Alaska State Legislature: HB 247

Testimony to House Resources Committee

Richard Ennis & Thomas Ryan

March 9, 2016

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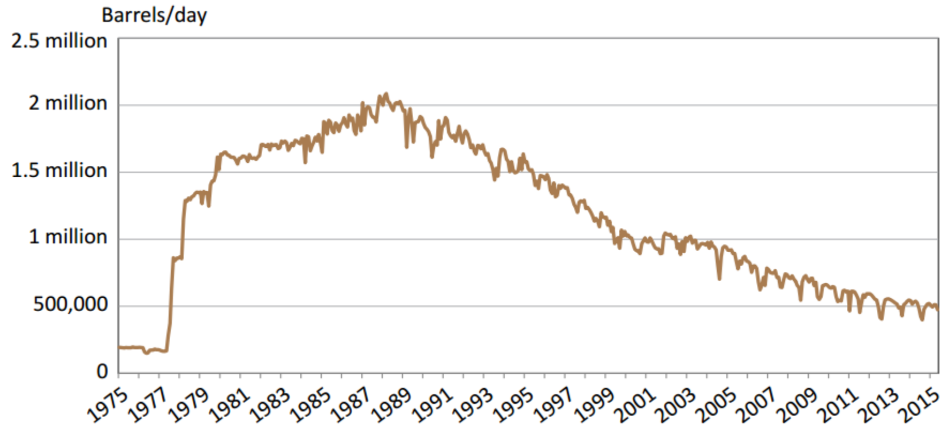
Tax Credit Program Overview

Overview of Alaska State Tax Credit Program

- The State of Alaska has adopted several exploration and development incentive programs to encourage active exploration and the timely development of the State's oil and gas reserves for export purposes and to meet in-state demand;
- Incentives are mostly available through the State's oil and gas production tax code and vary by production region, project size and project stage;
- Any explorer or developer is eligible for incentives; some incentives under the Alternative Credit for Exploration program require preapproval of projects by the State. Expenditures underlying tax credits are subject to approval and exploration data must be provided to the state for some credits;
- In order to incentivize and facilitate smaller E&P companies without a large capital base and/or a tax liability, the State, has given companies producing less than 50,000 bbl/day, with no tax liability, the option of exchanging generated tax credits with the State for cash;
- The tax credit program is subject to annual appropriation by the
  For FY 2016, the Governor's veto capped funds Available at $500 million;
- Furthermore, E&Ps have the ability to assign credits to 3rd parties, opening up various options for leveraging these receivables;
- Continued investment in the oil and gas sector is necessary to sustain volumes, which have been in secular decline since the 1980s;
- The tax credit program has recently come under scrutiny due to budget constraints, as a result of the sustained low commodity price environment;
- All parties are interested to know what changes may be necessary to continue, and the Governor's office has put forward HB 247 as a proposed solution.

Alaska Crude Oil, 1975 to 2015



Source: U.S. Energy Information Agency

Lender Feedback on Tax Credit Program as Currently Structured

- **Assignability of Tax Credits:** Allows E&P co. to carve out tax credits and finance them separately from the project financing at a lower cost
- **Ability to Monetize Tax Credits:** Provides cash constrained borrowers near term liquidity
- **DOR Pays Lender Controlled Account Directly**
- **No Retroactive Actions / Tax Code Changes to date:** Provided Lenders regulatory certainty surrounding this element of program
- **State Credit Risk:** State's sizeable funded reserves combined with credit track record
- **Willingness to Support all Developers Equally:** State's issuance of tax credits for the benefit of any developer
- **Clear Milestones Allow Predictability with Regard to Expense Qualifications**
- **Strong Tax Credit Program Track Record**

Neutral

- **Willingness to Pledge State General Fund Monies to Fund Shortfalls:** State has heretofore been unwilling to backstop tax credit program with General Fund commitment
- **Certificate tradability:** Ability to retroactively revise tax credit program and annual appropriation risks reduce the liquidity of a certificate

- **Future Appropriation Risk:** In the event that appropriations in a given year are insufficient to cover credits, they will be subject to repayment in future years when appropriation amounts are uncertain
- **Borrower Bankruptcy Risk:** State has generally been unwilling to refund credits filed by a Borrower in the midst of bankruptcy proceedings
- **Delay in lien perfection:** Inability to perfect lien until the end of the year (at the latest) creates Lender uncertainty
- **Governors veto risk / political uncertainty:** As in FY2016, unforeseen changes to appropriations creates Lender uncertainty

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Tax Credit Program – Proposed Changes

Tax Credit Amendment

- ING as a lender acknowledges that current market conditions in combination with the size of the existing tax credit program make it a target for potential reform.
- As a prudent lender ING would welcome some prospective amendments, effective after 2016, that would make the program more sustainable over the longer term but also make the functioning of the program more predictable.
- In summary HB 247 does make the program more sustainable and the proposed changes are prospective which is promising however it also makes it more risky for lenders to lend against credits specifically and also to projects in general. In its current form the legislation would mean that ING would be unlikely to lend to the smaller exploration and development companies who are most in need of third party capital.
- The specific provisions that are the most problematic are the hiring requirement to qualify for refund, the low annual cap for credit refunds, the expiration of loss credits, failure to improve the bankruptcy risk, and the failure to permanently solve the appropriation risk.
- ING, as secured lender earning very low interest, is in general reasonably agnostic as to the levels of credits available, however the precipitous drop in the amount of credits will mean that the overall risk of borrowers defaulting, failing to complete projects, going into bankruptcy, or failing to meet necessary milestones to qualify for credits is increased exponentially. This in turn increases the overall risk associated with financing the tax credits and so could materially effect ING willingness to lend.

Key Risk Factors and Considerations – Lender Perspective

	Lender Consideration	HB 247	Possible Solutions
Borrower Liquidity	- Borrower requires sufficient liquidity to continue to finance exploration and/or extraction activities over the medium term.	- Tax credit refund cap of $25mm significantly increases the risk of a bankruptcy before all credits are paid out. .	- Ensure that credits become the property of the secured lender and lender can continue to exchange for cash after a bankruptcy or change of ownership
Tax Credit Qualification Risk	- The risk of expenditures not qualifying under State guidelines for credits - The risk of expenditures and invoices not being genuine.	- Employment requirement significantly increases the risk that borrowers will not ultimately qualify for the refund.	- Eliminate the employment requirement or define it such that lenders could satisfy it or financially compensate the state in the absence or failure of borrower to do so.
Lien Perfection Risk	- Lender exposure to the pre-perfection risk due to bankruptcy before applications are filed or perfected	- No Change	- Would like to see any legislation strengthen the lender's senior claim in such a situation.
Intercreditor Risk	- Interface risk between a Tax Credit Lender and the Project Finance / Borrowing Base Lender	- Lower tax credits increases the need and cost of capital for projects. This worsens the bargaining power of the tax credit financing party and increases financing costs materially	- Increase annual refund cap for smaller explorers and developers who don't have access to cheap alternative funding sources and eliminate expiration of credits

How has 247 effected risks – Lender Perspective

	Current Risk	HB 247	Potential fixes
Appropriation Risk	- Risk that the legislature don't approve or governor vetoes an appropriation to pay cash refunds for tax credits.	- Creates Certainty for current credits prior to law change. - Increases appropriation risk for future years as term extended.	- Create either a legislative or permanent funding fix to ensure that funding is adequate and stable to pay future refunds.
Construction / Project Operating Risk	- Project completion or exploration risk.	- Completion risk for companies that need the credits most will increase significantly due to excessive risk and cost of operating in Alaska.	- Increase annual cap for smaller explorers and developers who don't have access to cheap alternative funding sources.
Interest Rate Risk	- Interest on Loans will be subject to accrual and repaid in full at maturity / upon repayment of draws with proceeds from tax credit payments. - Each advance will be a separate loan with an expected maturity.	- Marginal increase in risk due to longer term but this can be managed with small additional cost to borrower.	- Shorten term by increasing refund cap.
Change in Law Risk	- Risk that retroactive tax credit program changes will adversely affect outstanding tax credit claims.	- Current proposal is prospective although very soon.	- Ensure that all future amendments are also prospective and push back effective date to end of 2016.

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ING Credentials

A Leader in Alaska State Tax Credit Financings

May 2015

Caracol Petroleum LLC

North Slope Exploration Project

US$30.0 million

Senior Secured Revolving Credit Facility

Sole Arranger, Administrative Agent, Collateral Agent

Brooks Range Petroleum

ThyssenPetroleum

ING Capital LLC

July 2015

Cornucopia Oil and Gas Company LLC

Cook Inlet Exploration Project

US$150.0 million

Senior Secured Revolving Credit Facility

Sole Arranger, Administrative Agent, Collateral Agent

FURIE Operating Alaska LLC

ING Capital LLC

ING Has not closed a new transaction since Q3 of 2015 and has not advanced funds against 2016 expenditure in existing deals; in both cases due to uncertainty over the anticipated changes to the tax credit program.

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Natural Resources League Tables – US & Canada

2014

Position	MLA	Deal Value (US$m)	No.	% Share
1	Mitsubishi UFJ	1,774.37	5	11.24
2	Sumitomo Mitsui	1,672.23	6	10.60
3	Mizuho	1,242.82	5	7.87
4	JPMorgan	1,037.50	2	6.57
5	ING	1,002.26	6	6.35
6	Citigroup	962.50	1	6.10
7	HSBC	649.79	3	4.12
8	Societe Generale	599.18	4	3.80
9	Credit Agricole	517.99	4	3.28
10	Sumitomo Mitsui Trust	476.59	2	3.02
Subtotal		**9,935.23**	**38**	**62.95**
Total		**15,782.17**	**97**	**100.00**

2015

Position	MLA	Deal Value (US$m)	No.	% Share
1	ING	947.38	5	5.26
2	IFM Investors	925.00	1	5.14
3	Societe Generale	905.38	5	5.03
4	Scotiabank	904.88	4	5.02
5	Sumitomo Mitsui	878.18	3	4.88
6	Bank of America	875.05	4	4.86
7	Mitsubishi UFJ	855.36	3	4.75
8	HSBC	835.30	3	4.64
9	Mizuho	832.38	3	4.62
10	Intesa San Paolo	832.38	3	4.62
Subtotal		**8,791.29**	**34**	**48.82**
Total		**18,012.43**	**83**	**100.00**

Source: IJ Global

ING Structured Finance Oil & Gas

… with teams worldwide focusing on Oil & Gas structured finance (>70 professionals)

Selected Oil & Gas transaction accolades

Awards 2014

Americas
Deal of the Year
Freeport LNG (Trains 1&2)
US$8.4bn
Senior Secured Project Finance Facilities

PFI AWARDS 2014 | Project Finance International

Natural Resources

Awards 2014

Americas Petrochemical
Deal of the Year
Sasol
US$4.0bn
Senior Secured Project Finance Facilities

PFI AWARDS 2014 | Project Finance International

Natural Resources

Awards 2013

Americas Oil & Gas
Deal of the Year
Sabine Pass LNG
US$4.4bn
Construction / Term Loan

PFI AWARDS 2014 | Project Finance International

Natural Resources

Awards 2012

Latin America
Oil & Gas Deal of the Year
Tarahumara Pipeline
US$378m
Credit Facility

ProjectFinance | Project Finance Magazine

Natural Resources

Team Overview

Alaska Tax Credit Financings Coverage Team

Richard Ennis
Managing Director and Head of Natural Resources Group

Richard Ennis manages ING Natural Resource Structured Finance in the Americas, which comprises 21 banking professionals operating out of two offices, in New York and in Houston. Mr. Ennis has over 30 years' experience in the oil and gas, mining and project finance business and has been with ING for 11 years. Prior to joining ING in 2004, Mr. Ennis served as Director at Rothschild LLC, with responsibility for Oil and Gas Mergers and Acquisitions. He previously held project finance positions at UBS, New York and Sanwa Bank. Mr. Ennis is a member of the CFA and NYSSA. Mr. Ennis has served as Chairman of the Society of Petroleum Engineers, New York Chapter from 1986 to 1989. Mr. Ennis holds a BS in Petroleum Engineering from Marietta College in Marietta, Ohio. Mr. Ennis also is a CFA, and holds Series 7, 63 and 24.

Thomas Ryan
Managing Director and Head of Structured Solutions Group

Thomas Ryan manages the Structured Solutions Group in the Americas which has responsibility for tax credit financing both for ING's clients and ING's own account. Thomas has been with ING for 20 years and prior to that worked for NCB stockbrokers in Dublin, Ireland. Thomas holds a bachelors degree in business (economics and law) from university of Limerick (Ireland), a masters in Economics and Math from Tilburg university (the Netherlands) and an MBA from Columbia University .

Yury Marasanov
Vice President

Yury Marasanov is responsible for managing existing portfolio and executing new transactions for Structured Solutions Group in the Americas. Mr. Marasanov has over 8 years of experience in banking, and has been with ING for over 4 years. Prior to joining ING in 2011, Yury previously worked as a consultant at Financial Services Office of Ernst & Young providing services to large financial institutions in areas of due diligence, modeling, and Dodd-Frank reform. Yury is a member of New York Society of Security Analysts and CFA Institute. Yury graduated Summa Cum Laude from Quinnipiac University with dual degrees in Finance and Accounting. Yury holds the CFA designation, and the Series 79 and 63 licenses.

Shan Arunachalam
Vice President

Mr. Arunachalam joined ING in 2015 and is focused on structuring, negotiating, and executing project financings within the midstream oil and gas sector. Mr. Arunachalam has 9 years of experience in advisory and project finance in the oil and gas, power and infrastructure sectors. Prior to ING, Mr. Arunachalam spent 5 years at the Rabobank International in New York as a Vice President in the power project finance group. Mr. Arunachalam began his career at Citigroup in New York, within the capital markets division. Mr. Arunachalam graduated with a Bachelors Degree, High Honors, in Finance from Carnegie Mellon University. Mr. Arunachalam also holds a Series 79 license.

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