

**ALASKA STATE LEGISLATURE**  
**SENATE COMMUNITY AND REGIONAL AFFAIRS STANDING COMMITTEE**

January 28, 2016

3:30 p.m.

**MEMBERS PRESENT**

Senator Click Bishop, Chair  
Senator Bert Stedman, Vice Chair  
Senator Lyman Hoffman  
Senator Anna MacKinnon  
Senator Dennis Egan

**MEMBERS ABSENT**

All members present

**COMMITTEE CALENDAR**

SENATE BILL NO. 100

"An Act relating to the assessment of property for oil and gas exploration, production, and pipeline transportation property tax on a North Slope natural gas project; amending the definition of "taxable property"; adding a definition for "North Slope natural gas project"; and making conforming amendments."

- HEARD & HELD

**PREVIOUS COMMITTEE ACTION**

BILL: SB 100

SHORT TITLE: NORTH SLOPE GAS PROJ PROP TAX; ASSESSMENT

SPONSOR(S): RULES BY REQUEST OF THE GOVERNOR

04/07/15	(S)	READ THE FIRST TIME - REFERRALS
04/07/15	(S)	CRA, RES, FIN
04/14/15	(S)	CRA AT 3:30 PM BELTZ 105 (TSBldg)
04/14/15	(S)	Heard & Held
04/14/15	(S)	MINUTE(CRA)
01/28/16	(S)	CRA AT 3:30 PM BELTZ 105 (TSBldg)

**WITNESS REGISTER**

RANDALL HOFFBECK, Commissioner  
Alaska Department of Revenue (DOR)  
Juneau, Alaska

**POSITION STATEMENT:** Presented information on Payment in Lieu of Taxes (PILT).

JEFF STEPP, Special Assistant  
Office of the Mayor  
Fairbanks North Star Borough  
Fairbanks, Alaska

**POSITION STATEMENT:** Testified in support of SB 100.

CHARLOTTE BROWER, Mayor  
North Slope Borough  
Barrow, Alaska,

**POSITION STATEMENT:** Testified in support of SB 100, with revisions.

CLAY WALKER, Mayor  
Denali Borough  
Healy, Alaska,

**POSITION STATEMENT:** Testified in support of SB 100, with revisions.

CHARLES MCKEE, representing himself  
Anchorage, Alaska

**POSITION STATEMENT:** Testified during the discussion of SB 100.

#### **ACTION NARRATIVE**

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**CHAIR CLICK BISHOP** called the Senate Community and Regional Affairs Standing Committee meeting to order at 3:30 p.m. Present at the call to order were Senators Egan, MacKinnon, Stedman, and Chair Bishop.

#### **SB 100-NORTH SLOPE GAS PROJ PROP TAX; ASSESSMENT**

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**CHAIR BISHOP** announced the consideration of SB 100. He noted that the bill was reviewed during the interim and the purpose of the meeting is to provide the committee and the public with an update. He stated that no action would be taken on the bill today.

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**SENATOR MACKINNON** asked whether public testimony would be taken today.

**CHAIR BISHOP** answered yes.

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RANDALL HOFFBECK, Commissioner, Alaska Department of Revenue (DOR), presented information on Payment in Lieu of Taxes (PILT). He explained that last year DOR submitted SB 100 as a structure for negotiating a PILT under the provisions of SB 138. The bill was structured on "how to negotiate a PILT," however, soon the department realized that a different strategy was needed. The structure of negotiating a PILT was not going to result in a final resolution; the numbers had to be negotiated.

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CHAIR BISHOP noted the arrival of Senator Hoffman.

COMMISSIONER HOFFBECK reported that a tentative alignment had been reached with the producer parties on the amount of construction-related payment in lieu of tax (CPILT) and on the structure and target amount for operations-related payment in lieu of tax (OPILT). These agreements have to do with how the state will deal with impacts during construction and with PILT payments during the operation of the pipeline.

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COMMISSIONER HOFFBECK further explained CPILT. The total amount of impact payments during construction is \$800 million and includes BP, Conoco-Phillips, Exxon, and AGDC because the project will be paying the PILT. There is some question still regarding AGDC's portion, whether the state will pay itself a PILT, and how much the municipalities will get.

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SENATOR MACKINNON asked whether the project and the state's ownership of the project would be exempt from federal taxes.

COMMISSIONER HOFFBECK offered to get back to Senator MacKinnon.

SENATOR MACKINNON explained her question relates to the benefit of the state's 25 percent ownership of the project.

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COMMISSIONER HOFFBECK explained that the expected payout would be over the five-year construction period. The schedule of payments has not been finalized.

SENATOR STEDMAN requested a breakdown of the total amount of \$800 million and to know whether DOT has a list of targeted infrastructure improvements.

COMMISSIONER HOFFBECK explained that the \$800 million was negotiated and is about four times the amount negotiated under "stranded gas," as far as impact payments. He noted it was early in the process and there is no project design or construction schedule. It would be difficult to construct a PILT at this time. The amount does not include infrastructure, which will be paid elsewhere in the project. It does cover impacts to communities, such as the need to hire police, teachers, fire fighters, etc.

SENATOR STEDMAN asked how the number was derived and the mechanics behind it. He pointed out that some projects do not require a PILT.

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COMMISSIONER HOFFBECK answered that the allocation of the \$800 million is under discussion with the Municipal Advisory Gas Project Review Board (MAGPRB). There are two sides to the issue, the cost of the PILT - which is critical for the project, and the allocations - which are between the state and the impacted communities. The dollar amount was settled and now the department is working on the allocations. He said they are looking at a "grant" program where the municipalities would apply for impact funds. He stressed that it is early in the process.

CHAIR BISHOP noted there would be a more in-depth discussion in the future.

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COMMISSIONER HOFFBECK provided information on the OPILT, whose target amount totals \$15.7 billion to be paid out over the 25-year period of the contract. The actual payment amounts will vary based on the average five-year flow rate against project design. The payments could exceed, or be less than, \$15.7 billion in the case of expansion or interruptions. He said BP, Conoco-Phillips, Exxon, and AGDC are included in the contract. The payment schedule incorporates a 1 percent increase in payment each year, which is included in the target amount.

He related that currently there is discussion between the state and local jurisdictions regarding payout allocations.

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COMMISSIONER HOFFBECK addressed the methodology used to determine the OPILT. He explained the initial formula that was

used. It was the first iteration of taking current property tax statutes and simplifying them into a formula that would derive an estimated payment that would be equivalent to what status quo would have generated under property tax structure. There were simplifying assumptions and projections made in order to run out 25 years. He said the idea was to replicate current statutory language, as interpreted by the Supreme Court in the TAPS litigation.

COMMISSIONER HOFFBECK highlighted the initial formula: the capital cost times an inflation factor, times a depreciation factor, times a functional obsolescence calculation for throughput, with a scaling factor attached, times the mill rate. He noted that is how TAPS is being valued currently. He said MAGPRB also made recommendations for inputs and said the capital costs should be the FID estimate times 1.1, the cover overrides, with the inflation factor at 4 percent, appreciation based on a 50-year floating life, with actual throughput on a five-year floating average, and the actual scaling factor would be one.

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SENATOR STEDMAN pointed out that it appears that property taxes would be a big portion of the value the state would receive and the weighing of that will be significantly higher than that of the oil line. For example, when TAPS was set up there were 20 mills and the weighting of the property tax was not that significant, yet today, the property tax is a significant portion. He questioned the use of 20 mills today and cautioned to not drive too much value to too few communities because the asset is owned by everyone in the state. He stated great interest in the impact of the dollar flow.

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COMMISSIONER HOFFBECK explained that the reason 20 mills is part of the formula is because the starting point for PILT is what would have been paid in property tax if the PILT did not exist. He stressed that in all the hearings it was made clear to the municipalities that they should not have an expectation that monies would flow the same as they did under the current tax statutes. Within the PILT structure will be an allocation method whereby the state would reserve a substantially greater portion to themselves and use statewide allocations, as well as direct impact allocations. He said that is the position MAGPRB is taking right now. He predicted the discussion of allocations would be a difficult one. He stressed that the decision-making was up to the legislature.

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SENATOR MACKINNON asked if the state owns a portion of the property the proposed route will take and whether the state will receive a PILT payment.

COMMISSIONER HOFFBECK answered that a good portion of the property runs through unincorporated portions of the state where the state would have the taxing authority.

SENATOR MACKINNON noted her interest in seeing charts depicting how the money will move; the \$200 million fronted money and the receiving money.

COMMISSIONER HOFFBECK offered to provide that information.

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COMMISSIONER HOFFBECK described the modified OPILT formula, which he called a simplified version of the TAPS litigation and the basis of SB 100. The formula is the original cost, times the inflation factor, times the depreciation factor, times a throughput factor, times 20 mills. The inputs were not defined and will be negotiated. He explained that the original cost would be fixed by pre-FID project specific data. The inflation factor and the depreciation factor would be fixed by the fiscal agreement. The actual throughput is the operational measurable throughput. The design throughput would be fixed by pre-FID project specific data, and the mill rate would be fixed by statute.

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COMMISSIONER HOFFBECK highlighted the current OPILT formula, which was reached by tentative alignment and includes input. The formula includes original cost, times an escalation factor, times a depreciation factor, times a throughput adjustment, times a blended mill rate. The original cost was assumed to be \$55 billion, which the project participants want to lower. There is no true up included against actual cost.

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SENATOR MACKINNON asked if the gas treatment plant and off point are included, or if just pipeline is included.

COMMISSIONER HOFFBECK replied that it includes the feeder pipelines, the gas treatment plant, the pipeline, and the LNG plant.

SENATOR MACKINNON asked whether the valuation method uses property values in distant communities and all capital costs are included, not just the cost of the pipe and the transmission of volume.

COMMISSIONER HOFFBECK said that was correct.

CHAIR BISHOP asked if the \$55 billion amount is "hard and fast," even if there is a \$5 billion overrun.

COMMISSIONER HOFFBECK said that was correct. It is also hard and fast if it comes in at \$50 billion.

COMMISSIONER HOFFBECK continued with an explanation of the current formula's escalation factor of 2.5 percent, which is a composite of a 3.25 percent inflation rate, minus a .75 percent adjustment for obsolescence of technology that would occur over 25 years.

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COMMISSIONER HOFFBECK explained that the depreciation factor is based on a 30-year life and is a modified floating/fixed life. There were two positions regarding the pipeline. The floating life position was for gently reserved growth over the life of the assets with an expectation of more reserves at the end of the 25th year than were estimated at the beginning of the life of the pipeline and the pipeline would not be empty at 30 years. The department proposed that for every year the pipeline aged, it would "grow a year," as well. So, at 30 years, the pipeline would be 30 years old with a 60-year life.

He said the producers' position was that the life of the pipeline should be fixed over 30 years and its value would decline. A compromise was reached that blended the two positions, ending up that the life would increase by a half a year every year of the life of the asset.

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SENATOR STEDMAN asked what would happen after 30 years.

COMMISSIONER HOFFBECK answered that the assumption is that the pipeline valuation would revert to standard property tax. The expectation is that before the end of the contract, the parties would seek to negotiate an extension. The Municipality Advisory Group's report to the Governor provides for the option to re-negotiate the PILT.

SENATOR STEDMAN noted Sitka's paper mill used to have a 3.5 mill rate that worked fine for the community. He pointed out that there is a big difference between 3.5 mills and 20 mills. He said property tax is a heavy burden. He requested the department explain the estimated split on the value stream coming into the state, including royalties and property tax.

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COMMISSIONER HOFFBECK commented that the relative size is driven by the price point on the gas. He agreed that there is a price point on gas where this project is still viable where the property tax could be as much as a third of the total take. That is also a benefit to the state because if gas prices fluctuate, there will be variable revenue. The property tax stream would be the one fixed revenue stream that the state could count on which the others don't have.

SENATOR STEDMAN noted his concern about the one-third value and how it is split up. He called attention to British Columbia's solution of an impact fund. He pointed out that Southeast Alaska is not going to have much control over this project, but he expected fair allocation of resources.

COMMISSIONER HOFFBECK related that under any of the proposals, the state would get the largest share from PILT.

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COMMISSIONER HOFFBECK turned to the actual throughput under the current formula, which is based on operational measurable throughput on a five-year rolling average that buffers loss by interruptions in revenues. He said design throughput has yet to be determined. The department is reviewing a proposal by the producers on how to allocate the PILT to the various portions of the pipeline, where to measure the gas, and how much value to associate with each section in order to reach the \$15.7 billion total.

SENATOR BISHOP commented that throughput is measured at pump one for TAPS. He asked if there would be three measurements taken along this project.

COMMISSIONER HOFFBECK said that was correct. He explained that the reason was to deal with expansion or introduction of gas into the pipeline at some point downstream.

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COMMISSIONER HOFFBECK addressed the mill rate under the current formula, which is a blended rate at 13.75 mills. That is 20 mills for the gas treatment plant, 20 mills for the pipeline, and 7.5 mills for the LNG plant. The reason for a lower rate for the LNG plant is because it is locally assessed under current statute. The 7.5 mill rate for the Kenai Peninsula Borough was done by the state in consultation with the Borough.

SENATOR STEDMAN asked what taxing authority the Kenai Borough may gain or lose due to the new \$25 billion plant.

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COMMISSIONER HOFFBECK replied that currently their mill rate is slightly over 10 mills and a new asset will have an effect on the mill rate. The Borough estimated a mill rate range, and Commissioner Hoffbeck said he chose a number within that range.

CHAIR BISHOP clarified that with the upcoming plethora of assets soon to appear in the Kenai Peninsula Borough, they tentatively agreed to handicap themselves down to a 7.5 mill rate.

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COMMISSIONER HOFFBECK said that was true only to the extent when trying to calculate what the status quo property tax would have yielded. There will ultimately be a PILT regarding the LNG asset.

SENATOR MACKINNON discussed how property taxes use valuation to extract a payment for services in a community. She said it begs the question of what needs for new services the new asset will create. She shared her experience in Anchorage with taxation. She questioned the fairness of using valuation as a base. She asked if it was defined like that in statute.

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COMMISSIONER HOFFBECK said it was. He related that under property tax theory, land ownership and ownership of assets is an indication of ability to pay. Taxation is not tied to the impact a development might have on the community or the needs it engenders, but is an indication of the ability of the entity to pay the tax.

SENATOR MACKINNON spoke of California's impact fees for new housing developments based on a "cost causer/cost payer" idea.

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COMMISSIONER HOFFBECK said the current formula "got us to the \$15.7 billion," but must be converted to a PILT. There were two ideas that need to be embedded in the PILT. The first one is that governments do better with escalating revenues. This can be done by starting at a lower starting point to get to \$15.7 billion. It also reduces early payments when the project is most economically challenged.

SENATOR MACKINNON asked what the thousand cubic feet (MCF) gas price in the model was.

COMMISSIONER HOFFBECK answered that it is not sensitive to the gas price, only the cost of construction and the throughput.

SENATOR MACKINNON noted the state's facing a \$4 billion deficit currently and not much profit in oil. She said she has been told there is less profit in gas. She inquired what MCF number would generate half a billion dollars a year going forward to pay property taxes, which could be a third of the state's profits.

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COMMISSIONER HOFFBECK said they could run that analysis, but it would be largely based on producer information of costs and return investments.

SENATOR MACKINNON requested that information.

SENATOR STEDMAN asked if PILT, at one-third, was a fixed cost and whether the remaining royalty share would be very sensitive to the gas end price and would fluctuate depending on the market environments.

COMMISSIONER HOFFBECK said yes, to the extent that on the spot market, versus on long-term contracts, that price could fluctuate. He clarified that the one-third amount was just at a price point where the pipeline was still a viable project. If the gas is at a substantially higher rate, the one-third goes down very quickly.

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SENATOR MACKINNON wished to know "the ballpark we're playing in" and if local communities are assuming \$15 billion is coming their way. She said she wants to be realistic in discussions with communities.

CHAIR BISHOP commented that the state has 25 percent of the risk, too.

COMMISSIONER HOFFBECK agreed. He noted that most of the mayors were sensitive to the fact that some of their early decisions were made in order to help accommodate the project to move forward.

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COMMISSIONER HOFFBECK discussed the conceptual project benefits from PILT target payments. He said there are two areas where the agreement provides some relief on the front end where the project is most challenging due to low cash flow. One is the CPILT at \$800 million, which is between a half and a third of what the project would have collected under a standard property tax regime. For the first five years of the project, CPILT would lessen the burden. He explained that the second economic benefit is the five-year floating average of throughput. It also benefits municipalities by providing stability of payments in the out years.

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COMMISSIONER HOFFBECK turned to OPILT target payment components yet to be determined. He said the agreement still needs work on the volume for setting the design rate.

CHAIR BISHOP asked if those numbers have yet to be determined due to a possible change to a 48-inch pipeline.

COMMISSIONER HOFFBECK said that was correct, however, the contract has been negotiated so the throughput will be based on a design that is commensurate with \$55 billion. If the pipeline goes to 48 inches instead of 42 inches, that would allow for greater throughput and would increase the target payments. Rather than having to go back and re-calculate everything, tying everything to the throughput allows those kinds of changes in the discussion. The process is dynamic.

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SENATOR STEDMAN asked how hard the numbers actually are. He stated a goal to move smoother than during the TAPS process.

COMMISSIONER HOFFBECK explained that this would be a part of the fiscal package for the pipeline and part of the contract, and the PILTs would be set for 25 years.

SENATOR STEDMAN stated that he looks at it as the difference between "how we engage and make agreements with our three partners, versus how we interact with the state's portion." He

said he understood that this would be tied down for 25 years and the state would be giving up its appropriating power when dealing with the property tax issue on the gas line for that period. He stated that he is talking about changing the state's internal 25 percent, not the partnership split. He asked why the state should do that.

COMMISSIONER HOFFBECK clarified that "this is not part of the cash flow for our 25 percent, this is a separate cash flow with the project." He explained that the allocation between the state and the municipalities can be left as open-ended as the legislature feels necessary. The important part for the project is total dollars, in order for the producers to calculate the economics of the project in relation to all the other negotiated components. The statutory language regarding the state and the municipalities would be in the hands of the legislature.

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SENATOR STEDMAN asked if this is in addition to the 25 percent.

COMMISSIONER HOFFBECK said it was.

SENATOR MACKINNON clarified that the state is part of a megaproject and has a 25 percent ownership in that project.

COMMISSIONER HOFFBECK agreed.

SENATOR MACKINNON asked whether Governor Walker is bringing forward a fiscal package with various components that affect project viability and the economics of that project. There are a variety of fiscal certainties needed in order for the state and its partners to enter the project and make it successful.

COMMISSIONER HOFFBECK said yes - there are certain contracts that give certainty on both sides that need to be negotiated.

SENATOR MACKINNON summarized that there is a gas price, as far as taxing on a production level, in a different bill and a second component, property tax, in SB 100, and that value is made certain for the state and its parties through a PILT.

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COMMISSIONER HOFFBECK said that was correct.

SENATOR MACKINNON understood that as long as the fixed total of the property tax stays the same, the state can do what it wants with its share and it will not affect the project's economics.

She asked whether it is up to the legislature to decide to share more or less with the municipalities or whether the municipalities can count on that agreement staying fixed over 25 years.

COMMISSIONER HOFFBECK said that answer is still to be determined and MAGPRB is clarifying their position. It has been made clear to MAGPRB by the state that the expectation is the legislature will determine the proper way to make allocations.

SENATOR STEDMAN noted comments on the royalty share made at a Senate Resources Committee meeting the previous day, where it was stated that the property tax component was part of the 25 percent. He asked for clarification.

COMMISSIONER HOFFBECK offered to look into it.

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COMMISSIONER HOFFBECK returned to the subject of OPILT target payment components yet to be determined. It has not been decided whether the flow rate measurements will be based on Mcf (thousands of cubic feet) or mmbtu (millions of British Thermal Units). Whether the measurement location will be taken at each component (GTP, Pipeline, LNG) individually or at one location for the entire project has not been decided. Also undecided is whether the measurement will be taken at the inlet or the outlet of project components.

SENATOR MACKINNON questioned the flow rate measurement and asked whether there would be individual propane offtakes for communities in rural Alaska.

COMMISSIONER HOFFBECK said that would be part of the discussion and there could also be gas offtakes. The PILT would have to be set at the place it is measured.

SENATOR STEDMAN voiced concern about the possibility of disproportionate payments to small areas of the state and the state's appropriating power.

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CHAIR BISHOP thought that the flow rate measurement was already known based on Prudhoe Bay gas and might be quickly decided.

COMMISSIONER HOFFBECK said the producers have provided the department with multiple scenarios to choose from.

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COMMISSIONER HOFFBECK addressed the next steps for MAGPRB: they need to provide recommendations on proposed structure and target amounts for CPILT and OPILT in their report to the Governor, provide recommendations on allocation and disbursement of payments among state and local jurisdictions, draft the 2015 MAGPRB Annual Report, and provide recommendations legislation.

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CHAIR BISHOP noted that this is an early discussion of the PILT.

SENATOR STEDMAN commented that it would be nice to see how other jurisdictions deal with this issue.

COMMISSIONER HOFFBECK replied that there were discussions with the producers, particularly on construction impact payments, where some of their other agreements were shared. He pointed out that a PILT agreement to cover construction impacts is common.

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CHAIR BISHOP asked that Commissioner Hoffbeck provide the committee with the scenarios, if possible.

COMMISSIONER HOFFBECK agreed to do so. He stressed that the agreement with the producers is tentative, the MAGPRB has been brought along and informed and is in general alignment.

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CHAIR BISHOP opened public testimony.

[4:35:36 PM](#)

JEFF STEPP, Special Assistant, Office of the Mayor, Fairbanks North Star Borough, testified in support of SB 100. He related that Mayor Kassel has been a member of MAGPRB since November of 2015. Much of the work on PILT had already been completed at that time. He voiced appreciation for the work that has been done on PILT by various entities, but said there is still much work to be done by all stakeholders so the commercialization of gas becomes a reality and benefit all Alaskans.

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CHARLOTTE BROWER, Mayor, North Slope Borough, testified in support of SB 100, with revisions. She recalled the passage of SB 138, which created the framework for the Alaska Gas Pipeline Project. She noted a primary concern regarding how the state would address property taxes on the project. She said that taxable oil and gas properties represent 97 percent of the North

Slope Borough's full value determination. The Borough has a good working relationship with the oil companies and experience with property taxes and PILT.

She said the Borough is looking at further development with the LNG project and would like to see the project also benefit fellow Alaskans. She suggested that the system SB 100 determines should be allocated with respect to the location and value of the respective assets. Once the system and allocation plan has been agreed upon by the municipalities, state, and producers, the Borough would like to see annual payments made directly from the taxpayers to the impacted municipalities. She stressed the importance of a direct payment.

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CLAY WALKER, Mayor, Denali Borough, testified in support of SB 100, with revisions. He said he has served on MAGPRB for the past two years and supports their work. He pointed out that PILT language is included in SB 138. He said he saw SB 100 as a starting point, but it needs revisions. He described the MAGPRB as being fair and reasonable for municipalities, the state, and project partners regarding the tax structure. He thanked the committee for its work.

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At ease.

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CHAIR BISHOP called the committee back to order.

[4:45:20 PM](#)

CHARLES MCKEE, representing himself, testified during the discussion of SB 100. He requested transparency during the process.

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CHAIR BISHOP closed public testimony.

[4:49:44 PM](#)

CHAIR BISHOP commented that he feels honored to work with such a fine committee. He held SB 100 in committee.

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There being no further business to come before the committee, Chair Bishop adjourned the Senate Community and Regional Affairs Committee at 4:50 p.m.