

SENATE FINANCE COMMITTEE  
February 13, 2014  
9:07 a.m.

[9:07:50 AM](#)

CALL TO ORDER

Co-Chair Meyer called the Senate Finance Committee meeting to order at 9:07 a.m.

MEMBERS PRESENT

Senator Pete Kelly, Co-Chair  
Senator Kevin Meyer, Co-Chair  
Senator Click Bishop  
Senator Mike Dunleavy  
Senator Lyman Hoffman  
Senator Donny Olson

MEMBERS ABSENT

Senator Anna Fairclough, Vice-Chair

ALSO PRESENT

Deven Mitchell, State Investment Officer, Debt Management, Department of Revenue; Michael Pawlowski, Deputy Commissioner, Strategic Finance, Department of Revenue; Mark Davis, Deputy Director-Infrastructure Development, Alaska Industrial Development Export Authority (AIDEA); Gene Therriault, Deputy Director, Energy Policy Development, Department of Commerce, Community and Economic Development.

SUMMARY

ALASKA PUBLIC DEBT REPORT: DEPARTMENT OF REVENUE

INTERIOR ENERGY PROJECTS AND SETS PROGRAMS UPDATE: ALASKA INDUSTRIAL DEVELOPMENT AND EXPORT AUTHORITY

^ALASKA PUBLIC DEBT REPORT: DEPARTMENT OF REVENUE

[9:09:23 AM](#)

DEVEN MITCHELL, STATE INVESTMENT OFFICER, DEBT MANAGEMENT, DEPARTMENT OF REVENUE, spoke to a presentation titled "Alaska Public Debt Report: A Presentation to the Senate Finance Committee" dated February 13, 2014 (copy on file).

Mr. Mitchell cited slide 4 titled, "\$6.6 to 8.1 Billion in Outstanding State Debt 1999-2014 Summarized by category in millions." He related that the slide depicted the state's historical progression of obligations over the last 15 years. In 1999 the state's outstanding general obligation debt was 2.4 million. Prior to 1999, the state issued general obligation debt in 1987 and 1981. The total outstanding debt in 2014 was \$840.2 million with debt authorizations in 2002, 2008, 2010, and 2012 primarily for transportation and education needs (an additional \$303 million was authorized but remained unissued).

Senator Dunleavy inquired whether the \$840.2 million was the total amount of outstanding general obligation debt.

Mr. Mitchell replied that the \$840.2 million was the amount currently outstanding; however \$453 million was authorized in 2012 and \$303 million of the amount was unissued.

Senator Dunleavy inquired what the total amount with the future "encumbrance" was.

Mr. Mitchell replied that if the remainder was issued tomorrow the total amount of outstanding debt was approximately \$1.1 billion.

Mr. Mitchell continued to speak to slide 4. He noted that the State Supported category of debt included leases and school debt reimbursement. School debt reimbursement was the largest component of the category, which grew from approximately \$400 million in 1999 to approximately \$900 million in 2014 [category total in 1999 was 459.1 million and in 2014 was \$1.195 billion]. He reminded the committee that school debt reimbursement was the portion of municipal debt that was issued through a municipal general obligation bond, which obligated the state to pay back. In 1999 and several subsequent years, the state issued debt through Alaska Housing Finance Corporation (AHFC), and municipalities, i.e., Anchorage and the Matanuska Susitna Borough. In addition, the state's certificate of participation program was diminished; therefore the debt was not directly controlled by the state.

Mr. Mitchell spoke to the State Guaranteed debt category that reflected the Veteran's Mortgage Program. He expounded that the program was flat due to the competitive nature of the mortgage market. [Category total in 1999 was \$391 million and in 2014 was 383.9 million.] He referenced the State Moral Obligation debt category that included the Alaska Municipal Bond Bank Authority (AMBBA), Alaska Energy Authority (AEA) and the Alaska Student Loan Corporation (ASLC). [The total in 1999 was \$763.1 million and in 2014 was \$1,200.7 billion.] The growth in the category was primarily due to AMBBA. He turned to the State Revenue debt category that was \$210 million in 1999 and \$595.7 million in 2014. He reported that the category included the Anchorage Airport terminal "C" reconstruction, Fairbanks terminal project, and sport fishing hatchery bonds. The University debt category grew from \$85.7 million in 1999 to \$190.5 million in 2014.

Co-Chair Kelly inquired whether all of the university debt was in revenue bonds.

Mr. Mitchell responded that revenue bonds reflected the majority of the debt with a portion of the debt for lease obligations.

Mr. Mitchell addressed the State Agency Debt category, which was \$767.5 million in 1999 and \$543.3 million in 2014. He noted that state agency debt was primarily comprised of AHFC, and Northern Tobacco Securitization Corporation (NTSC) and had decreased. He moved to the State Agency Collateralized debt category that amounted to \$1.983.8 billion in 1999 and \$2.312.2 billion in 2014, which was comprised of debt from AHFC and Alaska Industrial Development and Export Authority (AIDEA). He qualified that the portion of AIDEA debt was relatively small. He highlighted that the Municipal debt category was \$2.303.4 billion in 1999 and \$3.150.6 billion in 2014. He reiterated that the growth in municipal debt corresponded to the growth in AMBBA [Bond Bank] debt, which was the same debt. The bond bank borrowed on behalf of municipalities.

Mr. Mitchell moved to slide 5:

#### Financial Management and Debt Metrics

Current Debt service costs remain below 5% of General Fund unrestricted revenues

In 2013, a \$35 million Certificate of Participation authorization to fund a residential housing facility co-located with the Alaska Native Medical Hospital

The State is expected to benefit from higher use of the ANMC and reduced Medicare co-payments

The School Debt Reimbursement Program continues to grow with open ended authorization

Mr. Mitchell directed the committee's attention to the slide's graphs related to debt service. He pointed to the graph in the lower left titled, "Historical Total State Debt Service (G.O. and State Supported) as a Percentage of Unrestricted Revenues" that depicted a high of approximately 2 percent in 2005 to a low of .5 percent in 2008. He observed that the fluctuations correlated to differentiation in the state's revenues. He turned to the graph in the upper right titled, "Projected State Debt Service (G.O. Plus State Supported compared to G.O., State Supported, & School Debt Reimbursement) as a Percentage of Unrestricted Revenues FY2014-2023." He noted that the level of debt was projected at almost 5 percent in 2016 as a percentage of unrestricted revenues. The projections did not include increases in school debt borrowing or additional authorizations for general obligation bonds.

Co-Chair Kelly wondered what a healthy level of debt was.

Mr. Mitchell replied that 8 percent was the plausible "upper threshold" in order for the state to maintain its rating category.

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Mr. Mitchell continued to speak to slide 5 and directed the committee's attention to the lower right hand portion of the slide titled, "Projected Total State Debt Service (G.O., State Supported, and School Debt Reimbursement) and Unrestricted Revenues FY2013-2022 (\$ millions)." He detailed that the green line depicted general obligation and state supported debt service in actual dollars, which was \$230 million annually, remained flat and decreased through 2023.

A blue line depicted the debt as unrestricted general fund revenue forecasted from the "Revenue Sources Book."

Mr. Mitchell discussed slide 6:

#### Financial Management and Debt Metrics

G.O. debt service is low, especially when compared to unrestricted revenues

On November 6, 2012, the 2012 \$453 million Transportation G.O. bond authorization was passed by voters

\$149.6 million of Bond anticipation Notes sold in March 2013

Balance of Authorization is projected to be sold over the next 18 months

Mr. Mitchell related that he recently received updated cash flow information and that the balance of the authorization was projected to be sold over the next 36 months as opposed to the next 18 months. The figure reflected debt for road projects, which were long lasting projects. He pointed to the graph on the lower left titled, " General Obligation Outstanding Debt Service before Anticipated Issuance of 2012 Authorization (\$ millions) and stated that the slide revealed that the debt service was at its peak in 2014 at approximately \$80 million and decreased through 2034. The decrease reflected "the maturity of the debt program."

Co-Chair Kelly inquired whether the graph depicted the "amortization path" if the state did not issue any more bonds.

Mr. Mitchell replied in the affirmative. He qualified that the state had "federally enhanced obligations" due in 2038 called, "Qualified School Bonds" that were structured as tax credits. The department placed the debt far down on the yield curve because the state was paying zero interest on the debt due to receipt of the tax credits and were not included in the graph.

Mr. Mitchell moved to the graph in the upper right corner titled, "Total General Obligation Debt Currently Outstanding or Authorized (\$ millions)" that peaked in 2015 to approximately \$1 billion and decreased each year through

2036. He turned to the lower right graph titled, " General Obligation Outstanding Debt Service after Projected Series 2014A and 2015A Issuances (\$ millions)" that showed "the potential structure of layered level debt service on top of the existing amortization of debt." He reported that the state was projected to pay approximately \$95 million in annual debt service with issuances.

Co-Chair Kelly inquired why the lower left graph was different from the upper right hand graph.

Mr. Mitchell responded that the lower left graph reflected the actual dollars spent on debt service. The upper right reflected outstanding balances in the particular point in time on the graph.

Co-Chair Kelly requested further clarification.

Mr. Mitchell explained that one graph reflected an annual payment amount and the other reflected an outstanding balance.

Mr. Mitchell moved to slide 7:

#### Financial Management and Debt Metrics

The State has a long track record of conservative debt practices

G.O. bonds carry pledge of full faith, credit and resources of the State

- State policy limits debt service to less than 8% of General Fund unrestricted revenue
- Debt service as a percentage of unrestricted General Fund revenues has remained low for 15 years

FY2013 was 1.7% (3.3% including school debt reimbursements)

Use of executive power to control expenses  
Historical Preference for utilizing pay-go funding versus debt

Future borrowing:

- 2012 G.O. Authorization for State transportation projects (up to \$453 million)
- Issued \$149.6 million Bond Anticipation Note in March 2013
- Anticipate issuing up to \$230 million Bond Anticipation Note in March 2014 and \$35 million Certificate of Participation in April 2014

State financial support has been discussed for a number of strategic capital initiatives

Every \$100 million borrowed costs \$7 to 9 million in debt service over 20 years (3-6% range)

Mr. Mitchell pointed out that the rating agencies favored the state's prudent borrowing approach of "belt tightening" when Alaska's "volatile" revenue stream had declined. He offered that the \$149.6 million bond issuance in 2013 had an interest rate of 9 basis points or .09 percent and was "extraordinarily low."

Co-Chair Kelly directed the committee's attention back to slide 6 and noted that the debt service for capital projects was reflected in the operating budget. He believed that the debt service should be reflected in the capital budget every year or else money was being spent on new projects in the capital budget that could be utilized to pay off bonds. He felt that "headroom was being created in the capital budget" that otherwise would not exist if the bond indebtedness from past capital expenditures was reflected in the capital budget. He added that the capital budget was larger than it appeared because the debt service on previously bonded capital projects was not included.

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Senator Bishop inquired whether the Department of Revenue (DOR) had looked at the impacts on the state's credit rating regarding having an equity share in the AK LNG project.

MICHAEL PAWLOWSKI, DEPUTY COMMISSIONER, STRATEGIC FINANCE, DEPARTMENT OF REVENUE, replied that in relation to the state's credit rating, the potential for financing a major gas pipeline was very far into the future and currently "unsettled." He stated that DOR had examined issues

regarding the debt capacity of the state. He voiced that the obligation of the state, assuming a 20 to 25 percent share of a \$45 billion to \$65 billion project exerted pressure on the state's debt capacity, which affected the capacity for other state needs. He relayed that the commissioner was concerned about the level of commitment the state could make in the out years.

Senator Olson inquired what the difference was between the percentage of interest the state was earning from money in the bank versus the debt service on bonding to finance projects.

Mr. Mitchell inquired whether he was referring to "the opportunity costs over time of spending the state's money for projects instead of borrowing other people's money."

Senator Olson answered in the affirmative.

Mr. Mitchell stated that the long-term cost of issuing 20-year debt was close to 3 percent on a tax exempt bond issue.

Senator Olson wondered what the state was earning through savings.

Mr. Mitchell responded that it depended on what fund accounts he was referring to. He relayed that the Constitutional Budget Reserve Fund (CBRF) earned 7 percent last year.

Co-Chair Kelly clarified that currently, when the state bonded it paid approximately 3 percent and the interest earned on the CBRF was about 7 percent.

Mr. Mitchell responded in the affirmative.

Senator Olson discerned that it made more sense for the state to bond even though it increased public debt since the state was earning 4 percent more in interest on its savings. He asked whether his hypothesis was correct.

Mr. Pawlowski replied that the question was a good opening for discussions on the issue and "the degree to which that [conclusion] made sense." He would provide information to the committee on the exact earnings and indebtedness costs following the meeting.

Co-Chair Kelly drew a parallel to his previous comments. He recalled that in 2002, the state had bonded for about \$226 million in capital budget projects. The state was still currently repaying for the 2002 bonds. However, the bond indebtedness expense was not accounted for in subsequent capital budgets. He maintained that subsequent capital budgets grew or shrunk irrespective of previous bonding for projects because the payments for bonded indebtedness were not recognized in the capital budgets. He reiterated that the situation resulted in the capital budget having "headroom that wasn't legitimate." He noted that when the state bonded for less than interest rates earned for savings it made sense, however, if the indebtedness expense was never recognized the budget continued to grow. He summarized that when you bond in the capital budget the expense was accounted for in the operating budget but the mounting debt was inescapable. He wanted discussions about moving the debt into that capital budget.

Co-Chair Meyer surmised that bonding made sense when there was a huge surplus in the CBR or Statutory Budget Reserve (SBR) that was earning 6 percent and it was possible to bond at 3 percent. He expressed concern that the state was in deficit spending and the state's savings were going to be spent to fund general operating expenses. He questioned whether the state should take on additional debt. He cautioned that the state was in a situation where it had to watch its indebtedness because it did not know what revenues would be in the future. He expressed additional concerns regarding school construction debt and noted that the state did not have control over the process. The municipalities voted for school bonds and the state was responsible for 70 percent of the debt.

Mr. Pawlowski replied that discussions focused on who was issuing the debt was important. He relayed that if the local government had a lower credit rating than the state "there might be inefficiencies in actual issuing of the school bond debt as opposed to the issuance coming through the state."

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Mr. Mitchell added that he had conversations with Commissioner Rodell about school debt reimbursement. He shared that the program limited the ability of the state to

control its obligation on school debt. The bond structuring on school municipal bonds were determined by the local municipalities and did not necessarily conform to the state's best interest.

Co-Chair Meyer observed that some concerns were raised by the rating agencies regarding the state's bond rating due to the amount of the state's unfunded liability at \$12 billion. He noted that the state included medical costs in its unfunded liability. He wondered whether the state received any credit from rating agencies for ending its defined benefit program, which would eventually solve the unfunded liability problem.

Mr. Mitchell replied that historically rating analysts did not consider unfunded liabilities but was no longer the case. Rating analysts consider unfunded liabilities in its rating criteria and expected the state to pay to its "arc." He related that the state did get credit for adjusting the retirement system away from defined benefits. He commented that there were no hard and fast rules regarding rating discussions because Alaska was much different than other states that operated from a "relatively stable revenue stream." The state relied on a volatile revenue stream from resource extraction. The state garnered the highest rating category because of the conservative spending nature of the legislature and the reserve position of the state. He noted that Alaska was a conservative state and even though the state was now experiencing deficit spending it was still building reserves, which was why Alaska was an AAA rated state. He revealed that although the AAA rating was a great accomplishment, the state could still access capital markets if it took action that caused a credit adjustment in order to accomplish a goal the state deemed important or in the long term best interest of the state.

Co-Chair Kelly noted that was the first time he had heard that point of view regarding the state's bond rating. He voiced that if an action was being considered that might affect the state's bond rating it was automatically off the table. He suggested that the state could undertake a cost benefit analysis.

Co-Chair Meyer inquired whether Mr. Mitchell was referencing the Permanent Fund when he spoke to the state saving money even during deficit spending.

Mr. Mitchell replied in the affirmative.  
Co-Chair Meyer asked whether the state got credit from credit raters for the Permanent Fund reserves even though the legislature cannot spend the funds.

Mr. Mitchell answered in the affirmative.

Senator Dunleavy believed that the credit raters do not consider the limit on Permanent Fund expenditures because it was self-imposed.

Mr. Mitchell agreed with the statement.

Senator Dunleavy indicated that the state had a small tax base to generate revenue from and did not have a diverse industry to generate potential tax revenue and relied on the oil revenue savings to pay for government until the state could expand its tax base. He thought that if the state spent at a higher rate and saved at a lower rate the state's credit worthiness was in a tenuous situation in the future.

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Mr. Pawlowski spoke to slide 7 and related that in addition to the Permanent Fund, the CBR was an asset that did not show up on the balance sheet as a traditional revenue source but that the rating agencies considered the broader view of state assets which included assets like the CBR.

Mr. Mitchell moved to slide 20:

Summary

The State has the Highest Credit Rating

While Strongly Positioned the State Faces Fiscal Challenges

The State has Capacity to Consider Additional Borrowing at the AAA level

Holistic Approach Should be used for New Debt

Estimate \$1 to \$1.5 billion in Total Additional Capacity at Current Credit Rating

Interest Rates Remain Low

Mr. Mitchell related that the state had the capacity to access capital. He stated that interest rates for the short-term market were less than a tenth of a percent, while the long-term market rates were approximately 3 percent.

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^INTERIOR ENERGY PROJECTS AND SETS PROGRAMS UPDATE: ALASKA INDUSTRIAL DEVELOPMENT AND EXPORT AUTHORITY

[9:57:44 AM](#)

GENE THERRIAULT, DEPUTY DIRECTOR, STATEWIDE ENERGY POLICY DEVELOPMENT, ALASKA ENERGY AUTHORITY, DEPARTMENT OF COMMERCE, COMMUNITY AND ECONOMIC DEVELOPMENT, discussed the intent of the presentation. He noted that the presentation provided an overview of the project to date.

MARK DAVIS, DEPUTY DIRECTOR, ALASKA INDUSTRIAL DEVELOPMENT AND EXPORT AUTHORITY, presented the PowerPoint presentation titled "Interior Energy Project Legislative Update - Interior Energy Project Bringing North Slope Natural Gas to Alaskans" (copy on file). He spoke to slide 2:

AGENDA

IEP Goals, Financing and Project Overview  
Project Location

Project Milestones

Schedule & Permitting

Gas Distribution and Demand

Mr. Davis commented that the project was a joint effort between Alaska Energy Authority (AEA) and Alaska Industrial Development and Export Authority (AIDEA).

Mr. Davis spoke to slide 3 titled, "IEP Project Overview" that depicted a general overview of the project. He

elaborated that the project would build a North Slope LNG (liquefied natural gas) plant in Prudhoe Bay. He shared that AIDEA would not have an equity position in the plant, but would provide project financing. The board arrived at the financing agreement with MWH Global on January 14, 2014. Trucking the LNG would be carried out via private contracts between the utilities and the trucking companies. On January 14, 2014 the AIDEA board approved a loan between AIDEA and a consortium headed by Northrim Bank and Fairbanks Natural Gas to build storage facilities for 5.5 million gallons of LNG storage in Fairbanks. The loan package financing was a private sector investment and not utilizing any SB 23 [AIDEA: LNG PROJECT; DIVIDENDS; FINANCING - Enacted 5/30/13] funds. He indicated that discussions were still being held regarding the distribution system.

Mr. Davis turned to slide 4:

#### IEP GOALS

Supply natural gas to Interior Alaska:

1. At the lowest cost possible
2. As many Alaska customers as possible
3. As soon as possible provide propane from the gas stream

IEP investments compliment alternative sources of gas supply

Use private-sector mechanisms

Mr. Davis spoke to slides 5 titled, "SB 23 FINANCE PACKAGE" and detailed that the legislature appropriated \$125 million from the Sustainable Energy Transmission and Supply Development Fund (SETS), \$57.5 million from SETS as a capital budget appropriation, and \$150 million AIDEA bond issuance. He briefly outlined the SETS funding. He explained that after the \$57.5 million deduction \$67.5 remained. The AIDEA board was examining establishing a guarantee program providing loans for energy with \$50 million of the remaining SETS funding. The guarantee program allowed AIDEA to leverage the funds into approximately \$150 million in guarantees and allowed AIDEA

"to do the most projects with the remaining funds." The remaining \$17.5 million was committed to a "potential loan."

Mr. Davis referenced to slides 6:

#### LNG AND PROPANE SALE PRIORITIES

1. Residential and commercial space heating
2. Electric utilities
3. Industrial customers
4. Other utilities
5. Open market LNG sales

Mr. Davis mentioned that all involved parties agreed to sell LNG to non-regulated utilities. Over the long-term, the North Slope Borough was interested in buying infrastructure and investing in the project to provide LNG from the liquefaction plant to its smaller communities through utilities run by the borough and under state law were non-regulated. AIDEA was working closely with other potential buyers of North Slope gas.

Mr. Davis discussed slide 6:

#### COMPLETED PROJECT MILESTONES

##### North Slope Facility

- Project Pre-Feasibility Analysis
- North Slope Plant Plan of Development
- Private Partner Due Diligence and Negotiations
- Pad Build and Design Procurement
- Long-lead Equipment Procurement

##### Distribution System

- Demand and Conversion Analysis
- RCA Service Area Resolution
- Distribution Cost Project Estimate
- FNG Storage Tank Financing (5.25MM gallon tank)

Estimated 6-year build-Out

Mr. Davis pointed out that RFP's (Request for Proposals) were received by AIDEA for building the pad that will be owned by AIDEA. Bids were also received for the long-lead equipment procurement and were in process to ensure equipment delivery in enough time to build the plant. Delivery will begin in July, 2015. Pad building will commence on October, 2014.

Mr. Therriault spoke to the distribution system. He explained that AEA calculated the number of miles for the expansion territory and both potential utility companies agreed with the territory chosen. The Regulatory Commission of Alaska (Regulatory Commission of Alaska) selected the Interior Gas Utility (IGU), the local municipal utility formed by the three local governments of the Fairbanks North Star Borough for distribution.

Co-Chair Kelly wondered whether the IGU established a more formal business structure.

Mr. Therriault responded that IGU had contracted with a branch of MWH to provide technical services.

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Co-Chair Kelly inquired whether IGU had a paid executive.

Mr. Therriault responded in the negative and communicated that MWH would provide the technical staffing.

Co-Chair Kelly asked whether [IGU board chairman] Bob Shefchik was coordinating the effort.

Mr. Therriault replied in the affirmative and added that [IGU board member] Steve Haagenon was also involved.

Mr. Therriault shared that IGU was moving rapidly to establish themselves as a strong entity in the project.

Mr. Therriault reported that IGU was in discussions with Golden Valley Utility about a possible storage facility in the North Pole area.

Mr. Davis spoke to slide 8 titled, AIDEA Interior Energy Project - Schedule." The slide depicted a chart that noted the predicted project progression through 2015. He detailed

that most of the permitting was in place. The air permit was completed and anticipated receiving the permit by September, 2014. He mentioned that the "404 Wetlands" permit was underway. The North Slope Borough issued the permit for the LNG plant.

Mr. Davis spoke to slide 9 titled, "PROPOSED PROJECT LOCATION: LNG PLANT." The slide depicted a map that contained the proposed project location. He emphasized that the project entities would enter into a contact with the producer to use the fuel gas.

Mr. Davis turned to slide 10:

#### NORTH SLOPE FACILITY NEXT STEPS

Letter of Intent - executed week of February 3, 2014

Establishes the basic parameters of the North Slope  
LNG Plant financing between AIDEA and MWH

#### Project Development Agreement - March 2014

Negotiate and finalize a detailed Project Development Agreement with MWH (Commercial Structure)

Secure LNG purchase agreements with potential customers - IGU, FNG and GVEA

Mr. Davis elaborated that AIDEA would loan approximately \$103 million to the project and the consortium would provide an additional \$80 million to \$90 million. He added that if a pipeline was not built to Fairbanks or the demand increased, MWH agreed to a letter of credit for expansion of the plant with private capital.

Mr. Davis addressed slide 11 titled, "Natural Gas Services Areas - As Defined by the RCA." He stated that AEA created the map on the slide that depicted the gas service areas defined by the RCA.

Mr. Therriault furthered that the RCA decision defined the territory the utility company would serve. (Fairbanks Natural Gas (FNG) would serve its existing territory of

approximately 1,100 customers with a total demand of approximately 1.1 bcf (billion cubic feet) of gas. The FNG territory contained 70 percent to 75 percent of high and medium density customers of "space heat demand." The expansion territory would be served by IGU. He expounded that the estimated cost for FNG to expand to meet customer demand was \$31 million. The cost would cover laying 130 miles of pipe underground and finish the "build out of the distribution system for the FNG service area. The build out was expected to be completed in two to three years. The IGU service area was substantially larger with the estimated need of 630 miles of pipe to serve 30 percent to 35 percent of potential demand for medium and high density customers. The estimated cost of the pipe construction was \$156 million.

Mr. Therriault moved to slide 12:

#### CONVERSION ANALYSIS STUDY

LNG Distribution System Demand Analysis

Report complete January 2014

Demographics, economics, and conversion rate forecasts

Full report posted to IEP website

Mr. Therriault elaborated that customers would not be forced to convert to natural gas and the process would take time. He expected the lower costs when compared to diesel would act as an incentive to convert. He reported that as part of the study, IGU conducted a phone survey with potential customers to determine what the "price sensitivity" was that would induce conversion. In addition, AEA conducted focus groups to determine what cost drivers would incentivize customers to convert to natural gas. The findings were included in the study [IEP Natural Gas Conversion Analysis] which allowed AEA to model demand at a realistic price point.

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Senator Bishop commented that hopefully a bank would offer a conversion loan to enable customers to convert their heating systems to natural gas.

Co-Chair Kelly inquired whether the borough could issue a bond for customer conversion paid for by a rate increase.

Mr. Therriault responded in the affirmative. The study contained a white paper written by a consultant who examined what mechanisms had been used successfully in other states that prompted conversion. He identified a successful mechanism called an "on bill financing mechanism." He explained that the mechanism allowed the homeowner to borrow money through a bank or utility to make the conversion and make the payments to repay the loan through their monthly gas bill. He believed that the mechanism would work well with the transient nature of the Fairbanks population. A customer would be able to make payments while living in the house and if sold, the new owners would assume the loan obligation via their gas bill. The mechanism enabled the customer to get the conversion without a lot of out - of - pocket expense. The conversion would enable the customer to maintain a savings even with the loan repayment.

Senator Olson inquired what would happen if multiple peoples' houses were for sale due to economic downturn.

Mr. Therriault replied that the home owner was still responsible for their heating bills until the house was sold. The industry had found that the mechanism maintained a very low default rate.

Senator Olson asked for details regarding FNG.

Mr. Davis answered that FNG would soon be a regulated utility (JUNE 2014) and was owned by Pentex [Pentex Alaska Natural Gas Company, LLC], which was owned by a series of investment funds located in Minneapolis, Minnesota.

Senator Olson wondered whether other communities would be able to "subscribe" to the North Slope LNG plant.

Mr. Davis replied that the gas would be sold at the plant FOB (Free on Board) to Fairbanks. The North Slope Borough also wanted to be added as a potential preferred customer when technology allowed the borough to build distribution systems and store the gas to small communities. He noted that relatively small LNG storage was very expensive and made adding on more communities problematic. However, he

reminded the committee that the plant had an expansion clause and if technology changed and demand increased the plant would expand.

Senator Olson pondered whether additional communities outside the service area could subscribe if they obtained the infrastructure.

Mr. Davis replied in the affirmative and added that the more subscribers to purchase the gas the lower the price for gas.

Mr. Therriault turned to slide 13 titled: "North Slope Plant Demand by Year - (GAS DISTRIBUTION ONLY)" and offered that based on the conversion analysis, AEA modeled expected demand and conversion over time. He noted that the expected demand in the FNG territory was to grow rapidly. The demand in the IGU territory was expected to begin slowly in 2016 and grow over time.

Mr. Therriault spoke to slide 14 titled, "North Slope Plant Demand by Year - (Adjust for Peak Day)". The chart depicted that demand would be much higher in the winter and the plant needed to be able to produce enough gas to meet seasonal demand.

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Mr. Therriault addressed slide 15 titled, "Pipeline Gas Demand by Customer" that graphed the expected demand growing through 2030.

Mr. Therriault discussed slide 16 titled, "Incentive Demand Comparison." He stated that the graph depicted the expected demand with or without incentive programs. The graph demonstrated that price for natural gas alone would be enough to motivate consumers to convert. The operation was based on volume so incentives would still help increase the volume to lower the price for the consumer.

Mr. Therriault spoke to slide 17:

#### DISTRIBUTION SYSTEM NEXT STEPS

Utility discussions on distribution financing access

## Negotiate Take or Pay Contracts

### RCA Approval of Contracts

Mr. Therriault added that the utility companies would be the main customers for the plant. He reminded the committee that the governor's vision for the project was to initially serve the core demand in Fairbanks in order to "anchor the plant." Once in progress, the service area could be expanded to include many other communities able to subscribe to the gas.

Senator Bishop inquired whether the plant would generate 10,000 gallons of propane per day and if any interest in propane was expressed.

Mr. Davis replied that approximately 2,200 to 2,900 residents were expected to be served by propane and interest in propane use was expressed.

Mr. Therriault interjected that the propane estimate was based on the product stream that was produced by the plant generating 9 bcf of gas and based on serving average households in the Fairbanks North Star Borough.

Co-Chair Meyer related that an overall legislative goal was to increase throughput in the oil pipeline. He asked for an update on AIDEA projects involved in attaining that goal and other resource development projects in progress.

Mr. Davis replied that AIDEA was assisting the small oil company, Brooks Range, in financing the Mustang Road and was currently working on an expansion project that would add 15,000 more barrels of oil per day through the pipeline. In addition, AIDEA was working with another small oil company on a project similar to the Brooks Range project, but details were confidential. He anticipated that AIDEA would file the Environmental Impact Statement (EIS) in March, 2014 for the Ambler Road. The authority had signed a Memorandum of Understanding (MOU) with Nova Copper. He noted that Nova Copper expressed interest in operating the Ambler Mine with LNG from IEP.

Co-Chair Meyer offered that many of the projects were capital intensive and AIDEA helped offset the decline in oil production and with mining job creation. He noted that

AIDEA provided significant help with a drill rig in Cook Inlet.

Mr. Davis shared that the drill rig was moving north and a new capital structure for the rig was established. Negotiations were in progress with other smaller producers in Cook Inlet.

Mr. Therriault interjected that the relationship between AEA and AIDEA was working very well.

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ADJOURNMENT

The meeting was adjourned at 10:37 a.m.