



Interior Energy Project

Quarterly Report to the Alaska State Legislature Interior Energy Project

October 2021



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ACRONYMS LIST

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

INTRODUCTION

During the period covered by the Report, the IGU continued its capital improvements and continued to sign up new customers for service. IGU is in the process of completing minor line extensions related to new service line installations and is adding 6.75 miles of new main lines during the 2021 construction season. These new connecting and main lines work in conjunction with 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. IGU has installed or is currently installing a total of 312 new service lines during the 2021 construction season.

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.”*

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-fifth 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 June 30, 2021, through September 30, 2021.

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 has not made any purchases under this contract as of the date of this report.

Liquefaction

Under the terms of the signed FA and PSA, steps are being taken to finalize the optimal design and commercial structure to increase the availability of liquefied natural gas (LNG) from the Titan plant through a Front End Engineering and Design (FEED) process. IGU contracted Braemar Technical Services to perform the FEED work in late March 2019. The FEED work has been completed and the Final Investment Decision (FID) is awaiting further stabilization of economic conditions. This agreed-upon plan and scope for expansion of LNG production capacity may be modified by mutual consent of IGU and AIDEA.

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. 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.

Given market conditions and turmoil related to the COVID-19 pandemic, IGU reviewed fuel price and demand forecasts, economic studies and assumptions and continues to pause the FID on the Titan LNG Plant expansion; however, IGU remains focused on providing the FNSB with clean burning natural gas.

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

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. As work continues to increase LNG storage capacity in the FNSB, rail delivery will be given future consideration. On June 21, 2021, ARRC received a renewal of the Federal Railroad Administrations approval to transport liquefied natural gas, in



Large-capacity fleet vehicle

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.

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

Systems Expansion

IGU is completing small main line extensions as part of its program to add new services and has budgeted approximately \$1 million in main line extensions for 2021, which provides increased access to natural gas in the FNSB. Before the end of the 2021 construction season, IGU will have installed approximately 6.75 miles of new main lines, providing increased access to natural gas in the FNSB.

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 of 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.

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.



North Pole Storage & Vaporization

On November 14, 2019, the FNSB Adopted Ordinance NO. 2019-45.² 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.

Consumer Interest in Conversion Assistance

The Cardno Entrix *Interior Energy Project Natural Gas Conversion Analysis*, finalized in January 2014, identified a high level of interest in converting to natural gas as a lower cost, cleaner source fuel for space heat if the delivered price approached the target of \$15 per thousand cubic feet (MCF). At the time the Cardno Entrix analysis was performed, many homeowners indicated a desire to forego financing conversion, and instead expressed a willingness to fund this action from personal savings due to the high cost of fuel oil. For individuals without personal funds for this purpose, the ability to finance all, or a portion, of the cost over an extended period scored high as a necessary tool to support their conversion to gas.

The ability to pass the obligation for repayment of conversion financing to a new owner, at the time of sale of a building, proved to be very attractive to residential owners. The ability to spread natural gas conversion costs over a 10- to 20-year period and the use of transferable financing are both

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.”

attributes of two energy efficiency financing mechanisms described below that have achieved widespread use across the continental United States.

Property Assessed Clean Energy Financing

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.

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.

Identified Funding Sources for Conversion Assistance

The Local Conversion Working Group has identified the following possible funding sources for conversion assistance:

- I. Commercial lenders
 - a. Commercial loans as part of a community-wide conversion program
- 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

- d. United States Environmental Protection Agency Targeted AirShed Grants
 1. Funding for the targeted airshed grants was increased to \$40,000,000 by federal budget action.

UPDATE ON THE STATUS OF LOCAL DISTRIBUTION INFRASTRUCTURE BUILD-OUT

IGU is completing minor line extensions related to new service line installations and is adding 6.75 miles of new main lines during the 2021 construction season. Detailed maps of the major build-out accomplished in 2015 are included in the October 1, 2015, *IEP Quarterly Report* that is available in the Archives Section at www.interiorenergyproject.com.

TO-DATE AND ANTICIPATED CONVERSIONS/CONNECTIONS

To-Date Conversions/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. IGU has installed or is currently installing a total of 312 new service lines during the 2021 construction season.

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 2 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 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						

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

Recognition for Capital Improvements and Marketing

In August of 2021, IGU won two awards at the American Public Gas Association's national conference for its work on capital improvements and its marketing efforts to secure new gas customers.

The IGU was one of 38 national winners in the field of safety. It received this award during a busy 2020 work season when it was working on LNG storage in North Pole, and bringing a Vaporization Facility online, in what was a heavy construction season for the utility. The IGU also placed number one in Marketing and Sales. It's campaign in 2020 focused on adding new customers, and its new storage facilities in Fairbanks and North Pole. "The utility utilized social media advertising, placed yard signs all throughout Fairbanks in places where natural gas mains are available and competed a redesign of its website

IGU currently has about 210 miles of gas mains between Fairbanks and North Pole. The utility gives access to its lines to businesses and residences throughout the summer. The IGU was accepting applications for new services in 2021 through August 15th.

Anticipated/Potential Connections

The IEP team is working with the FNSB and the cities of Fairbanks and North Pole to explore mechanisms to ensure that those new housing units use natural gas space heating. Options to be considered include incentives (e.g., reduced cost connections) and potential building code or other mandates. The financial viability of the consolidated FNSB natural gas utility—and its ability to offer low rates attractive enough to drive conversion of existing residences—can be substantially enhanced by adding demand from the new housing units.

FINANCIAL ACCOUNTING OF FUNDS EXPENDED AND FUNDS ANTICIPATED TO BE SPENT, INCLUDING LOANS, GRANTS, AND BONDS

Table 3 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.

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 Financial data per unaudited accounting system records as of 06/25/2020. * Expenditures include Actuals, Encumbrances, and Commitments as of 06/25/2020. Legislative Appropriation & Authorization(s) only include those identified above and do not include AIDEA operating, Economic Development Fund, or other sources. (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.				

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 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 an expansion of the liquefaction facility in Pt. Mackenzie. 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 enable 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.

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

IGU has installed or will install 6.75 miles of distribution mains and 312 new customer service lines during the 2021 construction season. Final construction activities are being completed as of the writing of this report. Given climate conditions in Fairbanks, the construction season is limited to June 15 to October 15 of each year.

Conversion

On November 14, 2019, the FNSB Adopted Ordinance NO. 2019-45.³ 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

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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.

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 \$1,286,512 of the bond funds and \$158,628 of SETS funds. IGU does not have plans to complete additional financing for the remainder of 2021. Total financing to date related to the IEP is \$149,435,943; \$11,790,000 (Bonding) and \$137,645,943 (SETS).

The next quarterly report is due in January 2022.