

SENATE FINANCE COMMITTEE
February 3, 2010
9:04 a.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:04 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

None

ALSO PRESENT

Christine Klein, Deputy Commissioner of Aviation, Department of Transportation and Public Facilities (DOTPF); John Parott, Airport Manager, Ted Stevens Anchorage International Airport; Patrick Gamble, President & CEO, Alaska Railroad Corporation (ARRC); Bill O'Leary, Chief Financial Officer, Alaska Railroad Corporation (ARRC)

PRESENT VIA TELECONFERENCE

None

SUMMARY

^PRESENTATIONS: ALASKA INTERNATIONAL AIRPORT SYSTEM; ALASKA RAILROAD CORPORATION

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ALASKA INTERNATIONAL AIRPORT SYSTEM

CHRISTINE KLEIN, DEPUTY COMMISSIONER OF AVIATION, DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES (DOTPF), introduced John Parott, the Anchorage Airport Manager. She related that the Alaska International Airport System (AIAS) consists of Anchorage International Airport and Fairbanks International Airport, which share many assets, resources, and capital and bonding capabilities. The AIAS has existed by statute since 1961 because of the need for a back up airport in case of bad weather.

Ms. Klein related that both airports are major hubs in the national transportation system. Anchorage International Airport is number 3 for cargo in North America and number 5 in the world. The aviation industry in Alaska provides over 47,000 jobs statewide, \$2 billion in direct expenditures, and \$3.4 billion in indirect expenditures, which is 40 percent higher than the national average.

Ms. Klein referred to a handout entitled "Alaska International Airports System" (copy on file). She stressed the importance of operating as a "system" due to the unique conditions in Alaska.

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Ms. Klein turned to slide 2 - Airport System Advantages. She listed the advantages; regulatory issues, location, and cost. She highlighted Alaska's global advantage regarding payload versus range - slide 3. Cargo aircraft can stop at the Anchorage or Fairbanks airports with a full load and pick up fuel. She listed AIAS's competitors: Vancouver, Seattle, Los Angeles, Oakland, San Francisco, and Sacramento. She said that AIAS has been very successful keeping rates competitive.

Ms. Klein noted that AIAS currently has 34 cargo carriers, and a very diverse mix. New cargo carriers have joined AIAS recently; Great Wall Airlines, World Airways, and Quantas. There are more than 50 different airlines that use the Anchorage Airport.

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Ms. Klein referred to slide 5, the comparison of AIAS's competitive rates, both for terminal rent and for landing fees. Landing fees reached a high point of \$1,700, but are

now lowered to about \$1,200. For the first time in eight years, AIAS has been able to lower costs in order to remain competitive.

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Ms. Klein spoke about the strengths of having diverse business revenues - shown on slide 6. She pointed out that the largest source of income is from landing fees. Fuel flowage fees are the second largest source of income, followed by terminal rents. Revenue sources are very diverse.

Ms. Klein spoke about AIAS's expenses. She noted that debt service of about \$50 million makes up the highest cost. The current total debt is about \$600 million.

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Ms. Klein shared information about the cargo operations, the majority of AIAS's revenue source - slide 7. The graph shows the growth rate for all-cargo aircraft landings.

Ms. Klein skipped ahead to slide 9, a graph depicting combined passenger and cargo certificated maximum gross take-off weight (CMGTW) from FY 06 until FY 10. She spoke of declines and increases during those years. She emphasized that Anchorage Airport was the first in the country to identify problems and respond to them. The drop in April 2009 was due to the eruption of the Redoubt Volcano. The green line shows a slight increase in FY 10. She reported the first positive increases in cargo in thirty months in November and December.

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Ms. Klein described the monthly enplanements (passenger numbers) as shown on slide 8. The numbers have been fairly stable with an increase last summer followed by a drop.

Ms. Klein reported that slide 10 shows the annual fuel consumption by air carriers at Anchorage International Airport. She reported on a recent upturn which is a positive sign. She shared aircraft landing statistics.

Ms. Klein showed slide 11 - Fairbanks International Airport's annual fuel consumption from FY 04 through FY 10.

She spoke of a decline during FY 05 through FY 07, followed by an increase and recovery.

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Ms. Klein shared information about total regional freight - slide 12. Most airports were 10-40 percent down in cargo and passengers; Alaska was 23 percent down. She described freight reductions from various regions. In November and December Alaska's cargo increased by 11 percent, higher than most airports. She listed regional reductions.

Ms. Klein highlighted ways that AIAS responded to the declines - slide 13. She listed ways that AIAS remained competitive and assessed the competition. She spoke of a reduction in the operating budget by \$7 million, as well as a hiring freeze and nine layoffs.

Ms. Klein reported on the results of AIAS's commitment to a new operating agreement and the addition of six air carriers - slide 14. A new business model has been adopted, as well.

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Ms. Klein shared improvements made at the Fairbanks Airport - slide 15. There was an increase in winter passengers and cargo flights. She reviewed the status of construction in the Fairbanks terminal, which came in on-schedule and under-budget and was financed without the use of general funds or federal funds - slide 16. She mentioned four new heavy cargo positions.

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JOHN PAROTT, AIRPORT MANAGER, TED STEVENS ANCHORAGE INTERNATIONAL AIRPORT, turned to slide 17 to report on the completion of construction on Anchorage Airport's A & B Concourses. He shared 2008 ACI cargo traffic statistics - slide 18. Anchorage is currently fifth in international cargo trade.

Mr. Parott reported on the specific economic impact to Anchorage from the Anchorage Airport - slide 19. A 2007 Institute of Social and Economic Research (ISER) report listed 18,000 jobs at or related to the airport. He

described the annual total economic impact as \$2.3 billion flowing through Anchorage and the state - slide 20.

Mr. Parott showed, by airline, the economic impact of international cargo at the Anchorage Airport - slide 21. He shared the successes and bright spots in the airport market - slide 22. In the past the airport has not had to provide incentives for international carriers. Now, there is a reduced fee structure for China Airlines. Japan Airlines operated 17 charters this past season. Concessions at the Anchorage Airport was recognized as a "Top Performer".

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Mr. Parott spoke of marketing team highlights at the Anchorage Airport - slide 23. Marketing materials and methods were improved and coordinated. He termed the Cargo Transfer Authority as important and "value added".

Mr. Parott summarized the statistics from FY 09 and FY 10, so far, as compared to prior years - slide 24. He shared future plans - slide 25. He spoke again of "value added" services. He said most of the revenue comes from landing fees and fuel flow. He shared AIAS's goals to continue with capital improvements, such as runway 7-R extension. He spoke of continued efforts with the marketing team. He mentioned that Kulis International Guard Base will be incorporated into the airport property.

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Co-Chair Hoffman was interested in how the Anchorage International Airport services Alaskans. He requested more information on whether air cargo operations and enplanements include Alaska destinations such as Barrow, Kotzebue, Nome, Dillingham, Sitka, etc. He commented that the airport was a good design for flights headed south, but did not necessarily serve rural passengers headed to villages. He termed the concourse "unuser-friendly".

Mr. Parott recognized and shared those concerns. He spoke of improvements in the concourse for regional carriers and the addition of a hot food service for rural passengers. The fuel flow numbers by regional carriers tend to be dwarfed by the international carriers. The enplanement numbers do include regional and domestic passengers. Rural

passengers no longer board after a long outside walk, but now use an inside gate.

Co-Chair Hoffman asked if the current system was now user friendly for rural passengers. Mr. Parott believed that significant progress had been made. He offered to continue to make improvements.

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Senator Thomas asked how much airport fuel comes from Alaska and what the price of fuel was. Ms. Klein replied that Alaska produces 49 percent of the fuel consumed at AIAS. She related that obtaining Alaskan fuel was a challenge due to availability. It is difficult to track the price of fuel because airlines pay for it themselves. Alaska's fuel cost is significantly higher than competitors' costs.

Senator Thomas asked about some of the landings at AIAS such as Federal Express. He referred to slide 24, which shows a downward trend in the numbers of landings in FY 09. Mr. Parott reported an upward trend the past few months, which, if it continues, would bring FY 10 above FY 09.

Senator Thomas requested information from last year's AIAS budget for capital projects. Mr. Parott listed one project, a runway extension and resurfacing project, which would total close to \$100 million.

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Co-Chair Stedman requested future predictions related to AIAS. Ms. Klein shared that she was leaving her job. She predicted a very slow recovery. She stated that the budget was balanced through June 31. Cargo recovery projects a modest 2 percent increase for this year. The combined passenger and cargo green line on the graph should increase very slowly due to changes in the business model. She did not see a return to previous levels for several years.

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Senator Ellis thought that overall, AIAS was doing a good job. He shared small complaints about the airport, such as a lack of hooks in the stalls and nowhere to put computer bags in the bathroom. He suggested installing more

electrical outlets for today's modern technology needs. He also expressed frustration about lack of a cab line in front of the terminal.

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Mr. Parott said he would tend to those suggestions. He offered to take another look at the cab situation.

Co-Chair Hoffman asked a question on behalf of Senator Menard who suggested that luggage carts be free of charge like they are at European and Asian airports.

Mr. Parott explained that international travelers in the customs area are provided a free cart because they have not yet been in the vicinity of a money exchange center. In Europe and Asia, advertising on the carts offset the expense of providing them for free. That idea has not worked for the Anchorage Airport. He noted that most airports in the United States charge for carts. The Anchorage Airport works to keep prices down because Alaskans travel with more baggage than most travelers. He offered to continue to look at the issue.

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Senator Huggins appreciated the wild game displays at the airport, the improvements in the rental car area, and the facilities for the military. He spoke highly of the customs area at the Anchorage Airport. He encouraged Ms. Klein to look at the north terminal parking expansion. He questioned if only 49 percent of the jet fuel came from Alaska.

Ms. Klein said that was correct. She related that Alaskan fuel came from Tesoro, Flint Hills, and Petro Star. Senator Huggins asked about the cost of fuel from Alaskan refineries versus the cost from refineries outside the state. Ms. Klein responded that fuel comes from many sources and the issue is complex. She reported that she is working with the airlines and the refineries to facilitate improvements. She thought the spot price differed by 20 cents.

Senator Huggins asked which was more favorable. Ms. Klein replied that it was currently more favorable at other airports. Senator Huggins wondered if the airport was subsidizing fuel. Ms. Klein responded that it was not.

Ms. Klein explained that airports bid long-term contracts for the volumes of fuel they expect to use. If that calculation changes suddenly they must purchase spot fuel, which is more expensive. Recently, there was sudden increase in flights and fuel was not available and it was more expensive due to shipping.

Senator Huggins spoke of a concern of not having adequate fuel. He wondered if Ms. Klein shared that concern.

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Ms. Klein did have a concern about the refined Jet A fuel supply in Alaska. The commissioners from DOT, DEC, and DNR are looking for solutions.

Co-Chair Stedman requested follow-up information about fuel production and refinery location in recent years in Alaska.

Senator Thomas asked a question for Senator Egan who had to leave the meeting. He wondered if the 8 percent number regarding FY 09 revenue income from investment income is typical of airport operations in other states.

Ms. Klein noted that investment income has decreased in the past year. She deferred to the comptroller to answer further.

Senator Thomas asked about the cost of fuel as it relates to royalty oil. He reported that Flint Hills maintains that the premium for royalty oil increases the cost of fuel. He requested Ms. Klein's opinion.

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Ms. Klein could not comment about contract agreements between the state and the refineries. She suggested that pricing is a concern and Alaska must remain competitive. Pricing is not controlled by the airport, but rather contractual business obligations between private businesses.

Senator Huggins asked if moving the airport is part of the strategic plan. He asked where MatSu fits into the strategic plan.

Ms. Klein responded that airport construction is costly. In the last 40 years there have only been two major airports constructed in the United States. Since Anchorage and Fairbanks have just improved airport capacity, it would be difficult for the state to finance a new airport. She suggested that private enterprise could come in and build another airport.

Senator Olson expressed concern about his constituents and the need to focus on Alaskans' needs. He wondered if "leveling the playing field" included having "135 operators" paying the same landing fees as "121 operators".

Co-Chair Stedman requested definitions of 121 and 135. Senator Olson explained that 135 operators are smaller than 121 operators, who can carry cargo and passengers, such as Alaska Airlines.

Ms. Klein noted that AIAS is very focused on rural Alaska and has put much attention on the smaller regional carriers. The lighter aircraft receive the benefits of lower rates and fees. She noted that there was still work to do on the terminal infrastructure to make things easier for regional carriers and passengers.

ALASKA RAILROAD CORPORATION

10:20:00 AM

PATRICK GAMBLE, PRESIDENT & CEO, ALASKA RAILROAD CORPORATION (ARRC), referred to a handout entitled, "About the Alaska Railroad" (copy on file). He noted that there was also a memorandum on bonding debt, which answered questions from a previous meeting (copy on file). He turned to slide 3 - Alaska Railroad quick facts. The only items that have shown an increase are the total assets of the railroad and the average age of employees. Everything else has decreased. He described the historical downward trend beginning in FY 05. The projected net earnings are down by about 19 percent in FY 09. He predicted that FY 10 would be the toughest year yet. The corporation has been preparing for FY 10 for several years, which today's briefing will show.

Mr. Gamble commented that the Alaska Railroad is different from other state agencies - slide 4. It is not a part of the Executive Budget Act, and its employees are not in the

state system. The railroad is more like a private business and needs to make a profit, which is its capital program. This model enables the railroad to respond in a competitive market.

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Mr. Gamble skipped to slide 6 in order to emphasize safety. He discussed statistics related to safety.

Mr. Gamble shared strategies involved with security management - slide 7. The railroad is making use of federal dollars for security purposes and is using a camera system. Many agencies do inspections or provide exercises in order to promote security.

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Mr. Gamble discussed the 2009 budget background - slide 13. There was an unsettled environment related to fuel costs and fuel volume. He predicted a further drop in volume by Flint Hills.

Mr. Gamble reported that the 2009 budget was for \$16.8 million. There was a reduction in passengers, a reduction in fuel volume, and higher fuel prices, which led to a loss of net earnings of 19 percent. He noted that this was unaudited information. He discussed the impact from personnel eliminations and expenses related to reductions.

Mr. Gamble explained that slide 14 depicts personnel impacts. He reported on a hiring freeze from 2007 to 2009 where 200 positions were eliminated. Eight management positions were eliminated, management pay was frozen, and departments were reorganized.

Mr. Gamble showed the ARRC fund flow model of 2009 data - slide 15. It shows how the railroad gets its money and what it does with it.

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BILL O'LEARY, CHIEF FINANCIAL OFFICER, ALASKA RAILROAD CORPORATION (ARRC), began with slide 16 - a history of freight revenue from 2004 - 2008, which is half of the total revenue for the Alaska Railroad. It shows the difference between the expected budget and the actual

budget in 2009. There was a significant weakness in the petroleum haul from North Pole and Flint Hills refineries. There were also weaker results from the interline barge service. Income from coal exports was a positive number.

Mr. O'Leary reported that slide 17 is a graph showing the fuel shipment history on the Alaska Railroad by Mapco, Williams Petroleum, and Flint Hills Resources from 1994 - 2009. There was a strong growth curve averaging about 9 percent up until 2003, followed by a loss which averaged about 8 percent annually.

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Mr. O'Leary talked about slide 18 - the exportation of coal in metric tons by year. Coal is mined in Healy and moved on the railroad to Seward where it is shipped to international destinations. He reported that 2009 was a record year, and even better results are expected for 2010. He mentioned a possible lawsuit related to the Clean Water Act, which could have an effect on the budget.

Mr. O'Leary reported that slide 19 shows passenger revenue grew until 2008 and then had a decline. Slide 20 depicts real estate revenue, the most consistent performer.

Mr. O'Leary related that slide 21 depicts controllable expenses which were reduced by \$8 million over the last two years. He explained that slide 22 shows a graph of unaudited net income. In 2009, that amount was \$13.6 million.

Co-Chair Stedman asked about expectations for operational cash flow. Mr. O'Leary replied that corporate net income was \$13.6 for FY 09, and \$8 million of net income is budgeted for FY 10, which would result in a loss of roughly \$4 million. Co-Chair Stedman emphasized that it was cash flow from operations, not net income. Mr. O'Leary agreed, but added that there would be positive cash flow.

Mr. Gamble clarified that was the amount made from train operations, principally made of up labor costs and fuel. Co-Chair Stedman noted that item was reflected in the chart.

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Mr. O'Leary turned to slide 23 - balance sheet highlights. He emphasized that the railroad has managed its balance sheet even with diminished earnings. The asset base has grown, liquidity is good, and debt is low - \$27 million of recourse debt. There is about \$157 million remaining on bonds backed by federal monies. The ARRC generated \$31.2 million in total cash in 2009.

Mr. Gamble explained slide 24 - the 2010 preview. He pointed out that FY 10 would be a tough year. There is a pending lawsuit and Flint Hills continues to decline. Passenger numbers are expected to drop again. The challenge is to continue expense reductions in an effort to offset revenue declines. The bottom of the chart shows projections for operating and capital expenses. The capital program is more robust due to federal entitlements.

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Mr. Gamble related that slide 25 shows the capital investment 2010-2014 five-year plan. The railroad is currently in the second five-year plan from 2008-2012. There are three large capital projects: the Tanana River Bridge for \$100 million; the line rebuild between Anchorage and Fairbanks; and a collision avoidance system for \$75 million.

Mr. O'Leary noted that slide 26 shows a breakout of capital spending by fund source. The biggest piece is from the FTA monies and bond proceeds. Slide 27 further breaks down the capital funding sources.

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Mr. O'Leary pointed out that slides 28 and 29 show ARRC's five-year plan for capital projects. Mr. Gamble noted that the reports are required by law and are submitted to legislative offices yearly.

Mr. O'Leary related that there were a number of slides on the employee benefit package, defined benefit pension plan, and retiree medical trust fund. He jumped to slide 39 - the 2009 status of benefit trust funds. He reported on a good recovery since the crash of 2008. Before the crash the pension fund was 114 percent funded and the medical fund was 75 percent funded. He expected both to be fully funded by the end of FY 09.

Mr. Gamble called slide 40 "wild cards" which could lead to possible gains and losses. He spoke of environmental issues and legislation as potentially negative factors.

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Co-Chair Stedman expressed appreciation for the information in the presentation which would allow the committee to make good decisions. He requested information about the fuel component of ARRC's business. Mr. Gamble elaborated on the relationship of fuel to ARRC; he called ARRC a mover of fuel, comparable to the pipeline. Flint Hills previously provided 50 percent of the fuel. Currently, ARRC expects to move half of that amount. There is concern about getting fuel back on its feet, or finding more business such as the pipeline or offshore drilling. The plan is to hunker down for the next two years in anticipation of the next five years. Mr. Gamble pointed out that corporate health is in good shape.

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Senator Thomas commented on moving the southern bypass project forward. He requested information about Flint Hills' plans. Mr. Gamble addressed the southern bypass. He reported that he recently met with the assembly for a discussion about the southern bypass. There will be a meeting to "scope the project", which will lead to an Environmental Impact Statement (EIS).

Senator Thomas drew attention to the Healy Subdivision issue and requested more information about how the land would be released by the railroad and returned to original owners. Mr. Gamble recognized those concerns.

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Senator Olson spoke, as a pilot, about the frustration of the inability to get fuel. He recalled that the Anchorage Airport ran out of fuel and could not provide fuel for some of the carriers. He wondered if the railroad cut costs by decreasing the number of cars carrying fuel. Mr. Gamble agreed that the number of cars were decreased due to less refined fuel being produced. He reported that he called Flint Hills who said the airport contract stipulated a certain amount of fuel. Flint Hills wanted to shut down the

third tower in the refinery in order to cut costs and until the contract requested more fuel.

Senator Olson said his information was from the private sector. He wondered about the status of claims against the railroad. Mr. Gamble related that the issue of land ownership is the "lightening rod issue". He stressed that ARRC is the steward of the land and, according to the Corporate Act, cannot sell land.

Senator Olson restated the question. He was referring to private landowners whose property is crossed by the railroad. Mr. Gamble used the North Pole as a hypothetical example. If the railroad were moved, the vacated property would go back to the state. It would be necessary to involve the attorney general because, currently, there is no legal way to dispense that property to the adjacent landowners.

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Senator Huggins agreed that the railroad was a good economic weather vane. He listed examples. Mr. Gamble reiterated that he thought the railroad was a good weather vane because most of its business deals with Alaskan issues. He gave examples. He emphasized that there was not much the railroad could do until the economy changes and goods and services move again.

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Co-Chair Hoffman requested a history of Flints Hills' providing fuel to the airport. He surmised that there was a fuel storage problem at the airport. He also requested information about the railroad's fuel capacity and costs over the last five years.

#

ADJOURNMENT

The meeting was adjourned at 10:59 AM.