**NEW ISSUE – Book-Entry-Only** **Ratings: See "RATINGS" herein**

*In the opinion of Bond Counsel for the Notes, based upon an analysis of laws, regulations, rulings and court decisions, and assuming continuing compliance with certain covenants made by the Commission, and subject to the conditions and limitations set forth herein under the caption "TAX TREATMENT," interest on the Notes is excludable from gross income for Federal income tax purposes and is not a specific item of tax preference for purposes of the Federal individual or corporate alternative minimum taxes. Interest on the Notes is exempt from Kentucky income tax and the Notes are exempt from ad valorem taxation by the Commonwealth of Kentucky and any of its political subdivisions.*

# $139,635,000
# KENTUCKY ASSET/LIABILITY COMMISSION
# PROJECT NOTES, 2005 FEDERAL HIGHWAY TRUST FUND FIRST SERIES

**Dated:** Date of Delivery **Due:** September 1, as shown below

The Project Notes, 2005 Federal Highway Trust Fund First Series (the "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 Notes. Purchasers will not receive certificates representing their ownership interest in the Notes purchased. So long as DTC or its nominee is the registered owner of the Notes, payments of the principal of and interest due on the Notes will be made directly to DTC. The Notes will be issued in denominations of $5,000 or any integral multiples thereof. Principal of and interest on the Notes will be paid directly to DTC by J.P. Morgan Trust Company, National Association, Louisville, Kentucky, as Trustee and Paying Agent (the "Trustee" and "Paying Agent").

The Notes will bear interest payable on each March 1 and September 1, commencing on September 1, 2005. The Notes mature on the dates, in the principal amounts, bear interest at the rates per annum and have the prices and yields as follows:

| Maturity (September 1) | Principal Amount | Interest Rate | Yield | Price | Maturity (September 1) | Principal Amount | Interest Rate | Yield | Price |
|---|---|---|---|---|---|---|---|---|---|
| 2005 | $3,210,000 | 3.000% | 2.750% | 100.052 | 2011 | $ 125,000 | 3.250% | 3.300% | 99.717 |
| 2006 | 2,580,000 | 3.000 | 2.800 | 100.237 | 2011 | 10,800,000 | 5.000 | 3.300 | 109.498 |
| 2006 | 6,065,000 | 5.000 | 2.800 | 102.638 | 2012 | 11,465,000 | 5.000 | 3.410 | 110.107 |
| 2007 | 9,025,000 | 5.000 | 2.860 | 104.588 | 2013 | 12,040,000 | 5.000 | 3.520 | 110.490 |
| 2008 | 730,000 | 3.000 | 2.970 | 100.089 | 2014 | 175,000 | 3.550 | 3.610 | 99.528 |
| 2008 | 8,745,000 | 5.000 | 2.970 | 106.204 | 2014 | 12,465,000 | 5.000 | 3.610 | 110.824 |
| 2009 | 1,240,000 | 3.000 | 3.070 | 99.721 | 2015 | 650,000 | 3.625 | 3.690 | 99.446 |
| 2009 | 8,695,000 | 5.000 | 3.070 | 107.597 | 2015* | 12,620,000 | 5.000 | 3.690 | 110.622 |
| 2010 | 460,000 | 3.125 | 3.180 | 99.733 | 2016* | 13,925,000 | 5.000 | 3.760 | 110.021 |
| 2010 | 10,000,000 | 5.000 | 3.180 | 108.701 | 2017* | 14,620,000 | 5.000 | 3.820 | 109.508 |

* Priced to first eligible date for optional redemption.

Payment of regularly scheduled principal of and interest on the Notes when due will be guaranteed under a financial guaranty insurance policy to be issued concurrently with delivery of the Notes by MBIA Insurance Corporation.

MBIA

The Notes are subject to redemption prior to maturity as described herein.

The Kentucky Asset/Liability Commission (the "Commission") is issuing the Notes pursuant to a Resolution of the Commission adopted April 18, 2005, to pay the costs of the Project (as described and defined herein) and pay the costs of issuing the Notes. See "THE PROJECT" herein. The Notes are being issued pursuant to the Master Trust Indenture dated as of May 1, 2005 and a Series Trust Indenture dated as of May 1, 2005 (collectively, the "Indenture"), each between the Commission and the Trustee. See "THE NOTES" herein.

The 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 payments received from the Transportation Cabinet (the "State Agency"), a department and agency of the Commonwealth of Kentucky (the "Commonwealth"), are to be deposited. Such payments arise under a Financing/Lease Agreement dated as of May 1, 2005 (the "Financing Agreement"), by and among the Commission, the State Agency and the Commonwealth of Kentucky Finance and Administration Cabinet. The Kentucky General Assembly has appropriated to the State Agency, from Federal Highway Administration (FHWA) funds described below, amounts projected to be sufficient to meet principal and interest requirements on the Notes through June 30, 2006. Such appropriations are subject to the discretion and approval of each successive regular or extraordinary session of the Kentucky General Assembly. There can be no assurance that (i) the FHWA funds that are available will be appropriated in future sessions or (ii) the Governor, in the performance of his or her obligation to balance the Commonwealth's annual budget, will not reduce or eliminate such appropriations. See "SECURITY FOR THE NOTES" and "SUMMARY OF CERTAIN PROVISIONS OF THE MASTER INDENTURE AND THE FINANCING AGREEMENT" herein.

The State Agency has entered into the Memorandum of Agreement with the FHWA. The Memorandum of Agreement provides that FHWA will reimburse the State Agency for debt service and costs incurred for the Notes, including principal, interest and other bond related costs, as provided in Title 23, Section 122, United States Code. Payments by the State Agency under the Financing Agreement ("Financing Payments") are payable solely from FHWA Funds (as defined herein) that are paid to the State Agency pursuant to the Memorandum of Agreement (as defined herein) and in accordance with Title 23 (as defined herein).

**THE NOTES ARE SPECIAL OBLIGATIONS OF THE COMMISSION AND DO NOT CONSTITUTE A DEBT OR OBLIGATION OF THE COMMONWEALTH, THE COMMISSION, OR ANY OTHER AGENCY OR POLITICAL SUBDIVISION OF THE COMMONWEALTH, WITHIN THE MEANING OF THE CONSTITUTION OR STATUTES OF THE COMMONWEALTH, AND NEITHER THE FAITH OR CREDIT, NOR THE TAXING POWER OF ANY OF THE FOREGOING ARE PLEDGED TO THE PAYMENT OF PRINCIPAL OF OR INTEREST ON THE NOTES.**

The Notes are offered when, as and if issued and accepted by the Underwriters, subject to the approving legal opinion of Peck, Shaffer & Williams LLP, Covington, Kentucky, Bond Counsel. Certain legal matters will be passed on for the Underwriters by their counsel, Ballard Spahr Andrews & Ingersoll, LLP, Philadelphia, Pennsylvania. It is expected that delivery of the Notes will be made on or about June 8, 2005, through the facilities of DTC, against payment therefor.

**Citigroup**
**UBS Financial Services Inc.**

**J.J.B. Hilliard, W.L. Lyons, Inc.** **Morgan Keegan & Company, Inc.**
**JPMorgan** **NatCity Investments, Inc.**
**Ross, Sinclaire & Associates, Inc.** **A.G. Edwards & Sons, Inc.**
**First Kentucky Securities Corp.** **Edward D. Jones & Co., L.P.**

Dated: May 25, 2005

This Official Statement does not constitute an offer to sell the Notes to any person, or the solicitation of an offer from any person to buy the 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 Notes shall, under any circumstances, create any implication that there has been no change in the matters described herein since the date hereof. This Official Statement is submitted in connection with the issuance of the 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 NOTES ABOVE THE LEVELS WHICH WOULD OTHERWISE PREVAIL. SUCH ACTIVITIES, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

## KENTUCKY ASSET/LIABILITY COMMISSION

### COMMISSION MEMBERS

R. B. Rudolph, Jr., Secretary of the Finance and Administration Cabinet, Chairman
Gregory D. Stumbo, Attorney General
Jonathan Miller, State Treasurer
Bradford L. Cowgill, State Budget Director

### SECRETARY TO THE COMMISSION

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

### TRUSTEE AND PAYING AGENT

J.P. Morgan Trust Company, National Association
Louisville, Kentucky

### BOND COUNSEL

Peck, Shaffer & Williams LLP
Covington, Kentucky

### UNDERWRITERS' COUNSEL

Ballard Spahr Andrews & Ingersoll, LLP
Philadelphia, Pennsylvania

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## SUMMARY

The following information is furnished solely to provide limited introductory information regarding the Kentucky Asset/Liability Commission (the "Commission"), the Commonwealth of Kentucky Transportation Cabinet (the "State Agency") and the 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 Notes is made only by means of the entire Official Statement, including the Exhibits hereto. No person is authorized to make offers to sell, or solicit offers to buy, the 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 State Agency** — The State Agency is a department and agency of the Commonwealth responsible for the management of the State Highway Program. See "THE STATE AGENCY AND MANAGEMENT OF STATE HIGHWAY PROGRAM" herein.

**The Offering** — The Commission is offering its Project Notes, 2005 Federal Highway Trust Fund First Series in an aggregate principal amount of $139,635,000 (the "Notes"). See "THE NOTES" herein.

**Authority** — The 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 April 18, 2005, the Master Trust Indenture dated as of May 1, 2005 and a Series Trust Indenture dated as of May 1, 2005 (collectively, the "Indenture"), as supplemented, between the Commission and J.P. Morgan Trust Company, National Association, Louisville, Kentucky, as trustee and paying agent (the "Trustee" and "Paying Agent"). The State Property and Buildings Commission of the Commonwealth has also approved the issuance of the Notes.

**Use of Proceeds** — The proceeds of the Notes, together with other funds, will be used by the Commission to (i) pay the costs of the Project and (ii) pay the costs of issuing the Notes. See "THE PROJECT" herein.

**Features** — The Notes will be dated as of the date of delivery, and will bear interest on each March 1 and September 1, commencing September 1, 2005, at the rates set forth on the cover page of this Official Statement and will mature on the dates set forth on the cover page of this Official Statement. The Notes are subject to redemption prior to their respective maturities as described herein.

The Notes are issuable only as fully registered Notes, without coupons. The Notes are being offered in the authorized denominations of $5,000 or any integral multiples thereof, at the rates shown on the cover page hereof. The 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 Notes. Purchasers will not receive

certificates representing their ownership interest in the Notes purchased. So long as DTC or its nominee is the registered owner of the Notes, payments of the principal of and interest due on the Notes will be made directly to DTC.

Principal of and interest on the Notes will be paid directly to DTC by the Trustee.

It is expected that delivery of the Notes will be made on or about June 8, 2005, through the facilities of DTC, against payment therefor.

**Security**

The 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 payments received from the State Agency are to be deposited. Such payments arise under a Financing/Lease Agreement, dated as of May 1, 2005 (the "Financing Agreement"), by and among the Commission, the State Agency and the Commonwealth of Kentucky Finance and Administration Cabinet.

Under the provisions of the Constitution of the Commonwealth, the State Agency is prohibited from entering into financing obligations extending beyond the biennial budget. Notwithstanding the foregoing, the Financing Agreement will be automatically renewed unless written notice of the election by the State Agency not to renew is given to the Commission by the last business day of May prior to the beginning of the next succeeding biennial renewal term.

The Kentucky General Assembly has appropriated to the State Agency, from Federal Highway Administration (FHWA) funds described below, amounts projected to be sufficient to meet principal and interest requirements on the Notes through June 30, 2006. Such appropriations are subject to the discretion and approval of each successive regular or extraordinary session of the General Assembly of the Commonwealth. THERE CAN BE NO ASSURANCE THAT (i) THE FHWA FUNDS THAT ARE AVAILABLE WILL BE APPROPRIATED IN FUTURE SESSIONS OR (ii) THE GOVERNOR, IN THE PERFORMANCE OF HIS OR HER OBLIGATION TO BALANCE THE COMMONWEALTH'S ANNUAL BUDGET, WILL NOT REDUCE OR ELIMINATE SUCH APPROPRIATIONS.

Appropriations to the State Agency to pay amounts due under the Financing Agreement are to be made solely from FHWA funds that are available to the State Agency, pursuant to the Memorandum of Agreement, under Section 122 of Title 23, United States Code, Highways for such purpose. See "INFORMATION CONCERNING THE FUNDING OF FEDERAL-AID HIGHWAYS" herein for information regarding these funds. Under the Financing Agreement, the State Agency is not obligated to request an appropriation of funds (for the payment of amounts due) from any other source.

The Notes are also secured by certain other funds and accounts pledged therefore and described herein. See "SUMMARY OF CERTAIN

PROVISIONS OF THE MASTER INDENTURE AND THE FINANCING AGREEMENT" herein.

The Commission may issue Additional Notes on a parity basis with the Notes under certain circumstances. See "SECURITY FOR THE NOTES – Additional Notes" herein.

THE NOTES ARE SPECIAL OBLIGATIONS OF THE COMMISSION AND DO NOT CONSTITUTE A DEBT OR OBLIGATION OF THE COMMONWEALTH, THE COMMISSION, OR ANY OTHER AGENCY OR POLITICAL SUBDIVISION OF THE COMMONWEALTH WITHIN THE MEANING OF THE CONSTITUTION OR STATUTES OF THE COMMONWEALTH, AND NEITHER THE FAITH OR CREDIT, NOR THE TAXING POWER OF ANY OF THE FOREGOING ARE PLEDGED TO THE PAYMENT OF PRINCIPAL OF OR INTEREST ON THE NOTES.

**Bond Insurance Policy**

The scheduled payment of principal of and interest on the Notes, when due, will be guaranteed under a financial guaranty insurance policy (the "Bond Insurance Policy") to be issued concurrently with the delivery of the Notes by MBIA Insurance Corporation ("MBIA"). See "BOND INSURANCE" herein.

**Tax Status**

In the opinion of Bond Counsel for the Notes, based upon an analysis of existing laws, regulations, rulings and court decisions, interest on the Notes is excludable from gross income for Federal income tax purposes and 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 Notes is of the opinion that interest on the Notes is exempt from income taxation by the Commonwealth and the Notes are exempt from ad valorem taxation by the Commonwealth and any of its political subdivisions. See "TAX TREATMENT" herein, and Exhibit B.

**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, the Commission will enter into a Continuing Disclosure Agreement (the "Continuing Disclosure Agreement") with the Trustee.

**General**

This Official Statement speaks only as of its date, and the information contained herein is subject to change. All summaries of documents and agreements in this 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 Notes is available by contacting the Office of Financial Management, 702 Capitol Avenue, Suite 261, Frankfort, Kentucky 40601 (502) 564-2924 or the Representative of the Underwriters, Citigroup Global Markets Inc., 390 Greenwich Street, New York, New York 10013, (212) 723-7093. |

# OFFICIAL STATEMENT

## $139,635,000
## KENTUCKY ASSET/LIABILITY COMMISSION
## PROJECT NOTES, 2005 FEDERAL HIGHWAY TRUST FUND FIRST SERIES

## INTRODUCTION

This Official Statement (this "Official Statement"), which includes the cover page, is being distributed by the Kentucky Asset/Liability Commission (the "Commission") to furnish pertinent information to the purchasers of $139,635,000 aggregate principal amount of its Project Notes, 2005 Federal Highway Trust Fund First Series (the "Notes"). The 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 April 18, 2005 (the "Resolution"), the Master Trust Indenture dated as of May 1, 2005 and a Series Trust Indenture dated as of May 1, 2005 (collectively, the "Indenture"), between the Commission and J.P. Morgan Trust Company, National Association, Louisville, Kentucky, as trustee and paying agent (the "Trustee" and "Paying Agent").

The proceeds of the Notes, together with other funds, will be used to (i) pay the costs of the Project and (ii) pay the costs of issuing the Notes. See "THE PROJECT" herein.

The Notes and the interest thereon are payable solely from payments of Financing Payments (as defined herein) to be made by the Kentucky Transportation Cabinet (the "State Agency") to the Commission under the Financing/Lease Agreement dated as of May 1, 2005 (the "Financing Agreement") among the Commission, the Commonwealth of Kentucky Finance and Administration Cabinet (the "Cabinet") and the State Agency. Financing Payments due from the State Agency under the Financing Agreement are payable solely from FHWA Funds (as defined herein) under the Memorandum of Agreement between the State Agency and the Federal Highway Administration ("FHWA") relating to the Project (the "Memorandum of Agreement") that are paid to the State Agency in accordance with Title 23 (as defined herein). The Notes are also secured by certain other funds and accounts pledged therefor and described herein. See "SECURITY FOR THE NOTES" herein.

The scheduled payment of principal of and interest on the Notes, when due, will be guaranteed under an insurance policy on the Notes to be issued concurrently with the delivery of the Notes by MBIA. See "BOND INSURANCE" and EXHIBIT D.

The summaries and references to the Notes, the Act, the Indenture and the Financing Agreement 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 ("OFM"), 702 Capitol Avenue, Room 261, Frankfort, Kentucky 40601, (502) 564-2924 or, during the initial offering period, at the office of the Representative of the Underwriters, Citigroup Global Markets Inc., 390 Greenwich Street, New York, New York 10013, (212) 723-7093.

Capitalized terms used in this Official Statement and not otherwise defined will have the meanings given them under the caption "DEFINITIONS" herein, in the Indenture or in the Financing Agreement.

## THE NOTES

### General

The Notes are issuable only as fully registered Notes. The Notes will be issuable in the denominations of $5,000 or any integral multiples thereof, will be dated as of the date of delivery, will bear interest payable on each March 1 and September 1, commencing September 1, 2005, at the rates set forth on the cover page of this Official Statement and will mature on the dates set forth on the cover page of this Official Statement. Principal of and interest on the Notes are payable in lawful money of the United States to the registered owner of the 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 "EXHIBIT C – Book-Entry-Only System."

### Optional Redemption

The Notes maturing on or before September 1, 2014 are not subject to optional redemption prior to maturity. The Notes maturing after September 1, 2014 are subject to redemption at the option of the Commission on or after March 1, 2015, in whole or in part at any time, at a redemption price equal to 100% of the principal amount of the Notes to be redeemed, plus accrued interest to the date fixed for redemption.

### Book-Entry-Only System

The 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 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 Notes under the Indenture. For additional information about DTC and the book-entry-only system see "EXHIBIT C – Book-Entry-Only System."

### Authorization

The Commission, at a meeting on April 18, 2005, adopted the Resolution, which, among other things (i) authorized the Indenture, (ii) authorized and approved the issuance of the Notes, subject to approval by a representative of 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 Notes.

## SECURITY FOR THE NOTES

### General

The Notes and any interest due thereon are payable solely and only from a special fund created under the Indenture defined therein as the Note Payment Fund (the "Note Payment Fund"). Pursuant to the Indenture, payments received from the State Agency arising under the Financing Agreement are to be deposited into the Note Payment Fund.

Under the provisions of the Constitution of the Commonwealth, the State Agency is prohibited from entering into financing obligations extending beyond the biennial budget. Notwithstanding the foregoing, the Financing Agreement will be automatically renewed unless written notice of the election by the State Agency to not so renew is given to the Commission by the last business day of May prior to the beginning of the next succeeding biennial renewal term.

The Kentucky General Assembly has appropriated to the State Agency, from FHWA Funds defined below under "Additional Notes," amounts sufficient to meet the Financing Payments under the Financing Agreement and therefore to permit the Commission to meet the debt service requirements of the Notes, through June 30, 2006. The availability of funds to pay Financing Payments under the Financing Agreement are (i) dependant on the availability of a sufficient amount of FHWA Funds and (ii) the appropriation of a sufficient amount of those FHWA Funds. See "INFORMATION CONCERNING THE FUNDING OF FEDERAL-AID HIGHWAYS" herein for information regarding FHWA Funds. The appropriation of FHWA Funds which are available to the State Agency is subject to the discretion and approval of each successive regular or extraordinary session of the General Assembly of the Commonwealth. There can be no assurance that (i) the FHWA funds that are available will be appropriated in future sessions or (ii) that the Governor, in the performance of his or her obligation to balance the Commonwealth's annual budget, will not reduce or eliminate such appropriations. FAILURE OF THE STATE AGENCY TO RECEIVE FHWA FUNDS OR TO HAVE AVAILABLE FHWA FUNDS APPROPRIATED FOR THE PAYMENT OF FINANCING PAYMENTS WILL HAVE A MATERIAL ADVERSE EFFECT ON THE COMMISSION'S ABILITY TO PAY THE PRINCIPAL OF AND INTEREST ON THE NOTES.

The Notes are also secured by certain other funds and accounts pledged therefore and described herein. See "SUMMARY OF CERTAIN PROVISIONS OF THE MASTER INDENTURE AND THE FINANCING AGREEMENT" herein.

The scheduled payment of principal of and interest on the Notes, when due, will be guaranteed under an insurance policy on the Notes to be issued concurrently with the delivery of the Notes by MBIA. See "BOND INSURANCE" and EXHIBIT D.

THE NOTES ARE SPECIAL OBLIGATIONS OF THE COMMISSION AND DO NOT CONSTITUTE A DEBT OR OBLIGATION OF THE COMMONWEALTH, THE COMMISSION, OR ANY OTHER AGENCY OR POLITICAL SUBDIVISION OF THE COMMONWEALTH WITHIN THE MEANING OF THE CONSTITUTION OR STATUTES OF THE COMMONWEALTH, AND NEITHER THE FAITH OR CREDIT, NOR THE TAXING POWER OF ANY OF THE FOREGOING ARE PLEDGED TO THE PAYMENT OF PRINCIPAL OF OR INTEREST ON THE NOTES.

**Additional Notes**

Under the Indenture, the Commission has reserved the right and authority to issue Additional Notes if it has received a certificate of an Authorized Representative of the State Agency stating that the amount of FHWA Funds received during the most recently completed Federal Fiscal Year was equal to at least 400% of the Maximum Annual Debt Service for all Notes Outstanding in the current and each future Federal Fiscal Year including the Additional Notes proposed to be issued, but in the case of a Series of Additional Notes to be issued for refunding purposes, excluding the Note Payments on the Notes to be refunded, with:

"Federal Fiscal Year" defined as, the period commencing October 1 of any year and ending September 30 of the ensuring year, or any other fiscal year of the FHWA.

"FHWA Funds" defined as, all amounts available to the State Agency to pay amounts due with respect to an Eligible Debt Financing Instrument, as defined in Section 122 of Title 23, or amounts under any similar or successor provisions of law regarding the use of funds payable to the State Agency by FHWA;

"Maximum Annual Debt Service" defined as, the sum of all amounts required to be paid, during the current or any future Federal Fiscal Year commencing after the date of such calculation, or set aside during such Federal Fiscal Year, for payment of debt service on all Outstanding Notes.

For the purpose of determining the Maximum Annual Debt Service, variable rate Notes are deemed to bear interest at the maximum rate of interest applicable to such variable rate Notes; provided however that if such maximum rate of interest is less than the interest rate quoted in The Bond Buyer 25 Revenue Bond Index (the "Index Rate") as published in The Bond Buyer for the last week of the month preceding the date of issuance of such variable rate Notes, then the interest rate on such variable rate Notes shall be deemed to be the Index Rate. If The Bond Buyer 25 Revenue Bond Index is no longer published, an index that is deemed to be substantially equivalent by nationally recognized bond counsel may be substituted therefore. Also for the purpose of determining the Maximum Annual Debt Service, any Note scheduled to be Outstanding during such period that is subject to tender at the option of the Holder will be assumed to mature on the stated maturity date or mandatory sinking fund payment date thereof.

The Commission has also reserved the right to issue notes that are secured by a pledge of the Pledged Receipts that is subordinate to the pledge created by the Indenture which do not rank on a basis of equality and parity with the Notes, but only if such subordinate notes are issued in express recognition of the priorities, liens and rights created and existing for the security and source of payment and protection of the Notes.

In addition, the Commission has reserved the right, in addition to issuing Notes as described in the first paragraph under this heading, to issue Refunding Notes which may be on a parity as to security with the Notes in order to refund any Notes then Outstanding, so long as Maximum Annual Debt Service is not increased as a result of issuing such Refunding Notes.

Furthermore, whenever the Commission has authorized or made provision for the authorization of, the issuance of a Series of Notes, the Commission also reserved the right in the Indenture to authorize the issuance of Construction Notes in anticipation of the sale of that Series of Notes in a principal amount not exceeding the principal amount of that Series of Notes. The principal or any interest on such Construction Notes and renewals thereof may be payable from and secured by a pledge of Pledged Receipts that is (i) subordinate to the pledge of such Pledged Receipts as security for Outstanding Notes or (ii) on a parity with the pledge of such Pledged Receipts securing Outstanding Notes, but, as to any parity pledge, only if the requirements described under this heading for the issuance of Additional Notes would be satisfied assuming the principal amount of such Construction Notes would be amortized over 20 years on a level payment basis at prevailing market interest rates existing at the time of the issuance of the Construction Notes.

## BOND INSURANCE

The following information has been furnished by MBIA for use in this Official Statement. Reference is made to Exhibit D for a specimen of the Bond Insurance Policy.

MBIA does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding the Bond Insurance Policy and MBIA set forth under the heading "BOND INSURANCE." Additionally, MBIA makes no representation regarding the Notes or the advisability of investing in the Notes.

**Bond Insurance Policy**

The Bond Insurance Policy unconditionally and irrevocably guarantees the full and complete payment required to be made by or on behalf of the Commission to the Paying Agent or its successor of an amount equal to (i) the principal of (either at the stated maturity or by an advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Notes as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed by the Bond Insurance Policy shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless MBIA elects in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any Owner of the Notes pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such Owner within the meaning of any applicable bankruptcy law (a "Preference").

The Bond Insurance Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Notes. The Bond Insurance Policy does not, under any circumstance, insure against loss relating to: (i) optional or mandatory redemptions (other than mandatory sinking fund redemptions); (ii) any payments to be made on an accelerated basis; (iii) payments of the purchase price of Notes upon tender by an owner thereof; or (iv) any Preference relating to (i) through (iii) above. The Bond Insurance Policy also does not insure against nonpayment of principal of or interest on the Notes resulting from the insolvency, negligence or any other act or omission of the Paying Agent or any other paying agent for the Notes.

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by MBIA from the Paying Agent or any owner of a Note the payment of an insured amount for which is then due, that such required payment has not been made, MBIA on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such insured amounts which are then due. Upon presentment and surrender of such Notes or presentment of such other proof of ownership of the Notes, together with any appropriate instruments of assignment to evidence the assignment of the insured amounts due on the Notes as are paid by MBIA, and appropriate instruments to effect the appointment of MBIA as agent for such owners of the Notes in any legal proceeding related to payment of insured amounts on the Notes, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners or the Paying Agent payment of the insured amounts due on such Notes, less any amount held by the Paying Agent for the payment of such insured amounts and legally available therefor.

**MBIA**

MBIA is the principal operating subsidiary of MBIA Inc., a New York Stock Exchange listed company (the "Company"). The Company is not obligated to pay the debts of or claims against MBIA. MBIA is domiciled in the State of New York and licensed to do business in and subject to regulation under the laws of all 50 states, the District of Columbia, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, the Virgin Islands of the United States and the Territory of Guam. MBIA has three branches, one in the Republic of France, one in the Republic of Singapore and one in the Kingdom of Spain.

The principal executive offices of MBIA are located at 113 King Street, Armonk, New York 10504 and the main telephone number at that address is (914) 273-4545.

**Regulation**

As a financial guaranty insurance company licensed to do business in the State of New York, MBIA is subject to the New York Insurance Law which, among other things, prescribes minimum capital requirements and contingency reserves against liabilities for MBIA, limits the classes and concentrations of investments that are made by MBIA and requires the approval of policy rates and forms that are employed by MBIA. State law also regulates the amount of both the aggregate and individual risks that may be insured by MBIA, the payment of dividends by MBIA, changes in control with respect to MBIA and transactions among MBIA and its affiliates.

The Bond Insurance Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

**Financial Strength Ratings of MBIA**

Moody's Investors Service, Inc. ("Moody's") rates the financial strength of MBIA "Aaa."

Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("Standard & Poor's") rates the financial strength of MBIA "AAA."

Fitch Ratings ("Fitch") rates the financial strength of MBIA "AAA."

Each rating of MBIA should be evaluated independently. The ratings reflect the respective rating agency's current assessment of the creditworthiness of MBIA and its ability to pay claims on its policies of insurance. Any further explanation as to the significance of the above ratings may be obtained only from the applicable rating agency.

The above ratings are not recommendations to buy, sell or hold the Notes, and such ratings may be subject to revision or withdrawal at any time by the rating agencies. Any downward revision or withdrawal of any of the above ratings may have an adverse effect on the market price of the Notes. MBIA does not guaranty the market price of the Notes nor does it guaranty that the ratings on the Notes will not be revised or withdrawn.

**Financial Information of MBIA**

As of December 31, 2004, MBIA had admitted assets of $10.4 billion (unaudited), total liabilities of $7.0 billion (unaudited), and total capital and surplus of $3.4 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities. As of March 31, 2005, MBIA had admitted assets of $10.6 billion (unaudited), total liabilities of $7.0 billion (unaudited), and total capital and surplus of $3.6 billion (unaudited) determined in accordance with statutory accounting practices prescribed or permitted by insurance regulatory authorities.

For further information concerning MBIA, see the consolidated financial statements of MBIA and its subsidiaries as of December 31, 2004 and December 31, 2003 and for each of the three years in the period ended December 31, 2004, prepared in accordance with generally accepted accounting principles, included in the Annual Report on Form 10-K of the Company for the year ended December 31, 2004 and the consolidated financial statements of MBIA and its subsidiaries as of March 31, 2005 and for the three month periods ended March 31, 2005 and March 31, 2004 included in the Quarterly Report on Form 10-Q of the Company for the

period ended March 31, 2005, which are hereby incorporated by reference into this Official Statement and shall be deemed to be a part hereof.

Copies of the statutory financial statements filed by MBIA with the State of New York Insurance Department are available over the Internet at the Company's web site at http://www.mbia.com and at no cost, upon request to MBIA at its principal executive offices.

**Incorporation of Certain Documents by Reference**

The following documents filed by the Company with the Securities and Exchange Commission (the "SEC") are incorporated by reference into this Official Statement:

(1) The Company's Annual Report on Form 10-K for the year ended December 31, 2004; and
(2) The Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2005.

Any documents, including any financial statements of MBIA and its subsidiaries that are included therein or attached as exhibits thereto, filed by the Company pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of the Company's most recent Quarterly Report on Form 10-Q or Annual Report on Form 10-K, and prior to the termination of the offering of the Notes offered hereby shall be deemed to be incorporated by reference in this Official Statement and to be a part hereof from the respective dates of filing such documents. Any statement contained in a document incorporated or deemed to be incorporated by reference herein, or contained in this Official Statement, shall be deemed to be modified or superseded for purposes of this Official Statement to the extent that a statement contained herein or in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Official Statement.

The Company files annual, quarterly and special reports, information statements and other information with the SEC under File No. 1-9583. Copies of the Company's SEC filings (including (1) the Company's Annual Report on Form 10-K for the year ended December 31, 2004, and (2) the Company's Quarterly Reports on Form 10-Q for the quarter ended March 31, 2005) are available (i) over the Internet at the SEC's web site at http://www.sec.gov; (ii) at the SEC's public reference room in Washington D.C.; (iii) over the Internet at the Company's web site at http://www.mbia.com; and (iv) at no cost, upon request to MBIA at its principal executive offices.

## THE PROJECT

The Project consists of, collectively, the "Bond Financed Projects" as described in the Memorandum of Agreement, which are more particularly described in the Financing Agreement and in the Budget Act, enacted by the General Assembly of the Commonwealth with respect to Fiscal Years 2005 and 2006 (the "Budget Act").

The Project consists of the design and construction by the State Agency of the following three projects:

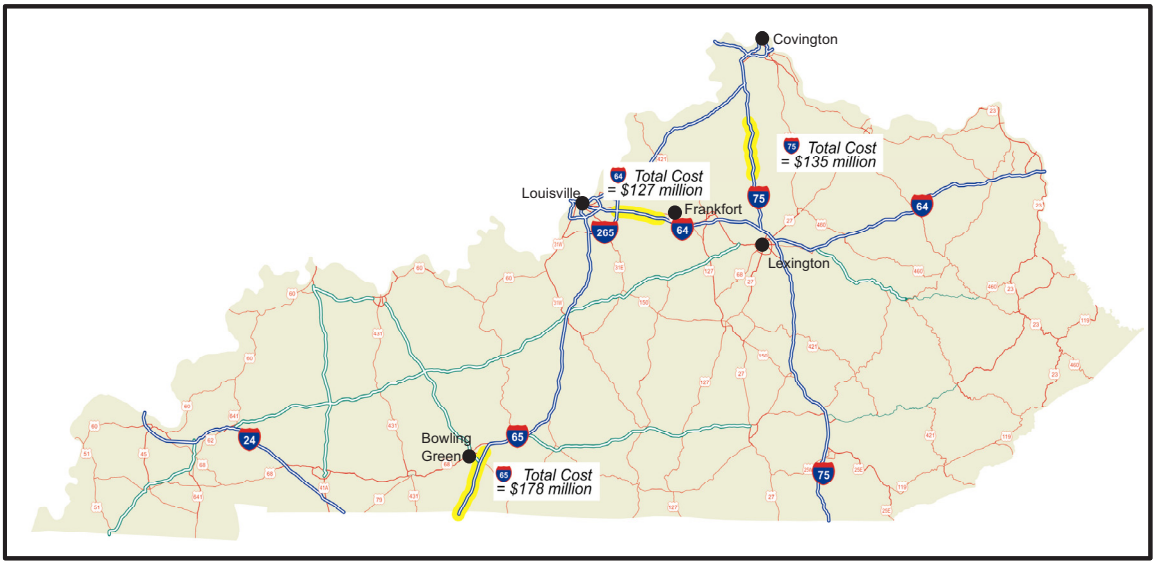
- **Interstate 65:** Widen to six lanes from the Tennessee state line to Bowling Green (estimated total cost $178 million)

- **Interstate 75:** Widen to six lanes from the end of the current six-lane section in northern Scott County to the current six-lane section south of KY 22 in Grant County (estimated total cost $135 million)

- **Interstate 64:** Widen to six lanes from the Snyder Freeway in Jefferson County toward Shelbyville (estimated total cost $127 million)

Each of these interstate widening projects constitutes a necessary investment in Kentucky's future. The need to accommodate both people and freight movement in each of these highway corridors is critical to Kentucky's economy in the years ahead. Each of these routes (see the attached map) currently carries a disproportionately high percentage of truck traffic, and forecasts call for the numbers of trucks in the traffic stream to continue to increase as NAFTA continues to yield higher and higher volumes of freight from Latin America to Canada.

The total cost of these three projects is estimated at $440 million. Additional authorization will be requested of future sessions of the General Assembly.



## ESTIMATED SOURCES AND USES OF FUNDS

### Sources and Uses of Funds

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

| | |
|---|---|
| Sources | |
| Par Amount of Notes | $139,635,000 |
| Plus: Net Bond Premium | 11,568,975 |
| Total Sources | $151,203,975 |
| Uses | |
| Deposit to Project Fund | $150,000,000 |
| Cost of Issuance* | 1,203,975 |
| Total Uses | $151,203,975 |

* Includes underwriters' discount, bond insurance premium, legal, printing, rating agency fees, trustee fees, and other expenses of the issuance and offering of the Notes.

## INFORMATION CONCERNING THE FUNDING OF FEDERAL-AID HIGHWAYS

### The Federal-Aid Highway Program

The Federal-Aid Highway Program (FAHP) is an "umbrella" term that encompasses most of the federal programs providing highway funds to the states, such as the Interstate Maintenance Program, the Bridge Program, the National Highway System Program, and the Surface Transportation Program. The Federal Highway Administration (FHWA) is the federal agency within the U.S. Department of Transportation responsible for administering the FAHP. The FAHP is financed from the transportation user-related revenues deposited in the federal Highway Trust Fund. The primary source of revenues in the federal Highway Trust Fund is derived from the federal excise taxes on motor fuels. Other taxes include excise taxes on tires, trucks and trailers, and truck use taxes.

Certain FAHP features or requirements are explained or further defined where they appear below but are introduced here for reference:

- *The Federal Highway Trust Fund (the "HTF")*: The HTF is a dedicated federal fund with dedicated revenues held in trust for reimbursement of expenditures by the states for costs of eligible transportation projects, including highway projects.

- *Authorization*: "Authorization" is the process by which Congress authorizes the expenditure of federal revenues on federal programs. For the FAHP, authorization historically has been provided on a multi-year basis. This, together with the availability of HTF revenues and future HTF collections permits states more certainty in planning long-term highway projects. See "STEA 2003" below.

- *Apportionment*: For each Federal Fiscal Year ("FFY"), the FHWA apportions the authorized funding among the states according to formulas that are established in authorizing statutes.

The distribution of federal funds that do not have a statutory formula is called "allocation" rather than "apportionment."

- *Obligation Authority*: "Obligation" is the commitment of the federal government to pay, through reimbursements to a state, its share of the eligible expenditures on an approved project. The amount of such federal revenues that a state can obligate in a given FFY is called its "Obligation Authority."

- *Advance Construction*: The Advance Construction procedure allows states to commence eligible projects without first having to obligate the federal government's share of expenditures. Thus, states may begin a project before amassing all of the Obligation Authority needed to cover the federal government's share. The Project is an Advance Construction Project.

- *Partial conversion of Advance Construction*: Under partial conversion of Advance Construction, in a given year a state may convert Advance Construction to Obligation Authority and thus be eligible for reimbursement for a portion of the federal share of an Advance Construction project in that or in a subsequent FFY. This removes any requirement for the state to wait for reimbursements until the full amount of Obligation Authority needed for the entire project is available.

These features of the FAHP work in a complementary fashion to provide a regular flow of federal reimbursements over the years to state highway projects.

The participation of the Commonwealth in such reimbursements, and the role of such participation in providing payment and security for the Bonds, is discussed in "FEDERAL AID REVENUES."

It should be noted that the terms and conditions of participation in the FAHP as described herein are subject to change at the discretion of Congress, and there can be no assurance that the laws and regulations now governing the FAHP will not be changed in the future in a manner that may adversely affect the ability of the Commonwealth to receive adequate FHWA Funds to pay the debt service on the Notes.

Although FHWA provides funding for eligible highway projects, federal-aid highways are under the administrative control of the state or local government responsible for their operation and maintenance.

Title 23, United States Code, entitled "Highways", includes most of the laws that govern the FAHP arranged systematically or codified. Generally, Title 23 embodies those substantive provisions of highway law that Congress considers to be continuing and which need not be reenacted each time the FAHP is reauthorized. Periodically, sections of Title 23 may be amended or repealed through surface transportation acts.

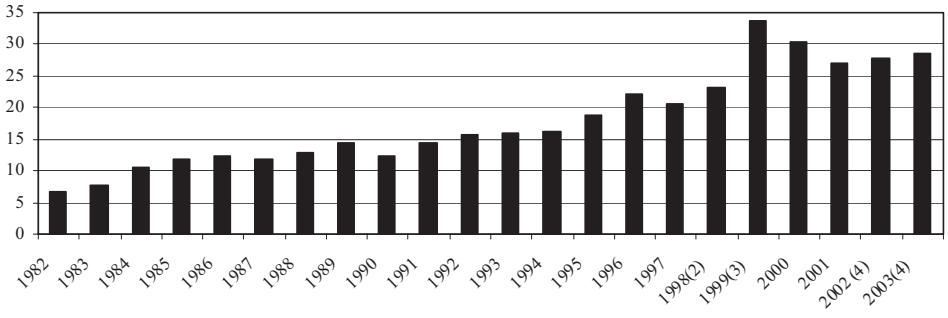
**Federal Highway Trust Fund**

The FHWA administers payments to states under the FAHP through the HTF. Funded by collection of federally-imposed motor vehicle user fees, primarily fuel taxes, the HTF is a dedicated fund with dedicated revenues that are held in trust for reimbursement of the states' cost of transportation projects, including highway projects. The HTF presently contains the Highway Account and a Mass Transit Account. Using revenues in the Highway Account of the HTF, the FHWA reimburses states for expenditures related to approved highway projects. The FHWA distributes these revenues to states based on apportionment and allocation rules prescribed by federal law.

Current law requires that the cash balance of the Highway Account of the HTF, plus projected revenues for the next two years, must suffice to repay all unpaid authorizations before any additional apportionments of revenues can be made from the HTF. As a result, and unlike most federal programs, the flow of federal funding to states for highway projects does not depend on timely appropriation of revenues by Congress.

Federal gasoline excise taxes are the largest revenue source for the HTF. The majority of these tax revenues, including 15.4 cents per gallon out of the current 18.4 cents per gallon tax, go to the Highway Account. The following table shows annual and projected HTF collections in the Highway Account for the period FFY 1982 to FFY 2003.

**Payments into the Highway Account of the Highway Trust Fund (1)**
**Federal Fiscal Years 1982-2003 (in billions)**




SOURCE: FFY 1982-2001, FHWA, Highway Statistics (2001) Table FE-210; FFY 2002-2003, U.S. Treasury Notice PO-3085 (May 9, 2002).

(1) Exclusive of Interest Earnings.
(2) Reflects the redirection of 3.44 cents of the Gas Tax from deficit reduction to the Highway Account of the HTF.
(3) FHWA estimates that $5.0 billion in FFY 1998 receipts were not received until FFY 1999 due to the Tax Payer Relief Act of 1997. Accordingly, adjusted FFY 1998 receipts would be $28.1 billion and adjusted FFY 1999 receipts would be $28.7 billion.
(4) Estimated.

*The HTF Balance.* Since 1956, the Highway Account of the HTF has accumulated a surplus of revenues because more revenues have been generated for the account through collections and interest income than have been distributed to states under the FAHP. TEA 21 established an opening balance of $8.0 billion for the Highway Account of the HTF, effective October 1, 1998. The HTF is required under current federal law to maintain a positive balance to ensure that prior commitments for federal revenues can be met. This requirement allows states the flexibility to earn and receive reimbursement revenues for up to four years after federal funds first were obligated.

*Reauthorization of HTF Collections*. Collection of HTF taxes ("HTF collections"), like the FAHP itself, must periodically be reauthorized by Congress. Historically, the HTF and its constituent taxes have been authorized to operate for limited periods of time. Originally, the HTF was authorized through June 1972; it has been reauthorized several times. Most recently, TEA 21 authorized HTF collections through FFY 2005, and the transfer of the taxes to the HTF through June 30, 2006.

**History**

The modern FAHP originated in the Federal-Aid Highway Act of 1956. The FAHP initially was established as a pay-as-you-go system, meaning that costs of constructing and maintaining the system were to

be borne primarily by its users, who would pay a federally-imposed tax on motor fuels. Federal user fees were to provide 90% of the cost of construction, with the remainder paid for by the states.

The Federal-Aid Highway Act of 1956 was the first of a long series of authorizing statutes for the FAHP. Extensions of the act were passed in 1958, 1959, 1960, 1961, 1962, 1964, 1966, 1968, 1970, 1973, 1974 and 1976; in each case the statute was known simply as the Federal-Aid Highway Act. The 1965 Highway Beautification Act made minor additions and changes to the program, as did the Highway Safety Act of 1973. The 1978 Surface Transportation Act and the Federal-Aid Highway Act of 1981 were also primarily extensions of existing authority. TEA 21, which expired on September 30, 2003, and its immediate predecessor, the Intermodal Surface Transportation Efficiency Act of 1991 ("ISTEA"), are the most recent multi-year authorizing statutes. The current authorizing statute, the Surface Transportation Efficiency Act of 2003 ("STEA 2003"), which expired on February 29, 2004, was passed by Congress on September 26, 2003 and is seen as an interim reauthorization.

The 1982 Surface Transportation Assistance Act ("STAA") made notable changes to the FAHP, and began the modern multi-year (i.e., four or more years) authorizing process. STAA also guaranteed each state a minimum 85% return on the money paid in by highway users of the state. Such "equity provisions" have continued in all subsequent authorizing legislation to date, and operate to compensate so-called "donor states," whose historic highway funding levels have been below their collections for the HTF.

In 1991, ISTEA broadened the focus of the FAHP, changed its structure significantly and created several new funding categories. ISTEA also gave state and local governments far greater flexibility in determining their transportation infrastructure priorities, whether transit or highways, and for the first time allowed significant flexibility to redirect federal revenues among programs. ISTEA also authorized innovative approaches to federal-aid highway funding, including the use of private sector funding sources for transportation improvements. Innovative financing procedures were authorized and encouraged, and states were authorized to augment federal revenues with alternate sources of revenues.

The National Highway System Designation Act of 1995 (the "NHS Act") designated the National Highway System to include the Interstate System as well as other roads important to the nation's economy, defense, and mobility. The NHS Act made several changes affecting the financing of federal-aid highway projects, including Advance Construction procedures:

- Standard federal highway financing practices require states to have sufficient Obligation Authority before they begin a highway project. If a state has many projects or a particularly large project, they may be unable to provide enough Obligation Authority to get federal approval to begin specific projects. To avoid delays in projects that are eligible for federal funding, the FHWA may approve Advance Construction for a project if the state can provide 100% of the costs up-front.

- Under Advance Construction procedures prior to the NHS Act, only when a state had amassed sufficient Obligation Authority to cover the federal share of a project's total costs could it convert the project from Advance Construction to Obligation Authority and be reimbursed for the federal share. The NHS Act removed the requirement that states must amass Obligation Authority equal to the full federal share before reimbursement could occur. Partial conversion now allows a state to be reimbursed for a portion of the federal share of the project's total costs as Obligation Authority becomes available each year and costs are expended.

In addition, the FHWA has issued guidelines for debt-financed federal-aid highway projects. Key provisions of these guidelines are:

- Debt-financed projects are subject to requirements of Federal Clean Air Act and federal air quality conformity requirements, discussed below under "Regional Planning and Air Conformity."

- A state may make arrangements with the FHWA Division Office regarding the procedures under which it would submit a billing to FHWA for debt-related costs. A request for debt service payment can be timed so that reimbursements could be received shortly before the debt service payment date.

- A state may designate a trustee or other depository to receive federal-aid debt service payments directly from FHWA.

*TEA 21*. TEA 21, which became law on June 9, 1998 and was amended on July 22, 1998, extended the authorization of the FAHP through FFY 2003. TEA 21 expired on September 30, 2003. According to the FHWA, under TEA 21 average annual authorizations for highway aid to the states for FFY 1998 through FFY 2003 are approximately $28.5 billion, as indicated in the table below (which shows figures by FFY and in billions of dollars):

| 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | Average |
|---|---|---|---|---|---|---|
| $23.8 | $28.2 | $28.7 | $29.5 | $30.0 | $30.6 | $28.5 |

Source: Financing Federal-Aid Highways, Publication No. FHWA-PL-99-015, August 1999 (available on FHWA website).

TEA 21 increased equity protections by assuring each state at least 90.5% of its proportional share of apportioned programs, based on its percentage contribution to HTF receipts, which were reauthorized through FFY 2005. TEA 21 also includes a provision known as Revenue Aligned Budget Authority ("RABA") which requires that HTF revenues be spent on transportation-related improvements, rather than allowed to accumulate into large surpluses. To this end, TEA 21 set yearly minimum guaranteed funding levels for the authorization period, which are based on annual HTF revenues.

TEA 21 also provided that interest will no longer accrue on funds in the Highway Account and that as of October 1, 1998 (the start of FFY 1999), the opening balance of the Highway Account of HTF would be set at $8.0 billion. According to the FHWA Office of Fiscal Services, this amendment reduced the HTF balance by approximately $7 billion, but will not affect the solvency of the HTF because actual annual funding levels will be based on the previous year's HTF revenues.

On September 30, 2004, Congress approved the Surface Transportation Extension Act of 2004, providing a sixth extension of TEA-21, the previous Federal Reauthorization Act of 2004, which expired on September 30, 2003. This sixth extension continued highway and transit funding at 2003 levels until May 31, 2005. A seventh extension through June 30, 2005 has been approved by Congress and signed by the President. While Congress' approval included an increase from 2003 funding levels, negotiation as to the amount of the increase continues.

**Operations**

The present FAHP continues to reimburse a large percentage of state expenditures for approved highway projects. The financial assurance provided by the FAHP is unusual among federal programs in that:

- The FAHP is based on dedicated revenues, from a user-tax source, deposited in a dedicated trust fund (the HTF);

- The budget and contract authority of the FHWA is typically established by a multi-year authorization act rather than annually through appropriation acts; and

- Contract authority is not at risk during the annual appropriations process (as budget authority is in most other federal programs).

The process for reimbursing state expenditures may be summarized in three steps: authorization, obligation and program implementation. The authorization step is the most critical step in establishing overall spending authority for federal highway funding. Authorizing legislation extends the life of the FAHP and the collections that fund the HTF, sets FAHP objectives and provides formulas for determining the distribution or apportionment of available resources among the states. The existence of the dedicated revenues in the Highway Account of the HTF and the existence of multi-year (or under STEA 2003, multi-month) contract authorizations are designed to help to make available a predictable and uninterrupted flow of reimbursements to the states. The risk of contract authority lapsing between authorizing acts is minimal since sufficient unobligated balances generally exist that cover gaps in coverage between multi-year (or multi-month) reauthorization acts.

The second step, obligation, is the process through which states make use of, or "obligate," the contract authority that has been apportioned or allocated to them in the authorization process (Step 1). Congress typically limits the amount of Obligation Authority that states may use annually. To whatever extent that a state's Obligation Authority is set below its authorization, the unobligated balance for that state is increased. These unobligated balances provide available funds, from which the FHWA allows states to draw, when there is a lapse period between authorization acts. But under current law the unobligated balances do not otherwise entitle the states to additional funds.

The third step, program implementation, leads to actual receipt of federal funds by states. FAHP implementation methods vary state-by-state. States are permitted to make use of Advance Construction and partial conversion of Advance Construction in order to obligate varying amounts of federal funds to an eligible project from FFY to FFY, depending on how much of the state's Obligation Authority is available from the FAHP and is desired for such use by the state.

### *Step 1: Authorization*

The first step, and the most crucial in financing the FAHP, is the multi-year (or under STEA 2003, multi-month), authorizing legislation. Such highway authorization acts:

- Establish the taxes that fund the HTF and extend their life (reauthorization);

- Establish the specific programs and procedures through which states receive federal financial assistance for their highway programs; and

- Set upper limits on funding for specific programs and for the overall FAHP.

*Multi-year Authorization Acts*. As noted earlier, the FAHP since 1982 has been periodically reauthorized on a multi-year basis by authorization acts, through which Congress influences the level of federal involvement in state highway program activities. There is no guarantee, however, that reauthorization of the FAHP will occur on a multi-year basis. Annual appropriations acts then establish any limits on the amount of federal funds that the FHWA may obligate to states in a given year.

*Budget and Contract Authority*. All federal programs require budget and contract authority before revenues may be committed and spent. Normally this authority is provided through a two-step process, with

authorizing legislation describing the purposes for a specific program and setting a proposed level of spending, and appropriations acts providing the budget authority or legal ability to spend federal revenues. Appropriations are often for a lower amount than that set by authorizations. The FAHP combines these two steps, with authorizing legislation providing the United States Secretary of Transportation with contract authority or the legal ability to enter into binding contracts with state transportation departments ("DOTs") and other bodies specified in the FAHP.

Contract authority provides state DOTs with assurance about the level of future federal revenues that will be available. This, in turn, makes it easier and more cost-effective to plan and execute multi-year construction projects. As a result of contract authority and the collection of user taxes into the dedicated HTF, the formal appropriation by Congress of revenues on an annual basis generally has been non-controversial. Constraints arising from the annual appropriation process are described in Step 2 below.

*Lapsing of Authorization*. All federal programs must be authorized through enacted legislation that defines the programs and establishes maximum funding levels, and for most programs annual appropriations acts are necessary in order to create budget authority. Indeed, for most federal domestic discretionary programs, a lapsed authorization may have little or no effect on a program, so long as revenues are appropriated. For the FAHP, the consequences of lapsed authorization caused when Congress fails to enact reauthorization legislation are somewhat different. While Congress may pass interim legislation, the existence of contract authority and a dedicated revenue stream means that the FHWA usually can continue to provide Obligation Authority by administrative action.

Though recent multi-year federal surface transportation legislation has authorized the Federal-Aid Highway Act for four to six years at a time, there occasionally have been periods in which the previous authorizing legislation had expired and the future multi-year legislation had yet to be enacted. In such circumstances, including the current period, Congress and/or the FHWA have found ways to avoid disruptions to state highway programs and, more importantly, have been able to maintain the flow of federal revenues to states in each instance. Two mechanisms in particular have kept revenues flowing:

- Access to Unobligated Balances: The 1987 Surface Transportation and Uniform Relocation Assistance Act ("STURAA") expired on September 30, 1991 and ISTEA was not enacted until December 18, 1991. The FHWA was able to act administratively to keep federal-aid funding flowing because states could use their unobligated balances to provide Contract Authority to use new Obligation Authority.

- Short-Term Authorization: ISTEA expired on September 30, 1997 and until approval of TEA 21 on June 9, 1998, no new long-term authorization legislation was enacted. Despite the lack of long-term authorizing legislation, states were provided an upper limit on Obligation Authority through passage of an appropriations act plus access to their unobligated balances. On November 13, 1997 Congress passed the Surface Transportation Extension Act of 1997 ("STEA"), which provided a six-month authorization for highway funding and established a limit on the amount of new Obligation Authority states can use at funding levels equal to about a quarter of FFY 1997 authorization levels. Similarly, TEA 21 expired on September 30, 2003 and no new long-term authorization has yet to be enacted. However, STEA 2003 reauthorized the FAHP for five months, to February 29, 2004, and a Continuing Resolution provided one month's additional funding for the FAHP. Subsequently, the reauthorization was extended to May 31, 2005. A Continuing Resolution is a joint resolution enacted by Congress and signed by the President, when the new federal fiscal year is about to begin or has begun, to provide budget authority for federal agencies and programs to continue in operation until appropriation acts are enacted.

From October 1, 1997, the expiration of ISTEA, through November 13, 1997, the passage of the STEA authorization, the FHWA was able to continue funding the FAHP through use of large unobligated balances (unused contract authority) in the FAHP. Since most states have unobligated balances of at least half their normal annual Obligation Authority levels and an authorization act need not be in place for the FHWA to give states new Obligation Authority, states were able to spend down prior unfunded federal apportionments (contract authority) with newly allocated Obligation Authority. The lack of an enacted authorization act during this period did not pose a threat to the continued flow of revenues, because dedicated highway user fees continued to flow into the HTF. (See Step 2, below, for further explanation of Obligation Authority and unobligated balances.)

*Annual Distributions*. For most components of the FAHP, the authorization acts set the distribution of spending authority among states. The primary methods used to distribute authorized federal highway revenues are "apportionment" and "allocation":

- Apportionments. The contract authority created by authorization acts such as ISTEA or TEA 21 is distributed annually among the 50 states, the District of Columbia, and Puerto Rico using a process called apportionment of revenues. Apportionments indicate the maximum amount of contract authority that each state can expend for eligible projects in specific programs. For each FFY, the FHWA has responsibility for apportioning authorized funding for the various programs among the states according to formulas established in the authorizing statute. Annual apportionments are generally made on the first day of the federal fiscal year, which is October 1.

- Allocations. While most highway revenues are distributed to states through apportionments, some funding categories do not contain legislatively-mandated apportionment formulas. Distribution of revenues where there are no statutory formulas is called "allocation" or "discretionary allocation". In most cases, allocated federal funding is divided among states using criteria determined administratively by the federal Department of Transportation or as provided in a statute, often through competitive grant procedures.

Apportionment formulas have been designed historically to ensure distribution of federal revenues among states according to program needs, but are also increasingly intended to provide states a share of total HTF expenditures relatively close to their payments into the HTF.

Since FFY 1991, each annual aggregate apportionment has exceeded $15 billion, and beginning in FFY 1998, has increased from $21.5 billion to $29.5 billion in FFY 2002. (Source: The FHWA, Highway Statistics, (1997 through 2001) Table FA-4.) The FHWA estimates that Highway Account income over the six-year period FFY 1998-2003 would be $169.8 billion; combined with the opening balance under TEA 21 of $8.0 billion, this would yield resources of $177.8 billion for the FAHP. TEA 21 authorized an annual average of approximately $28.5 billion for FFY 1998 through FFY 2003. STEA 2003 authorized a monthly average of approximately $2.8 billion for October, 2003 through February, 2004.

*Availability of Federal Highway Revenues*. Federal-aid highway revenues are available to states for use for more than one year. Their availability does not terminate at the end of the FFY, as is the case with many other federal programs. Consequently, when new apportionments or allocations are made, the amounts are added to a state's unused apportionments and allocations from the previous FFY. Should a state fail to *obligate* (commit to spend) a year's apportionments and allocations within the period of availability specified for a given program, however, the authority to obligate any remaining amount lapses—that is, it is no longer available except for a few programs which receive indefinite, or "no-year" Obligation Authority.

*Matching Requirements*. With a few exceptions, the federal government does not pay for the entire cost of construction or improvement of federal-aid highways. Federal reimbursements are typically matched with state and/or local government revenues to account for the necessary dollars to complete the project. The maximum federal share is specified in the legislation authorizing the program. Most projects have an 80% federal share while Interstate Construction and Maintenance projects typically have been funded with a 90% federal share.

### *Step 2: Obligation*

The second step of the federal-aid funding process occurs when revenues that have been authorized by legislation, and either apportioned or allocated to individual states, are obligated for a specific purpose. As noted in the previous section, Congress uses annual appropriations acts to control actual annual obligation of funds in the HTF. Appropriations acts limit the amount of federal money that actually will be obligated and thus ultimately spent, and these annual amounts may be less than the authorized amount. This ceiling on the amount of contract authority that states may use is called the "annual obligation limit."

*Obligation* is the commitment of the federal government to pay, through reimbursement to a state, the federal government's share of an approved project's eligible costs. This process is important to the states because it allows states to award contracts with assurance that the federal government will reimburse its share of incurred costs. From the federal perspective, obligations made are the outlays the federal government has committed to make from the HTF in the future. Because of the close relationship between obligations and outlays, Congress and the FHWA play a strong role in determining how much federal funding can be obligated by individual states through two primary processes:

- Appropriations acts; and
- Distribution of Obligation Authority.

*Appropriations Acts*. Congressional appropriations committees use the amount of federal-aid highway revenues that states can obligate in a given year, called "Obligation Authority", as a means of balancing the annual level of highway spending with other federal budgetary priorities. This is accomplished through the establishment of an annual obligation limitation in the annual Department of Transportation and Related Agency Appropriations Act. The annual obligation limitation can be less than the level of funding authorized for the same year, although the creation of budgetary firewalls and RABA in TEA 21 substantially limited the amount of HTF revenues that can be used for non-highway purposes.

*Distribution of Obligation Authority*. The obligation limitation is the amount of authorized funding that Congress allows states collectively to obligate in an individual year. Under TEA 21, the annual obligation limitation included two elements – a large portion protected by firewalls and tied to projected HTF receipts through RABA (roughly 90% of total annual contract authority), and a smaller portion that competes with other discretionary budget priorities for funding (less than 10% of total annual contract authority). Beginning in FY 2000, the level of Obligation Authority protected by firewalls is established each year as the guaranteed obligation limitation in TEA 21, adjusted by the difference between HTF revenue estimates made for TEA 21 and new Department of Treasury projections. Additional, discretionary Obligation Authority is determined when annual appropriations bills are developed and is counted under Congress' annual spending cap, which is the amount of federal dollars that can be spent on all domestic, non-entitlement programs in a given year. The combined total may still be below the authorized annual level, and serves as a limit on the total obligations in that particular year.

Once Congress establishes an overall obligation limitation, the FHWA distributes Obligation Authority to states proportionately to each state's share of apportioned and allocated revenues to include

minimum guarantee allocations that bring donor states up to the minimum 90.5% funding level. The actual ratio of Obligation Authority to apportionments and allocations may vary from state to state because some federal-aid programs are exempt from the obligation limitation. Once each state's Obligation Authority is set, states then submit requests to the FHWA to obligate revenues representing the federal share of specific projects throughout the years. (A further description of this process is included in Step 3.) As a state obligates revenues, its balance of Obligation Authority is commensurately reduced, although additional Obligation Authority may be received (e.g., via re-allocation from other states).

A state's Obligation Authority (unlike its apportionments and allocations of authorized funding) must be used before the end of the FFY for which it is made available; if not, it will be distributed to other states. The FHWA closely monitors each state's plans for use of Obligation Authority. In mid-summer, the FHWA collects any Obligation Authority from states that do not plan to obligate all of their available Obligation Authority before the end of the FFY, and redistributes it to other states that can obligate the revenues. This reallocation of Obligation Authority is known as the August redistribution.

*Unobligated Balances*. Because congressional authorization of federal-aid highway revenues represents a commitment to make all authorized revenues available to states for highway purposes, any shortfall between the limit on Obligation Authority created through the annual appropriations process and the amount of contract authority apportioned and allocated to states does not disappear. Instead, the difference between obligation limitations and authorization levels creates what are known as "unobligated balances."

Although most federal-aid apportionments lapse after four years, this rarely happens with apportioned highway revenues because old apportionments are always spent before new apportionments. That is, when a state receives new apportionments and Obligation Authority at the beginning of a FFY, obligations are first made against remaining prior year apportionments plus allocation until these are depleted. The net effect of this process, in conjunction with the year-to-year establishment of obligation limitations, has been that states have amassed considerable unobligated balances.

As explained in Step 1, above, unobligated balances permit the FAHP to continue to fund state highway projects during periods in which Congress fails to enact a reauthorization law before the expiration of the previous authorization period. In such periods, the unobligated balances allow states to continue to fund their programs for several months, or even longer, after an authorization act has expired.

### ***Step 3: Program Implementation***

The third and final step in the overall federal-aid highway funding process—program implementation—occurs after authorized revenues have been distributed to states, and after states have had the opportunity to obligate those revenues. Once federal-aid highway revenues have been authorized and obligated, states must have developed highway programs that describe, at a project-by-project level, exactly how federal reimbursements will be earned. The process of developing and implementing state highway programs has three broad stages:

- Budgeting;
- Planning and programming; and
- Fiscal management and reimbursement.

*Each stage helps to ensure that states develop programs which match funding availability, and that the FHWA is able to distribute federal reimbursements to states in a timely manner.*

*Budgeting*. Budgetary information about availability of funding is crucial to the development of state highway programs. Projected state and federal funding levels are used to budget transportation needs. Consequently, state transportation budget officials track the availability of funding and develop forecasts of future state and federal revenues. States must estimate the availability of short and long-term state and federal funding in order to plan their highway programs. They use this information as a guide during long-range planning, and as a strict constraint on short-term programming. In Kentucky, the State Agency's budget for the biennium period is prepared in accordance with Chapter 48 of the Kentucky Revised Statutes and based on two-year projections made in light of long-range program requirements and revenue estimates for both state and federal funds. The biennial budget request is prepared by the State Agency and presented to the Governor for submission to the Kentucky General Assembly at its biennial session. The estimates of state revenues are made by the consensus forecasting process as prescribed by Chapter 48.115 of the Kentucky Revised Statutes. The estimates for federal funds are made by the State Agency.

*Planning and Programming*. The Commonwealth's road planning process is structured to ensure the development of a continuous and credible highway improvement program that complements the Commonwealth's overall transportation system. The process and its products have evolved considerably in recent years as the State Agency has lengthened its planning horizon and the General Assembly has assumed a more participatory role.

Prior to 1982, the State Agency had internally identified, planned, and designed potential projects. Those projects which were approved by the Secretary were made a part of the State Agency's five-year program and moved to construction as funds became available. In the 1982 Regular Session of the Kentucky General Assembly, legislation was enacted calling upon the State Agency to present each regular session of the General Assembly with a proposed highway construction program for the next three biennial periods. This proposed program for the three biennial periods is referred to as the "Six-Year Plan."

The Six-Year Plan consists of a biennial construction program and a four-year preconstruction planning document. It is through this plan that legislative involvement in the project development process has been assured. In recent years, the Six-Year Plan has formed the foundation for development by the State Agency of a more forward-looking transportation planning tool, which is formally known as the "Statewide Transportation Plan." This plan, required first by the 1991 Federal Authorization Act, Intermodal Surface Transportation Efficiency Act ("ISTEA") and continued in the Transportation Equity Act for the 21st Century ("TEA-21") in 1998, integrates all modes of transportation and expands the horizon of project needs identification beyond the six-year period prescribed by Kentucky statutes and allows a more far-sighted approach to transportation planning.

*Highway Plan Development.* Beginning with an unconstrained list of potential projects, the planning process, utilizing input from local citizens and officials, Area Development District Public Involvement Committees, Metropolitan Planning Organization Committees, and Cabinet staff, sets priorities and establishes a 20-year program based on future funding levels. Highway projects identified for the first six years and approved by the Kentucky Legislature every two years, represent the highest priority projects and constitute the Six-Year Plan. The remaining projects are prioritized and selected every four years for the long range Statewide Transportation Plan and for possible inclusion in later Six-Year Plans. The most current Six-Year Plan consists of approximately 1,240 roadway projects that are eligible for state and federal funding. Each project has been evaluated, based on its relative contribution toward the satisfaction of four goal-oriented criteria. These goals focus on: (1) preservation and management of the existing transportation system, (2) providing system connectivity of the individual modes to promote economic development, (3) coordination and cooperation among a wide variety of interests in the transportation planning process, and (4) enhancement of transportation system safety and convenience for the benefit of its many users.

In preparing the Six-Year Plan, the State Agency projects anticipated future funding levels against which future projects can be established. An effort is made to identify annual funding ceilings within each funding category and to budget proposed highway activities against those dollars expected to be available during the period. Once anticipated funding levels are set, projects are included in each funding category.

*Needs Identification*. To assist in the identification of highway needs across the Commonwealth, the State Agency conducts an on-going roadway inventory program. The data gathered through the inventory process is wide-ranging and includes such criteria as traffic volumes, physical roadway features (pavement width, pavement condition, bridge conditions, etc.), accident statistics, and average travel speeds. This information is analyzed to arrive at a relative assessment of the service provided by each roadway section.

In addition to the evaluation of roadway inventory data, the State Agency relies heavily upon input from the Commonwealth's 15 Area Development Districts, the nine Metropolitan Planning Organizations, members of the General Assembly, public involvement and community action committees and the leaders of city and county governments for project needs identification. This "partnership" involving participants from the local, regional, and state levels provides information to the State Agency concerning growth trends, connectivity and access issues and economic development efforts to which the highway infrastructure must respond. Additionally, the State Agency's engineering and technical staff perform travel demand and traffic forecasting and systems analysis to allow application of those key elements in the identification of projects.

*Implementation of the Six-Year Plan*. Kentucky's Six-Year Highway Plan is funded through the use of Commonwealth and federal highway dollars. Commonwealth funds are generally derived from fuel and motor vehicle excise taxes and other revenues to the Road Fund, plus the proceeds from road bonds issued by the Turnpike Authority of Kentucky. Commonwealth funds are allocated to the State Agency on a biennial basis and are used to finance state-funded projects or to match federal aid funds at various participation ratios dictated by the federal government.

The majority of Kentucky's federal-aid highway funds are appropriated annually from the Federal Highway Trust Fund operated by the U.S. Department of Transportation. As an Appalachian state, the Commonwealth receives, in additional to standard apportionments, an annual apportionment of Appalachian highway funds from the Federal Highway Trust Fund. Regardless of origin, all federal dollars must be spent within the appropriate funding category and cannot be transferred for use in other federal-aid categories except as specifically permitted by federal legislation. The annual program of federal-aid projects is excerpted from the State Agency's Six Year Highway Plan and presented in the Statewide Transportation Improvement Plan ("STIP"). The STIP incorporates the nine Metropolitan Planning Organization's TIPs and represents the means through which the State Agency and FHWA jointly administer Kentucky's annual federal-aid transportation program.

*Fiscal Management and Federal Highway Reimbursements*. Once budgeting, planning and programming are complete, projects move into a fiscal management phase. This fiscal management process is the third element of the implementation step in the overall federal highway funding process. A state-led fiscal management system—conducted in accordance with FHWA requirements—is used to determine exactly how much federal funding will be received for each project, to obtain final FHWA authorization before projects are implemented, and to ensure timely federal reimbursement of state expenditures on contractor costs. In Kentucky, these activities are jointly performed by the State Agency's Department of Highway's Division of Program Management and the Department of Budget and Fiscal Management's Division of Accounts.

States must follow federal fiscal management procedures as they implement projects that have passed through the approval and programming processes. These fiscal management procedures ensure that the

FHWA and states are able to manage the process efficiently, from project authorization to actual payment of Federal Highway Reimbursements to the state.

In the traditional approach, a state simply obligates the full federal share of available funding at the beginning of the project, concurrent with project authorization. The first step in the fiscal management process begins when a state requests authorization to use federal funding on a project. The project sponsor (e.g., the State Agency) submits plans, specifications and estimates ("PS&Es") for a project to the FHWA division office, and requests that the FHWA approve the use of federal funding for the appropriate federal share of the project. The project must be in the STIP and the PS&Es must identify the category of federal funding that will be used.

The FHWA evaluates the PS&Es to ensure that the project is eligible for federal funding and meets a variety of federal requirements (e.g., design standards). Provided that all requirements are satisfied, the FHWA authorizes federal participation in the project, and obligates the federal share of project costs. By obligating the revenues, the FHWA makes a commitment to reimburse the state for the federal share of eligible project costs. It sets aside the appropriate amount of that state's Obligation Authority, and also sets aside an equivalent amount of apportioned revenues by program (or programs). Accordingly, the state must have sufficient Obligation Authority to cover the level of federal participation it is requesting.

Once authorization for a project has been obtained, the state advertises the project and receives bids. Based on actual costs identified in bids, the state awards the contract to the lowest qualified bidder and submits a request to the FHWA asking for any necessary adjustments to federal obligations for the project. If approved, the amounts agreed to are included in a project agreement which identifies the revenues that will be encumbered by the state (formally applied against the state's resources), and the amount that will be reimbursed by the federal government.

Construction begins, and contractors submit bills to the state as work is completed. A state pays its contractor's bills with cash from the state treasury; the state bills the FHWA electronically for the federal share of completed work for which payment has been made; and the FHWA makes payment to the state via electronic transfer. This FHWA reimbursement to the state liquidates its obligation for the federal share of the costs incurred to that point. As project work continues and state expenditures are reported to the FHWA, federal reimbursements are made. In Kentucky, reimbursement requests are submitted weekly and reimbursements are made by wire transfer generally within one to two days. The Commonwealth's systems and management in general, are highly automated, leading to a routine flow of Federal Highway Reimbursements based on actual spending on approved projects.

Innovative variations on this fiscal management approach include Advance Construction and partial conversion of Advance Construction. These variations complement one another to provide a state with additional flexibility in managing its Obligation Authority and cash.

The Advance Construction approach for authorizing projects allows states to finance projects that are eligible for federal aid without obligating the federal share of costs at the outset of the project. This allows states to begin a project before amassing all of the Obligation Authority needed to cover the federal share of that project. As with the traditional approach, the state submits PS&Es to the FHWA and requests project authorization. Under Advance Construction, however, the FHWA is asked to authorize the project without obligating federal revenues. As a result, the state will cover the entire cost of the project and later may request the obligation of revenues, when sufficient Obligation Authority is available and is desired by the state. Further, the state may then take credit for state expenditures, made from project approval to that date, as a basis for earning reimbursements.

Once the FHWA authorizes a project for federal assistance, the state follows the same procedure to advertise a project, to award the contract, and to reconcile the level of state and federal funding required. The state may request that the FHWA convert its Advance Construction amount to an obligation at any time, provided the state has sufficient Obligation Authority. This conversion of Advance Construction to Obligation Authority must occur in order for the state to be reimbursed for the federal share of the project. The state can convert Advance Construction to Obligation Authority long after state expenditures are made.

Under partial conversion of Advance Construction, moreover, a state follows the steps to apply for Advance Construction but converts, obligates, and receives reimbursement for only a portion of its funding of an Advance Construction project in a given year. This removes any requirement to wait until the full amount of Obligation Authority is available. The state can thus obligate varying amounts for the project's eligible cost in each year, depending on how much of the state's Obligation Authority is available and desired by the state.

States are required to use a detailed accounting system to track project expenditures and reimbursements. In addition, a federal system tracks payments to states. The State Agency uses a statewide computer-based project accounting, reporting and billing system to track encumbrances and expenditures for all projects, including highway projects, administered by the Commonwealth.

**The Memorandum of Agreement**

The State Agency has entered into, and the Commission and the Cabinet have acknowledged, the Memorandum of Agreement with FHWA relating to the Project. Under the Memorandum of Agreement, FHWA has agreed to make payments to the State Agency, which the State Agency has agreed, subject to appropriation, to remit to the Trustee, in an amount equal to the principal of, premium, if any, and interest on the Notes, when due. Under the Financing Agreement, the State Agency covenants to comply with applicable law and the Memorandum of Agreement to the extent required for the State Agency to receive on behalf of the Commonwealth all revenues from the FHWA under the Memorandum of Agreement. The Memorandum of Agreement does not constitute a commitment, guarantee or obligation on the part of the United States to provide for the payment of Financing Payments under the Financing Agreement or debt service on the Notes.

**STIP and Long Range Plan Conformity with Federal Clean Air Requirements**

The Commonwealth's counties of Kenton, Campbell, Boone, Jefferson, Bullitt, Oldham, Boyd and Christian are designated as non-attainment for the 8-hour ozone standard with a classification of "basic". The above referenced counties and a portion of Lawrence County are designated as non-attainment for the fine particulate (PM2.5) standard. The EPA's air quality conformity regulations require that the STIP and long range plans be evaluated for emissions impacts in both non-attainment and maintenance areas. The Kentucky STIP and long range plan are analyzed to evaluate change in ozone precursors (volatile organic compounds – VOC and oxides of nitrogen – Nox) and carbon monoxide – CO emissions due to implementation. The air quality analysis has demonstrated that implementation of the Commonwealth's long range transportation plan and STIP is consistent with federal air quality conformity criteria and regulations, and conforms to the air quality goals in Kentucky's State air quality Implementation Plan. See "THE STATE AGENCY AND MANAGEMENT OF STATE HIGHWAY PROGRAM."

## FEDERAL AID REVENUES

Below are tables identifying prior Apportionments, Obligation Authority and Receipts of Federal Aid Revenues by the State Agency from Federal Fiscal Year 1992 through the Federal Aid Authorization ending September 30, 2003. The ability to pay debt service on the Notes will depend upon the amount of funding provided to the Commonwealth under the FAHP and the Commonwealth's ability to use such funding. The

State Agency has been informed by FHWA that its Apportionment and Obligation Authority for the period October 1, 2004 through May 31, 2005 shall be $394,502,000 and $366,541,000, respectively.

**FEDERAL AID REVENUES**
**APPORTIONMENTS, OBLIGATION AUTHORITY AND RECEIPTS**
**FOR THE TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY**
**Under Prior Federal Aid Authorization Period**
**(Intermodal Surface Transportation Efficiency Act of 1991)**
**Federal Fiscal Years 1992 Through 1997**

| Federal Fiscal Year | Apportionments | Obligation Authority | Actual Receipts (State Fiscal Year) |
|---|---|---|---|
| 1992 | $ 289,583,496 | $ 238,378,118 | $ 185,550,415 |
| 1993 | 350,022,753 | 305,669,221 | 225,799,090 |
| 1994 | 277,264,628 | 274,270,944 | 251,620,676 |
| 1995 | 327,236,916 | 301,535,415 | 243,690,710 |
| 1996 | 276,904,396 | 268,049,590 | 259,319,255 |
| 1997 | 368,721,662 | 357,961,981 | 283,099,618 |
| **Totals** | **$1,889,733,851** | **$1,745,865,269** | **$1,449,079,764** |
| **Annual Average (1992-1997)** | **$ 314,955,642** | **$ 290,977,545** | **$ 241,513,294** |

**FEDERAL AID REVENUES**
**APPORTIONMENTS, OBLIGATION AUTHORITY AND RECEIPTS**
**FOR THE TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY**
**Under Prior Federal Aid Authorization Period**
**(Transportation Equity Act for the 21st Century)**
**Federal Fiscal Years 1998 Through 2004**

| Federal Fiscal Year | Apportionments | Obligation Authority | Actual Receipts (State Fiscal Year) |
|---|---|---|---|
| 1998 | $ 437,545,989 | $ 398,509,664 | $ 317,707,557 |
| 1999 | 462,449,235 | 408,005,511 | 363,772,286 |
| 2000 | 525,960,359 | 462,329,857 | 507,798,074 |
| 2001 | 588,422,708 | 524,762,964 | 485,240,901 |
| 2002 | 597,401,435 | 560,721,883 | 537,622,783 |
| 2003 | 542,835,750 | 568,620,816 | 475,614,887 |
| 2004 | 567,206,194 | 550,393,468 | 481,741,077 |
| **Totals (1998 – 2004)** | **$3,721,821,670** | **$3,473,344,163** | **$3,169,497,565** |
| **Annual Average (1998-2004)** | **$ 531,688,810** | **$ 496,620,595** | **$ 452,785,366** |

Source: The Transportation Cabinet of the Commonwealth of Kentucky.

## DEBT SERVICE REQUIREMENTS FOR THE NOTES

The following table shows the debt service requirements for the Notes. In order to issue Additional Notes the Commission will be required to comply with certain debt service coverage tests. See "SECURITY FOR THE NOTES - Additional Notes" and "THE PROJECT."

| Federal Fiscal Year | Principal | Interest | Total Debt Service |
|---|---|---|---|
| 2005 | $3,210,000.00 | $1,568,760.52 | $4,778,760.52 |
| 2006 | 8,645,000.00 | 6,707,962.50 | 15,352,962.50 |
| 2007 | 9,025,000.00 | 6,327,312.50 | 15,352,312.50 |
| 2008 | 9,475,000.00 | 5,876,062.50 | 15,351,062.50 |
| 2009 | 9,935,000.00 | 5,416,912.50 | 15,351,912.50 |
| 2010 | 10,460,000.00 | 4,944,962.50 | 15,404,962.50 |
| 2011 | 10,925,000.00 | 4,430,587.50 | 15,355,587.50 |
| 2012 | 11,465,000.00 | 3,886,525.00 | 15,351,525.00 |
| 2013 | 12,040,000.00 | 3,313,275.00 | 15,353,275.00 |
| 2014 | 12,640,000.00 | 2,711,275.00 | 15,351,275.00 |
| 2015 | 13,270,000.00 | 2,081,812.50 | 15,351,812.50 |
| 2016 | 13,925,000.00 | 1,427,250.00 | 15,352,250.00 |
| 2017 | 14,620,000.00 | 731,000.00 | 15,351,000.00 |
| | $139,635,000.00 | $49,423,698.02 | $189,058,698.02 |

## THE STATE AGENCY AND MANAGEMENT OF STATE HIGHWAY PROGRAM

### The State Agency

**General**. The Department of Highways was established as an agency of the Commonwealth by the 1912 General Assembly. Pursuant to Executive Orders 72-288 and 73-543, confirmed by the Kentucky General Assembly by legislation enacted in 1974, the Department of Transportation (the "Department"), predecessor to the State Agency, was created as the successor to, and represented a reorganization and consolidation of, the Departments of Highways, Motor Transportation and Aeronautics. The Department also succeeded to certain specific functions and responsibilities of the Department of Public Safety and the Department of Revenue as such functions and responsibilities related to transportation. Pursuant to legislation enacted in 1982, the State Agency was created as a successor to and succeeded to all duties of the Department.

The State Agency is responsible for the construction, reconstruction and maintenance of the Commonwealth's primary road system, which carries an estimated 87% of the Commonwealth's motor vehicle traffic. This represents nearly 41.3 billion vehicle miles of travel. The system consists of some 27,450 miles of toll roads, interstate highways, resource recovery roads, the economic development road system, primary roads, secondary roads, rural secondary roads and supplemental roads, and includes more than 9,000 bridges.

The State Agency also regulates the operation of motor vehicles upon Kentucky's public highways and registers approximately 3.3 million vehicles and licenses 2.6 million drivers. The State Agency is also responsible for enforcing Kentucky and federal laws and regulations pertaining to commercial vehicles in regard to weight and size limits, operating authority, safety, and tax compliance.

**Organization and Management**. The State Agency is organized into five major operating departments: Highways, Administrative Services, Intergovernmental Programs, Vehicle Regulation, and Aviation. Ten offices perform staff functions: Office of the Secretary, Budget and Fiscal Management, Legal Services, Legislative and Intergovernmental Affairs, Business and Occupational Development, Transportation Delivery, Inspector General, Transportation Operations Center, Personnel Management and Public Affairs. The State Agency employs approximately 5,400 people on a full-time basis.

The State Agency is headed by a Secretary of Transportation, who is appointed by the Governor. Each Department is organized under an appointed Commissioner and each Office is supervised by an Executive Director. The engineering functions of the organization are under the supervision of a Commissioner of Highways, a State Highway Engineer and four Executive Directors, who also serve at the pleasure of the Governor. Middle management of the State Agency is composed primarily of career employees, most of whom are members of the classified service, which is the Commonwealth's merit system for employees. Virtually all engineering personnel are protected under the classified service, assuring stability and continuity in the programs of the State Agency.

The State Agency received a letter dated May 9, 2005 from the Civil Rights Program Manager of the regional FHWA office. The letter expressed concerns relative to the State Agency's Affirmative Action Plan ("Plan") submitted to the office in August of 2004 for the period April 1, 2004 to March 31, 2007. The State Agency has reaffirmed its commitment to improving the Plan and cooperating fully with the FHWA in efforts to bring the Plan into compliance with FHWA standards.

**Management of the State Highway Program**

**Operations and Maintenance**. The State Agency provides transportation services to the traveling public through a network of highly developed programs and operating units. To assure prompt and efficient delivery of services across the Commonwealth, the State Agency operates 12 regional district offices, and highway maintenance facilities in each of the 120 counties.

The State Agency relies on automated systems for tracking and assessing the activities in virtually all functional areas. The State Agency uses a sophisticated automated maintenance management system that provides managers with performance data on all aspects of roadway maintenance work. The State Agency also maintains an extensive and detailed database of the Commonwealth's highway infrastructure, which the State Agency has valued at more than $150 billion (based on replacement cost).

The State Agency is committed to efficiency and cost containment. First, the Commonwealth has made an effort over the past decade to restrain growth in government employment levels. The State Agency has been among the most successful state agencies in actually reducing personnel levels. Second, the State Agency has sought to use private contractors to perform maintenance and other functions where economies can and have been realized. Finally, the State Agency's enhanced program of resurfacing and major road construction and reconstruction has reduced the need for day-to-day maintenance on many routes.

## 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 Secretary of the Revenue Cabinet and the State Budget Director. 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.

The current members of the Commission are as follows:

| | |
|---|---|
| R. B. Rudolph, Jr. | Secretary of the Finance and Administration Cabinet, Chairman |
| Gregory D. Stumbo | Attorney General |
| Jonathan Miller | State Treasurer |
| Bradford L. Cowgill | State Budget Director |

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**

**General.** The Commission has had outstanding obligations in several different forms, including tax and revenue anticipation notes and project notes. Project notes are issued as General Fund Series, Agency Fund Series and Road Fund Series depending upon the appropriation fund source that is being used to fund the payments under the related financing/lease agreement. The Notes are being issued as Federal Highway Trust Fund Series and are the first notes issued by the Commission with that repayment fund source. 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 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 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.

**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. These payments are ultimately dependent upon General Fund appropriations by the General Assembly of the Commonwealth. On the date of delivery of the Notes, the Commission will have the following General Fund Project Notes outstanding.

| Project Notes | Amount Issued | Amount Outstanding as of May 1, 2005 |
|---|---|---|
| 2001 General Fund First Series | $ 37,450,000 | $ 17,475,000 |
| 2003 General Fund Series A | 171,260,000 | 123,755,000 |
| 2005 General Fund First Series | 81,850,000 | 81,850,000 |
| Total | $290,560,000 | $223,080,000 |

**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 State Property and Buildings Commission 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. As of the date of delivery of the Notes, the Commission will have $11,275,000 in Agency Fund Project Notes outstanding.

**Project Notes, Road Fund Series**. There are currently no Road Fund Project Notes outstanding.

**Project Notes, Federal Highway Trust Fund Series.** The Notes are the first notes issued by the Commission as 2005 Federal Highway Trust Fund First Series.

**Future Financings**. On April 18, 2005, the Commission authorized the issuance of the Notes, as well as the issuance of TRANs in an amount not to exceed $800 million to fund expenditure demands on the General Fund in fiscal year 2006. The Commission may issue additional Project Notes to fund financing needs for projects authorized by the Budget Act.

## 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, 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 non-manufacturing 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.

### Financial Information Regarding the Commonwealth

The Commonwealth 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 2004 is incorporated herein by reference. The Commonwealth has filed *The Kentucky Comprehensive Annual Financial Report* for Fiscal Year 2004 with the following Nationally Recognized Municipal Securities Information Repositories ("NRMSIRs") in accordance with SEC Rule 15c2-12:

Bloomberg Municipal Repositories
100 Business Park Drive
Skillman, New Jersey 08558
Internet: munis@bloomberg.com
Tel: (609) 279-3225
Fax: (609) 279-5962

DPC Data Inc.
One Executive Drive
Fort Lee, New Jersey 07024
Internet: nrmsir@dpcdata.com
Tel: (201) 346-0701
Fax: (201) 947-0107

Standard & Poor's Securities Evaluations, Inc.
55 Water Street, 45th Floor
New York, New York 10041
Internet: nrmsir_repository@sandp.com
Tel: (212) 770-4595
Fax: (212) 770-7994

FT Interactive Data
Attn: NRMSIR
100 Williams Street
New York, New York 10038
Internet: nrmsir@ftid.com
Tel: (212) 771-6899
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 2004 may be obtained from the NRMSIRs or from the Office of Financial Management, 702 Capitol Avenue, Suite 261, Frankfort, Kentucky 40601 (502) 564-2924. Additionally, *The Kentucky Comprehensive Annual Financial Report* for Fiscal Year 2004 and certain other fiscal years may be found on the Internet at:

http://finance.ky.gov/ourcabinet/caboff/ooc/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 purchasers of the Notes 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.

**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 March 31, 2005, the Commonwealth's operating portfolio was approximately $3.25 billion in cash and securities. The composition of investments was as follows: U.S. treasury securities (11%); securities issued by agencies, corporations and instrumentalities of the United States Government, including mortgage backed securities and collateralized mortgage obligations (42%); repurchase agreements collateralized by the aforementioned (15%); municipal securities (6%); and corporate and asset backed securities, including money market securities (26%). The portfolio had a current yield of 3.35% and an effective duration of 0.89 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 million notional amount to a net market value approach, the absolute value of which cannot exceed $50 million 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.

As of December 31, 2004, the Commonwealth owned an asset-based interest rate swaption straddle. This straddle gives the Commonwealth the right, but not the obligation, to enter into either a receiver or payer five year interest rate swap on December 13, 2005. The market value of the position as of May 13, 2005 was $666,678.

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.

## SUMMARY OF CERTAIN PROVISIONS OF THE MASTER INDENTURE AND THE FINANCING AGREEMENT

### Definitions

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

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

"Additional Notes" shall mean notes issued under the provisions of Section 2.06(1) of the Master Indenture.

"Additional Payments" shall mean the Additional Payments payable under the Financing Agreement.

"Authorized Denominations" shall mean $5,000 and integral multiples thereof.

"Authorized Officer" shall mean, 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 State Agency, its Secretary and any other officer, member or employee of the State Agency authorized by a certificate of its Secretary to perform the act or sign the document in question.

"Budget Act" shall mean the Executive Branch Budget of the Commonwealth authorizing the related Project.

"Business Day" shall mean 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" shall mean the Finance and Administration Cabinet of the Commonwealth.

"Code" shall mean the Internal Revenue Code of 1986, as amended, and shall include the Regulations of the United States Department of the Treasury promulgated thereunder.

"Commission" shall mean the Kentucky Asset/Liability Commission.

"Construction Notes" shall mean Project Notes issued in accordance with the Act to pay the costs of a Project that are issued in anticipation of the issuance of Notes to provide permanent financing for that Project.

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

"Costs of Issuance" shall mean only the costs of issuing 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 the Notes.

"Counsel" or "Counsel's Opinion" shall mean 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.

"Counterparty Exchange Payment" shall mean a payment due from an Exchange Counterparty to the Trustee or the Commission pursuant to the applicable Exchange Agreement (including, but not limited to, payments in respect of any early termination, as provided in the applicable Exchange Agreement).

"Credit Facility" shall mean, with respect to any Series of Notes, a letter of credit, bond insurance policy, surety bond or similar instrument to be issued by a Credit Facility Provider having such terms as are set forth in the related Series Indenture.

"Credit Facility Agreement" shall mean the reimbursement agreement, bond insurance agreement or similar agreement between the Commission and any Credit Facility Provider.

"Credit Facility Provider" shall mean the provider of a Credit Facility with respect to any Series of Notes.

"Debt Servicing Date" shall mean any Interest Payment Date, as defined in the Master Indenture.

"Debt Servicing Obligation" shall mean 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 Cabinet. The Cabinet 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 Master Indenture and applicable law, can be used to meet the Debt Servicing Obligation. It is understood that, pursuant to the Master Indenture, all income derived from investment of the Project Fund may, at the discretion of the Cabinet, be transferred to the Note Payment Fund and, if so transferred, shall be a credit against Financing Payments due and payable by the Cabinet. Amounts transferred from the Cost of Issuance Fund, established by the Master Indenture, to the Note Payment Fund, shall be a further credit against Financing Payments due and payable by the Cabinet.

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

"Exchange Agreement" shall mean an interest rate exchange agreement between the Commission or the Trustee and an Exchange Counterparty, as originally executed and as amended or supplemented, or a similar interest rate hedge agreement, as originally executed and as amended or supplemented.

"Exchange Counterparty" shall mean any party with whom the Commission or the Trustee shall, from time to time, enter into an Exchange Agreement.

"Exchange Payment" shall mean a payment due from the Commission or the Trustee to an Exchange Counterparty, pursuant to the applicable Exchange Agreement, excluding, however, any payments in respect of any early termination other than amounts payable as accrued payments that would have been due had no early termination occurred.

"Executive Officer" shall mean the Chairman of the Commission.

"Federal Fiscal Year" shall mean the period commencing October 1 of any year and ending September 30 of the ensuing year, or any other fiscal year of the FHWA.

"FHWA" shall mean the Federal Highway Administration.

"FHWA Funds" shall mean all amounts available to the State Agency to pay amounts due with respect to an Eligible Debt Financing Instrument, as defined in Section 122 of Title 23, or amounts under any similar or successor provisions of law regarding the use of funds payable to the State Agency by FHWA.

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

"Financing Agreement" shall mean the Financing/Lease Agreement, dated as of May 1, 2005 among the Commission, the Cabinet and the State Agency by which the Project is leased to the State Agency, and any amendments or supplements thereto.

"Financing Payments" shall mean Financing Payments payable under the Financing Agreement.

"Fitch" shall mean Fitch Ratings.

"Funds and Accounts" shall mean the Cost of Issuance Fund, Note Payment Fund, Project Fund, Rebate Fund and any account thereof and any other fund or account established in accordance with the terms of the Master Indenture or a Series Indenture.

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

"Interest Account" shall mean the account by that name in the Note Payment Fund established under the Master Indenture.

"Interest Payment Date" shall mean, for each Series of Notes, the date upon which interest on the Notes of such Series shall be payable as provided in the applicable Series Indenture.

"Liquidity Facility" shall mean, with respect to any Series of Notes, a standby note purchase agreement, letter of credit, line of credit, revolving credit agreement, bond insurance policy, surety bond or similar liquidity enhancement or support facility or agreement or undertaking or combination thereof to be issued by a Liquidity Facility Provider having such terms as are set forth in the related Series Indenture.

"Liquidity Facility Provider" shall mean the provider of a Liquidity Facility with respect to any Series of Notes.

"Master Indenture" shall mean the Master Trust Indenture, dated as of May 1, 2005, and entered into between the Commission and the Trustee, as amended or supplemented from time to time.

"Maximum Annual Debt Service" shall mean the sum of all amounts required to be paid, during the current or any future Federal Fiscal Year commencing after the date of such calculation, or set aside during such Federal Fiscal Year, for payment of debt service on all Outstanding Notes.

"Memorandum of Agreement" shall mean the Memorandum of Agreement, executed in April of 2005, between the State Agency and FHWA, and acknowledged by the Commission and the Cabinet, as amended or supplemented.

"Memorandum of Instructions" shall mean the Memorandum of Instructions Regarding Rebate or similar memorandum or agreement regarding compliance with the requirement of the Code, that may be delivered to the Commission and the Trustee at the time of the issuance and delivery of Notes, as the same may be amended or supplemented in accordance with its terms.

"Moody's" shall mean Moody's Investors Service, Inc.

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

"Notes" shall mean Project Notes, Federal Highway Trust Fund Series, issued from time to time under the provisions the Master Indenture and a Series Indenture.

"Outstanding" when used with reference to Notes, shall mean, as of any date, all Notes theretofore or then being authenticated and delivered 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 Master Indenture or any Notes which are deemed to have been paid pursuant to the provisions of the Master Indenture; and

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

"Parity Obligations" shall mean obligations for borrowed money that are secured by a pledge of Revenues on a parity basis with the pledge of Revenues under the Financing Agreement, including, but not limited to, Additional Notes and Refunding Notes.

"Paying Agent" shall mean any bank or trust company so designated, and its successor or successors hereafter appointed, as paying agent for any Series of Notes in the manner provided in the Master Indenture or any Series Indenture.

"Pledged Receipts" shall include:

(i) all of the Financing Payments (being all of the payments to be paid by FHWA under the Memorandum of Agreement) and Additional Payments, each as defined in the Financing Agreement, to be paid by the State Agency 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 investment in the Rebate Fund and (b) unless the Master Indenture or any Series 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 Account" shall mean the account by that name in the Note Payment Fund established under Section 5.05 of the Master Indenture.

"Project" shall mean, collectively, the "Bond Financed Projects" described in the Memorandum of Agreement or any amendments thereto, which are more particularly described in Exhibit A to the Financing Agreement, and any additional "Projects," as defined in the Act, to be financed with the proceeds of Additional Notes or Construction Notes.

"Project Fund" shall mean the Project Fund created by Sections 5.03 and 5.06 of the Master Indenture.

"Purchase Account" shall mean the account by that name within the Note Fund established under Section 5.05 of the Master Indenture.

"Purchase Date" shall mean the date set forth in a Series Indenture on which Notes of the Series authorized by such Series Indenture may be tendered for purchase.

"Purchase Price" shall mean an amount equal to the principal amount of any Notes purchased under the tender option terms of a Series Indenture, plus, accrued interest, if any, to the purchase date.

"Rating Service" shall mean 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" shall mean the fund by that name established pursuant to Sections 5.03 and 5.07 of the Master Indenture.

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

"Redemption Date" shall mean the date set forth in a Series Indenture on which Notes of the Series authorized by such Series Indenture may be called for redemption.

"Refunding Notes" shall mean notes issued under the provisions of Section 2.06(2) of the Master Indenture, the proceeds of which are used solely and only to refund a portion of the Notes then Outstanding under the Master Indenture and to pay the costs of issuing such Refunding Notes.

"Registrar" shall mean the registrar maintaining the registration books for any Series of Notes and unless otherwise provided in a Series Indenture shall mean the Trustee.

"Remarketing Agent" shall mean any Remarketing Agreement appointed under the terms of a Series Indenture.

"Resolution" shall mean the resolution of the Commission adopted April 18, 2005 authorizing the issuance of Notes and the execution and delivery of the Master Indenture.

"S&P" shall mean Standard & Poor's Credit Markets Services, a division of The McGraw-Hill Companies, Inc.

"Series" shall mean all of the Notes authenticated and delivered on original issuance in a simultaneous transaction under a particular Series Indenture, and any Notes thereafter authenticated and delivered in lieu of or in substitution for such Notes.

"Series Indenture" shall mean a trust indenture providing for the issuance of a particular Series of Notes.

"Series of Notes" or words of similar import, shall mean the Series of Notes issued pursuant to a particular Series Indenture authorized by a Series Resolution.

"Series Resolution" shall mean a resolution of the Commission authorizing the issuance of a Series of Notes in accordance with the terms and provisions hereof, adopted by the Commission in accordance with Section 2.04 of the Master Indenture.

"State" shall mean the Commonwealth of Kentucky.

"State Agency" shall mean the Transportation Cabinet of the Commonwealth of Kentucky.

"State Fiscal Year" shall mean any period commencing July 1 of any year and ending June 30 of the ensuing year, or any other fiscal year of the Commonwealth.

"Supplemental Indenture" shall mean any trust indenture supplemental to or amendatory of the Master Indenture adopted by the Commission.

"Title 23" shall mean Chapter 1 of Title 23, United States Code, Highways, as amended and supplemented from time to time and any successor or replacement provision of law.

"Treasurer" shall mean the Treasurer of the State.

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

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

**The Master Indenture**

**Authorization for Notes in Series**. From time to time when authorized by the Master Indenture and subject to the terms, limitations and conditions established in the Master Indenture, the Commission may

authorize the issuance of a Series of Notes upon adoption of a Series Resolution and execution of a Series Indenture, and the Notes of any such Series may be issued and delivered upon compliance with the provisions of Article II and Article VII of the Master Indenture. The Notes of each Series are required to bear the title "Project Notes, [year of issue] Federal Highway Trust Fund [number of issue for that year] Series," and, at the option of the Commission, such other designation as may be necessary to distinguish them from the Notes of other Series. Notes of any Series may be authorized to be issued in the form provided by the Series Indenture.

Each Series Indenture is required to specify and determine: (i) the authorized principal amount of that Series of Notes; (ii) the purpose for which that Series of Notes is being issued, which shall be to provide funds for the purposes authorized by the Act and the Master Indenture or a Series Indenture including one or more of the following: (A) for deposit in the account of the Project Fund established for such Series for purposes for which the Project Fund may be utilized, all as provided in Section 5.06 of the Master Indenture; (B) for the redemption of Construction Notes and related purposes or for payment of the principal of, premium and interest on any Construction Notes; and (C) for deposit in the Cost of Issuance Fund or Note Payment Fund; (iii) the title and designation of, the manner of numbering and lettering, and the denomination or denominations of the Notes of that Series; (iv) the date or dates of maturity and the amounts thereof, and the dated date of that Series; (v) the interest rate or rates or the manner of determining such rate or rates of the Notes of that Series and the Interest Payment Dates of those Notes; (vi) the redemption price or redemption prices and the Redemption Date or Redemption Dates and other terms (if any) of redemption of any of the Notes of such Series; (vii) the Purchase Price and the Purchase Dates and other terms (if any) for the tender of any of the Notes of such Series; (viii) if the Paying Agent is to be different from the Paying Agent then serving under the Master Indenture, the Paying Agent or Paying Agents for such Notes; (ix) the manner in which Notes of such Series are to be sold and provisions for the sale thereof; and (x) any other provisions deemed advisable by the Commission, not in conflict with or in substitution for the provisions of the Master Indenture or any existing Series Indenture.

**Additional Notes; Refunding Notes.** The Commission has the right and authority to issue Additional Notes if it has received a certificate of an Authorized Representative of the State Agency stating that the amount of FHWA Funds received during the most recently completed Federal Fiscal Year was equal to at least 400% of the Maximum Annual Debt Service for all Notes Outstanding in the current and each future Federal Fiscal Year including the Additional Notes proposed to be issued, but in the case of a Series of Additional Notes to be issued for refunding purposes, excluding the Note Payments on the Notes to be refunded.

For the purpose of determining the Maximum Annual Debt Service, variable rate Notes will be deemed to bear interest at the maximum rate of interest applicable to such variable rate Notes; provided however that if such maximum rate of interest is less than the interest rate quoted in The Bond Buyer 25 Revenue Bond Index (the "Index Rate") as published in The Bond Buyer for the last week of the month preceding the date of issuance of such variable rate Notes, then the interest rate on such variable rate Notes shall be deemed to be the Index Rate. If The Bond Buyer 25 Revenue Bond Index is no longer published, an index that is deemed to be substantially equivalent by nationally recognized bond counsel may be substituted therefore. Also for the purpose of determining the Maximum Annual Debt Service, any Note scheduled to be Outstanding during such period that is subject to tender at the option of the Holder will be assumed to mature on the stated maturity date or mandatory sinking fund payment date thereof.

No Additional Notes on a parity as to security with the Notes for such specific purposes described above 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 Master Indenture. If any Additional Notes for such purposes are issued on a basis of parity as to security with the Notes, the Financing Agreement

is required to be amended to provide for payments sufficient to pay the principal and interest with respect to all Notes Outstanding under the Master Indenture and all Additional Notes.

No other Additional Notes may be issued at any time secured by the Pledged Receipts; provided that the Additional Notes, the issuance of which is herein conditioned and restricted, will be understood to mean Notes payable from the Pledged Receipts on a basis of parity and equality with Outstanding Notes, and will not be construed to include other notes, bonds or obligations, the security and source of payment of which are subordinate and subject to the priority of the Notes. The Commission has the right to issue notes that are secured by a pledge of the Pledged Receipts that is subordinate to the pledge created by the Master Indenture which do not rank on a basis of equality and parity with the Notes, but only if such subordinate notes are issued in express recognition of the priorities, liens and rights created and existing for the security and source of payment and protection of the Notes.

The Commission has reserved the right, in addition to issuing Notes as described above, 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 Master Indenture, so long as Maximum Annual Debt Service is not increased as a result of issuing such Refunding Notes.

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 hereunder and no default exists under the Financing Agreement.

Whenever the Commission shall have authorized or made provision for the authorization of, the issuance of a Series of Notes, the Commission has the right, by Series Resolution, to authorize the issuance of Construction Notes in anticipation of the sale of such Series of Notes in a principal amount not exceeding the principal amount of such Series of Notes. The principal or any interest on such Construction Notes and renewals thereof may be payable from and secured by a pledge of Pledged Receipts that is (i) subordinate to the pledge of such Pledged Receipts as security for Outstanding Notes or (ii) on a parity with the pledge of such Pledged Receipts securing Outstanding Notes, but, as to any parity pledge, only if the requirements described under this heading for the issuance of Additional Notes would be satisfied assuming the principal amount of such Construction Notes would be amortized over twenty (20) years on a level payment basis at prevailing market interest rates existing at the time of the issuance of the Construction Notes. (Section 2.06)

**The Pledge Effected By The Master Indenture**. Pursuant to the Act and the Master Indenture, there are pledged for the payment of the principal of and interest on the Notes other than Construction Notes which have not been issued upon compliance with the requirements of Section 2.06(3)(ii) (the "Non-Parity Construction Notes"), and all obligations of the Commission under any Liquidity Facility, Credit Facility Agreement or Exchange Agreement payable in accordance with their respective terms and the provisions of the Master Indenture, subject only to the provisions of the Master Indenture and the Act permitting the application thereof for or to the purposes and on the terms and conditions set forth in the Master Indenture and the Act, (i) the proceeds of sale of the Notes, other than the proceeds of Non-Parity Construction Notes, to the extent not required to be utilized for payment of Construction 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 Master Indenture and any Series Indenture, including moneys and securities therein.

Pursuant to the Act and the Master Indenture, there are pledged for the payment of the principal of and interest on a Series of Non-Parity Construction Notes, and all obligations of the Commission under any Liquidity Facility, Credit Facility Agreement or Exchange Agreement payable in accordance with their respective terms and the provisions of the Master Indenture that are related to that Series of Non-Parity

Construction Notes, subject only to the provisions of the Master Indenture and the Act permitting the application thereof for or to the purposes and on the terms and conditions set forth in the Master Indenture and the Act, (i) the proceeds of sale of the Non-Parity Construction Notes or any renewal Construction Notes issued to refund such Series of Non-Parity Construction Notes; (ii) Eligible Investments acquired from Non-Parity Construction Note proceeds or by application of moneys in the related series account of the Project Fund or related Note Payment Account (subject to the limitations of (iv) below); (iii) the Pledged Receipts, on a basis that is subordinate to the pledge thereof as security for Notes that are not Non-Parity Construction Notes; and (iv) all Funds and Accounts created and established with respect to that Series of Non-Parity Construction Notes pursuant to the Master Indenture and the related Series Indenture, including moneys and securities therein. (Section 5.02)

**Establishment of Funds**. The Master Indenture establishes (i) the Cost of Issuance Fund (Series); (ii) the Note Payment Fund; (iii) the Project Fund (Series); (iv) the Rebate Fund; and (v) such other Funds and Accounts which may be created from time to time as provided in the Master Indenture or in a Series Indenture in order to accomplish the purposes of the Act and the Master Indenture and which are not inconsistent with the requirements of the Master Indenture.

Each of the above Funds, in addition to other Funds and Accounts from time to time established, are required to be held and maintained by the Trustee pursuant to the provisions of the Master Indenture and any Series Indenture, except for the Project Fund, which is required to be held by the Treasurer. (Section 5.03)

**Cost of Issuance Fund**. The Master Indenture establishes and creates a separate Cost of Issuance Fund for each Series of Notes. There will be deposited in the Cost of Issuance Fund, the amount required by the applicable Series 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 Master 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 an account of the Cost of Issuance Fund on the date which is five months from the date of issuance of the related Series of Notes, the Trustee is required to transfer such amounts to the Interest Account (or subaccount of a Note Redemption Account for Construction Notes) of the Note Payment Fund. (Section 5.04)

**Note Payment Fund**. The Master Indenture establishes and creates a separate Note Payment Fund. In addition to any other accounts deemed necessary by the Trustee, there will be established within the Note Payment Fund an Interest Account, a Purchase Account, a Principal Account, and a Credit Facility Account.

An Interest Account will be established, into which will be deposited all amounts: (i) received as accrued interest upon the sale and delivery of any Notes, (ii) transferred from the Proceeds Fund for the payment of interest on the Notes, (iii) received as the interest portion of Financing Payments (including any prepayments of the interest portion of Financing Payments), and (d) received as Counterparty Exchange Payments. Amounts in the Interest Account will be used to pay (i) interest on the Notes, unless draws have been made on a Credit Facility for such purpose, in which case, amounts corresponding to such draws will be paid to the Credit Facility Provider, (ii) any Exchange Payments then due and payable and (iii) the fees of any Remarketing Agent, Credit Facility Provider or Liquidity Provider.

A Purchase Account will be established, for each Credit Facility and Liquidity Facility then securing any Notes, into which will be deposited all amounts received (i) from the Remarketing Agent with respect to any remarketing of the Notes related to that account, which shall be deposited into a "Remarketing Proceeds Subaccount" or (ii) under a draw on any Liquidity Facility or Credit Facility for the payment of the Purchase

Price for any Notes related to that account which are tendered and not remarketed by the Remarketing Agent, which will be deposited in a "Draw Subaccount." Amounts in a Purchase Account will be used to purchase Notes (related to the Credit Facility or Liquidity Facility for which the Purchase Account was created) which are tendered for purchase, subject to the provisions of the related Series Indenture.

A Principal Account will be established, into which will be deposited all amounts (i) transferred from the Proceeds Fund to pay principal of and premium, if any, on the Notes due at maturity, on a Redemption Date or upon acceleration and (ii) representing payments of principal and premium, if any, on Notes to pay such amounts at maturity, on a Redemption Date or upon acceleration. Amounts in the Principal Account will be used to pay principal of and premium, if any, on the Notes, unless draws have been made on a Credit Facility for such purpose, in which case, amounts corresponding to such draws (plus any related fees of the Credit Facility Provider) will be paid to the Credit Facility Provider.

A Credit Facility Account will be established, into which will be deposited all amounts received from draws under a Credit Facility to pay the principal of, interest on and premium, if any, on any Notes or any related Exchange Payments. Amounts in the Credit Facility Account will be used to pay the principal of, interest on (or any related Exchange Payments) and premium, if any, on Notes that are secured by a Credit Facility.

Upon issuance of any Construction Notes, there will be established a separate and distinct "Note Redemption Account" of the Note Payment Fund and accounts, which will be subaccounts thereof, as described above for accounts of the Note Payment Fund, into which will be deposited the amounts described above that are related to such Construction Notes. In addition, there will be deposited in such Note Redemption Account (i) any accrued interest received upon the sale of such Construction Notes and (ii) sufficient proceeds of the Series of Notes authorized to be issued at the time of issuance of such Construction Notes, when issued, to provide for the payment-in-full of such Construction Notes. Amounts in subaccounts of a Note Redemption Account will be disbursed in the same manner described above for accounts of the Note Payment Fund.

The Trustee will transmit to any Paying Agent, as appropriate, from moneys in the Note Fund applicable thereto, amounts sufficient to make timely payments of principal of, Purchase Price of, interest on and premium, if any, on the Notes to be made by such Paying Agent and then due and payable.

Provisions regarding draws on any Credit Facility or Liquidity Facility pursuant to their terms, in the amounts and at the times necessary to pay the Purchase Price, principal of, interest on (and any related Exchange Payments) and premium, if any, on any Notes will be set forth in the Series Indenture related to such Notes. (Section 5.05)

**Project Fund.** The Master Indenture establishes and creates a trust fund to be designated the Project Fund, which is required to be an account in the Commonwealth's management administrative and reporting system. The Project Fund is required to be separately identified from all other accounts in the Commonwealth's management administrative and reporting system and is required to be used solely for the purposes provided in the Master Indenture. A separate account of the Project Fund may be established for each separate component thereof. The amount required by each applicable Series Indenture will be deposited in the Project Fund. Under the Master Indenture, the Treasurer makes disbursements from each account of the Project Fund on a first-in-first-out basis in accordance with and as required by the provisions of written requisitions filed from time to time by an Authorized Officer of the State Agency and in accordance with the provisions of the Financing Agreement. The State Agency 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 each account of the Project Fund will, at the option of the State Agency, be transferred as received to the Note Payment Fund and disbursed therefrom on the next succeeding Interest Payment Date or held in the such

account and used for the purposes thereof. If any amount remains in an account of the Project Fund after an Authorized Officer of the State Agency certifies that the Project has been completed, such amount will be transferred to the Interest Account of the Note Payment Fund. (Section 5.06)

**Rebate Fund**. The Master Indenture establishes and creates a trust fund to be designated the Rebate Fund, which is established and maintained under the Master 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 Master 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 Master 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 Master 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 Master Indenture for investments in other funds established in the Master 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 is required to 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 Funds or Accounts 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 Master 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 Master 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 Master Indenture or any Series 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 Master 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 Master Indenture. (Section 5.08)

**Exchange Agreements; Counterparty Exchange Payments; Exchange Payments**. The Commission has authorized the Trustee to enter into or to acknowledge and agree to any Exchange Agreement hereafter entered into by itself or the Commission and an Exchange Counterparty under which (a) there may be required to be made, from time to time, Exchange Payments and (b) the Trustee may receive, from time to time, Counterparty Exchange Payments. The Trustee is required to deposit all Counterparty Exchange Payments in the Interest Account of the Note Payment Fund to be applied in accordance with the provisions of Section 5.05 of the Master Indenture. Nothing in the Master Indenture requires that an Exchange Payment or Counterparty Exchange Payment be made on an Interest Payment Date. (Section 5.09)

**Further Assurance**. The Master 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 Notes and Pledge**. Under the Master Indenture and each Series Indenture, the Commission is authorized to issue the Notes and execute and deliver the Master Indenture and each Series Indenture and pledge the income, revenues and assets pledged by the Master Indenture and each Series Indenture in the manner and to the extent provided in the Master 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 Master Indenture and each Series Indenture, and all official action on the part of the Commission to that end has been or will be duly and validly taken. The Notes and the provisions of the Master Indenture and each Series Indenture are and will be the valid and legally enforceable obligations of the Commission in accordance with their terms and the terms of the Master Indenture and each Series Indenture. The Budget Act includes authorization for the issuance of "bonds" (being the 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 Master Indenture and each Series Indenture and all the rights of the Holders under the Master Indenture and each Series Indenture against all claims and demands therefore of all persons whomsoever. (Section 6.05)

**Covenants as to Financing Payments and Additional Payments**. The Master Indenture establishes that the Financing Agreement will continue to be maintained by the Commission. In the event the State Agency 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 (i) the Commission has no obligation to make financing payments from any source other than amounts payable by the FHWA under the Memorandum of Agreement and (ii) no action

will 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 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 Master Indenture or Additional Payments are not sufficient to pay fees and expenses related to the Notes, in accordance with the provisions of the Master 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 State Agency to induce the State Agency 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 and Memorandum of Agreement**. So long as any of the Notes are Outstanding and unpaid as to either principal or interest or any obligation of the Commission under a Credit Facility, Liquidity Facility, or Exchange Agreement remains unpaid, the Commission will continuously enforce the Financing Agreement and Memorandum of Agreement to the maximum extent permitted by law, and will not consent to any modification of the Financing Agreement or Memorandum of Agreement which would in any particular way impair the security created for the holders of the Notes a Credit Facility Provider, Liquidity Provider or Exchange Counterparty. (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 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 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 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 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 Master Indenture, thereby better securing and protecting the Notes, the Commission from the date of adoption of the Master Indenture will not:

(a) make or cause to be made any investment of Note proceeds that produces a yield in excess of such applicable maximum yield as may be permitted by the Code, and

(b) 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 Master 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 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 Notes that, on the basis

of the facts, estimates and circumstances in existence on the date of issue of the Notes it is not expected that the proceeds of the 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 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 Master 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 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 Master 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 Master 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 Master Indenture; to modify any of the provisions of the Master Indenture or any Series 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 Indenture cease to be Outstanding; to cure any ambiguity or defect or inconsistent provision; to the extent not inconsistent with the terms of the Master Indenture, such provisions as may be necessary for the issuance of Additional Notes under the terms of the Master Indenture; to modify any provisions of the Master Indenture in order to obtain a Liquidity Facility, Credit Facility or Exchange Agreement, so long as such modifications affect only the Notes to which such Liquidity Facility, Credit Facility or Exchange Agreement relate; 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 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 Master 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 Master Indenture or any Series Indenture may also be modified or amended at any time or from time to time by a Supplemental Indenture, subject to the written consent of the Holders in accordance with and subject to the provisions of Article VIII of the Master 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 Master Indenture, is authorized or permitted by the Master 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 Master Indenture or any Series Indenture and of the rights and obligations of the Commission and of the Holders of the Notes pursuant to 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 of each Series affected by such amendment 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.

For the purposes of Section 8.01 of the Master Indenture, a Series will be deemed to be affected by a modification or amendment of the Master Indenture or any Series Indenture if the same adversely affects or diminishes the rights of the Holders of the Notes of such Series. The Trustee may in its discretion determine whether or not, in accordance with the foregoing provisions, Notes of any particular Series or maturity would be adversely affected by any modification or amendment of the Master Indenture and any such determination will be binding and conclusive on the Commission and all Holders of Notes. The Trustee may receive a Counsel's Opinion, as conclusive evidence as to whether Notes of any particular Series or maturity would be so affected by any such modification or amendment of the Master Indenture or any Series Indenture. (Section 8.01)

**Consent of Holders**. A copy of a Supplemental Indenture requiring consent of the Holders, or summary thereof, together with a request to the Holders must be mailed to the Holders. Such Supplemental 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 Indenture (which may be referred to as a Supplemental 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 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 is not be made when and as the same becomes due or upon call for redemption or otherwise; or

(2) Payment of any installment of interest on any Note or any Exchange Payment is not be made when and as the same becomes due; or

(3) payment of any Note tendered to the Remarketing Agent for purchase is not be made when due and the continuance of such failure for one Business Day after the Paying Agent has given

written notice of such failure to the Remarketing Agent, any Liquidity Provider, any Credit Facility Provider, and the Commission; or

(4) the Commission fails or refuses to comply with the provisions of the Act, or defaults in the performance or observance of any other of the covenants, agreements or conditions on its part contained in the Master Indenture, any Series Indenture or the Notes and such failure, refusal or default shall continue for a period of forty-five (45) days after written notice thereof by (i) a Liquidity Provider or Credit Facility Provider or (ii) the Trustee or the Holders of not less than five percent (5%) in principal amount of the Outstanding Notes, provided that the notice set forth in clause (ii) may only be given for Notes secured by a Credit Facility or a Liquidity Facility if the Credit Facility Provider or the Liquidity Provider is not in default of its obligations under such Credit Facility or Liquidity Facility, as applicable; or

(5) receipt by the Trustee (i) from a Credit Facility Provider, within the time period specified in a Credit Facility, of notice that it will not reinstate amounts drawn on such Credit Facility to pay interest on the Notes or (ii) from a Liquidity Provider or Credit Facility Provider of notice that an Event of Default has occurred under a Liquidity Facility or Credit Facility Agreement. (Section 9.02)

**Acceleration**. Unless otherwise provided in the Series Indenture, subject to provisions described in this paragraph and upon the occurrence of an Event of Default as specified in paragraphs (1), (2), (3) or (5) 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 an Event of Default an Event of Default as specified in paragraphs (4) above, the Trustee may, or at the direction of the Holders of not less than twenty-five percent (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. Upon the occurrence of an Event of Default with respect to Notes secured by a Credit Facility or Liquidity Facility, the Trustee is required to make any such declaration only upon the written direction, or upon the written consent of the related Credit Facility Provider and the Liquidity Provider; provided that such consent shall only be required when the Event of Default is not described in clause (i) of paragraph (5) above and the applicable Credit Facility Provider or Liquidity Provider is not in default of its obligations under its Credit Facility or Liquidity Facility, as applicable.

Any such declaration is required to be by notice in writing to the Commission and any Remarketing Agent, Credit Facility Provider, Liquidity Provider, and Exchange Counterparty, and, upon said declaration, principal and interest on all 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 Master 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 Master Indenture shall be construed to permit the acceleration of any payments of Financing Payments or Additional Payments by the State Agency 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), (2), (3) or (5) above, the Trustee is required to proceed, or upon the happening and continuance of an Event of Default specified in paragraph (4) above, with the written consent of any Credit Facility Provider, any Exchange Counterparty, and any Liquidity Provider the Trustee may proceed, and upon the written request of the Holders of not less than twenty-five percent (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 Master 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 Master Indenture.

Upon the occurrence of an Event of Default with respect to Notes secured by a Credit Facility or Liquidity Facility, the Trustee is required to make any such declaration only upon the written direction, or upon the written consent of the related Credit Facility Provider and Liquidity Provider; provided that such consent will only be required when the Event of Default is not described in clause (i) of paragraph (5) above and the applicable Credit Facility Provider or Liquidity Provider is not in default of its obligations under its Credit Facility or Liquidity Facility, as applicable. Any right of an Exchange Counterparty (whether as to request, consent or otherwise) under Article IX of the Master Indenture will be exercisable by the Exchange Counterparty only if (i) such Exchange Counterparty is not in default of its obligations under its Exchange Agreement and (ii) all obligations of the parties other than the Exchange Counterparty under such Exchange Agreement have not been satisfied.

In the enforcement of any rights and remedies under the Master Indenture or any Series 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 Master Indenture or any Series 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 Master 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 Master Indenture or any Series 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 Master Indenture, after making provision (i) for the payment of any expenses necessary in the opinion of the trustee to protect the interests of any Credit Facility Provider, and Liquidity Provider, any Exchange Counterparty, and 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 Master Trust Indenture or any Series Indenture, it being understood that amounts drawn on a Credit Facility will not be used for the purposes described in clauses (i) and (ii) and 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 (or Related Exchange Payments) 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, accordingly to the amounts due on such installments, to the persons entitled thereto, including amounts owed to a Credit Facility Provider in respect of interest, 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, including amounts owed to a Credit Facility Provider in respect of principal, 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 (or Related Exchange Payments) due and unpaid upon the Notes without preference or priority of principal over interest (or Related Exchange Payments) or of interest (or Related Exchange Payments) over principal, or of any installment of interest (or Related Exchange Payments) over any other installment of interest (or Related Exchange Payments), or of any Note over any other Note, ratably, accordingly to the amounts due respectively for principal and interest, to the persons entitled thereto, including amounts owed to the Credit Facility Provider and Liquidity Provider, 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 Master 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**. Unless otherwise provided in a Series Indenture, Anything in the Master Indenture or Series Indenture to the contrary notwithstanding, any Credit Facility Provider, any Liquidity Provider, any Exchange Counterparty, and 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 Master Indenture, provided that such direction will not be otherwise than in accordance with law or the provisions of the Master Indenture or any Series Indenture, and that the Trustee will have the right to decline to follow any such direction (i) which in the opinion of the Trustee would be unjustly prejudicial to Holders not parties to such direction or (ii) there has not been offered to the Trustee reasonable security and indemnity against the cost, expenses (including reasonable legal expenses) and liabilities to be incurred with respect thereto. In the event of a conflict between directions from a Credit Facility Provider, a Liquidity Provider, an Exchange Counterparty and such Holders, directions is required to be followed in priority order as follows: (i) a Credit Facility Provider, so long as such Credit Facility Provider is not in default of its obligations under its Credit Facility Agreement; (ii) a Liquidity Provider, so long as such Liquidity Provider is not in default of its obligations under its Liquidity Facility, (iii) the Holders and (iv) an Exchange Counterparty, so long as such Exchange Counterparty is not in default of its obligations under its Exchange Agreement. (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 Master Indenture, or for the protection or enforcement of any right under the Master 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 twenty-five percent (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 Master 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 required draws on any Credit Facility in accordance with the applicable Series Indenture, make payments on the Notes as provided in the Master Indenture (to the extent funds are available for such purpose) and declare the Notes due and payable as provided in the Master 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 Master Indenture or any Series Indenture or for any other remedy under the Master 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 Master Indenture, or to enforce any right under the Master Indenture or under law with respect to the Notes or the Master Indenture or any Series Indenture, except in the manner provided in the Master Indenture, and that all proceedings at law or in equity shall be instituted, had and maintained in the manner provided in the Master Indenture and for the benefit of all Holders. Nothing in the Article contained 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 Master Indenture to the Holder thereof at the time and place stated in said Note.

Anything in the Master Indenture or Series 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 Master Indenture or any Series 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 twenty-five percent (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 Master Indenture or the related Series 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 Master 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 Master Indenture, including payment of moneys out of any Fund or Account, such matter (unless other evidence in respect thereof be specifically prescribed in the Master 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 Master Indenture and any Series 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 Master Indenture, any request, order, notice or other direction required or permitted to be furnished pursuant to any provision of the Master 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 Master 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 Master Trust Indenture or any Series Indenture by giving not less than sixty (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 proved in the Master Indenture, or (ii) previously a successor shall have been appointed, as provided in the Master 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, are require to 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 Master 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 twenty (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 forty-five (45) days after the Trustee shall have given to the Commission written, as provided in above, 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 any 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 Seventy-Five Million Dollars ($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 Master Indenture or Series Indenture. (Section 10.09)

**Defeasance.** Notes or interest installments of particular Notes or Series of Notes for the payment or redemption of which moneys will have been set aside and are required to 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 or Series of 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 Master Indenture, and in the applicable Series 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, and all amounts payable under any related Liquidity Facility, Credit Facility Agreement or Exchange Agreement, (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 the exclusion from gross income for federal income tax purposes of interest on the 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 Master Indenture or Series 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 (6) 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 (6) 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 Master 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 ninety (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, Student Loan Marketing Association, Federal Farm Credit Banks, Federal Intermediate Credit Banks, Federal Land Banks, Federal Home Loan Banks, Bank for Cooperatives, Tennessee Valley Authority and any other similar institution. (Section 11.01)

**The Financing Agreement**

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

**Term, Renewals and Financing Payments**. The Commission has agreed to provide financing for the Project to the State Agency, for an initial term ending June 30, 2006. The State Agency has the right to continue the Financing Agreement and have the Project for succeeding biennial periods. The State Agency is required to pay, as Financing Payments during the initial period ending on June 30, 2006, and for each Renewal Term, the Debt Servicing Obligation relating to the Notes so long as any Notes are Outstanding; provided that, the Debt Service Obligation is payable solely from FHWA Funds authorized to be expended for such purpose. The State Agency has the exclusive option to renew the Financing Agreement for successive ensuing Renewal Terms, commencing July 1 in each even-numbered year, and ending June 30 in the next ensuing even-numbered year, and the last Renewal Term shall end on the first June 30 of an even-numbered year occurring after there are no Notes outstanding under the Indenture. Each of the options to renew are deemed automatically exercised (and the Financing Agreement automatically renewed for the succeeding Renewal Term) unless a written notice of the State Agency's election not to renew is delivered to the Commission before the close of business on the last business day in May, immediately preceding the beginning of such succeeding Renewal Term.

**Additional Payments**. The State Agency covenants and agrees to pay "Additional Payments" for the term of the Financing Agreement and for any Renewal Term during which 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 (Section 5.06)

**Effect of the State Agency's Election not to Renew.** In the event the State Agency shall give written notice to the Commission of the State Agency's election not to renew the Financing Agreement for any ensuing optional biennial Renewal Term, prior to the automatic renewal, the State Agency is not obligated to pay Financing Payments or Additional Payments beyond the last day of the then current term, and the State Agency is required to forfeit all of its future options to renew and must peacefully surrender, to the Commission, possession of the Project on or prior to the last day of the then current term; provided, however, an election on the part of the State Agency not to renew for a future term does not in any manner alter or diminish any obligation of the State Agency for the then current term; and does not preclude subsequent reinstatement of the Financing Agreement for any future renewal term, if agreed to by the Commission, upon the same terms and conditions as would have been applicable if the Financing Agreement had been renewed according to its provisions, except that if such reinstatement is sought when one or more installments of Financing Payments or any Additional Payments for such Renewal Term are overdue and unpaid, it is a condition of such reinstatement that such overdue Financing Payments or Additional Payments be tendered. (Section 7.01)

**State Agency to Comply with Memorandum of Agreement; Appropriations.** The State Agency has covenanted and agreed that it will comply with the terms of the Memorandum of Agreement, the provisions of Title 23, the regulations promulgated thereunder and all other federal laws and regulations related thereto.

The State Agency has also covenanted and agreed that on each and every occasion when appropriations bills are prepared for introduction in the various successive Sessions of the General Assembly of the Commonwealth, the State Agency will cause to be included in the appropriations proposed to be made for the State Agency, sufficient amounts in the aggregate (over and above all other requirements of the State Agency), but solely and only from FHWA Funds, to enable the State Agency to pay Financing Payments and Additional Payments and thereby provide to the Commission moneys sufficient for the payment of the principal and interest of the Notes as they mature. (Article IX)

**Additional Notes.** The State Agency may request that the Commission issue Additional Notes. Except as described below for Refunding Notes, before Additional Notes other than the Series 2005 Notes may be authenticated and delivered by the Commission, there shall be filed with the Commission a certificate of an Authorized Representative of the State Agency stating that the amount of FHWA Funds received during the most recently completed Federal Fiscal Year was equal to at least 400% of the Maximum Annual Debt Service for all Notes Outstanding in the current and each future State Fiscal Year including the Additional Notes proposed to be issued, but in the case of a Series of Additional Notes to be issued for refunding purposes, excluding the Note Payments on the Notes to be refunded.

For the purpose of determining the Maximum Annual Debt Service, variable rate Notes shall be deemed to bear interest at the maximum rate of interest applicable to such variable rate Notes; provided however that if such maximum rate of interest is less than the interest rate quoted in The Bond Buyer 25 Revenue Bond Index (the "Index Rate") as published in The Bond Buyer for the last week of the month preceding the date of issuance of such variable rate Notes, then the interest rate on such variable rate Notes

shall be deemed to be the Index Rate. If The Bond Buyer 25 Revenue Bond Index is no longer published, an index that is deemed to be substantially equivalent by nationally recognized bond counsel may be substituted therefore. Also for the purpose of determining the Maximum Annual Debt Service, any Note scheduled to be Outstanding during such period that is subject to tender at the option of the Holder shall be assumed to mature on the stated maturity date or mandatory sinking fund payment date thereof.

The State Agency may not become obligated for the payment of any other borrowed money secured by the Pledged Receipts unless (i) such borrowed money constitutes Additional Notes or (ii) the certifications required in the first paragraph under this heading can be made as to the borrowed money to be paid by the State Agency and all Notes then Outstanding; provided that, the incurring of obligations with respect to borrowed money which is conditioned and restricted, shall be understood to mean borrowed money payable from the Pledged Receipts on a basis of parity and equality with Outstanding Notes, and shall not be construed to include other borrowed money, the security and source of payment of which are subordinate and subject to the priority of the Notes. The State Agency has reserved the right to become obligated for the payment of any other borrowed money that is secured by a pledge of the Pledged Receipts that is subordinate to the pledge created by the Master Indenture or any Series Indenture which does not rank on a basis of equality and parity with the Notes, but only if such subordinate obligation for the repayment of borrowed money is incurred in express recognition of the priorities, liens and rights created and existing for the security and source of payment and protection of the Notes.

In addition to Additional Notes described above, the State Agency may become obligated for the payment Refunding Notes issued on a parity as to security with the Notes in order to refund any Notes then Outstanding under the Master Indenture so long as (i) Maximum Annual Debt Service is not increased as a result of issuing such Refunding Notes and the State Agency is in compliance with all of the provisions with reference to the payment of Financing Payments and Additional Payments under the Financing Agreement and (ii) no default exists under the Financing Agreement.

In addition to Additional Notes and Refunding Notes, the State Agency may become obligated for the payment of Construction Notes to the extent that capitalized interest and proceeds of the related Series of Notes authorized by the Commission to pay the principal of, premium and interest on such Construction Notes will not be adequate for such purpose. (Article X)

**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 State Agency will not be deemed to be in default if the State Agency commences to remedy said defaults other than related to payment of Financing Payments or Additional Payments within said thirty (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 State Agency terminate the Financing Agreement. No termination of the Financing Agreement will deprive the Commission of any of its remedies or actions against the State Agency. (Section 11.01)

**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. (Section 12.01)

**Tax Covenant**. To the full extent that it has the legal right to do so, the State Agency, the Cabinet and the Commission have agreed to all of the provisions of the Master Indenture authorizing the Notes; and the State Agency, the Cabinet and the Commission will not take any action nor omit to take any action which taking or omission would result in the exclusion of the receipt of interest on any of the Notes from the treatment afforded by Section 103(a) of the Code, and Section 122 of Title 23, to the extent the interest on such Notes is intended to be excludible from gross income for federal income tax purposes, under the terms of the Master Indenture or Bond Resolution.

Nothing has been done or will be done by either the Commission, the Cabinet or the State Agency which will cause the Notes to be private activity bonds within the meaning of Section 141 of the Code, including performance of any of the covenants contained herein, to the extent the interest on such Notes is intended to be excludible from gross income for federal income tax purposes, under the terms of the Master Indenture. (Section 13)

**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 Master 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. (Section 16.01)

## TAX TREATMENT

### General

In the opinion of Bond Counsel for the Notes, based upon an analysis of existing laws, regulations, rulings and court decisions, interest on the Notes is excludable from gross income for Federal income tax purposes and interest on the Notes 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 Notes is of the opinion that interest on the Notes is exempt from income taxation by the Commonwealth and the Notes are exempt from ad valorem taxation by the Commonwealth and any of its political subdivisions.

A copy of the opinion of Bond Counsel for the Notes is set forth in Exhibit B attached hereto.

The Code imposes various restrictions, conditions, and requirements relating to the exclusion from gross income for Federal income tax purposes of interest on obligations such as the Notes. The Commission has covenanted to comply with certain restrictions designed to ensure that interest on the Notes will not be includable in gross income for Federal income tax purposes. Failure to comply with these covenants could result in interest on the Notes being includable in gross income for Federal income tax purposes and such inclusion could be required retroactively to the date of issuance of the Notes. The opinion of Bond Counsel assumes compliance with these covenants. However, Bond Counsel has not undertaken to determine (or to inform any person) whether any actions taken (or not taken) or events occurring (or not occurring) after the date of issuance of the Notes may adversely affect the tax status of the interest on the Notes.

Certain requirements and procedures contained or referred to the Indenture and other relevant documents may be changed and certain actions (including, without limitation, defeasance of the Notes) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such

documents. Bond Counsel expresses no opinion as to any Notes or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of bond counsel other than Peck, Shaffer & Williams LLP.

Although Bond Counsel for the Notes has rendered an opinion that interest on the Notes is excludable from gross income for Federal income tax purposes and that interest on the Notes is excludable from gross income for Kentucky income tax purposes, the ownership or disposition of, or the accrual or receipt of interest on, the Notes may otherwise affect a Noteholder's Federal, state or local tax liabilities. The nature and extent of these other tax consequences may depend upon the particular tax status of the Noteholder or the Noteholder's other items of income or deduction. Bond Counsel expresses no opinions regarding any tax consequences other than what is set forth in its opinion and each Noteholder or potential Noteholder is urged to consult with tax counsel with respect to the effects of purchasing, holding or disposing the Notes on the tax liabilities of the individual or entity.

For example, corporations are required to include all tax-exempt interest in determining "adjusted current earnings" under Section 56(c) of the Code, which may increase the amount of any alternative minimum tax owed. Similarly, tax-exempt interest may also increase the amount of any environmental tax owed under Section 59 of the Code, which is based on the alternative minimum taxable income of any corporation subject to that tax. Ownership or disposition of the Notes may result in other collateral Federal, state or local tax consequence for certain taxpayers, including, without limitation, increasing the federal tax liability of certain foreign corporations subject to the branch profits tax imposed by Section 884 of the Code, increasing the federal tax liability of certain insurance companies, under Section 832 of the Code, increasing the federal tax liability and affecting the status of certain S Corporations subject to Sections 1362 and 1375 of the Code, and increasing the federal tax liability of certain individual recipients of social security or Railroad Retirement benefits, under Section 86 of the Code. Ownership of any Notes may also result in the limitation of interest and certain other deductions for financial institutions and certain other taxpayers, pursuant to Section 265 of the Code. Finally, residence of the holder of Notes in a state other than Kentucky or being subject to tax in a state other than Kentucky, may result in income or other tax liabilities being imposed by such states or their political subdivisions based on the interest or other income from the Notes.

The Commission has not designated the Notes as "qualified tax-exempt obligations" under Section 265 of the Code.

**Premium**

"Acquisition Premium" is the excess of the cost of a bond over the stated redemption price of such bond at maturity or, for bonds that have one or more earlier call dates, the amount payable at the next earliest call date. The Notes that have an interest rate that is greater than the yield, as shown on the cover page hereto (the "Premium Notes"), are being initially offered and sold to the public at an Acquisition Premium. For federal income tax purposes, the amount of Acquisition Premium on each bond the interest on which is excludable from gross income for federal income tax purposes ("tax-exempt bonds") must be amortized and will reduce the holder's adjusted basis in that bond. However, no amount of amortized Acquisition Premium on tax-exempt bonds may be deducted in determining holder's taxable income for federal income tax purposes. The amount of any Acquisition Premium paid on the Premium Notes, or on any of the Notes, that must be amortized during any period will be based on the "constant yield" method, using the original holder's basis in such bonds and compounding semiannually. This amount is amortized ratably over that semiannual period on a daily basis.

Holders of any Notes, including any Premium Notes, purchased at an Acquisition Premium should consult their own tax advisors as to the actual effect of such Acquisition Premium with respect to their own tax situation and as to the treatment of Acquisition Premium for state tax purposes.

**Original Issue Discount**

The Notes that have an interest rate that is lower than the yield, as shown on the cover page hereto (the "Discount Notes"), are being offered and sold to the public at an original issue discount ("OID") from the amounts payable at maturity thereon. OID is the excess of the stated redemption price of a bond at maturity (the face amount) over the "issue price" of such bond. The issue price is the initial offering price to the public (other than to bond houses, brokers or similar persons acting in the capacity of underwriters or wholesalers) at which a substantial amount of bonds of the same maturity are sold pursuant to that initial offering. For federal income tax purposes, OID on each bond will accrue over the term of the bond, and for the Discount Notes, the amount of accretion will be based on a single rate of interest, compounded semiannually (the "yield to maturity"). The amount of OID that accrues during each semi-annual period will do so ratably over that period on a daily basis. With respect to an initial purchaser of a Discount Note at its issue price, the portion of OID that accrues during the period that such purchaser owns the Discount Note is added to such purchaser's tax basis for purposes of determining gain or loss at the maturity, redemption, sale or other disposition of that Discount Note and thus, in practical effect, is treated as stated interest, which is excludable from gross income for federal income tax purposes.

Holders of Discount Notes should consult their own tax advisors as to the treatment of OID and the tax consequences of the purchase of such Discount Notes other than at the issue price during the initial public offering and as to the treatment of OID for state tax purposes.

## 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 Notes, or in any way contesting or affecting the validity of the 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 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 Notes are subject to the unqualified approving opinion of Peck, Shaffer & Williams LLP, Covington, Kentucky, Bond Counsel to the Commission. Certain other legal matters will be passed on by Ballard Spahr Andrews & Ingersoll, LLP, Philadelphia, Pennsylvania, counsel to the Underwriters.

## RATINGS

Fitch, Moody's and Standard & Poor's (each a "Rating Agency") have assigned the Notes ratings of "AAA," "Aaa" and "AAA," respectively, conditioned upon the issuance and delivery of the Bond Insurance Policy at the time of delivery of the Notes. Fitch, Moody's and Standard & Poor's have assigned the Notes underlying ratings of "AA-," "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: Fitch Ratings, One State Street Plaza, New York, New York 10004 (212) 908-0500; Moody's Investors Service, Inc., 99 Church Street, New York, New York 10007, (212) 553-0300; and Standard & Poor's, 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 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 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 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 Commonwealth is already providing ongoing market disclosure as required by Rule 15c2-12 pursuant to agreements entered into in connection with other outstanding securities.

## UNDERWRITING

The Underwriters have agreed to purchase the Notes for a purchase price of $150,572,365.84, which is an amount equal to the par amount of the Notes, plus net original issue premium of $11,568,975.00, less underwriters' discount of $631,609.16. The Underwriters are committed to purchase all of the Notes if any are purchased.

The Representative of the Underwriters has advised the Commission that the Underwriters intend to make a public offering of the Notes at the initial public offering prices or yields set forth on the 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 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 Notes.

KENTUCKY ASSET/LIABILITY
COMMISSION

By /s/ R.B. Rudolph, Jr.
R.B. Rudolph, Jr., Chairman

By /s/ F. Thomas Howard
F. Thomas Howard, Secretary

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# EXHIBIT A

## DEBT INFORMATION PERTAINING TO THE COMMONWEALTH OF KENTUCKY

## 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.

Non-appropriation or moral obligation debt carries the name of the Commonwealth for the benefit and convenience of other entities 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 do 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 any funds to fulfill the financial obligations represented by these types of indebtedness. In the event of a shortfall the issuer covenants to request from the Governor and the General Assembly sufficient amounts to pay debt service.

### 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/A+/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 |
| 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 $1.95 billion of debt outstanding. | Aaa/AA- |
| 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/A+/A |
| 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 (Insured) |

*Ratings, where applicable, include Moody's, S&P 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.

**EXHIBIT B**

**FORM OF BOND COUNSEL OPINION FOR NOTES**

[Date of Delivery]

Kentucky Asset/Liability Commission
Frankfort, Kentucky

Re: Kentucky Asset/Liability Commission
Project Notes, 2005 Federal Highway Trust Fund First Series

Gentlemen:

We have acted as bond counsel in connection with the issuance by the Kentucky Asset/Liability Commission, an independent agency and constituted authority of the Commonwealth of Kentucky (the "Issuer"), of its Project Notes, 2005 Federal Highway Trust Fund First Series in the amount of $139,635,000 (the "Notes").

The Notes are authorized to be issued pursuant to the Constitution and laws of the Commonwealth of Kentucky (the "Commonwealth"), including particularly Section 56.860 *et seq*. of the Kentucky Revised Statutes (the "Act"), a Resolution adopted by the Issuer on April 18, 2005 (the "Resolution"), the Master Trust Indenture dated as of May 1, 2005 and the Series Trust Indenture dated as of May 1, 2005 (collectively, the "Indenture"), each between the Issuer and J.P. Morgan Trust Company, National Association, Louisville, Kentucky, as trustee (the "Trustee").

We have examined such portions of the Constitution, Statutes and laws of the United States, the Constitution, Statutes and laws of the Commonwealth, and such applicable court decisions, regulations, rulings and opinions as we have deemed necessary or relevant for the purposes of the opinions set forth below.

We have also examined records and the transcript of proceedings relating to the authorization and issuance of the Notes, including a specimen Project Note, the Financing/Lease Agreement, dated as of May 1, 2005 (the "Financing Agreement"), by and among the Issuer, the Finance and Administration Cabinet of the Commonwealth of Kentucky (the "Cabinet") and the Transportation Cabinet of the Commonwealth of Kentucky (the "State Agency") and the Memorandum of Agreement, effective as of April 2005, as amended and supplemented (the "Memorandum of Agreement") between the State Agency and the Federal Highway Administration and acknowledged by the Cabinet and the Issuer. We have also made such investigation as we have deemed necessary for the purposes of such opinion, and relied upon certificates of officials of the Commonwealth, the Issuer and the State Agency as to certain factual matters.

Based upon the foregoing, it is our opinion, under the law existing on the date of this opinion, that:

1. The Issuer is an independent agency and constituted authority of the Commonwealth, duly organized and validly existing under the laws of the Commonwealth and has the legal right and authority to issue the Notes.

2. The Indenture, the Financing Agreement, and the Resolution have been duly authorized, executed and delivered by the Issuer and the Financing Agreement has been duly authorized, executed and delivered by the State Agency and are each valid and binding obligations of the Issuer and the State Agency, as applicable, enforceable in accordance with their respective terms.

3. The Notes have been duly and validly authorized and, when duly executed in the form and manner provided in the Indenture, duly authenticated by the Trustee and delivered and paid for, will constitute valid and binding limited and special obligations of the Issuer enforceable in accordance with their terms.

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 Issuer, the Cabinet, the State Agency 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, as defined in the Indenture, or by a pledge of or lien on the income derived from the Project, if any, but are payable as to principal and interest solely and only from and are secured by the Pledged Receipts. The ability of the State Agency to make payments under the Financing Agreement is dependent upon legislative appropriations to the State Agency, which has leased the Project for an initial term ending June 30, 2006, with the right to renew for additional successive terms of two years each until the Notes and interest thereon have been paid and discharged.

6. Under the laws, regulations, rulings and judicial decisions in effect as of the date hereof, interest on the Notes is excludable from gross income for Federal income tax purposes, pursuant to the Internal Revenue Code of 1986, as amended (the "Code"). Furthermore, interest on the Notes will not be treated as a specific item of tax preference, under Section 57(a)(5) of the Code, in computing the alternative minimum tax for individuals and corporations. In rendering the opinions in this paragraph, we have assumed continuing compliance with certain covenants designed to meet the requirements of Section 103 of the Code. We express no other opinion as to the federal tax consequences of purchasing, holding or disposing of the Notes.

7. Interest on the Notes is exempt from income taxation and the Notes are exempt from ad valorem taxation by the Commonwealth and any of its political subdivisions.

Our opinion set forth above is subject to the qualification that the enforceability of the Indenture, the Resolution, the Financing Agreement, the Notes and agreements relating thereto may be limited by bankruptcy, reorganization, moratorium, insolvency, or other similar laws relating to or affecting the enforcement of creditors' rights, and to the exercise of judicial discretion in accordance with general equitable principles.

In rendering our opinion as to the due authorization, execution and delivery of the Financing Agreement by the State Agency, we have relied on opinions of counsel to the State Agency.

Very truly yours,

## EXHIBIT C

## BOOK-ENTRY-ONLY SYSTEM

The Notes initially will be issued solely in book-entry 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 system is used, only DTC will receive or have the right to receive physical delivery of 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 Notes under the Resolution.

The following information about the book-entry-only system applicable to the 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 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 the Notes, in the aggregate principal amount of the Notes and will be deposited with DTC.

DTC, the world's largest securities 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** and **www.dtc.org**.

Purchases of Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the 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 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 Notes, except in the event that use of the book-entry system for the Notes is discontinued.

To facilitate subsequent transfers, all 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 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 Notes; DTC's records reflect only the identity of the Direct Participants to whose accounts such 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 Notes may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Notes, such as redemptions, tenders, defaults, and proposed amendments to the Note documents. For example, Beneficial Owners of Notes may wish to ascertain that the nominee holding the 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 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 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 Notes are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, distributions, and interest payments on the 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 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 BONDS; (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 BONDS; (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 BONDS; 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 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 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 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 Exhibit C 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.

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**EXHIBIT D**

**SPECIMEN BOND INSURANCE POLICY**

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# FINANCIAL GUARANTY INSURANCE POLICY

## MBIA Insurance Corporation
## Armonk, New York 10504

Policy No. [NUMBER]

MBIA Insurance Corporation (the "Insurer"), in consideration of the payment of the premium and subject to the terms of this policy, hereby unconditionally and irrevocably guarantees to any owner, as hereinafter defined, of the following described obligations, the full and complete payment required to be made by or on behalf of the Issuer to [PAYING AGENT/TRUSTEE] or its successor (the "Paying Agent") of an amount equal to (i) the principal of (either at the stated maturity or by any advancement of maturity pursuant to a mandatory sinking fund payment) and interest on, the Obligations (as that term is defined below) as such payments shall become due but shall not be so paid (except that in the event of any acceleration of the due date of such principal by reason of mandatory or optional redemption or acceleration resulting from default or otherwise, other than any advancement of maturity pursuant to a mandatory sinking fund payment, the payments guaranteed hereby shall be made in such amounts and at such times as such payments of principal would have been due had there not been any such acceleration, unless the Insurer elects in its sole discretion, to pay in whole or in part any principal due by reason of such acceleration); and (ii) the reimbursement of any such payment which is subsequently recovered from any owner pursuant to a final judgment by a court of competent jurisdiction that such payment constitutes an avoidable preference to such owner within the meaning of any applicable bankruptcy law. The amounts referred to in clauses (i) and (ii) of the preceding sentence shall be referred to herein collectively as the "Insured Amounts." "Obligations" shall mean:

**[PAR]**
**[LEGAL NAME OF ISSUE]**

Upon receipt of telephonic or telegraphic notice, such notice subsequently confirmed in writing by registered or certified mail, or upon receipt of written notice by registered or certified mail, by the Insurer from the Paying Agent or any owner of an Obligation the payment of an Insured Amount for which is then due, that such required payment has not been made, the Insurer on the due date of such payment or within one business day after receipt of notice of such nonpayment, whichever is later, will make a deposit of funds, in an account with U.S. Bank Trust National Association, in New York, New York, or its successor, sufficient for the payment of any such Insured Amounts which are then due. Upon presentment and surrender of such Obligations or presentment of such other proof of ownership of the Obligations, together with any appropriate instruments of assignment to evidence the assignment of the Insured Amounts due on the Obligations as are paid by the Insurer, and appropriate instruments to effect the appointment of the Insurer as agent for such owners of the Obligations in any legal proceeding related to payment of Insured Amounts on the Obligations, such instruments being in a form satisfactory to U.S. Bank Trust National Association, U.S. Bank Trust National Association shall disburse to such owners, or the Paying Agent payment of the Insured Amounts due on such Obligations, less any amount held by the Paying Agent for the payment of such Insured Amounts and legally available therefor. This policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Obligation.

As used herein, the term "owner" shall mean the registered owner of any Obligation as indicated in the books maintained by the Paying Agent, the Issuer, or any designee of the Issuer for such purpose. The term owner shall not include the Issuer or any party whose agreement with the Issuer constitutes the underlying security for the Obligations.

Any service of process on the Insurer may be made to the Insurer at its offices located at 113 King Street, Armonk, New York 10504 and such service of process shall be valid and binding.

This policy is non-cancellable for any reason. The premium on this policy is not refundable for any reason including the payment prior to maturity of the Obligations.

IN WITNESS WHEREOF, the Insurer has caused this policy to be executed in facsimile on its behalf by its duly authorized officers, this [DAY] day of [MONTH, YEAR].

**COUNTERSIGNED:**

SPECIMEN

_____
Resident Licensed Agent

_____
City, State

**MBIA Insurance Corporation**

SPECIMEN

_____
President

Attest: _____
Assistant Secretary

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01/05

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