

MUNICIPAL ADVISORY GAS PROJECT REVIEW BOARD

ANNUAL REPORT 2015

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

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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 a North Slope natural gas project infrastructure, and (iv) recommending legislative options to minimize the financial impact to communities not in proximity to a North Slope natural gas project. The MAGPRB has recently been reviewing information relating to a specific North Slope natural gas project referred to in this report as 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, representing impacted municipalities and local stakeholders, is a key component in recommending possible options to address and mitigate the impacts of new infrastructure associated with the Alaska LNG Project.

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

During 2015, the MAGPRB focused its activities on the development of the Alaska LNG Project Construction-related Payments in Lieu of Taxes (CPILT) and Operations-related Payments in Lieu of Taxes (OPILT), CPILT payments are in lieu of statutory property taxes during construction period, and OPILT payments are in lieu of statutory property taxes during the post-construction operational phase of the Alaska LNG project. 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 stakeholders, and discussions on mechanisms for allocating CPILT and OPILT from the Alaska LNG Project among the State and impacted municipalities and other local stakeholders.

Based on input from the MAGPRB regarding a high level understanding of a structure for CPILT and OPILT, the DOR and the Alaska LNG Project participants, ExxonMobil, ConocoPhillips and BP worked together to generate proposals with respect to CPILT and OPILT 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 CPILT to the State equal to \$800 million over a projected five year construction period. The proposal would have the CPILT payments paid out in fixed annual increments which total \$800 million. The total CPILT payments amount noted above assumes the Alaska LNG Project property owner will make the full CPILT fee payments to the State, and will pass on those costs proportionately to the members of the Alaska LNG Project entity, including the Alaska Gasline Development Corporation (AGDC).

The tentative proposal presented to the MAGPRB also included a post-construction OPILT calculated from the actual flow rate and a total proposed target amount of OPILT to be paid over the first 25 years of the Alaska LNG Project equal to a projected \$15.7 billion (assuming additional gas is committed to the project to keep the line full for 25 years). The target amount would be converted to an annual property tax in dollars-per-MCF (thousand cubic feet) volume or per-MMBtu (million British thermal unit) heating value which would be applied to measured Alaska LNG Project flow throughput averaged over five years and paid annually throughout the 25 year project period. The amount of \$15.7 billion is referred to as a target amount because the actual tax-per-MCF or per-MMBtu is established before production begins based on forecast design throughput and the actual flow throughput may differ from the design based throughput, such that the actual OPILT may be less than or more than the target amount. As noted with the CPILT, OPILT would be levied against the Alaska LNG Project property owner which will allocate the property taxes among the Project members, including AGDC.

It is understood by the MAGPRB, but not endorsed, that the legislature may determine that the portion of any CPILT or OPILT payments attributable to AGDC or any other State agency and related to the Alaska LNG Project is exempt from distribution, which could reduce the total target amount available for allocating to the State and local communities by as much as approximately 25 percent.

The MAGPRB provided initial feedback to the DOR on the tentative proposal raising questions regarding how the proposed CPILT and OPILT compared with what would be collected under the current provisions of AS 43.56 and AS 29.45.080. MAGPRB members were additionally concerned over any such gap given that any proposed CPILT and OPILT may be additionally reduced by the State's ownership percentage in the project, currently estimated at approximately 25 percent, as a result of AGDC participation, resulting in fewer tax revenues flowing to the local jurisdictions. If the State, or any State-owned entity operating as an owner in the project on behalf of the State, is exempt from contributing toward CPILT or OPILT payments or contributes less than at its full ownership percentage, the MAGPRB recommends that the State's share of disbursements be reduced proportionally.

Additional discussions are ongoing between the DOR and the Alaska LNG Project participants before finalizing recommendations on a OPILT. Additional discussion topics include

(i) setting the design rate basis for calculating the OPILT; (ii) establishing the OPILT throughput measurement units, whether MCF or MMBtu; (iii) establishing the throughput measurement locations for the Alaska LNG Project components (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, the MAGPRB can then consider proposing statutory changes necessary for implementing the CPILT and OPILT in lieu of current statutory provisions, and proposing agreements to implement the new property tax regime and move the Alaska LNG Project forward.

Additional discussions must also take place before final recommendations on allocations of CPILT and OPILT among the stakeholders can be achieved. However, the MAGPRB has considered an initial proposal on allocation of both CPILT and OPILT funds. The proposed CPILT disbursements would be made based on the merit of applications by impacted communities. The proposed OPILT allocation program would be formula driven based on two criteria, the OPILT proportional allocation, based on physical location of the Alaska LNG real property and an OPILT per capita allocation, based on community population.

The MAGPRB supports continued work to advance a viable gas commercialization project.

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) Alaska LNG Project leaders should be allowed to maintain the relative economic competitiveness of their Project compared to other projects worldwide.
- 3) There should be opportunities for all Alaskans to benefit from the Alaska LNG 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 generally disadvantage the global economic 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 Alaska LNG Project infrastructure is located or communities expected to have the preponderance of ongoing impacts from the Project.
- 9) All owners of the Alaska LNG Project, including the State of Alaska and all State-owned entities, shall make CPILT and OPILT payments proportional to their full ownership percentage in 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, payments for impacts to a community should be based on the anticipated actual impacts to that community.

GOVERNMENT TAKE METHODOLOGY

A preliminary analysis provided to the DOR by Greengate LLC (Greengate) helps define how much in property taxes would be paid on the Alaska LNG under current 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 the 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).

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. The status quo property tax during construction can then be compared to the tentative alignment on \$800 million in Construction-related Payments in Lieu of Taxes (CPILT), discussed later in this report. 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 five years; LNG Train 2 and GTP Train 2 is six years; and LNG Train 3 and GTP Train 3 is seven years. The expected capital expenditure breakdown by train 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

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.

where construction is completed one year earlier than under the Base Case and one where construction extends one year longer.

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 \$1.68 billion. Property tax during construction for the shorter and longer construction sensitivities is estimated at \$1.31 billion and \$2.06 billion, 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 inside and outside 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 \$1.68 billion, would increase to \$1.79 billion if temporary construction costs were to be 10 percent lower than expected and would decrease to \$1.58 billion 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. The agreed upon \$800 million in CPILT payments, discussed later in this report, are approximately 48 percent of the Base Case status quo tax during project construction. This is consistent with the prior discussions held by the MAGPRB and honors statutory requirement set out in SB 138.

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. The status quo property tax during project operations can then be compared to the tentative alignment on a target of \$15.7 billion in Operations-related Payments in Lieu of Taxes (OPILT), discussed later in this report. Capital expenditures are assumed to be \$55 billion, the initial asset value assumption. 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 calculated only for the first 25 years of operations with the assumption that the Prudhoe Bay and Point Thomson gas fields will be depleted by the end of the 25-year period and no other gas fields will have come on line during that time frame. This way appropriate comparisons can be made with the OPILT 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. When using a 40-year depreciation schedule, the same \$55 billion initial asset value and 2.5 percent annual escalation 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. Extending the depreciation schedule would require development of other gas fields to replace the depleted Prudhoe Bay and Point Thomson gas fields.

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 approximately \$15.7 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 outlined and highlighted. Results shown in \$ millions.

	Property Tax During Initial 25 years of Operations (\$ millions)			
	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 on CPILT Total Value

Tentative alignment has been reached between the DOR and the three project producer parties Exxon Mobil, ConocoPhillips, and BP, on CPILT during construction. The CPILT is tentatively set at \$800 million and is expected to be paid out in increments over the Alaska LNG Project construction period. Currently the construction period is anticipated to be five years, and although details have not been finalized, the CPILT is expected to be paid out in annual increments. The total CPILT amount quoted above assumes all Alaska LNG Project owners are obligated to pay the CPILT. However, it is possible that the CPILT available for distribution to communities may be reduced by the legislature by the State of Alaska's approximate 25 percent ownership share in the Alaska LNG Project, due to AGDC's property tax-exempt status. The allocation of the CPILT between the State and local communities has yet to be determined.

Tentative Proposal on OPILT Target Value

Tentative alignment has also been reached between the DOR and the three project producer parties on a target amount of OPILT that would be paid during the operation phase of the Alaska LNG Project. The OPILT tentative alignment establishes a total target amount paid over the first 25 years of the Alaska LNG 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 flow rate tax in dollars-per-MCF (million cubic feet) volume or per-MMBtu (million British thermal unit) heating value which will be applied to Alaska LNG Project 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 the actual tax-per-MCF or per-MMBtu is established before production begins based on forecast design throughput, and after Alaska LNG Project start-up, but actual throughput will differ from the forecast design rate and the actual tax paid will vary from the target amount. If actual Alaska LNG Project throughput is greater than forecast the total project property tax payments will be greater than the target amount. If throughput is less than forecast, total project property tax payments will be less than the target amount. The allocation of the OPILT payments between the State and municipalities has yet to be determined.

Additionally, as with the CPILT, the total OPILT target amount of \$15.7 billion is the amount payable by the Alaska LNG Project property owner as the taxpayer, without consideration of the tax status of the individual members of the Alaska LNG Project ownership entity. However, it is possible that the actual payments will be reduced by the anticipated approximately 25 percent State of Alaska ownership share in the Alaska LNG Project to be held by AGDC due to AGDC's property tax-exempt status.

Project Property Tax after 25 Year Term End

The proposed alternative payment in lieu of tax program applies for only the first 25 year period of the Alaska LNG Project's operation. An important consideration is what happens after the initial 25 year period. At the end of the currently proposed 25-year project period the State and municipalities may want to reopen negotiations to extend or reconfigure the OPILT methodology and allocation formulas for the Alaska LNG Project assets covered under the OPILT. If the State and municipalities choose to forego or cannot come to agreement on extending or reconfiguring the OPILT, the MAGPRB assumes that natural gas property taxes on the Alaska LNG Project assets will revert to the current property tax statutes for all years after the first 25 year period to the extent the Alaska LNG Project assets remain in operation.

CPILT Distribution Program Proposal

A preliminary proposal for a CPILT Distribution Program was provided by the Kenai Peninsula Borough and discussed, but not endorsed, by the MAGPRB in September 2015, and a draft document detailing the process is available on the MAGPRB's website titled "Draft Impact Aid Grant Program - KPB 9.17.15."⁴ This section provides a summary of the proposal which has not been agreed upon but is an initial basis for consideration.

The CPILT Distribution Program's primary objective is to provide fair and equitable distribution of the CPILT, from the Alaska LNG Project to municipalities. The CPILT is designed to address the impacts of the construction and development of the Alaska LNG Project on affected stakeholders. The proposal anticipates that the program would be administered and operated by the Department of Commerce, Community and Economic Development (DCCED). The CPILT Distribution Program would occur through a non-lapsing capital fund to assure the availability of the Alaska LNG Project's CPILT disbursements over the multi-year life of its construction, subject to Constitutional limitations on dedication of funds.

The CPILT Distribution Program proposal has designated DCCED as administrator of the program because that agency has a long history of administering municipal grant programs.⁵ The CPILT Distribution Program fund will pay for costs and services made necessary by the impact of construction of the Alaska LNG Project in lieu of a municipality's ability to directly 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.

⁴ "Draft Impact Aid Grant Program - KPB 9.17.15";

<http://dor.alaska.gov/Portals/5/Draft%20Impact%20Aid%20Grant%20Program%20Sept%20%2015%20KPB.pdf>

⁵ 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.).

To receive a distribution of CPILT Distribution Program funds under this proposal, an applicant must be a recognized municipality under AS 29 and demonstrate that the Alaska LNG Project has made a direct impact on the applicant's residents and that the requested funds will be directed toward addressing impacts of the Alaska LNG Project on the applicant municipality in one or more of three purpose categories:

- (1) planning;
- (2) construction, maintenance, and operation of essential public facilities; or
- (3) the provision of necessary public services.

Payments for projects in communities that are not municipalities would not be covered under the proposed CPILT Distribution Program, and should be made by legislative appropriation from the State's portion of the CPILT funds.

The application process is intended to be reasonably simple and DCCED is expected to provide technical assistance to all communities via easy-to-understand instructions and materials, as well as provide informational work sessions on applying for CPILT Distribution Program funds. It is the intention that the CPILT Distribution Program be simple enough that municipalities will not have to hire grant writers, and rationally administered so that municipalities can get funding for needed mitigation of impacts, but are held accountable for their expenditures.

Under the proposal, an application's merit will be evaluated based on the applicant and the project or purpose for which funds are to be used. The DCCED will assess merit based on the: 1) impact of the Alaska LNG Project on 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) applicant's population, finances, or employment; 3) proposed project's capability to alleviate or mitigate adverse economic, social, or cultural impacts on the applicant's residents; or 4) impact of Alaska LNG on an applicant's 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 project.

Types of eligible projects the CPILT Distribution Program is proposed to mitigate the impact of may include, but are not limited to: 1) increased public safety needs: police protection, search and rescue, fire protection, and emergency medical services; 2) increased public health and social service needs: hospitals, clinics, emergency medical facilities, alcohol and drug abuse facilities, mental health facilities and homeless shelters; 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; and 5) planning, design, and engineering activities related to an

eligible project. Similarly, in the Alaska LNG Project’s first draft resource reports submitted to the Federal Energy Regulatory Commission on February 2, 2015, the parties to the Alaska LNG 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 event that prioritization of the award of CPILT Distribution Program funds is necessary because the total amount of money requested by eligible applicants for eligible projects in meritorious applications exceeds the amount available for grants, DCCED shall give notice to the commissioners of revenue and natural resources and to the legislature of the insufficiency of funds and seek additional funding for the CPILT Distribution Program. Then, until such additional monies are deposited into the CPILT Distribution Program fund, the department shall rank applications for the purpose of establishing priority for funding based on the relative degree of the impact of the Alaska LNG Project on the municipality in comparison with other applicants; the degree to which the project proposed in the CPILT Distribution Program application alleviates the impact caused by development of the Alaska LNG Project; and the ability of the applicant to accommodate or absorb the impacts through existing facilities or programs.

It is intended that recipients of CPILT Distribution Program funds 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 CPILT Distribution Program funds would be subject to review in the annual audit or statement required of a municipality under AS 29.35.120.

If the State, or any State-owned entity operating as an owner in the project on behalf of the State, is exempt from contributing toward CPILT payments or contributes less than at its full ownership percentage, the MAGPRB recommends that the State’s share of disbursements from CPILT revenues be reduced proportionally.

OPILT Allocation Proposal

A preliminary proposal for an allocation methodology of OPILT funds was provided to the MAGPRB in December 2015. The proposed OPILT Allocation methodology disburses funds in a different method from the CPILT Distribution Program proposed above. The OPILT Allocation proposal is not based on application and award of funds, but is formula driven based on two criteria: a OPILT Proportional Allocation based on physical location of the Alaska LNG real property assets; and additional OPILT Per Capita Allocation based on community

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).

population. The per capita distribution will allow all communities to share in the Alaska LNG 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 property location-based OPILT payments for those municipalities where the Alaska LNG Project is physically located.

In their discussion of the December 2015 OPILT proposal, the MAGPRB determined that there may be good reason to allow for a third criteria for allocation of OPILT disbursements, not previously included in the December 2015 OPILT Allocation Proposal discussed here. In addition to the OPILT Per Capita Allocation and Proportional Allocation discussed above as part of the proposal, the board may explore an option to allocate OPILT funds based on impacts to communities. The MAGPRB has yet-to-determine how those impacts will be measured or quantified, but feel it is important to include the possibility of developing a third funding mechanism for impacted communities.

The OPILT Proportional Allocation determination would be made by the Department of Revenue each year of Alaska LNG property covered by the Tentative Proposal on OPILT target value. The determination should take into account not only pipeline mileage, but also the presence of compressor stations and other Alaska LNG Project-related infrastructure. Additions to the Alaska LNG Project assets 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.

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.

The State's allocated share of funds from the proposed OPILT Proportional Allocation of Alaska LNG property outside of any organized municipality shall be deposited in the general fund.

The proposed OPILT Proportional Allocation 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 OPILT agreement negotiated by the Project sponsors and the State. However, this section anticipates that additional property may be added to the Alaska LNG Project subsequent to the initial OPILT Proportional Allocation calculation by the Department of Revenue, and that such additions shall require the department to recalculate the OPILT Proportional Allocation as stated above. To further clarify, this section does not prevent a municipality from levying and collecting property taxes on property outside of the OPILT 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.

In addition to the OPILT Proportional Allocation distributed to those municipalities that have Alaska LNG property within their boundaries, the proposal recommends that an annual OPILT Per Capita Allocation disbursement is made by the DOR to each municipality in the state from the State's share of OPILT funds paid by the Alaska LNG Project participants. The OPILT Per Capita Allocation is proposed to be set at \$100 per capita and paid directly by the State to each municipality. A municipality is eligible for a per capita payment whether or not there is Alaska LNG Project property within its borders. For small population municipalities, the minimum annual OPILT Per Capita Allocation disbursement is proposed to be \$25,000.

It is understood by the MAGPRB, but not endorsed, that the legislature may determine that the portion of any CPILT or OPILT payments attributable to AGDC or any other State agency and related to the Alaska LNG Project is exempt from distribution, which could reduce the total target amount available for allocating to the State and local communities by as much as approximately 25 percent.

Under the OPILT Allocation proposal, the Proportional Allocation and Per Capita Allocation payments made by the DOR would be 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. In addition, those payments made to municipalities under the proposal are not subject to the limitations set out in AS 29.45.080 - 29.45.090.

If the State, or any State-owned entity operating as an owner in the project on behalf of the State, is exempt from contributing toward OPILT payments or contributes less than at its full ownership percentage, the MAGPRB recommends that the State's share of disbursements be reduced proportionally.

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 Alaska LNG Project the MAGPRB recommends that there be two tiers of CPILT: 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 Alaska LNG 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 Alaska LNG Project).

Impacts and Benefits Recommendations

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

Schedule: CPILT disbursements should be scheduled and paid, regardless of construction schedule or activity. This is critical for communities directly impacted by work stoppages, that 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 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 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

CPILT and OPILT Allocation Methodology

This past year the MAGPRB has effectively established the methodology for calculating overall payments in lieu of property tax from the Alaska LNG Project. Additional progress was made toward consensus on the overall size of the payments in lieu of property tax that will be made by the Alaska LNG Project in the construction period and during the operation phase of the project.

Further discussions have commenced regarding recommendations on final allocations of CPILT and OPILT among the stakeholders. Among other criteria, the MAGPRB may consider the research and data collected by the Alaska LNG Project in the ongoing 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 the first and second quarters of 2016.

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 Alaska LNG 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 and submission of a complete application to construct and operate the project, 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 thirteen (13) 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.

To the extent that FERC and NEPA filings may benefit the MAGPRB, we continue to recommend that the Department of Revenue monitor and participate in the FERC and NEPA process as allowed by federal law.

Outstanding Negotiations Regarding OPILT

Additional discussions and agreement must occur with the Project producing partners on several material elements of the OPILT before the MAGPRB can debate and come to a consensus recommendation regarding the OPILT. Future discussions will address (i) setting the

design rate basis for calculating the OPILT; (ii) establishing the OPILT throughput measurement units, whether MCF 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 Alaska LNG 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.

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:

RANDALL HOFFBECK (Chair)

Commissioner, Alaska Department of Revenue

MARK MYERS

Commissioner, Alaska Department of Natural Resources

FRED PARADY

Deputy Commissioner, Alaska Department of Commerce, Community, and Economic Development

CLAY WALKER

Mayor, Denali Borough

MIKE NAVARRE

Mayor, Kenai Peninsula Borough

ETHAN BERKOWITZ

Mayor, Municipality of Anchorage

CHARLOTTE BROWER

Mayor, North Slope Borough

KARL KASSEL

Mayor, Fairbanks North Star Borough

VERN HALTER

Mayor, Matanuska-Susitna Borough

ROBERT VENABLES

Energy Coordinator, Southeast Conference

ROBERT BARTHOLOMEW

Finance Director, City and Borough of Juneau