Texas Municipal Gas Acquisition and Supply Corporation III

(A Texas Public Facility Corporation)

Financial Statements as of and for the
Years Ended December 31, 2019 and 2018, and
Independent Auditors' Report

TEXAS MUNICIPAL GAS ACQUISITION AND SUPPLY CORPORATION III
(A Texas Public Facility Corporation)

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Deloitte.

Deloitte & Touche LLP
Suite 4500
1111 Bagby Street
Houston, TX 77002-2591
USA
Tel: + 1 713 982 2000
Fax: +1 713 982 2001
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of
Texas Municipal Gas Acquisition and Supply Corporation III
Houston, Texas

We have audited the accompanying financial statements of Texas Municipal Gas Acquisition and Supply Corporation III (a Texas Public Facility Corporation) (the "Company"), which comprise the statements of net position as of December 31, 2019 and 2018, and the related statements of revenues, expenses, and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3–6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Deloitte & Touche LLP

April 27, 2020

This narrative is provided by the management of Texas Municipal Gas Acquisition and Supply Corporation III (the "Company" or "TexGas III") as an overview of the financial activities of the Company for the years ended December 31, 2019 and 2018. The information provided in this overview should be read in conjunction with the accompanying financial statements and footnotes.

Formation and Business Purpose

The Company, a Texas Public Facility Corporation, was organized under the laws of the State of Texas by the City of La Grange, Texas (the "Sponsor"), along with other affiliates similarly organized by the Sponsor, to procure and supply natural gas ("gas") under a municipal gas purchasing program (the "Program") to participating municipal utility systems ("Municipal Buyers"). The Company serves as one of three upstream affiliates in the overall program. As such, in December 2012, the Company issued long-term bonds and acquired a 20-year gas supply contract (the "Prepaid Contract") from Macquarie US Gas Supply LLC. The Company, in turn, sells all scheduled gas volumes under the Prepaid Contract to its downstream affiliate, Municipal Gas Acquisition and Supply Corporation ("MuniGas"), under a gas supply contract (the "Resale Contract") extending through October 2032.

In order to facilitate the 2012 financing and the Prepaid Contract, the Company entered into related commodity price swaps. The cumulative effect of the Prepaid Contract, the Resale Contract, and the commodity price swaps is intended to enable the Company to receive stable monthly cash flows, regardless of changes in gas prices, which are expected to be adequate to pay the debt service requirements on the Company's bond indebtedness and other expenses. In addition, the Company passes through an operating margin to MuniGas and, in turn, from MuniGas to Municipal Buyers in the form of monthly gas discounts and subsequent anticipated rebates. The Company has engaged Municipal Energy Resources Partners, Ltd. to manage and administer the Company's operations.

Condensed Statements of Net Position

	Years Ended December 31		
	2019	2018	2017
Assets:			
Current assets	$ 159,693,871	$ 140,571,478	$ 135,868,308
Noncurrent assets	1,947,155,533	1,904,847,210	2,000,353,032
Total assets	2,106,849,404	2,045,418,688	2,136,221,340
Liabilities:			
Current liabilities	104,966,915	79,875,510	70,154,416
Noncurrent liabilities	2,376,443,708	2,303,674,956	2,361,635,274
Total liabilities	2,481,410,623	2,383,550,466	2,431,789,690
Net position - restricted	$ (374,561,219)	$ (338,131,778)	$ (295,568,350)

Condensed Statements of Revenues, Expenses, and Changes in Net Position

	Years Ended December 31		
	2019	2018	2017
Net operating revenues	$ 97,230,357	$ 92,714,130	$ 88,651,554
Operating expenses	77,288,019	77,481,475	77,443,867
Operating income	19,942,338	15,232,655	11,207,687
Nonoperating expenses-net	(56,371,779)	(57,796,083)	(59,035,351)
Change in net position	(36,429,441)	(42,563,428)	(47,827,664)
Beginning net position	(338,131,778)	(295,568,350)	(247,740,686)
Ending net position	$ (374,561,219)	$ (338,131,778)	$ (295,568,350)

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Company's financial statements, which are composed of basic financial statements and the accompanying notes to the financial statements. In accordance with Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—Management's Discussion and Analysis—State and Local Governments*, TexGas III is considered a special-purpose governmental entity engaged only in business-type activities.

Financial Highlights

While the Company issued bonds and purchased the Prepaid Contract in December 2012, gas deliveries from the Prepaid Contract commenced on January 1, 2013. Since that time, 100% of scheduled deliveries have occurred as initially contracted. Since inception, the Company has been timely paid for 100% of its resulting gas sales to MuniGas and, in turn, to Municipal Buyers. The Company's commodity price swaps, along with its investments of funds maintained under its Indenture of Trust and Security Agreement, have all performed in accordance with the underlying agreements. Furthermore, at December 31, 2019, the account balances and related changes from 2018 were consistent with the Company's expectations and underlying agreements.

Other financial highlights for the year ended December 31, 2019, include:

1. Current assets increased by $19.1 million to $159.7 million, primarily due to an increase in the derivative valuation of the current portion of the price swaps.

2. Noncurrent assets increased by $42.3 million to $1,947.2 million, primarily due to an increase in the derivative valuation of the noncurrent portion of the price swaps, offset by greater amortization of the Prepaid Contract,

3. Current liabilities increased by $25.1 million to $105.0 million, primarily affected by the increase of the derivative valuation of the current portion of the Prepaid Contract, and the increase in the current portion of debt.

4. Noncurrent liabilities increased by $72.8 million to $2,376.4 million, primarily due to the increase in the derivative valuation of the Prepaid Contract, offset by the decrease in long-term debt.

5. Operating revenues, net of municipal discounts and rebates, increased by $4.5 million to $97.2 million. These revenues, in the aggregate, approximate the value of scheduled gas deliveries at the hedged price levels established in 2012.

6. Operating expenses remained relatively unchanged from 2018. As a result, operating income increased by $4.7 million to $19.9 million.

7. Nonoperating expenses—net decreased by $1.4 million to $56.4 million, largely due to reduced interest expense in 2019 relative to 2018.

8. Net position decreased by $36.4 million due to net nonoperating expenses exceeding net operating income.

Other financial highlights for the year ended December 31, 2018, include:

1. Current assets increased by $4.7 million to $140.6 million, primarily due to an increase in the derivative valuation of the current portion of the price swaps.

2. Noncurrent assets decreased by $95.5 million to $1,904.8 million, driven by the amortization of the Prepaid Contract, and a decrease in the derivative valuation of the noncurrent portion of the price swaps.

3. Current liabilities increased by $9.7 million to $79.9 million, primarily affected by the increase of the derivative valuation of the current portion of the Prepaid Contract, and the increase in the current portion of debt.

4. Noncurrent liabilities decreased by $58.0 million to $2,303.7 million, primarily due to the decrease in the derivative valuation of the Prepaid Contract, and the decrease in long-term debt.

5. Operating revenues, net of municipal discounts and rebates, increased by $4.1 million to $92.7 million. These revenues, in the aggregate, approximate the value of scheduled gas deliveries at the hedged price levels established in 2012.

6. Operating expenses remained relatively unchanged from 2017. As a result, operating income increased by $4.0 million to $15.2 million.

7. Nonoperating expenses—net decreased by $1.2 million to $57.8 million, largely due to reduced interest expense in 2018 relative to 2017.

8. Net position decreased by $42.6 million due to net nonoperating expenses exceeding net operating income.

TEXAS MUNICIPAL GAS ACQUISITION AND SUPPLY CORPORATION III
(A Texas Public Facility Corporation)

STATEMENTS OF NET POSITION
AS OF DECEMBER 31, 2019 AND 2018

	2019	2018
ASSETS		
CURRENT ASSETS:		
Restricted cash and cash equivalents	$ 1,525,989	$ 1,461,934
Accounts receivable:		
Sales to affiliate	3,785,379	7,968,839
Settled price risk management derivatives	5,499,803	841,340
Short-term investments—restricted	8,215,933	7,797,776
Current portion of prepaid natural gas contract	76,294,834	75,970,983
Prepaid expenses and other assets	37,189	47,355
Current portion of price swaps	64,334,744	46,483,251
Total current assets	159,693,871	140,571,478
NONCURRENT ASSETS:		
Prepaid natural gas contract (net of accumulated amortization of $544,683,916 and $468,712,933 in 2019 and 2018, respectively)	887,779,876	964,074,709
Price swaps	1,059,375,657	940,772,501
Total noncurrent assets	1,947,155,533	1,904,847,210
TOTAL	$ 2,106,849,404	$ 2,045,418,688

(Continued)

TEXAS MUNICIPAL GAS ACQUISITION AND SUPPLY CORPORATION III
(A Texas Public Facility Corporation)

STATEMENTS OF NET POSITION
AS OF DECEMBER 31, 2019 AND 2018

LIABILITIES AND NET POSITION	2019	2018
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	$ 83,786	$ 80,124
Bond interest payable	2,648,385	2,712,135
Current portion of long-term bonds	37,900,000	30,600,000
Current portion of derivative component of prepaid natural gas contract	64,334,744	46,483,251
Total current liabilities	104,966,915	79,875,510
NONCURRENT LIABILITIES:		
Long-term bonds	1,317,068,051	1,362,902,455
Derivative component of prepaid natural gas contract	1,059,375,657	940,772,501
Total noncurrent liabilities	2,376,443,708	2,303,674,956
Total liabilities	2,481,410,623	2,383,550,466
COMMITMENTS AND CONTINGENCIES (Note 9)		
NET POSITION—Restricted	(374,561,219)	(338,131,778)
TOTAL	$ 2,106,849,404	$ 2,045,418,688

See notes to financial statements. (Concluded)

TEXAS MUNICIPAL GAS ACQUISITION AND SUPPLY CORPORATION III

(A Texas Public Facility Corporation)

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	2019	2018
OPERATING REVENUES:		
Gas sales to affiliate (net of discounts and rebates of $8,288,389 and $7,968,431 in 2019 and 2018, respectively)	$ 45,427,111	$ 55,439,989
Price risk management derivatives income	51,803,246	37,274,141
Total operating revenues	97,230,357	92,714,130
OPERATING EXPENSES:		
Gas management services	49,299	48,167
Amortization of prepaid natural gas contract	75,970,983	76,190,606
General and administrative	1,267,737	1,242,702
Total operating expenses	77,288,019	77,481,475
OPERATING INCOME	19,942,338	15,232,655
NONOPERATING REVENUES (EXPENSES):		
Interest income	721,318	665,688
Interest expense	(57,093,097)	(58,461,771)
Nonoperating expenses—net	(56,371,779)	(57,796,083)
CHANGE IN NET POSITION	(36,429,441)	(42,563,428)
BEGINNING—Position	(338,131,778)	(295,568,350)
ENDING—Net Position	$ (374,561,219)	$ (338,131,778)

See notes to financial statements.

TEXAS MUNICIPAL GAS ACQUISITION AND SUPPLY CORPORATION III
(A Texas Public Facility Corporation)

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from gas sales	$ 49,610,571	$ 52,426,621
Receipts from price risk management derivatives	47,144,783	39,885,953
Payments for gas management services	(49,323)	(47,973)
Payments for general and administrative expenses	(1,256,969)	(1,255,233)
Net cash provided by operating activities	95,449,062	91,009,368
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of short-term investments—restricted	(418,157)	(356,156)
Collection of interest	724,400	655,896
Net cash provided by investing activities	306,243	299,740
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Principal payments on Bonds	(30,600,000)	(24,960,000)
Interest payments on Bonds	(65,091,250)	(66,339,250)
Net cash used in noncapital financing activities	(95,691,250)	(91,299,250)
NET INCREASE (DECREASE) IN RESTRICTED CASH AND CASH EQUIVALENTS	64,055	9,858
RESTRICTED CASH AND CASH EQUIVALENTS—Beginning of year	1,461,934	1,452,076
RESTRICTED CASH AND CASH EQUIVALENTS—End of year	$ 1,525,989	$ 1,461,934
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$ 19,942,338	$ 15,232,655
Amortization of prepaid natural gas contract	75,970,983	76,190,606
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable—sales to affiliates	4,183,460	(3,013,368)
(Increase) decrease in accounts receivable—settled price risk management derivatives	(4,658,463)	2,611,812
(Increase) decrease in prepaid expenses and other assets	7,084	(14,639)
Increase in accounts payable and accrued liabilities	3,660	2,302
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 95,449,062	$ 91,009,368

(Continued)

TEXAS MUNICIPAL GAS ACQUISITION AND SUPPLY CORPORATION III
(A Texas Public Facility Corporation)

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2019 AND 2018

	2019	2018
SUPPLEMENTAL SCHEDULE OF NONCASH FINANCING AND INVESTING ACTIVITIES:		
Amortization of bond premium	$ 7,934,404	$ 7,825,479

See notes to financial statements. (Concluded)

1. ORGANIZATION AND NATURE OF OPERATIONS

Texas Municipal Gas Acquisition and Supply Corporation III ("TexGas III" or the "Company") was organized pursuant to and in accordance with the provisions of the Texas Public Facility Corporation Act, Chapter 303; Texas Local Government Code; and other applicable laws in October 2012, under the laws of the State of Texas with the approval of the City of La Grange, Texas (the "Sponsor"). TexGas III began operations on December 4, 2012, as described below.

In December 2012, TexGas III issued Gas Supply Revenue Bonds Series 2012 (the "Bonds") under an Indenture of Trust and Security Agreement (the "Indenture") and acquired a prepaid natural gas supply contract (the "Prepaid Contract") for approximately 20 years from Macquarie US Gas Supply LLC ("Macquarie" or the "Prepaid Supplier"). Under the Prepaid Contract, Macquarie committed to deliver specific monthly volumes of natural gas to TexGas III at Henry Hub (H.H.). TexGas III agreed to sell all gas acquired under the Prepaid Contract through the Sponsor to Municipal Gas Acquisition and Supply Corporation ("MuniGas") under a gas supply contract (the "Resale Contract") extending through October 2032. As a result, the Company serves as an upstream supplier of gas to the Sponsor's municipal gas purchasing program (the "Program"), while MuniGas serves as the Program's downstream marketing affiliate.

Under the Resale Contract, TexGas III agreed to sell all of the gas it receives under the Prepaid Contract to MuniGas at a discount from the applicable first-of-month (FOM) H.H. gas price. The discount is determined by TexGas III monthly and intended to be the maximum discount that enables TexGas III to receive sufficient net revenues to pay debt service on its bonds and expenses, while also maintaining required cash reserves.

TexGas III has engaged Municipal Energy Resources Partners, Ltd. (the "Administrator"), acting through its general partner, Municipal Energy Resources Corporation (MERC), to manage and administer the Company's operations. The president of MERC serves as executive director of the Company.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting—The Company follows enterprise fund accounting and reporting requirements using the accrual basis of accounting. Under this approach, revenues are recognized in the period earned, and expenses are recognized in the period incurred. The Company's financial statements presented in this report conform to the reporting requirements of the Governmental Accounting Standards Board (GASB).

The Company distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from the sale of gas and all activities around the sale of gas including the amortization of the prepaid gas contract, gas management fees, and related general and administrative expenses. Non-operating items pertain to financing costs associated with the bonds issued including interest expense. Additionally, interest income is included as a non-operating item.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results are not expected to be materially different from those estimates.

Income Taxes—The Company, as a Texas Public Facility Corporation, does not recognize federal or state taxes in its financial statements.

Accounts Receivable from Related Party—The Company sells its natural gas derived from the Prepaid Contract to MuniGas, a related party. At December 31, 2019 and 2018, MuniGas owed the Company $3,785,379 and $7,968,839, respectively. Both of the aforementioned amounts due from MuniGas were paid in January 2020 and 2019, respectively.

Prepaid Natural Gas Contract—The cost of the Prepaid Contract and related costs incurred in acquiring it are capitalized as an asset. This asset is amortized using the units-of-production method as gas is delivered by Macquarie beginning on January 1, 2013. The Company's financial statements reflect amortization expenses in 2019 and 2018 related to this asset of $75,970,983 and $76,190,606, respectively, under amortization of prepaid natural gas contract in the statements of revenues, expenses, and changes in net position.

Natural Gas Revenues—Gas revenues, which represent a portion of operating revenues, are recorded using the entitlements method, whereby the Company recognizes revenues based upon the amount of gas supplies it is entitled to receive from the Prepaid Contract.

Restricted Cash and Cash Equivalents—Pursuant to GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, all cash on hand and highly liquid investments (including restricted cash and cash equivalents) on deposit with financial institutions having original maturities of three months or less when purchased are considered to be cash and cash equivalents for purposes of the statements of cash flows. Refer to Note 3 for further information on restricted cash and cash equivalents.

Investments—The Company accounts for its investments in accordance with GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements) and Reverse Repurchase Agreements*; GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*; GASB Statement No. 40, *Deposit and Investment Risk Disclosure*—an amendment of GASB Statement No. 3; and GASB Statement No. 72, *Fair Value Measurement and Application*. GASB Statement No. 31 and Statement No. 72 require an entity to report investments at their cost or fair market values in the statements of net position. The investments held by the Company are reported at cost basis, as required. GASB Statements No. 3 and No. 40 require an entity to disclose legal or contractual provisions for deposits and investments; the types of investments authorized by legal or contractual provisions; significant violations during the period of legal or contractual provisions; the entity's deposit or investment policy; and, for certain types of deposits and investments, the risks related to the deposits and investments held by the entity. Refer to Note 3 for further information on investments.

New Accounting Pronouncement—In March 2018, the GASB issued GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, effective for financial statement periods beginning after June 15, 2018. The statement establishes additional financial statement note disclosure requirements related to debt obligations. Refer to Note 4 for further information on the debt obligations.

3. RESTRICTED CASH AND CASH EQUIVALENTS AND INVESTMENTS

Money Market Funds—The Company entered into the Indenture with The Bank of New York Mellon Trust Company, N.A. (the "Trustee"), effective on November 15, 2012, in order to secure the Bonds. The Indenture permits the Company to invest excess cash on hand in certain investment-grade government and insured bank obligations. The Company's investment policy is to invest surplus cash in money market mutual funds (the "Money Market Funds") and to invest cash reserved for the principal and interest payments of the Bonds in investment contracts permitted under the Indenture. All cash and cash equivalents and investments are restricted for the uses prescribed by the Indenture. At December 31, 2019 and 2018, the Company had $1,525,989 and $1,461,934, respectively, on deposit with the Trustee in the Money Market Funds that are included as restricted cash and cash equivalents in the statements of net position.

Risk Disclosures

Interest Rate Risk—The Money Market Funds maintain an average maturity of less than 90 days and seek to maintain a stable net asset value of $1. Further, the Money Market Funds are redeemable on same-day notice.

Credit Risk—The Money Market Funds hold only US dollar-denominated securities that present minimal credit risk. Further, the Money Market Funds are short-term investments with a "AAA" credit rating.

Custodial Credit Risk—The custodial credit risk for the Money Market Funds is that, in the event of failure of a counterparty, the Company will not be able to recover the full value of its investment or collateral securities in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not registered in the name of the Company and are held by either the counterparty or the counterparty's trust department or agent, but not in the Company's name. At December 31, 2019 and 2018, none of the Company's Money Market Funds were subject to custodial credit risk.

Investments—The Trustee, on behalf of the Company, entered into a guaranteed investment contract (the "DSF Investment Contract") with a financial institution (the "Provider") on December 4, 2012, in accordance with the terms of the Indenture. The DSF Investment Contract includes the parameters for the investment of funds deposited by the Company that will be used for payments of bond principal and bond interest. The DSF Investment Contract provides a schedule for deposits and withdrawals that will be made over the term of the Bonds. Interest earned on the deposits under the DSF Investment Contract is recorded in the statements of revenues, expenses, and changes in net position under interest income during the period that such interest is earned. The investments are recorded in the statements of net position using their cost values. At December 31, 2019 and 2018, $8,215,933 and $7,797,776, respectively, of the deposits were classified as short-term investments—restricted.

The Provider's obligations are guaranteed by Natixis. Through December 31, 2019, the Provider was in compliance with the terms of the DSF Investment Contract.

Interest Rate Risk—The investments are fixed-rate investments with the Provider, and the Provider is obligated to prenegotiated rates of interest on the investments.

Credit Risk—At December 31, 2019, the guarantor's long-term, unsecured ratings and outlooks by S&P and Moody's were "A+ (stable)/A-1" and "A1 (stable)/P-1", respectively. Pursuant to the terms of the DSF Investment Contract, the Provider's guarantor must maintain long-term debt ratings of the lesser of (1) "BBB" and "A3" from S&P and Moody's, respectively, and (2) a rating as a result of which, together with any requirement to transfer collateral in favor of the Company or the Trustee, Moody's or S&P has confirmed that the rating assigned to the Bonds will not be reduced below "BBB"/"A3". At December 31, 2019, the Provider's guarantor maintained at least the minimum long-term debt ratings required to maintain the uncollateralized DSF Investment Contract.

Custodial Credit Risk—The custodial credit risk for the investments is the risk that, in the event of failure of the counterparty, the Company will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are not registered in the name of the Company and are held by either the counterparty or the counterparty's trust department or agent, but not in the Company's name. At December 31, 2019, none of the Company's investments were subject to custodial credit risk.

Public Funds Investment Act

Chapter 2256 of the Texas Government Code is known as the Public Funds Investment Act. This act authorizes the Company to invest its funds pursuant to a written investment policy which primarily emphasizes the safety of principal and liquidity, and addresses investment diversification, yield, and maturity. The Company is in compliance with the requirements of the Act in the areas of investment practices, management reports, and establishment of appropriate policies.

4. THE BONDS

On December 4, 2012, the Company issued the Bonds in the aggregate principal amount of $1,395,655,000. The Bonds were issued at fixed rates and included $136,698,000 of original issue premium. The original issue premium, net of accumulated amortization of $52,954,949 and $45,020,545 at December 31, 2019 and 2018, respectively, is included under long-term bonds in the statements of net position. Premium amortization of $7,934,404 and $7,825,479 for the years ended December 31, 2019 and 2018, respectively, is included as a reduction of interest expense in the statements of revenues, expenses, and changes in net position.

The Bonds are limited recourse obligations, payable solely from and to the extent of revenues and funds pledged and secured under the Indenture by the Company's trust estate, including the Prepaid Contract. Neither the Company's sponsoring municipality, its other affiliates nor any Municipal Buyers are obligated or authorized to pay the principal of or interest on the Bonds.

The Company entered into a Funding Agreement with the Prepaid Supplier intended to mitigate risks to bondholders resulting from a deficiency in funds available for debt service. The Funding Agreement provides additional liquidity to the extent needed by the Company in future periods. Refer to Note 5 for further information on the Funding Agreement.

At December 31, 2019, the Bonds were rated "BBB+" and "A3" by S&P and Moody's, respectively.

At December 31, 2019 and 2018, the Company's par value of long-term bonds consisted of the following:

Series	Rate	Due in 2020	December 31, 2019	Principal Reduction	December 31, 2018	Principal Reduction	December 31, 2017
2012	5%	$ 37,900,000	$ 1,271,225,000	$ (30,600,000)	$ 1,301,825,000	$ (24,960,000)	$ 1,326,785,000

At December 31, 2019, the Company's future debt service requirements through 2032 were as follows:

Years Ending December 31	Principal	Interest	Total
2020	37,900,000	63,482,292	101,382,292
2021	45,355,000	61,571,760	106,926,760
2022	51,405,000	59,291,406	110,696,406
2023	59,955,000	56,703,344	116,658,344
2024	49,390,000	53,727,604	103,117,604
2025-2028	328,280,000	186,467,583	514,747,583
2029-2032	698,940,000	90,573,125	789,513,125
Total	1,271,225,000	571,817,114	1,843,042,114

The Bonds are subject to optional and mandatory redemption prior to maturity, as detailed in the Issuer's publicly available Official Statement. Mandatory redemptions, either in whole or in part, will occur following a termination or reduction event under the Prepaid Contract, changes in certain laws that affect the treatment of the key transaction contracts, or certain specified uncured shortfalls in liquidity or reserves.

5. FUNDING AGREEMENT

On November 15, 2012, TexGas III and Macquarie entered into the Funding Agreement. Pursuant to the Funding Agreement, Macquarie has the obligation to make advances to TexGas III, upon request, to fund certain liquidity requirements. The term of the Funding Agreement is co-terminus with the term of the Indenture. The liquidity advances outstanding at any time may not exceed the amounts specified for each year in the Funding Agreement, ranging from $20.3 million to $64.0 million as the Bonds reach final maturity. TexGas III is obligated to reimburse Macquarie for advances under the Funding Agreement pursuant to the flow of funds of the Indenture. The obligation of TexGas III to reimburse Macquarie for advances made under the Funding Agreement is secured by a lien on the trust estate of TexGas III. No such advances were made from Macquarie to TexGas III during the years ended December 31, 2018 and December 31, 2019, respectively. TexGas III pays Macquarie periodic fees in consideration of Macquarie's obligations under the Funding Agreement. Such periodic fees are payable in arrears on a calendar-quarter basis. In 2019 and 2018, TexGas III incurred $209,840 and $199,184, respectively, in such fees. TexGas III has paid $1,271,179 in total fees through December 31, 2019. These fees were recorded in general and administrative expenses in the statements of revenues, expenses, and changes in net position.

Overview and Risk Disclosures

Objective—The objective of the Funding Agreement is to provide an additional source of cash liquidity to support certain potential cash flow deficiencies of TexGas III related to the Bonds.

Terms—Macquarie shall fund general expense deficiency advances, price swap deficiency advances, and senior expense deficiency advances to TexGas III. The term of the Funding Agreement is coterminous with the term of the Indenture and the Prepaid Contract.

Credit Risk—At December 31, 2019, the Company was exposed to credit risk through the risk of potential nonperformance by Macquarie under the Funding Agreement; however, Macquarie's payment obligations under the Funding Agreement are guaranteed by Macquarie Group Limited (MGL). At December 31, 2019, MGL was rated "BBB+" and "A3" by S&P and Moody's, respectively.

Termination Risk—The Funding Agreement may not be terminated by either party, unless there is an event of default or misrepresentation, as such events are defined in the Prepaid Contract.

6. DERIVATIVES AND HEDGING TRANSACTIONS

Prepaid Contract and Price Risk Management Swaps—The Company acquired the Prepaid Contract, which has been recorded in the statements of net position as prepaid natural gas contract and will be amortized using the units-of-production method. Under the terms of the Prepaid Contract, the Company will receive scheduled volumes of gas deliveries at H.H. over the contract's 20-year term. The purchase price paid for the Prepaid Contract considered future gas prices at the noted index point, in combination with the scheduled gas delivery volumes. In accordance with accounting principles generally accepted in the United States of America, the noted contract includes a derivative and, as a result, requires the derivative component to be adjusted to fair value for financial statements and disclosure purposes. The changes in fair value of the derivative component will fluctuate based upon the increases or decreases in future gas prices through the end of deliveries under the Prepaid Contract.

The notional volumes of the derivative in the Prepaid Contract are equal to the notional volumes under the Price Swaps (as defined below), and the variable price indices of the two derivatives are also equal. As a result, the change in the fair values of the Prepaid Contract will offset the change in the fair values of the Price Swaps presented below, unless the terms of the Prepaid Contract natural gas deliveries are amended without a corresponding amendment of the Price Swaps.

In connection with the issuance of the Bonds and the acquisition of the Prepaid Contract, the Company entered into two similar gas commodity price swap agreements (the "Price Swaps")—one with JPMorgan Chase Bank, N.A. ("JPMorgan Chase Bank") and one with Citibank N.A. ("Citibank") (each a "Price Swap Provider"). In the aggregate, the two Price Swaps cover all of the scheduled gas deliveries under the Prepaid Contract. Pursuant to the terms of the Price Swaps, the Company will pay a price equal to FOM H.H. index and will receive a fixed price for gas quantities scheduled to be delivered to the Company under the Prepaid Contract in such month. The Price Swaps extend through October 2032, the term of the gas deliveries under the Prepaid Contract.

Overview and Risk Disclosures

Objective—The objective of the Price Swaps is to hedge against potential fluctuations in future gas prices related to the scheduled deliveries of gas under the Prepaid Contract. As a result, the Price Swaps effectively hedge the change in the fair value of the Prepaid Contract from the initial commodity forward value.

Terms—The remaining notional amount of the Price Swaps totaled 258,991,000 MMBtus, the total volume of remaining gas to be delivered pursuant to the Prepaid Contract used to determine the value of the derivative component. The Company will receive monthly fixed prices that vary from $5.27 per MMBtu to $9.75 per MMBtu, and the Company will pay the monthly floating FOM H.H. index gas price. The termination date of the Price Swaps is October 31, 2032.

Fair Value— Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1	Quoted prices in active markets for identical assets or liabilities
Level 2	Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
Level 3	Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

The fair values of the derivatives are categorized as hierarchy Level 2, calculated using the future net settlement payments required by the Price Swaps, assuming that the current forward prices implied by an independent forward price quote obtained by the Company represent future spot prices. These net payments were then discounted using the spot forward curve of London InterBank Offered Rate through October 31, 2032.

As of December 31, 2019, forward gas prices had decreased from the prices embedded in the initial Price Swaps. As a result, the Price Swaps had positive fair values (asset) of $1,123,710,401 and $987,255,752 on December 31, 2019 and 2018, respectively. The current portion is recorded in the statements of net position as a current asset at December 31, 2019 and 2018, of $64,334,744 and $46,483,251, respectively. The long-term portion is recorded in the statements of net position as a noncurrent asset at December 31, 2019 and 2018, of $1,059,375,657 and $940,772,501, respectively. At December 31, 2019 and 2018, the fair value of the derivative component of the Prepaid Contract had a negative value (liability) of $1,123,710,401 and $987,255,752, respectively. The current portion is recorded in the statements of net position as a current liability at December 31, 2019 and 2018, of $64,334,744 and $46,483,251, respectively. The long-term portion is recorded in the statements of net position as a noncurrent liability at December 31, 2019 and 2018, of $1,059,375,657 and $940,772,501, respectively. The changes in the fair values are recorded in the statements of revenues, expenses, and changes in net position as nonoperating revenues and expenses. Since the changes in fair value of the Price Swaps created an unrealized income of $136,454,649 in 2019 and an unrealized loss of $15,404,045 in 2018, and the changes in fair value of the derivative component of the Prepaid Contract created an unrealized loss of $136,454,649 in 2019 and an unrealized gain of $15,404,045 in 2018, there was no impact on the statements of revenues, expenses, and changes in net position.

Fair value of the Price Swaps and the Prepaid Contract for the years ended December 31, 2019 and 2018, is as follows:

	2019	**2018**
Fair value of Price Swaps:	$ 1,123,710,401	$ 987,255,752
Current portion	64,334,744	46,483,251
Long-term portion	1,059,375,657	940,772,501
Fair value of Prepaid Contract:	(1,123,710,401)	(987,255,752)
Current portion	(64,334,744)	(46,483,251)
Long-term portion	(1,059,375,657)	(940,772,501)

Credit Risk—At December 31, 2019, the Company was exposed to credit risk since the Price Swaps had positive fair value. At December 31, 2019, JPMorgan Chase Bank held current long-term debt ratings of

"A+" from S&P and "Aa2" from Moody's, and Citibank held long-term debt ratings of "A+" and "Aa3" from S&P and Moody's, respectively.

Basis Risk—The Company is not exposed to basis risk on the Price Swaps since, pursuant to the terms of the Price Swap, the Company pays a floating price, which is equal to the floating price for gas deliveries pursuant to the terms of the Resale Contract between the Company and MuniGas (see Note 7 for further information on the Resale Contract). The Price Swaps essentially stabilize the cash flows of the Company throughout the life of the Prepaid Contract and the Bonds.

Termination Risk—Pursuant to the terms of the Price Swaps, the Company and the Price Swap Providers may not terminate the Price Swaps, unless there is a specified event of default or misrepresentation, as such events are defined in the Price Swaps. Pursuant to the terms of the Prepaid Contract, the Company and Macquarie may not terminate the Prepaid Contract, unless there is a specified event of default or misrepresentation, as such events are defined in the Prepaid Contract.

7. TRANSACTIONS WITH THE SPONSOR AND DOWNSTREAM AFFILIATE

In order to accommodate the closing of the Bonds and the acquisition of the Prepaid Contract, the Company and MuniGas entered into the Resale Contract with the Sponsor. Facilitated by the Prepaid Contract's scheduled deliveries beginning January 2013, the Company sold $53,715,500 and $63,408,420 of gas (prior to discounts and rebates) to MuniGas during 2019 and 2018, respectively.

8. TRANSACTIONS WITH THE ADMINISTRATOR

Administrative Agreements—The Company entered into two base administrative agreements with the Administrator in 2012 consisting of the Program Administration Agreement (PAA) and the Gas Management Agreement (GMA). These agreements describe the Administrator's responsibilities and compensation framework related to transactions and ongoing Program management. In order to accommodate the closing of the Bonds and the acquisition of the Prepaid Contract, the original PAA and GMA specified the tenure, specific fee levels, deferrals, and contingencies related to the 2012 transaction. In addition, extraordinary services provided by the Administrator have the potential, with the approval of TexGas III, for creating expenses in future periods associated with such extraordinary services.

PAA

Under the PAA and related Letter Agreements, the Administrator assumed general responsibility for managing and administering the Company's role in the Program, including the negotiation of necessary contracts, coordinating the duties and activities of outside professionals/advisers and service providers, as well as providing the services of the president of MERC as executive director of TexGas III. Under the PAA, the Administrator also maintains Program accounting and collection systems, arranges for required rebates of arbitrage earnings, prepares Program budgets, provides continuing disclosures and other compliance-related activities, recommends price discounts, and provides office space and equipment. In the performance of its duties, the Administrator does not serve as an independent registered municipal adviser to the Company. The Administrator agreed that payment of approximately 60% of its ongoing PAA fees was conditional upon cash being available after payment of all respective senior obligations.

Through the 20-year base term of the PAA, the Company has agreed to pay specified fees to the Administrator for ongoing financial services and administration based on the value of acquired assets (unless otherwise agreed through amendment), along with specified cash services fees; such fees are generally adjusted for changes in the Consumer Price Index (CPI). The Company also agreed to reimburse the Administrator for out-of-pocket expenses incurred by the Administrator for the Company's benefit.

The PAA specifies the Administrator's compensation for ongoing monthly financial services and administrative fees in addition to Program structuring and development fees payable at transaction closings. These fees are included under general and administrative in the statements of revenues, expenses, and changes in net position.

GMA

Under the GMA, the Administrator assumed general responsibility to employ and supervise overall gas management services to provide for, among other services:

(1) marketing and transportation of gas produced from mineral interests and other transactions;

(2) coordinating the exchange and, when necessary, gathering, processing, and transporting of gas to designated points of delivery;

(3) coordinating the delivery, receipt, and confirmation of all necessary gas nominations;

(4) coordinating and administering the Company's rights and obligations under all agreements;

(5) determining the amounts to be paid or received under commodity hedge agreements; and

(6) invoicing and collections for gas sales.

The Administrator also agreed that payment of approximately 60% of its GMA fees were conditional upon cash being available after payment of senior obligations.

The GMA defines the term and ongoing gas management fees paid to the Administrator, generally adjusted for changes in the CPI. Under the terms of the Letter Agreements (and in accordance with federal tax code), the GMA has a five-year term, which automatically extends annually, unless either party provides written notice not to extend at least 45 days prior to each December 2nd. As of December 31, 2019, the term of the GMA with TexGas III extends until December 2, 2024. The GMA fees are included under gas management services in the statements of revenues, expenses, and changes in net position.

Based on the terms of the PAA and GMA, the Company compensated the Administrator for the years ended December 31, 2019 and 2018, as summarized below.

	2019	**2018**
PAA fees	$ 915,016	$ 893,570
GMA fees	49,299	48,167
Total	$ 964,315	$ 941,737

9. COMMITMENTS AND CONTINGENCIES

The Company has not been served as a plaintiff or defendant in any pending or threatened legal proceedings. Furthermore, the Company does not have any financial guarantees, performance guarantees, or leases. In addition, the Company is obligated under the terms of the Resale Contract to deliver all volumes received from the Prepaid Contract to MuniGas for the term of the gas deliveries.

The Company is also required to maintain compliance with the terms of the Indenture, other Program documents, and various regulatory requirements. The Company is in compliance with all terms of the Indenture, all Program documents, and all regulatory requirements.

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