

SENATE FINANCE COMMITTEE
February 21, 2014
9:09 a.m.

[9:09:46 AM](#)

CALL TO ORDER

Vice-Chair Fairclough called the Senate Finance Committee meeting to order at 9:09 a.m.

MEMBERS PRESENT

Senator Kevin Meyer, Co-Chair
Senator Anna Fairclough, Vice-Chair
Senator Click Bishop
Senator Mike Dunleavy
Senator Lyman Hoffman
Senator Donny Olson

MEMBERS ABSENT

Senator Pete Kelly, Co-Chair

ALSO PRESENT

Deepa Poduval, Principal, Black and Veatch Management Consulting Division; Michael Pawlowski, Deputy Commissioner, Strategic Finance, Department of Revenue.

SUMMARY

SB 119 BUDGET: CAPITAL

SB 119 was POSTPONED

Fiscal Analysis: The Heads of Agreement and the Memorandum of Understanding, Black and Veatch Management Consulting

^FISCAL ANALYSIS: THE HEADS OF AGREEMENT AND THE MEMORANDUM OF UNDERSTANDING, BLACK AND VEATCH MANAGEMENT CONSULTING

[9:10:07 AM](#)

Vice-Chair Fairclough introduced the speaker and presentation: "TransCanada Participation in Alaska

Liquefied Natural Gas (LNG) Project Presentation to Senate Finance committee (copy on file)."

DEEPA PODUVAL, PRINCIPAL, BLACK AND VEATCH MANAGEMENT CONSULTING DIVISION stated that she supported the state administration with economic analysis for oil and gas issues; providing analysis and commercial support for eight years.

Senator Bishop joined the committee.

[9:12:13 AM](#)

Ms. Poduval introduced slide 3: "Memorandum of Understanding Highlights of the Deal on the Table." She discussed the various options available to the state regarding TransCanada partnership with Alaska. She mentioned the Heads of Agreement between the producers, TransCanada, Alaska Gasline Development Corporation (AGDC), and the state administration. She chose to highlight a different option, The Memorandum of Understanding between the state administration and TransCanada. She wished to highlight the key elements of the agreement within the context of the Alaska LNG project.

Ms. Poduval listed the highlights on slide 3:

- TransCanada Holds the State's Equity Share in Gas Treatment Pipe (GTP) + Pipe
- State of Alaska (SOA) Option to Buy Back 40 percent of TransCanada's Share at front-end engineering and design (FEED)
- State Commits to 25 Year Transportation Agreement with TransCanada
- Agreement Commits TransCanada to a Weighted Average
- Cost of Capital (WACC) of 6.75 percent
- Various Milestones and off Ramps for SOA and TransCanada

[9:14:31 AM](#)

Ms. Poduval continued with slide 4: "Options Identified by State for Equity Participation." She explained the first option in which the state holds its share of the equity in the Alaska LNG project; with an assumption of a 25 percent stake for the state. The second option involved TransCanada

without exercise of a buyback. She explained that TransCanada would hold 25 percent of the GTP and pipeline and the state would hold 25 percent of the LNG plant. She studied the final option in which the state would exercise a buyback option with TransCanada. She stated that the option, with the beginning of pre-FEED, the state would assign 25 percent of the GTP and pipeline share to TransCanada. Following the completion of pre-FEED, the state had the option of buying back 10 percent of the share. The result would be TransCanada holding 15 percent of the GTP and pipeline and the state holding 10 percent of the GTP and pipeline.

[9:16:18 AM](#)

Senator Dunleavy asked about the entity within the state that would hold the share.

Ms. Poduval responded that the Alaska Gasline Development Corporation (AGDC) subsidiary would hold the share.

[9:16:38 AM](#)

Vice-Chair Fairclough clarified that additional Black and Veatch testifiers were available online for Ms. Poduval.

[9:16:55 AM](#)

Ms. Poduval continued with slide 5: "Implication of Options and Potential Off Ramps." She explained that the slide depicted the project's development prior to becoming operational. She noted that the first two years would encompass the pre-Feed, while the subsequent three years (2016 - 2018) would be identified as the FEED stage. The final five year period (2019 - 2023) would be considered the construction stage. She noted the final step between 2018 and 2019, which was the final investment decision when 95 percent of the project's costs were committed to the project.

Ms. Poduval reviewed the three alternative options listed on slide 4. The investment required by the state was depicted at different stages. The first stage involved a \$108 million state investment. She noted the increase to \$450 million in state investment for the FEED portion of the process. For construction, the state investment would

equal \$13 billion. The state investment using this option was naturally the most expensive.

[9:18:35 AM](#)

Vice-Chair Fairclough asked if the figures presented were cumulative. She asked if the \$108 million was a standalone number or was it included in the \$450 million.

Ms. Poduval replied that the numbers were not cumulative.

[9:19:08 AM](#)

Ms. Poduval continued with the next option, which included TransCanada without exercising a buyback. TransCanada would pay for the GTP and pipeline. The option reduced the upfront investment made by the state across all three stages.

Ms. Poduval discussed the third option. She noted that the TransCanada with the 40 percent buyback option elicited the same initial investment as the second option. The \$43 million for pre-FEED remained the same because the state would not yet exercise the option to buy back 10 percent from TransCanada. Beginning with the next phase, FEED, the option to buy back 10 percent allowed the state's investment to increase to \$360 million. Construction investment increased further to \$9.3 billion.

Ms. Poduval pointed out that the red boxes on the slide indicated off-ramps where the state could choose to remove TransCanada from the picture by paying them for the development cost invested up to that stage of the project. She noted that the payment to TransCanada would be (first red box) \$70 million including an Allowance for Funds Used During Construction (AFUDC) of \$5 million. The state would repay TransCanada for its expenses during the first two years of the project with interest. She clarified that \$65 million was the investment during the initial two years, with an additional \$5 million of interest paid to TransCanada at the off-ramp.

Ms. Poduval envisioned that \$65 million of the expenses would have been paid by the state anyway if the investments were made by Alaska during the pre-Feed stage of the project. The additional cost of having TransCanada make the initial investment was the interest payment of \$5 million.

If an off-ramp was exercised at the end of the FEED stage, the state would pay TransCanada's development cost of \$390 million. She clarified that \$340 million would have been spent by the state alone, if TransCanada was not included in the picture. The state would provide TransCanada \$50 million with an interest rate of approximately 7 percent. The interest was the cost of having TransCanada front the expense for the state through the FEED stage of the process.

[9:23:10 AM](#)

Vice-Chair Fairclough asked about potential interest earned if the money was retained in the bank. She understood the opportunity cost of the \$65 million investment. She hoped that the Department of Revenue would provide additional information.

[9:23:59 AM](#)

Ms. Poduval continued with slide 6: "Key Questions in Looking at Value of TransCanada's Participation."

- Economic impact to the state from TransCanada?
- Can the state go it alone?
- Is TransCanada a good partner?
- Does TransCanada bear any financial risk?

[9:24:55 AM](#)

Ms. Poduval discussed slide 7: "What is the Economic Impact to State from TransCanada's Participation?" She detailed the schematic detailing the involvement of TransCanada in the project's investment. The project development and construction timeframe was depicted on the left side of the slide. The deal permitted TransCanada to pay between 60 percent and 100 percent of the state's upfront capital cost for the GTP and pipeline. In exchange, over 25 percent of the project's initial operation, the state would pay TransCanada a negotiated tariff for 60 to 100 percent of GTP and pipeline capacity used to move the state's gas. The economic analysis would examine the net impact of reduced upfront payments and tariff expenses for a 25 period of operation.

[9:26:27 AM](#)

Ms. Poduval discussed slide 8: "TransCanada's Participation Impacts SOA up Front Cash Calls and Revenues from Project." The graph depicted the three different options. The light blue option showed the state investing alone. The grey line showed the involvement of TransCanada in the transaction with the buyback option. The green line depicted the involvement of TransCanada without buyback options. She noted that larger dips in the initial years resulted in higher cash flow in the out years. TransCanada's participation would reduce the state's upfront cash calls by \$1.4 billion to \$2.2 billion assuming 70/30 debt/equality. TransCanada's participation would reduce the annual revenues to the state by \$200 million to \$360 million.

[9:27:53 AM](#)

Ms. Poduval discussed slide 9: "What is the Economic Impact to State from TransCanada's Participation." The green bars on the left displayed the cumulative cash flows over the time period of 25 years. She stated that TransCanada's participation came at a cost of 4 percent to the state. She pointed out the blue bars on the right of the slide depicting the Net Present Value (NPV). She highlighted that TransCanada's NPV was anticipated to be \$150 million to \$200 million over the initial 25 year period.

[9:30:16 AM](#)

Ms. Poduval discussed slide 10: "Can the State go it Alone?"

- What are the capital cost and investment implications of going it alone?
- What are the debt implications of going it alone?

[9:30:59 AM](#)

Ms. Poduval discussed slide 10: "SOA Up Front Capital Cost Exposure is Reduced Through TransCanada Participation."

- Highest risk exposure is prior to project start when cash calls are not supported by project revenues
- TransCanada participation allows the state to retain 20 percent - 25 percent of gas share while being responsible for only 13 percent - 18 percent of the upfront costs

- This is especially important if cost overruns occur on projects

[9:32:19 AM](#)

Ms. Poduval discussed slide 12: "SOA Upfront Capital Cost Exposures is Reduced Through TransCanada Participation." The blue lines represented the state's required investment without TransCanada. The left side of the slide depicted a reference case capital cost estimate of \$45 billion. The right side of the slide depicted a case with cost overruns extending to \$54 billion. Having TransCanada's participation would reduce the state's investment obligation by \$4 billion under the base capital cost estimate and would reduce by \$5 billion with a cost overrun.

[9:33:26 AM](#)

Senator Dunleavy asked for further explanation of slide 12. He pointed out the phrase, "assumes state exercises 30 percent - 40 percent equity buy back with TransCanada."

Ms. Poduval referred to slide 4 in her answer. She noted that every mention of the term "no-buyback" represented the second option depicted on the slide. With the second option, TransCanada would hold 25 percent of GTP and pipeline for the life of the project. She stated that the buyback option referred to the third option, where TransCanada held 15 percent of GTP and pipeline until the second stage (FEED) when the state would have the option buy back from TransCanada. She noted that 40 percent of 25 percent was depicted in the 10 percent shown on slide 4's third option.

[9:34:53 AM](#)

Ms. Poduval moved to slide 13: "SOA Upfront Capital Cost Exposure is Reduced Through TransCanada Participation." The graph depicted the annual investment requirement needed for the state to support its equity share in the project. She pointed out the peak of construction in 2021 where the investment required for the project was at its highest. The three options demonstrated that TransCanada's participation would reduce the state's investment by approximately \$1.5 and \$2 billion.

9:36:18 AM

Senator Bishop asked if the chart assumed a range of \$45 billion to \$54 billion.

Ms. Poduval responded that the chart utilized a \$45 billion baseline cost.

9:36:46 AM

Ms. Poduval continued with slide 14: "Can the State go it Alone? -State's Debt Capacity." She clarified a key question regarding the state financing the LNG project alone. She recommended comparing the cost of the debt to the commitment by TransCanada to a WACC of 6.75 percent. She queried how much Alaska unrestricted general fund revenue would be allocated to serve as the debt associated with the Alaska LNG project. She pointed out the state's additional obligations including supporting infrastructure for the Alaska LNG the project, K-12 education and transportation needs statewide.

Ms. Poduval noted the three scenarios depicted in slide 14 that were indicative assumptions based on input from the Department of Revenue. The first scenario showed the lowest interest. The third scenario depicted a higher interest rate and cost. The assumed cost of debt for each scenario tied into the current market. The lower cost debt was 4.6 percent in scenario one. The second scenario predicted 4.9 percent and the third anticipated 5.6 percent. The concept of debt service regarding the dedication of unrestricted general fund revenue was related to the quality of debt available. The lower the portion of unrestricted general fund revenue required, the more comfort a lender would have issuing the debt to the state.

Ms. Poduval continued to explain that the first scenario depicted debt service limited to 3 percent. The first scenario allowed for the lowest interest rate. The higher the percentage of required unrestricted general fund revenue, the greater the interest charged. As general good debt policy, the state endeavored to limit its entire debt servicing to less than 8 percent of the unrestricted general fund revenue. She pointed out that scenario 3 required up to 6 percent of unrestricted general fund

revenue to pay back the debt associated with the Alaska LNG project leaving the state 2 percent to serve as state debt.

[9:41:54 AM](#)

Senator Dunleavy asked how Alaska's 8 percent limit compared to other states.

Ms. Poduval deferred the question to the Division of Treasury. She pointed out that the state operated well below the 8 percent limit during the last few years.

Vice-Chair Fairclough requested information about the state's policy regarding the 8 percent limit. She asked if the limit was established in statute or regulation. She asked for comparisons between Alaska and other states regarding debt service. She was interested in other entities in the resource business and how they established a debt service limit.

Co-Chair Meyer asked about the state's current debt ratio.

Ms. Poduval responded that Alaska's debt ratio was between 4 and 5 percent. She requested that the Division of Treasury confirm the information.

[9:43:36 AM](#)

Vice-Chair Fairclough requested a projection of state debt for the next 10 to 25 year time period. She recalled debt projections predicting that 100 percent of the state budget would be utilized by the Department of Education and Early Development and the Department of Health and Social Services in only 10 years. She believed that the finance committee would benefit from knowing the projected debt ratio.

[9:44:20 AM](#)

Ms. Poduval continued with slide 15: "The Amount of Cheap Debt Available to the State could be Limited." The slide explored the question about how much debt the state could borrow without violating the debt service limit constraint. The slide assumed the three scenarios discussed to source debt with their associated interest expenses and debt service obligations. The first scenario discussed the option of the state investing alone with a total investment

obligation of approximately \$11.5 billion. The second scenario depicted an investment of \$7 billion. The third scenario showed a total investment need of approximately \$6 billion. She explained that the green portion of the bars depicted the debt available to the state. The initial option (without TransCanada) showed clearly the restrictions to financing for the project. She stated that borrowing at 5.6 percent interest would allow 50 percent of the investment needed in financing without violating the debt service limit as a percentage of the state's general fund unrestricted revenue. She noted that the standalone option could be financed, but the debt capacity must be considered.

[9:48:19 AM](#)

Senator Hoffman asked for a comparison of slide 5 and 15 related to the total construction costs.

Ms. Poduval responded that slide 5 displayed the break up over each stage of the project, while slide 15 provided totals. She noted that slide 15 depicted a state investment of 20 percent, while slide 5 showed a 25 percent state investment in the project. The smallest investment possible was displayed to help answer questions.

[9:51:27 AM](#)

AT EASE

[9:52:44 AM](#)

RECONVENED

Vice-Chair Fairclough asked for any further questions about slide 15. Conversation would continue during the following week's committee meeting.

Co-Chair Meyer stated that the conversation would include additional consultants during the afternoon Senate Finance Committee Meeting. He discussed the schedule.

MICHAEL PAWLOWSKI, DEPUTY COMMISSIONER, STRATEGIC FINANCE, DEPARTMENT OF REVENUE added that the Department of Revenue would work to arrange a further change of schedule.

Vice-chair Fairclough discussed the schedule further.

#

ADJOURNMENT

9:54:52 AM

The meeting was adjourned at 9:54 a.m.