DOR Update on Alaska LNG Project

Presented by

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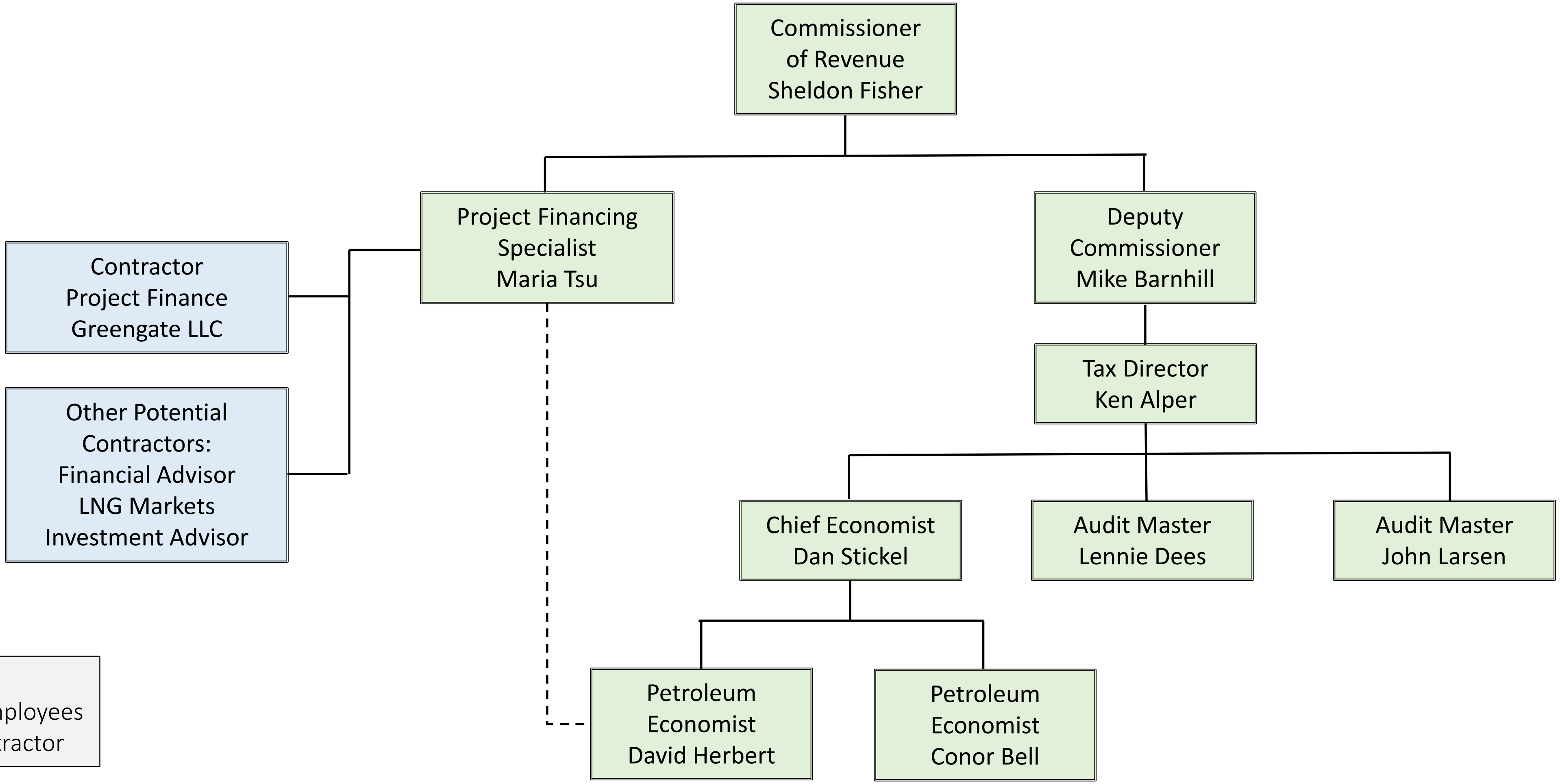
Presentation Outline

- **Progress Report**
  - DOR Fiscal Model(s)
  - DOR Work Plan
  - Overview of Risks to State of Alaska
  - Payment-in-lieu-of-Taxes (PILT)
  - Fiscal implications of Upstream Infrastructure Costs

DOR Functional Organization for Alaska LNG Project



Color Key:
Green = DOR Employees
Blue = DOR Contractor

Question 1: Goals of Investment and Fiscal Analyses

- Provide objective review of opportunity/risks of Alaska LNG project for State
- Evaluate fiscal implications of project for State:
  - Value blocks to State not dependent on State's investment in project (royalties, taxes, PILT)
  - Revenues to State depending on equity ownership and method of financing
  - Implications for State's fiscal situation with/without project
- Assess potential risks to State and mitigating factors
- Assist Legislature and State in decision to invest in project and financing options

Discuss DOR Modeling Efforts (Question 1 continued)

- ❑ Five modules:
  1. Alaska LNG project (midstream)
  2. Upstream model (taxes, royalties)
  3. Payment-in-lieu-of-taxes (PILT)
  4. Fiscal model (combined implications of 1 – 3 above)
  5. Broader economic impacts (will require additional consultant resources)

- ❑ Key functionalities:
  - Calculate equity returns and net revenues to State depending on level of equity ownership (direct and via AGDC) and manner of financing
  - Scenario analysis around base case assumptions
  - Stress testing to better understand risks and effectiveness of mitigation measures
  - Review of benefits/risks to State (project, upstream, fiscal, other)

Status of DOR's Fiscal Model (Question 1 continued)

DOR Alaska LNG Project Module

- Purpose: models economics of project and fiscal impacts associated with State equity ownership whether via AGDC or other State investment;
- Status: still under development;
- Greengate LLC is advising on model development and will provide independent validation.

DOR Royalty and Tax Fiscal Module:

- Purpose: uses DOR's existing fiscal model to analyze implications for oil and gas royalties and taxes;
- Status – in early stages of assessing data needs and required adaptations of existing DOR model;
- DOR team is coordinating with DNR on analyses of upstream impacts.

Project benchmarks needed for DOR model:

- Model has flexibility to analyze a range of commercial structures and contract terms;
- As AGDC finalizes key aspects of project's structure, the range of possible outcomes will narrow;
- DOR's model will capture the various options under consideration by AGDC.

Question 2: Describe DOR's work plan to consider possible State of Alaska investment in the project

(1) Continue tasks assigned in SB 138

- Finalize report to legislature on range of financing options (sec. 76(a)-(b))
- Submit report to legislature on plan and recommended legislation to permit municipalities, regional corporations and residents to participate as a co-owner of North Slope natural gas project (sec. 76(c))
- Consult with DNR on gas sales agreements under AS 38.05.020(b)(11) (sec. 24)
- Re-engage MAGPRB and annually report to Governor (sec. 74; AO 269)
- Consider additional approaches for engaging with municipal communities

Describe DOR's work plan to consider possible State of Alaska investment in the project (Question 2 continued)

(2) Evaluate any opportunities for State participation in AGDC capital fundraising

- Identify/recommend source(s) of capital to meet request
    - Appropriation
    - Issuance of debt
    - Investment of state funds
        - requires due diligence, compliance with prudent investor rule and fiduciary standard of care, approval of pertinent fiduciary
- Identify/recommend/evaluate capital structure(s) for State participation
    - Debt/Equity ratio
    - Third party participation in capital structure

Describe DOR's work plan to consider possible State of Alaska investment in the project (Question 2 continued)

- To implement and complete DOR State Investment Work Plan:
  - Complete modeling efforts (pp. 4-6, above)
  - Revenue will procure and retain consultants: e.g., financial advisor, LNG market consultant, project finance expert, investment due diligence consultant, risk analysis consultant

Question 3: Potential Risks to the State of Alaska

Question: Please discuss risks (and possible mitigation measures) to the State of Alaska, from DOR's perspective, in relation to the project, including risk as a potential investor; risk as a resource-owner; and risk as a taxing authority.

- Risks as potential investor:
  - possible loss of capital, reduced returns or negative impact to credit rating if actual project costs are higher or revenues are lower than expected.
  - See next slide for example investment risks and possible mitigation measures.
- Risks to the State as resource-owner and taxing authority:
  - If oil production is lower than expected and revenues from gas royalties and gas taxes are not sufficient to offset, overall royalties and taxes to State may be lower than expected.
  - Upstream capital and operating costs could reduce taxes and royalties depending on deductibility from taxes and whether field costs are allowed, respectively.

Potential Risks: State as an Investor
(Question 3 continued)

Note: these are just examples, not an exhaustive list

Project Phase	State Action(s)	Risk Level	Potential Risks	Possible Outcomes	Mitigating Measures
Pre-FID	Invest equity	Highest	Negative FID	Full loss of pre-FID capital	Rely on third-party investors; wait for key milestones
Post-FID / Construction	Invest equity / Issue bonds	High	Cost overruns / Completion risk	Reduced equity return; Need to invest more equity; State's credit rating reduced	Project utilizes lump-sum/turn-key contracts; State could invest less
Commercial Operation	Invest equity / Issue bonds	Medium / Low	Revenues lower / costs higher	Reduced equity return; State's credit rating reduced	State could invest less; only issue bonds if sufficient cash flow cushion

Question 4: Review progress on PILT/impact payments; status of Municipal Advisory Group

- Revenue will conduct a global survey of comparable LNG Project PILT practices
- Revenue will review and update as needed the project socioeconomic impact evaluations performed to date
- Revenue will re-convene the Municipal Advisory Gas Project Review Board (MAGPRB) (est. Q4 2018)
  - The MAGPRB last met in February 2016; last report December 2016
  - Revenue/MAGPRB will submit a report to the Governor for calendar year 2018
  - Revenue/MAGPRB will consider/recommend PILT enabling legislation as needed

Question 5: Fiscal Implications of Upstream Costs outside of the project's scope

- DOR's Fiscal Model forecasts state revenues from oil and gas royalties and production taxes;
- Fiscal Model will be able to analyze fiscal implications of upstream infrastructure build-up.
- Model calculates impacts of deductions for allowable lease expenditures associated with upstream costs incurred by producers, including the potential impacts of carried-forward annual losses as established in HB111;
- DOR and DNR are coordinating efforts to ensure consistency of data and model input assumptions.

Fiscal Implications (Question 5 continued)

- Beginning January 1, 2022, per SB 138, gas production will be taxed based on 13% of gross value (whether paid in cash or "tax as gas.")
  However, in accordance with AS 43.55.011(e)(3) and 43.55.160(h)(1), lease expenditures associated with gas exploration, development, and production remain deductible from oil production taxes.
- Lease expenditures include capital expenditures (CAPEX) and operations & maintenance expenses (O&M);
  - Expenditures are deductible in the year incurred up to the point where any joint oil/gas expenditures exceed the gross value at the point of production (GVPP) for oil
  - Deductions reduce tax obligations at the statutory tax rate, so long as prices support payments above the gross minimum tax level. Effectively, these expenditures will offset production taxes at 35% of the amount spent, which could reduce oil tax revenues to the State before the system is operational;
  - "Excess" or unused lease expenditures may be carried forward to future years in accordance with HB 111, and used to offset oil revenues in those years.

Fiscal Implications (Question 5 continued)

- Royalties may also be reduced if field costs are allowable under certain leases associated with gas production:
  - Leases issued before 1979 allow "cleaning and dehydrating" (i.e. field cost) deductions for RIK. Whether leases allow field costs for RIV remains unresolved;
  - Leases issued after 1979 do not allow field cost deductions.
- Prudhoe Bay:
  - Most leases are covered by a negotiated settlement from 1980 that allow a fixed per-MCF deduction (tied to Producer Price Index) from gas royalties following a major gas sale;
  - This volume-based deduction does not necessarily reflect actual upstream costs.
- Point Thomson:
  - BP and Conoco lease interests are subject to a 1995 settlement agreement that incorporates the same field cost formula as the 1980 settlement ;
  - Other working interests are not subject to a settlement agreement for gas;
  - Pending DNR appeal involves field costs for condensate production at PTU.

THANK YOU

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