State of Alaska
Department of Revenue
SB176: Oil & Gas Tax Credit Bond Proposal

Senate Resources Committee

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Commissioner Designee

Bill Objective #1: Critical component to Governor's economic stimulus package

- From 2015 – 2017, the private sector jobs are down ~3.8% or 9,200 jobs.
  - Oil and Gas industry jobs are down ~30.8%
  - For 2018, ISER forecasts year over year losses of and additional 0.7%.
    - "This does not indicate a recovery in activity."

- This bill will both provide an initial boost of funding and resolve the uncertainty surrounding these payments.
  - Provide up to $600+M of economic stimulus in 2018 to the oil and gas sector of the economy.
  - Resolve the uncertainty hanging over this sector and allow small producers to plan.
    - Bill seeks to unfreeze Alaska credit markets and seeks to incent new spending in Alaska.
    - Potentially $600M or more reinvested in Alaska.
    - This could mean substantial numbers of new jobs

Bill is Structured to Balance Competing Interests

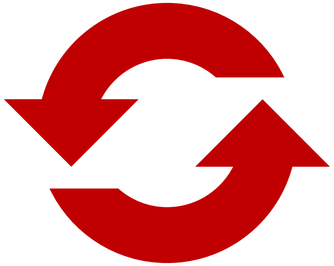
The Balance:

- ➢ The Credit holders to pay for the cost of the borrowing.
- ➢ Provides Small Producers the certainty and cash they need to invest.
- ➢ Maintains the state's credibility by acknowledging our part in creating this situation.

State Fiscal Budget

- Forecasted FY 19 deficit of $477M

- Deficit increases $180M without this program



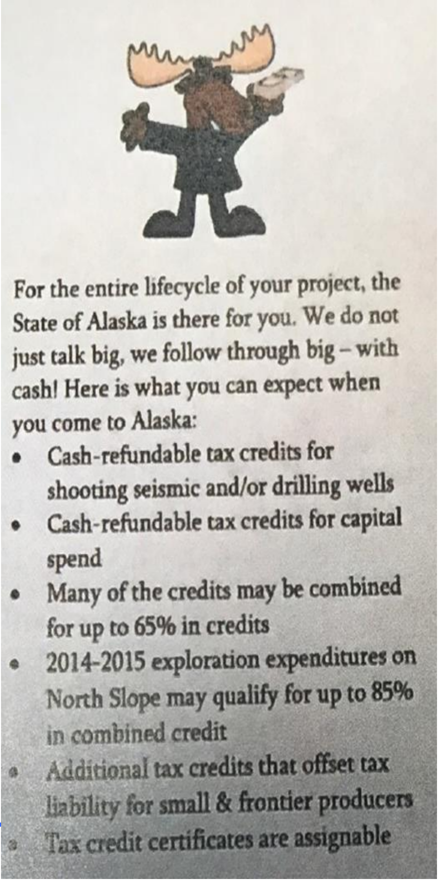
Support Small Producers

- Strategic interest in maintaining small producers.

- Bank lending has essentially stopped

Maintain State Credibility

- The state encouraged investment based on promises of support



For the entire lifecycle of your project, the State of Alaska is there for you. We do not just talk big, we follow through big – with cash! Here is what you can expect when you come to Alaska:

- Cash-refundable tax credits for shooting seismic and/or drilling wells
- Cash-refundable tax credits for capital spend
- Many of the credits may be combined for up to 65% in credits
- 2014-2015 exploration expenditures on North Slope may qualify for up to 85% in combined credit
- Additional tax credits that offset tax liability for small & frontier producers
- Tax credit certificates are assignable

Oil & Gas Tax Credit Background

- 2003: First oil & gas tax credits created to incentivize new exploration. Credits could only offset the company's taxes.
- 2006: Transferable tax credits introduced with transition to profits-based tax.

  New credits for capital expenditures and operating losses expanded incentives to include small field developers.

  State repurchases authorized, with caps and limits.
- 2007: Oil & Gas Tax Credit Fund established, with statutory formula tied to production tax revenue. Annual per-company caps eliminated.
- 2010: Cook Inlet Recovery Act incentivized new production to offset gas shortages in Southcentral. New incentive tied to drilling costs.

  Because of minimal Cook Inlet taxes, credits were not expected to be supported by new revenues.
- 2013: SB 21 eliminated capital credit on North Slope, replaced with per-barrel credit tied to price and production
- 2016-17 HB247 and HB111 wind down cashable credit programs

Oil & Gas Tax Credit Background

- **Oil & Gas Tax Credits Have Helped Heat Alaskans' Homes**
  - Incentivized Hilcorp to take over aging Cook Inlet assets and extend field life
  - Brought new companies into Alaska, including Bluecrest and Furie, to look for gas
  - Southcentral gas supply shortage essentially solved
  - Threat of brown-outs gone
  - Protected energy security of tens of thousands of Alaskans

- **Oil & Gas Tax Credits Have Created Potential for More Production**
  - New fields potentially mean new oil: Pikka, Nuna
  - Governor's economic stimulus goal
    - More revenue from production equals
    - New jobs
    - New royalties
    - New revenues for schools and government services
    - Economic ripple effect

Oil & Gas Tax Credit Background

State-purchased credits through the FY2018

- $3.6 billion total cash purchases
  - 16 Companies receiving credits now have production
  - Total production from these producers through end of 2016 is 175 million barrels of oil equivalent
    - Non-North Slope: 89mm BOE (mostly Cook Inlet gas)
    - North Slope: 86mm BOE (mostly oil)
- Balance of credit certificates for which purchase has been requested, as of 12/31/17, is $806 million
  - North Slope: $495 million
  - Non-North Slope: $311 million
  - These include $60 million in ‘conditional’ exploration certificates, split about evenly between the basins

Oil & Gas Tax Credit Background

Forecasted Production Helped by Known Credits (January 2017 through end of FY2027)

- North Slope
  - 106 million barrels from currently producing fields
  - 23 million barrels from fields not yet producing (substantial upside potential)
  - Total past and future production: 215 million barrels
- Cook Inlet (note: no forecasted “middle earth” production)
  - All current oil and gas production has benefited from credits
  - Future gas production to meet local demand is 90 billion cubic feet per year, or 15 million BOE
  - Forecasted oil production about 5 million barrels / year
  - Total past and future production 299 million BOE

Oil & Gas Tax Credit Background: The Challenge

- Historically, the State paid tax credits annually as presented.
  - FY16-FY18 state unable to pay all pending tax credits; applied statutory amount
- The O&G Tax Credit Fund statute (AS 43.55.028), sets out a formula for computing the appropriation to the fund for cash payment of tax credits.
  - The formula is based on the oil price projected for the fiscal year:
    - If the projected price is $60 or higher, the statutory minimum is 10% of production taxes.
    - If the projected price is less than $60, the statutory minimum is 15% of production taxes
  - The Department published forecast annually in its Revenue Sources Book
    - Updated in the Spring Forecast

	FY19	**FY20**	**FY21**	**FY22**	**FY23**	**FY24**	**FY25**
Estimated Statutory Payment ($mm)	$206	$167	$119	$132	$135	$139	$ 1

- Impact of Payment on Statutory Schedule
  - Exploration and development in some cases halted
  - Some banks have frozen supply of further credit for Alaska oil and gas exploration

Proposed Solution: Issue Bonds and use proceeds to pay off Tax Credits

Credit holders cover the cost of borrowing by accepting a discount on credits.

	FY2019	FY2020	FY2021	FY2022
Share of Statutory Appropriation	$25M	$25M	$25M	$25M

Discount Rate 10%

	FY2019	FY2020	FY2021	FY2022
Annual Payment	$25.00	$25.00	$25.00	$25.00
Discount Year 2		$22.73		
Discount Year 3			$20.66	
Discount Year 4				$18.78

Buyout Offer:	$87.17

Discount Rate 5.1%

	FY2019	FY2020	FY2021	FY2022
Annual Payment	$25.00	$25.00	$25.00	$25.00
Discount Year 2		$23.79		
Discount Year 3			$22.63	
Discount Year 4				$21.53

Buyout Offer:	$92.95

Example: Assume Credit holder has $100M in Credits payable over 4 years.

Program offers two alternative discount rate.

- 5.1% represents the State's cost of borrowing
  - Estimated 3.6% Total Interest Cost +1.5%
- 10% is mid-point between State's cost of borrowing and the Credit Holder's Weighted Average Cost of Capital.

The 10% Discount Rate is the Base Rate. To qualify for the lower rate, the Credit Holder must:

- Agree to an Overriding Royalty Interest
- Commit to reinvest the money in Alaska
- Agree to an early waiver of confidential seismic data
- Refinery and Gas Storage Credits.

The Discount is applied to each year of payments starting in the second year.

The difference between the face amount ($100M) and the "Buyout Offer" covers the cost of borrowing.

Oil & Gas Tax Credit Solution

Issue Bonds and Use Proceeds to Pay Off Tax Credit Certificates at a Fair Discount Rate That Covers State Bonding Costs

- **Step 1: Secure commitment from Credit Holders to participate in Program.**
  - Provide definitive statement of proceeds available under the program.
  - Interested credit holders make irrevocable commitment.
- **Step 2: Issue Bonds**
  - First issuance (for existing certificates):
    - Face Value: $706mm (assumes $100 million of existing credits are sold to producers)
    - Bond Issuance: $618mm-$660mm
    - Issue in August 2018
  - Future issuances, for anticipated certificates
    - Face Value: $200mm (est.)
    - Issue in August 2019-August 2021
    - Interest only with bullet payment at the end

Issue Bonds and Use Proceeds to Pay Off Tax Credit Certificates at a Fair Discount Rate That Covers State Bonding Costs

- **Step 2: Purchase Tax Certificates at Fair Discount Rate**
  - Two options: 10% discount rate or discount rate equal to state cost of capital (approx. 5.12%)
    - Option 1: 10% rate – no strings attached
      - Balances State's and credit holders' interests
      - Greater than State's cost of capital, less than tax credit holders' cost of capital
      - Covers State's costs of financing
    - Option 2: 5.12% rate (approx.—State's cost of capital) – strings attached
      - Tax credit holder can get lower discount rate (less discount from face value) in exchange for (four options):
        - Overriding royalty of equivalent value
        - Commitment to future investment of equivalent value, or
        - Early waiver of confidentiality of seismic data
        - Refinery and Gas Storage Credits receive the lower rate

Issue Bonds and Use Proceeds to Pay Off Tax Credit Certificates at a Fair Discount Rate That Covers State Bonding Costs

- **Step 3: Discount Covers State's Bonding Costs**
  - Bond Description
    - 10 year term
    - All-in Cost of Funds (estimated): 3.62%
    - Backloaded debt service to match projected profile of state revenues
      - 2 year interest only, 3 year increasing debt service, 5 year flat

- Objective with each purchase option is cost equivalency
  - Present value of total debt service will be equal to or less than the present value of appropriations under the statutory payment formula

Benefits of Program:
Move cost into periods where match cash flow.

	Statutory Payment Schedule	Cohort 1	Cohort 2	Cohort 3	Cohort 4	Aggregate
FY19	206	$24.08				$24.08
FY20	167	$24.08	$2.79			$26.87
FY21	119	$55.02	$2.79	$1.68		$59.48
FY22	132	$81.95	$2.79	$1.68	$0.60	$87.02
FY23	135	$101.08	$2.79	$1.68	$0.60	$106.15
FY24	139	$110.00	$2.79	$1.68	$0.60	$115.07
FY25	1	$110.00	$2.79	$1.68	$0.60	$115.07
FY26		$110.00	$2.79	$1.68	$0.60	$115.07
FY27		$110.00	$2.79	$1.68	$0.60	$115.07
FY28		$110.00	$2.79	$1.68	$0.60	$115.07
FY29			$79.92	$1.68	$0.60	$82.19
FY30				$47.96	$17.22	$65.18
FY31						$0.00

Impact on debt capacity and credit rating

- Limited impact on capacity as the credits are an existing obligation -
- Similar to state PERS/TRS payments on behalf of employers
- Neutral to positive impact on credit rating
- Reduces FY 2019 payment from 10.1% of UGF to 1.3% and results in a more predictable and level annual payment
- Financially beneficial to State
- Provides financial alternative to State's primary revenue generation industry

State of Alaska Debt Service to Unrestricted Revenues									
Fall 2017 Revenue Forecast of the Department of Revenue									
Fiscal Year	UGF Revenues	State G.O. Debt Service	State Supported Debt Service	Total State Debt Service	School Debt Reimburse-ments	Statutory Payment to PERS/TRS	Current Total Payments to Revenues	Current Tax Credit Statutory Payments	Proposed Tax Credit Financing
	($Millions)	%	%	%	%	%	%	%	%
2018	2,081.6	4.3	1.1	5.4	5.4	8.9	23.4	3.7	1.3
2019	2,047.1	4.4	1.1	5.5	5.2	14.6	35.3	10.1	1.3
2020	2,063.2	3.8	1.1	4.9	4.7	16.8	34.1	7.7	2.9
2021	2,155.7	3.6	1.0	4.6	4.4	17.8	32.4	5.5	4.1
2022	2,218.9	3.0	1.0	4.0	3.7	17.7	31.4	5.9	4.8
2023	2,275.2	2.9	1.0	3.9	3.7	17.7	31.2	5.9	5.1
2024	2,297.1	2.9	1.0	3.9	3.0	18.0	30.9	6.1	5.0
2025	2,426.8	2.5	0.9	3.4	2.4	17.6	23.5	0.0	4.8
2026	2,641.3	2.3	0.8	3.2	1.8	16.7	21.6		4.4
2027	2,838.8	2.1	0.8	3.0	1.5	16.1	20.6		4.1

Oil & Gas Tax Credit Solution

Benefits to Solution

- **Governor's economic stimulus**
  - Expect most credit holders will reinvest in Alaskan projects.
- **Support Small Producers - Unfreeze pending development projects**
  - Current bank financing to fields generating tax credits is frozen in some cases
  - Need to pay off credits so projects in development can be completed
  - State has a strategic interest in maintaining viability of small producers as it increases competition in the basin
- **Need to Re-establish Alaska as a Premier O&G E&P Basin**
  - Alaska has reputational issues re oil and gas exploration and development that need to be addressed now
  - Alaska is highly prospective
  - Alaska is a stable environment in which long-term projects can be mutually successful
- **More Revenue from Production is the Goal**
  - Future royalties equals: jobs, funding for schools and gov't services, economic growth
- **Move cost into periods where match cash flow.**

A healthy and growing Alaska economy benefits all Alaskans!

Questions?

Appendices

1. Sectional analysis
2. Spreadsheet
3. Sheldon Fisher – Op Ed