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STATE OF ALASKA
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JUNEAU

Questions and Answers: House Finance – 1:00 PM – October, 24 2015

Representative Wilson:

How would using the permanent fund account affect our credit rating vs using the CBR? If our credit rating is lowered, it will affect not only this project but all other projects the state is borrowing for correct? Why or why not would the State of Alaska want to invest in this?

Department of Revenue Response:

Using the Alaska Permanent Fund (APF) will have less of an impact on the states ratings than using the CBRF. The CBRF is available for all state expenditures while the APF is limited to investment opportunities. The CBRF will need to be repaid while the APF can be viewed as investment.

Representative Neuman:

Asked for copies of all reports that have been given out to the administration. Would also like base-line of what financial decisions are based on.

Department of Revenue Response:

- Lazard, FirstSouthwest and Greengate LLC have provided the following reports.
- The Interim Lazard Report, February 2015

http://dor.alaska.gov/Portals/5/AKLNG-PROJECT-LAZARD-INTERIM-REPORT-2015.pdf

FirstSouthwest analysis on the state's debt capacity as described below:
The most recent analysis of the State's debt capacity is attached.

The attached analysis is as of June 3, 2015. The analysis shows how much the State could potentially borrow for the project with general obligation bonds, taking into account ratios for debt service as a % of unrestricted general fund revenues and interest rates associated with specific credit ratings using both tax-exempt and taxable rates.

First Southwest believes that a State borrowing could be feasible. There are several ways that the State could access the debt capital markets. One method is to issue general obligation bonds.

General obligation bonds would require voter approval. A second method would be to issue appropriation backed bonds. Appropriation bonds would require annual appropriations from the State Legislature for the payment of debt service. Another alternative would be to have AGDC issue the bonds. This would also require an annual appropriation for debt service from the Legislature. Yet another alternative is to issue bonds for projects that are currently funded on a pay-as-you-go basis and use those freed up pay-go funds for the project which otherwise would not have qualified for lower cost tax-exempt bond funding. The financing costs under this option could be on a tax-exempt basis.

FirstSouthwest believes that any of the above alternatives would result in lower financing costs to the State. The basis behind that assumption is twofold. First, under the TransCanada Precedent Agreement, TransCanada is entitled to a "Carrying Cost Calculation" on its capital invested during the Pre-FEED JVA stage at a rate of 7.1%. This is materially higher than anticipated financing costs on a State borrowing. Current municipal market rates suggest an interest cost to the State of approximately 3.06% for 20 year AAA rated tax-exempt general obligation bonds and 4.36% for AAA rated taxable general obligation bonds, while interest costs for certificates of participation (appropriation backed debt) rated a notch below the State's general obligation rating are currently at 3.41% for tax-exempt bonds and 4.76% for taxable bonds. Secondly, the Precedent Agreement provides for an agreed weighted cost of capital for TransCanada of 6.15% (per B&V Report) for TransCanada's FEED and FID capital investment (with the Pre-FEED JVA capital and 7.1% Carrying Cost Calculation included as part of the capital investment against which the weighted cost of capital is applied). Again, we note this is higher than anticipated State financing costs as described above. Second, we believe that any debt issued by the State will carry a higher credit rating that the ratings on TransCanada debt that might be issued backed by the revenues from the State's Firm Transportation Services Agreement with TransCanada. TransCanada's current long term debt credit ratings (see attachment).

<u>Representative Neuman:</u>

Is this standard boiler plate contracts we have with TC or are we forging new ground here? What I am trying to get to is to see how much risk we are funding, and you said these circumstances are unique, I want to look at that further. Is the risk proportionate for all the parties or is the state taking on more risk than the other? Send us what are the risks and how and why they are risks, and what we can do to manage those risks?

<u>Department of Revenue Response:</u>

Risks Faced Generally by LNG Project Equity Participants:

- Technical Feasibility: determined during Pre-FEED/FEED; can the Project be technically constructed (permitting, route, geology, environmental, technology). Equity participants assume the risk of losing their investment in Pre-FEED/FEED costs if Project deemed not technically feasible.

• Financial Feasibility: determined during Pre-FEED/FEED; if built, can the Project be completed and operated at a cost that delivers a profit on gas sales with a return sufficient to justify constructing the Project. Equity participants assume the risk of losing their investment in Pre-FEED/FEED costs if Project deemed technically feasible but not financially feasible.
• Funding Feasibility: determined during Pre-FEED/FEED; if technically feasible and financially feasible, will the financial markets have sufficient liquidity to fund the Project construction costs at an acceptable level and cost of debt/equity. Equity participants assume the risk of losing their investment in Pre-FEED/FEED costs if Project deemed technically feasible, financially feasible, but not fundable under then current financial market conditions.
• Construction Completion: determined after FID; can the Project be completed and placed into service. Equity participants assume the risk of losing their Pre-FEED/FEED/ and Construction investment if the Project construction cannot be completed and placed in operation.
• Cost Overruns/Project Delays: determined during FID; if the Project experiences cost overruns and project delays, do those cost overruns and project delays undermine the financial feasibility of the Project and will funding be available to meet the cost overruns. Equity participants assume the risk of negative netback from the Project or loss of investment in worst case scenario.

Risks Allocated Among the AKLNG Participants

• Among Producer Parties and State: under the current commercial structure being negotiated, the categories of risk outlined above are allocated proportionately to each party based on its share of gas projected to flow into the Project from PBU and PTU, which is mirrored in the percentage ownership of and allocated of construction and operating costs in the Project.
• State Disproportionate Risk: although the Pre-FEED, FEED, and post-FID construction and operating cost risks are allocated proportionately among the Producers and the State, the State has a disproportionate risk as an indirect gas owner with no control of the upstream gas fields (vs. the Producers direct control), and as sole source gas market participant with no previous market experience and buyer relationships (vs. the Producers with multiple worldwide gas source availability, extensive market experience and multiple relationships with buyers).

Risks Allocated Between the State and TransCanada

• Technical Feasibility: under the terms of the PA and anticipated terms of an FTSA, all technical feasibility risk is born by the State with none born by TransCanada. If the Project does not proceed to FID, the State reimburses all of TransCanada Project costs plus interest at a negotiated rate (7.1% for Pre-FEED, as adjusted for 30 year Treasury Bill fluctuations through FEED).
• Financial Feasibility: under the terms of the PA and anticipated terms of an FTSA, all financial feasibility risk is born by the State with none born by TransCanada. If the Project does not proceed to FID, the State reimburses all of TransCanada Project costs plus interest at a negotiated rate (7.1% for Pre-FEED, as adjusted for 30 year Treasury Bill fluctuations through FEED).
• Funding Feasibility: under the terms of the PA and anticipated terms of an FTSA, all funding feasibility risk is born by the State with none born by TransCanada. If the Project does not proceed to FID, the State reimburses all of TransCanada Project costs plus interest at a negotiated rate (7.1% for Pre-FEED, as adjusted for 30 year Treasury Bill fluctuations through FEED). If the Project does proceed to FID, but TransCanada does not identify debt and equity funding for its share of the construction of the Project at a cost and on terms acceptable to TransCanada in its sole

discretion, TransCanada can unilaterally exit the Project and the State reimburses all of TransCanada Project costs plus interest at a negotiated rate (7.1% for Pre-FEED, as adjusted for 30 year Treasury Bill fluctuations through FEED).

- Construction Completion: under the terms of the PA and anticipated terms of an FTSA, all Construction Completion risk is born by the State with none born by TransCanada. If the Project construction is not completed and the Project does not go into service, the State reimburses all of TransCanada Project costs plus interest at a negotiated rate (7.1% for Pre-FEED, as adjusted for 30 year Treasury Bill fluctuations through construction).
- Cost Overruns/Project Delays: under the terms of the PA and anticipated terms of an FTSA, all Cost Overruns and Project Delays risk is born by the State with none born by TransCanada. Cost Overruns are included in TransCanada's tariff capital cost calculation to be recovered from the State through an increased tariff payment. Project delays are solely born by the State, as TransCanada has no gas sales/buyer default risks, and TransCanada interest continues to accrue and be capitalized into the tariff capital cost calculation to be recovered from the State through an increased tariff payment.
- Appropriation Risk: TransCanada assumes the risk that the Legislature will not appropriate funds necessary to reimburse TransCanada if TransCanada exits the Project or the Project is terminated or will not appropriate funds necessary to pay the TransCanada tariff after the Project is operational. To hedge this risk, TransCanada has included a requirement in the PA and anticipated terms of the FTSA that the State pledge the full faith and credit of the State to make such payments or dedicate a separate State fund to secure such payment (which would require a voter referendum or Constitutional Amendment). TransCanada has also included a requirement that the State maintain an investment grade credit ratings at all times during the Project, absent which TransCanada can terminated its participation in the Project and accelerate all reimbursement obligations of the State.

Representative Gara:

I would like to quantify the value. If we buy out TC and we finance it at a favorable rate, who can quantify if that is better than leaving them in the project and paying their tariff?

Department of Natural Resources Response:

Slides 19-21 of the "TransCanada's AKLNG Participation" presentation given by Deepa Poduval on Monday, October 27, 2015, in House Finance walks through a comparison of the value associated with retaining TransCanada vs. terminating the relationship.
The State could potentially achieve up to ~$400 million incremental annual cash flows, based on the State's expected lower cost of capital.

Representative Gara:

Can you provide scenarios on if we leave TC in through feed and pre feed or if we buy them out now, how much would we save/spend in each scenario?

Department of Natural Resources Response:

The table below shows the total cost to the State of leaving TC in for pre-FEED until Dec 2015 and a scenario leaving TC for FEED until December 2018. In the scenario where the State terminates

the TC relationship in Dec 2015, the State would need to repay TC approximately $70MM. In the scenario where the State terminates the TC relationship in Dec 2018 after FEED, the State would need to repay TC approximately $490MM. The total repayment to TC would include WP&B costs for AKLNG, TC's internal costs as well as 7.1% interest as shown below:

	Nominal $Millions	
	Dec 2015	Dec 2018 (Current Estimate for end of FEED)
WP&B Costs	$51	$400
TC Internal Management Fee	$16	$35
Interests Costs	$3	$55
Total	$70	$490

* All values are approximate and are based on estimated Pre-FEED and FEED costs and schedule.

Representative Gara:

In trying to determine the difference between the two (if the State buys out TC and fails after FEED or TC remains after FEED), would we calculate that the 7% payment would be on estimate of roughly $820 million dollars over 4 years?

Department of Natural Resources Response:

Of the total $820 million that is estimated to the total share of the State's cost going forward to complete Pre-FEED and FEED without TC, approximately $15MM for Pre-FEED and $365MM for FEED are associated with AGDC's investment in the AKLNG LNG plant component which would have been incurred directly by the State with or without TC. In addition to TC's estimated costs to date for Pre-FEED (of approximately $67MM), the 7% interest for TC would apply to approximately $60MM of remaining AKLNG midstream costs to complete Pre-FEED and $310MM of AKLNG midstream costs for FEED. As indicated in the response to Question 5, the total interest cost to TC if the agreement is terminated in Dec 2015 during Pre-FEED would be approximately $3MM and the interest expense to TC if the relationship is terminated assuming a Dec 2018 end of FEED would be approximately $55MM.

Representative Edgmon:

Is the permeant fund on anyone's sights here?

Department of Revenue Response:

The Permanent Fund is being considered as part of a financing package and a full analysis will be included in the final Lazard Report to be presented to the legislature when the Commissioner of the

Department of Natural Resource submits the first contract or agreement.

<u>**Representative Gara**</u>**:**

As a shipper of gas, if we send less gas than expected will we still owe on the amount that was supposed to be shipped?

<u>**Department of Natural Resources Response:**</u>

Yes. The SOA will be obligated to pay for transportation weather we ship the required volumes or not. Secondly, the long term gas contracts with the customers will require us to deliver the full volume of contracted gas. These are the reasons: the upstream supply and delivery agreements are so critical; billions of dollars are at stake. The SOA as a non-producer must use commercial agreements to ensure its gas is available.

<u>**Representative Saddler:**</u>

SB 138 sets up a clear process and in the AKLNG project over the last year we haven't firmed up the transportation services agreement and other milestones. Does the failure to hit these milestones affect our credit rating? Does AKLNG appear less valuable?

<u>**Department of Revenue answered in hearing, written response:**</u>

AKLNG is a complex process. The rating agencies have noted that the State is proceeding upon a difficult and complicated journey. It is unrealistic to expect that there will not be delays or challenges. To date, the State has not incurred significant obligations that required access the capital markets. The rating agencies will take a more intensive look when the State will issue debt.

<u>**Representative Neuman:**</u>

How do we see the state measuring these contracts that go for 25-30 years?
How do we see the credit agencies analyzing that knowing what is coming and our plan looks at a 30 year plan on financing this. How do you analyze the PA and the buyers of gas credit ratings? How much would the credit rates scrutinize the purchasers of gas? What are the possible alternatives the state could face? What are the possible future implications? What about the market in the future? What are long term projects in the Asian market looking like?

<u>**Department of Revenue answered in hearing, written response:**</u>

Using the purchasers of gas to help finance the project is one option that the State will explore. The purchase contracts have not been negotiated as of yet, and this process could take several years. When and if such contracts are executed, the rating agencies will review those contracts to see if they are creditworthy. There are a number of factors that will go into the rating agencies' analysis, but it is too early in the process to comment upon the potential purchaser at this time.

Representative Saddler:

When looking at all scenarios, the governor has mentioned going to Asian buyers. Can you describe the implications if we turn to buyers who look at both sides of our equity sheet as owners and buyer?

Department of Revenue answered in hearing, written response:

LNG buyers will be an important component of the Project's commercial structure and ultimate economic viability. The implications of having one or more LNG buyers potentially also participate as co-owners of the Project could help align incentives with key customers and, potentially, enable more favorable commercial terms than might otherwise be available. It is important to note that, given the early stage of the Project, it is premature to know whether or not pursuing LNG buyers as co-owners of the Project would be advantageous for the State, and the ultimate implications in this regard will largely depend on the specific terms of the agreements that would be negotiated in the future.