Semi-Annual Report of the Kentucky Asset/Liability Commission

33RD EDITION

Steven L. Beshear

Governor

Commonwealth of Kentucky

Lori H. Flanery

Secretary

Finance and Administration Cabinet

Ryan Barrow

Executive Director

Office of Financial Management

For the period ending June 30, 2013

This report may be viewed at:

http://finance.ky.gov/services/ofm/Pages/semi-annualreports.aspx

The Commonwealth's Comprehensive Annual Financial Report (CAFR) may be viewed at:

http://finance.ky.gov/services/statewideacct/Pages/ReportsandPublications.aspx

The Municipal Securities Rulemaking Board (MSRB) Electronic Municipal Market Access (EMMA) website is located at:

http://emma.msrb.org/

TABLE OF CONTENTS

INTRODUCTION

This is the Kentucky Asset/Liability Commission's ("ALCo" or "the Commission") thirty-third semi-annual report pursuant to KRS 56.863 (11) for the period beginning January 1, 2013 through June 30, 2013. Several factors on both the state and national level had an impact on activity during the reporting period. The most significant factors were:

On the national level

- The U.S. economy continues to recover from the 2008/2009 recession; although, growth in real Gross Domestic Product was only 1.425% during Fiscal Year 2013.

- The unemployment rate has fallen to 7.6% as nonfarm payrolls added on average 186,000 new jobs per month over the last 12 months.

- The Federal Reserve continues to target Federal Funds in the range of 0.00% to 0.25% but has indicated the end of quantitative easing as purchases of securities will likely be gradually wound down with the end expected in the Summer of 2014 if the economy continues to perform well.

- During the final two months of the fiscal year, long term interest rates jumped roughly 1.0% in response to the expected end of quantitative easing.

- The federal deficit has fallen dramatically as a result of sequestration, increased taxes, and general growth in the economy. However, further political wrangling over the deficit and debt ceiling will likely occur this fall.

On the state level

- General Fund receipts totaled $9,348.3 million for Fiscal Year 2013. General Fund receipts increased 2.8% for Fiscal Year 2013 over the same period in Fiscal Year 2012. Final General Fund receipts for Fiscal Year 2013 were $40.5 million, or 0.4%, more than the official revenue estimate which projected 2.4% growth.

- Road Fund receipts for Fiscal Year 2013 totaled $1,491.6 million. Road Fund receipts increased 3.3% for Fiscal Year 2013 over the same period in Fiscal Year 2012. Final Road Fund receipts for Fiscal Year 2013 fell short of the official revenue estimate by $8.0 million, or 0.5%.

- Implementation of bond authorizations from prior-year sessions of the General Assembly continues and is coming to a close as projects reach completion. Appendix D contains information on various projects financed through the State Property and Buildings Commission Revenue and Revenue Refunding Bonds, Project No. 106 (which will be discussed in more detail later in the report).

- Kentucky's seasonally adjusted unemployment rate stood at 8.4% at the end of June 2013, up from 8.2% one year ago.

INVESTMENT MANAGEMENT

MARKET OVERVIEW

In the previous semi-annual report, the growth in real Gross Domestic Product ("GDP") was reported at a 0.1% decline in the fourth quarter of Calendar Year 2012. Since that release, the data has been revised to report a 0.1% increase. While that is an improvement, the underlying trend remains a gradual decline in the level of economic growth in the United States since the end of the 2008/2009 recession. During Calendar Year 2010, real GDP growth was 2.775%. In Calendar Year 2011, growth fell to 2.05%. Calendar Year 2012 growth was 1.95%. Growth in the 12 months ended June 30, 2013, was down 1.425%, with the second half of that period being slightly weaker than the first half.

While the real GDP figures are showing a steady decline in the rate of growth, the employment numbers are showing a completely different trend. In Calendar Year 2010, 85,000 new jobs were created each month (on average) as reported on the Bureau of Labor Statistics Nonfarm Payroll report. This increased to 175,000 new jobs in Calendar Year 2011 and rose further to 180,000 new jobs in Calendar Year 2012. For the 12 months ended June 30, 2013, 186,000 jobs were created with the second half of the period showing stronger job creation than the first half. The unemployment rate is showing a similar trend to the payroll report.

To further explain, growth in Personal Consumption, on an inflation adjusted basis, has been running about 1.8% per quarter for the last year. Consumer Confidence as measured by the University of Michigan, reached a 4-year high in May, 2013, and is only off slightly in June. New Home Sales reached a 5-year high of an annual rate of 497,000 in June 2013. All of these indications point to an economy slowly growing but not strong enough to create as many new jobs as are being created. While not conclusive, some indications are that a larger portion of the new jobs are part-time than has historically been true.

Over the next six months, federal government action will be one of the economic highlights. First, the current spending authorization expires in September while a need to extend the debt ceiling will hit in October. The political parties are again opposed on how to handle the situation as the Democrats, led by the President, are pushing for tax increases, while the Republicans, led by the House, are pushing for spending cuts. In one of the previous chapters of this debate, Standard & Poor's downgraded the credit rating of the U.S. government due to the threat of a shutdown and expected future growth in entitlement spending.

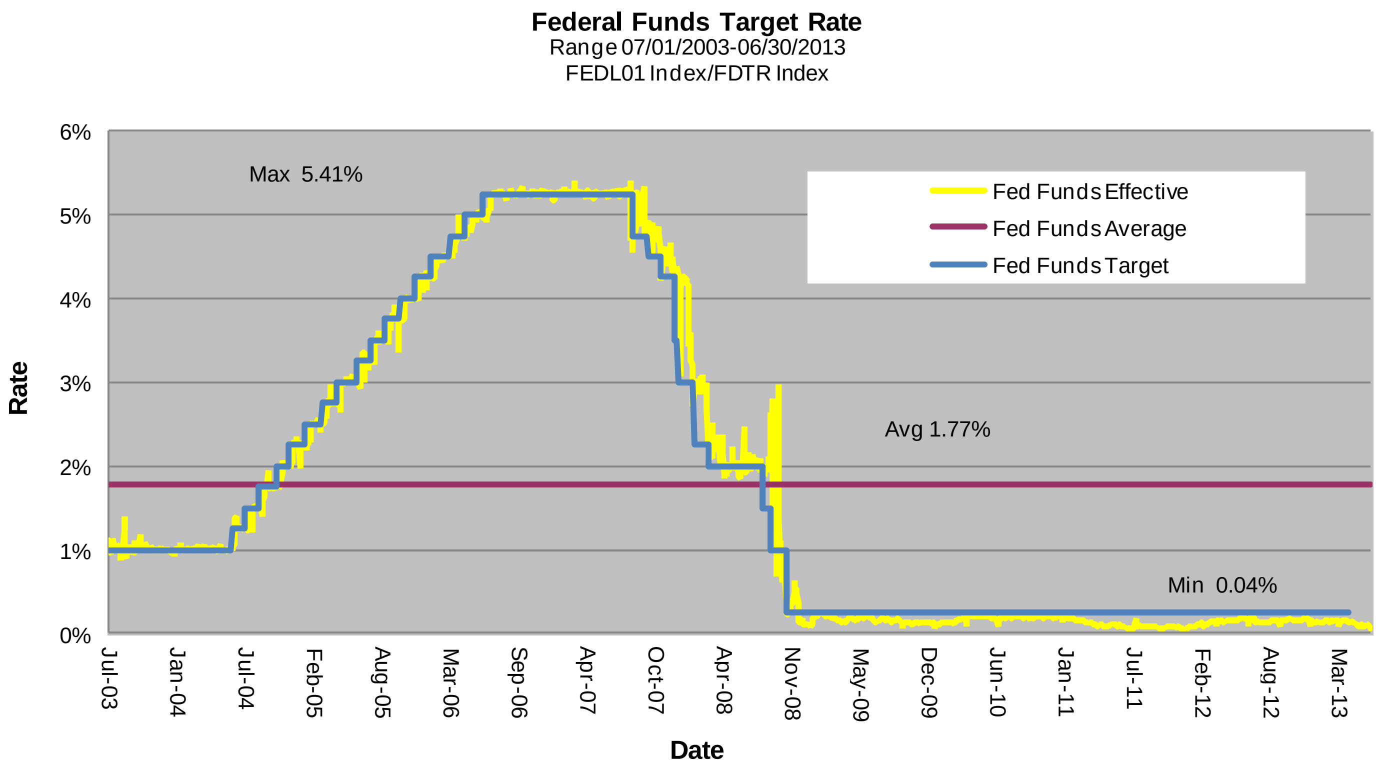
The bigger government action will be at the Federal Reserve. The Federal Reserve Open Market Committee has held Fed Funds at close to 0% since late 2008. At the same time, they have implemented several programs aimed at holding long term interest rates low. The quantitative easing program currently in place is to purchase $85 billion per month in Treasuries and Agency Mortgage-Backed Securities plus reinvest all principal proceeds in the current portfolio.

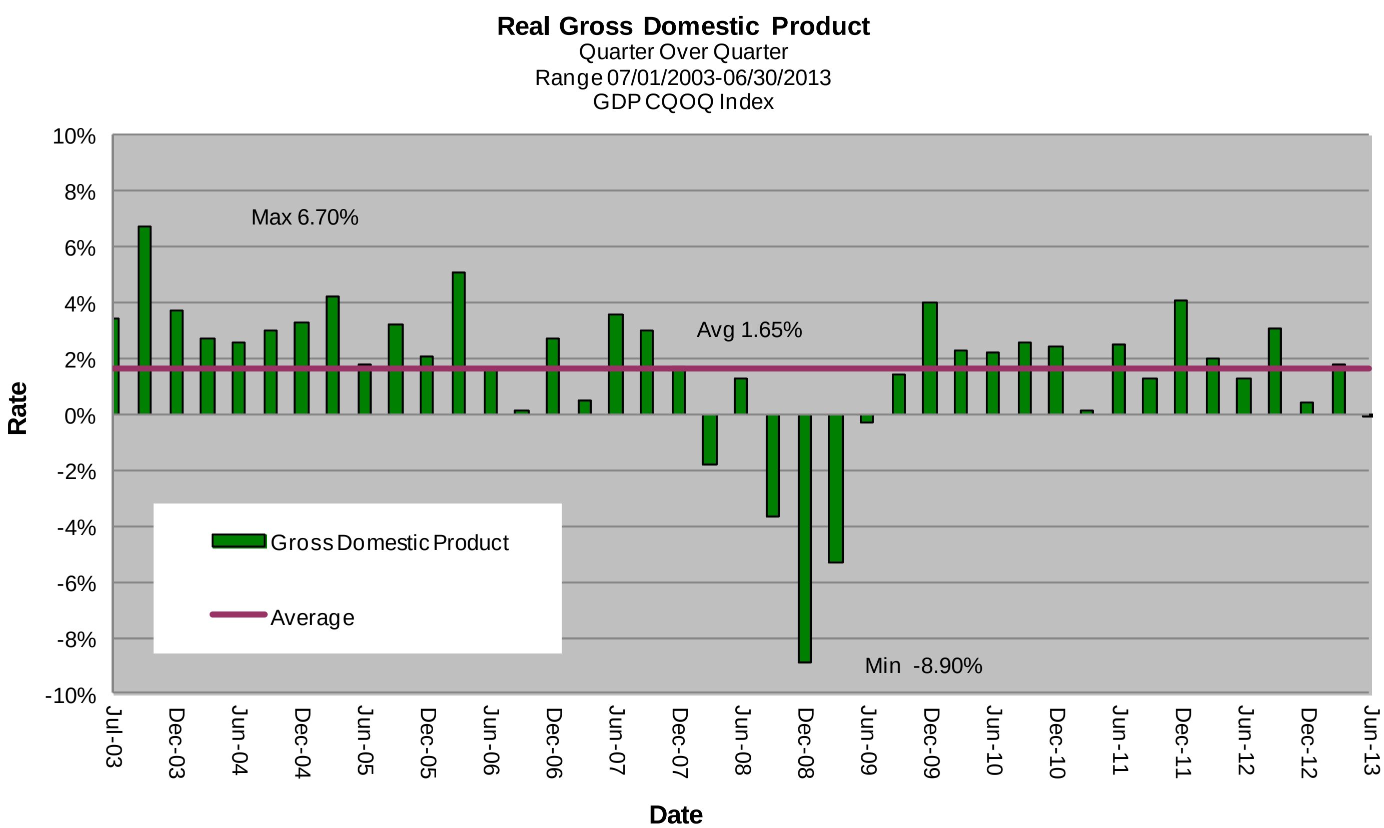
In May, Chairman Bernanke indicated, and in June, the full Board confirmed that the Fed will begin reducing the rate of purchases if the economy, primarily the unemployment rate, performs in line with Fed expectations. The press, not the Fed, has labeled this tapering. This announcement led to an immediate repricing of rates by the markets as the 10-year treasury and direct mortgage rates increased roughly 1.00% in a very short period of time. The Fed continues to maintain that Fed Funds will remain close to 0% for an extended period of time. They have targeted not to consider increasing it until the unemployment rate hits 6.50% unless inflation expectations rise substantially.

In addition to the economic activities coming, Chairman Bernanke has hinted, and the President has confirmed that he will not serve an additional term after the expiration of his current term in January 2014. Who will become the next Chair has been a matter of much speculation in the press.

INVESTMENT MANAGEMENT

Federal Funds Target Rate & Real Gross Domestic Product

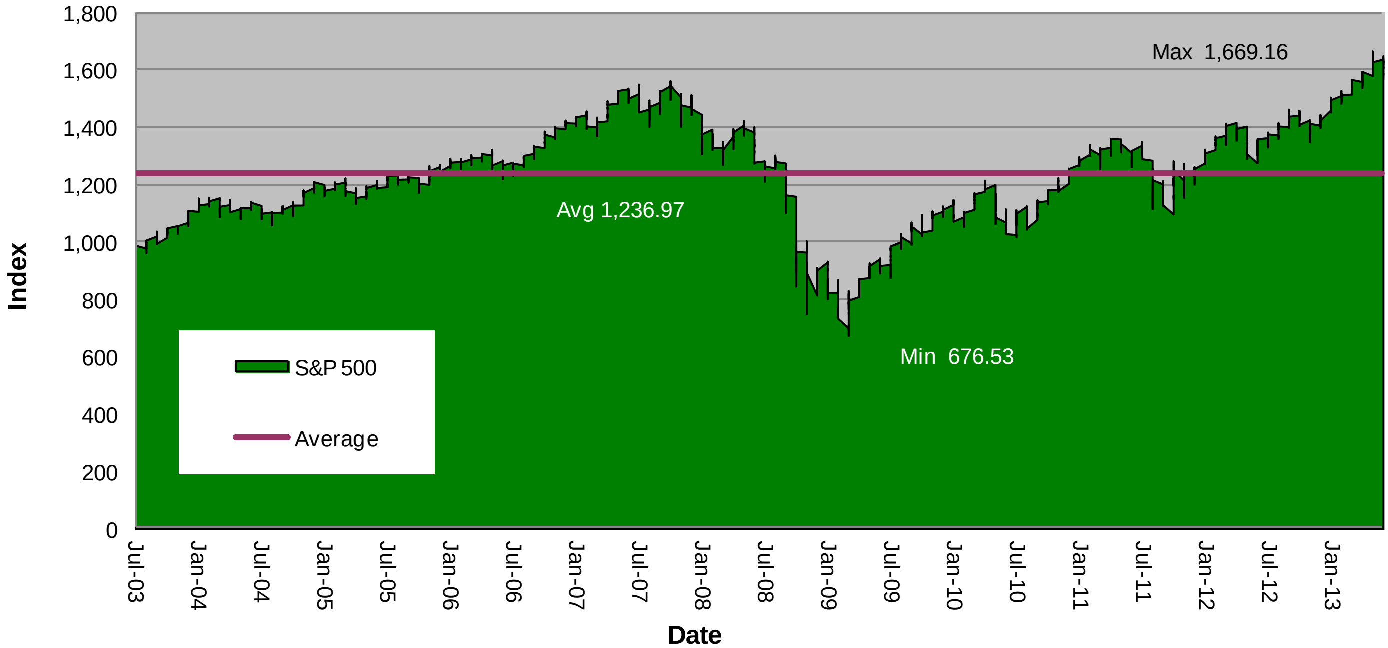




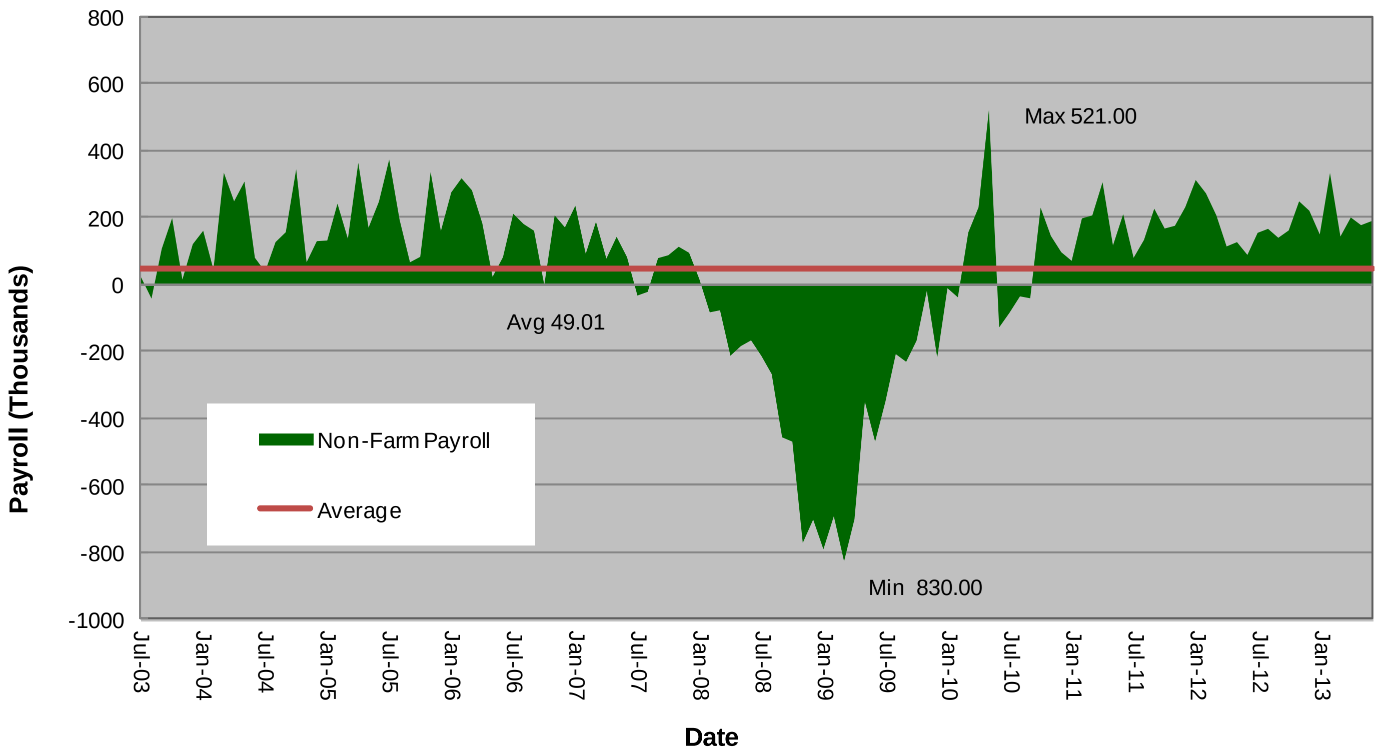
INVESTMENT MANAGEMENT

S&P 500 & NonFarm Payrolls

S&P 500
Range 07/01/2003-06/30/2013
SPX Index

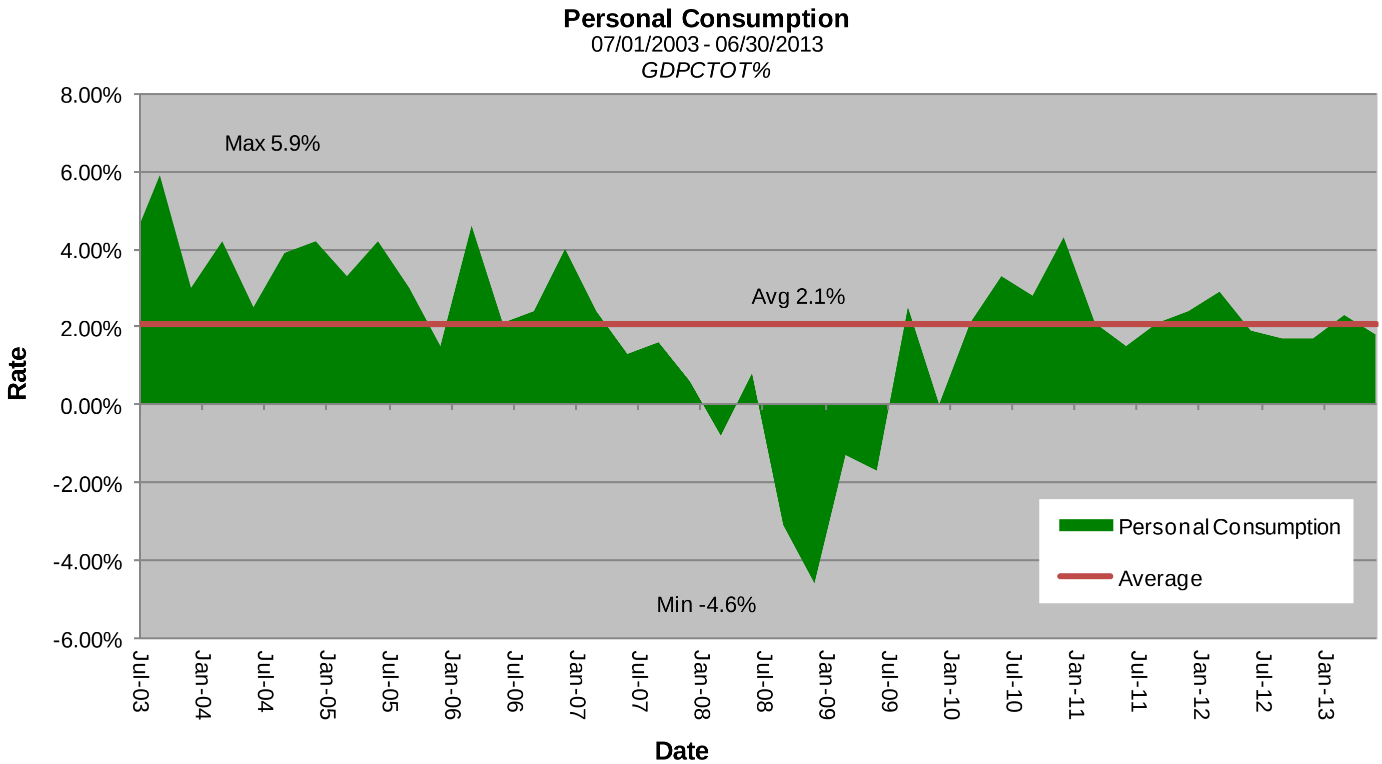


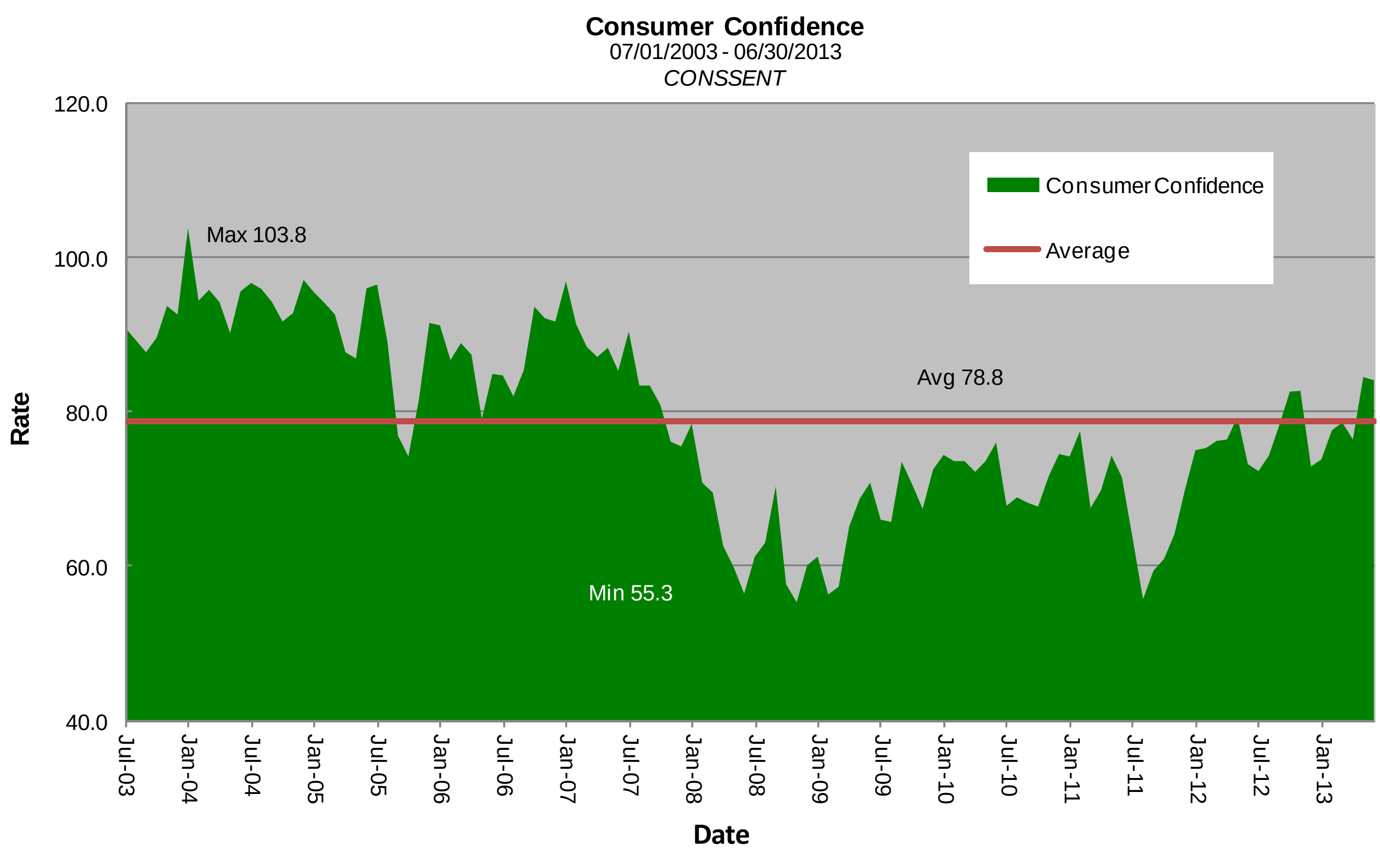
NonFarm Payrolls
07/01/2003 - 06/30/2013
NFP TCH



INVESTMENT MANAGEMENT

Personal Consumption & Consumer Confidence

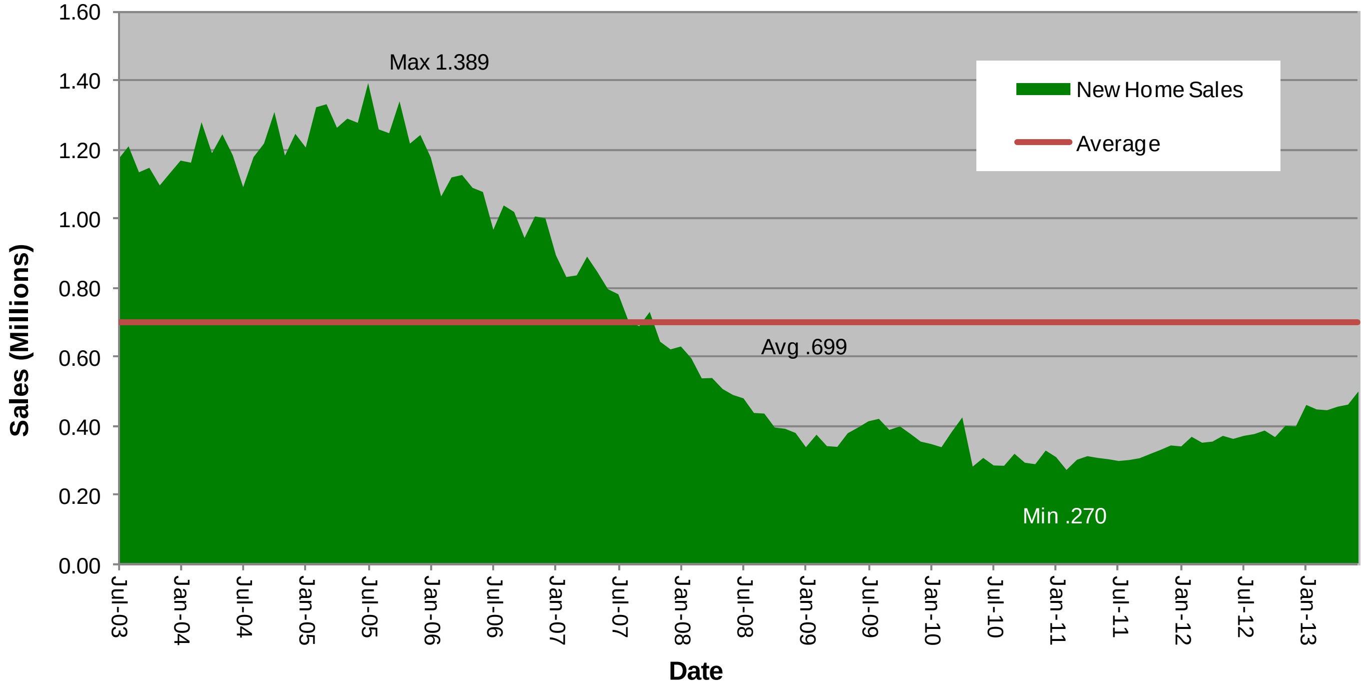




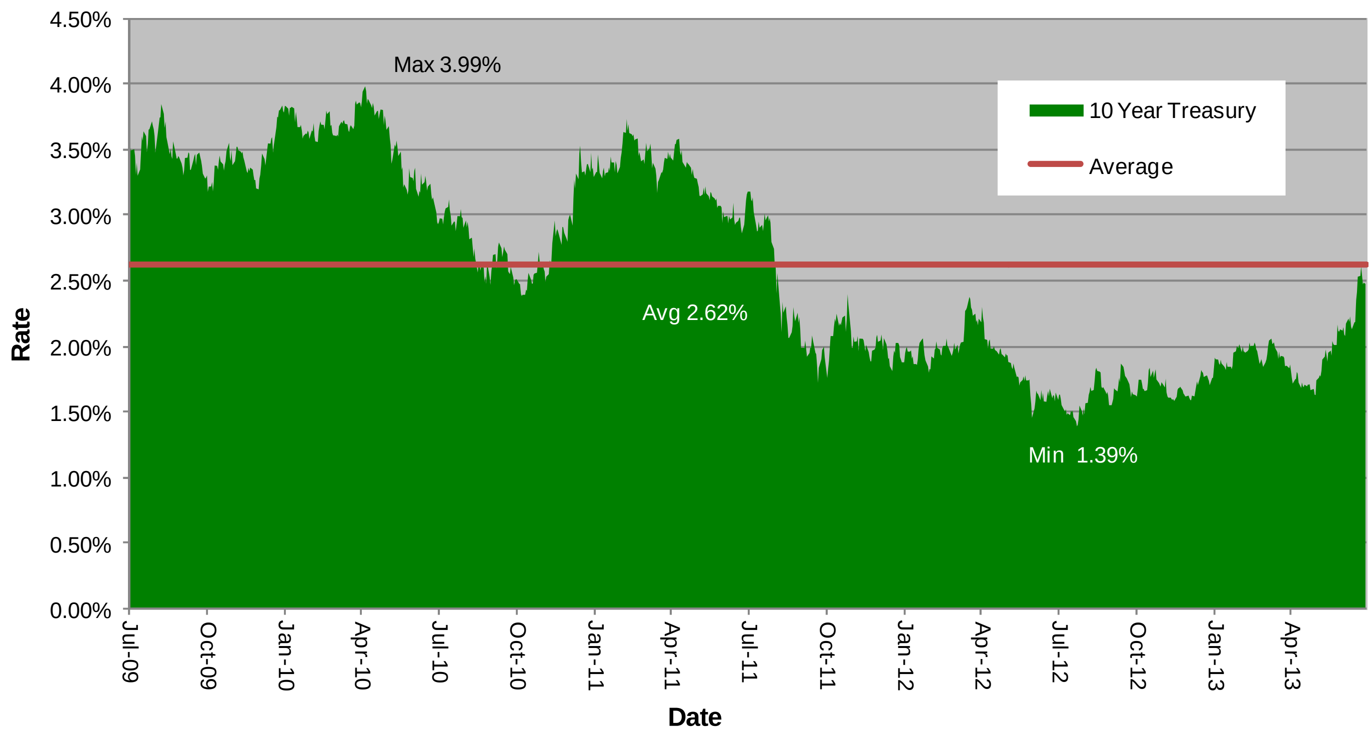
INVESTMENT MANAGEMENT

New Home Sales & 10 Year Treasury

New Home Sales
07/01/2003 - 06/30/2013
NHSLTOT



10 Year Treasury
07/01/2009 - 06/30/2013
GT10 Govt



INVESTMENT MANAGEMENT

PORTFOLIO MANAGEMENT

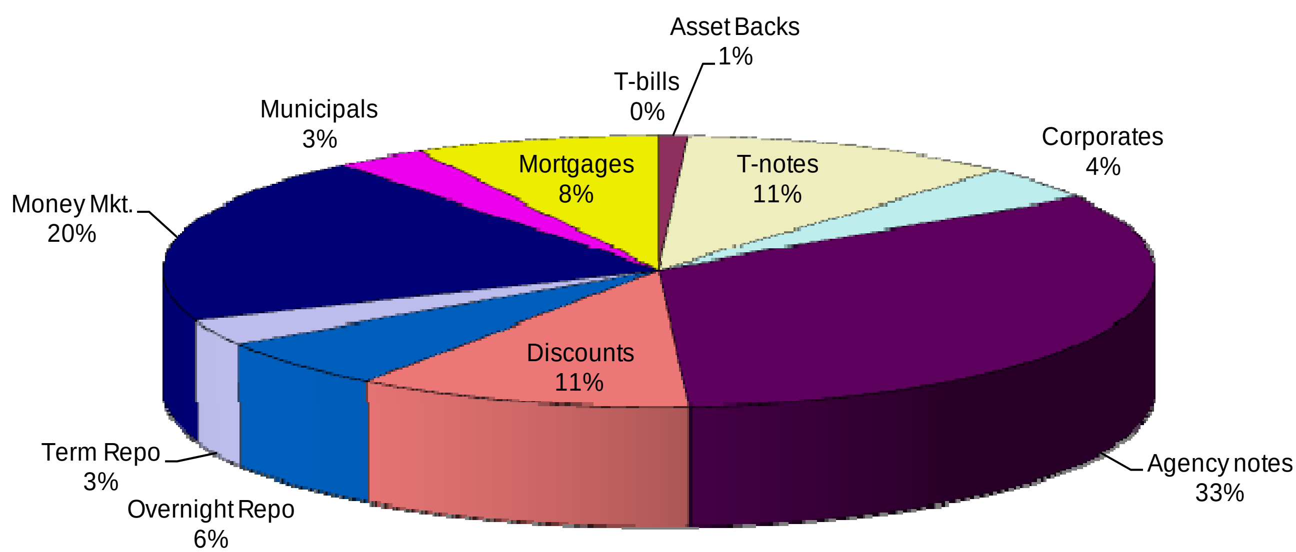
For Fiscal Year 2013, the Commonwealth's investment portfolio averaged $3.2 billion. As of June 30, 2013, the portfolio was invested in U. S. Treasury Securities (11 percent), U. S. Agency Securities (44 percent), Mortgage Pass Through Securities (<1 percent), Collateralized Mortgage Obligations (8 percent), Repurchase Agreements (9 percent), Municipal Securities (3 percent), Corporate Securities (4 percent), Asset-Backed Securities (1 percent), and Money Market Securities (20 percent). The portfolio had a market yield of 0.57 percent and an effective duration of 1.26 years.

The total portfolio is broken down into three investment pools. The pool balances as of June 30, 2013, were: Short Term Pool - $514 million, Limited Term Pool - $810 million, and Intermediate Term Pool - $2,251 million.

For Fiscal Year 2013, total investment income was $4.3 million compared to $19.8 million for the twelve months ended June 30, 2012. The reduction in income is due to a combination of historically low rates through most of the fiscal year plus an unrealized loss in market value during the last six weeks of the year as interest rates rose dramatically causing market prices to fall.

OFM engaged PFM Asset Management LLC ("PFM") to conduct an evaluation of existing statutes and regulations, general investment functions, and portfolio performance benchmarks reporting and suggested best practices. PFM has made its recommendations to OFM and the State Investment Commission, and some recommendations are being implemented. The Kentucky State Investment Commission Investment Program Review dated March 22, 2012 prepared by PFM may be found at: http://finance.ky.gov/services/ofm/Documents/SIC%20Invest%20Prog%20Rev.pdf.

Distribution of Investments as of June 30, 2013

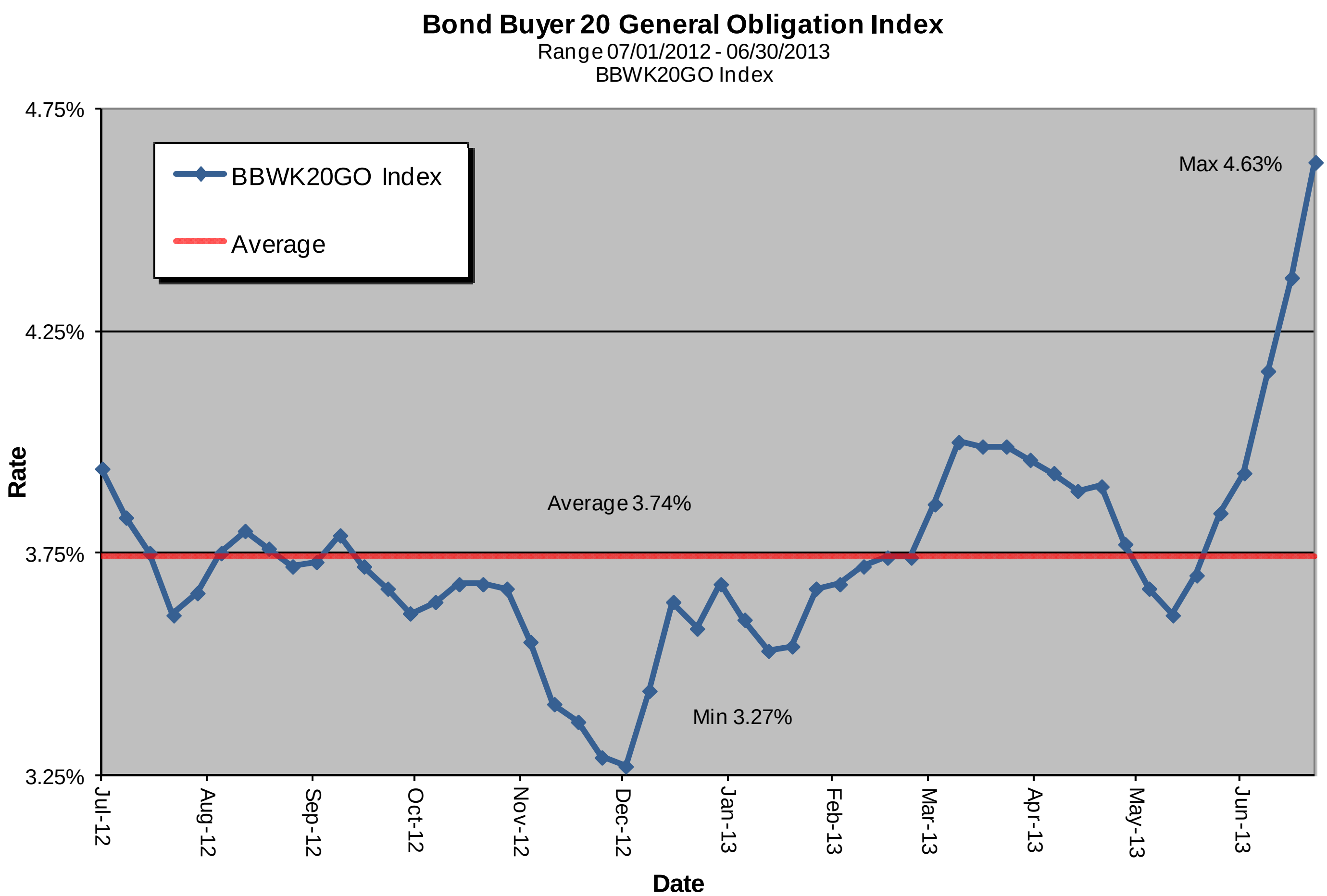


INVESTMENT MANAGEMENT

Tax-Exempt Interest Rates and Relationships

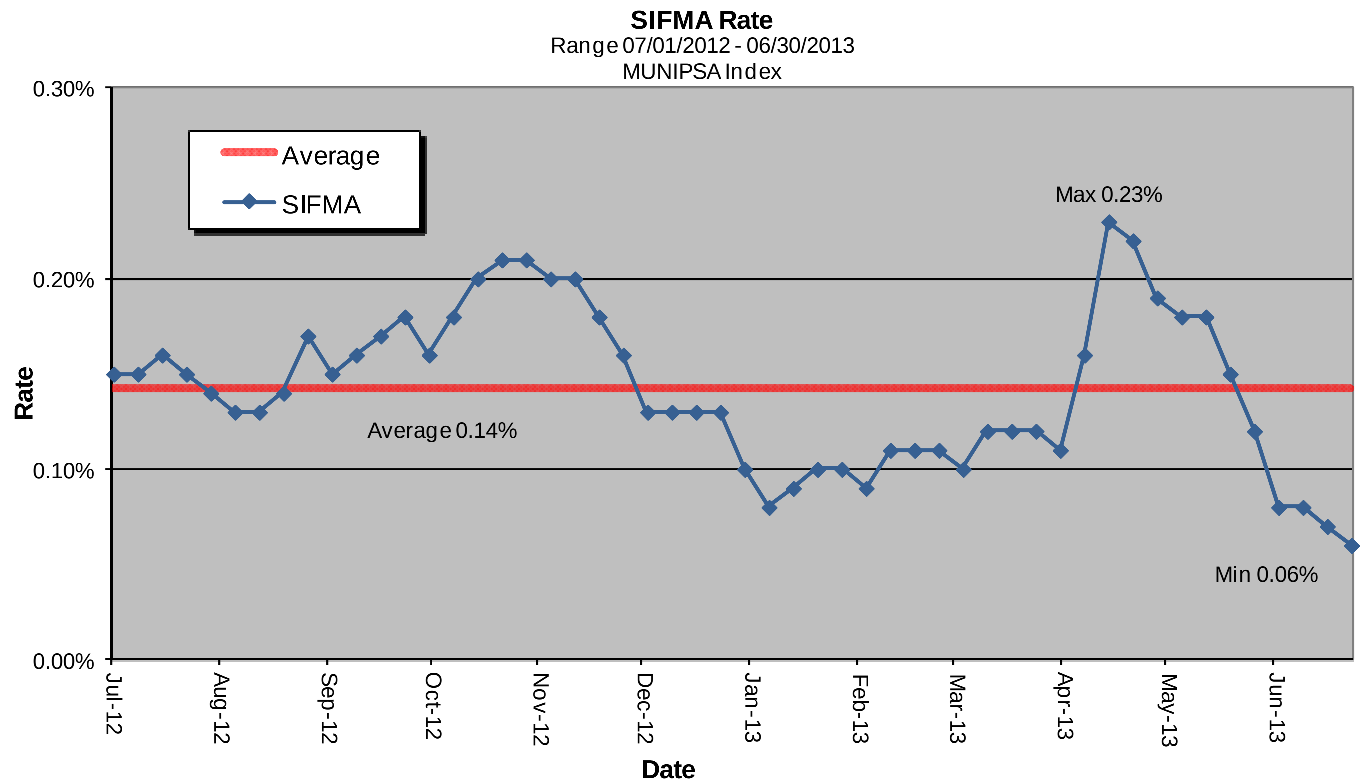
The Bond Buyer 20 year General Obligation Index averaged 3.85% for the reporting period from January 2013 through June 2013 and 3.74% for Fiscal Year 2013. The fiscal year high was 4.63% in June 2013 and the fiscal year low was 3.27% in December 2012 with the fiscal year end at 4.63%.

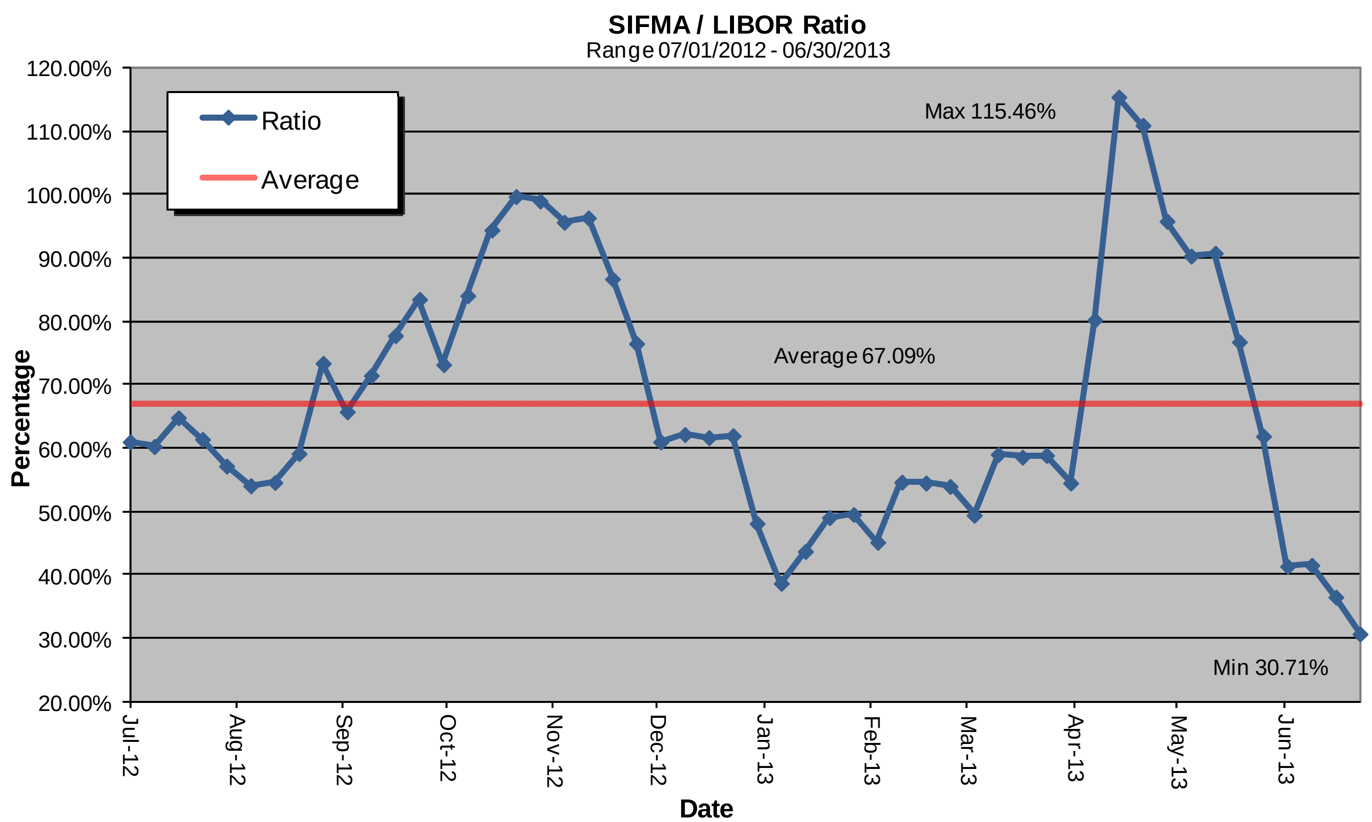
The Securities Industry and Financial Markets Association ("SIFMA") Municipal Swap Index averaged 0.12% for the reporting period from January 2013 through June 2013 and 0.14% for Fiscal Year 2013. The fiscal year high was 0.23% in April 2013 and the fiscal year low was 0.06% in June 2013, where the Index ended the fiscal year. The 30-day USD London Interbank Offered Rate ("LIBOR") averaged 0.1999% for the reporting period from January 2013 through June 2013 and 0.2118% for Fiscal Year 2013. The fiscal year high was 0.249% in July 2012; the fiscal year low was 0.192% in June 2013; and it ended the fiscal year at 0.195%. During the fiscal year, SIFMA traded at a high of 115% of the 30-day LIBOR in April 2013, at a low of 31% in June 2013, and at an average of 67% for the year. The fiscal year ended with SIFMA at 31% of the 30-day LIBOR.



INVESTMENT MANAGEMENT

SIFMA & SIFMA/LIBOR Ratio





DEBT MANAGEMENT

The 2010 Extraordinary Session of the General Assembly delivered House Bill 1 (Executive Branch Budget other than Transportation Cabinet) to the Governor on May 28, 2010 and House Bill 3 (Kentucky Transportation Cabinet Budget) to the Governor on May 29, 2010, establishing an Executive Branch Budget for the biennium ending June 30, 2012. Governor Beshear took final action on the bills on June 4, 2010. Together, the bills authorize bond financing for projects totaling $1,980.2 million to support various capital initiatives of the Commonwealth. Of the total authorization, $507.4 million was General Fund supported, $522.5 million was supported by Road Fund appropriations, $515.3 million was Agency Restricted Fund supported, and $435 million was Federal Highway Trust Fund supported and designated for the Lake Barkley and Kentucky Lake Bridges Project and the Louisville-Southern Indiana Ohio River Bridges Project. A portion of the General Fund, Road Fund, and Agency Restricted Fund authorizations listed above have been permanently financed.

The 2012 Regular Session of the General Assembly delivered House Bill 265 (Executive Branch Budget other than Transportation Cabinet) to the Governor on March 30, 2012, and the 2012 Extraordinary Session of the General Assembly delivered House Bill 2 (Kentucky Transportation Cabinet Budget) to the Governor on April 20, 2012, establishing an Executive Branch Budget for the biennium ending June 30, 2014. Governor Beshear took final action on House Bill 265 on April 13, 2012 and took final action on House Bill 2 on May 2, 2012. Together, the bills authorize bond financing for projects totaling $238.86 million to support various capital initiatives of the Commonwealth. Of the total authorization, $182.86 million is General Fund supported, $12.5 million is supported by Road Fund appropriations, and $43.5 million is Agency Restricted Fund supported. In addition, the 2012 Regular Session authorized $152.4 million of Funding Notes to finance the state-supported share of healthcare benefit contributions for Fiscal Years 2013 and 2014 to the Kentucky Teachers' Retirement System. A portion of the General Fund and the Agency Restricted Fund authorizations listed above have been permanently financed.

The 2013 Regular Session of the General Assembly delivered House Bill 7 to the Governor on February 20, 2013 authorizing a list of capital projects for the Kentucky state universities. Governor Beshear took final action on House Bill 7 on February 21, 2013. The bill authorizes bond financing for various university capital projects totaling $363.3 million to support various capital initiatives of the state universities, which are Agency Fund supported, of which $347.87 is still authorized to be issued.

In addition, House Bill 238 was signed by the Governor on March 22, 2013 authorizing an Agency Fund bond supported capital project for the Judicial Branch in conjunction with the Administrative Office of the Courts for financing of the Phase I E-Case and Docket Management system capital project totaling $28.1 million to be issued through the Kentucky State Property and Buildings Commission ("SPBC") or the Kentucky Asset/Liability Commission.

As of June 30, 2013, the unissued balances of bond authorizations from the General Assembly prior to and including 2013 were:

General Fund - $314.69 million

Road Fund - $423 million

Agency Restricted Fund - $422.74 million

Federal Highway Trust Fund - $566 million

Interim note financing through ALCo has not been available over the past few years due primarily to increased funding costs related to credit facilities for this type of program. However, ALCo continues to analyze potential interim borrowing structures and may look to re-establish this type of program in the future, if economically beneficial, to provide interim construction financing for the balance of the authorizations discussed above as well as future authorizations, as necessary.

DEBT MANAGEMENT

Ratings Update

The rating agencies continually monitor the Commonwealth's budgetary policies and actual performance in areas such as revenue, the economy and debt management. Unemployment and the softening in the national and state economies over the past few years have continued to put pressure on the Commonwealth's credit ratings.

In January and April of 2013, Fitch Ratings affirmed their ratings of "A+" on the Commonwealth's General Fund and Road Fund lease supported bonds and affirmed the ratings of "A" on certain Agency Fund lease supported bonds. In May of 2013, Fitch Ratings affirmed again their ratings of "A+" with a "stable" outlook on the Commonwealth's General Fund and Road Fund lease supported bonds. In their review, they noted the Commonwealth's reduced financial flexibility as fund balances have been depleted amidst revenue shortfalls during the recession, continued reliance on nonrecurring budget items, weak pension funding levels, the Commonwealth's above average debt position, and continued use of debt financing for operations. They also noted that fiscal pressures either on an operating basis or caused by the demands of long-term liabilities, particularly increasing needs of the employee retirement system. Fitch Ratings did note that Kentucky's economy appears to be rebounding from the recession but remains exposed to an oversized manufacturing presence.

In February 2013, S&P affirmed the Commonwealth's Issuer Credit Rating ("ICR") as "AA-" and its "A+" rating on Agency Fund, General Fund, and certain Road Fund lease supported bonds but revised its outlook from "stable" to "negative". The negative outlook reflects their view of Kentucky's weakened pension funded levels and failure to adequately fund post-retirement benefits in this biennium. Although the state recently adopted pension reform for Kentucky Employees Retirement System, State Police Retirement System, and County Employees Retirement System, the reform's actuarial impact has yet to be quantified. Even under the recently adopted reform, the state will not fully pay its actuarially required contribution until the next biennium. Furthermore, the underfunding of the state's post-retirement liabilities, including borrowing for current annual postemployment benefits expenditures is indicative of budgetary pressures that could contribute to credit deterioration. In April of 2013, S&P affirmed again its "A+" rating on certain Agency Fund lease supported bonds as well as the "negative" outlook. In May 2013, S&P again affirmed the Commonwealth's ICR as "AA-".

Tax and Revenue Anticipation Notes (TRAN)

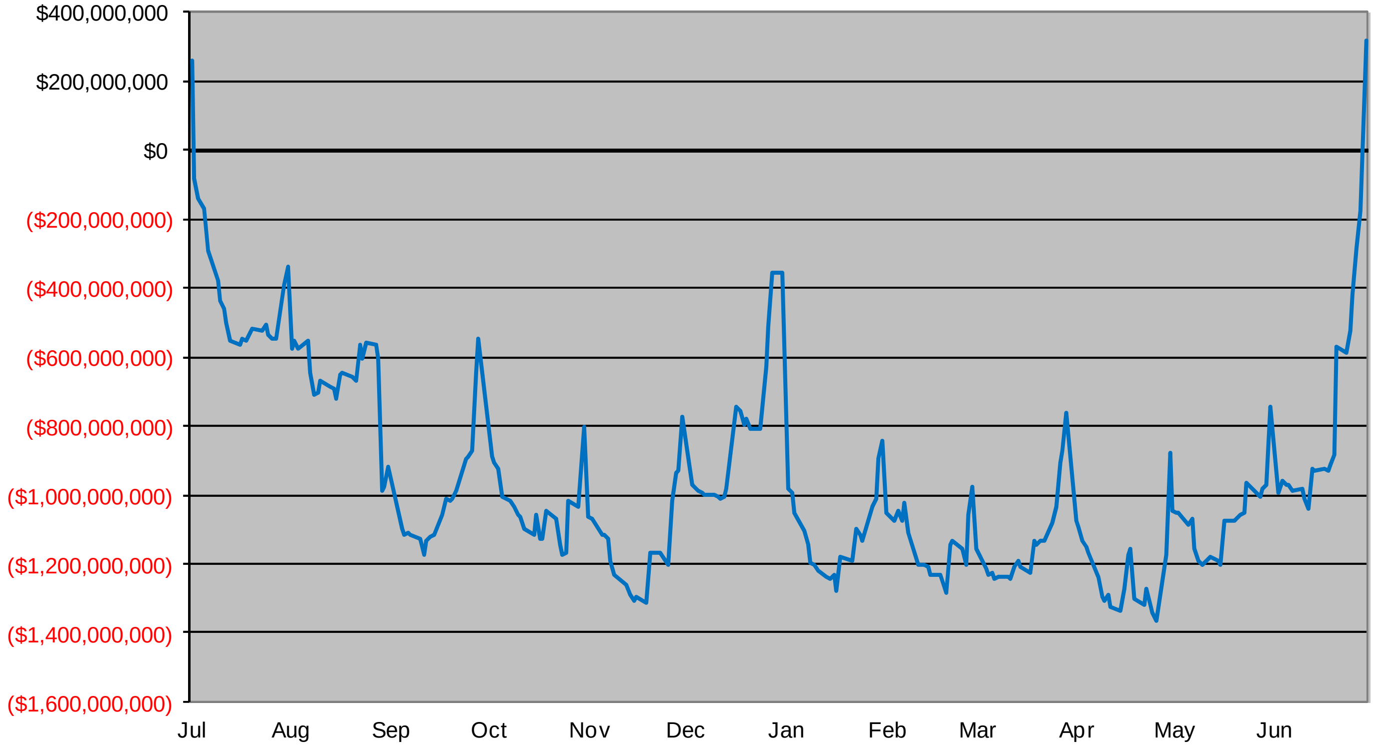
No General Fund TRAN was issued for Fiscal Year 2014. As in the previous four fiscal years, current reinvestment yields on TRAN proceeds would not be significantly higher than the cost of funds for a TRAN. At this time, borrowing internally from the state investment pools continues to be the most efficient and cost-effective way to provide short-term liquidity to the General Fund.

Fiscal Year	TRAN size	Economic Benefit
1998	200	3.2
1999	300	4.7
2000	400	7.3
2001	550	6.5
2002	650	4.3
2003	500	0.3
2004	NA	NA
2005	500	2.8
2006	600	6.0
2007	150	2.8
2008	350	5.9
2009	400	7.1
2010	NA	NA
2011	NA	NA
2012	NA	NA
2013	NA	NA
2014	NA	NA

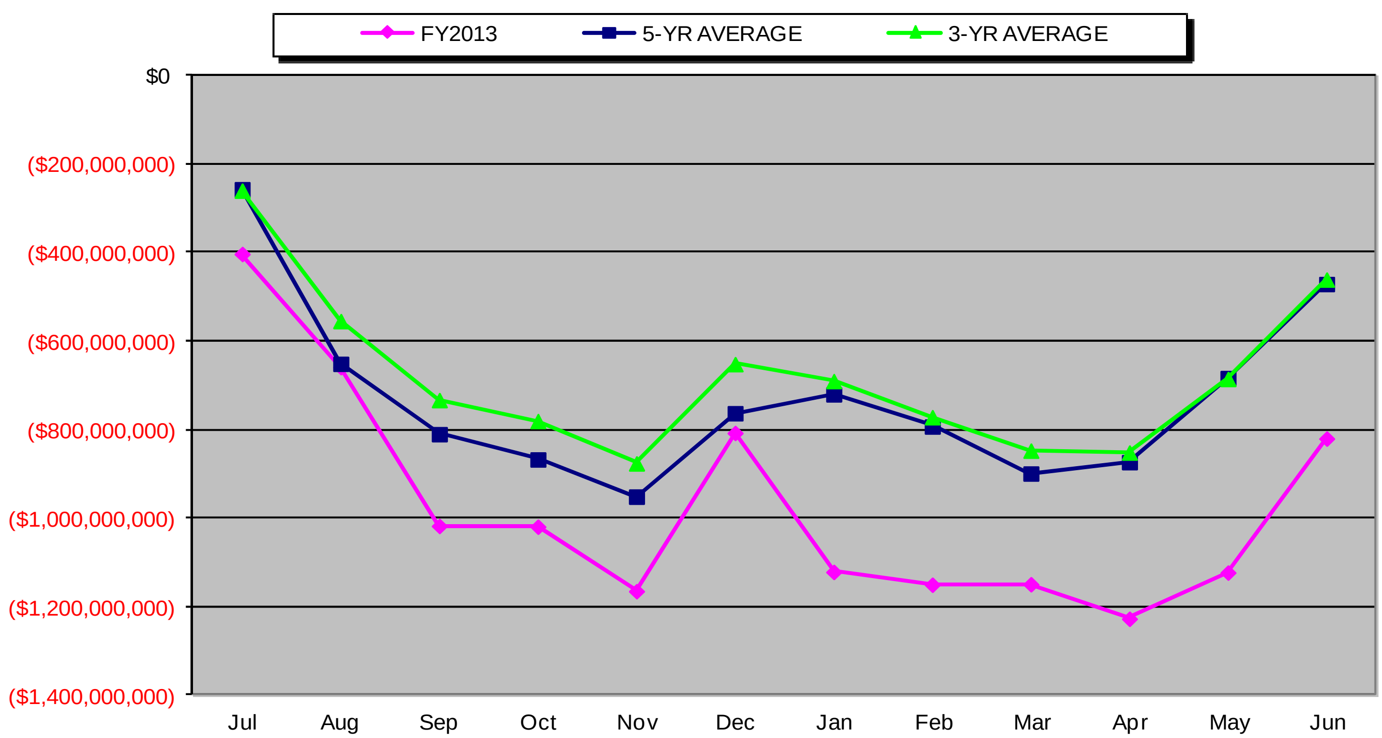
($ in millions)

DEBT MANAGEMENT

General Fund Cash Balance
Fiscal Year 2013



GENERAL FUND MONTHLY AVERAGE
(Excluding TRAN Proceeds)



DEBT MANAGEMENT

FINANCIAL AGREEMENTS

As of June 30, 2013, ALCo had four financial agreements outstanding, with a net notional exposure amount of $210.665 million. These financial agreements are described in the section below and the terms of these transactions are detailed in Appendix A. No additional financial agreements were executed during the reporting period.

General Fund – Floating Rate Note Hedges

In May, 2007, ALCo issued $243.08 million of Floating Rate Notes ("FRNs") to permanently finance $100 million of General Fund bond supported projects and to advance refund certain outstanding SPBC bonds for present value savings. The transaction entailed ALCo issuing four FRNs, each paying a rate of interest indexed to 3-Month LIBOR plus a fixed spread. Integrated into the transaction were four separate interest rate swaps which perfectly hedge the floating rates on the FRNs and lock in a fixed rate payable by ALCo on the transaction. The terms of the four interest rate swaps exactly match the notional amount, interest rate, and amortization schedule of the four FRNs and allowed ALCo to elect "super-integrated" tax status on the transaction, whereby it receives similar tax treatment as a fixed rate bond issue under IRS rules.

Under the FRN transaction, the Notes and interest rate swaps were each insured under separate policies by FGIC, which maintained an Aaa/AAA credit rating at the time from Moody's and S&P. Under the terms of the original interest rate swaps, the counterparty (Citibank) could optionally terminate the agreements if the insurer's claims paying rating fell below an A3/A- level. Subsequent to the transaction, FGIC was downgraded multiple times by the credit rating agencies and currently are no longer rated. In December 2008, MBIA (rated A2 by Moody's at the time) reinsured FGIC's municipal insurance portfolio providing additional coverage on the transaction. However, MBIA Insurance Corporation's credit rating was also subsequently downgraded on multiple occasions and is currently rated B3/B by Moody's and S&P. In February of 2009, MBIA established a new U.S. public finance financial guaranty insurance company known as National Guaranty Public Finance Corporation (National). National, at no additional charge, provided reinsurance on the FRNs and related swaps. However, on December 22, 2010, S&P downgraded National from A to BBB leaving both of National's claims paying ratings below the required A3/A- level. (National is currently rated Baa1 by Moody's).

In early 2011, ALCo spent considerable time working with Citibank and other parties analyzing a variety of remedies that would prevent the potential early termination of the interest rate swaps. After much consideration, ALCo determined the preferred remedy was one offered by Citibank whereby the remaining notional amount of each interest rate swap would be assigned to a new counterparty under the existing financial terms and at no cost to ALCo or the Commonwealth. On February 14, 2011, ALCo, Citibank and the new counterparty, Deutsche Bank AG, executed the assignment of the remaining notional balances of each swap to Deutsche Bank. The terms of the new interest rate swaps with Deutsche Bank are identical to the original swaps, with two exceptions: 1) the new swaps are not insured and there are no insurer provisions contained in the new agreements, and 2) the credit rating triggers under the automatic termination provisions are now symmetrical for both counterparties (ALCo and Deutsche Bank) at A3/A-. Under the original swaps, ALCo's credit rating trigger was Baa2/BBB, but rating recalibrations by the rating agencies, whereby municipal issuers are now rated on the same scale as corporations and other debt issuing entities, have facilitated the need for equal credit rating triggers for both parties.

Details related to the interest rate swaps as of June 30, 2013 are presented in Appendix A.

DEBT MANAGEMENT

ASSET/LIABILITY MODEL

General Fund

The total SPBC debt portfolio as of June 30, 2013 had $4,091 million of bonds outstanding with a weighted average coupon of 5.04 percent and a weighted average life of 7.57 years. The average coupon reflects an amount of taxable bonds issued under the Build America Bond Program during 2009 and 2010 as well as continued investor preference for tax-exempt callable premium bonds in the current market at a yield lower than par or discount coupon bonds. The $1,292 million callable portion had a weighted average coupon of 5.09 percent.

The SPBC debt structure has 31 percent of principal maturing in 5 years and 68 percent of principal maturing in 10 years. The first ratio is approximately in line with the rating agencies' proposed target of 27-30 percent due in 5 years, and the second ratio is approximately in line with the rating agencies' proposed target of 55-60 percent maturing within 10 years, primarily influenced by debt restructuring and the minimal amount of long-term new money permanent financings within the last two years.

The General Fund had a high balance of $315.5 million at the end of Fiscal Year 2013 and a low of negative $1.364 billion on April 26, 2013.

The average and median balances were a negative $955 million and a negative $1.038 billion, respectively. Since the General Fund continued to have a negative available cash balance for most of the fiscal year, there is little, if anything, that can be done from an asset management point of view beyond current actions.

From a liability management perspective, total General Fund debt service, net of credits was $631.4 million for Fiscal Year 2013. Net interest margin will continue to be negative due to low cash balances versus outstanding fixed rate debt, low level of interest rates, and the callability of the debt portfolio.

SPBC 106

In mid-June 2013, SPBC issued SPBC 106 which was a General Fund transaction for $147,120,000 consisting of $138,630,000 Revenue Bonds, Project No. 106 Series A and $8,490,000 Revenue Refunding Bonds, Project No. 106 Series B. The transaction: (1.) currently refunded a portion of the Commission's outstanding State Property and Buildings Commission Revenue and Revenue Refunding Bonds, Project No. 77, (2.) advance refunded a portion of the State Property and Buildings Commission Revenue Bonds, Project No. 79, (3.) refunded an ALCo direct bank loan through Citibank, N.A. from 2012 that provided interim financing for several authorized but unissued General Fund bond supported projects, and (4.) provided new money for approximately $111.8 million of additional authorized but unissued General Fund bond supported projects.

The SPBC 106 bonds received ratings of Aa3/A+/A+ from Moody's, S&P, and Fitch, respectively. Moody's and S&P assigned a "negative" outlook on SPBC 106, and Fitch assigned a "stable" outlook on the transaction.

The SPBC 106 transaction achieved a very attractive All-In True Interest Cost of 3.55% with an average life of 11.77 years to provide $872,423 in net present value savings for the Commonwealth. All bonds were sold on a tax-exempt basis via negotiated sale with Citigroup serving as senior managing underwriter and Peck, Shaffer & Williams LLP as bond counsel. The transaction closed on June 17, 2013.

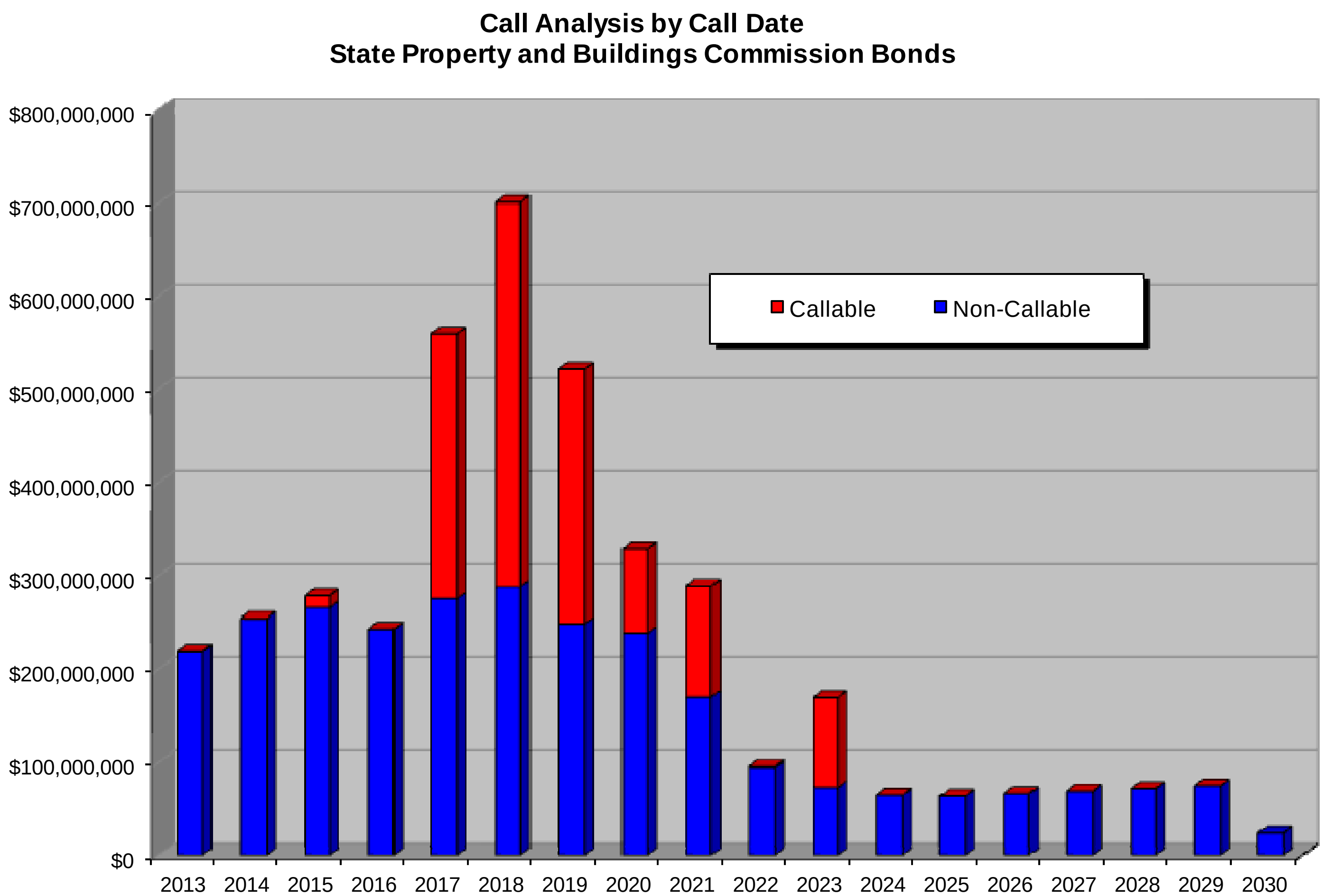
ALCo Funding Notes

On April 26, 2010, the Governor signed House Bill 531, which amended certain statutes by modifying the definition of "funding notes" and authorizing funding notes to be issued by the Commission for the purpose of financing or refinancing obligations owed under KRS 161.550(2) or 161.553 (2) to the Kentucky Teachers' Retirement System ("KTRS"). This authorization, together with cer-

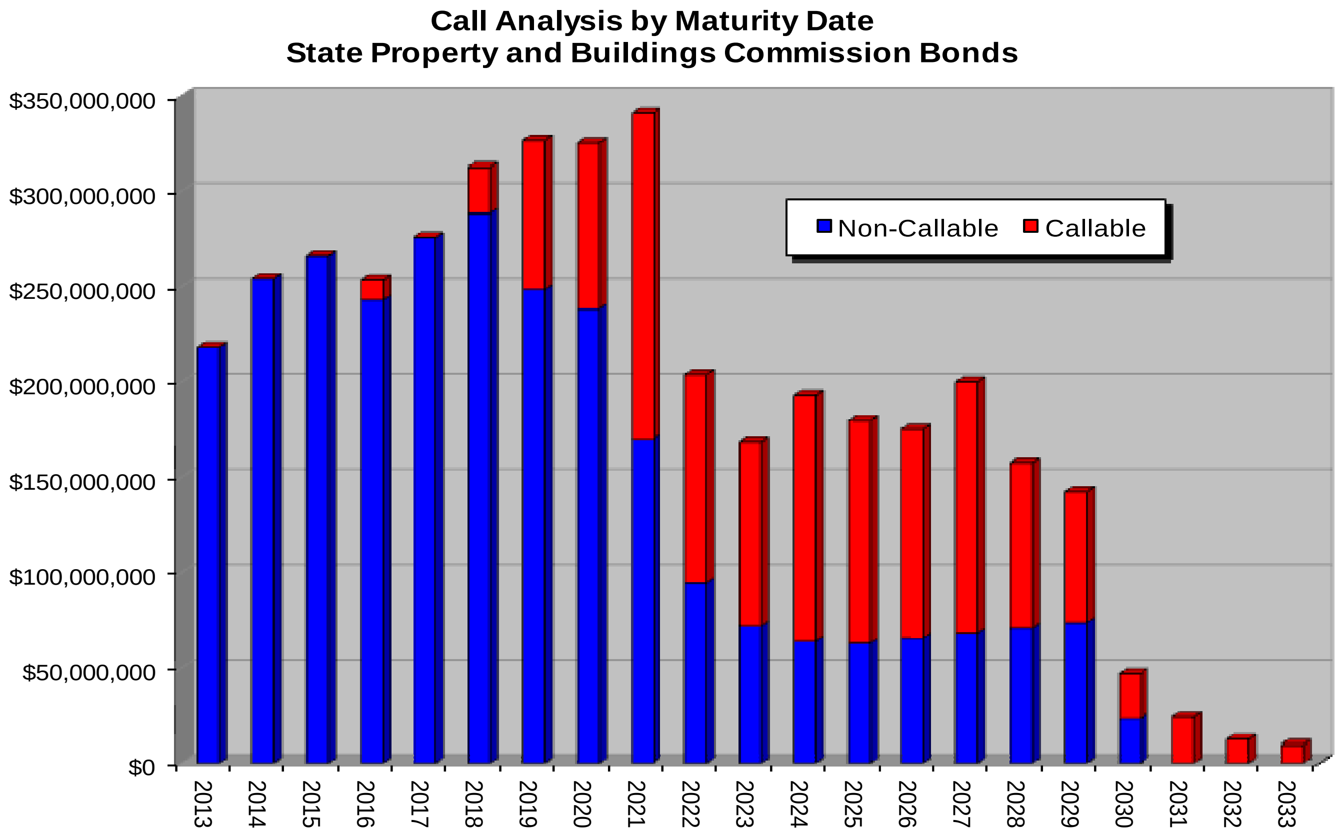
DEBT MANAGEMENT

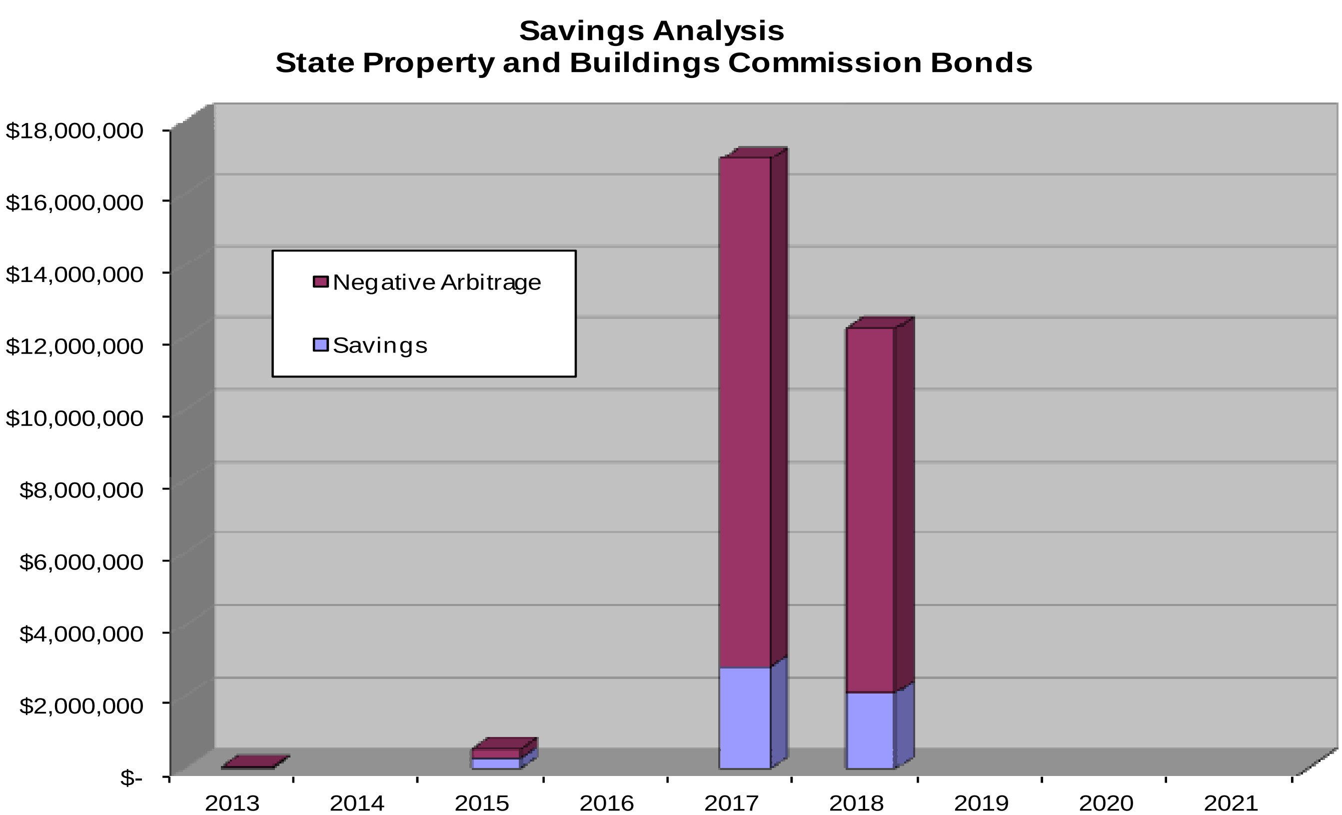
tain authorizations in the Budget Act, permitted the Commission to issue funding notes in an amount not to exceed $875 million to finance obligations owed to KTRS or refinance loans previously made from the KTRS Pension Fund to the KTRS Medical Insurance Fund for stabilization funding in prior fiscal years.

In August 2010, the Commission issued its $467.555 million Funding Notes, 2010 General Fund First Series to repay in full all loans previously made from the KTRS Pension Fund to the KTRS Medical Insurance Fund and will result in approximately $87 million in cashflow savings for the General Fund over Fiscal Years 2011 through 2020 versus the prior obligations. In February 2011, the Commonwealth issued its $269.815 million Funding Notes, 2011 General Fund First Series to provide the state-supported portion of healthcare benefit contributions to KTRS for Fiscal Years 2011 and 2012 and will provide the Commonwealth's General Fund over $40.59 million in cashflow savings over Fiscal Years 2013 through 2022. House Bill 265 of the General Assembly, 2012 Regular Session (the "Executive Branch Budget Bill") authorized an additional $152.4 million of Funding Notes for this purpose for Fiscal Years 2013 and 2014. In February 2013, the Commission issued its $153.290 million Funding Notes, 2013 General Fund First Series to provide the state-supported portion of healthcare benefit contributions to KTRS for Fiscal Years 2013 and 2014.



DEBT MANAGEMENT





DEBT MANAGEMENT

Agency Fund

SPBC 105

In mid-May 2013, SPBC issued SPBC Revenue Bonds, Project No. 105 which was an Agency Fund transaction for the Kentucky River Authority ("KRA") for $17,210,000. The transaction provided funding for the renovation of Locks 1 and 2 on the Kentucky River, the construction of Dam 8, including design costs, and the construction and renovation for additional public projects for KRA.

The SPBC 105 bonds were sold on a tax-exempt basis as a single series of serial bonds. The bonds received ratings of A1/A+/A from Moody's, S&P, and Fitch, respectively. Moody's and S&P both assigned a "negative" outlook on SPBC 105 while Fitch assigned a "stable" outlook on the transaction.

The SPBC 105 transaction achieved a very attractive All-In True Interest Cost of 3.29% with an average life of 13.95 years. All bonds were sold via competitive sale with First Southwest serving as financial advisor and Peck, Shaffer & Williams LLP as bond counsel. There were nine bidders for the transaction, and the winning bidder was PNC Capital Markets with a True Interest Cost bid of 3.249751%. The transaction closed on May 15, 2013.

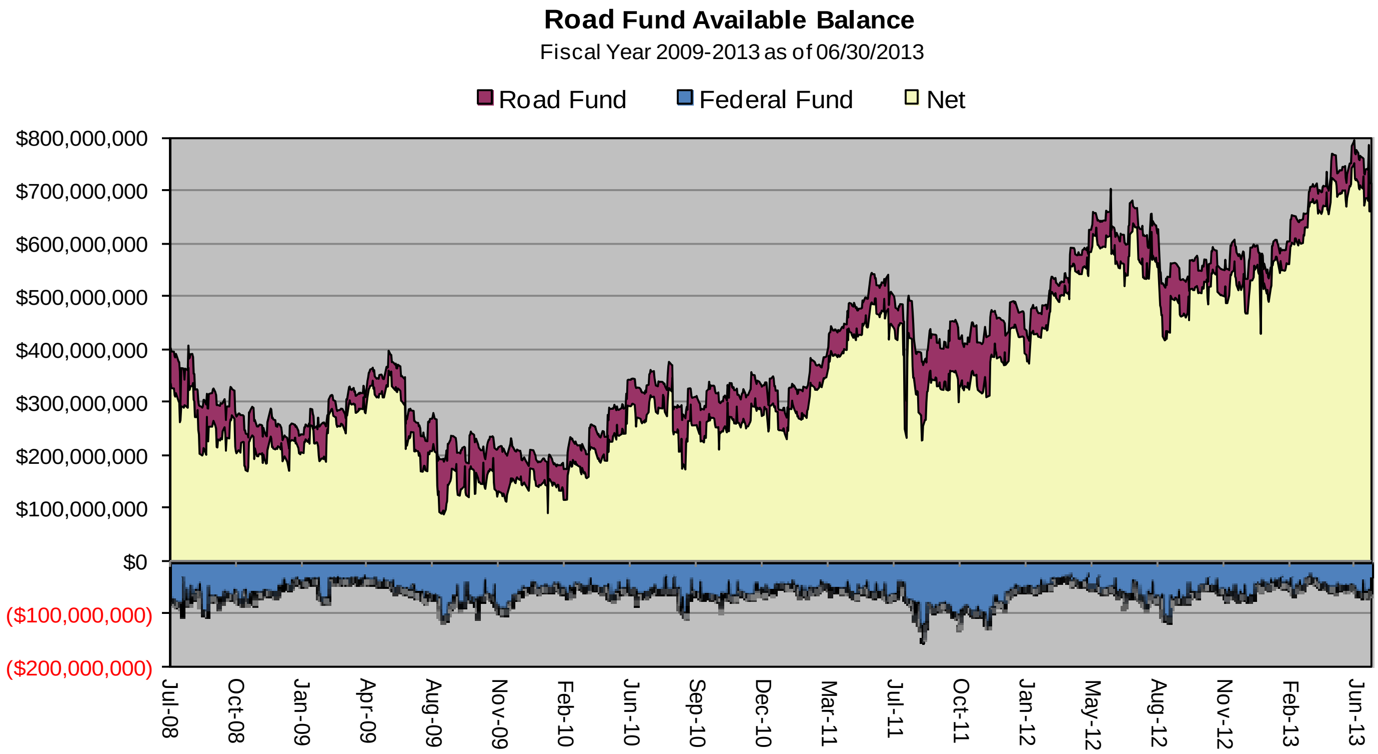
Road Fund

The Road Fund average daily cash balance for Fiscal Year 2013 was $626.7 million compared to $498 million for Fiscal Year 2012. The Road Fund cash was invested in the Intermediate Term Investment Pool which had a duration of 1.97 years as of June 30, 2013. The Road Fund earned a negative $0.4 million on a cash basis for Fiscal Year 2013 versus $3.1 million for Fiscal Year 2012. The continued relatively low level of investable balances at certain times during the fiscal year limits the investment opportunities.

As of June 30, 2013, the Turnpike Authority of Kentucky ("TAK") had $1,352 million of bonds outstanding with a weighted average coupon of 4.85 percent and an average life of 8.87 years.

Road Fund debt service for Fiscal Year 2013 was $145.4 million, resulting in a net interest margin (investment income earned less debt service paid) of negative $145.8 million. The negative amount stems from the level of investable balances and a general low level of interest rates on the investment side in addition to the limited callability of fixed rate obligations on the liability side.

DEBT MANAGEMENT



SUMMARY

ALCo's approach to managing the Commonwealth's interest-sensitive assets and interest-sensitive liabilities has provided tremendous flexibility and savings in financing the Commonwealth's capital construction program.

Since its inception, ALCo has been instrumental in adding incremental returns on investment income to the Commonwealth's investment portfolio. ALCo has continued to manage General Fund intra-year cashflow deficits through its TRAN program when cost effective. Until Fiscal Year 2010, ALCo had issued a General Fund TRAN each fiscal year since 1998 (with the exception of FY 2004), providing millions of dollars of incremental gains for the General Fund over this time (see Debt Management TRAN section for details). In addition, ALCo's management approach to project funding has allowed the Commonwealth to take advantage of short-term yields and achieve millions of dollars in budgetary savings through debt service lapses.

Over the past four years, the high cost of acquiring credit/liquidity support for short-term borrowing programs when compared to the low cost of long-term financing favored long-term financing structures. However, ALCo does and will continue to analyze the cost effectiveness of potential interim financing options during near term.

As always, ALCo continues to analyze potential opportunities for savings and to evaluate new financing structures which offer the Commonwealth the ability to diversify risk within its portfolio while taking advantage of market demand for various new or unique products.

APPENDIX

APPENDIX A

ALCo Financial Agreements	ALCo FRN Series A Hedge	ALCo FRN Series A Hedge	ALCo FRN Series B Hedge	ALCo FRN Series B Hedge
Fund Source	General Fund	General Fund	General Fund	General Fund
Hedge	2017 FRN	2027 FRN	2021 FRN	2025 FRN
Counter Party	Deutsche Bank AG	Deutsche Bank AG	Deutsche Bank AG	Deutsche Bank AG
Counter-Party Ratings *(Moody's / S&P / Fitch)*	A2/A/A+	A2/A/A+	A2/A/A+	A2/A/A+
Termination Trigger	A3/A-	A3/A-	A3/A-	A3/A-
Swap Type	Fixed Pay	Fixed Pay	Fixed Pay	Fixed Pay
Benchmark	67% 3M LIBOR + 40	67% 3M LIBOR + 53	67% 3M LIBOR + 52	67% 3M LIBOR + 55
Reset	Quarterly	Quarterly	Quarterly	Quarterly
Notional Amount	12,745,000	59,945,000	67,040,000	70,935,000
Amortize (yes/no)	yes	yes	yes	yes
Original Execution Date	5/16/2007	5/16/2007	5/16/2007	5/16/2007
Start Date	5/31/2007	5/31/2007	5/31/2007	5/31/2007
Assignment Date	2/14/2011	2/14/2011	2/14/2011	2/14/2011
Mandatory Early Termination				
End Date	11/1/2017	11/1/2027	11/1/2021	11/1/2025
Fixed Rate pay-(rec)	3.839%	4.066%	4.042%	4.125%
Day Count	30/360	30/360	30/360	30/360
Payment Dates	February 1, May 1, August 1, November 1			
Security Provisions	General Fund Debt Service Appropriations			
Current Market Valuation June 30, 2013 (negative indicates payment owed by ALCo if terminated)	(924,172)	(8,422,959)	(9,144,170)	(12,291,379)
Interest Earnings (not applicable)				
Total	not applicable	not applicable	not applicable	not applicable

Swap Summary

As of June 30, 2013

Total Notional Amount Executed

General Fund	Road Fund
243,080,000	0

Net Exposure Notional Amount

General Fund	Road Fund
210,665,000	0

Total Notional Amount Executed by Counter Party

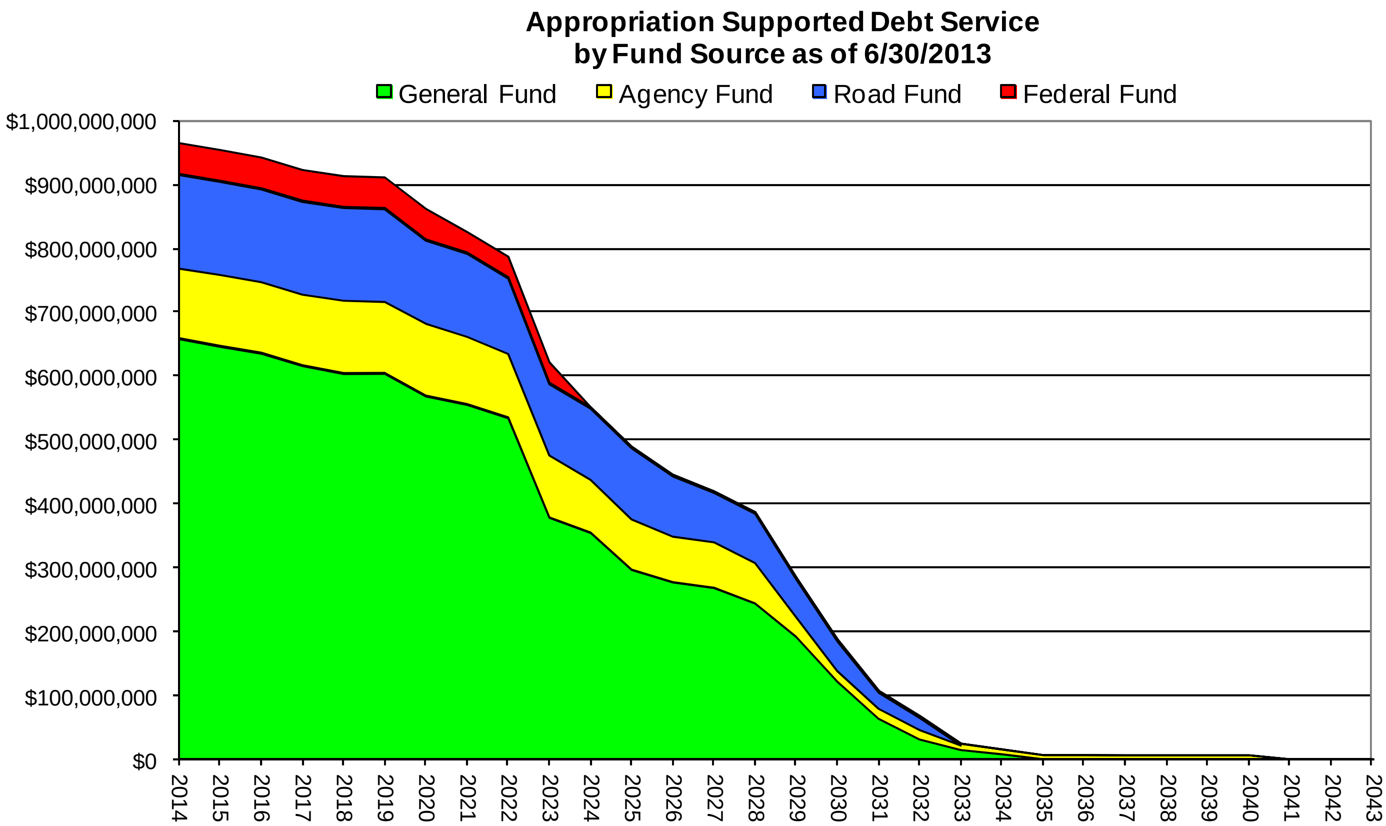
Deutsche Bank (assigned from Citibank on 2/14/2011)

243,080,000

	Debt: General Fund	Debt: Road Fund	10 Percent Net Exposures: General Fund	10 Percent Net Exposures: Road Fund
Bonds Outstanding	4,880,780,000	1,426,360,000	488,078,000	142,636,000
Authorized but Unissued	314,169,000	423,000,000	31,416,900	42,300,000
Total	5,194,949,000	1,849,360,000	519,494,900	184,936,000

Investment Pool Balances: Other Funds	Investment Pool Balances: Net Road Fund	10 Percent Investment Portfolio: Other Funds	10 Percent Investment Portfolio: Net Road Fund
2,911,978,728	662,720,187	291,197,873	66,272,019

APPENDIX B



Appropriation Supported Debt Service
by Fund Source as of 6/30/2013
General Fund
Agency Fund
Road Fund
Federal Fund
$1,000,000,000
$900,000,000
$800,000,000
$700,000,000
$600,000,000
$500,000,000
$400,000,000
$300,000,000
$200,000,000
$100,000,000
$0
2014
2015
2016
2017
2018
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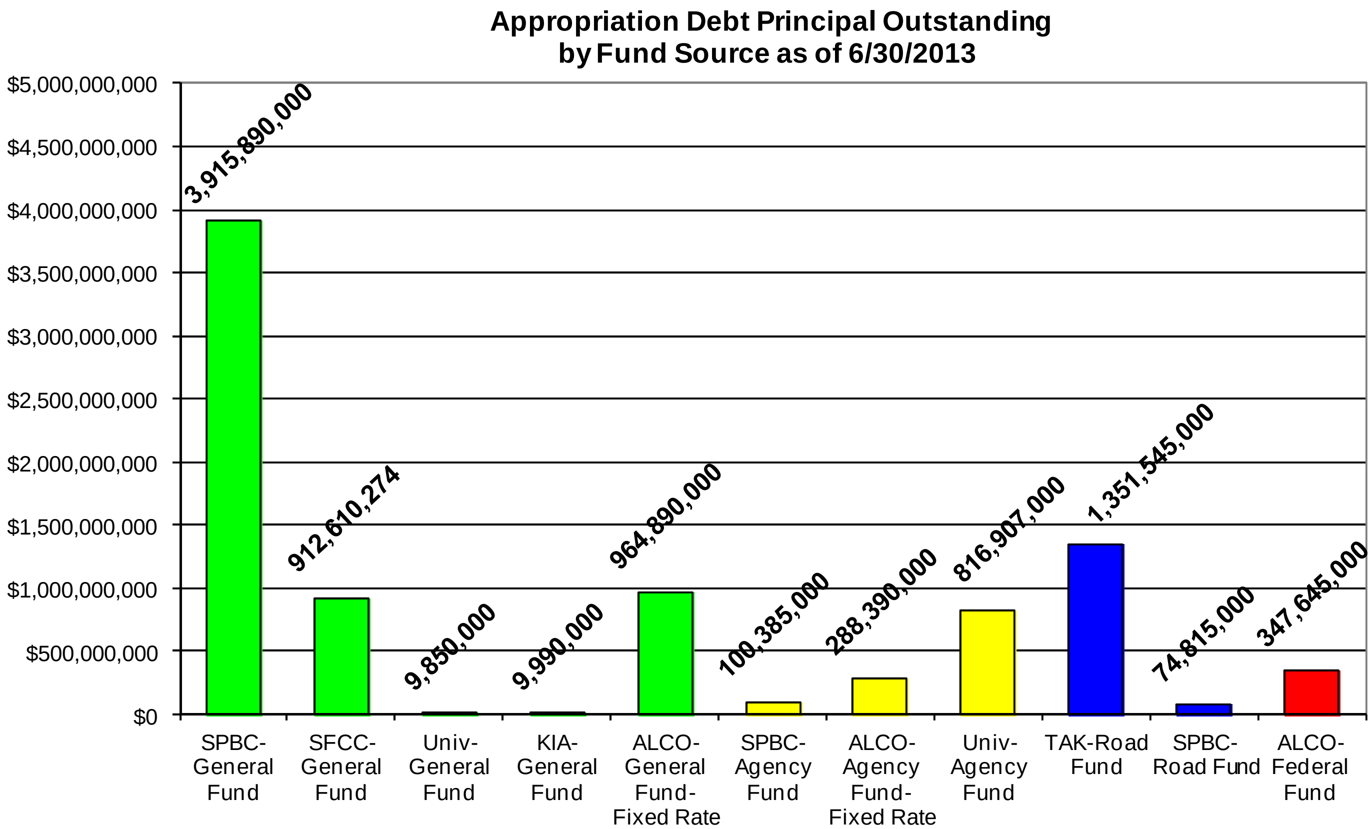

Appropriation Debt Principal Outstanding
by Fund Source as of 6/30/2013
$5,000,000,000
$4,500,000,000
$4,000,000,000
$3,500,000,000
$3,000,000,000
$2,500,000,000
$2,000,000,000
$1,500,000,000
$1,000,000,000
$500,000,000
$0
3,915,890,000
912,610,274
9,850,000
9,990,000
964,890,000
100,385,000
288,390,000
816,907,000
1,351,545,000
74,815,000
347,645,000
SPBC-General Fund
SFCC-General Fund
Univ-General Fund
KIA-General Fund
ALCO-General Fund-Fixed Rate
SPBC-Agency Fund
ALCO-Agency Fund-Fixed Rate
Univ-Agency Fund
TAK-Road Fund
SPBC-Road Fund
ALCO-Federal Fund

APPENDIX C

COMMONWEALTH OF KENTUCKY
ASSET/LIABILITY COMMISSION
SCHEDULE OF NOTES OUTSTANDING
AS OF 06/30/13

FUND TYPE / SERIES TITLE	AMOUNT ISSUED	DATE OF MATURITY ISSUE	DATE OF MATURITY DATE	PRINCIPAL OUTSTANDING
General Fund Project & Funding Notes				
2003 Series A	$171,260,000	7/2003	7/2013	$4,260,000
2005 1st Series	$81,850,000	6/2005	5/2025	$57,480,000
2007 A, B Series	$243,080,000	5/2007	11/2027	$210,665,000
2010 1st Series-KTRS Funding Notes	$467,555,000	8/2010	4/2020	$306,750,000
2011 1st Series-KTRS Funding Notes	$269,815,000	3/2011	4/2022	$232,445,000
2013 1st Series-KTRS Funding Notes	$153,290,000	2/2013	4/2023	$153,290,000
FUND TOTAL	**$1,386,850,000**			**$964,890,000**
Agency Fund Project Notes				
2005 1st Series	$11,275,000	6/2005	6/2025	$8,215,000
2005 Series A-UK Gen Recpts	$107,540,000	11/2005	10/2025	$88,980,000
2006 Series A-UK Gen Recpts	$66,305,000	10/2006	10/2022	$48,895,000
2007 Series A-UK Gen Recpts	$77,905,000	11/2007	10/2027	$69,270,000
2007 Series B-UK Gen Recpts	$80,245,000	11/2007	10/2027	$73,030,000
FUND TOTAL	**$343,270,000**			**$288,390,000**
Federal Hwy Trust Fund Project Notes				
2005 1st Series	$139,635,000	6/2005	9/2017	$66,495,000
2007 1st Series	$277,910,000	9/2007	9/2019	$191,440,000
2010 1st Series	$89,710,000	3/2010	9/2022	$89,710,000
FUND TOTAL	**$507,255,000**			**$347,645,000**
ALCo NOTES TOTAL	**$2,237,375,000**			**$1,600,925,000**

APPENDIX D

State Property and Buildings Commission Project 106 Project List

Session Authorized	Agency	Project Description	Bond Authorization [1]
2005	Kentucky Community Technical College System	LCC Classroom/Lab Building	$20,000,000
2006	Economic Development-Financial Incentives	Economic Development Bond Pool	12,000,000[2]
2006	Finance-Facilities and Support Services	Capital Plaza Complex - Renovation and Design	1,500,000[2]
2008	Agriculture	Animal Shelters	400,000
2008	Natural Resources	Kentucky Heritage Land Conservation Fund - Additional	3,311,040
2008	Kentucky Community Technical College System	LCC Classroom/Lab Building-Additional for Eastern St Hospital Site	4,000,000
2010 Special	Kentucky Infrastructure Authority	Ky Infrastructure Authority- Fund A Federally Assisted Wastewater Revolving Loan Program	14,296,000[2]
2010 Special	Kentucky Infrastructure Authority	Ky Infrastructure Authority-Fund F Drinking Water Revolving Loan Program	9,000,000
2010 Special	Kentucky Infrastructure Authority	Infrastructure for Econ-Dev Fund for Coal Producing Counties 06-08 Add'l	955,100
2010 Special	Kentucky Infrastructure Authority	Infrastructure for Econ-Dev Fund for Non-Coal Producing Counties 06-08 Add'l	1,250,000
2010 Special	Kentucky Infrastructure Authority	Infrastructure for Econ-Dev Fund for Coal Producing Counties 08-10 Add'l	4,240,000
2010 Special	Kentucky Infrastructure Authority	Infrastructure for Econ-Dev Fund for Non-Coal Producing Counties 08-10 Add'l	10,584,700
2010 Special	Economic Development-Financial Incentives	Economic Development Bonds - Base Realignment and Closure (BRAC)	15,000,000[2]
2010 Special	Economic Development-Financial Incentives	Kentucky Economic Development Finance Authority Loan Pool*	2,950,000[2]
2010 Special	Finance and Administration-Department of Revenue	Comprehensive Tax System - Additional	3,000,000[2]
2010 Special	Health and Family Services-Behavioral Health	Oakwood Specialty Clinic	1,964,000
2012	Kentucky Infrastructure Authority	Ky Infrastructure Authority Fund F - Drinking Water Revolving Loan Program 2012-2014	1,290,000[2]
2012	Department of Veterans' Affairs	Construct Fourth State Veteran's Nursing Home	14,000,000
2012	Finance and Administration Cabinet	Maintenance Pool 2012-14	4,000,000[2]
2012	Finance and Administration Cabinet	Statewide Microwave Network (KEWS) Maintenance	500,000[2]
2012	Finance and Administration Cabinet	Parking Garage Maintenance	1,500,000
2012	Finance and Administration Cabinet	Council of State Government's Building Complex	3,300,000[2]
2012	Health and Family Services Cabinet	Maintenance Pool 2012-14	5,000,000

APPENDIX D

State Property and Buildings Commission Project 106 Project List

Session Authorized	Agency	Project Description	Bond Authorization [1]
2012	Health and Family Services Cabinet	Electrical Systems Upgrade at Western State Hospital- Design	250,000[2]
2012	Health and Family Services Cabinet	Medicaid Eligibility System	5,000,000
2012	Justice and Public Safety Cabinet	Demolition and Construction of Training Academy Building	2,000,000
2012	Justice and Public Safety Cabinet	Maintenance Pool 2012-14	5,500,000
2012	Tourism Cabinet	Maintenance Pool 2012-14	6,000,000
2012	Tourism Cabinet	Upgrade Wastewater System-Fort Boonesborough	2,000,000
2012	Kentucky State Fair Board	Parking Garage Maintenance	2,000,000
			$156,790,840

(1) Excludes allocable costs of issuance.

(2) Less than full authorization.

* To be sold on a taxable basis.

REPORT PREPARED BY:

OFFICE OF FINANCIAL MANAGEMENT

Commonwealth of Kentucky
702 Capitol Ave Ste 76
Frankfort, KY 40601
Phone: 502-564-2924
Fax: 502-564-7416

Creating Financial Value for the Commonwealth