

The City of Albuquerque, New Mexico

COMMODITY COST MANAGEMENT POLICY

October 1, 2013

The goal of this Commodity Cost Management Policy (this “Policy”) is to establish responsibilities, objectives, and guidelines for the use of commodity cost management transactions (each a “Transaction”, or “Transactions”) to manage price risk related to commodity usage by the City of Albuquerque, New Mexico (the “City”) including, but not limited to, projected fuel consumption. This Policy and all Transactions shall collectively form the City’s commodity cost management program (the “Program”).

1. Authority

By recommendation of the Director of the Department of Finance and Administrative Services (the “Finance Director”) approval to execute a Transaction on behalf of the City shall be authorized by a resolution (each a “Resolution”) presented to and approved by the City Council on a case-by-case basis and pursuant to existing city policies and ordinance. The Debt Committee shall review, approve and recommend prior to Council adoption of Transactions. Management responsibility for the Program is hereby delegated to the Finance Director who shall establish written procedures for the operation of the Program consistent with this Policy.

The following nonexclusive list of criteria is included to help ensure that each Transaction executed by the City is in compliance with this Policy:

1.1 Resolution Guidelines

- 1.1.1 Each Resolution shall set forth applicable Transaction parameters including, but not limited to, anticipated volume / usage, commodity type, Transaction tenor (maturity), and sources of payments.
- 1.1.2 Each Resolution shall specify the appropriate City officials authorized to execute each Transaction contemplated by each Resolution within the parameters established by each Resolution.
- 1.1.3 Notwithstanding any expiration date specifically referenced in each Resolution, authorization granted under any Resolution shall expire 90 days after approval by the City Council.
- 1.1.4 In the event of a conflict between a Resolution and this Policy, the terms and conditions of each Resolution shall prevail.

- 1.1.5 Each Resolution shall set forth a finding that it is, or upon certain circumstances could be, prudent and advisable for the City to enter into Transactions to hedge usage of a specific commodity within the applicable budgetary period and that entry into each such Transaction is consistent with this Policy.

1.2 Program Advisor

The Finance Director will select and hire a Commodity Trading Advisor (the “Program Advisor”) that is registered with the Commodity Futures Trading Commission and regulated by the National Futures Association. The Program Advisor will assist the City: (i) in the management of the Program; (ii) in the implementation of each Transaction; and (iii) in the additional roles discussed in this Policy.

2. Purpose

The Program can be an integral part of the City’s ability to establish budgetary certainty with respect to anticipated commodity consumption or usage. It is the design of the Program that any Transaction agreed to by the City shall result in, but is not limited to, commodity price stability for all, or a portion, of certain anticipated commodity consumption or usage over a designated tenor.

The City shall not enter into a Transaction:

- 2.1 that is speculative or creates extraordinary leverage or risk based on a reasonably prudent investor standard;
- 2.2 for which the City lacks the adequate liquidity to terminate; or
- 2.3 that, at the time of execution, does not have sufficient price transparency to allow for reasonable valuation.

3. Counterparty Approval Guidelines

3.1 Eligibility for Over-the-Counter (“OTC”) Transactions

The City shall enter into each OTC Transaction only with qualified commodity hedge providers (each a “Counterparty”, or “Counterparties”). To qualify as a Counterparty under this Policy, at the time of entry into each OTC Transaction, the selected commodity hedge provider(s):

- (i) shall be rated at least AA-/Aa3/AA- by at least two of Standard & Poor’s Ratings Services (“S&P”), Moody’s Investors Service (“Moody’s”), and Fitch Ratings (“Fitch”), respectively, and shall have a minimum capitalization of \$50 million; or

- (ii) if rated below AA-/Aa3/AA- by at least two of S&P, Moody’s, and Fitch, respectively, or if not rated, shall provide credit support that may require such party to deliver collateral for the benefit of the City (a) that is of a kind and in such amounts as are specified therein and which relate to various rating threshold levels of the Counterparty or its guarantor, beginning at AA-/Aa3/AA- (S&P/Moody’s/Fitch) and (b) that, in the judgment of the City, is reasonable and customary for similar OTC transactions, taking into account all aspects of each OTC Transaction including without limitation the economic terms of each OTC Transaction and the creditworthiness of the Counterparty or, if applicable, its guarantor; or shall post suitable and adequate collateral (separate from any collateral requirements of Section 3.1.1) at a third party for the benefit of the City; or
- (iii) if rated below AA-/Aa3/AA- by at least two of S&P, Moody’s, and Fitch, respectively, or if not rated, shall obtain credit enhancement from a provider with respect to its obligations under each OTC Transaction that satisfies the requirements of clause (i) above, given the undertaking involved with the particular Transaction.

The City shall not enter into an OTC Transaction with a firm that does not qualify as a Counterparty consistent with the foregoing guidelines.

Each Counterparty shall make available audited financial statements and rating reports of the Counterparty (and any guarantor or credit enhancer, as the case may be) at the time of entering into each OTC Transaction and annually thereafter for so long as each Transaction remains outstanding. If at any time the Counterparty or credit enhancer undergoes a credit or regulatory review, then audited financial statements and rating reports of the Counterparty (and any guarantor or credit enhancer, as the case may be) shall be made immediately available to the City by the Counterparty.

3.1.1 Collateral Requirements

Collateral posting requirements between the City and each Counterparty shall not be unilateral in favor of the Counterparty. As part of each OTC Transaction, the City or the Counterparty may require that collateralization to secure any or all payment obligations under each OTC Transaction be posted. Collateral requirements shall be subject to the following guidelines:

- 3.1.1.1 Collateral requirements imposed on the City shall not be accepted to the extent that they would impair the City’s existing operational flow of funds.
- 3.1.1.2 Each Counterparty shall be required to provide credit support documentation (“Supporting Documents”) that is acceptable to the City.

- 3.1.1.3 A list of acceptable securities that may be posted as collateral and the valuation of such collateral shall be determined and mutually agreed upon during negotiation of each OTC Transaction with each Counterparty.
- 3.1.1.4 The market value of the collateral shall be determined on either a daily, weekly, or monthly basis by an independent third party, as provided in the documentation for each OTC Transaction.
- 3.1.1.5 Failure to meet collateral requirements shall be a default pursuant to the terms of each OTC Transaction.
- 3.1.1.6 The City and each Counterparty may provide in the Supporting Documents to each OTC Transaction for reasonable threshold limits for the initial deposit and for increments of collateral posting thereafter.
- 3.1.1.7 Each OTC Transaction may provide for the right of assignment by one of the parties in the event of certain credit rating events affecting the other party. The City (or the Counterparty) shall first request that the Counterparty (or the City) post credit support or provide a credit support facility. If the Counterparty (or the City) does not provide the required credit support, then the City (or the Counterparty) shall have the right to assign the Transaction to a third party acceptable to both parties and based on terms mutually acceptable to both parties. The credit rating thresholds to trigger an assignment shall be included in the supporting documents.

3.2 Eligibility for Exchange Traded Transactions

For a Transaction cleared through an exchange, the City's Counterparty will be the applicable exchange. No specific counterparty approval guidelines are necessary for an Exchange Traded Transaction.

3.3 Eligibility for Producer Price Agreements

No specific counterparty approval guidelines are necessary for transactions executed directly with the commodity producer.

4. **Transaction Descriptions**

The Finance Director shall, in consultation with the Program Advisor, determine the type of Transaction best suited to meet the City's commodity cost management needs on a case-by-case basis. The City may utilize, but shall not be limited to, any of the following Transaction types:

4.1 Producer Price Agreements

Producer Price Agreements are contracts negotiated and executed directly between the City and a producer of a specific commodity in which the producer will agree to deliver the commodity to the City in specified amounts on specific future dates at a specified price. The contract terms can include, but are not limited to, contract tenor, type of commodity, price, delivery amounts, delivery dates and locations, and any other applicable terms.

Risks associated with Producer Price Contracts can include, but are not limited to: (i) Consumption Risk (Section 6.3); (ii) Liquidity Risk (Section 6.4); and (iii) Delivery / Carry Risk (Section 6.6).

4.2 Futures and Options Contracts

Futures Contracts are agreements, commonly executed on the floor of a commodity exchange (i.e., exchange traded), to sell or buy a specific amount of a commodity, such as diesel fuel, gasoline, or natural gas, at a specific price and for delivery at a specific future date. Unless the contract is sold to another party before the settlement date, participants in the contract must buy or sell the underlying commodity

Futures Contracts differ from Options Contracts in that option buyers may choose whether or not to exercise the option on the exercise date. An option on a futures contract gives the holder the right, but not the obligation, to enter into a specific futures contract when the option expires. Positions may be either “long” (i.e., the option to buy the underlying asset) or “short” (i.e., the option to sell the underlying asset).

Risks associated with Futures and Options Contracts can include, but are not limited to, Liquidity Risk (Section 6.4) and Delivery / Carry Risk (Section 6.6).

4.3 Commodity Swaps and Other Derivative Transactions

Commodity swaps and other derivative transactions are OTC Transactions in which the City will agree to exchange cash flows with a Counterparty. Commodity swaps and other derivative transactions are financial transactions, and as such the City is expected to make and/or receive cash payments which are designed to offset the cost of its respective commodity purchases. There will be no physical delivery of a commodity under the terms of a Commodity swap or other derivative transaction.

Each commodity swap or other derivative transaction shall contain terms and conditions as set forth in a long-form confirmation for each Transaction, or in an International Swaps and Derivatives Association, Inc. (“ISDA”) Master Agreement and such other terms and conditions included in any supporting documentation including, but not limited to, schedules, credit support annexes, and transaction confirmations as approved in accordance with each respective Resolution. For any

commodity swap or other derivative transaction, the City shall follow all requirements of Section 7.1 of this Policy.

Risks associated with commodity swaps or other derivative transactions can include, but are not limited to: (i) Counterparty Risk (Section 6.1); (ii) Termination Risk (Section 6.2); (iii) Consumption Risk (Section 6.3); (iv) Liquidity Risk (Section 6.4); and (v) Basis (Index) Risk (Section 6.5).

5. General Guidelines for Transactions

Following is a list of certain guidelines that the City may follow in the evaluation and recommendation of each Transaction:

5.1 Legality

Each proposed Transaction shall fit within the legal constraints imposed by applicable federal and state statutes, City Resolutions, and existing City covenants and other contracts. Furthermore, the City shall determine that each proposed Transaction is consistent with this Policy.

5.2 Goals

Each Resolution shall clearly state the goals to be achieved through each proposed Transaction, and Transaction execution parameters shall be consistent with the City's stated goals.

5.3 Explanation of Risks & Benefits

Analysis necessary for the City staff, in consultation with its Program Advisor, to explain the costs, benefits, risks and other considerations regarding each proposed Transaction to the Finance Director must be included as a part of the approval process for each related Resolution.

5.4 Credit Ratings

Each proposed Transaction shall not have an adverse impact on any existing credit rating of the City.

5.5 Tenor

The City shall determine the appropriate term for each proposed Transaction on a case-by-case basis. However, in no circumstance may the term of each Transaction entered into by the City, or as applicable between the City and a Counterparty, extend beyond budgeted expected consumption.

5.6 Exit Strategy

The mechanics for determining termination values at various times and upon occurrences of various termination events shall be explicit in each Transaction. The Program Advisor and/or the Counterparty, if applicable, shall provide estimates under various economic scenarios of the potential costs, if any, of termination. Estimated termination costs and a plan for funding any such costs shall be considered during the approval process.

5.7 Volume

If the City's projected commodity usage does not align with its actual commodity usage in any budgetary period, then the City may be under-hedged or over-hedged in that particular budgetary period. For this reason, the City should consider hedging less than 100% of total projected commodity usage in any budgetary period (e.g., 80%).

5.8 Accounting Compliance

The impact of compliance with GASB standards, or other prevailing accounting principles, shall be disclosed in the City's annual financial reports.

5.9 Hedge Accounting

The City may, at its discretion, choose to implement hedge accounting treatment on a Transaction by Transaction basis. If the City elects hedge accounting treatment on a Transaction, then such Transaction will be constructed so that there is a reasonable expectation that it will qualify for hedge accounting treatment under GASB guidelines or other applicable rules.

5.10 Transaction Parameters

5.10.1 The Finance Director, in consultation with the Program Advisor, shall set forth specific commodity price targets and corresponding hedging volumes. The resulting transaction parameters shall be used as a guideline for the execution of each Transaction under the Program.

5.10.2 Select (and train if necessary) two persons from the Finance Department who shall be authorized to execute each Transaction when and as directed by the Finance Director in accordance with the authorization of each Resolution.

5.10.3 If the City chooses to hedge its commodity purchases for a given budgetary period, then by June 30th of the previous year, the coming fiscal year's appropriate budget category shall be hedged in such a way that the budget calculations can be

performed and the maximum expenses for each appropriate budget category can be determined.

5.11 Procurement

The Finance Director shall determine the appropriate procurement method for each Transaction contemplated. The Finance Director may select from, but is not limited to, the following procurement methods:

5.11.1 Competitive Bid

The solicitation of a Competitive Bid shall include not fewer than three Counterparties who are qualified under Section 3 of this Policy. If the City chooses to pursue a Competitive Bid for commodity swaps or other derivative products as part of the Program, then the City shall execute International Swaps and Derivatives Association, Inc. (“ISDA”) Master Agreements with as many Counterparties as the Finance Director deems necessary in order to assure through competition that the City transacts “at the market” and diversifies counterparty performance / credit risk.

5.11.2 Limited Bid

The solicitation of a Limited Bid shall include as many participants as deemed necessary by the Finance Director to ensure a fair and competitive process. All participants in a Limited Bid shall be Counterparties qualified under Section 3 of this Policy.

5.11.3 Negotiated Transactions

In the case of a Negotiated Transaction, the Finance Director: (i) shall set parameters for execution that are consistent with the related Resolution; (ii) may delegate to the Finance Department, in consultation with the Program Advisor, authority to negotiate the price; and (iii) shall arrange with the Program Advisor for delivery of a "fair market value" opinion. The Counterparty shall disclose to the Finance Director any payments made to third parties in connection with the execution of each Transaction. A Negotiated Transaction will only be executed with a Counterparty qualified under Section 3 of this Policy.

6. Transaction Risks

Certain risks may be created as the City enters into any Transaction. At the request of the City, the Program Advisor shall provide a disclosure memorandum to the City that shall include an analysis of the risks and benefits of each Transaction. In order to manage potential risks associated with the implementation of Transactions pursuant to the Program, guidelines and parameters for certain risk categories are as follows:

6.1 Counterparty Risk

Where applicable, the impact to the City of Counterparty default can be reduced by diversifying credit exposure across multiple Counterparties. The City may further mitigate Counterparty Risk by requiring Counterparties to post collateral on a mark-to-market basis, in accordance with the guidelines described in Section 3.1.1 of this Policy.

6.2 Termination Risk

Where applicable, the City may wish to mitigate termination risks associated with each Transaction.

A termination payment may be required in the event of termination of a Transaction due to a Counterparty default or following a decrease in the credit rating of the City or its Counterparty. It is the intent of the City to review all available options prior to effecting a termination or making any termination payment. All Transactions shall be designed to provide the City with sufficient time to determine whether it is financially advantageous to obtain a replacement Counterparty or to effect termination.

The City may wish to retain the right to terminate each Transaction at any time over its term at its then-prevailing market value. Termination values shall be readily obtainable through a market quote methodology or as provided by the Program Advisor.

The City may, but is not required to, explore the economic viability of a unilateral termination provision that allows termination without the necessity of a termination payment (i.e., cancellation options).

6.3 Consumption Risk

If the City's projected commodity usage does not align with its actual commodity usage in any budgetary period, then the City may be under-hedged or over-hedged in that particular budget period. For this reason, the City should consider hedging less than 100% of total projected commodity usage in any budgetary period (e.g., 80%).

6.4 Liquidity Risk

Where applicable, the City shall consider whether or not the market in which each Transaction trades is sufficiently liquid (i.e., if enough potential buyers and sellers participate actively in the market to assure fair pricing) for the type of Transaction being considered and the potential ramifications of an illiquid market for such type of Transaction. There may not be another appropriate party available to act as an offsetting Counterparty. The City may enter into liquidity or credit agreements with liquidity providers and/or credit enhancers to protect against this risk

6.5 Basis (Index) Risk

Where applicable, any index chosen as part of a Transaction shall be a recognized market index. The City shall not enter into a Transaction that does not have a direct correlation with the movement of an index, without thoroughly analyzing the risk associated with such Transaction.

The City shall not enter into a leveraged Transaction without thoroughly analyzing the risks associated with such Transaction.

6.6 Delivery / Carry Risk

Where applicable, the City shall be aware of its options with respect to physical delivery of commodities and, where applicable, shall make arrangements for the receipt and storage of any such physical delivery. The City shall confirm storage capacity (delivery) and the cost of such storage (carry) in advance of any such physical delivery of a commodity.

7. Regulatory Compliance

Following is a list of regulatory requirements imposed at the federal level with which the City shall make every reasonable effort to comply:

7.1 Dodd-Frank Compliance

Pursuant to the authority of Section 731 of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”), which includes amendments to the Commodity and Exchange Act (the “CEA”) regarding over-the-counter derivative instruments, regulations were published by the Commodity Futures Trading Commission (the “CFTC”) that define business conduct between swap dealers and their counterparties, including swap dealers engaged in swap transactions with state and local governmental counterparties such as the City (referred to in the regulations as “Special Entities”). The new business conduct rules are far ranging, and they can impact the City simultaneously on several fronts when entering into a Transaction in the form of a derivative, such as a commodity swap. The following sections are included in this Policy in order to help the City comply with the CEA as amended by Dodd-Frank:

7.1.1 Qualified Independent Representative

If the City elects to utilize Transactions in the form of a commodity swap or other derivative transaction as a part of the Program, then prior to the execution of any such transaction the City shall designate a qualified independent representative (the “QIR”) that meets the following criteria with respect to any such transaction:

- (i) has sufficient knowledge to evaluate the transaction and risks;
- (ii) is not subject to a statutory disqualification;
- (iii) is independent of the swap dealer or major swap participant;
- (iv) undertakes a duty to act in the best interests of the City;
- (v) makes appropriate and timely disclosures to the City;
- (vi) evaluates, consistent with any guidelines provided by the City, fair pricing and the appropriateness of the transaction; and
- (vii) is subject to restrictions on certain political contributions imposed by the CFTC, the Securities and Exchange Commission (the “SEC”), or a self-regulatory organization subject to the jurisdiction of the CFTC or the SEC (collectively, the “Enumerated Criteria”).

Prior to the execution of any subsequent Transaction in the form of a commodity swap or other derivative transaction, or as required by the City Council, the City shall conduct a review of its QIR to ensure that it still meets the Enumerated Criteria. If it is determined that the QIR no longer meets the Enumerated Criteria, then prior to the execution of any Transaction the City shall designate a replacement QIR that meets the Enumerated Criteria.

7.1.2 Written Representations

In order to ensure that the City is in compliance with the new regulations imposed by Dodd-Frank, the City may, but is not required to, execute certain documentation, as provided under ISDA mandated protocols, with its QIR and each Counterparty prior to entering into any Transactions in the form of a commodity swap or other derivative transaction. If the City elects not to execute a Protocol Agreement with each Counterparty, then the City shall provide an alternate form of written representation to each Counterparty that meets all applicable disclosure requirements as required by Dodd-Frank

7.1.3 Derivative Clearing Requirement

Section 2(h)(1) of the CEA requires that certain derivative transactions must be cleared through a derivatives clearing organization unless otherwise exempt from clearing under the “End User Exception” in Section 2(h)(7) of the CEA. In order to qualify for the End User Exception to the clearing requirements of the CEA, the Special Entity must report to the CFTC on either an annual or a transaction-by-transaction basis that it (i) is not a financial entity, (ii) is using swaps to hedge or mitigate commercial risk, and (iii) will notify the CFTC, in a manner set forth by the CFTC, how it generally meets its financial obligations associated with entering into non-cleared swaps.

If the City chooses to enter into Transaction in the form of a commodity swap or other derivative transaction as a part of the Program, then the City, in consultation with the Program Advisor, shall make its best efforts to comply with the applicable derivative clearing requirements of the CEA.

8. Reporting Requirements

The Finance Director shall review this Policy and propose changes (if any) to the City Council on an annual basis. This Policy must be reviewed and approved by the City Council annually in conjunction with the debt policy.

On a semi-annual basis, or as required by the City Council, an authorized designee of the City shall be required to report in writing the status of the Program to the City Council. Any such report may include, but not be limited to, the following information:

- 8.1 Disclosure of all changes to Transactions, or new Transactions entered into by the City since the last report to the City Council.
- 8.2 A summary of each Transaction including, but not limited to, the type of Transaction, specific terms, the marked-to-market value (if applicable), the Counterparty (including any guarantor or credit support provider) to each Transaction (if any), the final maturity date, and any other information of interest to the City Council.
- 8.3 The report shall: (i) include the credit ratings of each Counterparty; (ii) include the credit ratings of any credit enhancer insuring or guaranteeing payments or commodity delivery; (iii) indicate any Transaction default or rating change by a Counterparty; and (iv) indicate the results of any Transaction default, including the financial impact of the Transaction default to the City, if any.
- 8.4 The report shall list collateral posted by a Counterparty, if any, and by the City, if any, detailed by each Transaction and in total by each Counterparty. The report shall also include the market movement or rating change required to trigger a collateral posting requirement or additional collateral posting requirement, as applicable, for each Transaction. All collateral information shall be accompanied by the Program Advisor's collateral verification report.