

In the opinion of Kutak Rock LLP, Bond Counsel with respect to the Series 2007 B Notes, under existing laws, regulations, rulings and judicial decisions, interest (including original issue discount treated as interest) on the Series 2007 B Notes is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations, except that such interest must be included in the "adjusted current earnings" of certain corporations for purposes of calculating alternative minimum taxable income. Bond Counsel also is of the opinion, that, under existing laws of the Commonwealth of Kentucky, interest on the Series 2007 B Notes is excluded from the gross income of the recipients thereof for Kentucky income tax purposes and the Series 2007 B Notes are exempt from ad valorem taxes by the Commonwealth of Kentucky and all political subdivisions thereof. See "TAX MATTERS" herein.

\$80,245,000

**COMMONWEALTH OF KENTUCKY
KENTUCKY ASSET/LIABILITY COMMISSION
UNIVERSITY OF KENTUCKY GENERAL RECEIPTS PROJECT NOTES
2007 SERIES B**

Dated: Date of delivery

Due: As shown on inside front cover

The Kentucky Asset/Liability Commission (the "Commission") is issuing its University of Kentucky General Receipts Project Notes, 2007 Series B (the "2007 B Notes") in the principal amount of \$80,245,000. The 2007 B Notes will be issued only as fully registered notes, and when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the 2007 B Notes. Purchasers will not receive certificates representing their ownership interest in the 2007 B Notes purchased. So long as DTC or its nominee is the registered owner of the 2007 B Notes, payments of the principal of and interest due on the 2007 B Notes will be made directly to DTC. The 2007 B Notes will be issued in denominations of \$5,000 or any integral multiples thereof. Principal of and interest on the 2007 B Notes will be paid directly to DTC by U.S. Bank National Association having offices in Atlanta, Georgia, as Trustee and Paying Agent (the "Trustee" and "Paying Agent").

The 2007 B Notes will bear interest payable on each April 1 and October 1, commencing on April 1, 2008. The 2007 B Notes mature on the dates, in the principal amounts, bear interest at the rates per annum and have the prices or yields shown on the inside front cover.

The 2007 B Notes are subject to optional redemption prior to maturity, as set forth herein. See "THE 2007 B NOTES – Optional Redemption" herein.

The Commission is issuing the 2007 B Notes pursuant to a Resolution of the Commission adopted October 15, 2007, to (i) pay certain expenditures in certain amounts in connection with the construction of the Patient Care Facility Phase II – Hospital for the benefit of the University of Kentucky (the "University"), (ii) pay the interest coming due on the 2007 B Notes through and including October 1, 2009 and (iii) pay the costs of issuing the 2007 B Notes. See "THE PROJECT" herein. The 2007 B Notes are being issued pursuant to the Trust Indenture dated as of October 1, 2006 as amended and supplemented by a First Supplement to Trust Indenture dated as of November 1, 2007 (the "Indenture") between the Commission and the Trustee. See "THE 2007 B NOTES" herein.

The 2007 B Notes and any interest due thereon are payable solely and only from a special fund created under the Indenture and defined therein as the Note Payment Fund (the "Note Payment Fund"), into which Financing Payments (as defined herein) received from the University are to be deposited. The Financing Payments arise under a Financing/Lease Agreement, dated as of October 1, 2006 as amended and supplemented by a First Supplement to Financing/Lease Agreement dated as of November 1, 2007 (collectively the "Financing Agreement"), among the Commission, the University and the Commonwealth of Kentucky Finance and Administration Cabinet (the "Cabinet"). The University has authorized and entered into a Trust Agreement dated as of November 1, 2005 (the "Trust Agreement"), under which it has pledged its General Receipts, as defined in the Trust Agreement, as security for the payment of Obligations, as defined in the Trust Agreement, issued thereunder. The Financing Agreement constitutes an Obligation within the meaning of the Trust Agreement. See "SECURITY FOR THE 2007 B NOTES," "SUMMARY OF THE PRINCIPAL DOCUMENTS" and "APPENDIX B – SUMMARY OF THE TRUST AGREEMENT" herein.

THE 2007 B NOTES ARE SPECIAL AND LIMITED OBLIGATIONS OF THE COMMISSION. THE 2007 B NOTES DO NOT CONSTITUTE A DEBT, LIABILITY OR OBLIGATION OF THE COMMONWEALTH, OR A PLEDGE OF THE FULL FAITH AND CREDIT OR TAXING POWER OF THE COMMONWEALTH, BUT ARE PAYABLE SOLELY FROM AMOUNTS DEPOSITED IN CERTAIN FUNDS AND ACCOUNTS CREATED BY THE RESOLUTION AND FROM RENTAL INCOME DERIVED FROM A FINANCING AGREEMENT WITH THE UNIVERSITY.

The 2007 B Notes are offered when, as and if issued and accepted by the Underwriters, subject to the approving legal opinion of Kutak Rock LLP, Bond Counsel. Certain legal matters will be passed on for the Underwriters by their counsel, Thompson Hine LLP, Cincinnati, Ohio. It is expected that delivery of the 2007 B Notes will be made on or about November 29, 2007, through the facilities of DTC, against payment therefor.

MORGAN STANLEY

**J.J.B. Hilliard, W.L. Lyons, Inc.
Morgan Keegan & Co., Inc.
Wachovia Bank, National Association
First Kentucky Securities Corp.**

**NatCity Investments, Inc.
JPMorgan
Edward D. Jones & Co., L.P.
Ross, Sinclair & Associates, LLC**

\$80,245,000
UNIVERSITY OF KENTUCKY GENERAL RECEIPTS PROJECT NOTES, 2007 SERIES B
MATURITY SCHEDULE

<u>Maturity</u>	<u>Principal Amount</u>	<u>Interest Rate</u>	<u>Yield</u>	<u>CUSIP#</u>
October 1, 2010	\$2,325,000	3.375%	3.375%	49119GCZ0
October 1, 2011	2,405,000	3.500%	3.450%	49119GDA4
October 1, 2012	2,485,000	3.600%	3.550%	49119GDB2
October 1, 2013	1,680,000	3.600%	3.650%	49119GDC0
October 1, 2013	900,000	4.000%	3.650%	49119GDD8
October 1, 2014	1,270,000	3.700%	3.750%	49119GDE6
October 1, 2014	1,415,000	4.000%	3.750%	49119GDF3
October 1, 2015	600,000	3.800%	3.850%	49119GDG1
October 1, 2015	2,195,000	5.000%	3.850%	49119GDH9
October 1, 2016	625,000	3.900%	3.940%	49119GDJ5
October 1, 2016	2,310,000	5.000%	3.940%	49119GDK2
October 1, 2017	3,065,000	4.000%	4.000%	49119GDL0
October 1, 2018	3,190,000	4.000%	4.110%	49119GDM8
October 1, 2019	3,325,000	4.125%	4.210%	49119GDN6
October 1, 2020	745,000	4.250%	4.310%	49119GDP1
October 1, 2020	2,730,000	5.000%	4.310% C	49119GDQ9
October 1, 2021	510,000	4.375%	4.420%	49119GDR7
October 1, 2021	3,140,000	5.000%	4.420% C	49119GDS5
October 1, 2022	100,000	4.400%	4.470%	49119GDT3
October 1, 2022	3,740,000	5.000%	4.470% C	49119GDU0
October 1, 2023	1,000,000	4.400%	4.510%	49119GDV8
October 1, 2023	3,030,000	5.000%	4.510% C	49119GDW6
October 1, 2024	900,000	4.500%	4.550%	49119GDX4
October 1, 2024	3,330,000	5.000%	4.550% C	49119GDY2
October 1, 2025	135,000	4.500%	4.590%	49119GDZ9
October 1, 2025	4,305,000	5.000%	4.590% C	49119GEA3
October 1, 2026	235,000	4.600%	4.630%	49119GEB1
October 1, 2026	13,805,000	5.000%	4.630% C	49119GEC9
October 1, 2027	3,145,000	4.600%	4.660%	49119GED7
October 1, 2027	11,605,000	5.000%	4.660% C	49119GEE5

C – Priced to the October 1, 2017 optional call date at a redemption price of par.

This Official Statement does not constitute an offer to sell the 2007 B Notes to any person, or the solicitation of an offer from any person to buy the 2007 B Notes, in any jurisdiction where such offer or such solicitation of an offer to buy would be unlawful. The information set forth herein is provided by the Commonwealth of Kentucky from sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness and is not to be construed as a representation of the Underwriters. No dealer, salesman or any other person has been authorized to give any information or to make any representation, other than those contained in this Official Statement, in connection with the offering contained herein, and, if given or made, such information or representation must not be relied upon as having been authorized by the Commonwealth of Kentucky or the Underwriters. The information and expressions of opinion contained herein are subject to change without notice, and neither the delivery of this Official Statement nor the sale of any 2007 B Notes shall, under any circumstances, create any implication that there has been no change in the matters described herein since the date hereof. The Official Statement is submitted in connection with the issuance of the 2007 B Notes referred to herein and may not be reproduced or used, in whole or in part, for any other purpose.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION OR AUTHORITY, NOR HAS SUCH FEDERAL OR ANY STATE COMMISSION OR AUTHORITY PASSED UPON THE ACCURACY OR ADEQUACY OF THIS OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH TEND TO STABILIZE OR MAINTAIN THE MARKET PRICE FOR THE 2007 B NOTES ABOVE THE LEVELS WHICH WOULD OTHERWISE PREVAIL. SUCH ACTIVITIES, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

KENTUCKY ASSET/LIABILITY COMMISSION

COMMISSION MEMBERS

Robert M. Burnside, Secretary of the Finance and Administration Cabinet, Chairman

Gregory D. Stumbo, Attorney General

Jonathan Miller, State Treasurer

Stan Cave, Acting State Budget Director

Ed C. Ross, State Controller

SECRETARY TO THE COMMISSION

F. Thomas Howard, Executive Director of the Office of Financial Management

UNIVERSITY OF KENTUCKY BOARD OF TRUSTEES

Mira S. Ball, Chair

Stephen P. Branscum, Vice Chair

Pamela Robinette May, Secretary

Penelope A. Brown, Member

Dermontti F. Dawson, Member

Jeffrey B. Dembo, Faculty Member

Ann Brand Haney, Alumni Member

James F. Hardymon, Member

Billy Joe Miles, Member

Phillip R. Patton, Member

Sandy Bugie Patterson, Alumni Member

Nick Phelps, Student Member

Erwin Roberts, Member

Charles R. Sachatello, Member

C. Frank Shoop, Member

Myra Leigh Tobin, Alumni Member

JoEtta Y. Wickliffe, Member

Billy B. Wilcoxson, Member

Russ Williams, Staff Member

Ernest J. Yanarella, Faculty Member

TRUSTEE AND PAYING AGENT

U.S. Bank National Association
Having offices in Atlanta, Georgia

BOND COUNSEL

Kutak Rock LLP
Omaha, Nebraska

UNDERWRITERS' COUNSEL

Thompson Hine LLP
Cincinnati, Ohio

TABLE OF CONTENTS

	Page
SUMMARY	i
INTRODUCTION	1
THE 2007 B NOTES	2
General.....	2
Optional Redemption.....	2
Book-Entry-Only System	2
Authorization	2
SECURITY FOR THE 2007 B NOTES	3
General.....	3
Budgetary Process in the Commonwealth.....	3
Pledge of General Receipts.....	3
State Intercept	4
Additional Obligations.....	4
THE PROJECT	5
ESTIMATED SOURCES AND USES OF FUNDS	6
THE UNIVERSITY	6
THE KENTUCKY ASSET/LIABILITY COMMISSION	7
General Information.....	7
Financings of the Commission	7
THE FINANCE AND ADMINISTRATION CABINET	7
THE COMMONWEALTH	8
SUMMARY OF THE PRINCIPAL DOCUMENTS.....	8
Definitions	8
The Indenture.....	13
The Financing Agreement	25
TAX MATTERS.....	26
General.....	26
Changes in Federal Tax Law	27
Tax Treatment of Original Issue Discount	27
Tax Treatment of Premium.....	28
Backup Withholding.....	28
LITIGATION.....	29
APPROVAL OF LEGALITY.....	29
RATINGS	29
CONTINUING DISCLOSURE.....	29
UNDERWRITING	30
MISCELLANEOUS	30
APPENDIX A -INFORMATION PERTAINING TO THE UNIVERSITY OF KENTUCKY	
APPENDIX B -SUMMARY OF THE TRUST AGREEMENT	
APPENDIX C -CONSOLIDATED FINANCIAL STATEMENTS OF THE UNIVERSITY OF KENTUCKY AND THE UNIVERSITY OF KENTUCKY ALBERT B. CHANDLER MEDICAL CENTER UNIVERSITY HOSPITAL AS OF JUNE 30, 2007	
APPENDIX D -INFORMATION PERTAINING TO THE COMMONWEALTH OF KENTUCKY	
APPENDIX E - BOOK-ENTRY-ONLY SYSTEM	
APPENDIX F - FORM OF BOND COUNSEL OPINION FOR THE 2007 B NOTES	

SUMMARY

The following information is furnished solely to provide limited introductory information regarding the Kentucky Asset/Liability Commission (the "Commission") and the 2007 B Notes and does not purport to be comprehensive. Such information is qualified in its entirety by reference to the more detailed information and descriptions appearing elsewhere in this Official Statement and should be read together therewith. The terms used in this Summary and not otherwise defined shall have the respective meanings assigned to them elsewhere in this Official Statement. The offering of the 2007 B Notes is made only by means of the entire Official Statement, including the Appendixes hereto. No person is authorized to make offers to sell, or solicit offers to buy, the 2007 B Notes unless the entire Official Statement is delivered in connection therewith.

- The Commission** The Commission is an independent agency of the Commonwealth of Kentucky (the "Commonwealth"). See "THE KENTUCKY ASSET/LIABILITY COMMISSION" herein.
- The Offering** The Commission is offering its University of Kentucky General Receipts Project Notes, 2007 Series B in an aggregate principal amount of \$80,245,000 (the "2007 B Notes"). See "THE 2007 B NOTES" herein.
- Authority** The 2007 B Notes are being issued pursuant to Section 56.860 *et seq.* of the Kentucky Revised Statutes (the "Act"), a Resolution adopted by the Commission on October 15, 2007 (the "Resolution"), and a Trust Indenture dated as of October 1, 2006 as supplemented and amended by that First Supplement to Trust Indenture dated November 1, 2007 (the "Indenture"), between the Commission and U.S. Bank National Association having offices in Atlanta, Georgia, as trustee and paying agent (the "Trustee" and "Paying Agent"). The State Property and Buildings Commission of the Commonwealth also has approved the issuance of the 2007 B Notes.
- Use of Proceeds** The proceeds of the 2007 B Notes will be used by the Commission to (i) pay certain expenditures in certain amounts in connection with the construction of the Patient Care Facility Phase II - Hospital for the benefit of the University of Kentucky (the "University"), (ii) pay the interest coming due on the 2007 B Notes through and including October 1, 2009 and (iii) pay the costs of issuing the 2007 B Notes. See "THE PROJECT" herein.
- Features** The 2007 B Notes will be dated as of their date of delivery, and will bear interest on each April 1 and October 1, commencing April 1, 2008, at the rates set forth on the inside cover page of this Official Statement and will mature on the dates set forth on the inside cover page of this Official Statement.
- The 2007 B Notes are subject to optional redemption prior to their respective maturities as described herein.

The 2007 B Notes are issuable only as fully registered notes, without coupons. The 2007 B Notes are being offered in the authorized denominations of \$5,000 or any integral multiples thereof, at the rates shown on the inside cover page hereof. The 2007 B Notes, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the 2007 B Notes. Purchasers will not receive certificates representing their ownership interest in the 2007 B Notes purchased. So long as DTC or its nominee is the registered owner of the 2007 B Notes, payments of the principal of and interest due on the 2007 B Notes will be made directly to DTC.

Security

The 2007 B Notes and the interest thereon are payable solely from payments of the Financing Payments (as defined herein) to be made by the University, as lessee of the Project, to the Commission, as lessor of the Project, under the Financing/Lease Agreement dated as of October 1, 2006 as amended and supplemented by a First Supplement to Financing/Lease Agreement dated as of November 1, 2007 (collectively, the "Financing Agreement") among the Commission, the Commonwealth of Kentucky Finance and Administration Cabinet (the "Cabinet") and the University, and from the other sources described herein. The Commission has pledged to the payments of its obligations with respect to the 2007 B Notes, the Financing Payments to be received from the University under the Financing Agreement. In addition, if the University fails to make timely payments under the Financing Agreement, the Secretary of the Cabinet is obligated, pursuant to KRS 164A.608, to apply to such payments, any funds that have been appropriated to the University that have not been disbursed.

See "SECURITY FOR THE 2007 B NOTES" and "SUMMARY OF THE PRINCIPAL DOCUMENTS" herein.

The University has authorized and entered into a Trust Agreement dated as of November 1, 2005 (the "Trust Agreement"), under which it has pledged its General Receipts, as defined in the Trust Agreement, as security for the payment of Obligations, as defined in the Trust Agreement, issued thereunder. The Financing Agreement constitutes an Obligation within the meaning of the Trust Agreement. The University's obligations under the Financing Agreement are, therefore, secured by a pledge of the University's General Receipts. See "SECURITY FOR THE 2007 B NOTES" and "APPENDIX B – SUMMARY OF THE TRUST AGREEMENT" herein.

THE 2007 B NOTES ARE SPECIAL AND LIMITED OBLIGATIONS OF THE COMMISSION. THE 2007 B NOTES DO NOT CONSTITUTE A DEBT, LIABILITY OR OBLIGATION OF THE COMMONWEALTH, OR A PLEDGE OF THE FULL FAITH AND CREDIT OR TAXING POWER OF THE COMMONWEALTH, BUT ARE PAYABLE SOLELY FROM AMOUNTS DEPOSITED IN CERTAIN FUNDS AND ACCOUNTS CREATED BY THE RESOLUTION AND FROM RENTAL INCOME DERIVED FROM A FINANCING AGREEMENT WITH THE UNIVERSITY.

Tax Status

In the opinion of Bond Counsel for the 2007 B Notes, based upon an analysis of existing laws, regulations, rulings and court decisions, interest on the 2007 B Notes is excluded from gross income for Federal income tax purposes. Bond Counsel for the 2007 B Notes is also of the opinion that interest is not a specific item of tax preference under Section 57 of the Internal Revenue Code of 1986 (the "Code") for purposes of the Federal individual or corporate alternative minimum taxes. Furthermore, Bond Counsel for the 2007 B Notes is of the opinion that interest on the 2007 B Notes is exempt from income taxation by the Commonwealth and the 2007 B Notes are exempt from ad valorem taxation by the Commonwealth and any of its political subdivisions. See "TAX MATTERS" herein, and "APPENDIX F."

Continuing Disclosure

Rule 15c2-12 under the Securities and Exchange Act of 1934, as amended, generally prohibits an underwriter from purchasing or selling municipal securities in an initial offering unless it has determined that the issuer of such securities has committed to provide annually, certain information, including audited financial information and notice of various events, if material, to enable the purchaser to comply with the provisions of Rule 15c2-12.

General

The Official Statement speaks only as of its date, and the information contained herein is subject to change. All summaries of documents and agreements in the Official Statement are qualified in their entirety by reference to such documents and agreements, copies of which are available from the Office of Financial Management.

Information

Information regarding the 2007 B Notes is available by contacting the Office of Financial Management, 702 Capitol Avenue, Suite 76, Frankfort, Kentucky 40601 (502) 564-2924; or Office of the Treasurer, University of Kentucky, 301 Peterson Office Building, Lexington, Kentucky 40506 (859) 257-4758; or, during the initial offering period, Morgan Stanley & Co. Incorporated, 1585 Broadway, New York, New York 10036 (212) 761-1553.

OFFICIAL STATEMENT

\$80,245,000

**COMMONWEALTH OF KENTUCKY
KENTUCKY ASSET/LIABILITY COMMISSION
UNIVERSITY OF KENTUCKY GENERAL RECEIPTS PROJECT NOTES
2007 SERIES B**

INTRODUCTION

This Official Statement (the "Official Statement"), which includes the cover page, is being distributed by the Kentucky Asset/Liability Commission (the "Commission"), an independent agency of the Commonwealth of Kentucky (the "Commonwealth"), to furnish pertinent information to the purchasers of \$80,245,000 University of Kentucky General Receipts Project Notes, 2007 Series B Notes (the "2007 B Notes"). The 2007 B Notes are being issued pursuant to Section 56.860 *et seq.* of the Kentucky Revised Statutes (the "Act"), a Resolution adopted by the Commission on October 15, 2007 (the "Resolution"), and a Trust Indenture dated as of October 1, 2006 as amended and supplemented by a First Supplement to Trust Indenture dated as of November 1, 2007 (collectively the "Indenture"), between the Commission and U.S. Bank National Association having offices in Atlanta, Georgia, as trustee and paying agent (the "Trustee" and "Paying Agent").

The proceeds of the 2007 B Notes will be used to (i) provide financing for the Project (as defined and described herein), (ii) pay the interest coming due on the 2007 B Notes through and including October 1, 2009 and (iii) pay the costs of issuing the 2007 B Notes. See "THE PROJECT" herein.

The 2007 B Notes and the interest thereon are payable solely from payments of the Financing Payments (as defined herein) to be made by the University of Kentucky (the "University") to the Commission under the Financing/Lease Agreement dated as of October 1, 2006 as amended and supplemented by a First Supplement to Financing/Lease Agreement dated as of November 1, 2007 (collectively the "Financing Agreement") among the Commission, the Commonwealth of Kentucky Finance and Administration Cabinet (the "Cabinet") and the University. The 2007 B Notes are also secured by certain other funds and accounts pledged therefor and described herein. In addition, if the University fails to make timely payments under the Financing Agreement, the Secretary of the Cabinet is obligated, pursuant to KRS 164A.608, to apply to such payments, any funds that have been appropriated to the University that have not been disbursed. See "SECURITY FOR THE 2007 B NOTES" herein.

The University has authorized and entered into a Trust Agreement dated as of November 1, 2005 (the "Trust Agreement"), under which it has pledged its General Receipts, as defined in the Trust Agreement, as security for the payment of Obligations, as defined in the Trust Agreement, issued thereunder. The Financing Agreement constitutes an Obligation within the meaning of the Trust Agreement. The University's obligations under the Financing Agreement are, therefore, secured by a pledge of the University's General Receipts. See "SECURITY FOR THE 2007 B NOTES" and "APPENDIX B – SUMMARY OF THE TRUST AGREEMENT" herein.

The summaries and references to the Act, the Trust Agreement, the Indenture, the Financing Agreement described herein, and the 2007 B Notes included in this Official Statement do not purport to be comprehensive or definitive, and such summaries and references are qualified in their entirety by reference to each such document, copies of which are available for inspection at the Office of Financial Management, 702 Capitol Avenue, Suite 76, Frankfort, Kentucky 40601 (502) 564-2924; or Office of the Treasurer, University of Kentucky, 301 Peterson Office Building, Lexington, Kentucky 40506 (859) 257-4758; or, during the initial offering period, the Underwriter, Morgan Stanley & Co. Incorporated, 1585

Broadway, New York, New York 10036 (212) 761-1553, the underwriter of the 2007 B Notes (the "Underwriter").

Capitalized terms used in this Official Statement and not otherwise defined will have the meanings given them under the caption "SUMMARY OF THE PRINCIPAL DOCUMENTS - Definitions" herein and in "APPENDIX B."

THE 2007 B NOTES

General

The 2007 B Notes are issuable only as fully registered notes. The 2007 B Notes will be issuable in the denominations of \$5,000 or any integral multiples thereof, will be dated as of their date of delivery, will bear interest payable on each April 1 and October 1, commencing April 1, 2008, at the rates set forth on the inside cover page of this Official Statement and will mature on the dates set forth on the inside cover page of this Official Statement. Principal of and interest on the 2007 B Notes are payable in lawful money of the United States to the registered owner of the 2007 B Notes, Cede & Co., as nominee of The Depository Trust Company ("DTC") in New York, New York, pursuant to the global book-entry system operated by DTC. See "APPENDIX E – BOOK-ENTRY-ONLY SYSTEM."

Optional Redemption

The 2007 B Notes maturing on or before October 1, 2017 are not subject to optional redemption prior to maturity. The 2007 B Notes maturing after October 1, 2017 are subject to redemption at the option of the Commission on or after October 1, 2017, in whole or in part at any time, at a redemption price equal to 100% of the principal amount of the 2007 B Notes to be redeemed, plus accrued interest to the date fixed for redemption.

Book-Entry-Only System

The 2007 B Notes initially will be issued solely in book-entry form to be held in the book-entry-only system maintained by DTC. So long as such book-entry system is used, only DTC will receive or have the right to receive physical delivery of the 2007 B Notes and, except as otherwise provided herein with respect to tenders by Beneficial Owners of Beneficial Ownership Interests, each as hereinafter defined, Beneficial Owners will not be or be considered to be, and will not have any rights as, owners or holders of the 2007 B Notes under the Indenture. For additional information about DTC and the book-entry-only system see "APPENDIX E – BOOK-ENTRY-ONLY SYSTEM."

Authorization

The University, at a meeting held on September 12, 2006, adopted resolutions, which, among other things, authorized the Financing Agreement.

The Commission, at a meeting held on October 15, 2007, adopted the Resolution, which, among other things (i) authorized the First Supplement to Trust Indenture, (ii) authorized and approved the issuance of the 2007 B Notes, subject to approval by a representative of the Office of Financial Management ("OFM") acting as authorized officer of the Commission (the "Authorized Officer"), (iii) authorized the Financing Agreement and (iv) directed the preparation and distribution of this Official Statement.

The State Property and Buildings Commission of the Commonwealth also has approved the issuance of the 2007 B Notes.

SECURITY FOR THE 2007 B NOTES

General

The 2007 B Notes and the interest thereon are payable solely from payments of the Financing Payments to be made by the University, as lessee of the Project, to the Commission, as lessor of the Project, under the Financing Agreement and from other sources described under this heading.

The University, as lessee, has entered into the Financing Agreement with the Commission and the Cabinet in order to provide the Commission, as lessor, with amounts to pay the principal of and interest on the 2007 B Notes as they become due. The Commission has pledged, the Financing Payments to be received from the University under the Financing Agreement to the payments of its obligations with respect to the 2007 B Notes. The University has pledged its General Receipts as security for its payment obligations under the Financing Agreement.

Budgetary Process in the Commonwealth

The General Assembly is required by the Kentucky Constitution to adopt measures providing for the Commonwealth's revenues and appropriations for each fiscal year. The Governor is required by law to submit a biennial State Budget (the "State Budget") to the General Assembly during the legislative session held in each even numbered year. State Budgets have generally been adopted by the General Assembly during those legislative sessions, which end in mid-April, to be effective upon the Governor's signature for appropriations commencing for a two-year period beginning the following July 1.

Although the University is required to submit its budgets to the General Assembly for approval as a part of the State Budget, the pledge of General Receipts by the University described herein is not subject to appropriation. However, the funds of the University that are subject to intercept (see "SECURITY FOR THE 2007 B NOTES - State Intercept") are funds that are appropriated to the University.

Pledge of General Receipts

In the Financing Agreement, which is an "Obligation" under the Trust Agreement, the University has pledged its General Receipts as security for its payment obligations thereunder.

"General Receipts" means, as reported in the Financial Statements of the University (having the designations, to the extent not otherwise defined in the Trust Agreement, set forth in the Financial Statements or such successor designations that may hereafter be used in Financial Statements):

(a) certain operating and non-operating revenues of the University, being (i) Student Registration Fees, (ii) nongovernmental grants and contracts, (iii) recoveries of facilities and administrative costs, (iv) sales and services, (v) Hospital Revenues, (vi) Housing and Dining Revenues, (vii) auxiliary enterprises – other auxiliaries, (viii) other operating revenues, (ix) state appropriations (for general operations), (x) gifts and grants, (xi) investment income, (xii) other nonoperating revenues and (xiii) other;

(b) but excluding (i) any receipts described in clause (a) which are contracts, grants, gifts, donations or pledges and receipts therefrom which, under restrictions imposed in such

contracts, grants, gifts, donations or pledges, or, which as a condition of the receipt thereof or of amounts payable thereunder are not available for payment of Debt Service Charges, (ii) federal grants and contracts, (iii) state and local grants and contracts, (iv) federal appropriations, (v) county appropriations, (vi) professional clinical service fees, (vii) auxiliary enterprises – athletics; (viii) capital appropriations, (ix) capital grants and gifts, and (x) additions to permanent endowments, including research challenge trust funds;

provided, however, that General Receipts may

(c) include any other receipts that may be designated as General Receipts from time to time by a resolution of the board of the University delivered to the Trustee;

(d) exclude any receipts not heretofore pledged, which may be designated from time to time by a resolution of the board of the University delivered to the Trustee; and

(e) exclude any receipts heretofore pledged, which may be designated from time to time by a resolution of the board of the University delivered to the Trustee and each Rating Service then rating any Obligations, but only if each such Rating Service confirms in writing to the University that the exclusion of any such receipt would not cause a reduction or withdrawal of the then current rating on any Outstanding Obligations.

The University has outstanding, certain Consolidated Educational Buildings Revenue Bonds (the "Building Bonds") to which General Receipts described in (a)(i) and (a)(vi) above are respectively pledged on a priority basis to the pledge of those General Receipts under the Trust Agreement. The University has covenanted not to issue any additional Building Bonds. The prior pledge of those General Receipts securing Building Bonds will terminate when there are no Building Bonds outstanding. See "APPENDIX A" for information regarding outstanding Building Bonds. There are currently no other Obligations outstanding under the Trust Agreement other than the University's \$7,160,000 General Receipts Bonds, 2005 Series A, the University's obligations related to the Commission's \$107,540,000 University of Kentucky General Receipts Project Notes, 2005 Series A and the University's \$24,325,000 General Receipts Bonds (Student Health Facility Project), 2006 Series A and the University's obligations related to the Commission under the Financing Agreement relating to the 2007 A Notes and the 2006 Notes.

State Intercept

If the University fails to make timely payments under the Financing Agreement, the Secretary of the Cabinet is obligated, pursuant to KRS 164A.608, to apply to such payments, any funds that have been appropriated to the University that have not yet been disbursed. Payments under the Financing Agreement are required to be deposited with the Trustee at least ten days prior to the corresponding due date for a payment of any debt service on the 2007 B Notes. If the amount required to pay debt service is not on deposit by that date, the Trustee is obligated under the Indenture to immediately notify the Secretary of the Cabinet of the default in payment. Under KRS 164A.608, the Secretary of the Cabinet is required, within five days of the default, to remit the amount required to pay debt service to the Trustee from undisbursed funds which have been appropriated to the University.

Additional Obligations

The University has reserved the right to issue additional Obligations secured by a pledge of General Receipts. See "APPENDIX B". Those Obligations may be in the form of financing agreements related to the future issuance of notes by the Commission for the University.

THE PROJECT

The 2007 B Notes are being issued to pay a portion of the costs of the Construction Project and costs of issuance of the 2007 B Notes, and pay interest on the 2007 B Notes to and including October 1, 2009.

The Construction Project entails an expansion of and limited renovation to the existing University Hospital, situated adjacent to the existing Hospital Critical Care Center and the Gill Heart Institute, and the addition of a parking structure and overhead concourse (bridge) connector to the new addition.

In general the Construction Project is to contain the following:

1. Hospital Expansion of approximately 1,252,032 exterior gross square feet of building space. Interior fit-up spaces identified for the initial phase of the hospital program elements is 482,714 square feet. (fit-up figure includes 135,080 square feet of mechanical spaces). The remaining 595,698 square feet will be shelled for future program interior fit-up. Program elements of this initial phase presently includes: four new acute care Nursing Units (128 private patient room beds configured as a 12 bed ICU and 20-bed med/surge nursing units); admitting and related support space, new Security Office, new Loading Dock and Bulk Processing space; pedestrian and staff links for each floor of the new and existing Hospital buildings; 1-MRI Imaging unit in one suite (shell space for second unit); new Emergency Services department with adjacent support of Radiology services containing two new CT Scan and two R/F X-Ray suites; Emergency Services department will also contain Stat Lab and Ultrasound Room with Panarex X-ray unit; shell space for new Diagnostic and Treatment Department; new lobby and entrance and a new helipad on the roof to access the new Emergency Services Department.

2. Parking Structure containing space for approximately 1,600 cars. (The Parking Structure is expected to be completed in March 2008. Partial occupancy is expected in November 2007.)

3. Bridge concourse over South Limestone Street connecting the new parking structure and new hospital expansion. The estimated size is 20 feet in width and 250 feet in length. The juncture of the concourse to the garage will make future retail spaces available at street level and the concourse level for construction later.

4. Infrastructure expansion to the University's heating and cooling piping loops to include one (1-125,000 lb/HR) new boiler and four new 2,500 ton chillers. Three new emergency generators are being installed to support new Hospital power loads and added support for existing loads (2 MW of electrical capacity).

5. Renovation of existing Critical Care Center and Gill Heart Institute buildings, to interface with the new hospital expansion for operational efficiencies. Renovation is limited to construction required to make new building connections.

6. New entrance drives to support new Hospital Public and Visitor entrance and site improvements for Emergency Services entrance. New Employee entrance created to facilitate shuttle bus activity from remote parking locations.

The Regular Sessions of the 2005 and 2006 Kentucky General Assemblies authorized \$100 million and \$150 million, respectively, of bonds for the Construction Project, as well as \$100 million and \$25 million of University funds. The Capital Projects and Bond Oversight Committee of the Kentucky Legislative Research Commission has approved combining these and other project authorities for a total Construction Project scope of \$450 million.

ESTIMATED SOURCES AND USES OF FUNDS

The estimated sources and uses of funds are to be applied as follows:

<u>Sources</u>	<u>2007 B Notes</u>
Par Amount of Notes	\$80,245,000.00
Net Premium	<u>1,805,236.65</u>
Total Sources	\$ 82,050,236.65

<u>Uses</u>	
Deposit to Project Fund	\$ 75,000,000.00
Deposit to Note Payment Fund	
(capitalized interest)	6,538,952.42
Costs of Issuance ¹	<u>511,284.23</u>
Total Uses	\$ 82,050,236.65

¹ Includes underwriters' discount, legal fees, rating agency fees, printing, and other costs of issuance

THE UNIVERSITY

The University is a comprehensive, land-grant institution located in Lexington (Fayette County), Kentucky. Founded in 1865 under the provisions of the Morrill Land-Grant Act, the University began as part of Kentucky University. In 1878, the Agricultural and Mechanical College was separated from Kentucky University and reestablished on land given by Lexington and Fayette County. To provide a separate campus for the new institution, Lexington donated its 50-acre fairground and park and, along with Fayette County, contributed construction of the buildings. Thirty years later the name was changed to State University, Lexington, Kentucky, and in 1916 it became the University of Kentucky.

The University is organized into sixteen colleges and graduate schools plus extension programs, and is located in Lexington, Kentucky. From an enrollment of 273 students in 1876, the University has grown to over 27,000 students and more than 11,000 faculty and staff. The campus today has more than 100 major buildings including not only modern teaching and research facilities, but also renovated history-laden structures dating back to the 1800's. The University has produced two Nobel Laureates and seven governors of the Commonwealth including the first female governor. Scientific advances in medicine, energy, equine and other fields of research have caused the University to be ranked among the top 100 research universities in the nation, the only university in Kentucky to be so recognized.

Additional information regarding the University is set forth in "APPENDIX A."

THE KENTUCKY ASSET/LIABILITY COMMISSION

General Information

The Act created the Kentucky Asset/Liability Commission, which is composed of five members, each serving in an *ex officio* capacity. Under the Act, the members are as follows: the Secretary of the Finance and Administration Cabinet, who acts as Chairman; the Attorney General; the State Treasurer; the State Budget Director; and the State Controller. The State Controller was added to the Commission by Executive Order 2007-502 dated June 21, 2007 and effective June 16, 2007.

The current members of the Commission are as follows:

Robert M. Burnside	Secretary of the Finance and Administration Cabinet, Chairman
Gregory D. Stumbo	Attorney General
Jonathan Miller	State Treasurer
Stan Cave	Acting State Budget Director
Ed C. Ross	State Controller

The Secretary to the Commission is the Executive Director of OFM.

The Commission was created by the General Assembly to develop policies and strategies to minimize the impact of fluctuating interest rates on the Commonwealth's interest-sensitive assets and interest-sensitive liabilities. The Commission is authorized to issue tax and revenue anticipation notes, project notes and funding notes. Tax and revenue anticipation notes are to be used for the purpose of providing monies to discharge expenditure demands in anticipation of revenues and taxes to be collected during the fiscal year. Project notes are to be used for authorized projects upon request of the Finance and Administration Cabinet, to be repaid through financing agreements or alternative agreements. Funding notes are to be used for the purpose of funding judgments against the Commonwealth or any state agency. OFM, which is in the Finance and Administration Cabinet, serves as staff to the Commission.

Financings of the Commission

Information regarding outstanding notes of the Commission is included in "APPENDIX D" under the heading "Financings of the Commission."

THE FINANCE AND ADMINISTRATION CABINET

The Cabinet, created and governed by the provisions of KRS 12.020 and KRS 42.011, is a statutory administrative organization of the Commonwealth headed by the Secretary of the Cabinet, who is appointed by the Governor. The Secretary of the Cabinet is the chief financial officer of the Commonwealth.

Senate Bill 49 of the 2005 General Assembly reorganized the Finance and Administration Cabinet to assume the responsibilities of the former Revenue Cabinet and the Governor's Office of Technology. In addition to the newly assumed responsibilities, Cabinet functions include, (1) coordination and supervision of the fiscal affairs and fiscal procedures of the Commonwealth; (2)

accounting, fiscal reporting and auditing of Commonwealth accounts; (3) purchasing, storekeeping and control of property and stores; (4) the construction, maintenance and operation of public buildings, except those provided for the exclusive use of certain agencies; (5) providing administrative services of a financial nature to other agencies of state government; (6) the investment and management of all Commonwealth funds other than pension funds; and (7) oversight of the issuance and management of all debt incurred in the name of the Commonwealth or any agency thereof.

Under the Act, the Cabinet is required to be a party to the Financing Agreement.

THE COMMONWEALTH

The Commonwealth of Kentucky, nicknamed the Bluegrass State, was the first state west of the Alleghenies to be settled by pioneers. Kentucky is bounded by the Ohio River to the north and the Mississippi River to the west, and is bordered by the States of Illinois, Indiana, Ohio, West Virginia, Tennessee and Missouri and the Commonwealth of Virginia.

The Commonwealth's economy in many ways resembles a scaled-down version of the U.S. economy in its diversity. The Kentucky economy, once dominated by coal, horses, bourbon and tobacco has become a diversified modern economy including manufacturing of industrial machinery, automobiles and automobile parts and consumer appliances. In addition, Kentucky's nonmanufacturing industries have grown considerably in recent years, with strong gains in air transportation, health and business services, and retail trade. The Commonwealth's parks, horse breeding and racing industry, symbolized by the Kentucky Derby, play an important role in expanding the tourism industry in the Commonwealth.

Additional information regarding the Commonwealth is set forth in "APPENDIX D."

SUMMARY OF THE PRINCIPAL DOCUMENTS

Summarized below are certain provisions of the Indenture and the Financing Agreement. This summary does not purport to be complete, and is qualified by reference to the Indenture and the Financing Agreement. UNDER THE FINANCING AGREEMENT, THE UNIVERSITY HAS PLEDGED ITS GENERAL RECEIPTS. A SUMMARY OF THE PROVISIONS OF THE TRUST AGREEMENT UNDER WHICH THE FINANCING AGREEMENT WAS ISSUED IS INCLUDED IN APPENDIX B.

Definitions

Set forth below are the definitions of some of the terms used in this Official Statement, the Indenture and the Financing Agreement. Reference is made to the Indenture and the Financing Agreement for a complete recital of the terms defined therein.

"Act" means Section 56.860 et seq. of the Kentucky Revised Statutes, as amended.

"Additional Notes" means notes issued under the provisions of Section 2.06(a) of the Indenture.

"Additional Payments" means the Additional Payments payable under the Financing Agreement.

"Authorized Denominations" means \$5,000 and integral multiples thereof.

"Authorized Officer" means, as to the Cabinet or the Commission, the Executive Director of the Office of Financial Management and any other officer, member or employee of the Office of Financial Management authorized by a certificate of the Executive Officer to perform the act or sign the document

in question, and if there is no such authorization, means the Executive Officer and as to the University, its Treasurer and any other officer, member or employee of the University authorized by a certificate of the Chairman or Secretary of the Board of Trustees of the University to perform the act or sign the document in question.

"Budget Act" means, as to the 2007 Series A Notes and the 2007 Series B Notes, House Bill 380 of the General Assembly of the Commonwealth of Kentucky, 2006 Regular Session, as enacted and vetoed in part, and, as to any other Additional Notes, the Executive Branch Budget of the Commonwealth authorizing the construction of other portions of the Construction Project.

"Business Day" means any day other than (i) a day on which the Trustee or the Paying Agent is required, or is authorized or not prohibited, by law (including executive orders) to close and is closed and (ii) a day on which the New York Stock Exchange is closed.

"Cabinet" means the Finance and Administration Cabinet of the Commonwealth.

"Commission" means the Kentucky Asset/Liability Commission.

"Construction Project" means the Patient Care Facility Phase II Hospital, authorized for the University by the Budget Act and described in the Financing Agreement.

"Cost of Issuance Fund" means the Fund so designated which is established and created by Sections 5.03 and 5.04 of the Indenture.

"Costs of Issuance" means only the costs of issuing 2007 B Notes as designated by the Commission; including, but not being limited to, the fees and charges of the financial advisors or Underwriter, bond counsel, Trustee, Trustee's counsel, rating agencies, note and official statement printers and such other fees and expenses normally attendant to an issue of Notes.

"Counsel" or "Counsel's Opinion" means an opinion signed by such attorney or firm of attorneys of recognized national standing in the field of law relating to municipal bonds and municipal finance as may be selected by the Commission.

"Debt Servicing Date" means any Interest Payment Date, as defined herein.

"Debt Servicing Obligation" means the aggregate amounts required to be paid in respect of the Notes on any Debt Servicing Date, including (i) the scheduled maturity of principal of any Notes maturing on such Debt Servicing Date and the principal amount of Notes, if any, called for redemption on such Debt Servicing Date, and the premium, if any, with respect to such Notes, (ii) the interest required or estimated (by the Commission) to be paid on the Notes, and (iii) the reasonable and agreed fees of the Trustee, the Paying Agent and the Registrar, but only to the extent not otherwise paid directly by the University. The University shall be entitled to a credit against the Debt Servicing Obligation otherwise required to be paid on any Debt Servicing Date to the extent there are funds in the Interest Account of the Note Payment Fund prior to the payment of the Debt Servicing Obligation hereunder which, under the terms of the Indenture and applicable law, can be used to meet the Debt Servicing Obligation. It is understood that, pursuant to the Indenture, all income derived from investment of the Project Fund may, at the discretion of the University, be transferred to the Note Payment Fund and, if so transferred, shall be a credit against Financing Payments due and payable by the University. Amounts transferred from the Cost of Issuance Fund, established by the Indenture, to the Note Payment Fund, shall be a further credit against Financing Payments due and payable by the University.

"Eligible Investments" means any investment authorized by Section 42.500 of the Kentucky Revised Statutes, as the same may be amended from time to time.

"Executive Officer" means the Chairman of the Commission.

"Fiduciary" or "Fiduciaries" means the Trustee, any Paying Agent or Agents, or any combination of them, as may be appropriate.

"Financing Agreement" means the Financing/Lease Agreement, dated as of October 1, 2006 among the Commission, the Cabinet and the University by which the Project is leased to the University, and any amendments or supplements thereto.

"Financing Payments" means Financing Payments payable under the Financing Agreement.

"First Supplement to Trust Indenture" means the First Supplement to Trust Indenture dated November 1, 2007 amending and supplementing the Indenture.

"Fitch" means Fitch Ratings.

"Funds and Accounts" means the Cost of Issuance Fund, Note Payment Fund, Project Fund and Rebate Fund and the accounts within such funds established by the Trust Indenture.

"Holder" or "Owner" or any similar term (when used with reference to Notes) means the person in whose name a Note is registered.

"Indenture" or "Trust Indenture" means the Indenture, dated as of October 1, 2006, and entered into between the Commission and the Trustee, as amended or supplemented from time to time.

"Interest Accounts" means the accounts by that name in the Note Payment Fund established under the Indenture.

"Interest Payment Date" means each April 1 and October 1, commencing April 1, 2008 with respect to the 2007 B Notes.

"Memorandum of Instructions" means a Memorandum of Instructions Regarding Rebate which may be delivered to the Commission and the Trustee at the time of the issuance and delivery of the 2007 B Notes, as the same may be amended or supplemented in accordance with its terms.

"Moody's" means Moody's Investors Service, Inc.

"Note Payment Fund" means the Fund so designated which is established and created by Sections 5.03 and 5.05 of the Indenture.

"Notes" means, collectively, the 2006 Series A Notes, the 2006 Series B Notes, the 2007 Series A Notes and the 2007 Series B Notes, together with any Additional Notes and Refunding Notes issued from time to time under the provisions of the Indenture.

"Outstanding" when used with reference to Notes, means, as of any date, all Notes theretofore or then being authenticated and delivered under the Indenture except:

(a) Notes cancelled upon surrender, exchange or transfer or cancelled because of payment or redemption at or prior to such date;

(b) Notes for the payment, redemption or purchase for cancellation of which sufficient moneys have been deposited and credited for the purpose on or prior to that date in the Note Payment Fund (whether upon or prior to the maturity or Redemption Date of those Notes); provided that if any of those Notes are to be redeemed prior to their maturity, notice of that redemption shall have been given or arrangements satisfactory to the Trustee shall have been made for giving notice of that redemption, or waiver by the affected Noteholders of that notice satisfactory in form to the Trustee shall have been filed with the Trustee, and provided further that if any of those Notes are to be purchased for cancellation a firm offer for sale stating the price shall have been received and accepted;

(c) Notes which are deemed to have been paid pursuant to the provisions of Article IX of the Indenture or any Notes which are deemed to have been paid pursuant to the provisions of the Indenture; and

(d) Notes in lieu of which others have been authenticated under Sections 3.07, 3.08 and 3.11 of the Indenture.

"Paying Agent" means initially, the Trustee, and any bank or trust company so designated, and its successor or successors hereafter appointed, as paying agent for the Notes in the manner provided in the Indenture.

"Pledged Receipts" include:

(i) all of the Financing Payments and Additional Payments, as defined in the Financing Agreement, to be paid by the University to the Commission pursuant to the Financing Agreement; and

(ii) all interest earned and gains realized on Eligible Investments (a) except for earnings and gains on any investments in the Rebate Fund and (b) unless this Trust Indenture specifically requires such interest earned or gains realized to remain in a particular Fund or Account and does not therefore constitute a Pledged Receipt.

"Principal Accounts" means the accounts by that name in the Note Payment Fund established under Section 5.05 of the Indenture.

"Project" means that portion of the Patient Care Facility Phase II – Hospital, authorized for the University by the Budget Act and described in the Financing Agreement financed with the proceeds of the 2007 B Notes.

"Project Fund" means the Project Fund created by Sections 5.03 and 5.06 of the Indenture.

"Rating Service" means Moody's, if Moody's is then rating the Notes, S&P, if S&P is then rating the Notes, and Fitch, if Fitch is then rating the Notes, and their respective successors and assigns.

"Rebate Fund" means a fund by that name established pursuant to Sections 5.03 and 5.07 of the Indenture.

"Record Date" means the first day of the month next preceding the applicable Interest Payment Date.

"Redemption Date" means the date established for the redemption of 2007 B Notes as described under the heading "THE 2007 B NOTES – Optional Redemption."

"Refunding Notes" means notes issued under the provisions of Section 2.06(b) of the Indenture, the proceeds of which are used solely and only to refund a portion of the Notes then Outstanding under the Indenture and to pay the costs of issuing such Refunding Notes.

"Registrar" means the registrar maintaining the registration books for any 2007 B Notes.

"Resolution" means the resolution of the Commission adopted October 15, 2007 authorizing the issuance of the 2007 B Notes and the execution and delivery of the First Supplement to Trust Indenture.

"S&P" means Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc.

"State" means the Commonwealth of Kentucky.

"Supplemental Trust Indenture" means any trust indenture supplemental to or amendatory of the Indenture adopted by the Commission in accordance with the Indenture.

"Treasurer" means the Treasurer of the State.

"Trust Estate" means the trust estate created by the Indenture and by the pledges specifically set forth in Section 5.02 of the Indenture.

"Trustee" means the Trustee appointed pursuant to Section 9.01 of the Indenture, and its successor or successors, and any other corporation which may at any time be substituted in its place pursuant to the Indenture.

"Underwriter" means Morgan Stanley & Co. Incorporated, as representative of the underwriters identified in the Note Purchase Contact for 2007 Series B Notes.

"University" means the University of Kentucky.

"2006 Notes" means the 2006 A Notes and the 2006 B Notes.

"2006 A Notes" means the Commission's University of Kentucky General Receipts Refunding Project Notes, 2006 Series A, issued under the provisions of the Indenture.

"2006 B Notes" means the Commission's University of Kentucky General Receipts Taxable Refunding Project Notes, 2006 Series B, issued under the provisions of the Indenture.

"2007 A Notes" means the Commission's University of Kentucky General Receipts Project Notes, 2007 Series A, issued under the provisions of the Indenture.

"2007 B Notes" means the Commission's University of Kentucky General Receipts Project Notes, 2007 Series B, issued under the provisions of the Indenture.

The Indenture

Delivery of the 2007 B Notes. The Indenture authorizes the issuance of the 2007 B Notes in the aggregate amount set forth on the cover page hereto. All 2007 B Notes issued under the Indenture will rank on a parity and equality with one another and are entitled to the benefit of the continuing pledge and lien created by the Indenture to secure the full and final payment of the principal of and interest on the Notes. (Section 2.04)

Additional Notes; Refunding Notes. The Commission reserves the right and covenants that, to the extent the Executive Branch Budget of the State subsequently authorizes the University to incur additional debt for the purpose of completing additional construction projects, then the Commission may authorize, issue, sell and deliver a sufficient amount, but only a sufficient amount, of Additional Notes which may be on a parity as to security with the Notes in order to complete the construction projects to the extent approved by Executive Branch Budget. Additional Notes may also be issued pursuant to the Indenture, if at any time insurance proceeds are insufficient to make repairs or replace portions of the Construction Project which have been damaged, but only a sufficient amount, of Additional Notes in order to make such necessary repairs and replacements, subject to any limitations on the issuance of such notes as may then exist under the Kentucky Revised Statutes.

No Additional Notes on a parity as to security with the Notes for such specific purposes provided for in the Indenture, may be issued unless at such time the Commission is and has been in continuous compliance with all of the provisions with reference to the payment of the principal and interest with respect to the Notes and is and has been in continuous compliance with the Indenture. If any Additional Notes for such purposes are issued on a basis of parity as to security with the Notes, the Financing Agreement shall be amended to provide for payments sufficient to pay the principal and interest with respect to all Notes Outstanding under the Indenture and all Additional Notes.

No other Additional Notes may be issued at any time secured by the Pledged Receipts except and unless such pledge is made subject and subordinate to the priority of the pledges made in the Indenture to secure the Notes.

The Commission reserves the right to issue Refunding Notes which may be on a parity as to security with the Notes in order to refund any Notes then Outstanding under the Indenture.

No Refunding Notes on a parity as to security with the Notes may be issued unless at such time the Commission is and has been in continuous compliance with all of the provisions with reference to the payment of the principal and interest with respect to the Notes and is and has been in continuous compliance with all of the covenants under the Indenture. (Section 2.06)

The Pledge Effected By The Indenture. Pursuant to the Act and the Indenture, there is pledged for the payment of the principal of and interest on the Notes, payable in accordance with their terms and the provisions of the Indenture, subject only to the provisions of the Indenture permitting the application thereof for or to the purposes and on the terms and conditions set forth in the Indenture, (i) the proceeds of sale of the Notes, (ii) Eligible Investments acquired from Note proceeds or by application of moneys in Funds and Accounts (subject to the limitations of (iv) below), (iii) the Pledged Receipts, and (iv) all Funds and Accounts created and established pursuant to the Indenture other than the Rebate Fund, including moneys and securities therein. (Section 5.02)

Establishment of Funds. The Indenture establishes (i) the Cost of Issuance Fund; (ii) the Note Payment Fund; (iii) the Project Fund; (iv) the Rebate Fund and (v) such other Funds and Accounts which may be created from time to time in order to accomplish the purposes of the Act and the Indenture and

which are not inconsistent with the requirements of the Indenture. Each of the above Funds, in addition to other Accounts from time to time established, are required to be held and maintained by the Trustee pursuant to the provisions of the Indenture, except for the Project Fund, which is required to be held by the Treasurer. (Section 5.03)

Cost of Issuance Fund. The Indenture establishes and creates a separate Cost of Issuance Fund with a separate account established within the Cost of Issuance Fund for each series of the Notes, including the 2007 B Notes. There will be deposited in the Cost of Issuance Fund, the amount required by the Indenture. The Trustee is required from time to time pay out, or permit the withdrawal of, moneys from the Cost of Issuance Fund, free and clear of any lien or pledge or assignment in trust created by the Indenture, for the purpose of paying, any Costs of Issuance, upon receipt by the Trustee of a written requisition of the Commission signed by an Authorized Officer of the Commission stating with respect to each payment to be made, the Costs of Issuance to be so paid.

If any moneys remain in the Cost of Issuance Fund on the date which is five months from the date of issuance of the 2007 B Notes, the Trustee is required to transfer such amounts to the Note Payment Fund. (Section 5.04)

Note Payment Fund. The Indenture establishes and creates a separate Note Payment Fund. In addition to any other Accounts deemed necessary by the Trustee, the Indenture establishes within the Note Payment Fund the following:

An Interest Account for each Series of Notes, into which will be deposited all amounts (i) received as accrued interest upon the sale and delivery of any Notes of such Series and (ii) received as the interest portion of Financing Payments (including any prepayments of the interest portion of Financing Payments).

A Principal Account for each Series of Notes, into which will be deposited all amounts (i) transferred from the account in the Project Fund for such Series of Notes to pay principal of and premium, if any, on the Notes of such Series due at maturity, on a Redemption Date or upon acceleration; (ii) received as the principal portion of Financing Payments (including any prepayments of the principal portion of Financing Payments); and (iii) representing proceeds of and premium, if any, on Notes of such Series to pay principal of such Notes at maturity on a Redemption Date, or upon acceleration.

Amounts in the Interest Accounts are required to be used to pay interest on the related Series of Notes. Amounts in the Principal Accounts will be used to pay principal of and premium, if any, on the related Series of Notes.

The Indenture requires the Trustee to transmit to any Paying Agent, as appropriate, from moneys in the Note Payment Fund applicable thereto, amounts sufficient to make timely payments of principal of, interest on and premium, if any, on the Notes to be made by such Paying Agent and then due and payable. (Section 5.05)

Project Fund. The Indenture establishes and creates a trust fund to be designated the Project Fund and a separate account therein for the 2007 B Notes and each series of Additional Notes, which are required to be accounts in the Commonwealth's management administrative and reporting system. The Project Fund and the accounts therein are required to be separately identified from all other accounts in the Commonwealth's management administrative and reporting system and are required to be used solely for the purposes provided in the Indenture. A portion of the proceeds of the issuance and delivery of the 2007 B Notes in an amount not more than the amount authorized for the Project by the Budget Act, are required to be deposited in the Project Fund. Under the Indenture, the Treasurer makes disbursements

from the Project Fund on a first-in-first-out basis in accordance with and as required by the provisions of requisitions filed from time to time by an Authorized Officer of the University and in accordance with the provisions of the Financing Agreement. The University is required to keep and maintain adequate records pertaining to the Project Fund and all disbursements therefrom. All of the income derived from investment of the Project Fund will, at the option of the University, be transferred as received to the Note Payment Fund and disbursed therefrom on the next succeeding Interest Payment Date or held in the Project Fund and used for the purposes thereof. If any amount remains in the Project Fund after an Authorized Officer of the University certifies that the Project has been completed, such amount shall be transferred to the Interest Account of the Note Payment Fund. (Section 5.06)

Rebate Fund. The Indenture establishes and creates a trust fund to be designated the Rebate Fund, which is established and maintained under the Indenture or under any laws governing the creation and use of funds by the Commission. If a Series of Notes is determined to be subject to the "rebate" requirements in favor of the United States of America imposed by the Code, there will be deposited in the Rebate Fund such amounts as are required to be deposited therein pursuant to the related Memorandum of Instructions. Subject to the transfer provisions provided in Section 5.07 of the Indenture, all money at any time deposited in the Rebate Fund will be held by the Trustee in trust, to the extent required to satisfy the Rebate Amount (as defined in the Memorandum of Instructions), for payment to the federal government of the United States of America, and neither the Commission, nor the owner of any Notes will have any rights in or claim to such money. All amounts deposited into or on deposit in the Rebate Fund will be governed by Article V of the Indenture, and by the Memorandum of Instructions. The Trustee will be deemed conclusively to have complied with such provisions if it follows the directions of the Commission including supplying all necessary information in the manner provided in the Memorandum of Instructions, and will have no liability or responsibility to enforce compliance by the Commission with the terms of the Memorandum of Instructions.

Upon the Commission's written direction, an amount is required to be deposited to the Rebate Fund by the Trustee from deposits by the Commission, if and to the extent required, so that the balance of the Rebate Fund after such deposit equals the Rebate Amount for the Bond Year (as such term is defined in the Memorandum of Instructions) calculated as of the most recent Calculation Date (as defined in the Memorandum of Instructions). Computations of the Rebate Amount are required to be furnished by or on behalf of the Commission in accordance with the Memorandum of Instructions.

The Trustee will have no obligation to rebate any amounts required to be rebated pursuant to Section 5.07 of the Indenture, other than from moneys held in the Funds and Accounts or from other moneys provided to it by the Commission.

The Trustee is required to, upon written direction, invest all amounts held in the Rebate Fund, subject to the restrictions set forth in the Indenture for investments in other funds established in the Indenture and in the Memorandum of Instructions. The Trustee will retain all earnings (calculated by taking into account net gains or losses on sales or exchanges and taking into account amortized discount or premium as a gain or loss, respectively) on investments held in the Rebate Fund in the Rebate Fund. Moneys will not be transferred from the Rebate Fund except as provided in the following paragraph.

Upon receipt of the Commission's written directions, the Trustee shall remit part or all of the balances in the Rebate Fund to the United States, as so directed. In addition, if the Commission so directs, the Trustee will deposit moneys into or transfer moneys out of the Rebate Fund from or into such account or funds as directed by the Commission's written directions. Any funds remaining in the Rebate Fund after redemption and payment of all of the Notes and payment and satisfaction of any Rebate Amount, or provision made therefore satisfactory to the Trustee shall be withdrawn and remitted to, or at the direction of, the Commission.

Notwithstanding any other provision of the Indenture, the obligation to remit the Rebate Amounts to the United States and to comply with all other requirements of Section 5.07 of the Indenture and the Memorandum of Instructions will survive the defeasance or payment in full of the Notes. (Section 5.07)

Investment of Funds. The Indenture requires amounts on deposit in any Fund or Account to be invested in Eligible Investments, and for the Trustee to sell at the best price reasonably obtainable, or present for redemption or exchange, any Eligible Investments purchased by it as an investment pursuant to the Indenture whenever it will be necessary in order to provide moneys to meet any payment or transfer from the Fund or Account from which such investment was made. Except as otherwise provided in the Indenture, earnings and losses on Eligible Investments are required to be credited to the Fund or Account with respect to which such investments were made (or pro-rated thereto) and will become a part thereof for all purposes, except as otherwise provided in the Indenture. (Section 5.08)

Further Assurance. The Indenture requires the Commission, so far as it may be authorized by law, to pass, make, do, execute, acknowledge and deliver, all and every such further resolutions, acts, deeds, conveyances, assignments, transfers and assurances as may be necessary or desirable for the better assuring, conveying, granting, assigning and confirming all and singular the rights, assets and revenues pledged and assigned, or intended so to be, or which the Commission may become bound to pledge or assign. (Section 6.04)

Powers as to 2007 B Notes and Pledge. Under the Indenture, the Commission is authorized to issue the 2007 B Notes and execute and deliver the Indenture and pledge the income, revenues and assets pledged by the Indenture in the manner and to the extent provided in the Indenture. The income, revenues and assets pledged are and will be free and clear of any pledge, lien, charge or encumbrance thereon or with respect thereto prior to, or of equal rank with, the pledge created by the Indenture, and all official action on the part of the Commission to that end has been or will be duly and validly taken. The 2007 B Notes and the provisions of the Indenture are and will be the valid and legally enforceable obligations of the Commission in accordance with their terms and the terms of the Indenture. The Budget Act includes authorization for the issuance of "bonds" (including the 2007 B Notes) for the Project and includes adequate funds for the payment of Financing Payments and Additional Payments under the Financing Agreement. The Commission is required to at all times, to the extent permitted by law, defend, preserve and protect the pledge of the incomes, revenues and assets pledged under the Indenture and all the rights of the Holders under the Indenture against all claims and demands therefore of all persons whomsoever. (Section 6.05)

Covenants as to Financing Payments and Additional Payments. The Indenture establishes that the Financing Agreement will continue to be maintained by the Commission. In the event the University for any reason whatsoever fails to pay any Financing Payments or Additional Payments specified in the Financing Agreement, the Commission will use its best efforts to make or cause to be made payments of Financing Payments or Additional Payments so that the aggregate of the gross receipts and revenues from the Financing Agreement at all times will be sufficient to make such prescribed payments into the Note Payment Fund; provided, however, that in the event of any failure of the University to make its payments as aforesaid, no action shall be taken which, in Counsel's opinion, would have the effect of materially altering the federal income tax status of the interest earned on the 2006 A Notes, 2007 A Notes or 2007 B Notes.

If, at any time, the prescribed Financing Payments under the Financing Agreement are not sufficient to pay the principal of and the interest on the Notes authorized in the Indenture or Additional Payments are not sufficient to pay fees and expenses related to the Notes, in accordance with the provisions of the Indenture, such Financing Payments or Additional Payments are required to be immediately adjusted in order to produce sufficient revenues for such purposes. (Section 6.08)

Covenant to Confer with Appropriate Officials Concerning Biennial Budget. The Commission will, prior to the beginning of each fiscal biennium confer with the proper officials of the University to induce the University to include in its budget such provisions and arrangements as may be required and appropriate to continue to pay the prescribed Financing Payments and Additional Payments during such biennial period. (Section 6.09)

Covenant to Enforce the Financing Agreement. So long as any of the Notes are Outstanding and unpaid as to either principal or interest, the Commission will continuously enforce the Financing Agreement to the maximum extent permitted by law, and will not consent to any modification of the Financing Agreement which would in any particular way impair the security created for the holders of the Notes. (Section 6.10)

Tax Covenant. The Commission is required to do and perform all acts and things permitted by law and necessary or desirable in order to assure that interest paid by the Commission on the 2007 B Notes will, for the purposes of federal income taxation, be excludable from gross income under any valid provision of law including but not limited to, provisions of the Code and Section 122 of Title 23, as applicable.

The Commission will not permit at any time or times any of the proceeds of the 2007 B Notes to be used to acquire or to replace funds which were used directly or indirectly to acquire any securities or obligations which are "higher yielding investments" (as defined in the Code), the acquisition of which would cause any 2007 B Note to be an "arbitrage bond" as defined in Sections 103(b)(2) and 148 of the Code as then in effect, unless, under any valid provision of law hereafter enacted (i) such action would not cause arbitrage bond status to occur, or (ii) the interest paid by the Commission on the 2007 B Notes will be excludable from the gross income of a recipient thereof for federal income tax purposes without regard to compliance with the provisions of Section 103(a) of the Code.

In order to assure compliance with Section 6.11 of the Indenture, thereby better securing and protecting the 2007 B Notes, the Commission from the date of adoption of the Indenture will not:

- (1) make or cause to be made any investment of proceeds of the 2007 B Notes that produces a yield in excess of such applicable maximum yield as may be permitted by the Code, and
- (2) invest or cause the Trustee (or the Treasurer, as the case may be) to, and the Trustee (or the Treasurer, as the case may be) shall not, independent of any direction of the Commission, invest monies in any fund created under the Indenture in investment obligations that produce a yield in excess of such applicable maximum yield as may be permitted by the Code.

The Commission prior to the issuance of any of the 2007 B Notes and as a condition precedent to such issuance, the Commission is required to certify by issuance of a certificate by an Authorized Officer having responsibility for the receipt, disbursement, use and investment of the proceeds of the 2007 B Notes that, on the basis of the facts, estimates and circumstances in existence on the date of issue of the 2007 B Notes it is not expected that the proceeds of the 2007 B Notes will be used in a manner that would cause such obligations to be arbitrage bonds.

The Commission is required to pay from time to time all amounts required to be rebated to the United States pursuant to Section 148(f) of the Code and any temporary, proposed or final Treasury Regulations as may be applicable to the 2007 B Notes from time to time. This requirement will survive payment in full or defeasance of the Notes. The Commission is required to pay or cause to be paid to the United States at the times and in the amounts determined under Section 5.07 of the Indenture the Rebate

Amounts, as described in the Memorandum of Instructions. The Trustee is required to comply with all instructions of the Commission given in accordance with the Memorandum of Instructions.

Notwithstanding any provision described under this heading, if the Commission will provide to the Trustee a Counsel's opinion to the effect that any action required under Sections 6.11 and 5.07, of the Indenture is no longer required, or to the effect that some further action is required, to maintain the exclusion from gross income of the interest on the 2007 B Notes pursuant to Section 103(a) of the Code, the Commission and the Trustee may rely conclusively on such opinion in complying with those provisions. (Section 6.11)

Supplemental Trust Indentures Effective Without Consent of Holders. The Indenture prescribes procedures whereby the Commission may, with the written consent of the Trustee, execute and deliver at any time from time to time Supplemental Trust Indentures for any one or more of the following purposes; to further secure the payment of the Notes; to further limit and restrict the issuance of Notes and the incurring of indebtedness by the Commission; to surrender any right, power or privilege reserved to or conferred upon the Commission by the terms of the Indenture, to confirm any pledge under and the subjection to any lien, claim or pledge created or to be created by the provisions of the Indenture; to modify any of the provisions of the Indenture in any other respects (provided that such modifications will not be effective until after all Notes outstanding as of the date of execution and delivery of such Supplemental Trust Indenture cease to be Outstanding); to cure any ambiguity or defect or inconsistent provision; and for any other purpose provided that, in the opinion of Counsel, any such amendment or modification does not materially adversely affect the rights of Holders affected thereby.

A Supplemental Trust Indenture for the purposes described above, becomes effective upon the execution thereof by the Commission and the Trustee and delivery thereof to the Trustee. At any time thereafter, notice stating in substance that the Supplemental Trust Indenture has been delivered to the Trustee and is effective pursuant to the Indenture, is required to be given to Holders by the Commission by mailing such notice to Holders by regular United States mail. (Section 7.01)

Supplemental Trust Indentures Effective with Consent of Holders. The Indenture may also be modified or amended at any time or from time to time by a Supplemental Trust Indenture, subject to the written consent of the Holders in accordance with and subject to the provisions of Article VIII of the Indenture. (Section 7.02)

Supplemental Trust Indentures Effective with Counsel's Opinion. A copy of every Supplemental Trust Indenture adopted by the Commission when filed with the Trustee is required to be accompanied by a Counsel's Opinion stating that such Supplemental Trust Indenture has been duly and lawfully adopted in accordance with the provisions of the Indenture, is authorized or permitted by the Indenture and is valid and binding upon the Commission and enforceable in accordance with its terms. (Section 7.03)

Limitations on Powers of Amendment. Any modification or amendment of the Trust Indenture and of the rights and obligations of the Commission and of the Holders of the Notes made with the consent of the Holders of the Notes may be made by a Supplemental Trust Indenture, with the written consent given by the Holders of at least a majority in principal amount of the Notes Outstanding at the time such consent is given. No modification or amendment may permit a change in the terms of redemption or maturity of the principal of any Outstanding Note or of any installment of interest thereon or a reduction in the principal amount thereof or in the rate of interest thereon without the consent of the Holder of such Note, or reduce the percentages or otherwise affect the classes of Notes the consent of the Holders of which is required to effect any such modification or amendment. (Section 8.01)

Consent of Holders. A copy of a Supplemental Trust Indenture requiring consent of the Holders, or summary thereof, together with a request to the Holders must be mailed to the Holders. Such Supplemental Trust Indenture will not be effective unless and until (a) there shall have been filed with the Trustee (i) the written consents of the proper percentage of Holders and (ii) a Counsel's Opinion, and (b) notice thereof must have been mailed to all Holders. Any such consent will be binding upon the Holder of the Notes giving such consent and, upon any subsequent Holder of such Notes and of any Notes issued in exchange therefore (whether or not such subsequent Holder thereof has notice thereof), unless such consent is revoked in writing by the Holder of such Notes giving such consent or a subsequent Holder thereof by filing with the Trustee, prior to the time when the written statement of the Trustee described in this paragraph is filed, such revocation.

At any time thereafter, notice, stating in substance that the Supplemental Trust Indenture (which may be referred to as a Supplemental Trust Indenture adopted by the Commission on a stated date, a copy of which is on file with the Trustee) has been consented to by the Holders of the required percentages of Notes and will be effective as described in this paragraph, is required to be given to the Holders by the Commission by mailing such notice to the Holders. A transcript, consisting of the papers described in this paragraph to be filed with the Trustee, will be proof of the matters therein stated. Such Supplemental Trust Indenture making such amendment or modification will be deemed conclusively binding upon the Commission, the Fiduciaries and the Holders of all Notes. (Section 8.02)

Events of Default. Each of the following events shall constitute an "Event of Default":

(1) payment of any principal on any Note shall not be made when and as the same shall become due or upon call for redemption or otherwise; or

(2) payment of any installment of interest on any Note shall not be made when and as the same shall become due; or

(3) the Commission shall fail or refuse to comply with the provisions of the Act, or shall default in the performance or observance of any other of the covenants, agreements or conditions on its part contained in the Indenture or the Notes and such failure, refusal or default shall continue for a period of 45 days after written notice thereof by the Trustee or the Holders of not less than 5% in principal amount of the Outstanding Notes. (Section 9.02)

Acceleration. Subject to provisions described in this paragraph and upon the occurrence of an Event of Default as specified in paragraphs (1) or (2) above, the Trustee is required to declare, by a notice in writing delivered to the Commission, the principal of all Notes then outstanding (if not then due and payable), together with interest accrued thereon, to be due and payable immediately. Upon the occurrence of any other Event of Default, the Trustee may, or at the direction of the Holders of not less than 25% of the Notes Outstanding is required to, declare, by a notice in writing delivered to the Commission, the principal of all Notes then outstanding (if not then due and payable), together with interest accrued thereon, to be due and payable immediately.

Any such declaration is required to be by notice in writing to the Commission, and, upon said declaration, principal and interest on all Outstanding Notes will become and be immediately due and payable. The Trustee immediately upon such declaration is required to give notice thereof in the same manner as provided in the Indenture with respect to the redemption of the Notes without regard to the times stated for notice of redemption that the payment of principal and interest will be tendered immediately to the Holders of the Notes and that interest has ceased to accrue as of the date of such declaration of acceleration. Nothing contained in the Indenture shall be construed to permit the

acceleration of any payments of Financing Payments or Additional Payments by the University beyond the current term of the Financing Agreement. (Section 9.03)

Other Remedies. Upon the occurrence of an Event of Default specified in paragraphs (1) or (2) above, the Trustee is required to proceed, or upon the happening and continuance of any other Event of Default specified in paragraph (3) above, the Trustee may proceed, and upon the written request of the Holders of not less than 25% of the Outstanding Notes is required to proceed, in its own name, subject to the provisions described in this paragraph, to protect and enforce its rights and the rights of the Holders by such suits, actions or special proceedings in equity or at law, or by proceedings in the office of any board or officer having jurisdiction, whether for the specific performance of any covenant or agreement contained in the Indenture or in aid of the execution of any power granted therein or in the Act or for the enforcement of any legal or equitable rights or remedies as the Trustee, being advised by its counsel, will deem most effectual to protect and enforce such rights or to perform any of its duties under the Indenture.

In the enforcement of any rights and remedies under the Indenture, the Trustee will be entitled to sue for, enforce payment on and receive any and all amounts then or during any default becoming, and at any time remaining, due and unpaid from the Commission for principal, interest or otherwise, under any provision of the Indenture or of the Notes, with interest on overdue payments at the rate or rates of interest specified in such Notes, together with any and all costs and expenses of collection and of all proceedings under the Indenture and under the Notes, without prejudice to any other right or remedy of the Trustee or of the Holders, and to recover and enforce a judgment or decree against the Commission, but solely as provided in the Indenture and in the Notes for any portion of such amounts remaining unpaid, with interest, costs and expenses, and to collect in any manner provided by law, the moneys adjudged or decreed to be payable. (Section 9.04)

Priority of Payments After Default. In the event that upon the happening and continuance of any Event of Default the funds held by the Fiduciaries are insufficient for the payment of principal and interest then due on the Notes, such funds (other than funds held for the payment or redemption of particular Notes which have theretofore become due at maturity or by call for redemption) and any other moneys received or collected by the Trustee acting pursuant to the Act and the Indenture, after making provision (i) for the payment of any expenses necessary in the opinion of the trustee to protect the interests of the Holders of the Notes and (ii) for the payment of the charges and expenses and liabilities incurred and advances made by the Fiduciaries in the performances of their respective duties under the Trust Indenture, will be applied as follows:

(1) Unless the principal of all of the Notes shall have become or have been declared due and payable:

First: To the payment to the persons entitled thereto of all installments of interest then due in the order of the maturity of such installments, and, if the amount available shall not be sufficient to pay in full any installments, then to the payment thereof ratably, according to the amounts due on such installments, to the persons entitled thereto, without any discrimination or preference; and

Second: To the payment to the persons entitled thereto of the unpaid principal of any Notes which shall have become due, whether at maturity or by call for redemption, in the order of their due dates and, if the amounts available shall not be sufficient to pay in full all the Notes due on any date, then to the payment thereof ratably, according to the amounts of the principal due on such date, to the persons entitled thereto, without any discrimination or preference.

(2) If the principal of all of the Notes shall have become or have been declared due and payable, to the payment of the principal and interest due and unpaid upon the 2007 B Notes without preference or priority of principal over interest or of interest over principal, or of any installment of interest over any other installment of interest, or of any Note over any other Note, ratably, accordingly to the amounts due respectively for principal and interest, to the persons entitled thereto, without any discrimination or preference except as to any difference in the respective rates of interest specified in the Notes.

Whenever moneys are to be applied by the Trustee as described herein, such moneys are required to be applied by the Trustee at such times, and from time to time, as the Trustee in its sole discretion shall determine, having due regard to the amount of such moneys available for application and the likelihood of additional money becoming available for such application in the future. The deposit of such moneys with the Fiduciaries, or otherwise setting aside such moneys in trust for the proper purpose, shall constitute proper application by the Trustee, and the Trustee will incur no liability whatsoever to the Commission, to any Holder or to any other person for any delay in applying any such moneys, so long as the Trustee acts with reasonable diligence, having due regard for the circumstances, and ultimately applies the same in accordance with such provisions of the Trust Indenture as may be applicable at the time of application by the Trustee. Whenever the Trustee exercises such discretion in applying such moneys, it will fix the date (which shall be an Interest Payment Date unless the Trustee shall deem another date more suitable) upon which such application is to be made and upon such date interest on the amounts of principal to be paid on such date shall cease to accrue. The Trustee is required to give such notice as it may deem appropriate for the fixing of any such date. The Trustee is not required to make payment to the Holder of any unpaid Note unless such Note shall be presented to the Trustee for appropriate endorsement or for cancellation if fully paid. (Section 9.05)

Direction of Proceedings. Anything in the Indenture to the contrary notwithstanding, the Holders of the majority in principal amount of Notes then Outstanding will have the right by an instrument or concurrent instruments in writing executed and delivered to the Trustee, to direct the method of conducting all remedial proceedings to be taken by the Trustee under the Indenture, provided that such direction will not be otherwise than in accordance with law or the provisions of the Indenture, and that the Trustee will have the right to decline to follow any such direction which in the opinion of the Trustee would be unjustly prejudicial to Holders not parties to such direction. (Section 9.07)

Limitation on Rights of Holders. No Holder of any Note will have any right to institute any suit, action, mandamus or other proceeding in equity or at law under the Indenture, or for the protection or enforcement of any right under the Indenture or any right under the law unless such Holder has given to the Trustee written notice of the Event of Default or breach of duty on account of which such suit, action or proceeding is to be taken, and unless the Holders of not less than 25% of the Notes then Outstanding have made written request of the Trustee after the right to exercise such powers or right of action, as the case may be, have occurred, and have afforded the Trustee a reasonable opportunity either to proceed to exercise the powers granted in the Indenture or granted under the law or to institute such action, suit or proceeding in its name and unless, also, there shall have been offered to the Trustee reasonable security and indemnity against the cost, expenses (including reasonable legal expenses) and liabilities to be incurred therein or thereby, and the Trustee shall have refused or neglected to comply with such request within a reasonable time, it being understood that the Trustee is required to make all payments on the Notes as provided in the Indenture (to the extent funds are available for such purpose) and declare the Notes due and payable as provided in the Indenture, regardless of having received any indemnity or security; and such notification, request and offer of indemnity are in every such case, at the option of the Trustee, to be conditions precedent to the execution of the powers under the Indenture or for any other remedy under the Indenture or under law. It is understood and intended that no one or more Holders of the Notes will have any right in any manner whatever by his or their action to affect, disturb or prejudice

the security of the Indenture, or to enforce any right under the Indenture or under law with respect to the Notes or the Indenture, except in the manner provided in the Indenture, and that all proceedings at law or in equity shall be instituted, had and maintained in the manner provided in the Indenture and for the benefit of all Holders. Nothing described in this paragraph will affect or impair the right of any Holder to enforce the payment of the principal of and interest on its Notes, or the obligation of the Commission to pay the principal of and interest on each Note issued under the Indenture to the Holder thereof at the time and place stated in said Note.

Anything in the Indenture to the contrary notwithstanding, each Holder of any Note by his acceptance thereof will be deemed to have agreed that any court in its discretion may require, in any suit for the enforcement of any right or remedy under the Indenture or in any suit against the Trustee for any action taken or omitted by it as Trustee, the filing by any party litigant in such suit of an undertaking to pay the reasonable cost of such suit, and that such court may in its discretion assess reasonable costs, including reasonable attorneys' fees, against any party litigant in any such suit, having due regard to the merits and good faith of the claims or defenses made by such party litigant; but the provisions described in this paragraph will not apply to any suit instituted by the Trustee, to any suit instituted by any Holder, or group of Holders, holding at least 25% of the Notes Outstanding, or to any suit instituted by any Holders for the enforcement of the payment of the principal of, premium, if any, or interest on any Note on or after the respective due date thereof expressed in such Note. (Section 9.08)

Trustee. Prior to the occurrence of an Event of Default, the Trustee is required to perform only those duties specifically set forth in the Indenture. If an Event of Default, of which the Trustee has received notice, has occurred and is continuing, the Trustee is required to exercise its rights and powers and use the same degree of care and skill as a prudent man would exercise under the circumstances in the conduct of his own affairs. (Section 10.01)

Evidence on Which Fiduciaries May Act. Each Fiduciary will be protected in acting upon any notice, resolution, request, consent, order, certificate, report, opinion, note, or other paper or document believed by it to be genuine, and to have been signed or presented by the proper party or parties. Each Fiduciary may consult with counsel, who may or may not be of counsel to the Commission, and the opinion of such counsel will be full and complete authorization and protection in respect of any action taken or suffered by it under the Indenture in good faith and in accordance therewith. Whenever any Fiduciary will deem necessary or desirable that a matter be proved or established prior to taking or suffering any action under the Indenture, including payment of moneys out of any Fund or Account, such matter (unless other evidence in respect thereof be specifically prescribed in the Indenture) may be deemed to be conclusively proved and established by a certificate signed by an Authorized Officer of the Commission, and such certificate will be full warrant for any action taken or suffered in good faith under the provisions of the Trust Indenture in which said Fiduciary has accepted said trust upon the faith thereof, but in its discretion the Fiduciary may in lieu thereof accept other evidence of such fact or matter or may require such further or additional evidence as to it may deem reasonable. Except as otherwise expressly provided in the Indenture, any request, order, notice or other direction required or permitted to be furnished pursuant to any provision of the Indenture by the Commission to any Fiduciary is required to be sufficiently executed if executed in the name of the Commission by an Authorized Officer of the Commission. (Section 10.04)

Permitted Acts and Functions. The Trustee and any Paying Agent may become the owner of any Note, with the same rights it would have if it were not such Fiduciary. Any Fiduciary may act as depository for, and permit any of its officers or directors to act as a member of, or in any other capacity with respect to, any committee formed to protect the rights of Holders or to effect or aid in any reorganization growing out of the enforcement of the Notes or the Indenture, whether or not any such

committee is required to represent the Holders of a majority in principal amount of the Notes then outstanding. (Section 10.06)

Resignation of Trustee. The Trustee may at any time resign and be discharged of the duties and obligations created by the Trust Indenture by giving not less than 60 days' written notice to the Commission and by mailing notice (specifying the date such resignation is to take effect) through regular United States mail, postage prepaid, to each Holder of Notes, and such resignation will take effect upon the day specified in such notice unless (i) no successor has been appointed as provided in the Indenture, or (ii) previously a successor shall have been appointed, as provided in the Indenture, in which event such resignation will take effect immediately on the appointment of such successor. If a successor trustee is not appointed within 60 days, the Trustee will be entitled to petition a court of competent jurisdiction to appoint a successor Trustee. (Section 10.07)

Removal of Trustee. The Trustee may and, if at any time so requested by an instrument or concurrent instruments in writing (filed with the Trustee and the Commission, and signed by the Holders of a majority in principal amount of the Notes then Outstanding or their attorneys-in-fact duly authorized, excluding any Notes held by or for the account of the Commission), shall, be removed by the Commission (so long as no Event of Default has occurred and is continuing) by an instrument or concurrent instruments in writing, filed with the Trustee and the Commission and signed by the Commission or the Holders of Notes, as appropriate. No such removal will be effective until a successor Trustee has been appointed and assumed the duties of Trustee as provided in the Indenture. (Section 10.08)

Appointment of Successor Trustee. In case at any time the Trustee shall resign or shall be removed or shall become incapable of acting, or shall be adjudged bankrupt or insolvent, or if a receiver, liquidator or conservator of the Trustee, or of its property, shall be appointed, or if any public officer shall take charge or control of the Trustee, or of its property or affairs, the Commission covenants and agrees that it will thereupon appoint a successor Trustee. The Commission is required to provide notice of any such appointment made by it within 20 days after such appointment to Holders of Notes.

If no appointment of a successor Trustee shall be made pursuant to the foregoing provisions within 45 days after the Trustee shall have given to the Commission written notice, as provided above in the paragraph titled "Resignation of Trustee", or after a vacancy in the office of the Trustee shall have occurred by reason of its removal or inability to act, the Trustee or the Holder of any Note may apply to any court of competent jurisdiction to appoint a successor Trustee. Said court may thereupon, after such notice, if any, as such court may deem proper and prescribe, appoint a successor Trustee.

Any Trustee appointed in succession to the Trustee is required to be a trust company or bank having the powers of a trust company within or outside the Commonwealth, having a capital and surplus aggregating at least \$75,000,000 if there be such a trust company or bank willing and able to accept the office on reasonable and customary terms and authorized by law to perform all duties imposed upon it by the Indenture. (Section 10.09)

Defeasance. Notes or interest installments of particular Notes for the payment or redemption of which moneys will have been set aside and shall be held in trust by Fiduciaries will, at the maturity or date of redemption thereof, be deemed to have been paid within the meaning and with the effect expressed above. Particular Notes will, prior to the maturity or redemption thereof, be deemed to have been paid within the meaning and with the effect expressed above, if (a) in case any of said Notes are to be redeemed on any date prior to their maturity, the Commission will have given to the Trustee in form satisfactory to it irrevocable instructions to provide notice of redemption in the manner prescribed in the Indenture, (b) there will have been deposited with the Trustee either moneys in an amount which shall be

sufficient, or Defeasance Obligations, the principal of and the interest on which when due will provide moneys which, together with the moneys, if any, deposited with the Trustee at the same time, will be sufficient, to pay when due the principal and interest due and to become due on said Notes on and prior to the Redemption or maturity date thereof, as the case may be, (c) in the event said Notes are not subject to redemption within the next 60 days, the Commission will have given the Trustee in form satisfactory to it irrevocable instructions to notify the Holders of such Notes of such redemption in the manner herein provided for giving notice of redemption and (d) a Counsel's Opinion that the defeasance will not adversely affect any exclusion from gross income for federal income tax purposes of interest on the 2006 A Notes, 2007 A Notes or 2007 B Notes. Neither Defeasance Obligations or moneys deposited with the Trustee as described in this paragraph, nor principal or interest payments on any such obligations, may be withdrawn or used for any purpose other than, and must be held in trust for, the payment of the principal and interest on said Notes.

Anything in the Indenture to the contrary notwithstanding, any moneys held by a Fiduciary in trust for the payment and discharge of any of the Notes which remain unclaimed for six years after the date when all of the Notes have become due and payable, either at their stated maturity dates or by call for earlier redemption, if such moneys were held by the Fiduciary at such date, or for six years after the date of deposit of such moneys if deposited with the Fiduciary after said date when all of the Notes became due and payable, will (subject to the provisions of Article V of the Indenture), at the written request of the Commission, be repaid by the Fiduciary to the Commission, as its absolute property and free from trust, and the Fiduciary will thereupon be released and discharged.

"Defeasance Obligations" means and includes any of the following:

(1) Direct and general non-callable obligations of the United States of America, backed by the full faith and credit of the United States of America or obligations that are unconditionally guaranteed as to principal and interest by the United States of America. The obligations described in this paragraph are called "United States Obligations".

(2) Prerefunded municipal obligations rated "AAA" by each Rating Service then rating the Notes and meeting the following conditions:

(a) the municipal obligations are (i) not to be redeemed prior to maturity or the Trustee has been given irrevocable instructions concerning their calling and redemption and (ii) the issuer has covenanted not to redeem such municipal obligations other than as set forth in such instructions;

(b) the municipal obligations are secured by cash or United States Obligations that may be applied only to interest, principal, and premium payments of such municipal obligations;

(c) the principal of and interest on the United States Obligations (plus any cash in the escrow fund) are sufficient to meet the liabilities on the municipal obligations;

(d) the United States Obligations serving as security for the municipal obligations are held by an escrow agent or trustee;

(e) the United States Obligations (plus any cash in the escrow fund) are not available to satisfy any other claims, including those against the trustee or escrow agent; and

if the redemption date for the Notes to be discharged by the deposit of Defeasance Obligations is no later than 90 days from the date of such deposit, "Defeasance Obligations" shall also include direct and general non-callable obligations of any Federally sponsored enterprise, including Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, Federal Farm Credit Banks, Federal Intermediate Credit Banks, Federal Land Banks, Federal Home Loan Banks, Bank for Cooperatives and any other similar institution. (Section 11.01)

The Financing Agreement

The Commission, the Cabinet and the University have entered into the Financing Agreement which provides among other things for (i) financing of the Project by issuance of the 2007 B Notes by the Commission; and (ii) the leasing of the Project from the Commission to the University to provide revenues for amortization of the 2007 B Notes. As required by the Act, the Cabinet is also a party to the Financing Agreement.

Financing Payments. The Commission has agreed to provide financing for the Project to the University. The University has the right to continue the Financing Agreement until the final maturity date for the Notes. The University is required to pay, as Financing Payments, the Debt Servicing Obligation relating to the 2007 B Notes so long as any 2007 B Notes are Outstanding.

Additional Payments. The University covenants and agrees to pay "Additional Payments" for the term of the Financing Agreement and for any Renewal Term during which 2007 B Notes are outstanding, as follows:

- (1) To the Trustee, when due, all fees of the Trustee for services rendered, all fees and charges of any Paying Agent, Registrar, counsel, accountants, and others incurred in the performance on request of the Trustee of services for which the Trustee and such other persons are entitled to payment or reimbursement which are not paid as Financing Payments; and
- (2) To the Commission, upon demand, all reasonable expenses incurred by it in relation to the Project which are not otherwise specifically identified and required to be paid by the Commission under the terms of the Financing Agreement.

Financing Agreement an Obligation. The University has authorized and entered into the Trust Agreement. It is the intent of the University that the Financing Agreement constitute an Obligation within the meaning of the Trust Agreement, it is declared that the Financing Agreement is issued and delivered by the University in accordance with the terms of the Trust Agreement, and the Commission is granted all rights and privileges as Holder, as defined in the Trust Agreement, with respect to the Obligation (being the Financing Agreement), for all purposes under the Trust Agreement, subject to the terms of the Trust Agreement.

Events of Default. Each of the following events constitute an "event of default":

- (1) default in the due and punctual payment of any Financing Payments or Additional Payments; or
- (2) default in the performance of any of the covenants, terms, and conditions of the Financing Agreement, and failure to remedy such default within thirty (30) days after written receipt thereof if the default relates to matters other than the payment of Financing Payments or Additional Payments (but the University will not be deemed to be in default if the University commences to remedy said defaults other than related to payment of Financing Payments or

Additional Payments within said 30 day period, and proceed to and do remedy said default with due diligence).

If an event of default occurs, the Commission, in addition to all other remedies given to the Commission at law or in equity, may by written notice to the University terminate the Financing Agreement. No termination of the Financing Agreement will deprive the Commission of any of its remedies or actions against the University.

Provisions of the Financing Agreement Benefit of the Holders of the Notes. All of the provisions contained in the Financing Agreement, are made for the benefit of each of the holders of the Notes. Each and all of the holders of the Notes, and the Trustee on behalf of the holders of the Notes, have the rights of third party beneficiaries to enforce all of the provisions of the Financing Agreement; subject, however, to the provisions of the Indenture with respect to enforcement of rights.

Security and Assignment. The Financing Agreement secures (i) the payment of Financing Payments and Additional Payments, and (ii) the payment of the Notes in the aggregate principal amount which may from time to time be outstanding under the Indenture, with interest thereon at the rates per annum borne by such Notes.

The Financing Agreement is given subject to all of the terms, conditions and provisions of the Indenture. In the event that any conflict should exist or appear to exist between the provisions of the Financing Agreement and the Indenture, the provisions of the Indenture will prevail. (Financing Agreement Section 12.01)

Amendment. The Financing Agreement may be amended or supplemented from time to time by a writing duly executed by the parties thereto; subject, however, to the condition that any such amendment or supplement will be consistent with the terms and conditions of the Indenture and not diminish the Financing Payments or Additional Payments payable under the provisions of the Financing Agreement for so long as any Notes are Outstanding.

TAX MATTERS

General

In the opinion of Kutak Rock LLP, Bond Counsel, to be delivered at the time of original issuance of the 2007 B Notes, under existing laws, regulations, rulings and judicial decisions, interest on the 2007 B Notes (a) is excluded from gross income for federal income tax purposes and (b) is not a specific item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the 2007 B Notes, however, will be included in the "adjusted current earnings" (i.e., alternative minimum taxable income as adjusted for certain items, including those items that would be included in the calculation of a corporation's earnings and profits under Subchapter C of the Internal Revenue Code of 1986, as amended (the "Code")) of certain corporations and such corporations are required to include in the calculation of alternative minimum taxable income 75% of the excess of each such corporation's adjusted current earnings over its alternative minimum taxable income (determined without regard to this adjustment and prior to reduction for certain net operating losses).

The Commission and the University have each covenanted to comply with all requirements that must be satisfied in order for the interest on the 2007 B Notes to be excludible from gross income for federal tax purposes. The opinions set forth above are subject to continuing compliance by the Commission and the University and others with such covenants. Failure to comply with such covenants could cause

interest on the 2007 B Notes to be included in gross income retroactive to the respective dates of issue of the 2007 B Notes.

The accrual or receipt of interest on the 2007 B Notes may otherwise affect the federal income tax liability of certain recipients such as banks, thrift institutions, property and casualty insurance companies, corporations (including S corporations and foreign corporations operating branches in the United States), Social Security or Railroad Retirement benefit recipients, taxpayers otherwise entitled to claim the earned income credit or taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations, among others. The extent of these other tax consequences will depend upon the recipients' particular tax status or other items of income or deduction. Bond Counsel expresses no opinion regarding any such consequences and investors should consult their own tax advisors regarding the tax consequences of purchasing or holding the 2007 B Notes.

In Bond Counsel's further opinion, under the existing laws of the Commonwealth, interest on the 2007 B Notes is excluded from the gross income of the recipients thereof for Kentucky income tax purposes and such 2007 B Notes are exempt from ad valorem taxes by the Commonwealth and all political subdivisions thereof.

Changes in Federal Tax Law

From time to time, there are legislative proposals in the Congress and in the states that, if enacted, could alter or amend the federal and state tax matters referred to above or adversely affect the market value of the 2007 B Notes. It cannot be predicted whether or in what form any such proposal might be enacted or whether if enacted, it would apply to bonds issued prior to enactment. In addition, regulatory actions are from time to time announced or proposed and litigation is threatened or commenced which, if implemented or concluded in a particular manner, could adversely affect the market value of the 2007 B Notes. An example of such litigation is the case of Davis v. Kentucky Department of Revenue, 197 S.W.3d 557 (2006), the oral argument for which was heard by the U.S. Supreme Court on November 5, 2007 with a decision expected to be rendered in the spring of 2008, challenging Kentucky's taxation of bonds issued by other states and their political subdivisions differently than it taxes bonds issued by Kentucky and its political subdivisions. It cannot be predicted whether any such regulatory action will be implemented, how any particular litigation or judicial action will be resolved, or whether the 2007 B Notes or the market value thereof would be impacted thereby. Purchasers of the 2007 B Notes should consult their tax advisors regarding any pending or proposed legislation, regulatory initiatives or litigation. The opinions expressed by Bond Counsel are based upon existing legislation and regulations as interpreted by relevant judicial and regulatory authorities as of the date of issuance and delivery of the 2007 B Notes, and Bond Counsel has expressed no opinion as of any date subsequent thereto or with respect to any pending legislation, regulatory initiatives or litigation.

Tax Treatment of Original Issue Discount

The 2007 B Notes that have an original yield above their interest rate, as shown on the inside cover, are being sold at a discount (the "Discounted Obligations"). The difference between the initial public offering prices, as set forth on the inside cover page hereof, of the Discounted Obligations and their stated amounts to be paid at maturity, constitutes original issue discount treated as interest which is not includible in gross income for federal income tax purposes.

In the case of an owner of a Discounted Obligation, the amount of original issue discount which is treated as having accrued with respect to such Discounted Obligation is added to the cost basis of the owner in determining, for federal income tax purposes, gain or loss upon disposition of a Discounted Obligation (including its sale or payment at maturity). Amounts received upon disposition of a

Discounted Obligation which are attributable to accrued original issue discount will be treated as tax-exempt interest, rather than as taxable gain, for federal income tax purposes.

Original issue discount is treated as compounding semiannually, at a rate determined by reference to the yield to maturity of each individual Discounted Obligation, on days which are determined by reference to the maturity date of such Discounted Obligation. The amount treated as original issue discount on a Discounted Obligation for a particular semiannual accrual period is equal to (a) the product of (i) the yield to maturity for such Discounted Obligation (determined by compounding at the close of each accrual period) and (ii) the amount which would have been the tax basis of such Discounted Obligation at the beginning of the particular accrual period if held by the original purchaser, (b) less the amount of any interest payable for such Discounted Obligation during the accrual period. The tax basis is determined by adding to the initial public offering price on such Discounted Obligation the sum of the amounts which have been treated as original issue discount for such purposes during all prior periods. If a Discounted Obligation is sold between semiannual compounding dates, original issue discount which would have been accrued for that semiannual compounding period for federal income tax purposes is to be apportioned in equal amounts among the days in such compounding period.

The Code contains additional provisions relating to the accrual of original issue discount in the case of owners of a Discounted Obligation who purchase such Discounted Obligations after the Initial offering. Owners of Discounted Obligations including purchasers of the Discounted Obligations in the secondary market should consult their own tax advisors with respect to the determination for federal income tax purposes of original issue discount accrued with respect to such obligations as of any date and with respect to the state and local tax consequences of owning a Discounted Obligations.

Tax Treatment of Premium

The 2007 B Notes that have an original yield below their interest rate, as shown on the inside front cover, are being sold at a premium (collectively, the "Premium Obligations"). An amount equal to the excess of the issue price of a Premium Obligation over its stated redemption price at maturity constitutes premium on such Premium Obligation. An initial purchaser of such Premium Obligation must amortize any premium over such Premium Obligation's term using constant yield principles, based on the purchaser's yield to maturity (or, in the case of Premium Obligations callable prior to their maturity, by amortizing the premium to the call date, based upon the purchaser's yield to the call date and giving effect to any call premium). As premium is amortized, it offsets the interest allocable to the corresponding payment period and the purchaser's basis in such Premium Obligation is reduced by a corresponding amount resulting in an increase in the gain (or decrease in the loss) to be recognized for federal income tax purposes upon a sale or disposition of such Premium Obligation prior to its maturity. Even though the purchaser's basis may be reduced, no federal income tax deduction is allowed. The same treatment is afforded to 2007 B Notes purchased at a premium in the secondary market. Purchasers of Premium Obligations should consult with their own tax advisors with respect to the determination and treatment of amortizable premium for federal income tax purposes and with respect to the state and local tax consequences of owning such Premium Obligations.

Backup Withholding

As a result of the enactment of the Tax Increase Prevention and Reconciliation Act of 2005, interest on tax exempt obligations such as the 2007 B Notes is subject to information reporting in a manner similar to interest paid on taxable obligations. Backup withholding may be imposed on payments made after March 31, 2007 to any bondholder who fails to provide certain required information, including an accurate taxpayer identification number to any person required to collect such information pursuant to Section 6049 of the Code. The new reporting requirement does not in and of itself affect or alter the

excludability of interest on the 2007 B Notes from gross income for federal income tax purposes or any other federal tax consequence of purchasing, holding or selling tax exempt obligations.

LITIGATION

There is no controversy or litigation of any nature now pending or threatened restraining or enjoining the issuance, sale, execution or delivery of the 2007 B Notes, or in any way contesting or affecting the validity of the 2007 B Notes or any proceedings of the Commission taken with respect to the issuance or sale thereof, or the pledge or application of any monies or security provided for the payment of the 2007 B Notes or due existence or powers of the Commission.

APPROVAL OF LEGALITY

Certain legal matters incident to the authorization, issuance, sale and delivery of the 2007 B Notes are subject to the unqualified approving opinion of Kutak Rock LLP, Bond Counsel to the Commission. Certain other legal matters will be passed on by Thompson Hine LLP, Cincinnati, Ohio, counsel to the Underwriters.

RATINGS

Moody's Investors Service, Inc. and Standard & Poor's Ratings Services, a Division of The McGraw-Hill Companies, Inc. have given the 2007 B Notes the ratings of "Aa3" and "AA-," respectively. Each rating reflects only the views of the respective Rating Agency. Explanations of the significance of the ratings may be obtained from each Rating Agency as follows: Moody's Investors Service, Inc., 7 World Trade Center at 250 Greenwich Street, New York, New York 10007, (212) 553-0300; and Standard & Poor's Ratings Services, a Division of the McGraw-Hill Companies, 55 Water Street, New York, New York 10041 (212) 438-2124. A rating is a not recommendation to buy, sell or hold the 2007 B Notes, and there is no assurance that any rating will be maintained for any given period of time by a Rating Agency or that it will not be revised or withdrawn entirely by such Rating Agency, if in its judgment circumstances so warrant. Any such revision or withdrawal of a rating may have an adverse affect on the market price of the 2007 B Notes.

CONTINUING DISCLOSURE

The Commission will comply with the requirements of the Securities and Exchange Commission regarding secondary market disclosure as set forth in Rule 15c2-12 (the "Rule"), as amended, under the Securities Exchange Act of 1934. Specifically, the Commission will enter into a Continuing Disclosure Agreement in which it will covenant to provide notice in a timely manner to each nationally recognized municipal securities depository or the Municipal Securities Rulemaking Board, and the appropriate state information depository, if any, of any of the following types of events with respect to the 2007 B Notes, if material: (i) principal and interest payment delinquencies; (ii) non-payment related defaults; (iii) unscheduled draws on debt service reserves reflecting financial difficulties; (iv) unscheduled draws on credit enhancements reflecting financial difficulties; (v) substitution of credit or liquidity providers or their failure to perform; (vi) adverse tax opinions or events affecting the tax-exempt status of the securities; (vii) modifications to rights of security holders; (viii) bond calls; (ix) defeasances; (x) release, substitution, or sale or property securing repayment of the securities; and (xi) rating changes. The Commission is already providing ongoing market disclosure as required by Rule 15c2-12 pursuant to agreements entered into in connection with other outstanding securities.

UNDERWRITING

Morgan Stanley & Co. Incorporated, as representative of the underwriters set forth on the cover page hereof (the "Underwriters"), has agreed to purchase the 2007 B Notes for a purchase price of \$81,646,840.47, which is an amount equal to the par amount of such 2007 B Notes, plus net premium of \$1,805,236.65, less Underwriters' discount of \$403,396.18. The Underwriters are committed to purchase all of the 2007 B Notes if any are purchased.

The Underwriters have advised the Commission that they intend to make a public offering of the 2007 B Notes at the initial public offering prices or yields set forth on the inside cover page hereof; provided, however, that the Underwriters have reserved the right to make concessions to dealers and to change such initial public offering prices as the Underwriters deem necessary in connection with the marketing of the 2007 B Notes.

MISCELLANEOUS

Any statements in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Official Statement is not to be construed as a contract or agreement between the Commission and the purchasers or Holders of any of the 2007 B Notes.

KENTUCKY ASSET/LIABILITY COMMISSION

By: /s/ Robert M. Burnside
Chairman

By: /s/ F. Thomas Howard
Secretary

APPENDIX A

INFORMATION PERTAINING TO THE UNIVERSITY OF KENTUCKY

This APPENDIX A contains certain financial and operating information regarding the University (also referred to as "UK"). Reference is made to APPENDIX C for additional financial and operating information. For additional information about the University, please refer to www.uky.edu.

GENERAL

Nestled in the heart of Kentucky's scenic Bluegrass region, UK was founded in 1865 as a land-grant university. From its beginnings with only 190 students and 10 professors, UK's campus now covers more than 716 acres in Lexington and is home to more than 27,000 students and more than 13,500 employees.

The University has long embraced its mission to provide excellent education to outstanding resident and non-resident students, recognizing that a knowledgeable populace is the best foundation for a prosperous Commonwealth. This mission has been further enhanced since 1997 when the Kentucky General Assembly mandated that UK become a Top 20 public research university by 2020. President Lee T. Todd Jr. focused the University on achieving this goal through the development of a Top 20 Business Plan in 2005 that gained national prominence for its vision and detail.

Students from 117 countries, every state in the nation and every Kentucky county provide a diverse learning and cultural environment that enriches the educational experience at UK. While the student population has enjoyed steady growth in the past several years, the average ACT score of entering freshmen has continually exceeded the national average and is competitive with UK's benchmark institutions – the top public universities in America. The high quality of UK's students is confirmed by their successful competition for the most prestigious awards, including the Fulbright, Truman, Goldwater and Marshall scholarships. UK has twice been selected as one of only 13 universities nationwide to participate in the Beckman Foundation Scholarship Program, allowing the University to award grants to students to support their own research projects. Boasting 12 Truman Scholars, UK has won recognition from the Harry S Truman Foundation as an honor institution for exemplary participation in the program.

Thousands of Kentuckians from across the state feel the impact of UK's research and public service annually, through programs aimed at improving industrial productivity, agricultural profitability and home life. Programs like the Health Education through Extension Leadership bring the results of health research to local communities, helping boost the quality of life across the state.

Meanwhile, Kentuckians have responded to the University's commitment to the Commonwealth through their remarkable support of The Campaign for the University of Kentucky. The fundraising effort – the largest in state history – to enhance facilities, academic programs, public service and scholarships recently surpassed its \$1 billion goal. The generosity of UK's alumni and friends allowed it to fully utilize its allocation of state support available through Kentucky's Research Challenge Trust Fund program.

UK students enjoy an enormous array of choices, with some 200 majors and degree programs in 17 academic and professional colleges available. UK is one of only a few public universities nationally to house colleges of Agriculture, Arts and Sciences, Business and Economics, Communications and Information Studies, Dentistry, Design, Education, Engineering, Fine Arts, Health Sciences, Law, Libraries, Medicine, Nursing, Pharmacy, Public Health and Social Work on a single campus.

"Determination" is truly the word describing UK's focus on achieving its Top 20 research goal. For the last five years, the University has consistently exceeded \$200 million in sponsored projects awards. UK faculty recently attracted a record-breaking total of \$290 million in extramural funding for grants and contracts. A recent ranking placed UK at 26th among all public universities for federal expenditures. Meanwhile, the inventiveness of UK faculty continues to earn the University its standing as 17th among land-grant universities, 34th among public universities, and 57th overall in licensing income and patents. Another national ranking recently put UK 19th among public institutions for the scholarly productivity of its faculty.

The UK Chandler Medical Center, opened in 1960, stands among the nation's finest academic medical centers. Its faculty, students and staff take pride in achieving excellence in education, patient care, research and community service. One of two Level 1 Trauma Centers in Kentucky, UK cares for the most critically injured and ill patients in the region. More than 500 faculty physicians and dentists, 400 resident physicians and a staff of 3,600 health professionals provide care in the 473-bed UK Chandler Hospital and Kentucky Children's Hospital.

In spring 2007, ground was broken for a new \$450 million UK Chandler Hospital. This more than 1-million square foot facility, to be completed in 2011, is the cornerstone of a 20-year, \$2.5 billion plan to construct the Commonwealth Medical Campus of the Future. Among the campus' components are a now-under-construction \$120 million pharmacy building, additional research buildings, a new shared Health Sciences Learning Center, and additional buildings to house programs for the colleges of Medicine, Nursing, Health Sciences, Dentistry and Public Health. See **The University of Kentucky Albert B. Chandler Hospital** for a description of recent developments regarding the UK Chandler Hospital.

No university can provide adequate opportunities to its students – or to the residents of the state it serves – without outstanding library facilities. The University exceeds expectations because it operates a nationally recognized research library system, with the capstone being the world-class William T. Young Library. UK's book endowment is the largest among public universities. Its library network and technology provide extraordinary service to students in the colleges of Medicine, Law, Engineering, Fine Arts and other programs. Meanwhile, students, faculty and Kentucky residents can use UK Libraries' advanced technology to access the most up-to-date information from online journals, government publications and private studies.

UK's agenda aims to accelerate the University's movement toward academic excellence in all areas and gaining worldwide recognition for its outstanding academic programs, its commitment to undergraduates, its success in building a diverse community, and its engagement with the larger society. It's all part of the University's strategy to help position Kentucky as a leader in American prosperity.

NOTE: Effective January 14, 1998, the Board of Trustees pursuant to the direction of the General Assembly (The Kentucky Postsecondary Education Improvement Act of 1997) delegated to the Board of Regents of the Kentucky Community and Technical College System ("KCTCS"), the management responsibilities for the University of Kentucky Community College System ("UKCC") except for the Lexington Community College. This delegation of management responsibilities to KCTCS includes management of facilities and grounds, assets, liabilities, revenues, personnel, programs, financial and accounting services and support services. Governmental Accounting and Financial Reporting Standards provide that the financial operations of the UKCC no longer be included in the University financial reports as of July 1, 1997. Therefore, in general, statistical information in this Supplemental Official Statement does not include Community Colleges (other than Lexington Community College).

Effective July 1, 2004, the Board of Trustees, pursuant to the direction of the Kentucky General Assembly, delegated to the Board of Regents of KCTCS the management of Lexington Community College. Therefore, in general, statistical information in this Supplemental Official Statement does not include Lexington Community College for the Fiscal Years after 2004.

Governing Board

The governing body of the University is the Board consisting of twenty members, sixteen appointed by the Governor of the Commonwealth of Kentucky; two faculty members elected by the faculty; one student member, who is the President of the student body, or if he or she is not a full-time student who maintains permanent residence in the Commonwealth, a full-time student who does maintain permanent residency in the Commonwealth elected by the student body; and one member of the University staff. Pursuant to Section 164.160 of the Kentucky Revised Statutes, the Board is a body corporate with the powers usually vested in corporations and, as such, subject to the statutes of the Commonwealth, has control and management of the University, together with the properties and funds thereof.

Administrative Officers

The President of the University is Dr. Lee T. Todd, Jr.; the Provost is Kumble R. Subbaswamy; the Executive Vice President for Finance and Administration is Frank Butler; the Executive Vice President for Health Affairs is Dr. Michael Karpf; and the Treasurer of the University is Henry Clay Owen.

Financial Management

The University operates on a fiscal year (the "Fiscal Year") that begins on July 1 and ends on June 30 and any reference to a particular Fiscal Year means the Fiscal Year that ends on June 30 in the indicated year. The Office of the Treasurer is responsible for establishing and maintaining the official accounting systems and records, and related systems of internal control, of the University, in accordance with generally accepted accounting principles and with the requirements of the Commonwealth of Kentucky; for providing stewardship and accountability for institutional assets and all financial resources received and used; for providing services and support in the acquisition of goods and services. The Office of Planning, Budget and Policy Analysis is to coordinate and provide leadership for University-wide planning, budgeting and policy analysis. These activities include strategic planning; capital planning and budgeting; development of biennial budget requests and annual operating budgets; institutional data management; and budgetary and policy analysis.

FISCAL YEAR 2008 BUDGET

The Fiscal Year 2008 budget for the University is \$2,072,187,800, an increase of \$179,154,600 from the final Fiscal Year 2007 budget.

OPERATIONS

I. Summary of Revenues, Expenses and Changes in Net Assets

The following is a summary of the University's revenues, expenses and changes in net assets for the most recent three Fiscal Year periods available:

	Fiscal Year		
	(Dollars in Thousands)		
	<u>2005</u>	<u>2006</u>	<u>2007</u>
Operating revenue	\$1,186,978	\$1,332,491	\$1,435,329
Operating expenses	<u>1,468,205</u>	<u>1,639,568</u>	<u>1,808,629</u>
Operating loss	(281,227)	(307,077)	(373,299)
Non-operating revenue, including state appropriations	<u>405,906</u>	<u>546,023</u>	<u>548,848</u>
Increase in net assets	<u>\$124,679</u>	<u>\$238,946</u>	<u>\$175,549</u>

Enrollment

The following schedule indicates the Fall Semester head count and full-time equivalent enrollment at the University for each of the academic years 1998-99 through 2007-08. The full-time enrollment calculation is made in accordance with the method used by the United States Department of Education.

Academic Year	<u>Lexington Community College¹</u>			<u>Main Campus</u>		Total
	<u>Head Count</u>	<u>Full-Time Equivalent²</u>	<u>Head Count</u>	<u>Full-Time Equivalent²</u>	<u>Head Count</u>	<u>Full-Time Equivalent²</u>
1998-99	6,118	4,035	24,394	20,729	30,512	24,764
1999-00	6,807	4,461	23,742	20,128	30,549	24,589
2000-01	7,150	4,685	23,816	20,150	30,966	24,835
2001-02	7,793	5,871	23,901	20,878	31,694	26,749
2002-03	8,270	6,251	24,985	21,872	33,255	28,122
2003-04	8,672	6,517	25,398	22,310	34,070	28,827
2004-05	N/A	N/A	26,545	22,604	26,545	22,604
2005-06	N/A	N/A	26,439	23,628	26,439	23,628
2006-07	N/A	N/A	27,209	24,094	27,209	24,094
2007-08 ³	N/A	N/A	26,625	23,737	26,625	23,737

¹ As of June 30, 2004, Lexington Community College is no longer part of UK.

² Full-time and part-time enrollment equated to full-time enrollment.

³ Preliminary.

In reviewing enrollment projections, consideration has been given to planning for adequate academic and housing accommodations for future enrollments. The programs will be developed so that academic and housing facilities will not be limiting factors on the enrollment growth projected. The enrollment projection for the University is set forth in the following tabulations:

<u>Academic Year</u>	Main Campus Fall Semester Student	
	<u>Enrollment (Full-Time Equivalent)^{1, 2}</u>	
2008-2009	24,150	
2009-2010	24,400	
2010-2011	25,000	
2011-2012	25,500	
2012-2013	26,000	

¹ Projections based on 2006-2007 data

² Full-time and part-time enrollment equated to full-time enrollment.

Approximately 23% of the students enrolled in the University are non-residents of Kentucky and it is anticipated that the percentage of non-resident enrollments will remain at this level in future years.

Admissions Information – Fall Semester Undergraduate Admissions

The following is a summary of certain undergraduate admission information for the most recent five years:

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007¹</u>
Number of Applications	9,418	10,604	10,515	10,024	10,619
Number Approved for Enrollment	7,603	8,353	8,123	8,073	8,172
Number Enrolled	3,688	3,961	3,844	4,190	3,922
Average ACT Scores (First time full-time Freshman)	24.5	24.2	24.75	23.92	24.3

¹ Preliminary

State Appropriations

The following is a summary of the University's General Fund state appropriations for the most recent ten Fiscal Years:

<u>Fiscal Year</u>	<u>Appropriation</u>
1999	\$286,475,000
2000	290,640,000
2001	307,821,000
2002	303,639,000
2003	304,735,000
2004	302,539,000
2005	295,807,600
2006	314,293,600
2007	318,567,900
2008	336,216,500 ¹

¹ Budgeted

The amount of funds appropriated has been based in part on the debt service on the University's outstanding Consolidated Educational Buildings Revenue Bonds. The amounts set forth above, except for Fiscal Year 2008, are amounts actually received, which, in certain years, have been less than amounts included in the original state budget for that year. The Board presently intends, but is not obligated, to continue to seek to have funds appropriated by the General Assembly to partially support the operations of the University. THE GENERAL ASSEMBLY IS NOT NOW OBLIGATED, NOR WILL THERE BE AN OBLIGATION IN THE FUTURE TO MAKE APPROPRIATIONS TO THE UNIVERSITY. IN ADDITION, THERE CAN BE NO ASSURANCE THAT IN THE PERFORMANCE OF HIS OR HER OBLIGATION TO BALANCE THE STATE BUDGET ANNUALLY, THE GOVERNOR WILL NOT REDUCE OR ELIMINATE ANY APPROPRIATIONS WHICH ARE MADE.

Grants and Contracts

The following is a summary of the University's grant and contract amounts for the most recent ten Fiscal Years:

<u>Fiscal Year</u>	<u>Amount</u>
1998	\$ 119,852,159
1999	124,819,725 ¹
2000	128,116,917 ¹
2001	146,914,931 ¹
2002	170,378,424 ¹
2003	197,651,327 ¹
2004	218,890,770 ¹
2005	250,381,051 ¹
2006	270,278,010 ²
2007	287,185,815 ^{2,3}

¹ Does not include Community Colleges Student Financial Aid except for Lexington Community College.

² Does not include any Community College Student Financial Aid

³ Preliminary

Student Financial Aid

The following is a summary of the University's student financial aid for the most recent ten Fiscal Years:

<u>Fiscal Year</u>	<u>Amount</u>
1998	\$ 146,673,202
1999	108,902,995 ¹
2000	110,992,616 ¹
2001	129,340,356 ¹
2002	139,411,538 ¹
2003	167,461,348 ¹
2004	184,255,947 ¹
2005	171,972,107 ²
2006	172,720,169 ²
2007	167,665,430 ^{2,3}

¹ Does not include Community Colleges Student Financial Aid except for Lexington Community College.

² Does not include any Community College Student Financial Aid.

³ Preliminary

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

Comparative Report of Student Financial Aid

The following is a comparative summary of the University's student financial aid for Fiscal Years 2006 and 2007.

	<u>2006</u>	<u>2007</u> ³
Scholarships & Grants	\$ 30,670,976	\$ 37,234,576
Federal Grants		
Pell	8,888,247	8,413,011
SEOG	671,917	659,874
ACG ¹		533,294
SMART ¹		394,185
College Work Study	1,158,491	855,561
Financial Aid from Outside Agencies		
Federal Grants	1,052,338	NA
State Grants	20,710,532	20,445,389
Agency Grants	6,187,044	820,431
Loans		
Federal Perkins Loans	3,318,690	2,627,343
Federal Direct Loans ²		78,850,620
Federal Family Education Loans (FFEL) ²		2,930,674
Health Professions Loans	421,200	503,027
Loans - Outside Agencies ²	89,587,843	12,769,407
Other Loans (Institutional)	<u>10,052,891</u>	<u>628,038</u>
Total	<u><u>\$ 172,720,169</u></u>	<u><u>\$ 167,665,430</u></u>

¹ New Grant program beginning in 2007

² Federal Direct Loans and FFEL reported in Loans – Outside Agencies prior to 2007

³ Preliminary

NA – Not Available

The University of Kentucky Albert B. Chandler Hospital

History and Background. The Albert B. Chandler Hospital ("University Hospital") is an organizational unit of the University. It holds a position of leadership as a statewide, regional, and national tertiary referral hospital. Initial funds for the University Hospital were appropriated by the 1956 General Assembly, and the first patients were admitted to the University Hospital in 1962.

In its commitment to quality care, the University Hospital and the University Hospital's medical staff representing all medical and surgical specialties, provides a full scope of services, such as extensive pediatric services offering sophisticated neonatal intensive care, renal, bone marrow and solid organ transplant programs, and comprehensive high-risk obstetrical services. The University Hospital and its

staff are leaders in developing and refining new technology including imaging and comprehensive medical, surgical, cancer, geriatric, cardiac, and burn specialty programs. Patients benefiting from these services come from all of Kentucky's counties, contiguous states, other states, and many foreign countries.

Relationship to Other Units of the Academic Medical Center. Within the Academic Medical Center, along with the University Hospital, there are the Colleges of Medicine, Nursing, Dentistry, Pharmacy, Public Health, and Health Sciences.

In its support of the College of Medicine the University Hospital provides a facility for teaching and research. The College of Medicine annually graduates approximately 95 physicians and supervises the clinical experience of nearly 500 post-graduate physicians each year. The facilities at the medical school adjoin the University Hospital containing lecture halls, classroom space, offices, and laboratories.

The primary function of the College of Medicine is the education of physicians through a four-year doctor of medicine degree (M.D.) program and three to seven year residency programs which are offered in 32 medical and surgical subspecialties. In addition, masters (M.S.), doctoral (PhD), and post-doctoral programs are offered in five basic science areas. The College of Medicine also operates the Sanders Brown Research Center on Aging, which is among the nation's leaders in Alzheimer's disease research. The Center is engaged in the multi-disciplinary study of the problems of aging. Both inpatient hospital and ambulatory patient care services are provided by the faculty of the College of Medicine within the Medical Center, as well as a number of clinical practice settings principally in Eastern Kentucky in conjunction with the University's eight Area Health Education Center Affiliations in Bowling Green, Hazard, Morehead, Mt Vernon, Madisonville, Murray, Louisville and Park Hills.

The other colleges within the Academic Medical Center, Nursing, Dentistry, Pharmacy, Public Health, and Health Sciences also use the University Hospital as a prime teaching site for students and residents and patient care facility to carry out their mission of research and education.

Recent Developments. During the 2007 legislative session the Kentucky General Assembly gave the University authority to spend \$70 million towards the acquisition of Samaritan Hospital and its related properties and to make improvements to the site. The University acquired the use of the land and buildings utilized by Samaritan Hospital through a capital lease in April 2007 that includes a \$35 million put/call purchase option. The University completed the acquisition of the business unit effective July 1, 2007 for \$13 million and immediately renamed the hospital UK HealthCare Good Samaritan ("UKHGS"). The acquired hospital and properties are adjacent to the University campus and within walking distance of the University Hospital. UKHGS has joined the University Hospital as an operating unit of the University and provides the University immediately with an additional 302 licensed beds. An additional 34 beds have been leased to a third party for two years. When added to the current University Hospital licensed bed compliment of 473 and approved Certificate of Need NICU beds of 16, the University will have 825 licensed beds for current and future needs all within the University Campus. This acquisition complements the existing University Hospital and related facilities including the new replacement project and allows UK HealthCare to continue to grow and increase patient volume as the University Hospital has reached its functional capacity. UKHGS will serve both community and College of Medicine physicians as part of an integrated hospital entity. The University expects to operate UKHGS for at least ten years and will evaluate the longer term use of the site based on patient demand, the future cost to maintain and upgrade the facilities and academic needs. The site is a natural bridge between the University and downtown Lexington making it very valuable for future long-term needs.

Hospital Mission, Vision and Critical Success Factors. The University Hospital recognizes the need for organizational planning to maintain its position as a quality health care provider. The University

Hospital's mission is to help people of the Commonwealth and beyond gain and retain good health through creative leadership and quality initiatives in patient care, education and research. To achieve this Mission the University Hospital has set a Vision of being a top 20 public academic health center, recognized nationally and internationally for excellence in patient care, education and research. The University Hospital was recently included in the Thompson Healthcare (formerly Solucient) list of 100 Top Performance Improvement Leaders. It is the second year in a row the hospital has been recognized by Thompson Healthcare.

Hospital Administration. The University Hospital and UKHGS are managed by the UK HealthCare executive group that includes the Executive Vice President for Health Affairs Michael Karpf M.D.; the Senior Vice President for Health Affairs and CFO of the HealthCare Enterprise Sergio Melgar; the Vice President for Clinical Affairs/Dean of the College of Medicine Jay Perman, M.D.; the Chief Medical Officer Richard P. Lofgren, M.D., M.P.H.; the Associate Vice President and Chief Information Officer for the UK Healthcare Enterprise Zed E. Day. The daily operations of the University Hospital are managed by the Associate Vice President for Medical Center Operations Murray B. Clark, Jr. and the Chief Nursing Officer/Associate Hospital Director Karen Stefaniak, RN, Ph.D. The daily operations at UKHGS are managed by the hospital director Frank Beirne.

Hospital Operating Results and Financial Condition.

Statement of Revenue, Expenses and Changes In Net Assets. The following is a summary of the University Hospital's revenue, expenses and changes in net assets for each of Fiscal Years 2005, 2006 and 2007.

	<u>2005</u>	<u>2006</u>	<u>2007</u>
	(Dollars in Thousands)		
Operating revenue	\$441,935	\$521,664	\$580,839
Operating expenses	<u>404,777</u>	<u>491,090</u>	<u>563,732</u>
Operating income	<u>37,158</u>	<u>30,574</u>	<u>17,107</u>
Net non-operating revenue (expenses)	<u>8,502</u>	<u>49,532</u>	<u>39,413</u>
Net income before other revenues, expenses, gains or losses	<u>45,660</u>	<u>80,106</u>	<u>56,520</u>
Transfer to University	(17,305)	(11,156)	(9,316)
Net loss from discontinued operations	<u>(40)</u>	<u>(43)</u>	<u>5</u>
Increase in net assets	<u>\$ 28,315</u>	<u>\$ 68,907</u>	<u>\$ 47,206</u>

Certain Operating Information

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Average Licensed Beds	473	473	473
Available Beds	436	462	473
Patient Days	122,704	134,520	148,289
Patient Days Equivalents ¹	191,892	206,672	240,201
Admissions	22,312	24,754	27,331
Discharges	22,269	24,760	27,292
Average Length of Stay (days)	5.51	5.43	5.43
Occupancy	77.13%	79.69%	85.89%
Emergency Visits	42,909	44,646	45,655
Outpatient Visits with Hospital Charge	266,245	275,608	290,910

¹Total patient activity computed by converting outpatient activity to an inpatient equivalent.

OUTSTANDING BONDS OF THE UNIVERSITY OF KENTUCKY

The University had the following bonds outstanding as of June 30, 2007.

Consolidated Educational Buildings Revenue Bonds

	<u>Year of Issue</u>	<u>Amount of Issue</u>	<u>Amount Outstanding</u>	<u>Year Of Final Maturity</u>
Series M (2 nd Series)	1998	\$4,695,000	\$3,065,000	2011
Series N (2 nd Series)	2001	18,795,000	9,785,000	2012
Series K (3 rd Series)	2003	5,115,000	2,295,000	2010
Series S	2003	29,775,000	26,520,000	2024
Series T	2003	17,635,000	15,280,000	2023
Series O (2 nd Series)	2003	9,335,000	6,625,000	2015
Series E, J & L (3 rd Series)	2004	19,520,000	6,890,000	2011
Series P, Q & R (2 nd Series)	2004	52,110,000	44,965,000	2021
Series U	2005	<u>11,495,000</u>	<u>10,800,000</u>	2025
TOTAL		<u>\$168,475,000</u>	<u>\$126,225,000</u>	

Library Bonds (issued by the Lexington-Fayette Urban County Government)

	<u>Year of Issue</u>	<u>Amount of Issue</u>	<u>Amount Outstanding</u>	<u>Year of Final Maturity</u>
1998 Series	1998	\$43,420,000	\$39,035,000	2025

Obligations Outstanding Under the Trust Agreement

	<u>Year of Issue</u>	<u>Amount of Issue</u>	<u>Amount Outstanding</u>	<u>Year of Final Maturity</u>
Kentucky Asset/Liability Commission General Receipts Project Notes, 2005 Series A	2005	\$107,540,000	\$107,540,000	2025
Kentucky Asset/Liability Commission General Receipts Refunding Project Notes, 2006 Series A	2006	66,305,000	66,155,000	2022
Kentucky Asset/Liability Commission General Receipts Taxable Refunding Project Notes, 2006 Series B	2006	2,220,000	2,220,000	2007
Kentucky Asset/Liability Commission General Receipts Refunding Project Notes, 2007 Series A*	2007	<u>77,905,000</u>	<u>77,905,000</u>	2027
Total ALCo Notes		<u>\$253,970,000</u>	<u>\$253,820,000</u>	
University of Kentucky General Receipts Bonds, 2005 Series A Bonds	2005	7,160,000	6,915,000	2025
University of Kentucky General Receipts Bonds, 2006 Series A Bonds	2006	<u>24,325,000</u>	<u>24,325,000</u>	2026
Total General Receipts Bonds		<u>\$31,485,000</u>	<u>\$31,240,000</u>	
Total Under Trust Agreement		<u>\$285,455,000</u>	<u>\$285,060,000</u>	

Please refer to the financial statements included in "APPENDIX C" for additional obligations of the University.

*2007 A Notes were delivered November 1, 2007.

TOTAL ANNUAL DEBT SERVICE REQUIREMENTS

Year Ending June 30	Existing Debt Service	Principal	Interest	Total	Total Debt Service
2008	\$ 32,986,080.91	\$ 0.00	\$ 1,254,104.08	\$ 1,254,104.08	\$ 34,240,184.99
2009	35,277,316.31	0.00	3,700,635.00	3,700,635.00	38,977,951.31
2010	39,642,623.81	0.00	3,700,635.00	3,700,635.00	43,343,258.81
2011	41,515,067.56	2,325,000.00	3,661,400.63	5,986,400.63	47,501,468.19
2012	39,337,615.69	2,405,000.00	3,580,078.76	5,985,078.76	45,322,694.45
2013	37,105,058.80	2,485,000.00	3,493,261.26	5,978,261.26	43,083,320.06
2014	37,098,513.80	2,580,000.00	3,400,291.26	5,980,291.26	43,078,805.06
2015	37,096,827.55	2,685,000.00	3,300,256.26	5,985,256.26	43,082,083.81
2016	36,154,178.80	2,795,000.00	3,182,186.26	5,977,186.26	42,131,365.06
2017	36,160,640.05	2,935,000.00	3,045,973.76	5,980,973.76	42,141,613.81
2018	36,165,324.42	3,065,000.00	2,914,736.26	5,979,736.26	42,145,060.68
2019	35,673,427.53	3,190,000.00	2,789,636.26	5,979,636.26	41,653,063.79
2020	38,085,223.77	3,325,000.00	2,657,258.13	5,982,258.13	44,067,481.90
2021	33,308,213.14	3,475,000.00	2,504,598.75	5,979,598.75	39,287,811.89
2022	30,981,703.76	3,650,000.00	2,330,861.25	5,980,861.25	36,962,565.01
2023	30,967,981.26	3,840,000.00	2,145,505.00	5,985,505.00	36,953,486.26
2024	24,296,187.51	4,030,000.00	1,952,055.00	5,982,055.00	30,278,242.51
2025	25,339,025.01	4,230,000.00	1,750,805.00	5,980,805.00	31,319,830.01
2026	18,057,365.63	4,440,000.00	1,536,642.50	5,976,642.50	24,034,008.13
2027	8,232,650.00	14,040,000.00	1,075,450.00	15,115,450.00	23,348,100.00
2028	<u>6,725,250.00</u>	<u>14,750,000.00</u>	<u>362,460.00</u>	<u>15,112,460.00</u>	<u>21,837,710.00</u>
Total	<u>\$660,206,275.31</u>	<u>\$80,245,000.00</u>	<u>\$54,338,830.42</u>	<u>\$134,583,830.42</u>	<u>\$794,790,105.73</u>

**PLEGGED REVENUES – GENERAL RECEIPTS
UNIVERSITY OF KENTUCKY
FISCAL YEAR 2007**

<u>Revenue Type</u>	2007 Amount (000's)	Pledged (000's)	Prior Pledge Debt Service (000's)	Net General Receipts Pledged Revenues (000's)
Student tuition and fees	\$166,742	\$166,742	\$18,162	\$148,580
Nongovernmental grants and contracts	31,869	6,916		6,916
Recoveries of facilities and administrative costs	43,792	43,792		43,792
Sales and services	45,717	45,717		45,717
Hospital patient services	579,222	579,222		579,222
Auxiliary enterprises - housing and dining	35,783	35,783		35,783
Auxiliary enterprises – other	21,705	21,705		21,705
Other operating revenue	1,507	1,507		1,507
State appropriations	319,859	319,859		319,859
Gifts and grants	34,218	2,087		2,087
Investment income	160,975	30,654		30,654
TOTAL	<u>\$1,441,389</u>	<u>\$1,253,984</u>	<u>\$18,162</u>	<u>\$1,235,822</u>

**PLEGGED REVENUES – GENERAL RECEIPTS
UNIVERSITY OF KENTUCKY
FISCAL YEAR 2006**

<u>Revenue Type</u>	2006 Amount (000's)	Pledged (000's)	Prior Pledge Debt Service (000's)	Net General Receipts Pledged Revenues (000's)
Student tuition and fees	\$147,267	\$147,267	\$19,365	\$127,902
Nongovernmental grants and contracts	31,547	7,543		7,543
Recoveries of facilities and administrative costs	43,303	43,303		43,303
Sales and services	42,024	42,024		42,024
Hospital patient services	520,310	520,310		520,310
Auxiliary enterprises - housing and dining	36,385	36,385	6,314	30,071
Auxiliary enterprises – other	20,633	20,633		20,633
Other operating revenue	2,222	2,222		2,222
State appropriations	314,294	314,294		314,294
Gifts and grants	32,135	1,123		1,123
Investment income	119,067	55,382		55,382
TOTAL	<u>\$1,309,187</u>	<u>\$1,190,486</u>	<u>\$25,679</u>	<u>\$1,164,807</u>

APPENDIX B

SUMMARY OF THE TRUST AGREEMENT

The following is a summary of certain provisions of the Trust Agreement dated as of November 1, 2005, between the University and U.S. Bank National Association, as Trustee. This summary is not to be regarded as a complete statement of the Trust Agreement to which reference is made for a complete statement of the actual terms thereof. Copies of the Trust Agreement are on file with the Trustee.

Defined Terms

The terms defined below are among those used in the Official Statement and in this summary of the Trust Agreement. Except where otherwise indicated or provided, words in the singular number include the plural as well as the singular number and vice versa.

"Act" means Sections 162.340 to 162.380 of the Kentucky Revised Statutes, Chapter 56 of the Kentucky Revised Statutes and Sections 58.010 to 58.140 of the Kentucky Revised Statutes as the same may be amended, modified, revised, supplemented, or superseded from time to time.

"Additional Obligation Instruments" means agreements providing for the repayment of money that the University may, from time to time, be authorized to enter into under the laws of the Commonwealth. The definition of Additional Obligation Instruments does not include "Bond" or "Bonds," "Note" or "Notes," Financing Agreements or SPBC Leases.

"ALCo" means the Kentucky Asset/Liability Commission and any successor thereto.

"Authenticating Agent" means the Trustee and the Registrar for the series of Obligations and any bank, trust company or other Person designated as an Authenticating Agent for such series of Obligations by or in accordance with the Trust Agreement.

"Beneficial Owner" means, with respect to the Obligations, a Person owning a Beneficial Ownership Interest therein, as evidenced to the satisfaction of the Trustee.

"Beneficial Ownership Interest" means the beneficial right to receive payments and notices with respect to a series of Obligations which are held by a Depository under a Book Entry System.

"Board" means the Board of Trustees of the University, or if there shall be no such Board of Trustees, such Person or body which, pursuant to law or the organizational documents of the University, is vested with the power to direct the management and policies of the University, and shall include any committee empowered to act on behalf of such board or body.

"Bond" or "Bonds" means any bond, or all of the bonds, or an issue or series of bonds, as the case may be, as so identified in the certificate of the Fiscal Officer, of the University issued pursuant to the 2005 General Bond Resolution, a Series Resolution and the Trust Agreement. The definition of Bond and Bonds does not include "Note" or "Notes," Financing Agreements, SPBC Leases or Additional Obligation Instruments.

"Bond Counsel" means an attorney or firm of attorneys of nationally recognized standing on the subject of municipal bonds selected by the University or its counsel and acceptable to the Trustee.

"Book Entry Form" or "Book Entry System" means, with respect to the Obligations, a form or system, as applicable, under which (a) the Beneficial Ownership Interests may be transferred only through a book entry and (b) physical Obligation certificates in fully registered form are registered only in the name of a Depository or its nominee as Holder, with the physical Obligation certificates "immobilized" in the custody of the Depository. The Book Entry System maintained by and the responsibility of the Depository and not maintained by or the responsibility of the University or the Trustee is the record that identifies, and records the transfer of the interests of, the owners of book entry interests in the Obligations.

"Business Day" means a day of the year, other than a Saturday or Sunday, on which banks located in the city in which the principal corporate trust office of the Trustee is located are not required or authorized to remain closed or a day on which The New York Stock Exchange is not closed.

"Certificate of Award" means, with respect to any series of Obligations, the Certificate of Award for such series, if any, authorized in the applicable Series Resolution or the contract of purchase for such series of Obligations.

"Commonwealth" means the Commonwealth of Kentucky.

"Costs of University Facilities" means the costs of or related to University Facilities, and the financing thereof, for the payment of which Obligations may be issued under the Act.

"Credit Support Instrument" means an irrevocable letter of credit, line of credit, standby bond purchase agreement, insurance policy, guaranty or surety bond or similar instrument providing for the payment of or guaranteeing the payment of principal or purchase price of and interest on Obligations when due, either to which the University is a party or which is provided at the request of the University.

"Credit Support Provider" means the provider of a Credit Support Instrument.

"Debt Service Charges" means, generally, for any applicable time period, (i) the principal (including any Mandatory Sinking Fund Requirements), interest and redemption premium, if any, required to be paid by the University on Obligations pursuant to any Series Resolution, less any capitalized interest for such time period and accrued interest on deposit in the Debt Service Payment Account; (ii) any amounts due to a Credit Support Provider to the extent as set forth in a Credit Support Instrument; and (iii) any amounts due to a Hedge Provider to the extent as set forth in an Interest Rate Hedge Agreement.

"Debt Service Fund" means the Debt Service Fund authorized and created pursuant to the Trust Agreement.

"Debt Service Payment Account" means the Debt Service Payment Account within the Debt Service Fund authorized and created pursuant to the Trust Agreement.

"Debt Service Reserve Account" means the Debt Service Reserve Account authorized and created pursuant to the Trust Agreement.

"Depository" means any securities depository that is a clearing agency under federal law operating and maintaining, together with its participants a Book Entry System to record beneficial ownership of a series of Obligations, and to effect transfers of such Obligations, in Book Entry Form, and includes the Depository Trust Company (a limited purpose trust company), New York, New York.

"Direct Participant" means a Participant as defined in the Letter of Representations.

"Eligible Investments" means any investment authorized by Section 42.500 and 56.520(5) of the Kentucky Revised Statutes, as the same may be amended, modified, revised, supplemented, or superseded from time to time.

"Extraordinary Services" and "Extraordinary Expenses" means all services rendered and all reasonable expenses (including counsel fees) properly incurred by the Trustee under the Trust Agreement, other than Ordinary Services and Ordinary Expenses. Extraordinary Services and Extraordinary Expenses shall specifically include services rendered or expenses incurred by the Trustee in connection with, or in contemplation of, an Event of Default.

"Event of Default" means an Event of Default as defined at the caption "Events of Default" in this Appendix B.

"Financial Statements" means the University's Annual Consolidated Financial Statements.

"Financing Agreement" means a "Financing Agreement" as defined in Chapter 56 of the Kentucky Revised Statutes between the University and ALCo or the applicable state agency as then provided by law. The definition of Financing Agreement does not include "Bond" or "Bonds," "Note" or "Notes" or Additional Obligation Instruments, but may also mean an SPBC Lease.

"Fiscal Officer" means either the Treasurer of the University or such other person designated by the Chairman of the Board to act as Fiscal Officer for purposes of the Trust Agreement.

"Fiscal Year" means a period of twelve consecutive months constituting the fiscal year of University commencing on the first day of July of any year and ending on the last day of June of the next succeeding calendar year, both inclusive, or such other consecutive twelve month period as hereafter may be established from time to time for budgeting and accounting purposes of the University by the Board to be evidenced, for purposes of the Financing Agreement, by a certificate of a Fiscal Officer filed with the Trustee.

"Fitch" means Fitch Ratings.

"General Receipts" means, as reported in the Financial Statements (having the designations, to the extent not otherwise defined in the Financing Agreement, set forth in the Financial Statements or such successor designations that may hereafter be used in Financial Statements):

(a) certain operating and non-operating revenues of the University, being (i) Student Registration Fees, (ii) nongovernmental grants and contracts, (iii) recoveries of facilities and administrative costs, (iv) sales and services, (v) Hospital Revenues, (vi) Housing and Dining Revenues, (vii) auxiliary enterprises – other auxiliaries, (viii) other operating revenues, (ix) state appropriations (for general operations), (x) gifts and grants, (xi) investment income, (xii) other nonoperating revenues and (xiii) other;

(b) but excluding (i) any receipts described in clause (a) which are contracts, grants, gifts, donations or pledges and receipts therefrom which, under restrictions imposed in such contracts, grants, gifts, donations or pledges, or, which as a condition of the receipt thereof or of amounts payable thereunder are not available for payment of Debt Service Charges, (ii) federal grants and contracts, (iii) state and local grants and contracts, (iv) federal appropriations, (v) county appropriations, (vi) professional clinical service fees, (vii) auxiliary enterprises – athletics;

(viii) capital appropriations, (ix) capital grants and gifts, and (x) additions to permanent endowments, including research challenge trust funds;

provided, however, that General Receipts may

(c) include any other receipts that may be designated as General Receipts from time to time by a resolution of the Board delivered to the Trustee; and

(d) exclude any receipts not pledged under the Trust Agreement, which may be designated from time to time by a resolution of the Board delivered to the Trustee;

(e) exclude any receipts pledged under the Trust Agreement, which may be designated from time to time by a resolution of the Board delivered to the Trustee and each Rating Service then rating any Obligations, but only if each such Rating Service confirms in writing to the University that the exclusion of any such receipt would not cause a reduction or withdrawal of the then current rating on any Outstanding Obligations.

"Government Bonds" means (a) direct obligations of the United States of America for the payment of which the full faith and credit of the United States of America is pledged, (b) obligations issued by a Person controlled or supervised by and acting as an instrumentality of the United States of America, the payment of the principal of, premium, if any, and interest on which is fully guaranteed as a full faith and credit obligation of the United States of America (including any securities described in (a) or (b) issued or held in book-entry form on the books of the Department of Treasury of the United States of America or Federal Reserve Bank), and (c) securities which represent an interest in the obligations described in (a) and (b) above.

"Hedge Provider" means the provider of an Interest Rate Hedge Agreement.

"Holder" means any Person in whose name a registered Obligation is registered; provided that ALCo, or its assignee, shall be the Holder of any Financing Agreement and SPBC, or its assignee, shall be the Holder of any SPBC Lease.

"Hospital Revenues" means operating revenues having the designation "hospital services" in the Financial Statements or any successor designation or designations for such receipts that may hereafter be used in Financial Statements.

"Housing and Dining Bonds" means Obligations, the proceeds of which will be used to pay Costs of University Facilities which constitute Housing and Dining Facilities.

"Housing and Dining Facilities" means Housing and Dining Facilities, as defined in the Prior Housing Indenture.

"Housing and Dining Revenues" means operating revenues (auxiliary enterprises) having the designation "housing and dining" in the Financial Statements or any successor designation or designations for such receipts that may hereafter be used in Financial Statements.

"Indirect Participant" means a Person utilizing the Book Entry System of the Depository by, directly or indirectly, clearing through or maintaining a custodial relationship with a Direct Participant.

"Interest Payment Dates" means the dates specified in the applicable Series Resolution or Certificate of Award on which interest on the Obligations or any series of Obligations is to be paid.

"Interest Rate Hedge Agreement" means an interest rate swap, an interest rate cap or other such arrangement obtained, either directly by the University (or the Trustee on behalf of the University) or through ALCo, with the goal of lowering the effective interest rate to the University on Obligations or hedging the exposure of the University with respect to its obligations on the Obligations against fluctuations in prevailing interest rates.

"Letter of Representations" means the Blanket Letter of Representations from the University to the Depository.

"Mandatory Sinking Fund Requirements" means amounts required by any Series Resolution or the Certificate of Award to be deposited to the Debt Service Payment Account in any fiscal year for the purpose of retiring principal maturities of Obligations which by the terms of such Obligations are due and payable, if not called for prior redemption, in any subsequent fiscal year.

"Maximum Annual Debt Service" means the highest amount of (i) Debt Service Charges plus (ii) the principal of and interest on all Prior Obligations that are outstanding under the terms of the Prior Basic Resolution or the Prior Housing Indenture, for the current or any future Fiscal Year.

"Moody's" means Moody's Investors Service, Inc., a Delaware corporation, and its successors and assigns.

"Notes" or "Note" means any note or all of the notes, or an issue of notes, as the case may be, as so identified in the certificate of the Fiscal Officer issued by the University in anticipation of the issuance of Obligations or receipt of grants or appropriations to pay Costs of University Facilities, or to pay costs of refunding or retirement of Notes previously issued pursuant to the Act, the 2005 General Bond Resolution, a Series Resolution and the Trust Agreement. The definition of Note and Notes does not include "Bond" or "Bonds," Financing Agreements, SPBC Leases or Additional Obligation Instruments.

"Obligations" means Bonds, Notes, Financing Agreements, SPBC Leases and Additional Obligation Instruments.

"Ordinary Services" and "Ordinary Expenses" means those services normally rendered and those expenses (including counsel fees) normally incurred by a trustee under instruments similar to the Trust Agreement.

"Original Purchaser" means, as to any Obligations, the Person or Persons expressly named in the applicable Series Resolution or the Certificate of Award as the original purchaser of those Obligations from the University.

"Outstanding" means, as of any date, Notes and Bonds which have been authenticated, and with respect to all Obligations, have been delivered, or are then being delivered, by the Trustee or the University under the Trust Agreement except:

- (a) Obligations surrendered for exchange or transfer or canceled because of payment or redemption at or prior to such date;
- (b) Obligations for the payment, redemption or purchase for cancellation of which sufficient moneys have been deposited prior to such date with the Trustee or Paying Agents (whether upon or prior to the maturity or redemption date of any such Obligations), or which are deemed to have been paid and discharged pursuant to the provisions of the Trust Agreement; provided that if such Obligations are to be redeemed prior to the maturity thereof, notice of such

redemption shall have been given or arrangements satisfactory to the Trustee shall have been made therefor, or waiver of such notice satisfactory in form to the Trustee shall have been filed with the Trustee, and provided, further, that if such Obligations are to be purchased for cancellation, a firm offer for sale stating the price has been received and accepted; and

(c) Lost, stolen, mutilated or destroyed Obligations in lieu of which others have been authenticated, if applicable, (or payment, when due, of which is made without replacement) under the Trust Agreement.

"Paying Agents" means any banks or trust companies designated as the paying agencies or places of payment for Obligations by or pursuant to the applicable Series Resolution, and their successors designated pursuant to the Trust Agreement, and shall also mean the Trustee when so designated for such purpose.

"Person" means an individual, a corporation, a partnership, an association, a joint stock company, a joint venture, a trust, an unincorporated organization, or a government or any agency or political subdivision thereof.

"Predecessor Obligation" of any particular Obligation means every previous Obligation evidencing all or a portion of the same debt as that evidenced by the particular Obligation. For the purposes of this definition, any Bond or Note authenticated and delivered under the Trust Agreement in lieu of a lost, stolen or destroyed Bond or Note shall, except as otherwise provided in the Trust Agreement, be deemed to evidence the same debt as the lost, stolen or destroyed Bond or Note.

"Prior Basic Resolution" means the resolution adopted by the Board on September 20, 1960, that has provided for the issuance of Consolidated Educational Buildings Revenue Bonds of the University.

"Prior Financing Documents" means, collectively, the Prior Basic Resolution and the Prior Housing Indenture.

"Prior Funds" means all funds and accounts created by the Prior Financing Documents that are pledged as security and a source of payment of bonds and notes issued thereunder.

"Prior Housing Indenture" the Trust Indenture and Supplemental Trust Indenture dated as of June 1, 1965 (and all supplemental indentures related thereto) between the University and Farmers' Bank & Capital Trust Company that, has provided for the issuance of Housing and Dining Bonds.

"Prior Obligations" means any notes or bonds that are outstanding under the Prior Financing Documents.

"Prior Pledged Funds" means, collectively, all funds and accounts created under the Prior Financing Documents.

"Prior Pledged Revenues" means amounts required to be deposited in the "Revenue Fund" created by the Prior Basic Resolution and in the "System Revenue Fund" created by the Prior Housing Indenture.

"Project Fund" means the Project Fund created pursuant to the Trust Agreement.

"Purchase Price" means, as to any series of Obligations, the amount provided for in the Series Resolution and the Certificate of Award authorized thereby, plus accrued interest, if any, on the aggregate

principal amount of those Obligations from their date to the date of their delivery to the Original Purchaser and payment therefor.

"Rating Service" means Fitch, Moody's, S&P or any other nationally recognized rating service.

"Redemption and Purchase Account" means the Redemption and Purchase Account authorized and created pursuant to the Trust Agreement.

"Register" means the books kept and maintained by the Registrar for the registration and transfer of Obligations pursuant to the Trust Agreement.

"Registrar" means, with respect to a series of Obligations, the keeper of the Register for those Obligations, which shall be the Trustee except as may be otherwise provided by or pursuant to the Series Resolution for those Obligations, each of which shall be a transfer agent registered in accordance with Section 17(A)(c) of the Securities Exchange Act of 1934.

"Regular Record Date" means, with respect to any Obligation and unless otherwise provided in the Series Resolution authorizing the particular series of Obligations, the fifteenth day of the calendar month next preceding an Interest Payment Date applicable to that Obligation.

"Reimbursement Agreement" means, with respect to a series of Obligations, any agreement or agreements between one or more Credit Support Providers and the University under or pursuant to which a Credit Support Instrument for such series of Obligations is issued or provided and which sets forth the respective obligations of the University and of the Credit Support Provider.

"Remarketing Agent" means any entity which acts as the remarketing agent with respect to a series of Obligations.

"Revenue Fund" means the Revenue Fund authorized and created pursuant to the Trust Agreement.

"S&P" means Standard & Poor's Rating Services, a Division of The McGraw Hill Companies, and its successors and assigns.

"Series Resolution" means a Resolution of the Board authorizing one or more series of Obligations and the execution and delivery of a Supplemental Trust Agreement, all in accordance with the 2005 General Bond Resolution and the Trust Agreement.

"SPBC" means the State Property and Buildings Commission of the Commonwealth and any successor thereto.

"SPBC Lease" means a lease between the University and SPBC or the applicable state agency as then provided by law. The definition of SPBC Lease does not include "Bond" or "Bonds," "Note" or "Notes" or Additional Obligation Instruments, but may also mean a Financing Agreement.

"Special Funds" means the Debt Service Fund and accounts therein and any other funds or accounts permitted by, established under, or identified in the Trust Agreement or a Series Resolution and designated as Special Funds. The Revenue Fund shall not be a Special Fund.

"Student Registration Fees" means operating revenues having the designation "student tuition and fees" in the Financial Statements or any successor designation or designations for such receipts that may hereafter be used in Financial Statements.

"Subordinated Indebtedness" means obligations which, with respect to any issue thereof, are secured by a pledge of the General Receipts which is subordinate to that of the holders of Obligations and which are evidenced by instruments, or issued under an indenture or other document, containing provisions for the subordination of such obligations.

"Supplemental Trust Agreement" means any one or more of Supplemental Trust Agreements entered into by the parties pursuant to the Trust Agreement and a Series Resolution.

"Tender Agent" means any entity which acts as a tender agent for a series of Obligations.

"Trust Agreement" means the Trust Agreement, dated as of November 1, 2005, between the University and the Trustee, as the same may be duly amended, modified or supplemented in accordance with its terms.

"Trustee" means the Trustee at the time serving under the Trust Agreement, originally U.S. Bank National Association and any successor Trustee as determined or designated under or pursuant to the Trust Agreement.

"2005 General Bond Resolution" means the resolution of the Board adopted on September 20, 2005, authorizing the execution and delivery of the Trust Agreement.

"University" means the University of Kentucky, a public body corporate, and an educational institution and agency of the Commonwealth of Kentucky, and every part and component thereof as from time to time existing, and when the context requires, includes the Board.

"University Facilities" means buildings and appurtenances to be used in connection with the University for educational purposes, including, but not limited to any Authorized Project, any Building, any Building project and any Public project, as those terms are defined in the Act, and further includes any one, part of, or any combination of such facilities, and further includes site improvements, utilities, machinery, furnishings and any separate or connected buildings, structures, improvements, sites, open space and green space areas, utilities or equipment to be used in, or in connection with the operation or maintenance of, or supplementing or otherwise related to the services or facilities to be provided by such facilities.

Any reference in the Financing Agreement to the University, the Board, or to any officers or to other public boards, commissions, departments, institutions, agencies, bodies, entities or officers, shall include those which succeed to their functions, duties or responsibilities pursuant to or by operation of law or who are lawfully performing their functions. Any reference to a section or provision of the Kentucky Revised Statutes or to the laws of Kentucky shall include such section or provision and such laws as from time to time amended, modified, revised, supplemented, or superseded, provided that no such amendment, modification, revision, supplementation, or super session shall alter the obligation to pay the Debt Service Charges in the amount and manner, at the times, and from the sources provided in this Resolution, the applicable Series Resolution, and the Trust Agreement, except as otherwise permitted in the Trust Agreement.

Debt Service Fund and Other Special Funds

The Trustee will hold and administer the Debt Service Fund and any other Special Fund created under the Trust Agreement, together with the accounts contained therein, upon the terms and conditions, including, without limitation, the terms and conditions set forth in the Trust Agreement and the applicable Series Resolution and/or Supplemental Trust Agreement for the investment of moneys deposited in such Funds, set forth in the applicable Series Resolution and the Trust Agreement.

There will be maintained in the Debt Service Fund the following Accounts: the Debt Service Payment Account, the Debt Service Reserve Account and the Redemption and Purchase Account. The Trustee will maintain a separate subaccount within the Debt Service Payment Account for each series of Obligations and each separate subaccount will secure only the particular series of Obligations to which it is related. (Section 4.01)

Use of Debt Service Payment Account; Intercept

The Debt Service Account is pledged to and will be used solely for the payment of Debt Service Charges as they fall due. Payments sufficient in an amount to pay the Debt Service Charges as they become due will be paid by the University directly to the Trustee, and deposited in the Debt Service Payment Account to the extent moneys in the Debt Service Payment Account are not otherwise available therefore. Upon the occurrence and during the continuation of an Event of Default described in the Trust Agreement with respect to a specific series of Obligations, if a subaccount in the Debt Service Reserve Account has been created to secure such series of Obligations, moneys in the applicable subaccount of the Debt Service Reserve Account may be transferred by the Trustee to the Debt Service Payment Account to be used to pay Debt Service Charges with respect to such series of Obligations pursuant to the Trust Agreement. Except as provided in the Trust Agreement, moneys in the Debt Service Payment Account shall be used solely for the payment of Debt Service Charges on the Obligations, for the redemption of Obligations prior to maturity, for the payment of any amounts due to a Credit Support Provider to the extent as set forth in a Credit Support Instrument, for the payment of any amounts due to a Hedge Provider to the extent as set forth in an Interest Rate Hedge Agreement and as otherwise provided in the Trust Agreement and the 2005 General Bond Resolution.

If, ten days prior to any date that the payment of Debt Service Charges are due, sufficient funds are not on deposit in the Debt Service Payment Account to enable the Trustee to pay such Debt Service Charges, or if the Trustee shall have transferred funds from a Debt Service Reserve Account to the Debt Service Payment Account to forestall a default in the payment of Debt Service Charges, then in each such instance the Trustee shall immediately notify the Treasurer of the University and the Secretary of the Finance and Administration Cabinet of the Commonwealth in writing of such event and request that amounts be remitted to the Trustee pursuant to the then applicable provisions of Section 164A.608 of the Kentucky Revised Statutes to cure such deficiency or to restore the amount transferred from the Debt Service Reserve Account. (Section 4.02)

Debt Service Reserve Account

The Trustee will hold and administer a Debt Service Reserve Account to be used, solely for the payment of Debt Service Charges with respect to any series of Obligations for which a reserve fund has been mandated pursuant to the Series Resolution which authorized the issuance of such series of Obligations. A separate subaccount shall be created in the Supplemental Debt Service Reserve Account for each series of Obligations for which a reserve fund has been mandated by the Series Resolution which authorized such series of Obligations and each separate subaccount shall secure only the particular series of Obligations to which it is related.

If, on the date upon which Debt Service Charges on any Obligations which are secured by a Debt Service Reserve Account or subaccount held by the Trustee fall due, the subaccount within the Debt Service Payment Account related to such Obligations is insufficient to meet such Debt Service Charges to be paid therefrom on such date, the Trustee will immediately transfer from the appropriate subaccount of the Debt Service Reserve Account an amount sufficient to make up such deficiency in the subaccount of the Debt Service Payment Account. Except as may be provided in the applicable Series Resolution or Supplemental Trust Agreement, if on the day upon which amounts are due to a Hedge Provider under an Interest Rate Hedge Agreement or are due to a Credit Support Provider in reimbursement for amounts provided under a Credit Support Instrument, the amount in the subaccount within the Debt Service Payment Account related to such Debt Service Charges (other than from any amounts provided under an Interest Rate Hedge Agreement or Credit Support Instrument) is insufficient to pay such amounts to such Hedge Provider or Credit Support Provider on that date, the Trustee, without necessity for any further order of the University or officer thereof, will make available for such reimbursement any amounts in the related subaccount of the Debt Service Reserve Account for the series of Obligations to which the Interest Rate Hedge Agreement or Credit Support Instrument applies that are necessary to make up that insufficiency. The amount so transferred will be applied only to the payment of Debt Service Charges on the Obligations to which that Debt Service Reserve Account pertains or for the payment of any amounts due to a Hedge Provider under an Interest Rate Hedge Agreement or to a Credit Support Provider as reimbursement of draws under a Credit Support Instrument in connection with the Obligations to which that Debt Service Reserve Account pertains.

Subject to the foregoing, any amount in a subaccount of the Debt Service Reserve Account in excess of the amount required to be maintained therein pursuant to the Series Resolution which created such subaccount or the Certificate of Award (the "Required Amount") will be transferred to the Debt Service Payment Account or to the Redemption and Purchase Account for the purposes thereof, if and to the extent ordered by the Fiscal Officer. Such excess will be determined by calculating the Required Amount with reference to Outstanding Obligations of the particular series only, excluding any Obligations for the redemption or purchase of which such excess is being transferred to the Redemption and Purchase Account.

Within 180 days after the end of each Fiscal Year, the University shall, from General Receipts, restore to the various subaccounts within the Debt Service Reserve Account any amounts transferred therefrom or any decrease in value determined pursuant to the Trust Agreement in such Fiscal Year so that the amounts in such subaccounts are at least equal to the various Required Amounts. (Section 4.03)

Redemption and Purchase Account

There will be deposited in the Redemption and Purchase Account that portion (if any) of the proceeds of refunding Obligations, as provided in the Series Resolution authorizing their issuance, allocated to the payment of the principal, interest and redemption premium, if any, or purchase price of the Obligations to be refunded, funded or retired through the issuance of such refunding Obligations; amounts to be transferred thereto from the Debt Service Reserve Account by order of the Fiscal Officer as set forth under the caption "Debt Service Reserve Account" above; and any other amounts made available by the University for the purposes of the Redemption and Purchase Account. Amounts for the redemption of Obligations to be provided pursuant to the mandatory sinking fund requirements of the Series Resolution authorizing such Obligations will not be deposited to the credit of the Redemption and Purchase Account, but shall be deposited to the credit of the Debt Service Payment Account.

Any amounts in the Redemption and Purchase Account may be committed, by Series Resolution or other action by the Board, for the retirement of and for Debt Service Charges on specified Obligations and, so long as so committed, will be used solely for such purposes whether directly or through transfer to

the Debt Service Fund. Subject to the foregoing provisions of the Trust Agreement, the Fiscal Officer may cause moneys in the Redemption and Purchase Account to be used to purchase any Obligations for cancellation and to redeem any Obligations in accordance with the redemption provisions of the applicable Series Resolution. From moneys in the Redemption and Purchase Account, the Trustee will transmit or otherwise disburse such amounts at such times as required for the redemption or purchase for cancellation of Obligations, and Debt Service Charges, in accordance with the applicable Series Resolution, or other action by the Board or order of the Fiscal Officer not inconsistent therewith. Any amounts in the Redemption and Purchase Account not required for the purposes thereof pursuant to a commitment theretofore made, may be transferred to the Debt Service Payment Account or the Debt Service Reserve Account upon order of the Fiscal Officer. (Section 4.04)

Project Fund

Upon the issuance and delivery of Obligations, the proceeds of which will be used to pay Costs of University Facilities, there is to be created and the Treasury of the State is to hold and administer a fund designated the "University of Kentucky Project Fund" with an additional series identification for each series of Obligations.

Amounts in a Project Fund will be disbursed therefrom by the Treasurer of the State according to such inspection, audit, and disbursement procedures as may from time to time be provided by law, for the purpose of paying Costs of University Facilities as identified in the related Series Resolution or Supplemental Trust Agreement and to reimburse the University for any payments which may have been made from other available resources in anticipation of the issuance of such Obligations.

Any balance remaining in a Project Fund after the final payment of all Costs of University Facilities for which such Project Fund was created, will be deposited in the Debt Service Fund and (i) credited to the related subaccount, if any, within the Debt Service Reserve Account if and to the extent that such subaccount of the Debt Service Reserve Account contains less than the Required Amount, and/or (ii) either applied as a credit against the next deposit required to be made into the Debt Service Payment Fund, or used to purchase Obligations in the open market at a purchase price not exceeding par plus accrued interest, as may be directed by the Fiscal Officer; provided that, if proceedings are then pending or imminently contemplated for incurring additional Costs of University Facilities which are or will be paid from the proceeds of Obligations, any such unexpended balance may be taken into account in determining the amount of Obligations to be authorized for such purpose, or may otherwise be applied to such Costs of University Facilities, in which event such unexpended balance may be transferred to a Project Fund created for such purpose.

If so provided in any Series Resolution or a Supplemental Trust Agreement, to the extent permitted by law, a Project Fund may be held and disbursed by the Trustee. Furthermore, if the Obligations with respect to which a Project Fund is created are Financing Agreements, SPBC Leases or Additional Obligation Instruments, a Project Fund may be created in accordance with the requirements of such Financing Agreements, SPBC Leases or Additional Obligation Instruments. (Section 4.05)

General Covenant

So long as any Obligations are Outstanding pursuant to the Trust Agreement, the University covenants and agrees: (i) to fix, make, adjust and collect such fees, rates, rentals, charges and other items of General Receipts so that there shall inure to the University General Receipts, in view of other revenues and resources available to the University, sufficient: to pay Debt Service Charges then due or to become due in the current Fiscal Year; to pay any other costs and expenses payable under the Trust Agreement; and to pay all other costs and expenses necessary for the proper maintenance and successful and

continuous operation of the University; and (ii) that it will include in its budget for each Fiscal Year the amount required to be paid to the Debt Service Fund established under the Trust Agreement, during such Fiscal Year. (Section 4.12)

Investment of Debt Service Fund and Project Fund

Except as provided in the Trust Agreement, moneys in the Debt Service Fund and the Project Fund shall be invested and reinvested by the Trustee (or the Fiscal Officer, as applicable) in Eligible Investments at the oral or written direction of the University, but if oral, confirmed promptly in writing. Investment of moneys in the Debt Service Fund shall mature or be redeemable at the times and in the amounts necessary to provide moneys to pay Debt Service Charges as they become due at stated maturity, by redemption or pursuant to any mandatory sinking fund requirements. Each investment of moneys in the Debt Service Fund and the Project Fund will mature or be redeemable without penalty at such time as may be necessary to make payments when necessary from such fund. In the absence of any written direction from the Fiscal Officer, the Trustee will invest all funds in sweep accounts, money-market funds and similar short-term investments, provided that all such investments shall constitute Eligible Investments. The Trustee may trade with itself or its affiliates in the purchase and sale of securities for such investments.

Subject to any directions from the University with respect thereto, the Trustee may sell at the best price reasonably obtainable Project Fund investments and reinvest the proceeds therefrom in Eligible Investments maturing or redeemable as aforesaid. Any of those investments may be purchased from or sold to the Trustee, the Registrar, an Authenticating Agent, a Paying Agent, or any bank, trust company or savings and loan association affiliated with any of the foregoing. The Trustee will sell or redeem investments credited to the Debt Service Fund to produce sufficient moneys applicable under the Trust Agreement to and at the times required for the purposes of paying Debt Service Charges when due as aforesaid, and shall do so without necessity for any order on behalf of the University and without restriction by reason of any order. An investment made from moneys credited to the Debt Service Fund and the Project Fund will constitute part of that respective fund, and each respective fund will be credited with all proceeds of sale and income from investment of moneys credited thereto.

For purposes of qualifying any investment as an Eligible Investment, where such qualification is dependent upon the rating assigned to such investment by a Rating Service, such qualification will be determined as of the date of purchase of such investment or deposit thereof with the Trustee, whichever is later. (Section 4.15)

Revenue Fund

So long as any Obligations remain Outstanding, there will be maintained a Revenue Fund, which, to the extent required by law, may be a fund (and accounts) in the Commonwealth's management administrative and reporting system. There will be maintained in the Revenue Fund the following Accounts: a "Student Registration Fees Account," a "Hospital Revenues Account" and a "Housing and Dining Revenues Account." The "Revenue Fund" created pursuant to the Prior Bond Resolution will continue to be maintained so long as any bonds remain outstanding under the Prior Bond Resolution, such Revenue Fund will constitute the Student Registration Fees Account of the Revenue Fund until there are no bonds outstanding under the Prior Bond Resolution and all Student Registration Fees will be deposited therein. The "Revenue Fund" created pursuant to a Master Resolution adopted by the Board on June 25, 1986 will continue to be maintained as the Hospital Revenues Account of the Revenue Fund and all Hospital Revenues shall be deposited therein. The "System Revenue Fund" created pursuant to the Prior Housing Indenture will continue to be maintained so long as any bonds remain outstanding under the Prior Housing Indenture, such System Revenue Fund will constitute the Housing and Dining Revenues

Account of the Revenue Fund until there are no bonds outstanding under the Prior Housing Indenture and all Housing and Dining Revenues will be deposited therein. (Section 4.16)

Maintenance of Pledge

The University will not make any pledge or assignment of or create or suffer any lien or encumbrance upon the Debt Service Fund and, except for the existing pledges under the Prior Basic Resolution and Prior Housing Indenture, the University will not make any pledge or assignment of or create or suffer any lien or encumbrance upon the General Receipts prior to or on a parity with the pledge thereof under the Trust Agreement, except as authorized or permitted under the Trust Agreement. The University will issue no additional bonds or notes under the Prior Basic Resolution. The University will issue no additional bonds or notes under the Prior Housing Indenture unless, with respect to a series of Housing and Dining Bonds, (i) such bonds or notes could be issued as Obligations under the Trust Agreement within the limitations set forth in the Trust Agreement and (ii) it is provided in the supplemental indenture authorizing such notes or bonds that on the date no Housing and Dining Bonds are outstanding under the Prior Housing Indenture, other than notes or bonds issued in accordance with the provisions of the Trust Agreement summarized in this paragraph, the lien securing such Housing and Dining Bonds created by the Prior Housing Indenture will terminate and such Housing and Dining Bonds will continue as Obligations under the Trust Agreement on a parity with all other Obligations. (Section 4.18)

Events of Default

Events of Default under the Trust Agreement include:

(a) Failure to pay any Debt Service Charges when and as the same becomes due and payable;

(b) Failure to pay the principal of or any premium on any Prior Obligations when and as the same becomes due and payable, whether at the stated maturity thereof or by redemption or acceleration or pursuant to any mandatory sinking fund requirements;

(c) Failure by the University to perform or observe any other covenant, agreement or condition on the part of the University contained in the Trust Agreement or in the Obligations, which failure or Event of Default shall have continued for a period of 30 days after written notice, by registered or certified mail, given to the University by the Trustee, specifying the failure or Event of Default and requiring the same to be remedied, which notice shall be given by the Trustee upon the written request of the Holders of not less than 25% in aggregate principal amount of the Obligations then Outstanding; provided that the Person or Persons requesting such notice may agree in writing to a 90-day extension of such period prior to the expiration of the initial 30-day period; provided further, however, that if the University will proceed to take curative action which, if begun and prosecuted with due diligence, cannot be completed within a period of 90 days, then such period shall be increased without such written extension up to 180 days as will be necessary to enable the University to diligently complete such curative action;

(d) The University will (i) admit in writing its inability to pay its debts generally as they become due, (ii) have an order for relief entered in any case commenced by or against it under federal bankruptcy laws, as now or hereafter in effect, (iii) commence a proceeding under any federal or state bankruptcy, insolvency, reorganization or similar laws, or have such a proceeding commenced against it and have either an order of insolvency or reorganization entered against it or have the proceeding remain undismissed and unstayed for 90 days, (iv) make an assignment

for the benefit of creditors, or, (v) have a receiver or trustee appointed for it or for the whole or substantial part of its property. (Section 6.01)

Supplemental Trust Agreements Not Requiring Consent of Holders

The University and the Trustee without the consent of, or notice to, any of the Holders, may enter into indentures supplemental to the Trust Agreement and other instruments evidencing the existence of a lien as shall not, in the opinion of the Trustee, be inconsistent with the terms and provisions of the Trust Agreement for any one or more of the following purposes:

(a) To cure any ambiguity, inconsistency or formal defect or omission in the Trust Agreement or in any Supplemental Trust Agreement;

(b) To grant to or confer upon the Trustee for the benefit of the Holders any additional rights, remedies, powers or authority that may lawfully be granted to or conferred upon the Holders or the Trustee;

(c) To subject additional revenues or property to the lien and pledge of the Trust Agreement;

(d) To add to the covenants and agreements of the University contained in the Trust Agreement other covenants and agreements thereafter to be observed for the protection of the Holders, or, if in the judgment of the Trustee such is not to the prejudice of the Trustee or the Holders, to surrender or limit any right, power or authority reserved to or conferred upon the University in the Trust Agreement, including the limitation of rights of redemption so that in certain instances Obligations of different series will be redeemed in some prescribed relationship to one another;

(e) To evidence any succession to the University and the assumption by such successor of the covenants and agreements of the University contained in the Trust Agreement or other instrument providing for the operation of the University or University Facilities, and the Obligations;

(f) In connection with the issuance of Obligations in accordance with the Trust Agreement;

(g) To permit the Trustee to comply with any obligations imposed upon it by law;

(h) To permit the exchange of Obligations, at the option of the Holder or Holders thereof, for coupon Obligations of the same series payable to bearer, in an aggregate principal amount not exceeding the unmatured and unredeemed principal amount of the Predecessor Obligations, bearing interest at the same rate or rates and maturing on the same date or dates, with coupons attached representing all unpaid interest due or to become due thereon if, in the opinion of nationally recognized Bond Counsel selected by the University and acceptable to the Trustee, that exchange would not result in the interest on any of the Obligations Outstanding becoming subject to federal income taxation;

(i) To specify further the duties and responsibilities of, and to define further the relationship among, the Trustee, the Registrar and any Authenticating Agents or Paying Agents;

(j) To achieve compliance of the Trust Agreement with any applicable federal or Kentucky laws, including tax laws;

(k) To modify any provisions of the Trust Agreement in order to obtain a Credit Support Instrument or Interest Rate Hedge Agreement, so long as such modifications affect only the Obligations to which such Credit Support Instrument or Interest Rate Hedge Agreement relate; and

(l) In connection with any other change to the Trust Agreement which, in the judgment of the Trustee, is not to the material prejudice of the Trustee or the Holders of the Obligations.

The provisions of (g) and (j) above will not be deemed to constitute a waiver by the Trustee, the Registrar, the University or any Holder of any right which it may have in the absence of those provisions to consent to the application of any change in law to the Trust Agreement or the Obligations. (Section 7.01)

Supplemental Trust Agreements Requiring Consent of Holders

Exclusive of supplemental indentures summarized under the heading "Supplemental Trust Agreements Not Acquiring Consent of Holders", above, and subject to the terms and provisions and limitations contained in this paragraph, and not otherwise, the Holders of a majority in aggregate principal amount of the Obligations then Outstanding shall have the right, from time to time, anything contained in the Trust Agreement to the contrary notwithstanding, to consent to and approve the execution by the University and the Trustee of such other indenture or indentures supplemental to the Trust Agreement as shall be deemed necessary and desirable by the University for the purpose of modifying, altering, amending, adding to or rescinding, in any particular, any of the terms or provisions contained in the Trust Agreement; provided that nothing in this paragraph or in the Trust Agreement will permit, or be construed as permitting, a Supplemental Trust Agreement providing for (a)(i) a reduction in the percentage of Obligations the consent of the Holders of which are required to consent to such Supplemental Trust Agreement or (ii) a preference or priority of any Obligation or Obligations over any other Obligation or Obligations, without the consent of the Holders of all Obligations then Outstanding, (b) effect a change in the times, amount or currency of payment of the principal of, premium, if any, on or interest on any Obligation or a reduction in the principal amount or redemption price of any Obligation or the rate of interest thereon, without the consent of the Holder of each such Obligation so affected or (c) modify the right of the Holders of not less than 25% in aggregate principal amount of the Obligations then Outstanding and in default as to payment of principal, premium or interest to compel the Trustee to declare the principal of all Obligations to be due and payable, without the consent of the Holders of a majority in aggregate principal amount of the Obligations then Outstanding.

If at any time the University requests the Trustee to enter into any such Supplemental Trust Agreement for any of the purposes summarized under this subheading, the Trustee, upon being satisfactorily indemnified with respect to expenses, shall cause notice of the proposed execution of such Supplemental Trust Agreement to be mailed by first class mail, postage prepaid, to all Holders of Obligations then Outstanding at their addresses as they appear on the Registrar at the close of business on the Business Day immediately preceding that mailing. The Trustee will not, however, be subject to any liability to any Holder by reason of its failure to mail, or the failure of such Holder to receive, the notice required by the Trust Agreement, and any such failure shall not affect the validity of such Supplemental Trust Agreement when consented to and approved in accordance with the procedures described under this subheading. Such notice will briefly set forth the nature of the proposed Supplemental Trust Agreement and will state that copies thereof are on file at the principal corporate trust office of the Trustee for inspection by all Holders.

If within such period, not exceeding one year, as prescribed by the University, following the mailing of such notice, the Trustee receives an instrument or instruments purporting to be executed by the Holders of a majority in aggregate principal amount of the Obligations then Outstanding, which instrument or instruments shall refer to the proposed Supplemental Trust Agreement described in such notice and will specifically consent to and approve the execution thereof in substantially the form of the copy thereof referred to in such notice as on file with the Trustee, thereupon, but not otherwise, the Trustee will execute such Supplemental Trust Agreement in substantially such form; without liability or responsibility to any Holder of any Obligation, whether or not such Holder will have consented thereto.

Any such consent is binding upon the Holder of the Obligation giving such consent, upon any subsequent Holder of such Obligation and upon the Holder of any Obligation issued in exchange therefor (whether or not such subsequent Holder thereof has notice thereof), unless such consent is revoked in writing by the Holder of such Obligation giving such consent or by a subsequent Holder thereof by filing with the Trustee, prior to the execution by the Trustee of such Supplemental Trust Agreement, such revocation and, if such Obligation or Obligations are transferable by delivery, proof that such Obligations are held by the signer of such revocation in the manner permitted by the Trust Agreement. At any time after the Holders of the required percentage of the Obligations shall have filed their consents to the Supplemental Trust Agreement, the Trustee shall make and file with the University a written statement that the Holders of such required percentage of the Obligations have filed such consents. Such written statement shall be conclusive evidence that such consents have been so filed.

If the Holders of the required percentage in aggregate principal amount of the Obligations shall have consented to and approved the execution thereof as provided in the Trust Agreement, no Holder of any Obligation has any right to object to the execution of such Supplemental Trust Agreement, to object to any of the terms and provisions contained therein or the operation thereof, or in any manner to question the propriety of the execution thereof or to enjoin or restrain the Trustee or the University from executing the same or from taking any action pursuant to the provisions thereof.

Authorization to the Trustee; Effect of Supplemental Trust Agreements

The Trustee is authorized to join with the University in the execution of any such Supplemental Trust Agreement provided for in the Trust Agreement and to make the further agreements and stipulations which may be contained therein. Any Supplemental Trust Agreement executed in accordance with the provisions of the Trust Agreement will thereafter form a part of the Trust Agreement, all the terms and conditions contained in any such Supplemental Trust Agreement as to any provision authorized to be contained therein will be deemed to be part of the terms and conditions of the Trust Agreement for any and all purposes, the Trust Agreement will be and be deemed to be modified and amended in accordance therewith, and the respective rights, duties and obligations under the Trust Agreement of the University, the Trustee, the Registrar, the Authenticating Agents, the Paying Agents and all Holders of Obligations then Outstanding will thereafter be determined, exercised and enforced thereunder, subject in all respects to such modifications and amendments. Express reference to such executed Supplemental Trust Agreement may be made in the text of any Obligations issued thereafter, if deemed necessary or desirable by the Trustee or the University. There will be no modification, change or amendment to the Trust Agreement or any other document related to the Obligations which affects the rights, duties or obligations of the Trustee thereunder, without the Trustee's prior written consent.

Opinion of Counsel

The Trustee is entitled to receive, and shall be fully protected in relying upon, the opinion of any counsel approved by it, who may be counsel for the University, as conclusive evidence that any such proposed Supplemental Trust Agreement complies with the provisions of the Trust Agreement and that it

is proper for the Trustee, under the provisions of the Trust Agreement, to join in the execution of such Supplemental Trust Agreement. (Section 7.04)

Modification by Unanimous Consent

Notwithstanding anything contained elsewhere in the Trust Agreement, the rights and obligations of the University and of the Holders of the Obligations, and the terms and provisions of the Obligations and the Trust Agreement or any Supplemental Trust Agreement, may be modified or altered in any respect with the consent of the University and the consent of the Holders of all of the Obligations then Outstanding and the Trustee. (Section 7.05)

Release of Trust Agreement

If the University pays or cause to be paid and discharged, or there shall otherwise be paid to the Holders of the Outstanding Obligations all Debt Service Charges due or to become due thereon and provision shall also be made for paying all other sums payable under the Trust Agreement, then and in that event the Trust Agreement (except for the provisions summarized under the captions "Use of Debt Service Payment Account; Intercept," "Redemption and Purchase Account," "Project Fund," "Payment and Discharge of Obligations" and "Survival of Certain Provisions" in this Appendix B") will cease, determine and become null and void, and the covenants, agreements, and other obligations of the University under the Trust Agreement are discharged and satisfied, and thereupon the Trustee will release the Trust Agreement, including the cancellation and discharge of the lien thereof, and execute and deliver to the University such instruments in writing as required to satisfy and terminate the lien thereof and to enter on the records such satisfaction and discharge and to re-convey to the University the estate created by the Trust Agreement and such other instruments to evidence such release and discharge as may be reasonably required by the University, and the Trustee and Paying Agents will assign and deliver to the University any property at the time subject to the lien of the Trust Agreement which may then be in their possession, except amounts in the Debt Service Fund required to be held by the Trustee and Paying Agents under the Trust Agreement or otherwise for the payment of Debt Service Charges. (Section 8.01)

Payment and Discharge of Obligations

All the Outstanding Obligations of one or more series will be deemed to have been paid and discharged within the meaning of the Trust Agreement, including without limitation, the provisions of the Trust Agreement summarized under the immediately preceding heading, if either (i) the Trustee as paying agent and any Paying Agents are required to hold, in the Debt Service Payment Account in trust for and irrevocably committed thereto, sufficient moneys or (ii) the Trustee is required to hold, in the Debt Service Fund in trust for and irrevocably committed thereto, investments qualifying as Government Bonds as of the date of the determination required in provisions of the Trust Agreement summarized in this paragraph which are, in either case, certified by an independent public accounting firm of national reputation to be of such maturities and interest payment dates and to bear such interest as will, without further investment or reinvestment of either the principal amount thereof or the interest earnings therefrom (likewise to be held in trust and committed, except as provided in the Trust Agreement), be sufficient together with moneys referred to in clause (i) above, for the payment, at their maturity, redemption or due date, as the case may be, of all Debt Service Charges on those Obligations to their maturity, redemption or due date, as the case may be, or if Event of Default in such payment will have occurred on such date then to the date of the tender of such payment; provided that if any of such Obligations are to be redeemed prior to the maturity thereof, notice of such redemption will have been duly given or irrevocable provisions satisfactory to the Trustee have been duly made for the giving of such notice; provided that if the Obligations are to be redeemed prior to the maturity thereof, notice of

such redemption shall have been duly given or irrevocable provision satisfactory to the Trustee shall have been duly made for the giving of such notice. (Section 8.02)

Survival of Certain Provisions

Notwithstanding the foregoing, those provisions of a Series Resolution and the Trust Agreement relating to the maturity of Obligations, interest payments and dates thereof, optional and mandatory redemption provisions, credit against Mandatory Sinking Fund Requirements, exchange, transfer and registration of Obligations, replacement of mutilated, destroyed, lost or stolen Obligations, the safekeeping and cancellation of Obligations, non-presentment of Obligations, the holding of moneys in trust, repayments to the University from the Special Funds and the rights, remedies and duties of the Trustee and the Registrar in connection with all of the foregoing, shall remain in effect and shall be binding upon the Trustee, the Registrar, the Authenticating Agent, Paying Agents and the Holders notwithstanding the release and discharge of the lien of the Trust Agreement. The provisions of the Trust Agreement described in this paragraph and under the two headings that immediately precede it shall survive the release and discharge of the Trust Agreement. (Section 8.03)

Limitation of Rights

With the exception of rights expressly conferred in the Trust Agreement, nothing expressed or mentioned in or to be implied from the Trust Agreement or the Obligations is intended or shall be construed to give to any Person other than the parties to the Trust Agreement, the University, any Credit Support Provider and the Holders of the Obligations any legal or equitable right, remedy or claim under or in respect to the Trust Agreement or any covenants, conditions and provisions in contained in the Trust Agreement; the Trust Agreement and all of the covenants, conditions and provisions of the Trust Agreement being intended to be and being for the sole and exclusive benefit of the parties hereto, the University, any Credit Support Provider and the Holders of the Obligations as provided in the Trust Agreement. (Section 9.02)

APPENDIX C

**UNIVERSITY OF KENTUCKY
CONSOLIDATED FINANCIAL STATEMENTS AS OF JUNE 30, 2007**

And

**UNIVERSITY OF KENTUCKY
ALBERT B. CHANDLER MEDICAL CENTER
UNIVERSITY HOSPITAL
CONSOLIDATED FINANCIAL STATEMENTS AS OF JUNE 30, 2007**

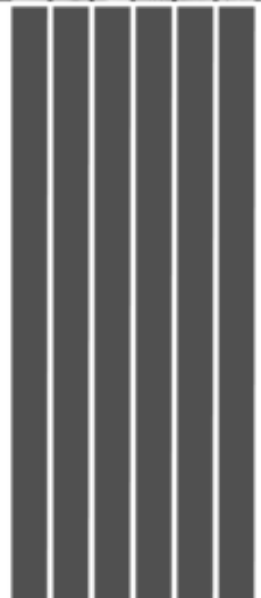
(THIS PAGE INTENTIONALLY LEFT BLANK)



2007

UK
UNIVERSITY
OF KENTUCKY

University of Kentucky
**Consolidated
Financial
Statements**



University of Kentucky Consolidated Financial Statements Year Ended June 30, 2007

TABLE OF CONTENTS

Message from the President	i
Independent Auditors' Report	1
Management's Discussion and Analysis	2
Consolidated Financial Statements	
Statements of Net Assets	13
Statements of Revenues, Expenses and Changes in Net Assets	14
Statements of Cash Flows	15
Notes to Financial Statements	16
Independent Auditors' Report on Additional Information	38
Supplemental Information	
Consolidating Schedule – Statement of Net Assets	39
Consolidating Schedule – Statement of Revenues, Expenses and Changes in Net Assets	40
Board of Trustees	
Administrative Executive Officers	
Academic Officers	

MESSAGE FROM THE PRESIDENT

I think 2006-07 at the University of Kentucky can best be summed up in one word: Momentum.

Excitement and support for the university's Top 20 Business Plan was evident throughout campus, the community and the Commonwealth. From our Board of Trustees members to our students, faculty, staff, alumni and friends, our Top 20 quest was at the center of many conversations.

You could feel the momentum in the classroom, as we admitted the largest and most diverse freshman class in UK history in fall 2006. Nearly 4,200 first-year students called UK home. This year's class included 294 African-American students, a 96 percent increase from last year, and 57 Hispanic students, representing a 54 percent increase over last year.

We did not simply concentrate on bringing in more students; our Admissions Office focused on attracting brighter, more academically-prepared students who can lead us in our Top 20 mission. Last year's incoming class included 354 Governor's Scholars and Governor's School for the Arts students, shattering our previous record of 318.

Our students continued to show something we have known around this campus for a long time: They are some of the best and the brightest in the world.

- Five UK students will receive government-funded Fulbright Scholarships for graduate study and research abroad for the 2007-2008 academic year, making it UK's largest class of Fulbright scholars for an academic year.
- Several undergraduates competed in the National Conference on Undergraduate Research in April. UK had 16 research papers accepted at the conference. The University of Michigan, a national leader in undergraduate research, had 20. Two other leading research universities, the University of California-Berkley and the University of Texas at Austin, had 13 and 12 papers accepted, respectively.
- Andrew Lynch, a junior from Corbin, Kentucky, majoring in chemical engineering, was awarded three of this nation's most prestigious scholarships this spring. He was named a Udall,

Goldwater, and Beckman Scholar. Only 80 sophomores and juniors nationwide receive the Udall Scholarship each year and only 317 students were named Goldwater Scholars.

It was also a monumental year for our student-athletes. Several of our teams excelled in competition throughout the year. UK football topped off one of its finest seasons in history by capturing the Music City Bowl championship in December. The Kentucky women's soccer team capped its magical run through the Southeastern Conference by winning the SEC title. Harry Mullins led the UK Rifle team to another terrific season and was named conference Coach of the Year for his efforts.

UK Diver Taryn Ignacio and Coach Mike Lyden set the gold standard of diving excellence in the Southeastern Conference. In 2007, Taryn was named SEC Diver of the Year and Mike was tabbed Coach of the Year for the third consecutive season. In the past three seasons, Taryn, a native of Richmond, Kentucky, has captured five SEC titles, three on the platform and two on the one-meter board. She also won the national title in platform last year. Her five SEC titles are the most of any Kentucky swimmer or diver in history – male or female.

The Top 20 momentum could be felt in our capital campaign. UK achieved its billion dollar capital campaign this spring, becoming one of only 31 American universities that have successfully completed campaigns of that size. The campaign, which was completed nine months ahead of schedule, brought in 640,000 gifts from 122,000 donors.

It was a year in which our research enterprise soared to new heights, as the university's total research expenditures for fiscal year 2006, as reported to the National Science Foundation, increased to a record-high \$324 million. The university's continuing upward trend in research expenditures helped propel UK from 26th to 24th in ranking for the research domain as being tracked in our Top 20 Business Plan.

It was also a time for growth, expansion, and improved quality within UK HealthCare. We broke ground on three major construction projects on the southern end of campus this year. The new \$24 million University Health Service building, the \$120 million College of Pharmacy, and the \$450 million UK Chandler Hospital are



President Lee T. Todd Jr.

currently under construction. The three projects are major components of UK's quest to build the Commonwealth's Medical Campus of the Future.

UK HealthCare added to its regional network in June by receiving approval to acquire one of Lexington's most storied medical facilities, Good Samaritan Hospital. Not only will the move bolster our medical enterprise, it saved more than 500 central Kentucky jobs and preserved a vital community hospital.

UK Chandler Hospital was named one of the nation's 100 Top Performance Improvement Leaders by Thomson Healthcare (formerly Solucient), an organization that has been identifying America's top performing hospitals since 1993 and is well-known among the health care industry. UK is the only academic medical center in Kentucky to receive the ranking, which is based on UK Chandler Hospital's continued strong growth in financial performance, operational efficiency, and quality care for patients. For the second time in two years, UK is ranked by Thomson Healthcare among the top 15 academic medical centers in the nation for having faster and more consistent organization-wide improvement than most other teaching hospitals. Rankings released in July by U.S. News & World Report place UK Chandler Hospital among the nation's top hospitals. Of 5,462 U.S. hospitals evaluated, only 173 made the list. UK

Chandler Hospital is the only Lexington hospital included and one of only three in the state. Three of UK's programs – gynecology; ear, nose and throat; and cancer – were recognized by the magazine for their excellence.

Momentum could be felt in the areas of commercialization and economic development. Five new companies were created as a result of university intellectual property. It was also a banner period for Coldstream Research Campus, as 16 new companies and 181 employees were added to that campus.

Our drive to become a Top 20 public research university has captured the attention of higher education leaders across the country. We hosted several prominent visitors this year, each of whom was seeking to learn more about our Business Plan. Officials from West Virginia, a legislator from Georgia, and a delegation from the University of Illinois all spent time on campus discussing our planning process.

The most significant change since we unveiled our Top 20 Business Plan is not something that can be calculated in a statistical analysis or benchmarked against other institutions. But it is just as important as any scientific measure. There has been a seismic cultural shift on this campus. The change in attitude can be felt across campus – in conversations with students, faculty, and staff.

There is a newfound belief that the University of Kentucky is uniquely positioned to change the Commonwealth of Kentucky.

There is a belief that the decisions and sacrifices made on campus today will positively impact lives for years to come.

Most importantly, there is a belief that our Top 20 dream truly is possible.

A handwritten signature in dark ink, appearing to read "Lee T. Todd Jr." in a cursive style.

Lee T. Todd Jr.
President



Deloitte & Touche LLP
220 West Main Street
Suite 2100
Louisville, KY 40202-2284
USA

Tel: +1 502 562 2000
Fax: +1 502 562 2073
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of the University of Kentucky

and

the Secretary of Finance and Administration Cabinet of the
Commonwealth of Kentucky

We have audited the accompanying consolidated statements of net assets of the University of Kentucky (the "University") (an agency of the Commonwealth of Kentucky) and affiliated corporations as of June 30, 2007 and 2006, and the related consolidated statements of revenues, expenses and changes in net assets and of cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the University of Kentucky and affiliated corporations as of June 30, 2007 and 2006, and their changes in net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis (MD&A) on pages 2 through 12 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This supplementary information is the responsibility of the University's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Deloitte & Touche LLP

October 5, 2007

Management's Discussion and Analysis

The following Management's Discussion and Analysis, or MD&A, provides an overview of the financial position and activities of the University of Kentucky (the University) and its affiliated corporations for the years ended June 30, 2007 and 2006. Management has prepared this discussion, and we encourage you to read it in conjunction with the consolidated financial statements and the notes appearing in this report.

About the University of Kentucky

From Paducah to Pikeville, Covington to Cumberland, the University of Kentucky touches lives across the Bluegrass State, providing education, cultural stimulation and economic development in all 120 counties. Considering that residents of all Kentucky counties benefit from the University's medical care, community service, innovative research, and creative teaching and instruction, there's no question UK is *The* University of Kentucky.

History. Nestled in the heart of Kentucky's scenic Bluegrass region, UK was founded in 1865 as a land-grant university. From its beginnings with only 190 students and 10 professors, UK's campus now covers more than 716 acres in Lexington and is home to more than 27,000 students and more than 13,500 employees.

Mission. The University of Kentucky has long embraced its mission to provide excellent education to outstanding resident and non-resident students, recognizing that a knowledgeable populace is the best foundation for a prosperous Commonwealth. This mission has been further enhanced since 1997 when the Kentucky General Assembly mandated that UK become a Top 20 public research university by 2020. President Lee T. Todd Jr. focused the University on achieving this goal through the development of a Top 20 Business Plan in 2005 that gained national prominence for its vision and detail.

Students. Students from 117 countries, every state in the nation and every Kentucky county provide a diverse learning and cultural environment that enriches the educational experience at UK. While the student population has enjoyed steady growth in the past several years, the average ACT score of entering freshmen has continually exceeded the national average and is competitive with UK's benchmark institutions – the top public universities in America. The high quality of UK's students is confirmed by their successful competition for the most prestigious awards, including the Fulbright, Truman, Goldwater and Marshall scholarships. UK has twice been selected as one of only 13 universities nationwide to participate in the Beckman Foundation Scholarship Program, allowing the University to award grants to students to support their own research projects. Boasting 12 Truman Scholars, UK has won recognition from the Harry S. Truman Foundation as an honor institution for exemplary participation in the program.

Outreach. Thousands of Kentuckians from across the state feel the impact of UK's research and public service annually, through programs aimed at improving industrial productivity, agricultural profitability and home life. Programs like the Health Education through Extension Leadership bring the results of health research to local communities, helping boost the quality of life across the state.

Meanwhile, Kentuckians have responded to the University's commitment to the Commonwealth through their remarkable support of The Campaign for the University of Kentucky. The fundraising effort – the largest in state history – to enhance facilities, academic programs, public service and scholarships recently surpassed its \$1 billion goal. The generosity of UK's alumni and friends allowed it to fully utilize its allocation of state support available through Kentucky's Research Challenge Trust Fund program.

Programs. UK students enjoy an enormous array of choices, with some 200 majors and degree programs in 17 academic and professional colleges available. UK is one of only a few public universities

nationally to house colleges of Agriculture, Arts and Sciences, Business and Economics, Communications and Information Studies, Dentistry, Design, Education, Engineering, Fine Arts, Health Sciences, Law, Libraries, Medicine, Nursing, Pharmacy, Public Health and Social Work on a single campus.

Research. "Determination" is truly the word describing UK's focus on achieving its Top 20 research goal. For the last five years, the University has consistently exceeded \$200 million in sponsored projects awards. UK faculty recently attracted a record-breaking total of \$290 million in extramural funding for grants and contracts. A recent ranking placed UK at 26th among all public universities for federal expenditures. Meanwhile, the inventiveness of UK faculty continues to earn the University its standing as 17th among land-grant universities, 34th among public universities, and 57th overall in licensing income and patents. Another national ranking recently put UK 19th among public institutions for the scholarly productivity of its faculty.

Medical Center. The UK Chandler Medical Center, opened in 1960, stands among the nation's finest academic medical centers. Its faculty, students and staff take pride in achieving excellence in education, patient care, research and community service. One of two Level 1 Trauma Centers in Kentucky, UK cares for the most critically injured and ill patients in the region. More than 500 faculty physicians and dentists, 400 resident physicians and a staff of 3,200 health professionals provide care in the 473-bed UK Chandler Hospital and Kentucky Children's Hospital.

In spring 2007, ground was broken for a new \$450 million UK Chandler Hospital. This more than 1-million square foot facility, to be completed in 2011, is the cornerstone of a 20-year, \$2.5 billion plan to construct the Commonwealth Medical Campus of the Future. Among the campus' components are a now-under-construction \$120 million pharmacy building, additional research buildings, a new shared Health Sciences Learning Center, and additional buildings to house programs for the colleges of Medicine, Nursing, Health Sciences, Dentistry and Public Health.

Libraries. No university can provide adequate opportunities to its students – or to the residents of the state it serves – without outstanding library facilities. The University of Kentucky exceeds expectations because it operates a nationally recognized research library system, with the capstone being the world-class William T. Young Library. UK's book endowment is the largest among public universities. Its library network and technology provide extraordinary service to students in the colleges of Medicine, Law, Engineering, Fine Arts and other programs. Meanwhile, students, faculty and Kentucky residents can use UK Libraries' advanced technology to access the most up-to-date information from online journals, government publications and private studies.

Agenda. UK's agenda aims to accelerate the University's movement toward academic excellence in all areas and gaining worldwide recognition for its outstanding academic programs, its commitment to undergraduates, its success in building a diverse community, and its engagement with the larger society. It's all part of the University's strategy to help position Kentucky as a leader in American prosperity.

Financial Highlights

The University's overall financial position remains strong with assets of \$3.14 billion and liabilities of \$859.9 million. Net assets, which represent the University's residual interest in assets after liabilities are deducted, were \$2.28 billion or 73 percent of total assets.

- Total assets increased \$325.5 million, or 12 percent, primarily due to increases in endowment investments and capital assets, net.
- Total liabilities increased \$150.0 million, or 21 percent, primarily due to the issuance of additional bonds, notes, capital leases and other long-term obligations for the purchase and/or construction of land, buildings, equipment and computer software.

- Total net assets increased \$175.5 million, or 8 percent, due to an increase in net capital assets of \$10.5 million; an increase in restricted net assets of \$107.2 million, primarily due to investment income on endowments, net of spending distributions, of \$69.1 million and gifts and other additions to endowments of \$29.9 million; and an increase of \$57.9 million in unrestricted net assets, primarily due to excess revenues over expenses in the hospital of \$47.8 million.
- Operating revenues were \$1.44 billion and operating expenses were \$1.81 billion, resulting in a loss from operations of \$373.3 million. Nonoperating and other revenues, including \$319.9 million in state appropriations, net of nonoperating expenses, were \$548.8 million, which, when combined with the loss from operations, resulted in an overall increase in net assets of \$175.5 million.

Using the Consolidated Financial Statements

The University presents its financial reports in a “business type activity” format, in accordance with Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments* and GASB Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34*. In addition to this MD&A section, the financial report includes a Statement of Net Assets, a Statement of Revenues, Expenses and Changes in Net Assets, a Statement of Cash Flows and Notes to the Financial Statements. GASB requires that statements be presented on a consolidated basis to focus on the University as a whole.

Reporting Entity

The University of Kentucky is a component unit of the Commonwealth of Kentucky. The consolidated financial statements of the University include the operations of the University and the following entities:

- University of Kentucky Research Foundation, and its for-profit subsidiaries, Kentucky Technology, Inc. and Coldstream Laboratories, Inc.
- University of Kentucky Athletic Association
- The Fund for Advancement of Education and Research in the University of Kentucky Medical Center
- University of Kentucky Business Partnership Foundation, Inc.
- University of Kentucky Center on Aging Foundation, Inc.
- University of Kentucky Gluck Equine Research Foundation, Inc.
- University of Kentucky Humanities Foundation, Inc.
- University of Kentucky Mining Engineering Foundation, Inc.
- Central Kentucky Management Services, Inc.
- Kentucky Medical Services Foundation, Inc.
- Kentucky Healthcare Enterprises, Inc., a for-profit subsidiary.

Consolidated Statement of Net Assets

The Consolidated Statement of Net Assets is the University’s balance sheet. It reflects the total assets, liabilities and net assets (equity) of the University as of June 30, 2007, with comparative information as of June 30, 2006. Liabilities due within one year, and assets available to pay those liabilities, are classified as current. Other assets and liabilities are classified as non-current. Net assets, the difference between total assets and total liabilities, are an important indicator of the University’s current financial condition, while the change in net assets is an indicator of whether the overall financial position has improved or worsened during the year. Generally, assets and liabilities are reported using current values. A major exception is capital assets, which are stated at historical cost, less accumulated depreciation. A summarized comparison of the University’s assets, liabilities and net assets at June 30, 2007, 2006 and 2005 is as follows:

Condensed Consolidated Statements of Net Assets (in thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
ASSETS			
Current assets	\$ 608,720	\$ 551,899	\$ 512,426
Capital assets, net of depreciation	1,208,670	1,081,156	1,028,064
Other noncurrent assets	<u>1,320,191</u>	<u>1,178,993</u>	<u>904,618</u>
Total Assets	<u>3,137,581</u>	<u>2,812,048</u>	<u>2,445,108</u>
LIABILITIES			
Current liabilities	299,995	229,343	213,913
Noncurrent liabilities	<u>559,935</u>	<u>480,603</u>	<u>368,039</u>
Total Liabilities	<u>859,930</u>	<u>709,946</u>	<u>581,952</u>
NET ASSETS			
Invested in capital assets, net of related debt	773,962	763,476	750,485
Restricted			
Nonexpendable	454,316	423,755	393,224
Expendable	383,817	307,195	217,643
Unrestricted	<u>665,556</u>	<u>607,676</u>	<u>501,804</u>
Total Net Assets	<u>\$ 2,277,651</u>	<u>\$ 2,102,102</u>	<u>\$ 1,863,156</u>

Assets. As of June 30, 2007, total assets amounted to \$3.14 billion. Of this amount, investment in capital assets (net of depreciation) of \$1.21 billion, or 39 percent of total assets, represented the largest asset class. Endowment investments amounted to \$945.3 million, or 30 percent of total assets, and cash and cash equivalents amounted to \$515.4 million, or 16 percent of total assets. During the year, total assets increased by \$325.5 million primarily due to increases in endowment investments resulting from market value appreciation and gifts, and capital assets due to new additions of land, buildings, equipment and computer software.

Liabilities. As of June 30, 2007, total liabilities amounted to \$859.9 million. Bonds and notes payable, capital leases and other long-term obligations issued for educational buildings, the housing and dining system, the University hospital, the William T. Young library, equipment and computer software amounted to \$537.5 million, or 63 percent of total liabilities. During the year, total liabilities increased by \$150.0 million primarily due to the issuance of additional debt, principally for the construction of a new student health facility, for computer software, and to lease land, buildings and equipment.

Net Assets. The equity of the University of \$2.28 billion as of June 30, 2007 is reported on the statement of Net Assets in four net asset categories: invested in capital assets, net of related debt, \$774.0 million (34 percent); restricted-nonexpendable, \$454.3 million (20 percent); restricted-expendable, \$383.8 million (17 percent); and unrestricted, \$665.6 million (29 percent).

Restricted net assets are subject to externally imposed restrictions governing their use. Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the unrestricted net assets have been internally designated for support of academic and research programs and initiatives, capital projects, and working capital requirements.

Total net assets increased \$175.5 million during the year ended June 30, 2007. Invested in capital assets, net of related debt, increased \$10.5 million primarily due to payment of current year maturities of principal on bonds and capital leases. Restricted net assets increased \$107.2 million, primarily due to endowment investment returns which increased from 10.0% to 16.8% compared to the prior year, resulting in an increase in investment income on endowments, net of spending distributions, of \$69.1 million. Unrestricted net assets increased \$57.9 million, primarily due to excess revenues over expenses in the hospital of \$47.8 million and general funds revenues in excess of expenses of \$6.9 million.

2006 Versus 2005. During the year ended June 30, 2006:

- Total assets increased by \$366.9 million, primarily due to increases in cash and cash equivalents and capital assets, net, from the proceeds of debt issued during the year, as well as increases in endowment investments and other increases in capital assets.
- Liabilities increased by \$128.0 million, primarily due to the issuance of additional debt, principally for the hospital patient care facility project.
- Total net assets increased by \$238.9 million during the year ended June 30, 2006. Invested in capital assets, net of related debt, increased by \$13.0 million, primarily due to payment of current year maturities of principal on bonds and capital leases. Restricted net assets increased by \$120.1 million, primarily due to gifts and other additions to endowments of \$36.4 million, investment income on endowments, net of spending distributions, of \$25.2 million, and capital grants from the Commonwealth of Kentucky restricted for building projects of \$48.5 million. Unrestricted net assets increased \$105.9 million, primarily due to excess revenues over expenses in the hospital of \$68.9 million and general funds revenues in excess of expenses.

Consolidated Statement of Revenues, Expenses and Changes in Net Assets

The Consolidated Statement of Revenues, Expenses and Changes in Net Assets is the University's income statement. It details how net assets have increased during the year ended June 30, 2007, with comparative information for the year ended June 30, 2006. This statement is prepared on the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. All items that increase or decrease net assets must appear on the Consolidated Statement of Revenues, Expenses and Changes in Net Assets as revenues, expenses, gains or losses.

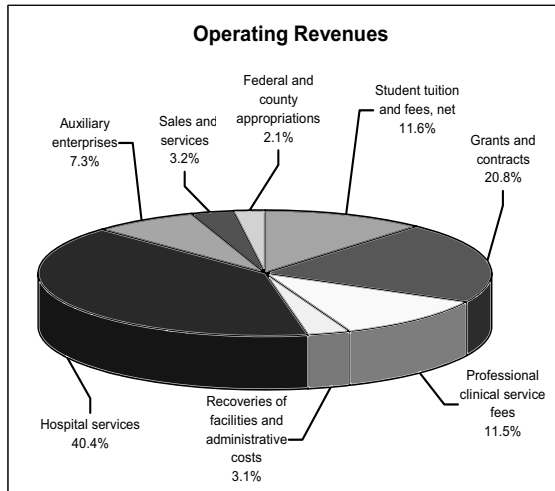
Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 requires state appropriations, gifts, and investment and endowment income to be classified as nonoperating revenues. Accordingly, the University reports a net operating loss for the year prior to the addition of nonoperating revenues. The utilization of long-lived capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life. Tuition revenue is reduced by gift scholarships and institutional aid, and is reported net of scholarship allowances in the financial statements. A summarized comparison of the University's revenues, expenses and changes in net assets for the years ended June 30, 2007, 2006 and 2005 is as follows:

Condensed Consolidated Statements of Revenues, Expenses and Changes in Net Assets
(in thousands)

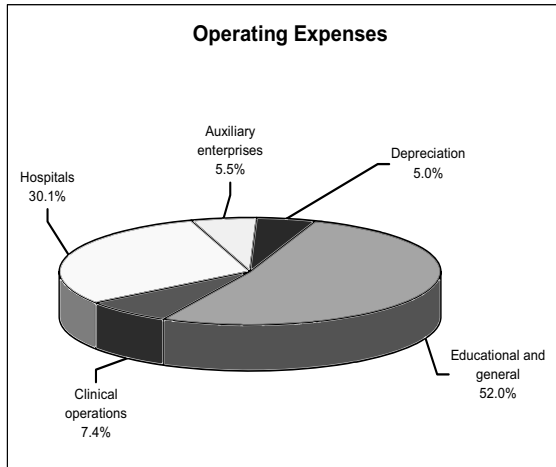
	<u>2007</u>	<u>2006</u>	<u>2005</u>
OPERATING REVENUES			
Student tuition and fees, net of scholarship allowances	\$ 166,742	\$ 147,267	\$ 133,389
Grants and contracts	298,237	297,361	268,219
Hospital services	579,222	520,310	440,609
Professional clinical service fees	164,432	150,241	142,154
Auxiliary enterprises, net of scholarship allowances	105,005	102,080	95,249
Sales and services	45,717	42,024	38,857
Recoveries of facilities and administrative costs	43,792	43,303	40,332
Federal and county appropriations	30,675	27,682	27,703
Other operating revenues	1,507	2,222	466
Total operating revenues	<u>1,435,329</u>	<u>1,332,490</u>	<u>1,186,978</u>
OPERATING EXPENSES			
Educational and general, excluding depreciation	940,314	864,844	797,183
Clinical operations, excluding depreciation	133,271	119,910	116,852
Hospital, excluding depreciation	544,914	475,767	387,685
Auxiliary enterprises, excluding depreciation	99,630	94,825	87,884
Depreciation	90,270	83,761	78,219
Other operating expenses	229	460	382
Total operating expenses	<u>1,808,628</u>	<u>1,639,567</u>	<u>1,468,205</u>
OPERATING LOSS	<u>(373,299)</u>	<u>(307,077)</u>	<u>(281,227)</u>
NONOPERATING REVENUES (EXPENSES)			
State appropriations	319,859	314,294	287,897
Capital appropriations	-	475	732
Capital grants and gifts	23,536	63,188	18,915
Gifts and grants	34,218	32,135	24,638
Investment income	160,975	119,067	56,517
Interest on capital asset - related debt	(12,723)	(13,497)	(13,062)
Additions to permanent endowments	29,931	24,336	33,650
Transfer of net assets of Lexington Community College	-	-	(4,968)
Other, net	(6,948)	6,025	1,587
Total nonoperating revenues (expenses)	<u>548,848</u>	<u>546,023</u>	<u>405,906</u>
Total increase in net assets	<u>175,549</u>	<u>238,946</u>	<u>124,679</u>
Net assets, beginning of year	2,102,102	1,863,156	1,738,477
Net assets, end of year	<u>\$ 2,277,651</u>	<u>\$ 2,102,102</u>	<u>\$ 1,863,156</u>

Total operating revenues were \$1.44 billion for the year ended June 30, 2007, an increase of \$102.8 million (8 percent). The primary components of operating revenues were student tuition and fees of \$166.7 million; grants, contracts and recoveries of facilities and administrative costs of \$342.0 million; hospital services of \$579.2 million; and professional clinical fee income of \$164.4 million.

The major increase was in hospital services revenue of \$58.9 million, caused almost exclusively by an increase in patient volume, due to growth from strategic initiatives in certain product lines and an enhanced outreach network. Additional significant increases in operating revenues related to student tuition and fees, net, of \$19.5 million due to tuition increases of approximately 12 percent and an overall enrollment increase, and of \$14.2 million in professional clinical service fees due to increased patient volume.



Operating expenses totaled \$1.81 billion, an increase of \$169.1 million (10 percent). Of this amount, \$940.3 million was expended for educational and general programs, including the functions of instruction, research and public service. Hospital expenses, excluding depreciation, amounted to \$544.9 million and clinical operations expenses, excluding depreciation, were \$133.3 million. Depreciation expense for the year amounted to \$90.3 million.



The most significant increase was in educational and general expenses, excluding depreciation, of \$75.5 million (9 percent) due primarily to increases in instruction, research and public service. Hospital expenses, excluding depreciation, increased \$69.1 million (15 percent) due to increased usage of medical supplies and increased personnel costs due to higher utilization.

The net loss from operations for the year amounted to \$373.3 million. Nonoperating revenues, net of expenses, amounted to \$548.8 million, resulting in an increase in net assets of \$175.5 million for the year. Nonoperating revenues include state appropriations of \$319.9 million, which increased \$5.6 million, and investment income of \$161.0 million, which increased \$41.9 million in the current year.

2006 Versus 2005. Total operating revenues were \$1.33 billion for the year ended June 30, 2006, including student tuition and fees of \$147.3 million (11 percent), grants, contracts and recoveries of facilities and administrative costs of \$340.7 million (26 percent), professional clinical service fees of \$150.2 million (11 percent) and hospital services of \$520.3 million (39 percent). Operating revenues for fiscal 2006 increased by \$145.5 million or 12 percent over fiscal 2005, primarily due to increases in hospital services revenues of \$79.7 million, in grants, contracts and recoveries of facilities and administrative costs of approximately \$32.1 million and in student tuition and fees of \$13.9 million.

Operating expenses totaled \$1.64 billion. Of this amount, \$864.8 million, or 53 percent, was expended for educational and general programs, including the functions of instruction, research and public service. Hospital expenses, excluding depreciation, amounted to \$475.8 million, or 29 percent of the total expenses and clinical operations expenses, excluding depreciation, were \$119.9 million, or 7 percent. Depreciation amounted to \$83.8 million, or 5 percent. Operating expenses for fiscal 2006 increased by \$171.4 million or 12 percent over fiscal 2005, primarily due to increases in hospital expenses, excluding depreciation, of \$88.1 million (23 percent) due to increased usage of medical supplies and increased personnel costs due to higher utilization. Educational and general expenses increased \$67.7 million (8 percent) due primarily to increases in instruction, research and public service.

The net loss from operations for the year amounted to \$307.1 million. Nonoperating revenues, net of expenses, amounted to \$546.0 million, resulting in an increase in net assets of \$238.9 million for the year. This compares with an increase in net assets for fiscal 2005 of \$124.7 million. The most significant difference between fiscal 2005 and 2006 was an increase in non-operating revenue of \$140.1 million due primarily to increases in state appropriations, capital grants and gifts, and investment income.

Consolidated Statement of Cash Flows

The Consolidated Statement of Cash Flows details how cash has increased (or decreased) during the year ended June 30, 2007, with comparative financial information for the year ended June 30, 2006. It breaks out the sources and uses of cash into the following categories:

- Operating activities
- Noncapital financing activities
- Capital financing activities
- Investing activities

Cash flows associated with the University's expendable net assets appear in the operating and noncapital financing categories. Capital financing activities include payments for capital assets, proceeds from long-term debt, and debt repayments. Purchases and sales of investments are reflected in investing activities.

The primary purpose of the Consolidated Statement of Cash Flows is to provide information about the cash receipts and cash payments made by the University during the year that will allow financial statement readers to assess the institutions:

- Ability to generate future net cash flows,
- Ability to meet obligations as they become due, and
- The possible need for external financing.

A comparative summary of the University's consolidated statement of cash flows for the years ended June 30, 2007, 2006 and 2005 is as follows:

Condensed Consolidated Statements of Cash Flows (in thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
CASH PROVIDED (USED) BY:			
Operating activities	\$ (255,774)	\$ (228,971)	\$ (203,467)
Noncapital financing activities	383,141	373,395	345,427
Capital and related financing activities	(159,328)	16,357	(118,891)
Investing activities	<u>5,649</u>	<u>(58,921)</u>	<u>15,696</u>
Net increase (decrease) in cash and cash equivalents	(26,312)	101,860	38,765
Cash and cash equivalents, beginning of year	<u>541,715</u>	<u>439,855</u>	<u>401,090</u>
Cash and cash equivalents, end of year	<u>\$ 515,403</u>	<u>\$ 541,715</u>	<u>\$ 439,855</u>

The University's cash and cash equivalents decreased \$26.3 million in 2007. Total cash provided by operating and non-capital financing activities was \$127.4 million, down \$17.0 million compared to 2006. Total cash used by capital financing activities was \$159.3 million, reflecting both capital funding sources (debt proceeds) and uses (purchases of capital assets and debt service). Total cash provided by investing activities was \$5.6 million.

Major sources of cash received from operating activities are student tuition and fees of \$166.0 million, hospital services of \$573.1 million, grants, contracts and recoveries of facilities and administrative costs of \$328.1 million and professional clinical service fees of \$168.5 million. Major uses of cash for operating activities were payments to employees for salaries and benefits of \$1.08 billion and to vendors and contractors of \$572.0 million.

Noncapital financing activities includes state appropriations from the Commonwealth of Kentucky of \$319.9 million.

Capital and related financing activities include proceeds of capital debt of \$107.9 million and capital grants and gifts of \$19.4 million. Cash of \$175.8 million was expended for construction and acquisition of capital assets, \$83.0 million was used for refunding bonds, and \$36.6 million was expended for principal and interest payments on debt.

Investing activities include proceeds from sales and maturities of investments of \$1.95 billion and interest and dividends on investments of \$48.9 million. Cash of \$1.99 billion was used to purchase investments.

2006 Versus 2005. Cash balances improved when comparing fiscal 2006 versus fiscal 2005 with a net increase in cash of approximately \$101.9 million. The net increase in cash was due primarily to the increased funding provided by capital and related financing activities of \$135.2 million.

Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation, totaled \$1.21 billion at June 30, 2007, an increase of \$127.5 million. Capital assets as of June 30, 2007 and significant changes in capital assets during the years ended June 30, 2007 and 2006 are as follows (in millions):

	Balance June 30, 2005	Net Additions FY 05-06	Balance June 30, 2006	Net Additions FY 06-07	Balance June 30, 2007
Land and land improvements	\$ 98	\$ 14	\$ 112	\$ 16	\$ 128
Buildings, fixed equipment and infrastructure	1,210	67	1,277	58	1,335
Equipment, vehicles and capitalized software	401	41	442	54	496
Library materials and art	132	6	138	5	143
Construction in progress	55	(12)	43	61	104
Accumulated depreciation	(868)	(63)	(931)	(66)	(997)
Total	<u>\$ 1,028</u>	<u>\$ 53</u>	<u>\$ 1,081</u>	<u>\$ 128</u>	<u>\$ 1,209</u>

At June 30, 2007, the University has capital construction projects in progress totaling approximately \$664 million in scope. Major projects include the new hospital patient care facility, the Biological Pharmaceutical Research building, the new student health facility, and the expansion and upgrade of the Livestock Disease Diagnostic Center. The estimated cost to complete these projects is approximately \$514 million.

Debt

At June 30, 2007, capital debt amounted to \$537.5 million, summarized by trust indenture and type as follows (in millions):

	2007	2006	2005
General Receipts bonds and notes	\$ 207.3	\$ 114.7	
Consolidated Educational Buildings Revenue Bonds	126.2	139.2	\$ 141.6
Housing and Dining System Revenue Bonds	-	74.0	77.0
Hospital Revenue Bonds	-	-	1.8
Commonwealth Library Project (W.T. Young Library) Bonds	39.0	40.2	41.4
Capital lease obligations	143.4	65.2	66.1
Notes payable	21.6	3.4	3.1
Total	<u>\$ 537.5</u>	<u>\$ 436.7</u>	<u>\$ 331.0</u>

Debt increased \$100.8 million during the year primarily due to the issuance of bonds for the construction of the Student Health Facility, and capital leases for the purchase of land, buildings, equipment and computer software.

Economic Factors That Will Affect the Future

Executive management believes that the University is well-positioned to maintain its strong financial condition and to continue providing excellent service to students, patients, the community and the Commonwealth of Kentucky. The University's strong financial condition, as evidenced by the receipt of credit ratings of Aa3 and AA- from Moody's Investors Service and Standard & Poor's Ratings Services, respectively, will provide a high degree of flexibility in obtaining funds on competitive terms. This flexibility, along with ongoing efforts toward revenue diversification and cost containment, will enable the University to obtain the necessary resources to sustain excellence. The following are known facts and circumstances that will affect future financial results:

- As a result of an improving economy, budgeted state appropriations will increase by \$16 million to \$335 million for fiscal year 2007-08.
- Tuition rates for fiscal year 2008 will increase an average of approximately 9.0 percent for resident undergraduate students and 6.6 percent for non-resident undergraduate students. The tuition rate increases are expected to generate additional operating revenues of approximately \$16.5 million.
- As of June 30, 2007, grants and contracts of approximately \$390 million have been awarded to the University, but not expended. These contracts will provide grant revenue to future periods.
- A new hospital patient care facility with an estimated construction project cost of \$450 million has been approved by the General Assembly and construction is under way. General Receipts Notes in the amount of \$107.5 million have been issued to provide initial funding for this project. An additional \$150 million in related bond authority has been approved for the current biennium and the University anticipates issuing bonds in this amount during fiscal year 2007-08.
- On July 1, 2007, the University purchased Good Samaritan Hospital, a 336 bed community hospital located in Lexington, Kentucky, contiguous to the University campus. The purchase price, exclusive of direct transaction costs, was approximately \$13,000,000. This acquisition greatly expands the patient care opportunities available for the University to serve the Commonwealth.
- The University will continue its long-term endowment investment strategy to maximize total returns, at an appropriate level of risk, while utilizing a spending rate policy to insulate programs funded by the endowment from temporary market volatility.
- The University does not record a liability for post-employment retiree health benefits. Governmental Accounting Standards require that this liability be recognized in the financial statements beginning June 30, 2008. The impact of implementing this change from a cash basis to an accrual basis for recognizing the cost of post-employment retiree health benefits will increase the annual expense associated with providing this benefit from \$6.4 million to \$13.6 million per year beginning in fiscal year 2008.

Economic challenges will continue to impact the future. However, university management believes that the University of Kentucky will be able to sustain its sound financial position and continue its progress to become one of America's 20 best public research institutions.

UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS
CONSOLIDATED STATEMENTS OF NET ASSETS
JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 372,287,497	\$ 369,087,885
Notes, loans and accounts receivable, net	205,349,472	154,909,270
Investments	4,196,757	3,099,588
Inventories and other	26,886,295	24,802,495
Total current assets	<u>608,720,021</u>	<u>551,899,238</u>
Noncurrent Assets		
Restricted cash and cash equivalents	143,116,091	172,627,182
Endowment investments	945,305,685	767,693,088
Other long-term investments	172,433,672	201,137,365
Notes, loans and accounts receivable, net	38,181,625	35,872,190
Other noncurrent assets	21,154,371	1,662,816
Capital assets, net	1,208,670,346	1,081,156,203
Total noncurrent assets	<u>2,528,861,790</u>	<u>2,260,148,844</u>
Total assets	<u>3,137,581,811</u>	<u>2,812,048,082</u>
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	161,633,804	126,320,063
Deferred revenue	60,285,131	57,521,650
Long-term liabilities - current portion	78,076,113	45,501,341
Total current liabilities	<u>299,995,048</u>	<u>229,343,054</u>
Noncurrent Liabilities		
Long-term liabilities	559,935,302	480,602,627
Total liabilities	<u>859,930,350</u>	<u>709,945,681</u>
NET ASSETS		
Invested in capital assets, net of related debt	<u>773,961,907</u>	<u>763,475,732</u>
Restricted		
Nonexpendable		
Scholarships and fellowships	92,820,528	83,311,656
Research	210,371,384	194,070,426
Instruction	63,940,014	59,711,569
Academic support	82,106,259	82,115,782
Other	5,078,180	4,545,612
Total restricted nonexpendable	<u>454,316,365</u>	<u>423,755,045</u>
Expendable		
Scholarships and fellowships	76,587,645	57,540,489
Research	99,382,538	63,706,209
Instruction	58,535,959	44,326,525
Academic support	43,274,887	29,671,893
Loans	9,455,269	8,972,452
Capital projects	77,426,390	76,815,088
Debt service	3,623,967	4,171,226
Auxiliary	4,561,675	9,833,881
Other	10,968,912	12,157,229
Total restricted expendable	<u>383,817,242</u>	<u>307,194,992</u>
Total restricted	<u>838,133,607</u>	<u>730,950,037</u>
Unrestricted	<u>665,555,947</u>	<u>607,676,632</u>
Total net assets	<u>\$ 2,277,651,461</u>	<u>\$ 2,102,102,401</u>

UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS
CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2007 AND 2006

	2007	2006
OPERATING REVENUES		
Student tuition and fees	\$ 224,668,456	\$ 201,192,585
Less: Scholarship allowances	(57,926,127)	(53,925,121)
Net tuition and fees	166,742,329	147,267,464
Federal grants and contracts	170,466,382	170,590,760
State and local grants and contracts	95,901,471	95,222,942
Nongovernmental grants and contracts	31,869,123	31,547,216
Recoveries of facilities and administrative costs	43,791,890	43,303,460
Sales and services	45,717,176	42,023,694
Federal appropriations	17,857,797	15,683,789
County appropriations	12,817,459	11,998,193
Professional clinical service fees	164,431,689	150,240,798
Hospital services	579,222,126	520,310,461
Auxiliary enterprises:		
Housing and dining	40,605,278	40,781,440
Less: Scholarship allowances	(4,822,458)	(4,396,917)
Net housing and dining	35,782,820	36,384,523
Athletics	47,516,947	45,062,540
Other auxiliaries	21,705,111	20,632,796
Other operating revenues	1,507,086	2,222,388
Total operating revenues	1,435,329,406	1,332,491,024
OPERATING EXPENSES		
Educational and general:		
Instruction	257,954,660	240,101,280
Research	242,473,926	236,141,392
Public service	195,347,405	164,011,200
Libraries	16,591,647	14,866,441
Academic support	67,475,522	61,655,329
Student services	22,836,323	21,564,839
Institutional support	58,864,836	50,213,111
Operations and maintenance of plant	55,554,077	53,047,615
Student financial aid	23,215,661	23,242,484
Depreciation	61,324,257	57,901,456
Total educational and general	1,001,638,314	922,745,147
Clinical operations (including depreciation of \$1,342,478 in 2007 and \$807,937 in 2006)	134,613,845	120,717,535
Hospital and clinics (including depreciation of \$21,691,682 in 2007 and \$19,210,460 in 2006)	566,605,640	494,978,315
Auxiliary enterprises:		
Housing and dining (including depreciation of \$3,433,154 in 2007 and \$3,366,341 in 2006)	38,132,789	38,780,215
Athletics (including depreciation of \$2,478,790 in 2007 and \$2,474,802 in 2006)	53,792,125	47,810,546
Other auxiliaries	13,617,266	14,075,804
Other operating expenses	228,599	460,336
Total operating expenses	1,808,628,578	1,639,567,898
Net loss from operations	(373,299,172)	(307,076,874)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	319,859,256	314,293,555
Gifts and grants	34,217,737	32,134,557
Investment income	160,975,415	119,066,760
Interest on capital asset-related debt	(12,722,644)	(13,497,227)
Other nonoperating revenues and expenses, net	3,121,530	3,749,372
Net nonoperating revenues (expenses)	505,451,294	455,747,017
Net income (loss) before other revenues, expenses, gains or losses	132,152,122	148,670,143
Capital appropriations	-	475,068
Capital grants and gifts	23,536,462	63,188,237
Additions to permanent endowments, including Research Challenge		
Trust Funds of \$15,401,331 in 2007 and \$9,076,476 in 2006	29,930,763	24,335,856
Other, net	(10,070,287)	2,276,607
Total other revenues (expenses)	43,396,938	90,275,768
INCREASE IN NET ASSETS	175,549,060	238,945,911
NET ASSETS, beginning of year	2,102,102,401	1,863,156,490
NET ASSETS, end of year	\$ 2,277,651,461	\$ 2,102,102,401

**UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2007 AND 2006**

	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Student tuition and fees	\$ 166,039,394	\$ 144,545,367
Grants and contracts	285,559,893	283,967,680
Recoveries of facilities and administrative costs	42,548,136	41,178,394
Sales and services	45,313,405	44,686,045
Federal appropriations	15,868,099	14,746,791
County appropriations	12,449,258	12,176,710
Payments to vendors and contractors	(571,958,331)	(532,207,183)
Student financial aid	(23,207,121)	(23,306,717)
Salaries, wages and benefits	(1,082,516,038)	(990,500,114)
Professional clinic service fees	168,460,192	154,322,459
Hospital services	573,080,357	511,222,775
Auxiliary enterprise receipts:		
Housing and Dining	36,011,751	36,405,967
Athletics	49,920,644	46,092,778
Other auxiliaries	21,963,117	20,003,727
Loans issued to students	(19,967,396)	(16,292,186)
Collection of loans to students	20,910,174	16,844,054
Self insurance receipts	39,330,989	38,995,996
Self insurance payments	(36,334,387)	(35,761,650)
Other operating receipts (payments), net	753,747	3,908,082
Net cash provided (used) by operating activities	<u>(255,774,117)</u>	<u>(228,971,025)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	319,859,256	314,293,555
Gifts and grants received for other than capital purposes:		
Gifts received for endowment purposes	29,930,763	24,335,856
Gifts received for other purposes	31,337,959	30,353,354
Agency and loan program receipts	114,295,027	107,162,039
Agency and loan program payments	(116,061,303)	(106,656,275)
Other noncapital financing receipts (payments), net	3,779,592	3,906,093
Net cash provided (used) by noncapital financing activities	<u>383,141,294</u>	<u>373,394,622</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital grants and gifts	19,382,629	56,273,834
Purchases of capital assets	(175,833,565)	(136,651,651)
Proceeds from capital debt	107,885,704	128,410,581
Payments to refunding bond agents	(83,020,792)	-
Proceeds from sales of capital assets	5,241,755	10,400,000
Principal paid on capital debt and leases	(20,373,014)	(25,758,025)
Interest paid on capital debt and leases	(16,189,397)	(15,292,480)
Other capital and related financing receipts (payments), net	3,579,115	(1,025,361)
Net cash provided (used) by capital and related financing activities	<u>(159,327,565)</u>	<u>16,356,898</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	1,945,208,797	1,675,818,484
Interest and dividends on investments	48,887,958	62,359,530
Purchase of investments	(1,988,447,846)	(1,797,098,674)
Net cash provided (used) by investing activities	<u>5,648,909</u>	<u>(58,920,660)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>(26,311,479)</u>	<u>101,859,835</u>
CASH AND CASH EQUIVALENTS, beginning of year	<u>541,715,067</u>	<u>439,855,232</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 515,403,588</u>	<u>\$ 541,715,067</u>
Reconciliation of net loss from operations to net cash used by operating activities:		
Operating loss	\$ (373,299,172)	\$ (307,076,874)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation expense	90,270,361	83,760,995
Change in assets and liabilities:		
Notes, loans and accounts receivable, net	(22,749,645)	(25,801,876)
Inventories and other assets	(1,869,950)	(4,576,243)
Accounts payable and accrued liabilities	40,374,417	12,042,808
Deferred revenue	2,763,478	10,184,938
Long term liabilities	8,736,394	2,495,227
Net cash used by operating activities	<u>\$ (255,774,117)</u>	<u>\$ (228,971,025)</u>

UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The University of Kentucky (the University) is a component unit of the Commonwealth of Kentucky and is included in the basic financial statements of the Commonwealth. The consolidated financial statements of the University include the operations of the University, its for-profit subsidiary (Kentucky Healthcare Enterprise, Inc.) and its affiliated non-profit corporations (entities for which the University is financially accountable as defined by Statement No. 14 and amended by Statement No. 39 of the Governmental Accounting Standards Board (GASB), and which meet the definition of an affiliated corporation under Kentucky Revised Statute (KRS) section 164A.550) as follows: the University of Kentucky Research Foundation and its for-profit subsidiaries (Kentucky Technology, Inc. and Coldstream Laboratories, Inc.); The Fund for Advancement of Education and Research in the University of Kentucky Medical Center; University of Kentucky Athletic Association; Central Kentucky Management Services, Inc.; University of Kentucky Mining Engineering Foundation, Inc.; University of Kentucky Business Partnership Foundation, Inc.; University of Kentucky Gluck Equine Research Foundation, Inc.; University of Kentucky Humanities Foundation, Inc.; and University of Kentucky Center on Aging Foundation, Inc. The consolidated financial statements also include the operations of Kentucky Medical Services Foundation, Inc. (KMSF), a non-profit entity for which the University is financially accountable as defined by GASB, but which is not an affiliated corporation under KRS.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the GASB. GASB establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and financial reporting purposes into the following net assets categories:

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted:
 - Nonexpendable* – Net assets subject to externally imposed stipulations that they be maintained permanently by the University. Such assets include the principal of the University's permanent endowment funds.
 - Expendable* – Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time.
- Unrestricted: Net assets whose use by the University is not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation is intended to provide a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

Summary of Significant Accounting Policies

Accrual Basis. The consolidated financial statements have been prepared on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when an obligation has been incurred. The University reports as a Business Type Activity (BTA) as defined by GASB Statement No. 35. BTA's are those activities that are financed in whole or part by fees charged to external parties for goods and services.

Cash and Cash Equivalents. The University considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Noncurrent cash and cash equivalents includes plant funds allocated for capital projects and endowment fund cash pending transfer to the custodian for investment. Cash and cash equivalents held by the University's endowment fund managers are included in endowment investments.

Inventories. Inventories are stated principally at the lower of average cost or market.

Pooled Endowment Funds. The University employs the total return concept of investment management for setting investment objectives and determining investment performance. This concept recognizes dividends and interest, plus or minus realized and unrealized gains or losses, in determining the total return earned during any particular period. The market value method of accounting for pooled endowment funds is employed to ensure proper distribution of market price changes, realized gains (losses) on sales, accrued income earned, and distribution of investment earnings for expenditure by participating funds.

The Uniform Management of Institutional Funds Act (UMIFA), as adopted by the Commonwealth of Kentucky, permits the University to appropriate an amount of the realized and unrealized endowment appreciation to support current programs. Accordingly, spendable return from the endowment is determined using the total return philosophy. This philosophy recognizes a prudent amount of realized and unrealized gains as spendable return in addition to traditional yield. Distribution of investment earnings for expenditure by participating funds is supported first by traditional yield earned and, if necessary, a transfer from the endowment of any prior years' accumulated earnings (unexpended traditional yield) or net realized or unrealized gains.

In fiscal years 2006-07 and 2005-06, the University's endowment spending rule provided for annual distributions of 4.50 percent and 4.75 percent, respectively, of the three-year moving average market value of fund units. For the years ended June 30, 2007 and 2006 approximately \$9,445,000 and \$10,498,000, respectively, was transferred from endowment realized and unrealized gains to support current programs in accordance with the University's endowment spending rule. Appreciation on endowments available to support future spending rule distributions amounted to approximately \$211,159,000 at June 30, 2007. The Investment Committee of the University's Board of Trustees has approved a spending rate distribution for future fiscal years of 4.50 percent of the three-year moving average market value of fund units. Additionally, the University assesses eligible endowment accounts with a management fee to support fundraising and endowment administration. The management fee was .50 percent and .75 percent, respectively, of total asset value during the years ended June 30, 2007 and 2006. The Investment Committee has approved a management fee of .50 percent of total asset value for future fiscal years.

Investments. Investments in marketable securities are carried at fair value, as determined by the major securities markets. Changes in unrealized gain (loss) on the carrying value of investments are reported as a component of investment income in the Statement of Revenues, Expenses and Changes in Net Assets.

Capital Assets. Capital assets are stated at cost at date of acquisition or, in the case of gifts, at fair market value at date of gift.

Equipment with a unit cost of \$2,000 or more (\$1,000 for computers) and having an estimated useful life of greater than one year, is capitalized. Renovations to buildings, infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the respective assets, generally 40 years for buildings, 10 – 25 years for land and building improvements and infrastructure, 10 years for library books and 5 – 20 years for equipment.

The University capitalizes, but does not depreciate, works of art and historical treasures that are held for exhibition, education, research and public service.

Deferred Revenue. Deferred revenue consists primarily of amounts received from grant and contract sponsors that have not yet been earned under the terms of the agreement. Deferred revenue also includes amounts received in advance of an event, such as advance athletic ticket sales relating to future fiscal years and unearned summer school revenue.

Student Tuition and Fees. Student tuition and fees are presented net of scholarship allowances applied to student accounts. Stipends and other payments made directly to students are presented as student financial aid expenses.

Hospital and Clinical Services Revenues. Hospital and clinical services revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including contractual allowances and estimated retroactive adjustments under reimbursement programs with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Income Taxes. The University is an agency and instrumentality of the Commonwealth of Kentucky, pursuant to Kentucky Revised Statutes sections 164.100 through 164.280. Accordingly, the University is excluded from Federal income taxes as an organization described in Section 115 of the Internal Revenue Code of 1986. Each of the University's affiliated non-profit organizations has received a determination from the Internal Revenue Service granting exemption from federal income taxation pursuant to the provisions of Internal Revenue Code section 501(c)(3). KMSF is also a not-for-profit corporation as described in Section 501 (c)(3) of the Internal Revenue Code.

Restricted Asset Spending Policy. The University's policy is that restrictions on assets cannot be fulfilled by the expenditure of unrestricted funds for similar purposes. The determination on whether restricted or unrestricted funds are expended for a particular purpose is made on a case-by-case basis. Restricted funds remain restricted until spent for the intended purpose.

Operating Activities. The University defines operating activities, as reported on the Statement of Revenues, Expenses and Changes in Net Assets, as those that generally result from exchange transactions, such as payments received for providing goods and services and payments made for goods and services received. Nearly all of the University's expenses are from exchange transactions. Certain significant revenues relied upon for operations, such as state appropriations, gifts and investment income, are recorded as non-operating revenues, in accordance with GASB Statement No. 35.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to use estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The accompanying financial statements include estimates for items such as bad debt and contractual allowances, self-insurance reserves, accrued expenses and other liability accounts.

Recent Accounting Pronouncements. In June 2004, the GASB issued Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions." This statement establishes standards for the measurement, recognition and display of other post employment benefit expenses/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information in the financial reports of employers subject to governmental accounting standards.

Statement No. 45 requires employers to record, as the annual cost of the plan, the actuarially determined annual required contribution. The annual required contribution is calculated to include the normal annual cost for the year for current employees plus a component to amortize the unfunded actuarial accrued liabilities of the plan over a period not to exceed 30 years.

The provisions of this statement are effective for financial statements for fiscal periods beginning after December 15, 2006. The impact of implementing this change in the method of recognizing the cost for post employment retiree health benefits will increase the annual expense associated with providing this benefit from \$6.4 million to \$13.6 million per year beginning in fiscal year 2008.

2. DEPOSITS AND INVESTMENTS

The fair value of deposits and investments, by type, at June 30, 2007 and 2006 is as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Deposits with banks and the Commonwealth of Kentucky	\$ 48,576	\$ 45,631
U.S. Treasury fixed income securities	30,537	37,201
Government agency fixed income securities	79,753	94,973
Common and preferred stocks	92,083	66,858
Pooled equity funds	582,392	476,257
Private equity	8,524	2,426
Pooled real estate funds	73,433	53,602
Pooled fixed income funds	481,270	510,613
Corporate fixed income securities	29,369	25,626
Guaranteed investment contracts	10,545	13,487
Repurchase agreements	144,437	142,705
Certificates of deposit	22,254	19,263
Cash and cash equivalents	33,944	24,855
Other	223	148
Total	<u>\$ 1,637,340</u>	<u>\$ 1,513,645</u>

	<u>2007</u>	<u>2006</u>
Statement of Net Assets classification		
Cash and cash equivalents	\$ 372,287	\$ 369,088
Current investments	4,197	3,100
Restricted cash and cash equivalents	143,116	172,627
Endowment investments	945,306	767,693
Other long-term investments	172,434	201,137
Total	<u>\$ 1,637,340</u>	<u>\$ 1,513,645</u>

During fiscal 2006, the University sold its approximately 84 percent ownership of CHA Service Company (CHA), a Kentucky for-profit corporation established to provide an integrated health care delivery system throughout the Commonwealth of Kentucky, at a gain of approximately \$28.8 million. The University accounted for its investment in CHA by the equity method since, under the provision of CHA's by-laws, the University could not exercise control over the day-to-day operations of CHA. A summary of the University's investment in CHA is as follows (in thousands):

	June 30, 2005	Fiscal 2005-06	June 30, 2006
Capital investment	\$ 38,180		\$ 38,180
Equity in income (losses) through December 31 (CHA fiscal year end) and date of sale	(7,885)	\$ 11,731	3,846
Cash dividend	-	(25,148)	(25,148)
Sale proceeds	-	(45,714)	(45,714)
Gain on sale	-	28,836	28,836
Net investment	<u>\$ 30,295</u>	<u>\$ (30,295)</u>	<u>\$ -</u>

As part of the CHA sales agreement, escrow funds were established totaling \$9.5 million to cover any potential unrecorded liabilities or overstatement of asset value and for any additional transaction costs. Monies remaining in these escrow accounts as of August 2007 were to be returned to the Hospital in proportion to its prior ownership interest in CHA. The Hospital recorded, and included in the gain above, a receivable of \$3.75 million, as of June 30, 2006, for its estimated share of these escrow funds. The actual amount distributed in August 2007 was approximately \$7.4 million, resulting in an addition gain on sale of \$3.65 million, which was recorded in income of fiscal year 2007 along with an additional \$1.4 million adjustment to the purchase price in January 2007. The total gain recognized on this sale amounts to approximately \$33.9 million.

Deposit and investment policies. The University's Board of Trustees is responsible for establishing deposit and investment policies. Once established, the Board has delegated day-to-day management to the Treasurer of the University, who is also the Treasurer of the Board. Deposit and investment policies are developed to insure compliance with state laws and regulations as well as to establish and maintain sound financial management practices.

The University follows Kentucky Revised Statutes (KRS 42.500) for the investment of public funds, which list allowable investment instruments to include: obligations of the United States or a United States government agency; obligations of any corporation of the United States Government; collateralized certificates of deposit; highly rated uncollateralized certificates of deposit, bankers acceptances and commercial paper; highly rated securities issued by a state or local government; and mutual funds comprised of any of the above allowable investments.

For purposes of investment management, the majority of the University's deposits and investments can be grouped into five significant categories, as follows:

- Overnight investments (deposits and repurchase agreements) with local banks and the Commonwealth of Kentucky;
- Bond revenue fund investments held by the Treasurer of the Commonwealth of Kentucky as required by the University's bond trust indentures, and invested in pooled fixed income funds managed by the Commonwealth of Kentucky;
- Short-term investments managed by the University, including individual securities purchased and held by the University and short-term investments in pooled fixed income funds managed by the Commonwealth of Kentucky;
- Debt service reserve fund investments required by the University's bond trust indentures and held by the bond trustees;
- Endowment investments administered by the University and managed using external investment managers.

The Treasurer manages the overnight and short-term investment programs of the University based on the Statement of Investment Objectives and Policies for Short-Term Current Funds Investments established by the Investment Committee of the University's Board of Trustees.

The University's policy for the investment of bond revenue and debt service reserve funds is governed by each respective bond's trust indenture.

The Investment Committee of the University's Board of Trustees establishes and maintains the University's Endowment Investment Policies.

Deposit and investment risks. The University's deposits and investments are exposed to various risks, including credit, interest rate and foreign currency risk, as discussed in more detail below:

Credit Risk. Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligation, causing the University to experience a loss of principal.

As a means of limiting its exposure to losses arising from credit risk, the University's investment policies limit the exposure of its various investment types, as follows:

- Overnight investment (deposits and repurchase agreements) policies minimize credit risk in several ways. Deposits are governed by state law which requires full collateralization. Credit risk on repurchase agreements with local banks is mitigated by the issuing financial institution's pledge of specific U.S. treasury or agency securities, held in the name of the University by the Federal Reserve Bank. Credit risk on repurchase agreements with the Commonwealth of Kentucky is mitigated by the Commonwealth's requirement that providers of overnight repurchase agreements collateralize these investments at 102% of face value with U.S. treasury or agency securities, pledged in the name of the Commonwealth.
- Bond revenue fund investments held in the Commonwealth's investment pools can invest in U.S. treasuries and agencies; commercial paper or asset backed securities rated in the highest category by a nationally recognized rating agency; certificates of deposit, bankers acceptances, state or local government securities and corporate, Yankee and Eurodollar securities rated in one of the three highest categories by a nationally recognized rating agency; shares of mutual funds (up to 10%); and state and local property tax certificates of delinquency secured by interests in real estate.
- Short-term investments managed by the University are limited to direct obligations of the U.S. Treasury, other appropriate securities issued by federal agencies, repurchase agreements of U.S. government obligations, and certificates of deposit collateralized by U.S. government obligations or general obligations of the University of Kentucky. Short-term investments held in the Commonwealth's investment pools are subject to the same credit quality requirements as denoted above for bond revenue fund investments.
- Investment securities held in bond debt service reserve funds may be invested and reinvested solely in bonds or interest bearing notes of the United States Government.
- Endowment investments held by fixed income managers are generally limited to holdings of high quality fixed income securities. These managers may invest a portion of the portfolio in other below-investment grade bonds, non-U.S. dollar denominated bonds, and emerging market bonds, provided the overall credit quality of the fixed income portfolios is not lower than A-.

At June 30, 2007, the credit quality of the University's fixed income investments is as follows (in thousands):

	<u>S&P/Moody's Credit Ratings</u>					Rating	
	AAA/Aaa	AA/Aa	A	BBB/Baa	Not rated	Not Applicable	Total
U.S. Treasury fixed income						\$ 30,537	\$ 30,537
Government agency fixed income	\$ 78,147				\$ 1,606	-	79,753
Pooled fixed income	641	\$ 1,919			478,710	-	481,270
Corporate fixed income	20,267	-	\$ 448	\$ 8,654	-	-	29,369
Guaranteed investment contracts	-	-	-	-	10,545	-	10,545
Repurchase agreements	-	-	-	-	139,493	4,944	144,437
Certificates of deposit	-	-	-	-	22,254	-	22,254
Cash and cash equivalents	28,745	-	2,160	-	3,025	14	33,944
Total fixed income investments	\$ 127,800	\$ 1,919	\$ 2,608	\$ 8,654	\$ 655,633	\$ 35,495	\$ 832,109

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investment or collateral securities that are in possession of an outside party.

As a means of limiting its exposure to losses arising from custodial credit risk, the University's investment policies limit the exposure of its various investment types, as follows:

- Overnight investments (deposits and repurchase agreements) are not exposed to custodial credit risk other than repurchase agreements with the Commonwealth of Kentucky which are held in the Commonwealth's name.
- Bond revenue fund investments and short-term investments held in the Commonwealth's investment pools are held in the Commonwealth's name by the Commonwealth's custodian.
- Short-term investments managed by the University are held in the University's name by the University's custodian.
- Investment securities held in bond debt service reserve funds are held by the respective bond trustee in a specific trust account for the benefit of the University and bondholders.
- Endowment investments are held in the University's name by the University's custodian.

At June 30, 2007, the following University deposit and investment balances held in the name of the Commonwealth of Kentucky, included in the above significant investment types, were exposed to custodial credit risk as follows (in thousands):

	State Deposits	Overnight Investments	Bond Revenue Investments	Short-term Investments	Other State Investments	Total
Uninsured and collateralized with securities held by the pledging financial institution's trust department or agent but not in the University's name	\$ 40,987	\$ 110,000				\$ 150,987
Uninsured, not registered in the name of the University and held by the counterparty but not in the University's name	-	-	\$ 232,343	\$ 59,434	93,507	385,284
Total	\$ 40,987	\$ 110,000	\$ 232,343	\$ 59,434	\$ 93,507	\$ 536,271

Concentrations of Credit Risk. University investments can be exposed to a concentration of credit risk if significant amounts are invested in any one issuer.

As a means of limiting its exposure to concentrations of credit risk, the University's investment policies limit concentrations in various investment types, as follows:

- Overnight investments (deposits and repurchase agreements) are not limited as to the maximum amount that may be invested in one issuer. However, all such investments in excess of Federal Depository Insurance are required to be fully collateralized by U.S. treasury and/or U.S. agency securities or other similar investments as provided by KRS 41.240.
- Bond revenue fund investments and short-term investments held in the Commonwealth's investment pools are limited as follows: U.S. dollar denominated corporate and Yankee securities issued by foreign and domestic issuers shall not exceed twenty-five (25) percent of an individual pool and \$25,000,000 per issuer, inclusive of commercial paper, bankers' acceptances and certificates of deposit; and U. S. dollar denominated sovereign debt shall not exceed five (5) percent of any individual portfolio and \$25,000,000 per issuer.
- There is no specific limit on the maximum amount of short-term investments managed by the University that may be invested in one issuer. However, such investments are limited to direct U.S. government obligations (U.S. Treasuries) and U.S. government agencies.
- There is no specific limit on the maximum amount of investment securities held in bond debt service reserve funds that may be invested in one issuer. However, such investments are limited to bonds or interest bearing notes of the U.S. government.
- Endowment investment managers are limited to a maximum investment in any one issuer of no more than five (5) percent of total investments.

At June 30, 2007, the University has no investments in any one issuer, other than U.S. treasury and/or agency securities, that represent 5 percent or more of total investments.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

As a means of limiting its exposure to fair value losses arising from increasing interest rates, the University's investment policies limit the maturity of its various investment types, as follows:

- Overnight investments (deposits and repurchase agreements) have limited exposure to interest rate risk due to the short-term nature of the investment. The University requires that all deposits and repurchase agreements be available for use on the next business day.
- Bond revenue fund investments and short-term investments held in the Commonwealth's short-term investment pool are limited to a duration that does not exceed 90 days. Such investments in the Commonwealth's intermediate-term investment pool must maintain a modified duration of less than 3 years.
- Short-term investments managed by the University are limited to a maximum maturity of 24 months.
- Investment securities held in bond debt service reserve funds are required to have a maturity no later than two years from the date of the investment.
- Endowment investments held by fixed income managers are limited to a duration that is within +/-25 percent of the duration of the Lehman Aggregate Bond Index.

Below is the maturity distribution of the University's fixed income investments at June 30, 2007 (in thousands):

Investment Type	Maturities in Years					Managed based on duration	Total
	Less than 1	1-3	3-5	5-10	Greater than 10		
U.S. Treasury fixed income	\$ 10,483	\$ 976		\$ 71	\$ 42	\$ 18,965	\$ 30,537
Government agency fixed income	36,085	2,317	\$ 498	432	1,369	39,052	79,753
Pooled fixed income	-	-	-	-	-	481,270	481,270
Corporate fixed income	-	-	-	433	160	28,776	29,369
Guaranteed investment contracts	2,611	4,248	150	361	3,175	-	10,545
Repurchase agreements	139,493	-	-	1,008	3,936	-	144,437
Certificates of deposit	22,254	-	-	-	-	-	22,254
Cash and cash equivalents	33,944	-	-	-	-	-	33,944
Total fixed income investments	\$ 244,870	\$ 7,541	\$ 648	\$ 2,305	\$ 8,682	\$ 568,063	\$ 832,109

At June 30, 2007, the University had the following investments managed based on duration (in thousands):

Investment Type	Fair Value	Modified Duration (Years)
U.S. Treasury fixed income securities		
Pooled endowment fund	\$ 18,965	7.17
Government agency fixed income securities		
Pooled endowment fund	39,052	4.11
Pooled fixed income funds		
Pooled endowment fund	93,426	4.66
Other endowment investments	2,560	3.55
Commonwealth of Kentucky short-term pool	219,006	0.06
Commonwealth of Kentucky intermediate pool	166,278	1.18
Corporate fixed income securities		
Pooled endowment fund	28,776	2.94
Total	\$ 568,063	

Foreign Currency Risk. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit.

The University's exposure to foreign currency risk derives from certain limited endowment investments, including pooled fixed income funds, a pooled global equity fund, and pooled non-U.S. equity funds. The University's endowment investment policy allows fixed-income managers to invest a portion of their funds in non-U.S. securities and equity fund managers of co-mingled portfolios to invest in accordance with the guidelines established in the individual fund's prospectus.

At June 30, 2007, the following endowment investments were subject to foreign currency risk (in thousands):

Endowment Investments	Fair Value
Pooled fixed income funds	\$ 11,857
Pooled global equity fund	75,411
Pooled non-U.S. equity funds	106,623
Total	\$ 193,891

3. NOTES, LOANS AND ACCOUNTS RECEIVABLE, NET

Notes, loans and accounts receivable as of June 30, 2007 and 2006, respectively, are as follows (in thousands):

	2007		
	Gross Receivable	Allowance	Net Receivable
Hospital patient accounts	\$ 84,501	\$ (18,416)	\$ 66,085
KMSF patient accounts	21,734	(3,337)	18,397
Dentistry patient accounts	3,491	(848)	2,643
KMSF receivable - Good Samaritan transaction	18,669	-	18,669
Student loans	25,592	(2,426)	23,166
Reimbursement receivable - grants and contracts	56,166	-	56,166
Reimbursement receivable - federal appropriations	3,915	-	3,915
Pledges receivable	32,061	(12,095)	19,966
Accrued interest receivable	5,863	-	5,863
Student receivables	7,957	(2,278)	5,679
Escrow funds receivable - CHA sale	7,400	-	7,400
Other	16,547	(965)	15,582
Total	\$ 283,896	\$ (40,365)	\$ 243,531
Current portion			\$ 205,349
Noncurrent portion			38,182
Total			\$ 243,531
	2006		
	Gross Receivable	Allowance	Net Receivable
Hospital patient accounts	\$ 68,087	\$ (13,900)	\$ 54,187
KMSF patient accounts	24,015	(6,151)	17,864
Dentistry patient accounts	2,936	(664)	2,272
Student loans	26,696	(2,494)	24,202
Reimbursement receivable - grants and contracts	49,167	-	49,167
Reimbursement receivable - federal appropriations	1,797	-	1,797
Pledges receivable	23,638	(8,359)	15,279
Accrued interest receivable	4,215	-	4,215
Student receivables	8,090	(2,191)	5,899
Escrow funds receivable - CHA sale	3,750	-	3,750
Other	12,809	(660)	12,149
Total	\$ 225,200	\$ (34,419)	\$ 190,781
Current portion			\$ 154,909
Noncurrent portion			35,872
Total			\$ 190,781

4. CAPITAL ASSETS, NET

Capital assets as of June 30, 2007, and capital asset activity for the year ended June 30, 2007, are summarized as follows (in thousands):

	June 30, 2006	Additions	Deletions	June 30, 2007
Land	\$ 44,681	\$ 14,505	\$ 982	\$ 58,204
Land improvements - nonexhaustible	16,291	808	-	17,099
Land improvements - exhaustible	51,070	1,342	28	52,384
Buildings	1,184,627	67,953	15,805	1,236,775
Fixed equipment - communications	44,473	3,866	-	48,339
Infrastructure	47,954	2,166	-	50,120
Equipment	373,354	50,881	20,062	404,173
Vehicles	18,528	1,569	681	19,416
Library materials	124,133	4,859	379	128,613
Nondepreciable library materials	6,313	68	-	6,381
Capitalized software	50,212	22,413	-	72,625
Art	7,054	251	-	7,305
Construction in progress	43,108	83,132	22,223	104,017
	<u>2,011,798</u>	<u>253,813</u>	<u>60,160</u>	<u>2,205,451</u>
<u>Accumulated Depreciation</u>				
Land improvements - exhaustible	41,935	1,621	11	43,545
Buildings	495,053	31,581	3,767	522,867
Fixed equipment - communications	24,124	3,405	-	27,529
Infrastructure	10,218	1,961	-	12,179
Equipment	242,945	36,703	19,673	259,975
Vehicles	13,641	2,234	680	15,195
Library materials	96,134	6,504	-	102,638
Capitalized software	6,592	6,261	-	12,853
	<u>930,642</u>	<u>90,270</u>	<u>24,131</u>	<u>996,781</u>
Capital assets, net	<u>\$ 1,081,156</u>	<u>\$ 163,543</u>	<u>\$ 36,029</u>	<u>\$ 1,208,670</u>

Capital assets as of June 30, 2006, and capital asset activity for the year ended June 30, 2006, are summarized as follows (in thousands):

	<u>June 30, 2005</u>	<u>Additions</u>	<u>Deletions</u>	<u>June 30, 2006</u>
Land	\$ 39,559	\$ 5,122		\$ 44,681
Land improvements - nonexhaustible	13,128	3,195	\$ 32	16,291
Land improvements - exhaustible	45,787	5,306	23	51,070
Buildings	1,125,326	70,672	11,371	1,184,627
Fixed equipment - communications	40,253	4,247	27	44,473
Infrastructure	44,779	3,238	63	47,954
Equipment	351,879	49,686	28,211	373,354
Vehicles	17,699	1,840	1,011	18,528
Library materials	118,856	5,628	351	124,133
Nondepreciable library materials	5,947	366	-	6,313
Capitalized software	31,465	18,747	-	50,212
Art	6,969	85	-	7,054
Construction in progress	54,802	38,571	50,265	43,108
	<u>1,896,449</u>	<u>206,703</u>	<u>91,354</u>	<u>2,011,798</u>
<u>Accumulated Depreciation</u>				
Land improvements - exhaustible	39,841	2,094	-	41,935
Buildings	464,944	30,775	666	495,053
Fixed equipment - communications	21,036	3,088	-	24,124
Infrastructure	8,334	1,884	-	10,218
Equipment	227,735	35,181	19,971	242,945
Vehicles	13,003	1,505	867	13,641
Library materials	90,228	5,906	-	96,134
Capitalized software	3,264	3,328	-	6,592
	<u>868,385</u>	<u>83,761</u>	<u>21,504</u>	<u>930,642</u>
Capital assets, net	<u>\$ 1,028,064</u>	<u>\$ 122,942</u>	<u>\$ 69,850</u>	<u>\$ 1,081,156</u>

At June 30, 2007, the University has construction projects in process totaling approximately \$664 million in scope. The estimated cost to complete these projects is approximately \$514 million. Such construction is principally financed by proceeds from the University's general receipts bonds and by capital appropriations from the Commonwealth of Kentucky.

The University has utilized capital leases to acquire various items of equipment costing approximately \$18.3 million. Additionally, the University has entered into capital lease agreements to finance renovations to Commonwealth Stadium and for the construction of several buildings, including the new hospital patient care facility. The University has also utilized capital leases to fund the purchase and implementation of its new administrative computing systems and for the lease purchase of land and buildings associated with its purchase of Good Samaritan Hospital (see note 24).

5. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2007 and 2006, respectively, are as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Payable to vendors and contractors	\$ 61,330	\$ 46,336
Accrued expenses, including vacation and sick leave	62,380	42,685
Employee withholdings and deposits payable to third parties	37,924	37,299
Total	<u>\$ 161,634</u>	<u>\$ 126,320</u>

6. DEFERRED REVENUE

Deferred revenue as of June 30, 2007 and 2006, respectively, is as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Unearned summer school revenue	\$ 4,338	\$ 4,421
Unearned hospital revenue	10,972	12,542
Unearned grants and contracts revenue	29,627	28,906
Prepaid athletic ticket sales	11,943	9,162
Other	3,405	2,491
Total	<u>\$ 60,285</u>	<u>\$ 57,522</u>

7. LONG-TERM LIABILITIES

Long-term liabilities as of June 30, 2007, and long-term liability activity for the year ended June 30, 2007, are summarized as follows (in thousands):

	June 30, 2006	Additions	Reductions	June 30, 2007	Current Portion	Noncurrent Portion
<u>Bonds, notes and capital leases</u>						
General receipts notes	\$ 107,540	\$ 68,525	\$ 150	\$ 175,915	\$ 2,745	\$ 173,170
General receipts bonds	7,160	24,325	245	31,240	1,040	30,200
Educational buildings bonds	139,170	-	12,945	126,225	10,520	115,705
Housing and dining bonds	74,000	-	74,000	-	-	-
Library bonds	40,250	-	1,215	39,035	1,265	37,770
Capital leases and other long-term obligations	65,195	91,459	13,239	143,415	17,740	125,675
Notes payable	3,408	18,659	441	21,626	21,055	571
Total bonds, notes and capital leases	<u>436,723</u>	<u>202,968</u>	<u>102,235</u>	<u>537,456</u>	<u>54,365</u>	<u>483,091</u>
<u>Other liabilities</u>						
Medical malpractice	29,779	6,528	4,330	31,977	5,013	26,964
Long term disability	10,056	1,774	2,007	9,823	1,958	7,865
Annuities payable	5,937	784	17	6,704	621	6,083
Health insurance	8,458	29,654	27,208	10,904	10,904	-
Federal loan programs	21,889	963	958	21,894	-	21,894
Workers compensation	5,276	6,785	1,985	10,076	3,016	7,060
Compensated absences	3,250	187	-	3,437	490	2,947
Supplemental disability	431	178	254	355	229	126
Arbitrage rebate	365	163	-	528	93	435
Unamortized bond premium	2,182	1,701	193	3,690	220	3,470
Outstanding check liability	596	644	596	644	644	-
Unemployment compensation	455	448	380	523	523	-
Other	707	-	707	-	-	-
Total other liabilities	<u>89,381</u>	<u>49,809</u>	<u>38,635</u>	<u>100,555</u>	<u>23,711</u>	<u>76,844</u>
Total	<u>\$ 526,104</u>	<u>\$ 252,777</u>	<u>\$ 140,870</u>	<u>\$ 638,011</u>	<u>\$ 78,076</u>	<u>\$ 559,935</u>

Long-term liabilities as of June 30, 2006, and long-term liability activity for the year ended June 30, 2006, are summarized as follows (in thousands):

	June 30, 2005	Additions	Reductions	June 30, 2006	Current Portion	Noncurrent Portion
<u>Bonds, notes and capital leases</u>						
General receipts notes		\$ 107,540		\$ 107,540		\$ 107,540
General receipts bonds		7,160		7,160	\$ 245	6,915
Educational buildings bonds	\$ 141,565	11,495	\$ 13,890	139,170	12,945	126,225
Housing and dining bonds	77,055	-	3,055	74,000	3,155	70,845
Hospital bonds	1,770	-	1,770	-	-	-
Library bonds	41,415	-	1,165	40,250	1,215	39,035
Capital leases and other long-term obligations	66,077	4,845	5,727	65,195	5,110	60,085
Notes payable	3,104	3,017	2,713	3,408	2,608	800
Total bonds, notes and capital leases	<u>330,986</u>	<u>134,057</u>	<u>28,320</u>	<u>436,723</u>	<u>25,278</u>	<u>411,445</u>
<u>Other liabilities</u>						
Medical malpractice	27,964	5,067	3,252	29,779	3,396	26,383
Long term disability	10,460	1,899	2,303	10,056	1,912	8,144
Annuities payable	5,691	419	173	5,937	559	5,378
Health insurance	8,614	27,176	27,332	8,458	8,458	-
Federal loan programs	21,840	1,081	1,032	21,889	-	21,889
Workers compensation	4,235	4,565	3,524	5,276	3,300	1,976
Mining and Minerals Trust	55	-	55	-	-	-
Compensated absences	3,000	250	-	3,250	473	2,777
Supplemental disability	342	284	195	431	254	177
Arbitrage rebate	365	190	190	365	-	365
Unamortized bond premium	-	2,267	85	2,182	113	2,069
Outstanding check liability	450	596	450	596	596	-
Unemployment compensation	419	505	469	455	455	-
Other	1,079	377	749	707	707	-
Total other liabilities	<u>84,514</u>	<u>44,676</u>	<u>39,809</u>	<u>89,381</u>	<u>20,223</u>	<u>69,158</u>
Total	<u>\$ 415,500</u>	<u>\$ 178,733</u>	<u>\$ 68,129</u>	<u>\$ 526,104</u>	<u>\$ 45,501</u>	<u>\$ 480,603</u>

Principal maturities and interest on bonds, notes, capital leases and other long-term obligations for the next five years and in subsequent five-year periods as of June 30, 2007, are as follows (in thousands):

	Principal	Interest	Total
2008	\$ 54,365	\$ 20,484	\$ 74,849
2009	33,580	18,228	51,808
2010	38,888	17,003	55,891
2011	36,135	19,355	55,490
2012	65,400	19,031	84,431
2013-2017	123,768	56,533	180,301
2018-2022	116,360	29,679	146,039
2023-2027	68,960	6,246	75,206
Total	<u>\$ 537,456</u>	<u>\$ 186,559</u>	<u>\$ 724,015</u>

At June 30, 2007, assets with a fair market value of approximately \$122,914,000 have been placed on deposit with trustees to totally defease bonds with a par amount of \$114,020,000. The liability for these fully defeased bonds is not included in the financial statements.

On October 5, 2006, the University sold \$77,905,000 of University of Kentucky General Receipts Project Notes, 2007 Series A, at a net interest cost of 4.55 percent. These bonds were sold with a forward delivery date of November 1, 2007. The proceeds of this bond issue will provide additional funding for the construction of the University's new hospital patient care facility.

On October 18, 2006, \$66,305,000 of University of Kentucky General Receipts Project Notes Series 2006A and \$2,220,000 of Series 2006B were issued at a net interest cost of 4.12 percent, representing a full refunding of all Consolidated Housing and Dining System Revenue Bonds (\$74,000,000 par), and a partial refunding of \$6,420,000 of State Properties and Building Commission Project Notes. The refunding will reduce the University's total debt service payments over the next seventeen years by approximately \$635,000, representing an economic gain (difference between the present value of the debt service payments on the old and new debt) of approximately \$646,000.

8. COMPONENTS OF RESTRICTED EXPENDABLE NET ASSETS

Restricted expendable net assets are subject to externally imposed stipulations or conditions that must be followed and cannot be used for support of general operations of the University. As of June 30, 2007 and 2006, respectively, restricted expendable net assets were composed of the following (in thousands):

	<u>2007</u>	<u>2006</u>
Appreciation on permanent endowments	\$ 170,338	\$ 102,412
Term endowments	7,791	6,867
Quasi-endowments initially funded with restricted assets	43,077	43,177
Funds restricted for capital purposes	81,050	80,986
Funds restricted for noncapital purposes	72,106	64,781
Loan funds (primarily University funds required for federal match)	<u>9,455</u>	<u>8,972</u>
Total	<u>\$ 383,817</u>	<u>\$ 307,195</u>

9. DESIGNATIONS OF UNRESTRICTED NET ASSETS

Unrestricted net assets are designated for specific purposes by action of the Board of Trustees or management or may otherwise be limited by contractual agreements. Commitments for the use of unrestricted net assets as of June 30, 2007 and 2006, respectively, are as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Working capital requirements	\$287,077	\$246,063
Budget appropriations for future year fiscal operations	66,928	32,462
Designated for capital projects	34,640	53,958
Designated for renewal and replacement of capital assets	27,508	73,396
Hospital	185,372	137,608
Affiliated corporations	<u>64,031</u>	<u>64,190</u>
Total	<u>\$665,556</u>	<u>\$607,677</u>

10. PLEDGED REVENUES

Under the University's General Receipts Trust Indenture, substantially all of the unrestricted operating and non-operating revenues of the University are pledged to secure the payment of debt. For the years ended June 30, 2007 and 2006, respectively, pledged revenues are as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Student tuition and fees	\$ 166,742	\$ 147,267
Nongovernmental grants and contracts	6,916	7,543
Recoveries of facilities and administrative costs	43,792	43,303
Sales and services	45,717	42,024
Hospital services	579,222	520,310
Auxiliary enterprises - housing and dining	35,783	36,385
Auxiliary enterprises - other	21,705	20,633
Other operating revenue	1,507	2,222
State appropriations	319,859	314,294
Gifts and grants	2,087	1,123
Investment income	<u>30,654</u>	<u>55,382</u>
	<u>\$ 1,253,984</u>	<u>\$ 1,190,486</u>

11. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2007 and 2006 are as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Interest and dividends earned on endowment investments	\$ 20,860	\$ 13,706
Realized and unrealized gains and losses on endowment investments	104,660	39,368
Interest and dividends on cash and non-endowment investments	30,035	24,979
Realized and unrealized gains and losses on non-endowment investments	3,689	40,022
Investment income from external trusts	<u>1,731</u>	<u>992</u>
Total	<u>\$ 160,975</u>	<u>\$ 119,067</u>

12. FUNDS HELD IN TRUST BY OTHERS

The University is the income beneficiary of various trusts that are held and controlled by external trustees. For the years ended June 30, 2007 and 2006, the University received income from these trusts of approximately \$1,731,000 and \$992,000, respectively. The market value of the external trust assets as of June 30, 2007 and 2006 was approximately \$45,028,000 and \$40,706,000, respectively. As the University does not have ownership of the trust assets held by external trustees, the trusts are recorded at a nominal value of \$1 each.

13. PLEDGES AND DEFERRED GIFTS

At June 30, 2007, pledges totaling approximately \$65,678,000 are expected to be collected primarily over the next five years, as follows (in thousands):

Operating purposes	\$ 10,384
Capital projects	24,789
Endowment principal	<u>30,505</u>
Total	<u>\$ 65,678</u>

In accordance with GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions," the University is required to record operating and capital pledges as revenue when all eligibility requirements have been met. Endowment pledges are not recognized as revenue until the gifts are actually received. Accordingly, for the years ended June 30, 2007 and 2006, the University recorded the discounted value of operating and capital pledges, net of the allowance for uncollectible pledges, of approximately \$19,966,000 and \$15,279,000, respectively.

Deferred gifts through insurance, known bequests and irrevocable trusts in which the University has a remainder interest are estimated to be approximately \$100,509,000 at June 30, 2007. The University records these amounts as revenue when the cash is received.

14. GRANTS AND CONTRACTS AWARDED

At June 30, 2007, grants and contracts of approximately \$390 million have been awarded to the University and the University of Kentucky Research Foundation but not expended. These amounts will be recognized in future periods.

15. PENSION PLANS

Regular full-time employees, including faculty, are participants in the University of Kentucky Retirement Plan, a defined contribution plan. The University of Kentucky Retirement Plan consists of five groups as follows:

Group I	Established July 1, 1964, for faculty and certain administrative officials.
Group II	Established July 1, 1971, for staff members in the clerical, technical and service categories.
Group III	Established July 1, 1972, for staff members in the managerial, professional and scientific categories.
Group IV	Established January 1, 1973, for staff members having U.S. Civil Service retirement entitlement.
Group V	Established July 1, 1987, for staff members covered under the Federal Employees Retirement System that replaced Civil Service (those whose employment began during the period from January 1, 1984 to March 31, 1987). Staff members whose employment began after March 31, 1987 are under one of the above University of Kentucky Retirement Plans.

Participation in the University of Kentucky Retirement Plan is mandatory for all regular full-time employees in groups I, II and III who are age 30 or older. Participation is voluntary for regular full-time employees under the age of 30 and for those employees in groups IV and V. Participants in groups I, II, III and IV contribute 5 percent and the University contributes 10 percent of the participant's eligible compensation to the retirement plan. Participants in group V contribute 1 percent and the University contributes 2 percent of the participant's eligible compensation to the retirement plan.

The University has authorized three retirement plan carriers, as follows:

Teachers Insurance and Annuity Association/College
Retirement Equities Fund (TIAA/CREF)
Fidelity Investments Institutional Services Company
American Century Investments

Under the fully funded University of Kentucky Retirement Plan, the University and plan participants make contributions to provide fully vested retirement benefits to employees in individually owned contracts. The University's contributions and costs for 2007 and 2006 were approximately \$62,534,000 and \$58,578,000, respectively. Employees contributed approximately \$31,003,000 in 2007 and \$29,120,000 in 2006. The University's total payroll costs were approximately \$848,973,000 and \$804,628,000, respectively, for the years ended June 30, 2007 and 2006. The payroll for employees covered by the retirement plan was approximately \$625,344,000 and \$585,778,000 for the years ended 2007 and 2006, respectively.

In addition to retirement benefits provided from the group retirement plan, the University provides supplemental retirement income benefits to certain eligible employees in each of the retirement groups (see Note 16).

16. MINIMUM ANNUAL RETIREMENT BENEFITS AND SUPPLEMENTAL RETIREMENT INCOME

Employees in retirement groups I, II and III, referred to in Note 15 above, who were age 40 or older prior to the date of establishment of each group plan, and who were employed by the University prior to that date, qualify for the minimum annual retirement benefit provisions of the retirement plan. Benefits for these eligible employees are based upon a percentage, determined through years of service, of the participant's annual salary in the last year of employment prior to retirement. Retirement benefits as determined are funded by each individual retiree's accumulation in the group retirement plan, with the balance, if necessary, provided by the University as supplemental retirement income.

The Legislature of the Commonwealth of Kentucky has appropriated funds to the University for the payment of supplemental retirement income benefits since adoption of the group retirement plans, and is expected to continue this practice. However, the Constitution of the Commonwealth of Kentucky prohibits the commitment of future revenues beyond the end of the current biennium. Accordingly, the University does not recognize the liability for supplemental retirement income benefits during the service life of covered employees, but recognizes its costs when funds are appropriated by the Legislature and payments are made. The University intends to continue paying supplemental retirement income benefits contingent upon the Legislature continuing to appropriate funds required to make these payments. Supplemental retirement benefit payments were approximately \$3,089,000 and \$3,255,000 for the years ended June 30, 2007 and 2006, respectively.

The latest actuarial valuation was prepared as of July 1, 2006, by TIAA. The actuarial present value of accumulated supplemental retirement income benefits as determined by this valuation, utilizing an assumed rate of return of 7 percent, was \$18,356,000.

17. HEALTH INSURANCE BENEFITS FOR RETIREES

The University provides a health care credit towards health insurance coverage to retirees who have a minimum of fifteen years service. The University recognizes the cost of providing this credit by expensing the credit in the year provided. These health care credits totaled approximately \$6,203,000 and \$7,716,000 for the years ended June 30, 2007 and 2006, respectively. As of June 30, 2007, there were approximately 2,200 retirees who met the service requirement and were receiving the health care credit.

18. RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by (1) the State Fire and Tornado Insurance Fund (the Fund), (2) Sovereign Immunity and the State Board of Claims, or (3) in the case of risks not covered by the Fund and Sovereign Immunity, commercial insurance, participation in insurance risk retention groups or self-insurance.

The Fund covers losses to property from fire, wind, earthquake, flood and most other causes of loss between \$250,000 and \$500,000 per occurrence. Losses in excess of \$500,000 are insured by commercial carriers up to \$500 million per occurrence, buildings at replacement cost and contents on an actual cash value basis. As a state agency, the University is vested with Sovereign Immunity and is subject to the provisions of the Board of Claims Act, under which the University's liability for certain negligence claims is limited to \$200,000 for any one person or \$350,000 for all persons damaged by a single act of negligence. Claims against educators' errors and omissions and wrongful acts are insured through a reciprocal risk retention group. There have been no significant reductions in insurance coverage from 2006 to 2007. Settlements have not exceeded insurance coverage during the past three years.

The University and its agents are insured against medical malpractice by a combination of Sovereign Immunity, self-insurance, commercial liability insurance, and an excess coverage fund established by the Commonwealth of Kentucky. The malpractice liability as of June 30, 2007 is based on the requirements of GASB Statement No. 10, which requires that a liability for claims be recorded if it is probable that a liability has occurred and the amount of loss can be reasonably estimated. The liability includes an estimate for claims that have been incurred but not reported as of June 30, 2007.

The University is self-insured for the long-term disability income program and has established a 501(c)(9) trust for purposes of paying claims and establishing necessary reserves. The estimated long-term disability payments for known claims as of June 30, 2007 are reported at their present value assuming an investment yield of 6 percent.

The University also self-insures certain employee benefits, including health insurance, worker's compensation, unemployment claims, and a long-term disability supplemental reserve, to the extent not covered by insurance. The University has recorded an estimate for asserted claims at June 30, 2007.

Long-term liabilities related to self-insurance are detailed in Note 7, above.

19. CONTINGENCIES

The University is a defendant in various lawsuits. The nature of the educational and health care industries is such that, from time to time, claims will be presented on account of alleged negligence, acts of discrimination, medical malpractice, breach of contract or disagreements arising from the interpretation of laws or regulations. While some of these claims may be for substantial amounts, they are not unusual in the ordinary course of providing educational and health care services at a large institution. However, University officials are of the opinion, based on advice of in-house legal counsel, that the effect of the ultimate outcome of all litigation will not be material to the future operations or financial position of the University.

20. RESEARCH CHALLENGE TRUST FUND

The Research Challenge Trust Fund (RCTF) was created by the Kentucky General Assembly with the passage of the Postsecondary Education Improvement Act of 1997 (House Bill 1). The objectives of the Trust Fund, as stated in the Bill, include support of efforts by the University of Kentucky to attain status as a top-20 public research university. The RCTF Endowment Match Program provides state funds on a dollar-for-dollar match basis. This program, also known as "Bucks for Brains", supports endowed chairs, professorships and graduate fellowships, and the research and graduate mission of the University.

The status of the RCTF endowed funds as of June 30, 2007, is summarized as follows (in thousands):

	<u>Kentucky General Assembly Funding</u>	<u>University of Kentucky Share of Funding</u>	<u>State Funds Received to Date</u>	<u>Matching Pledges Receivable</u>
1998 Biennium	\$ 100,000	\$ 66,667	\$ 66,667	
2000 Biennium	100,000	68,857	68,857	\$ 191
2002 Biennium	<u>100,000</u>	<u>66,667</u>	<u>40,811</u>	<u>12,084</u>
Total	<u>\$ 300,000</u>	<u>\$ 202,191</u>	<u>\$ 176,335</u>	<u>\$ 12,275</u>

Interest income of approximately \$2.2 million earned on the state matching funds is included in the University's share of the 2000 Biennium funding. Requests to the State for RCTF funds totaling approximately \$23.1 million have been submitted and are outstanding as of June 30, 2007.

The University expects to fully realize all outstanding matching pledges; however, it may be obligated to return any state funds and accrued interest income related to pledges not received within five years of the initial pledge dates if unable to replace the unpaid pledges with other eligible gifts. A payment schedule of the outstanding pledges is shown below (in thousands):

	<u>2000 Biennium</u>	<u>2002 Biennium</u>
Pledges due in fiscal years 2007 or prior	\$ 109	\$ 635
Pledges due in fiscal year 2008	82	1,547
Pledges due in fiscal year 2009	-	1,603
Pledges due in fiscal year 2010	-	1,253
Pledges due in fiscal year 2011	-	7,012
Pledges due in fiscal year 2012	<u>-</u>	<u>34</u>
Total	<u>\$ 191</u>	<u>\$ 12,084</u>

Pledges due in fiscal years 2007 or prior reflected above includes unpaid pledges of approximately \$35,000 that are past five years of the initial pledge date. The University intends to replace the unpaid pledges with other eligible gifts.

21. CANCER RESEARCH MATCHING FUND

The Kentucky General Assembly created the Cancer Research Institutions Matching Fund, which is funded by a one-cent surtax levied on each 20 cigarettes sold in Kentucky. Tax revenues are made available equally to the University of Kentucky and the University of Louisville when matched dollar-for-dollar by private sources.

A summary of the receipts and expenses related to the fund as of June 30, 2007 and 2006, respectively, is as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Funds from private sources approved for match	\$ 2,346	\$ 4,227
Cigarette excise tax funds distributed	<u>3,119</u>	<u>3,054</u>
Total cancer research matching fund revenues	<u>\$ 5,465</u>	<u>\$ 7,281</u>
Cancer research matching fund expenses	<u>\$ 3,996</u>	<u>\$ 2,720</u>

22. NATURAL CLASSIFICATION

The University's operating expenses by natural classification were as follows for the years ended June 30, 2007 and 2006, respectively (in thousands):

	<u>2007</u>	<u>2006</u>
Salaries and wages	\$ 852,929	\$ 789,040
Employee benefits	248,154	224,907
Supplies and services	422,517	360,947
Depreciation	90,270	83,761
Student scholarships and financial aid	36,559	36,065
Purchased utilities	38,560	36,648
Hospital bad debt expense	45,060	51,769
Other, various	74,579	56,430
Total	<u>\$ 1,808,628</u>	<u>\$ 1,639,567</u>

23. RECLASSIFICATIONS

Certain reclassifications to fiscal 2006 comparative amounts have been made to conform to the 2007 classifications. Certain transactions previously reported on a net basis in the Consolidated Statement of Revenues, Expenses, and Changes in Net Assets are now being reported on a gross basis. Additionally, certain investments previously reported as current are now recorded as long-term based on revised utilization expectations.

24. SUBSEQUENT EVENTS

On July 1, 2007, the University purchased Good Samaritan Hospital, a 336 bed community hospital located in Lexington, Kentucky, contiguous to the University campus. The purchase price, exclusive of direct transaction costs, was approximately \$13,000,000.

INDEPENDENT AUDITORS' REPORT ON ADDITIONAL INFORMATION

To the Board of Trustees of the
University of Kentucky

and

the Secretary of Finance and
Administration Cabinet of the
Commonwealth of Kentucky

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The additional consolidating information contained on pages 39 and 40 is presented for the purpose of additional analysis and is not a required part of the basic consolidated financial statements. This additional information is the responsibility of the University's management. Such information has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects, in relation to the basic consolidated financial statements taken as a whole.

Deloitte & Touche LLP

October 5, 2007

UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS
 CONSOLIDATING SCHEDULE
 STATEMENT OF NET ASSETS
 JUNE 30, 2007
 (in thousands)

	UK	Research Foundation	The Fund	Gluck Equine Research Foundation	Athletic Association	Humanities Foundation	Mining Engineering Foundation	Business Partnership Foundation	Center on Aging	Central Kentucky Management Services	Kentucky Medical Services Foundation	Total
ASSETS												
Current Assets												
Cash and cash equivalents	\$ 340,069	\$ 10	\$ 11,533	\$ 2,950	\$ 13,725	\$ 52	\$ 3	\$ 365	\$ 40	\$ 617	\$ 2,924	\$ 372,288
Notes, loans and accounts receivable, net	108,197	56,975	2,844		522			1			36,810	205,349
Investments											4,197	4,197
Inventories and other	21,565	2,201			3,075					12	33	26,886
Total current assets	469,831	59,186	14,377	2,950	17,322	52	3	366	40	629	43,964	608,720
Noncurrent Assets												
Restricted cash and cash equivalents	143,080											143,116
Endowment investments	910,764	4,748	252	9,937	350	1,516	2,118	15,621				945,306
Other long-term investments	123,672	1,585			3,176						44,000	172,433
Notes, loans and accounts receivable, net	37,917										256	38,182
Other noncurrent assets	20,552	6									596	21,154
Capital assets, net	1,131,836	9,892			48,027					475	18,440	1,208,670
Total noncurrent assets	2,367,821	16,231	252	9,937	51,553	1,519	2,154	15,627	-	475	63,292	2,528,861
Total assets	2,837,652	75,417	14,629	12,887	68,875	1,571	2,157	15,993	40	1,104	107,256	3,137,581
LIABILITIES												
Current Liabilities												
Accounts payable and accrued liabilities	142,352	9,461	382		1,997		1	1		629	6,811	161,634
Deferred revenue	17,066	31,276			11,943							60,285
Long-term liabilities - current portion	54,536	631			1,265						21,644	78,076
Total current liabilities	213,954	41,368	382	-	15,205	-	1	1	-	629	28,455	299,995
Noncurrent Liabilities												
Long-term liabilities	514,666	4,869			37,770						2,630	559,935
Total liabilities	728,620	46,237	382	-	52,975	-	1	1	-	629	31,085	859,930
INTERFUND BALANCES												
	34,324	(11,842)	(773)		(151)						(21,558)	-
NET ASSETS												
Invested in capital assets, net of related debt												
	743,643	4,391			12,167					475	13,286	773,962
Restricted												
Nonexpendable	439,754	889	31	4,676		640	642	7,684				454,316
Expendable	358,435	4,184	1,787	8,211	407	931	1,514	8,308	40			383,817
Total restricted	798,189	5,073	1,818	12,887	407	1,571	2,156	15,992	40	-	-	838,133
Unrestricted												
	601,524	7,874	11,656		3,175						41,327	665,556
Total net assets	\$ 2,143,356	\$ 17,338	\$ 13,474	\$ 12,887	\$ 15,749	\$ 1,571	\$ 2,156	\$ 15,992	\$ 40	\$ 475	\$ 54,613	\$ 2,277,651

UNIVERSITY OF KENTUCKY AND AFFILIATED CORPORATIONS
CONSOLIDATING SCHEDULE FOR THE YEAR ENDED JUNE 30, 2007
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
(in thousands)

	UK	Research Foundation	The Fund	Gluck Equine Research Foundation	Athletic Association	Humanities Foundation	Mining Engineering Foundation	Business Partnership Foundation	Center on Aging	Central Kentucky Management Services	Kentucky Medical Services Foundation	Total
OPERATING REVENUES												
Student tuition and fees, net	\$ 166,742											\$ 166,742
Federal grants and contracts	10,986	\$ 159,480										170,466
State and local grants and contracts	34,424	61,467	\$ 10									95,901
Nongovernmental grants and contracts	4,625	24,955	2,289									31,869
Recoveries of facilities and administrative costs	223	43,569										43,792
Sales and services	26,407	1,956	11,840						\$ 7	\$ 5,507		45,717
Federal appropriations	17,858											17,858
County appropriations	12,818											12,818
Professional clinical service fees											\$ 164,432	164,432
Hospital patient services	579,222											579,222
Auxiliary enterprises:												
Housing and Dining, net	35,783											35,783
Athletics					\$ 47,517							47,517
Other auxiliaries	21,705											21,705
Other operating revenues	446		107								954	1,507
Total operating revenues	911,239	291,427	14,246	-	47,517	-	-	-	7	5,507	165,386	1,435,329
OPERATING EXPENSES												
Educational and general:												
Instruction	242,129	15,184	485			\$ 5	\$ 34	\$ 118				257,955
Research	75,780	166,327	143	\$ 1			34		189			242,474
Public service	106,547	87,879	913				8					195,347
Libraries	16,589		3									16,592
Academic support	61,618	2,511	2,909					437				67,475
Student services	22,726	31	75			4						22,836
Institutional support	52,537	844	314	9						5,161		58,865
Operations and maintenance of plant	55,554											55,554
Student financial aid	21,074	1,879	106			44		113				23,216
Depreciation	60,887	379								58		61,324
Total educational and general	715,441	275,034	4,948	10	-	53	76	668	189	5,219	-	1,001,638
Clinical operations (including depreciation of \$1,342)											134,614	134,614
Hospital (including depreciation of \$21,692)	566,048		558									566,606
Auxiliary enterprises:												
Housing and Dining (including depreciation of \$3,433)	38,133											38,133
Athletics (including depreciation of \$2,479)	201				53,591							53,792
Other auxiliaries	13,617											13,617
Other expenses	228											228
Total operating expenses	1,333,668	275,034	5,506	10	53,591	53	76	668	189	5,219	134,614	1,808,628
Net income (loss) from operations	(422,429)	16,393	8,740	(10)	(6,074)	(53)	(76)	(668)	(182)	288	30,772	(373,299)
NONOPERATING REVENUES (EXPENSES)												
State appropriations	319,859											319,859
Gifts and grants	32,843		1,008	130		54		74	109			34,218
Investment income	153,354	689	611	1,572	565	216	312	2,246	5	36	1,369	160,975
Interest on capital asset-related debt	(10,734)	(37)			(1,952)							(12,723)
Grant to/(from) the University for non-capital purposes	53,033	(17,099)	(8,364)	(508)	9,442	(7)	(10)	(119)			(36,368)	-
Other nonoperating revenues and expenses, net	(12)	1,646			1,488							3,122
Net nonoperating revenues (expenses)	548,343	(14,801)	(6,745)	1,194	9,543	263	302	2,201	114	36	(34,999)	505,451
Net income (loss) before other revenues, expenses, gains, or losses	125,914	1,592	1,995	1,184	3,469	210	226	1,533	(68)	324	(4,227)	132,152
Capital grants and gifts	12,279	11,407									(150)	23,536
Additions to permanent endowments	29,829	1										29,931
Grant to/(from) the University for capital purposes	15,375	(11,500)	(347)		(3,491)			(18)	(19)			-
Other, net	(12,347)	501			(35)					(50)	1,861	(10,070)
Total other revenues	45,136	409	(347)	-	(3,526)	-	-	83	(19)	(50)	1,711	43,397
INCREASE (DECREASE) IN NET ASSETS	171,050	2,001	1,648	1,184	(57)	210	226	1,616	(87)	274	(2,516)	175,549
NET ASSETS, beginning of year	1,972,306	15,337	11,826	11,703	15,806	1,361	1,930	14,376	127	201	57,129	2,102,102
NET ASSETS, end of year	\$ 2,143,356	\$ 17,338	\$ 13,474	\$ 12,887	\$ 15,749	\$ 1,571	\$ 2,156	\$ 15,992	\$ 40	\$ 475	\$ 54,613	\$ 2,277,651

University of Kentucky
Governing Board and Administrative Staff as of June 30, 2007

Officers of the Board

James F. Hardymon, Chair
JoEtta Y. Wickliffe, Vice Chair
Pamela R. May, Secretary

Board of Trustees

Mira S. Ball
Stephen P. Branscum
Jonah K. Brown
Penelope A. Brown
Dermontti F. Dawson
Jeffrey B. Dembo
Ann Brand Haney
Billy Joe Miles
Sandy Bugie Patterson
Phillip R. Patton
Erwin Roberts
C. Frank Shoop
Myra Leigh Tobin
Billy B. Wilcoxson
Russ Williams
Ernest J. Yanarella
Barbara S. Young

Administrative Executive Officers

Lee T. Todd Jr., President
Kumble R. Subbaswamy, Provost
Frank Butler, Executive Vice President for
Finance and Administration
Michael Karpf, Executive Vice President for
Health Affairs
Terry Mobley, Vice President for Institutional
Advancement
Connie A. Ray, Vice President for
Institutional Research, Planning, and
Effectiveness
Douglas A. Boyd, Chief of Staff
Barbara W. Jones, General Counsel
Mitchell S. Barnhart, Director of Athletics
Jaime Nebbitt, Interim Chair, Commission on
Diversity
Dorothy Y. Brockopp, Chair, Commission on
Women
Kaveh Tagavi, Chair, University Senate
Council
Kyle Dippery, Chair, Staff Senate
Henry Clay Owen, Treasurer
Marc A. Mathews, Controller

Academic Officers

M. Scott Smith, Dean
College of Agriculture
Steven L. Hoch, Dean
College of Arts and Sciences
Devanathan Sudharshan, Dean
College of Business and Economics
J. David Johnson, Dean
College of Communications
Sharon P. Turner, Dean
College of Dentistry
David Biagi, Acting Dean
College of Design
James G. Cibulka, Dean
College of Education
Thomas W. Lester, Dean
College of Engineering
Robert Shay, Dean
College of Fine Arts
Jeannine Blackwell, Dean
Graduate School
Lori Gonzalez, Dean
College of Health Sciences
Allan W. Vestal, Dean
College of Law
Carol Diedrichs, Dean
Libraries
Jay A. Perman, Dean
College of Medicine
Jane M. Kirschling, Dean
College of Nursing
Kenneth B. Roberts, Dean
College of Pharmacy
Stephen Wyatt, Dean
College of Public Health
Kay S. Hoffman, Dean
College of Social Work
Heidi M. Anderson, Associate Provost for
Faculty Affairs
Philipp J. Kraemer, Associate Provost for
Undergraduate Education
C. William Balke, Associate Provost for
Clinical and Translational Science
John Yopp, Associate Provost for
Educational Partnerships
Karen T. Combs, Vice Provost for Budget
and Administrative Services



UNIVERSITY OF KENTUCKY

www.uky.edu

The University of Kentucky is committed to a policy of providing opportunities to people regardless of economic or social status and will not discriminate on the basis of race, color, ethnic origin, national origin, creed, religion, political belief, sex, sexual orientation, marital status, age, veteran status, or physical or mental disability.

The University of Kentucky is an equal opportunity university.
Questions concerning compliance with regulations may be directed to the Equal Opportunity Office, 13 Main Building, University of Kentucky, Lexington, KY 40506-0033,
(859) 257-8927 or at <http://www.uky.edu/evpfa/eoo>.

**University of Kentucky
Albert B. Chandler Medical Center
University Hospital
Consolidated Financial Statements**

CONTENTS	PAGE
Independent Auditors' Report	1
Management's Discussion and Analysis	2
Consolidated Financial Statements	
Statements of Net Assets	12
Statements of Revenues, Expenses and Changes in Net Assets	13
Statements of Cash Flows	14
Notes to Financial Statements	15

INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of the
University of Kentucky

We have audited the accompanying consolidated statements of net assets of the University of Kentucky Albert B. Chandler Medical Center University Hospital (an organizational and component unit of the University of Kentucky) and subsidiary (the "Hospital") as of June 30, 2007 and 2006, and the related consolidated statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the respective financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The financial statements of the Hospital are intended to present the financial position, and the changes in net assets and cash flows, of only that portion of the activities of the University of Kentucky that are attributable to the transactions of the Hospital. They do not purport to, and do not, present fairly the financial position of the University of Kentucky and affiliated corporations as of June 30, 2007 and 2006, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Hospital and its subsidiary as of June 30, 2007 and 2006, and the changes in their net assets and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis ("MD&A") on pages 2 through 11 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Hospital's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Deloitte & Touche LLP

October 19, 2007

Management's Discussion and Analysis

The following Management's Discussion and Analysis, or MD&A, provides an overview of the financial position and activities of the University of Kentucky Albert B. Chandler Medical Center University Hospital (the Hospital) and its wholly-owned for-profit subsidiary for the years ended June 30, 2007 and 2006. Management has prepared this discussion, and we encourage you to read it in conjunction with the consolidated financial statements and the notes appearing in this report.

About the University Hospital

The UK Chandler Medical Center, which opened in 1960, is considered one of the nation's finest academic medical centers. The faculty, students and staff take pride in achieving excellence in education, patient care, research and community service. As one of two Level 1 Trauma Centers in the state and the first health-care facility in central and eastern Kentucky to obtain distinction as a Primary Stroke Center, UK Hospital cares for the most critically injured and ill patients in the region. The 473-bed UK Hospital and Kentucky Children's Hospital are supported by more than 500 faculty physicians and dentists, 400 resident physicians, and a staff of 3,700 health professionals committed to high-quality patient care.

The Hospital's mission is to help the people of the Commonwealth and beyond gain and retain good health through creative leadership and quality initiatives in patient care, education and research. The Hospital serves patients primarily from central and eastern Kentucky and offers a full spectrum of routine and specialty services appropriate for a major regional quaternary care center.

Financial Highlights

The Hospital's overall financial position remains strong with assets of \$802.3 million and liabilities of \$229.5 million. Net assets, which represent the Hospital's residual interest in assets after liabilities are deducted, were \$572.8 million or 71.4 percent of total assets. For the fiscal year ended June 30, 2007, the Hospital reported net income before other changes in net assets of \$56.5 million, generating a margin of 9.7 percent.

- Financial results for fiscal year 2007 significantly exceeded revenue expectations with net inpatient revenue increasing approximately \$40.3 million or 11.4 percent over the prior fiscal year and net outpatient revenues increasing \$17.0 million or 10.4 percent over the previous fiscal year. This net patient service revenue is primarily the result of increases in patient activity and rate increases in selected services.
- Total assets increased \$115.0 million or 16.7 percent. This increase is primarily due to the increase in capital assets, net, of \$96.0 million.
- Total liabilities increased \$67.8 million or 42.0 percent, primarily due to an increase of \$59.9 million in capital leases.
- Total net assets increased \$47.2 million or 9.0 percent, primarily due to current year net income.
- Operating revenues increased \$59.2 million or 11.3 percent.
- Operating expenses increased \$72.6 million or 14.8 percent due primarily to increases in personnel costs and supplies due to increased patient activity and increases in outside purchased services.
- Nonoperating revenues decreased \$10.1 million due primarily to a decrease in income from the sale of CHA in 2006, offset by an increase in current year investment income.
- During the year, the Hospital invested an additional \$50 million of available cash in the University of Kentucky pooled endowment fund. It is intended that this cash will remain invested for the foreseeable future and that it will generate a superior return on investment in excess of overnight investment rates. As of June 30, 2007, the total principal invested in the University of Kentucky pooled endowment fund was \$200 million.

Operating Statistics

The following table presents utilization statistics for the Hospital for fiscal years ended 2007, 2006 and 2005:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Discharges:			
Medicare	7,093	6,225	5,574
Medicaid	7,828	7,005	6,544
Commercial/Blue Cross	9,074	8,827	7,933
Patient/charity	3,297	2,703	2,218
Total discharges	<u>27,292</u>	<u>24,760</u>	<u>22,269</u>
Average daily census	406	369	336
Average length of stay	5.43	5.43	5.51
Patient Days:			
Medicare	42,536	37,998	32,871
Medicaid	43,222	41,012	41,084
Commercial/Blue Cross	45,705	41,710	36,099
Patient/charity	16,826	13,800	12,650
Total patient days	<u>148,289</u>	<u>134,520</u>	<u>122,704</u>
Outpatient visits:			
Hospital clinics	290,910	275,608	266,245
Emergency visits	45,655	44,646	42,909
Total visits	<u>336,565</u>	<u>320,254</u>	<u>309,154</u>

Total discharges increased by 2,532 or 10.2 percent compared to the prior fiscal year.

Total patient days increased by 13,769 or 10.2 percent. The case mix index decreased to 1.6677 from 1.7119 and the average length of stay remained constant at 5.43.

Total outpatient visits increased by 16,311 or 5.1 percent over the prior year.

Using the Consolidated Financial Statements

The Hospital presents its financial reports in a “business type activity” format, in accordance with Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments* and GASB Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities – an amendment of GASB Statement No. 34*. In addition to this MD&A section, the financial report includes a Statement of Net Assets, a Statement of Revenues, Expenses and Changes in Net Assets, a Statement of Cash Flows, and Notes to the Financial Statements. GASB requires that statements be presented on a consolidated basis to focus on the Hospital as a whole.

Reporting Entity

The University of Kentucky Albert B. Chandler Medical Center University Hospital is an organizational unit of the University of Kentucky (the University). The consolidated financial statements include Kentucky Healthcare Enterprise, Inc. (KHE), a wholly-owned for-profit subsidiary (collectively, the Hospital).

The Hospital provides inpatient, outpatient and emergency care services for residents of the Commonwealth of Kentucky.

Consolidated Statement of Net Assets

The Consolidated Statement of Net Assets is the Hospital's balance sheet. It reflects the total assets, liabilities and net assets (equity) of the Hospital as of June 30, 2007, with comparative information as of June 30, 2006. Liabilities due within one year, and assets available to pay those liabilities, are classified as current. Other assets and liabilities are classified as non-current. Net assets, the difference between total assets and total liabilities, are an important indicator of the Hospital's current financial condition, while the change in net assets is an indicator of whether the overall financial position has improved or worsened during the year. Generally, assets and liabilities are reported using current values. A major exception is capital assets, which are stated at historical cost, less accumulated depreciation. A summarized comparison of the Hospital's assets, liabilities and net assets at June 30, 2007, 2006 and 2005 is as follows:

Condensed Consolidated Statements of Net Assets (in thousands)

ASSETS	2007	2006	2005
Current assets	\$ 238,677	\$ 260,494	\$ 322,867
Capital assets, net of depreciation	252,440	156,412	133,279
Other noncurrent assets	311,146	270,336	53,183
Total assets	<u>802,263</u>	<u>687,242</u>	<u>509,329</u>
 LIABILITIES			
Current liabilities	51,032	39,136	42,165
Noncurrent liabilities	178,441	122,522	10,487
Total liabilities	<u>229,473</u>	<u>161,658</u>	<u>52,652</u>
 NET ASSETS			
Invested in capital assets, net of related debt	128,207	131,137	130,986
Restricted nonexpendable	14	-	-
Restricted expendable	8,412	2,855	687
Unrestricted	436,157	391,592	325,004
Total net assets	<u>\$ 572,790</u>	<u>\$ 525,584</u>	<u>\$ 456,677</u>

Assets. As of June 30, 2007, the Hospital's total assets amounted to approximately \$802.3 million. Capital assets, net of depreciation, totaling \$252.4 million or 31.5 percent represented the Hospital's largest asset. Long-term investments totaling \$227.2 million or 28.3 percent of total assets were the Hospital's next largest asset. Cash and cash equivalents totaling \$196.9 million or 24.5 percent of total assets represent another significant asset of the Hospital. The Hospital had accounts receivable, primarily patient-related, totaling \$67.7 million or 8.4 percent of total assets at year end.

Total assets increased by \$115.0 million during the year ended June 30, 2007. This increase was driven by an increase in capital assets, net, of \$96.0 million, primarily due to the construction of a new patient care facility and the acquisition of land and buildings related to the purchase of Good Samaritan hospital.

Liabilities. At June 30, 2007, the Hospital's liabilities totaled approximately \$229.5 million. Long-term debt, which consists of hospital project notes, represents the largest liability of \$107.5 million or 46.9 percent of total liabilities. Capital lease obligations totaled \$63.5 million or 27.7 percent of liabilities. Accrued expenses, primarily payroll, vacation and other employee benefits, totaled \$28.8 million or 12.5 percent of liabilities. Accounts payable represent approximately \$18.7 million or 8.1 percent of liabilities.

Net Assets. Net assets at June 30, 2007 totaled approximately \$572.8 million, or 71.4 percent of total assets. Net assets invested in capital assets, net of related debt, totaled \$128.2 million or 22.4 percent of total net assets. Restricted net assets totaled approximately \$8.4 million or 1.5 percent of total net assets. Unrestricted net assets accounted for \$436.2 million or 76.2 percent of total net assets. Total net assets increased \$47.2 million or 9.0 percent.

Restricted net assets are subject to externally imposed restrictions governing their use. Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the unrestricted net assets have been internally designated for capital projects and working capital requirements.

2006 Versus 2005 During the year ended June 30, 2006:

- Total assets increased by \$177.9 million, primarily due to proceeds from the issuance of \$107.5 million in hospital project notes and increases in cash and cash equivalents as a result of operating and non-operating net income of \$68.9 million.
- Total liabilities increased \$109.0 million, primarily due to the issuance of hospital project notes of \$107.5 million.
- Total net assets increased \$68.9 million. Unrestricted net assets increased \$66.6 million due primarily to the net income of \$68.9 million mentioned above.

Consolidated Statement of Revenues, Expenses and Changes in Net Assets

The Consolidated Statement of Revenues, Expenses and Changes in Net Assets is the Hospital's income statement. It details how net assets have increased during the year ended June 30, 2007, with comparative information for the year ended June 30, 2006. This statement is prepared on the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. All items that increase or decrease net assets must appear on the Consolidated Statement of Revenues, Expenses and Changes in Net Assets as revenues, expenses, gains or losses.

Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 requires state appropriations, gifts and investment income to be classified as nonoperating revenues. The utilization of long-lived capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

A summarized comparison of the Hospital's revenues, expenses and changes in net assets for the years ended June 30, 2007, 2006 and 2005 is as follows:

**Condensed Consolidated Statements of Revenues, Expenses and Changes
in Net Assets (in thousands)**

	<u>2007</u>	<u>2006</u>	<u>2005</u>
OPERATING REVENUES			
Net patient service revenues	\$ 573,536	\$ 516,289	\$ 439,027
Sales and services	7,303	5,375	2,908
Total operating revenues	<u>580,839</u>	<u>521,664</u>	<u>441,935</u>
OPERATING EXPENSES			
Salaries and wages	167,078	150,247	126,685
Fringe benefits	42,965	39,236	32,898
Supplies	128,356	105,832	85,194
Purchased services	107,916	80,908	66,178
Other expenses	50,952	44,019	35,208
Provision for uncollectible accounts	44,773	51,638	39,380
Provision for depreciation and amortization	21,692	19,210	19,234
Total operating expenses	<u>563,732</u>	<u>491,090</u>	<u>404,777</u>
OPERATING INCOME-continuing operations	17,107	30,574	37,158
NONOPERATING REVENUES (EXPENSES)			
State appropriations	1,053	1,053	1,053
Permanent additions to endowments	1	-	-
Gifts	1,355	1,149	1,012
Investment income	32,951	6,098	5,674
Interest expense	(131)	(117)	(85)
Gain (loss) on disposal of capital assets	(66)	344	(418)
Other	(799)	645	-
Gain on sale of investment	5,049	28,836	-
Equity in income (loss) of unconsolidated investees	-	11,524	1,266
Income before other revenues, expenses, gains or losses	<u>56,520</u>	<u>80,106</u>	<u>45,660</u>
Transfer to the University of Kentucky-noncapital	(8,558)	(10,833)	(13,347)
Transfer to the University of Kentucky-capital	(761)	(323)	(3,958)
Net income (loss) from discontinued operations	<u>5</u>	<u>(43)</u>	<u>(40)</u>
Total increase in net assets	47,206	68,907	28,315
Net assets, beginning of year	<u>525,584</u>	<u>456,677</u>	<u>428,362</u>
Net assets, end of year	<u>\$ 572,790</u>	<u>\$ 525,584</u>	<u>\$ 456,677</u>

Operating Revenues:

Total operating revenues were approximately \$580.8 million for the year ended June 30, 2007, an increase of \$59.2 million or 11.3 percent over 2006. The most significant source of operating revenue for the Hospital was net patient service revenue of \$573.5 million. Net patient revenues increased \$57.2 million or 11.1 percent in fiscal year 2007 over 2006.

The majority of the net patient service revenue increase was the result of an increase in patient activity due to growth from strategic initiatives in select product lines and an enhanced outreach network. Patient service revenues are net of estimated allowances from contractual arrangements with Medicare, Medicaid and other third-party payors and have been estimated based on the terms of reimbursement and contracts currently in effect.

The following table shows net patient revenue by funding source for fiscal years ended June 30, 2007, 2006 and 2005 (in thousands):

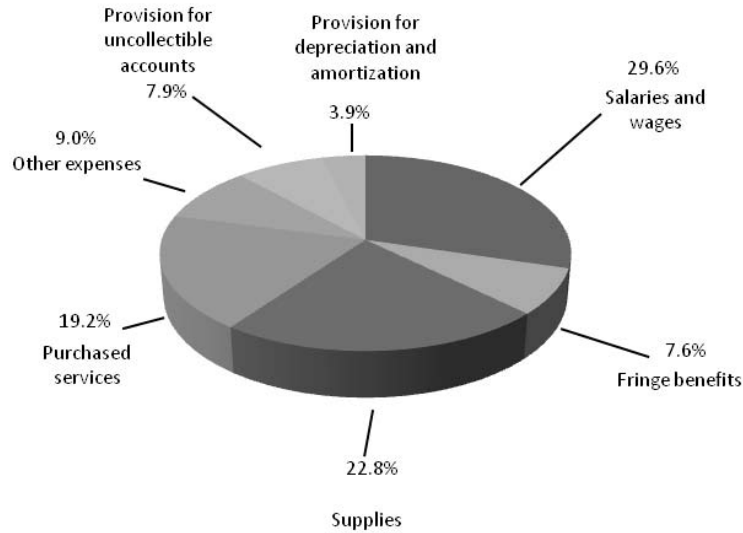
Payor	2007	2006	2005
Medicare	\$ 147,569	\$ 133,772	\$ 107,903
Medicaid	125,607	112,925	102,020
Commercial/Blue Cross	246,091	226,350	186,618
Patient/charity	54,269	43,242	42,486
Total	\$ 573,536	\$ 516,289	\$ 439,027

Net revenues for Medicare represent payments for services provided to patients under Title XVIII of the Social Security Act. Payments for inpatient services provided to Medicare beneficiaries are paid on a per-discharge basis at rates set at the national level with adjustments for prevailing area labor costs. The Hospital also receives additional payments for direct and indirect costs for graduate medical education, disproportionate share of indigent patients, capital reimbursement, and outlier payments on cases with unusually high costs of care. Hospital outpatient care is reimbursed under a prospective payment system. Medicare reimburses the Hospital for allowable costs at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. Settlements with the Medicare program for prior years' cost reports are recognized in the year the settlement is resolved.

Net revenues for Medicaid represent payments for services provided to Medicaid beneficiaries. Payments for inpatient services are paid on a per discharge basis and include Intensity Operating Allowance revenues, which are intergovernmental transfer payments available for public institutions to assure access to medical care for Medicaid participants. Outpatient services are reimbursed based upon a combination of fee schedule, per case and retrospective cost settlement basis.

Net revenues for patient/charity include reimbursement for uncompensated care by the Commonwealth of Kentucky from Disproportionate Share Hospital funds.

TOTAL OPERATING EXPENSES



Operating Expenses:

Total operating expenses, including \$21.7 million of depreciation and amortization, were \$563.7 million, an increase of \$72.6 million or 14.8 percent over the prior year.

Salaries and employee benefit expenses increased by \$20.6 million over the prior fiscal year due to increased staffing required for the increased patient activity and merit increases. The Hospital added 140 full-time equivalent employees, which added an additional \$10.3 million in wages and \$2.0 million in benefits.

Supplies expenses increased by \$22.5 million or 21.3 percent mainly due to increases in overall patient activity and higher costs.

Purchased services increased \$27.0 million or 33.4 percent from fiscal year 2006. The Hospital purchased services from various departments in the College of Medicine, including resident costs, totaling \$76.9 million or an increase of \$17.1 million from the prior fiscal year.

Other expenses rose by \$6.9 million or 15.8 percent in fiscal year 2007. Maintenance and repair of buildings accounted for the largest dollar increase of \$3.7 million while advertising constituted another \$1.4 million. Other factors contributing to the increase were increased building rental for relocated support units, increased collection costs and organ procurement costs.

The provision for uncollectible accounts decreased by \$6.9 million or 13.3 percent primarily due to improved self-pay collection efforts and a new financial assistance policy for outpatient cases.

Nonoperating Revenues (Expenses):

Total nonoperating revenues (expenses) were \$39.4 million for fiscal year 2007 compared to \$49.5 million for the prior fiscal year. This decrease is primarily due to the fact that 2006 contained a gain on the sale of CHA for \$28.8 million compared to the \$5.0 million in 2007 and the income of unconsolidated investee (CHA) of \$11.5 million in 2006. These revenues were somewhat replaced by an increase in investment income of \$26.9 million.

2006 Versus 2005 Total operating revenues were \$521.7 million for the year ended June 30, 2006, an increase of \$79.7 million over 2005. Essentially all of the increase in operating revenues was due to increased patient activity.

Operating expenses totaled \$491.0 million, an increase of \$86.3 million over 2005. The increase was primarily caused by higher costs for personnel, purchased services and medical supplies.

Nonoperating revenues, net of expenses, amounted to \$49.5 million. The increase of \$41.0 million over the previous year was primarily due to the gain on the sale of CHA of \$28.8 million and an increase in the equity in income of unconsolidated investees of \$10.3 million.

Consolidated Statement of Cash Flows

The Consolidated Statement of Cash Flows details how cash has increased (or decreased) during the year ended June 30, 2007, with comparative financial information for the year ended June 30, 2006. It breaks out the sources and uses of cash into the following categories:

- Operating activities
- Noncapital financing activities
- Capital and related financing activities
- Investing activities

Cash flows associated with the Hospital's expendable net assets appear in the operating and noncapital financing categories. Capital financing activities include payments for capital assets, proceeds from long-term debt and debt repayments. Purchases and sales of investments are reflected in investing activities.

The primary purpose of the Consolidated Statement of Cash Flows is to provide information about the cash receipts and cash payments made by the Hospital during the year that will allow financial statement readers to assess the Hospital's:

- Ability to generate future net cash flows,
- Ability to meet obligations as they become due, and
- The possible need for external financing.

A comparative summary of the Hospital's Statement of Cash Flows for the years ended June 30, 2007, 2006 and 2005 is as follows:

Condensed Consolidated Statements of Cash Flows (in thousands)

Cash provided (used) by:	<u>2007</u>	<u>2006</u>	<u>2005</u>
Operating activities	\$ 27,425	\$ 41,446	\$ 60,104
Noncapital financing activities	(7,481)	(16,885)	(10,909)
Capital and related financing activities	(75,957)	60,011	(20,312)
Investing activities	<u>(29,790)</u>	<u>(72,423)</u>	<u>6,260</u>
Net increase (decrease) in cash and cash equivalents	(85,803)	12,149	35,143
Cash and cash equivalents, beginning of year	<u>282,703</u>	<u>270,554</u>	<u>235,411</u>
Cash and cash equivalents, end of year	<u><u>\$ 196,900</u></u>	<u><u>\$ 282,703</u></u>	<u><u>\$ 270,554</u></u>

The major source of cash included in operating activities is patient service revenues of \$516.9 million. The largest cash payments for operating activities were \$285.2 million to suppliers and \$208.9 million to employees for salaries, wages and fringe benefits.

Cash used by noncapital financing activities consists primarily of transfers to the University for noncapital purposes.

The major source of cash from capital and related financing activities relates to proceeds from capital debt of \$12.5 million. The largest use of cash is due to the purchase of capital assets of \$68.4 million.

Investing activities include proceeds from sales and maturities of investments of \$381.8 million and interest and dividends of \$19.8 million. Cash of \$431.4 million was used to purchase investments.

2006 Versus 2005 Cash balances improved when comparing fiscal 2006 versus fiscal 2005 with a net increase in cash of approximately \$12.1 million. The major source of cash was patient service revenues in excess of operating expenses.

Key Ratios

The following table shows key liquidity and capital ratios for fiscal years 2007, 2006 and 2005:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Days cash on hand	102	153	251
Days of revenue in accounts receivable	37	37	42
Debt service coverage (times)	11.0	16.2	14.0

Days cash on hand decreased to 102 days in fiscal year 2007 from 153 days in fiscal year 2006 due to the transfer of cash to the University endowment pool reflected in the increase in long-term investments. Days cash on hand measures the average number of days' expenses the Hospital maintains in cash.

The days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable. Fiscal year 2007 days in accounts receivable stayed the same as 2006.

Debt service coverage ratio measures the amount of funds available to cover the principal and interest on long-term debt. The Hospital's ratio for fiscal year 2007 is 11.0 versus 16.2 in fiscal year 2006.

Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation, totaled approximately \$252.4 million at June 30, 2007, a net increase of \$96.0 million over the prior year end. Significant changes in capital assets during fiscal 2006-2007 included (in millions):

• Land, buildings and structures, net additions	\$46.0
• Equipment and vehicles, net additions	\$14.9
• Capitalized software additions	\$ 2.4
• Construction in process, net additions	\$50.4
• Increase in accumulated depreciation, net	(\$17.7)

Debt

At year-end, the Hospital had \$107.5 million in hospital project notes outstanding. On October 5, 2006, the University sold \$77,905,000 of University of Kentucky General Receipts Project Notes, 2007 Series A, at a net interest cost of 4.55%. These bonds were sold with a forward delivery date of November 1, 2007.

Economic Factors Impacting Future Periods

The following are known facts and circumstances that will affect future financial results:

- On July 1, 2007, the University purchased Good Samaritan Hospital, a 336 bed community hospital located in Lexington, Kentucky. The purchase price was approximately \$13.0 million. This acquisition greatly expands the patient care opportunities available for the Hospital to serve the Commonwealth.
- Net operating revenue for FY 2007-08 is budgeted to increase approximately 21.8 percent or \$126.5 million due to the addition of Good Samaritan Hospital, a 4.5 percent rate increase effective July 1, 2007 and a 5.4 percent projected increase in discharges due to growth and 10.7 percent increase from existing volume at Good Samaritan. Growth includes the impact of strategic initiatives in Cardiology, Hematology/Oncology, Orthopedics, Neurosurgery, Digestive Health and Pediatrics.
- State appropriations continue to remain constant at \$1.1 million.
- The first phase of construction for the new hospital is underway. The new parking garage is on time and within budget and is scheduled to open in November 2007. Ground was broken on the new one million square foot UK Chandler Hospital, which will be the cornerstone for a new 20-year, \$2.5 billion plan on the south side of campus to construct an academic medical campus of the future that will further accelerate growth in research and health education.
- The University does not record a liability for post-employment retiree health benefits. Governmental Accounting Standards require that this liability be recognized in the financial statements beginning June 30, 2008. The impact of implementing this change from a cash basis to an accrual basis for recognizing the cost of post employment retiree health benefits will increase the University's annual expense associated with providing this benefit from \$6.4 million to \$13.6 million per year beginning in fiscal 2008. The Hospital will recognize its proportionate share of this increase.

UNIVERSITY OF KENTUCKY
ALBERT B. CHANDLER MEDICAL CENTER
UNIVERSITY HOSPITAL
CONSOLIDATED STATEMENTS OF NET ASSETS (in thousands)
JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 151,795	\$ 195,078
Accounts receivable (less allowance for doubtful accounts of \$18,416 and \$13,901)	67,673	52,065
Inventories and other	12,747	10,279
Accrued interest receivable	352	95
Estimated third-party payor settlements receivable	4,028	1,603
Notes receivable	2,082	1,374
Total current assets	<u>238,677</u>	<u>260,494</u>
Noncurrent Assets		
Restricted cash and cash equivalents	45,105	87,625
Long-term investments	227,172	156,901
Capital assets, net	252,440	156,412
Other assets	38,869	25,810
Total noncurrent assets	<u>563,586</u>	<u>426,748</u>
Total assets	<u>802,263</u>	<u>687,242</u>
LIABILITIES		
Current Liabilities		
Accounts payable	18,684	15,920
Accrued expenses	21,757	16,647
Deferred revenue	5,271	5,685
Capital lease obligations - current portion	5,320	884
Total current liabilities	<u>51,032</u>	<u>39,136</u>
Noncurrent Liabilities		
Accrued expenses	7,035	6,880
Deferred revenue and other	5,701	5,399
Long-term debt	107,540	107,540
Capital lease obligations	58,165	2,703
Total noncurrent liabilities	<u>178,441</u>	<u>122,522</u>
Total liabilities	<u>229,473</u>	<u>161,658</u>
NET ASSETS		
Invested in capital assets, net of related debt	<u>128,207</u>	<u>131,137</u>
Restricted		
Nonexpendable other	<u>14</u>	<u>-</u>
Expendable		
Debt service	110	-
Capital projects	6,193	1,857
Other	2,109	998
Total restricted expendable	<u>8,412</u>	<u>2,855</u>
Total restricted	<u>8,426</u>	<u>2,855</u>
Unrestricted		
	<u>436,157</u>	<u>391,592</u>
Total net assets	<u>\$ 572,790</u>	<u>\$ 525,584</u>

See notes to consolidated financial statements.

**UNIVERSITY OF KENTUCKY
ALBERT B. CHANDLER MEDICAL CENTER
UNIVERSITY HOSPITAL
CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (in thousands)
FOR THE YEARS ENDED JUNE 30, 2007 AND 2006**

	<u>2007</u>	<u>2006</u>
OPERATING REVENUES		
Net patient service revenues	\$ 573,536	\$ 516,289
Sales and services	<u>7,303</u>	<u>5,375</u>
Total operating revenues	<u>580,839</u>	<u>521,664</u>
OPERATING EXPENSES		
Salaries and wages	167,078	150,247
Fringe benefits	42,965	39,236
Supplies	128,356	105,832
Purchased services	107,916	80,908
Other expenses	50,952	44,019
Provision for uncollectible accounts	44,773	51,638
Provision for depreciation and amortization	<u>21,692</u>	<u>19,210</u>
Total operating expenses	<u>563,732</u>	<u>491,090</u>
Net income from continuing operations	<u>17,107</u>	<u>30,574</u>
NONOPERATING REVENUES (EXPENSES)		
State appropriations	1,053	1,053
Permanent additions to endowments	1	-
Gifts	1,355	1,149
Investment income	32,951	6,098
Interest expense	(131)	(117)
Gain (loss) on disposal of capital assets	(66)	344
Other	(799)	645
Gain on sale of investments	5,049	28,836
Equity in income (loss) of unconsolidated investees	<u>-</u>	<u>11,524</u>
Net nonoperating revenues (expenses)	<u>39,413</u>	<u>49,532</u>
Net income before other revenues, expenses, gains or losses	<u>56,520</u>	<u>80,106</u>
Transfers (to) from the University of Kentucky for noncapital purposes	(8,558)	(10,833)
Transfers (to) from the University of Kentucky for capital purposes	<u>(761)</u>	<u>(323)</u>
Total other revenues (expenses)	<u>(9,319)</u>	<u>(11,156)</u>
Income (loss) from discontinued operations	<u>5</u>	<u>(43)</u>
INCREASE IN NET ASSETS	<u>47,206</u>	<u>68,907</u>
NET ASSETS, beginning of year	<u>525,584</u>	<u>456,677</u>
NET ASSETS, end of year	<u>\$ 572,790</u>	<u>\$ 525,584</u>

See notes to consolidated financial statements.

**UNIVERSITY OF KENTUCKY
ALBERT B. CHANDLER MEDICAL CENTER
UNIVERSITY HOSPITAL
CONSOLIDATED STATEMENTS OF CASH FLOWS (in thousands)
FOR THE YEARS ENDED JUNE 30, 2007 AND 2006**

	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net patient service revenues	\$ 516,925	\$ 453,113
Sales and services	7,539	6,515
Payments to vendors and contractors	(285,244)	(224,445)
Salaries, wages and fringe benefits	(208,912)	(193,426)
Other receipts (payments)	(2,883)	(311)
Net cash provided (used) by operating activities	<u>27,425</u>	<u>41,446</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	1,053	1,053
Gifts	1,282	1,149
Additions to permanent endowments	1	-
Loan to University of Kentucky departmental units	(2,484)	(9,479)
Payments on loans to University of Kentucky departmental units	1,225	1,225
Transfers to (from) the University of Kentucky for noncapital purposes	(8,558)	(10,833)
Net cash provided (used) by noncapital financing activities	<u>(7,481)</u>	<u>(16,885)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of capital assets	127	566
Purchases of capital assets	(68,379)	(37,363)
Payments for deposits	(18,085)	-
Principal payments-capital leases and long-term obligations	(1,358)	(2,292)
Interest payments-capital leases and long-term obligations	(4,939)	(1,871)
Proceeds from capital debt	12,500	109,722
Proceeds from sales and maturities of investments - funds on deposit with trustee	6,976	13,053
Purchase of investments - funds on deposit with trustee	(2,447)	(20,033)
Payments to bond agents - cost of issuance	(68)	(1,013)
Transfers (to) from the University of Kentucky for capital purposes	(284)	(758)
Net cash provided (used) by capital and related financing activities	<u>(75,957)</u>	<u>60,011</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	381,848	79,488
Other income	-	683
Purchase of investments	(431,442)	(189,147)
Interest and dividends on investments	19,804	36,553
Net cash provided (used) by investing activities	<u>(29,790)</u>	<u>(72,423)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>(85,803)</u>	<u>12,149</u>
CASH AND CASH EQUIVALENTS, beginning of year	<u>282,703</u>	<u>270,554</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 196,900</u>	<u>\$ 282,703</u>
Reconciliation of net income from continuing operations to net cash provided (used) by operating activities:		
Operating income - continuing operations	\$ 17,107	\$ 30,574
Income (loss) from discontinued operations	5	(43)
Adjustments to reconcile net income from continuing operations to net cash provided (used) by operating activities:		
Depreciation and amortization	21,692	19,210
Write off of principal - note receivable	198	152
Uncollectible accounts	44,773	51,638
Change in assets and liabilities:		
Accounts receivable	(52,981)	(53,474)
Inventories and other	(2,399)	(3,064)
Estimated third-party payor settlements receivable	(2,425)	(1,603)
Other assets	(2,883)	(298)
Accounts payable and accrued expenses	5,908	(687)
Estimated third-party payor settlements payable	-	(2,399)
Deferred revenue	(1,570)	1,440
Net cash provided (used) by operating activities	<u>\$ 27,425</u>	<u>\$ 41,446</u>

See notes to consolidated financial statements.

**UNIVERSITY OF KENTUCKY
ALBERT B. CHANDLER MEDICAL CENTER
UNIVERSITY HOSPITAL**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The University of Kentucky Albert B. Chandler Medical Center University Hospital is an organizational unit of the University of Kentucky (the University). The consolidated financial statements include Kentucky Healthcare Enterprise, Inc. (KHE), a wholly owned for-profit subsidiary (collectively, the Hospital). All significant balances and transactions between University Hospital and its subsidiary have been eliminated.

The University Hospital provides inpatient, outpatient and emergency care services for residents of the Commonwealth of Kentucky.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). GASB establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net assets categories:

- Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted:
 - Nonexpendable* – Net assets subject to externally imposed stipulations that they be maintained permanently by the Hospital.
 - Expendable* – Net assets whose use by the Hospital is subject to externally imposed stipulations that can be fulfilled by actions of the Hospital pursuant to those stipulations or that expire by the passage of time.
- Unrestricted: Net assets whose use by the Hospital is not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation is intended to provide a comprehensive, entity-wide perspective of the Hospital's assets, liabilities, net assets, revenues, expenses, changes in net assets and cash flows.

Summary of Significant Accounting Policies

Accrual Basis. The consolidated financial statements have been prepared on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when an obligation has been incurred. The Hospital reports as a Business Type Activity (BTA) as defined by GASB Statement No. 35. BTA's are those activities that are financed in whole or part by fees charged to external parties for goods and services.

Cash and Cash Equivalents. The Hospital considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Noncurrent cash and cash equivalents include the Hospital's plant funds allocated for capital projects, with the exception of unrestricted renewal and replacement cash, which is included in current cash and cash equivalents, and endowment fund cash pending transfer to the custodian for investment. Cash and cash equivalents held by the University's endowment fund managers are included in endowment investments.

Pooled Endowment Funds. The Hospital's endowment investments are administered as part of the University's pooled endowment funds. The University employs the total return concept of investment management for setting investment objectives and determining investment performance. This concept recognizes dividends and interest, plus or minus realized and unrealized gains or losses, in determining the total return earned during any particular period. The market value method of accounting for pooled endowment funds is employed to ensure proper distribution of market price changes, realized gains (losses) on sales, accrued income earned, and distribution of investment earnings for expenditure by participating funds.

The Uniform Management of Institutional Funds Act (UMIFA), as adopted by the Commonwealth of Kentucky, permits the University to appropriate an amount of the realized and unrealized endowment appreciation to support current programs. Accordingly, spendable return from the endowment is determined using the total return philosophy. This philosophy recognizes a prudent amount of realized and unrealized gains as spendable return in addition to traditional yield. Distribution of investment earnings for expenditure by participating funds is supported first by traditional yield earned and, if necessary, a transfer from the endowment of any prior years' accumulated earnings (unexpended traditional yield) or net realized or unrealized gains. In fiscal years 2006-07 and 2005-06, the University's endowment spending rule provided for annual distributions of 4.50 percent and 4.75 percent, respectively, of the three-year moving average market value of fund units. For the years ended June 30, 2007 and 2006, approximately \$5.9 million and \$1.1 million, respectively, were transferred from endowment realized and unrealized gains to support current programs in accordance with the University's endowment spending rule. Appreciation on endowments available to support future spending rule distributions amounted to approximately \$15.9 million at June 30, 2007.

The Investment Committee of the University's Board of Trustees has approved a spending rate distribution for future fiscal years of 4.50 percent of the three-year moving average market value of fund units. Additionally, the University assesses eligible endowment accounts with a management fee to support fundraising and endowment administration. The management fee was .50 percent and .75 percent, respectively, of total asset value during the years ended June 30, 2007 and 2006. The Investment Committee has approved a management fee of .50 percent of total asset value for future fiscal years.

Inventories. Inventories are stated principally at the lower of cost or market.

Capital Assets. Capital assets are stated at cost at date of acquisition or, in the case of gifts, at fair market value at date of gift. Equipment with a unit cost of \$2,000 or more (\$1,000 for computers) and having an estimated useful life of greater than one year is capitalized. Renovations to buildings, infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred. Interest costs incurred during construction are capitalized.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the respective assets, generally 40 years for buildings, 10 – 25 years for land improvements, building improvements and infrastructure, and 5 – 20 years for equipment.

Title to all capital assets of the Hospital belongs to the University. The financial information relating to capital assets represents assets that the Hospital occupies and uses. Transfer of capital assets to/from the University represents changes in control of individual assets within divisions of the University from one period to another.

Deferred Revenue. Deferred revenue consists of amounts received from the federal government through the Commonwealth of Kentucky for Disproportionate Share Hospital (DSH) funds and other unearned amounts. The DSH amounts are recognized as revenue over the term of the federal government fiscal year, October 1 – September 30.

Net Patient Service Revenues. Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including contractual allowances and estimated retroactive adjustments under reimbursement programs with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

The Hospital provides services for patients under third-party reimbursement programs, principally Medicare and Medicaid. These payors generally reimburse the Hospital at amounts different from the Hospital's established rates. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits by the fiscal intermediary.

Revenue from the Medicare and Medicaid programs accounted for approximately 25 percent and 22 percent, respectively, of the Hospital's net patient service revenues for the year ended June 30, 2007 and approximately 26 percent and 22 percent, respectively for the year ended June 30, 2006. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Charity Care. The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Since the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Income Taxes. The University, of which the Hospital is an organizational unit, is an agency and instrumentality of the Commonwealth of Kentucky, pursuant to Kentucky Revised Statutes sections 164.100 through 164.280. Accordingly, the University is excluded from federal Income taxes as an organization described in Section 115 of the Internal Revenue Code of 1986.

Restricted Asset Spending Policy. The Hospital's policy is that restrictions on assets cannot be fulfilled by the expenditure of unrestricted funds for similar purposes. The determination on whether restricted or unrestricted funds are expended for a particular purpose is made on a case-by-case basis. Restricted funds remain restricted until spent for the intended purpose.

Operating Activities. The Hospital defines operating activities, as reported on the Consolidated Statement of Revenues, Expenses and Changes in Net Assets, as those that generally result from exchange transactions, such as payments received for providing goods and services and payments made for goods and services received. Nearly all of the Hospital's revenues and expenses are from exchange transactions. Certain revenues relied upon for operations, such as state appropriations, gifts and investment income, are recorded as non-operating revenues, in accordance with GASB Statement No. 35.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. The accompanying financial statements include estimates for items such as contractual allowances, allowances for doubtful accounts, estimated third-party payor settlements and estimated medical claims payable.

Transactions with the University of Kentucky. Because of the nature of the relationship of the Hospital with the University, the Hospital has substantial transactions with the University, including purchases of various supplies and services. Additionally, the University and its affiliates provide certain administrative support functions to the Hospital. During 2007 and 2006, the Hospital paid approximately \$4.7 million and \$5.8 million, respectively, to the University as reimbursement for various educational and support functions. The Hospital also received income from the University for providing medical services to employees under a capitation health plan. During 2007 and 2006, the Hospital received payments of approximately \$27.9 million and \$25.5 million respectively.

2. DEPOSITS AND INVESTMENTS

The fair value of deposits and investments, by type, at June 30, 2007 and 2006 is as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Cash on deposit with the Commonwealth of Kentucky	\$ 196,900	\$ 282,703
United States government securities	10,011	9,912
Investment in University of Kentucky pooled endowment funds	217,161	146,989
	<u>\$ 424,072</u>	<u>\$ 439,604</u>
	<u>2007</u>	<u>2006</u>
Statement of Net Assets classification		
Cash and cash equivalents	\$ 151,795	\$ 195,078
Restricted cash and cash equivalents	45,105	87,625
Long-term investments	227,172	156,901
	<u>\$ 424,072</u>	<u>\$ 439,604</u>

At June 30, 2007, the University's pooled endowment fund consists of common and preferred stock funds (8.7%), pooled equity funds (61.4%), private equity funds (0.9%), pooled real estate funds (7.9%), U.S. Treasury fixed income funds (2.0%), government agency fixed income funds (4.2%), corporate fixed income funds (3.1%), pooled fixed income funds (10.0%) and cash equivalents (1.8%).

During fiscal year 2006, the Hospital sold its approximately 84 percent ownership of CHA Service Company (CHA), a Kentucky for-profit corporation established to provide an integrated health care delivery system throughout the Commonwealth of Kentucky, at a gain of approximately \$28.8 million. The Hospital accounted for its investment in CHA by the equity method since, under the provision of CHA's by-laws, the Hospital could not exercise control over the day-to-day operations of CHA.

The Hospital also owned a 33 percent interest in Bluegrass Stone Therapy Center, Inc. (Bluegrass Stone), a tax-exempt organization, organized in 1987 as a non-stock corporation to provide outpatient lithotripsy services. During fiscal year 2006, Bluegrass Stone was dissolved thus eliminating the Hospital's investment.

A summary of the Hospital's investment in CHA and Bluegrass Stone is as follows (in thousands):

	2006		
	CHA	Bluegrass Stone	Total
Balance, June 30, 2005	\$ 30,295	\$ 1,084	\$ 31,379
Equity in net income	11,731	(207)	11,524
Distributed earnings	(25,148)	(877)	(26,025)
Sale proceeds of investment	(45,714)	-	(45,714)
Gain on sale of investment	28,836	-	28,836
Balance, June 30, 2006	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

As part of the CHA sales agreement, escrow funds were established totaling \$9.5 million to cover any potential unrecorded liabilities or overstatement of asset value and for any additional transaction costs. Monies remaining in these escrow accounts as of August 2007 were to be returned to the Hospital in proportion to its prior ownership interest in CHA. The Hospital recorded, and included in the gain above, a receivable of \$3.75 million, as of June 30, 2006, for its estimated share of these escrow funds. The actual amount distributed in August 2007 was approximately \$7.4 million, resulting in an additional gain on sale of \$3.65 million, which was recorded in income of fiscal year 2007 and a \$1.4 million adjustment to the purchase price in January 2007. The total gain recognized on this sale amounts to approximately \$33.9 million.

Deposit and investment policies. The University's Board of Trustees is responsible for establishing deposit and investment policies for the Hospital. Once established, the Board has delegated day-to-day management to the Treasurer of the University. Deposit and investment policies are developed to insure compliance with state laws and regulations as well as to establish and maintain sound financial management practices.

The Hospital follows Kentucky Revised Statutes (KRS 42.500) for the investment of public funds, which list allowable investment instruments to include: obligations of the United States or a United States government agency; obligations of any corporation of the United States Government; collateralized certificates of deposit; highly rated uncollateralized certificates of deposit, bankers acceptances and commercial paper; highly rated securities issued by a state or local government; and mutual funds comprised of any of the above allowable investments.

For purposes of investment management, the Hospital's deposits and investments can be grouped into four significant categories, as follows:

- Cash on deposit with the University of Kentucky, which the University invests in deposits and repurchase agreements with local banks and the Commonwealth of Kentucky;
- Bond revenue fund investments are held by the Treasurer of the Commonwealth of Kentucky as required by the University's general receipts trust indenture, and are invested in pooled fixed income funds managed by the Commonwealth of Kentucky;
- Short term investments managed by the University, including individual securities purchased and held by the University and short term investments in pooled fixed income funds managed by the Commonwealth of Kentucky and,
- Endowment investments in the University's pooled endowment fund.

Cash on deposit with the University and short term investments managed by the University following the University's Statement of Investment Objectives and Policies for Short-Term Current Funds Investments established by the Investment Committee of the University's Board of Trustees.

The Hospital's policy for the investment of bond revenue funds is governed by the University's General Receipts bond trust indenture.

Endowment investments are managed by the University's Endowment Investment Policy as established by the Investment Committee of the University's Board of Trustees, which governs the University's pooled endowment fund.

Deposit and investment risks. The Hospital's deposits and investments are exposed to various risks, including credit, interest rate and foreign currency risk, as discussed in more detail below:

Credit Risk. Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligation, causing the Hospital to experience a loss of principal.

As a means of limiting its exposure to losses arising from credit risk, the University's investment policies limit the exposure of its various investment types, as follows:

- Cash on deposit with the Commonwealth of Kentucky is governed by policy that minimizes credit risk in several ways. Deposits are governed by state law which requires full collateralization. Credit risk on repurchase agreements with local banks is mitigated by the issuing financial institution's pledge of specific U.S. treasury or agency securities, held in the name of the University by the Federal Reserve Bank. Credit risk on repurchase agreements with the Commonwealth of Kentucky is mitigated by the Commonwealth's requirement that providers of overnight repurchase agreements collateralize these investments at 102% of face value with U.S. treasury or agency securities, pledged in the name of the Commonwealth.
- Bond revenue funds held in the Commonwealth's investment pools can be invested in U.S. treasuries and agencies; commercial paper or asset backed securities rated in the highest category by a nationally recognized rating agency; certificates of deposit, bankers acceptances, state or local government securities and corporate, Yankee and Eurodollar securities rated in one of the three highest categories by a nationally recognized rating agency; shares of mutual funds (up to 10%); and state and local property tax certificates of delinquency secured by interests in real estate.
- Short-term investments managed by the University are limited to direct obligations of the U.S. Treasury, other appropriate securities issued by federal agencies, repurchase agreements of U.S. government obligations, and certificates of deposit collateralized by U.S. government obligations or general obligations of the University of Kentucky. Short term investments held in the Commonwealth's investment pools are subject to the same credit quality requirements as denoted above for bond revenue fund investments.
- Endowment investments held by fixed income managers are generally limited to holdings of high quality fixed income securities. These managers may invest a portion of the portfolio in other below-investment grade bonds, non U.S. dollar denominated bonds, and emerging market bonds, provided the overall credit quality of the fixed income portfolios is not lower than A-.

Custodial Credit Risk. Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in possession of an outside party.

As a means of limiting its exposure to losses arising from custodial credit risk, the University's investment policies limit the exposure of its various investment types, as follows:

- Cash on deposit with the Commonwealth of Kentucky is invested in deposits and repurchase agreements with local banks, which are held in the University's name, and deposits and repurchase agreements with the Commonwealth of Kentucky, which are held in the Commonwealth's name.
- Bond revenue fund investments and short term investments held in the Commonwealth's investment pools are held in the Commonwealth's name by the Commonwealth's custodian.
- Short term investments managed by the University are held in the University's name by the University's custodian.
- Endowment investments are held in the University's name by the University's custodian.

Concentrations of Credit Risk. Hospital investments can be exposed to a concentration of credit risk if significant amounts are invested in any one issuer.

As a means of limiting its exposure to concentrations of credit risk, the University's investment policies limit concentrations in various investment types, as follows:

- Cash on deposit with the University is not limited as to the maximum amount that may be invested in one issuer. However, all such investments in excess of Federal Depository Insurance are required to be fully collateralized by U.S. treasury and/or U.S. agency securities or other similar investments as provided by KRS 41.240.
- Bond revenue fund and short-term investments held in the Commonwealth's investment pools are limited as follows: U.S. dollar denominated corporate and Yankee securities issued by foreign and domestic issuers shall not exceed twenty-five (25) percent of an individual pool and \$25,000,000 per issuer, inclusive of commercial paper, bankers' acceptances and certificates of deposit; and U. S. dollar denominated sovereign debt shall not exceed five (5) percent of any individual portfolio and \$25,000,000 per issuer.
- There is no specific limit on the maximum amount of short term investments managed by the University that may be invested in one issuer. However, such investments are limited to direct U.S. government obligations (U.S. Treasuries) and U.S. government agencies.
- Endowment investment managers are limited to a maximum investment in any one issuer of no more than 5 percent of total investments.

At June 30, 2007, the Hospital has no investments in any one issuer that represent 5 percent or more of total investments.

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

As a means of limiting its exposure to fair value losses arising from increasing interest rates, the University's investment policies limit the maturity of its various investment types, as follows:

- Cash on deposit with the Commonwealth of Kentucky has limited exposure to interest rate risk due to the short term nature of the investment. The University requires that all deposits and repurchase agreements be available for use on the next business day.
- Bond revenue fund and short-term investments held in the Commonwealth's short term investment pool are limited to a duration that does not exceed 90 days. Such investments in the Commonwealth's intermediate-term investment pool must maintain a modified duration of less than 3 years.
- Short term investments managed by the University are limited to a maximum maturity of 24 months.
- Endowment investments held by fixed income managers are limited to a duration that is within +/-25% of the duration of the Lehman Aggregate Bond Index.

Foreign Currency Risk. Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit.

The Hospital's exposure to foreign currency risk derives from certain limited endowment investments, including pooled fixed income funds, a pooled global equity fund, and a pooled non-U.S. equity fund. The University's endowment investment policy allows fixed-income managers to invest a portion of their funds in non-U.S. securities and equity fund managers of co-mingled portfolios to invest in accordance with the guidelines established in the individual fund's prospectus.

3. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net, as of June 30, 2007 and 2006 are as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Medicare, Medicaid, and other	\$ 57,057	\$ 50,246
Private pay and receivables	3,216	1,819
CHA escrow	<u>7,400</u>	<u>-</u>
Total accounts receivable, net	<u>\$ 67,673</u>	<u>\$ 52,065</u>

4. CAPITAL ASSETS, NET

Capital assets as of June 30, 2007 and capital asset activity for the year ended June 30, 2007 are summarized as follows (in thousands):

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
Land	\$ 7,974	\$ 11,534		\$ 19,508
Non-depreciable land improvements	40	-		40
Depreciable land improvements	3,171	-		3,171
Buildings	152,887	33,750	\$ 421	186,216
Fixed equipment	6,058	1,120	-	7,178
Infrastructure	64	-	-	64
Equipment	125,170	18,964	4,274	139,860
Vehicles	210	229	-	439
Capitalized software	13,898	2,413	-	16,311
Construction in process	18,305	50,957	524	68,738
	<u>327,777</u>	<u>118,967</u>	<u>5,219</u>	<u>441,525</u>
<u>Accumulated Depreciation:</u>				
Depreciable land improvements	2,763	155	-	2,918
Buildings	88,247	5,423	5	93,665
Fixed equipment	2,515	660	-	3,175
Infrastructure	6	3	-	9
Equipment	73,207	13,643	4,645	82,205
Vehicles	120	90	-	210
Capitalized software	4,507	2,396	-	6,903
	<u>171,365</u>	<u>22,370</u>	<u>4,650</u>	<u>189,085</u>
Net Capital Assets	<u>\$ 156,412</u>	<u>\$ 96,597</u>	<u>\$ 569</u>	<u>\$ 252,440</u>

Capital assets as of June 30, 2006 and capital asset activity for the year ended June 30, 2006 are summarized as follows (in thousands):

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Deletions</u>	<u>Ending Balance</u>
Land	\$ 3,973	\$ 4,001		\$ 7,974
Non-depreciable land improvements	7	33		40
Depreciable land improvements	3,149	22		3,171
Buildings	152,228	1,272	\$ 613	152,887
Fixed equipment	4,891	1,167	-	6,058
Infrastructure	24	40	-	64
Leasehold improvements	536	-	536	-
Equipment	115,319	18,178	8,327	125,170
Vehicles	174	36	-	210
Capitalized software	12,365	1,533	-	13,898
Construction in process	1,541	16,772	8	18,305
	<u>294,207</u>	<u>43,054</u>	<u>9,484</u>	<u>327,777</u>
<u>Accumulated Depreciation:</u>				
Depreciable land improvements	2,651	112	-	2,763
Buildings	83,407	5,128	288	88,247
Fixed equipment	2,233	282	-	2,515
Infrastructure	2	4	-	6
Leasehold improvements	258	-	258	-
Equipment	70,193	11,634	8,620	73,207
Vehicles	74	46	-	120
Capitalized software	2,110	2,397	-	4,507
	<u>160,928</u>	<u>19,603</u>	<u>9,166</u>	<u>171,365</u>
Net Capital Assets	<u>\$ 133,279</u>	<u>\$ 23,451</u>	<u>\$ 318</u>	<u>\$ 156,412</u>

At June 30, 2007 the Hospital has construction projects in process totaling approximately \$410.2 million in scope. The estimated cost to complete these projects is approximately \$342.3 million.

5. OTHER ASSETS

Other assets at June 30, 2007 and 2006 are as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Noncurrent portion of non-interesting bearing, unsecured receivable from UK Parking and Transportation, payable \$250,000 annually through 2013	\$ 1,750	\$ 2,000
Noncurrent portion of non-interesting bearing, unsecured receivable from UK Office of Associate Vice President-Research, payable \$500,000 annually through 2010	1,000	1,500
Noncurrent portion of non-interesting bearing, unsecured receivable from UK Office of Associate Vice President-Research payable \$475,000 annually through 2009	475	950
Noncurrent portion of unsecured receivable, bearing interest at 4.34%, from UK Biomedical Biological Sciences Research Building, payable \$ 27,856 monthly through 2012	928	1,455
Noncurrent portion of non-interesting bearing, unsecured receivable from UK College of Pharmacy	6,819	8,000
Noncurrent portion of interest bearing, 7.0%, capital equipment lease receivable from Coldstream Laboratories Inc (CLI) payable \$18,224 monthly through 2013	1,025	-
Noncurrent portion of non-interest bearing, unsecured receivable from UK College of Pharmacy	2,484	-
Notes receivable	307	247
Unamortized bond cost of issuance - noncurrent portion	874	924
Amounts on deposit with trustee, primarily invested in US government agencies	2,522	6,984
Escrow funds receivable - CHA sale	-	3,750
Investment in CLI through loan to University of Kentucky Research Foundation	1,900	-
Noncurrent portion of prepaid expenses	700	-
Escrow deposit and other prepaid costs - Good Samaritan hospital acquisition	18,085	-
	<u>\$ 38,869</u>	<u>\$ 25,810</u>

6. LONG-TERM LIABILITIES

Long-term liabilities as of June 30, 2007 and 2006 are summarized as follows (in thousands):

	Beginning Balance	Additions	2007		Current Portion	Noncurrent Portion
			Reductions	Ending Balance		
General Receipts						
Project Notes	\$ 107,540	-	-	\$ 107,540	-	\$ 107,540
	<u>\$ 107,540</u>	<u>-</u>	<u>-</u>	<u>\$ 107,540</u>	<u>-</u>	<u>\$ 107,540</u>

	Beginning Balance	Additions	2006		Current Portion	Noncurrent Portion
			Reductions	Ending Balance		
Hospital Revenue Bonds	\$ 1,770	-	\$ 1,770	-	-	-
General Receipts Project Notes	-	\$ 107,540	-	\$ 107,540	-	\$ 107,540
	<u>\$ 1,770</u>	<u>\$ 107,540</u>	<u>\$ 1,770</u>	<u>\$ 107,540</u>	<u>-</u>	<u>\$ 107,540</u>

Principal maturities and interest on notes for the next five years and in subsequent five-year periods as of June 30, 2007 are as follows (in thousands):

Years ending June 30	Principal	Interest	Total
2008		\$ 4,808	\$ 4,808
2009		4,808	4,808
2010	\$ 4,395	4,735	9,130
2011	4,545	4,585	9,130
2012	4,715	4,415	9,130
2013-2017	26,925	18,731	45,656
2018-2022	33,780	11,886	45,666
2023-2026	33,180	3,348	36,528
	<u>\$ 107,540</u>	<u>\$ 57,316</u>	<u>\$ 164,856</u>

Interest costs incurred during the construction, net of related investment income, are capitalized. Total interest capitalized was \$96 for 2007 and \$969 for 2006.

On October 5, 2006, the University sold \$77.9 million of University of Kentucky General Receipts Project Notes, 2007 Series A, at a net interest cost of 4.55 percent. These bonds were sold with a forward delivery date of November 1, 2007. The proceeds of this bond issue will provide additional funding for the construction of the Hospital's new patient care facility.

7. CAPITAL LEASE OBLIGATIONS

Capital lease obligations as of June 30, 2007 and 2006 are summarized as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Capital lease obligations, at varying rates of imputed interest of 3.49% to 18.84%, collateralized by leased land, building and equipment with an amortized cost of \$50,671 and \$3,790 at June 30, 2007 and 2006	\$ 63,485	\$ 3,587
Less current portion	<u>(5,320)</u>	<u>(884)</u>
Capital lease obligations - long term portion	<u>\$ 58,165</u>	<u>\$ 2,703</u>

Scheduled payments of capital lease obligations are as follows:

Years ending June 30	
2008	\$ 6,230
2009	6,225
2010	6,216
2011	5,582
2012	40,237
2013 and later years	<u>7,731</u>
Total	72,221
Less amount representing interest	<u>(8,736)</u>
Present value of net minimum lease payments	<u>\$ 63,485</u>

8. DESIGNATIONS OF UNRESTRICTED NET ASSETS

Unrestricted net assets are designated for specific purposes by action of the University's Board of Trustees or management or may otherwise be limited by contractual obligations. Commitments for the use of unrestricted net assets at June 30, 2007 and 2006 are as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Working capital requirements	\$ 185,372	\$ 133,858
Future capital expenditures	<u>250,785</u>	<u>257,734</u>
Total	<u>\$ 436,157</u>	<u>\$ 391,592</u>

9. INVESTMENT INCOME

Components of investment income for the years ended June 30, 2007 and 2006 are as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Interest and dividends earned on endowment investments	\$ 4,163	\$ 754
Realized and unrealized gains and losses on endowment investments	21,529	(2,497)
Realized and unrealized gains on non-endowment investments	72	-
Interest on cash and non-endowment investments	<u>7,187</u>	<u>7,841</u>
Total	<u>\$ 32,951</u>	<u>\$ 6,098</u>

10. PROGRAM FOR INDIGENT CARE AND CHARITY CARE

The Hospital is reimbursed for uncompensated care, including indigent care, by the Commonwealth of Kentucky based upon available Disproportionate Share Hospital funds. The amounts are included in net patient service revenues and summarized below (in thousands):

	<u>2007</u>	<u>2006</u>
Revenue from the Commonwealth	\$ 23,299	\$ 26,810
2.5% tax paid by Hospital on patient cash receipts	(10,449)	(10,449)
Matching contribution paid by Hospital	<u>(7,107)</u>	<u>(8,213)</u>
Net amount received, included in net patient service revenues	<u>\$ 5,743</u>	<u>\$ 8,148</u>

The amount of charges forgone for services and supplies furnished under the Hospital's charity care policy aggregated to approximately \$63,000 and \$55,000 in 2007 and 2006, respectively.

11. PLEDGED REVENUES

Substantially all operating and nonoperating revenues are pledged as collateral for the General Receipt Project Notes.

12. PENSION PLANS

Regular full-time employees of the Hospital are participants in the University of Kentucky Retirement Plan, a defined contribution plan. Hospital employees participate in one of the following three groups of the University of Kentucky Retirement Plan:

Group I	Established July 1, 1964, for faculty and certain administrative officials.
Group II	Established July 1, 1971, for staff members in the clerical, technical and service categories.
Group III	Established July 1, 1972, for staff members in the managerial, professional and scientific categories.

Participation in these groups of the University of Kentucky Retirement Plan is mandatory for all regular full-time employees age 30 and older. Participation is voluntary until age 30. The Hospital contributes 10% and each employee contributes 5% of eligible compensation.

The University has authorized three retirement plan carriers, as follows:

Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF)
Fidelity Investments Institutional Services Company
American Century Investments

In addition to retirement benefits provided from the group retirement plan, the Hospital provides supplemental retirement income benefits to certain eligible employees of the Hospital.

The total contributions charged to operations for the various retirement plans were approximately \$12.0 million and \$10.6 million for the years ended June 30, 2007 and 2006, respectively. Employees contributed \$6.0 million and \$5.3 million during 2007 and 2006, respectively. The payroll for employees covered by the retirement plans was \$120.1 million and \$105.6 million for 2007 and 2006, respectively.

13. HEALTH INSURANCE BENEFITS FOR RETIREES

The University of Kentucky provides a health care credit towards health insurance to retirees of the Hospital who have a minimum of fifteen years service. The University recognizes the cost of providing this credit by expensing the credit in the year paid.

14. RISK MANAGEMENT

The University, of which the Hospital is an organizational unit, is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by (1) the State Fire and Tornado Insurance Fund (the Fund), (2) Sovereign Immunity and the State Board of Claims, or (3) in the case of risks not covered by the Fund and Sovereign Immunity, commercial insurance, participation in insurance risk retention groups or self-insurance.

The Fund covers losses to property from fire, wind, earthquake, flood and most other causes of loss between \$250,000 and \$500,000 per occurrence. Losses in excess of \$500,000 are insured by commercial carriers up to \$500 million per occurrence, buildings at replacement cost and contents on an actual cash value basis. As a state agency, the University is vested with Sovereign Immunity and is subject to the provisions of the Board of Claims Act, under which the University's liability for certain negligence claims is limited to \$200,000 for any one person or \$350,000 for all persons damaged by a single act of negligence. Claims against educators' errors and omissions and wrongful acts are insured through a reciprocal risk retention group. There have been no significant reductions in insurance coverage from 2006 to 2007. Settlements have not exceeded insurance coverage during the past three years.

The University and its agents are insured against medical malpractice by a combination of Sovereign Immunity, self-insurance, commercial liability insurance, and an excess coverage fund established by the Commonwealth of Kentucky. The malpractice liability at June 30, 2007, is based on the requirements of GASB Statement No. 10, which requires that a liability for claims be recorded if it is probable that a liability has occurred and the amount of loss can be reasonably estimated. The liability includes an estimate for claims that have been incurred but not reported at June 30, 2007. All assets and liabilities related to medical malpractice are recorded in the financial records of the University. However, the Hospital does fund its required share of the actuarially determined medical malpractice expense and, accordingly, no assets or liabilities related to medical malpractice are recorded on the Hospital's financial statements.

The University is self-insured for the long-term disability income program and has established a 501(c)(9) trust for purposes of paying claims and establishing necessary reserves. The estimated long-term disability payments for known claims at June 30, 2007 are reported at their present value assuming an investment yield of 6 percent.

The University also self-insures certain employee benefits, including health insurance, worker's compensation, unemployment claims, and a long-term disability supplemental reserve, to the extent not covered by insurance. The University has recorded an estimate for asserted claims at June 30, 2007.

15. FUNCTIONAL INCOME/EXPENSES

Below is a summary of functional income/expenses for the year ended June 30, 2007 (in thousands):

	Hospital Operations	Nonhospital Operations	Total
Operating Revenue:			
Health care services	\$ 573,536		\$ 573,536
Other revenues	7,303		7,303
Total operating revenues	<u>580,839</u>		<u>580,839</u>
Operating Expenses:			
Health care services	511,885		511,885
General and administrative	51,847		51,847
Total operating expenses	<u>563,732</u>		<u>563,732</u>
Income from continuing operations	<u>17,107</u>		<u>17,107</u>
Nonoperating revenues (expenses):			
State appropriations	1,053		1,053
Permanent additions to endowments	1		1
Gifts	1,355		1,355
Investment income	32,951		32,951
Interest expense	(131)		(131)
Gain (loss) on disposal of capital assets	(66)		(66)
Other	(799)		(799)
Gain on sale of investment	-	\$ 5,049	5,049
Net nonoperating revenues	<u>34,364</u>	<u>5,049</u>	<u>39,413</u>
Income before other revenues, expenses, gains or losses	<u>51,471</u>	<u>5,049</u>	<u>56,520</u>
Transfers to UK-noncapital	<u>(8,558)</u>	<u>-</u>	<u>(8,558)</u>
Transfers to UK-capital	<u>(761)</u>	<u>-</u>	<u>(761)</u>
General and administrative expenses discontinued operations	<u>-</u>	<u>(5)</u>	<u>(5)</u>
Net income from discontinued operations	<u>-</u>	<u>5</u>	<u>5</u>
Increase in net assets	<u>\$ 42,152</u>	<u>\$ 5,054</u>	<u>\$ 47,206</u>

Nonhospital operations include the accounts of KHE and the Hospital's interests in CHA.

Below is a summary of functional income/expenses for the year ended June 30, 2006 (in thousands):

	Hospital Operations	Nonhospital Operations	Total
	<u>Hospital Operations</u>	<u>Nonhospital Operations</u>	<u>Total</u>
Operating Revenue:			
Health care services	\$ 516,289		\$ 516,289
Other revenues	5,375		5,375
Total operating revenues	<u>521,664</u>		<u>521,664</u>
Operating Expenses:			
Health care services	448,832		448,832
General and administrative	42,258		42,258
Total operating expenses	<u>491,090</u>		<u>491,090</u>
Income from continuing Operations	<u>30,574</u>		<u>30,574</u>
Nonoperating revenues (expenses):			
State appropriations	1,053		1,053
Gifts	1,149		1,149
Investment income	6,098		6,098
Interest expense	(117)		(117)
Gain (loss) on disposal of capital assets	344		344
Other	(38)	\$ 683	645
Gain on sale of investment	-	28,836	28,836
Equity in income (loss) unconsolidated investees	-	11,524	11,524
Net nonoperating revenues	<u>8,489</u>	<u>41,043</u>	<u>49,532</u>
Income before other revenues, expenses, gains or losses	<u>39,063</u>	<u>41,043</u>	<u>80,106</u>
Transfers to UK-noncapital	(10,833)	-	(10,833)
Transfers to UK-capital	(323)	-	(323)
General and administrative expenses discontinued operations	-	43	43
Net loss from discontinued operations	<u>-</u>	<u>(43)</u>	<u>(43)</u>
Increase in net assets	<u>\$ 27,907</u>	<u>\$ 41,000</u>	<u>\$ 68,907</u>

Nonhospital operations include the accounts of KHE and the Hospital's interests in CHA and Bluegrass Stone.

16. RECLASSIFICATIONS

Certain reclassifications to fiscal 2006 comparative amounts have been made to conform to the 2007 classifications. Certain transactions previously reported on a net basis in the Consolidated Statement of Revenues, Expenses, and Changes in Net Assets are now being reported on a gross basis.

17. SUBSEQUENT EVENTS

On July 1, 2007, the University purchased Good Samaritan Hospital, a 336 bed community hospital located in Lexington, Kentucky, contiguous to the University campus. The purchase price was approximately \$13.0 million. This acquisition greatly expands the patient care opportunities available for the Hospital to serve the Commonwealth.

APPENDIX D

INFORMATION PERTAINING TO THE COMMONWEALTH OF KENTUCKY

Financial Information Regarding the Commonwealth

The Commonwealth of Kentucky (the "Commonwealth" or the "State") annually publishes *The Kentucky Comprehensive Annual Financial Report* with respect to the Fiscal Year of the Commonwealth most recently ended. The *Kentucky Comprehensive Annual Financial Report* includes certain financial statements of the Commonwealth as well as general financial information pertaining to the Accounting System and Budgetary Controls, Debt Administration, Cash Management, Risk Management, General Fund Budgetary Basis and Governmental Funds GAAP Basis. In addition, the Notes to Financial Statements as set forth in *The Kentucky Comprehensive Annual Financial Report* contain information regarding the basis of preparation of the Commonwealth's financial statements, Funds and Pension Plans. The "Statistical Section" of *The Kentucky Comprehensive Annual Financial Report* includes information on Commonwealth revenue sources, Commonwealth expenditures by function, taxes and tax sources, taxable property, assessed and estimated values, property tax, levies and collections, demographic statistics (population, per capita income and unemployment rate), construction and bank deposits, sources of personal income and largest Commonwealth manufacturers.

Certain Financial Information Incorporated by Reference; Availability from NRMSIRs and the Commonwealth

The Kentucky Comprehensive Annual Financial Report for Fiscal Year 2006 is incorporated herein by reference. The Commonwealth has filed *The Kentucky Comprehensive Annual Financial Report* for Fiscal Year 2006 with the following Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs") in accordance with SEC Rule 15c2-12:

- (i) Bloomberg Municipal Repositories
100 Business Park Drive
Skillman, New Jersey 08558
Email: munis@bloomberg.com
Tel: (609) 279-3225
Fax: (609) 279-5962
Website: <http://www.bloomberg.com/markets/rates/municontacts.html>
- (ii) DPC Data Inc.
One Executive Drive
Fort Lee, New Jersey 07024
Email: nrmsir@dpccdata.com
Tel: (201) 346-0701
Fax: (201) 947-0107
Website: <http://www.dpccdata.com>
- (iii) Standard & Poor's Securities Evaluations, Inc.
55 Water Street, 45th Floor
New York, New York 10041
Email: nrmsir_repository@sandp.com
Tel: (212) 770-4595
Fax: (212) 770-7994
Website: www.jjkenny.com/jjkenny/pser_descrip_data_rep.html

- (iv) FT Interactive Data
Attn: NRMSIR
100 William Street, 15th Floor
New York, New York 10038
Internet: nrmsir@ftid.com
Tel: (212) 771-6999; (800) 689-8466
Fax: (212) 771-7390 (Secondary Market Information)
(212) 771-7391 (Primary Market Information)
Website: <http://www.InteractiveData.com>

A copy of *The Kentucky Comprehensive Annual Financial Report* for Fiscal Year 2006 may be obtained from the NRMSIRs or from the Office of Financial Management, 702 Capitol Avenue, Suite 76, Frankfort, Kentucky 40601, (502) 564-2924. Additionally, *The Kentucky Comprehensive Annual Financial Report* for Fiscal Year 2006 and certain other fiscal years may be found on the Internet at:

<http://finance.ky.gov/ourcabinet/caboff/ooc/ofm/debt/cafr.htm>

Only information contained on the Internet web page identified above is incorporated herein and no additional information that may be reached from such page by linking to any other page should be considered to be incorporated herein.

The Commission will enter into a Continuing Disclosure Agreement in order to enable the purchaser of the Bonds to comply with the provisions of Rule 15c2-12. See "CONTINUING DISCLOSURE" herein. In addition, ongoing financial disclosure regarding the Commonwealth will be available through the filing by the Commonwealth of two documents entitled *The Kentucky Comprehensive Annual Financial Report* and *Supplementary Information to the Kentucky Comprehensive Annual Financial Report* (or successor reports) with the NRMSIRs as required under Rule 15c2-12.

Fiscal Year 2005

The *Government-Wide Financial Statements* provide a broad view of the Commonwealth's operations in a manner similar to a private-sector business. The Commonwealth's combined net assets (governmental and business-type activities) totaled \$17.4 billion at the end of 2005, as compared to \$16.6 billion at the end of the previous year.

At \$17.4 billion, the largest portion of the Commonwealth's net assets is invested in capital assets (e.g. land, infrastructures, buildings and improvements and machinery and equipment), less any related debt used to acquire those assets that is still outstanding. The Commonwealth uses these capital assets to provide services to its citizens; therefore, these assets are not available for future spending.

The second largest portion of the Commonwealth's net assets, totaling \$1.46 billion, is restricted and represents resources that are subject to either external restrictions or legislative restrictions on how they may be used. The remaining balance is unrestricted net assets. The unrestricted net assets, which if positive could be used at the Commonwealth's discretion, showed a negative balance of \$1.45 billion. Therefore, no funds were available for discretionary purposes. A contributing factor to the negative balance is that liabilities are recognized on the government-wide statement of net assets when the obligation is incurred. Accordingly, the Commonwealth recognizes long-term liabilities (such as general bonded debt, compensated absences, unfunded employer pension cost, and contingent liabilities) on the statement of net assets.

The Commonwealth received program revenues of \$7.8 billion and general revenues (including transfers) of \$9.3 billion for total revenues of \$17.0 billion during Fiscal Year 2005. Expenses for the Commonwealth during Fiscal Year 2005 were \$16.1 billion, which resulted in a total increase of the Commonwealth's net assets in the amount of \$927 million, net of contributions, transfers and special items.

As a result of the improving economy during the fiscal year, the net assets of governmental activities increased by \$850 million or 5.10 percent. Approximately 56 percent of the governmental activities' total revenue came from taxes, while 35 percent resulted from grants and contributions (including federal aid). Overall, program revenues were insufficient to cover program expenses for governmental activities. Therefore, the net program expenses of these governmental activities were supported by general revenues, mainly taxes.

As of the end of the fiscal year, the Commonwealth's governmental funds reported combined ending fund balances of \$2.62 billion, an increase of \$682 million in comparison with the prior year. The unreserved portion of fund balance (\$1.88 billion), which is the portion of fund balance available for spending in the coming year, has increased to 72 percent of the total fund balance. The remainder of fund balance is reserved to indicate that it is not available for new spending.

The General Fund is the chief operating fund of the Commonwealth. At the end of the fiscal year, total fund balance reached \$670 million, with an unreserved balance of \$593 million. This compares to a General Fund unreserved fund balance of \$304 million as of June 30, 2004. An unreserved fund balance represents the excess of the assets of the General Fund over its liabilities and reserved fund balance accounts. Reservations of fund balances of governmental funds represent amounts that are not available for appropriation. Examples of fund balance reservations reported include reserves for encumbrances, inventories and capital outlay.

The fund balance of the Commonwealth's General Fund increased by \$284 million during the fiscal year. This is a 72.8 percent increase in net assets from the prior year. The contributing factors to this increase were continuing spending reduction efforts, an improving economy and tax reform.

The Transportation Fund balance at June 30, 2005 totaled \$317 million, an increase of \$83 million during the fiscal year. The increase primarily relates to completion of an accelerated program which funded the construction of road projects with current available resources.

The Commonwealth of Kentucky's bonded debt increased by \$11 million to \$3,236,766,000, a .35 percent increase during the fiscal year. No general obligation bonds were authorized or outstanding at June 30, 2005. The key factor in this increase was the issuance of new debt during Fiscal Year 2005.

Fiscal Year 2006

The *Government-Wide Financial Statements* provide a broad view of the Commonwealth's operations in a manner similar to a private-sector business. The Commonwealth's combined net assets (governmental and business-type activities) totaled \$17.9 billion at the end of 2006, as compared to \$17.4 billion at the end of the previous year.

At \$17.9 billion, the largest portion of the Commonwealth's net assets is invested in capital assets (e.g. land, infrastructures, buildings and improvements and machinery and equipment), less any related debt used to acquire those assets that is still outstanding. The Commonwealth uses these capital assets to provide services to its citizens; therefore, these assets are not available for future spending.

The second largest portion of the Commonwealth's net assets, totaling \$1.77 billion, is restricted and represents resources that are subject to either external restrictions or legislative restrictions on how they may be used. The remaining balance is unrestricted net assets. The unrestricted net assets, which if positive could be used at the Commonwealth's discretion, showed a negative balance of \$1.80 billion. Therefore, no funds were available for discretionary purposes. A contributing factor to the negative balance is that liabilities are recognized on the government-wide statement of net assets when the obligation is incurred. Accordingly, the Commonwealth recognizes long-term liabilities (such as general bonded debt, compensated absences, unfunded employer pension cost, and contingent liabilities) on the statement of net assets.

The Commonwealth received program revenues of \$8.7 billion and general revenues (including transfers) of \$10.0 billion for total revenues of \$18.7 billion during Fiscal Year 2006. Expenses for the Commonwealth during Fiscal Year 2006 were \$18 billion, which resulted in a total increase of the Commonwealth's net assets in the amount of \$662 million, net of contributions, transfers and special items.

As a result of the improving economy during the fiscal year, the net assets of governmental activities increased by \$431 million or 2.47 percent. Approximately 56 percent of the governmental activities' total revenue came from taxes, while 34 percent resulted from grants and contributions (including federal aid). Overall, program revenues were insufficient to cover program expenses for governmental activities. Therefore, the net program expenses of these governmental activities were supported by general revenues, mainly taxes. As of the end of Fiscal Year 2006, the Commonwealth's governmental funds reported combined ending fund balances of \$3.14 billion, an increase of \$527 million in comparison with the prior year. The unreserved portion of fund balance (\$2.36 billion), which is the portion of fund balance available for spending in the coming year, has increased to 75 percent of the total fund balance. The remainder of fund balance is reserved to indicate that it is not available for new spending.

The General Fund is the chief operating fund of the Commonwealth. At the end of Fiscal Year 2006, total fund balance reached \$897 million, with an unreserved balance of \$713 million. This compares to a General Fund unreserved Fund Balance of \$593 million as of June 30, 2005. An unreserved fund balance represents the excess of the assets of the General Fund over its liabilities and reserved fund balance accounts. Reservations of fund balances of governmental funds represent amounts that are not available for appropriation. Examples of fund balance reservations reported include reserves for encumbrances, inventories and capital outlay.

The fund balance, of the Commonwealth's general fund, increased by \$226 million during Fiscal Year 2006. This is a 33.8 percent increase in fund balance from the prior year. The contributing factors to this increase were continuing spending reduction efforts, an improving economy and tax reform.

The major special revenue funds had moderate increases in revenues and slight fluctuations in expenditures with no significant changes in fund balance. The major contributing factors include an increase in motor fuels tax receipts, in the Transportation Fund, increased benefit payments in the Federal Fund, and increased spending in the Transportation function in the Agency Revenue Fund.

The Commonwealth of Kentucky's bonded debt increased by \$310 million to \$3,546,468,000 a 9.57 percent increase during Fiscal Year 2006. No general obligation bonds were authorized or outstanding at June 30, 2006. The key factor in this increase was the issuance of new debt during fiscal year 2006.

Fiscal Year 2007 (Unaudited)

Fiscal Year 2007 General Fund revenues totaled \$8,573.8 million versus \$8,376.0 million for the prior fiscal year, which represents an increase of 2.4 percent. Actual revenues for Fiscal Year 2007 were \$36.2 million below the official revised revenue estimate rendered in January 2007 by the Consensus Forecasting Group ("CFG") as modified by the 2007 General Assembly, which anticipated revenue growth of 2.8 percent. The growth rate of the General Fund in FY 2007 was lower than in the previous two fiscal years as a result of several factors, including especially the anticipated effects of various tax law changes.

Tobacco tax receipts fell during the fiscal year due to the inclusion in FY 2006 of the floor-stocks tax. The floor stocks tax was a one-time tax paid in the spring and summer of 2005, some of which added to FY 2006 receipts.

Individual income tax receipts rose 4.2 percent in FY 2007 compared to the previous fiscal year, aided by a shift in the reporting requirement for limited liability pass-through entities. Sales and use tax receipts grew 2.5 percent, as the national housing slump and higher energy prices cut into consumers' ability to make other taxable purchases. Corporate income and license taxes dropped 4.3 percent. Corporation income tax revenue had risen sharply in FY 2006, largely as a result of increased corporate profits and tax shifts within JOBS for Kentucky tax modernization. The slowing economy and the elimination of the corporate license tax contributed to the decline in FY 2007. Coal severance taxes declined by 1.1 percent in FY 2007 after several years of rapid growth. Property tax receipts fell by 2.0 percent from the previous fiscal year. The elimination of intangible property taxes and the removal of telecommunications companies from the Public Service Company property tax contributed to the decline. The lottery, meanwhile, dipped by 1.8 percent. Lottery receipts were unable to match the results of the previous year which was boosted by unusually large Powerball sales.

Fiscal Year 2008 (Unaudited)

On January 26, 2007, the CFG made an official revision to the General Fund revenue estimate for Fiscal Year 2008. The revised official estimate for Fiscal Year 2008 is \$8,902.3 million, an increase of \$227 million over the original official forecast of \$8,675.7 million provided on December 20, 2005. The revised official revenue estimate reflects anticipated growth of 3.6 percent compared to Fiscal Year 2007 actual receipts.

The official General Fund revenue estimate excludes Phase I Tobacco Master Settlement Agreement ("MSA") payments, now expected to be \$103.1 million in Fiscal Year 2008, based on the CFG's revised estimates. This represents an increase of \$9.1 million in Fiscal Year 2008 over the original official forecast for the MSA payments.

Fiscal Year 2008 General Fund actual revenues total \$2,067.1 million through September 2007, an increase of 1.5 percent over the first three months of Fiscal Year 2007. Based on year-to-date receipts, the rate of growth required in the final 9 months of Fiscal Year 2008 to meet official budgeted General Fund revenues is 4.3 percent.

General Fund revenues for September 2007 were \$843.9 million, a decrease of 1.4 percent compared to September 2006. During September 2007, sales and use tax revenues grew by 5.1 percent over September 2006. Individual income tax receipts rose by 18.1 percent. The Corporation income tax was down 40.6 percent due to a reassignment of taxes paid by businesses organized as pass-through entities and a rate reduction effective on January 1, 2007. Property tax revenues increased 85.1 percent

due primarily to timing in the area of the public service company property tax. Coal severance tax receipts were down 7.8 percent, while Lottery revenues were unchanged from the previous September.

Investment Policy

The Commonwealth's investments are governed by KRS 42.500 et seq. and KAR Title 200 Chapter 14. The State Investment Commission, comprised of the Governor, the Treasurer, Secretary of the Finance and Administration Cabinet and gubernatorial appointees of the Kentucky Banker's Association, is charged with the oversight of the Commonwealth's investment activities. The Commission is required to meet at least quarterly, and delegates day-to-day investment management to the Office of Financial Management.

At June 30, 2007, the Commonwealth's operating portfolio was approximately \$4.3 billion in cash and securities. The composition of investments was as follows: U.S. treasury securities (8%); securities issued by agencies, corporations and instrumentalities of the United States Government, including mortgage backed securities and collateralized mortgage obligations (32%); repurchase agreements collateralized by the aforementioned (20%); municipal securities (6%); and corporate and asset backed securities, including money market securities (34%). The portfolio had a current yield of 5.36% and an effective duration of 0.59 years.

The Commonwealth's investments are currently categorized into three investment pools: Short-term, Intermediate-term and Bond Proceeds Pools. The purpose of these pools is to provide economies of scale that enhance yield, ease administration and increase accountability and control. The Short-term Pool consists primarily of General Fund and related accounts and provides liquidity to the remaining pools. The Intermediate-term Pool represents Agency Fund investments, state held component unit funds and fiduciary fund accounts held for the benefit of others by the Commonwealth. The Bond Proceeds Pool is where bond proceeds for capital construction projects are deposited until expended for their intended purpose.

The Commonwealth engages in selective derivative transactions. These transactions are entered into only with an abundance of caution and for specific hedge applications to minimize yield volatility in the portfolio. The State Investment Commission expressly prohibits the use of margin or other leveraging techniques. The Commonwealth executes a variety of transactions which may be considered derivative transactions, which include: the securities lending program, over-the-counter treasury options, interest rate swaps, mortgage backed securities, collateralized mortgage obligations and asset backed securities.

The Commonwealth has used over-the-counter treasury options since the mid-1980s to hedge and add value to the portfolio of treasury securities. These transactions involve the purchase and sale of put and call options on a covered basis, holding either cash or securities sufficient to meet the obligation should it be exercised. The State Investment Commission limits the total option commitment to no more than twenty percent of the total portfolio of treasury and agency securities. Historically, actual commitments have been less than ten percent of the portfolio.

The Commonwealth has had a securities lending program since the mid-1980s. The Commonwealth is able to enter into either a principal relationship or an agent relationship. In a principal relationship the Commonwealth reverses its treasury and agency securities in exchange for 102% of eligible collateral, marked to market daily. Eligible Collateral is defined as securities authorized for purchase pursuant to KRS 42.500. In an agent program the agent lends the Commonwealth's treasuries and agencies, takes the cash received from the loan and invests it in securities authorized for purchase pursuant to KRS 42.500. The income generated by these transactions is split between the agent and the

Commonwealth. At the present time the Commonwealth has entered into an agent agreement that has a guarantee of 10 basis points of the average market value of securities in the program.

On June 20, 2003, the State Investment Commission adopted Resolution 03-03, which amended the Commonwealth's investment policy concerning asset-based interest rate swaps. The change modifies the exposure limits from a \$200,000,000 notional amount to a net market value approach, the absolute value of which cannot exceed \$50,000,000 for all counterparties. The Commonwealth engages in asset-based interest rate swaps to better manage its duration and to stabilize the volatility of interest income.

House Bill 5 of the First Extraordinary Session of 1997 was enacted on May 30, 1997. The Bill amended KRS 42.500 to authorize the purchase of additional investment securities with excess funds available for investment. The new classes of investment securities include: United States dollar denominated corporate securities, issued by foreign and domestic issuers, including sovereign and supranational governments, rated in one of the three highest categories by a nationally recognized rating agency, and asset backed securities rated in the highest category by a nationally recognized rating agency.

KAR Title 200 Chapter 14 provides, among other things that: corporate securities, inclusive of Commercial Paper, Banker's Acceptances and Certificates of Deposit are limited to twenty-five million per issuer and a stated final maturity of five years or less. Money market securities rated A1-P1 or higher are limited to 20% of any investment pool and when combined with corporate and asset backed securities (ABS) must not exceed 25% of any investment pool. United States Agency Mortgage Backed Securities (MBS) and Collateralized Mortgage Obligations (CMO) are also limited to a maximum of 25% of any investment portfolio. ABS, MBS and CMO must have a weighted-average-life of four years or less at time of purchase.

State Retirement Systems

Following is information about the state's retirement system, including pension plans and other post employment benefits. Capitalized terms used under this heading and not otherwise defined shall have the respective meanings given by the CAFRs, as herein defined.

Pension Plans. Eligible state employees participate in one of two multi-employer defined benefit plans, the Kentucky Retirement Systems and the Kentucky Teacher's Retirement System ("KTRS"). The Kentucky Retirement Systems is comprised of four retirement plans, Employees Non-Hazardous and Employees Hazardous, County Employees and State Police. Each retirement plan is state supported, except for the County Employees, which has been excluded from the Kentucky Retirement Systems information provided herein. The Kentucky Retirement Systems and KTRS (collectively, the "Pension Plans") provide both pension and Other Post Employment Benefits ("OPEB") to state employees and teachers based upon their years of service and retirement dates. The Pension Plans are component units of the Commonwealth for financial reporting purposes and are included in the Commonwealth's Comprehensive Annual Financial Report. For a brief description of the Pension Plans and of the Pension Plans' assets and liabilities, see the Commonwealth's 2006 Comprehensive Annual Financial Report, Note 8 on page 78. Additional information regarding the Kentucky Retirement Systems and KTRS can be found in their respective web sites at <http://www.kyret.com> and <http://www.ktrs.ky.gov>, including their respective Comprehensive Annual Financial Reports (collectively, the "CAFRs") and the accompanying actuarial studies, described under "Other Post Employment Benefits ("OPEB").

Pension Funding. Based upon the assumptions employed in the Pension Plans' June 30, 2006 actuarial valuation reports used in preparing the associated Pension Plans' 2006 CAFRs, the Kentucky Retirement Systems had a state supported pension Unfunded Actuarial Accrued Liability (the "UAAL") of \$3,853.9 million, while KTRS had a UAAL of \$5,467.1 million. The state supported portion of the

Pension Plans for Fiscal Year end June 30, 2006 had funding percentages of 61.5 percent for the Kentucky Retirement Systems and 73.1 percent for KTRS. The Kentucky Retirement Systems state supported Annual Required Contribution for Fiscal Year ended June 30, 2006 pension benefits was \$156.3 million versus the Actual Contribution of \$75.7 million. The KTRS state supported Annual Required Contribution for Fiscal Year ended June 30, 2006 was \$406.1 million, which was the amount contributed.

Other Post Employment Benefits (“OPEB”). The Governmental Accounting Standards Board has promulgated Statement 45 (“Accounting and Financial Reporting by Employers for Post-employment Benefits other than Pensions”). The State has not yet adopted these standards and is not required to do so until Fiscal Year ending June 30, 2008.

The State is obligated to provide healthcare benefits to certain retired state employees and teachers. The Pension Plans administer two multi-employer defined benefit healthcare plans (collectively, the “Health Plans”) for which the state pays a portion of the cost of the benefits of the retired employees. As of January 1, 2006, the State commenced self-funding of healthcare benefits for state employees. The Kentucky Retirement Systems also adopted, on January 1, 2006, a self funding health care plan for Medicare Eligible Retirees. KTRS became self-insured for post retirement healthcare costs for Medicare Eligible Retirees on July 1, 1991. Beginning January 1, 1997, KTRS offered non-Medicare Eligible Employees insurance through the state health insurance program, which has since become self insured.

The Pension Plans have commissioned actuarial studies which have provided results for consideration, under certain actuarial funding methods and sets of assumptions. A five year experience study was just completed for the Kentucky Retirement Systems and the next scheduled experience study period will be prepared in January, 2011. KTRS’ last five-year experience study was for the period ending June 30, 2005, the next five year experience study will be for the period ending June 30, 2010. Pursuant to their respective actuarial studies, the OPEB UAAL as of June 30, 2006 has been estimated to not exceed \$8,089.5 million for the Kentucky Retirement Systems and \$4,210.3 million for KTRS. These estimates represent the amount of healthcare benefits under the respective Health Plans, payable for the ensuing 30-year period and allocated by the actuarial cost method, as of June 30, 2006. The actuarial estimates for the Kentucky Retirement Systems OPEB liabilities substantially exceed the \$2,406.3 million amount previously reported in the Kentucky Retirement Systems’ 2005 CAFR, primarily due to changes in actuarial assumptions regarding investment return. The actuarial estimates for KTRS actually declined from \$4,616.6 million to \$4,210.3 million due to changes in claims valuation and certain assumptions.

The Kentucky Retirement Systems state supported Annual Required Contribution for Fiscal Year ended June 30, 2006 healthcare benefits was \$129.2 million versus the Actual Contribution of \$66.0 million. The KTRS state supported Annual Required Contribution for Fiscal Year ended June 30, 2006 was \$89.3 million, which was the contributed amount. Previously, the state legislature directed transfers of \$62.3 million and \$29.1 million in Fiscal Year 2005 and Fiscal Year 2006 respectively, from the KTRS Guarantee Fund to the Medical Insurance Stabilization Fund. This amount is to be repaid from the State General Fund over a 10-year period. The state supported portion of the Health Plans for Fiscal Year ended June 30, 2006 had funding percentages of 10.3 percent for the Kentucky Retirement Systems and 3.0 percent for KTRS.

The Commonwealth’s 2006-2008 biennial budget increased employer contribution rates by 44 percent for the Kentucky Retirement Systems and 40 percent for KTRS over the two-year budget cycle. Additionally, Governor Fletcher deposited \$12 million each to the Kentucky Retirement Systems and KTRS from the Fiscal Year 2006 General Fund surplus to offset a portion of the Pension Plans UAAL including the Health Plans. On December 15, 2006, the Governor announced the establishment of a Blue

Ribbon Task Force to study what actions are needed to fulfill the state's current obligations and to ensure the financial integrity of each of the Pension and Health Plans. Pending the report of the Blue Ribbon Task Force, the Commonwealth expects to continue to fund its share of the cost of retiree healthcare benefits under the Health Plans on a pay-as-you-go basis.

Financings of the Commission

General. The Commission has had outstanding obligations in several different forms, including tax and revenue anticipation notes and project notes. Project notes have been issued as General Fund Series, Agency Fund Series, Road Fund Series and Federal Highway Trust Fund Series depending upon the appropriation fund source that is being used to fund the payments under the related financing/lease agreement. Each type of obligation, described below, is secured by the trust indenture to which such types of obligations relate, and holders of notes issued under a particular trust indenture do not have any claim on the pledged receipts of the Commission arising under any other trust indenture.

The holders of the 2007 B Notes do not have a claim against the moneys pledged under the trust indenture related to any other project notes issued as General Fund Series, Agency Fund Series, Road Fund Series or Federal Highway Trust Fund Series. The indentures for each particular type of notes issued by the Commission generally allow the issuance of additional notes on parity with the outstanding notes of the same type. The Commission's outstanding obligations as of September 30, 2007 are described below.

General Fund Tax and Revenue Anticipation Notes. Since 1997, with the exception of 2003, the Commission has issued General Fund Tax and Revenue Anticipation Notes ("TRANs") on an annual basis corresponding with its fiscal year. The TRANs are payable from taxes and certain revenues collected by the Commonwealth in the Fiscal Year in which they are issued. The 2007 TRAN Series was issued on July 3, 2007 in the amount of \$350,000,000 and will mature on June 26, 2008.

Project Notes, General Fund Series. The Commission from time to time issues separate series of project notes, the proceeds of which are used to fund capital projects (the "General Fund Project Notes") authorized by the General Assembly. All General Fund Project Notes are payable from payments to be received by the Commission under separate financing/lease agreements and, as to bond anticipation notes, the issuance of bonds by the State Property and Buildings Commission ("SPBC"). These payments are ultimately dependent upon General Fund appropriations by the General Assembly of the Commonwealth. The Commission has authorized the issuance of an aggregate principal amount not to exceed \$950,000,000 of Project Notes, 2005 General Fund Second Series. The Commission has the following General Fund Project Notes outstanding:

<u>Project Notes</u>	<u>Amount Issued</u>	<u>Amount Outstanding</u>
2001 General Fund First Series	\$37,450,000	\$6,095,000
2003 General Fund Series A	171,260,000	52,985,000
2005 General Fund First Series	81,850,000	76,150,000
2005 General Fund Second Series	300,000,000	200,000,000*
2007 General Fund FRN Series A	100,835,000	100,835,000
2007 General Fund FRN Series B	<u>142,245,000</u>	<u>142,245,000</u>
TOTAL	\$833,640,000	\$578,310,000

* It is anticipated that State Property and Building Commission Revenue Bonds, Project No. 88 will be issued in November 2007 and \$100 million of the proceeds used to redeem the Commission's 2005 General Fund Second Series Project Notes.

Project Notes, Agency Fund Series. The Commission from time to time also issues separate series of project notes (the "Agency Fund Project Notes"), which are payable from payments to be received by the Commission under financing/lease agreements with various state agencies and from proceeds of bonds to be issued by the SPBC or a state agency. The payments used to pay Agency Fund Project Notes are ultimately dependent upon Agency Fund appropriations by the General Assembly of the Commonwealth. The Commission has authorized the issuance of an aggregate principal amount not to exceed \$250,000,000 of Project Notes, 2005 Agency Fund Second Series. These notes may be issued incrementally as needed by various state agencies. The Commission has the following Agency Fund Project Notes outstanding:

<u>Project Notes</u>	<u>Amount Issued</u>	<u>Amount Outstanding</u>
2005 Agency Fund Taxable First Series	\$11,275,000	\$10,890,000
2005 UK General Receipts Series A	107,540,000	107,540,000
2006 UK General Receipts Series A	66,305,000	66,155,000
2006 UK General Receipts Series B	2,220,000	2,220,000
2007 UK General Receipts Series A*	<u>77,905,000</u>	<u>77,905,000</u>
TOTAL	\$265,245,000	\$264,710,000

*2007 A Notes were delivered November 1, 2007.

Project Notes, Road Fund Series. The Commission from time to time also issues separate series of project notes (the "Road Fund Project Notes"), which are payable from payments to be received by the Commission under financing/lease agreements with the Commonwealth of Kentucky Transportation Cabinet ("KYTC") and from proceeds of bonds to be issued by the Turnpike Authority of Kentucky. The payments used to pay Road Fund Project Notes are ultimately dependent upon Road Fund appropriations by the General Assembly of the Commonwealth. The Commission has authorized the issuance of an aggregate principal amount not to exceed \$350,000,000 of Project Notes, 2007 Road Fund First Series. These notes may be issued incrementally as needed by KYTC. The Commission has the following Road Fund Project Notes outstanding:

<u>Project Notes</u>	<u>Amount Issued</u>	<u>Amount Outstanding</u>
2007 Road Fund First Series A	\$150,000,000	\$150,000,000

Project Notes, Federal Highway Trust Fund Series. The Commission is authorized to issue project notes (the "Federal Highway Trust Fund Project Notes") which are payable from payments to be received by the Commonwealth of Kentucky Transportation Cabinet from the Federal Highway Administration. Amounts used to pay those notes are ultimately dependent upon receipt of federal highway funds. The Commission has the following Federal Highway Trust Fund Project Notes outstanding:

<u>Project Notes</u>	<u>Amount Issued</u>	<u>Amount Outstanding</u>
2005 First Series	\$139,635,000	\$118,755,000
2007 First Series	<u>277,910,000</u>	<u>277,910,000</u>
TOTAL	\$417,545,000	\$396,665,000

Future Financings. The 2005 General Assembly enacted a State Budget for the biennium ending June 30, 2006, which authorized \$2.056 billion of bond funded capital projects. The General Fund authorization was \$1,204 million; the Road Fund authorization was \$450 million; Agency Funds were authorized at \$251.7 million; and \$150 million was authorized to be supported by the Federal Highway Trust Funds. The Road Fund and Federal Highway Trust Fund authorizations have been issued. A significant portion of the Agency Fund and General Fund projects have been permanently funded.

The 2006 General Assembly adopted a State Budget for the biennium ending June 30, 2008 which authorized an additional \$2.3 billion of capital projects to be funded with debt. The General Fund authorization is \$1,392.9 million; the Agency Fund authorizations total \$267.5 million; while the Road Fund and Federal Highway Trust Fund authorizations are \$350 million and \$290 million, respectively. The Federal Highway Trust Fund and a portion of the Agency Fund and General Fund projects have been permanently funded. The Road Fund projects are being funded by the 2007 Road Fund First Series Notes. The 2007 B Notes will permanently fund a significant portion of the remaining Agency Fund authorization.

The Kentucky General Assembly may authorize debt financing to support various capital initiatives of the Commonwealth in future sessions, which may result in the issuance of additional project notes by the Commission. Project notes may also be issued to refund outstanding Commission project notes. The Commission may also issue TRANs as funding needs arise.

The timing of permanent funding for the remaining various obligations, which may result in the retirement of certain outstanding Commission notes, is uncertain.

In 2006, the Commission entered into interest rate swap transactions to hedge the future issuance of approximately \$300 million of future SPBC Revenue Bonds expected to fund a portion of the remaining authorized, but un-issued bonds for General Fund projects. The interest rate swaps were executed in anticipation of approximately \$150 million of SPBC bonds being sold in each of February 2007 and February 2008. In February 2007, SPBC Project No. 87 bonds were sold to permanently finance various General Fund projects authorized by the 2005 and 2006 General Assemblies. The net payment from the \$150 million 2007 swap was used to offset borrowing costs and reduce the amount of bonds issued.

In August of 2007, the Commission entered into two additional interest rate swap transactions to hedge the future issuance of approximately \$300 million of future SPBC Revenue Bonds expected to fund a portion of the remaining authorized, but un-issued bonds for General Fund projects. The interest rate swaps were executed in anticipation of approximately \$150 million of SPBC bonds being sold in each of November 2008 and November 2009.

The Commission may enter into additional interest rate swaps or other agreements to manage the state's interest rate risk profile and/or hedge the future issuance of bonds authorized by the 2005, 2006 and future sessions of the Kentucky General Assembly.

Commonwealth Debt Management

Management

The Office of Financial Management ("OFM"), Finance and Administration Cabinet has central responsibility for the issuance, management, review and approval of all debt issued by the Commonwealth and its agencies. Table I lists state agencies which are active issuing entities. OFM is also responsible for the coordination and monitoring of cash needs relative to debt activity, debt service payments and the development of a comprehensive long-term debt plan. OFM serves as primary staff to the State Property and Buildings Commission, the Kentucky Asset/Liability Commission, and the Kentucky Local Correctional Facilities Construction Authority.

Structure

The Commonwealth's indebtedness is classified as either appropriation supported debt or non-appropriation supported debt.

Appropriation supported debt carries the name of the Commonwealth and is either (i) a general obligation of the State, or (ii) a project revenue obligation of one of its debt issuing agencies created by the Kentucky General Assembly to finance various projects which is subject to state appropriation for all or a portion of the debt service on the bonds.

General obligation bonds pledge the full faith, credit and taxing power of the Commonwealth for the repayment of the debt. The Kentucky Constitution requires voter approval by general referendum prior to the issuance of general obligation bonds in amounts exceeding \$500,000. Kentucky has not issued general obligation bonds since 1966. The Commonwealth has no general obligation bonds outstanding.

Project revenue notes and bonds are issued by various debt issuing authorities of the Commonwealth. The revenues produced by the projects funded by the debt are pledged as security for repayment of the debt. Project revenues are not a direct obligation of the Commonwealth. Project revenues are, in some cases, derived partially or solely from biennial appropriations of the General Assembly. In other cases, the direct revenues generated from the project funded constitute the entire source of payment.

Moral obligation debt carries the name of the Commonwealth for the benefit and convenience of agencies or municipal corporations within the State. This type of indebtedness is a special obligation of the issuer, secured and payable solely from the sources pledged for the payment thereof and does not constitute a debt, liability, obligation or a pledge of the faith and credit of the Commonwealth. The General Assembly does not intend to appropriate General Funds to fulfill the financial obligations represented by these types of indebtedness. In most circumstances, in the event of a shortfall the issuer covenants to request from the Governor and the General Assembly sufficient amounts to pay debt service. The Kentucky Infrastructure Authority Governmental Agencies Program and certain Kentucky Higher Education Student Loan Corporation bond issues no longer represent moral obligation debt of the Commonwealth.

Default Record

The Commonwealth has never defaulted in the payment of principal or interest on its general obligation indebtedness or its project revenue obligations.

**TABLE I
ACTIVE DEBT ISSUING ENTITIES**

ENTITY	STATUTORY AUTHORITY/ PURPOSE	DEBT LIMITATIONS	RATING*
State Property and Buildings Commission	KRS 56.450 Provide financing for capital construction projects and financing programs approved by the General Assembly.	Cannot incur debt without prior approval of projects and appropriation of debt service by General Assembly.	Aa3/A+/AA-
Kentucky Asset/Liability Commission	KRS 56.860 Provide interim financing of capital projects and cash flow borrowings to meet working capital needs of the state.	Cannot incur debt without prior approval of projects and appropriation of debt service by General Assembly, exclusive of cash flow borrowings within a fiscal year.	Varies
Turnpike Authority of Kentucky	KRS 175.410-175.990 Construct, maintain, repair, and operate Turnpike projects, resource recovery roads and economic development roads	Cannot incur debt without prior approval of projects and appropriation of debt service by General Assembly.	Aa3/AA+/AA-
The State Universities (consisting of nine)	KRS 56.495 Construct educational buildings and housing and dining facilities.	Cannot incur debt without prior approval of projects and appropriation of debt service by General Assembly.	Varies
Kentucky Housing Corporation	KRS 198A Make low interest mortgage loans and construction loans to increase the supply of housing for low and moderate income residents in the State.	Limited to \$2.5 billion of debt outstanding	Aaa/AAA/NR
Kentucky Infrastructure Authority	KRS 224A Provide financial assistance to local governments for the construction or refinancing of infrastructure facilities and to provide loans to industries for construction of pollution control facilities.	Revolving Fund programs cannot incur debt without appropriation of debt service by the General Assembly. Without legislative approval, other programs are limited to debt outstanding of \$500 million.	Aa3/A+/AA-
Kentucky Higher Education Student Loan Corporation	KRS 164A Make guaranteed student loans to residents of the state to attend postsecondary institutions and to make loans to students attending postsecondary schools within the state.	Limited to \$5.0 billion of debt outstanding.	NR/AAA/AAA (Sr. Series) NR/A/A (Subord. Series)
School Facilities Construction Commission	KRS 157.611-157.665 Assist local school districts with the financing and construction of school buildings. Finance the construction of vocational education facilities.	Cannot incur debt without appropriation of debt service by General Assembly.	Aa3
Kentucky Economic Development Finance Authority	KRS 154 Issue industrial revenue bonds on behalf of industries, hospitals, and commercial enterprises in the state. Provide low interest loans to developing businesses. Provide financing and tax credits to manufacturing entities expanding or locating facilities in the state.	None.	Varies
Kentucky Local Correctional Facilities Construction Authority	KRS 441.605-441.695 Provide an alternative method of constructing, improving, repairing and financing local jails.	Limited to the level of debt service supported by court fees pledged as repayment for the bonds.	Aaa/AAA/NR (Insured)

*Ratings, where applicable, include Moody's, Standard & Poor's and Fitch. S&P rates the Kentucky Infrastructure Authority's bonds which are paid from revenues (not appropriated funds), AA. Certain State Property and Buildings Commission Agency Fund Revenue Bonds may have ratings different than those identified above.

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX E

BOOK-ENTRY-ONLY SYSTEM

The 2007 B Notes initially will be issued solely in book-entry-only form to be held in the book-entry-only system maintained by The Depository Trust Company ("DTC"), New York, New York. So long as such book-entry-only system is used, only DTC will receive or have the right to receive physical delivery of 2007 B Notes and, except as otherwise provided herein with respect to tenders by Beneficial Owners (as hereinafter defined) of beneficial ownership interests, Beneficial Owners will not be or be considered to be, and will not have any rights as, owners or holders of the 2007 B Notes under the Resolution.

The following information about the book-entry-only system applicable to the 2007 B Notes has been supplied by DTC. Neither the Commission nor the Trustee makes any representations, warranties or guarantees with respect to its accuracy or completeness.

DTC will act as securities depository for the 2007 B Notes. The Securities will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Note certificate will be issued for each maturity of each Series of the 2007 B Notes, in the aggregate principal amount of the 2007 B Notes and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, FICC and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of 2007 B Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the 2007 B Notes on DTC's records. The ownership interest of each actual purchaser of each Note ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of

the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the 2007 B Notes are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in 2007 B Notes, except in the event that use of the book-entry system for the 2007 B Notes is discontinued.

To facilitate subsequent transfers, all 2007 B Notes deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of 2007 B Notes with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the 2007 B Notes; DTC's records reflect only the identity of the Direct Participants to whose accounts such 2007 B Notes are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of 2007 B Notes may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the 2007 B Notes, such as redemptions, tenders, defaults, and proposed amendments to the Note documents. For example, Beneficial Owners of 2007 B Notes may wish to ascertain that the nominee holding the 2007 B Notes for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the Trustee and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the 2007 B Notes are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the 2007 B Notes unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Commission as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts 2007 B Notes are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and interest payments on the 2007 B Notes will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Commission or the Trustee, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with bonds held for the accounts of customers in bearer form or registered in "street name" and will be the responsibility of such Participant and not of DTC or its nominee, the Trustee or the Commission, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and interest payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Commission or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the 2007 B Notes at any time by giving reasonable notice to the Commission or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, Note certificates are required to be printed and delivered.

The Commission may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Note certificates will be printed and delivered.

NEITHER THE COMMISSION NOR THE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO ANY DIRECT PARTICIPANT, INDIRECT PARTICIPANT OR ANY BENEFICIAL OWNER OR ANY OTHER PERSON NOT SHOWN ON THE REGISTRATION BOOKS OF THE TRUSTEE AS BEING A HOLDER WITH RESPECT TO: (1) THE 2007 B NOTES; (2) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT; (3) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY AMOUNT DUE TO ANY BENEFICIAL OWNER IN RESPECT OF THE PRINCIPAL OR REDEMPTION PRICE OF OR INTEREST ON THE 2007 B NOTES; (4) THE DELIVERY BY ANY DIRECT PARTICIPANT OR INDIRECT PARTICIPANT OF ANY NOTICE TO ANY BENEFICIAL OWNER WHICH IS REQUIRED OR PERMITTED UNDER THE TERMS OF THE INDENTURE TO BE GIVEN TO HOLDERS; (5) THE SELECTION OF THE BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF ANY PARTIAL REDEMPTION OF THE 2007 B NOTES; OR (6) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS HOLDER.

Each Beneficial Owner for whom a Direct Participant or Indirect Participant acquires an interest in the 2007 B Notes, as nominee, may desire to make arrangements with such Direct Participant or Indirect Participant to receive a credit balance in the records of such Direct Participant or Indirect Participant, to have all notices of redemption or other communications to or by DTC which may affect such Beneficial Owner forwarded in writing by such Direct Participant or Indirect Participant, and to have notification made of all debt service payments.

Beneficial Owners may be charged a sum sufficient to cover any tax, fee, or other governmental charge that may be imposed in relation to any transfer or exchange of their interests in the 2007 B Notes.

The Commission cannot and does not give any assurances that DTC, Direct Participants, Indirect Participants or others will distribute payments of debt service on the 2007 B Notes made to DTC or its nominee as the registered owner, or any redemption or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or that DTC, Direct Participants or Indirect Participants will serve and act in the manner described in this Official Statement.

The information in this "APPENDIX E" concerning DTC and DTC's book-entry system has been obtained from sources that the Commission believes to be reliable, but the Commission takes no responsibility for the accuracy thereof.

(THIS PAGE INTENTIONALLY LEFT BLANK)

APPENDIX F

FORM OF BOND COUNSEL'S OPINION FOR 2007 B NOTES

[To be dated the date of delivery]

Commonwealth of Kentucky
Kentucky Asset/Liability Commission
Frankfort, Kentucky

\$80,245,000
Commonwealth of Kentucky
Kentucky Asset/Liability Commission
University of Kentucky
General Receipts Project Notes, 2007 Series B

Ladies and Gentlemen:

We have acted as Bond Counsel in connection with the issuance and sale by the Kentucky Asset/Liability Commission (the "Commission") of \$80,245,000 aggregate principal amount of General Receipts Project Notes, 2007 Series B (the "Notes"). The Notes are issuable as fully registered Notes without coupons dated as of their date of delivery in the denomination of \$5,000 or any integral multiple thereof, bearing interest payable semiannually on April 1 and October 1 of each year commencing on April 1, 2008, at the rates per annum set forth in the schedule below and maturing on the dates and in the principal amounts as follows:

Maturity Date (October 1)	Principal Amount	Interest Rate	Maturity Date (October 1)	Principal Amount	Interest Rate
2010	\$2,325,000	3.375%	2020	\$2,730,000	5.00%
2011	2,405,000	3.50	2021	510,000	4.375
2012	2,485,000	3.60	2021	3,140,000	5.00
2013	1,680,000	3.60	2022	100,000	4.40
2013	900,000	4.00	2022	3,740,000	5.00
2014	1,270,000	3.70	2023	1,000,000	4.40
2014	1,415,000	4.00	2023	3,030,000	5.00
2015	600,000	3.80	2024	900,000	4.50
2015	2,195,000	5.00	2024	3,330,000	5.00
2016	625,000	3.90	2025	135,000	4.50
2016	2,310,000	5.00	2025	4,305,000	5.00
2017	3,065,000	4.00	2026	235,000	4.60
2018	3,190,000	4.00	2026	13,805,000	5.00
2019	3,325,000	4.125	2027	3,145,000	4.60
2020	745,000	4.25	2027	11,605,000	5.00

The Notes are subject to redemption upon the terms and at the prices set forth therein and as set forth in the Indenture described below.

The Notes are being issued by the Commission, pursuant to the Constitution and laws of the Commonwealth of Kentucky (the “Commonwealth”), including particularly Sections 56.860 et seq. of the Kentucky Revised Statutes, as supplemented and amended (the “Act”), a resolution adopted by the Commission on October 15, 2007 (the “Resolution”), and a Trust Indenture, dated as of October 1, 2006, as supplemented and amended by a First Supplement to Trust Indenture, dated as of November 1, 2007 (as so supplemented and amended, the “Indenture”), each between the Commission and U.S. Bank National Association having offices in Atlanta, Georgia, as trustee (the “Trustee”). The proceeds of the Notes will be used to provide funds (a) to pay a portion of the costs related to the Patient Care Facility Phase II – Hospital, and (b) to pay the costs of issuance of the Notes, all for the benefit of the University of Kentucky (the “University”). The project to be financed with the proceeds of the Notes (the “Project”) has been leased to the University, pursuant to the Financing/Lease Agreement, dated as of October 1, 2006, as supplemented and amended by a First Supplement to Financing/Lease Agreement, dated as of November 1, 2007 (as so supplemented and amended, the “Lease”), each among the Commission, the University and the Finance and Administration Cabinet of the Commonwealth of Kentucky (the “Cabinet”).

The Commission has covenanted in the Indenture to at all times do and perform all acts and things permitted by law and necessary or desirable to assure that the interest on the Notes shall, for purposes of federal income taxation, be excludable from the gross income of the recipient.

We have examined the laws of the Commonwealth of Kentucky, the Act, a certified copy of the Indenture, an executed counterpart of the Lease, an executed counterpart of the Memorandum of Instructions Regarding Use of Proceeds and Arbitrage Compliance, as amended, of the Commission relating to the Notes, certified copies of proceedings of the Commission authorizing the issuance of the Notes, a copy of an executed note of each of said issue, House Bill 380 of the General Assembly of the Commonwealth of Kentucky, 2006 Regular Session, as enacted and vetoed in part, and such other documents, records, certificates and opinions as we have deemed relevant and necessary in rendering this opinion.

From such examination, we are of the opinion that:

1. The Indenture and the Resolution have been duly authorized, executed and delivered by the Commission, and constitute valid and binding obligations of the Commission enforceable in accordance with their respective terms.

2. The Lease has been duly authorized, executed and delivered by the Commission, the University and the Cabinet, and constitutes the valid and binding obligation of the Commission, the University and the Cabinet, as applicable, enforceable in accordance with its terms.

3. Assuming compliance by the Commission with certain covenants, including the covenant referred to in the fourth paragraph of this letter, under existing laws, regulations, rulings and judicial decisions, interest on the Notes (including any original issue discount properly allocable to the owners thereof) is excluded from gross income for federal income tax purposes and is not a special preference item for purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Notes, however, must be included in the “adjusted current earnings” of certain corporations (i.e., alternative minimum taxable income as adjusted for certain items, including those items that would be included in the calculation of a corporation’s earnings and profits under Subchapter C of the Code) and such corporations are required to include in the calculation of alternative minimum taxable

income 75% of the excess of each such corporation's adjusted current earnings (which includes tax-exempt interest) over its alternative minimum taxable income (determined without regard to this adjustment and prior to reduction for certain net operating losses).

The accrual or receipt of interest on the Notes may otherwise affect the federal income tax liability of the recipient. The extent of these other tax consequences will depend upon the recipient's particular tax status or other items of income or deduction. We express no opinion regarding any such consequences. Purchasers of the Notes, particularly purchasers that are corporations (including S corporations and foreign corporations operating branches in the United States), property or casualty insurance companies, banks, thrifts or other financial institutions or certain recipients of Social Security or Railroad Retirement benefits, taxpayers otherwise entitled to claim the earned income credit or taxpayers who may be deemed to have incurred (or continued) indebtedness to purchase or carry tax-exempt obligations are advised to consult their tax advisors as to the tax consequences of purchasing or holding the Notes.

4. The Notes are payable as to principal, premium, if any, and interest from and are secured by a pledge of and a first lien on the Pledged Receipts, as defined in the Indenture. The Notes do not pledge the general credit or taxing power, if any, of the Commonwealth, the Commission, the University, the Cabinet or any other agency or political subdivision of the Commonwealth.

5. The Notes are not secured by a pledge of or lien on the properties constituting the Project but are payable as to principal and interest solely and only from and are secured by the Pledged Receipts. The ability of the University to make payments under the Lease is dependent upon legislative appropriations to the University, which has leased the Project for a term ending on the final maturity date of the Notes.

6. Under the existing laws of the Commonwealth of Kentucky, interest on the Notes is excluded from the gross income of the recipients thereof for Kentucky income tax purposes and the Notes are exempt from ad valorem taxation by the Commonwealth of Kentucky and all political subdivisions and taxing authorities thereof.

The obligations of the Commission, the University and the Cabinet, and the enforceability thereof, with respect to the Notes and the other documents described above are subject, in part, to the provisions of the bankruptcy laws of the United States of America and to other applicable bankruptcy, insolvency, reorganization, moratorium or similar laws relating to or affecting creditors' rights generally, now or hereafter in effect. Certain of such obligations, and enforcement thereof, are also subject to general equity principles, which may limit the specific enforcement of certain remedies but which do not affect the validity of such documents.

We express no opinion as to the title to, or the sufficiency in the Indenture or otherwise of the description of, the Project, or the priority of any liens, charges or encumbrances on the Project.

Very truly yours,

[To be signed and delivered at closing by Kutak
Rock LLP]

[THIS PAGE INTENTIONALLY LEFT BLANK]

[THIS PAGE INTENTIONALLY LEFT BLANK]

[THIS PAGE INTENTIONALLY LEFT BLANK]

