

SENATE FINANCE COMMITTEE
March 23, 2009
1:37 p.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 1:37 p.m.

MEMBERS PRESENT

Senator Lyman Hoffman, Co-Chair
Senator Bert Stedman, Co-Chair
Senator Charlie Huggins, Vice-Chair
Senator Johnny Ellis
Senator Donny Olson
Senator Joe Thomas

MEMBERS ABSENT

None

ALSO PRESENT

Christine Klein, Deputy Commissioner of Aviation, Department of Transportation and Public Facilities.

SUMMARY

^Aviation Industry Presentation by Christine Klein, Deputy Commissioner of Aviation, Department of Transportation and Public Facilities.

[1:38:11 PM](#) AT EASE
[1:38:23 PM](#) RECONVENED

CHRISTINE KLEIN, DEPUTY COMMISSIONER OF AVIATION, DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES briefed the committee on the Aviation Industry with the PowerPoint presentation, "Alaska International Airports" (Copy on File).

Overview:

I. System Advantages & Strengths

1. Alaska System Global Advantage
2. Airport System Strengths
3. Economic Impacts

II. Traffic, Trends, Concerns

1. Growth of Past 10 Years
2. Weakening of 2008 Events
3. AIAS Responses

III. Future Outlook

1. AIAS Tie to Global & National Markets
2. Responsiveness and Competitive
3. Cautious Stable Growth

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Ms. Klein discussed Slide 3, "Alaska International Airport System" (AIAS):

- Established in 1961
- Airports of Anchorage International Airport (ANC) and Fairbanks international Airport (FAI)
 - Shared Assets and Resources
 - Capital and Bonding Capability
- Aviation Support across vast and remote distances
 - Aircraft Alternate and Diversion Options for weather/disasters.
- Serving Alaska and World
 - Part of the National Priority International Airport system.

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Ms. Klein discussed Slide 4, "Alaska's Global Advantage Payload versus Range." She explained the advantages of Alaska's location, with both Fairbanks and Anchorage approximately nine hours distance from all centers of the industrialized world. Alaska's location allows profitable transport for air carriers traveling across the globe. She cited an example of a freighter traveling from Hong Kong to Chicago, explaining that a stop in either Anchorage or Fairbanks earns double the revenue. A direct flight from Hong Kong to Chicago must carry more fuel without the paying commodity.

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Ms. Klein discussed Slide 5, "Alaska System Advantages":

Regulatory:

- Progressive Clearance
- International to International Cargo Transfers
- United States Department of Transportation awarded Cargo Transfer Flexibility in 1996
- Expanded Cargo Transfer 2003

Location and Cost:

- Strategic Location for Trans-Pacific Asia Cargo
- Pay-load versus Range
- Growing Asia Market and Base of Chinese Freighters
- Close alternate airport
- No Slots or Curfews
- Parts exchange program
- Competitive airports: each with same low rates and fees

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Ms. Klein discussed Slide 6, "AIAS Strengths":

- One Revenue System
- Two Large International Airports
- Competitive Rates and Fees
- Diverse Revenue Sources
- Wide Mix of Air Carriers
- Air Cargo center for Asia
- Long-term Commitments
- System Capacity for Growth
- Economic Engines for the State of Alaska and the Local Communities

Ms. Klein mentioned the expansion potential in Alaska in comparison to other urban areas. Anchorage maintains traffic and revenue because of expansion potential.

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Ms. Klein discussed Slide 7, "Strength: Diverse Business Revenues" (Pie Chart). She discussed diversity of revenue sources. Landing fees generate over 42 percent of revenue.

The certificated maximum gross take-off weight determines the landing fee.

Senator Huggins requested a reciprocal approach to landing fees. He wondered if there were disparities in landing fees for different airports. Ms. Klein answered that each international airport is different. The United States use similar landing fee structures, but international airports outside of the United States have widely different fee structures.

Ms. Klein noted that nearly two thirds of revenue include cargo and passenger sources. Fuel flowage is the second largest revenue source. The final revenue sources consist of concession fees, parking fees, federal inspection service, and land rents.

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Ms. Klein stated that the total budget is \$112 million for the system including operating and maintenance costs ranging from \$49 million to \$70 million in the last 10 years. Currently, the FY09 budget is \$71 million, which is similar to the FY06 budget.

Ms. Klein discussed Slide 8, "Cargo and Diversity of Carriers": She informed that Alaska has thirty-five different air cargo carriers. She noted that 14 carriers were from the United States while 16 are from other countries. She informed that 35 percent of cargo carriers serve China.

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Ms. Klein discussed Slide 9, "Overall Statewide Aviation Economic Contribution to Alaska." She noted that the Alaska Aviation System is the largest system in the United States with more airports than the Russian Federation. The aviation industry provides over 47 thousand jobs in Alaska, and is the fifth largest provider of Alaska's gross state product equating approximately \$3.5 billion of Alaska's \$44 billion economy.

Ms. Klein discussed Slide 10, "Anchorage Specific Economic Impact:

- One in eight jobs

- about \$562 million direct annual payroll
- Another \$288 million in annual community jobs payroll
- \$2.36 billion total annual Anchorage Impact

Co-Chair Stedman questioned the accuracy of the estimates for payroll for annual community jobs. He asked if the aviation industry used a multiplier including bands of comfort. Ms. Klein responded that an Institute of Social and Economic Research (ISER) update provides necessary data biyearly. The standard deviation or margin of error for this particular report is unknown.

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Senator Huggins introduced the debate about airport parking. He opined that a great demand for airport parking exists, but he requested an expert opinion. Ms. Klein answered that excess airport parking, although disconnected from the terminals, exists.

Senator Olson clarified the location of the additional parking as east of the Department of Transportation facility near Anchorage International Airport.

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Ms. Klein addressed Slide 11, "Traffic, Trends, and Concerns":

Traffic, Trends, and Concerns

1. Growth Past 10 Years
2. Past Year 2008 Weakened
3. Traffic Downturn & Concerns
4. AIAS Responses

Ms. Klein discussed Slide 12, "Traffic: Passenger Growth" (Graph): She stated that growth has been steady. She informed that last year showed 5 percent growth, while this year shows 0.5 percent growth.

Co-Chair Stedman asked about Slide 12 and the final portion of 2008. He requested data through February 2009. Ms. Klein replied that the requested information is included later in her presentation.

Senator Olson asked about the classification of cargo carriers used in Alaska's aviation industry. Ms. Klein reported that traffic is measured using certified activity reports for 121 cargo carriers.

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Co-Chair Stedman asked for a definition of a 135 carrier. Ms. Klein answered that there are different categories of cargo carriers. Those with greater than sixty seats are termed "121 carriers," while "135 carriers" contain fewer than 60 seats.

Ms. Klein discussed Slide 13, "Fairbanks": a Star in Winter International Passenger Enplanements." She attributed the increasing international enplanement numbers in Fairbanks to winter tourism from Asia.

Ms. Klein discussed Slide 14, "Traffic: Cargo Growth." She discussed the measurements of aircraft and the effect on revenue. She informed of the 4 to 6 percent annual growth. The bar graph illustrates the take-off weight used to measure revenue. The landing portion of the graph varies from year to year due to holidays in other countries, down markets, and fuel cost variables.

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Ms. Klein discussed Slide 15, "International Cargo is big business":

Air Cargo dominates airfield activity at Anchorage International Airport and generates most of the aircraft landing fees.

- Nearly 35 percent of International Cargo traffic is from China
- 2000-15 landings per week.
- 2006-198 landings per week.
- 2007- 260 landings per week.
- Total China-US air cargo market in 2007 is equal to 36.7 percent of all Asia North America air cargo.

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Ms. Klein discussed Slide 16, "International Cargo at Anchorage." She named nine international carriers that account for over 55 percent of cargo revenue. These include Cathay Pacific, China Airlines, Korean Airlines, Eva Airways Corporation, Japan Airlines International, Asiana Airlines, Singapore Airline Cargo, Nippon Cargo Airlines, and Air China. She mentioned that Federal Express and United Parcel Service are major players in the Alaskan market as they are Anchorage hubs.

Ms. Klein discussed Slide 17, "2007 ACI Cargo Traffic Stats (Metric Tons)." She stated that Anchorage ranked number three in 2007.

Senator Huggins asked why Memphis was such a key location. Ms. Klein answered that Memphis is in close proximity to manufacturing as it has roads available for transportation. Alaska does not have the same base of exports. Memphis will continue as a strong competitor.

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Senator Huggins asked how much business compared for domestic versus international in Memphis. Ms. Klein admitted that she did not know.

Senator Olson added that Memphis was headquarters for Federal Express. He asked if there were differences that would create a fee structure in Anchorage competitive with Memphis, enabling higher revenues. Ms. Klein responded that she had reviewed the items and would address them later in the presentation. She noted that other US ports with manufacturing and exports are competitors.

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Ms. Klein discussed Slide 18, "Weakening in 2008":

Weakening in 2008

- US Economic Recession
 - Passenger downturn elsewhere
- Aviation Industry in Crisis
 - Airline Bankruptcies & Mergers
 - High Fuel Costs
 - Fewer Flights & Capacity
- AIAS Activity & Revenue

- Cargo Activity Declines
- Fuel Flowage Down
- High Debt

Ms. Klein spoke about the US economic recession. The decreases in traffic began in June 2008, increasing as the year progressed. Other airports in the US began to follow Alaska's trends. High fuel costs added to the fall in international as well as rural traffic. Many bankruptcies and mergers were seen and many older aircraft taken out of service. She noted that multiple communities lost all air service, a tragedy that would devastate Alaska.

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Ms. Klein stated that when United pulled out of Alaska, while Delta and Northwest Airlines merged. When United Airlines pulled out, existing air carriers such as Delta and Northwest Airlines picked up the traffic demand.

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Ms. Klein discussed Slide 19, "Summary of Fiscal Year 2008 Alaska International Airport System (AIAS) Activity":

Summary of Fiscal Year 2008

AIAS Activity

- Total Landings = 101,863 (-05%)
- Cargo by Landings = 46,965 (-5.4%)
- Passengers by seats = 5,380,811 (+4.4%)
- Fuel Flowage = 865 million gallons (-6.6%)

Ms. Klein discussed Slide 20, "AIAS FY06-FY09 YTD Monthly Passenger Enplanements." The monthly passenger enplanements equate the number of people entering an aircraft. The noted decreases are consistent with the rest of the country.

Ms. Klein discussed Slide 21, "Landing Revenue by Aircraft Certified Maximum Gross Take-Off Weight":

Landing Revenue by Aircraft

Certified Maximum Gross Take-Off Weight

- Cargo aircraft
- Passenger (Pax) aircraft
- Airport's as a standard, charge landing fees to air carriers for use

- Airport Landing Fees are charged by the aircraft manufacturers Certified Maximum Gross Take-Off Weight (CMGTW) for each use
- Air Carriers are required to report aircraft weights monthly in certified Activity reports (CAR's) to the airport's they utilize

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Ms. Klein discussed Slide 22, "AIAS FY06 and FY09 YTD Monthly Combined Cargo-Pax CMGTW": She referenced the trends exhibited in the graph that follow global market trends. She informed that the monthly combined cargo is down 19 percent in the beginning of the fiscal year. The months varied, yet the system's average is 19 percent. In Fairbanks, the average is 2 percent higher. Traffic by weight is down 12 to 28 percent. The international market in December, referred to as an airfreight collapse throughout the world, shows a 26 percent decline.

Co-Chair Stedman inquired about the availability of March data. Ms. Klein answered that the requested data lags about one month because the carrier must send in the certified activity reports.

Co-Chair Stedman asked if Ms. Klein expected changes in the trends. He asked if the estimation was continued downward momentum or an increase in March.

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Ms. Klein projected a 20 percent decline through the end of this year.

Ms. Klein stated that with a comparison seen on Slide 23 "Airport CMGTW Concerns and Comparisons":

AIAS:

- Month of December CMGTW compared to same month of prior year down 22.50 percent
- FY09 (with 7 months of year) shows a CMGTW average decline of 19.92 percent

Other Airports in the US:

- San Francisco freight for December down 43 percent
- Los Angeles freight for December down 24.3 percent

- IATA reports "22.6 percent collapse in air freight volumes for December as export volumes fell 20-30 percent in the US, Asia, and Europe"

Ms. Klein explained that the market is dependant on products coming from Asia to the US. She admitted recently learning that market trends follow the housing construction market.

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Ms. Klein discussed Slide 24, "AIAS FY06-FY09 YTD Monthly Fuels." She informed about declines in fuel consumption for several years. She added that the consumption in FY09 is 414 million gallons, which correlates with decreased traffic. Since fuel is one of the greatest costs in the Aviation Industry, many airlines are reducing aircraft weight improving fuel efficiency. The cargo carriers are only required to carry enough fuel to get to an alternate location and many airlines carry less fuel as lower weight raises fuel efficiency.

Ms. Klein discussed Slide 25, "AIAS Fuel Trends":

Fuel Flowage Fees

- Charged on each gallon of fuel
- \$0.027 per gallon for aircraft >12,5000 (signatory carriers)
- Accounts for ~20% of the AIAS Revenue

Changes

- Cargo Freight Down
- Old Aircraft Being Parked
- Airlines Improved Efficiencies
- Carrying Less Fuel Weight

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Senator Huggins asked about the price of fuel and the flying habits of large carriers. He wondered if commercial carriers are bound to change to a blend fuel as the military is. Ms. Klein answered that the Federal Aviation Administration, which is looking for alternative fuels for commercial aircraft, regulates the commercial market. Senator Huggins stated that Alaska would be part of a

demonstration project for aviation fuel. He wondered if a certain gas price attracts carriers landing in Alaska.

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Ms. Klein discussed Slide 26, "Trends in International Freight." She reminded that the tragedy of September 11 had a huge impact on the aviation industry. The current recession has not led to that level of traffic decrease. Most airports took years to recover from September 11, yet Alaska recovered in six months.

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Ms. Klein discussed Slide 27, "AIAS Responded Early to Trends":

Reduced Operating Costs:

- June: reduce 2008 budget spending
- July: defer, delay, and cut capital projects by \$300 million
- August: projected year traffic declines of 15-20 percent
 1. Cut development funds
 2. Hold utility increases and costs flat
 3. Put TSA reimbursement to debt
- October: reduce 2009 operating budget by \$3 million (3%)
- March further containment

Stay Competitive:

- September: Initiated independent third party Asian Cargo Analysis Report...(Keiser Phillips)
- Assess and track Other US Competing Airports...
- December: Airport Operating Agreement Lease completed in partnership with airlines

Ms. Klein noted the industry's decreases and projections. She discussed cutting some development funds collected from airlines and placing those funds toward debt. She mentioned significant utility increases, although staff preformed superbly finding efficiencies to keep impacts flat. She reported receiving \$8 million in TSA reimbursement funds for security screening allocated to airport debt equaling

more than half of the industry's operating budget. She shared that a 3 percent reduction of the operating budget, using the supplemental budget as part of negotiations with the airlines, presented a solution.

Ms. Klein informed about an industry consultant hired to aid in better understanding of the Asian market. The aviation industry monitors other airports across the country for useful competitor data. She informed about the recent completion of an airport operating agreement with the airlines that was in holdover for three years.

Co-Chair Stedman asked if Ms. Klein was a state employee listed in the state financial directory. He noted the debt level of 50 percent. Ms. Klein clarified that the debt was between \$39 and \$40 million.

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Co-Chair Stedman asked if cash flow from operations was positive or negative. He requested a debt service report on the previously requested financial document.

Ms. Klein surmised that the debt service was \$39 million, but she would respond to the committee with the exact information. Ms. Klein referred to the 35 percent of operating expenses illustrated in Slide 7, "Strength: Diverse Business Revenues" as the possible debt service. Co-Chair Stedman asked for a breakdown of the industry's depreciation, amortization, and debt service, as they are three separate components.

Ms. Klein stated that she would verify that the debt service is \$39 million. She intended to provide the requested information to the committee as soon as possible.

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Senator Huggins asked about the \$300 million for capital projects. He asked about capital expansion projects including the main terminal connecting to the north terminal. Ms. Klein responded that the connection is one of the main projects in the five-year program currently under construction, for completion in June 2009.

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Ms. Klein discussed Slide 28, "AIAS and the Future Outlook":

III. AIAS and the Future Outlook

1. Tied to National & Global Economy
2. Responsive & Competitive Airport
3. Cautious Positive Growth

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Ms. Klein discussed Slide 29, "AIAS Linked to the World":

Global Economy

- AIAS tied to World and US trends
- Economic recession

Response and Vigilance

- Respond to Market and Costs
- Track Airport Competition
- Assess Over-flights to US

Realize Limitations

- Surface and Intermodal Limited
- Northern Climate Disadvantage
- No local manufacturing
- Limited air exports

Ms. Klein discussed Slide 30, "Alaska Tied to World Air Trade":

Projections:

- Air Freight Growing Worldwide by 6 percent a year
- Market size doubles every 10 years
- World Air Cargo will Triple over next two Decades (Boeing)
- US Cargo Share of Air freight Revenue:
 - o 5 percent Domestic Majors
 - o 15 percent European Majors
 - o 20-50 percent Asian Majors

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Ms. Klein discussed Slide 31, "AIAS on the Forefront":

AIAS on the Forefront

Responsive:

- Early Response to USA Economic Downturn
 - Responded to Carrier's Requests for Relief (Fuel)
 - Focused on Debt and Rate Stability (Finance)
 - Reduced Operating Expenses
 - Lower Landing Fees

- International trade Impacts
 - Asian Producers
 - USA Consumers

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Ms. Klein discussed Slide 32 "Asian Market Projected to Lead Growth." The expectation is that Anchorage remains competitive.

Ms. Klein discussed Slide 33 and "AIAS Remains Competitive": She stated that the landing fee was lowered by ten cents. She provided an example of other airport fees. Competitors include Memphis and Chicago.

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Ms. Klein concluded her presentation with Slide 34, "Conclusion: AIAS Leads the Way":

Responsive, Vigilant, and Serving

- Assess the Competitors
 - Other USA Cargo Airports
 - Asian Cargo Carriers and Markets

- New Carrier Partnerships
 - NCA- JFK Station
 - Cathay Pacific- New freighters and new stations
 - Evergreen/Kalitta- New China designation
 - UPS- Anchorage Training Center, China frequencies

Ms. Klein noted that the international airport must remain a low cost airport system in order to remain competitive. The declines observed link with the recession and the economy, with some recovery anticipated in the coming year.

Ms. Klein disclosed some new carrier partnership with the United Parcel Service (UPS) adding 20 pilots to the Anchorage station. She concluded that Alaska remains on the major world crossroad.

Co-Chair Stedman asked about the last annual financial statements. He asked if Ms. Klein received quarterly or yearly updates. Ms. Klein replied that annual financial audits occur as required by the legislature.

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Co-Chair Stedman asked for the financial statement for June 30, 2008 along with any updated statements.

Senator Huggins asked about the carrier's request for relief. He asked where Anchorage was nationally regarding retail fuel pricing. He asked where the money originates to provide the requested relief. Ms. Klein answered that fuel dispensers match the spot price, which for Anchorage is Los Angeles, California. Airlines buy fuel in great quantities to remain competitive.

Senator Huggins repeated that the price of fuel in Anchorage International Airport matches the spot price in Los Angeles, California. He asked how to reduce the price of fuel in order to provide relief. Ms. Klein answered that the slide was referring to other relief reducing the impact of the high fuel cost. She cited an example of escalating fuel costs leading to cost increases on terminal rents.

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Senator Huggins asked if most of the aviation fuel in Anchorage came from Flint Hills. Ms. Klein answered that the fuel originates from multiple locations such as the Tesoro, Nikiski, Valdez, and Flint Hills.

Co-Chair Stedman asked Ms. Klein to reply to the committee regarding the origin of fuel at the Anchorage International Airport. He requested the information presented in total gallons and percentages. Ms. Klein responded that she would retrieve the requested information from the fueling consortium. Co-Chair Stedman explained that the information ties many of the legislators' considerations during legislative session.

Senator Huggins asked if Flint Hills closed tomorrow would concern her. Ms. Klein answered by submitting an example. The response from the fueling consortium was that there was ample storage capacity for the fuel. She understood that the storage capacity exists.

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Senator Ellis asked about the selection of the airport director. Ms. Klein answered that the airport system has an airport manager for many years. The prior airport director had the position currently termed system director. She stated that she posted the vacant position, but has not selected a replacement. Currently, two competent airport managers exist, one in Fairbanks and one in Anchorage.

Senator Ellis observed oddities in the selection process. He opined that the selection process was not efficient. He hoped for an airport administrator more capable than the previous one.

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Ms. Klein appreciated the committee's confidence in her. She suggested that the AIAS adequately addressed challenges. She stated that she connected with competitors; many are past coworkers of hers. She added that she would continue to search for the right manager.

Senator Ellis appreciated the ability to speak. He asked about the Capstone Loan Program, with only six loans made since the beginning of this legislative session. He asked if this level of performance was adequate or low. Ms. Klein answered that the Capstone Loan Program was slower than expected. She offered to provide the committee with future information regarding the program. She felt that the program was successful, as it remains focused on Alaska. Co-Chair Stedman echoed the request for a program update.

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Senator Olson appreciated Ms. Klein's approach and style. He opined that the airline industry is in distress due to the thin margin necessary for stockholder comfort. He asked about accounts receivable and how many carriers have not paid. Ms. Klein stated that she could not answer the question, but stated that AIAS accomplished much as an

international airport. Some small regional carriers have greater difficulty.

Co-Chair Stedman asked Ms. Klein to include the 30, 60, and 90-day interest calculation for presentation to the committee. He clarified his interest in dollar amounts.

Senator Olson asked about mergers with Era Aviation. Ms. Klein responded that even in the economic downturn there is ability to lease. She stated that the commissioner for Military and Veteran's Affairs understands the merger.

Senator Olson asked about trends in Alaska General Aviation within the Anchorage International Airport.

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Ms. Klein stated that General Aviation numbers remain the same. Additional parking North of Lake Hood, replaced the previous parking situation. The wait list for float operations is 3-5 years rather than 20 years. The operations may be down but the citing and use of the airport remains the same for General Aviation.

Senator Olson asked about plans for the Lake Hood Strip. Ms. Klein responded that the Lake Hood Strip has about 50 percent of customers requesting pavement. She thought it ill advised to pave the strip, with paved runways existing on the international side of the airport already providing that option.

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Senator Thomas asked about a similar chart for the Fairbanks International Airport. Ms. Klein answered that no chart exists for the Fairbanks International Airport. She communicated that she intends to create such a chart. She anticipated an economic impact assessment for the community of Fairbanks through a system plan.

Senator Thomas asked about the study's projected date of completion. Ms. Klein replied that the necessary approval granted by the Federal Aviation Administration (FAA) to utilize grant funds. She hoped for a completed study with information available prior to the next legislative session in January.

Senator Huggins asked about volcano eruptions and the decision process for airport closure. Ms. Klein responded that the airport is always open. It is the discretion of the pilot and airline to fly during a volcano eruption.

Co-Chair Stedman expressed gratitude for Ms. Klein's presentation.

Ms. Klein stated that AIAS successfully sold a bond refinancing the variable debt in January, which she felt illustrates the confidence in Alaska aviation. She had great confidence in Anchorage International and Fairbanks International airports.

Co-Chair Stedman asked for a debt schedule included in the requested financial statements.

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ADJOURNMENT

The meeting was adjourned at 2:59 PM.