Cash Flow Options for Oil Tax Credits

APFC as a Fiduciary

- The prudent investor rule requires the APFC to make independent investment decisions
- APFC investment decisions are independent of State of Alaska policy considerations
- APFC investments in Alaska must equal or exceed out-of-state opportunities
- This is law and best practices
- Therefore this investment opportunity must stand on its own relative to other opportunities without consideration of State policy priorities

Introduction to Credit Program

- Alaska's production tax and incentives differ between the North Slope, Cook Inlet, and all other regions of the state ("Middle Earth")
- There are non-transferable credits, like the small producer credit, or the per barrel credit, that can only be used to offset a taxpayer's tax liability in the production year
- There are credits that are transferable in that they can be carried forward to offset future tax liability, sold to another taxpayer, <u>or, to the extent State funding is appropriated, redeemed for cash from the State</u>

Carryforward Annual Loss Credits

- Most are "carryforward annual loss credits" which are received when a lease expenditure is not offset by income
  - sometimes called "net operating loss credits"
- Once earned, a producer applies for and receives a tax credit certificate
- That certificate can be redeemed
  - as an offset to owed production taxes; or
  - for cash if production is less than 50,000 bpd
- Certificates can be freely transferred to third parties, but once transferred can only be used by the transferee to offset up to 20% of current production tax liability (and not for cash).

Assignment

- Within 30 days of when a carryforward annual loss credit is applied for, a producer may "assign" the cash payment to a third party
  - Example: a bank that lends a producer money and is assigned the future cash flow payment by the State as all or part of collateral for loan
- Limitations
  - Once transferred a certificate cannot be redeemed for cash
  - A producer cannot name an "assignee" after 30 days of filing for the certificate.
  - Thus for a producer to sell the right to future payment under an existing non-assigned certificate to a third party, the money must first be paid to the producer

Why Redeemable Tax Credits Not Paid

- Credits redeemable for cash paid based on priority until funds in account depleted
  - Priority based on filing, with like timed filed applications paid pro rata
- Statute provides the State will fund about $30 million annually for the redeemable pool, but State has historically appropriated enough each year to pay all redeemable credits
  - Except FY 2016 & FY 2017

FY 2016 & 2017

- Unpaid from FY 2016, is a line-item veto of $200 million
- For FY 2017, there was a projected credit obligation of $760 million
- Legislature did not pass necessary changes to restructure the fiscal system for sustainability
- For FY 2017, Governor Walker vetoed $430 million of $460 million appropriated for cash payments for the "Refunded Credit" program
  - ~$30 million under statutory formula not vetoed

- "Walker said the administration would work with companies and the Legislature to find other ways to eventually pay the credits. He emphasized that he could not approve the spend out of savings without a long-term fiscal plan that legislators all but rejected."
  - Associated Press and Alaska Journal of Commerce (Posted: Wed, 06/29/2016 - 8:25pm)

Department of Revenue estimated scale of Cash Credits

millions $	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
Total Refunded Credits	30	1,170	285	190	150	150	150	150	150

Source: Department of Revenue, forecast

Potential Action

- State can pay the credits immediately – cannot occur without legislative appropriation
- State can provide clarity around a short term and long term plan
- Operator can arrange debt financing against future credit payments
- Operator can exchange equity for credit position
- Operator can sell credit certificate
  - Heavy discount, since market is thin, a small number of companies can use credit certificates, and value of credit is capped
- Operator or assignee can sell right to future payment from the State on credits

Purchasing Right to Payment
No Assignee

Purchasing Right to Payment With Assignee

Purchasing Right to Payment Pricing = Costs & Risks

- Transaction cost
- Time value of money
- State credit risk
  - State of Alaska no-pay or partial pay risk
  - State of Alaska timing payment risk
- Other credit risk
  - Assignee risk, if assigned
  - Operator risk
    - Filing risk (for new credits)
    - Audit risk
    - Pass through risk, if not assigned

Examples

- Example 1:
  - Bank 1 lent 85% of $120 million credits in 2015, with a first position in 2016 credits and second position in field assets. So bank only owed 65% of all credits due next September.
    - But Operator challenged to pay interest between now and when credits presumed paid in Fall 2017.
  - Operator has residual right to 5% of 2015 and 100% of 2016 credit payment.
  - Another lender for field infrastructure has first position on field assets, and second position on credits.
  - A purchase of the 2015 credit assignments at 90% par makes bank whole and operator gets $.05 on dollar. Second lender happy because bankruptcy avoided.
  - Purchaser has little operator risk, assignee risk negligible, so this is primarily a State credit play.

Examples

- Example 2:
  - Bank 2 lent 95% against $100 million in 2015 credits, also secured by field assets in producing field.
  - Bank 2 loan comes due this month; private equity commitments held up due to loan situation.
  - A 90% par purchase of credit assignments would not make Bank 2 whole, but Operator might very will work with PE funding to make Bank 2 whole to access further financing for next project phase.
  - Purchaser has little operator risk, assignee risk negligible, so this is primarily a State credit play.

Appendix – Statute Credit Guide

AS 43.55.019	Oil or gas producer education credit
AS 43.55.023(a)	Qualified capital expenditure credit
AS 43.55.023(b)	Carried-forward annual loss credit
AS 43.55.023(l)	Well Lease Expenditures credit
AS 43.55.023(d)	Transferable tax credit certificate
AS 43.55.023(i)	Transitional investment expenditure credit
AS 43.55.024(a)	New area development credit
AS 43.55.024(c)	Small producer credit
AS 43.55.024(i)-(j)	Per-taxable-barrel credit
AS 43.55.025(a)(1)-(4)	Alternative Tax Credit for Exploration
AS 43.55.025(a)(5)	Cook Inlet jack-up rig credit
AS 43.55.025(a)(6)-(7)	Frontier basin credits
AS 43.55.028	Cash purchases of tax credit certificates