Alaska Railroad's Seward Loading Facility

Coal: History, Status and Economic Viability (August 2016)

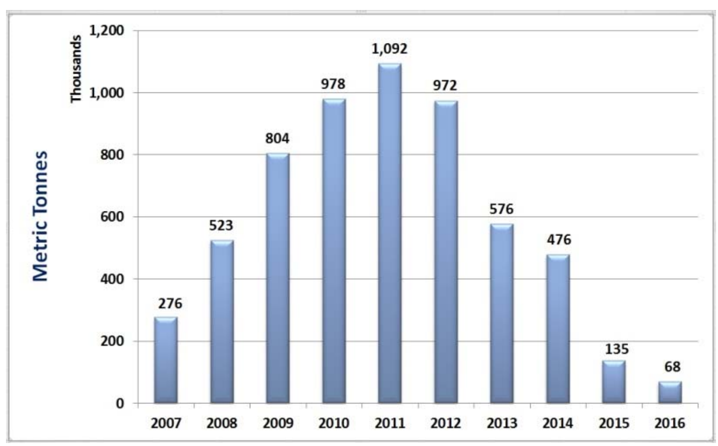
History

The Seward Loading Facility (SLF) was built in 1984, when Korean coal purchaser Suneel Alaska Corporation **a)** negotiated for the Alaska Dept. of Transportation & Public Facilities to build the dock, and **b)** secured a loan from the Alaska Industrial Development Export Authority (AIDEA) to install the conveyor and loading facility. The Alaska Railroad (ARRC)'s original role was to lease waterfront property for the facility and to transport coal (purchased by Suneel under contract) from Healy to Seward.

In the early 1990s, Hyundai Merchant Marine (HMM) purchased the SLF and operated it through 2006. In 1995, AIDEA became co-owner. In 2003, ARRC purchased the SLF with a $9.5 million federal grant intended to help save Alaska's export coal industry from a rapid decline due to global depressed coal prices. The grant money repaid the AIDEA loan and enabled some efficiency upgrades. HMM continued to operate the ARRC-owned facility until 2007 when HMM exited the business. At that point, Usibelli and ARRC hired Usibelli subsidiary Aurora Engergy Services (AES) to operate the facility.

Costs and Investments

Since 2007, ARRC and AES have invested more than $2 million on safety, operational and environmental upgrades. Export coal demand peaked at nearly 1.1 million metric tonnes (MT) in 2011 (18 ships). Since then the export coal sales have decreased by 95% over the past five years. In 2015, just 2 ships were loaded at the SLF, and in 2016 one ship. Likewise, from a pricing peak in 2012, coal prices have decreased by more than 35% and are still falling. The downturn is due in large part to a sustained influx of cheap energy on the market, slowing Asian economies and a strong U.S. dollar that puts U.S. exporters at a disadvantage with their global competitors. This trend is likely to continue for the foreseeable future.



Despite the grim outlook, ARRC has kept the facility open to allow Usibelli time to seek out new contracts and customers, and in keeping with our role as an economic developer. During these past two years the railroad has absorbed significant operating losses. Under the most recent SLF operating agreement with AES, ARRC underwrites a big chunk of the facility costs, and coal-hauling revenues are based on the market price of coal, as opposed to the actual cost of providing rail transport. Therefore, in a depressed market, with just one to two ships, the railroad is operating at a $1-2 million deficit, when accounting for SLF maintenance costs, management fees, and train operating expenses that, together, far exceed income from hauling the coal.

Moreover, in 2011, at Usibelli's request, ARRC spent several million dollars to purchase 70 additional aluminum hoppers to support anticipated growth in coal demand that never materialized. ARRC has since continued to repay this considerable debt on assets that provide little return and are not well-suited for other commodities. This too, is unsustainable.

ARRC can no longer absorb the financial losses associated with the SLF and related assets. While owned by the State of Alaska, ARRC is mandated to be self-supporting, and must make business decisions accordingly. Like so many companies, the railroad faces continued fiscal and economic uncertainty. This is coupled with the tremendous cost of developing and installing a federally-mandated Positive Train Control (PTC) system, the considerable annual cost to operate PTC, and other regulatory-required expenditures in the near to mid-term.

ARRC has offered to lease the SLF to Usibelli and also offered Usibelli first opportunity to purchase the excess hoppers. Usibell has declined. ARRC is now actively seeking a buyer for the aluminum hoppers. Based on offers thus far, ARRC expects to recoup about 60% of the original purchase price. These proceeds will be used to repay the loan debt.

In early April 2016, ARRC notified Usibelli that we must suspend SLF operations and terminate the operating agreement with AES, effective September 1, after which there will be no employees working at the facility. At the height of its operations, the SLF employed 16 full-time AES people, and accounted for dozens of jobs at the Alaska Railroad and the Usibelli Coal Mine in Healy. The SLF will not be permanently closed, but rather it will be placed into suspended operation. This means power will be shut off to all areas except the office building; electrical and other weather-sensitive equipment will be removed to avoid damage; and regular maintenance on remaining equipment (including belts, the stacker/reclaimer and ship loader) will cease.

The largely operation-specific SLF buildings will be very difficult to lease to another user. Until the SLF buildings and equipment are removed, ARRC can do little with the land to promote other economic opportunities. While unsuitable for unloading passenger vessels or cargo ships, the SLF dock can provide mooring services. In light of the railroad's mission to foster economic development, the facilities will be left intact for now to facilitate resumed operations in support of our customer if new opportunities arise. Should the export coal market rebound, the facility could resume operations with a 30- to 90-day lead time and at a re-start expense of about $200,000. In today's coal and fuel price environment, coal sales contracts totalling 560,000 MT (about 8 ships) would be needed to break even. If the facility reopened, ARRC would enter into a renegotiated agreement with Usibelli / AES that would compensate ARRC appropriately for its role and expense as a transport provider.