



THE STATE
of ALASKA
GOVERNOR BILL WALKER

Department of Revenue

COMMISSIONER'S OFFICE

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October 21, 2015

The Honorable Cathy Giessel, Chair Senate Resources Committee
The Honorable Benjamin Nageak, Co-Chair House Resources Committee
The Honorable David Talerico, Co-Chair House Resources Committee
Juneau, AK 99801

Dear Senator Giessel and Representatives Nageak and Talerico:

The purpose of this letter is to provide responses to questions posed on September 9, 2015 by the Joint Resources Committee related to AKLNG Project matters within the scope of the Department of Revenue (DOR) under SB 138.

Pursuant to Section 76 of SB 138, the State commissioned Lazard to provide an analysis of State funding options for FEED and for FID. The final report to the legislature on a range of financing options for State acquisition of an ownership interest and participation in a North Slope natural gas project is due at the time the commissioner of natural resources submits the first agreement or contract to the legislature for approval under AS 38.05.020(b)(11) enacted by Section 24.

The Administration and its consultants developed and executed a work plan with a targeted delivery date of special session for the final report. Because no contracts have been submitted to the legislature for approval, the final report will not be issued during this special session. To comply with statutory and contractual requirements, the Administration made the decision to defer issuing the final Lazard report until the commissioner of natural resources submits the first commercial agreement or contract to the legislature for approval.

The Administration wishes to comply with your request for information. Although no agreement or contract will be presented to the Legislature at the October 2015 Special Session, ongoing communications and analysis with Lazard, other financial advisors, and consultants are the basis for the responses below.

Lazard and First Southwest are the State's financial advisors. Preliminary analysis indicates that the State has a number of viable financing alternatives for funding the State's equity interest in the Project. These financing alternatives include general obligation and annual appropriation bonds, bank financing, Certificates of Participation, or combinations of the four. Lazard is also analyzing project finance alternatives, subject to the limitations of Alaska Constitution Article 9, Section 7 prohibiting dedication of State revenues. Pursuant to Section 76 of SB 138, Lazard is also analyzing and will report on opportunities for the Permanent Fund, Municipalities, Native Corporations, and members of the public to participate in the funding of the State's interest in the Project.

Following are the questions asked of the DOR during the September 9, 2015 hearing, and the DOR's written responses.

Are the commissioners of DNR and DOR and AGDC relieved of their responsibility because of Mr. Boykin taking over the lead negotiator role? SB138 preserves responsibilities to accountable commissioners, not just hired gun. Is it intent of the Administration to remove DNR & DOR commissioners from their responsibilities (Representative Hawker)?

Answer: DOR continues to exercise its responsibilities as directed by the legislature under SB 138. DOR has the lead role with respect to Property Tax and Finance matters, which are not part of Mr. Boykin's role as lead negotiator. DOR also continues to provide consultation to DNR on the Project Agreement negotiations as provided in SB 138. There is no intent on the part of the Administration to remove the DOR commissioner of his and the Department's responsibilities assigned to it under SB 138.

Is PILT wholly within our (the Administration's) authority (Representative Josephson)?

Answer: Property taxes are not totally within the administration's purview. The process of establishing and allocating AKLNG Project Property Tax mechanisms is a multi-faceted stakeholder engagement. Some of the stakeholders include the Administration, municipalities, boroughs, Producer Parties, lenders, and the legislature. Any changes from the status quo Property Tax provisions in AS 43.56 and AS 29.45.080 will require legislative action. Section 74 of SB 138 directs the Governor to establish the Municipal Advisory Gas Project Review (MAGPR) Board to assist the Governor in proposing any recommend changes to AS 43.56 and AS 29.45.080 to facilitate the development and implementation of the AKLNG Project, including proposals to minimize impacts on affected communities from activities related to the construction and operation of the AKLNG Project. Neither the DOR nor the MAGPR Board have any authority to bind the legislature to any Property Tax or payment in lieu of taxes (PILT) agreement.

So who is the State relying on for project financing (services)? Are you using Lazard or are we counting on another organization (Senator MacKinnon)?

Answer: With the understanding that your question was geared toward project finance from the standpoint of arranging a project finance package, due to the preliminary phase of the Project, the DOR has not retained a financial advisor to perform a bankability review or compile a financing package.

The DOR has retained Lazard to advise the State on its financing alternatives with respect to the Project, as required under Section 76 of SB 138. While, Lazard will advise the State on its financing alternatives, it will not participate in the actual underwriting of any debt securities issued in connection with the State's actual financing of the project. Under the new SEC Rules, the State has retained First Southwest as its independent registered municipal adviser for the project, and anticipates retaining one or more municipal financing underwriters in advance of the execution of the financing.

The Administration has also retained the services of Greengate LLC, Milbank Tweed Hadley and McCloy LLP, and Greenberg Traurig LLP to collaborate with other State advisors in reviewing, verifying and confirming recommended financing structures for the State's participation in a liquefied natural gas project. In addition, these firms provide assistance to the State in comparative financial analyses of various project structures and categories of investors and their variable impacts on financing options. Both Greengate and Milbank have long standing LNG project experience from a financing perspective. Greenberg Traurig provides legal advice concerning the financing aspects of public private partnerships.

TC brings more to the table besides building pipelines. They also provide financing. How do we propose to replace TC as pipeline builder and provider of financing for the construction phase of midstream facilities (Senator Giessel)?

Answer: The engineering procurement and construction (EPC) contractor to construct the pipeline has not yet been determined.

To replace TC's financing, the State could choose from a range of financing options that include financing from the municipal bond or bank loan markets or a combination of both. Alternatively, part or all of the TC debt financing repayment could be funded from the Constitutional Budget Reserve Fund, other available State revenue funds, third party equity providers, or gas off-takers.

The TC Precedent Agreement is a form of State borrowing which TC can demand payment on at its discretion within 90 days of a positive FID (similar to a demand promissory note). The TC interest rate is higher than the interest cost anticipated by the State if it borrowed the same amount of money from the municipal bond or bank loan market. A lower interest cost could be realized if the legislature decided to use available State funds to finance some or all of the Project costs.

I want to follow up on comments with Mr. Fauske who is known for his expertise in financing. We as the State do not pay federal income tax. Do you think tax exempt non-recourse project bonds are a viable option for a project like this (Senator Giessel)?

Answer: First Southwest does not anticipate the ability to directly access tax-exempt non-recourse financing for the entire investment in the project by the State. To clarify this possibility the State intends to make a private letter ruling request to the IRS regarding the State's ability to issue tax-exempt non-recourse financing for the State's share of the Project. There are, however, other opportunities for the State to access tax exempt financing for other State needs that are currently being funded on a pay as you go basis. Looking at total State funding needs on an integrated basis, there may be an opportunity to combine tax-exempt and taxable bond financing in a blended approach so that the State as a whole would obtain the lowest financing cost possible.

Who is the integrated finance team (Representative Saddler)?

Answer: The Integrated Finance Team (FT) advises the Sponsor Representatives as described in the Venture Alignment MOU (VAMOU) and is comprised of representatives from AGDC, SOA, BP, CP, EM, and TC. The Finance Team's broad mandate is to provide advice on all finance and funding related matters for the Project.

I would like to see some documentation of that and if you could lay that out in diagram or narrative form that would be helpful. Who is the person or party that would make the decision of how that financing would take place (Representative Saddler)?

Answer: Please see the attached AKLNG Finance Team overview provided by the Parties (Attachment #1).

Under the current Project commercial structure, each of the Producer Parties, TransCanada, and the State (State legislature) will separately make the decision on how to finance such Party's participation in the Project. The Integrated Finance Team will look to assure coordination across those individual financing decisions, and be prepared to address financing options if a different commercial structure evolves.

Also please see the attached Project Committee Matrix for the State Finance Team (Attachment #2).

What is the MAGPRB Process and how does the legislature engage in it?

Answer: SB 138, Section 74 requested the Governor establish the Municipal Advisory Gas Planning Review Board (MAGPRB). Section 74 requests the MAGPRB provide recommendations on AKLNG Project impacts on communities within the State including construction period impact payments for communities in

proximity to the Project facilities and those not in proximity, recommend AKLNG Project property taxes to facilitate and mitigate impacts of the Project once in operation, and recommend legislation for consideration by the Legislature to implement the recommendations of the MAGPRB. MAGPRB meetings are publicly noticed and open to public participation, including participation by legislators. The Department of Revenue coordinates meetings and agendas with the other Board members. The Board has been systematically analyzing the property tax issues as charged under Section 74, with copies of reports and presentations posted to the Department of Revenue, MAGPRB website. The MAGPRB is still in the analysis stage and legislators have the opportunity to provide input to the Board before the Board finalizes recommendations for the Legislature. Members of the MAGPRB have stated their desire to hear legislator's views on target property tax and impact payment amounts, and on allocation of tax receipts between the State and local communities. Issues that legislators may want to address with the Board can be coordinated with the Commissioner of Revenue, Chair of the Board, who will add them to Board meeting agendas. The DOR will take any statutory recommendations from the Board and coordinate with the Department of Law to draft new legislation. Draft legislation will be presented to the legislature for consideration and action, if any.

With regard to PILT and allocation, can you tell me the distribution between state and municipalities (Senator MacKinnon)?

Answer: The distribution of the impact payments and flow-related property taxes have not yet been determined. The process for determining the recommendation coming from the municipal review board will include not only the formula and legislation for the property taxes, but also the allocation of the tax payment between the State and the municipalities. Recommendations on an allocation process are currently being discussed internally and with the MAGPRB, and are very preliminary. The Legislature's input and action will begin when bills covering allocation of property taxes are presented for enactment. Since property tax and impact payments are not part of the call for the October 2015 Special Session, Commissioner Hoffbeck anticipates that these issues will be discussed at length with the legislature during the spring 2016 regular session. MAGPRB recommendations on legislative modifications to AS 43.56 and AS 29.45 will be brought to the legislature for consideration and action.

What is the State's long-term financing plan absent TC for its equity share in the project? Need to understand how SOA will fund equity and how the State will finance its share of the project (Representative Saddler).

Answer: Please see Black and Veatch's report TransCanada Participation Decision.

Please also see the attached Treasury Division's analysis of the short term impacts and means for funding. Any payment to TransCanada will require an appropriation from the Legislature. The Legislature could appropriate from existing funds (e.g., General Fund, Constitutional Budget Reserve Fund, Earnings Reserve Fund) or authorize the State to complete a bond issue for this purpose. Based on the Treasury Division's analysis, drawing upon the CBRF to fund the TransCanada reimbursement and the Midstream Pre-FEED and FEED costs will accelerate the depletion of the DBRF by approximately three months. The analysis shows that using proceeds from a bond issuance and funding debt service from the CBRF would have minimal impact on the projected depletion date of the CBRF, with the anticipation that debt service costs of approximately \$271 million would be rolled in to the financing of the costs of the project at FID.

Who decides on the ultimate financing package (Representative Saddler)?

Answer: Under SB 138, Section 76, the Administration provides a report to the legislature of financing alternatives for the AKLNG Project. The Legislature will determine the ultimate financing plan for the State's equity participation in the Project and will make the decision on the type of debt and appropriation of funds. The Department of Revenue and its Treasury division will implement the plan and secure the necessary funds.

Do you think tax exempt bonds are a possibility for this project (Senator Giessel)?

Answer: This will depend, in part, on the commercial structure of the Project. At this time the final commercial structure has not been agreed to by the Parties and is currently in negotiation.

First Southwest does not anticipate the ability to directly access tax-exempt non-recourse financing for the entire investment in the project by the State. To clarify this possibility, the State intends to make a private letter ruling request to the IRS to access tax-exempt non-recourse financing for the State's share of the Project. There are, however, other opportunities for the State to access tax exempt financing for other State needs that are currently being funded on a pay as you go basis. Looking at total State funding needs on an integrated basis, there may be an opportunity to combine tax-exempt and taxable bond financing in a blended approach so that the State as a whole would obtain the lowest financing cost possible.

How have we pursued the possibility of giving Alaskans and private individuals the opportunity to invest in the project? Do we have a timeline for offering that investment opportunity? Policy decision? Estimates of numbers/amounts that could be raised (Senator MacKinnon)?

Answer: SB 138 Section 76 requires the final Lazard report include a plan on how regional corporations, municipalities and individuals can participate in investment opportunities in the pipeline. Lazard, First Southwest and members of the state Finance team have participated in an outreach over the summer, including hosting several face to face meetings and other conference call follow up discussions. The goals of the outreach have been to educate potential investors on the project, discuss particular investment strategies, uncover limitations, either statutory or by policy, and begin the process of determining and understanding the potential capacity and interest in such parties participating in the financing of the project. Lazard and the State's internal finance team is also reviewing SEC and IRS regulations to understand limits that may be placed on such parties participation and potential investment in a Project. The final Lazard report, when submitted, will include a high level plan on this topic.

We hope that we adequately addressed your questions. Please do not hesitate to contact us if you have further questions or need clarification.

Respectfully,

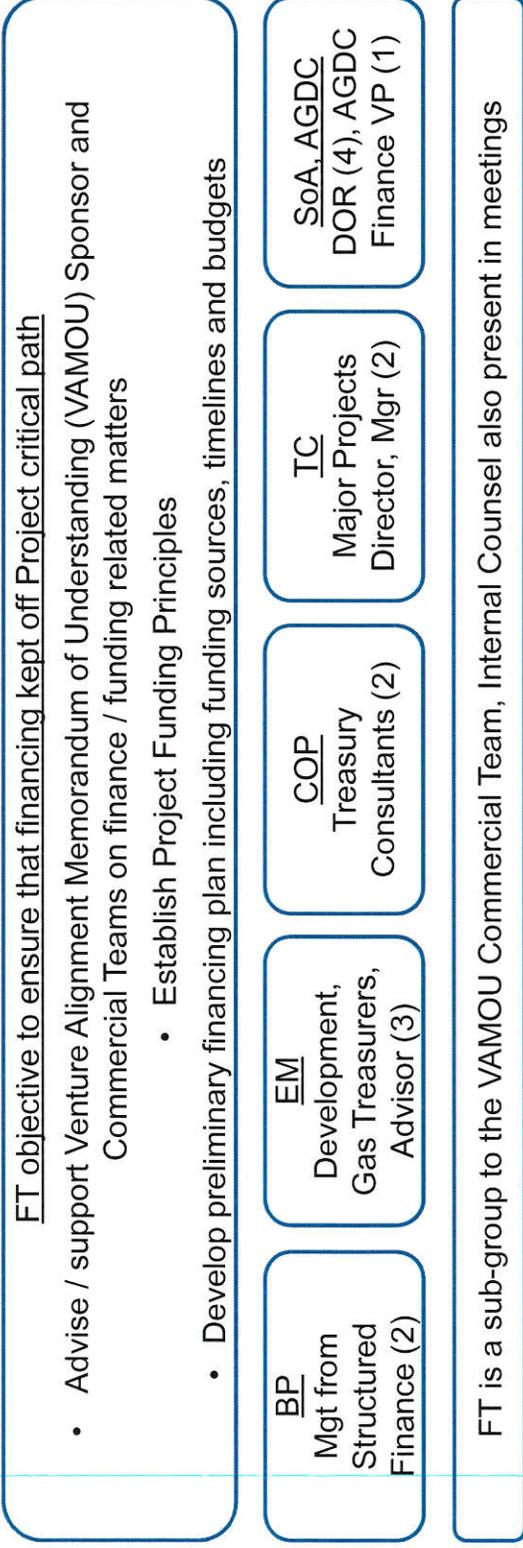


Dona B. Keppers
Deputy Commissioner

Cc: Commissioner Randall Hoffbeck

Alaska LNG Finance Team Overview

- Summary of Finance Team (FT) composition and work scope:



- FT currently working to engage joint legal counsel to advise on financing matters
 - Legal due diligence on proposed commercial and legal structures
 - Bankability assessment on structures from external Project financing perspective
 - Recommendations on potential modifications to enhance ability to raise external Project finance
- Recent interactions indicate need to develop more detailed, common understanding of structure and bankability
 - Expert, independent counsel able to advise on external financing implications of key commercial issues
 - Provision of neutral advice may help bridge any potential gaps on financing matters between the parties

AKLNG State Gas Team - Project Committee Matrix

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Finance		
Meeting Times	Bi-Weekly, Thursday	Monthly
	10am AKST	Monthly, face to face quarterly, Integration 2-3 times per year
SB138 Statutory Authority	DOR Commissioner, SB 138, Section 76, DNR Commissioner, in consultation with the Commissioner of Revenue, AS 38.05.020(b)(10),(11),(12)	DOR Commissioner, SB 138, Section 76, DNR Commissioner, in consultation with the Commissioner of Revenue, AS 38.05.020(b)(10),(11),(12)
StateLeads	Deputy Commissioner, DOR	Rotating Producer/TC led with facilitation, VP Finance, AGDC, Deputy Commisser, DOR
Committee Focus	Internal Team	(Integrated) Project Finance Team
	Responsible for issues related to state's project financing options, SB 138 Section 76 relating to regional corporations and individuals as co-owners, and coordination with project finance teams, commercial and fiscal teams.	Producer, State and TC parties responsible for ensuring financing is kept off of critical path of the project. FT is sub group to the VAMOU Commercial Team, FT is an advisory team that provides financing expertise to VAMOU Commercial and to VAMOU Sponsor Representatives as necessary.
State Team Members	Treasury Division, State Investment Officers (4)	EM Development, Gas Treasurers, Advisor (3)
	DOR, Tax Division Audit Masters, Commerical Analysts (5)	BP Management from Structured Finance (2)
	AGDC, VP Finance, Advisors, Consultants (3)	COP Treasury Consultants (2)
	First Southwest, Managing Director, Vice Presidents (3)*	TC Major Projects Director, Manager (2)
	Greengate LLC, Director (1)	SOA, AGDC, DOR (5)
	Lazard, Vice Chairman Investment Banking, Global Head Power Energy& Infrastructure, Directors, VP's, Associates (6)*	
	Greenberg Traurig, Counsel (1)	
	Black & Veatch, Principal and Senior Consultants (2)*	
	* Sub teams	