

HB

183

<TARGET><BILL>HB 183</BILL><SUBJECT>HB
183</SUBJECT><COMM>HCRA29</COMM></TARGET>

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Governor Bill Walker
STATE OF ALASKA

April 6, 2015

The Honorable Mike Chenault
Speaker of the House
Alaska State Legislature
State Capitol, Room 208
Juneau, AK 99801-1182

Dear Speaker Chenault:

Under the authority of Article III, Section 18, of the Alaska Constitution, I am transmitting a bill relating to the assessment of property for the property tax for a North Slope natural gas project.

Due to the achievements by the Municipal Advisory Gas Project Review Board and the Alaska Liquefied Natural Gas project, it is time to move forward with legislation to address the property tax on a North Slope natural gas project. Revenues from the property tax on a North Slope natural gas project are anticipated to provide vital support for the State and local governments to establish sustainable fiscal platforms.

The bill would provide a framework for the assessment of property tax on a North Slope natural gas project once the project begins to transport gas. The assessment for property exclusively used for a North Slope natural gas project would be based on the full and true value of the property determined by adjusted original cost and annualized throughput. The bill would define a North Slope natural gas project for the purposes of the property tax to include a gas treatment plant, a gas pipeline, a liquefaction plant, and a marine terminal. Consistent with the concerns expressed by local governments and legislative direction last year, the property tax on existing North Slope oil and gas and pipeline properties would be unchanged by this bill.

There is still much work to be done before this all-important project can be built. This bill demonstrates my Administration's continued commitment to building a gasline to provide gas to Alaskans and liquefied natural gas to world markets. I urge your prompt and favorable action on this measure.

Sincerely,

A handwritten signature in blue ink that reads "Bill Walker".

Bill Walker
Governor

Enclosure



THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

Department of Revenue

COMMISSIONER'S OFFICE

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April 7, 2015

The Honorable Cathy Tilton, Chair
House Community & Regional Affairs Committee
State Capitol Building
Juneau, AK 99801

Dear Representative Tilton:

The Department of Revenue (DOR) respectfully requests that HB 183, "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," be scheduled in the House Community & Regional Affairs Committee at your earliest convenience.

Your favorable consideration of this request is appreciated. If you need any additional information, please contact Jerry Burnett, Deputy Commissioner for the Department of Revenue at 907-465-3669.

Sincerely,

A handwritten signature in blue ink, appearing to read "Randall J. Hoffbeck".

Randall J. Hoffbeck, Commissioner

Cc: Darwin Peterson, Legislative Director, Office of the Governor
Jerry Burnett, Deputy Commissioner, Department of Revenue
Ken Alper, Director, Tax Division, Department of Revenue



HB183

Presentation to House Community & Regional Affairs

April 16, 2015

Randall J. Hoffbeck, Commissioner
Alaska Department of Revenue



Components of Property Tax that need to be Considered for the AKLNG Project

- Impact Payments during the construction period in lieu of property tax payments
- **Durable and predictable property tax payments during operational period**
- Distribution of revenues among State and Local Government entities

Initial Feedback from the Municipal Advisory Gas Project Review Board (MAGP Board)

- **Fair**
 - Must be fair and equitable to all stakeholders
- **Clear**
 - Must be easily understood
- **Robust/Durable**
 - Should be able to cope with future changes
- **Unambiguous**
 - Should not be subject to judgment and interpretation
- **Commercially Sound**
 - Must not exceed an amount that would unreasonably impact the AK LNG project ability to compete in global markets

Initial Feedback from AK LNG Producers

- **Simpler is better**
 - Fewer variables is preferred
- **Prefer a general property tax formula**
 - Enacted as a law of general application
 - Meets AK LNG Project economic expectations
 - Acceptable to the municipalities
- **Prefer a flow related property tax payment**
 - Fixed unit rate per actual (not design) throughput basis (e.g., ¢/mcf or ¢/mmbtu)
 - Adjusts annually by known non-variable factors

Formulaic Interpretation of Initial Feedback

$$\left(\text{Actual Cost} \times \left(\frac{\text{Actual Gas Flow}}{\text{Design Throughput}} \right)^n \times \frac{\text{Year (n) Index} - y}{\text{Year (0) Index}} \times 20 \text{ mills} \right) \times \text{Adjustment Factor}$$

Additional Feedback from AK LNG Producers

1. Mill Rate

- Currently, the proposed LNG plant and terminal (possibly the GTP also) are excluded from the definition of “taxable property” subject to the 20 mill rate under AS 43.56. Mill rates under AS 29.45 are sometimes lower and prevailing rates in the relevant jurisdictions should inform final Mill rate in the LNG (and possibly the GTP) PILT formulation.

2. Capital Cost

- The Project cost estimated at FEED or FID (Final Investment Decision) in lieu of actual Project cost determined after completion could be adopted for additional simplicity and to remove as constructed actual cost uncertainty for an FID decision.

3. Depreciation/Obsolescence

- Depreciation/obsolescence are acknowledged features of the current methodology, and a factor should be included in the formula to address them.

4. Flow Adjustment

- The HOA between the parties contemplates payments in lieu of property taxes (PILT) for each property based on a simple unit rate per throughput basis.
- Use of an exponent may detract from the ability to use a single, durable formula for debottlenecking and expansion.
- Flow variations could be dealt with through monthly averaging.

5. Inflation

- Inflation is an acknowledged feature of the current methodology (e.g., replacement cost), but represents a future variability risk. A fixed escalation would remove that risk.

6. Adjustment Factor

- This factor could be viewed as arbitrary. A formula that is sufficiently robust would avoid use of an adjustment factor.

MAGP Board Recommendation (March 13, 2015)

MAGP Board Recommendation (Formula)

$$\left(\text{Capital Cost} \times (1 + e)^m \times \text{Depreciation Factor} \times \left(\frac{\text{Actual Throughput}}{\text{Design Throughput}} \right)^n \times \text{Mill Rate} \right)$$

n = exponent to dampen effect of actual flow
e = annual escalation rate
m = years of operation (startup = 0)

MAGP Board Recommendation (Formula Values)

Capital Cost = FID estimate x 1.1
e = 4% per annum
Depreciation Factor based on 50 year floating life
Actual Throughput = 5 year floating average
n = 1
Mill Rate based on current statutes for all Project assets including LNG Plant

Subsequent Feedback from AK LNG Producers

1. Formula Values

- Commercial soundness can be accommodated through adjustments in the formula

2. Capital Cost

- If use constructed actual cost instead of pre-FID estimated cost, then a cost overrun would damage project economics, so consider a mechanism that doesn't exacerbate consequences of overrun.

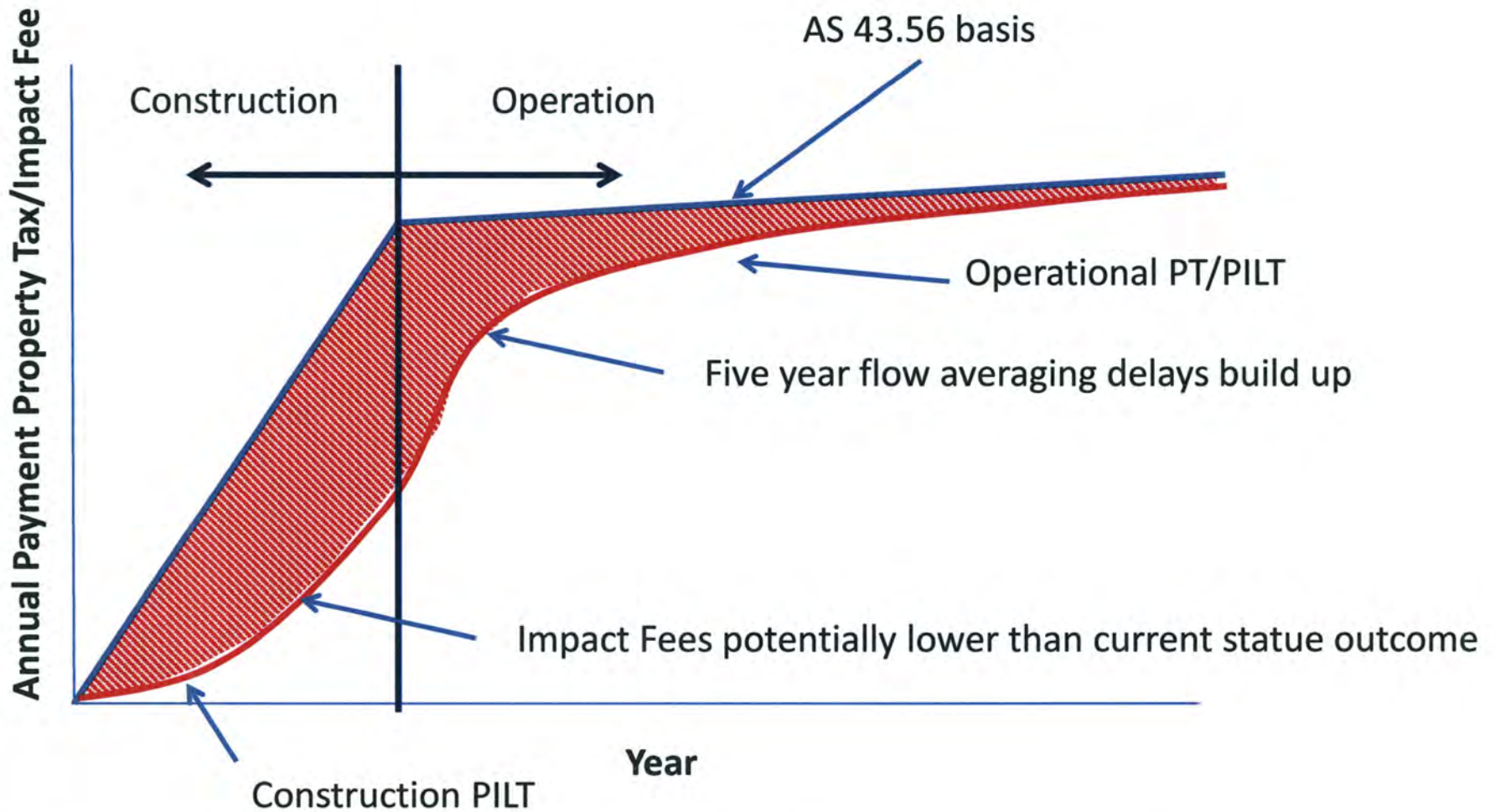
3. Depreciation/Obsolescence

- Instead of using depreciation formula, consider averaging asset value over time (depreciating to a fixed minimum), and applying a single averaged factor.

4. Inflation/Escalation

- Consider slope (i.e., lower initial PT, with an agreed escalation)

Potential Project Benefits



**Schematic, not to scale, representative of one of a number of potential outcomes*

HB 183 Recommendation

$$\left(\text{Original Cost} \times \text{Inflation Factor} \times \text{Depreciation Factor} \times \left(\frac{\text{Actual Throughput}}{\text{Design Throughput}} \right) \times 20 \text{ Mills} \right)$$

Original Cost = Fixed by pre-FID project specific data/fiscal agreement

Inflation Factor = Fixed by fiscal agreement

Depreciation Factor = Fixed by fiscal agreement

Actual Throughput = Operational measurable

Design Throughput = Fixed by pre-FID project specific data

Mill Rate = Fixed by Statute, with total take adjusted by fiscal agreement

THANK YOU

Please find our contact information below:

Randall Hoffbeck

Commissioner

Alaska Department of Revenue

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MIKE NAVARRE
BOROUGH MAYOR

April 14, 2015

Representative Cathy Tilton, Chair
House Community and Regional Affairs Committee
Alaska State Legislature
Room 411
State Capitol, Juneau

Dear Representative Tilton and Committee Members,

As you would expect, the Kenai Peninsula Borough and its almost 60,000 residents are keenly interested in House Bill 183, regarding the assessment of property taxes on a North Slope natural gas project, as we focus on seeing this project move forward in the best interests of all Alaskans for decades to come. The economics of financing, building and operating the facilities and marketing liquefied natural gas in today's global marketplace are challenging, with multiple LNG hopefuls worldwide all competing for the same customers. As such, the Kenai Peninsula Borough sees the need — and the wisdom — of adopting a fiscal structure that will allow an Alaska North Slope gas pipeline and LNG project to succeed in that competitive environment.

A key part of that fiscal structure is property taxes; key for the municipalities affected by the project and key for the project sponsors as they strive to determine all of their costs before committing to tens of billions of dollars in debt and equity to pay for construction. Looking at the decades of contentious litigation between the trans-Alaska oil pipeline owners and the state and municipalities, arguing over the assessed value of the oil line and related facilities, it's important that all parties avoid a repeat of a similar property tax debate over a North Slope gas project. The investment decision cannot afford that level of fiscal uncertainty, nor can the affected municipalities.

As a member of the Municipal Advisory Gas Project Review Board (more often called the Municipal Advisory Group, or MAGP), I have been involved in the search for the best way to avoid years of disputes over the property tax assessment for a natural gas pipeline and liquefaction plant, and I believe the bill before you Thursday, April 16, House Bill 183, is a good step toward a solution. The bill is far from complete but, while it currently lacks details and will require more work to meet the needs of all parties, it provides positive momentum toward a successful project. It is good to see the administration and legislature willing to address this issue, one of the many complex components necessary to advance an Alaska North Slope gas pipeline and LNG project that will benefit all Alaskans.

If we're willing to learn from our history, I'm confident there is a better way to assess the property tax liability of a North Slope gas project. The proposal HB183 of an alternative calculation, as proposed for AS43.56.060(h), looks to be a good way to get there, certainly a more durable way than decades of fighting over the replacement value, income-producing value or depreciated value of a world-class investment for which there are no easily quantifiable comparables.

I commend the administration for working on legislation intended to protect municipalities' interests while treating the project sponsors fairly. I also commend the House Community and Regional Affairs Committee for making time to hear the bill in these final days of the regular legislative session.

Please call on my office for any assistance we can provide as work continues on this bill after adjournment of the regular session. Only through a concerted effort by the state, municipalities and project partners can we get where we need to go with this bill — a fair solution to property taxes and a successful project investment decision.

Sincerely,

A handwritten signature in blue ink that reads "Mike Navarre". The signature is written in a cursive, flowing style.

Mike Navarre
Mayor

HB 183 COMMENTARY

**Presentation to House Community and Regional Affairs Committee
Juneau, Alaska > Thursday, April 16, 2015**

Janak Mayer, Partner > janak.mayer@enalytica.com

Nikos Tsafos, Partner > nikos.tsafos@enalytica.com

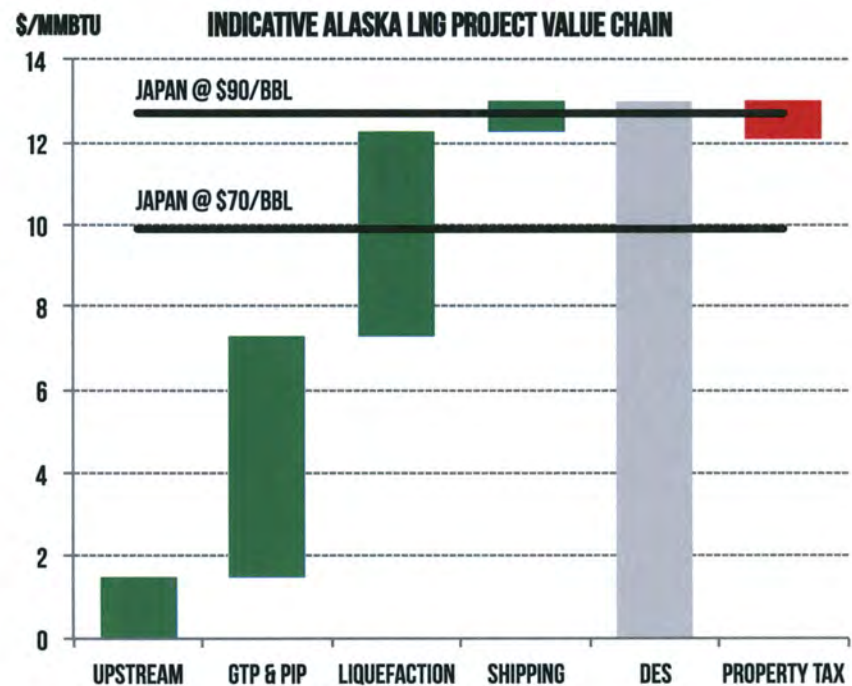
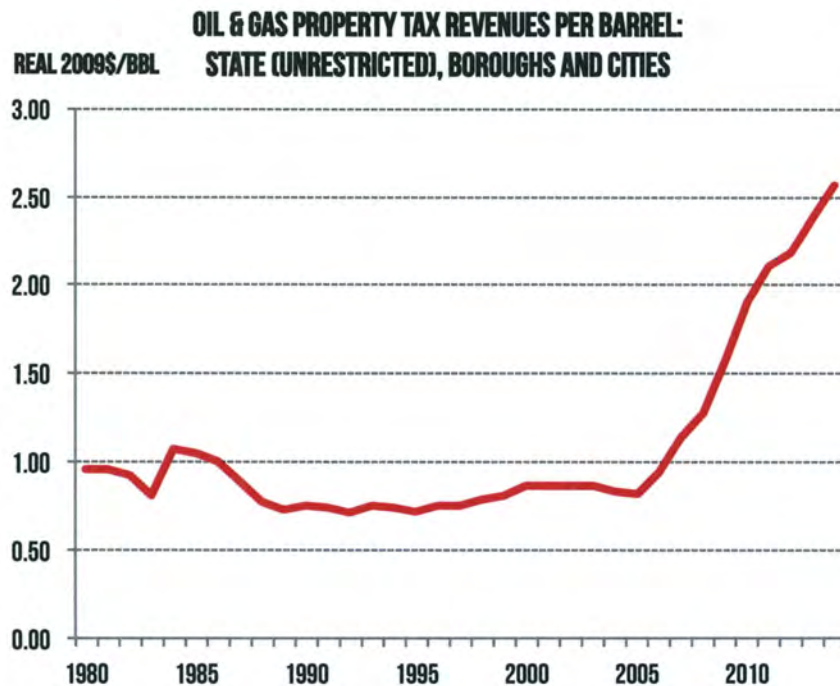
<http://enalytica.com>

Why property tax matters?

- Lots of money (e.g. \$1 bn)
- Long construction period
- Regressive (fixed regardless of revenue)
- Possibly contentious (given history)

What does a good framework look like?

- Clear formula (simple)
- Predictable / stable
- Balanced (fair, equitable)
- Enables project development



SOURCE: ANALYTICA BASED ON DOR, REVENUE SOURCES BOOK (VARIOUS EDITIONS); DEPARTMENT OF COMMERCE, COMMUNITY, AND ECONOMIC DEVELOPMENT, ALASKA TAXABLE (VARIOUS EDITIONS)

PILT VS PROPERTY TAX STATUTE

Negotiated PILT

Simple, stable \$/mcf payment

Numerous payment profiles possible

Contractual - stabilization implicit

Separated from property assessment

Property Tax

Emulate PILT \$/mcf figure through property tax

Depreciation/Inflation - limited levers

Additional stabilization essential

Link to property assessment remains

WHOLE PROJECT UNDER AS43.56

If property tax approach were to be taken (rather than PILT) may make sense - uniform regime, not municipal patchwork

Represents a significant tax increase over status quo - cause for concern for companies

Is 20 mill rate simply a starting point for negotiations?

TREATMENT OF TRANSMISSION LINES

HB183 project definition excludes transmission lines from Point Thomson / Prudhoe Bay to the Gas Treatment Plant.

Differs from project definition in SB138 - implying transmission lines would not benefit from negotiated property tax / PILT treatment

PAYMENTS DURING CONSTRUCTION

Agreed framework is that payments during construction should be limited to impact payments, not property tax
Not currently reflected in bill

IMPORTANCE OF MILESTONES

Companies & SOA currently maintaining high level of project spending - contingent on meeting milestones
Authorization for PILT negotiation key milestone for this session

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