

SENATE FINANCE COMMITTEE  
March 22, 2018  
9:02 a.m.

[9:02:18 AM](#)

CALL TO ORDER

Co-Chair MacKinnon called the Senate Finance Committee meeting to order at 9:02 a.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair  
Senator Anna MacKinnon, Co-Chair  
Senator Click Bishop, Vice-Chair  
Senator Peter Micciche  
Senator Donny Olson  
Senator Gary Stevens  
Senator Natasha von Imhof

MEMBERS ABSENT

None

ALSO PRESENT

Sheldon Fisher, Commissioner, Department of Revenue; Maria Tsu, Specialist, Alaska Gasline Project Financing; Mike Barnhill, Deputy Commissioner, Department of Revenue.

SUMMARY

^DEPARTMENT OF REVENUE'S ROLE IN THE ALASKA LNG PROJECT

[9:03:48 AM](#)

SHELDON FISHER, COMMISSIONER, DEPARTMENT OF REVENUE, discussed the presentation, "DOR Update on Alaska LNG Project State as Potential Investor/Owner" (copy on file).

[9:04:45 AM](#)

AT EASE

[9:05:17 AM](#)

RECONVENED

9:06:07 AM

Commissioner Fisher highlighted slide 2, "Presentation Outline":

DOR Role

- Legislative role as project advances
- DOR deliverables under SB 138
  - Property tax/Payment-In-Lieu-of-Tax (PILT)
  - Report on plan for State/Alaskan equity ownership
- Anticipated timing for legislative approval

State as potential investor/owner and DOR Role

- DOR evaluation process for potential state ownership
- Interface with AGDC
  - DOR staff positions/time commitments
  - DOR consultants

Commissioner Fisher addressed slide 3, "Legislative Role on DOR Lead Items":

PAYMENT-IN LIEU- OF TAX (PILT)

Property Tax Proposal and Property Tax Allocation and Disbursement Proposal/Recommendations

MAGPR/DOR

Alaska LNG Project Entity Owners

Legislative Approval

Sec. 74, SB 138: Payment-in-lieu-of-Tax (PILT) needs to be analyzed in light of anticipated equity ownership mix (AGDC, State, Private).

SOA PARTICIPATION

Finance options for State ownership and participation in Alaska LNG project

AGDC/DOR

Alaska LNG Project Company

Authorization of Funding

ALASKAN PARTICIPATION

Plan to allow a municipality, regional corporation or state resident to participate as co-owner in Alaska LNG project AGDC/DOR In-State Investors Review Plan, Provide Feedback, and Possible Legislation

Sec. 76, SB 138: requires DOR to present plan to Legislature.

[9:10:57 AM](#)

Co-Chair MacKinnon wondered when the administration would advance the detailed numbers on the advancement of the project. Commissioner Fisher replied that he would separate whether the project was good for Alaska and whether the state would choose to invest in the project. He understood that they may be the same or different questions. He noted that the statute was created at a time when the concept was different than the current concept. He stated that as Alaska Gasline Development Corporation (AGDC) developed its financing structure would result in a process. He remarked that there was work to develop a financial model, which would be the foundation for any investment. The model would be central to all future decisions of the viability of the project. As that model is finalized, there would be points of equity investments. He remarked that it was typical to receive the investments in stages. He noted that there would be a series of decisions, and on each stage of financing the valuation increased.

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Co-Chair MacKinnon wondered how a model would be developed without knowing whether the legislature was willing to

invest in the project. She asked whether it was assumed by the governor that the state would not financially invest in the project. Commissioner Fisher replied in the negative. He sensed that the governor and AGDC would be pleased in state participation at any level.

Co-Chair MacKinnon wondered whether there was a request to pledge resources to the project. Commissioner Fisher replied in the affirmative. He explained that the current model included required financial investments and assumed a certain profile based in costs and revenues. The result was a return profile to model assumptions about the investment.

Co-Chair MacKinnon stressed that there was some concern about the financial aspect of the project, specifically the rate of return for the state's investment. She stressed that there was a desire to provide the stable resource to Alaskans, and there as an expectation of a blended diversified portfolio. She expressed concern that there was not an internal rate of return hurdle for the state. She requested the Alaska rate of return and the risk of ownership by someone other than Alaska. Commissioner Fisher replied that he could not know at this stage. He was defaulting to a process rather than an answer.

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Co-Chair MacKinnon stressed that people wanted to know the terms of the project. She wondered whether there was an unacceptable rate of return for Alaska. Commissioner Fisher stated that he could not make that determination until the model was completed.

Co-Chair MacKinnon wondered whether the administration would take a project without revenue. She requested the internal rate of return. She appreciated the legislative role in the department. She queried any legal binding to allow the legislature to weigh in on accepting to much risk on the project. Commissioner Fisher replied that there was a certain amount of risk that the state had taken. He remarked that there had been meaningful investments, that were sunk. He understood that there was a concern about the return based on the current investments.

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Co-Chair MacKinnon wondered whether the proposal would be shared with the legislature. She wondered whether the administration represented to potential partners the need to receive any information to the legislature. Commissioner Fisher replied that he did not know the answer to that question.

Senator von Imhof understood that a financial model would be created. She asked whether a confidentiality agreement was signed and whether he had seen the AGDC model. Commissioner Fisher responded that he had not seen the model.

Senator von Imhof understood that there would be close work with the AGDC model. Commissioner Fisher agreed. He stated that the model was currently under development.

Senator von Imhof wondered whether there were confidentiality agreements signed in order to see the models. Commissioner Fisher replied that that he had not signed a confidentiality agreement.

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MARIA TSU, SPECIALIST, ALASKA GASLINE PROJECT FINANCING, replied that she worked for the department, but there was an agreement with the president of AGDC that to best address the goals of the state was to imbed her into the team and be given full access to the other AGDC staff were granted access. She stated that she had full access to the model.

Senator von Imhof wondered whether there was a conversation about what could be shared with the legislature about the model. Ms. Tsu replied that she was operating under the assumption that she would maintain the confidentiality of the information presented in the model. She shared that there was an exploration of potential information protocol, because the model was quite fluid.

Senator von Imhof felt that there should be an inclusion of the acceptable rate of return within the model. She felt that Alaska should be considered an "early investor." Commissioner Fisher agreed.

[9:35:49 AM](#)

Senator Micciche would wait to ask his questions.

Co-Chair MacKinnon stated that the committee was attempting to do its fiduciary responsibility.

Commissioner Fisher stated that the PILT was important to the model, because it was a cost-driver.

9:37:02 AM

MIKE BARNHILL, DEPUTY COMMISSIONER, DEPARTMENT OF REVENUE, looked at slide 4, "DOR Deliverables: Payment-in-lieu-of-Tax":

DOR has direct responsibility under SB 138 for the following:

Section 74 of SB 138: Requests that governor establish an advisory planning group to advise governor on municipal involvement in a North Slope natural gas project and make recommendations related to property tax under AS 43.56 and AS 29.45

- Municipal Advisory Gas Project Review Board (MAGPR) - established by AO 269 in 2014 to discuss property tax issues associated with the project and recommend possible options
- Last meeting was in February 2016
- Tentative decisions regarding Payment-in-lieu-of-Taxes (PILT) were reached, but more work is required
- DOR intends to start up MAGPR Board meetings again shortly

Mr. Barnhill discussed slide 5, "Payment-in-lieu-of-Tax (PILT)":

The MAGPR Board last met February 2016. Board members' terms have expired and board needs to be re-constituted.

While additional discussions must occur prior to a final recommendation, the board agreed to the following:

Construction PILT (C-PILT) should be distributed based on the merit of applications by impacted communities.

Operations PILT (O-PILT) should be allocated on a formula-driven calculation based on two criteria: Physical location of the project's real property and a per-capita distribution.

The board left several unresolved issues for both C-PILT and O-PILT. These issues (see next slide) remain unresolved.

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Co-Chair Hoffman wondered whether it was normal PILT was levied during the construction process. Mr. Barnhill replied that he did not know what was normal. He agreed to provide further information. He stated that in the property tax statute, there was a tax exemption during the construction period.

Mr. Barnhill addressed slide 6, "Unresolved Issues for C-PILT and O-PILT":

The unresolved issues for C-PILT include the following:

- Will the state pay into the C-PILT fund the same as private-sector partners, given that State is not a taxable entity?
- How exactly will impacted municipalities draw on the fund, and how will their requests be decided?
- Will the state be allowed to draw on the fund the same as municipalities?
- And will municipalities outside of the footprint of the project be allowed to draw on the fund for direct and indirect impacts?

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Senator von Imhof noted that the PILT was a significant component of the financial model. She remarked that the components and elasticity of PILT. She asked for more information about the determination of what was put into PILT. She was pleased, but stressed that she wanted to see the underlying assumptions and factors into PILT and their effects. Mr. Barnhill replied that he did not want to ascribe any of the work of the Municipal Advisory Review Board to Department of Revenue (DOR). He stressed that DOR facilitated that board, but it was not work in DOR. He stated that the computation and derivation of the numbers was absolutely important. He noted that a PILT that was too high could produce a negative net present value of the project.

[9:54:02 AM](#)

Mr. Barnhill continued to discuss slide 6:

The unresolved issues for O-PILT include the following:

- Will the state pay into the O-PILT the same as private-sector partners?
- How will the fund be distributed to municipalities? Strictly based on project mileage or value within each municipality's boundaries? Or based on some hybrid formula? What amount, if any, should be assigned to a statewide municipal per-capita sharing of the PILT money?
- Will the state receive funds from the account for the project mileage/value not within a municipal tax jurisdiction?

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Co-Chair MacKinnon wanted to be able to examine the expenses to make a competitive project.

Senator Micciche expressed concerns with PILT. He stressed that many Alaskans were concerns. He felt that there was a high level of fanfare with the Chinese partnerships. He wanted DOR to bring the project back to the people.

Senator von Imhof stressed that the model included factors like thresholds. She stressed that it was the hope that DOR would be objective, and use financial lens to create the model.

[10:05:35 AM](#)

Senator Micciche understood that forced political projects may not be able to conclude.

Commissioner Fisher looked at slide 7, "DOR Deliverables: State/Alaskan Participation":

Section 76 of SB 138: DOR to provide report on financing options, including options for municipalities, residents, or regional corporations to invest in the project and proposed legislation.

- In 2015, DOR engaged Lazard to prepare an interim draft report, which was delivered to the legislature.
- DOR is working with AGDC to update/revise draft report (1) to reflect new project structure and financing options, and (2) evaluate options to provide mechanism for Alaskan participation in ownership.
- Regarding options for municipalities, residents, or regional corporations, Lazard's summary assessment stated:

"Although Regional Corporations, Municipalities and Individual Residents may provide potentially viable funding sources that align Project stakeholder incentives, certain practical constraints (e.g., potentially limited overall availability of funds, liquidity preferences, investment mandates, and structuring, marketing and monitoring costs) may be prohibitive."

Co-Chair MacKinnon wondered whether Lazard was still under contract with the state. Commissioner Fisher replied in the negative.

[10:10:12 AM](#)

Co-Chair MacKinnon wondered whether Black and Veatch was still under contract with the state. Commissioner Fisher replied in the affirmative.

10:10:25 AM

Commissioner Fisher introduced Ms. Tsu.

Ms. Tsu discussed her background.

10:17:29 AM

Ms. Tsu highlighted slide 8, "Evaluation Process for Potential Equity Stake":

DOR is responsible for evaluating whether State should take equity interest in Alaska LNG.

DOR has hired Maria Tsu as Alaska Gasline Project Financing Specialist to lead effort.

- Ms. Tsu has 20+ years of institutional investment experience, including nine years at the Alaska Permanent Fund Corporation, where she was most recently Director of Investments for Private Markets (private equity and infrastructure). She also worked for the SOA Treasury Division, for the Municipality of Anchorage, and for the North Pacific Fisheries Management Council. Prior to moving to Alaska in early 2000, Ms. Tsu worked at Goldman Sachs in New York. She holds B.S. and M.S. degrees in Chemical Engineering from the University of Washington, and a Masters degree in economics from Virginia Tech.

Evaluation steps include:

1. Understand all aspects of Alaska LNG project
2. Develop financial model needed to guide decision
3. Conduct in-depth due diligence

4. Assist AGDC in identifying sources of equity funding
5. Assist AGDC in obtaining approvals from relevant entities
6. Assist AGDC in equity fundraising

10:19:00 AM

Ms. Tsu discussed slide 9, "Evaluation Steps (continued)":

1. Review: Understand project scope, timelines, underlying economics, cash flows, funding needs, capital sources, opportunities and risks.
2. Financial Modeling: Model project financials plus other State revenues (royalties, taxes) and other economic benefits to Alaska (jobs, growth, fiscal stability).
3. Due Diligence: In-depth review of project aspects most relevant to investment decision: sources of returns and risks (both financial and non-financial, including impact to State's bonding capacity and credit rating). Draft due diligence report.
4. Funding Sources: Identify equity funding sources, including state, Alaskans (individuals, municipalities, Alaska Native corporations), and non-Alaskan third-party sources.
5. Obtain Approvals: Assist AGDC in obtaining necessary approvals from State and national entities (e.g., CFIUS).
6. Fundraising: Assist with fundraising and documentation of investment merits and risks.

10:24:39 AM

Senator von Imhof felt reassured that Ms. Tsu was part of the team. She noted that AGDC was asking for receipt authority. She assumed that the funding sources would occur in the upcoming summer. She wondered whether summer was the time to bring the model to the communities. Ms. Tsu replied in the affirmative.

[10:28:03 AM](#)

Senator von Imhof understood that there was some current money to complete FERC, but the question was whether \$60 million was sufficient. She felt that there was knowledge about questions to make informed decisions. She imagined that there would be great detail to make an informed decision. She wondered whether the third party funding sources would sign nondisclosure agreements, including municipalities, individual investors, and the state. Ms. Tsu replied that securities laws were in place to limit work with individuals. She stated that there was work with Hilltop Securities to understand all the requirements. She stated that there were some concerns about offering it to unsophisticated investors and the risk without full understanding.

[10:34:54 AM](#)

Senator Micciche understood that there were various factors in determination. He wondered whether the value of the peripheral benefits could replace the pure economics, and bring the state to a zero rate of return. Ms. Tsu replied that it was not her starting point. She distinguished between the stage of the project, the financing needs, and the return potential for that equity capital investment. She stressed that the early needed capital was to finalize much of the critical work to proceed with the final investment decision and construction.

[10:40:40 AM](#)

Senator Micciche requested assurance that there would not be an overplay of the less quantifiable benefits. Ms. Tsu replied that she hoped to address what could be quantified.

Co-Chair MacKinnon queried the process of the Committee on Foreign Investment. Ms. Tsu explained intention of the committee was to evaluate foreign investment in the U.S.

[10:46:35 AM](#)

Co-Chair MacKinnon explained that there was a trade deficit with a partner on the opportunity. She remarked that China had a different structure. Commissioner Fisher replied that the group was less involved in those discussions.

Ms. Tsu furthered that in addition to helping the trade balance and deficit with China, the project would provide access to a critical natural resource that would grow China's economy.

[10:50:04 AM](#)

Co-Chair MacKinnon stressed that she did not provide risk to the state with the conduit of financing.

Commissioner Fisher discussed slide 10, "DOR Deliverables: Tax As Gas (TAG)":

AS 43.05.010(17): DOR commissioner directs disposition of revenue from TAG

- If DNR elects Royalty-In-Kind (RIK), then producers have the option to elect Tax-As-Gas (TAG), although there are other triggers for a TAG election.
- Under current AGDC-led project structure, if DNR elects RIK, State could sell royalty gas and Tax-as-Gas to AGDC
- DNR is actively engaged with AGDC on discussions regarding Gas Sales Agreement
- Contract for sale of State's royalty and TAG gas by DNR will require royalty board recommendation and legislative approval
- If DNR elects RIK and the producers elect TAG, then DOR will establish regulations to support a TAG election.

Commissioner Fisher highlighted slide 11, "Anticipated Timeline for DOR Deliverables":

Final Report(s) to legislature on:

- Financing options for State of Alaska ownership in Alaska LNG project (as noted above, DOR/AGDC working on interim reports regarding whether State invests and options to do so)

- Plan for Municipalities, Regional Corporations, and residents to participate in ownership of project

Anticipated timeline: SB 138 requires these to be submitted at time DNR submits agreements, e.g. RIK gas sales agreement, for legislative approval under AS 38.05.020(b)(11)

Property tax proposal, allocation and disbursement:

Payment-in-lieu-of-Tax (PILT) is under consideration for construction period (C-PILT) and once project is operational (O-PILT)

Anticipated timeline: must be resolved before equity fund raising for bulk of construction costs.

Commissioner Fisher looked at slide 12, "DOR Interaction with AGDC":

DOR has one full-time RSA/staff position (Maria Tsu), reporting to Commissioner Fisher, assigned to work with AGDC. Ms. Tsu splits time between Atwood (20 percent) and AGDC's office (80 percent).

- Embedded into AGDC financial modeling group
- Fully integrated into team
- Participates in meetings with other AGDC teams (commercial, technical)
- Interacts with other Anchorage-based DNR and DOR staff

Ms. Tsu works closely with Commissioner Fisher and Deputy Commissioner Barnhill in coordinated effort to address issues.

As project ramps up, DOR may need to add resources to ensure expertise and work-load demands are satisfied.

[10:54:03 AM](#)

Senator Micciche shared that he had been seconded in the private sector. He requested that there be alliance to DOR. Ms. Tsu replied that she worked for the commissioner.

Commissioner Fisher discussed slide 13, "DOR Consultants":

DOR has two consultants (Greengate LLC and Hilltop Securities) under contract.

Greengate LLC is tasked with the following:

- Provide high-level review of AGDC financial model and suggest improvements
- Validate final AGDC financial model, which serves as basis for equity investor and DOR models
- Assist/provide input on DOR model to consider benefits to Alaska more broadly (royalties, taxes, jobs, economic growth, fiscal stability, etc.)
- Review/validate DOR model

Hilltop Securities is tasked with the following

- Provide expertise and advice on project finance and underwriting

DOR may engage additional consultants or advisors as project develops to provide independent expert advice in other areas.

#

ADJOURNMENT

[11:00:27 AM](#)

The meeting was adjourned at 11:00 a.m.