

MUNICIPAL ADVISORY GAS PROJECT REVIEW BOARD

ANNUAL REPORT 2014

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This report is available exclusively online and can be downloaded at the Board's website provided by the Department of Revenue:

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

CONTENTS

Preamble	3
1. Overarching Principles That Shape the Government Take Methodology	4
2. Options for Fiscal Terms	5
3. Other Recommendations	6
4. Impact Statements	8
5. Next Steps: FERC Pre-File Process	9
6. Resources	11
Appendices	12
Appendix A-1. Alaska Municipal Advisory Gas Project Review Board Members	

PREAMBLE

The Municipal Advisory Gas Project Review Board (MAGP Board), formed as a consequence of Administrative Order No. 269 on March 25th, 2014, is charged with 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. The MAGP has recently been reviewing information relating to a specific gas project, the Alaska LNG Project.

The MAGP Board consists of twelve members who are appointed by the Governor of the State of Alaska. Members include the Commissioners of Revenue, Natural Resources and Commerce, Community and Economic Development; Mayors of the North Slope Borough, the Fairbanks North Star Borough, the Matanuska-Susitna Borough, the Denali Borough, the Kenai Peninsula Borough, and the Municipality of Anchorage. In order to provide representation for other areas of the state the Mayor of the Northwest Arctic Borough, the Finance Director for the City and Borough of Juneau, and the Energy Coordinator for the Southeast Conference were also appointed to the board.

The first meetings of the MAGP Board were on August 5th-6th, 2014, and have been held regularly since. Board members attended presentations on selected information related to the status of the Alaska LNG Project by company representatives, consultants contracted with the State, and the Office of the Federal Pipeline Coordinator. Certain documents from the MAGP Board meetings can be found on the following link:

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

The work of the MAGP Board will be relevant to a range of gas commercialization options.

This report reflects the MAGP Board's preliminary recommendations regarding structural options to establish the amount and means of providing value to the State and local communities to mitigate the costs to these governments of supplying support to the project both during construction and subsequently during the project's operational phase. Due to the change in administration and substantial turnover in board membership, this report is submitted as an interim document. A final version will be approved and submitted in early 2015.

The MAGP Board supports continued work to advance a viable gas commercialization project. Should the Alaska LNG Project not come to fruition, the MAGP Board urges that other projects be explored as alternative means of supplying communities with long term, stable supplies of lower-cost energy.

One of the major issues surrounding the construction and commercialization of North Slope natural gas is determining the form and size of total government "take" for municipalities and the State.

OVERARCHING PRINCIPLES THAT SHAPE THE GOVERNMENT TAKE METHODOLOGY

The state laws concerning the taxation of oil and gas property in Alaska are Alaska Statutes 29.45 (Municipal Property Tax) and 43.56 (State of Alaska Oil and Gas Exploration, Production and Pipeline Transportation Property Taxes). While the MAGP Board may not share a common view on certain issues, nonetheless the Board 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 throughout the life of the project.
- 2) Industry project leaders should be allowed to maintain the relative competitiveness of their project compared to other projects.
- 3) There should be opportunities for all Alaskans to benefit from the project.
- 4) Any property tax or alternative tax system should be predictable for both investors 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 under the contract.
- 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 20 mils of the full and true value of the Alaska LNG Project.
- 7) Any revisions to AS 29.45 or AS 43.56 relevant to the Alaska LNG Project should not disadvantage the 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 expected to have ongoing impacts from the project.
- 9) 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 MAGP Board 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, impact payments should be based on the actual community impacts.

OPTIONS FOR FISCAL TERMS

With the above principles in mind, the MAGP Board explored options for structuring government take methodologies, recognizing that there are several alternative fiscal structures under which municipal take may be determined. Below is a list of those options. While the MAGP Board does not endorse any one particular choice, it does have recommendations on necessary characteristics that some of the options need to have to ensure an equitable outcome for all stakeholders.

- 1) **The Alaska LNG Project could be taxed under AS 43.56**
- 2) **The Alaska LNG Project could be taxed under AS 29.45**
- 3) **PILT:** The State and municipalities could agree to a PILT contract through negotiations. A “payment in lieu of taxes” or PILT for a gas project is statutorily authorized under AS 29.45. The statutes also allow the municipalities to negotiate a PILT collectively. The State could serve as a facilitator in those proceedings should this avenue be pursued; however, if the State does facilitate the PILT negotiations, the municipalities must be allowed to participate and concur with the terms of any PILT.
- 4) **Appropriation:** If PILT payments are to be paid in lieu of property taxes during operation of the Alaska LNG Project, payments should be made directly to municipalities, and not subject to legislative appropriation.
- 5) **Throughput Based Calculation:** This method would take the full and true value (which could potentially be based on the original cost of construction adjusted upward for inflation and downward for depreciation) and divide it by the throughput of natural gas molecules through the pipeline. This potentially leads to more predictable value for every thousand cubic feet (mcf). These calculations still need to be determined for the future. Appraisal methods will be further discussed and defined by the report.
- 6) **Municipal Equity Share:** Municipalities could be provided with an equity share in the Alaska LNG Project infrastructure. This creates consistent and predictable revenues for communities.

OTHER RECOMMENDATIONS

A. Access to Alaska LNG Project Economics: As referenced earlier, the MAGP Board support efforts to further gas commercialization, including the Alaska LNG Project. To that end, local governments need to be informed about a gas project's economics to determine how their choices of government-take methodologies impact the competitiveness of the Alaska LNG Project under consideration. However, the MAGP Board on behalf of the communities they represent must be able to maintain adequate transparency to assure their constituents that their local government is striking a fair balance. MAGP Board members acknowledge that more work is needed to ascertain more precisely the type of information that will need to be maintained in confidence to protect the viability of a gas project.

B. PILT/Impact Payment Team: An alternative to property taxes is a PILT. A PILT would calculate a set of payments and could be subject to fewer adjustments than annual property tax assessments. The communities most affected by the adoption of a PILT are those local jurisdictions that would cede taxing authority, and these same communities would feel the greatest impacts from the development and operation of the Alaska LNG Project. Therefore, the MAGP Board recommends the formation of a PILT/Impact Payment Team if this option is pursued. A PILT to a municipality ceding taxing authority should not be subject to legislative appropriation.

The team could consist of those local government members of the MAGP Board, who represent communities directly impacted by the adoption of a PILT (i.e., those jurisdictions that will be ceding taxing authority); and two (2) members appointed by the Governor. The team would meet and deliberate the terms of a proposed PILT, and agree to a determination of impact payments dealing with the Alaska LNG Project. Decisions would be reached by majority vote. The PILT/Impact Payment Team shall offer its recommendations to the MAGP Board for its consideration.

C. Conditions on Adopting PILT: In the event that a PILT system is acceptable to municipalities, the PILT should be adjusted for inflation. The term of the PILT should be carefully considered and perhaps limited to the initial term of the gas contracts. There should also be provisions for inclusion of qualified new communities to the PILT structure.

D. Payment During Interruption: In the event of an interruption during operation of the Alaska LNG Project post-construction, continued PILT payments, or another commensurate form of payment, should be made to communities during that time period.

E. Local Control: Nothing in these recommendations, or state contracts, should be

construed to prohibit a municipality from making its own individual decision to govern their tax bases or negotiate separate agreements on infrastructure, other than as agreed to by a municipality in a PILT agreement.

- F. Contractual Limitation of Scope:** A municipality should never be coerced into ceding its taxing authority or into agreeing to the assessment of taxable property on any basis other than on the full and true value used to tax other taxpayers. The MAGP Board strongly supports prohibiting the targeting of a municipality's tax provisions within any of the contracts for a specific gas project. Likewise, the MAGP Board agrees that a gas project designed to benefit all Alaskans and their communities, should not be subject to blockage because of one individual community.

- G. Dual Use Facilities:** Contracts for a gas project should clarify how dual use facilities will be taxed.

IMPACT STATEMENTS

Assessing Impact Payments: Alaska LNG Projects designed to move gas in interstate and international commerce will be permitted by the Federal Energy Regulatory Commission under the Natural Gas Act, Section 3. This will require an Environmental Impact Statement (EIS) that assesses, among other matters, the socio-economic impacts to communities from the project. Those documents, and the processes associated with them, will be authoritative and publically documented. Any effort at this point to assess impacts should consider how to coordinate and/or incorporate those impacts into the FERC Pre-File and EIS processes respectively.

Appropriation: If impact payments are to be paid in lieu of property taxes during construction of the Alaska LNG Project, payments should be made directly to municipalities, and not subject to legislative appropriation.

Tiers: The MAGP Board recommends that there be two tiers of impact payments: direct and indirect payments. Direct impact payments are for those communities that will be affected immediately by the construction of the Alaska LNG Project through the use of municipal services and infrastructure. Indirect impact payments are for communities where the Alaska LNG Project is not an immediate presence in their jurisdiction, but nevertheless indirectly impacts the municipal services (e.g. loss of municipal workforce to the project). Indirect impact payments could be made by the State through a separate fund.

Schedule: Impact payments should be scheduled and paid, regardless of construction schedule or activity. This is critical for communities directly impacted by work stoppages, who require a predictable revenue stream to offset impacts on services. The contract should also include provisions for the extension of construction terms, allowing for overruns.

Local Hire: Wherever possible, the State of Alaska 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 of Alaska should consult with the MAGP Board on the location of off-take points and other facilities that would provide communities with access to energy.

NEXT STEPS: FERC PRE-FILE PROCESS

Interstate/International Gas 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 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 environment of the project. After initiation of the pre-filing process, 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 twelve (12) resource reports that the applicant is required to submit to FERC. The MAGP Board 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 MAGP Board also recommends that local governments participate in the EIS process on behalf of their respective communities.

Pre-filing is important because the burden is on the applicant to gather data for the EIS and review by FERC. The early identification of potential issues with regard to community concerns, environmental impacts and others during the pre-file process will generally result in a stronger application outcome.

Once the pre-filing process is complete, FERC will then issue a draft EIS. That draft will be open for public comment and review. After the public comment and review process, a final EIS draft is issued. Finally, the FERC commissioners will make a determination as to whether or not to authorize the construction and operation of the project. Without an EIS and FERC authorization, the Alaska LNG Project does not reach the critical Final Investment Decision (FID) phase, which is the stage when the majority of funds for a project are committed and construction begins.

Of the twelve resource books that collectively make up the draft EIS, resource book number five (5) is of the most interest to the MAGP Board. Resource Book No. 5 is the socioeconomic resource report. That book describes the baseline in communities regarding their socioeconomic conditions, and evaluates the socioeconomic impacts of the project as well as what can be done to reduce those impacts. The baseline encompasses everything from employment, housing, school enrollment and government services.

The MAGP Board recognizes that the fiscal impact analysis of any gas project will be crucial in terms of determining the costs associated with an influx of temporary or permanent workers, the duration of their stay, and the use of municipal services. The MAGP Board

therefore reiterates its recommendation to stay very active in the drafting of an EIS.

In the context of the EIS timeline, the Alaska LNG Project has hosted open houses in several communities; twelve (12) open houses were conducted between October and November, 2014. FERC personnel, though not participating, did observe the proceedings. The Alaska LNG Project is in the preliminary front end engineering design (pre-FEED). The estimated cost is between \$400-500 million, encompassing 2014 and 2015. If the project still holds promise after that period, then the project moves into full front end engineering design (full FEED). The estimated cost of that phase is in excess of \$2 billion, and a timeline of two to three years. During that time, the draft resource reports will be submitted, along with agency and community feedback. The final draft of the resource reports would then be made available. Scoping sessions are expected to begin sometime in February, 2015. The MAGP Board strongly recommends having a presence at these scoping sessions and contributing to the information being gathered for the Resource Books and the final EIS.

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:

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Commissioner, Alaska Department of Revenue

MARK MYERS

Commissioner, Alaska Department of Natural Resources

FRED PARADY

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

CLAY WALKER

Mayor, Denali Borough

MIKE NAVARRE

Mayor, Kenai Peninsula Borough

DAN SULLIVAN

Mayor, Municipality of Anchorage

CHARLOTTE BROWER

Mayor, North Slope Borough

LUKE HOPKINS

Mayor, Fairbanks North Star Borough

LARRY DEVILBISS

Mayor, Matanuska-Susitna Borough

REGINALD JOULE

Mayor, Northwest Artic Borough

ROBERT VENABLES

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ROBERT BARTHOLOMEW

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