Office of Management and Budget: Tax Credit Certificates Bond Financing Program

The Walker-Mallott Administration is committed to funding outstanding oil and gas exploration tax credit certificates (tax credit certificates) and recognizes them as an important part of the State's partnership with independent oil and gas exploration companies. Ultimately, whether through appropriation or application against future tax liabilities, these tax credit certificates will be paid. The Governor's FY2019 budget includes a program to begin purchasing outstanding tax credit certificates at a present value discount in FY2019.

The Department of Revenue's Fall 2017 Revenue Forecast estimates that $711 million of tax credit certificates will be available for purchase by early FY2019, with an estimated additional $188 million over the following three years. This estimate assumes that $100 million of credits will be transferred to taxpayers and used to offset tax liability. Based on the statutory appropriation formula and the Fall 2017 Revenue Forecast, we estimate the following state purchase schedule for these remaining credits:

$ millions	**FY2019**	**FY2020**	**FY2021**	**FY2022**	**FY2023**	**FY2024**	**FY2025**
Estimated Statutory Payment	$206	$167	$119	$132	$135	$139	$1

In January 2018, the Governor will introduce legislation to implement the Tax Credit Certificates Bond Financing program that will provide:

- Authority for the Department of Revenue to negotiate discounted tax credit certificate purchases.
- Authority to issue bonds to finance the cost of the discounted tax credit certificate purchases.
- An appropriation for debt service on the proposed bonds for FY2019 in the operating budget. The Governor's FY2019 budget proposal includes $27 million for the estimated bond payment.

Beginning in FY2019 under the program, bonds would be issued to pay off the discounted present value of the $711 million of existing tax credit certificates. Bonds will be issued later to cover the remaining tax credit certificates. The proposed base discount rate will be 10 percent (base discount rate), which is believed to be less than the credit holders' weighted average cost of capital. Tax credit certificates will be discounted to a current value based on expected payments under the then existing statutory formula.

Credit holders will have the option to receive a reduced discount rate equal to the State's break-even cost (the cost necessary to cover the cost of borrowing and the uncertainty of earnings during the bond repayment period) in exchange for an overriding royalty interest (ORRI) to be defined by the Department of Natural Resources (DNR).

The reduced discount rate helps ensure that tax credit certificates are paid at a reasonable amount and the State's financing costs are covered by earnings on funds that would otherwise be appropriated. The reduced discount rate will be determined at the time each bond offering is priced, however, based on current market conditions, we estimate that the reduced discount rate would be between five and six percent.

This proposal of discounting the currently expected Tax Credit Certificates payments to a current value offers a variety of benefits to both the state and Tax Credit Certificate holders:

- A predictable annual payment for paying Tax Credit Certificates.
- Financial cost to the State (financing costs and interest), will be equal or less than the discount to the face value paid on the Tax Credit Certificates plus the anticipated earnings on the amount that would have been paid under the statutory formula, net of debt service.
- Tax Credit Certificate holders will be able to monetize their Tax Credit Certificates at a reasonable net present value.
- Removing uncertainty regarding the Tax Credit Certificate payments is expected to lead to additional Alaska investment by these firms.

Our proposed model is based on a 10-year amortization for each bond issuance. The estimated face amount of the credits is approximately $899 million. The Present Value of the estimated statutory payment formula is approximately $801 million. The present value of this program, assuming that all credit holders elect to take the Reduced Discount Rate, would be approximately $741 million.

In exchange for payment of certificates under this program, DNR would obtain any geologic and geophysical data developed with funds from the underlying Tax Credit Certificates, and the credit holder would waive any expectations of confidentiality under state law. Similarly, credit holder would waive, without limitation, any right to confidentiality by DNR of well data developed with funds from the underlying Tax Credit Certificates that has been provided to DNR.