Municipal Advisory Gas Project Review Board

February 20th, 2015

Agenda item:

Payment in Lieu of Tax (PILT)

Commissioner Randall Hoffbeck

Recap from November 2014

- Defining principles for Property Tax PILT Mechanism

Defining principles for new LNG PT
• **Fair** ○ Must be fair and equitable to all stakeholders • **Clarity** ○ Must be easy to be understood • **Robust/Durable** ○ Should be able to cope with changing future needs • **Unambiguous** ○ Should not be subject to judgement and interpretation • **Commercially sound** ○ Must enable Alaskan LNG project to compete in global market

  - Reflected in Report to the Governor, in December 2014

- MAGPR Board Teleconference in January 2015
  - Administration asked to set out PILT concepts to enable process to move from analysis mode to solution mode

Proposed process for H1 2015

Defining principles for new LNG PT

- **Fair**
  - Must be fair and equitable to all stakeholders
- **Clarity**
  - Must be easy to be understood
- **Robust/Durable**
  - Should be able to cope with changing future needs
- **Unambiguous**
  - Should not be subject to judgement and interpretation
- **Commercially sound**
  - Must enable Alaskan LNG project to compete in global market

- Step 1: Establish a PILT methodology based on the principles of clarity, robustness, and lack of ambiguity

Establish PILT formula and distribution through dialogue with MAGPR Board

- Step 2b: Establish whether PILT enables a globally competitive project

- Step 2a: Establish distribution of PILT revenues based on principle of fairness

Feedback from AK LNG Project on **Formula only**

Establishing the PILT formula and distribution will be the core focus for the MAGPR

Potential Features of PILT formula – Challenges

Measure	Clear	Robust/durable	Unambiguous	Comments
Replacement Cost New	🟢	🔴	🔴	Open to interpretation
Obsolescence	🔴	🔴	🔴	Difficult to apply to LNG
Depreciation methodology	🟡	🔴	🔴	Financial versus plant actual life
Sales based approach	🔴	🔴	🔴	Sales of gas difficult to audit
Property Tax as Gas	🔴	🔴	🔴	Valuation challenge

Application of some of the Property Tax Methodology applied to oil, becomes harder to apply reliably to LNG

Potential Features of PILT formula – Screened Parameters

Measure	Clear	Robust/durable	Unambiguous	Comments
Actual Cost	🟢	🟢	🟢	Fully auditable
Design throughput	🟢	🟢	🟢	Eg acceptance trials for EPC
Actual gas flow	🟢	🟢	🟢	Metered accurately
Annual inflation	🟡	🟢🟠	🟡	Established measure
Tax rate	🟢	🟢	🟢🟠	Clear for AS 43.56 plant

Applying a screen for easily understood, durable, and clear parameters provides sufficient basis for a PILT

Combining Acceptable Parameters into a PILT

Measure
Actual Cost
Design Throughput
Actual Gas Flow
Annual inflation
Tax Rate

Actual Cost

Foundation of Property Tax Calculation

Combining Acceptable Parameters into a PILT

Measure
Actual Cost
Design Throughput
Actual Gas Flow
Annual inflation
Tax Rate

Actual Cost

$$\frac{\text{Actual Gas Flow}}{\text{Design Throughput}}$$

Ratio of actual throughput to design throughput introduces relationship to a flow based formula. Flow could be averaged over a period of time.

Combining Acceptable Parameters into a PILT

Measure
Actual Cost
Design Throughput
Actual Gas Flow
Annual inflation
Tax Rate

$$\text{Actual Cost} \quad \frac{\text{Actual Gas Flow}}{\text{Design Throughput}} \quad \frac{\text{Year (n) Index}}{\text{Year (0) Index}}$$

Using a measure of inflation, such as Consumer Price Index (CPI), maintains real value of PILT

Combining Acceptable Parameters into a PILT

Measure
Actual Cost
Design Throughput
Actual Gas Flow
Annual inflation
Tax Rate

$$\text{Actual Cost} \quad \frac{\text{Actual Gas Flow}}{\text{Design Throughput}} \quad \frac{\text{Year (n) Index}}{\text{Year (0) Index}}$$

20 mills

Statutory Rate for Oil and Gas Property Tax (AS 43.56)

Potential Additional Features – Gas Flow Exponent

$$\text{Actual Cost} \left(\frac{\text{Actual Gas Flow}}{\text{Design Throughput}} \right)^{n} \frac{\text{Year (n) Index}}{\text{Year (0) Index}} \quad 20 \text{ mills}$$

n- flow ratio raised to the power “n” (where n is less than 1) to reflect greater capital efficiency of expansion/de-bottlenecking

Potential Additional Features – Inflation adjustment

$$\text{Capital Cost} \quad \frac{\text{Actual Gas Flow}}{\text{Design Throughput}} \quad \frac{\text{Year (n) Index - y}}{\text{Year (0) Index}} \quad \text{20 mils}$$

Adjustment to inflation denominator, y, to better reflect underlying value of hydrocarbon sales

Potential Additional Features – Tax Rate

$$\text{Actual Cost} \quad \frac{\text{Actual Gas Flow}}{\text{Design Throughput}} \quad \frac{\text{Year (n) Index}}{\text{Year (0) Index}} \quad 20 \text{ mills}$$

Amended Mill rate to reflect location and statutory differences.

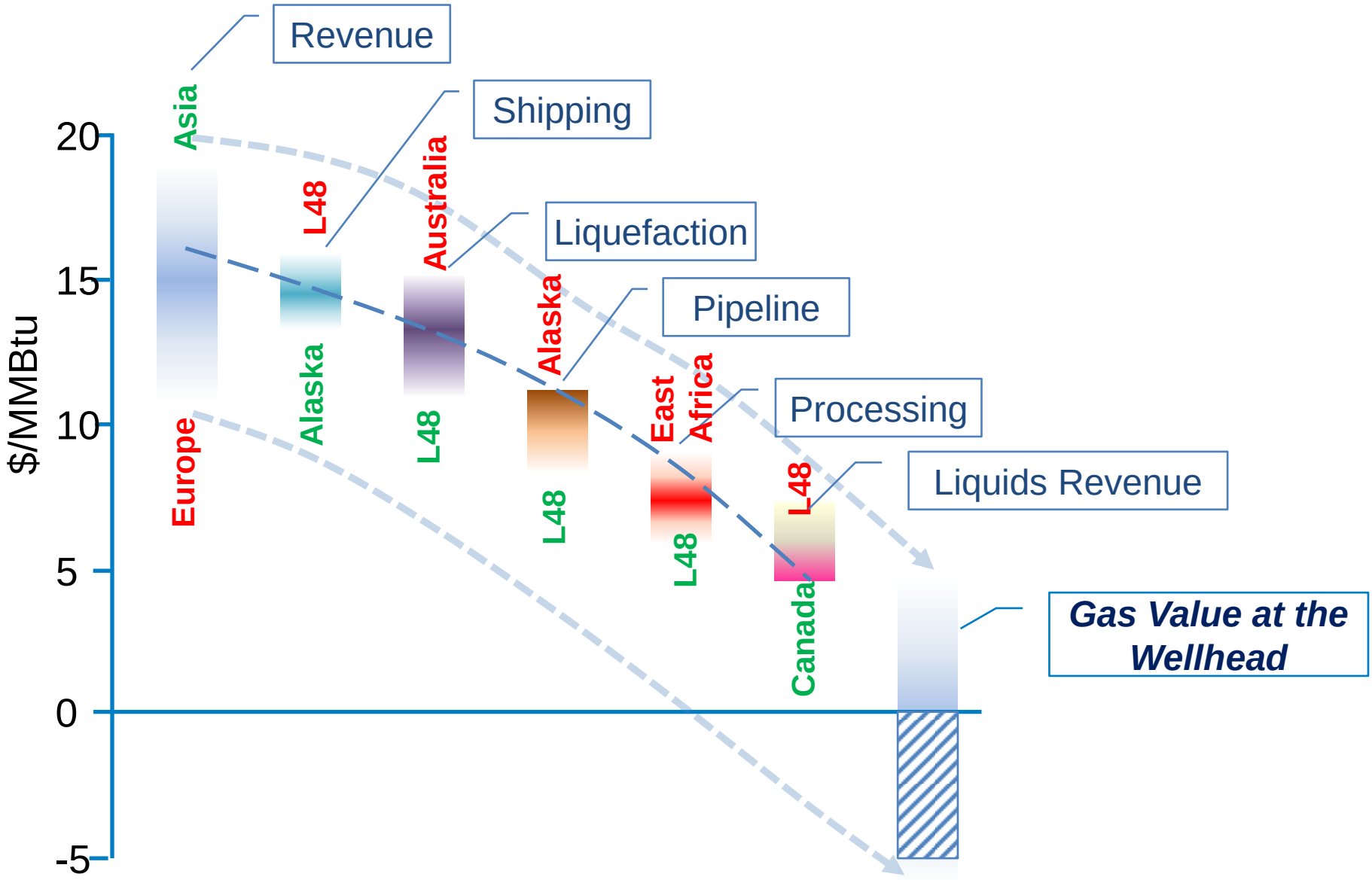
Basic equation:

$$\text{Actual Cost} \times \frac{\text{Actual Gas Flow}}{\text{Design Throughput}} \times \frac{\text{Year (n) Index}}{\text{Year (0) Index}} \times 20 \text{ mils}$$

Each component of the project would have its own PILT driven by different base parameters. This could also include different secondary parameters such as gas flow exponent, inflation adjuster, and Mill rate

Potential Building Blocks for a clear, unambiguous and durable approach to a PILT for AK LNG

LNG Value Chain Schematic



PILT represents a material element of supply costs

LNG project competitiveness:

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- **Commercially sound**
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$$\left(\text{Actual Cost} \times \left(\frac{\text{Actual Gas Flow}}{\text{Design Throughput}} \right)^{n} \times \frac{\text{Year (n) Index - y}}{\text{Year (0) Index}} \times 20 \text{ mils} \right) \times \text{adjustment factor}$$

Based on a $50bn capital cost, and a design throughput of 3bcfd, the estimated PILT would be $1bn or 91c/mcf in first year

In order to comply with the final criteria identified for the PILT, an overall adjustment may be needed

Potential Building Blocks for a clear, unambiguous and durable approach to a PILT for AK LNG

Potential Basis for Impact Fee mechanism

FERC Resource Report # 5 (Socio-Economic) posted online last week:

FERC Docket # PF 13-12-000
http://elibrary.ferc.gov

Submittal 20150211-5025	02/10/2015 02/11/2015	PF14-21-000	Alaska LNG Project - Resource Report 5 (SocioEconomics) by Alaska Gasline Development Corporation, BP Alaska LNG LLC, ConocoPhillips Alaska LNG Company, ExxonMobil Alaska LNG LLC, TransCanada Alaska Midstream LP in PF14-21. Availability: Public Highlighted Version

FERC NEPA Pre-Filing was submitted 11th Feb

Next Steps

- Discuss PILT Building Blocks
  - Are there other, more appropriate drivers for deriving a PILT?
- Consider refining mechanisms:
  - Gas flow index to reflect capital efficiencies
  - Capturing inflation in a fair and equitable manner
  - Mill rate vs AS 43.56
  - X Factor to enable a competitive project

- Follow FERC NEPA Pre-File process

Potential Building Blocks for a clear, unambiguous and durable approach to a PILT for AK LNG