ALASKA
RAILROAD

2017

ANNUAL REPORT

MISSION

Through excellent customer service and sound business management practices, provide safe, efficient, and economical transportation and real estate services that support and grow economic development opportunities for the State of Alaska.

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ALASKA RAILROAD LEADERSHIP

MANAGEMENT TEAM

Bill O'Leary
President and CEO

Clark Hopp
Chief Operating Officer

Barbara Amy
Chief Financial Officer

Andy Behrend
Chief Counsel

Jim Kubitz
VP Real Estate

Brian Lindamood
VP Engineering

Susan Lindemuth
Chief Human Resources Officer

Eileen Reilly
VP Advanced Train Control Systems

Dale Wade
VP Marketing & Customer Service

BOARD OF DIRECTORS

Linda Leary
Director

Bill Sheffield
Vice Chair

John Binkley
Director

Jack Burton
Director

Jon Cook
Chair

Mike Navarre
Commissioner

Marc Luiken
Commissioner

by Judy Patrick

2017 LEADERSHIP YEAR IN REVIEW

RAILROAD DRAWS ON HISTORIC FORTITUDE IN FACE OF ADVERSITY

Fortitude: noun (fôr·tə·t(y)oəod): courage in pain or adversity.

The Alaska Railroad knows adversity... and fortitude. Difficulties born of politics, finances and our business environment have been a part of railroad history from the beginning. 2017 was a tough year. Yet, our status by year's end offers proof that history's lessons in fortitude are still relevant.

During 2017, ARRC generated total revenues of $191.3 million, which reflects an increase of approximately $21.5 million, or 12.7%, when compared to the prior year. Total expenses, net of grant revenue were $168.9 million, which reflects a decrease of approximately $5.2 million, or 3.0%, when compared to the prior year. The net income reported in 2017 – $22.4 million – compares favorably to the net loss of $4.4 million in 2016. That result comes from the fortitude to face hard truths, make hard decisions and to forge ahead.

WORKFORCE FORTITUDE

Over the last half century, the railroad has weathered lean times and invested during eras of robust earnings, and our employee ranks have shrunk and grown accordingly. In the early 1970s, while the Railroad was under federal ownership, our workforce swelled to over 1,000 strong to meet demands linked to the Trans-Alaska Pipeline construction. By the late 1980s, we employed roughly half that number. Late in the 1990s, as federal funding flowed to help underwrite capital improvements, railroaders numbered over 900. Over the last decade, repeated personnel reductions have decreased our workforce by several hundred. Following the most recent layoff – 50 positions eliminated in early 2017 – ARRC now employs approximately 544 railroaders year-round and another 134 during the peak summer season.

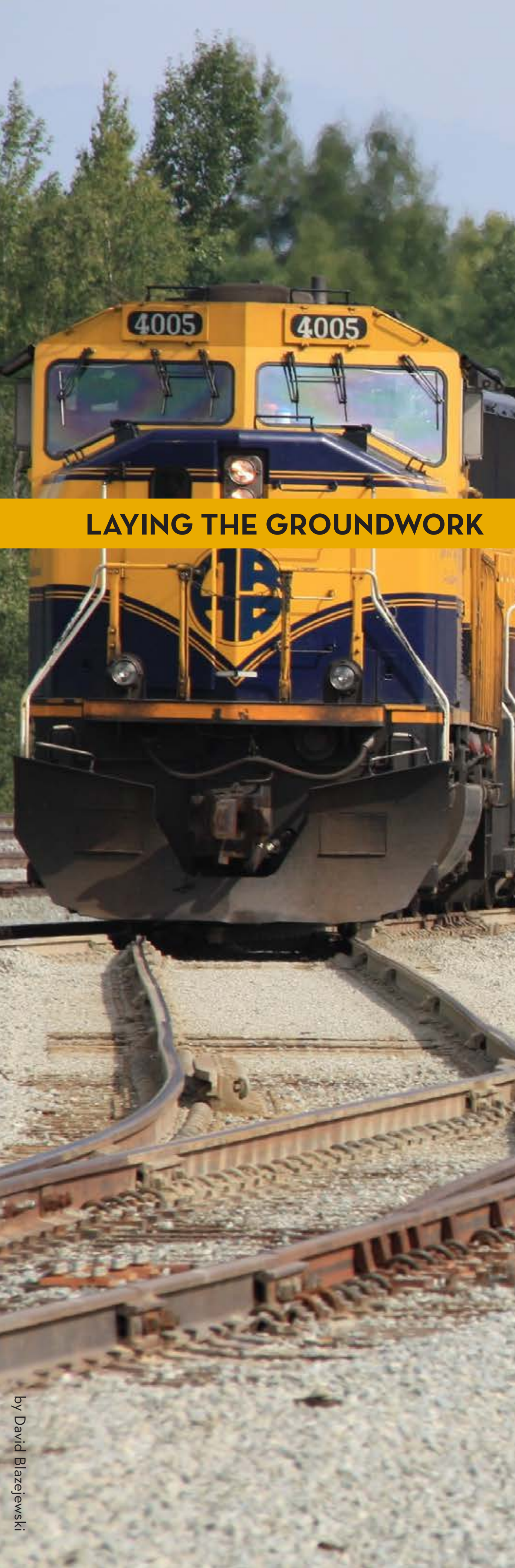
One constant over the decades is the spirit and grit of Alaska Railroad employees – our workforce fortitude. From 1914 to 1923, hardy railroad laborers worked long hours, often in

(courtesy of Anchorage Museum's Alaska Railroad historic photo collection)

CONTINUED...

the bitter cold, living in tents with scant comforts. Because they endured, a new transportation corridor gained a foothold, and a railway foundation was laid through a wilderness full of natural obstacles.

Today, we aim to maintain a strong foundation that can drive economic development for Alaskans. We do so by keeping our infrastructure and equipment in good working order, by meeting regulatory requirements, and making enough money to do just that.



by David Blazejewski

LAYING THE GROUNDWORK

As is the case for many Alaska businesses, the state's ongoing recession presented an obstacle to our aims, and we saw it reflected in our 2017 freight business numbers. Petroleum volumes were down 14%, barge-rail (interline) were down 8%, domestic coal nearly flat, and export coal no longer operating. Gravel was the exception with Seward Highway and O'Malley Road construction projects driving gravel-hauling activity to more than 1 million tons above a typical year.

Despite the gravel anomoly, a multi-year decline in freight revenue gave rise to a nagging financial uncertainty. We responded by laying the groundwork to serve new customers and to grow business with existing customers. On the freight side, we proved our mettle as a reliable logistics partner for the military's missile defense upgrade project, starting with removal of the old demolished radar system at Clear Air Force Station. We continued talks to support the new F-35 unit coming to Eileson AFB — from moving materials for new facility construction to hauling consumer commodities to support an influx of military personnel. Our Trailer/Container-on-Flat-Car service will play a key role in upcoming Defense projects, and so we continued to innovate to ensure TOFC/COFC service can meet and exceed expectations.

by Bruce Gough

CONTINUED...

The oil and gas sector also held promise, and we fostered relationships and partnerships to be part of new commerce as it comes online. For example, we outlined how rail continues to fit into affordably supplying North Slope infrastructure projects on the horizon, and we actively fostered Petro Star's potential fuel storage-and-distribution business. ARRC still remains one of the only railroads in the country authorized to haul liquified natural gas in ISO or intermodal containers, and we continued to work with interior agencies to make hauling LNG by rail a viable option.

On the passenger side, for the first time since 2008, the railroad carried more than a half-million passengers (506,000 in 2017). The 2017 winter train ridership (11,157) was nearly double the ridership in 2013 (6,299), continuing a steady climb in winter and shoulder season business. More and longer mid-week trains met this demand, and railroaders made it happen with a minimal increase in expense, helping the railroad to maximize income. In February 2017, we also added a new Valentine Train, which proved as popular as our other family-friendly specialty trains. We'll look for more of these opportunities.

Our real estate business line also laid the groundwork — figuratively and literally — to facilitate some exciting new developments in Anchorage and Fairbanks. Early in the year we signed a 95-year lease and helped the developer unveil plans for a new condo housing project in downtown Anchorage. Ground may break in 2018. We entered talks with an Alaska business that may buy a building and lease land in the Ship Creek area, potentially to establish a small manufacturing enterprise. This is expected to develop further in 2018.

In Fairbanks, we rezoned the 60-acre Chena Landings site to become a residential district, helping to address the community's riverfront housing shortage. We signed a 50-year lease with

by Judy Patrick

CONTINUED...

Petro Star, and we prepared the 5.5-acre leased parcel at the west end of the Fairbanks Yard to accommodate a potential fuel terminal. In addition, Petro Star leased railroad land with fuel storage facilities near the Port of Alaska in Anchorage, putting the company in a position to expand fuel storage and distribution along the railbelt in the future.

POLITICAL SOLUTIONS

In 2017, we encouraged and worked with state legislators to introduce Alaska Senate Bill 86 in 2018. The legislation would allow ARRC to sell land that is not needed for railroad purposes without legislative approval. If passed, the legislation will allow ARRC to move more quickly on business opportunities, and to generate revenue from disposal of non-producing land.

Another important source of revenue comes from grants. Beginning in 2016, the railroad and Municipality of Anchorage (MOA) disagreed on how to split Federal Transit Administration formula grant money that is derived from a public transportation entity's passenger-miles. The prior year challenge with the FTA split letter resulted in the loss of $7.4 million in grant revenue, which was subsequently received and recognized during 2017. The resolution of the impasse restored the traditional split so that the railroad receives railroad-generated funds, and the Municipality's People Mover receives funds generated by public bus activity. In addition, the railroad agreed to sell 20 acres of land at the Port of Alaska to the MOA at fair market value.

INFRASTRUCTURE RESILIENCY

Generating new revenues adds to our resiliency. How we spend money also impacts our ability to forge ahead through difficult years. Despite dramatic belt-tightening on the operating side, ARRC invested in safety and infrastructure, because a safe foundation is a strong foundation. Capital investments during 2017 totaled $52.9 million.

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This included significant spending on the federally mandated Positive Train Control safety system designed to prevent accidents caused by human error. By year end, ARRC had equipped locomotives, switches, signals and communications sites, and began system testing — all prerequisites to demonstrating PTC in revenue train service during 2018. This steady, proven progress on PTC makes ARRC eligible to request an extension to the full implementation deadline from December 31, 2018 to December 31, 2020. The total price tag for ARRC to implement PTC is now estimated to markedly exceed $150 million. Like a majority of railroads required to implement still-developing PTC technology, ARRC will need the additional time and funding.

Other capital investments focused on the nuts and bolts — track, bridges and depots. Notably in 2017, we eliminated five non-essential sidings to help reduce the tremendous cost of implementing PTC (equipping a siding for PTC costs approximately $1 million). We rebuilt at-grade crossings between Anchorage and Talkeetna, making conditions better for vehicles and trains. We completed a new bridge at Skookum Creek, south of Portage, where washout problems persisted. During December 2017, we mobilized for construction on a $17 million pier replacement and embankment protection project at the Ferry Bridge (north of Nenana), where the Nenana River caused significant scour and erosion problems during the 2012 fall flooding disaster. In Anchorage, we finished a project to improve street traffic and pedestrian access to the Historic Depot on First Avenue. Our capital program included many other smaller construction and maintenance projects.

Capital improvements add to our net value. Today, the Alaska Railroad maintains a strong balance sheet and a strong foundation with over $1 billion in assets.

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The ARRC board and management continue to manage conservatively to face the economic headwinds that are challenging Alaska. With steady growth in passenger services and real estate, and ongoing evaluation of all expenses and new revenue opportunities, ARRC is ready for Alaska's economic turn-around.

The Alaska Railroad remains a vital transportation system that perseveres through thick and thin to provide services that Alaskans and visitors need for a long time to come.

Bill O'Leary | President and CEO

Jon Cook | Board Chair

2017 HIGHLIGHTS

Infrastructure: Tracks, Bridges and Depots

Siding Reduction and Realignment

Crews eliminated five non-essential sidings along the stretch from Talkeetna to Denali National Park. One of these projects involved realigning the main line track next to the Alaska Railroad Denali Depot passenger platform, effectively replacing the siding.

The main line track is realigned to replace the siding next to the Denali Depot's passenger platform.

Anchorage Historic Depot

ARRC finished a project to improve access to the Anchorage Historic Depot on First Avenue. Enhancements provided greater separation between vehicle and pedestrian traffic, as well as replaced and widened the sidewalk in front of the depot.

2017 Bridge Program includes two new bridges

The Alaska Railroad completed construction on two new bridges in 2017. Bridge crews replaced a 123-foot open deck military pony truss bridge with a thru-girder ballast deck span structure at ARRC MP 147.4, within the Matanuska Flood Plain. Crews also constructed a new 70-foot bridge at Skookum Creek at ARRC MP 59.7, about five miles south of Portage, where washout issues persist.

Locomotives cross the new bridge at Skookum Creek, about five miles south of Portage.

A new thru-girder bridge replaces the old military pony truss bridge (left) crossing Matanuska Flood Plain waterways.

by Judy Patrick

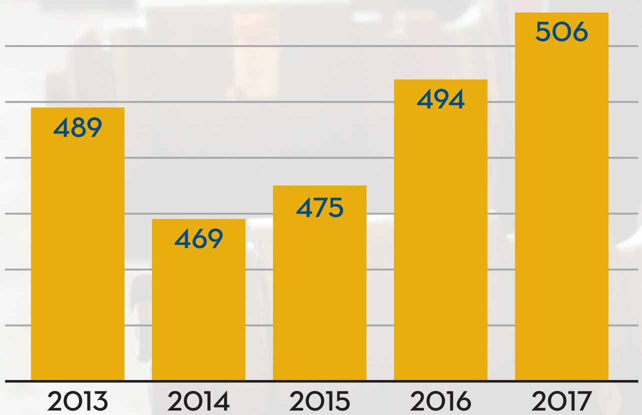
2017 HIGHLIGHTS

PASSENGER BUSINESS

Passenger Growth Trends

The railroad's passenger business has continued to grow steadily over the past decade. In 2017, ridership surpassed half million passengers (506,000) for the first time since 2008. Winter/shoulder season (mid-September to mid-May) ridership nearly doubled over the past five years, from 6,299 passengers in 2013 to 11,157 passengers in 2017.

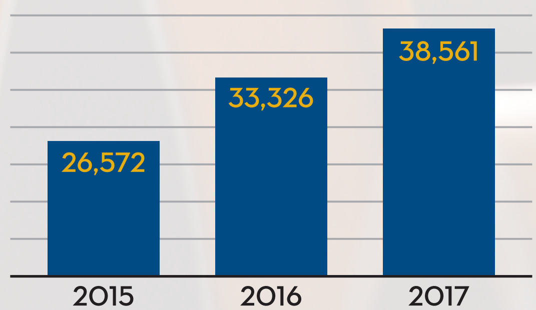
Passenger Ridership (in thousands)



Online Passenger Booking Growth

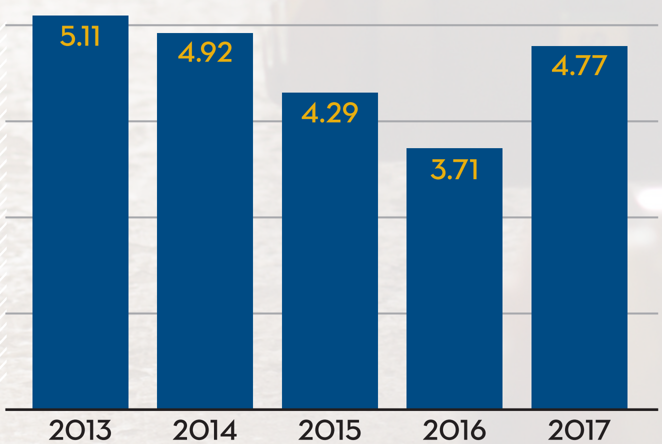
Passenger ticket sales online grew 45% from 2015 to 2017, thanks to customer-centric improvements that began with a new website launch in 2016. Throughout 2016 and 2017, ARRC streamlined travel trade partner (TTP) processes and introduced a TTP portal. Direct passengers took advantage of website features to ease the booking function. In 2018, customers can look for an online shopping cart that enables booking more than one trip at a time.

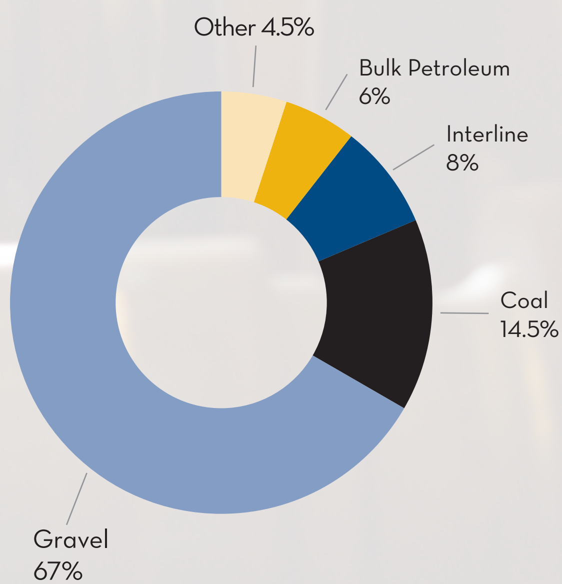
Passenger Seats Sold Online



FREIGHT BUSINESS

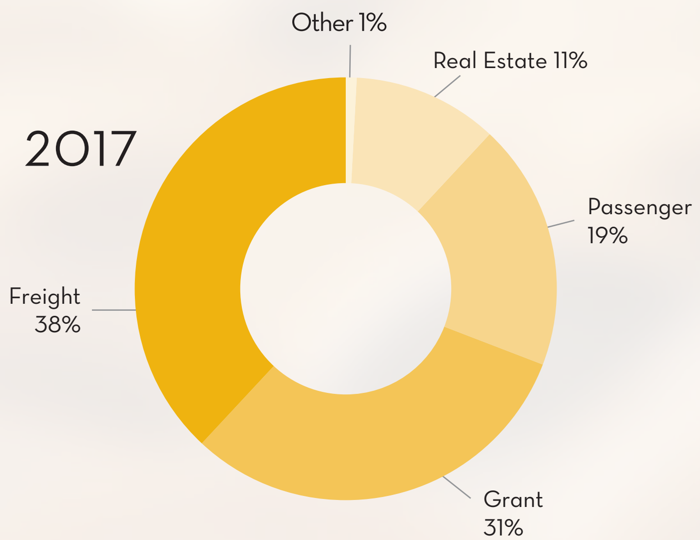
Total Freight Tonnage (millions of tons)

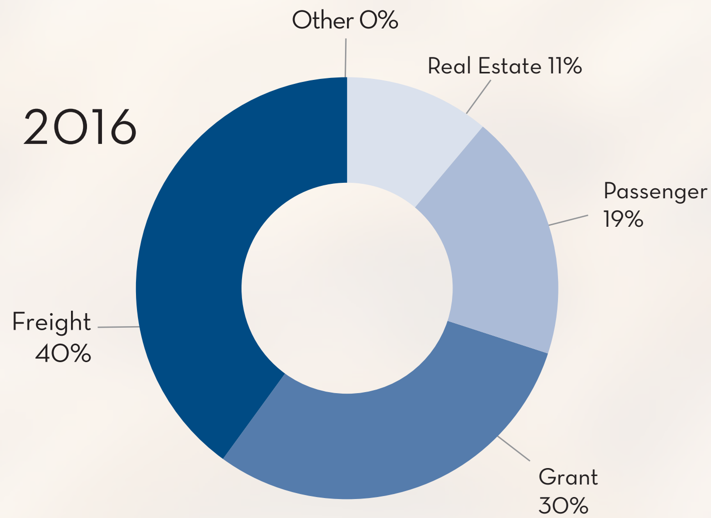




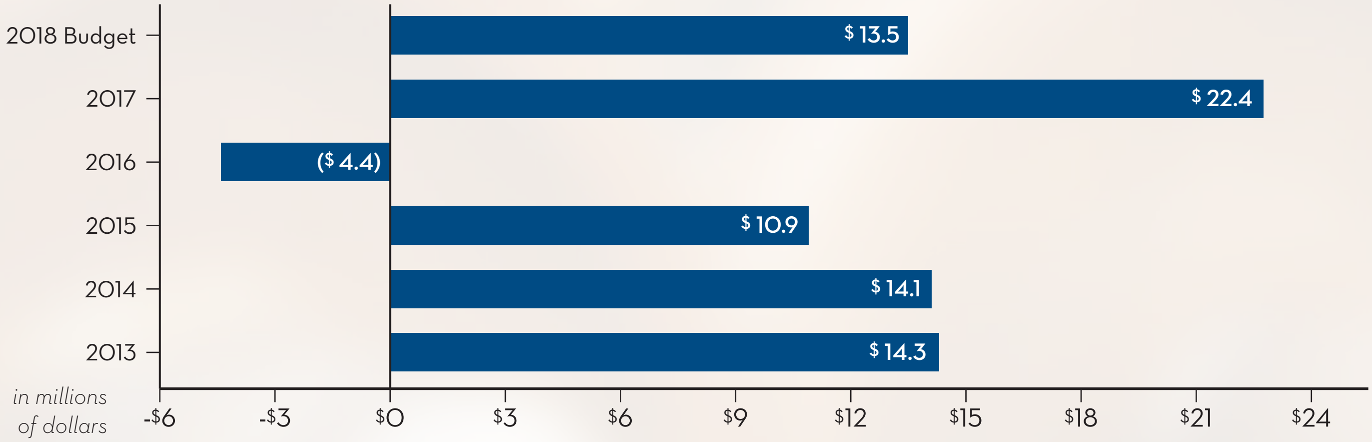
by Judy Patrick

REVENUE

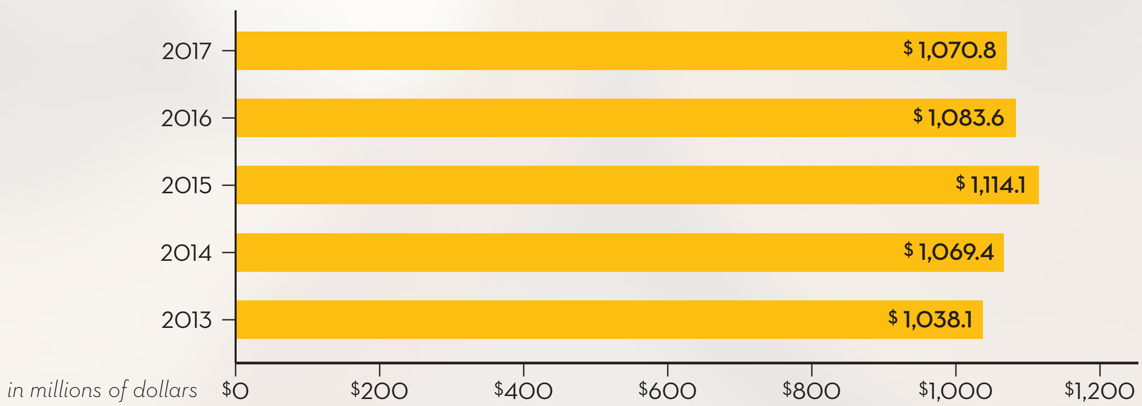




NET INCOME



TOTAL ASSETS



by Judy Patrick

2017 FINANCIAL HIGHLIGHTS

EARNINGS
(IN THOUSANDS)

	2017	2016
Operating Revenues		
Freight	$ 71,824	$ 69,578
Passenger	35,427	32,721
Other	520	662
Grant	57,380	46,933
TOTAL OPERATING REVENUE	**165,151**	**149,894**
Operating Expenses	158,696	161,098
OPERATING INCOME	6,455	(11,204)
Non-Operating Revenues (Expenses):		
Net Real Estate Income	12,546	11,695
Loss on Sale of Capital Assets	–	(1,516)
Investment Income	1,128	365
Interest Expense	(2,219)	(3,693)
Grant Revenue	4,450	–
NET INCOME (LOSS)	**22,360**	**(4,353)**
Net Position, Beginning of Year	316,338	320,691
NET POSITION, END OF YEAR	**$ 338,698**	**$ 316,338**
OPERATING RATIO	**0.96**	**1.07**

STATEMENTS OF NET POSITION
(IN THOUSANDS)

Assets:		
Current Assets	$ 133,967	$ 115,727
Capital Assets	894,851	902,356
Restricted Assets	7,046	23,009
Other Assets	29,493	27,431
Deferred Outflows:		
Pension and Postretirement Actuarial	5,453	14,537
TOTAL ASSETS & DEFERRED OUTFLOWS	**$ 1,070,810**	**$ 1,083,060**
Liabilities:		
Current Liabilities	42,508	45,918
Other Liabilities	118,502	146,963
TOTAL LIABILITIES	**161,010**	**192,881**
Deferred Inflows:		
Pension and Postretirement Actuarial	6,029	1,633
Unearned Grant Revenue	565,073	572,208
TOTAL LIABILITIES & DEFERRED INFLOWS	**732,112**	**766,722**
NET POSITION	**338,698**	**316,338**
TOTAL LIABILITIES, DEFERRED INFLOWS AND NET POSITION	**$ 1,070,810**	**$ 1,083,060**

March 29, 2018

In accordance with Alaska Statute (AS) 42.40.260, it is our pleasure to present the financial section of the Alaska Railroad Corporation's (ARRC) Annual Report for the fiscal year ending December 31, 2017.

The financial section of the Annual Report is presented in four parts:

- Management's Discussion and Analysis (MD&A) — provides an introduction, overview, and analysis of the basic financial statements
- The independent auditor's report on the basic financial statements
- The basic financial statements and accompanying notes
- Required supplementary information relating to the ARRC's defined benefit pension and other post-employment benefit plans

Whether an ARRC customer, creditor, or other resident of the State of Alaska, we hope you find this section of the Annual Report useful.

Sincerely,

Barbara Amy
Chief Financial Officer

Wendy Richerson, CPA
Controller

ALASKA RAILROAD CORPORATION

Financial Statements

December 31, 2017 and 2016

(With Independent Auditors' Report Thereon)

ALASKA RAILROAD CORPORATION

Table of Contents

This section of the Alaska Railroad Corporation's (ARRC's) annual financial report presents management's discussion and analysis of the ARRC's financial performance during the years ended December 31, 2017 and 2016. Please read it in conjunction with the ARRC's financial statements, which follow this section.

Financial Highlights

The ARRC's total net position increased 7.1% during the course of this year's operations and decreased 1.4% over the course of 2016 operations.

- During 2017, the ARRC's operating revenue was greater than operating expenses by $6.5 million, yielding an operating ratio of 0.96. Last year, operating revenue was less than operating expenses by $11.2 and yielded an operating ratio of 1.07.
- The total 2017 operating costs of the ARRC's programs were $158.7 million, a decrease of 1.5% compared to last year. The total 2016 operating costs of the ARRC's programs were $161.1 million, a decrease of 2.0% compared to the prior year.
- Expenditures on capital assets totaled $52.9 million during 2017, a decrease of 7.1% compared to last year. Expenditures on capital assets totaled $57.0 million during 2016, an increase of 21.3% compared to last year.
- Grant funding was used for $20.1 million, or 38.1%, of the 2017 capital expenditures. Grant funding was used for $15.7 million, or 27.5%, of the 2016 capital expenditures. These amounts were recorded as unearned revenue in the regulatory liabilities section of the statements of net position. Revenue associated with capital grants is recognized when the assets are depreciated. Grant revenue for capital assets equals grant depreciation expense in operations and real estate. More detailed information can be found in notes 4 and 8 to the financial statements.

Overview of the Financial Statements

The ARRC is a component unit of the State of Alaska and operates like a stand-alone business. The ARRC is subject to the jurisdiction of the Surface Transportation Board (STB), and the ARRC's rates for services are established by its board of directors and designed to recover the cost of providing the service. The financial statements report information about the ARRC using accounting methods similar to those used by private sector companies. This annual report consists of two parts – *management's discussion and analysis (this section)* and the *basic financial statements*. The basic financial statements consist of three statements that present information about the ARRC's overall financial status:

- Statement of net position – The statement of net position reports assets, deferred outflows, liabilities, deferred inflows, and net position of the ARRC. Assets and liabilities are segregated into current and noncurrent; that is, assets and liabilities that are expected to be received or liquidated within one year (current), and those that are not expected to be received or liquidated within one year (noncurrent). Net position, the difference between the ARRC's assets, liabilities, deferred outflows, and deferred inflows is one way to measure the ARRC's financial health. Over time, increases or decreases in the ARRC's net position are an indicator of whether its financial health is improving or deteriorating, respectively.
- Statement of revenues, expenses, and changes in net position – This statement reflects revenue earned from services and expenses incurred to operate the ARRC, as well as the activities of the ARRC not considered to be operations. All of the current year's revenue and expenses are accounted for in this statement, regardless of when cash is received or paid.

- Statement of cash flows – This statement reports activities of the ARRC as they affect cash balances.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

In addition to the basic financial statements and accompanying notes, the financial statements present certain required supplementary information regarding the Defined Benefit Pension Plan and Defined Benefit Postretirement Medical Plan. The statements also include notes to the required supplementary information.

Financial Analysis of the Alaska Railroad Corporation

Net position – ARRC's net position increased 7.1% between fiscal years 2016 and 2017 to approximately $338.7 million. ARRC's net position decreased 1.4% between fiscal years 2015 and 2016 to approximately $316.3 million.

		2017	2016	2015
			(In thousands)	
Assets:				
Current assets	$	133,967	115,727	118,573
Capital assets		894,851	902,356	913,345
Other noncurrent assets		36,539	50,440	70,587
Total assets		1,065,357	1,068,523	1,102,505
Deferred outflows				
Pension and postretirement		5,453	14,537	11,629
Total	$	1,070,810	1,083,060	1,114,134
Liabilities:				
Current liabilities	$	42,508	45,918	46,519
Notes payable outstanding, less current installments		8,332	11,286	15,330
Revenue bonds payable, less current portion, net of a unamortized premiums		90,386	104,894	118,401
Net pension liability		15,385	25,466	19,728
Other liabilities		4,399	5,317	4,510
Deferred inflows:				
Pension and postretirement		6,029	1,633	—
Regulatory liabilities:				
Unearned grant revenue		565,073	572,208	588,955
Total liabilities and deferred inflows	$	732,112	766,722	793,443
Net position:				
Net investment in capital assets	$	216,797	215,053	211,483
Restricted for reinvestment in infrastructure		121,901	101,285	109,208
Total net position	$	338,698	316,338	320,691

Capital assets – Capital assets, net of accumulated depreciation decreased $7.5 million in 2017 and $11.0 million in 2016. During 2017 and 2016, the ARRC continued an extensive capital improvement plan, including bridge rehabilitations and track refurbishing. Also during this time period, ARRC continued developing the federally mandated positive train control system. Capital expenditures also funded dock and slip work, and vehicle and equipment fleet replacements.

Long-term debt – Notes payable decreased $2.9 million and $4.6 million in 2017 and 2016, respectively. During 2016, ARRC retired a long-term equipment loan when surplus hopper cars were sold. No new debt was issued during 2017 or 2016.

Regulatory liabilities – The STB regulate the ARRC's operations and has specific accounting requirements. The ARRC's board of directors establishes rates for services that are designed to recover the cost of providing the services. The ARRC records regulatory assets and liabilities, as allowed by Governmental Accounting Standards Board Codification Section Re. 10, *Regulated Operations*. The regulatory liability consists of unearned grant revenue relating to capital assets funded with federal grants. Unearned grant revenue decreased $7.1 million in 2017 and decreased $16.7 million in 2016. This decrease reflects the grant revenue recognized as the related capital assets are depreciated, partially offset by capital assets constructed with grant funding.

Net other postemployment benefit assets and net pension liabilities – The postretirement benefits assets increased $2.1 million and the accrued pension benefit liability decreased $10.1 million during 2017 as a result of favorable investment returns on plan assets. The postretirement benefits assets increased $1.3 million as a result of favorable investment returns on plan assets and the accrued pension benefit liability increased $5.7 million during 2016 as a result of differences between expected and actual plan experience.

Deferred outflows and inflows – Deferred outflows or inflows of resources relating to pension and postretirement plans increase or decrease based on the net difference between actual and projected plan earnings, variances in plan activity versus projected activity, or changes in plan assumptions. The deferred outflows of resources will be recognized as expense and the deferred inflows of resources will be recognized as income during the years 2018 and later, as reflected in note 7. Deferred outflows of resources decreased $9.1 million and $2.9 million during 2017 and 2016, respectively. Deferred inflows of resources increased $4.4 million and $1.6 million during 2017 and 2016, respectively.

Deferred inflows of resources related to unearned grant revenue decreased $7.1 million and $16.7 million during 2017 and 2016, respectively, for the recognition of grant revenue equal to depreciation and other grant activities, as discussed in note 8.

		2017	2016	2015
			(In thousands)	
Deferred outflows:				
Postretirement actuarial (note 7)	$	1,410	3,410	2,776
Pension actuarial (note 7)		4,043	11,127	8,853
Total deferred outflows	$	5,453	14,537	11,629
Deferred inflows:				
Postretirement actuarial (note 7)	$	1,582	1,633	—
Pension actuarial (note 7)		4,447	—	—
Regulatory liability – unearned grant revenue (note 8)		565,073	572,208	588,955
Total deferred inflows	$	571,102	573,841	588,955

Change in net position – During 2017, ARRC reported a net income of $22.4 million, an increase of $26.8 million from ARRC's reported net loss in 2016 of $4.4 million. ARRC's 2016 net loss of $4.4 million was a $15.3 million decrease from the prior year net income of $10.9 million.

	2017	2016	2015
		(In thousands)	
Operating revenue:			
Freight	$ 71,824	69,578	81,525
Passenger	35,427	32,721	30,754
Other	520	662	1,636
Total transportation revenue	107,771	102,961	113,915
Grant revenue	57,380	46,933	49,965
Total	165,151	149,894	163,880
Operating expense:			
Transportation	33,455	32,341	34,283
Passenger	13,516	12,857	12,293
Advanced train control systems	310	344	315
Marketing and customer service	15,807	16,248	20,292
Mechanical	24,339	24,371	24,992
Engineering	49,489	50,015	49,680
Facilities	11,641	12,160	13,832
General and administrative	10,139	12,762	8,749
Total	158,696	161,098	164,436
Operating income (loss)	6,455	(11,204)	(556)
Nonoperating revenue (expenses):			
Corporate planning and real estate, net of expenses	12,546	11,695	12,559
Loss on sale of capital assets	—	(1,516)	—
Investment income	1,128	365	46
Interest expense	(2,219)	(3,693)	(4,606)
Grant revenue	4,450	—	3,423
Net income (loss)	$ 22,360	(4,353)	10,866

Revenue – The ARRC's total revenue increased approximately 12.7% and totaled $191.3 million in 2017. The ARRC's total revenue decreased approximately 7.6% and totaled $169.8 million in 2016. Approximately 37.6% and 41.0% of the ARRC's revenue comes from freight revenue during 2017 and 2016, respectively, and 18.5% and 19.3% of the revenue comes from passenger services during 2017 and 2016, respectively. The majority of the remaining income relates to real estate activities and federal grant revenue.

Total transportation revenue for 2017 was $4.8 million greater than 2016. The increase in transportation revenue is attributed to a strong road construction season and continued growth in passenger revenue.

Total transportation revenue for 2016 was $10.9 million less than 2015. The decrease in transportation revenue is attributed to a weakened Alaska economy that impacted interline shipments, soft global coal markets and fewer petroleum shipments, which were partially offset by growth in passenger revenue.

Grant revenue – Generally, federal grant revenue is recognized as the capital assets funded by the grants are depreciated. The ARRC also recognizes grant revenue associated with maintenance expense and grant funded bond principal, interest, and issuance costs. During 2016, maintenance expenses and interest costs were not adjusted by Federal Transit Administration (FTA) 5307 Urbanized Area Formula Funds grant revenue. Under this program, formula funds flow from the FTA to a local area planning organization in a lump sum, where designated recipients, ARRC and Municipality of Anchorage (MOA), are required to agree on how best to split the funds to benefit the area's transportation needs. Since 2006, ARRC and MOA have agreed to split the funds along programmatic lines so that all funds generated by ARRC as "rail tier" funds have gone to ARRC and all funds generated as "bus tier" funds have gone to MOA. During 2016, the MOA did not agree to continue this practice and the amount ARRC would ultimately receive was uncertain. As a result, ARRC did not recognize FTA Section 5307 grant revenue during 2016. During 2017, the MOA and ARRC reached an agreement to continue the historical practice of allocating all "rail tier" funds to ARRC. During 2017, ARRC recognized FTA Section 5307 "rail tier" funds of $7.4 million for 2016 and $8.5 million for 2017, which were included in operating and nonoperating grant revenue.

Operating expenses were $158.7 million in 2017, $161.1 million in 2016, and $164.4 million in 2015, a decrease of $2.4 million, or 1.5%, from 2016 to 2017 and a decrease of $3.3 million, or 2.0%, from 2015 to 2016.

Real estate expenses were $8.0 million in 2017, $7.8 million in 2016, and $7.3 million in 2015, an increase of 2.6% from 2016 to 2017 and an increase of 6.6% from 2015 to 2016.

Capital Asset and Debt Administration

Capital Assets

At the end of 2017, the ARRC had invested $894.9 million in a broad range of capital assets (net of accumulated depreciation) including land, road and roadway structures, equipment, and leasehold improvements. This amount represents a net decrease (including additions and deductions) of $7.5 million, or 0.8%, over last year. Grants have funded $486.1 million and $513.5 million of the assets, net of accumulated depreciation at the end of 2017 and 2016, respectively.

		2017	2016	2015
			(In thousands)	
Land and improvements	$	32,744	32,683	32,553
Road materials and supplies		9,712	9,308	12,787
Road and roadway structures		632,450	653,663	672,431
Equipment		135,076	146,782	166,892
Leasehold improvements		179	262	345
Quarry improvements		3,272	3,272	3,417
Construction in progress		81,418	56,386	24,920
Total capital assets, net of accumulated depreciation	$	894,851	902,356	913,345

The ARRC's fiscal year 2018 capital budget approved spending another $43.6 million for capital projects, principally for continued track and bridge rehabilitation, planned replacement of vehicles and equipment, and other infrastructure improvements. The ARRC intends to use federal grant funding for $14.3 million of the capital additions. The remaining capital projects will be funded out of current year earnings and cash flow. During 2015, ARRC issued FTA Capital Grant Receipt Bonds to fund approximately $37.0 million of costs related to the federally mandated Positive Train Control system. During 2018, ARRC anticipates spending the remaining $2.3 million balance of the bond funds. Additional detailed information about the ARRC's capital assets is presented in note 4 to the financial statements.

Long-Term Debt

At the end of 2017, the ARRC had $11.3 million in notes payable outstanding, a decrease of 20.4% from 2016, and $104.0 million in revenue bonds payable outstanding, a decrease of 11.7% from 2016. At the end of 2016, the ARRC had $14.2 million in notes payable outstanding, a decrease of 24.4% from 2015, and $117.8 million in revenue bonds payable outstanding, a decrease of 10.1% from 2015. More detailed information about the ARRC's long-term debt is presented in note 6 to the financial statements.

Bond Rating

During June 2015, Moody's issued an "A3" rating with a stable outlook and Standard & Poor's issued an "A" rating with a stable outlook in association with the ARRC's Capital Grant Receipts Bonds, Series 2015A and 2015B.

More detailed information about ARRC's bond-funded activities is presented in note 6 to the financial statements.

Next Year's Budget

The 2018 budgets for freight and passenger revenue is $70.0 million and $38.2 million, respectively. As a result, the ARRC's net position is expected to increase $13.5 million, or approximately 4.0%, by the close of 2018.

Contacting the ARRC's Financial Management

This financial report is designed to provide residents of the state of Alaska and customers and creditors with a general overview of the ARRC's finances and to demonstrate accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Alaska Railroad Corporation, P.O. Box 107500, Anchorage, Alaska 99510-7500, 907-265-2300, or visit the Web site at www.alaskarailroad.com.

KPMG LLP
Suite 600
701 West Eighth Avenue
Anchorage, AK 99501

Independent Auditors' Report

The Board of Directors
Alaska Railroad Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of the Alaska Railroad Corporation, a component unit of the State of Alaska, which comprise the statements of net position as of December 31, 2017 and 2016, the related statements of revenue, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Alaska Railroad Corporation as of December 31, 2017 and 2016, and the changes in its financial position and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

Other Matter

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 1–8 and the schedules relating to the Alaska Railroad Corporation's defined-benefit pension plan and other postemployment benefit plans on pages 45–49 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 29, 2018 on our consideration of the Alaska Railroad Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Alaska Railroad Corporation's internal control over financial reporting and compliance.

KPMG LLP

March 29, 2018

ALASKA RAILROAD CORPORATION

Statements of Net Position

December 31, 2017 and 2016

(In thousands)

Assets and Deferred Outflows		**2017**	**2016**
Current assets:			
Cash and cash equivalents (note 3)	$	71,268	59,023
Accounts receivable, net of allowance for doubtful accounts of $396 in 2017 and $430 in 2016		11,936	12,894
Grants receivable		17,775	11,026
Materials and supplies		11,768	11,851
Prepaid expenses and other current assets		1,411	1,603
Restricted assets (note 3)		19,809	19,330
Total current assets		133,967	115,727
Capital assets, net (notes 4 and 8)		894,851	902,356
Restricted assets (note 3)		7,046	23,009
Net other postemployment benefit (OPEB) asset (note 7)		29,475	27,413
Other assets		18	18
Total assets		1,065,357	1,068,523
Deferred outflows:			
Postretirement actuarial (note 7)		1,410	3,410
Pension actuarial (note 7)		4,043	11,127
Total deferred outflows		5,453	14,537
Total assets and deferred outflows	$	1,070,810	1,083,060
Liabilities, Deferred Inflows, and Net Position			
Current liabilities:			
Current portion of notes payable (notes 5 and 6)	$	2,954	2,894
Accounts payable and accrued liabilities (notes 5 and 12)		9,843	12,406
Payroll liabilities		10,087	10,400
Environmental remediation reserve (notes 5 and 13)		311	380
Interest payable		1,959	2,225
Over recovery of vehicle and equipment allocated costs (note 2(k))		318	1,113
Unearned revenue		3,461	3,555
Current portion of revenue bonds payable (notes 5 and 6)		13,575	12,945
Total current liabilities		42,508	45,918
Notes payable, less current portion (notes 5 and 6)		8,332	11,286
Revenue bonds payable (net of unamortized premiums), less current portion (notes 5 and 6)		90,386	104,894
Environmental remediation reserve, less current portion (notes 5 and 13)		2,144	2,180
State of Alaska advances (notes 3 and 5)		2,255	3,031
Payable from restricted assets (note 5)		—	106
Net pension liability (note 7)		15,385	25,466
Total liabilities		161,010	192,881
Deferred inflows:			
Postretirement actuarial (note 7)		1,582	1,633
Pension actuarial (note 7)		4,447	—
Regulatory liability – unearned grant revenue		565,073	572,208
Total deferred inflows		571,102	573,841
Total liabilities and deferred inflows		732,112	766,722
Net position:			
Net investment in capital assets (note 4)		216,797	215,053
Restricted for reinvestment in infrastructure (notes 2(a) and 2(l))		121,901	101,285
Total net position		338,698	316,338
Commitments and contingencies (notes 5, 6, 7, 11, 12,13, and 14)			
Total liabilities, deferred inflows, and net position	$	1,070,810	1,083,060

See accompanying notes to financial statements.

ALASKA RAILROAD CORPORATION

Statements of Revenues, Expenses, and Changes in Net Position

Years ended December 31, 2017 and 2016

(In thousands)

		2017	2016
Operating revenues:			
Freight (note 9)	$	71,824	69,578
Passenger		35,427	32,721
Other		520	662
		107,771	102,961
Grant revenue (note 8)		57,380	46,933
		165,151	149,894
Operating expenses:			
Transportation		33,455	32,341
Passenger		13,516	12,857
Advanced train control systems		310	344
Marketing and customer service		15,807	16,248
Mechanical		24,339	24,371
Engineering		49,489	50,015
Facilities		11,641	12,160
General and administrative, net of indirect cost recovery of $1,823 in 2017 and $1,588 in 2016		10,139	12,762
		158,696	161,098
Operating income (loss)		6,455	(11,204)
Nonoperating revenues (expenses):			
Real estate income, less direct expenses of $7,978 in 2017 and $7,808 in 2016 (notes 6 and 10)		12,546	11,695
Loss on sale of capital assets		—	(1,516)
Investment income		1,128	365
Interest expense		(2,219)	(3,693)
Grant revenue (notes 6 and 8)		4,450	—
Total nonoperating revenues		15,905	6,851
Net income (loss)		22,360	(4,353)
Net position, beginning of year		316,338	320,691
Net position, end of year	$	338,698	316,338

See accompanying notes to financial statements.

ALASKA RAILROAD CORPORATION

Statements of Cash Flows

Years ended December 31, 2017 and 2016

(In thousands)

		2017	2016
Cash flows from operating activities:			
Receipts from customers	$	108,729	115,403
Operating grants received		17,325	6,849
Payments to suppliers		(39,482)	(39,383)
Payments to employees		(58,356)	(61,456)
Net cash provided by operating activities		28,216	21,413
Cash flows from capital and related financing activities:			
Principal payments on long-term debt		(16,788)	(17,878)
Interest payments on long-term debt		(2,485)	(3,965)
Grant received for interest expense		4,450	—
Purchases and construction of capital assets		(57,408)	(51,412)
Proceeds from sales of capital assets		66	2,112
Grants and advances received for construction of capital assets		25,411	22,543
Net cash used for capital and related financing activities		(46,754)	(48,600)
Cash flows from investing activities:			
Real estate income and related cash flows		20,430	19,238
Real estate direct expenses paid		(6,153)	(6,194)
Proceeds from sales of restricted investments		15,378	21,088
Interest received		1,128	365
Net cash provided by investing activities		30,783	34,497
Net increase in cash and cash equivalents		12,245	7,310
Cash and cash equivalents at beginning of year		59,023	51,713
Cash and cash equivalents at end of year	$	71,268	59,023
Reconciliation of operating income (loss) to net cash provided by operating activities:			
Operating income (loss)	$	6,455	(11,204)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:			
Depreciation and amortization		58,919	59,445
Bond issuance cost and amortization		16	48
Grant revenue associated with capital assets		(40,071)	(40,132)
Changes in operating assets and liabilities that provided (used) cash:			
Materials and supplies		83	(278)
Accounts receivable		958	12,442
Prepaid expenses and other assets		192	56
Accounts payable and accrued liabilities		1,540	(2,651)
Over (under) recovery of vehicle and equipment allocated costs		(795)	350
Payroll liabilities		(313)	317
Environmental remediation reserve		(105)	(133)
Accrued postretirement and pension benefits		1,337	3,153
Net cash provided by operating activities	$	28,216	21,413
Supplemental schedule of noncash investing and capital and related financing activities:			
Depreciation included in real estate activity	$	67	28
Capital assets acquired through accounts payable		1,238	5,341

See accompanying notes to financial statements.

(1) Organization and Operations

The United States Congress authorized construction of the Alaska Railroad (ARR) in 1914 and operations began in 1923. The federal government operated the railroad until its sale to the State of Alaska in January 1985. The sale of the ARR to the State of Alaska was authorized under the Alaska Railroad Transfer Act of 1982, which was signed into law on January 14, 1983. The State of Alaska legislature created the Alaska Railroad Corporation (ARRC), a component unit of the State of Alaska, to own and operate the railroad and to manage the railroad's rail, industrial, port, and other properties. The ARRC commenced operations on January 6, 1985. The investment by the State of Alaska as of December 31, 2017 and 2016 was $34.17 million.

The ARRC operates 683 track miles, providing both freight and passenger services. The ARRC serves the cities of Anchorage and Fairbanks, the ports of Whittier, Seward, and Anchorage, as well as Denali National Park and military installations. Vessel and rail barge connections are provided from Seattle, Washington and Prince Rupert, British Columbia.

(2) Summary of Significant Accounting Policies

In preparing the financial statements in accordance with accounting principles generally accepted in the United States of America, management is required to make a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements and revenue and expenses for the reporting period. Actual results could differ from these estimates. The more significant accounting and reporting policies and estimates applied in the preparation of the accompanying financial statements are discussed below:

(a) Basis of Accounting

As a component unit of the State of Alaska and for the purpose of preparing financial statements in accordance with accounting principles generally accepted in the United States of America, the ARRC is subject to the accounting requirements as set forth by the Governmental Accounting Standards Board (GASB).

The ARRC is an enterprise fund of the State of Alaska. Accordingly, the financial activities of the ARRC are reported using the economic resources measurement focus and the accrual basis of accounting, whereby revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The ARRC is subject to the jurisdiction of the Surface Transportation Board (STB) and the ARRC's rates for services are established by the board of directors and designed to recover the cost of providing the service. Accordingly, the ARRC follows the provisions of GASB Codification Section Re. 10, *Regulated Operations*.

The ARRC's board of directors has adopted a resolution requiring a measure of net income in the statement of revenues, expenses, and changes in net position. The ARRC's board of directors has also adopted a resolution restricting net position for reinvestment in infrastructure.

(b) Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include time deposits, money market accounts, money market mutual funds, and repurchase agreements with original maturities of three months or less at the time of purchase. Restricted assets are excluded from cash and cash equivalents for purposes of the statements of cash flows.

Money market accounts are valued at amortized cost. Money market mutual funds are recorded at fair value, which is determined by management based on published market prices and quotations from national exchanges.

(c) Materials and Supplies

Materials and supplies inventories are carried at the lower of weighted average cost or market. Road materials and supplies include rail, ties, ballast, and other track materials. These items will generally be capitalized when placed into service and, accordingly, are included in capital assets.

(d) Capital Assets

Capital assets are stated at cost. Costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Depreciation and amortization are computed on the straight-line basis over the estimated useful lives of the related assets, ranging from 3 to 32 years.

(e) Restricted Assets

Restricted assets include interest bearing savings, money market mutual fund accounts, and receivable from Healthcare Trust, and are reported at fair value. These assets are restricted as to use by Trust or other third-party agreements.

(f) Regulatory Assets and Liabilities

The ARRC's rates for services are established by the board of directors and are designed to recover the cost of providing the service. For purposes of establishing rates, the ARRC defers the recognition of grant revenue relating to depreciable capital assets funded with grants and amortizes the unearned amounts over the life of the related capital assets.

(g) Operations

The ARRC considers all revenues and expenses related to the transportation of freight and passengers, including general and administrative costs, to be operating revenues and expenses. Revenues and expenses associated with leasing and permitting ARRC property are not considered a part of the ARRC's primary operations and are reported as nonoperating activities.

(h) Grants

Grant revenue is recognized when all eligibility requirements have been met; however, revenue for grants expended for depreciable capital assets is recognized over the period in which the asset is depreciated, as described in note 2(f).

(i) Income Taxes

As a corporation owned by the State of Alaska, the ARRC is exempt from federal and state income taxes.

(j) Environmental Remediation Costs

The ARRC accrues for losses, including legal fees, associated with environmental remediation obligations based on obligating events as defined under GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. Costs of future expenditures for environmental remediation liabilities are not discounted to their present value.

(k) Vehicle and Equipment Allocated Costs

The ARRC's vehicle and equipment costs for maintenance, fuel, depreciation, and leases are recorded in the vehicle and equipment cost pool. These costs are recovered through various responsibility centers through a fixed charge rate based on usage of vehicles and equipment. Any over recovery or under recovery of actual vehicle and equipment cost is applied against fixed charge rates in subsequent years. Accordingly, the ARRC has recorded over recoveries of $318,000 and $1,113,000 as of December 31, 2017 and 2016, respectively.

(l) Net Position

As of December 31, 2017 and 2016, the ARRC's board of directors has restricted $121,901,000 and $101,285,000, respectively, of net position for reinvestment in infrastructure.

(m) Pensions and Defined-Benefit Postretirement Medical Plan

For purposes of measuring the net pension liability, net other post employment benefit asset (OPEB), deferred outflows of resources and deferred inflows of resources related to pensions and OPEB asset, and pension and OPEB expense, information about the fiduciary net position of the ARRC's defined-benefit plans (the Plans) and additions to/deductions from the Plans' fiduciary net position have been determined on the same basis as they are reported by the Plans. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value. The fair value for mutual fund investments is determined based on published market prices and quotations from national security exchanges. The fair value of real estate and collective funds is determined based on the net asset value per share of the fund.

(n) Recently Issued Accounting Pronouncements not yet Adopted

GASB Statement No. 83, *Certain Asset Retirement Obligations* (GASB 83) was issued in November 2016. This Statement establishes uniform criteria for governments to recognize and measure certain asset retirement obligations (AROs), including obligations that may not have been previously reported, and requires disclosures related to those AROs. GASB 83 is effective for reporting periods beginning after June 15, 2018. The ARRC is currently evaluating the impact GASB 83 will have on its future financial statements.

(Continued)

GASB Statement No. 84*, Fiduciary Activities* (GASB 84) was issued in January 2017. This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. GASB 84 is effective for reporting periods beginning after December 15, 2018. The ARRC is currently evaluating the impact GASB 84 will have on its future financial statements.

GASB Statement No. 87, *Leases* (GASB 87) was issued in June 2017. This Statement requires recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources. GASB 87 is effective for reporting periods beginning after December 15, 2019. The ARRC is currently evaluating the impact GASB 87 will have on its future financial statements.

(o) Reclassifications

Certain reclassifications not affecting net income have been made to the 2016 financial statements to conform to the 2017 presentation.

(3) Deposits

Restricted assets are reported on the statements of net position as follows at December 31, 2017 and 2016:

		2017	2016
		(In thousands)	
Restricted assets – current:			
Money market mutual funds	$	18,348	17,467
Receivable from Healthcare Trust		1,461	1,863
		19,809	19,330
Restricted assets – long term:			
Interest bearing savings		153	153
Money market mutual funds		5,067	20,594
Receivable from Healthcare Trust		1,826	2,262
		7,046	23,009
	$	26,855	42,339

These assets are restricted by the terms of grant, trust, bond, debt service, or other agreements and are summarized as follows at December 31, 2017 and 2016:

Description of restriction		2017	2016
		(In thousands)	
Capital assets as authorized by the Department of Natural Resources	$	153	153
Advance grant funding		426	424
State of Alaska advance funding for Positive Train Control		643	1,290
State of Alaska advance funding for Northern Rail Extension		1,476	1,596
Projects authorized by bond agreements		2,266	16,924
Welfare benefits plan		3,287	4,125
Debt service reserve 2006, 2007, 2015A, and 2015B		18,348	17,467
Arbitrage rebate reserve		—	105
Debt service reserve 2012A and 2012B for notes payable		256	255
	$	26,855	42,339

Cash and cash equivalents consist of the following at December 31, 2017 and 2016:

		2017	2016
		(In thousands)	
Cash	$	7,265	2,696
Money market deposit accounts		10,085	10,067
Money market mutual funds		53,918	46,260
	$	71,268	59,023

(a) Custodial Credit Risk

In the case of deposits, custodial credit is the risk that in the event of a bank failure, the ARRC's deposits may not be returned to it. For an investment, custodial credit risk is a risk that, in the event of the failure of the counterparty, the ARRC will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The ARRC's Investment Policy requires that all investments be collateralized and/or insured.

At December 31, 2017, the ARRC's carrying amount of cash and cash equivalents was $71.3 million and the bank balance was $71.6 million. Of the bank balance, $250,000 was covered by federal depository insurance, $64.0 million represents money market funds held by the ARRC's agent in the ARRC's name, and the remaining balance is uncollateralized. At December 31, 2017, the ARRC's carrying amount and bank balance of restricted assets was $26.9 million, all of which was held by a custodian bank in ARRC's name.

At December 31, 2016, the ARRC's carrying amount of cash and cash equivalents was $59.0 million and the bank balance was $59.5 million. Of the bank balance, $250,000 was covered by federal depository insurance, $56.3 million represents money market funds held by the ARRC's agent in the ARRC's name, and the remaining balance is uncollateralized. At December 31, 2016, the ARRC's carrying amount and bank balance of restricted assets was $42.3 million, all of which was held by a custodian bank in ARRC's name.

(b) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The ARRC's Investment Policy limits investment maturities to five years or less as a means of managing its exposure to fair value losses arising from increasing interest rates. The ARRC uses the specific identification method to report maturities of investments.

(c) Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of an investment. The ARRC's Investment Policy authorizes the ARRC to invest in U.S. Treasury and agency obligations, state and local government obligations, corporate bonds, certificates of deposit, bankers' acceptances, commercial paper, asset-backed securities, and money market funds. The ARRC's cash and cash equivalents and its restricted assets consist primarily of money market funds, which are excluded from credit risk disclosure requirements.

(d) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributable to holding investments from a single issuer. The ARRC Investment Policy places no limit on the amount the ARRC may invest in any one issuer.

(e) Foreign Currency Risk

Foreign currency risk arises when changes in foreign exchange rates will adversely affect the fair value of an investment. ARRC does not have a policy to limit foreign currency risk associated with investment funds. ARRC does not have exposure to foreign currency risk in its investment funds at December 31, 2017 or 2016.

(f) Fair Value Measurements

The ARRC categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The ARRC has the following recurring fair value measurements as of December 31, 2017 and 2016:

		Fair value measurements using		
	December 31, 2017	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(In thousands)			
Investments by fair value level:				
Cash and cash equivalents:				
Money market mutual funds	$ 53,918	53,918	—	—
Restricted assets:				
Money market mutual funds	23,415	23,415	—	—
Total investments by fair value level	$ 77,333	77,333	—	—

		Fair value measurements using		
	December 31, 2016	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(In thousands)			
Investments by fair value level:				
Cash and cash equivalents:				
Money market mutual funds	$ 46,260	46,260	—	—
Restricted assets:				
Money market mutual funds	38,061	38,061	—	—
Total investments by fair value level	$ 84,321	84,321	—	—

(4) Capital Assets

During 2002, the ARRC received initial approval from its federal cognizant agency, which was updated in 2005, of its indirect cost rate agreement. In compliance with Federal Transit Administration (FTA) Circulars, ARRC will continue to update its indirect cost rate proposal but will retain it on site and make it available for review during its annual financial audit. This agreement allows ARRC to allocate certain general and administrative expenses to grant-funded capital assets. Indirect costs allocated to capital assets under this agreement totaled $1,823,000 and $1,588,000 during the years ended December 31, 2017 and 2016, respectively.

The following tables summarize activity in the capital assets accounts during the years ended December 31, 2017 and 2016:

	Balance at December 31, 2016	Increases	Decreases	Balance at December 31, 2017
		(In thousands)		
Capital assets not being depreciated:				
Land and improvements	$ 32,683	61	—	32,744
Road materials and supplies	9,308	4,897	(4,493)	9,712
Construction in progress	56,386	52,901	(27,869)	81,418
Total capital assets not being depreciated	98,377	57,859	(32,362)	123,874
Capital assets being depreciated:				
Road and roadway structures	1,083,046	18,609	(34)	1,101,621
Equipment	408,797	9,199	(2,030)	415,966
Leasehold improvements	2,172	—	—	2,172
Total capital assets being depreciated	1,494,015	27,808	(2,064)	1,519,759
Capital assets being depleted:				
Quarry improvements	4,114	—	—	4,114
Less accumulated depreciation for:				
Road and roadway structures	429,383	39,823	(35)	469,171
Equipment	262,015	20,838	(1,963)	280,890
Leasehold improvements	1,910	83	—	1,993
Total accumulated depreciation	693,308	60,744	(1,998)	752,054
Less accumulated depletion for:				
Quarry improvements	842	—	—	842
Capital assets being depreciated and depleted, net	803,979	(32,936)	(66)	770,977
Net capital assets	$ 902,356	24,923	(32,428)	894,851

	Balance at December 31, 2015	Increases	Decreases	Balance at December 31, 2016
		(In thousands)		
Capital assets not being depreciated:				
Land and improvements	$ 32,553	130	—	32,683
Road materials and supplies	12,787	—	(3,479)	9,308
Construction in progress	24,920	57,014	(25,548)	56,386
Total capital assets not being depreciated	70,260	57,144	(29,027)	98,377
Capital assets being depreciated:				
Road and roadway structures	1,062,385	20,661	—	1,083,046
Equipment	409,526	4,756	(5,485)	408,797
Leasehold improvements	2,172	—	—	2,172
Total capital assets being depreciated	1,474,083	25,417	(5,485)	1,494,015
Capital assets being depleted:				
Quarry improvements	4,114	—	—	4,114
Less accumulated depreciation for:				
Road and roadway structures	389,954	39,429	—	429,383
Equipment	242,634	21,402	(2,021)	262,015
Leasehold improvements	1,827	83	—	1,910
Total accumulated depreciation	634,415	60,914	(2,021)	693,308
Less accumulated depletion for:				
Quarry improvements	697	145	—	842
Capital assets being depreciated and depleted, net	843,085	(35,642)	(3,464)	803,979
Net capital assets	$ 913,345	21,502	(32,491)	902,356

(Continued)

Depreciation was charged to the following departments during the years ended December 31, 2017 and 2016:

		2017		2016	
		Grant-funded depreciation	**Nongrant-funded depreciation**	**Grant-funded depreciation**	**Nongrant-funded depreciation**
		(In thousands)			
Transportation	$	6,805	741	6,843	745
Passenger		11	104	11	171
Marketing and customer service		—	955	—	904
Mechanical		3,198	6,202	3,314	6,425
Engineering		26,095	6,854	26,015	6,760
Facilities		3,771	2,049	3,765	2,268
General and administrative		188	1,946	183	1,897
Real estate		67	1,758	28	1,585
	$	40,135	20,609	40,159	20,755

Net investment in capital assets is as follows at December 31, 2017 and 2016:

		2017	2016
		(In thousands)	
Net capital assets	$	894,851	902,356
Notes payable (note 6)		(11,286)	(14,180)
Outstanding balance of revenue bonds (note 6)		(103,961)	(117,839)
Assets restricted for projects authorized by revenue bond agreements (note 3)		2,266	16,924
Unearned grant revenue		(565,073)	(572,208)
	$	216,797	215,053

(5) Long-Term Liabilities

Long-term liability activity is summarized as follows during the years ended December 31, 2017 and 2016:

		Balance at December 31, 2016	Additions	Reductions	Balance at December 31, 2017	Due within one year
				(In thousands)		
Long-term debt:						
Notes payable	$	14,180	—	(2,894)	11,286	2,954
Revenue bonds payable		105,240	—	(12,945)	92,295	13,575
Plus (less) unamortized amounts:						
Issuance premiums		12,617	—	(951)	11,666	—
Unamortized issuance costs		(18)	18	—	—	—
Total revenue bonds payable		117,839	18	(13,896)	103,961	13,575
Environmental remediation reserve		2,466	—	(11)	2,455	311
Other claims		230	—	—	230	230
State of Alaska advances		3,031	—	(776)	2,255	—
Payable from restricted assets		106	—	(106)	—	—
Total long-term liabilities	$	137,852	18	(17,683)	120,187	17,070

	Balance at December 31, 2015	Additions	Reductions	Balance at December 31, 2016	Due within one year
			(In thousands)		
Long-term debt:					
Notes payable	$ 18,768	—	(4,588)	14,180	2,894
Revenue bonds payable	117,920	—	(12,680)	105,240	12,945
Plus (less) unamortized amounts:					
Issuance premiums	13,227	—	(610)	12,617	—
Unamortized issuance costs	(66)	48	—	(18)	—
Total revenue bonds payable	131,081	48	(13,290)	117,839	12,945
Environmental remediation reserve	2,693	536	(763)	2,466	286
Other claims	230	—	—	230	—
State of Alaska advances	2,179	1,923	(1,071)	3,031	—
Payable from restricted assets	105	1	—	106	106
Total long-term liabilities	$ 155,056	2,508	(19,712)	137,852	16,231

The ARRC has arrangements for three short-term unsecured lines of credit. The two general purpose lines of credit allow borrowing up to $20,000,000 at rates of 64.4% to 100% of London Interbank Offered Rate (LIBOR) plus 1.29% to 2.00%. The self-insurance line of credit allows borrowing up to $10,000,000 at rates of 64.4% to 100% of LIBOR plus 1.29% to 2.00%. None of the lines of credit had an outstanding balance at December 31, 2017 or 2016.

(6) Long-Term Debt

Long-term debt at December 31, 2017 and 2016 consists of the following:

		2017	2016
		(In thousands)	
Notes payable:			
Note payable, secured by real estate revenue, due in monthly payments of $36,210, including interest at 2.65%, matures on April 21, 2023	$	2,159	2,530
Note payable, secured by real estate revenue, due in monthly payments of $48,538, including interest at 2.65%, matures on April 21, 2023		2,894	3,392
Note payable, secured by equipment, due in monthly payments of $136,842, including interest at 1.71%, matures on August 1, 2019		2,696	4,278
Note payable to State of Alaska, secured by real property, due in annual payments (varies), including interest at 3.00%, matures on September 1, 2023		1,669	1,757
Note payable, secured by equipment, due in monthly payments of $32,469, including interest at 1.67%, matures on December 18, 2022		1,868	2,223
		11,286	14,180
Less current portion		2,954	2,894
	$	8,332	11,286
Revenue bonds:			
Revenue Bonds – Series 2015A and 2015B, interest at 4.0%–5.0%, payable semiannually on February 1 and August 1, secured by 5307 and 5337 FTA Formula Funds, matures on August 1, 2023	$	103,961	110,399
Revenue Bonds – Series 2006 and 2007, interest at 3.625%–5.25%, payable semiannually on February 1 and August 1, secured by 5307, 5309, and 5337 FTA Formula Funds, matured on August 1, 2017		—	7,440
		103,961	117,839
Less current portion		13,575	12,945
	$	90,386	104,894

Annual payments on debt are scheduled as follows at December 31, 2017:

		Notes payable		Revenue bonds payable		
		Principal	Interest	Principal	Interest	Total
				(In thousands)		
Years ending December 31:						
2018	$	2,954	234	13,575	4,325	21,088
2019		2,671	173	14,250	3,634	20,728
2020		1,622	126	14,960	2,909	19,617
2021		1,663	85	15,705	2,147	19,600
2022		1,705	43	16,490	1,347	19,585
2023–2026		671	9	17,315	505	18,500
		11,286	670	92,295	14,867	119,118
Current portion of principal		(2,954)		(13,575)		(16,529)
Unamortized premium		—		11,666		11,666
Total noncurrent portion	$	8,332		90,386		114,255

Federal Transit Program – ARRC Participation in Section 5307 Urbanized Area Formula Program and Section 5337 State of Good Repair Formula Program

In association with the issuance of the 2015 revenue bonds, Moody’s issued an “A3” rating with a stable outlook and Standard & Poor’s issued an “A” rating with a stable outlook. These ratings have not changed through December 31, 2017. The following table sets forth the authorized funding allocation of the FTA Section 5307 Formula Program Funds and Section 5337 Formula Program Funds to ARRC in Federal Fiscal Years (FFY) 2017 and the estimated apportionments for FFY 2018 through 2022:

FFY		Section 5307 formula program	Section 5337 formula program	Total
2017 Apportionments	$	11,101,830	22,956,792	34,058,622
2018 Estimated apportionments		10,960,693	23,727,963	34,688,656
2019 Estimated apportionments		11,149,122	24,136,557	35,285,679
2020 Estimated apportionments		11,397,071	24,552,177	35,949,248
2021 Estimated apportionments		11,625,012	24,969,564	36,594,576
2022 Estimated apportionments		11,857,513	25,394,047	37,251,560

The FTA 5307 Urbanized Area Formula Funds flow from the FTA to a local area planning organization in a lump sum, where designated recipients, ARRC and MOA, are required to agree on how best to split the funds to benefit the area’s transportation needs. Since 2006, ARRC and MOA have agreed to split the funds along programmatic lines so that all funds generated by ARRC as “rail tier” funds have gone to ARRC and all funds generated as “bus tier” funds have gone to MOA. During 2016, the MOA did not agree to continue this practice and the amount ARRC would ultimately receive was uncertain. As a result, ARRC did not recognize FTA Section 5307 grant revenues during 2016. During 2017, the MOA and ARRC reached an agreement to continue the historical practice of allocating all “rail tier” funds to ARRC. During 2017, ARRC recognized FTA Section 5307 funds “rail tier” funds of $7.4 million for 2016 and $8.5 million for 2017, which were included in grant revenue.

Section 509 of the Trust Indenture required five-year arbitrage certificates to be filed with the trustee for the Capital Grant Receipts Bonds, Series 2006 and Series 2007. There was no rebate due on the Series 2006 during the final filing of the 2016 arbitrage certificate. There was a rebate paid during August 2017 of $102,000 due on the final Series 2007 filing of the 2017 arbitrage certificate.

The ARRC expended $9.2 million and $18.5 million during 2017 and 2016, respectively, of the 2015B bond proceeds on eligible capital costs relating to the development of the federally mandated Positive Train Control.

The following table sets forth the interest capitalized or applied to the long-term capital construction projects:

		2017	2016
		(In thousands)	
Capitalized interest:			
Interest expense	$	2,016	1,726
Less interest income		(76)	(113)
Total capitalized interest	$	1,940	1,613

State of Alaska Authorizations

Chapter 8, SLA 2015, authorized the ARRC to issue up to $37 million in revenue bonds to finance a positive train control rail transportation safety project that qualifies for federal financial participation and associated costs. To date, $34.7 million in bonds have been issued, with a premium of $5.1 million.

Chapter 65, SLA 2007, authorized the ARRC to issue up to $2.9 billion in revenue bonds to finance all or a portion of the Kenai gasification project and Port MacKenzie rail spur project, subject to an agreement with a third party to pay the debt service and other costs of the bonds. To date, no bonds have been issued.

Chapter 28, SLA 2006, authorized the ARRC to issue up to $165 million in revenue bonds to finance rail transportation projects that qualify for federal financial participation and associated costs. To date, $165 million in bonds were issued and were fully refunded subsequent to issuance.

Chapter 46, SLA 2004, authorized the ARRC to issue up to $500 million in revenue bonds, subject to an agreement with a third party to pay the debt service and other related bond costs, to finance the cost of extending its rail line to Fort Greely, Alaska. To date, no bonds have been issued.

Chapter 71, SLA 2003, authorized the ARRC to issue up to $17 billion in revenue bonds to finance the construction of a natural gas pipeline and related facilities, subject to an agreement with a third party to pay the debt service and other costs of the bonds. To date, no bonds have been issued.

(Continued)

Chapter 77, SLA 1994, authorized the ARRC to issue up to $55 million in revenue bonds to finance the construction and acquisition of the Alaska Discovery Center for the Ship Creek Project in Anchorage. To date, no bonds have been issued.

(7) Employee Benefits

(a) Alaska Railroad Corporation Pension Plan

The ARRC has a single-employer defined-benefit-pension plan (the Plan) administered by the Tax Deferred Savings and Pension Committee covering all regular represented and nonrepresented employees who are not covered by the Civil Service Retirement System (CSRS). Benefits provided by the Plan include retirement, disability, and death benefits. Benefit terms and contribution rates are established and amended under the authority of the Board of Directors. Benefits under this Plan are based upon the employee’s years of service and final average compensation. The ARRC’s funding policy is to contribute each year an actuarially determined contribution rate recommended by an independent actuary. The actuarially determined contribution rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. Employees contribute an amount equal to 9% of eligible compensation.

As of December 31, 2017, the Plan assets consist of cash and cash equivalents of 4.3%, fixed-income securities of 27.0%, equities of 57.5%, commodities of 1.8%, and real estate investments of 9.4%.

At December 31, the plan membership consisted of the following:

		2017	2016
Inactive plan members or beneficiaries currently receiving benefits	$	268	244
Inactive plan members entitled to but not yet receiving benefits		364	350
Active plan members		647	679
	$	1,279	1,273

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions: At December 31, 2017 and 2016, the ARRC reported a liability for the pension plan. The net pension liability was measured as of December 31, 2017 and 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of January 1, 2016 and 2015, respectively. For the years ended December 31, 2017 and 2016, the ARRC recognized pension expense of $5,498,000 and $7,627,000, respectively.

(Continued)

At December 31, the ARRC reported deferred outflows of resources and deferred inflows of resources related to pension as follows:

		2017		2016	
Deferred outflows and (inflows) of resources		**Deferred outflows of resources**	**Deferred inflows of resources**	**Deferred outflows of resources**	**Deferred inflows of resources**
		(In thousands)		(In thousands)	
Differences between expected and actual experience	$	3,826	(383)	5,097	—
Changes of assumptions		217	—	—	—
Net difference between actual and projected earnings on investments		—	(4,064)	6,030	—
Total	$	4,043	(4,447)	11,127	—

The deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

		Amount
		(In thousands)
Year ending December 31:		
2018	$	1,281
2019		1,281
2020		(932)
2021		(2,034)
2022		—
Thereafter		—
	$	(404)

Actuarial Assumptions: The total pension liability in the January 1 actuarial valuation was determined using the following actuarial assumptions:

Actuarial assumption	2017	2016
Inflation	2.8%	2.8%
Salary increases	3.0% CPI plus merit based rates	3.0% CPI plus merit based rates
Cost of living allowance	1.4%	1.4%
Retirement, disablement, and termination	Based on 2010-2014 experience study	Based on 2010-2014 experience study
Administrative expenses	0.86% of payroll, based on current year Actuarially Determined Contribution (ADC)	1.24% of payroll, based on current year Actuarially Determined Contribution (ADC)

Mortality rates were based on the Society of Actuaries RP-2000 combined mortality table (65%/35%; blended blue/white collar) and the Scale AA generational mortality improvement in longevity that management expects to occur in the future.

The long-term expected rate of return on pension plan investments of 7.5% was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

Asset class	Target allocation	Long-term expected real rate of return
Cash	— %	0.50 %
U.S. Treasury Inflation-Protected Securities (TIPS)	5.00	2.00
Total return bond	13.00	2.50
Global bond	5.00	2.50
High yield bond	7.00	4.00
Domestic large cap	20.00	7.00
Domestic mid cap	12.00	8.00
Domestic small cap	8.00	9.00
International equity	13.00	7.25
Commodities	2.00	1.50
Real estate	15.00	4.75
Total	100.00 %	

Discount Rate: The discount rate used to measure the total pension liability was 7.5%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate and the ARRC contributions will be made based on the actuarially determined contribution rate. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the net pension liability to changes in the discount rate: The following presents the net pension liability calculated using the discount rate of 7.5%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower or higher than the current rate:

		1% Decrease (6.5)%	**Current discount rate (7.5)%**	**1% Increase (8.5)%**
			(In thousands)	
Net pension liability (asset) as of:				
December 31, 2017	$	44,208	15,385	(8,293)
December 31, 2016		52,620	25,466	3,117

Changes in the net pension liability are as follows:

		Total pension liability (a)	**Plan fiduciary net position (b)**	**Net pension liability (a) – (b)**
			(In thousands)	
Balances at January 1, 2017	$	187,054	161,588	25,466
Changes for the year:				
Service cost		5,777	—	5,777
Interest		14,230	—	14,230
Changes of benefit terms		154	—	154
Difference between expected and actual experience		(482)	—	(482)
Changes of assumptions		272	—	272
Contributions – employer		—	4,051	(4,051)
Contributions – employee		—	4,302	(4,302)
Net investment income		—	22,088	(22,088)
Benefit payments, including refunds of employee contributions		(6,197)	(6,197)	—
Administrative expenses		—	(409)	409
Net changes		13,754	23,835	(10,081)
Balances at December 31, 2017	$	200,808	185,423	15,385

		Total pension liability (a)	Plan fiduciary net position (b)	Net pension liability (a) – (b)
			(In thousands)	
Balances at January 1, 2016	$	167,130	147,402	19,728
Changes for the year:				
Service cost		5,853	—	5,853
Interest		13,244	—	13,244
Difference between expected and actual experience		6,368	—	6,368
Contributions – employer		—	4,163	(4,163)
Contributions – employee		—	4,383	(4,383)
Net investment income		—	11,774	(11,774)
Benefit payments, including refunds of employee contributions		(5,541)	(5,541)	—
Administrative expenses		—	(593)	593
Net changes		19,924	14,186	5,738
Balances at December 31, 2016	$	187,054	161,588	25,466

Additional required supplementary information for ARRC's defined-benefit pension plan can be found on pages 45 and 46.

(b) Alaska Railroad Corporation Health Care Trust

The ARRC sponsors a single-employer, defined-benefit retiree health care plan (Plan) administered by the Nonrepresented Tax Deferred Saving, 457 and Health Care Trust Plan Committee covering nonrepresented and Alaska Railroad Workers (ARW) represented employees, who became employed prior to November 4, 2014. The Plan also covers regular represented employees covered under the American Train Dispatchers Association (ATDA) or other represented employees hired before March 4, 2016 for United Transportation Union (UTU), April 2, 2015 for Carmen's Division of Transportation Communication International Union (TCU), and April 26, 2016 for International Brotherhood of Teamsters Local 959 (IBT), as specified in the labor agreements.

The Plan provides postretirement medical benefits to employees receiving retirement under the pension plan and retired CSRS employees who do not qualify for the federal medical insurance, and who move directly from active coverage to retiree coverage. The Plan is contributory with retiree premiums adjusted annually, and contains other cost-sharing features such as deductibles and coinsurance. The ARRC's funding policy is to contribute each year an amount equal to the actuarially determined contribution. Benefit terms and contribution rates are established and amended under the authority of the Board of Directors and management.

There were no contributions recognized or due by the Plan from the ARRC during the year ended December 31, 2017 or 2016. As of December 31, 2017, the Plan assets are held in trust and consist of cash and cash equivalents of 4.8%, fixed-income securities of 48.1%, equities of 35.9%, and real estate investments of 11.2%. The value of trust assets used for GASB Statement No. 75 *Accounting and Financial Reporting for Postemployment Benefits other than Pensions* excludes certain Trust assets segregated for use toward the ARRC Welfare Benefit Plan.

At December 31, the Plan membership consisted of the following:

	2017	2016
Inactive plan members or beneficiaries currently receiving benefits	31	32
Inactive plan members entitled to but not yet receiving benefits	—	—
Active plan members	444	480
	475	512

The components of the net other postemployment benefit (OPEB) asset for the Plan at December 31, 2017 and 2016 were as follows:

	2017	2016
	(In thousands)	
Total OPEB liability	$ 17,152	15,327
Fiduciary net position	(46,627)	(42,740)
Net OPEB asset	$ (29,475)	(27,413)
Plan fiduciary net position as a percentage of the total OPEB asset	(271.8)%	(278.9)%

OPEB Assets, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB: At December 31, 2017 and 2016, the ARRC reported an asset for the OPEB plan. The net OPEB asset was measured as of December 31, 2017 and 2016, and the total OPEB asset used to calculate the net OPEB liability was determined by an actuarial valuation as of January 1, 2016 and 2015. For the years ended December 31, 2017 and 2016, the ARRC recognized net OPEB income of $113,000 and $311,000, respectively.

(Continued)

At December 31, the ARRC reported deferred outflows of resources and deferred inflows of resources related to OPEB as follows:

	2017		2016	
Deferred outflows and (inflows) of resources	**Deferred outflows of resources**	**Deferred inflows of resources**	**Deferred outflows of resources**	**Deferred inflows of resources**
	(In thousands)		(In thousands)	
Differences between expected and actual experience	$ —	(1,582)	—	(1,633)
Changes of assumptions	1,129	—	1,285	—
Net difference between actual and projected earnings on investments	281	—	2,125	—
Total	$ 1,410	(1,582)	3,410	(1,633)

The deferred outflows and inflows of resources related to OPEB will be recognized in OPEB expense or income as follows:

	Amount
	(In thousands)
Year ending December 31:	
2018	$ 360
2019	360
2020	(334)
2021	(344)
2022	(60)
Thereafter	(154)
	$ (172)

Actuarial Assumptions: The total OPEB liability in the January 1 actuarial valuation was determined using the following actuarial assumptions.

Actuarial assumption	2017	2016
Discount rate	6.75% based on crossover test	6.75% based on crossover test
Inflation	2.8%	2.8%
Salary increases	3.0% CPI plus merit based rates	3.0% CPI plus merit based rates
Cost of living allowance	Not Applicable	Not Applicable
Retirement, disablement, and termination	Based on 2010-2014 experience study	Based on 2010-2014 experience study
Administrative expenses	0.22% of payroll, based on current year ADC	0.14% of payroll, based on current year ADC
Participation rates	Varies from 35% to 85%	Varies from 35% to 85%
Medical trend	6.2%, grading down over five years to 4.5%	7.5%, grading down over eight years to 4.5%

Mortality rates were based on the Society of Actuaries RP-2000 combined mortality table (65%/35% blended blue/white collar) and the Scale AA generational mortality improvement in longevity that management expects to occur in the future.

The long-term expected rate of return of 6.75% on OPEB plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of OPEB plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

Asset class	Target allocation	Long-term expected real rate of return
Cash	— %	0.50 %
U.S. TIPS	5.00	2.00
Intermediate term bond	30.00	2.50
Global bond	5.00	2.50
High yield bond	10.00	4.00
Domestic large cap	15.00	7.00
Domestic mid cap	5.00	8.00
Domestic small cap	4.00	9.00
U.S. healthcare (equity)	5.00	7.50
International equity	6.00	7.25
Real estate	15.00	4.75
Total	100.00 %	

Discount Rate: The discount rate used to measure the total OPEB liability was 6.75%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate, and contributions from employers will be made based on the actuarially determine contribution rate. Based on those assumptions, the OPEB plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

Sensitivity of the net OPEB liability to changes in the discount rate: The following presents the net OPEB liability calculated using the discount rate of 6.75%, as well as what the net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower or higher than the current rate:

		1% Decrease (5.75)%	Current discount rate (6.75)%	1% Increase (7.75)%
			(In thousands)	
Net OPEB liability (asset) as of:				
December 31, 2017	$	(26,769)	(29,475)	(31,658)
December 31, 2016		(24,912)	(27,413)	(29,426)

Sensitivity of the net OPEB liability to changes in the Medical Cost Trend Rate: The following presents the net OPEB liability calculated using the medical cost trend rate of 7.5% beginning in 2015, reducing over eight years to 4.5%, as well as what the net OPEB liability would be if it were calculated using a trend rate that is 1-percentage-point lower or higher than the current rate:

		1% Decrease (6.5)%	Medical cost trend rate (7.5)%	1% Increase (8.5)%
			(In thousands)	
Net OPEB liability (asset) as of:				
December 31, 2017	$	(32,177)	(29,475)	(26,022)
December 31, 2016		(29,888)	(27,413)	(24,243)

Changes in the OPEB liabilities are as follows:

		Total OPEB liability (a)	Plan fiduciary net position (b)	Net OPEB asset (a) – (b)
			(In thousands)	
Balances at January 1, 2017	$	15,327	42,740	(27,413)
Changes for the year:				
Service cost		700	—	700
Interest		1,095	—	1,095
Changes of benefit terms		526	—	526
Difference between expected and actual experience		(165)	—	(165)
Changes in assumptions		—	—	—
Contributions – employer		—	—	—
Net investment income		—	4,295	(4,295)
Benefit payments, net of retiree premiums		(331)	(331)	—
Administrative expenses		—	(77)	77
Net changes		1,825	3,887	(2,062)
Balances at December 31, 2017	$	17,152	46,627	(29,475)

		Total OPEB liability (a)	Plan fiduciary net position (b)	Net OPEB asset (a) – (b)
			(In thousands)	
Balances at January 1, 2016	$	14,539	40,642	(26,103)
Changes for the year:				
Service cost		699	—	699
Interest		985	—	985
Difference between expected and actual experience		(1,832)	—	(1,832)
Changes in assumptions		1,442	—	1,442
Contributions – employer		—	—	—
Net investment income		—	2,670	(2,670)
Benefit payments, net of retiree premiums		(506)	(506)	—
Administrative expenses		—	(66)	66
Net changes		788	2,098	(1,310)
Balances at December 31, 2016	$	15,327	42,740	(27,413)

(Continued)

Additional required supplementary information for ARRC's OPEB plan can be found on pages 47 through 49.

(c) Civil Service Retirement System (CSRS)

Federal employees who transferred to the ARRC continue to participate in the CSRS, a multiemployer, defined-benefit plan. ARRC is required to contribute 7% of the transferred employees' eligible compensation. Benefit expense related to CSRS was $44,000 and $60,000 for the years ended December 31, 2017 and 2016, respectively.

(d) Alaska Railroad Corporation 401(k) Tax Deferred Savings Plan

The ARRC sponsors a defined contribution plan (Plan) under Section 401(k) of the Internal Revenue Code (IRC) for employees. All regular employees are eligible to contribute to the Plan. Under the terms of certain collective bargaining agreements and the plan document for nonrepresented employees, representing 80% of employees, the ARRC will match a portion of employee contributions. The maximum amount of matching required under the agreements is 66% of employee contributions for the first 9% of salary. Benefit expense related to the Plan was $742,000 and $711,000 for the years ended December 31, 2017 and 2016, respectively.

(e) Alaska Railroad Corporation 457 Deferred Compensation Plan

ARRC sponsors a Section 457 deferred compensation plan (Plan) under Section 457(b) of the IRC for nonrepresented employees. There are no benefit expenses related to the Plan for the years ended December 31, 2017 or 2016.

(8) Grants

The ARRC has spent grant funding on a variety of operating property, right-of-way acquisition, and equipment. Generally, grant revenue will be recognized equal to depreciation on these assets each year.

The original cost of assets constructed or acquired with grant funding as of December 31, 2017 and 2016 consists of the following:

			2017	2016
			(In thousands)	
Land and improvements		$	8,729	8,729
Road and roadway structures	15–32 year life		662,175	656,290
Equipment	5–25 year life		181,412	180,586
Construction in process			26,300	12,864
		$	878,616	858,469

Grant revenue earned during the years ended December 31, 2017 and 2016 consisted of the following:

		2017	2016
		(In thousands)	
Depreciation on assets constructed with grant funds	$	40,135	40,159
Grant funded maintenance expense		17,296	6,759
Grant funded bond principal, interest, and issuance costs		4,466	43
		61,897	46,961
Less grant revenue included in real estate nonoperating revenues		(67)	(28)
Less grant funded interest on Series 2015A revenue bonds included in nonoperating revenues		(4,450)	—
	$	57,380	46,933

The original cost of assets constructed or acquired with Capital Grant Receipts Bonds consists of the following:

			2017	2016
			(In thousands)	
Road and roadway structures	15–32 year life	$	163,779	163,779
Equipment	5–25 year life		18,960	18,960
Construction in process			39,142	24,578
		$	221,881	207,317

(9) Concentrations

During 2016, ARRC entered into an agreement with a customer under the Internal Revenue Code §45G. Under the agreement, ARRC received $4.8 million for qualified track maintenance expenses and gave the customer a rebate of $2.5 million. The 2016 qualified track maintenance expenses and the rebate are recorded as net reductions in operating expenses.

A significant portion of ARRC's funding comes from the federal government in the form of grants. Federal grant funding was used for 38.1% and 27.5% of capital expenditures in 2017 and 2016, respectively.

(10) Land

The ARRC leases a significant portion of its land to various parties under long-term agreements. Rental income on these leases, which is included in real estate income, was $16,764,000 and $16,086,000 in 2017 and 2016, respectively. The following table summarizes future minimum lease receipts contractually due under long-term agreements as of December 31, 2017:

		Amount (In thousands)
Year ending December 31:		
2018	$	13,847
2019		13,118
2020		12,764
2021		12,406
2022		11,428
Thereafter		165,770
	$	229,333

(11) Operating Leases and Agreements

The ARRC leases certain operating equipment and barge services under operating leases and agreements. Payments under the leases and agreements totaled $9,456,000 and $9,703,000 in 2017 and 2016, respectively. Future minimum lease payments as of December 31, 2017 are summarized as follows:

		Amount (In thousands)
Year ending December 31:		
2018	$	9,428
2019		1,390
2020		—
2021		—
2022		—
Thereafter		—
	$	10,818

(Continued)

(12) Insurance

The ARRC is self-insured to certain limits for employee health benefits, personal injury, property and casualty damage claims, and workers' compensation claims, and establishes reserves for the estimated losses of such claims, including estimates of losses incurred but not reported, based on historical experience adjusted for current trends. The ARRC uses third-party administrators that process claims based on the provisions of the employee health plan, or for on-the-job injuries, in compliance with the State of Alaska Workers' Compensation Act. ARRC's commercial insurance policies with self-insured retention limits are summarized as follows at December 31, 2017 and 2016:

		2017	2016
		(In thousands)	
Casualty/liability	$	300,000	200,000
Property damage		100,000	100,000
Casualty/liability retention		5,000	5,000
Property damage retention		10,000	10,000

Self-insurance activity is summarized as follows during the years ended December 31, 2017 and 2016:

		Balance at December 31, 2016	Incurred claims	Claim payments	Balance at December 31, 2017
			(In thousands)		
Employee health benefits	$	1,174	11,155	(11,116)	1,213
Workers' compensation		1,732	1,401	(1,737)	1,396
	$	2,906	12,556	(12,853)	2,609

		Balance at December 31, 2015	Incurred claims	Claim payments	Balance at December 31, 2016
			(In thousands)		
Employee health benefits	$	1,449	12,005	(12,280)	1,174
Workers' compensation		1,690	1,474	(1,432)	1,732
	$	3,139	13,479	(13,712)	2,906

(13) Environmental Remediation Reserve

The ARRC has accrued certain environmental pollution remediation liabilities for its properties. ARRC has estimated the liability for pollution remediation by estimating a reasonable range of potential outlays and multiplying those outlays by the probability of occurrence, reduced by the allocation of liability to other potentially responsible parties, where applicable. The liabilities associated with these sites could change over time due to changes in costs of goods and services, changes in remediation technology, or changes in laws and regulations governing the remediation efforts.

(14) Commitments and Contingencies

Approximately 72% of the ARRC's labor force is subject to one of five collective bargaining agreements with various expiration dates. The representative unions are:

United Transportation Union (UTU),
International Brotherhood of Teamsters Local 959 (IBT),
American Train Dispatchers Association (ATDA),
Carmen's Division of Transportation Communication International Union (TCU), and the
Alaska Railroad Workers (ARW)

The ATDA labor agreement expired on May 2017; a successor agreement was negotiated but not ratified by the membership, so the expired agreement was extended until a successor agreement is successfully negotiated. The ARW labor agreement expired November 2017, and negotiations for a successor agreement are ongoing. The TCU labor agreement will expire on April 2018 and negotiations will commence on March 2018. The IBT labor agreement will expire April 2019. The UTU labor agreement will expire on February on 2021.

The ARRC has certain other contingent liabilities resulting from lawsuits, contract disputes, and claims incident to the ordinary course of business. Provision has been made in the financial statements for probable losses, if any, from such contingencies. In the opinion of management, the resolution of such contingencies will not have a material effect on the financial position of the ARRC.

(15) Related Party Transactions

The State of Alaska awarded ARRC appropriations for two capital improvement projects totaling $116,500,000. The ARRC has incurred $454,000 and $3,016,000 of costs under these appropriations, which are included in accounts receivable, construction in progress, and unearned grant revenue as of December 31, 2017 and December 31, 2016, respectively. Consistent with other grants, revenue from these appropriations will be deferred and recognized over the life of the related capital assets.

REQUIRED SUPPLEMENTARY INFORMATION
(Unaudited)

ALASKA RAILROAD CORPORATION

Required Supplementary Information (Unaudited)

Schedule of Changes in Plan Net Pension Liability and Related Ratios – Defined-Benefit Pension Plan

Last 10 Fiscal Years*

(In thousands)

		2017	2016	2015
Total pension liability:				
Service cost	$	5,777	5,853	5,834
Interest		14,230	13,244	11,832
Changes of benefit terms		154	—	—
Differences between expected and actual experience		(482)	6,368	—
Changes of assumptions		272	—	—
Benefit payments, net of retiree premiums		(6,197)	(5,541)	(4,920)
Net change in total pension liability		13,754	19,924	12,746
Total pension liability – beginning		187,054	167,130	154,384
Total pension liability – ending (a)		200,808	187,054	167,130
Plan fiduciary net position:				
Contributions – employer		4,051	4,163	3,571
Contributions – employees		4,302	4,383	4,290
Total net investment income		22,088	11,774	(199)
Other miscellaneous income		—	—	—
Benefit payments, including refunds of member contributions		(6,197)	(5,541)	(4,920)
Administrative expenses		(409)	(593)	(550)
Net change in plan fiduciary net position		23,835	14,186	2,192
Plan fiduciary net position – beginning		161,588	147,402	145,210
Plan fiduciary net position – ending (b)		185,423	161,588	147,402
Plan's net pension liability (a) – (b)	$	15,385	25,466	19,728
Plan fiduciary net position as a percentage of the total pension liability		92.33 %	86.39 %	88.20 %
Covered payroll	$	47,804	48,705	47,660
Net pension liability as a percentage of covered payroll		32.18 %	52.29 %	41.39 %

* This schedule is intended to present information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors' report and notes to required supplementary information.

ALASKA RAILROAD CORPORATION

Required Supplementary Information (Unaudited)

Schedule of ARRC Contributions – Defined-Benefit Pension Plan

Last 10 Fiscal Years*

(In thousands)

		2017	2016	2015
Actuarially determined contribution	$	4,051	4,163	3,571
Contributions in relation to the actuarially determined contribution		4,051	4,163	3,571
Contribution deficiency (excess)	$	—	—	—
Covered payroll	$	47,804	48,705	47,660
Contributions as a percentage of covered payroll		8.47%	8.55%	7.49%

* This schedule is intended to present information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors' report and notes to required supplementary information.

ALASKA RAILROAD CORPORATION

Required Supplementary Information (Unaudited)

Schedule of Changes in Plan Net OPEB Liability and Related Ratios –
Defined-Benefit Postretirement Medical Plan

Last 10 Fiscal Years *

(In thousands)

		2017	2016	2015
Total OPEB liability:				
Service cost	$	700	699	633
Interest		1,095	985	1,021
Changes of benefit terms		526	—	—
Differences between expected and actual experience		(165)	(1,832)	—
Changes of assumptions		—	1,442	—
Changes in benefit terms		—	—	—
Benefit payments, net of retiree premiums		(331)	(506)	(193)
Net change in total OPEB liability		1,825	788	1,461
Total OPEB liability – beginning		15,327	14,539	13,078
Total OPEB liability – ending (a)		17,152	15,327	14,539
Plan fiduciary net position:				
Contributions – employer		—	—	—
Total net investment income		4,295	2,670	(384)
Other miscellaneous income		—	—	—
Benefit payments, net of retiree premiums		(331)	(506)	(193)
Administrative expenses		(77)	(66)	(48)
Net change in plan fiduciary net position		3,887	2,098	(625)
Plan fiduciary net position – beginning		42,740	40,642	41,267
Plan fiduciary net position – ending (b)		46,627	42,740	40,642
Plan's net OPEB liability (asset) (a) – (b)	$	(29,475)	(27,413)	(26,103)
Plan fiduciary net position as a percentage of the total OPEB liability		(271.85)%	(278.85)%	(279.54)%
Covered payroll	$	35,292	46,941	47,660
Net OPEB liability as a percentage of covered payroll		(83.52)%	(58.40)%	(54.77)%

* This schedule is intended to present information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors' report and notes to required supplementary information.

ALASKA RAILROAD CORPORATION

Required Supplementary Information (Unaudited)

Schedule of ARRC Contributions – Defined-Benefit Postretirement Medical Plan

Last 10 Fiscal Years *

(In thousands)

		2017	2016	2015
Actuarially determined contribution	$	—	—	—
Contributions in relation to the actuarially determined contribution		—	—	—
Contribution deficiency (excess)	$	—	—	—
Covered payroll	$	35,292	46,941	47,660
Contributions as a percentage of covered payroll		— %	— %	— %

* This schedule is intended to present information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors’ report and notes to required supplementary information.

ALASKA RAILROAD CORPORATION

Required Supplementary Information (Unaudited)

Schedule of Investment Returns – Defined-Benefit Postretirement Medical Plan

Last 10 Fiscal Years *

	2017	2016	2015
Annual money-weighted rate of return, net of investment expense	10.55 %	3.50 %	0.70 %

* This schedule is intended to present information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors’ report and notes to the required supplementary information.

(1) Actuarial Assumptions and Methods

The significant actuarial assumptions used in the defined-benefit pension valuation as of December 31, 2017 are as follows:

(a) Actuarial Valuation Date: January 1, 2017

(b) Amortization Period: The Unfunded Actuarial Accrued Liability is amortized as a level dollar payment over a rolling (open) 30-year period.

(c) Actuarial Determined Contribution: Sum of (1) employer normal cost (2) amortization of unfunded actuarial accrued liability and (3) expected administrative expenses

(d) Asset valuation method: Actuarial value of assets, 5-year smoothed market value, gains/losses recognized over 5 years

(e) Inflation: 2.8%

(f) Investment rate of return: 7.5%

(g) Administrative Expenses: $90,000 payable as of the last day of the plan year

(h) Cost of Living Allowance: 1.4% (1/2 assumed inflation Tier 1, none for Tier 2)

(i) Mortality: Society of Actuaries RP-2000 combined mortality table (65%/35%; blended blue/white collar) and Scale AA generational mortality improvement

(j) Termination: Ultimate withdrawal rates of the V Table (Employee Termination Study, Roger L. Vaughn, 1992)

(k) Disability: 1985 Pension Disability table (blended 80% Class 1 and 20% Class 3)

(l) Retirement: Rates vary based on age. Sample rates follow. Tier 1 deferred vested members are assumed to retire at age 58:

Age	Tier 1 rate	Tier 2 rate
55	6.0 %	N/A
56	6.0	N/A
57	12.5	N/A
58	12.5	N/A
59	20.0	N/A
60	20.0	10.0 %
61	20.0	10.0
62	25.0	15.0
63	15.0	15.0
64	20.0	20.0
65	15.0	25.0
66	15.0	25.0
67	25.0	25.0
68	25.0	25.0
69	25.0	25.0
70	100.0	100.0

The significant actuarial assumptions used in the actuarially determined contribution for the OPEB healthcare plan as of December 31, 2017 are as follows:

(a) Actuarial Valuation Date: January 1, 2017

(b) Amortization Period: The Overfunded Actuarial Accrued Liability is amortized as a level dollar payment over a rolling (open) 6-year period

(c) Actuarially Determined Contribution: Sum of (1) employer normal cost (2) amortization of unfunded actuarial accrued liability and (3) Expected administrative expenses.

(d) Asset valuation method: Actuarial value of assets, 5-year smoothed market value: gains/losses recognized over 5 years, reduced by Trust payments expected to be made for non-OPEB medical benefits.

(e) Inflation: 2.8%

(f) Investment rate of return: 6.75%

(g) Administrative Expenses: $14,000 payable as of the last day of the plan year

(h) Mortality: Society of Actuaries RP-2000 combined mortality table (65%/35%; blended blue/white collar) and Scale AA generational mortality improvement

(i) Termination: Ultimate withdrawal rates of the V Table (Employee Termination Study, Roger L. Vaughn, 1992)

(j) Disability: 1985 Pension Disability table (blended 80% Class 1 and 20% Class 3)

(k) Retirement: Rates vary based on age. Sample rates:

Age	Tier 1 rate	Tier 2 rate
55	6.0 %	N/A
56	6.0	N/A
57	12.5	N/A
58	12.5	N/A
59	20.0	N/A
60	20.0	10.0 %
61	20.0	10.0
62	25.0	15.0
63	15.0	15.0
64	20.0	20.0
65	15.0	25.0
66	15.0	25.0
67	25.0	25.0
68	25.0	25.0
69	25.0	25.0
70	100.0	100.0

(l) Medical Trend:

Year	Increase rate
2018	6.2 %
2019	5.8
2020	5.4
2021	5.1
2022	4.8
2023+	4.5

(m) ACA Excise Tax: Estimated based on blended rates.

(n) Participation: 45% of future retirees elect coverage, 85% of future disabled retirees to elect coverage, 25% of disabled retirees under age 65 are Medicare eligible, all retirees over age 65 are assumed Medicare eligible, 55% of nondisabled retirees continue coverage at first Medicare eligibility.

(o) Per capita claims costs:

Age		Old plan		Blue plan		Gold plan	
		Male	Female	Male	Female	Male	Female
50	$	10,240	11,832	9,659	11,213	9,230	10,750
55		13,746	13,915	13,091	13,255	12,588	12,748
60		18,807	17,021	18,072	16,311	17,472	15,742
64		21,021	18,346	20,254	17,615	19,614	17,021
65		7,470	6,197	6,706	5,475	6,065	4,894
70		8,640	7,007	7,755	6,191	7,015	5,534
75		10,274	8,222	9,223	7,264	8,342	6,494
80		12,341	9,810	11,078	8,668	10,020	7,748
85		14,490	11,521	13,007	10,180	11,765	9,099

Changes in Actuarial Methods since the prior Valuation

Defined-Benefit OPEB healthcare plan

Participation: The participation assumption changed. The key participation assumption changes are:

(1) Future retirees assumed to elect coverage was 45%

(2) The percentage of retirees continuing coverage upon reaching Medicare eligibility changed was 55%

(3) Laid off employees accumulate 75% of full-time service in the future.

Administrative expenses: Administrative expenses changed from 0.16% of payroll to actual expenses paid in the prior year, which increased by 9.6%.

Discount rate: The discount rate was 6.75%.

The funding method was entry age normal.

ALASKA RAILROAD OFFICES

ALASKA RAILROAD OFFICES	PHYSICAL LOCATION	PHONE	FAX
ANCHORAGE, ALASKA (99501)			
Headquarters Offices	327 W. Ship Creek Avenue	907.265.2300	907.265.2312
Reservations & Depot	411 W. 1st Avenue	907.265.2494	907.265.2509
Operations Center	825 Whitney Road	907.265.2434	907.265.2643
FAIRBANKS, ALASKA (99701)			
Passenger Depot	1031 Railroad Depot Road	907.458.6025	907.458.6068
Freight Customer Service	1888 Fox Avenue	907.458.6022	907.458.6034
Freight House	230 Jack Lindsey Lane	907.458.6048	907.458.6061
SEWARD, ALASKA (99664)			
Dock Operations / Terminal	913 Port Avenue	907.224.5550	907.265.2660
SEATTLE, WASHINGTON (98134)			
Barge Operations Office	1140 SW Massachusetts Street	206.767.1100	206.767.1112

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