ALASKA RAILROAD CORPORATION

ANNUAL REPORT

2014

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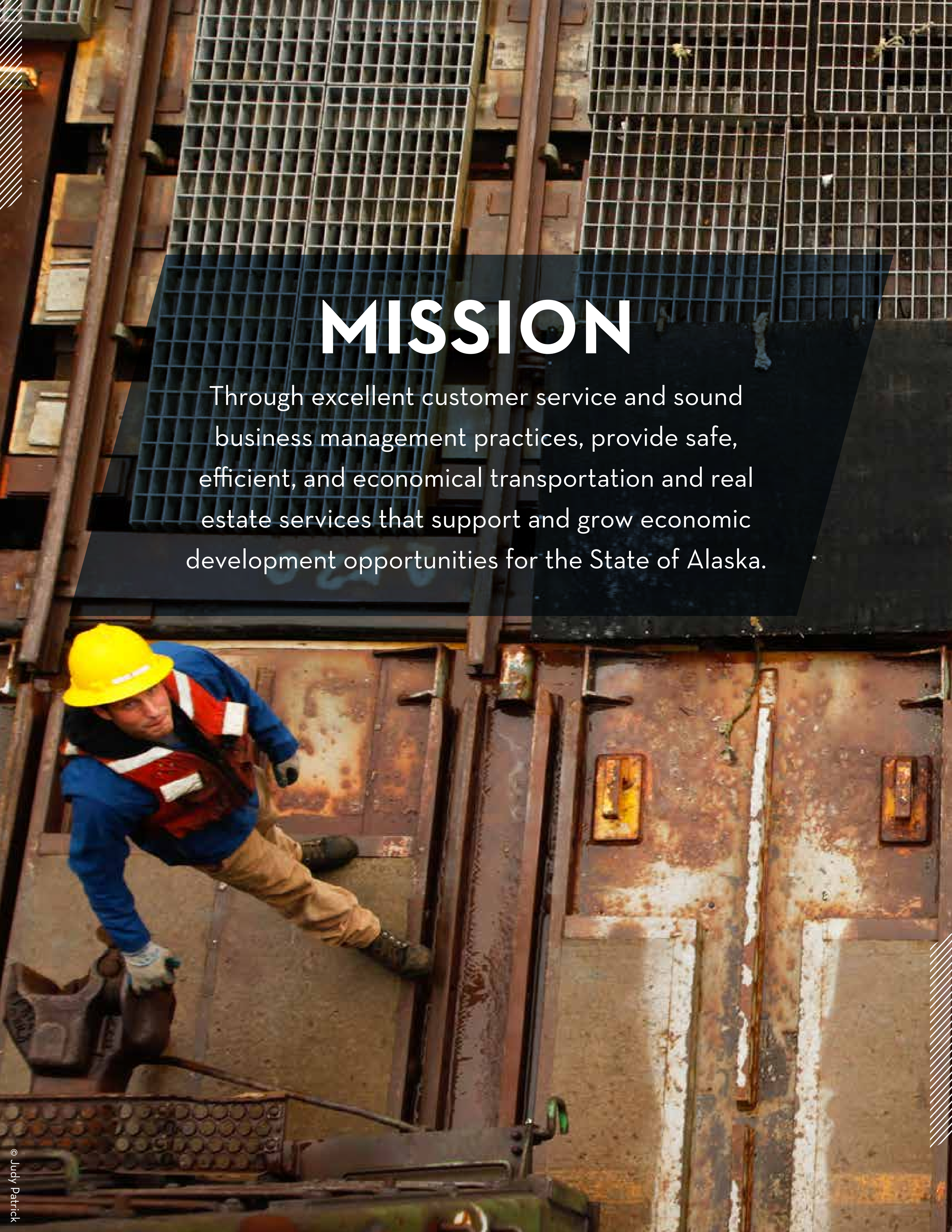
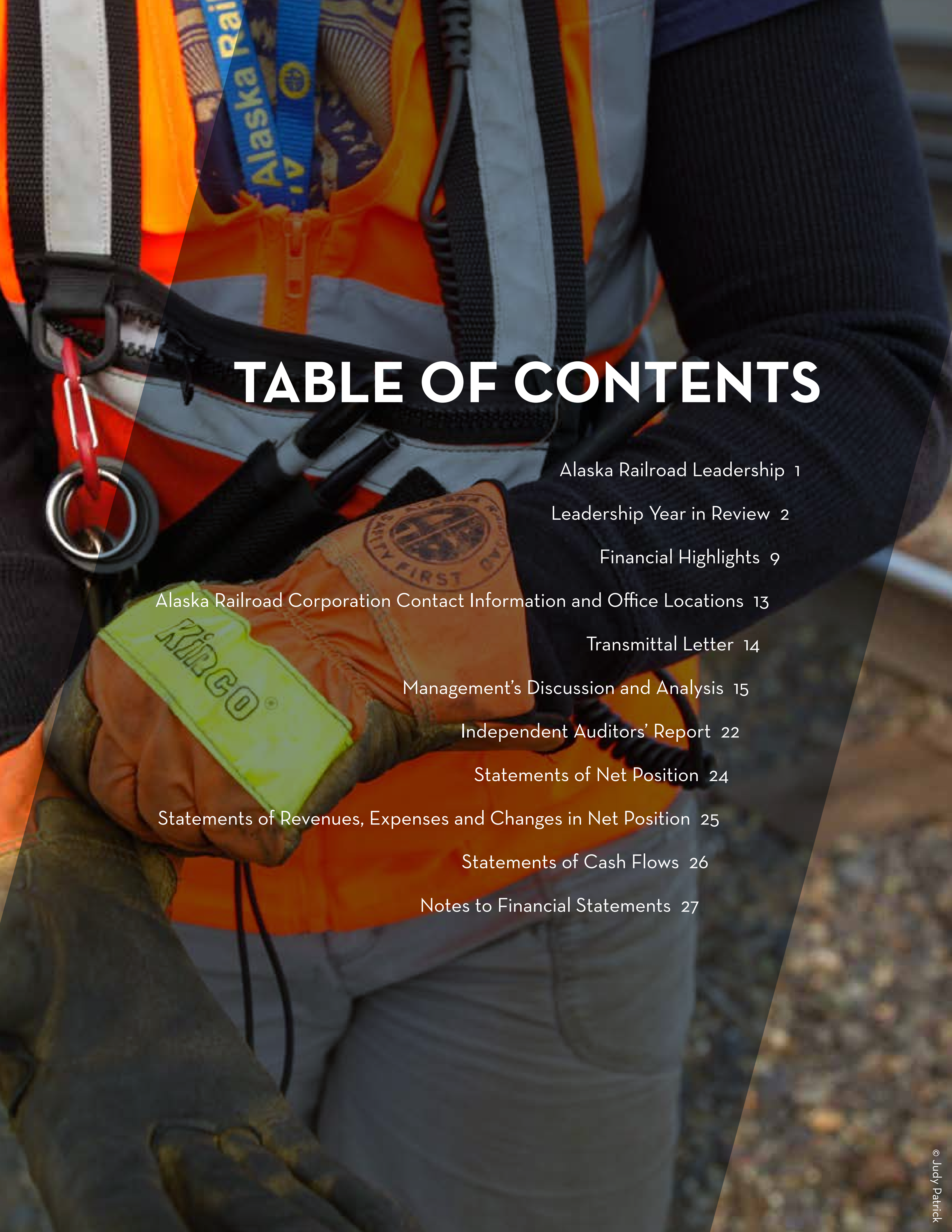
ALASKA

RAILROAD

MISSION

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





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ALASKA RAILROAD LEADERSHIP

Bill O'Leary
President & CEO

MANAGEMENT TEAM

Doug Engebretson
Chief Operating Officer

Barbara Amy
Chief Financial Officer

Clark Hopp, VP
Engineering & Maintenance

Bill Hupprich, VP
General Counsel & Legal

Jim Kubitz, VP
Corporate Planning & Real Estate

Wendy Lindskoog, VP
Business Management & Corporate Affairs

James Ratchford
Chief Information Officer

Eileen Reilly, VP
Advanced Train Control Systems

Dale Wade, VP
Marketing & Customer Service

BOARD OF DIRECTORS

Linda Leary
Board Chair

Bill Sheffield
Vice Chair

Susan Bell
Commissioner

John Binkley
Director

Jack Burton
Director

Jon Cook
Director

Pat Kemp
Commissioner

2014 LEADERSHIP YEAR IN REVIEW

SEEKING SURER FOOTING IN AN ERA OF SHIFTING SANDS

As 2014 began, the Alaska Railroad's revenue projections were grim with the North Pole Refinery's imminent closure topping the list of potentially devastating "shifting sands." Yet we gained surer footing through planning, regrouping and adapting to conclude the year with a $14.1 million net income that exceeded the original budget by $5.5 million. That strong outcome began with deliberate planning and pursuit of strategies to expand and diversify business revenue, curb costs, optimize scarce capital dollars, foster our safety culture with engaged employees and enhance our economic role in Alaska's communities. These strategies remain just as important to weathering significant uncertainty in 2015, when the Railroad faces a full year's impact from the refinery closure, as well as deflated coal and oil prices.

STRATEGY 1: GROW AND DIVERSIFY REVENUE

When the refinery closed mid-year and later retrofitted as a fuel distribution facility, southbound fuel traffic stopped, and some northbound fuel traffic picked up. All told, fuel volumes are about a fifth of the peak petroleum volumes hauled a decade ago, yet petroleum is still important to the Railroad. Reinvigorated North Slope oilfield exploration has spurred a significant up-tick in our rail-barge business (Seattle and Prince Rupert to Whittier) since 2010. Most (85-90%) of the freight hauled via Alaska Rail Marine System is oil-and-gas related. The growth in pipe volumes tells the story. In 2012, the Railroad hauled 24,350 tons of pipe; in 2013 ARRC hauled 33,150 tons; and in 2014, we hauled 39,905 tons — that's a 64% increase in tonnage from 2012 to 2014.

Railroad adaptability helped the trailers/containers on flat cars (TOFC/COFC) business emerge as another bright spot. In 2014, TOFC volumes climbed 10% to a record-breaking 9,760 trailers, while reducing expense by 11% and dramatically improving customer service. The win-win-win came by way of Railroad teamwork and listening carefully to customer input. Railroad modifications boosted on-time train performance from 49% in 2013 to 84% in 2014. TOFC customers rewarded the greater reliability by sending more business our way.

STRATEGY 1: GROW AND DIVERSIFY REVENUE

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CONTINUED...

Shifts in our passenger business were similarly customer-centric. We adapted multiple services to meet the needs and expectations of Alaskan patrons in particular. First, ARRC introduced mid-week *Aurora Winter Train* service during the two-week Spring Break. Hundreds took advantage of discounted fares for Tuesday-Wednesday travel between Anchorage and Fairbanks. The mid-March mid-week service was so well-received, it was expanded to nearly a month in 2015.

Thousands of Alaskans happily rode the fair train between Anchorage and the Palmer State Fairgrounds in late summer. Compared to 2013, the 2014 service more than quadrupled capacity with longer trains, more daily round-trips and more days of service. Green Star helped secure six sponsors, which made the $12 fare feasible... and popular. Every fair train sold out.

The *Hurricane Turn* also experienced a banner year with several sold-out days. The flag stop service attracts a loyal following among patrons who live and recreate along the remote stretch, including 50-year customers Clyde and Mary Lovel, who moved to a home along the route in September 1964. In September 2014, the Railroad honored the Lovels with a small celebration at their homestead.

The Railroad also answered the call of Fairbanks residents who have long clamored for special-event trains on the north end. This year we made the logistics work with the first October-fest *HooDoo Choo Choo* train featuring the products of a local brewer.

Visitors to Alaska benefited from new infrastructure in Healy, where a turn-around track and train servicing facilities gave cruise passengers new options for travel between Seward/Whittier ports and Denali aboard a dedicated cruise charter train. This improved customer service and satisfaction for an important partner and individual riders.

STRATEGY 2: CONTROL COSTS

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Railroaders regrouped and adapted to shifts on the expense side as well. As a self-insured company, the Railroad took a hard look at unsustainable double-digit growth in annual health care expenses. Months of research and union coordination led to modernized health care benefits for about two-thirds of the ARRC work force. Beginning with implementation January 1, 2015, savings are expected from cost-containment features such as generic prescription preferences, medical tourism and over-the-phone advice. Cost reductions may also help avoid or postpone the impact of the Cadillac tax provisions of the Affordable Care Act. Changes will be phased in for the remaining represented employee groups over the next few years.

Big savings are already being realized with efforts to lower facility electrical use and peak demand charges. As ARRC's number one power consumer, the Anchorage Car Shop is the poster child for a monitoring program that keeps shop workers aware of usage levels. The car shop's annual electrical bill dropped from $242,000 in 2012 to $170,000 in 2014. Plus, the shop cut consumption nearly in half, from 1.85 million KWh in 2013 to 983,000 KWh in 2014.

The Railroad gained operating efficiencies when the Supply Management Warehouse adopted a new barcode scanning system in September. The system improves inventory accuracy and saves time with automated data input and accounting activities.

Finally, the Railroad shifted toward electronic distribution of news to external and internal audiences. The *Community Ties* newsletter became solely electronic by third quarter 2014. Likewise, employees can receive the company newsletters electronically, access paystub information online, and get instant notices through their own company email address. Moreover, ARRC began major projects to revamp both the internal and external websites to become cornerstone communications by 2015. Along with lower distribution costs, electronic forums offer more timely access and less environmental impact.

STRATEGY 3: OPTIMIZE CAPITAL INVESTMENTS AND PROJECTS

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The Railroad's capital improvement focus was dominated by three mega projects, including two rail extensions. In partnership with the Matanuska-Susitna Borough, the Alaska Railroad continued to manage progress on the Port MacKenzie Rail Extension project. By the end of 2014, embankment, bridge and communication construction were substantially complete on nearly half of the 32-mile route. Once the spur is complete as early as 2017, it could become a conduit for moving natural gas to the interior, should potential liquefied natural gas (LNG) projects pan out.

As phase one of the Northern Rail Extension, the Tanana River bridge at Salcha was completed mid-summer 2014, on time and under budget. The sturdy 3,300-foot 19-pier bridge – now Alaska's longest – and levee involved more than 11,500 tons of steel; 12,000 cubic yards (CY) of concrete; 9,000 truckloads of riprap; and 600,000 CY of embankment. Given its size, complexity and relatively remote location, the $188 million river crossing is a testament to the Railroad's stewardship and project management expertise.

The Railroad continues to shepherd another huge and complex capital project to develop Positive Train Control (PTC), a federal mandate for any railroad with passenger service. Thanks to state support ($19 million in 2013 and $15 in 2014), ARRC continued work on a fail-safe braking system to prevent accidents due to human error. Work includes equipment installed on 52 locomotives; trackside communication towers and equipment; wayside equipment to detect track status and problems; and a new computer-aided dispatch (CAD) system. The Railroad needs $55 million more to complete the PTC system by the end of 2018.

STRATEGY 4: PROMOTE SAFETY AND ENGAGE EMPLOYEES

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PTC is just one of the federal regulatory factors the Railroad is responding to. Railroads nationwide are implementing new safety planning and training due to intense federal regulatory requirements. ARRC is implementing team problem-solving at front-line, mid-management and executive levels. Aggressive safety incident reporting includes even minor incidents to help reveal root causes. While the number of incidents rose due to new reporting requirements, injuries resulting in time lost from work decreased 20%. An overall decrease in injury severity is reflected in a Worker Compensation claim expense total that dropped by $1 million ($1.2 in 2014 compared to $2.2 million in 2013).

The Alaska Railroad made good progress on developing a System Safety Program Plan (SSPP) in 2014, well ahead of an anticipated Federal Railroad Administration mandate. The activities and procedures outlined in an SSPP already make business sense and ARRC is doing nearly everything that an SSPP requires. By being proactive in 2014, ARRC is confident that our SSPP will not only be drafted, but completed, by 2015.

Safety was the driving factor behind implementing the Residential Right-of-Way Use Policy (RRUP) and Permit program in 2014. The RRUP permit process ensures gardens, yards, sheds, storage, and other existing uses won't pose a safety hazard or interfere with Railroad operations in the right-of-way (ROW; 100 feet on either side of the track). While ARRC has always had exclusive use of its ROW, we spent two years listening to people living along the ROW through one-on-one discussions, multiple public meetings, several mailings and correspondence. The resulting program balances safety and operations needs with the concerns of our neighbors. Relatively low usage fees help cover program administration for permits that are renewable and transferable. The Railroad's priority is to identify and prevent uses that potentially put the public, Railroad employees and customers at risk.

STRATEGY 5: ENHANCE STAKEHOLDER RELATIONS AND ECONOMIC DEVELOPMENT

The outreach demonstrated in the RRUP process is a hallmark of Railroad efforts to engage stakeholder groups, some of which comprise entire communities. Mid-year, ARRC established a quarterly Fairbanks Discussion Group that expands upon a pilot program begun two years ago in Seward. These forums enable Railroad officials and community representatives to avoid conflicts before they occur and to explore new opportunities and issues of mutual interest.

One item of mutual interest in Seward is the potential for expanding Railroad dock facilities. In 2014 the U.S. Department of Transportation granted $2.5 million toward developing a Seward Marine Terminal Expansion Master Plan, to include passenger traffic, freight traffic and transportation connectivity studies. A Master Plan would help prioritize infrastructure improvement. Ultimately such improvements could support a natural gas line with fortified port facilities able to handle associated supply demands. In the meantime, the Railroad remains an economically viable option to haul liquefied natural gas to interior consumers – another reminder that oil and gas will remain important to the Railroad for some time to come.

The future is never certain, but history shows the wisdom of strategic planning and a willingness to adapt. That approach often requires fortitude and practice. Fortunately, we have Railroad leaders that possess an abundance of both. Indeed, one director on the ARRC Board draws from five decades of experience. In 2014, Track Repairer and Board Member Jack Burton marked 50 years as a Railroader. Through the sands of time – a half century! – he has witnessed the ups and downs, and participated in opportunities and solutions – as a front-line employee, as a union leader in touch with labor concerns, and as a trusted director serving on the board for the past two decades. Experience offers no guarantees, but shifting sands tend to solidify when we can plan and adapt with know-how on our side.

Bill O'Leary | President, CEO

Linda Leary | Board Chair

2014 HIGHLIGHTS

During the Tanana River Bridge ribbon-cutting, August 5, the Railroad presented its prestigious *Colonel Frederick Mears Award for Excellence* to key players in the project: Railroad project managers Clark Hopp, Brian Lindamood and Mark Peterburs, and contractors Kiewit Infrastructure West, HDR, Inc. and Hanson Alaska LLC.

Department of Transportation Commissioner Pat Kemp, left, congratulates Maintenance-of-Way employee and Board Member Jack Burton as he marked 50 years working for the Railroad during a November celebration.

Employee engagement campaign

The Railroad adopted an updated Safety Policy as part of its ongoing focus on safety.

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2014 FINANCIAL HIGHLIGHTS

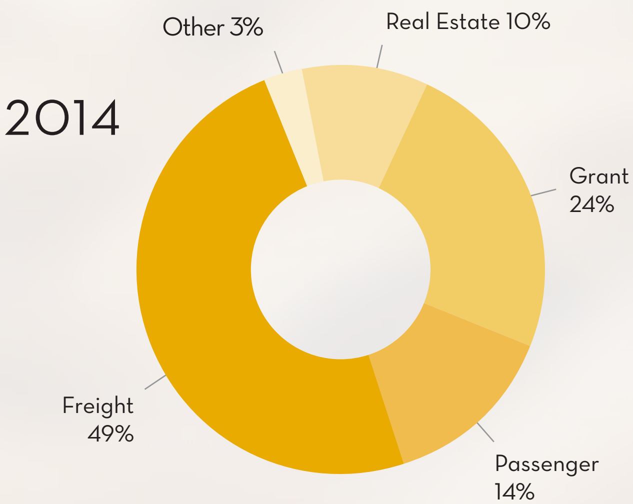
EARNINGS
(IN THOUSANDS)

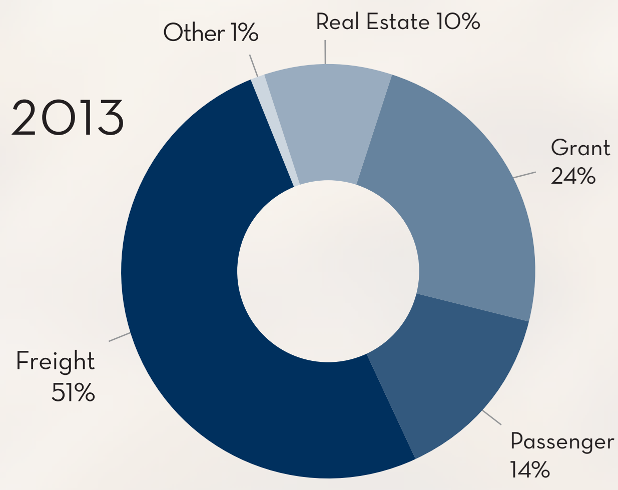
	2014	2013
Operating Revenues		
Freight	$ 94,249	$ 96,575
Passenger	27,605	25,650
Other	3,228	3,242
Grant	42,237	40,111
TOTAL OPERATING REVENUE	**167,319**	**165,578**
Operating Expenses	(163,585)	(160,725)
OPERATING INCOME	**3,734**	**4,853**
Non-operating Revenue (Expenses)		
Net Real Estate Income	11,627	10,929
Gain (Loss) on Sale of Capital Assets	-	6
Investment Income	20	31
Interest Expense, Net of Grant Revenue	(1,275)	(1,502)
NET INCOME	**14,106**	**14,317**
Other Changes in Net Position	12,370	8,372
Change in Net Position	26,476	22,689
Net Position, Beginning of Year	278,231	255,542
NET POSITION, END OF YEAR	**304,707**	**278,231**
OPERATING RATIO	**0.98**	**0.97**

STATEMENTS OF NET POSITION
(IN THOUSANDS)

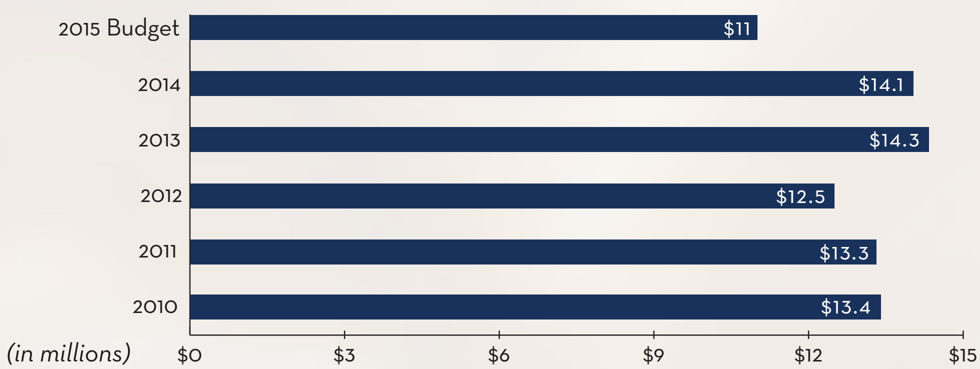
	2014	2013
Assets		
Current Assets	$ 126,289	$ 113,716
Capital Assets	923,413	911,367
Restricted Assets	982	982
Other Assets	18	26
Regulatory Assets	18,738	11,989
TOTAL ASSETS	**1,069,440**	**1,038,080**
Liabilities		
Current Liabilities	57,970	49,642
Other Liabilities	109,105	124,249
TOTAL LIABILITIES	**167,075**	**173,891**
Deferred Inflows		
Accrued Pension Benefits	42	5,661
Unearned Grant Revenue	597,616	580,297
TOTAL LIABILITIES AND DEFERRED INFLOWS	**764,733**	**759,849**
NET POSITION	**304,707**	**278,231**
TOTAL LIABILITIES, DEFERRED INFLOWS & NET POSITION	**1,069,440**	**1,038,080**

REVENUE

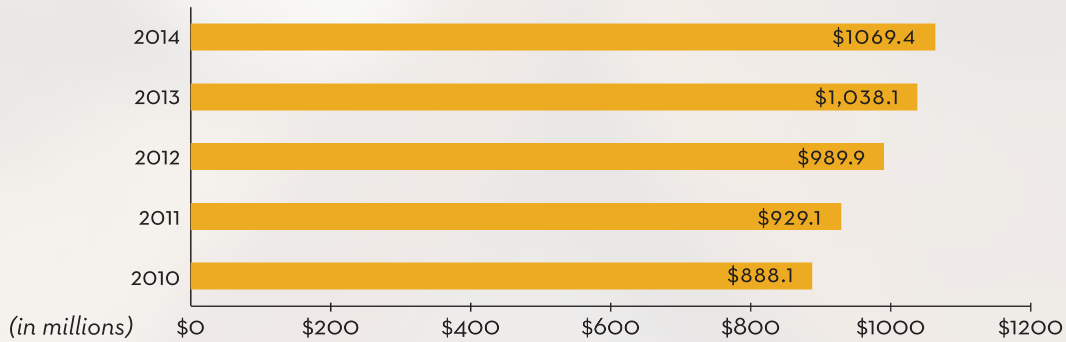




NET INCOME

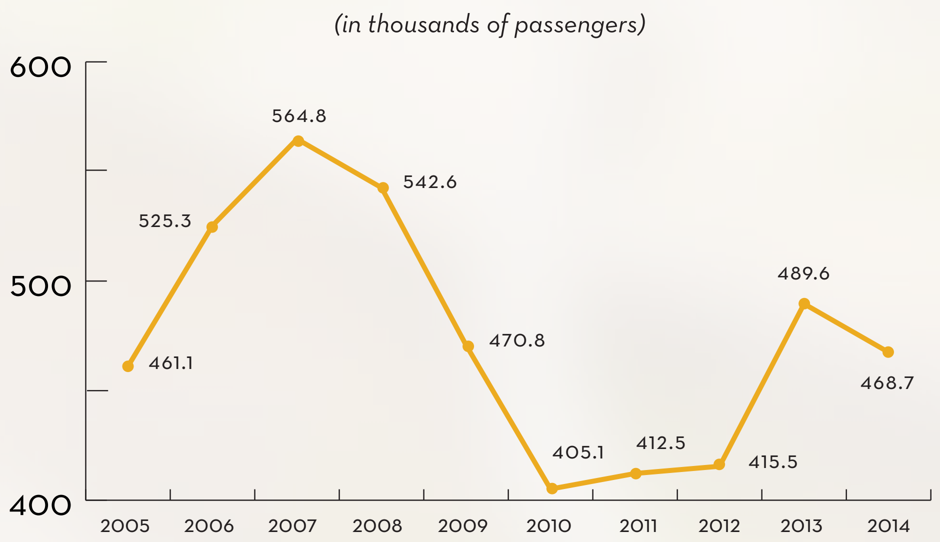


TOTAL ASSETS

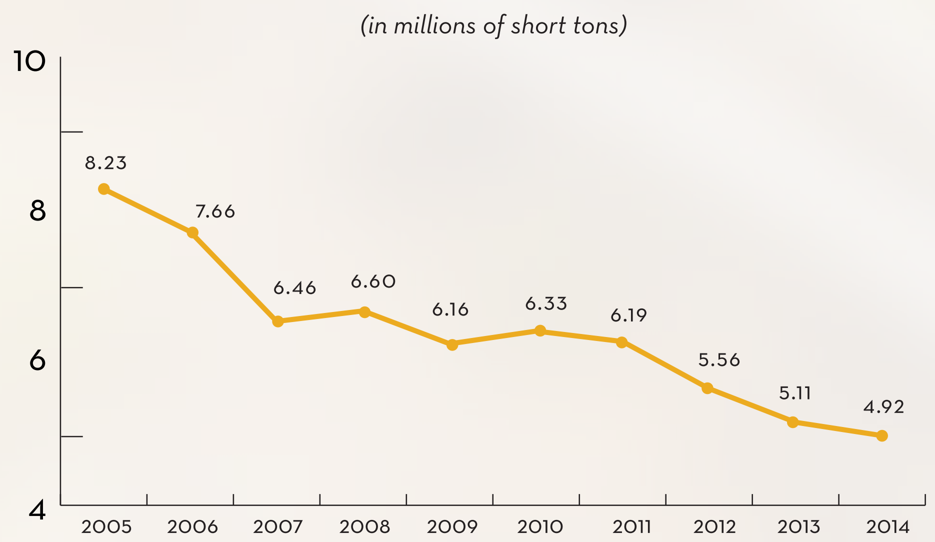


10-YEAR OPERATING TRENDS

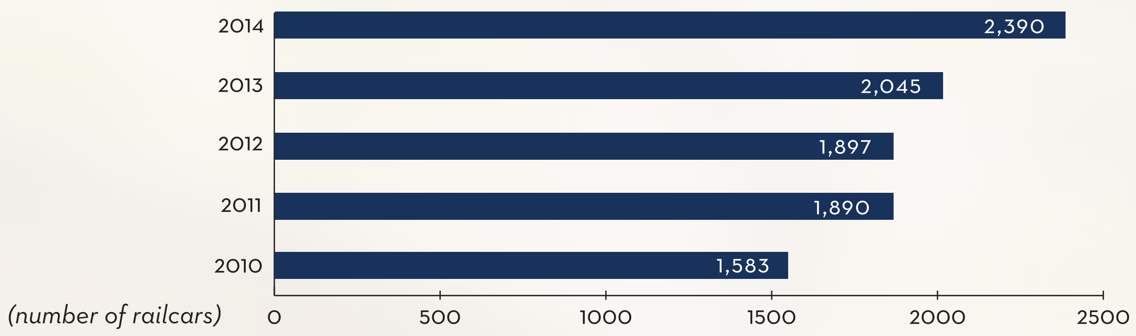
PASSENGER RIDERSHIP



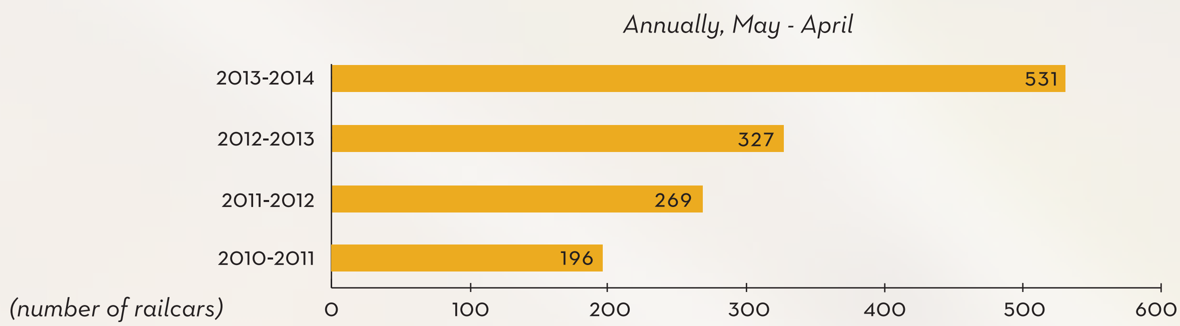
FREIGHT TONNAGE



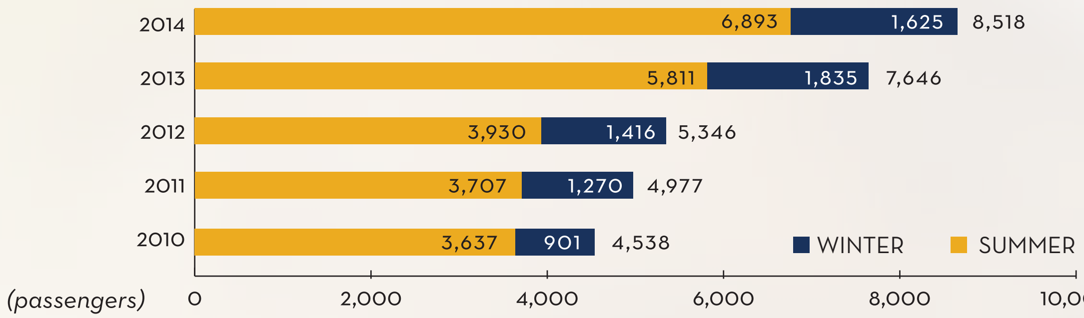
ALASKA RAIL MARINE SYSTEM (ARMS) NORTHBOUND RAIL-BARGE TRAFFIC



OILFIELD-RELATED PIPE HAULED BY RAIL-BARGE



HURRICANE TURN TRAIN PASSENGER RAIL GROWTH



ALASKA RAILROAD OFFICES

ALASKA RAILROAD OFFICES	PHYSICAL LOCATION	PHONE	FAX
ANCHORAGE, ALASKA (99501)			
Headquarters Offices	327 W. Ship Creek Avenue	907.265.2300	907.265.2312
Reservations & Depot	411 W. 1st Avenue	907.265.2494	907.265.2509
Operations Center	825 Whitney Road	907.265.2434	907.265.2643
FAIRBANKS, ALASKA (99701)			
Passenger Depot	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 (99664)			
Dock Operations / Terminal	913 Port Avenue	907.224.5550	907.265.2660
SEATTLE, WASHINGTON (98106)			
Barge Operations Office	1001 Klickitat Ave, Ste 200B	206.767.1100	206.767.1112

TOLL FREE NUMBERS			
Corporate Information 1.800.321.6518	Freight Marketing/Customer Service 1.800.321.6518	Passenger Customer Service 1.800.544.0552	Seattle Office 1.800.834.2772

www.AlaskaRailroad.com

Headquarters Mailing Address | P.O. Box 107500 | Anchorage, AK 99510-7500

April 1, 2015

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, 2014.

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,

Barbara Amy
Chief Financial Officer

Wendy Richerson, CPA
Controller

327 W. Ship Creek Avenue, Anchorage, Alaska 99501 | Mail to: P.O. Box 107500 Anchorage, Alaska 99510-7500 | 907.265.2300 | AlaskaRailroad.com

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, 2014 and 2013. Please read it in conjunction with the ARRC's financial statements, which follow this section.

Financial Highlights

The ARRC's total net position increased 10% during the course of this year's operations and increased 9% over the course of 2013 operations.

- During 2014, the ARRC's operating revenues exceeded operating expenses by $3.7 million, yielding an operating ratio of 0.98. Last year, operating revenues exceeded operating expenses by $4.9 million and yielded an operating ratio of 0.97.
- The total 2014 operating costs of the ARRC's programs were $163.6 million, an increase of 2% compared to last year. The total 2013 operating costs of the ARRC's programs were $160.7 million, a decrease of 2% compared to 2012.
- Expenditures on capital assets totaled $61.9 million during 2014, a decrease of 31% compared to last year. Expenditures on capital assets totaled $90.2 million during 2013, a decrease of 28% compared to 2012.
- Grant funding was used for $40.2 million, or 65%, of the 2014 capital expenditures. Grant funding was used for $67.7 million, or 75%, of the 2013 capital expenditures. These amounts were recorded as unearned 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 statement of net position reports 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 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 10% between fiscal years 2013 and 2014 to approximately $304.7 million. ARRC's net position increased 9% between fiscal years 2012 and 2013 to approximately $278.2 million.

	2014	2013 (in thousands)	2012
Assets:			
Current assets	$ 126,289	113,716	104,860
Capital assets	923,413	911,367	875,284
Other noncurrent assets	19,738	12,997	9,748
Total assets	1,069,440	1,038,080	989,892
Liabilities:			
Current liabilities	57,970	49,642	50,933
Notes payable outstanding, less current installments	16,195	19,137	19,049
Revenue bonds payable, less current portion, net of unamortized premiums	90,031	102,347	114,137
Other liabilities	2,774	2,660	2,035
Payable from restricted assets	105	105	105
Deferred inflows:			
Regulatory liabilities:			
Pension	42	5,661	10,781
Unearned grant revenue	597,616	580,297	537,310
Total liabilities and deferred inflows	764,733	759,849	734,350
Net position:			
Net invested in capital assets	204,534	194,689	188,937
Restricted for reinvestment in infrastructure	100,173	83,542	66,605
Total net position	$ 304,707	278,231	255,542

Capital assets – Capital assets, net of accumulated depreciation increased $12.0 million in 2014 and $36.1 million in 2013. During 2014 and 2013, the ARRC continued an extensive capital improvement plan, including a new bridge for the Northern Rail Extension, bridge rehabilitations, and track refurbishing to allow faster train speed and reduce wear. Also during this time period, ARRC continued developing the federally mandated positive train control system and acquired right of way in anticipation of future rail realignments. Capital expenditures, also funded dock and slip work, and vehicle and equipment fleet replacements.

Long-term debt – Notes payable decreased $2,869,000 and $88,000 in 2014 and 2013, respectively. There was no new debt issued during 2014. During 2013, ARRC refinanced a long-term loan of $9.4 million and issued a new long-term loan of $1.9 million to fund the acquisition of real property.

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:

- Unearned grant revenue relates to capital assets funded with federal grants. Unearned grant revenue increased $17.3 million in 2014 and $43.0 million in 2013. 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 $6.7 million and the accrued pension benefit liability decreased $5.6 million during 2014, due primarily to investment earnings. The postretirement benefits asset increased $3.3 million and the accrued pension benefit liability decreased $5.1 million during 2013, due primarily to investment earnings.

Change in net position – ARRC's 2014 net income of $14.1 million and other changes in net position of $12.4 million combined to increase overall net position by $26.5 million, a 10% increase from fiscal year 2013's change in net position. ARRC's 2013 net income of $14.3 million and other changes in net position of $8.4 million combined to increase overall net position by $22.7 million, a 118% increase from fiscal year 2012's change in net position.

		2014	2013 (in thousands)	2012
Operating revenue:				
Freight	$	94,249	96,575	100,022
Passenger		27,605	25,650	24,027
Other		3,228	3,242	4,059
Total transportation revenue		125,082	125,467	128,108
Grant revenue		42,237	40,111	40,341
Total		167,319	165,578	168,449
Operating expense:				
Transportation		37,624	38,578	43,883
Passenger		10,099	9,311	9,755
Marketing and customer service		22,857	21,165	20,735
Mechanical		26,057	25,110	26,276
Engineering		42,562	40,394	40,348
Facilities		14,904	15,327	15,953
General and administrative		9,482	10,840	7,701
Total		163,585	160,725	164,651
Operating income		3,734	4,853	3,798
Nonoperating revenues (expenses):				
Corporate planning and real estate, net of expenses		11,627	10,929	10,104
Gain on sale of capital assets		—	6	—
Investment income		20	31	87
Interest expense, net of grant revenue		(1,275)	(1,502)	(1,474)
Net income		14,106	14,317	12,515
Other changes in net position		12,370	8,372	(2,108)
Change in net position	$	26,476	22,689	10,407

Revenue – The ARRC's total revenues increased approximately 1% and totaled $190.7 million in 2014. The ARRC's total revenues decreased less than 1% and totaled $188.7 million in 2013. Approximately 49% and 51% of the ARRC's revenue comes from freight revenue during 2014 and 2013, respectively, and 15% and 14% of the revenue comes from passenger services during 2014 and 2013, respectively. The majority of the remaining income relates to real estate activities and federal grant revenue. Generally, federal grant revenue is recognized as the capital assets funded by the grants are depreciated.

Total transportation revenue for 2014 was $385,000 less than 2013. The decrease in transportation revenue is attributed to weakening global coal markets and less petroleum shipments, which were partially offset by shipments for oil field activities.

Total transportation revenue for 2013 was $2.6 million less than 2012. The decrease in transportation revenue is attributed to weakening global coal markets and less petroleum shipments, which were partially offset by shipments for oil field activities.

Operating expenses were $163.6 million in 2014, $160.7 million in 2013 and $164.7 million in 2012, an increase of $2.9 million or 2% from 2013 to 2014 and a decrease of $4.0 million or 2% from 2012 to 2013.

Real estate expenses were $7.6 million in 2014 and 2013, and $7.2 million in 2012, no change from 2013 to 2014 and an increase of 5% from 2012 to 2013.

Other change in net position – ARRC records costs and accrued benefits under its defined benefit and postretirement plans. The other changes in net position of an increase of $12.4 million and an increase of $8.4 million during 2014 and 2013, respectively, represent the changes in the overfunded or unfunded actuarial accrued liability of the defined benefit pension and postretirement plans.

Capital Asset and Debt Administration

Capital Assets

At the end of 2014, the ARRC had invested $923.4 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 $12.0 million, or 1.3%, over last year. Grants have funded $547.6 million and $541.6 million of the assets, net of accumulated depreciation, at the end of 2014 and 2013, respectively.

		2014	2013	2012
			(in thousands)	
Land and improvements	$	32,144	31,671	30,424
Road materials and supplies		10,304	6,904	9,947
Road and roadway structures		694,284	537,818	549,345
Equipment		159,293	145,414	152,683
Leasehold improvements		428	515	122
Quarry improvements		3,534	3,534	3,534
Construction in progress		23,426	185,511	129,229
Total capital assets, net of accumulated depreciation	$	923,413	911,367	875,284

The ARRC's fiscal year 2015 capital budget approved spending another $50.2 million for capital projects, principally for continued track and bridge rehabilitation, planned replacement of vehicles and equipment, other infrastructure improvements, and continuing the development of federally mandated Positive Train Control. The ARRC intends to use federal grant funding for $6.0 million of the capital additions. The remaining capital projects will be funded out of current year earnings and cash flow and approximately $3.7 million new debt. ARRC anticipates issuing FTA Capital Receipt Bonds for approximately $37.0 million to fund remaining costs related to the federally mandated Positive Train Control systems. 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 2014, the ARRC had $19.1 million in notes payable outstanding, a decrease of 13.0% from 2013, and $102.1 million in revenue bonds payable outstanding, a decrease of 10.3%. At the end of 2013, the ARRC had $22.0 million in notes payable outstanding, a decrease of 6% from 2012, and $113.9 million in revenue bonds payable outstanding, a decrease of 9%. 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 (FTA Section 5307 Urbanized Area Formula Funds and Section 5309 Fixed Guideway Modernization Formula Funds).

The ratings and outlooks have changed multiple times since the original ratings in 2006 and 2007. The most current ratings:

> On June 16, 2014, Moody's affirmed their "A3" rating and revised the outlook on the bonds to stable.
>
> On August 20, 2014, Fitch Ratings affirmed their "BBB" rating and stable outlook.
>
> On October 1, 2014, Standard & Poor's Rating Service affirmed its "A+" rating and affirmed the stable outlook.

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

Next Year's Budget

The 2015 budgets for freight and passenger revenues are $93.0 million and $31.1 million, respectively. As a result, the ARRC's net position is expected to increase $11.0 million or less than 4% by the close of 2015.

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, 2014 and 2013, and the related statements of revenues, 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, 2014 and 2013, and the changes in financial position and cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matter

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 1–7 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 31, 2015 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 31, 2015

ALASKA RAILROAD CORPORATION

Statements of Net Position

December 31, 2014 and 2013

(In thousands)

		2014	2013
Assets:			
Current assets:			
Cash and cash equivalents (note 3)	$	42,964	41,136
Accounts receivable, net of allowance for doubtful accounts of $388 in 2014 and $346 in 2013		23,128	16,388
Grants receivable		21,420	24,737
Materials and supplies		11,134	10,327
Prepaid expenses and other current assets		1,315	1,487
Under recovery of vehicle and equipment allocated costs (note 2(k))		—	209
Restricted assets (note 3)		26,328	19,432
Total current assets		126,289	113,716
Capital assets (notes 4 and 8):			
Land and improvements and quarry improvements (note 11)		36,258	35,785
Road materials and supplies		10,304	6,904
Road and roadway structures		1,044,980	853,205
Equipment (note 6)		383,760	352,243
Leasehold improvements (note 11)		2,172	2,172
Accumulated depreciation, depletion and amortization		(577,487)	(524,453)
Construction in progress		23,426	185,511
Total capital assets, net		923,413	911,367
Restricted assets (note 3)		982	982
Other assets		18	26
Regulatory asset:			
Postretirement benefits (note 7)		18,738	11,989
Total assets	$	1,069,440	1,038,080
Liabilities:			
Current liabilities:			
Current portion of notes payable (notes 5 and 6)	$	2,942	2,869
Accounts payable and accrued liabilities (notes 5 and 13)		19,312	18,227
Payroll liabilities		9,628	10,403
Environmental remediation reserve (notes 5 and 15)		477	624
Interest payable		2,081	2,280
Over recovery of vehicle and equipment allocated costs (note 2(k))		948	—
State of Alaska advances (notes 3 and 5)		7,186	—
Unearned revenues		3,301	3,619
Current portion of revenue bonds payable (notes 5 and 6)		12,095	11,620
Total current liabilities		57,970	49,642
Notes payable, less current portion (notes 5 and 6)		16,195	19,137
Revenue bonds payable (net of unamortized premiums), less current portion (notes 5 and 6)		90,031	102,347
Environmental remediation reserve (notes 5 and 15)		2,140	1,849
State of Alaska advances (notes 3 and 5)		158	162
Payable from restricted assets (note 5)		105	105
Accrued postretirement benefits (note 7)		476	649
Total liabilities		167,075	173,891
Deferred inflows:			
Regulatory liabilities:			
Accrued pension benefits (note 7)		42	5,661
Unearned grant revenue (note 8)		597,616	580,297
Total deferred inflows		597,658	585,958
Total liabilities and deferred inflows		764,733	759,849
Net position (note 9):			
Net investment in capital assets (note 4)		204,534	195,097
Restricted for reinvestment in infrastructure (notes 2(a) and 2(l))		100,173	83,134
Total net position		304,707	278,231
Commitments and contingencies (notes 5, 7, 12, 13, and 15)			
Total liabilities, deferred inflows, and net position	$	1,069,440	1,038,080

See accompanying notes to financial statements.

ALASKA RAILROAD CORPORATION

Statements of Revenues, Expenses, and Changes in Net Position

Years ended December 31, 2014 and 2013

(In thousands)

		2014	2013
Operating revenues:			
Freight (note 10)	$	94,249	96,575
Passenger		27,605	25,650
Other		3,228	3,242
		125,082	125,467
Grant revenue (note 8)		42,237	40,111
		167,319	165,578
Operating expenses:			
Transportation		37,624	38,578
Passenger		10,099	9,311
Marketing and customer service		22,857	21,165
Mechanical		26,057	25,110
Engineering		42,562	40,394
Facilities		14,904	15,327
General and administrative, net of indirect cost recovery of $1,909 in 2014 and $2,011 in 2013		9,482	10,840
		163,585	160,725
Operating income		3,734	4,853
Nonoperating revenues (expenses):			
Corporate planning and real estate income, less direct expenses of $7,568 in 2014 and $7,583 in 2013 (notes 6 and 11)		11,627	10,929
Gain on sale of capital assets		—	6
Investment income		20	31
Interest expense, net of grant revenue of $4,150 in 2014 and $4,617 in 2013 (note 6)		(1,275)	(1,502)
Total nonoperating revenues		10,372	9,464
Net income		14,106	14,317
Other change in net position:			
Change in pension and postretirement funding status (note 7)		12,370	8,372
Change in net position		26,476	22,689
Net position, beginning of year		278,231	255,542
Net position, end of year	$	304,707	278,231

See accompanying notes to financial statements.

ALASKA RAILROAD CORPORATION

Statements of Cash Flows

Years ended December 31, 2014 and 2013

(In thousands)

		2014	2013
Cash flows from operating activities:			
Receipts from customers	$	118,342	127,330
Operating grants received		10,120	9,486
Payments to suppliers		(50,198)	(48,957)
Payments to employees		(60,317)	(59,643)
Net cash provided by operating activities		17,947	28,216
Cash flows from capital and related financing activities:			
Principal payments on long-term debt		(14,770)	(14,711)
Interest payments on long-term debt		(5,624)	(6,299)
Grant received for interest expense		5,349	5,934
Purchases and construction of capital assets		(66,152)	(88,720)
Proceeds from sales of capital assets		29	85
Increase in unearned revenues, net of advances		58,796	71,927
Net cash used for capital and related financing activities		(22,372)	(31,784)
Cash flows from investing activities:			
Real estate income and related cash flows		18,877	18,865
Real estate direct expenses paid		(5,748)	(5,901)
Purchases of restricted investments		(8,275)	241
Proceeds from sales of restricted assets		1,379	—
Interest received		20	31
Net cash provided by investing activities		6,253	13,236
Net increase in cash and cash equivalents		1,828	9,668
Cash and cash equivalents at beginning of year		41,136	31,468
Cash and cash equivalents at end of year	$	42,964	41,136
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	3,734	4,853
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization		53,178	49,909
Bond issuance cost amortization		60	54
Grant revenue on capital assets		(32,177)	(30,679)
Changes in operating assets and liabilities that provided (used) cash:			
Materials and supplies		(807)	(386)
Accounts receivable		(6,740)	1,863
Prepaid expenses and other assets		180	(278)
Accounts payable and accrued liabilities		166	1,738
Over (under) recovery of vehicle and equipment allocated costs		1,157	(566)
Payroll liabilities		(775)	819
Environmental reserve		144	1,088
Accrued postretirement and pension benefits		(173)	(199)
Net cash provided by operating activities	$	17,947	28,216
Supplemental schedule of noncash investing and capital and related financing activities:			
Depreciation included in real estate activity	$	1,820	1,682
Construction of capital assets not yet paid		15,859	14,940
Capital assets acquired through issuance of note		—	1,940

See accompanying notes to financial statements.

(1) Organization and Operations

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

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

(2) Summary of Significant Accounting Policies

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

(a) Basis of Accounting

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

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

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

(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.

(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 grants, and amortizes the unearned amounts over the life of the related capital assets. Additionally, ARRC records the funded status of its defined benefit 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 nonoperating activities.

(h) Grants

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

(i) Income Taxes

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

(j) Environmental Remediation Costs

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

(k) Vehicle and Equipment Allocated Costs

The ARRC's vehicle and equipment costs for maintenance, fuel, depreciation, and leases are recorded in the vehicle and equipment cost pool. These costs are recovered through various responsibility centers through a fixed charge rate based on usage of vehicles and equipment. Any over recovery or under recovery of actual vehicle and equipment cost is applied against fixed charge rates in subsequent years. Accordingly, the ARRC has recorded an over recovery of $948,000 and an under recovery of $209,000 as of December 31, 2014 and 2013, respectively.

(l) Net Position

As of December 31, 2014 and 2013, the ARRC's board of directors has restricted $100,173,000 and $83,134,000, respectively, of net position for reinvestment in infrastructure.

(m) Recently Issued Accounting Pronouncements

In June 2012, the GASB issued GASB Statement No. 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 June 15, 2014. The ARRC is currently evaluating the impact that the adoption of Statement 68 will have on its financial statements.

(n) Reclassifications

Certain reclassifications not affecting net income have been made to the 2013 financial statements to conform to the current presentation.

(3) Deposits and Investments

Restricted assets consist entirely of money market funds and are reported on the statements of net position as follows at December 31, 2014 and 2013:

		2014	2013
		(in thousands)	
Restricted assets – current	$	26,328	19,432
Restricted assets – long-term		982	982
	$	27,310	20,414

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, 2014 and 2013:

Description of restriction		**2014**	**2013**
		(in thousands)	
Capital assets as authorized by the Department of Natural Resources	$	162	162
State of Alaska advance funding for Positive Train Control		7,647	461
Debt service reserve		19,142	19,432
Arbitrage rebate reserve		104	104
Debt service reserve 2012A and 2012B		255	255
	$	27,310	20,414

(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, 2014, the ARRC's carrying amount of cash and cash equivalents was $42,964,000 and the bank balance was $43,286,000. Of the bank balance, $250,000 was covered by federal depository insurance, and $34,865,000 represents money market funds held by the ARRC's agent in the ARRC's name.

At December 31, 2013, the ARRC's carrying amount of cash and cash equivalents was $41,136,000 and the bank balance was $41,693,000. Of the bank balance, $250,000 was covered by federal depository insurance, and $38,845,000 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.

(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, 2014 and 2013.

(4) Capital Assets

During 2002, the ARRC received initial approval from its federal cognizant agency, which was updated in 2005, of its indirect cost rate agreement. In compliance with Federal Transit Administration (FTA) Circulars, ARRC will continue to update its indirect cost rate proposal but will retain it 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-funded capital assets. Indirect costs allocated to capital assets under this agreement totaled $1,909,000 and $2,011,000 during the years ended December 31, 2014 and 2013, respectively.

The following tables summarize activity in the capital assets accounts during the years ended December 31, 2014 and 2013:

		Balance at December 31, 2013	Increases	Decreases	Balance at December 31, 2014
			(In thousands)		
Capital assets not being depreciated:					
Land and improvements	$	31,671	473	—	32,144
Road materials and supplies		6,904	3,400	—	10,304
Construction in progress		185,511	61,936	(224,021)	23,426
Total capital assets not being depreciated		224,086	65,809	(224,021)	65,874
Capital assets being depreciated:					
Road and roadway structures		853,205	191,775	—	1,044,980
Equipment		352,243	31,773	(256)	383,760
Leasehold improvements		2,172	—	—	2,172
Total capital assets being depreciated		1,207,620	223,548	(256)	1,430,912
Capital assets being depleted:					
Quarry improvements		4,114	—	—	4,114
Less accumulated depreciation for:					
Road and roadway structures		315,387	35,309	—	350,696
Equipment		206,829	17,869	(231)	224,467
Leasehold improvements		1,657	87	—	1,744
Total accumulated depreciation		523,873	53,265	(231)	576,907
Less accumulated depletion for:					
Quarry improvements		580	—	—	580
Capital assets being depreciated and depleted, net		687,281	170,283	(25)	857,539
Net capital assets	$	911,367	236,092	(224,046)	923,413

	Balance at December 31, 2012	Increases	Decreases	Balance at December 31, 2013
		(In thousands)		
Capital assets not being depreciated:				
Land and improvements	$ 30,424	1,247	—	31,671
Road materials and supplies	9,947	—	(3,043)	6,904
Construction in progress	129,229	90,195	(33,913)	185,511
Total capital assets not being depreciated	169,600	91,442	(36,956)	224,086
Capital assets being depreciated:				
Road and roadway structures	831,288	21,917	—	853,205
Equipment	342,614	10,749	(1,120)	352,243
Leasehold improvements	1,650	522	—	2,172
Total capital assets being depreciated	1,175,552	33,188	(1,120)	1,207,620
Capital assets being depleted:				
Quarry improvements	4,114	—	—	4,114
Less accumulated depreciation for:				
Road and roadway structures	281,943	33,444	—	315,387
Equipment	189,931	18,018	(1,120)	206,829
Leasehold improvements	1,528	129	—	1,657
Total accumulated depreciation	473,402	51,591	(1,120)	523,873
Less accumulated depletion for:				
Quarry improvements	580	—	—	580
Capital assets being depreciated and depleted, net	705,684	(18,403)	—	687,281
Net capital assets	$ 875,284	73,039	(36,956)	911,367

Depreciation was charged to the following departments during the years ended December 31, 2014 and 2013:

	2014		2013	
	Grant funded depreciation	Nongrant funded depreciation	Grant funded depreciation	Nongrant funded depreciation
	(in thousands)			
Transportation	$ 3,106	511	2,762	534
Passenger	35	390	35	405
Marketing and customer service	—	843	—	846
Mechanical	3,607	6,146	3,652	6,242
Engineering	21,442	6,061	19,727	5,667
Facilities	3,764	2,760	4,246	2,784
General and administrative	223	2,704	257	2,752
Corporate planning and real estate	235	1,438	235	1,447
	$ 32,412	20,853	30,914	20,677

Net investment in capital assets is as follows at December 31, 2014 and 2013:

	2014	2013
	(in thousands)	
Net capital assets (note 4)	$ 923,413	911,367
Notes payable (note 6)	(19,137)	(22,006)
Outstanding balance of revenue bonds (note 6)	(102,126)	(113,967)
Unearned grant revenue (note 8)	(597,616)	(580,297)
	$ 204,534	195,097

(5) Long-Term Liabilities

Long-term liability activity is summarized as follows during the years ended December 31, 2014 and 2013:

	Balance at December 31, 2013	Additions	Reductions (in thousands)	Balance at December 31, 2014	Due within one year
Long-term debt:					
Notes payable	$ 22,006	—	(2,869)	19,137	2,942
Revenue bonds payable	109,805	—	(11,620)	98,185	12,095
Plus (less) unamortized amounts:					
Issuance of premiums	4,629	—	(281)	4,348	—
Unamortized insurance costs	(467)	—	60	(407)	—
Total revenue bonds payable	113,967	—	(11,841)	102,126	12,095
Environmental remediation reserve	2,473	783	(639)	2,617	477
Other claims	425	100	(295)	230	230
State of Alaska advances	162	7,185	(4)	7,343	7,185
Payable from restricted assets	105	—	—	105	—
Total long-term liabilities	$ 139,138	8,068	(15,648)	131,558	22,929

	Balance at December 31, 2012	Additions	Reductions (in thousands)	Balance at December 31, 2013	Due within one year
Long-term debt:					
Notes payable	$ 23,433	1,940	(3,367)	22,006	2,869
Revenue bonds payable	120,925	—	(11,120)	109,805	11,620
Plus (less) unamortized amounts:					
Issuance of premiums	4,860	—	(231)	4,629	—
Unamortized insurance costs	(529)	—	62	(467)	—
Total revenue bonds payable	125,256	—	(11,289)	113,967	11,620
Environmental remediation reserve	1,385	1,455	(367)	2,473	624
Other claims	240	385	(200)	425	295
State of Alaska advances	167	—	(5)	162	—
Payable from restricted assets	105	—	—	105	—
Total long-term liabilities	$ 150,586	3,780	(15,228)	139,138	15,408

The ARRC has arrangements for two short-term unsecured lines of credit. The general purpose lines of credit allow borrowing up to $20,000,000 at rates of 65.2% to 100% of London Interbank Offered Rate (LIBOR) plus 1.30% to 2.25%. The self-insurance line of credit allows borrowing up to $10,000,000 at rates of 65.2% to 100% of LIBOR plus 1.30% to 2.25%. None of the lines of credit had an outstanding balance at December 31, 2014 or 2013.

ARRC also had an irrevocable letter of credit in the amount of $36,000 and $430,800, during the years ended December 31, 2014 and December 31, 2013, respectively.

(6) Long-Term Debt

Long-term debt at December 31, 2014 and 2013 consists of the following:

		2014	2013
		(in thousands)	
Notes payable:			
Note payable, secured by equipment, due in monthly payments of $60,553, including interest at 2.89%, matures July 2018	$	2,471	3,116
Note payable, secured by real estate revenue, due in monthly payments of $36,210, including interest at 3.95%, matures August 2023		3,183	3,486
Note payable, secured by real estate revenue, due in monthly payments of $48,538, including interest at 3.95%, matures August 2023		4,267	4,672
Note payable, secured by equipment, due in monthly payments of $136,842, including interest at 1.71%, matures August 2019		7,360	8,862
Note payable to State of Alaska, unsecured, due in annual payments (varies), including interest at 3.00%, matures September 2023		1,856	1,870
		19,137	22,006
Less current portion		2,942	2,869
	$	16,195	19,137
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, 5309, and 5337 FTA Formula Funds, matures August 2021	$	102,126	113,967
Less current portion		12,095	11,620
	$	90,031	102,347

Annual payments on debt are scheduled as follows at December 31, 2014:

		Notes payable		Revenue bonds payable		
		Principal	Interest	Principal	Interest	Total
				(in thousands)		
Year ending December 31:						
2015	$	2,942	513	12,095	4,841	20,391
2016		3,088	437	12,680	4,257	20,462
2017		3,168	357	13,305	3,635	20,465
2018		2,947	275	13,950	2,989	20,161
2019		2,247	207	14,645	2,295	19,394
2020–2024		4,745	347	31,510	2,363	38,965
		19,137	$ 2,136	98,185	$ 20,380	139,838
Current portion of principal		(2,942)		(12,095)		(15,037)
Unamortized premium		—		4,348		4,348
Unamortized issuance cost		—		(407)		(407)
Total long-term portion	$	16,195		90,031		128,742

Federal Transit Program – Corporation Participation in Section 5307 Formula Program and Section 5309/5337 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 (FGIC).

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 FGIC.

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 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 & 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.

On September 5, 2013, Fitch Ratings affirmed their "BBB" rating and stable outlook. On October 1, 2013, Standard & Poor's Rating Service affirmed its "A+" rating and affirmed the stable outlook on the bonds.

On June 16, 2014, Moody's affirmed their "A3" rating and revised the outlook on the bonds to stable. On August 20, 2014, Fitch Ratings affirmed their "BBB" rating and stable outlook. On October 1, 2014, Standard & Poor's Rating Service affirmed its "A+" and affirmed the stable outlook.

The following table sets forth the authorized funding allocation of the FTA Section 5307 Formula Program Funds and Section 5309 or 5337 Formula Program Funds to ARRC in Federal Fiscal Years (FFY) 2013 and 2014 and estimated apportionments for FFY 2014 and 2015:

FFY		Section 5307 formula program	Section 5309 or Section 5337 formula program	Total
2013	$	9,546,553	18,275,577	27,822,130
2014		9,597,624	18,426,377	28,024,001
2015 Estimated apportionments		9,597,624	18,426,377	28,024,001

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. There was no rebate due on the Series 2006 during the filing of the 2011 arbitrage certificate. The Series 2007 rebate of $936,000 was paid in February 2012. The next rebate calculations for the Capital Grant Receipts Bonds, Series 2006 and Series 2007 will occur during 2016 and 2017, respectively.

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 unfunded or overfunded actuarial accrued liabilities associated with pension and postretirement 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*.

The overfunded actuarial accrued liability (AAL) of the postretirement plan, which is the difference between the actuarial value of the assets and the actuarial accrued liability of the plan, is reported as regulatory assets. The unfunded AAL of the pension plan is reported as a regulatory liability. The change in pension and postretirement funding status is presented as other changes in net position and represents the change in the overfunded or unfunded actuarial accrued liability for both plans. The following table presents the regulatory assets and liabilities and other changes in net position for both plans at December 31, 2014, 2013, and 2012:

		2014	2013 (in thousands)	2012
Regulatory asset:				
Overfunded postretirement AAL	$	18,738	11,989	8,738
Regulatory liability:				
Unfunded pension AAL	$	42	5,661	10,781
Other change in net position:				
Change in pension and postretirement funding status	$	12,370	8,372	(2,108)

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 nonrepresented employees who are not covered by the Civil Service Retirement System (CSRS). 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, 2014 and 2013 are as follows:

	2014	2013
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

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, 2014 and 2013:

		2014	2013
		(in thousands)	
Income:			
Contributions received:			
Employee	$	4,091	4,062
Employer		3,365	3,957
Investment earnings		7,040	19,576
Total income		14,496	27,595
Disbursements:			
Benefit payments		4,369	3,405
Administrative and investment consulting expenses		599	468
Total disbursements		4,968	3,873
Net income		9,528	23,722
Fair value of assets at beginning of year		135,682	111,960
Fair value of assets at end of year	$	145,210	135,682

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, 2014, 2013, and 2012:

		2014	2013	2012
			(in thousands)	
Fair value of assets at end of year	$	145,210	135,682	111,960
Unamortized actuarial gains		(5,630)	(11,510)	(5,376)
Actuarial value of assets at the end of year		139,580	124,172	106,584
Actuarial accrued liability (AAL)		139,622	129,833	117,365
Unfunded AAL	$	42	5,661	10,781
Funded ratio (actuarial value of plan assets/AAL)		100.0%	96.0%	91.0%
Covered payroll (active plan members)	$	46,084	48,661	48,134
UAAL as a percentage of covered payroll		0.1%	11.6%	22.4%

The ARC of $3,365,000 and $3,957,000 and the associated expenses of $2,922,000 and $3,490,000 were included in the accompanying financial statements for the years ended December 31, 2014 and 2013, respectively. The ARRC's Annual Pension Cost (APC), which is the periodic cost of the plan, the percentage of APC contributed to the plan, and the net pension obligation for 2014 and the two preceding years were as follows:

		2014	2013	2012
			(in thousands)	
Annual pension cost	$	3,365	3,957	3,647
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 premiums adjusted annually, and contains other cost-sharing features such as deductibles and coinsurance.

Assumptions used to determine annual postemployment benefit cost and related information for the years ended December 31, 2014 and 2013 are as follows:

	2014	2013
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	8.0 to 4.5	8.9 to 4.5
Prescription	8.0 to 4.5	8.9 to 4.5

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 6-year period as a level dollar amount. The ARRC has incorporated the impact of the Patient Protection and Affordable Care Act 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, 2014 and 2013:

		2014	2013
		(in thousands)	
Income:			
Contributions received – employer	$	—	—
Investment earnings		2,173	6,755
Total income		2,173	6,755
Disbursements:			
Benefit payments, net of premiums and copay		445	253
Administrative and investment consulting expenses		61	80
Total disbursements		506	333
Net income		1,667	6,422
Fair value of assets at beginning of year		43,724	37,301
Fair value of assets at the end of year	$	45,391	43,723

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, 2014, 2013, and 2012:

		2014	2013	2012
			(in thousands)	
Fair value of assets at end of year	$	45,391	43,723	37,301
Unamortized actuarial gains		(2,025)	(4,016)	(1,847)
Actuarial value of assets at the end of year		43,366	39,707	35,454
Actuarial accrued liability (AAL)		24,628	27,718	26,716
Overfunded AAL	$	(18,738)	(11,989)	(8,738)
Funded ratio (actuarial value of plan assets/AAL)		176.1%	143.0%	133.0%
Covered payroll (active plan members)	$	46,084	48,661	48,134
Over funded AAL as a percentage of covered payroll		(40.7)%	(24.6)%	(18.2)%

The following table shows the components of the ARRC's net other postemployment benefit (OPEB) cost for the year. 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, 2014, 2013, and 2012:

		2014	2013	2012
			(in thousands)	
Annual required contribution (ARC)	$	—	—	20
Interest on net OPEB obligation		94	108	126
Adjustment to the ARC		(267)	(308)	(359)
Annual OPEB cost		(173)	(200)	(213)
Contributions made		—	—	(623)
Decrease in the net OPEB obligation		(173)	(200)	(836)
Net OPEB obligation at beginning of year		649	849	1,685
Net OPEB obligation at the end of year	$	476	649	849
Annual OPEB cost contributed		—%	—%	(9)%

(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 $90,000 and $111,000 for the years ended December 31, 2014 and 2013, 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 80% of employees, the ARRC will match a portion of employee contributions. The maximum amount of matching required under the agreements is 66% of employee contributions for the first 9% of salary. Benefit expense related to the Plan was $553,000 and $548,000 for the years ended December 31, 2014 and 2013, 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 nonrepresented employees. There are no benefit expenses related to the Plan for the years ended December 31, 2014 and 2013.

(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, 2014 and 2013 consists of the following:

		2014	**2013**
		(in thousands)	
Land and improvements		$ 8,729	8,322
Road and roadway structures	15–32 year life	641,604	468,382
Equipment	5–25 year life	162,504	139,053
Construction in process		8,141	165,069
		$ 820,978	780,826

Grant revenue earned during the years ended December 31, 2014 and 2013 consisted of the following:

		2014	2013
		(in thousands)	
Depreciation on assets constructed with grant funds	$	32,412	30,914
Right of way acquisitions		407	182
Grant funded maintenance expense		9,599	9,196
Grant funded bond principal, interest, and issuance costs		4,204	4,671
		46,622	44,963
Less grant revenue included in real estate nonoperating revenues		(235)	(235)
Less grant funded interest included in Series 2006 and 2007 Bond revenues		(4,150)	(4,617)
	$	42,237	40,111

The original cost of assets constructed or acquired with Capital Grant Receipts Bonds, Series 2006 and 2007, consists of the following:

			Total
			(in thousands)
Road and roadway structures	15–32 year life	$	163,779
Equipment	5–25 year life		18,960
		$	182,739

(9) Net Position

Net position consists of the following major items as of December 31, 2014 and 2013:

		Investment by the State of Alaska	Cumulative net income	Cumulative other changes in net position	Total net position
			(in thousands)		
Balance at December 31, 2012	$	34,174	223,407	(2,039)	255,542
Net income		—	14,317	—	14,317
Other changes in net position		—	—	8,372	8,372
Total changes in net position					22,689
Balance at December 31, 2013		34,174	237,724	6,333	278,231
Net income		—	14,106	—	14,106
Other changes in net position		—	—	12,370	12,370
Total changes in net position					26,476
Balance at December 31, 2014	$	34,174	251,830	18,703	304,707

(10) Concentrations

Two ARRC customers accounted for 29% and 36% of freight revenue in 2014 and 2013, respectively. During 2014 and 2013, 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 2014 and 2013. 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 65% and 75% of capital expenditures in 2014 and 2013, respectively.

(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 $15,778,000 and $15,199,000 in 2014 and 2013, respectively. The following table summarizes future minimum lease payments as of December 31, 2014:

	Amount (in thousands)
Year ending December 31:	
2015	$ 13,035
2016	12,389
2017	12,099
2018	11,081
2019	10,370
Thereafter	122,117
	$ 181,091

(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 $9,799,000 and $9,849,000 in 2014 and 2013, respectively. Future minimum lease payments as of December 31, 2014 are summarized as follows:

	Amount (in thousands)
Year ending December 31:	
2015	$ 10,523
2016	1,955
2017	209
2018	59
2019	—
Thereafter	—
	$ 12,746

(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, 2014 and 2013:

		2014	2013
		(in thousands)	
Casualty/liability	$	200,000	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, 2014, 2013, and 2012:

		Balance at December 31, 2013	Incurred claims	Claim payments	Balance at December 31, 2014
			(in thousands)		
Employee health benefits	$	1,404	11,945	(12,179)	1,170
Workers' compensation		2,508	1,208	(1,854)	1,862
	$	3,912	13,153	(14,033)	3,032

		Balance at December 31, 2012	Incurred claims	Claim payments	Balance at December 31, 2013
			(in thousands)		
Employee health benefits	$	1,367	11,709	(11,672)	1,404
Workers' compensation		1,691	2,669	(1,852)	2,508
	$	3,058	14,378	(13,524)	3,912

		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

(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 75% of the ARRC's labor force is subject to one of five collective bargaining agreements. The representative unions are United Transportation Union (UTU), International Brotherhood of Teamsters Local 959 (IBT), American Train Dispatchers Association (ATDA), Carmen's Division of Transportation Communication International Union (TCU) and the Alaska Railroad Workers (ARW). The labor agreement with TCU expired September 2014. A tentative agreement was reached with TCU and members voted on March 24, 2015, to accept the tentative labor agreement. The IBT labor agreement expires August 2015. All other labor agreements expire in 2017 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.

(16) Related Party Transactions

The State of Alaska awarded ARRC appropriations for two capital improvement projects totaling $118,100,000. The ARRC has incurred $32,032,000 and $60,769,000 of costs under these appropriations, which are included in accounts receivable, construction in progress, and unearned grant revenue as of December 31, 2014 and December 31, 2013, respectively. Consistent with other grants, revenue from these appropriations will be deferred and recognized over the life of the related capital assets.

During the year ended December 31, 2013, the ARRC issued a $1,940,000 note payable to the State of Alaska, Department of Transportation and Public Facilities in exchange for real property.