BLANK ROME LLP
COUNSELORS AT LAW

MEMORANDUM

TO: Alaska Railroad Corporation

FROM: Blank Rome LLP

DATE: March 23, 2009

RE: House Bill 127

C/M # 811156-00301

We are furnishing this memorandum to provide analysis of the effects of House Bill 127 ("HB 127"), now pending in the State Legislature, on (i) the Alaska Railroad Corporation ("ARRC") Capital Grant Receipts Bonds, Series 2006 and Series 2007 (FTA Section 5307 Urbanized Area Formula Funds and Section 5309 Fixed Guideway Modernization Formula Funds) (the "Series 2006 Bonds" and "Series 2007 Bonds", respectively, and collectively, the "Bonds"), (ii) the credit ratings assigned to the Bonds, and (iii) compliance with the provisions of the Alaska Railroad Transfer Act, 45 U.S.C. §1201 et seq. ("ARTA").

1. The Effect of HB 127 on the Bonds.

The Bonds are revenue bonds secured solely by and payable solely from FTA Section 5307 and Section 5309 Formula Funds (collectively, the "Formula Funds") received by ARRC for the Federal Fiscal Year commencing October 1, 2006 and each Federal Fiscal Year thereafter. Thus, all Formula Funds received or receivable by ARRC are pledged under the Trust Indenture securing the Bonds ("Trust Indenture") and are required to be paid directly to the Trustee under the Trust Indenture for deposit in a trust fund designated "Grant Receipts Deposit Fund".

The Bonds and the Official Statements used in the primary offerings of the Bonds recite that the Bonds are not a debt or liability of the State of Alaska and further that the Bonds are not general obligations of ARRC and do not pledge the assets or revenues of ARRC except for the Formula Funds.

The Bondholders have been informed in the Official Statements that receipt of Formula Funds is subject to authorization and appropriation by the United States Congress, but that once Congress has acted, the Formula Funds in their entirety are paid directly to the Corporation or the Trustee and the obligation of the Corporation to pay all the Formula Funds over to the

Trustee is absolute and unconditional. This requirement, by the way, includes any Formula Funds ARRC is to receive under the recently enacted Stimulus legislation.

The Bondholders have never been told that the payment of the Formula Funds to the Trustee and of debt service on their Bonds is subject to appropriation by the State Legislature, a risk that would certainly have merited prominent disclosure had it been in the law at the time.

Should HB 127 be enacted, it will be necessary for ARRC to file a material event notice under its Continuing Disclosure Undertakings executed pursuant to SEC Rule 15c2-12 advising the Bondholders that their rights to unfettered payment of the Formula Funds to the Trustee and of debt service on the Bonds have been impaired by the enactment of a law conferring on the State Legislature the discretion to determine the amounts, if any, appropriated to the Grant Receipts Deposit Fund or allocated to pay debt service and that such payments are subject to the risks of non-appropriation and/or delayed appropriation by the State.

We note that in accordance with A.S. 42.40.675, the Trust Indenture includes the pledge made by the State in A.S. 42.40.675 not to impair the rights of the holders of the Bonds. We believe that the provisions of HB 127 would be viewed by Bondholders as an impairment of their rights to receive all of the Formula Funds for the Grant Receipts Deposit Fund to assure payment in full of debt service of the Bonds prior to application of the Formula Funds to other purposes, as required by the Indenture.

Parenthetically, A.S. 42.40.675 makes the same pledge to any federal agency contributing funds to ARRC. You will, no doubt, have ascertained whether any federal agency's rights contained in any grant agreement or other contractual obligation are impaired by HB 127.

2. Effect of HB 127 on Credit Ratings Assigned to the Bonds.

At the time the Bonds were issued, each Series was insured with a policy of municipal bond insurance issued by Financial Guaranty Insurance Company ("FGIC") and the Bonds then carried insured ratings of "AAA" by Standard & Poor's Ratings Service ("S&P") and Fitch ("Fitch Ratings") and "Aaa" by Moody's Investors Service ("Moody's"). ARRC also obtained unenhanced ratings for the Bonds of "A+" by S&P, "A" by Fitch and "A1" by Moody's, based on the structure outlined in Part 1 of this Memorandum.

Since the original issuance of the Bonds, the FGIC ratings have all been downgraded and the Bonds now bear the unenhanced ratings assigned to them by S&P, Fitch and Moody's, since the unenhanced ratings are now higher than the insured ratings.

If HB 127 were to be enacted, ARRC is obligated to notify S&P, Fitch and Moody's (collectively, the "Rating Agencies") that the structure on which the unenhanced ratings were based has been altered and that the Bonds now have two levels of appropriation risk — United States Congress and State Legislature. The unenhanced ratings rely on the transfer of all Formula Funds directly to the Trustee as provided in the Indenture with no risk of delay or diversion once federally appropriated.

There is a high degree of likelihood that the Rating Agencies would take action to change the ratings downward or to at least put them on negative outlook pending a closer review of the actions of the State Legislature.

ARRC will want to consult with its independent financial advisors on the Rating Agencies and their potential actions. We advise you that our experience is that in this difficult economy, rating agencies are quick to take action on the occurrence of a negative event. It is much harder and takes much longer to raise a rating than it does to lower one.

Any rating changes will require that ARRC file a material event notice pursuant to its Continuing Disclosure Undertakings.

Material event notices of the types of adverse changes described in Part 1 of this memorandum and in this Part 2 usually lead to adverse effects in the secondary market for the Bonds and affect pricing and liquidity.

3. Effect of HB 127 on Compliance with ARTA.

In the brief time we have had to review HB 127 and the relevant provisions of ARTA, we have substantial concern that HB 127 in the form now pending, violates ARTA which explicitly provides that revenues generated by ARRC, "including any amount appropriated or otherwise made available to the State-owned railroad shall be retained and managed by the State-owned railroad for railroad and related purposes." 45 U.S.C. § 1207(a)(5). This provision has always been read and applied to mean that **one hundred percent** of ARRC's revenues, whether fares, tariffs, fees or federal funds or investment income are to be kept and managed by ARRC solely for rail and related purposes. HB 127 purports to grant to the State legislature the power to determine how much, if any, of ARRC's revenues can be appropriated to ARRC in each fiscal year and that at least some of them can be deposited in the State's general fund. See HB 127, Section 3. This is clearly at odds with ARTA, which dedicates all of the money to the "State-owned railroad" (defined in ARTA to mean the authority, agency or corporation designated by the State to own, operate or manage the railroad) or, in other words, ARRC. Nothing in HB 127 indicates any recognition by the drafters of the requirement that all of the revenues of ARRC must be retained and managed by ARRC and that the Legislature cannot withhold or divert those funds to other purposes. ARTA was amended in 2004 to insert the phrase, "including any amount appropriated or otherwise made available" in Section 1207(a)(5) to make even more explicit that all revenues of ARRC from whatever source derived are to be retained and managed by ARRC.

Conclusion

HB 127 in the form now pending would be viewed as impairing the rights of the holders of the Bonds, is likely to have an adverse effect on the unenhanced ratings assigned to the Bonds and appears to conflict with Section 1207(a)(5) of ARTA.