Alaska Industrial Development and Export Authority

Overview of Interior Energy Project and Potential Purchase of Pentex Alaska Natural Gas Company, LLC

Legislative Budget and Audit

February 12, 2015

IEP Goals

- Supply natural gas to Interior Alaska:
  - At the lowest cost possible
  - As many Alaska customers as possible
  - As soon as possible
- IEP investments compliment alternative sources of gas supply from a natural gas pipe line
- Lower PM2.5 in nonattainment areas of Interior

Focus on Full Supply Chain

- Natural Gas Supply
  - Existing North Slope natural gas supply agreements
  - Exploring concepts to purchase low price Cook Inlet natural gas
- LNG Plant
  - Exploring costs of new LNG capacity in Cook Inlet
- Transportation
  - Working with private trucking contractors and AK. Railroad on costs and logistics for a Cook Inlet solution
- Storage
  - AIDEA will work to build FNG's cancelled storage project
- Distribution
  - Ongoing AIDEA financing of buildout
  - Integrating the Interior utilities to lower costs
- Conversions
  - Existing natural gas conversion working group

Work Performed Under the Concession Agreement

- Last January, the AIDEA Board chose MWH to be the private partner for a North Slope LNG project
  - Development of the project was performed under a Concession Agreement
- Concession Agreement set out conditions required for financial close
  - AIDEA had to agree to project costs and commercial terms
  - MWH would provide construction and operating agreements
  - MWH would negotiate and secure LNG supply with utilities
  - Develop a financial model with an agreed LNG price
- AIDEA would take the risk of a natural gas pipeline

Termination of the Concession Agreement

- The Concession Agreement was terminated due to inability to meet conditions of financial close
- Costs to the consumer, based on the CA model, were higher than the community's goal
  - Utilities would not commit to purchase based on modeled prices
  - Reduced consumer willingness to convert at current fuel oil prices
  - The projected delivered price to Fairbanks was high enough that, in conjecture with projected distribution costs, did not achieve the goals of the IEP
- Trucking LNG from the North Slope may still be a viable part of the supply mix for the Interior

Termination of the Concession Agreement and Re-Evaluation

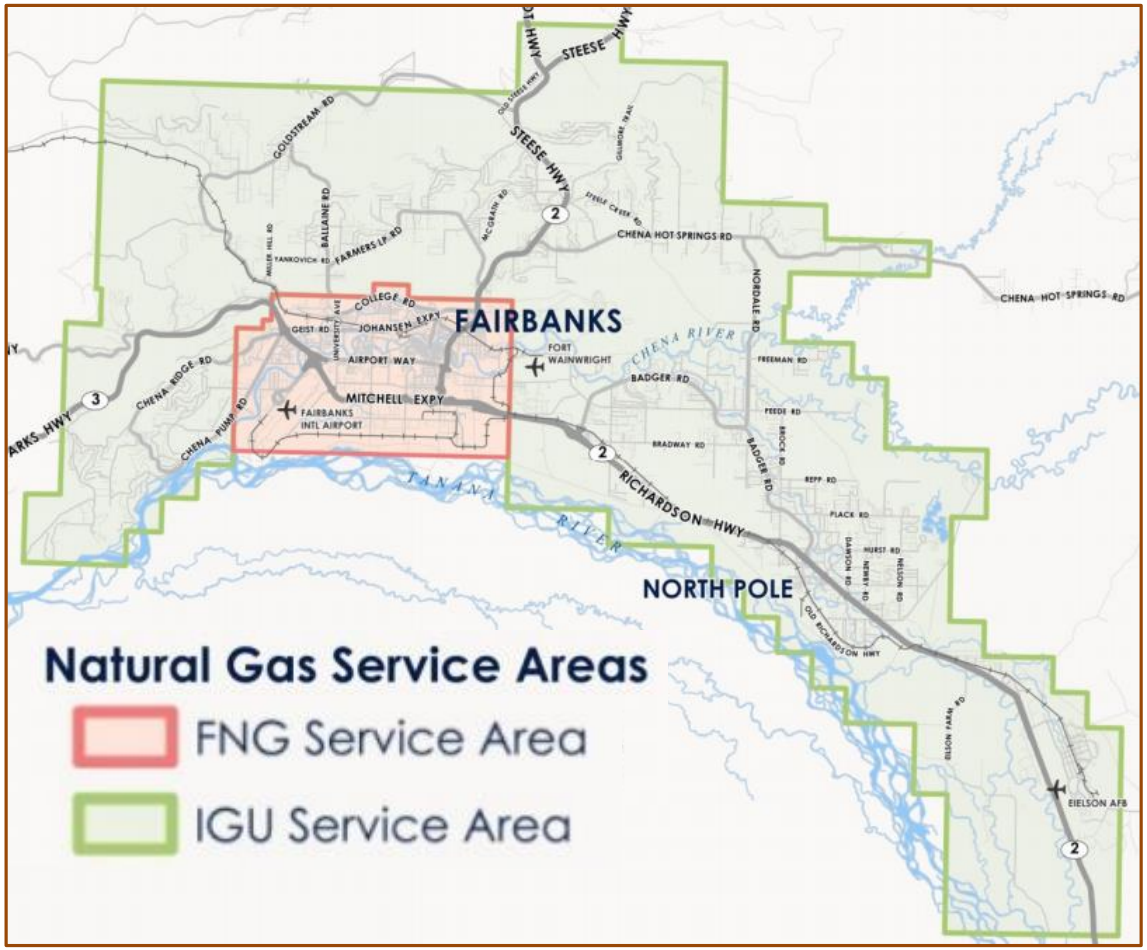
- AIDEA began a process of re-evaluating all options to achieve the intent of the IEP
  - AIDEA shifted its focus quickly
  - AIDEA utilized the deep understanding of the community's energy needs that it gained over the last two years
- AIDEA determined that acquiring PENTEX would advance the goals of the IEP
  - Reduce the cost of natural gas distribution, a key component of the value chain
  - Open up new opportunities for LNG supply
  - Cash-flowing utility could use bonds authorized in SB23

Decision to Begin Negotiations to Purchase Pentex

- Provides the opportunity for immediate and long term rate relief for FNSB customers
  - AIDEA's cost of capital is lower than Pentex's
  - An AIDEA (or local publicly owned) utility is not subject to Federal income tax
  - Certain non-cash expenses (e.g. depreciation) can be eliminated from the rate structure
- AIDEA's preliminary financial plan indicates that FNG rates could be reduced
  - 2015 rates could be reduced by ~8% from current rates or ~14% from proposed rates in pending rate case
  - Estimated FNG 2019 rates could be 15-20% lower

Benefits of Utility Coordination & Integrated Distribution System

- Reduce construction cost
- Reduce O&M and overhead costs
- Restart FNG's efforts to build storage
- Unified effort to purchase LNG
- Faster expansion of service to customers through coordinated build out of system



The Proposed Acquisition of Pentex Alaska

- Pentex is a holding entity that owns Titan LLC, Artic Energy Transportation, Polar, Cassini, and FNG
- Pentex has entered into agreements with Harvest/Hilcorp
  - To sell Titan and AET to Harvest/Hilcorp
  - For FNG to purchase LNG from Harvest
  - These agreement are subject to review by the AG and the RCA
- AIDEA's acquisition of Pentex would not displace any pre-existing contractual obligations for asset sale and LNG supply agreements

Pentex Acquisition Overview

- AIDEA signed a Letter of Intent to purchase Pentex Alaska Natural Gas Company, LLC
  - Signed January 26, 2015
  - Non-binding
  - $52.5 million price includes all Pentex assets
  - Subject to AIDEA due diligence, AIDEA Board vote, and regulatory approval
  - Letter of Intent provides framework for evaluating the proposed purchase through a public process
- Intended to reduce distribution costs
- Opens up new LNG supply options with demand growth
- AIDEA will not directly operate FNG

FNG's LNG Supply Agreement with Harvest/Hilcorp

- Under the agreement, FNG will purchase LNG from Harvest/Hilcorp
  - Only up to the amount of current "baseline" demand – a maximum of 0.95Bcf per year
  - Agreement has a 10-year term
  - Allows FNG to secure other supplies starting after year 5, in the event that a lower-cost supply becomes available
- The agreement does not cover any supplies FNG may secure to meet expansion demand beyond the 0.95 Bcf baseline
  - This agreement provides less than 20% of the total Interior needs

Regulatory Consequences

- FNG has the RCA-granted certificate rights provide the core Fairbanks area with natural gas
  - FNG would be rate regulated under a pending RCA rate case
- As a political subdivision of the state, it is most likely that an AIDEA owned FNG will not be regulated by the RCA
- AIDEA owned utility would be akin to a utility owned by a municipal or borough government
- AIDEA would have to seek a transfer of FNG's certificate to AIDEA or to AIDEA's designated utility operator

Additional Cook Inlet Supplies

- The rationale of acquiring Pentex and FNG is not dependent on:
  - Securing additional supply of lower cost natural gas from Cook Inlet or
  - Using any particular supply of gas for expanded demand
- The proposed Pentex/AIDEA purchase does not restrict AIDEA and AEA from pursuing other supply options
  - AIDEA has put together a team that will be tasked to looking for the optimal sources of gas supply
- AIDEA does not expect the relatively small demand of the Interior could significantly impact Southcentral's gas supply

Due Diligence Review of the Proposed Purchase of Pentex

- Full due diligence will be completed before the deal is approved
  - Full financial, technical, and legal review
  - Ensure proposed purchase price reflective of fair market value
  - Examine the existing agreements with Hilcorp
  - Complete finance plan that shows AIDEA will recover its investment with rate of return under AS: 44.88.172
  - Ensure purchase will advances the Interior Energy Project goals and promotes economic development
  - Solicit review and advice of local governments

Due Diligence Review of the Proposed Purchase of Pentex

- AIDEA is in the process of gathering all information from Pentex relevant to the proposed purchase
  - All Pentex assets, liabilities, operations, etc.
  - Evaluate Pentex vs. comparable companies to determine final terms and feasibility
- AIDEA intends to hold Pentex assets for a short period
  - After the assumed sale of Titan and AET to Harvest/Hilcorp
  - Create an integrated plan for storage and distribution with other utilities
  - Secure long term supply
  - Establish lowest cost financing

Analysis of AIDEA's Cost to Provide Gas

- As part of its due diligence, AIDEA will ensure that it will be able to reduce the cost of natural gas with the proposed purchase of Pentex
- AIDEA's analysis of cost will be based on:
  - The negotiated terms for the proposed purchase of Pentex
  - FNG's historic operating costs
  - Known capital costs for storage and distribution expansion
  - AIDEA's internal financing costs
  - LNG purchase cost under existing agreement
  - Estimated alternative LNG purchase costs above baseline demand

AIDEA's Authority and Ability to Purchase Pentex

- AIDEA has the statutory authority to purchase Pentex
  - Does not need new legislation or new appropriation
  - Proposed purchase under its powers in AS 44.88.172(a)
  - Funds from AIDEA's Economic Development Account
- AIDEA has used these funds to invest in projects such as the Endeavor Jack-up Rig
  - AIDEA recently sold its share and received payment this week
- To move IEP forward it may be useful to use:
  - SB 23 appropriated funds for purpose other than a North Slope LNG plant (requires a re-appropriation)
  - SB 23 SETS funds to finance an LNG plant at any location (requires a legislative amendment)

Natural Gas Distribution Financing

- In 2014, AIDEA financed:
  - FNG's build out of 33.4 miles of pipe in Fairbanks
  - IGU's system design and purchase of pipe
- The AIDEA Board recently approved IGU's application for a $30 million financing
  - Summer 2015 construction of Phase 1 (North Pole build out – 72 miles reaching 2,177 customers)
- In 2015, FNG projects to build out approximately 26.2 miles of pipe in Fairbanks

Statutory Authority to Make Loans for Distribution System

- Under SB 23, financing the LNG plant is limited to the North Slope
- No such limitation regarding financing the needed expansions of Interior natural gas distribution
  - AIDEA's proposed purchase of Pentex is to provide a cost effective means to expand the distribution system
  - Section 11(a) of SB 23 does not contain an express limitation on the type of natural gas that can be used in a "natural gas distribution system and affiliated infrastructure in Interior Alaska" under SB 23

AIDEA's Remaining Funds for the Interior Energy Project

- SB 23 authorized AIDEA to utilize up to $275 of SETS financing to advance the Interior Energy Project
- AIDEA has $222.2 million of SB 23 financing remaining
  - SETS (original appropriation) balance: $16.1 million
  - SETS (SB 23 appropriation) balance: $72.2 million
  - AIDEA SETS Bonds (SB 23): $150 million
- In addition, AIDEA received a $57.5 million capital budget appropriation for use of a North Slope LNG production and distribution system
  - $45 million of the capital budget appropriation remaining

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Questions?