term:** 30 years
- **Gas Supply:** 20,000 MMBtu/day (seasonally shaped)
- **Price Discount:** Estimated discount of \$1.00+ per MMBtu
- **Gross Cost Savings:** \$260 million, \$8.67 million annually
- **Prepay Bonds:** Fixed-rate bonds, will also consider LIBOR-indexed note structures that eliminate tax and basis risk
- **Savings Guarantee:** Supplier guarantees any unrealized savings in event of supplier default or early termination
- **Remarketing:** Supplier remarkets any excess gas

Cost Comparisons

Winter 06/07 Price (per MMBtu)



— SoCalGas — LBGO Actual — LBGO Prepay

Risk/Benefit Comparison

Current Supply

Prepay Supply

Price Risk

**Revenue
Shortfall**

**Long Term
Uncertainty**

**Decreased
Price Risk**

**Long Term
Stability**

**Competitive
Certainty**

**Funding Source
for Pipeline**



Independent Analysis

■ Conclusion of Recon Research report:

“The Long Beach gas prepaid purchase program appears to be a low risk transaction which can bring substantial benefits to the City’s gas utility. It is an innovative use of the City’s municipal bonding authority which is allowable under IRS regulation, and which should provide stable and cost-advantaged gas flows for baseload natural gas demands of LBGO.”

Next Steps

- Provide follow-up to Council, as needed
- Conclude negotiations with Merrill Lynch
- Obtain City Council approval in Aug 07
- Issue gas prepay bonds in Sept 07
- In Oct 07, begin deliveries of prepay gas and begin realizing cost savings



Questions or Comments???