2012

Alaska Railroad Corporation
Annual Report

(Photo by Frank Keller)

The measure of our mission:

Operate safely and profitably, foster economic development and provide high-quality service.

2012

The majority of images pictured in the annual report are by Judy Patrick.

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Year in Leadership

Board of Directors

Susan Bell
John Binkley
Jack Burton
Jon Cook
Patrick Kemp
Linda Leary
Bill Sheffield

Management Team

President & CEO
Chris Aadnesen

Engineering & Maintenance
VP Tom Brooks

General Counsel / Legal
VP Bill Hupprich

Real Estate & Facilities
VP Jim Kubitz

Corporate & Gov't Affairs
VP Wendy Lindskoog

CFO /Finance
VP Bill O'Leary

Info, Telecom & Signal
VP Eileen Reilly

Mechanical & Transportation
VP Patrick Shake

Business Development
VP Dale Wade

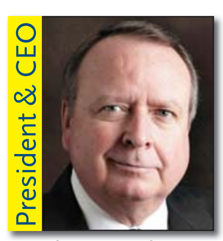
Mission accomplished amidst adversity

The Alaska Railroad Corporation's (ARRC) 2012 finances tell a story of balance between mitigating unforeseen trials and maximizing productive opportunities. On the operations side, our net income of $12.5 million is remarkable in light of surprising business revenue downturns and a few soaring cost items. Total 2012 revenue of $189.7 million (operating and real estate revenue of $145.4 million; and grant revenue of $44.3 million) is $3.6 million more than in 2011, thanks to the pursuit of new sources to offset reductions in traditional business lines. Total expense of $177.2 million is just under $5 million more than 2011 because stringent cost containment efforts helped to compensate for unpredicted expense hikes. On the capital side, railroad assets grew by $61.4 million to total $989.9 million by the end of 2012, demonstrating an ongoing commitment to safe, reliable infrastructure.

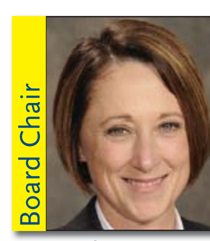
The measure of the railroad's response and resilience goes beyond income and assets. Our standing comes also from the caliber of our people. In the midst of adversity, railroad employees at every level, in every department, expertly executed the components of our mission: to operate safely and profitably, to facilitate economic development, and to provide high-quality service. We struck the right balance among our core values, and earned some well-deserved accolades along the way.

Operating Profitably and Safely

The Alaska Railroad suffered serious revenue declines in two major lines of business, which were partially offset by non-recurring business. We also experienced severe weather mitigation expenses during 2011-2012 winter and 2012 fall. In response, we sought additional savings across the board. A prime example is our revitalized fuel conservation program, which included a locomotive idle-reduction initiative that significantly lowered fuel expense and reduced emissions. Additionally, mid-year we eliminated 52 positions, most through attrition and halting vacancy hires, resulting in fewer than 10 actual layoffs.



Chris Aadnesen



Linda Leary

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Review

While such cost-cutting initiatives kept the railroad on solid financial footing in 2012, we prepared for compounding problems in 2013. We continued to curb hiring during the last half of 2012 as the fiscal picture for 2013 became clearer. By doing so, we limited actual layoffs to less than 25 when eliminating another 54 positions in early 2013. Moving forward, we expect our fuel-hauling business to remain at its lowest volume in two decades, and to haul 30% less export coal than in 2012. This trend leaves far less to fund essential capital maintenance and investment projects.

For about a decade, our capital program has also relied heavily on Federal Transit Administration (FTA) formula funds. In 2012, ARRC's share of FTA funding came under fire from members of Congress who don't believe we are eligible. With new surface transportation legislation (MAP 21) passed into law, our 2013 FTA funding allocation will drop from $35 million to $27 million and the required local match increases from 9% to 20%. Despite the strong support from Alaska's congressional delegation, we expect an uphill battle to keep FTA funding in 2014, when MAP 21 expires.

Much of our limited capital resources are consumed by a federal mandate to develop a Positive Train Control (PTC) system designed to prevent train-to-train collisions and derailments caused by human error. The U.S. Rail Safety Improvement Act of 2008 requires PTC implementation, but provides no funding to develop it.

Despite these fiscal dilemmas, in 2012 we continued to invest in opportunities for real estate customers. We supported a new state law to extend our maximum land lease term from 55 to 95 years. We revised our long-term lease policy to be more flexible and enhance investment prospects. We built the first phase of a sewer extension benefitting Ship Creek area tenants. And we welcomed the U.S. Forest Service into our Historic Freight Shed, Alaska's only historic building renovated to meet Leadership in Energy and Environmental Design (LEED) standards.

Commissioner

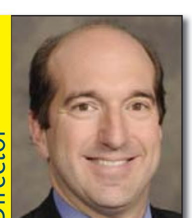
Susan Bell

Director

John Binkley

Director

Jack Burton

Director

Jon Cook

Commissioner

Pat Kemp

Vice Chair

Bill Sheffield

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During 2012, the railroad saw serious and unexpected declines begin in two key freight business lines — refined petroleum and export coal.

Efforts to facilitate new real estate revenue and to conserve resources drew local recognition. On the south end, the Historic Freight Shed project inspired a new Alaska Railroad Mears Award of Excellence presented to the architectural firm and railroad employees with the vision and persistence to see it through. To the north, the Fairbanks North Star Borough praised our efforts to reduce engine idling and emissions, thereby helping to address poor air quality during the Interior's frigid winter months.

Customer and Community Service

Customer service often begins with community service and exchange. For example, in January, we galvanized the interest and support of Alaska's rail fan community by keeping a promise to return Steam Engine 557 to Alaska to provide a nostalgic service along the railroad in the future. The non-profit entity formed to oversee the historic locomotive's restoration has already recruited more than a dozen volunteers, including railroad customers, partners and employees. In October, we organized a small community open house in Healy. Similar to the large spring open house events in Fairbanks and Anchorage, the Healy event provided fun children's activities and free train rides to residents. It was combined with rail-related training for local emergency responders.

Just north of Healy, the Alaska Railroad played an integral role in serving the logistical needs of the Golden Valley Electric Association's Eva Creek wind energy project. Over a six-month period, our trains hauled more than 2,000 pieces of equipment and tons of supplies on time and under budget. Our transportation service in support of this important energy project garnered the Alaska Railroad national recognition. The American Short Line and Regional Railroad Association (ASLRRA) recently announced ARRC as the winner of a prestigious ASLRRA Marketing Award to be presented during its 2013 spring annual meeting. ARRC's nomination was selected for exceptional customer service using a customer care team approach, for enhancing client and community relationships, and for showcasing ARRC capabilities to future potential customers.

Economic Development

The Eva Creek wind project also demonstrates our role in fostering economic development through infrastructure. Several railroad and state infrastructure projects progressed in 2012. The Port MacKenzie Rail Extension project moved forward on final design and civil construction, and successfully defended the environmental work against a National Environmental Policy Act challenge in the 9th Circuit Court of Appeals. To the north, we completed the environmental assessment for the North Pole Road/Rail Crossing Reduction project, and the Federal Railroad Administration (FRA) issued a Finding of No Significant Impact (FONSI). Pending funding, the FONSI paves the way for the project to move forward. We built the levee and began constructing the impressive 19-pier bridge over the Tanana River near Salcha. This first phase of the Northern Rail Extension (NRE) also spawned a remarkable partnership between ARRC, the Salcha Elementary School, Alaska Department of Fish & Game, and the Tanana Valley Watershed Association to implement a 10-year beaver dam mitigation measure identified in the NRE Environmental Impact Study.

Community and public involvement is a cornerstone of railroad capital project planning. Along these lines, the Alaska Railroad is engaged in the Alaska Department of Transportation and Public Facilities (ADOT&PF) long-awaited update to the Alaska State Rail Plan, which will help guide state policy on developing its rail assets throughout the state. ARRC CEO Chris Aadnesen and two ARRC Board members Susan Bell (Commerce Commissioner) and Patrick Kemp (ADOT&PF Commissioner) are participating on the Steering Committee. The railroad hosted the first committee meeting in November 2012. The plan will be complete by December 2013.

The Greater Wasilla Chamber of Commerce recently acknowledged the railroad's importance to local communities and to statewide commerce by naming ARRC its 2012 Outstanding Large Company of the Year. The annual award recognized the Alaska Railroad for contributions to railbelt communities through important transportation services and corporate philanthropy, while achieving balance in a challenging economic climate.

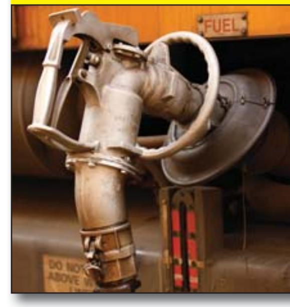
While the year ahead certainly poses more trials and opportunities, the Alaska Railroad will continue a balanced approach to accomplishing its mission for the benefit of Alaskans statewide.

Sincerely,

Chris Aadnesen, President & CEO

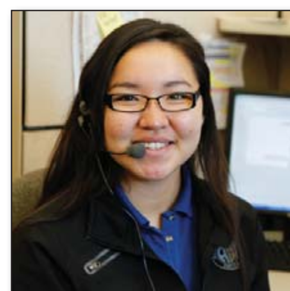
Linda Leary, Chair

Pursuing Opportunity



Fuel conservation efforts to save thousands of dollars.

First small community open house organized in Healy.



Passenger reservations and ridership was up by 10,000.

Specialized transportation services earned $ and award.

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Financial Highlights

Earnings (in thousands):

	2012	2011
Operating revenue:		
Freight	$ 100,022	$ 98,045
Passenger	24,027	22,382
Other	3,984	4,965
Grant	40,443	39,892
Total operating revenue	168,476	165,284
Operating expenses:	164,659	160,033
Operating income	3,817	5,251
Non-operating revenue (expenses):		
Net real estate income	10,073	8,246
Gain on sale of capital assets	—	1,391
Investment income	87	110
Interest expense, net of grant revenue	(1,473)	(1,562)
Net income:	12,504	13,436

Statements of Net Position (in thousands):

	2012	2011
Assets:		
Current assets	$ 104,860	$ 111,098
Capital assets	875,284	798,121
Restricted assets	992	12,131
Regulatory assets	8,738	7,171
Other assets	18	18
Total assets	989,892	928,539
Liabilities:		
Current liabilities	50,964	54,645
Non-current liabilities	683,272	628,634
Total liabilities	734,236	683,279
Net Position:	255,656	245,260
Total liabilities and net position	989,892	928,539
Operating Ratio:	0.98	0.97

The Alaska Railroad Corporation has not received any bona-fide offers of a sale arrangement within the calendar year of 2012, nor is the Corporation aware of any potential sales that require analysis under AS 42.40.260.

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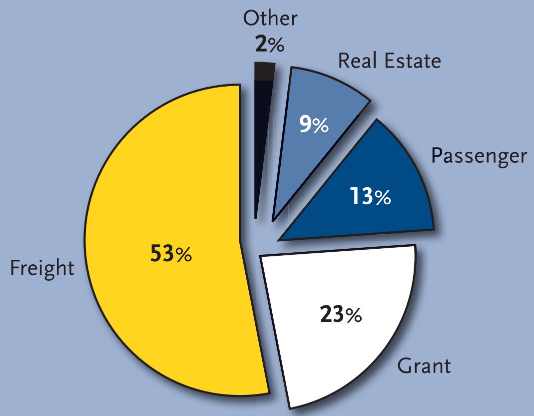
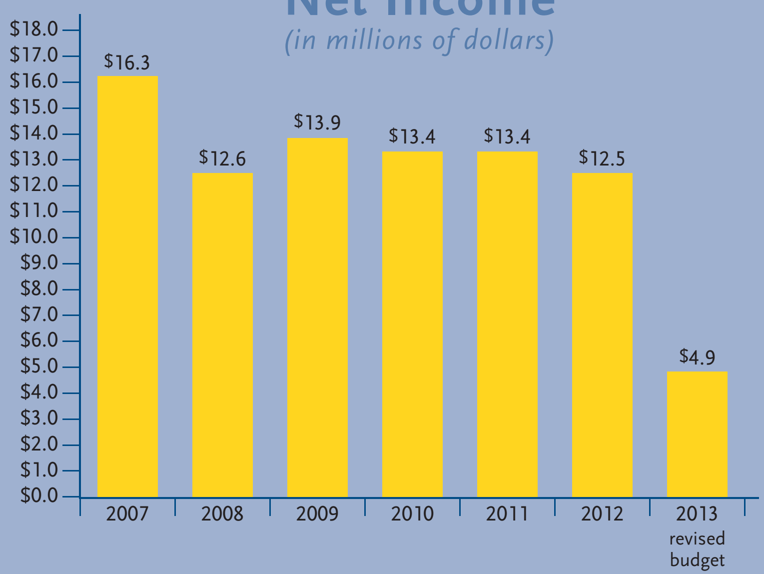
2012

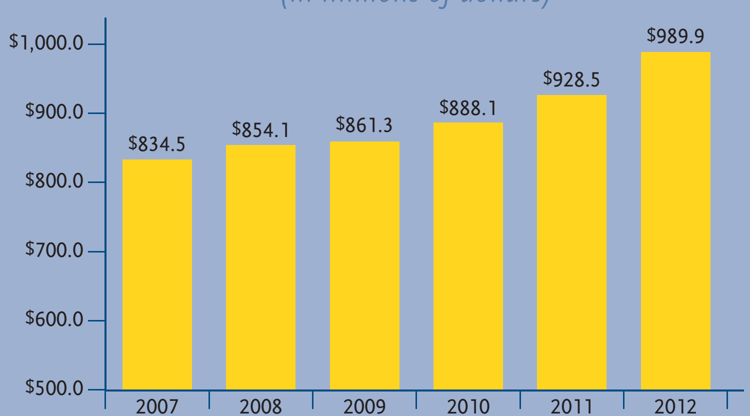
2012 Revenue



Net Income
(in millions of dollars)

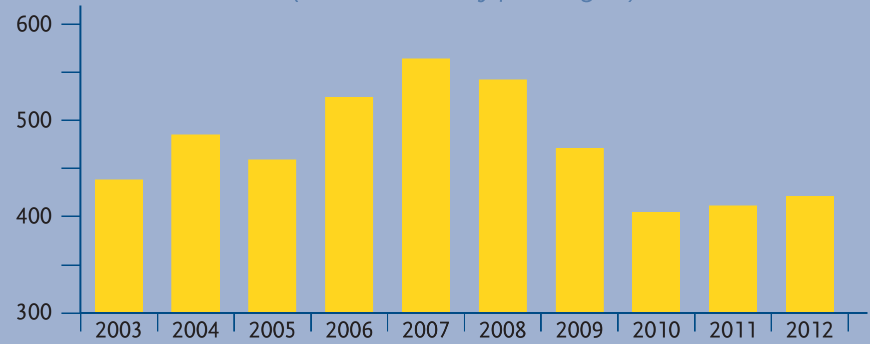


Total Assets
(in millions of dollars)

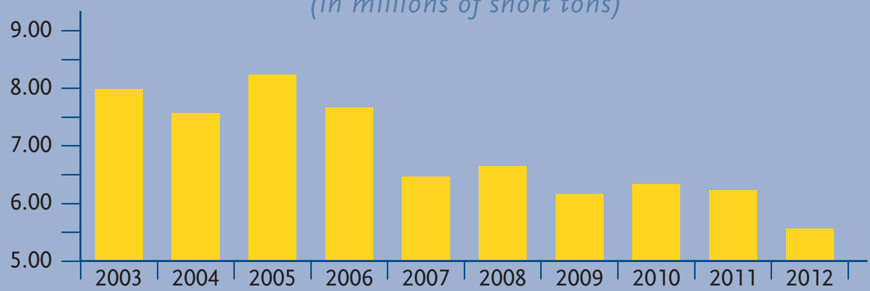


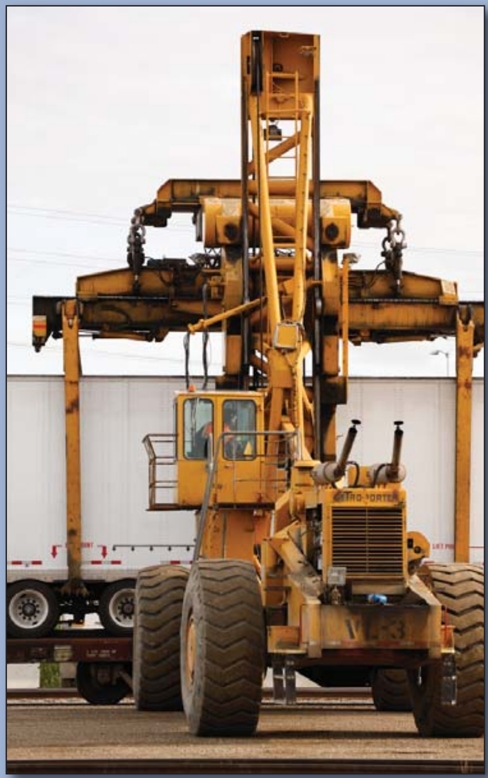
To protect the track infrastructure for safe operation, Maintenance of Way employees are on the front line in the battle against fast-growing vegetation.

Total Passenger Ridership
(in thousands of passengers)



Total Freight Tonnage
(in millions of short tons)





A van-loader lifts a truck trailer off of a railroad flatcar. Freight moved by containers or trailers was a revenue growth area for the railroad.

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Contact and Connections

Alaska Railroad Corporation

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327 W. Ship Creek Avenue • Anchorage, AK 99501

(907) 265-2300

Follow the Alaska Railroad:

facebook.com/alaskarailroad twitter.com/akrr

Limited capital funding is focused on critical track repair and rehabilitation work.

March 28, 2013

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, 2012.

The financial section of the Annual Report is presented in three 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

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,

Bill O'Leary, CPA
Vice President Finance and
Chief Financial Officer

Wendy Richerson, CPA
Controller

December 31, 2012 and 2011

This section of the Alaska Railroad Corporation’s (ARRC’s) annual financial report presents the discussion and analysis of the ARRC’s financial performance during the years that ended on December 31, 2012 and 2011. Please read it in conjunction with the ARRC’s financial statements, which follow this section.

Financial Highlights

- The ARRC’s total net position increased 4% during the course of this year’s operations and increased 5% over the course of 2011 operations.
- During 2012, the ARRC’s operating revenues exceeded operating expenses by $3.8 million, yielding an operating ratio of 0.98. Last year, operating revenues exceeded operating expenses by $5.3 million and yielded an operating ratio of 0.97.
- The total 2012 operating costs of the ARRC’s programs were $164.7 million, an increase of 3% compared to last year. The total 2011 operating costs of the ARRC’s programs were $160.0 million, an increase of 10% compared to 2010.
- Expenditures on capital assets totaled $125.6 million during 2012, an increase of 43% compared to last year. Expenditures on capital assets totaled $87.9 million during 2011, an increase of 20% compared to 2010.
- Grant funding was used for $90.1 million, or 72%, of the 2012 capital expenditures. Grant funding was used for $40.3 million, or 46%, of the 2011 capital expenditures. These amounts were recorded as deferred revenue in the regulatory liabilities section of the statement 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 statements of net position report assets, liabilities, 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 and its liabilities, 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 revenues earned from services and expenses incurred to operate the ARRC, as well as the activities of the ARRC not

December 31, 2012 and 2011

considered to be operations. All of the current year's revenues 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.

Financial Analysis of the Alaska Railroad Corporation

Net position – ARRC's net position increased 4% between fiscal years 2011 and 2012 to approximately $255.7 million. ARRC's net position increased 5% between fiscal years 2010 and 2011 to approximately $245.3 million.

		2012	2011 (in thousands)	2010
Assets:				
Current assets	$	104,860	111,098	97,910
Capital assets		875,284	798,121	761,002
Other noncurrent assets		9,748	19,320	29,206
Total assets	$	989,892	928,539	888,118
Liabilities:				
Current liabilities	$	50,964	54,645	43,863
Notes payable outstanding, less current installments		19,049	24,328	24,028
Revenue bonds payable, net of unamortized premiums and deferred amounts		113,144	124,426	135,133
Other liabilities		2,457	3,076	1,434
Payable from restricted assets		105	99	757
Regulatory liabilities:				
Pension		10,781	7,107	2,933
Deferred grant revenue		537,736	469,598	447,341
Total liabilities	$	734,236	683,279	655,489
Net position:				
Invested in capital assets, net of related debt	$	189,852	175,546	166,416
Restricted for reinvestment in infrastructure		65,804	69,714	66,213
Total net position	$	255,656	245,260	232,629

Capital assets – Capital assets, net of accumulated depreciation increased $77.2 million in 2012 and $37.1 million in 2011. During 2012 and 2011, the ARRC continued an extensive capital improvement plan, including a new bridge, bridge rehabilitations, siding extensions, track refurbishing, straightening of curves, and welding rail to allow faster train speed and reduce wear. Also during this time period, ARRC continued

December 31, 2012 and 2011

developing the federally mandated positive train control system and acquired right of way in anticipation of future rail realignments.

Long-term debt – Notes payable decreased $4.9 million and increased $1.0 million in 2012 and 2011, respectively. During 2012, ARRC refinanced two long term loans of $4.0 million and $5.3 million. During 2011, ARRC issued a new long-term loan of $4.6 million to partially fund the acquisition of 110 freight cars.

Regulatory assets and liabilities – The STB regulates 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 (GASB) Codification section Re. 10, *Regulated Operations*.

A description of each of the regulatory assets and liabilities is as follows:

- Deferred grant revenue relates to capital assets funded with federal grants. Deferred grant revenue increased $68.1 million in 2012 and $22.3 million in 2011. This increase reflects the amount of capital assets constructed with grant funding, partially offset by grant revenue recognized as the related capital assets are depreciated.
- The postretirement benefits asset increased $1.6 million and the accrued pension benefit liability increased $3.7 million during 2012, due primarily to the increase in the actuarial accrued liability. The postretirement benefits asset increased $3.4 million and the accrued pension benefit liability increased $4.2 million during 2011, due primarily to market performance of the assets invested.

Revenue – The ARRC's total revenues increased 2% and totaled $190.0 million in 2012. The ARRC's total revenues increased 8% and totaled $185.7 million in 2011. Approximately 53% of the ARRC's revenue comes from freight revenue during 2012 and 2011, respectively, and 13% and 12% of the revenue comes from passenger services during both 2012 and 2011. The majority of the remaining income is related to real estate activities and federal grant revenue. Generally, federal grant revenue is recognized as the capital assets funded by the grants are depreciated.

Real estate expenses were $7.2 million in 2012, $8.3 million in 2011, and $8.9 million in 2010, a decrease of 13% from 2011 to 2012 and a decrease of 7% from 2010 to 2011.

December 31, 2012 and 2011

		2012	2011	2010
			(in thousands)	
Operating revenue:				
Freight	$	100,022	98,045	87,019
Passenger		24,027	22,382	20,783
Other		3,984	4,965	4,156
Total transportation revenue		128,033	125,392	111,958
Grant revenue		40,443	39,892	40,225
Total		168,476	165,284	152,183
Operating expense:				
Transportation	$	44,028	44,607	39,153
Passenger		10,661	9,832	9,486
Business development		20,853	18,925	16,916
Mechanical		26,182	24,920	23,870
Maintenance		36,318	34,761	31,553
Facilities		13,913	13,892	12,276
Engineering services		1,418	1,392	1,451
Signals		3,214	3,021	2,856
General and administrative		8,072	8,683	8,579
Total		164,659	160,033	146,140
Operating income		3,817	5,251	6,043
Nonoperating revenues (expenses):				
Real estate and facilities income, net of expenses		10,073	8,246	8,887
Gain on sale of capital assets		—	1,391	—
Investment income		87	110	78
Interest expense, net of grant revenue		(1,473)	(1,562)	(1,561)
Net income		12,504	13,436	13,447
Other changes in net position		(2,108)	(805)	5,409
Change in net position	$	10,396	12,631	18,856

Several events occurred during 2012 that significantly impacted the change in net position:

- ARRC's indirect cost rate agreements allowed ARRC to allocate eligible general and administrative expenses to capital projects. A total of $2.1 million was allocated to capital projects during 2012, reducing general and administrative expenses. The overall indirect cost recovery was $21,000 less than 2011.

December 31, 2012 and 2011

- Total transportation revenue was $3.6 million greater than 2011. The increase in transportation revenue is attributed to fuel surcharges related to increased fuel costs and the global recovery, which impacted freight shipments, passenger services and other operating revenues.
- ARRC used $202,000 of federal grant funding to acquire right of way in anticipation of future rail realignments.
- During 2012, ARRC entered into an agreement with one customer under the Internal Revenue Code (IRC) §45G. Under the agreement, ARRC received $4.8 million for qualified track maintenance expense and gave the customer a shipping credit of $2.7 million.
- ARRC records costs and accrued benefits under its defined benefit and postretirement plans. The other changes in net position of $2.1 million represent the change from the prior year in the unfunded actuarial accrued liability of the defined benefit pension and postretirement plans.

Several events occurred during 2011 that significantly impacted the change in net position:

- ARRC's indirect cost rate agreements allowed ARRC to allocate eligible general and administrative expenses to capital projects. A total of $2.1 million was allocated to capital projects during 2011, reducing general and administrative expenses. The overall indirect cost recovery was $50,000 less than 2010.
- Total transportation revenue was $12.6 million greater than 2010. The increase in transportation revenue is attributed to fuel surcharges related to increased fuel costs and the global recovery, which impacted freight shipments, passenger services and other operating revenues.
- ARRC used $397,000 of federal grant funding to acquire right of way in anticipation of future rail realignments.
- ARRC received $1.3 million from the sale of capital assets for right of way relating to a State of Alaska highway project.
- During 2011, ARRC entered into an agreement with one customer under the Internal Revenue Code (IRC) §45G. Under the agreement, ARRC received $4.8 million for qualified track maintenance expense and gave the customer a shipping credit of $2.7 million.
- ARRC records costs and accrued benefits under its defined benefit and postretirement plans. The other changes in net position of $0.8 million represent the change from the prior year in the unfunded actuarial accrued liability of the defined benefit pension and postretirement plans.

December 31, 2012 and 2011

Capital Asset and Debt Administration

Capital Assets

At the end of 2012, the ARRC had invested $875.3 million in a broad range of capital assets including land, road and roadway structures, equipment, and leasehold improvements. This amount represents a net increase (including additions and deductions) of $77.2 million, or 10%, over last year. Grants have funded $479.4 million of the assets, net of accumulated depreciation.

	2012	2011	2010
		(in thousands)	
Land and improvements	$ 30,424	29,719	29,288
Road materials and supplies	9,947	7,575	6,684
Road and roadway structures	561,864	566,700	558,876
Equipment	140,164	146,146	146,372
Leasehold improvements	122	251	415
Quarry improvements	3,534	3,675	3,801
Construction in progress	129,229	44,055	15,566
Total capital assets, net of accumulated depreciation	$ 875,284	798,121	761,002

The ARRC's fiscal year 2012 capital budget approved spending another $23.5 million for capital projects, principally for continued track and bridge rehabilitation and other infrastructure improvements. The ARRC intends to use federal grant funding to provide $11.1 million of the capital additions. The remaining capital projects will be funded out of current year earnings and cash flow. More detailed information about the ARRC's capital assets is presented in note 4 to the financial statements.

Long-Term Debt

At the end of 2012, the ARRC had $23.4 million in notes payable outstanding, a decrease of 17% from 2011, and $124.3 million in revenue bonds payable outstanding, a decrease of 8%. At the end of 2011, the ARRC had $28.4 million in notes payable outstanding, an increase of 4% from 2010, and $135.1 million in revenue bonds payable outstanding, a decrease of 7%. Bond issuance costs from FTA Capital Grants Receipts, Series 2007 of $1.2 million and Series 2006 of $1.4 million are being amortized over the life of the bonds. More detailed information about the ARRC's long-term debt is presented in note 6 to the financial statements.

Bond Rating

In July 2006, Standard & Poor's Ratings Services and Fitch Ratings assigned "A+" and "A" ratings, respectively, to the approximately $76.4 million of Capital Grant Receipts Bonds, Series 2006 (FTA Section 5307 Urbanized Area Formula Funds and Section 5309 Fixed Guideway Modernization Formula Funds). These ratings were used to determine the ARRC's financial strength for the bond issuance insured under a policy issued by Financial Guaranty Insurance Company.

In August 2007, Standard & Poor's Ratings Services, Fitch Ratings, and Moody's Investor Services assigned "A+", "A," and "A1" ratings to the approximately $88.6 million of Capital Grant Receipts Bonds, Series 2007

December 31, 2012 and 2011

(FTA Section 5307 Urbanized Area Formula Funds and Section 5309 Fixed Guideway Modernization Formula Funds). These ratings were used to determine the ARRC's financial strength for the bond issuance insured under a policy issued by Financial Guaranty Insurance Company.

On April 16, 2010, Moody's Investors Service raised its underlying unenhanced rating assigned to ARRC's Capital Grant Receipts Bonds to "Aa3" as a result of the recalibration by Moody's Investors Service of its municipal rating scale to align it with the scales used by Moody's Investors Service in assessing the creditworthiness of other types of issuers. On September 12, 2011, Moody's Investors Service lowered its underlying unenhanced rating assigned to ARRC's Capital Grant Receipts Bonds to "A1" with a stable outlook as a result of a reassessment of such bonds in comparison with similar bonds to which Federal Transit Administration grants are pledged and the relatively low additional bonds test applicable to ARRC's Capital Grant Receipts Bonds. Moody's Investors Service no longer rates FGIC. On September 30, 2008, FGIC entered into a Reinsurance Agreement with MBIA Insurance Corporation (Reinsurance Agreement) pursuant to which certain of FGIC's policyholders may receive the benefit of MBIA's reinsurance by presenting claims directly to MBIA under their FGIC-issued policies. ARRC's Capital Grant Receipts Bonds are included in the list of bonds covered by the Reinsurance Agreement. Based on the Reinsurance Agreement, Moody's Investors Service assigned an enhanced rating of "Aa3" to ARRC's Capital Grant Receipts Bonds.

Fitch Ratings no longer rates Financial Guaranty Insurance Company and, accordingly, has assigned only an underlying, unenhanced rating to ARRC's Capital Grant Receipts Bonds. Fitch Ratings affirmed an "A" rating and stable outlook on ARRC's Capital Grant Receipts Bonds in September 2010. In March 2011, Fitch Ratings changed the outlook on all grant receipts bonds payable solely from and secured solely by Federal Transit Administration (FTA) formula funds, including ARRC's Capital Grant Receipts Bonds, from stable to negative, citing growing uncertainty in federal transportation policy, less predictable funding levels and a pending expiration of a majority of federal motor fuel taxes. Fitch Ratings affirmed this negative outlook on March 6, 2012.

On July 6, 2012, the President signed into law Public Law 112-141, titled "Moving Ahead for Progress in the 21st Century Act" or "MAP-21," commonly known as the multi-year surface transportation reauthorization bill, which reduced ARRC's FTA formula funding by approximately 21% or $7.3 million.

On September 12, 2012, Fitch Ratings lowered the ratings assigned to the bonds to "BBB" from "A" and revised the outlook on the bonds to stable from negative. On September 28, 2012, Standard and Poor's Rating Service affirmed its "A+" underlying and unenhanced rating to the bonds and affirmed the stable outlook on the bonds. On November 14, 2012, Moody's Investors Service lowered the ratings assigned to the bonds to "A3" from "A2" and revised the outlook on the bonds from stable to negative. More detailed information about ARRC's bond-funded activities is presented in note 6 to the financial statements.

Next Year's Budget

The revised 2013 budgets for freight and passenger revenues are $88.0 million and $24.8 million, respectively. As a result, the ARRC's net position is expected to increase $4.9 million or 2% by the close of 2013.

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 website 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, 2012 and 2011, and 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, 2012 and 2011, and the changes in financial position and cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 1–8 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 28, 2013 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 28, 2013

STATEMENTS OF NET POSITION

December 31, 2012 and 2011

(In thousands)

Assets		2012	2011
Current assets:			
Cash and cash equivalents (note 3)	$	31,468	48,523
Accounts receivable, net of allowance for doubtful accounts of $275 in 2012 and $370 in 2011		18,251	19,039
Grants receivable		24,320	12,184
Materials and supplies		9,941	9,828
Prepaid expenses and other current assets		1,217	1,229
Under recovery of vehicle and equipment allocated costs (note 2(k))		—	416
Restricted assets (note 3)		19,663	19,879
Total current assets		104,860	111,098
Capital assets (notes 4 and 8):			
Land and improvements and quarry improvements (note 11)		34,538	33,833
Road materials and supplies		9,947	7,575
Road and roadway structures		869,263	839,892
Equipment (note 6)		304,639	294,549
Leasehold improvements (note 11)		1,650	1,650
Accumulated depreciation, depletion and amortization		(473,982)	(423,433)
Construction in progress		129,229	44,055
Total capital assets, net		875,284	798,121
Restricted assets (note 3)		992	12,131
Other assets		18	18
Regulatory asset:			
Postretirement benefits (note 7)		8,738	7,171
	$	989,892	928,539

Liabilities		2012	2011
Current liabilities:			
Current portion of notes payable (notes 5 and 6)	$	4,384	4,051
Accounts payable and accrued liabilities (notes 5 and 13)		19,396	21,568
Current portion of payable from restricted assets (note 5)		—	936
Environmental remediation reserve (notes 5 and 15)		397	801
Interest payable		2,460	2,672
Payroll liabilities		9,584	10,660
Over recovery of vehicle and equipment allocated costs (note 2(k))		357	—
Unearned revenues (note 11)		3,266	3,322
Current portion of revenue bonds payable (notes 5 and 6)		11,120	10,635
Total current liabilities		50,964	54,645
Notes payable, less current portion (notes 5 and 6)		19,049	24,328
Revenue bonds payable (net of unamortized premiums and deferred amounts), less current portion (notes 5 and 6)		113,144	124,426
Environmental remediation reserve (notes 5 and 15)		1,441	1,218
State of Alaska advances (notes 3 and 5)		167	173
Payable from restricted assets (note 5)		105	99
Accrued postretirement benefits (note 7)		849	1,685
Regulatory liabilities:			
Accrued pension benefits (note 7)		10,781	7,107
Deferred grant revenue (note 8)		537,736	469,598
Total liabilities		734,236	683,279
Net position (note 9):			
Investment in capital assets, net of related debt and deferred grant revenue (note 4)		189,852	175,546
Restricted for reinvestment in infrastructure (notes 2(a) and 2(l))		65,804	69,714
Total net position		255,656	245,260
Commitments and contingencies (notes 5, 7, 12, 13, and 15)			
	$	989,892	928,539

See accompanying notes to financial statements.

Years ended December 31, 2012 and 2011

(In thousands)

	2012	2011
Operating revenues:		
Freight (note 10)	$ 100,022	98,045
Passenger	24,027	22,382
Other	3,984	4,965
	128,033	125,392
Grant revenue (note 8)	40,443	39,892
	168,476	165,284
Operating expenses:		
Transportation	44,028	44,607
Passenger	10,661	9,832
Business development	20,853	18,925
Mechanical	26,182	24,920
Maintenance	36,318	34,761
Facilities	13,913	13,892
Engineering services	1,418	1,392
Signals	3,214	3,021
General and administrative, net of indirect cost recovery of $2,102 in 2012 and $2,123 in 2011	8,072	8,683
	164,659	160,033
Operating income	3,817	5,251
Nonoperating revenues (expenses):		
Real estate and facilities income, less direct expenses of $7,225 in 2012 and $8,309 in 2011 (notes 6 and 11)	10,073	8,246
Gain on sale of capital assets	—	1,391
Investment income	87	110
Interest expense, net of grant revenue of $3,833 in 2012 and $2,361 in 2011 (note 6)	(1,473)	(1,562)
Total nonoperating revenues	8,687	8,185
Net income (note 2(a))	12,504	13,436
Other change in net position:		
Change in pension and postretirement funding status (note 7)	(2,108)	(805)
Change in net position	10,396	12,631
Net position, beginning of year	245,260	232,629
Net position, end of year	$ 255,656	245,260

See accompanying notes to financial statements.

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STATEMENTS OF CASH FLOWS

Years ended December 31, 2012 and 2011

(In thousands)

		2012	2011
Cash flows from operating activities:			
Receipts from customers	$	128,821	127,926
Operating grants received		9,880	8,326
Payments to suppliers		(54,124)	(51,541)
Payments to employees		(65,110)	(58,663)
Net cash provided by operating activities		19,467	26,048
Cash flows from capital and related financing activities:			
Principal payments on long-term debt		(15,919)	(14,001)
Interest payments on long-term debt		(6,948)	(7,684)
Grant received for interest expense		3,098	2,201
Proceeds from long-term debt		—	4,600
Purchases and construction of capital assets		(126,571)	(78,444)
Proceeds from sales of capital assets		138	1,690
Increase in deferred revenues, net of advances		87,470	53,647
Net cash used by capital and related financing activities		(58,732)	(37,991)
Cash flows from investing activities:			
Real estate income and related cash flows		17,242	16,176
Real estate direct expenses paid		(5,608)	(5,625)
Purchase of restricted investments		(16,689)	(17,991)
Proceeds from sale of restricted investments		27,114	33,448
Interest received		151	970
Net cash provided by investing activities		22,210	26,978
Net (decrease) increase in cash and cash equivalents		(17,055)	15,035
Cash and cash equivalents at beginning of year		48,523	33,488
Cash and cash equivalents at end of year	$	31,468	48,523
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	3,817	5,251
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization		48,965	48,536
Bond issuance cost amortization		176	176
Grant revenue on capital assets		(30,739)	(31,742)
Changes in operating assets and liabilities:			
Materials and supplies		(113)	(605)
Accounts receivable		788	2,534
Prepaid expenses and other assets		12	(165)
Accounts payable and accrued liabilities		(2,118)	911
Over recovery of vehicle and equipment allocated costs		773	369
Payroll liabilities		(1,076)	1,097
Environmental reserve		(181)	(297)
Accrued postretirement and pension benefits		(837)	(17)
Net cash provided by operating activities	$	19,467	26,048
Supplemental schedule of noncash investing, capital and related financing activity:			
Depreciation included in real estate activity	$	1,617	2,684
Change in construction of capital assets not yet paid		54	7,473

See accompanying notes to financial statements.

December 31, 2012 and 2011

(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 manage the railroad's rail, industrial, port and other properties. The ARRC commenced operations on January 6, 1985.

The ARRC operates 685 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 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 and repurchase agreements with original maturities of three months or less.

(Continued)

December 31, 2012 and 2011

(c) Materials and Supplies

Materials and supplies inventories are carried at the lower of 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

Money market accounts, investments in commercial paper and U.S. Treasury notes are reported at cost. Guaranteed Investment Contracts are reported at amortized cost because they cannot be negotiated or transferred to a third party.

(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 revenues relating to depreciable capital assets funded with federal grants, and amortizes the deferred amounts over the life of the related capital assets. Additionally, ARRC records the funded status of its defined pension and postretirement plans as regulatory assets and liabilities.

(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 non-operating activities.

(h) Grants

Grants are recognized as earned when all eligibility requirements have been met; however, recognition of revenue for grants expended for depreciable capital assets is deferred and 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.

(Continued)

December 31, 2012 and 2011

(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 or under recovery of actual vehicle and equipment cost is applied against fixed charge rates in subsequent years. Accordingly, the ARRC has recorded an over recovery of $357,000 and an under recovery of $416,000 as of December 31, 2012 and 2011, respectively.

(l) Net Position

As of December 31, 2012 and 2011, the ARRC's board of directors has restricted $65,804,000 and $69,714,000, respectively, of net position for reinvestment in infrastructure.

(m) Reclassifications

Certain reclassifications not affecting net income have been made to the 2011 financial statements to conform to the current presentation.

(n) Recently Issued Accounting Pronouncements

In December 2010, the GASB issued GASB Statement 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (Statement 62). Statement 62 incorporated into the GASB's authoritative literature certain accounting and financial reporting guidance that was previously contained elsewhere. Statement 62 also eliminated the election for enterprise funds and business-type activities to apply post-November 30, 1989 standards of accounting and financial reporting issued by the Financial Accounting Standards Board (FASB). However, enterprise funds and business-type activities can continue to apply FASB pronouncements that do not conflict with or contradict GASB pronouncements as other accounting literature. The ARRC's adoption of Statement 62 during the year ended December 31, 2012 did not have a significant impact on the ARRC's financial statements.

In June 2011, the GASB issued GASB Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* (Statement 63). Statement 63 provided financial reporting guidance for deferred outflows of resources and deferred inflows of resources, and amended the net asset reporting requirements to rename that measure as net position. The ARRC's adoption of Statement 63 during the year ended December 31, 2012 did not have a significant impact on the ARRC's financial statements, other than to retitle what was previously known as "Fund Equity" as "Net Position."

In March 2012, the GASB issued GASB Statement 65, *Items Previously Reported as Assets and Liabilities* (Statement 65). Statement 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The new standard is effective for periods beginning after December 15, 2012. The ARRC is currently evaluating the impact that the adoption of Statement 65 will have on its financial statements.

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December 31, 2012 and 2011

In June 2012, the GASB issued GASB Statement 68, *Accounting and Financial Reporting for Pensions* (Statement 68), an amendment of GASB Statement No. 27. This Statement requires that an employer recognize its obligation for pensions net of the amount of the pensions plan's fiduciary net position that is available to satisfy that obligation as well as additional note disclosures regarding the obligation. The new standard is effective for financial statements for periods beginning after December 15, 2012. The ARRC is currently evaluating the impact that the adoption of Statement 68 will have on its financial statements.

(3) Deposits and Investments

The carrying values of investments consist of the following at December 31, 2012 and 2011:

Investment type		2012	2011
		(in thousands)	
Commercial paper	$	—	1,016
Guaranteed investment contract		—	10,418
Total investments		—	11,434
Money market		20,655	20,576
Total	$	20,655	32,010

These assets are restricted by the terms of grant or other agreements or by the ARRC's board of directors and are summarized as follows at December 31, 2012 and 2011:

Description of restriction		2012	2011
		(in thousands)	
Capital assets as authorized by the Department of Natural Resources	$	173	177
Advance grant funding		460	461
Projects authorized by bond agreements		—	10,463
Debt service reserve		19,663	19,879
Arbitrage rebate reserve		104	—
Debt service reserve 2012A and 2012B		255	—
Forward sale agreement 2006A and 2006B		—	1,030
	$	20,655	32,010

(Continued)

December 31, 2012 and 2011

Deposits and investments are reported on the statements of net position as follows at December 31, 2012 and 2011:

		2012	2011
		(in thousands)	
Restricted assets – current	$	19,663	19,879
Restricted assets – long-term		992	12,131
	$	20,655	32,010

(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, 2012, the ARRC's carrying amount of cash and cash equivalents was $31,468,000 and the bank balance was $32,575,000. Of the bank balance, $250,000 was covered by federal depository insurance, and $30,320,000 represents money market funds held by the ARRC's agent in the ARRC's name.

At December 31, 2011, the ARRC's carrying amount of cash and cash equivalents was $48,523,000 and the bank balance was $49,347,000. Of the bank balance, $4,079,000 was covered by federal depository insurance, and $45,518,000 represents money market funds held by the ARRC's agent in the ARRC's name.

(b) Interest Rate Risk

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

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.

(d) Concentration of Credit Risk

The ARRC Investment Policy places no limit on the amount the ARRC may invest in any one issuer.

(Continued)

December 31, 2012 and 2011

(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, 2012 and 2011.

(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 Authority (FTA) Circular 5010.1C, ARRC will continue to update its indirect cost rate proposal but will retain it onsite and make it available for review during its annual financial audit. This agreement allows ARRC to allocate certain general and administrative expenses to grant projects. Indirect costs allocated to capital projects under this agreement totaled $2,102,000 and $2,123,000 during the years ended December 31, 2012 and 2011, respectively.

(Continued)

December 31, 2012 and 2011

The following tables summarize activity in the capital assets accounts during the years ended December 31, 2012 and 2011:

	Balance at December 31, 2011	Increases	Decreases	Balance at December 31, 2012
		(in thousands)		
Capital assets not being depreciated:				
Land and improvements	$ 29,719	705	—	30,424
Road materials and supplies	7,575	9,204	(6,832)	9,947
Construction in progress	44,055	125,554	(40,380)	129,229
Total capital assets not being depreciated	81,349	135,463	(47,212)	169,600
Capital assets being depreciated:				
Road and roadway structures	839,892	29,371	—	869,263
Equipment	294,549	10,303	(213)	304,639
Leasehold improvements	1,650	—	—	1,650
Total capital assets being depreciated	1,136,091	39,674	(213)	1,175,552
Capital assets being depleted:				
Quarry improvements	4,114	—	—	4,114
Less accumulated depreciation for:				
Road and roadway structures	273,192	34,207	—	307,399
Equipment	148,403	16,246	(174)	164,475
Leasehold improvements	1,399	129	—	1,528
Total accumulated depreciation	422,994	50,582	(174)	473,402
Less accumulated depletion for:				
Quarry improvements	439	141	—	580
Capital assets being depreciated and depleted, net	716,772	(11,049)	(39)	705,684
Net capital assets	$ 798,121	124,414	(47,251)	875,284

(Continued)

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December 31, 2012 and 2011

		Balance at December 31, 2010	Increases	Decreases	Balance at December 31, 2011
			(in thousands)		
Capital assets not being depreciated:					
Land and improvements	$	29,288	433	(2)	29,719
Road materials and supplies		6,684	19,821	(18,930)	7,575
Construction in progress		15,566	87,873	(59,384)	44,055
Total capital assets not being depreciated		51,538	108,127	(78,316)	81,349
Capital assets being depreciated:					
Road and roadway structures		797,677	42,215	–	839,892
Equipment		279,317	16,736	(1,504)	294,549
Leasehold improvements		1,650	—	–	1,650
Total capital assets being depreciated		1,078,644	58,951	(1,504)	1,136,091
Capital assets being depleted:					
Quarry improvements		4,114	—	–	4,114
Less accumulated depreciation for:					
Road and roadway structures		238,801	34,391	–	273,192
Equipment		132,945	16,665	(1,207)	148,403
Leasehold improvements		1,235	164	–	1,399
Total accumulated depreciation		372,981	51,220	(1,207)	422,994
Less accumulated depletion for:					
Quarry improvements		313	126	–	439
Capital assets being depreciated and depleted, net		709,464	7,605	(297)	716,772
Net capital assets	$	761,002	115,732	(78,613)	798,121

(Continued)

December 31, 2012 and 2011

Depreciation was charged to the following departments during the years ended December 31, 2012 and 2011:

	2012		2011	
	Grant funded depreciation	**Nongrant funded depreciation**	**Grant funded depreciation**	**Nongrant funded depreciation**
	(in thousands)			
Transportation	$ 2,811	725	3,399	830
Passenger	796	564	880	537
Business development	118	1,010	118	1,331
Mechanical	3,376	6,278	3,299	5,615
Maintenance	18,329	5,637	17,639	5,737
Facilities	3,570	1,734	3,529	1,423
Engineering services	29	28	2	18
Signals	1,078	252	1,079	267
General and administrative	397	2,233	472	2,361
Real estate and facilities	235	1,382	1,325	1,359
	$ 30,739	19,843	31,742	19,478

Net position invested in capital assets, net of related debt and deferred grant revenue is as follows at December 31, 2012 and 2011:

	2012	2011
	(in thousands)	
Net capital assets (note 4)	$ 875,284	798,121
Notes payable (note 6)	(23,432)	(28,379)
Outstanding balance of revenue bonds, less unexpended bond proceeds (note 6)	(124,264)	(124,598)
Deferred grant revenue (note 8)	(537,736)	(469,598)
	$ 189,852	175,546

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December 31, 2012 and 2011

(5) Long-Term Liabilities

Long-term liability activity is summarized as follows during the years ended December 31, 2012 and 2011:

	Balance at December 31, 2011	Additions	Reductions	Balance at December 31, 2012	Due within one year
			(in thousands)		
Long-term debt:					
Notes payable	$ 28,379	—	(4,946)	23,433	4,384
Revenue bonds payable	131,560	—	(10,635)	120,925	11,120
Plus (less) deferred amounts:					
Issuance of premiums	5,199	—	(339)	4,860	—
Unamortized issuance costs	(1,697)	—	176	(1,521)	—
Total revenue bonds payable	135,062	—	(10,798)	124,264	11,120
Environmental remediation reserve	2,019	1,390	(1,571)	1,838	397
Other claims	346	120	(226)	240	240
State of Alaska advances	173	—	(6)	167	—
Payable from restricted assets	1,036	—	(931)	105	—
Total long-term liabilities	$ 167,015	1,510	(18,478)	150,047	16,141

	Balance at December 31, 2010	Additions	Reductions	Balance at December 31, 2011	Due within one year
			(in thousands)		
Long-term debt:					
Notes payable	$ 27,337	4,600	(3,558)	28,379	4,051
Revenue bonds payable	141,755	—	(10,195)	131,560	10,635
Plus (less) deferred amounts:					
Issuance of premiums	5,447	—	(248)	5,199	—
Unamortized issuance costs	(1,874)	—	177	(1,697)	—
Total revenue bonds payable	145,328	—	(10,266)	135,062	10,635
Environmental remediation reserve	2,316	653	(950)	2,019	801
Other claims	150	201	(5)	346	346
State of Alaska advances	177	—	(4)	173	—
Payable from restricted assets	757	279	—	1,036	936
Total long-term liabilities	$ 176,065	5,733	(14,783)	167,015	16,769

The ARRC has arrangements for three short-term unsecured lines of credit. The general purpose lines of credit allow borrowing up to $20,000,000 at a rate of 68% of London Interbank Offered Rate (LIBOR) plus 2.25%. The self-insurance line of credit allows borrowing up to $10,000,000 at a rate of 68% of LIBOR plus 2.25%. On September 19, 2012, an irrevocable letter of credit in the amount of $430,800 was issued. None of the lines of credit had an outstanding balance at December 31, 2012 or 2011.

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December 31, 2012 and 2011

(6) Long-Term Debt

Long-term debt at December 31, 2012 and 2011 consists of the following:

		2012	2011
		(in thousands)	
Notes payable:			
Note payable, secured by equipment, due in monthly payments of $285,842 including interest at 3.73%, matures March 2019	$	10,852	13,817
Note payable, secured by equipment, due in monthly payments of $60,553 including interest at 2.89%, matures July 2018		3,743	4,351
Note payable, secured by real estate revenue, due in monthly payments of $36,211, including interest at 3.95%, matures June 2026		3,776	—
Note payable, secured by real estate revenue, due in monthly payments of $48,539, including interest at 3.95%, matures June 2026		5,062	—
Note payable, secured by real estate revenue, due in monthly payments of $36,211, including interest at 5.40%, matures June 2026		—	4,363
Note payable, secured by real estate revenue, due in monthly payments of $48,539, including interest at 5.40%, matures June 2026		—	5,848
		23,433	28,379
Less current portion		4,384	4,051
	$	19,049	24,328
Revenue bonds:			
Revenue Bonds – Series 2006 and 2007, interest at 3.625% – 5.25% payable semi annually February 1 and August 1, secured by 5307 and 5309 FTA Formula Funds, matures August 2021	$	124,264	135,061
Less current portion		11,120	10,635
	$	113,144	124,426

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Annual payments on debt are scheduled as follows at December 31, 2012:

		Notes payable		Revenue bonds payable		
		Principal	Interest	Principal (in thousands)	Interest	Total
Year ending December 31:						
2013	$	4,384	789	11,120	5,820	22,113
2014		2,992	648	11,620	5,319	20,579
2015		2,757	550	12,095	4,841	20,243
2016		2,858	449	12,680	4,257	20,244
2017		2,962	345	13,305	3,635	20,247
2018 – 2022		6,815	648	60,105	7,648	75,216
2023 – 2027		665	10	—	—	675
		23,433	3,439	120,925	31,520	179,317
Current portion of principal		(4,384)		(11,120)		(15,504)
Unamortized premium		—		4,860		4,860
Unamortized issuance cost		—		(1,521)		(1,521)
Total long-term portion	$	19,049		113,144		167,152

Federal Transit Program – Corporation Participation in Section 5307 Formula Program and Section 5309 Formula Program

In July 2006, Standard & Poor's Ratings Services and Fitch Ratings assigned "A+" and "A" ratings, respectively, to the approximately $76.4 million of Capital Grant Receipts Bonds, Series 2006 (FTA Section 5307 Urbanized Area Formula Funds and Section 5309 Fixed Guideway Modernization Formula Funds). These ratings were used to determine the ARRC's financial strength for the bond issuance insured under a policy issued by Financial Guaranty Insurance Company. Bond issuance costs of $1.4 million and bond premium of $3.4 million will be amortized over the life of the bonds.

In August 2007, Standard & Poor's Ratings Services, Fitch Ratings, and Moody's Investor Services assigned "A+", "A" and "A1" ratings to the approximately $88.6 million of Capital Grant Receipts Bonds, Series 2007 (FTA Section 5307 Urbanized Area Formula Funds and Section 5309 Fixed Guideway Modernization Formula Funds). These ratings were used to determine the ARRC's financial strength for the bond issuance insured under a policy issued by Financial Guaranty Insurance Company (FGIC). Bond issuance costs of $1.2 million and bond premium of $2.4 million will be amortized over the life of the bonds.

On April 16, 2010, Moody's Investors Service raised its underlying unenhanced rating assigned to ARRC's Capital Grant Receipts Bonds to "Aa3" as a result of the recalibration by Moody's Investors Service of its municipal rating scale to align it with the scales used by Moody's Investors Service in assessing the creditworthiness of other types of issuers. On September 12, 2011, Moody's Investors Service lowered its underlying unenhanced rating assigned to ARRC's Capital Grant Receipts Bonds to "A1" with a stable outlook as a result of a reassessment of such bonds in comparison with similar bonds to which Federal Transit Administration grants are pledged and the relatively low additional bonds test applicable to ARRC's Capital Grant Receipts Bonds. Moody's Investors Service no longer rates FGIC. On

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December 31, 2012 and 2011

September 30, 2008, FGIC entered into a Reinsurance Agreement with MBIA Insurance Corporation (Reinsurance Agreement) pursuant to which certain of FGIC's policyholders may receive the benefit of MBIA's reinsurance by presenting claims directly to MBIA under their FGIC-issued policies. ARRC's Capital Grant Receipts Bonds are included in the list of bonds covered by the Reinsurance Agreement. Based on the Reinsurance Agreement, Moody's Investors Service assigned an enhanced rating of "Aa3" to ARRC's Capital Grant Receipts Bonds.

Fitch Ratings no longer rates FGIC and, accordingly, has assigned only an underlying, unenhanced rating to ARRC's Capital Grant Receipts Bonds. Fitch Ratings affirmed an "A" rating and stable outlook on ARRC's Capital Grant Receipts Bonds in September 2010. In March 2011, Fitch Ratings changed the outlook on all grant receipts bonds payable solely from and secured solely by Federal Transit Administration formula funds, including ARRC's Capital Grant Receipts Bonds, from stable to negative, citing growing uncertainty in federal transportation policy, less predictable funding levels and a pending expiration of a majority of federal motor fuel taxes. Fitch Ratings affirmed this negative outlook on March 6, 2012.

On July 6, 2012, the President signed into law Public Law 112-141, titled "Moving Ahead for Progress in the 21st Century Act" or "MAP-21", commonly known as the multi-year surface transportation reauthorization bill, which reduced ARRC's FTA formula funding by approximately 21% or $7.3 million.

On September 12, 2012, Fitch Ratings lowered the ratings assigned to the bonds to "BBB" from "A" and revised the outlook on the bonds to stable from negative. On September 28, 2012, Standard and Poor's Rating Service affirmed its "A+" underlying and unenhanced rating to the bonds and affirmed the stable outlook on the bonds. On November 14, 2012, Moody's Investors Service lowered the ratings assigned to the bonds to "A3" from "A2" and revised the outlook on the bonds from stable to negative.

The following table sets forth the authorized funding allocation of the Federal Transit Administration (FTA) Section 5307 Formula Program Funds and Section 5309 or 5337 Formula Program Funds to ARRC in Federal Fiscal Years (FFY) 2012 and 2013:

FFY		Section 5307 formula program	Section 5309 or Section 5337 formula program	Total
			(in thousands)	
2012	$	18,064,178	16,405,108	34,469,286
2013*		9,350,908	17,775,452	27,126,360

*FFY 2013 estimates are reasonable estimates based on formula programs contained in the Moving Ahead for Progress in the 21st Century Act, 2012 (Public Law 112-141).

The ARRC expended $5.0 million during 2012 and $23.1 million during 2011 of the bond proceeds on eligible capital costs related to the capital improvement program.

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The following table sets forth the interest capitalized during the years ended December 31, 2012 and 2011:

		2012	2011
		(in thousands)	
Interest expense	$	1,430	3,581
Less interest income		64	860
Interest capitalized	$	1,366	2,721

Section 509 of the Trust Indenture requires five year arbitrage certificates to be filed with the trustee for the Capital Grant Receipts Bonds, Series 2006 and Series 2007, as of December 31, 2011 and December 31, 2012, respectively. There was no rebate amount due on the Series 2006, as of December 31, 2012. The Series 2007 rebate of $936,000 was paid in February 2012.

State of Alaska Authorizations

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 have been issued with a premium of $5.8 million.

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.

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

The ARRC's board of directors has established a method of accounting for pension and postretirement cost, which is designed to recover the full costs of these benefits. As a result, the unfunded or overfunded actuarial accrued liabilities associated with these benefits are reported as regulatory assets or liabilities in the statements of net position. Periodic benefit costs related to these plans are included in operating expenses and capital additions. Pension costs and accrued benefits under the defined benefit pension and postretirement plans (Plans) are calculated under the provisions of GASB Statements No. 27, *Accounting for Pensions by State and Local Government Employers*, and No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

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The overfunded actuarial accrued liability of the postretirement plan, which is the difference between the actuarial value of the assets and the actuarial accrued liability of the plans, is reported as a regulatory asset of $8,738,000 and $7,171,000 at December 31, 2012 and 2011, respectively. The unfunded actuarial accrued liability of the pension plan, is reported as a regulatory liability of $10,781,000 and $7,107,000 at December 31, 2012 and 2011, respectively. The change in pension and postretirement funding status presented as other changes in net position of a decrease of $2,108,000 and $805,000 in 2012 and 2011, respectively, represents the change in the unfunded actuarial accrued liability for both plans.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

(a) Alaska Railroad Corporation Pension Plan

The ARRC has a defined benefit pension plan (Plan) covering all regular represented and non-represented employees who are not covered by the Civil Service Retirement System. 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 amount equal to the annual required contribution (ARC). Employees contribute an amount equal to 9% of eligible compensation. Contributions are made continuously throughout the year. Plan assets consist of fixed income securities, common stocks, real estate investment trusts, and real estate separate accounts.

Assumptions used to determine annual pension cost (APC) and related information for the years ended December 31, 2012 and 2011 are as follows:

	2012	2011
Actuarial assumptions compounded annually:		
Inflation rate	2.80%	2.80%
Discount rate	7.50	7.50
Investment return for funding purposes	7.50	7.50
Expected investment return	7.50	7.50
Investment return on employee accounts	4.50	4.50
Projected salary increase	4.00	4.00
Cost of living allowance	1.40	1.40

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December 31, 2012 and 2011

All valuations are as of January 1st of each year. The actuarial cost method used was the projected unit credit. The unfunded actuarial accrued liability is amortized over an open 30-year period as a level dollar amount.

The following table presents activity of the Plan's assets during the years ended December 31, 2012 and 2011:

		2012	2011
		(in thousands)	
Income:			
Contributions received:			
Employee	$	4,172	3,965
Employer		3,647	3,014
Investment earnings		14,440	241
Total income		22,259	7,220
Disbursements:			
Benefit payments	$	3,107	2,639
Administrative and investment consulting expenses		356	441
Total disbursements		3,463	3,080
Net income		18,796	4,140
Fair value of assets at beginning of year		93,164	89,024
Fair value of assets at end of year	$	111,960	93,164

(Continued)

December 31, 2012 and 2011

The following table reconciles the Plan's fair value of the assets to the actuarial value of the assets based on valuation dates of January 1st of each year and presents the funding status at December 31, 2012, 2011 and 2010:

		2012	2011 (in thousands)	2010
Fair value of assets at end of year	$	111,960	93,164	89,024
Unamortized actuarial (gains) losses		(5,376)	3,860	588
Actuarial value of assets at the end of year		106,584	97,024	89,612
Actuarial accrued liability (AAL)		117,365	104,131	92,545
Unfunded AAL (UAAL)	$	10,781	7,107	2,933
Funded ratio (actuarial value of plan assets/AAL)		90.8%	93.2%	96.8%
Covered payroll (active plan members)	$	48,134	43,773	45,048
UAAL as a percentage of covered payroll		22.4%	16.2%	6.5%

The ARC of $3,647,000 and $3,014,000 and the associated expenses of $3,082,000 and $2,434,000 were included in the accompanying financial statements for the years ended December 31, 2012 and 2011, respectively. The ARRC's APC, which is the periodic cost of the plan, the percentage of APC contributed to the plan, and the net pension obligation for 2012 and the two preceding years were as follows:

		2012	2011 (in thousands)	2010
Annual pension cost	$	3,647	3,014	2,254
Contributed		100%	100%	100%
Net pension obligation	$	—	—	—

(b) Alaska Railroad Postretirement Health Care Trust

The ARRC sponsors a retiree health care plan (Plan) that 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 contributions adjusted annually, and contains other cost-sharing features such as deductibles and coinsurance.

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December 31, 2012 and 2011

Assumptions used to determine annual postemployment benefit cost and related information for the years ended December 31, 2012 and 2011 are as follows:

	2012	2011
Discount rate	7.50%	7.50%
Investment return for funding purposes	7.50	7.50
Expected investment return	7.50	7.50
Health cost trend (grading down):		
Medical	8.9 to 4.5	9.4 to 4.5
Prescription	8.9 to 4.5	9.4 to 4.5

All valuations are as of January 1st of each year. The actuarial cost method used was the projected unit credit. Beginning on January 1, 2012 the unfunded actuarial accrued liability is amortized over an open 6-year period as a level dollar amount. Previously the unfunded accrued liability was amortized over an open 30-year period as a level dollar amount.

The ARRC has incorporated the impact of the Patient Protection and Affordable Care Act (PPACA) or "Health Care Reform," as currently enacted, in calculating its actuarial accrued liability.

The following table represents activity of the Plan's assets during the years ended December 31, 2012 and 2011:

		2012	2011
		(in thousands)	
Income:			
Contributions received – employer	$	20	1,665
Investment earnings		4,997	(157)
Total income		5,017	1,508
Disbursements:			
Benefit payments		217	363
Administrative and investment consulting expenses		82	57
Total disbursements		299	420
Net income		4,718	1,088
Fair value of assets at beginning of year		32,583	31,495
Fair value of assets at the end of year	$	37,301	32,583

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December 31, 2012 and 2011

The following table reconciles the Plan's fair value of the assets to the actuarial value of the assets based on valuation dates of January 1st of each year and presents the funding status at December 31, 2012, 2011 and 2010:

		2012	2011 (in thousands)	2010
Fair value of assets at end of year	$	37,301	32,583	31,495
Unamortized actuarial (gains) losses		(1,847)	1,078	(580)
Actuarial value of assets at the end of year		35,454	33,661	30,915
Actuarial accrued liability (AAL)		26,716	26,490	27,113
Unfunded (overfunded) AAL	$	(8,738)	(7,171)	(3,802)
Funded ratio (actuarial value of plan assets/AAL)		132.7%	127.1%	114.0%
Covered payroll (active plan members)	$	48,134	43,773	45,048
UAAL as a percentage of covered payroll		(18.2)%	(16.4)%	(8.4)%

The following table shows the components of the ARRC's net other postemployment benefit (OPEB) cost for the year, the amount actually contributed to the plan (including a $603,000 prepayment made during 2012), changes in the ARRC's net OPEB obligation to the plan, and the percentage of annual OPEB cost contributed to the plan during the years ended December 31, 2012, 2011, and 2010:

		2012	2011 (in thousands)	2010
Annual required contribution (ARC)	$	20	1,665	2,099
Interest on net OPEB obligation		126	128	129
Adjustment to the ARC		(359)	(145)	(145)
Annual OPEB cost		(213)	1,648	2,083
Contributions made		(623)	(1,665)	(2,099)
Increase (decrease) in the net OPEB obligation		(836)	(17)	(16)
Net OPEB obligation at beginning of year		1,685	1,702	1,718
Net OPEB obligation at the end of year	$	849	1,685	1,702
Annual OPEB cost contributed		(9.0)%	101.0%	101.0%

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(c) ***Civil Service Retirement System (CSRS)***

Federal employees who transferred to the ARRC continue to participate in the CSRS, a multi-employer defined benefit plan. ARRC is required to contribute 7% of the transferred employees' eligible compensation. Benefit expense related to CSRS was $152,000 and $179,000 for the years ended December 31, 2012 and 2011, 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, representing 55% 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 $558,000 and $537,000 for the years ended December 31, 2012 and 2011, respectively.

(e) ***Alaska Railroad Corporation 457 Deferred Compensation Plan***

ARRC sponsors a Section 457 deferred compensation plan under Section 457(b) of the IRC for non-represented employees. There are no benefit expenses related to the Plan for the years ended December 31, 2012 and 2011.

(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, 2012 and 2011 consists of the following:

			2012	2011
			(in thousands)	
Land and improvements		$	8,140	7,938
Road and roadway structures	15 – 32 year life		489,403	482,280
Equipment	5 – 25 year life		106,783	104,380
Construction in process			108,820	28,492
		$	713,146	623,090

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The original cost of assets constructed or acquired with Capital Grant Receipts Bonds, Series 2006 and 2007 funding at December 31, 2012 and 2011 consists of the following:

		2012	2011
		(in thousands)	
Road and roadway structures	15 – 32 year life	$ 163,776	149,462
Equipment	5 – 25 year life	18,960	18,960
Construction in process		—	9,332
		$ 182,736	177,754

(9) Net Position

Net position consists of the following major items as of December 31, 2012 and 2011:

	Investment by the State of Alaska	Cumulative net income	Cumulative other changes in net position	Total net position
		(in thousands)		
Balance at January 1, 2011	$ 34,174	197,584	871	232,629
Net income	—	13,436	—	13,436
Other changes in net position	—	—	(805)	(805)
Total changes in net position				12,631
Balance at December 31, 2011	34,174	211,020	66	245,260
Net income	—	12,504	—	12,504
Other changes in net position	—	—	(2,108)	(2,108)
Total changes in net postion				10,396
Balance at December 31, 2012	$ 34,174	223,524	(2,042)	255,656

(10) Concentrations

Two ARRC customers accounted for 38% and 41% of freight revenue in 2012 and 2011, respectively. During 2012 and 2011, ARRC entered into agreements with one of the customers under the Internal Revenue Code §45G. Under the agreements, ARRC received $4.8 million for qualified track maintenance expenses and gave the customer a shipping credit of $2.7 million in 2012 and 2011. The qualified track maintenance expenses and the shipping credit 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 57% and 46% of capital expenditures in 2012 and 2011, respectively.

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(11) 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 $14,132,000 and $12,751,000 in 2012 and 2011, respectively. The following table summarizes future minimum lease payments as of December 31, 2012:

		Amount (in thousands)
Year ending December 31:		
2013	$	12,756
2014		12,084
2015		11,501
2016		11,277
2017		11,239
Thereafter		142,769
	$	201,626

(12) 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 $10,152,000 and $10,076,000 in 2012 and 2011, respectively. Future minimum lease payments as of December 31, 2012 are summarized as follows:

		Amount (in thousands)
Year ending December 31:		
2013	$	9,648
2014		8,659
2015		8,492
2016		1,413
2017		135
Thereafter		53
	$	28,400

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(13) 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. 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, 2012 and 2011:

		2012	2011
		(in thousands)	
Casualty/liability	$	75,000	75,000
Property damage		65,000	65,000
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, 2012, 2011, and 2010:

		Balance at December 31, 2011	Incurred claims	Claim payments	Balance at December 31, 2012
			(in thousands)		
Employee health benefits	$	1,330	11,292	(11,255)	1,367
Workers' compensation		1,599	2,025	(1,933)	1,691
	$	2,929	13,317	(13,188)	3,058

		Balance at December 31, 2010	Incurred claims	Claim payments	Balance at December 31, 2011
			(in thousands)		
Employee health benefits	$	2,068	9,299	(10,037)	1,330
Workers' compensation		1,867	1,734	(2,002)	1,599
	$	3,935	11,033	(12,039)	2,929

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		Balance at December 31, 2009	Incurred claims	Claim payments	Balance at December 31, 2010
			(in thousands)		
Employee health benefits	$	1,995	10,414	(10,341)	2,068
Workers' compensation		1,575	1,714	(1,422)	1,867
	$	3,570	12,128	(11,763)	3,935

(14) 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.

(15) Commitments and Contingencies

Approximately 76% of the ARRC's labor force is subject to one of five collective bargaining agreements. The representative unions are United Transportation Union, International Brotherhood of Teamsters Local 959, American Train Dispatchers Association, Carmen's Division of Transportation Communication International Union and the Alaska Railroad Workers. The labor agreement with the ARW will expire October 2013. All other labor agreements expire in 2014 or later.

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.

(Continued)

ALASKA RAILROAD CORPORATION

Mailing Address: P.O. Box 107500, Anchorage, Alaska 99510-7500

OFFICES	PHYSICAL ADDRESS	TELEPHONE	FAX
Anchorage, Alaska			
Headquarters Offices	327 W. Ship Creek Avenue	(907) 265-2300	(907) 265-2312
Reservations and Information	411 W. 1st Avenue	(907) 265-2494	(907) 265-2509
Anchorage Operations Center	825 Whitney Road	(907) 265-2434	(907) 265-2643
Fairbanks, Alaska			
Passenger Depot	1745 Johansen Expressway	(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			
913 Port Avenue, P.O. Box 95, Seward, Alaska 99664		(907) 224-5550	(907) 265-2660
Seattle, Washington			
5615 W. Marginal Way S.W., Seattle, Washington 98106		(206) 767-1100	(206) 767-1112
Toll-free Numbers			
Corporate Information		1-800-321-6518	
Freight Marketing/Customer Service		1-800-321-6518	
Passenger Service		1-800-544-0552	
Seattle Office		1-800-843-2772	

The Alaska Railroad Corporation has not received any bona-fide offers of a sale arrangement within the calendar year of 2012, nor is the Corporation aware of any potential sales that require analysis under AS 42.40.260.

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