



THE STATE
of **ALASKA**
GOVERNOR BILL WALKER

Department of Revenue

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March 7, 2016

The Honorable Bert Stedman
Alaska State Senator
State Capitol Room 115
Juneau AK 99801

Senator Stedman:

I would like to take this opportunity to respond to questions posed to the Department of Law several weeks ago, that were then forwarded to the Department of Revenue (DOR) on February 3, 2016 for answers. The DOR subset of questions are reprinted here in italics with the respective responses. Responses to your remaining questions will be addressed separately by the Department of Law.

1. *Please provide the estimated amounts the State would pay and receive in property taxes (before any split with municipalities) during the construction period of the gas pipeline under currently existing law, AS 43.56 and AS 29.45. (No PILT)*

The DOR cannot say with certainty what the State would pay or receive in taxes at a future date. The DOR has attempted to estimate those amounts based on our current knowledge and assumptions about the future.

In the attached analysis performed by DOR's consultant, Greengate LLC¹, it is estimated that, under currently existing law, in the base case scenario the Alaska LNG Project, as a whole, could generate approximately \$1.68 billion over an assumed seven-year construction period, which includes: (a) \$1.34 billion during an assumed five-year period to construct the pipeline, transmission lines and the initial trains of the GTP and LNG facilities; and (b) approximately \$0.34 billion associated with the construction of the additional process trains during the remaining two years of the construction period until all project components have been constructed.

Based on current preliminary estimates, the State may be responsible for about 25 percent of the overall project property tax obligation, or approximately \$420 million over the assumed construction period.

¹ Greengate LLC, October 2015, AKLNG Status Quo Property Tax Analysis, 14 pages.

To determine the allocation of property tax that the State may receive for the project under existing law DOR created a preliminary allocation estimate using 1) publicly available asset value estimates from the Alaska LNG Project, 2) an allocation of those Project asset value by location presented before the Municipal Advisory Gas Project Review Board (MAGPRB), and 3) historic property tax allocation splits for existing oil and gas property in the boroughs where the Alaska LNG Project will be physically located. Under the DOR preliminary allocation estimate the State may possibly receive about 42 percent of the property tax payments, or about \$706 million over the construction period. After an estimated property tax payment from the State of approximately \$420 million and estimated property tax receipts to the State of \$706 million, the State may realize a net gain in revenue from property tax of approximately \$286 million under existing property tax law.

2. *Please provide the estimated amounts the Producers would pay in property taxes during the construction period of the gas pipeline under currently existing law. (No PILT)*

The DOR cannot say with certainty what the Producers would pay in taxes at a future date. The DOR has attempted to estimate those amounts based on our current knowledge and assumptions about the future.

In the attached analysis performed by Greengate LLC, referred to above, it is estimated that in the base case scenario, assuming that the Producers may be responsible for about 75 percent of the overall \$1.68 billion estimated construction period project property tax obligation under currently existing law, the Producers are forecast to pay approximately \$1.26 billion over the anticipated five-year construction period.

3. *Please provide the estimated amounts the State would pay and receive in property taxes (before any split with municipalities) during the construction period of the gas pipeline if we assume a PILT and impact aid as described in Senate CRA.?*

The DOR cannot say with certainty what the State would pay or receive in taxes at a future date. The DOR has attempted to estimate those amounts based on our current knowledge and assumptions about the future.

Based on the tentative agreement that the State has reached with the producers the Alaska LNG Project is forecast to pay \$800 million in Construction-related Payments in Lieu of Tax (CPILT) over a five year period. This CPILT payout period is shorter than the actual construction period under the status quo because there is overlap in timing of project construction and operations, i.e. there will be additional trains added at the LNG Plant and the Gas Treatment Plant after startup of operations of the first train at both locations. The State and the MAGPRB have agreed that once operations have commenced, PILT will be referred to as Operations-related Payment in Lieu of Tax (OPILT).

Based on current preliminary estimates, the State may be responsible for about 25 percent of the project property tax obligation, or approximately \$200 million over the first five years after commencement of construction.

The DOR does not know how much of the \$800 million the State will receive because discussions with the municipalities regarding PILT allocations are only in their early stages. The DOR is not prepared to discuss changes from the status quo property tax statutes related to the allocation between the State and the municipalities at this time. The DOR anticipates advancing the discussions with the MAGPRB and having more definitive information at a later date.

4. *Please provide the estimated amounts the Producers would pay in property taxes during the construction period of the gas pipeline if we assume a PILT and impact aid as described in the Senate Community and Regional Affairs Committee.*

The DOR cannot say with certainty what the Producers would pay in taxes at a future date. The DOR attempted to estimate those amounts based on our current knowledge and assumptions about the future.

Based on current preliminary estimates, the Producers may be responsible for about 75 percent of the \$800 million project CPILT obligation, they are forecast to pay about \$600 million over the first five years after commencement of construction.

5. *Same questions as above for the time period the PILT would be in effect.*

The DOR cannot say with certainty what the State or Producers would pay or receive in taxes at a future date. The DOR has attempted to estimate those amounts based on our current knowledge and assumptions about the future.

In Greengate LLC's analysis, referred to above, it is estimated that, under currently existing law, the property tax for the Alaska LNG Project, as a whole, is expected to generate approximately \$15.78 billion during the initial 25 years after commencement of operations.² Based on current preliminary estimates, the State may be responsible for about 25 percent of the overall project property tax obligation, or approximately \$3.94 billion during the initial 25 years of operations of the project. Under the DOR preliminary allocation estimate, discussed above, the State may receive about 42 percent of the property tax payments, or about \$6.63 billion during the initial 25 years of operations of the project, the proposed agreed period. After an estimated property tax payment from the State of \$3.94 billion and estimated property tax receipts to the State of \$6.63 billion, the State may realize a net gain in revenue from property tax of \$2.96 billion under existing property tax law.

In Greengate LLC's analysis, referred to above, the scenario estimates that it could generate approximately \$15.78 billion in property taxes, and assuming that the producers may be responsible for about 75 percent of the overall estimated property tax obligation under currently existing law, the Producers are forecast to pay approximately \$11.83 billion in property tax in the initial 25 years of operations of the project.

² This estimate of property taxes on the Alaska LNG assets is the result of a scenario that assumes a straight-line depreciation over a period of 30 years and 2.5 percent annual escalation of asset value.

Based on the tentative agreement that the State has reached with the producers, the Alaska LNG Project is forecast to pay a target amount of \$15.7 billion in Operations-related Payments in Lieu of Tax (OPILT) during operations in the 25 year period. Based on current preliminary estimates, the State is expected to be responsible for about 25 percent of the project property tax obligation, or about \$3.9 billion during operations in the 25 year period. The DOR does not know how much of the estimated \$15.7 billion the State will receive because discussions with the municipalities regarding PILT allocations are only in their early stages. The DOR is not prepared to discuss changes from the status quo property tax statutes related to the allocation between the State and the municipalities at this time. The DOR anticipates advancing the discussions with the MAGPRB and having more definitive information at a later date.

Of the \$15.7 billion in estimated OPILT payments under the scenario discussed above, and assuming that the Producers may be responsible for about 75 percent of the overall estimated property tax obligation under currently existing law, the Producers are expected to pay approximately \$11.8 billion in property tax during operations in the 25 year period.

6. *Same questions as above except for a 10 year time period of operations after the PILT expires.*

At the end of the 25 year period for the Alaska LNG Project, during which the PILT may be in place, DOR's current assumption is that property taxes will revert to existing oil and gas property tax statutes. To forecast oil and gas property taxes a number of difficult to forecast assumptions would need to be made related to 1) the specific property tax law to be applied, 2) remaining life of the project facilities after decades of use, 3) future throughput volume, 4) future market price of natural gas, and a number of other assumptions as well. DOR is uncomfortable forecasting and modeling property taxes that far into the future using current assumptions.

7. *Is it possible to get an estimate or number of the aggregate amount of State of Alaska corporate income tax paid by the 3 producers last year or previous year?*

The aggregated tax liability after credits on calendar year 2014 state corporate income tax returns for the three largest producers in Alaska (2014 is the most current year available) totaled about \$174.6 million. Please note that this amount is subject to possible amendment or adjustment in the future and may vary significantly from amounts reported in the Tax Division's Annual Report since Annual Report numbers reflect actual cash collections on a fiscal year basis.

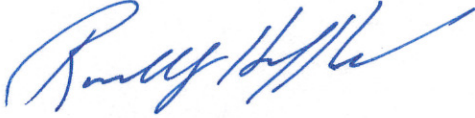
8. *What is the State's projected total take on property tax, including funding by the State into AGDC to pay its share of the property tax and then out to the State*

It is unknown how the CPILT or OPILT will be split between the State and the municipalities or how the Alaska Gasline Development Corporation (AGDC) will be affected. The State and the municipalities are in the early stages of discussion on an allocation methodology for

property taxes or payments in lieu of tax. However, the tentatively agreed total overall property tax for the project is \$800 million in CPILT and \$15.7 billion in OPILT.

Please let me know if you have additional questions or need clarification on any of the answers above.

Sincerely,

A handwritten signature in blue ink, appearing to read "Randall J. Hoffbeck". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Randall J. Hoffbeck
Commissioner

Attachment 1: Greengate LLC, October 2015, AKLNG Status Quo Property Tax Analysis, 14 pages.

AKLNG

Status Quo Property Tax Analysis

Prepared for the State of Alaska

9 October 2015

Important Notice

The findings herein are preliminary and subject to change, revision and/or addition based on further analysis by Greengate LLC (“Greengate”) and/or further information provided by the State of Alaska (the “State” or “SoA”), any of the State’s other advisors and consultants, AGDC and/or the affiliates of BP, ConocoPhillips and ExxonMobil (collectively, the “Producers”).

The analysis herein is based on: (i) information contained provided by the State team or the State’s other consultants; (ii) publicly available data; and (iii) Greengate analysis based on Greengate’s experience with similar projects. Greengate has not verified any of the information provided to it in connection with AKLNG and no representation or warranty, express or implied, is made and no liability or responsibility is accepted by Greengate as to the accuracy or completeness thereof.

Furthermore, Greengate’s analysis provided herein contains a number of assumptions and interpretation of data. No assurance can be given that such assumptions or interpretation will prove to be realistic or accurate and, therefore, any projections or estimates provided herein should be viewed with caution.

This document has been prepared for the State of Alaska as part of Greengate’s analysis of AKLNG, and any advice, recommendations, information or work product provided by Greengate is not intended for the benefit of any third party and may not be relied upon by any third party. Any use of this presentation shall constitute user’s waiver and release of Greengate and all of its affiliates, partners, employees, agents and subcontractors from and against of all claims and liability in connection with such use and, to the fullest extent permitted by law, such waiver and release shall apply notwithstanding the negligence, fault, or breach of warranty or contract by Greengate or any of its affiliates, partners, employees, agents or subcontractors.

1. Property Tax During Construction

Key Assumptions: Mill Rates and Capex

- Mill Rates:
 - LNG Plant/Marine Terminal 1.001%
 - Pipeline 2.000%
 - GTP 2.000%
 - PBU Transmission Line 2.000%
 - PTU Transmission Line 2.000%

- Capex and Capex Allocation :
 - LNG Plant/Marine Terminal 50.27%
 - Pipeline 25.51%
 - GTP 22.90%
 - PBU Transmission Line 0.05%
 - PTU Transmission Line 1.27%

- Total Capex: \$55 billion (nominal)

Key Assumptions: Construction Schedule and Cost by LNG/GTP Train

- Construction Period – Base Case:
(generic schedule based in part on the public version of the project’s Draft Resource Report 1 FERC filing)
 - Pipelines, LNG Train 1 and GTP Train 1: 5 years
 - LNG Train 2 and GTP Train 2: 6 years
 - LNG Train 3 and GTP Train 3: 7 years

- Sensitivity Cases:
 - Longer Construction: Construction schedule 1 year longer than under the Base Case
 - Shorter Construction: Construction schedule 1 year shorter than under the Base Case

- LNG and GTP Capex breakdown by Train:
 - Train 1 44%
 - Train 2 30%
 - Train 3 26%

Property Tax During Construction: Construction Schedule Cases

	Base Case	Longer Construction	Shorter Construction
Pipelines and GTP/LNG Train 1 Construction Period	60 month	72 month	48 month
GTP/LNG Train 2 Construction Period	+12 months	+12 months	+12 months
GTP/LNG Train 3 Construction Period	+12 months	+12 months	+12 months
Total Through Train 3 Completion	84 months	96 months	78 months
Property Tax During Construction (\$ millions)	1,682	2,055	1,310

Notes:

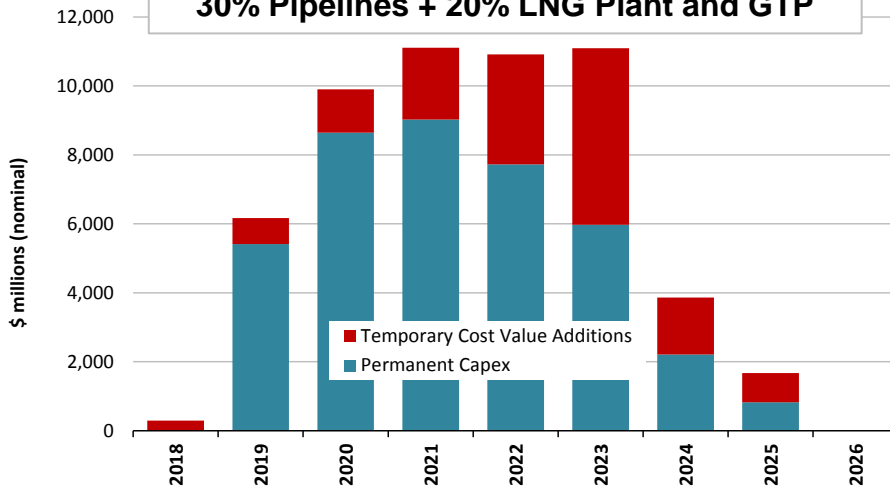
- The Longer Construction Case assumes an increase in the overall construction schedule by 12 months, while the incremental periods to complete Trains 2 and 3 remain as in the Base Case.
- The Shorter Construction Case assumes an decrease in the overall construction schedule by 12 months, while the incremental periods to complete Trains 2 and 3 remain as in the Base Case.

Permanent Capex vs. Temporary Construction Costs

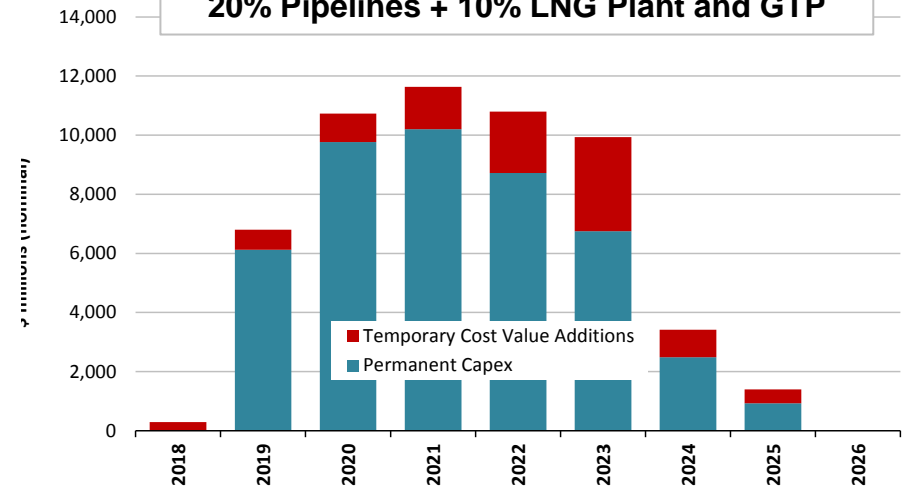
- The calculation of property tax during construction requires a distinction between permanent capital expenditures and temporary construction costs
- Permanent Capex:
 - “permanent camps and related facilities, pump stations, permanent storage facilities, roads, permanent air strips, terminal facilities, tank farms, docks, labor, materials, supplies, machinery, equipment, pipe, easements, rights-of-way, improvements, structures, and all other related costs” (15 AAC 56.110)
 - added to value as incurred (15 AAC 56.110)
- Temporary Construction Costs:
 - construction machinery and equipment, construction camps and related facilities; unallocated costs which relate to the overall project and are incurred both within and without the state and include such items as overhead and administrative costs, engineering costs, design costs, and research and development costs (15 AAC 56.110)
 - pro-rated accrual to value, based on months remaining to complete construction (15 AAC 56.110)
- If everything else is held constant, higher percentage of temporary construction costs as part of overall capex would result in lower property tax during construction, as the CWIP balance would accrue less rapidly
- The Precise breakdown between permanent capex and temporary construction costs is not known at this time. The Base Case assumes that the share of temporary construction costs is 30% for the pipelines and 20% for the LNG plant and GTP. Sensitivities are evaluated for 10% higher and 10% lower share of temporary construction costs.

Permanent vs. Temporary Costs: Illustration of Value Additions

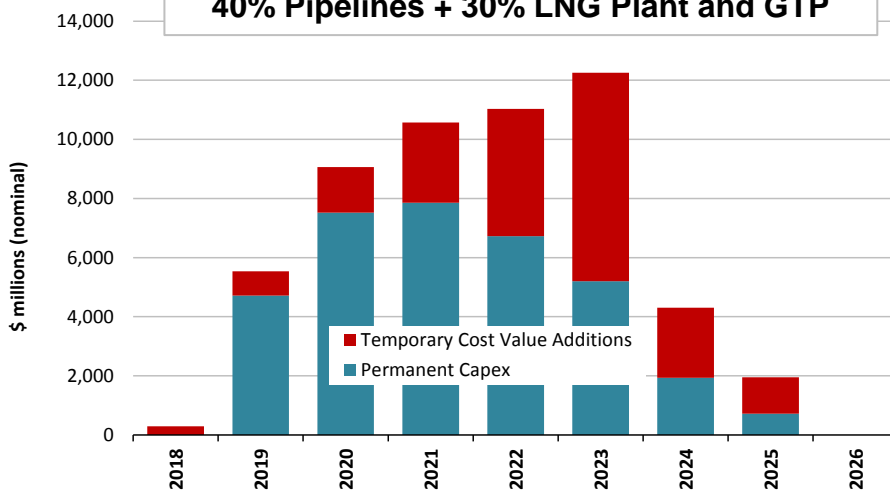
**Base Case Temporary Construction Costs:
30% Pipelines + 20% LNG Plant and GTP**



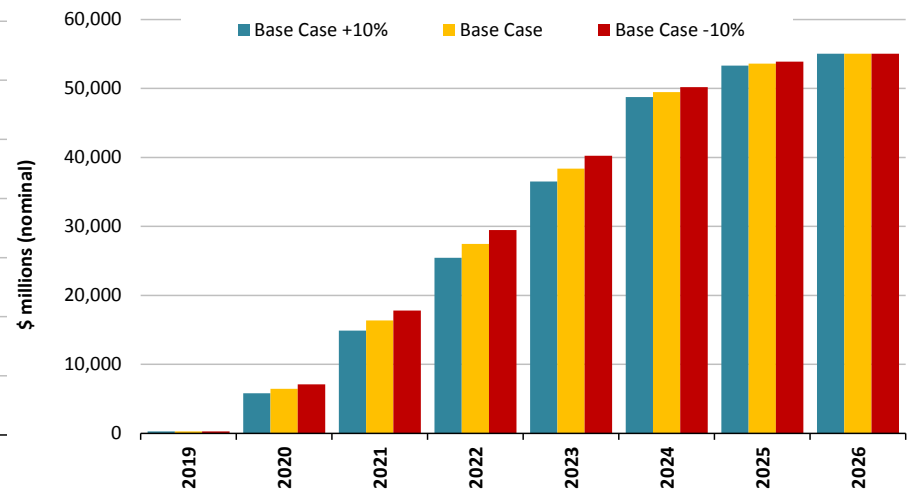
**10% Lower Share of Temporary Costs:
20% Pipelines + 10% LNG Plant and GTP**



**10% Higher Share of Temporary Costs:
40% Pipelines + 30% LNG Plant and GTP**



Cumulative CWIP



Sensitivity Cases for the Share of Temporary Construction Costs

	Base Case -10%	Base Case	Base Case +10%
Share of Temporary Construction Costs - Pipelines	20%	30%	40%
Share of Temporary Construction Costs - GTP and LNG Plant	10%	20%	30%
Property Tax During Construction (\$ millions)	1,785	1,682	1,579

Notes:

- The cases above assess the effect on the amount of Property Tax During Construction of varying the share of temporary construction costs as percentage of post-FID capex (pre-FID capex is assumed to be allocated to temporary costs).
- The results indicate that the sensitivity of the amount of property tax during construction to variations in the proportion of temporary construction costs is relatively modest.

2. Property Tax During Operations

Key Assumptions and Overview of Depreciation Cases

- Key Drivers for the amount of Property Tax During Operations:
 - Capex as built – assumed to be \$55 million
 - Depreciation period
 - Rate of escalation of replacement cost post-construction

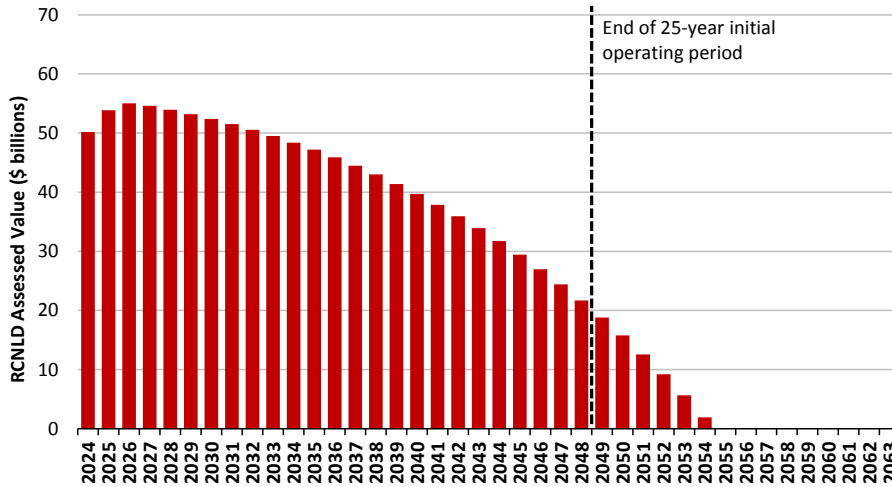
- Rate of escalation for replacement cost:
 - Base Case assumes 2.5% p.a.
 - Sensitivity cases assessed: 2.0%, 3.0% and 3.5% p.a.

- Depreciation cases assessed: 25, 30, 35, 40 years from start-up

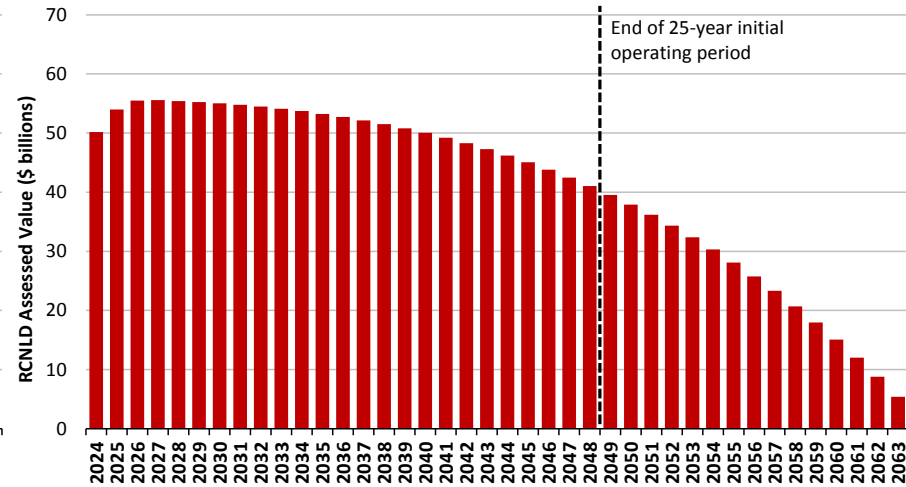
- In each case, the total amount of property tax after start-up is calculated for the first 25 years of operations (for comparison with the FRPT target amount of \$15.7 million)

Depreciation Cases: Assessed RCNLD Value @ 2.5% Escalation

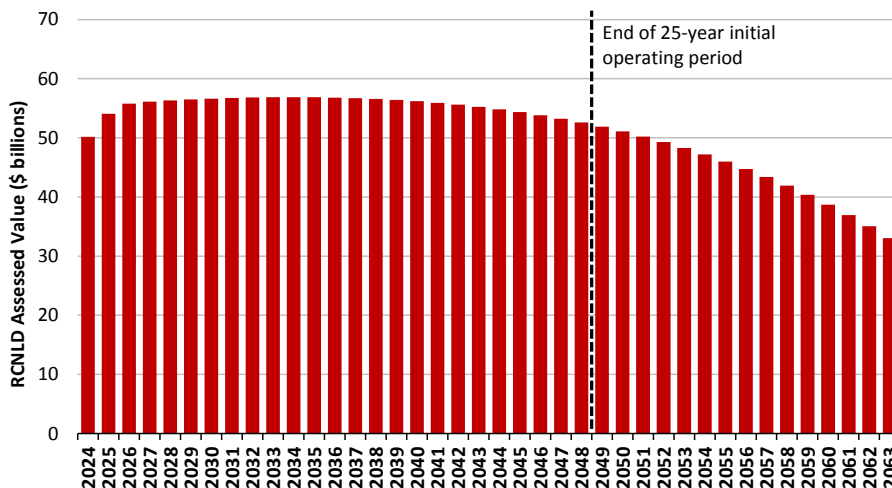
30-year Depreciation



40-year Depreciation



50-year Depreciation

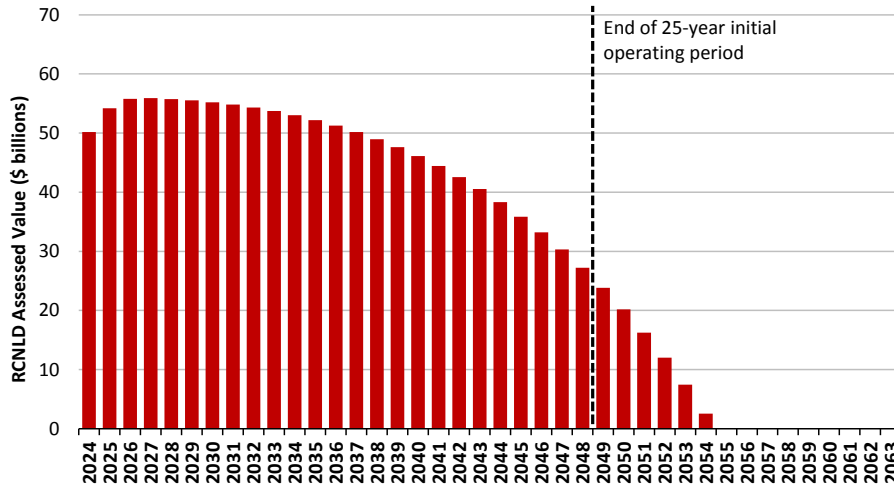


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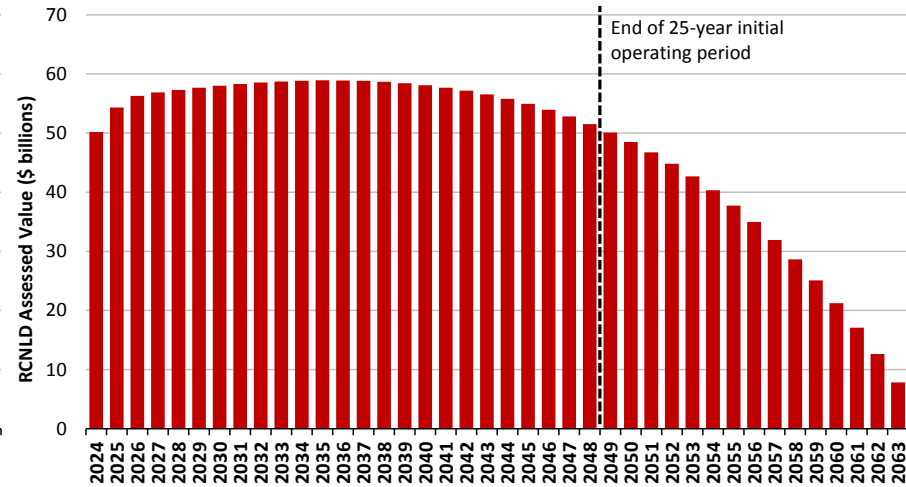
- All cases shown on this side assume **2.5%** annual escalation
- The 30-year depreciation case results in rapid decline in asset value. By the end of the initial 25-year operating period, the RCNLD value is reduced to \$22 billion.
- Under the 40-year depreciation case, RCNLD value is reduced from \$55 million to about \$40 billion by the end of the initial 25 operating years.
- Under the 50-year depreciation case, RCNLD value remains above \$50 billion throughout the initial 25 operating years.

Depreciation Cases: Assessed RCNLD Value @ 3.5% Escalation

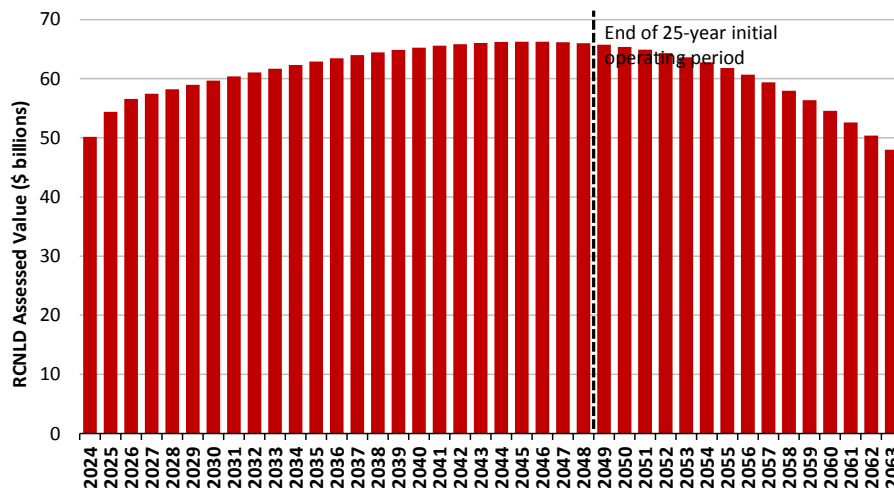
30-year Depreciation



40-year Depreciation



50-year Depreciation



Notes:

- All cases shown on this side assume **3.5%** annual escalation
- The 30-year depreciation case results in rapid decline in asset value. By the end of the initial 25-year operating period, the RCNLD value is \$27 billion.
- Under the 40-year depreciation case, RCNLD value remains above \$50 billion throughout the initial 25 operating years.
- Under the 50-year depreciation case, RCNLD value increases to \$66 billion by the end of the initial 25 operating years.

Property Tax During Initial 25 Years of Operations: Results

Property Tax During Initial 25 years of Operations (\$ millions)				
Depreciation Period	2.0% p.a. Escalation	2.5% p.a. Escalation	3.0% p.a. Escalation	3.5% p.a. Escalation
25 years	12,846	13,412	14,013	14,651
30 years	15,024	15,777	16,581	17,440
35 years	16,571	17,456	18,404	19,421
40 years	17,726	18,710	19,766	20,900
45 years	18,621	19,682	20,821	22,047
50 years	19,335	20,457	21,664	22,962