

SENATE FINANCE COMMITTEE  
February 2, 2011  
9:02 a.m.

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CALL TO ORDER

Co-Chair Stedman called the Senate Finance Committee meeting to order at 9:02 a.m.

MEMBERS PRESENT

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

MEMBERS ABSENT

None

ALSO PRESENT

Steve Hatter, Deputy Commissioner of Aviation, Department of Transportation and Public Facilities; Bill O'Leary, Chief Financial Officer, Alaska Railroad Corporation; Senator Cathy Giessel

PRESENT VIA TELECONFERENCE

None

SUMMARY

^Presentation on Statewide Transportation Economic Indicators

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Co-Chair Stedman stressed importance of understanding the state transportation projects. He felt that the recession had affected transportation projects, and stressed the importance of developing projects that enhance the economy.

STEVE HATTER, DEPUTY COMMISSIONER OF AVIATION, DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES, presented the PowerPoint: "Alaska Department of Transportation & Public Facilities. Aviation-Economic Engine for Alaska" (copy on file). Commissioner Hatter presented slide 1: "Alaska's Airports and Aviation." He stated that the Airport system in Alaska was the largest system in the United States with 255 state airports. Aviation was the main mode of transportation for all citizens and regions. He stated that airports were the only means of access for 169 Alaskan communities. The Alaska International Airport System (AIAS) was an economic engine for the state.

Commissioner Hatter showed slide 3: "Aviation Industry Economic Contribution to Alaska." He remarked that there were currently 47,000 aviation jobs statewide. Aviation was the fifth largest contributor to Alaska's Gross State Product (GSP), which was \$3.5 billion in the \$44 billion economy. He remarked that the Department of Transportation and Public Facilities was currently completing an aviation system plan, and aviation system planning had not occurred since 1996.

Commissioner Hatter showed slide 4, and stated that the biggest aviation contributor to the state economy was the AIAS: Ted Stevens Anchorage International Airport, and the Fairbanks International Airport. He remarked that Anchorage received the highest cargo landed weight in America, and Anchorage was ranked number five in America for cargo throughput weight. He emphasized that cargo was a strong economic driver of the AIAS.

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Commissioner Hatter showed slide 5, and stated that the picture featured a weather diversion on a ramp in Fairbanks. He remarked that the Anchorage and Fairbanks airports work together as alternate routes due to environmental changes and weather. He stressed the importance of the two airports working together as a system.

Commissioner Hatter discussed slide 6: "AIAS Overview." He stated the AIAS was established by the legislature in 1961, and it operated as a single business enterprise. He reported that AIAS operated as an enterprise fund, is

financially self-sustaining, and had specific statutory provisions for issuing general airport revenue bonds. The airport bonds were only backed by revenue of the AIAS; not by the full credit of the state. The AIAS served as regional hubs for intrastate mobility, and served as a trans-Pacific hub for international cargo. He remarked that AIAS was a very important stopping point for the Asia to North-America cargo route.

Commissioner Hatter presented slide 7: "AIAS Presentation Points." He stated that he would be discussing AIAS advantages and strengths; finances, statistics, and trends; fuel supply funding; successes; and future.

Commissioner Hatter displayed slide 9: "Advantage Location." He stated that the Anchorage Airport was approximately 9.5 hours from 90 percent of northern industrialized world. Alaska was uniquely situated between Asia and the United States, which made sense for planes to carry more cargo. Planes could stop for fuel in Anchorage, before continuing to their desired location. He remarked that Fairbanks and Anchorage were separated by 200 land miles, which was ten minutes by air, so diversion opportunities were easy. He stated that both airports had never closed at the same time, except on 9/11.

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Commissioner Hatter discussed slide 10: "Advantage-Payload v. Range." He stated that airlines stop in Alaska for fuel, because it allows them to carry more cargo. He remarked that there were some aircraft that could not stop in Alaska to refuel, but almost all aircraft would need to reduce their cargo in order to carry enough fuel to have a direct flight.

Commissioner Hatter presented slide 11: "AIAS Cargo Traffic Standings." He stated that the Anchorage Airport was one of the busiest cargo airports in North-America and the world. He stated that AIAS was focused on the global airport system.

Commissioner Hatter discussed slide 12: "Strength-Diverse Customer Base." He stated that a significant strength of the AIAS cargo business was the diversity of its customer base. He stated diversity was important, because of the

high replacement factor. He remarked that large hubs in the lower 48 were mostly dependant on a single carrier.

Commissioner Hatter showed slide 13: "Strength-Large Cargo Anchor Tenants." He stated that two large cargo anchor tenants were the United Parcel Service (UPS) and Federal Express (FedEx). He announced that UPS and FedEx infused jobs and commerce in the Anchorage community.

Commissioner Hatter discussed slide 15: "Monthly Enplanements." He stated that the data showed steady enplanements over the recent global economic downturn. He remarked that there was a consistent base over the winter time frame, and displayed the importance of the summer tourism peak. The graph also showed large troop deployments to the Middle East; and was represented by spikes in August 2009 and May 2008. He stated that there was mutual importance in the system, regarding the Alaskan military installations. He pointed out that there was passenger travel stability in Alaska.

Commissioner Hatter showed slide 16: "Monthly Enplanements." He stated that cargo was historically much more volatile than passenger travel. He reiterated that AIAS was moving in a beneficial direction.

Commissioner Hatter discussed slide 17: "Cargo Operations." He stated that cargo operations were on the rebound, and the indicators were moving in a positive direction.

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Commissioner Hatter displayed slide 18: "Impact of Global Economic Downturn." He felt that trends seemed positive. He remarked that FY10 saw a dramatic up-take in trans-Pacific cargo.

Commissioner Hatter discussed AIAS Close Watch Topics, and began with slide 20: "Fuel." He reiterated that there must be an affordable and available fuel system to operate the AIAS. He remarked that there was a market shift in fall 2009, which resulted in a fuel shortage. He stated that stake-holders came together, and tried to develop mutually beneficial solutions. The meetings resulted in the addition of fuel suppliers: Delta Western and Cosmo. He remarked that all new suppliers needed to be approved by the Department of Environmental Conservation (DEC). He stated

that, with the addition of the suppliers, the fuel supply was adequate for the foreseeable future. The Alaska Fuel Supply Consortium (AFSC) was discussing additional storage options, and DOT/PF would continue to track the fuel supply issue.

Commissioner Hatter presented slide 21: "Federal Funding and Regulation." He stated that for capital projects, the airport business depended significantly on the Federal Aviation Administration (FAA) Airport Improvement Program (AIP) funding. He remarked that DOT/PF was carefully watching trends toward regulatory oversight; which sometimes meant unfunded mandates.

Co-Chair Hoffman queried the improvements of the Anchorage and Fairbanks airports and federal earmark funding. Commissioner Hatter replied agreed to provide that information.

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Commissioner Hatter discussed AIAS successes with slide 23: "AIAS Response to Recession." He stated that the leadership of the AIAS responded well to the recession, and were able to remain competitive.

Commissioner Hatter displayed slide 24: "AIAS Recent (2010) Successes." He stated that in August 2010, 18 international cargo carriers attended Alaska International Cargo Summit held in Anchorage. The summit's meetings included information on Alaska's unique air cargo transfer rights. He remarked that winter charters from Tokyo to Fairbanks on Japan Airlines increased to 15 flights, which were up from 10 flights the previous year. He stated that Frontier Airlines added seasonal non-stop service in 2010 from Denver to FAI. He added that Jet Blue would provide Anchorage to Long Beach daily flights from May to September. He stated that Edelweiss Airlines would provide a Zurich to Whitehorse to Anchorage weekly flight from May to September. He reported that Cargolux cargo flights returned in October, 2010, with 10 to 14 stops a week.

Commissioner Hatter discussed the AIAS future with slide 26: "Asian Market Projected to Lead Growth." He stated that the chart was a forecast from Boeing World Air Cargo from 2010 to 2011. The line that represented North America to Asia had the highest annual growth percentage, and

represented a large portion of Alaska's cargo market share. The graph showed that Asia cargo was expected to grow.

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Commissioner Hatter showed slide 27: "Cargo Summit and Follow On." He stated that there was a plan for a second annual Alaska International Cargo Summit for August 2011.

Commissioner Hatter presented slide 28: "Strategic Planning and Marketing." He stated that for many years the system focused on capital improvement, and was transitioning into the next phase of helping to build a world class enterprise. He stated that AIAS was looking at an organizational study that would focus on talent and skill sets, in order to become a world class operation. He stated that AIAS was looking closely at the Asian market, and how to brand AIAS when approaching potential customers.

Co-Chair Stedman referred to slide 11, and wondered if Commissioner Hatter could go back to FY07. He also queried the potential competitor in British Columbia. Commissioner Hatter replied that he had been watching British Columbia's marketing strategy, and would continue to distinguish the Anchorage system. He agreed to provide the rest of the information.

Senator Olson referred to a comment about Anchorage and Fairbanks being closed on 9/11, and how planes were diverted to Whitehorse on 9/11. Commissioner Hatter replied that 9/11 was a unique situation, and lessons had been learned from that situation. He stated that collaboration, communication, and partnership were essential tools in working with the Canadian carriers.

Senator Olson remarked that the airports were eroding, and wondered how to maintain the airports. Commissioner Hatter stated that there was a thorough airport project evaluation board process, and stakeholders determine the prioritize airport projects. He stated that most of the capital improvement projects for the rural airports were funded through the FAA.

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Senator Thomas wondered how the activity on slide 24 impacted slides 15 and 16. Commissioner Hatter replied that

the indicators showed growth, and were moving in a positive direction.

Senator Thomas queried the Flint Hills jet fuel situation. Commissioner Hatter replied that from an international airport perspective, the priority lies in affordability. He reiterated that the AIAS was not in the fuel business, but merely enabled the carriers to feel comfortable using Alaskan business. He stated that the AIAS was not a part of the fuel consortium.

Senator Thomas stressed the importance of using fuel produced in Alaska.

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Senator McGuire requested data for cargo traffic standings of the Anchorage Airport compared to the Vancouver, British Columbia International Airport. She also stated that there was interest in collecting Alaskan seafood on the empty cargo planes that were on their way back to Asia.

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Senator Olsen asked about runway and ramp extensions. Commissioner Hatter replied that many agencies had expressed interest in runway and ramp extensions, but there was a challenge with lack of infrastructure.

Senator Olsen asked if the state was going to attempt to service the more rural and infrastructure poor areas. Commissioner Hatter replied that he would get the information to the committee at a later date.

Senator Olson pointed out some new military issues, and wondered what the department's position was for dropping the ceiling from 5000 feet to 500 feet. He felt it would inhibit some commuter aircraft. Commissioner Hatter believed that the Department of Defense had plans for defense training and required studies related to airspace and safety. He felt that Alaska had unique capacity to explore options about using airspace only when imperative. He remarked that the state should not cater to the military, but also not inhibit the military.

Senator Olson stated that cargo should not be the number one priority, because the airports were designed for the state residents.

Co-Chair Hoffman expressed concern on the state's position on bypass mail infrastructure. He felt that federal bypass mail decisions were basically a transfer of costs from the federal government to the state. He stated that the state needed to have a better stance on bypass mail, because of the burden bypass mail places on the rural areas. He stressed that attention should be placed on the smaller communities, because of hazardous weather conditions. He reiterated the importance of focusing on service to Alaskan residents. Commissioner Hatter replied that he would fulfill his duties as commissioner, and therefore determine priorities.

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BILL O'LEARY, CHIEF FINANCIAL OFFICER, ALASKA RAILROAD CORPORATION, stated that "The Alaska Railroad Corporation Briefing to the Senate Finance Committee" (copy on file) would touch on three areas: corporate overview, financial position, and earnings/operating budget outlook.

Mr. O'Leary discussed slide 3: "Alaska Railroad Corporation." He stated that the railroad was built by the federal government between 1914 and 1923, and was purchased by the state of Alaska for \$22 million in 1985. He remarked that the railroad was a self-supporting, state-owned corporation. The railroad was serving ports and communities from the Gulf of Alaska to Interior Alaska with 469 miles of mainline track; and it was a full-service passenger and freight railroad serving communities from the Gulf Alaska to Fairbanks.

Co-Chair Hoffman wondered if there was a Railroad board. Mr. O'Leary replied that there was a seven member board, and they are appointed by the governor with two members in the governor's cabinet. The board meets on an average of every six weeks. He remarked that board members were paid \$400 per day when working on railroad business.

Mr. O'Leary presented slide 4: "201 Sources of Customer Revenue." He stated that freight provided 67 percent of the revenue; and real estate and passenger revenue also provided a significant portion of the revenue.

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Mr. O'Leary discussed slide 5: "Freight Business." He stated that the railroad moved 6.3 million tons of freight overall in 2010, compared to 6.2 million tons in 2009. He anticipated 3.5 percent freight growth in 2010. He stressed that the railroad was heavily reliant on three primary commodities: petroleum, coal, and rail barge services that supported the oil industry.

Mr. O'Leary discussed slide 6: "Passenger Business." He stated that the railroad was known around the state for its passenger business. He noted that the passenger business included both ARRC trains and cruise partner movements; and the trains moved 405,000 passengers in 2010, compared to 471,000 in 2009 (14 percent decrease). He anticipated a 3.2 percent growth over 2010. He pointed out the year-round scheduled passenger services made the ARRC eligible for Federal Transit Administration formula funds.

Mr. O'Leary displayed slide 7: "Real Estate." The railroad real estate focused on property development; leases and permits; dockage and wharfs; facilities maintenance and management; and revenue from real estate activities was a key component to ARRC being self-sustaining.

Mr. O'Leary showed slide 8: "Capital Funding Sources." He stated that ARRC earnings provided the required match for federal funds, and was essential for freight-related improvements. He furthered that the USDOT/Federal Transit Administration provided formula funds, grants, and repayment for bonds. He remarked that other federal agencies were also a funding source for ARRC. He stated that federal funds allocated to ARRC did not affect federal funding for other state transportation projects; and ARRC federal match was not from the general fund, because the match was solely based on ARRC earnings.

Mr. O'Leary continued with slide 10: "Balance Sheet Highlights-Assets/Debt." He stated that the railroad had experienced revenue challenges, but ARRC had managed to withstand the challenges. He remarked that ARRC was poised to gain \$1 billion in assets. He divulged that ARRC had two levels of debt: recourse and outstanding bonds. He stressed that railroad debt was not the state of Alaska's debt.

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Mr. O'Leary discussed slide 11: "Balance Sheet Highlights-Liquidity." He remarked that liquidity was improving.

Co-Chair Stedman queried cash flow of the ARRC. Mr. O'Leary agreed to provide that information.

Mr. O'Leary displayed slide 12: "Benefit Trust Funds." He announced that ARRC was not a part of the state's retirement or medical programs. He stated that ARRC was a planned sponsor of two benefit trust funds: Defined Benefit (DB) pension fund and the Retiree medical fund. He noted that both plans were financially sound: the DB pension was 99 percent funded as of January 2010, and the Retiree medical was 118 percent funded as of January 2010.

Co-Chair Stedman queried the actuary and consultant on the investment side. Mr. O'Leary replied that ARRC used Mercer for the investment consulting, and were currently using Gabriel Roeder Smith and Company (GRS) as the actuary.

Co-Chair Stedman wondered if ARRC used Mercer for asset management. Mr. O'Leary affirmed.

Mr. O'Leary discussed earnings and the operating budget outlook and showed slide 14: "Recent History." He stated that the blue bars indicated the corporate net income, and stated that the income reflected the calendar year. He stated that for four years prior core train operations ran at a loss. He stated that the loss coincided with the decline in petroleum cargo from Flint Hills. He stated that Flint Hills decided to stop hauling naphtha product for export at the end of 2005; and that decision greatly impacted ARRC financials. He stressed that ARRC was healthy, and had taken steps to insure its financial comfort. He stated that in 2009 ARRC eliminated approximately 200 staff positions, which resulted in a significant cost structure reduction.

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Co-Chair Hoffman queried the total number of positions the 200 layoffs were taken. Mr. O'Leary replied that ARRC had a large seasonal staff, but felt that ARRC fluctuated between approximately 725 employees to approximately 875 in the summer.

Co-Chair Hoffman wondered the number of seasonal employees that were laid off. Mr. O'Leary guessed that 30 percent of the layoffs were seasonal workers. He stressed that the eliminations were done in the fall, and agreed to provide the committee with more detailed information.

Mr. O'Leary presented slide 15: "2010 Financial Snapshot." He stated that there were low expectations for 2010, and there had been significant uncertainty with some of the key revenue lines. He remarked that petroleum haul was anticipated to be half of that of 2003; passenger operations were lower because of cruise ship redeployments; and there was a significant impact of the 2009 personnel downsizing. The budgeted net earnings for 2010 were \$8.4 million, with a \$4.3 million loss from train operations budgeted.

Co-Chair Hoffman wondered if ARRC anticipated increased cruise ship passengers in the future. Mr. O'Leary replied that they did anticipate more cruise ship passengers, because cruise ships were being redeployed back to Alaska.

Co-Chair Stedman requested cash flow financial data, with the last four years of the ARRC balance sheet, an income statement, and cash flow statement with foot notes.

Senator Egan wondered if the \$4.3 million deficit in trade operations displayed in slide 15 was recovered from the real estate. Mr. O'Leary replied that real estate was a key component, as well as the ability to use the federal formula funds to reimburse for certain operating expenses.

Mr. O'Leary presented slide 16: "2010 Financial Snapshot." He declared that preliminary 2010 numbers exceeded expectations. He stated that 14 million dollars in earnings were expected in the final numbers in March 2011. He reported that petroleum performed worse than expected, but it was offset by Trailer on Flat Car (TOFC) and Gravel hauls; passenger revenue did not fall as far as anticipated; solid expense control offset rising fuel costs; solid expense control offset rising fuel costs; and there was a year-end boost from tax credit legislation approved by congress. He furthered that preliminary, unaudited net earnings were \$13.7 million, with \$700,000 from train operations. The audit would be completed March 2011.

Steve Silverstein, Vice President of Business Development, discussed the passenger and freight revenue details of the railroad. He stated that there were many companies and ports throughout the state that had ties to the railroad. He pointed out that the railroad's capacity to move freight into the state was 8 percent of the overall capacity. He stressed that most of the heavy weight moving was done throughout the rail belt. Moving large capacities was their specialty. The numbers for 2010 were down due to a lag in oil production. He cited slide 18: "2011 Freight Revenue Budget-Local Coal." He stated that the export coal market was strong. Slide 19 illustrated the future expectations for coal haul on the railroad. Slide 21 detailed petroleum income related to the railroad. He noted that funds were down in 2010.

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Co-Chair Stedman queried the petroleum shipment expectations for 2011 through 2013. Mr. Silverstein responded that he expected 2011 to be better than 2010, because Flint Hills forecasted a positive year in 2010. He remarked that there were mostly unknowns, particularly in regard to the refinery in North Pole. He stressed that the local petroleum was getting replaced with imported fuel from Singapore. He remarked that there was a slight increase in product produced at the smaller in state refineries. He furthered that most of the petroleum was delivered by ship to the Port of Anchorage and the Port of Nikiski. He reiterated that the decline in business from the petroleum trade was a concern for ARRC, because was the number one source of revenue for the railroad.

Mr. Silverstein continued with slide 23: "Petroleum Revenue vs. Other Freight and Passenger Revenue." He stated that petroleum and passenger growth had been in decline over the two years prior, but other freight business was growing rapidly. He continued to slide 24: "2011 Freight Revenue Budget - Gravel" and highlighted the benefits of gravel shipping for the railroad.

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Co-Chair Stedman believed that gravel industry would be increased given road infrastructure projects throughout the state. Mr. Silverstein stated that the gravel that the

railroad moves was only competitive in a small geographic area. He remarked that the airport provided the most projects for the gravel that the railroad hauls. He stated that the railroad competes with truckers in the gravel business.

In response to a question from Senator Thomas, Mr. Silverstein stated that the success of the railroad was based on the success of the petroleum industry.

Senator Thomas queried the railroad's Flint Hills jet fuel business. Mr. Silverstein replied that jet fuel was approximately 90 percent of what the railroad hauls for Flint Hills.

Mr. Silverstein presented Slide 25: "2011 Freight Revenue Budget-ARMS Barge." He stated that the railroad's interstate business was through the ARMS barge. He stressed that business from the oil fields provided 70 percent of the ARMS barge revenue.

In response to a question from Co-Chair Stedman, Mr. Silverstein stated that while many of the ARMS goods are oil related, the goods might not necessarily go directly to an oil company.

Co-Chair Stedman requested more information about the ARMS barge, and Mr. Silverstein agreed to provide that information.

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Mr. Silverstein discussed slide 26: "2011 Freight Revenue Budget-CN Barge." He stated that the Canadian National (CN) Barge is a railcar shipment service, with Prince Rupert to Whittier to Anchorage routes. He announced that the largest portion of the CN barge business was methanol related shipments. He specified that methanol was used for freeze protection in the oil fields. He stated that the second largest shipment on the CN barge was propane, which was primarily used in Kenai during the winter.

Mr. Silverstein displayed slide 27: "2011 Revenue Budget-ICOFC." He explained the Interline Container on Flat Car (ICOFC), and stated that the barges had racks over the rail cars. The racks can be used by a customer to haul containers, then the containers are hauled in on the tracks

from Whittier to Anchorage and Fairbanks. He stated that business had been down, because a customer chose to use their own barge to haul goods. That lost business was made up through in-state business in other areas.

Mr. Silverstein showed slide 28: "2011 Freight Revenue Budget-Misc Local." He remarked that the miscellaneous business was difficult to accurately predict.

Senator McGuire wondered why there was a 14 percent passenger decrease from 2009 to 2010. Mr. Silverstein replied that the decrease was because cruise ships had been redeployed. He stated that the railroad hauled the cruise ships' containers and also hauled passengers.

Senator McGuire wondered if the two new cruise ships scheduled to dock in Anchorage would any effect on the ARRC's marketing strategy. Mr. Silverstein replied that there had always been marketing for every direction the railroad traveled.

Mr. Silverstein displayed slide 29: "Passenger Revenue History and 2011 Budget." He announced that 2011 to be a good year for passenger business.

Mr. Silverstein discussed slide 30: "Passenger Count. 2006-2010." He remarked that as the cruise line container revenue dropped drastically, the passenger revenue did not experience such a drop. The passenger revenue was maintained, because of the marketing toward independent travelers.

Co-Chair Hoffman wondered if there were any programs to encourage Alaskans to travel on the railroad. Mr. Silverstein stated that there were advertised specials for Alaskans, with regular campaigns for 20 to 50 percent off fares. He remarked that ARRC had partnered with hotels for Alaskan resident discount packages.

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Mr. O'Leary discussed slide 31: "2011 Outlook-Operating Budget." He stated that the ARRC's financial situation was still fragile. He announced that there was planned revenue growth, although the market uncertainty, expense, and pressures still persidedt. Revenue grown was anticipated for Flint Hills, export coal, passengers, and fuel. He

reiterated that the ARRC board approved an earnings budget of \$18.million, with \$8.7 million net income from core train operations, and he concluded that contingency plans were in place if the revenue did not materialize.

Co-Chair Stedman queried the impact of the Federal Transportation Administration's (FTA) potential changes to the formula funds, specifically the debt service to the bonds. Mr. O'Leary replied that he felt that FTA would not apply changes to the formula funds regarding debt service, because it would directly affect bond holders. He remarked that the ARRC's ability to be in the formula program was a key to making the debt service payments to the bonds. He stated that they were watching the FTA closely, and hoped there would not be a negative impact.

Senator Olson queried right of way resolutions regarding the railroad. Mr. O'Leary requested a more specific question.

Senator Olson explained that the railroad owns some land that they are not opening for use, so he wondered if ARRC was making any further allowances for land use. Mr. O'Leary responded that the CEO might be able to answer the question.

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Co-Chair Stedman stated that ARRC CEO could provide more information at a later time.

Senator Olson wondered if the ARRC would contribute to the road to Nome. Mr. O'Leary replied that there had been work with DOT/PF, and there were discussions about the benefits of a rail connection to Nome.

Co-Chair Stedman stated that the railroad was also involved in the expansion of Port Mackenzie.

Senator Thomas wondered if a northern extension of the railroad would be compatible with the transportation of mining materials. Mr. O'Leary agreed to provide that information.

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ADJOURNMENT

The meeting was adjourned at 10:51 AM.

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