

Alaska
Railroad
Corporation

HFIN

FILE

ALASKA STATE LEGISLATURE
LEGISLATIVE BUDGET AND AUDIT COMMITTEE
Division of Legislative Finance



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MEMORANDUM

DATE: January 28, 1997

TO: Representative Terry Martin
House Finance Committee

FROM: Mike Greany, Legislative Fiscal Analyst
Division of Legislative Finance

BY: Dave Tonkovich, Fiscal Analyst
Division of Legislative Finance

SUBJECT: State Appropriations to the Alaska Railroad

A handwritten signature in black ink, appearing to be "Mike Greany", written over the "FROM" field of the memorandum.

At your request we've prepared a list of state appropriations to the Alaska Railroad:

SLA84, Ch. 171, Sec. 319 (Department of Commerce and Economic Development)

Alaska Railroad Acquisition	\$22,271,000 GF
Alaska Railroad Capital Equipment and Improvements	6,000,000 GF
Railroad Working Capital Fund	4,900,000 GF

SLA90, Ch. 208, Sec 145

Locomotives, Rolling Stock, and associated equipment cost (Associated with Wishbone Hill Coal Project)	\$9,000,000 Railbelt Energy
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Alaska Railroad Corporation

Financial Audits

- The financial affairs of the Alaska Railroad Corporation are audited annually by a public accounting firm. The corporation typically receives a "clean" opinion on its financial statements.

Performance Audits

- Alaska statute also requires the corporation to have an annual performance audit conducted by a recognized railroad management expert. This audit is conducted presently by Mercer Management Consulting and is presented to the Board of Directors of the corporation annually.

Significant Special Audits

Ship Creek Redevelopment Follow-up, November 17, 1994

- This audit was conducted to follow up on the findings and conclusions we made in our original review (1992) of this project. Several of the issues we initially raised appeared to have been satisfactorily resolved. Our concern in this review was whether the development would be successful.
- The redevelopment project had yielded little construction to date. None of the four centerpiece projects envisioned had commitments in place.

Anchorage Gravel Activities, July 3, 1996

- The report addresses our concerns that the Alaska Railroad Corporation's (ARRC) agreement with the Flamingo Brothers Partnership to market and extract gravel from the corporation's Anchorage property may not have been in the best interest of the corporation.
- ARRC's public procurement process was not followed. In the corporation's opinion, the gravel agreement was the disposal of real property and therefore, not subject to its procurement rules. We believe it was a commodity sale that should have been subject to the provisions of those rules.
- ARRC's real estate leases are inappropriately offered on a "first come, first served" basis.
- ARRC's justification of the project was unclear.

- ARRC's lack of public process excluded the community.
- We recommended ARRC improve its monitoring of employee conflict of interest disclosure statements.

Chena Landings Development, August 20, 1996

- This audit reviewed ARRC's management of the development project related to utility procurement, leasing, and public amenities.
- The utility project was delayed by planning and design difficulties.
- Request for proposal criteria and evaluation procedures were inadequate.
- The corporation lacked documentation regarding project development planning.
- Leases are not competitively offered; ARRC inappropriately uses a "first come, first served" approach to leasing property.

Ongoing or Pending Audits

Alaska Railroad Corporation, Equipment Purchases/Disposals

Alaska Railroad Corporation, Real Estate Appraisal Methodology

Auditor Observations

The Alaska Railroad Corporation has been under the "legislative microscope" for the last few years. The Audit Division has conducted five audits of the corporation since 1992 and has one audit in progress and another pending. Of those seven audits, two deal with rail operations, and five involve the corporation's management of real estate.

During the interim, the Legislative Budget and Audit Committee also pursued a greater understanding of the corporation and its assets. We believe that it is important that the Legislature understand the operation of the corporation and be aware of issues that impact its operation. The Legislative Budget and Audit Committee appears to be the appropriate vehicle currently available to provide that oversight.

The Alaska Railroad Corporation finds itself in an unenviable position. On one hand, it is operating under a statutory mandate to generally manage the corporation on a self-sustaining basis. On the other hand, as a corporation wholly owned by the State, the corporation must be

held to certain standards of openness and public accountability. It is in this vein that we often find ourselves at odds with the corporation. We believe that as long as the corporation is owned by the public, public accountability must come first.

We also believe that the corporation can be run in an efficient manner and still uphold those public accountability standards. Management by corporate officers and policy direction by the board of directors should strive for the appropriate balance. In our opinion, we have seen recent signs of improvement in this effort by the board, primarily through our contact with the chairman. We are hopeful that the appointment of a new chief executive officer will further foster these goals.

Without going into great detail on issues we remain concerned about regarding the Alaska Railroad Corporation, we offer these summary observations and would be happy to discuss them further with any member or committee of the Legislature. They are in no particular order of significance.

- The corporation's budget is not subject to the Executive Budget Act. We see no reason why the corporation should be exempt or even whether constitutionally, it can be. Similarly, significant federal funds have been received by the corporation for capital rehabilitation and improvements without any legislative oversight.
- The corporation has shown a profit for the last two fiscal years (calendar year end). Total net income for 1996 (unaudited) and 1995 was \$8.0 million and \$7.9 million, respectively. The net income from operations represented \$4.0 million and \$4.1 million, respectively. Approximately half of the corporation's income is generated from management of its real estate. The majority of this real estate is considered non-rail use property.
- A much talked about concern is deferred maintenance, however, little is factually known about the extent or estimated cost of that maintenance. We believe that a serious discussion needs to take place. It is possible, or even likely, that without the federal funding authorized the last two years (\$10 million per year) the railroad's income statement would look significantly different. Neither the financial statements nor the notes to the financial statements reflect any estimate of the amount of deferred maintenance.
- An observation that is important to understanding the fragile nature of the corporation's financial health is its dependence on two major customers. As disclosed in the notes to the financial statements for 1995, these two customers accounted for 45% of the corporation's revenue. The corporation's existence is dependent on those two customers.
- Through a combination of statute and corporation rules, the salary of railroad employees is confidential and therefore can not be disclosed to the public. Statute provides that the corporation may by rule designate and withhold public disclosure of matters of a

privileged or proprietary nature. Statute goes on to describe matters as including personnel records. Corporation rules include salary as a personnel record.

- Alaska Statute 42.40.260(b) requires the annual report of the corporation to include an analysis of potential sale arrangements whereby the corporation may be transferred into private ownership. The corporation has not pursued sale discussions with potential or interested buyers. The corporation has gone so far as to notify interested parties that the Board of Directors is not interested in selling the railroad.
- Statute requires the corporation to have an annual performance audit conducted by a recognized railroad expert to assure that the railroad is being managed and operated effectively and efficiently. There are two reports generated from this review. A confidential report is produced for the use of railroad management. A public version of the report is issued that does not go into nearly as much detail. We recommend that the legislature annually request a confidential briefing on the detail version of the performance report.

Governor Bill Sheffield
Pouch A
Juneau, AK. 99811

Senator Jalmar Kerttula
President, Alaska State Senate
Pouch V
Juneau, AK. 99811

Representative Joe Hayes
Speaker, Alaska House of Representatives
Pouch V
Juneau, AK. 99811

Gentlemen:

Enclosed herewith is the Interim Report of the Alaska Railroad Transfer Advisory Commission. This report is the product of ten months of public hearing, deliberation, and intensive analysis of the alternatives for management and operation of the Alaska Railroad after transfer from the federal government has been accomplished.

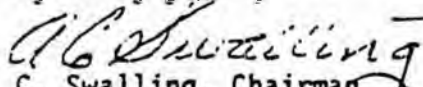
The Commission met a total of nine times in Anchorage, Fairbanks and Juneau. The Commission listened to over fifty hours of public testimony from individuals and groups from literally every corner of the State of Alaska. In addition, we have analyzed almost 1,000 pages of documents and submissions from interested individuals and groups.

In fulfillment of our legislatively mandated duties, we hereby formally tender this report to you for your consideration during the coming months as the transfer of the Alaska Railroad approaches. We hope you will find it helpful not only for the specific recommendation it contains but as a source of information about the wishes, desires and hopes of the people of the State of Alaska.

It should be mentioned that not all Commission members share each and every view expressed within this document. The combination of the change in State Administrations and the convening of the State Legislature made it difficult for the public officials on the Commission to attend all sessions. In many cases, the views expressed in the Interim Report represent an attempt by the Commission to summarize for your consideration consensus opinions heard again and again during public testimony. We feel this provides you with the full benefit of this information as it was expressed to us.

On behalf of the entire commission, I would like to thank you for the opportunity of serving the people of the State in this most important and worthwhile endeavor.

Very truly yours,


A.C. Swalling, Chairman
Alaska Railroad Transfer Advisory Commission

EXECUTIVE SUMMARY

The Alaska Railroad Transfer Advisory Commission met a total of nine times in Anchorage, Fairbanks and Juneau. The Commission listened to over fifty hours of public testimony and heard from over fifty individuals and groups regarding all aspects of the transfer of the Alaska Railroad from federal to state control. This Executive Summary is a compilation of the major policy recommendations of the Commission and a list of specific changes pending state legislation which the Commission feels are most important.

I--POLICY RECOMMENDATIONS OF THE COMMISSION

1. The railroad should eventually be owned and/or operated by private industry. Almost unanimously those testifying before the Commission felt strongly that it was in the best interests of the people of the State of Alaska and the best interests of the railroad to plan for the eventual transfer of the ownership and/or operation of the railroad to private industry.

2. Plans for expansion of the railroad should begin immediately. The Commission recommends the immediate preparation and filing of five right-of-way applications: (1) to Delta, (2) to Canada, (3) to Kenai, (4) to Beluga, (5) to Tanana and Kobuk/Ambler.

3. The railroad should cooperate with local governments. The Commission urges the State not to compete with local governments in the operation of railroad-related facilities, such as ports, which are historically operated by local governments.

4. The railroad should expand into connecting services by contracting with private enterprise. The Commission urges that the policy of the Alaska Railroad should be that, to the maximum extent possible, expansion should occur by contracting private enterprise and by not competing in a service area previously provided by private industry.

5. The interim operation of the railroad should be conducted by an independent authority under a separate department on a temporary basis. The Commission feels that the short term management of the railroad is critical to the overall future of the railroad and the state. Therefore, the Commission recommends the creation of an independent authority under a separate department of state government on a temporary basis as provided for in Article III, Section 22 of the Alaska Constitution.

6. State oversight of the railroad should be kept at a minimum. The Commission recommends that only the bare minimum of oversight consistent with good public policy be provided for in the legislation and that the legislation specifically provide for a public process so that policy determinations made by the board are based upon adequate public input.

7. Alaska railroad mineral rights should be preserved. The Commission recommends that any authority or private operator of the railroad should be able to utilize all subsurface resources and railroad land for railroad purposes without any restriction as to ownership or use of those resources which might otherwise be applicable under existing state law.

8. Additional appropriation for the Commission. The Commission feels that to adequately fulfill its legislative mandate between the date of this interim report and the final transfer of the Alaska Railroad to the State, an appropriation in the amount of \$75,000.00 is essential. This amount will provide the Commission with the ability to hire the necessary staff and incur necessary operational expenses so that a final report can be prepared.

II--SPECIFIC RECOMMENDATIONS FOR CHANGES IN PENDING STATE LEGISLATION

In the body of the report, the Commission makes numerous recommendations for specific changes in SB10, pending state legislation accepting transfer of the railroad. However, in this Executive Summary the Commission would like to call attention to a few specific matters which it considers to be critical.

1. The Commission urges that a seven-member board of commissioners be established for the railroad authority. Balanced geographic distribution for the board is critical and the Commission recommends that at least two members be from areas served by the railroad north of Windy Pass and at least two from south of Windy Pass.

2. If consistent with law, the Commission recommends that the Commissioner of Transportation and Public Facilities be a non-voting member of the authority.

3. The Commission recommends that a representative from the employee bargaining units and the general manager of the Alaska Railroad be non-voting members of the board of Commissioners.

4. Consistent with federal legislation, all bargaining agreements should be honored and maintained for a period of time until renegotiation can be accomplished smoothly and without disruption of rail service.

ALASKA RAILROAD CORPORATION

Corporate Address: P.O. Box 107500, Anchorage, Alaska 99510
327 W. Ship Creek Avenue, Anchorage, Alaska 99501

265-2403

FAX 258-1456

Kathryn Thomas
PO Box 3005
Kenai, AK

December 27, 1996

Dear Kathryn,

As you may be aware, the chamber recently adopted a resolution concerning the Alaska Railroad submitted by the lobbyist representing Montana Rail Link. As chairman of the board of directors for the Alaska Railroad Corporation, I would like you to keep in mind three important points as we come into this Legislative session:

- The Alaska Railroad is not a state agency;
- The Alaska Railroad does not take a subsidy from the state;
- The Alaska Railroad makes money.

In 1995, the Railroad earned an \$8 million profit. In 1996, I expect the line will earn more than \$7 million. We have been able to do that by providing good service, using professional railroad management, and aggressively using our assets to increase revenues. We accomplished all this without taking a nickel – not for operating, not for capital, not for labor contracts or benefits – not a single nickel from the state treasury since the purchase 12 years ago. Our employees are not state workers and are not part of the state retirement system. Our labor contracts are in place, long-term, and independent of the state employee unions.

The Alaska Railroad is managed by a board of Alaskans. The operators are professional railroaders. The money the railroad makes is earned in Alaska, and stays in Alaska. Our balance sheet is rock-solid, and we have excellent access to capital for expansion. The bottom line is that the railroad is safe, profitable, professional, and Alaskan.

Very truly yours,



Bill Sheffield
Chairman of the Board
Alaska Railroad Corporation

FY 1997

110 STAT. 2962

PUBLIC LAW 104-205—SEPT. 30, 1996

PUBLIC LAW

HIGH-SPEED RAIL TRAINSETS AND FACILITIES

For the National Railroad Passenger Corporation, \$80,000,000, to remain available until September 30, 1999, to pursue public/private partnerships for high-speed rail trainset and maintenance facility financing arrangements.

RAILROAD REHABILITATION AND IMPROVEMENT PROGRAM

The Secretary of Transportation is authorized to issue to the Secretary of the Treasury notes or other obligations pursuant to section 612 of the Railroad Revitalization and Regulatory Reform Act of 1976 (Public Law 94-210), as amended, in such amounts and at such times as may be necessary to pay any amounts required pursuant to the guarantee of the principal amount of obligations under sections 511 through 513 of such Act, such authority to exist as long as any such guaranteed obligation is outstanding: *Provided*, That no new loan guarantee commitments shall be made during fiscal year 1997.

NEXT GENERATION HIGH-SPEED RAIL

For necessary expenses for Next Generation High-Speed Rail studies, corridor planning, development, demonstration, and implementation, \$24,757,000, to remain available until expended: *Provided*, That funds under this head may be made available for grants to States for high-speed rail corridor design, feasibility studies, environmental analyses, and track and signal improvements.

TRUST FUND SHARE OF NEXT GENERATION HIGH-SPEED RAIL

(LIQUIDATION OF CONTRACT AUTHORIZATION)

(HIGHWAY TRUST FUND)

For grants and payment of obligations incurred in carrying out the provisions of the High-Speed Ground Transportation program as defined in subsections 1036(c) and 1036(d)(1)(B) of the Intermodal Surface Transportation Efficiency Act of 1991, including planning and environmental analyses, \$2,855,000, to be derived from the Highway Trust Fund and to remain available until expended.

~~Alaska Railroad Rehabilitation~~

To enable the Secretary of Transportation to make grants to the Alaska Railroad, \$10,000,000 shall be for capital rehabilitation and improvements benefiting its passenger operations.

RHODE ISLAND RAIL DEVELOPMENT

For the costs associated with construction of a third track on the Northeast Corridor between Davisville and Central Falls, Rhode Island, with sufficient clearance to accommodate double stack freight cars, \$7,000,000 to be matched by the State of Rhode Island or its designee on a dollar for dollar basis and to remain available until expended: *Provided*, That as a condition of accepting such funds, the Providence and Worcester (P&W) Railroad shall enter

Contracts.

into an agreement with the Federal Railroad Administration up to the first \$13,000,000 action initiated by the P&W with Amtrak relating to the Davisville and Central Falls freight operations.

GRANTS TO THE NATIONAL RAILROAD PASSENGER CORPORATION

To enable the Secretary of the National Railroad Passenger Corporation, U.S.C. 24104, \$665,450,000 of which \$342,000,000 shall be for capital improvement this head for capital improvement before July 1, 1997: *Provided* appropriated shall be used vehicles or for the hire employee, other than the the lease of passenger motor while in official travel status.

FEDERAL TRAVEL

ADMINISTRATION

For necessary administrative Administration's program: United States Code, 41,45

F

For necessary expenses 5311, and 5336, to remain *Provided*, That no more shall be available for the the funds provided under than \$400,000,000 may 49 U.S.C. 5336(d): *Provided* ing assistance provided areas of less than 200,000 five percent of the amount eligible to receive under. That in the distribution of ing to urbanized areas the of 1,000,000 or more, the to give priority consideration ing assistance on smaller area and to consider the n ties when the limitation is operating in the area.

FY 1996

Oct 1 - Sept 30th

109 STAT. 446

PUBLIC LAW 104-50—NOV. 15, 1995

PUBLIC LAW

seq.) and 49 U.S.C. 24909, \$115,000,000, to remain available until September 30, 1998.

RHODE ISL

RAILROAD REHABILITATION AND IMPROVEMENT PROGRAM

The Secretary of Transportation is authorized to issue to the Secretary of the Treasury notes or other obligations pursuant to section 512 of the Railroad Revitalization and Regulatory Reform Act of 1976 (Public Law 94-210), as amended, in such amounts and at such times as may be necessary to pay any amounts required pursuant to the guarantee of the principal amount of obligations under sections 511 through 513 of such Act, such authority to exist as long as any such guaranteed obligation is outstanding: *Provided*, That no new loan guarantee commitments shall be made during fiscal year 1996.

For the costs associated on the Northeast Corridor Rhode Island, with sufficient freight cars, \$1,000,000 to 1 or its designee on a dollar until expended: *Provided*, funds, the Providence and into an agreement with the or the Federal Railroad Ad: up to the first \$6,000,000 action initiated by the P& with Amtrak relating to the Davisville and Central Fall freight operations.

NATIONAL MAGNETIC LEVITATION PROTOTYPE DEVELOPMENT

GRANTS TO THE NATIONAL

(LIMITATION ON OBLIGATIONS)

(INCLUDE)

(HIGHWAY TRUST FUND)

None of the funds in this Act shall be available for the planning or execution of the National Magnetic Levitation Prototype Development program as defined in subsections 1036(b) and 1036(d)(1)(A) of the Intermodal Surface Transportation Efficiency Act of 1991.

To enable the Secretary the National Railroad P: U.S.C. 24104, \$635,000,00 of which \$305,000,000 shall be for mandatory passenger: be for transition costs \$230,000,000 shall be for up to \$15,000,000 of the for capital improvements: be transferred to the No *Provided further*, That no commitments shall not be made *further*, That none of the for lease or purchase of of vehicle operators for president of the Corporation vehicles for those officers:

NEXT GENERATION HIGH SPEED RAIL

For necessary expenses for Next Generation High Speed Rail studies, corridor planning, development, demonstration, and implementation, \$19,205,000, to remain available until expended: *Provided*, That funds under this head may be made available for grants to States for high speed rail corridor design, feasibility studies, environmental analyses and track and signal improvements.

FEDERAL T

TRUST FUND SHARE OF NEXT GENERATION HIGH SPEED RAIL

ADMIN

(LIQUIDATION OF CONTRACT AUTHORIZATION)

(HIGHWAY TRUST FUND)

For grants and payment of obligations incurred in carrying out the provisions of the High Speed Ground Transportation program as defined in subsections 1036(c) and 1036(d)(1)(B) of the Intermodal Surface Transportation Efficiency Act of 1991, including planning and environmental analyses, \$7,118,000, to be derived from the Highway Trust Fund and to remain available until expended: *Provided*, That none of the funds in this Act shall be available for the implementation or execution of programs the obligations for which are in excess of \$5,000,000.

For necessary admin Administration's program United States Code, §42,C

ALASKA RAILROAD REHABILITATION

To enable the Secretary of Transportation to make grants to the Alaska Railroad, \$10,000,000 shall be for capital rehabilitation and improvements benefiting its passenger operations.

For necessary expenses 5311, and 5336, to remain *Provided*, That no more shall be available for the funds provided under than \$400,000,000 may 49 U.S.C. 5336(d): *Providing* assistance provided areas of less than 200,0

FEDERAL FUNDING

ALASKA RAILROAD REVOLVING FUND

ESTIMATES

APPROPRIATIONS

1975	\$6,500,000	1975	\$6,031,000
1976	0	1976	9,000,000
1977	6,000,000	1977	6,000,000
1978	3,000,000	1978	3,000,000
1979	3,000,000	1979	9,300,000
1980	5,000,000	1980	6,500,000
1981	10,640,000	1981	10,640,000
1981 (Supp.)	2,000,000	1981 (Supp.)	2,000,000
1982	6,160,000	1982	6,160,000
1983	0	1983 (2nd Cont. Res.)	7,600,000
1984	0	1984	0



THE TIES THAT BIND ALASKA



The Alaska Railroad

**PRESENTATION TO THE ALASKA
LEGISLATURE
JOINT COMMITTEES ON FINANCE AND
TRANSPORTATION**

**JANUARY 30, 1997
JUNEAU, ALASKA**

Before the committees

- Governor Bill Sheffield, Chairman,
Alaska Railroad Corporation Board of Directors
- Senator John Binkley, Board of Directors
- Patricia Dunn, Vice President, Finance and Administration,
Alaska Railroad Corporation
- Evan McKinney, Vice President, Maintenance, and Engineering

Order of presentation

- Mission, objectives, historical background (Governor Sheffield)
- Current business setting (Ms. Dunn)
- Five-year strategic outlook (Mr. McKinney)
- Summary of legislative issues (Governor Sheffield)

EXECUTIVE SUMMARY

The Alaska Railroad is a professionally-run, self-sustaining railroad serving ports and communities from the Gulf of Alaska to Fairbanks. Owned by the State of Alaska since 1985, the Railroad overseen by a seven-member board of directors appointed by the Governor and confirmed by the Legislature.

Under this management and ownership arrangement created and approved by the Legislature in 1984, the Alaskans maintain control of Southcentral Alaska's principal transportation corridor, retain 38,000 acres of land transferred from the federal government, and have the revenues needed to operate, maintain, and expand the line.

The Railroad is operated by professional railroad managers, requires no subsidies from the state treasury, and has no state employees.

HISTORICAL OVERVIEW

Purpose The Alaska Railroad was built by the United States government between 1914-23 as a way to open up and develop Alaska's westward Interior. It served as the focal point for the development of Anchorage and the Matanuska Valley, the Interior's mining districts' link to ocean transportation, a vital carrier of World War II troops and supplies, and principal freight line from tidewater during the Cold War construction boom and construction of the Trans-Alaska Pipeline.

It remains one of the state's oldest and most important pieces of infrastructure for transportation and economic development.

Alaska control In the early 1980s the United States no longer considered the Alaska Railroad an important federal asset and sought to sell it. The State of Alaska saw an opportunity to gain Alaska control of the line.

The Legislature approved acquisition of the line in 1984 specifically because:

- The Railroad "is an essential part of the state's transportation network that may, unless preserved by state action, cease to be a transportation option in Alaska." (AS 42.40)

The intent was to bring the line under Alaska ownership and direction, keep the profits in-state, assure that the line had the resources to operate safely and efficiently, and make sure the Railroad continued to serve Alaska businesses and communities as an engine of community development and economic growth.

The transfer took place January 5, 1985.

Purchase agreement The State paid the United States \$22.271 million cash for the Railroad's track, rolling stock, and 38,000 acres of land. The United States also retained \$10.978 million in the Railroad's cash-on-hand, in exchange for also accepting significant past liabilities.

As part of the purchase agreement, the Legislature replaced the nearly \$11 million in operating capital, bringing the total cost to just under \$34 million.

Note: The Railroad has *neither requested nor received* any additional state money outside of the agreement and legislation approved by the Legislature in 1984.

Public ownership, private management In bringing the Railroad under state control, the Legislature specifically created a structure that would avoid the liabilities and limitations of traditional public management, while maintaining the accountability of public ownership.

The Alaska Railroad Corporation Act of 1984 created a state corporation that is:

- *Accountable* to the Governor and Legislature through appointment and confirmation of board members;
- *Professionally operated* by railroad managers who have the flexibility to negotiate their own labor contracts with professional railroad workers;
- *Self-sustaining* through retention of all profits generated by the enterprise.

This 12-year-old arrangement is one of the few examples of a situation in which government is, indeed, run like a business. The Alaska Railroad Corporation has the flexibility to meet the needs of its customers (such as refiners, tour companies, and construction operations) and earn a profit, which helps support vital public transportation services that do not pay their way, and would otherwise be dropped by an exclusively private, profit-centered operation.

Note: Since 1984, the line has earned and reinvested \$102 million in maintenance and expansion of Railroad facilities.

The structure also provides that major and minor expansion of Railroad operations — from line extensions to leasing of Railroad land — are viewed not just by how much money they may make for the corporation, but whether the action is consistent with community and state development goals and opportunities. This, in turn, is consistent with the findings of the Legislature expressed in the Alaska Railroad Corporation Act of 1984.

MANAGEMENT

The management structure of the Railroad is designed so that it may respond quickly to service and customer needs, changes in the economy, or business opportunities, while being accountable to the state's elected leadership and the public.

Board of directors As noted above, the Railroad is managed by a seven-member board of directors appointed by the Governor and confirmed by the Legislature.

The board is configured, by law, so that:

- At least one member has substantial railroad management experience;
- One member represents the railroad's employee unions;
- Each judicial district of the state is represented on the board;
- At-large appointees have substantial business management experience in Alaska.

The intent is to have business, railroad business, and public policy interests all on the board. With this mix, it is possible for the board to make wise railroad business decisions, but with the leavening provided by broad Alaska public policy perspectives.

Operations The board has the authority to hire a professional, chief executive officer outside the ranks of the state personnel system and political supporters, or even outside of Alaska itself. Pay and other contract terms are negotiated according to professional standards in the industry. The CEO serves at the pleasure of the board.

All other members of the management team are hired according to the judgment and the needs of the CEO and the board. Performance is measured on merit, not longevity or classification. Railroad managers are paid at industry standards, out of the Railroad's own revenues.

The Railroad has had two CEOs under state ownership: Frank Turpin, who came to the Railroad after extensive upper-level management experience in the oil industry, and Robert Hatfield, a professional railroad executive.

Mr. Hatfield recently accepted a similar position with a railroad Outside. The board is conducting a national search for a replacement.

Labor The labor force at the Alaska Railroad consists of 470 fulltime workers (seasonal employees bring the total to around 600 in the summer). Most are represented by one of five labor unions.

In 1996 the Railroad completed negotiations with all five unions and long-term contracts are in place. Over time, the unions have demonstrated a willingness and ability to work cooperatively with management on contract measures that ensure the Railroad's safety, service objectives, and profitability.

The Legislature and the state treasury make no contributions to Railroad payroll, benefit packages, or retirement and pension programs.

Railroaders *are not* part of the public employee personnel system or the state public employee bargaining units.

Railroaders *are not* part of the state retirement and benefits system.

BUSINESS

Profit The Alaska Railroad earned more than \$8 million in 1996, the line's second straight year of record profit. Current projections estimate a 1997 profit of \$7.3 million.

In 12 years under state ownership, the Railroad has earned a profit nine times. The only years in which it lost money were 1986 (primarily due to a weak economy in the state overall, plus costs incurred after serious Southcentral floods that wiped out bridges and washed out or weakened the roadbed), and 1993-4, during a scheduled management restructuring. The restructuring, which resulted in the elimination of a number of middle management positions, also resulted in one-time costs related to severance pay and other related matters.

Financially healthy In addition to the profits posted the last two years, other indicators further buttress the Railroad's financial good standing:

- Increase in cash balances for the last three years;
- Decrease in current liabilities due to improved cash flow;
- No short-term borrowing in 1996;
- Significant reductions in long-term debt in 1996, with more than half of the long-term debt scheduled to be paid off in 1997;
- Improved equity position through improved earnings;
- Significant increases in fixed assets.

The Railroad's accounting is done in accordance with accepted accounting principles and railroad industry practices. KPMG Peat Marwick audits the Railroad's financial records.

Self-sustaining By law, the Railroad's profits are retained by the line and reinvested in capital improvements, maintenance, and other business needs.

Because the Railroad — like other rail lines — is a capital-intensive business (locomotives, roadbed maintenance and repair, and other asset maintenance), the Legislature specifically allocated operating profits to the Railroad so that it could be maintained without state subsidy.

The profits generated by money-making aspects of the business (real estate, freight, and contract passenger car pulls) allow the Railroad to pay for operations that are important to Alaskans, but that lose money.

Under current law, the Railroad may request an appropriation from the Legislature to subsidize services that do not pay for themselves. **The Railroad has never asked for or received subsidies, relying instead on its profits to sustain services that don't support themselves.**

Access to capital The Railroad is a public/private hybrid, which gives the corporation a variety of options for both operating and capital loans. In addition to work with lending institutions directly on traditional business financing, the Railroad has options to issue bonds (with Legislative approval) and seek direct appropriations (which it has not chosen to do).

As a public entity, it also has the benefit of access to tax-exempt financial instruments.

Freight The health of the Railroad mirrors the health of the Alaska economy. Fully 75 percent of the Railroad's business is in hauling freight such as gravel, oilfield supplies and chemicals, groceries and consumer goods (linked to the Railroad's barge connections to Seattle).

- A third of the Railroad's freight revenue comes from hauling MAPCO Alaska petroleum products from North Pole to Anchorage under a 20-year contract that expires in 2013;

- The Railroad hauls Usibelli coal from Healy to Fairbanks for heat and power generation, as well as coal exported from Seward to Korea under a contract that expires in 1998.

Passenger service About 15 percent of the Railroad's income comes from passenger services, primarily tourism-related pull contracts and seasonal service. In addition to the contract pulls for Holland America and Princess Tours, the Railroad operates seasonal general passenger service to Fairbanks and Seward.

The Railroad is adding Anchorage-Whittier service this summer, working in tandem with the day cruise tour boat businesses that operate out of Whittier.

The Railroad also provides year-round service for Whittier, using the shuttle system from Portage, and for roadless areas north of Talkeetna. The Hurricane Turn and Anchorage-Fairbanks Local (winter) are the only flag-stop services in the country, providing access and freight hauling for individuals and families along the line to the Interior.

Real estate While accounting for only 7 percent of total Railroad annual revenues, **on a percentage basis, real estate contributes more to net income — literally, the bottom line — than rail operations do.** The simple explanation is that real estate leases do not carry the same capital-intensive maintenance and repair costs as rail operations do.

Because of its contribution to the bottom line, real estate revenue from the 36,000 acres of land owned by the Railroad is a critical piece of the corporation's overall health. **It is difficult to envision any owner — public or private — able to earn a profit and provide the full range of services now provided by the Railroad without real estate revenues.**

Fair-market-value leases on Railroad land along the provide the bulk of the real estate revenue, along with revenue generated by the Whittier and Seward docks, and various permits.

SAFETY, MAINTENANCE, ENVIRONMENT

The Railroad's programs in these areas are a mix of solid, standard industrial practice, and initiatives generated by specific public or community concern.

Safety Safety for employees, customers, and neighbors of the Railroad is the line's principal operating priority. The Railroad's health and safety manager is the only company employee, other than the vice presidents, who reports directly to the Chief Executive Officer.

The Railroad has a wide variety of on-going, high-priority safety, training and education programs for employees.

The Railroad conducts a variety of programs — some of them supported by employees on their own time — to educate people about safety hazards such as walking or snowmachining on the tracks, failing to pay attention at crossings, and other potential hazards.

Well maintained We believe the Railroad's assets and roadbed are in better shape than they were at transfer, largely due to almost \$100 million in maintenance work and capital improvement under state ownership.

The Railroad spends \$11 million a year on maintenance of 660 miles of track, 192 bridges, 75 crossing signals, the roadbed, and other assets. An additional \$9 is invested in maintenance of the cars and locomotives. Almost half of the Railroad's fulltime workforce is primarily involved in maintenance and repair.

This \$100 million investment has come at no cost to the general fund and has required no state appropriations from the Legislature.

This money has come from the line's operating revenues.

The Railroad is maintained above and beyond Federal Railroad Administration requirements. And because the Railroad carries passengers as well as freight, the entire line is maintained to the higher, passenger-grade safety and operations standards.

Safety and maintenance are directly linked. Yearly improvements include:

- Installation of 40,000 ties;
- Replacement of 20,000 linear feet of mainline rail;
- Place 60,000 cubic yards of ballast (gravel)
- Surface 150-200 miles of mainline track
- Conduct \$1.2 million in repairs and upgrades to bridges.

Cleaner Under state ownership, the Railroad is seeking out and meeting higher standards of environmental protection, compliance, and efficiency.

The Railroad has removed tanks and soil at 60 former underground storage sites, voluntarily limits and controls air emissions in Anchorage, and does not use herbicides to control vegetation — a rarity in the industry. **This is in direct response to public concerns.**

Much of the post-1989 federal and state oil spill response regulation does not apply to railroads. Nonetheless, the Alaska Railroad has upgraded its spill response capabilities with response vans in Anchorage and Fairbanks, and with 12 caches of equipment and material along the line. Twenty-five key employees are trained in spill response organization and techniques — not just for oil and refined products, but in hazardous materials as well.

The Railroad also has an aggressive set waste management and reduction policies intended to eliminate certain additions to the waste stream, and to reuse materials whenever possible. For example, used ties are chipped and shipped to utility systems in Fairbanks to generate power.

Outreach and involvement While the Railroad has consistently maintained community partnerships and sponsorships through donations of cash and tickets, Railroad Week activities, and other outreach efforts, we believe that communication and outreach is an area in which the Alaska Railroad can use improvement.

Particularly, the line's managers and board need to make a stronger and more consistent effort to keep the Legislature informed, as well as work with community leaders and local governments.

FIVE-YEAR STRATEGIC OUTLOOK

Another profit for 1997 Current projections suggest that 1997 net income will be \$7.3 million. This is a conservative figure that assumes freight revenue and expenses to similar to 1996, but that passenger service will increase with the addition of new service to Whittier. Increases in leasing and permitting activities will increase real estate revenues by approximately \$500,000.

New service to Whittier and Girdwood In response to the growth of the day cruise tour business in Prince William Sound, the Railroad is adding daily round-trip service to Whittier from Anchorage. While the current Whittier Shuttle is safe and dependable, the new service is targeted more for visitor industry needs and demands, and will complement the existing service.

Passenger depots in Fairbanks, Denali Park, Talkeetna, Anchorage, Girdwood and Seward will be upgraded, replaced, or added.

New locomotive fleet The Railroad will phase out its older locomotives over the next few years, resulting in cleaner, more cost-effective, and more efficient service. Newer, more advanced, more powerful engines will allow us to use less fuel, have fewer locomotives, and reduce locomotive maintenance expenses.

The Railroad will use conventional business financing — not legislative appropriations — to acquire this new technology.

Systematic reduction of the Railroad's long-term debt over the last few years (including 1997), set the stage for the Railroad's ability to make this new investment.

Traffic management and communication upgrades A series of technology-based upgrades to the traffic control and separation system will improve safety, reduce operating costs, and more effectively manage train movement.

This year, the Railroad will also begin working with the State of Alaska to upgrade the Parks Highway microwave link from analog to digital.

New barge service The Railroad's current contract for rail-barge service between Alaska and Seattle expires next year. After extensive review of proposals, the Railroad has selected a company that will build new barges, use new technology, move more freight in the same time, with fewer sets of equipment.

Port and dock facilities Both Whittier and Seward are targeted for significant improvements in the dock and port facilities to meet community needs and growth of the visitor industry.

Near-term rail expansion Three opportunities for expansion of the Alaska Railroad are developing:

- Extending a line from downtown to the Anchorage International Airport would eliminate bus transfers of visitors, providing better service for passengers and for major contractors;
- Adding a spur into Girdwood and the Alyeska Prince resort would serve the expanding tourist destination opportunities there;
- Development of coal deposits at Sutton would be enhanced by extension of the line from Palmer to Wishbone Hill.

Long-term rail expansion Three long-term opportunities for expansion are developing:

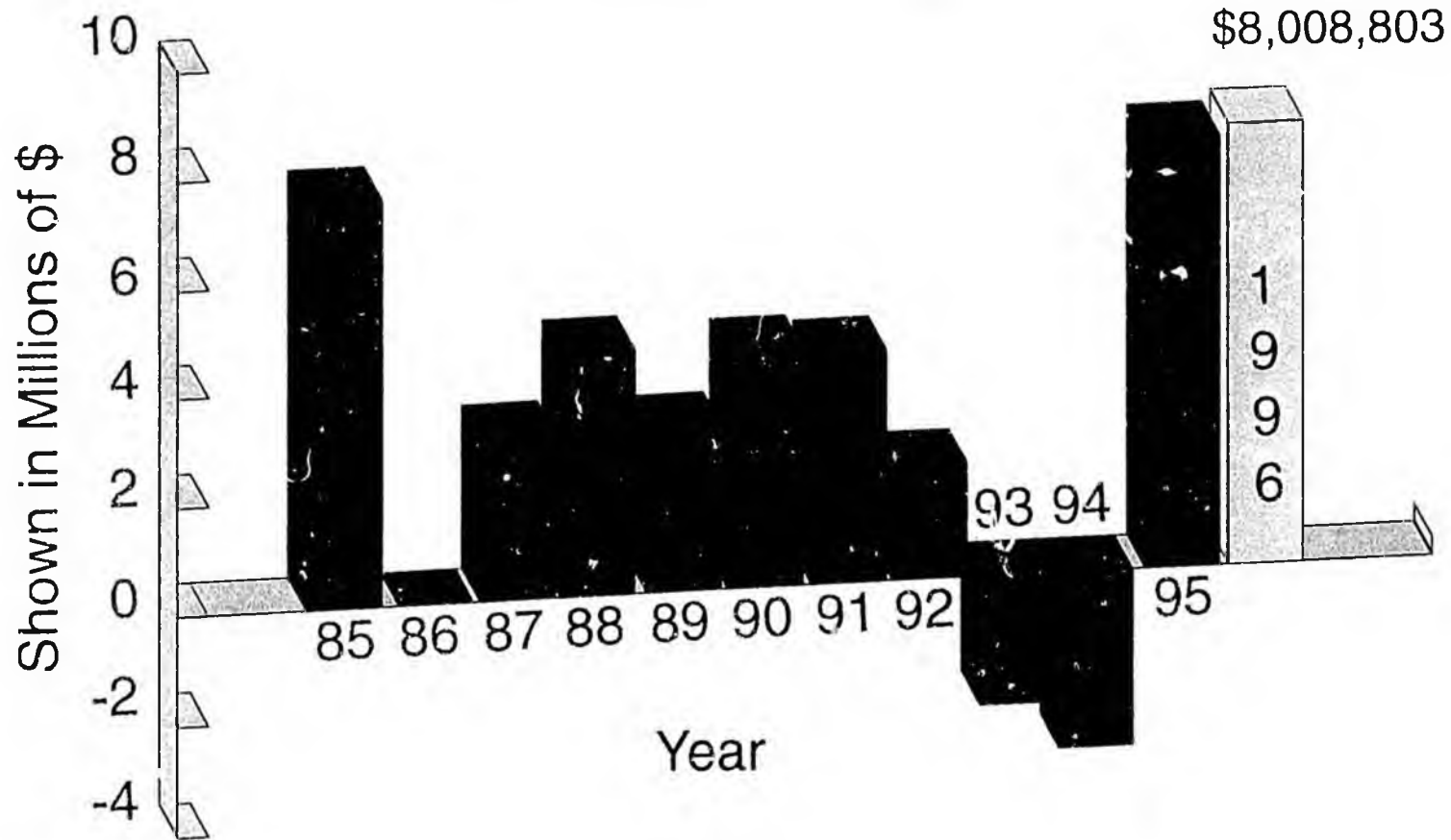
- Access to Kantishna via rail would cost more up-front than a road, but would likely to a better alternative from the standpoint of the environment and park management goals;
- Partnerships with mining interests could lead to expansion from Nenana to the Northwest Arctic;
- A rail link from Fairbanks to the pipeline corridor during construction and operation of a North Slope natural gas pipeline is an attractive expansion option from the Railroad's standpoint.

In all cases, expansion will occur when market conditions will support it, when communities and other public interests have their concerns met, and when revenue from operations will support the expanded line.

The Alaska Railroad's status positions the line to play a key role in the development agreements with both business and public agencies, gain access to public and private financing, and be responsive to public and legislative concerns.

Alaska Railroad Corporation

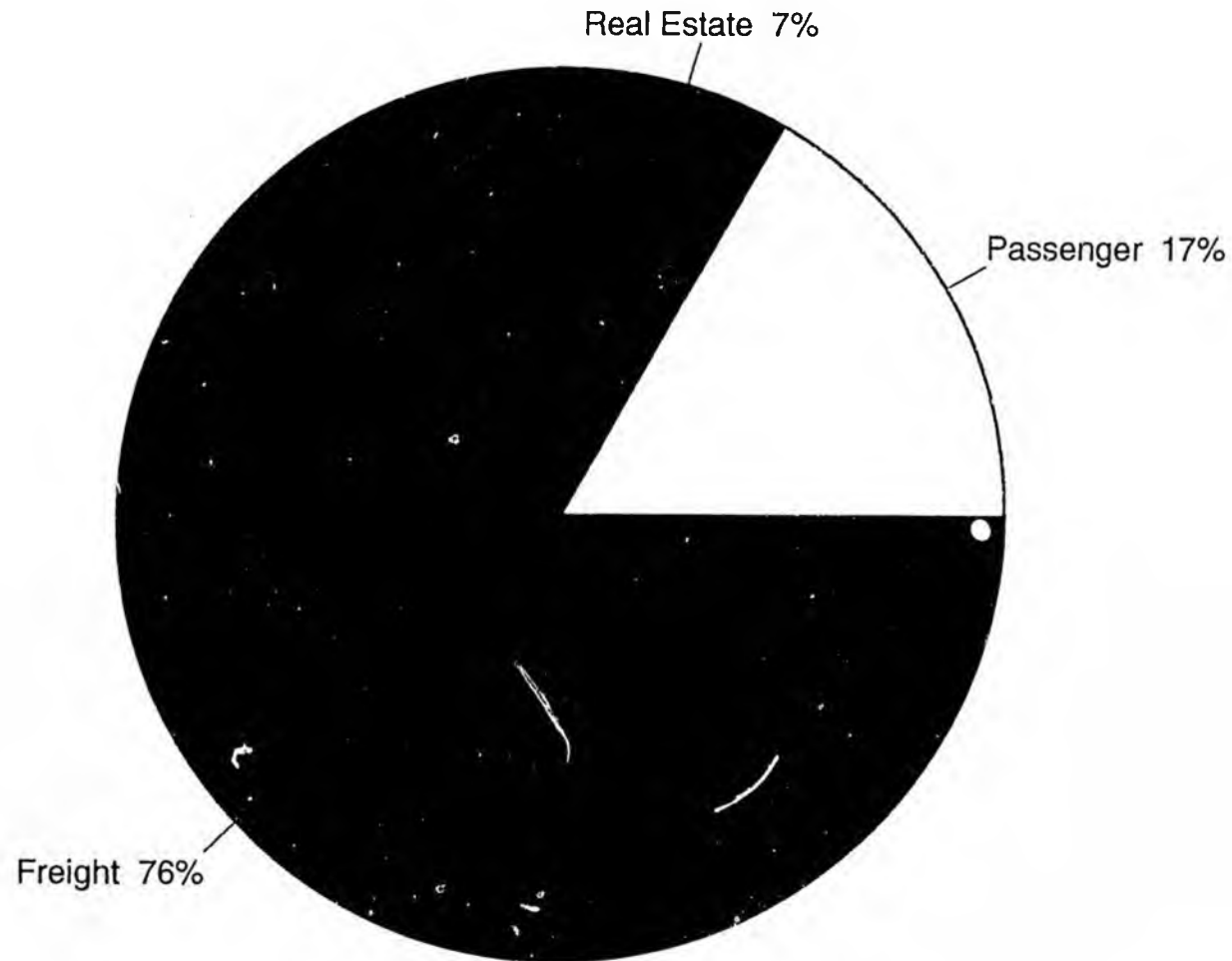
Annual Profit



Un-audited

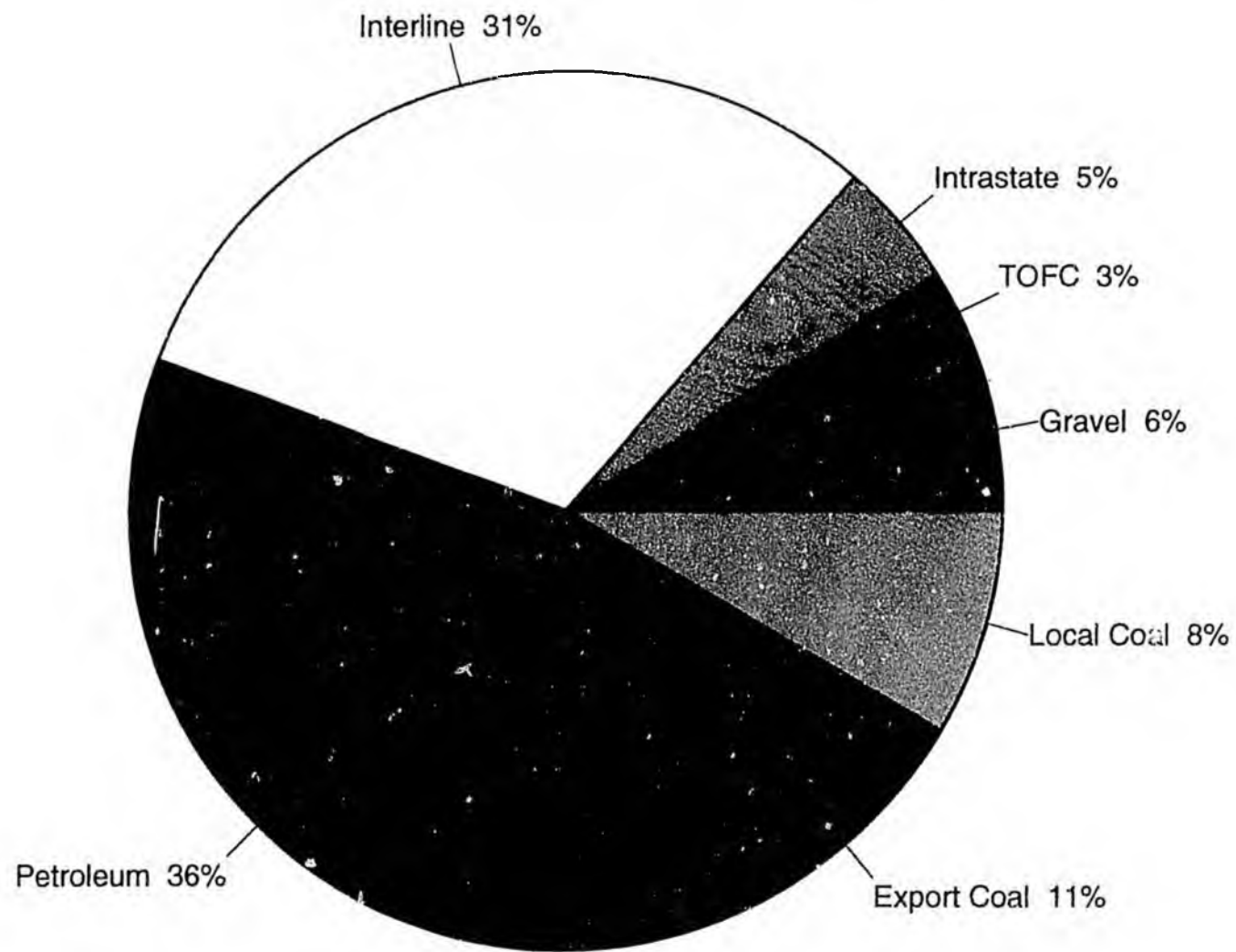
Alaska Railroad Corporation

1997 Projected Revenue



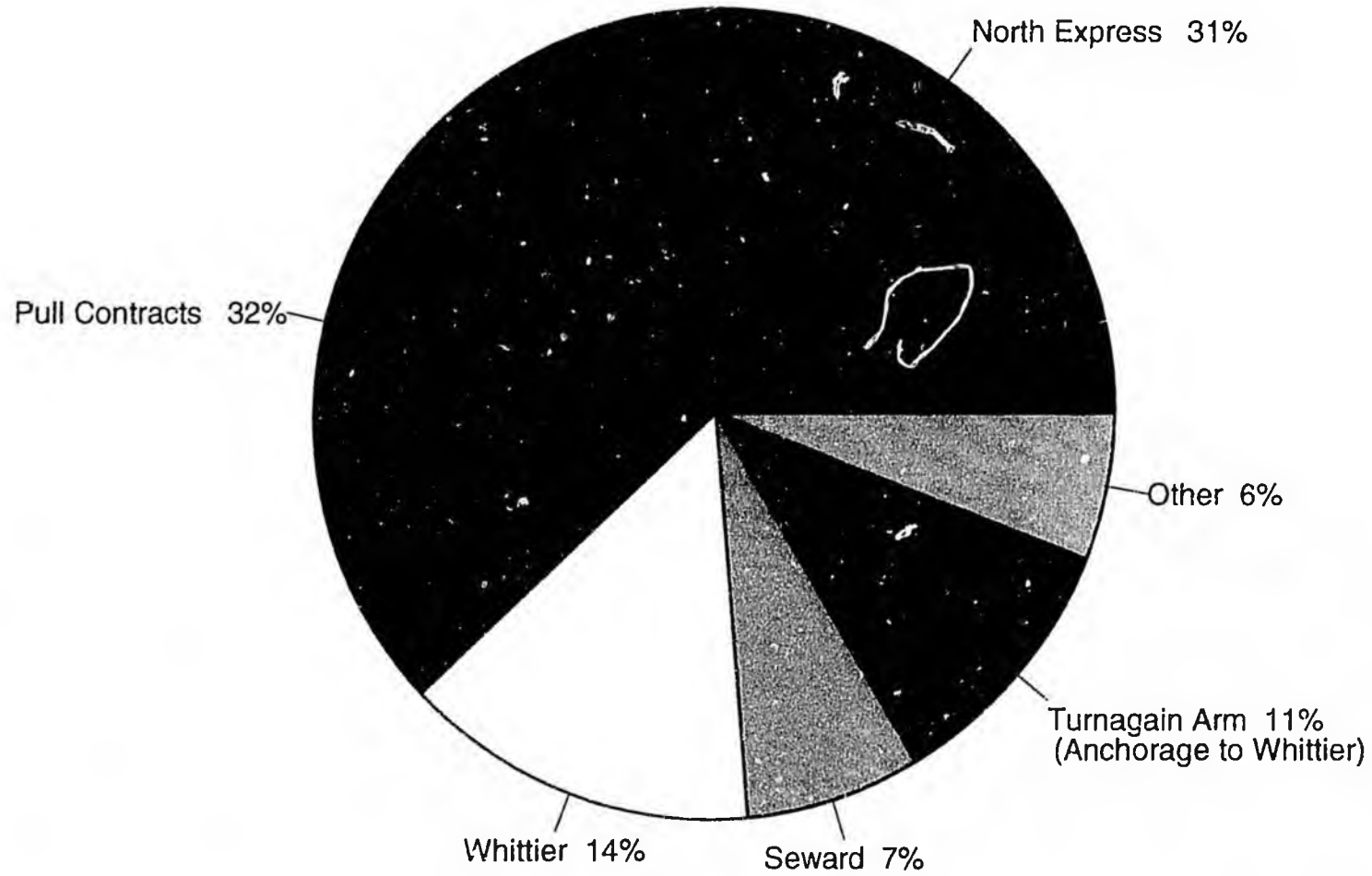
General Cargo and Carload Freight

1997 Projected Revenue



Passenger Services

1997 Projected Revenue



**Alaska Railroad Corporation
Five Year Capital Plan**

Project Description	1997	1998	1999	2000	2001
Ties and Ballast	\$7,750,000	\$5,300,000	\$5,300,000	\$5,300,000	\$5,300,000
Rail Replacement	1,150,000	1,350,000	1,350,000	1,350,000	1,350,000
Bridge Improvements	900,000	1,200,000	1,200,000	1,200,000	1,200,000
Siding & Track Improvements	0	755,000	1,134,100	1,452,400	200,000
Freight Terminal Improvements	900,000	600,000	1,300,000	700,000	0
Whittier Barge Slip	130,000	750,000	0	100,000	0
Equipment Replacements & Purchases:					
Locomotives	0	0	22,000,000	0	0
Track	469,000	1,115,000	1,697,000	1,200,000	1,200,000
Maintenance Shop	328,500	1,169,000	1,520,000	704,000	94,000
Passenger	0	575,000	125,000	350,000	150,000
Transportation	150,000	430,000	180,000	750,000	750,000
Environmental	155,000	75,000	75,000	75,000	75,000
Facility Improvements:					
Maintenance Shops	55,000	500,000	500,000	500,000	500,000
Passenger Depots	739,600	1,141,600	486,400	0	0
Port & Dock	650,000	600,000	400,000	200,000	200,000
Real Estate	425,000	200,000	500,000	500,000	200,000
Automated Track Control System	4,000,000	0	0	0	0
Communications & Computer Technology Upgrades	994,000	500,000	1,000,000	1,000,000	500,000
Total New Capital Projects	\$18,796,100	\$16,260,600	\$38,767,500	\$15,381,400	\$11,719,000
1997 FRA Grant	\$10,000,000				
Bank Financed			\$22,000,000		
ARRC Internally Funded	8,796,100	\$16,260,600	16,767,500	\$15,381,400	11,719,000
Total	\$18,796,100	\$16,260,600	\$38,767,500	\$15,381,400	\$11,719,000

Balance Sheet as of DEC 1996

	12/31/1996	DEC, PRIOR YEAR
Assets		
Cash	4,213,735	3,895,628
Accounts Receivable	11,160,062	12,079,580
Materials and Supplies	3,345,833	3,271,536
Other Current Assets	317,695	441,949
	-----	-----
Total Current Assets	19,637,325	19,688,693
Road & Roadway Structures	72,869,195	64,623,609
Inventory - Road Materials	1,268,520	1,039,812
Equipment	41,863,015	41,485,742
Accumulated Depreciation	(46,131,089)	(44,331,286)
	-----	-----
Construction in Progress	69,869,641	62,817,877
Land	3,138,348	838,726
	-----	-----
Total Road & Equipment	86,857,989	77,506,603
Other Assets	13,082,851	15,934,781
	-----	-----
Total Assets	119,578,165	113,130,077
	=====	=====
Liabilities & Equity		
Short Term Notes Payable		
A/P - Interline	1,984,080	2,402,269
A/P - Trade	2,282,207	2,051,240
Payroll Payable	5,523,005	4,471,200
Unearned Revenue	1,455,212	1,220,255
Current Portion, LT Debt	3,598,061	4,952,576
Other Current Liabilities	904,717	1,434,067
	-----	-----
Total Current Liabilities	15,747,282	16,531,607
Long Term Debt	3,513,818	14,114,776
Def. Revenue, FRA Grant	7,708,718	
Def. Revenue, Wishbone Hill	12,832,038	12,125,360
Environmental Claims		
Post Retirement Med. Benefit	6,325,893	4,916,721
	-----	-----
Total Liabilities	46,127,749	47,688,464
Equity		
Investment - State of Alaska	34,173,555	34,173,555
Retained Earnings	39,276,360	31,268,057
	-----	-----
Total Equity	73,450,415	65,441,612
	-----	-----
Total Liabilities & Equity	119,578,164	113,130,076
	=====	=====

Income Statement for the Month Ended DEC 1996

	DEC, 1996	YEAR TO DATE	DEC, PRIOR YR	YTD, PRIOR YR
Operating Revenue:				
Freight	4,743,543	61,690,979	4,775,191	48,807,420
Freight Related	82,508	556,399	104,147	356,339
Dock	16,187	1,169,122	34,121	1,085,956
Passenger	28,497	10,594,323	86,666	9,749,206
Other	36,654	500,221	72,825	273,505
	<u>4,907,389</u>	<u>74,511,044</u>	<u>5,072,950</u>	<u>60,272,426</u>
Transportation Services				
Transportation	1,271,051	15,253,249	1,206,143	14,541,101
Passenger Services	66,878	2,690,957	62,076	2,280,749
VP & Staff	169,428	2,107,340	158,696	2,119,129
Freight Services	1,113,987	14,754,178	262,691	2,112,461
	<u>2,621,344</u>	<u>34,805,724</u>	<u>1,689,606</u>	<u>21,053,440</u>
Operations				
Mechanical	1,135,755	8,793,422	1,044,016	9,060,582
Engineering	1,248,470	13,007,003	1,309,112	13,031,331
Operations Admin	117,151	1,513,319	99,191	1,193,026
	<u>2,501,376</u>	<u>23,313,744</u>	<u>2,452,319</u>	<u>23,284,939</u>
Depreciation	533,617	6,089,907	522,173	6,132,806
General & Administrative				
Finance	204,714	2,602,523	242,222	2,571,039
Corporate Overhead	(218,427)	436,794	(274,038)	(406,337)
Exec & Board of Directors	205,995	1,473,532	144,516	1,257,671
Legal	198,956	1,762,236	171,369	2,258,411
	<u>391,238</u>	<u>6,295,085</u>	<u>284,069</u>	<u>5,680,784</u>
Total Operating Expense	<u>6,047,575</u>	<u>70,504,460</u>	<u>4,948,167</u>	<u>56,151,969</u>
Net Income from Operations	(1,140,186)	4,006,584	124,783	4,120,457
Other Income (Expense)				
Real Estate Income	454,887	5,403,639	478,622	5,254,462
Real Estate Expense	(2,305)	(968,533)	(104,230)	(686,626)
	<u>452,582</u>	<u>4,435,106</u>	<u>374,392</u>	<u>4,567,836</u>
Interest Income	(26,915)	429,911	2,133	190,567
Interest Expense	(38,233)	(862,798)	(78,139)	(1,007,579)
	<u>(65,148)</u>	<u>(432,887)</u>	<u>(76,006)</u>	<u>(817,012)</u>
Other Inc (Exp), Net	387,434	4,002,219	298,386	3,750,824
Net Income (Loss)	<u>(752,752)</u>	<u>8,008,803</u>	<u>423,159</u>	<u>7,871,281</u>