FISCAL NOTE

STATE OF ALASKA
2002 LEGISLATIVE SESSION

Fiscal Note Number: 3
Bill Version: CSHB 519(FIN)
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Revision Date/Time (Note if correction):
Title: Natural Gas Pipeline Special Provisions
Sponsor: House Rules Committee
Requester: House Finance Committee

Dept. Affected: Revenue
BRU: Administration and Support
Component: Office of the Commissioner
Component No. 123

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Personal Services	83.0	83.0				
Travel	30.0	30.0				
Contractual	420.0	420.0				
Supplies	5.0	5.0				
Equipment	6.0					
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	**544.0**	**538.0**	**0.0**	**0.0**	**0.0**	**0.0**
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )			**(19,000.0)**	**(50,000.0)**	**(69,000.0)**	**(76,000.0)**

FUND SOURCE (Thousands of Dollars)

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
1002 Federal Receipts						
1003 GF Match						
1004 GF	294.0	288.0				
1005 GF/Program Receipts						
1037 GF/Mental Health						
Statutorily Designated Receipts	250.0	250.0				
TOTAL	**544.0**	**538.0**	**0.0**	**0.0**	**0.0**	**0.0**

Estimate of any current year (FY2002) cost: 0.0

Check this box (X) if funding for this bill is included in the Governor's FY 2003 budget proposal: [ ]

POSITIONS

	FY 2003	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
Full-time	1	1				
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

See attached pages.

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Date/Time: 4/29/02 9:34 PM

Approved by: Wilson Condon, Commissioner
Agency: Department of Revenue
Date: 4/29/2002

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OVERVIEW – Stranded Gas Development Act and Alaska Railroad Bond Issuance

This legislation would reauthorize the Alaska Stranded Gas Development Act under AS 43.82. The act expired June 30, 2001, and this legislation would extend the application date for a project sponsor from June 30, 2001 to April 1, 2004.

The Stranded Gas Development Act, adopted by the 1998 Legislature, authorized the Commissioner of Revenue to negotiate a contract for payments in lieu of taxes with the developer of an LNG project to commercialize Alaska's North Slope natural gas reserves. No project sponsor applied under the act before it expired last year. The intent of the legislation was to provide a mechanism whereby the state could help promote commercialization of its natural gas reserves by structuring payments in lieu of taxes to help relieve the burden on a project sponsor in the early years, when cash flow is not positive, and in return receive a larger share of the revenues in later years after the project sponsor had recovered its heavy development costs. This also would allow the state to receive a greater share of the revenues in later years if gas prices increased.

The Stranded Gas Act allows for a negotiated contract for payments in lieu of one or some or all of the following taxes:

- Production taxes and surcharges
- Oil and gas production property taxes (state and municipal portions) under AS 43.56)
- Municipal property taxes
- Municipal special assessments
- Corporate income taxes
- Municipal sales and use taxes

This legislation (HB 519) expands the definition of a qualifying project under the Stranded Gas Act to include a natural gas pipeline to serve markets outside Alaska. In addition, this legislation clarifies the definition of a qualifying LNG project to include any project that serves Lower 48 states or overseas markets.

This legislation also would authorize the Alaska Railroad Corporation to issue up to $17 billion in tax-exempt bonds to help finance the natural gas project. Although the Railroad Corporation would issue the bonds, the project sponsor(s) would be responsible for all of the debt and liable for 100% of the repayment of the bonds. Neither the Alaska Railroad Corporation nor the State of Alaska would be liable for the debt, which would be secured by the project developer(s) and the project's revenue stream. The tax-exempt financing would help reduce the project's cost of debt.

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COST OF LEGISLATION

This fiscal note includes the following costs and assumptions leading up to the costs:

- We assume the state would receive a project application early in Fiscal 2003.
- Negotiating the contract for payments in lieu of taxes would start immediately, and would be completed with the conclusion of the 2004 legislative session.
- Project construction would start in Fiscal 2005 and continue through Fiscal 2008.
- Natural gas production would start in Fiscal 2009.
- A special assistant to the commissioner would be hired for Fiscal 2003 and 2004 to coordinate the Department of Revenue's work with the project sponsor and the affected communities. *($83,000 per year for total personnel costs)*
- Travel, supplies, contractual and equipment costs would be associated with the new position and with the department's overall effort to meet with the project applicant and officials of the affected communities. *($45,000 per year)*
- The contractual expenses would be incurred in two areas:
  1. Oil and gas economic and tax consultants to advise the department in negotiating with the project applicant and structuring a contract for payment in lieu of taxes that is both advantageous to the project and provides for a fair return to the state on the publicly owned resource. *($250,000 per year, to be reimbursed by the project applicant)*
  2. A Reimburseable Services Agreement with the Department of Law to assist in the legal issues involved in negotiating a contract in lieu of taxes. *($100,000 per year)*
- Because of the importance of this project to the state's economy and public finances, and the complexity of the bond issuance, it is important that the Railroad Corporation receive expert advice. The Department of Revenue proposes to transfer to the Railroad Corporation, via a Reimburseable Services Agreement, $50,000 per year for the first two years to ensure that the corporation can contract with a financial adviser and bond counsel for this project. The Commissioner's Office also requests $10,000 per year to cover the expenses of contracting with the state's financial adviser and bond counsel to make certain that the state's own interests, separate from those of the Railroad Corporation, are adequately considered and protected.

Money for the new position, contractual and supplies are requested from the general fund. That total is $294,000 in Fiscal 2003 and $288,000 in Fiscal 2004.

The cost of the independent consultants allowed under AS 43.82.240 to assist in the department's evaluation of the project application and in developing terms of the contract would be reimbursed by the applicant. The statute allows the commissioner to condition the contract on agreement by the applicant to reimburse the state for the expenses of the independent contractors. Those funds are requested as authority to receive and expend statutorily designated program receipts. Those costs are $250,000 each in Fiscal 2003 and Fiscal 2004.

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PROPERTY TAX WAIVER

Although the Stranded Gas Act calls for the commissioner to negotiate a contract for payments in lieu of taxes, including property taxes, this legislation waives all state and municipal property taxes on the project during construction and in the first 24 months of operation. This also would be imposed upon municipalities, which would not have any option in accepting or rejecting the 100% property tax waiver for the estimated six years total of construction and operation.

The department believes it is premature to waive an estimated $763 million in municipal and state property taxes without first determining if the tax relief would be needed to help make the project economical. (The $763 million estimate is based on the assumption that the tax waiver would apply only to the pipeline, compressor stations along the line, and a gas conditioning plant at Prudhoe Bay.) The department believes such a complete waiver of taxes could be giving away more than necessary to make the project economical. Proponents argue, however, that the state would not be waiving any taxes, since the line would not be built without the waiver.

The tax waiver also could apply to other facilities associated with the gasline. The department believes the language in this legislation is ambiguous and could result in oil and gas producers and/or the project developer reaching further than intended by this bill in an attempt to bring other facilities under the waiver provision. This fiscal note estimate of property tax revenues that would be lost does not include such facilities as additional gas conditioning plants, separation facilities, well conversion and Point Thomson field developments, but the department is concerned that owners of these properties also might construe the waiver to their benefit.

The Stranded Gas Act allows for tax relief or deferral, but the explicit mandate of the Act was to tailor the state's fiscal terms to the particular economics of the project and to maximize the benefit to the people of the state from the development. For example, the Act enables the state to give tax relief where needed to make the project economic, but then recoup its foregone revenue — or more — when the project's economics improve.

Under this bill, however, the state would get nothing in exchange for property tax relief. What happens if the price of gas goes up and the project developer profit enormously from the upside, but the state would lose out on sharing in that additional profit potential as "repayment" for any tax relief granted early in the development? Yes, the legislature could then raise taxes, but this is not the fiscal certainty that the state and potential project sponsors seek from this legislation.

The department recommends changing the waiver provision of this bill to (1) include an opportunity for the state to share in the potential future benefits from the project as part of the package for any tax relief, (2) provide an opportunity for the affected communities to participate in the tax relief discussions, and (3) a tighter definition of facilities eligible for the tax relief.

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DECREASE IN STATE and MUNICIPAL REVENUES

Under Sections 4 and 5 of this legislation:

- The state would lose an estimated $359 million or more in property tax revenues during construction and through the first 24 months of project operation.
- The Fairbanks North Star Borough and North Slope Borough would lose an estimated $404 million or more in property tax revenues during construction and through the first 24 months of production.
- Although the state and the municipalities would never receive this property tax revenue if the project is not built, there is no opportunity to determine whether the tax relief provided by this bill is needed to make the project economic.
- The above property tax estimates are based on a natural gas project carrying North Slope gas to Alberta, for distribution to markets in the Lower 48 states. The estimate of lost revenues would be different and would include additional municipalities if the project was an LNG line to tidewater at Valdez or Cook Inlet.
- The affected municipalities would face higher expenses during the influx of construction workers and the resulting demand for increased school, police, road and various other public services. Meeting those demands without the ability to tax the project itself would put a severe strain on local resources. This issue is at least partially met by the section of the legislation that would establish a Natural Gas Pipeline Impact Assistance Fund at the Department of Community and Economic Development. Subject to future legislative appropriations, the department could use the fund to make state grants to affected municipalities.
- One option for localities would be raise property taxes on all other property within their jurisdiction. The state's share of property taxes on the Trans-Alaska Oil Pipeline and other oil and gas facilities already in place is reduced dollar for dollar by property taxes paid to local communities. Therefore increased municipal property taxes in the affected municipalities would reduce the state's oil and gas property tax receipts.