



2022 Interior Energy Project



Quarterly Report to the Alaska State Legislature

Second Quarter 2022





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List of **Acronyms**

AIDEA	Alaska Industrial Development and Export Authority
AS	Alaska Statute
CPCN	Certificate of Public Convenience and Necessity
COVID-19	Coronavirus Disease 19
DOT&PF	Alaska Department of Transportation & Public Facilities
FA	Financing Agreement
FEED	Front End Engineering and Design
FID	Final Investment Decision
FNG	Fairbanks Natural Gas
FNSB	Fairbanks North Star Borough
HB	House Bill
HILCORP	Hilcorp Alaska, LLC
IEP	Interior Energy Project
IGU	Interior Gas Utility
LNG	Liquefied natural gas
Mcf	Thousand cubic feet
MOU	Memorandum of Understanding
PACE	Property Assessed Clean Energy
Pentex	Pentex Alaska Natural Gas Company, LLC
PSA	Purchase and Sale Agreement
RCA	Regulatory Commission of Alaska
RUS	Rural Utilities Service
SETS	Sustainable Energy Transmission and Supply Development Fund
SLA	Session Laws of Alaska
Titan	Titan Alaska LNG, LLC
USDA	United States Department of Agriculture

Interior Energy Project Introduction

Quarterly Report to the Alaska State Legislature

House Bill (HB) 105 passed the 29th Alaska Legislature on April 27, 2015, and was signed into law on June 30, 2015. This legislation was enacted to renew and advance the Interior Energy Project (IEP), a project designed to bring low-cost energy to as many residents and businesses of Interior Alaska as possible, as quickly as possible. The financing package refreshed by this legislation provided the Alaska Industrial Development and Export Authority (AIDEA) the tools necessary to develop an integrated supply chain bringing lower-cost energy to residents and businesses through local utilities.

A critical component of the original financing for the IEP was the ability to provide financing for the project that would permit the development of a unified gas utility with competitive rates (Chapter 26, Session Laws of Alaska [SLA] 2013). The passage of initial legislation in 2013 provided AIDEA with several financial tools and a designated deposit of \$125 million into the Sustainable Energy Transmission and Supply Development Fund (SETS; Alaska Statute [AS] 44.88.660). The legislation included a limitation on interest charged for the project financing and an allowance for AIDEA to waive “any limitations or requirements of its regulation that are otherwise applicable to the Alaska Industrial Development and Export Authority sustainable energy transmission and supply development fund.” This language was retained in the IEP financing tools when HB 105 became law on June 30, 2015, expanding the possible sources of energy for the project.

HB 105 required AIDEA to provide written quarterly reports to the Alaska State Legislature on the status of the IEP. The specific bill language includes:

“The Alaska Industrial Development and Export Authority shall submit quarterly to the legislature a written report on the Interior Energy Project. The authority shall deliver the report to the senate secretary and the chief clerk of the House of Representatives and notify the legislature that the report is available. The report must include:

- (1) a description of project progress on all components;*
- (2) an update on the status of local distribution infrastructure buildout;*
- (3) to-date and anticipated conversions; and*
- (4) a financial accounting of funds expended and funds anticipated to be spent, including loans, grants, and bonds.”*



Interior Energy Project

Introduction (cont'd)

Quarterly Report to the Alaska State Legislature

On September 21, 2017, the AIDEA Board considered and approved a development plan that met the requirements of HB 105 outlined above. Reaching this milestone provided the Authority access to the remaining IEP financial tools. AIDEA continued to advance IEP goals by pursuing consolidation of the existing natural gas utility infrastructure owned by AIDEA under Pentex Alaska Natural Gas Company, LLC (Pentex), with infrastructure owned by the Interior Gas Utility (IGU).

This is the twenty-eighth quarterly report submitted under the HB 105 requirements. Each section of the report corresponds to one of the four items required by the legislation. This report augments information previously provided and covers the period from April 1, 2022 through June 30, 2022.



To date, approximately 215 miles of natural gas distribution lines have been installed throughout the core, non-attainment areas of Fairbanks and North Pole.

Description of Project Progress on All Components

The IEP effort is structured on the following project components: Supply, Liquefaction, Transportation, Distribution (including Storage and Regasification), and Conversions.

Following negotiations in 2016, a non-binding Utility Integration Memorandum of Understanding (MOU) was approved by the IGU and AIDEA Boards in January 2017. The purpose of the MOU was to provide guidance and structure for a separate Financing Agreement (FA) and Purchase and Sale Agreement (PSA), designed to form a single, investment-grade natural gas sourcing and distribution utility within the Fairbanks North Star Borough (FNSB) through the sale of the AIDEA-owned Pentex Natural Gas System, commonly referred to as Fairbanks Natural Gas (FNG), to IGU.

Although the PSA and FA were signed in December, IGU approval was contingent on a final vote of the utility Board prior to the target closing date of May 31, 2018. Final closure of the utility consolidation was extended to June 14, 2018, by mutual consent of AIDEA and IGU, due to last-minute discussions. With these negotiations concluded, the IGU Board approved finalization of the consolidation deal on June 12, 2018, and the closing documents were signed on June 13, 2018. Under the terms of the PSA and FA, the IEP will now progress utilization of the project financing authorized under Chapter 26, SLA2013, and capital funds appropriated in Sec. 11, Ch. 38, SLA2015, page 32, lines 17–25. As required by HB 105, the status of Supply, Liquefaction, Transportation, Distribution (including Storage and Regasification), and Conversions is summarized below.

Supply

IGU executed a natural gas supply contract with Hilcorp Alaska, LLC (Hilcorp), to provide the current liquefaction facility with natural gas with an effective date of January 1, 2021. This Agreement provides IGU with enough capacity (5 million cubic feet/day) for its existing customers, and allows for the expansion of up to 15 million cubic feet/day upon 18 months' advance notice to Hilcorp. The contract has an initial term of five years and may be extended for up to two additional three-year terms.

The IGU Board in January of 2021 passed Resolution 2021-1 authorizing the General Manager to enter into an LNG supply contract as a back-up source of gas with Cryopeak LNG Solutions, Corporation (Cryopeak). The agreement with Cryopeak specifies the purchase from a new LNG plant located in Fort Nelson, BC, Canada. The Fort Nelson LNG facility became operational on June 8, 2021. IGU is purchasing approximately 250,000 gallons (20,600 MCF) in 2022 to bolster its supplies and may purchase additional volumes under this contract.

Liquefaction

Additional liquefaction capacity is needed to support IGU's growth. In light of recent announcements that the supply of natural gas in the Cook Inlet is not guaranteed past current contracts, IGU is exploring all available options. A solution will likely come from a combination of Cook Inlet gas, North Slope gas, and imported LNG. The IGU Board of Directors is expected to make a decision in 2022 regarding additional LNG capacity.

LNG expansion under ownership and control of a consolidated natural gas utility structure will necessitate access to AIDEA project bonds that were pre-authorized with the passage of Chapter 26, SLA2013. HB 119, passed by the Alaska Legislature on May 12, 2018, extends access to the bonds for the purpose of project financing through June 30, 2023. HB 307, extending the sunset date of AIDEA's authorization to issue bonds for the Interior Energy Project through July 1, 2028 was signed into law on June 8, 2022.

On March 3, 2020, the AIDEA Board authorized Resolution NO. G20-03¹. Resolution NO. G20-03 authorizes AIDEA to issue up to \$78,000,000 in conduit revenue bonds to finance IGU projects located in the Matanuska-Susitna Borough and FNSB. IGU decided to move forward with a smaller financing package consisting of issuing \$11,790,000 of conduit revenue bonds in September of 2020 to fund a portion of IGU's capital improvement plan. This issuance of bonds is being used for:

- A. A portion of the costs of the acquisition, construction, expansion, furnishing, and equipping of natural gas mains, residential and commercial natural gas service lines, and customer meter sets to be located in the FNSB
- B. A portion of the costs of advancing the design of the acquisition, expansion, renovation, furnishing and equipping of natural gas liquefaction facilities in the Matanuska-Susitna Borough.
- C. Capitalized interest on the bonds
- D. Funding of a debt service reserve account and costs of issuance.

IGU installed approximately 200 service lines in 2020 and 312 in 2021, with 600 additional service lines planned to be added in 2022.

¹ "RESOLUTION OF THE ALASKA INDUSTRIAL DEVELOPMENT AND EXPORT AUTHORITY PROVIDING FOR THE SALE OF NOT TO EXCEED \$78,000,000 OF ALASKA INDUSTRIAL DEVELOPMENT AND EXPORT AUTHORITY REVENUE BONDS (INTERIOR GAS UTILITY PROJECT) SERIES 2020A; AUTHORIZING AN INDENTURE BY AND BETWEEN THE AUTHORITY AND U.S. BANK NATIONAL ASSOCIATION, AS TRUSTEE, TO SECURE SAID BONDS; AUTHORIZING THE EXECUTION OF A LOAN AGREEMENT SECURING PAYMENT OF SAID BONDS.

Transportation

Rail Option Update

IGU continues to explore the potential for shipments of LNG with the Alaska Railroad Corporation (ARRC) as part of the overall IEP effort. On June 21, 2021, ARRC received a renewal of the Federal Railroad Administration’s approval to transport liquefied natural gas, in intermodal portable tanks, in container-on-flatcar service on the ARRC rail system. The approval authorizes up to two trains per week with each train containing a maximum of 24 loaded portable tanks. The approval is effective through December 31, 2022.

IGU, FNSB, Mat-Su Borough, and ARRC formed the Alaska Railbelt Clean Energy Transportation Infrastructure Growth Cluster and submitted a joint application for the Build Back Better program in October 2021. While the proposal wasn’t selected for phase II, it did create opportunities for all of the above-listed entities to identify common goals. As work continues to increase LNG storage capacity in the FNSB, rail delivery will be given future consideration.



Large-capacity fleet vehicle

Trucking Update

The fleet has seen the addition of large-capacity trailers, configured to facilitate the addition of a hitch at a later date, which will allow an additional “pup” trailer to be pulled if this proves to be feasible and is determined to be economically advantageous. IGU also utilizes two Kenworth T-800 trucks fueled by LNG as part of its fleet.

Distribution

During the period covered by the Report, the IGU continued to sign up new customers for service. IGU's goal for the 2022 construction season is 600 new service lines and, as of the end of the quarter, approximately 450 applications were vetted and approved for 2022 construction and 100 were installed. Of the 450 approved for construction, 18% are commercial and 82% are residential properties; 35% are in North Pole and 65% are in Fairbanks.

Increased LNG storage capacity from the commissioning of a 5.25MM gallon storage tank in Fairbanks in 2019, and a 150,000-gallon plant in North Pole in 2021, allows IGU to add new customers and IGU will continue to install new service lines. IGU installed approximately 200 service lines in 2020 and 312 in 2021.

IGU budgeted \$1MM for short main line extensions for the 2022 construction season. As of the end of the quarter, approximately 5,500 ft of main line were installed.

In December 2017, the AIDEA and IGU Boards agreed to initiate construction of a 5.25 million gallon LNG storage tank. Following a competitive Request for Proposals process, Preload Cryogenics was selected as the primary Engineering, Procurement, and Construction contractor for a facility with a double-walled, full-containment design. This facility was completed in December 2019.

Construction of a new LNG storage and vaporization facility with a total 150,000-gallon capacity was completed in February 2021 and is in full operation serving the North Pole distribution system. The completion of the North Pole facility facilitated gasification of over 70 miles of distribution system and provides natural gas service to the North Pole community for the first time in its history. Additionally, completion of these storage projects provides IGU access to significantly more customers in support of its customer growth.



North Pole Storage & Vaporization

The completion of the North Pole facility...provides natural gas service to the North Pole Community for the first time in its history.

Conversion

Efforts to assist consumers with conversion to natural gas have centered primarily on access to favorable financing mechanisms and identification of possible low-cost loan funds. Work has also been done with furnace and boiler manufacturers regarding new boiler components that may reduce the cost of individual customer conversion to natural gas.

On September 23, 2021, the FNSB adopted Ordinance NO. 2021-2-D which among other things, appropriates \$1 million from federal coronavirus state and local fiscal recovery funds established under the American Rescue Plan Act to the Oil to Gas Conversion Program. Applications for the program opened to residents on March 25, 2022. The program had a huge success, reaching its maximum capacity in early April. The program pays \$2,500 for a conversion of an oil boiler to natural gas, or \$7,500 toward a new natural gas boiler that is installed in the place of an oil boiler.



On March 17, 2022, the U.S. Environmental Protection Agency awarded \$5.6 million to the Alaska Department of Environmental Conservation to help the Fairbanks North Star Borough improve air quality. \$3.2 million of the awarded amount, originated from a Targeted Airshed Grant, will go toward a combination of the Oil to Gas Conversion Program and Woodstove Changeout program. Customers will be able to use up to \$10,000 per each solid fuel-burning device and up to \$7,500 for each oil-burning appliance. This program gives the ability to combine up to three appliances to pay for one new natural gas appliance. Funding is expected to become available to residents at the beginning of October 2022. FNSB is accepting and processing applications and wait-listing applicants in anticipation of the funding. Another \$1.25MM was allocated from the state capital budget to the Oil to Gas Changeout Program. The budget was signed at the beginning of Q3, and details regarding award rules and timeline are in development.

² "AN ORDINANCE AMENDING CHAPTER 21.28 FNSBC TO ADD A NEW SECTION FNSBC 21.28.045, VOLUNTARY HEATING OIL TO NATURAL GAS OR PROPANE CONVERSION PROGRAM."

Property Assessed Clean Energy Financing (PACE)

Property Assessed Clean Energy (PACE) is a means of financing improvements that increase the energy efficiency of commercial buildings. The improvements are financed with repayment accomplished through a voluntary assessment placed on the annual property tax bill. PACE financing is often structured to allow a longer payback period than is possible with conventional business loans. The strength of the PACE collection mechanism results in low-default/low-risk loans, which may justify a lower interest rate.

PACE legislation (HB 80) was passed by the 30th Alaska Legislature on April 17, 2017. HB 80 was signed into law on October 6, 2017. The Alaska Energy Authority is working with municipalities to determine how to best implement the law.

A municipality with taxing authority is the entity that would authorize and manage the program locally. IGU has identified C-PACE as a priority to FNSB.

On-Bill Financing

To remove ambiguity regarding the allowance of on-bill financing in Alaska, HB 374 was introduced on February 21, 2018. On-bill financing allows utility customers to borrow funds that are repaid via a voluntary line item added to their standard utility bill. This financing mechanism is often used by utilities to assist new customers in overcoming the initial cost of accessing a utility service.

Funds for on-bill financing may be provided by the utility itself or in conjunction with local, private sector financial institutions. Previous conversion surveys and focus group work performed as part of the IEP indicated that access to a transferable financing mechanism would help incentivize conversion to natural gas. Coupling this tool with low-cost loan funds will be helpful. The Alaska Legislature approved HB 374 on May 12, 2018. IGU is looking for opportunities to initiate this program and is seeking potential funding sources. The main barrier the utility is encountering is its ability to manage a program that would (a) not increase its debt coverage ratio, and (b) would not make IGU liable for loan default.

Identified Funding Sources For Conversion Assistance

IGU identified the following possible funding sources for conversion assistance:

- a. Commercial lenders: after contacting all local lenders, IGU has created relationships with three different local banks and credit unions. The lenders either created a new loan product or started marketing existing loan products as oil to gas conversion loans. They are all secured by home equity and have different terms and conditions.
- II. Local government
 - a. PACE-enabled conversion loans
 - b. Possible local government back-stop funding for PACE loans
 - c. Property Tax credits to businesses and residents who invest in property improvements resulting in increased energy efficiency or improved air quality as provided by HB 232, and signed into law on May 18, 2020, with an effective date of July 19, 2020

III. State sources

- a. Air quality programs
- b. Community Development Block Grants

IV. Federal sources

- a. United States Department of Agriculture (USDA) Rural Utilities Service (RUS) Energy Efficiency and Conservation Loan Program
- b. USDA RUS Rural Energy Savings Program loans
- c. Clean Water Fund

Update on the Status of Local Distribution Infrastructure Build-Out

IGU completed minor line extensions related to new service line installations and added 6.75 miles of new main lines during the 2021 construction season. An additional \$1MM was budgeted for the 2022 construction season and 5,500 ft. of main line have been installed as of the end of Q2. Detailed maps of the existing distribution system, before 2022 construction are available at <https://www.interiorgas.com/maps/>

To-Date and Anticipated Conversions and Connections

To-Date Conversions and Connections

- The large storage tank project was completed in December 2019. Increased LNG storage capacity allows IGU to add new customers and IGU continues to install new service lines. The completion of the large storage tank project allowed new customers to begin using natural gas in 2020. IGU installed approximately 200 service lines in 2020 and 312 new service lines during the 2021 construction season.

To date, approximately 215 miles of natural gas distribution lines have been installed throughout the core, non-attainment areas of Fairbanks and North Pole.

- Natural gas mains in the City of Fairbanks have been expanded to now serve approximately 1,650 residential and commercial customers.
- Natural gas mains that have been installed in Fairbanks could serve up to ~8,500 properties.
- Gas distribution lines in the City of North Pole now serve 125 customers.
- Natural gas mains in North Pole could serve up to ~3,000 properties.

Anticipated Conversions

The number of anticipated conversions is based on the Cardno Entrix 2014 analysis. The report assessed “willingness to convert” based on a number of factors related to conversion costs, prior conversion history, survey data, and potential savings. A copy of that report can be found at https://interiorenergyproject.com/wp-content/uploads/2021/05/iep_conversion_analysis_final.pdf

The significant change in the price of heating fuel required a fresh look at the “willingness to convert,” with specific attention paid to the closing of the cost gap between heating fuel and the IEP natural gas price targets. Cardno Entrix was engaged to update the analysis of “willingness to convert” based on a range of scenarios of lowered heating oil prices. In the most conservative scenario, expected conversions were projected to drop by approximately one-third from the original analysis.

The change in projected “willingness to convert,” combined with an extension of the time needed to reach conversions from six to eight years, results in a revision to the number of anticipated conversions and the anticipated demand for the project. Table 1 depicts the anticipated number of conversions, by year, based on the revised Cardno Entrix analysis. IGU in the development of its Financial Model and Proforma took a more conservative approach to the projected “willingness to convert”. Table 1 depicts IGU’s nine-year projected conversions.

Table 2 depicts IGU’s nine year projected conversions.

Table 1: Natural Gas Customer Conversion Projections and Actuals¹

	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025	FY 2026	FY 2027
Cardno Projected	4316	5987	7864	9453	10805				
IGU Projected	1182	1233	1324	1671	2143	2741	3464	4191	4900
Actuals	1182	1233	1448	1765					

¹Due to project delays, the first year in customer growth started to occur in Fairbanks in 2020 and in North Pole in 2021.



Financial Accounting of Funds Expended and Funds Anticipated to be Spent, Including Loans, Grants and Bonds

Table 2 outlines the IEP expenditures related to the \$57.5 million capital appropriation, the \$125 million of SETS fund capitalization, and the \$150 million of SETS bond authorization.

Table 2: Expenditures from and Remaining Funds of Legislative Appropriation & Authorization(s)

Expenditures* from and Remaining Funds of Legislative Appropriation & Authorization(s):					
	HCS CSSB 18 \$57.5 mill Cap Approp	SB 23 SLA 2013 \$125 mill SETS	SB 23 SLA 2013 \$150 mill Bonds	Total	
Development Costs	IEP Phase 1 (Pre HB 105)				
	LNG Plant	7,585,150	-	-	7,585,150
	North Slope Pad	6,003,418	-	-	6,003,418
	Distribution	500,005	-	-	500,005
	Total	14,088,573	-	-	14,088,573
	IEP Phase 2 (Post HB 105)				
	Commodity	100,786	-	-	100,786
	LNG Plant	430,030	-	-	430,030
	Trucking	14,075	-	-	14,075
	Storage	1,517,594	-	-	1,517,594
	Distribution	26,000	-	-	26,000
	Project Management	528,916	-	-	528,916
	Due Dilligence & Deal Structuring	539,230	-	-	539,230
	Total	3,156,631	-	-	3,156,631
	Total	17,245,204	-	-	17,245,204
Loans & Investments	LNG Plant	-	-	-	
	Trucking	-	-	-	
	Storage	-	55,173,868	-	55,173,868
	Distribution	-	48,692,219	-	48,692,219
	Sale of Pentex	40,254,796	21,133,913	-	61,388,709
	Total	40,254,796	125,000,000	-	165,254,796
Total	Total Expenditure	57,500,000	125,000,000	-	182,500,000
	Remaining Funds	-	-	(1)150,000,000	150,000,000
Notes					
<i>Financial data per unaudited accounting system records as of 06/25/2020.</i>					
<i>* Expenditures include Actuals, Encumbrances, and Commitments as of 06/25/2020.</i>					
<i>Legislative Appropriation & Authorization(s) only include those identified above and do not include AIDEA operating, Economic Development Fund, or other sources.</i>					
<i>(1) Additional SETS loans in the amount of \$10 million and \$4 million have been made bringing the total SETS loan to IGU to \$139 million. Bonds of \$136 million of the \$150 million authorized may be issued to provide the \$275 million financing cap authorized under SB23 SLA 2013.</i>					

Summary

The adoption of an HB 105 Plan by the AIDEA Board on September 21, 2017 provided access to IEP financing tools necessary to accomplish consolidation of the Pentex assets (FNG) with IGU under IGU's local control. Transfer of control of FNG to IGU was approved by the Regulatory Commission of Alaska (RCA) on April 30, 2018. The IGU Board approved the close of the consolidation deal on June 12, 2018, and the final closing documents were signed on June 13, 2018.

As a result, IGU has made progress as is outlined below:

Supply

IGU has a long-term contract with Hilcorp which meets its current needs and the required gas supply to support IGU's growth. . This contract is for a base term of 5 years beginning in January 2021 and may be extended by two additional 3-year terms. Additionally, IGU has executed an LNG supply Agreement with Cryopeak LNG Solutions, which enables LNG purchases on an as needed and available basis. There have been no changes to IGU's gas and LNG supply portfolio in the last quarter. IGU management is exploring natural gas supply options.

Liquefaction

There have been no changes to IGU's liquefaction capacity in the last quarter.

Transportation

On June 21, 2021, the Alaska Railroad Corporation (ARRC) received a renewal of the Federal Railroad Administration's approval to transport liquefied natural gas in intermodal portable tanks in container-on-flatcar service on the ARRC rail system. The approval authorizes up to two trains per week with each train containing a maximum of 24 loaded portable tanks. The approval is effective through December 31, 2022. This approval furthers IGU's option to consider utilization of the ARRC in the future.

Distribution

During the period covered by the Report, the IGU continued to sign up new customers for service. IGU's goal for the 2022 construction season is 600 new service lines and, as of the end of the quarter, approximately 450 applications were vetted and approved for 2022 construction and 100 services were installed. Of the 450 approved for construction, 18% are commercial and 82% are residential properties; 35% are in North Pole and 65% are in Fairbanks.



IGU installed 5,500 feet of distribution mains 100 service lines this quarter. Given climate conditions in Fairbanks, the construction season is limited to June to October of each year.

Conversion

On November 14, 2019, the FNSB Adopted Ordinance NO. 2019-45.¹ This Ordinance creates a program to help offset the cost of conversion from heating oil to natural gas or propane. Additionally, the FNSB appropriated \$1 million to fund the program in 2020. The program was very successful and the initial \$1 million of funding has been fully allocated. IGU continues to pursue options for additional funding for this program, and on September 23, 2021, the FNSB adopted Ordinance NO. 2021-2-D which among other things, appropriates \$1 million from Federal coronavirus state and local fiscal recovery funds established under the American Rescue Plan Act to the Oil to Gas conversion program. The program has received significant success and residents started being put on waitlists two weeks after the application period opened. An additional \$3.2 million has been allocated to the program from the Targeted Airshed Act and it is planned to be available to residents starting October 2022.

Another \$1.25MM was allocated from the state capital budget to the Oil to Gas Changeout Program. The budget was signed at the beginning of Q3, and details regarding award rules and timeline are in development.

Financing

IGU issued \$11,790,000 of conduit revenue bonds in September of 2020 to fund a portion of IGU's capital improvement plan. This issuance of bonds is primarily being used for IGU mains and service lines. During the quarter IGU expended \$1,096,424 of the bond funds. Total financing to date related to the IEP is \$150,790,000; \$11,790,000 (Bonding) and \$139,000,000 (SETS).

The next quarterly report is due in October 2022.



³ "AN ORDINANCE AMENDING CHAPTER 21.28 FNSBC TO ADD A NEW SECTION FNSB 21.28.045, VOLUNTARY HEATING OIL TO NATURAL GAS OR PROPANE CONVERSION PROGRAM."