For Jan 5th
Assembly
~~Thanksgiving~~ Clayton

Ver—

To: Assemblymembers
John Moosey
George Hays
Nick Spiropolous
Tammy Clayton
James Wilson

This packet is from the last Mayors Meeting on Municipal/State Allocation formula - ENG - Payment in Lieu of Property Taxes (PILT). Randall Kowalke and James Wilson attended with me last week.

~~[illegible]~~

PILT

75 mill to 80 mill to Kenai
54 mill to North Slope

Hypothetical PILT distribution between municipalities and state

						Municipalities	State of Alaska
$ 596,000,000						27%	73%
	PILT Payment						$ (149,000,000)
	Statewide PILT Allocation 100 purpose					$ 75,000,000	$ (75,000,000)
			Pipeline Miles	Compressor Stations	Percentage of Totals		
$ 140,000,000	Pipeline Allocation	North Slope Borough	183	2	23.02%	$ 8,701,560	$ 23,526,440
		Fairbanks North Star Borough	2	0	0.20%	$ 75,600	$ 204,400
		Denali Borough	86	1	11.03%	$ 4,169,340	$ 11,272,660
		Matanuska-Susitna Borough	179	2	22.80%	$ 8,618,400	$ 23,301,600
		Kenai Peninsula Borough	50	0	5.00%	$ 1,890,000	$ 5,110,000
		State of Alaska	304	3	37.95%		$ 53,130,000
$ 171,000,000	GTP and Feeder Pipeline Allocation	North Slope Borough			100.00%	$ 46,170,000	$ 124,830,000
$ 285,000,000	LNG Plant Allocation	Kenai Peninsula Borough			100.00%	$ 76,950,000	$ 208,050,000
						$ 221,574,900	$ 225,425,100

129,000,000

454,425,100

ASSUMPTIONS - Pipeline mileage, compressor station locations, % cost estimates subject to change

Original construction cost for total project, $55 billion:

LNG plant and marine facility, $25 billion

North Slope gas treatment plant and Point Thomson pipeline, $15 billion

Main pipeline and compressor stations, $15 billion

Compressor stations (eight initial stations) represent 20% of the construction cost of the pipeline component of the Alaska LNG project (42-inch line)

100,000 people
100
$1,000,000

PILT calculations as per state/producers negotiated formula presented to the municipal advisory group Sept. 23, 2015

(Original cost + inflation factor - depreciation x throughput x blended mill levy)

PILT calculations and municipal shares based on assumed blended levy of 13.75 mills

43.56

Allocations of PILT revenues:

50:50 split of revenues after accounting for State PILT payment and Statewide allocation

Projected PILT revenues are for eighth year of operations

(Due to the five-year rolling average for actual throughput in the PILT calculation, the eighth year could be the first year under the formula to reflect full operations -- assuming three years for phased start-up of the three liquefaction trains and three gas treatment plant trains.)

20 mill to normal
20% tax

(SOA/DOR) 12-14-15

65 billion cost + value
55 billion total cost

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(SOA/DOR) 12-14-15

DRAFT MUNICIPAL-STATE ALLOCATION FORMULA

FOR ALASKA LNG PROJECT PAYMENTS IN LIEU OF PROPERTY TAXES (PILT)

I. Introduction

The commercial sponsors of the Alaska liquefied natural gas project (Alaska LNG) have negotiated with the State of Alaska a methodology and formula under which the project will make payments in lieu of the property taxes (PILT) that the project might otherwise pay to the state and municipalities during project operations based on annual assessed value under AS 29.45 and AS 43.56. The agreement under consideration includes a PILT formula based on the original cost of the project infrastructure with certain annual adjustments for inflation, depreciation and throughput. Once that PILT structure is formally accepted by the project sponsors and the state, the state — not the project sponsors — shall be responsible for allocating a share of the revenues among those municipalities in which the project is located. A share of the revenues also may be distributed to all communities in the state, regardless whether there is any taxable property of the Alaska LNG project within the communities.

The Municipal Advisory Gas Project Review Board (MAG board) proposes a distribution formula intended to apportion the negotiated PILT payments to each municipality in which the project is located based on the percentage of the project within the municipality.

In addition to the PILT distributions based on the percentage of the Alaska LNG project within a municipality's borders, this proposal also provides a per capita payment for each municipality in the state regardless of its connection to the project property. This per capita distribution will allow all communities to share in the project's benefits to Alaska and assist in dealing with any additional costs as a consequence of the project. The per capita distributions would be in addition to the proportional PILT payments for those municipalities where the project is located.

The two components of this distribution plan — one based on payment in lieu of taxes for Alaska LNG property and one based on population — are designed to apply only to municipalities.

II. Allocation of PILT for project property in a municipality: Calculation of proportional allocation.

A. The Department of Revenue shall

(1) determine the proportional share of the Alaska LNG Project located within each municipality and located outside any municipality, expressing the shares as a percentage to the nearest one-hundredth (0.001) of the project cost:

(2) divide the project into three components, each with its own proportional calculation as described in A(1) of this section;

(a) The gas treatment plant at Prudhoe Bay and the natural gas pipeline from Point Thomson to Prudhoe Bay;

(b) The main pipeline, compressor stations and related infrastructure for transporting natural gas from the gas treatment plant at Prudhoe Bay to the intake to the liquefaction plant at Nikiski;

(c) The liquefaction plant, LNG storage tanks, jetty, marine facilities and related infrastructure at the LNG plant site located in Nikiski.

(3) calculate the proportional share of the project cost for each project component in A(2) of this section within each municipality's borders and outside any municipality as a percentage of the component total, as illustrated by the following example:

If 17.052 percent of the Alaska LNG Project in Component A(2)(b) is located within Borough A, 71.894 percent in Borough B, and 11.054 percent outside a municipality, then 17.052 percent of the PILT for Component A(2)(b) would be allocated to Borough A, 71.894 percent to Borough B, and 11.054 percent to the state.

(4) On September 1 of each year, pay to each municipality the percentage of the Alaska LNG PILT revenue paid to the state that year that is proportional to the municipality's share of the project cost of the Alaska LNG project within its borders as calculated under A. (1) – (3) of this section.

B. Non-municipal allocation. The state's allocated share of PILT funds for the proportional share of Alaska LNG property outside of any organized municipality shall be deposited in the general fund.

C. Property not related to the project. This section does not preclude a municipality from levying and collecting a municipal tax on the full and true value of taxable property under AS 29.45 or AS 43.56 that is unrelated to the Alaska LNG project and not part of the PILT agreement negotiated by the project sponsors and the state. However, this section anticipates that additional property may be added to the project subsequent to the initial PILT calculation by the Department of Revenue, and that such additions shall require the department to recalculate the PILT allocation formulas stated above in II.A. To further clarify, t~~Nor~~his section does not~~it~~ prevent a municipality from levying and collecting property taxes on property outside of ~~not covered by or added subsequent to~~ the PILT agreement between the state and Alaska LNG Project sponsors, regardless whether that property may be used to produce natural gas for eventual inclusion in the Alaska LNG Project.

D. Reconsideration. A municipality aggrieved by the determination of proportionate share under A(1) or (2) of this section may within 45 days of the determination seek reconsideration from the commissioner of revenue. As the distribution formula under this section is based on the percentage of the cost of project property within a municipality's boundaries, a municipality may only seek reconsideration of the percentage allocation of property within its boundaries and not a determination of infrastructure costs. The commissioner shall have 60 days to issue a decision on a reconsideration request. A dispute involving taxation under (c) of this section shall be determined as provided in AS 29.45 and AS 43.56.

E. Definition. In this section, "project cost" means the amount the state and the Alaska LNG project's commercial sponsors have agreed represents the original cost of the Alaska LNG project, but does not include subsequent annual adjustments for inflation or depreciation. "Project cost" would include any subsequent additions to the Alaska LNG project, as described in VI. below.

III. Per-capita allocation.

A. In addition to the PILT funds distributed to those municipalities that have Alaska LNG property within their boundaries, the Department of Revenue shall on September 1 of each year distribute to each municipality in the state from the state's share of PILT funds paid by the project participants an amount equal to $100 per capita multiplied by the number of residents of a municipality. A municipality is eligible for a per capita payment whether or not there is Alaska LNG project property within its borders.

B. Notwithstanding B(1) of this section, the Department of Revenue shall pay a minimum of $25,000 a year to a municipality with a population of 500 or less.

C. The population of the municipality shall be determined by the Department of Commerce, Community and Economic Development as provided in AS 29.45.080(e).

D. A municipality may within 45 days of a population determination under this section seek reconsideration from the commissioner of commerce, community and economic development.

IV. Funding; payment process.

The Department of Revenue shall administer the payment of the allocations made under II and III from a fund established in the general fund to receive payments made by the Alaska LNG Project in lieu of property taxes paid to the state and municipalities.

V.. Payments not subject to cap.

The payments made to municipalities under sections II and III are not subject to the limitations set out in AS 29.45.080 - 29.45.090.

VI. Discussion.

PILT. The proportional allocation determination by the Department of Revenue each year of Alaska LNG property covered by the PILT agreement should take into account not only pipeline mileage, but also the presence of compressor stations and other project-related infrastructure. (Basing the proportional sharing for the pipeline component of the project on mileage alone, for example, would not account for the value of compressor stations along the route.) As noted above, the basis for determining the value of the property covered by the municipal distribution proportional-sharing formula shall be the original cost as established in the negotiated PILT calculation between the project sponsors and the state. Though that negotiated PILT formula includes annual inflationary escalation and depreciation factors, neither would change the proportionate share of the subject property within each municipality, allowing the percentages under the original cost determination to remain valid through the life of the PILT agreement unless property is later added to the project (such as additional compressor stations). Additions to the project subsequent to the original PILT calculation, such as additional compressor stations, additional pipeline mileage or related improvements, expansions and other real property, shall require the Department of Revenue to revise its proportional shares of project components within the affected municipalities. (Such unknown additions are not presently included in this proposal.)

For comparison purposes, there are other PILT funding distribution programs in state statute, some based on the value of the property in question, others on a formula related to road mileage, school population, or the dollar amount of receipts.[1]

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[1] For example, in the forest receipts program, the federal government pays the state based on stumpage payment and road construction credits. 16 U.S.C. 500. Payments are allocated to a

Per-capita payments. The per-capita payments are proposed as a form of revenue sharing to ensure that the benefits of the project, apart from access to natural gas, are shared by the state as a whole, especially as the state will be a partner in the venture. This proposal would establish a stable, long-term funding source for revenue sharing to municipalities.[2]

municipality based on the proportion of its area in a national forest, to a city exercising road powers a portion of road miles, and to regional education attendance areas based on student population. AS 41.14.180. The federal government PILT program for national park land is paid to a local government with park land within its boundaries, based on population and lost real estate taxes in the amount of 1% of fair market value on the date the federal government acquires interest in the real estate. 31 U.S.C. 6902, 6904. AHFC's holdings for the purpose of providing housing are subject to PILT that are based on the properties' value. AS 18.55.620.

[2] *Compare*, for example, the state community revenue sharing program, which involves a base amount depending on municipality type, with additional funds (if available) distributed on a per capita basis. AS 29.60.850 – 29.60.890.

ALASKA LNG PROJECT MUNICIPAL IMPACT GRANT PROGRAM

TABLE OF CONTENTS

I. INTRODUCTION

The Municipal Advisory Gas Project Review Board (MAG board) is tasked with, among other things, providing recommendations concerning the financial and other impacts on Alaska communities from the development and construction of the Alaska liquefied natural gas (Alaska LNG) project, which will include construction of a 56-mile gas pipeline from Point Thomson to Prudhoe Bay, a gas treatment plant at Prudhoe Bay, an 806-mile pipeline from Prudhoe Bay to Nikiski, and a gas liquefaction plant and storage tanks and marine terminal at Nikiski..[1] The parties to the Alaska LNG project have agreed that the project participants should make impact payments during construction to offset costs borne by state and local government in lieu of property taxation under AS 43.56 and AS 29.45..[2] The MAG board proposes that impact funds be placed in a nonlapsing capitalized fund. The fund should be divided into two subfunds, one for the purpose of addressing the project's impact on statewide and unincorporated communities and the other to fund a grant program to distribute funds to affected municipalities. The municipal program should be administered by the Department of Commerce, Community and Economic Development (DCCED). The proposed municipal grant process and a brief discussion of its rationale are set out below.

[1] Section 74, ch. 14, SLA 2014 (28th Legislature's SB 138, enacted May 8, 2014); Administrative Order No. 269 (March 25, 2014).

[2] *See* "Heads of Agreement" at 15, par. 9.3.1(b) (January 14, 2014).

II. GRANT PROCESS

1. General objective.

The primary objective of the municipal impact grant program is to provide financial assistance to municipalities to address the impacts of the development and construction of a natural gas pipeline, liquefaction plant and associated infrastructure for the Alaska LNG project as described above.

2. Administration.

(a) The Department of Commerce, Community and Economic Development, will receive, review, and evaluate applications for grants from eligible municipalities.

(b) Grant awards shall be made from a nonlapsing fund consisting of negotiated payment in lieu of property taxes for the purpose from the entities participating in the development and construction of the Alaska LNG project.[3]

(c) If the total amount of money requested by eligible municipalities exceeds the amount in the fund, the department will allocate the available funds in accordance with the criteria set out in paragraph II.8 below.

3. Eligibility.

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[3] The creation of the fund, a municipal grant program, and the initial assignment of a department to administer the grant program will require statutory changes.

(a) To be eligible to receive assistance under the municipal impact aid grant program, an applicant must

(1) be a municipality under AS 29;

(2) demonstrate that the construction of infrastructure for the Alaska LNG project has a direct impact on the applicant or the applicant's residents;

(3) have the legal authority to exercise the powers necessary to carry out the work to be funded by the grant.

(b) To be eligible for funding, the applicant's project must be for the purpose of addressing the Alaska LNG project's impact on the applicant municipality and for the purpose of

(1) planning;

(2) construction, maintenance, and operation of essential public facilities; or

(3) the provision of necessary public services.

4. Submission of applications; technical assistance to applicants.

(a) Applications must be made on forms provided by the department.

(b) The department shall provide all municipalities with technical assistance in completing the application, including written step-by-step instructions and training and information sessions and materials.

5. Evaluation of applications.

(a) In determining the merit of an application, the department shall consider the impact of the development and construction of the Alaska LNG project on

(1) the applicant's ability to provide essential public services and prevent the degradation of existing services, including health care, social services, public safety, housing, education, transportation, utilities, and government administration;

(2) the applicant's population, finances, or employment;

(3) the alleviation or mitigation of adverse economic, social, or cultural impacts on the applicant or the application's residents; or

(4) other facilities, services and functions of demonstrable importance to the applicant or the applicant's residents that are or will be affected by the development and construction of the Alaska LNG project.

(b) Examples of impacts that eligible projects may address include, but are not limited to, the following:

(1) increased public safety needs: police protection, search and rescue, fire protection, and emergency medical services;

(2) increased public health and social services needs: hospitals, clinics, emergency medical facilities, alcohol and drug abuse facilities, mental health facilities, homeless shelters, waste disposal systems, and water distribution systems;

(3) increased burdens on municipally owned utilities: electric generating plants and distribution systems, waste disposal, water supply systems, telephone systems, and any fuel distribution systems;

(4) increased need for housing, educational and other public services and facilities: educational institutions, recreational facilities activities, daycare centers, affordable housing and related infrastructure, and local and regional roads and transportation systems;

(5) planning, design, and engineering activities related to an eligible project.

(c) A project is not eligible for funding if it is

(1) made necessary by the applicant's failure to maintain existing infrastructure, services and facilities rather than by the impact of the Alaska LNG project;

(2) for a new infrastructure, service, facility, or enterprise the need for which is not the result of the development and construction of the Alaska LNG project.

(d) The department shall issue decisions on grant applications within 60 days after submission of a complete application and all necessary backup requested of the applicant.

6. Award and payment of grants; reports and records.

(a) The department may accept applications and award grants on a continuous basis except that if there are insufficient funds under section II.8, below, the department may set a deadline for applications.

(b) The department may

(1) pay a grant award of under $100,000 in a lump sum;

(2) for grant awards of $100,000 or more, make periodic payments for the anticipated expenses of a project based on the municipality grantee's anticipated expenses for the period and, after the initial payment, based on progress reports submitted by the grantee;

(c) The department shall not require a grantee to obtain funding on a reimbursable basis.

(d) A grantee shall retain records related to the grant and shall make them available to the department at the department's request.

(e) The department may require a grantee to make reports to the department on its use of grant funds, but shall not require a grantee to obtain a grant-specific audit.

(f) A grantee may make amendments to a project with notice to and the consent of the department.

(g) If a project revision is not approved, or if the project as it was originally funded is not feasible or is discontinued, the grantee shall return any remaining funds to the department.

(h) If a grantee misuses or mismanages grant funds awarded under this section, the department shall cease payment and recover misspent payments; recovered payments shall be returned to the fund.

7. Priority for award of grants.

If the total amount of money requested by eligible applicants for eligible projects in meritorious applications exceeds the amount available for grants, the department shall

(a) give notice to the commissioners of revenue and natural resources and to the Legislature of the insufficiency of funds and seek additional funding for grants under this program.

(b) and until or unless such additional monies are deposited into the municipal grant program fund, the department shall rank applications for the purpose of establishing priority for funding based on

(1) the relative degree of the impact of the Alaska LNG project on the municipality in comparison with other applicants;

(2) the degree to which the project proposed in the grant application alleviates the impact caused by development of the Alaska LNG project; and

(3) the ability of the applicant to accommodate or absorb the impacts through existing facilities or programs.

8. Reconsideration.

An applicant aggrieved by a decision made under this chapter may within 45 days of the decision request reconsideration by the commissioner of commerce, community and economic development.

8. Definitions.

(a) "Alaska liquefied natural gas project" has the meaning given in AS 31.25.390.

(b) "Direct impact" means an effect that is clearly attributable to the development and construction of the Alaska LNG project.

III. DISCUSSION

1. Considerations.

(a) The MAG board has requested that DCCED administer the program because it has a long history of administering municipal grant programs.[4] The impact aid fund will pay for projects made necessary by the impact of construction of the Alaska LNG project in lieu of affected municipalities' ability to assess and collect property taxes during construction. Because the fund will cover the expenses of municipal operations rather than the development of new energy-related projects, the expansion of businesses, or the state's participation in a commercial enterprise, DCCED seems a better choice than the Alaska Energy Authority, the Alaska Industrial Development and Export Authority or the Alaska Gasline Development Corporation to operate the program.

(b) The grant program should to be simple enough that municipalities do not have to hire grant writers, and rationally operated so that municipalities receive what they need but are accountable for their expenditures.

(c) As reflected in paragraph II.6, the MAG board recommends that once a project is approved, grant funds be provided promptly, without requiring the grantee municipality to advance its own funds to initiate the project. This aim will also be served by awarding (or denying) grants on a rolling basis.

[4] Several such programs are administered by DCCED's division of community and regional affairs. *See, e.g.*, AS 29.60.450 (fisheries business tax allocation); the National Petroleum Reserve – Alaska special revenue fund (AS 37.05.530(c)); community development block grants (AS 44.33.020, administering 42 U.S.C. 5301 ff.).

(d) Grantees should not be required to incur audit expenses. For smaller projects, and in smaller municipalities, the cost of an independent audit or audited financial statement can be prohibitive. The need for accountability can be served with adequate recordkeeping and reporting requirements, and, in any case, municipal expenditure of any grant program funds would be subject to review in the annual audit or statement required of a municipality under AS 29.35.120.

(e) The program should be funded from a non-lapsing capital fund to assure the availability of the Alaska LNG project's impact payments over the multi-year life of its construction..[5]

(f) Payments for projects in communities that are not municipalities should be made from the state's portion of the impact funds.

2. Anticipated impacts.

Paragraph II.5.b. sets out, by way of example, but not limitation, examples of the types of projects that might be funded by the program. In the Alaska LNG project's first draft resource reports submitted February 2, 2015, to the Federal Energy Regulatory Commission, the parties to the project indicate that they anticipate impacts in the areas of "population, employment, housing, public services, construction payroll and material purchase, tax revenue, land use, transportation and traffic management, subsistence, health impacts, and environmental justice.".[6] In the

[5] Enabling legislation will be necessary to authorize such a fund. For examples of nonlapsing funds, see AS 18.08.085 (trauma care fund); AS 37.06.010 (municipal capital project matching grant program); AS 43.90.400 (Alaska Gasline Inducement Act reimbursement fund).

[6] "Draft Resource Report No. 5, Socioeconomics," Docket No. PF14-21-000; Doc No: USAI-EX-SRREG-00-0005 at 5-3, par. 5.1.1(February 2, 2015) (Public Version), a component of the environmental impact statement required for an application governed by the federal Natural Gas Act under 18 C.F.R. 380.12(g).

submission, the project participants set out the facilities it anticipates the project will use, where they may be located, and a general indication of what impact might occur..[7] The examples provided above fall generally within the categories already identified. A municipality applying for grant fund under this program may find it useful to examine the subsequent, more detailed versions of the project's resource reports as it considers what its needs might be, with the understanding that this grant program is limited to the construction phase of the Alaska LNG project.

[7] Draft Resource Report No. 5 at 5-7 – 5-11 (identifying potentially affected communities); at 5-84, par. 5.3 (setting out indicators of potential construction and operations impacts, and potential mitigation measures). In Report No. 4, Cultural Resources, the project identifies in greater detail the anticipated impact of particular activities on air and marine navigation, water, waste disposal, the use of public land, the environment for similar projects. Docket No. PF14-21-000, Doc. No. USAI-EX-SRREG-00-0004 at Appendix F,

Oct. 30, 2015

Governor Bill Walker
Senate President Kevin Meyer
House Speaker Mike Chenault

The Municipal Advisory Gas Project Review Board commends the administration and legislature for their efforts to advance the Alaska LNG project. The decisions are not easy, the numbers are huge and the risks significant — as are the potential rewards for the state and its residents. Thank you.

The municipal review board would like to address two important issues currently being worked by state negotiators that we expect could come before the legislature next year. They are the issues of impact payments to municipalities during project construction (in lieu of property taxes), and the negotiated payment in lieu of property taxes (PILT) during project operations.

The state negotiating team and Alaska LNG project sponsors ExxonMobil, BP and ConocoPhillips have settled on impact aid payments during construction totaling $800 million, with the expense shared by the producers and the state. The negotiations also settled on a formula for calculating PILT during project operations, targeting $15.7 billion in revenues over a 25-year period.

The municipal advisory group has no significant problem with either of the raw numbers or the calculation methodology for the PILT. Although only one part of a bigger equation, the numbers look reasonable. It's the allocation of those amounts that concerns us. We realize the need for the state and its partners to move ahead with negotiating and setting fiscal terms in order to stay on schedule for a project decision in the third quarter of 2016 for front-end engineering and design. As such, the advisory group is willing to endorse the gross numbers agreed to in the negotiatons, as long as everyone accepts that detailed discussions still need to occur for the net distribution to the municipalities — recognizing those discussions are entirely between the state and municipalities and do not involve the producer partners.

While the municipalities understand the need for a negotiated structure for impact aid and PILT, understand the risk of too high a tax burden on the project's competitive economics, and understand that the municipalities should share in the effort to achieve a successful project, we have identified a number of concerns.

First, we recognize that if the entire Alaska LNG project were assessed at the status quo under AS 43.56 for the pipeline and gas treatment plant, and AS 29.45 for the liquefaction plant, the combined annual property tax levy could come close to $900 million to $1 billion in the first year of operations. That works out to almost $1 per million Btu, which is the equivalent of 15 percent of current spot-market prices for LNG in Asia. Though prices are expected to rise before

Alaska LNG ever loads it first cargo at Nikiski, $1 per million Btu is almost certainly too heavy of a burden for the project to carry in the highly competitive marketplace. As such, the municipalities are willing to do their part to help the project succeed. If the project goes forward, we all win.

But, as municipal officials, we also understand that changing the existing tax structure to allow for impact aid payments and a PILT formula means we relinquish local control over our respective tax revenues. It's a trade-off we are willing to accept and endorse, pending more details on the administration and allocation of the payments.

For example, the $800 million in impact aid, to be paid out over the anticipated five years of construction, probably is adequate to cover community impacts on schools, roads, police and other public services, but it could quickly become inadequate if the state decided not to contribute its share as a project partner and, in addition, if the state intends to withdraw from the fund to cover its own impacts. Under that set of "what ifs," the $800 million could easily be reduced to an amount inadequate to address impacts to municipalities.

Also regarding the impact aid, the municipalities are rightfully concerned about how the money would be distributed by the state (which would receive the funds from the project sponsors). Though the advisory group has lightly discussed the need for a new grant program of some kind (which would require legislation), we have not settled on any specific details. To help move that discussion along, the Kenai Peninsula Borough drafted a discussion paper, outlining and suggesting a mechanism for such a grant program (attached). The municipalities will need to know how distributions from the impact aid fund will be administered, for what purposes and the rules associated with the operation of the fund.

As to the PILT, the biggest question is allocation — sharing <u>between</u> the municipalities and, we assume, with the state.

The $15.7 billion "target" for PILT revenues negotiated by the state team and Alaska LNG partners assumes more than just Prudhoe Bay and Point Thomson gas to keep the pipeline full for 25 years. Additionally, there is some uncertainty about PILT revenues during the initial "ramp up" in the throughput volumes. Again, as with the impact aid funds, the total PILT revenues are dependent on the state paying its share as a project partner. If the state's portion is determined to be tax exempt or the state decides against paying its share, the available funds would be significantly reduced. The actual total makes a big different to the municipalities and directly affects the allocation of the PILT funds.

Just as with the impact aid money, the portion of the PILT funds the state intends to lay claim to has a direct impact on the PILT funds available for allocation among the municipalities. There are also questions whether the allocation of PILT funds among municipalities will be based on the proportional allocation of property assets in their respective jurisdictions or some other, as yet undefined, structure for allocating the PILT funds. Unlike AS 43.56, which sets out clear directions for how the state and municipalities will share tax proceeds on oil and gas exploration, production and transportation property, the PILT calculation, as it now stands, is silent on such sharing.

We are not attempting to criticize the work of the state negotiators or project sponsors, merely pointing out that there are significant unresolved issues and lack of specific detail . The MAG has drafted a proposal for allocating PILT revenues between the state, affected municipalities along the project route and all municipalities statewide (attached). The proposal is offered to help begin discussions, knowing full well it is only a starting point. Legislation will be required to establish the allocation formula, and we look forward to working with the administration and lawmakers to achieve that goal.

Much of the discussion about the state share of PILT revenues comes down to what the state sees as its take from the Alaska LNG project. That state take includes the revenues from the sale of the state's 25 percent share of the gas stream, plus corporate income taxes, plus a possible share of PILT. We believe any discussion of dividing PILT dollars between the state and municipalities has to occur within the context of the overall state take. The municipalities have essentially one option — PILT, as a substitute for property taxes — whereas the state has at least two other options for its share of revenues from the project.

As you would expect, each affected municipality has different issues. The North Slope Borough and Kenai Peninsula Borough would have the two largest components — and taxable property — of the project, the gas treatment plant and the LNG plant and marine terminal. As such, they will have the single largest concentration of workers and property during construction and operations — and localized community impacts — and the PILT allocation structure should not unduly shortchange those communities.

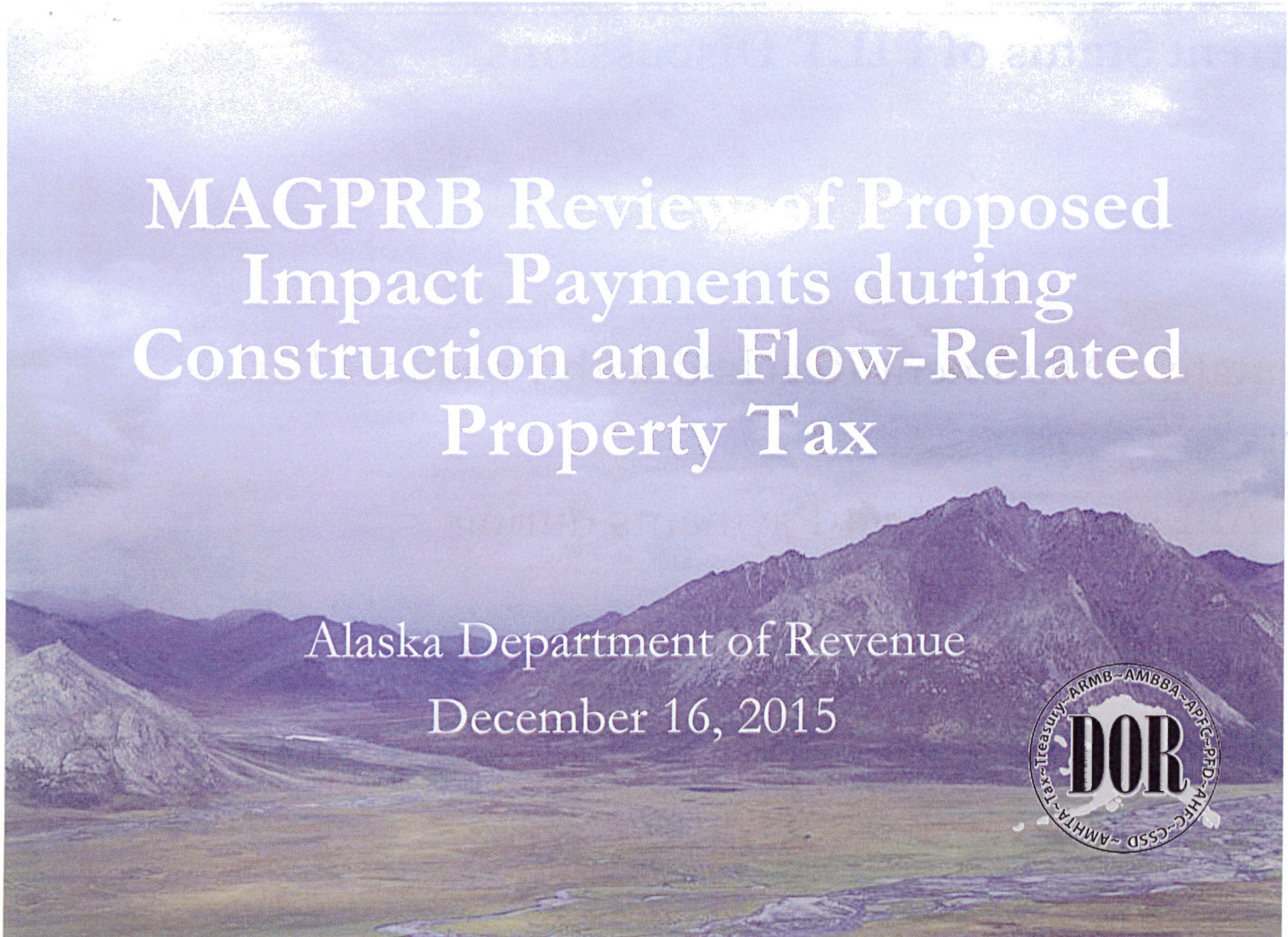
The Denali Borough and Matanuska-Susitna Borough will see more miles of pipeline than anyone else, which creates its own impacts and PILT allocation issues. And although the Fairbanks North Star Borough will have the fewest pipeline miles of any of the affected municipalities along the route, Fairbanks no doubt will see significant impact as a supply and worker hub during construction.

There are a lot of questions to answer and policies to decide. The state and project sponsor negotiations have made progress and the municipal advisory group is involved. Now we need to work through the list above to get to a point where everyone understands the numbers, the sharing and the process for distributing the impact aid and PILT funds. We look forward to working with you in support of a successful project.

Thank you.

Municipal Advisory Gas Project Review Board members

Attachments: Proposed municipal grant program for impact aid
Proposed allocation of PILT funds


MAGPRB Review of Proposed
Impact Payments during
Construction and Flow-Related
Property Tax
Alaska Department of Revenue
December 16, 2015
DOR
ARMB~AMBBA~APFC~PFD~AHFC~CSSD~AMHTA~Tax~Treasury

Current Status of PILT Discussions

Tentative Alignment Reached with Producer Parties on:

1. Amount of Impact Payments during Construction and
2. Structure and Target Amount for Flow-Related Property Tax

Overview

- Conceptual overview of Impact Payments during Construction
- Conceptual overview of Flow-Related Property Tax
- Flow-Related Property Tax calculation
- Impact Payment Proposal

Impact Payments during Construction

- Total Amount = $800 million
  - 4:4ths
  - Expected pay out over 5-year construction period
- Annual Payment amount, schedule, and allocation among State and impacted local jurisdictions yet to be determined

Flow-Related Property Tax

- Total Target Amount = $15.7 billion
  - Actual payment amount will vary as actual flow rate with five year averaging varies from project design flow
  - Calculated using MAGPRB recommended formula
  - Paid out over 25-year period
  - 4:4ths
  - Payment schedule incorporates 1% increase in payments each year, which is included in target amount

- Allocation among State and local jurisdictions yet to be determined

Flow-Related Property Tax

MAGP Board Recommendation (March 13, 2015)

$$\left(\text{Capital Cost} \times (1+e)^m \times \text{Depreciation Factor} \times \left(\frac{\text{Actual Throughput}}{\text{Design Throughput}}\right)^n \times \text{Mill Rate}\right)$$

n = exponent to dampen effect of actual flow
e = annual escalation rate
m= years of operation (startup = 0)

MAGP Board Recommendation
(Formula Values)

Capital Cost = FID estimate x 1.1
e = 4% per annum
Depreciation Factor based on 50 year floating life
Actual Throughput = 5 year floating average
n = 1
Mill Rate based on current statutes for all Project assets including LNG Plant

Flow-Related Property Tax

SB 100 Recommendation

$$\left(\text{Original Cost} \times \text{Inflation Factor} \times \text{Depreciation Factor} \times \left(\frac{\text{Actual Throughput}}{\text{Design Throughput}}\right) \times \text{20 Mills}\right)$$

Original Cost = Fixed by pre-FID project specific data/fiscal agreement
Inflation Factor = Fixed by fiscal agreement
Depreciation Factor = Fixed by fiscal agreement
Actual Throughput = Operational measurable
Design Throughput = Fixed by pre-FID project specific data
Mill Rate = Fixed by Statute, with total take adjusted by fiscal agreement

Flow-Related Property Tax

<u>Tentative Alignment</u>

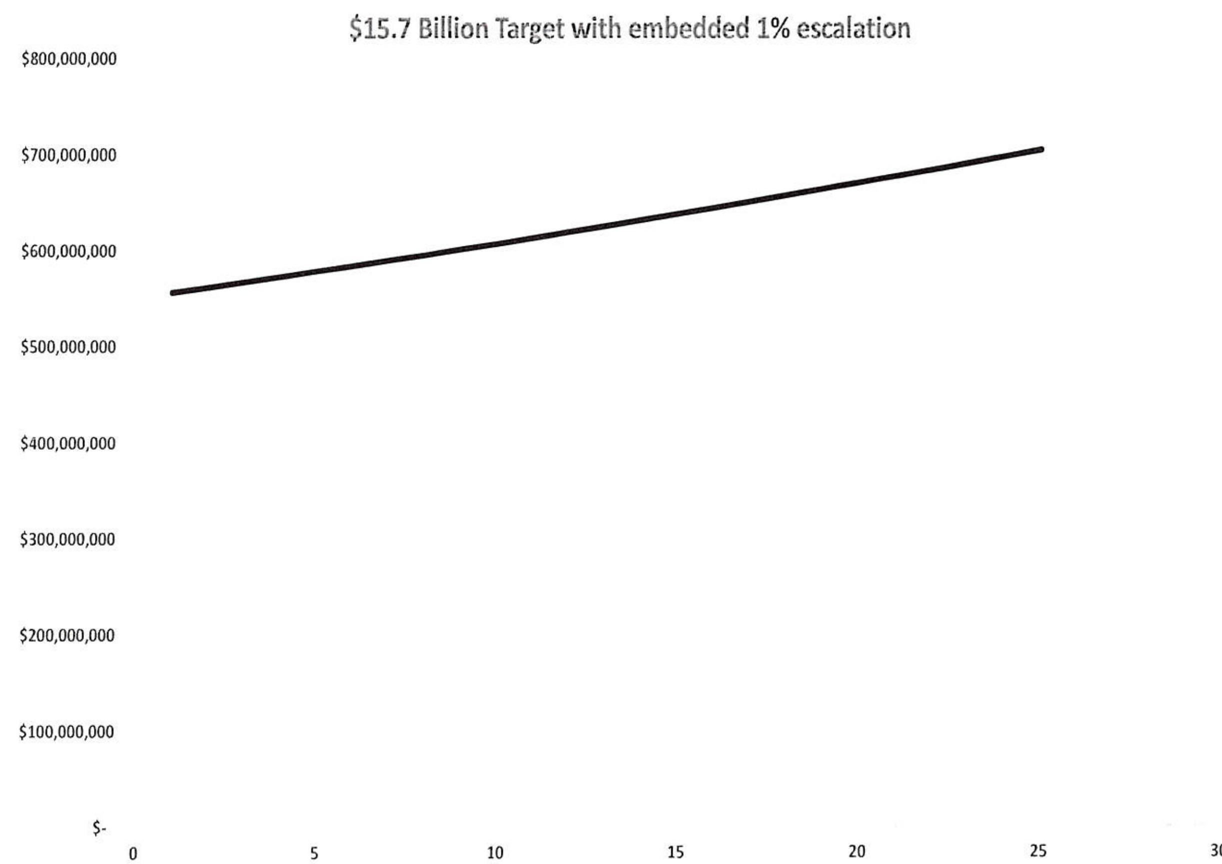
$$\left(\text{Original Cost} \times \text{Escalation Factor} \times \text{Depreciation Factor} \times \left(\frac{\text{Actual Throughput}}{\text{Design Throughput}}\right) \times \text{Blended Mill Rate}\right)$$

Original Cost = $55 Billion
Escalation Factor = 2.5% (3.25% inflation - .75% obsolescence)
Depreciation Factor = 30 year modified floating/fixed life
Actual Throughput = Operational measurable (5 year rolling average)
Design Throughput = To Be Determined
Mill Rate = 13.75 Mills (20 Mills GTP, 20 Mills Pipeline, 7.5 Mills LNG*)

$15.7 Billion

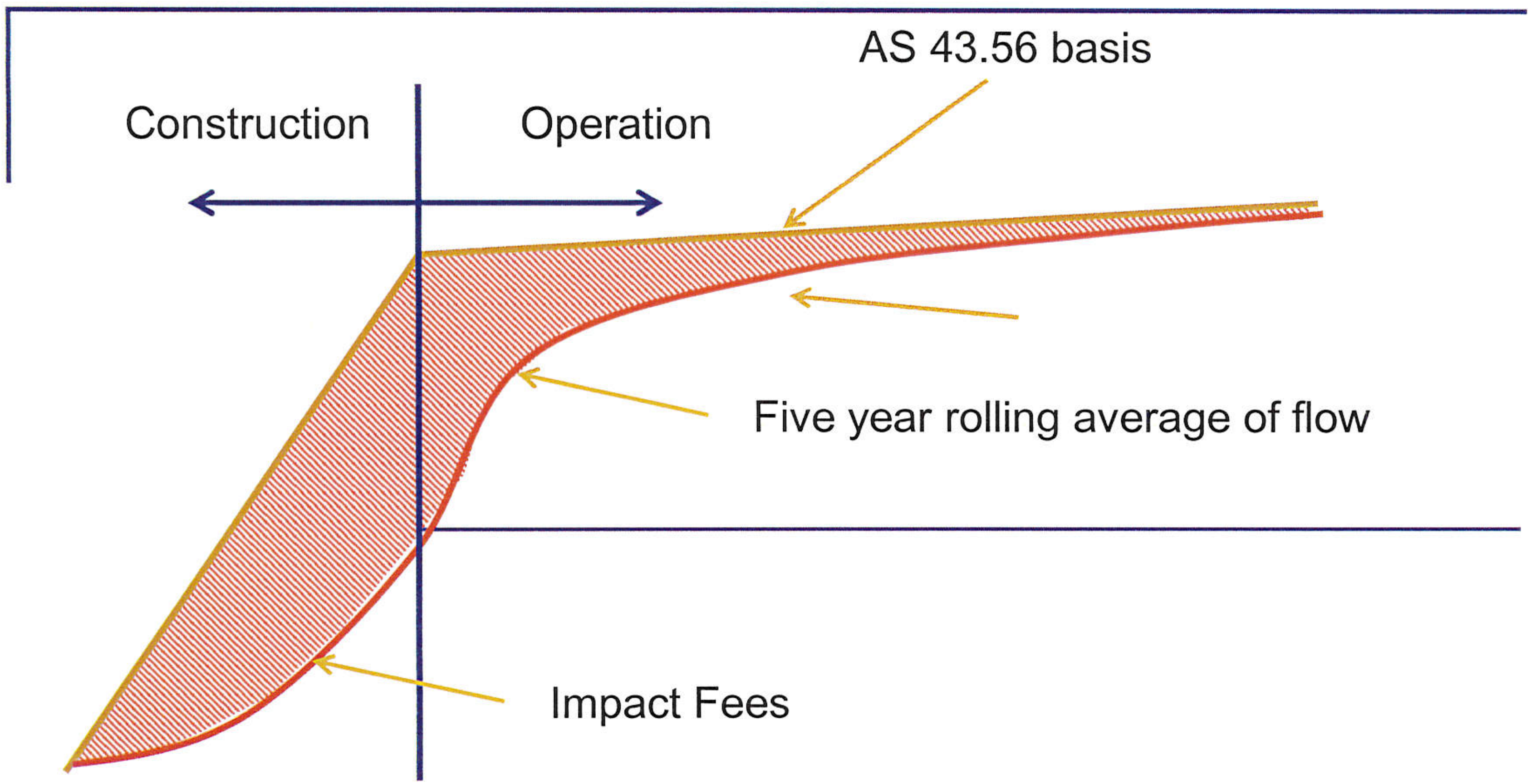
Flow-Related Property Tax Target Payments (millions)*

Year 1	$	556
Year 2	$	562
Year 3	$	567
Year 4	$	573
Year 5	$	578
Year 6	$	584
Year 7	$	590
Year 8	$	596
Year 9	$	602
Year 10	$	608
Year 11	$	614
Year 12	$	620
Year 13	$	626
Year 14	$	633
Year 15	$	639
Year 16	$	645
Year 17	$	652
Year 18	$	658
Year 19	$	665
Year 20	$	672
Year 21	$	678
Year 22	$	685
Year 23	$	692
Year 24	$	699
Year 25	$	706
Target	$	15,700



*Actual payment amount will vary as actual flow rate with 5 year averaging varies from project design flow

Conceptual Project Benefits from Flow-Related Property Tax Target Payments



Schematic, not to scale

Flow-Related Property Tax Target Payment Components yet to be Determined

- Volume and Timing for setting Design Rate
- Flow rate measurement based on Mcf (thousands of cubic feet) or mmbtu (millions of British Thermal Units)
- Measurement location taken at each component (GTP, Pipeline, LNG) individually or one location for entire project
- Measurement taken at the inlet or the outlet of project components

Next Steps for MAGPRB

- Provide Recommendations on Proposed Structure and Target Amounts
  - Impact Payments during Construction and
  - Flow-Related Property Tax
- Provide Recommendations on allocation of payments among State and local jurisdictions
- Drafting 2015 MAGPRB Annual Report
- Recommendations on legislation

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MEMORANDUM

TO: Commissioner Randy Hoffbeck

C: Governor Bill Walker
Attorney General Craig Richards
MAGPR Board Members:
Mark Myers
Fred Parady
Clay Walker
Vern Halter
Mike Navarre
Robert Venables
Karl Kassel
Robert Bartholomew
Ona Brause
Jacob Adams

FROM: Robin O. Brena

DATE: December 15, 2015

RE: Payment in Lieu of Taxes (PILT) Tentative Agreement
Our File No. 1197-020

I. PILT Tax Payments Should Reflect Full and True Value

A payment in lieu of taxes ("PILT") should be based upon the full and true value of the gas line.[1] This is the standard for ad valorem taxation under existing law in Alaska and throughout the country. The Municipal Advisory Gas Project Review ("MAGPR")

[1] The phrase "gas line" is intended to mean the gas line and related facilities.

Board was originally told the purpose for the PILT was to increase the certainty and decrease the conflict associated with property tax payments and *not* to reduce the amount of tax payments that would otherwise be due under the full and true value standard. The MAGPR Board accepted this standard and recommended a PILT be based upon the full and true value of the gas line.[2] Reducing the PILT to any level below what would otherwise be due under the full and true value standard would be simply reducing tax payments without proper analysis or clear purpose.[3]

II. Determining Full and True Value

Perhaps the best and least controversial estimate of the full and true value of the gas line would be based upon the *actual* cost of building and expanding it. Generally, a pipeline cannot be worth less than the cost to build and expand it, or it would not be built and expanded.

Unfortunately, the proposed PILT is based upon preliminary cost estimates and not the actual costs of building and expanding the gas line.[4] These preliminary cost estimates are currently \$45 billion to \$65 billion.[5] Such preliminary cost estimates do not take into consideration the (1) additional work revealed by either the preliminary or the more-detailed final engineering, (2) unanticipated project delays and construction events, (3) scope changes (42-inch pipeline upsized to 48-inch pipeline), and (4) capacity expansion after initial construction (adding additional compression or looping portions).

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[2] Importantly, there has been no economic analysis suggesting a subsidy of the gas line is necessary to support its construction or suggesting an economic subsidy in the form of a reduced PILT is necessary. Moreover, it is not apparent that a reduced PILT would be the most appropriate method for providing a subsidy for the gas line were such a subsidy to become necessary. In all likelihood, an economic subsidy by the State rather than by the Municipalities would be a more appropriate form of subsidy. In short, there is a complete absence of any analysis suggesting a reduced PILT is needed or appropriate to achieve the construction of a gas line.

[3] As a matter of sound policy, ad valorem taxes should generally be assessed on the same basis among all taxpayers unless there is a clear policy and legal basis to provide cross-subsidization among taxpayers. While detailed consideration of such policy and legal concerns is beyond the scope of this memorandum, it should be recognized that such policy and legal considerations should be carefully considered before PILT tax payments are based on any other basis than the full and true value of the taxable property.

[4] Earlier in the process, the use of the actual costs was suggested but apparently was not adopted.

[5] It appears the negotiations concerning the PILT were based on the average in this range of preliminary estimates, or \$55 billion. These preliminary estimates are currently slated to be updated as the engineering becomes more defined.

As a result, such preliminary cost estimates have proven notoriously unreliable for major cross-country pipeline projects. In fact, even the final cost estimates for major pipeline projects after final engineering is complete have tended to understate the actual costs for such projects by an average of 46 percent.[6] Cost overruns for similar major pipeline projects in Alaska have far exceeded this average of 46 percent.[7] For these reasons, the current preliminary cost estimates of $45 billion to $65 billion are likely to substantially understate the actual cost of building the gas line.

Any reliance upon such preliminary cost estimates for establishing the PILT transfers a substantial project risk to the Municipalities. Generally, project risk should not be borne by the Municipalities because they are completely unfamiliar with the basis for the preliminary cost estimates and have no ability to manage such risk. For these reasons, the Municipalites should not take the significant project risk associated with establishing a PILT based upon preliminary cost estimates. Instead, the Municipalities should base a PILT upon the *actual* costs of building and expanding the gas line. Accordingly, any proposed PILT should provide for initial tax payments equal to 20 mills of the actual costs of building and expanding the gas line.

While using the actual cost of constructing the gas line is the best initial reference for the full and true value of the gas line, the best evidence suggests that the full and true value of the gas line over its economic life would be upwardly influenced by the rising costs of building such pipelines and downwardly influenced by depreciation. Generally, the result of these two offsetting influences is that the value of a pipeline rises slightly in nominal terms while it depreciates in real terms.[8] Accordingly, the full and true value of the gas line may be conservatively based on the actual costs of building and expanding the pipeline increased slightly over its economic life.

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[6] Average cost overrun from the final cost estimate with a contingency included for large pipeline and oil field projects is 46 percent. Edward W. Merrow, *Mega-field developments require special tactics, risk management*, www.offshore-mag.com (June 1, 2003).

[7] The largest two pipeline projects in Alaska are illustrative. These two pipeline projects are the original construction of TAPS and the strategic reconfiguration project electrifying the pump stations and control systems of TAPS. The preliminary cost estimates for original construction of TAPS were less than $1 billion, and the actual costs were over $8 billion. The preliminary cost estimates for the strategic reconfiguration project were roughly $200 million and the actual costs were roughly $1 billion.

[8] To use TAPS as an example, TAPS cost $8 billion (1977 dollars) or $24 billion (2015 dollars) to build but is currently valued for ad valorem purposes at $10 billion. This represents an increase in nominal dollars of roughly 25% ($8 billion to $10 billion) from 1977 to 2015. The gas line may reasonably be expected to experience a similar slight increase in nominal terms over its economic life.

For the purposes of the following analysis concerning the PILT, it has been assumed that the full and true value of the gas line would ramp up to $65 billion during the construction phase and would remain at $65 billion during the economic life of the gas line. It has also been assumed that the appropriate tax rate is 20 mills.[9]

III. Full and True Value During Construction Period

The proposed PILT reflects no tax payments during the construction period of the gas line. Under existing law, the full and true value during the construction period would otherwise be based on "the actual cost incurred or accrued . . . as of the date of assessment." AS 43.56.060(e)(1). Since the construction period for the gas line may be several years in duration, the proposed PILT substantially understates tax payments that would otherwise be due under existing law. Assuming an average construction balance of $32.5 billion over five years,[10] the proposed PILT would under collect tax payments during the construction period by roughly $3.25 billion.[11]

IV. Full and True Value During Initial Project Period

The proposed PILT reflects substantially lower tax payments during the initial twenty-five year project period than would otherwise be due under the full and true value standard. Conservatively, the tax payments under the full and true value for this initial twenty-five year project period would be $32.5 billion,[12] but the proposed PILT only provides tax payments of $15.7 billion or less than half of the amount that would otherwise be due. Moreover, the proposed PILT payments are weighted toward the outer years which further reduces the net present value of the total tax payments.

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[9] The author is aware that the Kenai Peninsula Borough currently has a mill rate less than 20 mills and a significant portion of the gas line facilities may be built within the borough. Nevertheless, the author has chosen to use 20 mills because there have been no assurances that the current and lower mill rate would remain in effect should the gas line be built. Moreover, assuming the Kenai Peninsula Borough residents seek to maximize taxes from the gas line facilities under Title 29, the mill rate may be expected to rise to 20 mills.

[10] The major spend in a major pipeline project is generally in the last three years, so this simplifying assumption would slightly overstate the impact. Given the likelihood that $65 billion is substantially understated, this simplifying assumption was considered reasonable.

[11] The calculation would be $32.5 billion * 20 mills * 5 years.

[12] The calculation would be $65 billion * 20 mills * 15 years. This is considered conservative because of the likelihood that the preliminary cost estimate of $65 billion substantially understates the actual costs of building the gas line.

V. Full and True Value During Remaining Economic Life

The proposed PILT only reflects tax payments during the initial twenty-five year project period and does not reflect tax payments for the remaining economic life of the gas line. We understand, based on Commissioner Hoffbeck's comments to the MAGPR Board, that the intention would be that after the initial twenty-five year project period, the ad valorem taxes would be based upon the full and true value as currently determined under AS 43.56.

Since the proposed PILT payments were intended to reflect the tax payments that would otherwise be due based on the full and true value of the gas line, any enabling statute must be clear that the tax payments would continue to be based on the full and true value of the gas line during its remaining economic life. This is a critical issue because the economic life of the gas line may well extend 50 to 75 years beyond the initial twenty-five year project period.[13] The tax payments otherwise due during this potentially 75-year remaining economic life would approach $100 billion.[14]

VI. Recommendations Summarized

A. The PILT should be based upon the full and true value of the gas line.

B. The full and true value of the gas line should be based upon the actual costs of building and expanding the gas line and not upon preliminary cost estimates.

C. During the construction period, PILT payments should be based upon the actual cost incurred as of the lien date.

D. During the initial 25-year project period, the PILT should be based on the actual costs of building and expanding the gas line.

E. After the initial 25-year project period and through the remaining economic life of the gas line, ad valorem tax payments should be based upon existing law as set forth under AS 43.56.

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[13] There is massive potential gas resource on the Alaska North Slope, and considerable likelihood of resource growth over time. With proper maintenance, the physical life of the gas line would be indefinite. The economic life of the gas line would likely be the same as the economic life of the gas resources on the Alaska North Slope. Large-diameter gas or liquids pipelines are rarely abandoned.

[14] The calculation would be $65 billion * 20 mills * 75 years or $97.5 billion.

MUNICIPAL ADVISORY GAS PROJECT REVIEW BOARD

ANNUAL REPORT 2015

(November 2015 - DRAFT)

This report is availible exclusively online and can be downloaded at the Board's website provided by the Department of Revenue:

http://dor.alaska.gov/MunicipalAdvisoryGasProjectReviewBoard.aspx

Contents

Executive Summary

The Municipal Advisory Gas Project Review Board (MAGPRB), formed as a consequence of the enactment of SB 138, Section 74, and Administrative Order No. 269 on March 25th, 2014, is charged with advising the governor on municipal involvement in a North Slope natural gas project, including (i) developing a framework to evaluate the local governmental options that could be adopted to address and mitigate the impacts of new infrastructure associated with the development of the State's North Slope natural gas resources, (ii) recommending changes to property taxes under AS 43.56 and AS 29.45.080 relating to a North Slope natural gas project; (iii) recommending legislative options to minimize the financial impact to communities in proximity to the North Slope natural gas project infrastructure, and (iv) recommending legislative options to minimize the financial impact to communities not in proximity to the North Slope natural gas project. The MAGPRB has recently been reviewing information relating to a specific North Slope natural gas project, the Alaska LNG Project.

The Department of Revenue (DOR) is the lead agency in the Administration's efforts to communicate with and facilitate the efforts of the 12-member MAGPRB. The MAGPRB is a key component, representing directly and indirectly impacted municipalities and local stakeholders, in recommending possible options to address and mitigate the impacts of new infrastructure associated with the Alaska LNG project.

This report presents and update of the status of the MAGPRB's activities during 2015, since the 2014 Annual Report.

During 2015, the MAGPRB focused its activities on the development of Alaska LNG Project construction period impact fees in lieu of statutory property taxes and the development of post-construction operational phase property taxes in the form of variable flow rate based assessment in lieu of a fixed annual property tax levy based on property valuation. The DOR provided expert consultant presentations to the MAGPRB and received input from the MAGPRB members on the two proposed structures. In addition, the MAGPRB initiated discussions on options and alternatives for identifying impacts for all State stake holders, and discussions on mechanisms for distributing impact fees and flow rate based property taxes from the Alaska LNG Project. No conclusions have been reached yet by the MAGPRB on these subjects.

Based on input from the MAGPRB as to a high level understanding of a structure for impact payments and flow related property taxes, the DOR and the Alaska LNG property participants, ExxonMobil, ConocoPhillips and BP worked together to generate proposals with respect to impact payments and flow related property taxes and reached a tentative alignment that was presented to the MAGPRB for consideration and feedback.

The tentative proposal presented to the MAGPRB included the Alaska LNG Project, paying impact payments to the State equal to $800 million over a projected fie year construction period,The proposal would have the impact payments paid out in fixed annual increments which total $800 million. The total impact payment amount noted above assumes the project property owner will make the full impact fee payments to the State, and will pass on those costs proportionately to the members of the Project (including the Alaska Gasline Development Corporation (AGDC) for payment. Discussion was had with the Board that the legislature may determine that any share from AGDC is exempt from distribution, which would reduce the amount available for allocating to the State and local communities by 25%.

The tentative proposal presented to the MAGPRB also included a post-construction flow related property tax with a flow rate based on a total target amount of property taxes paid over the first 25 years of the project equal to $15.7 billion. The target amount would be converted to a tax in dollars-per-MMCF (million cubic feet) volume or per-MMBtu (million British thermal unit) heating value which would be applied to measured project flow throughput averaged over 5 years and paid annually throughout the 25-year project period. The amount of $15.7 billion is referred to as a target amount because (i) the actual tax-per-MMCF or per-MMBtu is established before production begins based on forecast design throughput and may be adjusted for final design throughput, and (ii) since the actual flow throughput may differ from the design based throughput, the flow rate based property tax may be less than or more than the target amount. As noted with the impact payments, flow related property taxes would be levied against the Project property owner which will allocate the property taxes among the Project members, including AGDC. Discussion was had with the Board that the legislature may determine that any share from AGDC is exempt from distribution, which would reduce the total target amount available for allocating to the State and local communities by 25 percent.

The MAGPRB provided initial feedback to the DOR on the tentative proposal raising questions regarding how the proposed impact payment and flow related property taxes compared with what would be collected under the current provisions of AS 43.56 and AS 29.45.080. A preliminary analysis presented by a Board member indicated a gap between the current property tax regime and the proposed property tax regime. Board members were concerned over any such gas given that any proposed impact payment and flow related property tax may be reduced by 25% as a result of AGDC participation, thereby creating an even greater gap and fewer tax revenues flowing to the local municipalities.

The MAGPRB will be further analyzing the proposed impact fee and flow related structure and the proposed target amounts to be paid by the Alaska LNG Project. The primary goals of the DOR are to finalize a consensus recommendation from the MAGPRB for the overall structure and target amounts of the impact payments and flow rate based property tax, and to reach an objective, predictable and equitable allocation methodology for disbursement of the impact payments and flow related property taxes between the State of Alaska and local municipalities.

Additional discussions must take place before final recommendations on a flow related property tax can be achieved to (i) set design rate basis for calculating the FRPT; (ii) establish the FRPT throughput measurement units, whether MMCF or MMBtu; (iii) establish the throughput measurement locations, gas treatment plant (GTP), pipeline, and LNG liquefaction plant, and (iv) determine whether measurement should be made at the inlet or outlet of the project components. When these determinations have been agreed upon, DOR can then consider statutory changes necessary for implementing the agreements and moving the Alaska LNG project forward.

Additional discussions must take place before recommendations on final allocations of impact payments among the stake holders can be achieved. The MAGPRB will be analyzing the research and data collected by the Alaska LNG project in the on-going FERC (Federal Energy Regulatory Commission)/NEPA (National Environmental Policy Act of 1969) pre-filing process as soon as that information is filed with FERC in 2016.

The MAGPRB supports continued work to advance a viable gas commercialization project. If the Alaska LNG Project does not come to fruition, the MAGPRB urges that other projects be explored as alternative means of supplying communities with long term, stable supplies of lower-cost energy.

Overarching Principles That Shape the Government Take Methodology

The state laws concerning the taxation of oil and gas property in Alaska are AS 29.45 (Municipal Property Tax) and AS 43.56 (State of Alaska Oil and Gas Exploration, Production and Pipeline Transportation Property Taxes). While the MAGPRB may not share a common view on certain issues, nonetheless the MAGPRB does agree that any recommendations for changes to the tax structure in AS 29.45 and/or AS 43.56 should be based on a set of principles. These principles include:

1) Municipal governments and the State must be able to maintain their financial capacity to address impacts created by the Alaska LNG Project throughout the life of the project.
2) Industry project leaders should be allowed to maintain the relative competitiveness of their project compared to other projects.
3) There should be opportunities for all Alaskans to benefit from the project.
4) Any property tax or alternative tax system should be predictable for both investors, including the State, and municipalities.
5) Revisions to AS 29.45 or AS 43.56 should be limited only to the Alaska LNG Project under consideration. Those revisions shall not include any property that is taxable under AS 29.45 or AS 43.56 prior to construction of the Alaska LNG Project. Furthermore, no property taxed under AS 29.45 or AS 43.56 prior to construction of the Alaska LNG Project should receive a tax deferral or a tax exemption.
6) Revenues received by municipalities and the State through any alternative property tax methodology to the existing property tax methodology set forth in AS 29.45 or AS 43.56 must realize revenues of no less than revenues that would have been received under the current property tax statutes.
7) Any revisions to AS 29.45 or AS 43.56 relevant to the Alaska LNG Project should not disadvantage the competitiveness of the Alaska LNG Project under consideration.
8) Reflecting the statewide nature of a large gas project, revenues from the Alaska LNG Project should be shared by all communities across Alaska, and not just communities where the project infrastructure is located or communities expected to have the preponderance of ongoing impacts from the project.

Actual impacts on communities and the State; incurred during the construction and operation of the Alaska LNG Project, should be paid by the Alaska LNG Project. The MAGPRB recognizes that the actual impacts are not commensurate to the length of the pipeline or the value of taxable property within a community's boundaries. Instead, impact payments should be based on the anticipated actual community impacts.

Government Take Methodology

A preliminary analysis provided to the DOR by Greengate LLC (Greengate) helps define what property taxes on the Alaska LNG project would be anticipated under pre-existing oil and gas property tax statutes and regulations (i.e. the status quo property tax)[1,2,3]. The analysis provides a range of status quo property tax revenue outcomes based on different project assumptions, so that the MAGPRB can better understand a variety of possible outcomes based on its weighing of project assumptions. Note that thr preliminary analysis is based on publicly available information regarding the Alaska LNG Project and may be subject to change, revision and/or addition based on further analysis by the State, Greengate and/or further publicly available information provided by other agencies from the State of Alaska (the State), any of the State's other advisors and consultants, Alaska Gasline Development Corporation (AGDC) and/or the affiliates of BP, ConocoPhillips and ExxonMobil (collectively, the Producers). It is anticipated that once the FERC application for the project is submitted significant additional information will be available to the MAGPRB for its deliberations.

Status Quo Property Tax during Project Construction

The status quo property tax during construction analysis provided here contains a number of assumptions and interpretation of data related to the Alaska LNG project and plan. Key assumptions for analyzing a status quo property tax during the construction phase include estimates for the length of the construction phase for and an allocation of capital expenditures to the various components. The "Base Case" plan construction period estimates for the pipeline, LNG Train 1 and GTP Train 1 is 5 years; LNG Train 2 and GTP Train 2 is 6 years; and LNG train 3 and GTP Train 3 is 7 years. The expected capital expenditure breakdown by train the three trains of both the LNG and GTP facilities are 44 percent for the first train, 30 percent for the second, and 26 percent for the third. Two sensitivities were also analyzed, one where construction is completed one year earlier than under the Base Case and one where construction extends one year longer. No assurance can be given that the assumptions used in this analysis will prove to be realistic or accurate and, therefore, any projections or estimates provided herein should be viewed with caution.

The status quo property tax analysis provided to DOR concludes that the property tax during construction when using the assumptions mentioned above for the Base Case would equal approximately

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1 Greengate's status quo analysis is based on: (i) information provided by the State Alaska LNG team or the State's other consultants; (ii) publicly available data; and (iii) Greengate analysis based on Greengate's experience with similar projects.

2 Greengate has not verified any of the information provided to it in connection with Alaska LNG and no representation or warranty, express or implied, is made and no liability or responsibility is accepted by Greengate as to the accuracy or completeness thereof.

3 Greengate's analysis of the Alaska LNG project provided here, and any advice, recommendations, information or work product provided by Greengate is not intended for the benefit of any third party and may not be relied upon by any third party. Any use of their analysis shall constitute user's waiver and release of Greengate and all of its affiliates, partners, employees, agents and subcontractors from and against of all claims and liability in connection with such use and, to the fullest extent permitted by law, such waiver and release shall apply notwithstanding the negligence, fault, or breach of warranty or contract by Greengate or any of its affiliates, partners, employees, agents or subcontractors.

$1,682 million. Property tax during construction for the shorter and longer construction sensitivities is estimated at $1,310 million and $2,055 million, respectively.

Additionally, the calculation of property tax during construction requires a distinction between permanent capital expenditures and temporary construction costs. Permanent capital expenditures, as stated in 15 AAC 56.110, include "permanent camps and related facilities, pump stations, permanent storage facilities, roads, permanent air strips, terminal facilities, tank farms, docks, labor, materials, supplies, machinery, equipment, pipe, easements, rights-of-way, improvements, structures, and all other related costs." Capital expenditures for the construction of these items are added to the property tax assessed value, as incurred.

Temporary construction costs, as stated in 15 AAC 56.110, include construction machinery and equipment, construction camps and related facilities; unallocated costs which relate to the overall project and are incurred both within and without the state and include such items as overhead and administrative costs, engineering costs, design costs, and research and development costs. A pro-rated accrual to value, based on months remaining to complete construction is then done. If everything else is held constant, a higher percentage of temporary construction costs as part of overall capital expenditures would result in lower property tax during construction, as the construction work in-progress (CWIP) balance would accrue less rapidly. The precise breakdown between permanent capital expenditures and temporary construction costs is not known at this time. The Base Case assumes that the share of temporary construction costs is 30% for the pipelines and 20% for the LNG plant and GTP. Sensitivities were evaluated for 10% higher than the Base Case and 10% lower share of temporary construction costs.

The status quo property tax analysis for the Base Case, previously stated as approximately $1,682 million, would increase to $1,785 million if temporary construction costs were to be 10 percent lower than expected and would decrease to $1,579 million if temporary construction costs were 10 percent higher. These sensitivities indicate that the variation in the amount of property tax during construction is modest when temporary construction costs vary as indicated here.

Status Quo Property Tax during Project Operations

Key assumptions for the analysis of status quo property tax during operations include assumptions around capital expenditures, the depreciation period, and the rate of escalation of replacement cost post-construction. Capital expenditures are assumed to be $55 billion, the initial asset value. The rate of escalation for the Base Case is assumed to be 2.5 percent annually. The analysis also includes sensitivity cases at 2, 3, and 3.5 percent annual escalation. Several depreciation cases were analyzed including, 25, 30, 35 and 40 years from start-up, but in each case, the total amount of property tax after start-up is only calculated for the first 25 years of operations so that appropriate comparisons can be made with the Flow Related Property Tax (FRPT) target amount of $15.7 billion discussed later in this report as part of the tentative proposal.

Analysis using $55 billion as the initial asset value, 2.5 percent annual escalation and a 30-year depreciation schedule results in a decline in replacement-cost-new-less-depreciation (RCNLD) asset value to $22 billion by the end of the initial 25-year operating period. Whereas, the same $55 billion initial asset value, 2.5 percent annual escalation and a 40-year depreciation schedule results in RCNLD value of $40 billion at the end of the first 25 years of operations. Further lengthening the depreciation schedule to 50 years results in a RCNLD value above $50 billion throughout the initial 25 years of operations.

The same analysis using 3.5 percent annual escalation results in less decline or even appreciation in RCNLD values in equivalent time periods. RCNLD under a 30-year depreciation schedule declines to $27 billion, under a 40-year depreciation schedule stays relatively stable above $50 billion, and under a 50-year depreciation schedule appreciates in value to $66 billion, by the end of the initial 25 years of operations.

Based on the RCNLD values discussed above and additional RCNLD calculations around different scenarios of asset escalation and depreciation, estimates of Alaska LNG project-related property taxes were calculated and provided in Table 1. This table shows that under the Base Case, the estimate of property taxes during the first 25 years of operations, assuming 2.5 percent escalation and 30 years of depreciation under the status quo property tax statutes equals $15.8 billion.

Table 1. Estimated Alaska LNG project-related property tax during initial 25 years of project operations after start-up using different assumptions for depreciation period and escalation. The Base Case estimate is highlighted in yellow. Results shown in $ millions.

	Property Tax During Initial 25 years of Operations ($ millions)			
Depreciation Period	**2.0% p.a. Escalation**	**2.5% p.a. Escalation**	**3.0% p.a. Escalation**	**3.5% p.a. Escalation**
25 years	12,846	13,412	14,013	14,651
30 years	15,024	15,777	16,581	17,440
35 years	16,571	17,456	18,404	19,421
40 years	17,726	18,710	19,766	20,900
45 years	18,621	19,682	20,821	22,047
50 years	19,335	20,457	21,664	22,962

Source: Greengate LLC

PRELIMINARY PROPERTY TAX TERMS PROPOSAL

Tentative Proposal from DOR and Producer Parties on Impact Payments

Tentative alignment has been reached between the DOR and the three project producer parties Exxon Mobil, ConocoPhillips, and BP, on Impact Payments during construction. Impact Payments during construction is in lieu of property tax payments that during the construction phase, also referred to as Construction Payments in Lieu of Tax (CPILT). The Impact Payments during construction are tentatively set at $800 million and are expected to be paid out in increments over the project construction period. Currently the construction period is anticipated to be five years, and although details have not been finalized, the impact payments are expected to be paid out in annual increments. The total impact payment amount quoted above assumes all project owners are obligated to make impact payments. However, it is possible that the actual payments will be reduced by the State of Alaska's ownership share in the project, which is currently estimated at approximately 25 percent of the project, due to its tax-exempt status. The allocation of the Impact Payments between the State and municipalities has yet to be determined.

Tentative Proposal from DOR and Producer Parties on Flow-Related Property Tax Payments

Tentative alignment has also been reached between the DOR and the three project producer parties on a target amount of Flow-Related Property Tax (FRPT) that will be paid during the operation phase of the project. The FRPT tentative alignment establishes a total target amount paid over the first 25 years of the project equal to $15.7 billion. If an alignment is finalized between the State and producer parties, it is anticipated that the target amount will be converted to a tax in dollars-per-MMCF (million cubic feet) volume or per-MMBtu (million British thermal unit) heating value which will be applied to project throughput averaged over 5 years and paid regularly throughout the 25-year project period. The amount of $15.7 billion is referred to as a target amount because the actual tax-per-MMCF or per-MMBtu is established before production begins based on forecast design throughput. Then after project start-up, it is assumed actual throughput will differ from the forecast design rate and the actual tax paid will vary from the target amount. If project throughput is greater than forecast the total project tax payments will be greater than the target amount. If throughput is less than forecast, total project tax payments will be less than the target amount. The allocation of the FRPT payments between the State and municipalities has yet to be determined.

Additionally, as with the Impact Payments, the total FRPT payment target amount of $15.7 billion is the amount payable by the property taxpayer, without consideration of the tax status of the individual property owners. However, it is possible that the actual payments will be reduced by the anticipated 25 percent State of Alaska ownership share in the project due to its tax-exempt status.

The $15.7 billion FRPT total amount is referred to as a target amount because the actual tax-per-MMCF or per-MMBtu is established before production begins based on forecast design throughput. Then after project start-up, it is assumed actual throughput will differ from the forecast design rate and the actual tax paid will vary from the target amount. If project throughput is greater than forecast the total project tax payments will be greater than the target amount. If throughput is less than forecast, they will be less than the target amount.

Project Property Tax after Project-End

After the end of the agreed project period, it is assumed that oil and gas property taxes on project assets will revert to the status quo and be assessed under the applicable oil and gas property tax statutes in existence at that time.

Allocation Methodology

The allocation methodology of both Impact Payments and FRPT between State and local jurisdictions is yet to be determined. Any discussions to-date of allocation of property tax payments by the project have been preliminary.

Impact and Benefits of a North Slope Natural Gas Project

This section describes the potential impact and benefits of infrastructure development resulting from a North Slope gas project, whether designed to provide natural gas for in-state sale or for export, or both, on communities in the state, including consideration of tax structure under AS 29.45 and AS 43.56, and consideration of other payments before construction of new infrastructure associated with North Slope gas development. For purposes of assessing and compensating communities for impact from the project the MAGPRB recommends that there be two tiers of impact payments: direct and indirect payments.

Direct Impacts and Benefits

Direct impacts and benefits are those experienced by municipalities and communities on or very near the proposed project facilities, pipelines or infrastructure, including locations used as staging areas or material sources for construction. These communities are expected to be affected immediately by the construction of the Alaska LNG Project through the use of municipal services and infrastructure. These communities are also more likely to experience benefits from the expected increase in economic activity that will result during construction of infrastructure located within or near their boundaries.

Indirect Impacts and Benefits

Indirect impacts and benefits are those experienced by municipalities and communities located in more removed locations, away from the direct locations of the facilities, pipelines or infrastructure. In these communities the Alaska LNG Project is not planned to be an immediate presence within their jurisdiction, but nevertheless is expected to indirectly impact municipal services (e.g. loss of municipal workforce to the project).

Impacts and Benefits Recommendations

Assessing Impact Payments: Alaska LNG Projects designed to move gas in interstate and international commerce will be permitted by the Federal Energy Regulatory Commission under the Natural Gas Act, Section 3. This will require the Project to prepare an Environmental Impact Statement (EIS) that assesses, among other matters, the socio-economic impacts to communities from the project. Those documents, and the processes associated with them, will be authoritative and publically documented. Any effort at this point to assess impacts should consider how to coordinate and/or incorporate those impacts into the FERC Pre-File and EIS processes respectively.

Appropriation: If impact payments are to be paid in lieu of property taxes during construction of the Alaska LNG Project, the municipalities believe that payments should be made directly to municipalities as provided under current property tax statutes, and not subject to legislative appropriation. Indirect impact payments could be made by the State through a separate fund.

Schedule: Impact payments should be scheduled and paid, regardless of construction schedule or activity. This is critical for communities directly impacted by work stoppages, who require a predictable revenue stream to offset impacts on services. The recommendations should also include provisions for the extension of construction terms, allowing for overruns.

Local Hire: Wherever possible, the State of Alaska and the Alaska LNG Project should maximize local hire to ensure the employability of the local workforce and to reduce the impacts of an imported labor pool overloading municipal services

Access to Energy: The State should commit to providing access to energy infrastructure in order to lower the cost of delivered energy for Alaskans. This can occur at off-take points, or other facilities that provide natural gas, or other forms of energy to communities, including through use of the Alaska Affordable Energy Fund (AAEF). The Alaska LNG Project and the State of Alaska should consult with the MAGPRB on the location of off-take points and other facilities that would provide communities with access to energy.

NEXT STEPS

Impact Payments and Flow-Related Property Tax Payment Allocation Methodology

The MAGPRB will be further analyzing the proposed impact fee and flow related structure and the proposed target amounts to be paid by the Alaska LNG Project prior to a final recommendation from the board. DOR has stated its plans to achieve a consensus recommendation from the MAGPRB for the overall structure and target amounts of the impact payments and flow rate based property tax.

Additional discussions must take place before recommendations on final allocations of impact payments among the stake holders can be achieved. The MAGPRB will be analyzing the research and data collected by the Alaska LNG project in the on-going FERC (Federal Energy Regulatory Commission)/NEPA (National Environmental Policy Act of 1969) pre-filing process as soon as that information is filed with FERC in 2016. Also, a plan for the timing of impact payments during construction and FRPT payments will likely need further discussion and analysis before a consensus recommendation is achieved.

The MAGPRB supports continued work to advance a viable gas commercialization project. If the Alaska LNG Project does not come to fruition, the MAGPRB urges that other projects be explored as alternative means of supplying communities with long term, stable supplies of lower-cost energy.

The MAGPRB continues to recommend that the Department of Revenue be as integrated in the FERC and NEPA process as is allowed by the project participants.

LNG export projects are subject to many different permits at the federal level. There are two federal agencies whose approval is necessary for the success of the project. One is the Department of Energy, which is responsible for issuing export licenses for countries with free trade agreements, and those without free-trade agreements.

The second federal agency relevant to the Alaska LNG Project is the Federal Energy Regulatory Commission (FERC), which regulates the construction, operation and safety environmental impacts of the project. After initiation of the pre-filing process, FERC coordinates the preparation of a single Environmental Impact Statement (EIS), to be used by all federal agencies for their respective permit and authorization services. The basis for the EIS is twelve (12) resource reports that the applicant is required to submit to FERC. The MAGPRB recommends that it stay very active in the drafting of the EIS for any gas project by submitting timely responses to any relevant resource reports and maintaining open lines of communication with FERC and any other relevant agencies. The MAGPRB also recommends that local governments participate in the EIS process on behalf of their respective communities.

Pre-filing is important because the burden is on the applicant to gather data for the EIS and review by FERC. The early identification of potential issues with regard to community concerns, environmental impacts and others during the pre-file process will generally result in a stronger application outcome.

Once the pre-filing process is complete, FERC will then issue a draft EIS. That draft will be open for public comment and review. After the public comment and review process, a final EIS draft is issued. Finally, the FERC commissioners will make a determination as to whether or not to authorize the construction and operation of the project. Without an EIS and FERC authorization, the Alaska LNG Project does not reach the critical Final Investment Decision (FID) phase, which is the stage when the majority of funds for a project are committed and construction begins.

Of the twelve resource books that collectively make up the draft EIS, resource book number five (5) is of the most interest to the MAGPRB. Resource Book No. 5 is the socioeconomic resource report. That book describes the baseline in communities regarding their socioeconomic conditions, and evaluates the socioeconomic impacts of the project as well as what can be done qualitatively to reduce those impacts. The baseline encompasses everything from employment, housing, school enrollment, medical services and government services.

The MAGPRB recognizes that the fiscal impact analysis of any gas project will be crucial in terms of determining the impact costs associated with an influx of temporary or permanent workers, the duration of their stay, and the use of municipal services. The MAGPRB therefore reiterates its recommendation to stay very active in the drafting of an EIS. Likewise the findings in the resource reports and the draft EIS will provide essential information necessary for the MAGPRB to complete its tasks under SB 138, Section 74 and the its Executive Order.

In the context of the EIS timeline, the Alaska LNG Project has hosted open houses in several communities; twelve (12) open houses were conducted between October and November, 2014. FERC personnel, though not participating, did observe the proceedings. The Alaska LNG Project is in the preliminary front end engineering design (pre-FEED). The estimated cost is between \$400-500 million, encompassing 2014 and 2015. If the project still holds promise after that period, then the project moves into full front end engineering design (full FEED). The estimated cost of that phase is in excess of \$2 billion, and a timeline of two to three years. During that time, the draft resource reports will be submitted, along with agency and community feedback. The final draft of the resource reports would then be made available. Scoping sessions are expected to begin sometime in February, 2015. The MAGPRB strongly recommends having a presence at these scoping sessions and contributing to the information being gathered for the Resource Books and the final EIS.

Outstanding Negotiations Regarding Flow Related Property Tax

Additional discussions and agreement must occur with the project producing partners on several material elements of the FRPT before the MAGPRB can debate and come to a consensus recommendation regarding the FRPT. Future discussions will address (i) setting the design rate basis for calculating the FRPT; (ii) establishing the FRPT throughput measurement units, whether MMCF or MMBtu; (iii) establishing the throughput measurement locations, gas treatment plant (GTP), pipeline, and LNG liquefaction plant, and (iv) determining whether measurement should be made at the inlet or outlet of the project components. When these determinations have been agreed upon, DOR can then present the agreed upon results to the MAGPRB and consider statutory changes necessary for implementing the agreements and moving the Alaska LNG project forward.

Recommendations for Change to AS 43.56 and AS 29.45.080

This section will recommend changes to AS 29.45.080 and the oil and gas exploration, production, and pipeline transportation property taxes under AS 43.56 related to infrastructure for commercialization of natural gas that would facilitate development of a North Slope natural gas project and mitigate financial impacts to communities affected by a North Slope natural gas project, but is left blank as a placeholder for the board's use….

OTHER RECOMMENDATIONS

This section left blank as a placeholder for the board's use….

RESOURCES

Office of the Federal Pipeline Coordinator: http://www.arcticgas.gov/

Municipal Advisory Gas Project Review Board Website:
http://dor.alaska.gov/MunicipalAdvisoryGasProjectReviewBoard.aspx

Alaska LNG Project Website: www.ak-lng.com

Alaska Department of Revenue Website: http://www.dor.alaska.gov

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Appendices

Appendix A-1. Municipal Advisory Gas Project Review Board members: (?NEEDS MODIFICATION?)

Randall Hoffbeck (Chair)
Commissioner, Alaska Department of Revenue

Mark Myers
Commissioner, Alaska Department of Natural Resources

Fred Parady
Acting Commissioner, Alaska Department of Commerce, Community, and Economic Development

Clay Walker
Mayor, Denali Borough

Mike Navarre
Mayor, Kenai Peninsula Borough

Dan Sullivan (?NEEDS MODIFICATION?)
Mayor, Municipality of Anchorage

Charlotte Brower
Mayor, North Slope Borough

Luke Hopkins (?NEEDS MODIFICATION?)
Mayor, Fairbanks North Star Borough

Larry DeVilbiss (?NEEDS MODIFICATION?)
Mayor, Matanuska-Susitna Borough

Reginald Joule
Mayor, Northwest Artic Borough

Robert Venables
Energy Coordinator, Southeast Conference

Robert Bartholomew
Finance Director, City and Borough of Juneau