

SB

176

<TARGET><BILL>SB 176</BILL><SUBJECT>SB
176</SUBJECT><COMM>SRES30</COMM></TARGET>



Tax Credit Bond Legislation

SB 176

SECTIONAL ANALYSIS

FOR SENATE RESOURCES

Section 1:

Exempts the bond corporation created in Sec. 2, and any overriding royalty interests negotiated under Sec. 11, from the procurement code.

Section 2:

Establishes the Alaska Tax Credit Certificate Bond Corporation within DOR. *[Largely patterned after Alaska Pension Obligation Bond Corporation, AS 37.16]*

37.18.010 Creates the corporation.

37.18.020 Establishes the board of directors, all of whom are state department commissioners.

37.18.030 Authorizes the corporation to issue bonds up to \$1 billion and contract for associated services.

37.18.040 Authorizes the corporation to have a reserve fund which will hold funds to be used for purchases of certain tax credits, as well as funds appropriated for the purpose of interest and principal payments to bond holders.

37.18.050 Authorizes the corporation to set the terms of bonds to be issued; authorization expires December 31, 2021.

37.18.060 Corporation must adopt a resolution to approve the issuance of bonds.

37.18.070 Gives certain enforcement rights to certain bond holders.

37.18.080 Bonds may not be issued unless the discount rate by which tax credits are purchased is at least 1.5% greater than the total interest cost of the bonds.

37.18.090 Corporation may refund bonds prior to the maturity date.

37.18.100 Bonds are legal instruments.

37.18.800 This chapter shall be liberally construed to carry out its purposes.

37.18.810 Corporation may adopt regulations necessary to implement this chapter.

37.18.900 Definitions.

Section 3:

Amends the Gas Storage Credit in the corporate income tax statutes to enable purchase of any credits via the bond program.

Section 4:

Amends the LNG Storage Credit in the corporate income tax statutes to enable purchase of any credits via the bond program.

Section 5:

Amends the Refinery Infrastructure Credit in the corporate income tax statutes to enable purchase of any credits via the bond program.

Sections 6-9:

Amends various provisions of AS 43.55.028, the tax credit purchase fund.

Section 6:

.028(e) The department may either use the tax credit fund money, or money disbursed from the bond program, to purchase tax credits. Written to maximize flexibility and retain the existing program and procedures.

Section 7:

.028(g) Clarifies that the current \$70 million per company per year cap, with the associated "haircut", does not apply to purchases via the bond program.

Section 8:

.028(i) Adds definitions for "money disbursed to the commissioner," and "total interest cost."

Section 9:

.028(j) Clarifies that if a company has an outstanding liability to the state, this can be offset against a payment via the bond program as well as via traditional purchase.

Section 10:

Adds new subsections to AS 43.55.028 specific to the bond purchase program

- .028(k)** New subsection authorizing the department to negotiate a purchase of all credits held by a company, and describing how the holder of credits indicates their desire to participate in the program. This subsection contemplates that if a holder of credits existing at the time of a bond issuance declines to participate in the program, such holder is precluded from submitting such existing credits for purchase in connection with future bond issuances. This provision does not preclude such holder from submitting credits claimed after a bond issuance for purchase in connection with a future bond issuance.
- .028(l)** New subsection describes how the department calculates a purchase when using money disbursed to the commissioner from bond proceeds. This calculation includes the mechanism by which the department estimates the assumed cash flow to a company via the current purchase process from the oil and gas fund based on assumed future annual appropriations and the assumed prorated share of each year's funds. From this estimate, a purchase offer can be calculated based on the discount rate determined in (m).
- .028(m)** New subsection establishing a base discount rate of 10%, with four methods to reduce this to a number equal to total interest cost + 1.5%.

 1. For a seismic credit, the company has waived the 10 year confidentiality period for the data;
 2. The company has agreed to an overriding royalty interest (ORRI) agreement with the Department of Natural Resources;
 3. The company has committed reinvest the entire amount received within an Alaska oil and gas project within 24 months; or
 4. The credit is against the corporate income tax, primarily impacting refinery infrastructure credits.
- .028(n)** New subsection clarifying that the amount of a credit in excess of the discounted amount purchased retains no value and cannot be used against taxes or sold.

Section 11:

Authorizes the Department of Natural Resources to negotiate Overriding Royalty Interests (ORRI) in the proceeds of future oil production. These are then valued, and a determination is made whether the incremental value received by the state warrants the approval of the lower discount rate for purposes of credit purchase. The form of the interest and the payment amount are set in statute.

Section 12:

Authorizes DNR and DOR to adopt regulations to implement this act

Section 13:

Authorizes retroactive application of regulations.

Section 14:

Immediate effective date.

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Governor Bill Walker
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February 2, 2018

The Honorable Pete Kelly
President of the Senate
Alaska State Legislature
State Capitol, Room 111
Juneau, AK 99801-1182

Dear President Kelly:

Under the authority of Article III, Section 18, of the Alaska Constitution, I am transmitting a bill to create a State corporation authorized to issue bonds for the purpose of purchasing oil and gas exploration tax credits.

The passage of legislation last year, HB 111 (CH. 3, SSSLA 17), signaled the end of the State's program to purchase oil and gas tax credits. These credits were earned by small producers and explorers; major producers have always been ineligible to participate. Since the beginning of this program in 2007, Alaska has purchased over \$3.5 billion in these credits, with about \$800 million currently in company hands awaiting payment. Another \$200 million are expected before the program is fully terminated. Just as we value our large producers, we value these small producers. Some of the most exciting new developments in the past few years are the result of the efforts of these new small producers.

After the downturn in oil prices and the State's budget challenges, the State was no longer able to purchase these credits as quickly as they were submitted. Since 2016, the State has appropriated funds based on a statutory formula, resulting in the large accrued balances. The payment delay has resulted in significant uncertainty for Alaska's small producers, some of whom have had a difficult time borrowing additional money to complete their projects. Last year's legislation to end the program was an important step towards restoring the State to a more stable fiscal foundation. This bill would allow the State to take the next vital step in resolving the State's oil and gas tax credit obligation.

The bill would establish an Alaska Tax Credit Certificate Bond Corporation that would be authorized to issue up to \$1 billion in bonds to finance purchases of oil and gas tax credits at a discount from face value. This discount offered to these small producers would then be used to pay the cost of financing the bonds. In short, the State would not bear the cost of financing the bonds, but rather that would be paid by the small producers. The bonds would not constitute a general obligation of the State. The corporation's authority to issue bonds would expire on December 31, 2021.

The Honorable Pete Kelly
February 2, 2017
Page 2

This bill would provide authority for the Department of Revenue to negotiate the purchase of tax credits at less than full value when bond proceeds are used for those purchases. Under the bill, applicants that have requested purchase of tax credits from the oil and gas tax credit fund would notify the Department of Revenue of interest in purchase of tax credits from bond proceeds at a discounted amount. Those applicants would need to include all tax credits requested for purchase from the fund in the notice of interest. A purchase offer amount by the Department of Revenue from bond proceeds would be determined by discounting the face amount of such tax credits based on the assumed payment schedule of the tax credits if the Department of Revenue had purchased the tax credits through the oil and gas tax credit fund over a number of years.

The face amount of the tax credits would be discounted each year by 10 percent. A lower discount could apply for an applicant that agrees to one or more conditions that provide additional value to the State. These conditions include agreements for overriding royalty interests, waivers of confidentiality for early release of seismic data, and commitments to make future qualified capital expenditures in the state. The lower discount rate would apply automatically to purchases of certain corporate income tax credits for gas storage facilities and in-state oil refineries. The lower discount rate will be based on the State's true interest cost plus 1.5 percent, which we currently estimate will be about 5.5 percent. The corporation would not issue bonds unless it found that the discount rate applied in the Department of Revenue's purchase of the tax credits would exceed the State's true interest cost on the bonds by at least 1.5 percent per year.

The Department of Natural Resources would handle the agreements for overriding royalty interests and waivers of confidentiality for early release of seismic data. The bill would have an immediate effective date. The immediate effective date would allow the new Alaska Tax Credit Certificate Bond Corporation, the Department of Revenue, the Department of Natural Resources, and those requesting purchase from the oil and gas tax credit fund the ability to start work right away to address these tax credits.

I am proposing this bill to achieve a fair resolution to the oil and gas tax credit purchase program, and to free up capital for the small companies impacted by the program to resume investing in future oil production. Passage of this bill would allow the state to move past the uncertainty on these tax credits and focus on growing Alaska.

I urge your prompt and favorable action on this measure.

Sincerely,



Bill Walker
Governor

Enclosure

ALASKA Journal of Commerce ^(S)

GUEST COMMENTARY: Bill to pay off credits fulfills state side of bargain

By: Sheldon Fisher (/authors/sheldon-fisher),

Guest commentary

Post date: Wed, 02/07/2018 - 8:10am



Alaska Revenue Commissioner Sheldon Fisher hopes that oil and gas companies owed tax credit payments by the state will be open to a proposal to take a discount on what they're due in exchange for being repaid quicker. Gov. Bill Walker is proposing selling bonds to pay off some \$900 million in such credits, with the discount taken by companies enough to offset the state's borrowing costs on the bonds. (Photo/Becky Bohrer/AP)

This week, the Walker Administration introduced a bill to pay off up to \$1 billion of outstanding oil and gas tax credits by issuing bonds to pay for them at a fair discount. By purchasing these tax credits held by small oil and gas exploration companies, the bill will free up frozen credit markets to allow new exploration and development to continue.

This bill is part of Gov. Bill Walker's economic stimulus plan calculated to put Alaskans back to work, and will ultimately result in increased production, leading to increased revenue for the benefit of all Alaskans.

Some Alaskans are asking hard but good questions about why we are doing this.

First some background. Last year, we worked with the Legislature to end the cashable oil and gas tax credits program. In many cases the program had worked — it brought small oil and gas exploration companies to Alaska to look for new fields.

In Cook Inlet, the tax credit program largely solved the serious problem of disappearing gas supplies — gas that Alaskans need for electricity to light and heat their homes. And there have been new large oil discoveries on the North Slope, like the Pikka field, that have promise to put substantial volumes into the pipeline and bring new revenues to the State.

With the passage of House Bill 111 last year, we have ended the program of cashable oil and gas tax credits. The tax credits had quickly added up to a huge sum, and given the collapse in oil prices, the state was simply unable to continue paying them immediately.

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The point of this bill is to be able to "clear the decks" and put the saga of cashable oil and gas tax credits behind us.

Alaskans are asking, why provide a bail-out to large oil and gas companies? We aren't. The point of the tax credits was to encourage small oil and gas companies to explore for new oil and gas reserves. We promised cash and they came. Not only that, they employed Alaskans.

They borrowed hundreds of millions from banks and attracted capital from investors. They spent this money and hired Alaskans. In many cases they found new oil and gas. The production from these new finds will create new revenues for all Alaskans. We need to fulfill our side of the bargain.

Alaskans should know that the bill is cost neutral to the state. We are asking for a fair discount from face value when we buy the tax credits under this bill. The small oil and gas companies get paid immediately, but they will take a discount that will cover our cost of paying the bonds.

The companies have the option to take a smaller discount, but in that case, they have to commit to further in-state capital expenditures or give the state an additional royalty. This is a win-win for Alaskans.

We are proposing this program to achieve a fair resolution and conclusion to the cashable oil and gas tax credit system. Fair to the State, fair to Alaskans, and fair to the small oil and gas exploration companies that came and did what we asked them to do: look for new oil and gas resources.

We look forward to successful outcomes: fully and quickly extinguishing these tax credits, completion of the exploration and development of prospects funded by the tax credits, new production, and new oil and gas revenues for the state.

More investment means more jobs for Alaskans. More production equals more revenue to benefit all Alaskans.

Sheldon Fisher is the commissioner of the Department of Revenue.

Updated: 02/07/2018 - 8:19am

Comments

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Alaska Journal of Commerce

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Tax Credit Bond Legislation – Model for 2018 Bond Issuance

Estimated State Borrowing Cost	3.62%	Amt to be financed	\$653.35	Financing Cost Armt	\$6.53
Required Spread (in legislation)	1.50%	Interest Rate	3.62%	Total Amt Financed	\$659.88
Discount Rate for Tax Credits	5.12%	Term	10 years	Earnings Assumption	5.0%
		Financing Costs	1%		

Table 1: Tax Credit Discounting	Tax Credit Payment Schedule per Revenue Sources Book		Due to be Pd (per statute)	Years Discount	Discounted Present Value	\$ Discount from Face	% of Face Value Paid
	FY Tax Credit Presented						
	\$206.00	CY 2016	FY 2019	0	\$206.00	\$0.00	100.0%
	\$167.00	CY 2016	FY 2020	1	\$158.87	-\$8.13	95.1%
	\$119.00	CY 2016 - 2017	FY 2021	2	\$107.69	-\$11.31	90.5%
	\$132.00	CY 2017	FY 2022	3	\$113.64	-\$18.36	86.1%
	\$82.00	CY 2017	FY 2023	4	\$67.15	-\$14.85	81.9%
	<u>\$706.00</u>				<u>\$653.35</u>	<u>-\$52.65</u>	<u>92.5%</u>

Table 2: Discounting Comparison		% of Face Value Paid @ Discount Rate:		10% Discount Rate: No strings attached 5.12% Discount Rate: Overriding Royalty, Capital Commitment or Waiver of Seismic Confidentiality
Due to be Paid	# Years Discount	10%	5.12%	
FY 2019	0	100.0%	100.0%	
FY 2020	1	90.9%	95.1%	
FY 2021	2	82.6%	90.5%	
FY 2022	3	75.1%	86.1%	
FY 2023	4	68.3%	81.9%	

Table 3: Bond Amortization Schedule		Req. Balance	Interest	Principal	P+I	Ending Balance
FY19		\$659.88	-\$23.89	\$0.00	-\$23.89	\$659.88
FY20		\$659.88	-\$23.89	\$0.00	-\$23.89	\$659.88
FY21		\$659.88	-\$23.89	-\$30.69	-\$54.58	\$629.19
FY22		\$629.19	-\$22.78	-\$58.53	-\$81.30	\$570.66
FY23		\$570.66	-\$20.66	-\$79.62	-\$100.28	\$491.04
FY24		\$491.04	-\$17.78	-\$91.36	-\$109.13	\$399.69
FY25		\$399.69	-\$14.47	-\$94.66	-\$109.13	\$305.03
FY26		\$305.03	-\$11.04	-\$98.08	-\$109.13	\$206.95
FY27		\$206.95	-\$7.49	-\$101.63	-\$109.13	\$105.31
FY28		\$105.31	-\$3.81	-\$105.31	-\$109.13	\$0.00
Total			-\$169.69	-\$659.88	-\$829.57	

Table 4: Equivalency	Tax Credit Approps		Debt Svc Approps
	Made	Not Made	
FY19	\$206.00	\$23.89	\$23.89
FY20	\$167.00	\$23.89	\$23.89
FY21	\$119.00	\$54.58	\$54.58
FY22	\$132.00	\$81.30	\$81.30
FY23	\$82.00	\$100.28	\$100.28
FY24		\$109.13	\$109.13
FY25		\$109.13	\$109.13
FY26		\$109.13	\$109.13
FY27		\$109.13	\$109.13
FY28		\$109.13	\$109.13
Total	\$706.00	\$829.57	\$829.57
Net Present Value @ 5% discount rate:	\$654.47	\$607.21	
Net PV Savings:	\$47.26		

Regarding SB 176

Hello There,

My name is Ryan McGovern and I work with United Association Local Union #375 Plumbers and Pipefitters of Fairbanks, And I'm calling in today regarding SB #176.

Thank you all for accepting my call, and I'd like to thank Governor Walker for introducing this in my opinion very important bill and also Sen, Giessel for hearing it today.

Reason's I support SB 176 include the need for the State of Alaska to recognize the obligation and responsibility it has to repay the credits already earned. Doing so would show prospective investors and companies looking to get involved in Alaskan business, that the State is committed to making and following through on deals and or investments needed to make things happen.

I can imagine that those who've earned the credits are understandably reluctant to invest more money knowing that the last promise made didn't come to fruition, I know I'd be.

Another reason I support the bill is that the debt has been made, it exists and eventually must be paid. It's not going away, therefore if the State can satisfy their obligation to pay those credits while doing so at a discount that would save money immediately by replacing the \$140 million that is the DOR suggested statutory minimum payment, with a \$34 million-dollar bond debt payment. How doesn't that make sense considering the State's current financial deficit?

Passing this Bill could spur new investment that would put more Alaskans to work, help repair Alaska's damaged reputation that no doubt exists in investors' minds, and hopefully that will lead to even more future investment and improved relations with the company's owed and the investors looking to get involved.

Alaska Oil and Gas Association



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Anchorage, Alaska 99503-2035
Phone: (907) 272-1481 Fax: (907) 279-8114
Kara Moriarty, President/CEO

AOGA Testimony

SB 176 – Senate Resources Committee

March 23, 2018

Chair Giessel, members of the Committee, thank you for the opportunity to testify on Senate Bill 176. For the record, my name is Brandon Brefczynski and I am the External Affairs Manager for the Alaska Oil & Gas Association, commonly referred to as “AOGA.” AOGA is a private trade association that represents the majority of oil and gas producers, explorers, refiners, and transporters of Alaska’s oil and gas. The following testimony reflects the opinion of our membership.

AOGA supports an expedited resolution this year to refund the earned credits. Companies earned these credits by investing hundreds of millions of dollars to hire Alaskans for the exploration and production of oil. The delay in the rebates has damaged the state’s reputation and chilled future investment; caused projects to be shelved, resulting in negative economic impacts to the state and local communities; and many Alaskans are now out of work, especially within the oil and gas industry.

AOGA believes the state should honor all outstanding earned tax credits in full, and in as expedited process as possible. The Governor’s bill is an innovative approach that seeks to refund a portion of the earned credits via bonding to raise the money, then refunding the credits at a reduced rate. The Governor proposes to lower the refunding rate to cover the state's bond finance costs. AOGA has concerns about the steep discount rates and other provisions of the bill. But AOGA is committed to working with the administration and legislature to finding an equitable solution – it's simply too important. AOGA does applaud the administration for acknowledging that refunding these payments is a critical step this year.

AOGA supports an equitable plan that will refund the entirety of the earned credits this year: Let’s send a strong signal to investors that Alaska is open for business and attract much needed new investment to employ Alaskans, produce more oil, and drive Alaska’s economy forward. Thank you.

Fiscal Note

State of Alaska
2018 Legislative Session

Bill Version:	SB 176
Fiscal Note Number:	2
(S) Publish Date:	3/26/2018

Identifier: DOR-TAX-2-5-18
 Title: TAX CREDIT CERT. BOND CORP; ROYALTIES
 Sponsor: RLS BY REQUEST OF THE GOVERNOR
 Requester: House Rules Committee

Department: Department of Revenue
 Appropriation: Taxation and Treasury
 Allocation: Tax Division
 OMB Component Number: 2476

Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2019	Included in	Out-Year Cost Estimates				
	Appropriation Requested	Governor's FY2019 Request	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
OPERATING EXPENDITURES	FY 2019	FY 2019					
Personal Services							
Travel							
Services							
Commodities	2.5		2.5	2.5	2.5	2.5	2.5
Capital Outlay							
Grants & Benefits							
Miscellaneous							
Total Operating	2.5	0.0	2.5	2.5	2.5	2.5	2.5

Fund Source (Operating Only)

1004 Gen Fund (UGF)	2.5		2.5	2.5	2.5	2.5	2.5
Total	2.5	0.0	2.5	2.5	2.5	2.5	2.5

Positions

Full-time							
Part-time							
Temporary							

Change in Revenues

None							
Total	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Estimated SUPPLEMENTAL (FY2018) cost: 0.0 (separate supplemental appropriation required)
 (discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2019) cost: 0.0 (separate capital appropriation required)
 (discuss reasons and fund source(s) in analysis section)

ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? Yes
 If yes, by what date are the regulations to be adopted, amended or repealed? 01/01/19

Why this fiscal note differs from previous version/comments:

Initial Version

Prepared By:	Ken Alper, Director	Phone:	(907)465-8221
Division:	Tax Division	Date:	01/02/2018 06:00 PM
Approved By:	Mike Barnhill	Date:	01/31/18
Agency:	Department of Revenue		

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2018 LEGISLATIVE SESSION

Analysis

Bill Background and Structure

This bill is intended to provide a mechanism for oil and gas explorers and small producers to obtain payment towards the tax credits they are currently holding awaiting state repurchase. For several years, the legislature authorized open-ended appropriation language in the annual budget, so the state repurchased all certificates that were presented. Beginning in FY2016, the annual spend has been capped in the budget, with the number in FY2017 and 2018 being based on the statutory calculation in AS 43.55.028(b) and (c). The net result of this has been delay and uncertainty for these companies, as well as in some cases their inability to borrow additional funds.

The legislation accomplishes four primary things. First, it creates a new state bond corporation empowered to sell up to \$1 billion in bonds to repurchase outstanding oil and gas tax credits. Second, it establishes rules and criteria by which to determine the expected cash flow of credit repurchases to a company, in order to calculate a discounted value. This will enable the department to make an offer to purchase them with bond proceeds at a particular discounted value. Third, it describes the multiple methods by which a company can obtain a lower discount rate, and by extension a higher repurchase offer. Finally, it establishes a process for the Department of Natural Resources to negotiate an overriding royalty interest, the acceptance of which is one of the methods to obtain the lower discount rate. The program is designed as a choice for producers, with the option retained for a company to await regular appropriations instead of participating in the bond repurchase program.

Scope of Issue

At the end of calendar year 2017, about \$800 million in tax credits are outstanding that are awaiting state repurchase. Of these, about half requested repurchase in 2016, and the rest in 2017. Current law ensures that the older credits are paid first out of available funds. Most cashable tax credits were repealed by the legislature in 2017 via HB111, although it will take some time for the remaining credits to work their way through the process. The Department of Revenue expects about another \$200 million in credits to be awarded over the next several years. Of this \$1,000 million in possible demand, the Department expects about \$100 million to be transferred (sold) to major producers to offset taxes, leaving \$900 million potentially available for the bond repurchase program. If all of these credits are offered into the program, the state will pay between \$700 and \$800 million depending on the discount rate. The intent is for the state to pay off the bonds over 10 years, with the first two years' payments being interest only, with rising payments for three years, and flat payments thereafter. The debt service and other bond costs will be more than offset by the savings received by the state through discounts to the tax credit obligations.

Method of Determining Discounted Value

In order to determine the discounted value the state will offer, the bill provides a process to estimate what a producer's expected payment amount and timing would be in future years, based on several factors. These include the amount of credits held by a given company, the year in which those credits were received and requested state repurchase, the proportion of the certificates from a given year held by each company, and the expected annual statutory appropriation. Based upon the most current revenue forecast, that statutory appropriation would be: FY2019- \$206 million; FY2020- \$167 million; FY2021- \$119 million; FY2022- \$132 million; FY2023- \$135 million; FY2024- \$139 million. These numbers are likely to change with the spring revenue forecast, which would impact the final calculations should this bill become law.

Implementation Cost

The department anticipates that the tasks required to implement this bill will be absorbed within existing staff. The only new funds being requested are the cost of agent fees to be paid by the new Alaska Tax Credit Certificate Bond Corporation, which will total about \$2,500 per year when bonds are outstanding. The cost of issuing the bonds will be built into the state's future the interest and principal payments.

Fiscal Note

State of Alaska
2018 Legislative Session

Bill Version:	SB 176
Fiscal Note Number:	1
(S) Publish Date:	2/5/2018

Identifier: 0863-DNR-DOG-01-29-18
 Title: TAX CREDIT CERT. BOND CORP; ROYALTIES
 Sponsor: RLS BY REQUEST OF THE GOVERNOR
 Requester: Governor

Department: Department of Natural Resources
 Appropriation: Oil & Gas
 Allocation: Oil & Gas
 OMB Component Number: 439

Expenditures/Revenues

Note: Amounts do not include inflation unless otherwise noted below. (Thousands of Dollars)

	FY2019	Included in	Out-Year Cost Estimates				
	Appropriation Requested	Governor's FY2019 Request	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
OPERATING EXPENDITURES	FY 2019	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024
Personal Services							
Travel							
Services							
Commodities							
Capital Outlay							
Grants & Benefits							
Miscellaneous							
Total Operating	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Fund Source (Operating Only)

None							
Total	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Positions

Full-time							
Part-time							
Temporary							

Change in Revenues

None							
Total	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Estimated SUPPLEMENTAL (FY2018) cost: 0.0 *(separate supplemental appropriation required)*
(discuss reasons and fund source(s) in analysis section)

Estimated CAPITAL (FY2019) cost: 0.0 *(separate capital appropriation required)*
(discuss reasons and fund source(s) in analysis section)

ASSOCIATED REGULATIONS

Does the bill direct, or will the bill result in, regulation changes adopted by your agency? No
 If yes, by what date are the regulations to be adopted, amended or repealed?

Why this fiscal note differs from previous version/comments:

Initial version

Prepared By:	Chantal Walsh, Director	Phone:	(907)269-7493
Division:	Division of Oil and Gas	Date:	01/29/2018 11:26 AM
Approved By:	Andrew T. Mack, Commissioner	Date:	01/29/18
Agency:	Department of Natural Resources		

FISCAL NOTE ANALYSIS

STATE OF ALASKA
2018 LEGISLATIVE SESSION

Analysis

The Department of Natural Resources does not anticipate any fiscal impact from this legislation.

The Division of Oil and Gas will be required to conduct resource and commercial analyses of any overriding royalty interest agreement applications. This would involve staff time to conduct analysis, but can be absorbed if the number of applications are low. If many applications are received, this would require additional funding for contractual assistance.



**State of Alaska
Department of Revenue
SB176: Oil & Gas Tax Credit Bond Proposal**

**Senate Resources Committee
February 21, 2018**

**Sheldon Fisher
Commissioner Designee**



Bill Objective #1: Critical component to Governor's economic stimulus package

- From 2015 – 2017, the private sector jobs are down ~3.8% or 9,200 jobs.
 - Oil and Gas industry jobs are down ~30.8%
 - For 2018, ISER forecasts year over year losses of and additional 0.7%.
 - “This does not indicate a recovery in activity.”

- This bill will both provide an initial boost of funding and resolve the uncertainty surrounding these payments.
 - Provide up to \$600+M of economic stimulus in 2018 to the oil and gas sector of the economy.
 - Resolve the uncertainty hanging over this sector and allow small producers to plan.
 - Bill seeks to unfreeze Alaska credit markets and seeks to incent new spending in Alaska.
 - Potentially \$600M or more reinvested in Alaska.
 - This could mean substantial numbers of new jobs

Bill is Structured to Balance Competing Interests

The Balance:

- The Credit holders to pay for the cost of the borrowing.
- Provides Small Producers the certainty and cash they need to invest.
- Maintains the state's credibility by acknowledging our part in creating this situation.

State Fiscal Budget

- Forecasted FY 19 deficit of \$477M
- Deficit increases \$180M without this program



Support Small Producers

- Strategic interest in maintaining small producers.
- Bank lending has essentially stopped

Maintain State Credibility

- The state encouraged investment based on promises of support



For the entire lifecycle of your project, the State of Alaska is there for you. We do not just talk big, we follow through big - with cash! Here is what you can expect when you come to Alaska:

- Cash-refundable tax credits for shooting seismic and/or drilling wells
- Cash-refundable tax credits for capital spend
- Many of the credits may be combined for up to 65% in credits
- 2014-2015 exploration expenditures on North Slope may qualify for up to 85% in combined credit
- Additional tax credits that offset tax liability for small & frontier producers
- Tax credit certificates are assignable

Oil & Gas Tax Credit Background

- 2003: First oil & gas tax credits created to incentivize new exploration. Credits could only offset the company's taxes.
- 2006: Transferable tax credits introduced with transition to profits-based tax. New credits for capital expenditures and operating losses expanded incentives to include small field developers. State repurchases authorized, with caps and limits.
- 2007: Oil & Gas Tax Credit Fund established, with statutory formula tied to production tax revenue. Annual per-company caps eliminated.
- 2010: Cook Inlet Recovery Act incentivized new production to offset gas shortages in Southcentral. New incentive tied to drilling costs. Because of minimal Cook Inlet taxes, credits were not expected to be supported by new revenues.
- 2013: SB 21 eliminated capital credit on North Slope, replaced with per-barrel credit tied to price and production
- 2016-17 HB247 and HB111 wind down cashable credit programs

Oil & Gas Tax Credit Background

➤ **Oil & Gas Tax Credits Have Helped Heat Alaskans' Homes**

- Incentivized Hilcorp to take over aging Cook Inlet assets and extend field life
- Brought new companies into Alaska, including Bluecrest and Furie, to look for gas
- Southcentral gas supply shortage essentially solved
- Threat of brown-outs gone
- Protected energy security of tens of thousands of Alaskans

➤ **Oil & Gas Tax Credits Have Created Potential for More Production**

- New fields potentially mean new oil: Pikka, Nuna
- Governor's economic stimulus goal
 - More revenue from production equals
 - New jobs
 - New royalties
 - New revenues for schools and government services
 - Economic ripple effect

Oil & Gas Tax Credit Background

State-purchased credits through the FY2018

- \$3.6 billion total cash purchases
 - 16 Companies receiving credits now have production
 - Total production from these producers through end of 2016 is 175 million barrels of oil equivalent
 - Non-North Slope: 89mm BOE (mostly Cook Inlet gas)
 - North Slope: 86mm BOE (mostly oil)
- Balance of credit certificates for which purchase has been requested, as of 12/31/17, is \$806 million
 - North Slope: \$495 million
 - Non-North Slope: \$311 million
 - These include \$60 million in 'conditional' exploration certificates, split about evenly between the basins

Oil & Gas Tax Credit Background

Forecasted Production Helped by Known Credits (January 2017 through end of FY2027)

➤ North Slope

- 106 million barrels from currently producing fields
- 23 million barrels from fields not yet producing (substantial upside potential)
- Total past and future production: 215 million barrels

➤ Cook Inlet (note: no forecasted “middle earth” production)

- All current oil and gas production has benefited from credits
- Future gas production to meet local demand is 90 billion cubic feet per year, or 15 million BOE
- Forecasted oil production about 5 million barrels / year
- Total past and future production 299 million BOE

Oil & Gas Tax Credit Background: The Challenge

- Historically, the State paid tax credits annually as presented.
 - FY16-FY18 state unable to pay all pending tax credits; applied statutory amount
- The O&G Tax Credit Fund statute (AS 43.55.028), sets out a formula for computing the appropriation to the fund for cash payment of tax credits.
 - The formula is based on the oil price projected for the fiscal year:
 - If the projected price is \$60 or higher, the statutory minimum is 10% of production taxes.
 - If the projected price is less than \$60, the statutory minimum is 15% of production taxes
 - The Department published forecast annually in its Revenue Sources Book
 - Updated in the Spring Forecast

	FY19	FY20	FY21	FY22	FY23	FY24	FY25
Estimated Statutory Payment (\$mm)	\$206	\$167	\$119	\$132	\$135	\$139	\$ 1

- Impact of Payment on Statutory Schedule
 - Exploration and development in some cases halted
 - Some banks have frozen supply of further credit for Alaska oil and gas exploration

Proposed Solution: Issue Bonds and use proceeds to pay off Tax Credits
Credit holders cover the cost of borrowing by accepting a discount on credits.

	FY2019	FY2020	FY2021	FY2022
Share of Statutory Appropriation	\$25M	\$25M	\$25M	\$25M

Discount Rate 10%

	FY2019	FY2020	FY2021	FY2022
Annual Payment	\$25.00	\$25.00	\$25.00	\$25.00
Discount Year 2		\$22.73		
Discount Year 3			\$20.66	
Discount Year 4				\$18.78

Buyout Offer:	\$87.17
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Discount Rate 5.1%

	FY2019	FY2020	FY2021	FY2022
Annual Payment	\$25.00	\$25.00	\$25.00	\$25.00
Discount Year 2		\$23.79		
Discount Year 3			\$22.63	
Discount Year 4				\$21.53

Buyout Offer:	\$92.95
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Example: Assume Credit holder has \$100M in Credits payable over 4 years.

Program offers two alternative discount rate.

- 5.1% represents the State's cost of borrowing
 Estimated 3.6% Total Interest Cost + 1.5%
- 10% is mid-point between State's cost of borrowing and the Credit Holder's Weighted Average Cost of Capital.

The 10% Discount Rate is the Base Rate. To qualify for the lower rate, the Credit Holder must:

- Agree to an Overriding Royalty Interest
- Commit to reinvest the money in Alaska
- Agree to an early waiver of confidential seismic data
- Refinery and Gas Storage Credits.

The Discount is applied to each year of payments starting in the second year.

The difference between the face amount (\$100M) and the "Buyout Offer" covers the cost of borrowing.

Oil & Gas Tax Credit Solution

Issue Bonds and Use Proceeds to Pay Off Tax Credit Certificates at a Fair Discount Rate That Covers State Bonding Costs

- **Step 1: Secure commitment from Credit Holders to participate in Program.**
 - Provide definitive statement of proceeds available under the program.
 - Interested credit holders make irrevocable commitment.
- **Step 2: Issue Bonds**
 - First issuance (for existing certificates):
 - Face Value: \$706mm (assumes \$100 million of existing credits are sold to producers)
 - Bond Issuance: \$618mm-\$660mm
 - Issue in August 2018
 - Future issuances, for anticipated certificates
 - Face Value: \$200mm (est.)
 - Issue in August 2019-August 2021
 - Interest only with bullet payment at the end

Oil & Gas Tax Credit Solution

Issue Bonds and Use Proceeds to Pay Off Tax Credit Certificates at a Fair Discount Rate That Covers State Bonding Costs

➤ Step 2: Purchase Tax Certificates at Fair Discount Rate

- Two options: 10% discount rate or discount rate equal to state cost of capital (approx. 5.12%)
 - Option 1: 10% rate – no strings attached
 - Balances State's and credit holders' interests
 - Greater than State's cost of capital, less than tax credit holders' cost of capital
 - Covers State's costs of financing
 - Option 2: 5.12% rate (approx.—State's cost of capital) – strings attached
 - Tax credit holder can get lower discount rate (less discount from face value) in exchange for (four options):
 - Overriding royalty of equivalent value
 - Commitment to future investment of equivalent value, or
 - Early waiver of confidentiality of seismic data
 - Refinery and Gas Storage Credits receive the lower rate

Issue Bonds and Use Proceeds to Pay Off Tax Credit Certificates at a Fair Discount Rate That Covers State Bonding Costs

➤ Step 3: Discount Covers State's Bonding Costs

➤ Bond Description

- 10 year term
- All-in Cost of Funds (estimated): 3.62%
- Backloaded debt service to match projected profile of state revenues
 - 2 year interest only, 3 year increasing debt service, 5 year flat

➤ Objective with each purchase option is cost equivalency

- Present value of total debt service will be equal to or less than the present value of appropriations under the statutory payment formula

Benefits of Program:

Move cost into periods where match cash flow.

	Statutory Payment Schedule	Cohort 1	Cohort 2	Cohort 3	Cohort 4	Aggregate
FY19	206	\$24.08				\$24.08
FY20	167	\$24.08	\$2.79			\$26.87
FY21	119	\$55.02	\$2.79	\$1.68		\$59.48
FY22	132	\$81.95	\$2.79	\$1.68	\$0.60	\$87.02
FY23	135	\$101.08	\$2.79	\$1.68	\$0.60	\$106.15
FY24	139	\$110.00	\$2.79	\$1.68	\$0.60	\$115.07
FY25	1	\$110.00	\$2.79	\$1.68	\$0.60	\$115.07
FY26		\$110.00	\$2.79	\$1.68	\$0.60	\$115.07
FY27		\$110.00	\$2.79	\$1.68	\$0.60	\$115.07
FY28		\$110.00	\$2.79	\$1.68	\$0.60	\$115.07
FY29			\$79.92	\$1.68	\$0.60	\$82.19
FY30				\$47.96	\$17.22	\$65.18
FY31						\$0.00

Impact on debt capacity and credit rating

- Limited impact on capacity as the credits are an existing obligation -
- Similar to state PERS/TRS payments on behalf of employers
- Neutral to positive impact on credit rating
- Reduces FY 2019 payment from 10.1% of UGF to 1.3% and results in a more predictable and level annual payment
- Financially beneficial to State
- Provides financial alternative to State's primary revenue generation industry

State of Alaska Debt Service to Unrestricted Revenues									
Fall 2017 Revenue Forecast of the Department of Revenue									
Fiscal Year	UGF Revenues	State G.O. Debt Service	State Supported Debt Service	Total State Debt Service	School Debt Reimbursements	Statutory Payment to PERS/TRS	Current Total Payments to Revenues	Current Tax Credit Statutory Payments	Proposed Tax Credit Financing
	(\$Millions)	%	%	%	%	%	%	%	%
2018	2,081.6	4.3	1.1	5.4	5.4	8.9	23.4	3.7	1.3
2019	2,047.1	4.4	1.1	5.5	5.2	14.6	35.3	10.1	1.3
2020	2,063.2	3.8	1.1	4.9	4.7	16.8	34.1	7.7	2.9
2021	2,155.7	3.6	1.0	4.6	4.4	17.8	32.4	5.5	4.1
2022	2,218.9	3.0	1.0	4.0	3.7	17.7	31.4	5.9	4.8
2023	2,275.2	2.9	1.0	3.9	3.7	17.7	31.2	5.9	5.1
2024	2,297.1	2.9	1.0	3.9	3.0	18.0	30.9	6.1	5.0
2025	2,426.8	2.5	0.9	3.4	2.4	17.6	23.5	0.0	4.8
2026	2,641.3	2.3	0.8	3.2	1.8	16.7	21.6		4.4
2027	2,838.8	2.1	0.8	3.0	1.5	16.1	20.6		4.1

Oil & Gas Tax Credit Solution

Benefits to Solution

- **Governor's economic stimulus**
 - Expect most credit holders will reinvest in Alaskan projects.
- **Support Small Producers - Unfreeze pending development projects**
 - Current bank financing to fields generating tax credits is frozen in some cases
 - Need to pay off credits so projects in development can be completed
 - State has a strategic interest in maintaining viability of small producers as it increases competition in the basin
- **Need to Re-establish Alaska as a Premier O&G E&P Basin**
 - Alaska has reputational issues re oil and gas exploration and development that need to be addressed now
 - Alaska is highly prospective
 - Alaska is a stable environment in which long-term projects can be mutually successful
- **More Revenue from Production is the Goal**
 - Future royalties equals: jobs, funding for schools and gov't services, economic growth
- **Move cost into periods where match cash flow.**

A healthy and growing Alaska economy benefits all Alaskans!

Questions?

Appendices

1. Sectional analysis
2. Spreadsheet
3. Sheldon Fisher – Op Ed