

SENATE FINANCE COMMITTEE
February 10, 2012
9:02 a.m.

[9:02:10 AM](#)

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; Christopher Aadnesen, President & CEO, Alaska Railroad Corporation; Bill O'Leary, Chief Financial Officer & Vice President for Finance, Alaska Railroad Corporation;

SUMMARY

^PRESENTATION ON STATEWIDE TRANSPORTATION ECONOMIC INDICATORS

[9:02:49 AM](#)

STEVE HATTER, DEPUTY COMMISSIONER OF AVIATION, DEPARTMENT OF TRANSPORTATION AND PUBLIC FACILITIES, introduced his support staff. He directed committee attention to the presentation, "Aviation-Economic Engine for Alaska"(copy on file). He discussed Slide 2, which illustrated the scope of the aviation arm of the department:

- Largest System in the US
- 254 State-owned Airports
- Lifeline Transportation Mode for all citizens and regions
- Airports only means of year round access for 169 communities
- Alaska International Airport (AIAS) is an economic engine for the state

Commissioner Hatter turned to Slide 3, which showed the aviation industries economic contributions to Alaska:

- 47,000 aviation jobs statewide in both rural and urban areas
- 5th largest contributor to Alaska's Gross State Product (GSP)
- Contributes \$3.5B to \$44B economy

Commissioner Hatter assured the committee that the department had been working to create better standards for more accurately gaging the size of budget necessary to keep its system running. He said that the biggest focus for airports was in the area of safety.

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Commissioner Hatter continued to Slide 5, "Two Airports - One System," which highlighted that the International Airport System was made up of two airports: Ted Stevens International Airport and Fairbanks International Airport. He noted that the system had been created 50 years ago by Ch88 SLA 1961 - (AS 37.15.410-550). He believed that it marketed well globally to have the two airports housed in one system.

Commissioner Hatter discussed Slide 6, which showed that the system was self-sustaining through user rates and fees; the businesses that used the airport funded the entire system.

[9:07:10 AM](#)

Commissioner Hatter turned to Slide 7, which contained two pie charts detailing AIAS revenues and costs. He relayed that aviation attracted \$101 million in annual operating revenues, 37 percent was generated through landing fees. He

said aviation listed \$1.5 billion in assets and averaged \$50 million per year in federal capital project contributions. He pointed out that carriers funded 70 percent of the \$101 million through rates and fees.

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Commissioner Hatter explained that the rates and fees for use of the airports facilities were developed and administered through the Alaska International Airport System and Passenger Terminal Lease Operating Agreement. He furthered that the agreement was a contract between the system and each individual member of a majority of airlines; the residual cost model required a signatory airline to sign the operating agreement contract and received benefits in return, such as reduces fees and rates, as well as a voice in the capital project game plan.

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Commissioner Hatter continued to Slide 10, "Economic Engine":

Anchorage Int'l Airport

- 15,577 Jobs - one in ten jobs in Anchorage
- About \$724 million in direct annual payroll
- Another \$303 million in annual payroll jobs in the community
- #2 Airport in North America for landed cargo weight

Fairbanks Int'l Airport

- 1,900 Jobs - one in twenty jobs in Fairbanks attributable to the airport
- \$225 million in statewide economic output
- Ranked 85th in the nation in weight of total mail and freight (2010)

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Commissioner Hatter spoke to Slide 11, "Asia Centric Cargo Market":

- Over 99 percent of cargo through AIAS - five Asian origins (China, Taiwan, Korea, Japan, Hong Kong)

- N.America - Asia cargo through AIAS expected to grow - 1-2 percent
- 71 percent of all Asia - bound cargo from U.S. goes through ANC
- 82 percent of all U.S. - bound air cargo from Asia goes through ANC
- All Asia - North America carriers have flights through Anchorage
- Approximately 80 percent of AIAS carrier generated revenue is cargo

Commissioner Hatter shared that the airport would be receiving an award in 2012 for customer service.

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Commissioner Hatter discussed Slide 14, which indicated that the success of the airports was attributable to its location; 9.5 hours from 90 percent of the industrialized world and because there was never a same day closure (except 9/11). He noted that it was a perfect balance between fuel weight and cargo payload.

Commissioner Hatter noted Slide 18, which contained a graph illustrating the passenger activity for FY08 through FY12. He said that the close grouping of the lines indicated that changes in the global economy and other factors that affected the cargo market did not reflect the same on the passenger market.

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Commissioner Hatter continued to Slide 19, which charted the cargo activity. He stated that the numbers had yet to fully recover from a currently uncertain economy.

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Co-Chair Stedman queried the cargo numbers for FY12.

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Commissioner Hatter indicated that the purple line represented FY12. He opined that the line was tracking FY09, which sloped due to the Mt. Redoubt activity.

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Co-Chair Stedman requested the January 2012 data as soon as it was available.

Commissioner Hatter said he would supply the information when it was available.

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Commissioner Hatter directed committee attention to Slide 20, which listed the causes for decreased activity in the cargo market:

- The global economy.....
- Other risk factors:
 - o Fleet mix
 - o Potential competitor airports
 - o Perceptions that operating at/through AIAS doesn't "pencil"
- We aggressively and collaboratively manage those factors within our control, while also proactively marketing and myth busting

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Commissioner Hatter continued to Slide 22, "Fuel Supply":

- Fuel market is entirely private
- 2009 fuel shortage caused by swift and unexpected recovery in air cargo market
- Some carriers opted to overfly AIAS lacking confidence in fuel supply
 - o Fuel price and supply a large part of airline routing decisions
- New suppliers entered the market
- Private industry is increasing storage
- Status today: low risk of a repeat of 2009

Commissioner Hatter stated that the aviation was a business enterprise and it was important that customers felt assured of a readily available fuel supply. He stressed that the state did not buy, transport, store or dispense fuel for commercial purposes.

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Commissioner Hatter continued to Slide 23, "Competitor Airports":

- Tough for competitors to overcome our location
- We have liberal cargo transfer options
- However.....Portland, Seattle, Vancouver, Prince George, other US West Coast airports have all visited Asia in efforts to recruit cargo business
- We are "right sizing" our response to competition - emphasize competitive advantage; retain and attract

Commissioner Hatter relayed that the US competitors were restricted in providing incentives because the Federal Aviation Administration (FAA) strictly restricted some activities, such as direct payments to carriers; however, local governments, and some state governments could. He believed that the downturn in traffic was not related to carriers using other airports, but that they were simply slowing down their activity level.

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Commissioner Hatter spoke to Slide 25, "Preserving/Increasing Cargo Activity":

- Working cooperatively with airlines
- Held Alaska Cargo Summits in 2010, 2011
- Followed up with Asia trips
 - Build relational equity and market Alaska advantages
- Comprehensive AIAS Strategic Planning in 2011
- Implemented Cargo Incentive Program

Commissioner Hatter asserted that the best way to keep customers was to keep rates and fees competitive. He noted a 15 percent rate increase implemented in November 2011. He turned to Slide 26, "Collaborative Relationships:

We're working closely with airline partners to get through recent traffic downturn. The following is Alaska Airport Affairs Committee's (AAAC) written response to AIAS's November 2011 rate increase:

"The State worked collaboratively with the AAAC Chairs...to determine the most prudent course to take."

"The Sate has been very collaborative in their approach...to address the needs of both the Airlines and the Airport." AAAC Cc-Chairs

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Commissioner Hatter stressed the importance of the operating agreement and of maintaining relational equity with the 31 signatory carriers when facing possible downturn in activity.

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Commissioner Hatter continued to Slide 27, "Passenger Activity":

- 550,000 out-of-state and int'l visitors transited ANC; 85,000 through FAI in 2011
- Japan Airlines winter charters
- Jet Blue initiated ANC-Long Beach
- United announced new Fairbanks-Denver for 2012
- Working with Alaska "Coalitions of the Willing"
- Implemented Passenger Incentive Program

Commissioner Hatter added that passenger activity was not an area in need of improvement.

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Commissioner Hatter discussed Slide 28, "Strategic Planning & Marketing":

- Systems planning/responses to previous management reviews
 - Strategic Plan (2011)
 - Business Plan (2012)
 - Human Resource Study (2011/12)
 - Marketing Plans/System Branding (Ongoing)
- Proactive communications
 - Work with CVB's and EDC's to strategize opportunities

- o Attend passenger and cargo conferences to promote AIAS
- o Pursue Asian carriers

Commissioner Hatter explained that the focus was to market aviation as a cargo operation and to expand marketing. He added the department sought to make improvements in measuring where the state stood in the changing economic climate and to bring in value added businesses in and around the airport.

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Commissioner Hatter turned to Slide 29, "New Operating Agreement":

- Negotiate Operating Agreement with Signatory Airlines
- Existing OA expires June, 2013
- New Capital Improvement Program
- Review rates and fees model
- Review next OA term

Commissioner Hatter shared that the department was in pre-negotiations with its 31 carriers and was hoping for a short negotiation timeframe.

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Commissioner Hatter discussed Slide 30, "FY13 Aviation Capital Request":

FAA Airport Improvement Program (AIP) Legislative Authority-Totals \$200.7M

- AIAS - \$14.1M
- Central Region - \$75.1M
- Northern Region - \$63.1M
- Southeast Region - \$13.4M
- Statewide - \$35M

Non-Federal Funding

- AIAS Airport Revenue Funds - \$.8M
- AIAS Construction Bond Funds - \$16.8M
- GF Match for AIP Projects - \$11.7M
- GF Deferred Aviation Maintenance - \$3.5M

- GF for Umiat Airport Survey & Planning - \$.25M

State-Federal Partnerships

- Statewide Digital Mapping Initiative - \$12.2M Fed/\$3.7M GF
- Alaska Aviation Safety Project/Flight Simulation Training - \$1.5M Fed/\$1M GF

Co-Chair Stedman stated that the department would be called to committee for further capital budget discussions and should present projections at that time.

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Commissioner Hatter concluded with Slide 31, "Takeaways":

- Two Airports - One System
- Self-sustaining - no general funds
- Business-centric: rates and fees and self-supporting bonds
- Economic engine of regional, state, and global significance
- Critical aviation enabler in our nation's most aviation-centric state
- Working cooperatively with the airlines - they shoulder the financial risk - unilateral state action puts this relationship at risk
- Aggressive strategic planning to protect and enhance our system
- Great people doing great things for our state

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Co-Chair Stedman requested further elaboration concerning the 2012 projections.

Commissioner Hatter said he would provide the numbers as soon as they were available.

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Senator Thomas queried the economic impact on the aviation industry of the downsizing, and possible eventual closing, of Eielson Air Force Base.

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Commissioner Hatter assured the committee he would provide the information. He stated that master planning had already begun in Fairbanks.

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Co-Chair Stedman turned the gavel over to Co-Chair Hoffman.

CHRISTOPHER AADNESEN, PRESIDENT & CEO, ALASKA RAILROAD CORPORATION, introduced the presentation, "Senate Finance Committee Briefing: February 10, 2012." He turned to Slide 3, "Alaska Railroad Corporation":

- Railroad built by the federal government (1914-1923)
- Purchased by the State of Alaska for \$22 million in January 1985
- Self-supporting, State-owned corporation
- Seven-member Board of Directors appointed by Governor
- Full-service passenger and freight railroad serving ports and communities from the Gulf of Alaska to Fairbanks

- Supports 3,000 jobs and \$150 million in payroll across the State.

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Commissioner Aadnesen discussed Slide 4, "Alaska Railroad Quick Facts"(copy on file). He pointed out that the union population made up a considerable amount of the total number of railroad employees. He continued to Slide 5, which contained a pie chart that detailed the 2011 sources of preliminary and unaudited customer revenue for the railroad: Freight, 70 percent; Passenger, 16 percent; Real Estate, 14 percent; Other, 1 percent. He turned to Slide 6, which contained illustrations pertaining to freight business commodities:

- Logs
- Gravel
- Oilfield pipe
- Petroleum
- Military
- Coal

- Interstate Barge
- Trailers
- Moved 6.2 million tons of freight overall in 2011, compared to 6.3 million tons in 2010 (1.6 percent decrease)
- 2012: Anticipate 8.5 percent overall freight growth over 2011
- Heavily reliant on three primary commodities

Commissioner Aadnesen stated that not many logs had been moved in recent years.

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Commissioner Aadnesen reiterated that the freight business had been fairly flat in 2011, but that growth was expected.

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Commissioner Aadnesen discussed Slide 7, "Passenger Business":

- Moved 412,000 passengers in 2011, compared to 405,000 in 2010 (2 percent increase)
- Includes both ARRC trains and cruise partner movements
- 2012: Anticipate 9.6 percent passenger growth over 2011
- Makes ARRC eligible for Federal Transit Administration formula funds

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Commissioner Aadnesen turned to Slide 8, "Real Estate":

- Property Development
- Leases and Permits
- Dockage and Wharfage
- Facilities Maintenance and Management
- Revenue from Real Estate activities are key component to ARRC being self-sustaining
 - 2011: 62 percent of corporate net income derived from real estate (preliminary/unaudited)

Commissioner Aadnesen added that he the railroad managed 36 thousand acres of state land and two docks.

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BILL O'LEARY, CHIEF FINANCIAL OFFICER & VICE PRESIDENT FOR FINANCE, ALASKA RAILROAD CORPORATION, presented Slide 9, "Capital Funding Sources":

- ARRC Earnings
 - Provides required match for federal funds
 - Essential for freight-related improvements
- USDOT/Federal Transit Administration
 - Formula Funds used for projects and bond repayment
 - 9-20 percent ARRC Match Required
- Other Federal Agencies - (Dept. of Defense, FEMA, FHWA, FRA, Homeland Security, ect.)
- Federal funds allocated to ARRC do not affect federal funding for other state transportation projects
- ARRC federal match is not from State of Alaska general fund; match derived solely from ARRC earnings

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Commissioner O'Leary turned to Slide 11, "Balance Sheet Highlights: Assets/Debt," which contained two bar graphs depicting in millions total assets and total debt. He noted that the railroad ran on a calendar year rather than a fiscal year. He pointed out to the committee that assets continued to grow and debt maintained at a manageable level.

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Commissioner O'Leary continued to Slide 12, "Balance Sheet Highlights: Liquidity," which contained two bar graphs illustrating the current ratio calculated by dividing current assets and current liabilities, and the working capital calculated by subtracting current liabilities from current assets.

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Commissioner O'Leary turned to Slide 13, "Benefit Trust Funds":

- ARRC is plan sponsor of two benefit trust funds

- o Defined Benefit (DB) pension fund: ~\$95 million assets
- o Retiree medical fund: ~\$35 million assets
- Both plans financially sound
 - o DB pension: 96 percent funded as of 1/1/11
 - o Retiree medical: 135 percent funded as of 1/1/11

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Commissioner O'Leary explained Slide 15, "Recent History," which contained a bar graph illustrating net income and adjusted operating income history. He stated that beginning 2006 the railroad had experienced a loss on their core train operations. He said that in 2009 the organization downsized, which had resulted in more operational efficiency.

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Commissioner O'Leary spoke to Slide 16, "2011 Financial Snapshot":

- 2011 Plan - guarded optimism about revenue recovery
- 2011 Actuals did not meet early expectations
 - o Petroleum growth did not materialize, offset somewhat by coal, Trailer on Flat Car (TOFC) and Interline Barge hauls
 - o Passenger revenue performed better than anticipated
 - o Solid expense control partially offset by rising fuel costs
 - o Boost from tax credit legislation approved by Congress
- Still closing 2011's books - preliminary numbers expected mid-February
 - o Corporate net earnings not anticipated to be markedly different than 2010
 - o Positive earnings from train operations anticipated (not seen since 2005)
 - o Audit to be completed in March 2011

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Commissioner O'Leary discussed Slide 17, "Freight & Passenger Revenues: 2010-2012 (Budget)," which detailed what the anticipated budget would be for both freight and passengers; \$105.5 and \$24.9, respectively.

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Commissioner O'Leary turned to Slide 18, "2012 Sources of Freight Revenue," which was a pie chart illustrating the different revenue sources: Petroleum, 29 percent; Interline ARMS, 23 percent; Coal, Export, 16 percent; Cola, Local, 8 percent; Gravel, 7 percent; TOFC, 7 percent; COFC, 4 percent; Interline, CN, 3 percent; Other, 3 percent.

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Commissioner O'Leary continued to Slides 19 through 32, which was a series of graphs and charts that illustrated individual lines of business pertaining to freight and passenger activity. He directed attention to Slide 20, which contained a bar graph illustrating petroleum gallons shipped from 1994 to 2012. He felt that the slide encapsulated the financial life of the railroad over the 18 years.

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Commissioner O'Leary noted the marked drop-off in 2005 and 2006. He stated that 2010 through 2012 continued to be lower than the peak in 2003. He noted that Fling Hills Resources, a refinery in North Pole, would be renegotiating its royalty contract with the state in 2014.

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Commissioner O'Leary turned to Slide 21, "Changing ARRC Dependence on Petroleum Haul," which contained two pie charts that showed how the railroads dependence on Flint Hills had changed since 2008. He stated that revenue diversification was a goal for the railroad.

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Commissioner O'Leary continued to Slide 22, "Freight Revenue - ARMS Barge." He explained that the barge took rail cars and containers from the Seattle area to Whittier, where they were offloaded and taken to primarily Anchorage or Fairbanks. He added the revenue depended heavily on oil and gas activity on the North Slope.

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Commissioner O'Leary discussed Slide 24, "Freight Revenue - CN Barge." He noted that the drop in revenue for 2011 was due to 4 missed voyages, he asserted that the numbers would increase in 2012.

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Commissioner O'Leary spoke Slide 25, "Freight Revenue - ICOFC." He explained that the Interline container on flat

car (ICOFC) were container shipments on ARMS Barge from Whittier to Anchorage and Fairbanks. He said that the drop in 2010 was related to a customer moving their business off of the barge and directly into Seward.

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Commissioner O'Leary discussed Slide 26, "Freight Revenue - Export Coal." He stated that the railroad saw significant growth potential in this area because of a strong worldwide demand for Alaskan coal. He continued to Slide 27, "Freight Revenue - Local Coal," which charted that coal hauls from Healy, into the interior, and up to Fairbanks including military bases. He noted that the numbers tended to stay level over the years.

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Commissioner O'Leary turned to Slide 28, "Freight Revenue - TOFC/COFC," which was a bar graph illustrating trailers and containers moved between Seward, Anchorage and Fairbanks. He relayed that the 2012 budget number was purposefully conservative.

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Commissioner O'Leary spoke to Slide 29, which detailed the freight revenue pertaining to the gravel haul. The slide listed the aggregate products moved from Mat-Su Valley to Anchorage by Anchorage Sand & Gravel, Granite Construction, and Quality Asphalt Paving.

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Commissioner O'Leary turned to Slide 30, which charted the miscellaneous or "catch all" revenue; generally railcar revenue and limited miscellaneous revenue that did not fit into other revenue lines. He shared that in 2011 several military moves improved the financial picture.

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Commissioner O'Leary explained Slide 31, which shifted to the passenger revenue numbers. He indicated they were expecting some very good numbers from 2012.

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Commissioner O'Leary turned to Slide 32, which illustrated the passenger counts for the railroad versus cruise line railcars. The chart indicated a 50/50 split in 2011.

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Commissioner O'Leary turned to Slide 33, "2012 Outlook - Operating Budget":

- ARRC financial situation still fragile
- Revenue growth planned, but markedly uncertain/expense pressures persist
 - Export Coal-string global demand, tempered by environmental issues, and capacity constraints
 - Interline business growth potential
 - Flat-line petroleum haul level planned
 - Moderate passenger growth seen: independents and return of Princess ship
 - Fuel, benefit cost increases dragging on bottom line
- ARRC Board approved earnings budget of \$15.4 million
 - \$6.4 million net income from core train operations planned
 - Contingency plans in place if revenue does not materialize

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Commissioner O'Leary turned to Slide 34, "2012 Outlook - Capital Budget":

- Approximately \$55.4 million in total funding planned for capital projects:
 - Federal Formula and Bond funds - \$26.3 million
 - Other Federal funds/litigation settlement - \$5.7 million
 - Cash flow from earnings - \$23.4 million
- Program primarily maintains/upgrades existing infrastructure
 - Concludes seven-year accelerated track rehabilitation program - \$31 million
 - Continues the development of Positive Train Control technology - \$5 million
 - Continues vehicle and equipment replacement program - \$3.3 million
 - Continues bridge rehabilitation program - \$3 million

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Commissioner Aadnesen turned to Side 35, "Challenges/Risks":

- **Federal Surface Transportation Reauthorization/FTA Formula Funds**

- o \$36 million annually at risk
- o Key Fund source for ARRC's continued viability in current form
- o Sole security for \$137 million in outstanding bonds
- o Draconian changes to corporation necessary should certain proposals in Congress move forward
- **Positive Train Control**
 - o Unfunded federal mandate with remarkably aggressive implementation timeline requirements
 - o Over \$45 million spent to-date, with at least another \$70 million to go
 - o Technology development program designed to prevent collisions, unauthorized train movements, and other human factor errors.
- **Strategic initiatives developed and in various stages of implementation to address these and other identified challenges/risks**
 - o Joint Board/management strategic planning process

[9:59:16 AM](#)

Commissioner Aadnesen discussed Slide 36, "Strategic Initiatives":

- Integrated Safety Management Initiative
- Maintain Eligibility for Federal Transit Administration Formula Programs
- Protect Existing Revenue Base and Grow our Business
- Customer and Community Relationships
- Economic Development of State
- Cost Containment Initiatives and Technology Initiatives
- Mitigate Impact of Spend-Out of Federal Transit Administration Bond Funds

[10:02:29 AM](#)

Co-Chair Hoffman queried the railroads plans for long-term maintenance on the Port MacKenzie and Northern Railroad extensions.

Commissioner Aadnesen responded that once they were built the traffic across each of the tracks would be light. He felt that it would take \$150,000 per year to fund the maintenance until enough current income from train operations could pay for maintenance. He relayed that when Port MacKenzie was completed it was expected to support traffic immediately.

[10:03:46 AM](#)

Co-Chair Stedman asked if there were any forward contracts or letters of interest associated with Point MacKenzie. He stated that the finances indicated that the railroad was in the red for cash flow from operations.

Commissioner Aadnesen replied that the port should be in place within 3 years, at which time it was expected to service a small amount of traffic. The traffic as not anticipated to cover expenses; expenses would come directly out of the operating funds. He stated that there were no letters of interest or contracts, but that the borough had been in discussions with Usibelli Mine concerning the transport of coal.

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Co-Chair Stedman asked any financial modeling had been done. He understood that the plan for the railroad included the shifting of, but not additional, funds.

Commissioner Aadnesen responded that they had not done any financial models. He said that the borough had done all of the financial planning. He said that the railroad was the program manager, and was building, but had yet to even acquire the right-of-way.

[10:06:12 AM](#)

Co-Chair Hoffman asked if the borough had shared any of its financial projections with the railroad.

Commissioner Aadnesen replied yes. He noted that the projections had been shared with the committee in 2011.

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Senator Egan understood that the railroad did not own land in the Port MacKenzie area.

Commissioner Aadnesen replied that the railroad did not currently own land in the area but that discussions were ongoing. He shared that there had been some disagreement concerning what that future model for the port should look like. He relayed that there was a certain amount of revenue that went with owning the railroad right-of-way.

[10:07:29 AM](#)

Senator Egan asked who would produce the steel for the Tanana River Bridge.

Commissioner Aadnesen responded that 20 percent of the steel was from China and the rest was domestic.

[10:08:07 AM](#)

Senator Thomas requested information regarding the potential impact of the downsizing or closure of Eielson Air Force base. He added a request for dollar figures that related the tonnage indicated in Slides 20, 23, 26, and 27.

Commissioner Aadnesen responded that he would provide the information.

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Co-Chair Hoffman turned the gavel back over to Co-Chair Stedman

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ADJOURNMENT

[10:09:13 AM](#)

The meeting was adjourned at 10:09 AM.