Semi-Annual Report of the Kentucky Asset/Liability Commission

38th edition

For the period ending December 31, 2015

Matt Bevin
Governor
Commonwealth of Kentucky

William M. Landrum III
Secretary
Finance and Administration Cabinet

Ryan Barrow
Executive Director
Office of Financial Management

An electronic copy of 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/

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INTRODUCTION

This is the Kentucky Asset/Liability Commission's ("ALCo" or the "Commission") thirty-eighth semi-annual report pursuant to KRS 56.863 (11) for the period beginning July 1, 2015 through December 31, 2015. 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 Federal Reserve, on December 16, 2015, took the first step towards normalizing interest rates as they raised the target for fed funds by 25 basis points from the range of 0.0%-0.25% to 0.25%-0.50%.
- The unemployment rate continued to drift lower reaching 5.0% at the end of the year while indications of wage pressures began to appear as average hourly wages drifted higher throughout the year.
- The inflation rate has gradually drifted higher through most of 2015 with the core rate (ex-energy and food) reaching roughly 2.0% (depending on the particular measure) while the headline rates remain considerably lower driven largely by energy prices.
- The annual rate of growth of real Gross Domestic Product fell to a seasonally adjusted rate of 1.0% in the fourth quarter.

On the state level

- General Fund increased 4.0% for the first six months of Fiscal Year ("FY") 2016 compared to the same timeframe in FY 2015.
- Road Fund receipts decreased 5.4% for the first six months of FY 2016 compared to the same timeframe in FY 2015 due to a substantial decline in the price of motor fuels.
- The Consensus Forecast Group ("CFG") met on December 16, 2015. The CFG's official estimate of General Fund revenues for FY 2016 was revised to $10,289.9 million, an increase of $222.7 million from the official enacted estimate. General Fund official revenue estimates for FY 2017 are $10,617.2 million and $10,875.5 million for FY 2018. General Fund revenues are projecting a growth rate of 3.1% for FY 2017 and a growth rate of 2.4% for FY 2018.
- The CFG also revised the official estimate for Road Fund revenues for FY 2016 to $1,445.9 million, a $112.5 million decrease from the official enacted estimate. Road Fund revenue estimates for FY 2017 are $1,456.9 million and $1,478.2 million for FY 2018. Road Fund revenues are projecting a growth rate of 0.8% for FY 2017 and a growth rate of 1.5% for FY 2018.
- Kentucky's seasonally adjusted unemployment rate stood at 5.3% at the end of December 2015, down from 5.5% one year ago.
- Implementation of bond authorizations from prior-year sessions of the General Assembly continued.

INVESTMENT MANAGEMENT

Market Overview

On December 16th, the long awaited lift off of interest rates began. The Federal Reserve Open Market Committee voted unanimously to lift the target fed funds rate from 0%-0.25% to 0.25%-0.50%. Their statement and the subsequent press conference stressed that this is the first move in a process of "normalizing" monetary policy. In other words, while normally raising interest rates is considered tightening monetary policy, this is a process of removing accommodative policy. The current expectation at the fed is that rates will gradually rise, as economic conditions allow, until fed funds reach 3.75% in 2018.

The Federal Reserve, prior to Dodd-Frank, had a dual mandate of low inflation and high employment. Dodd-Frank added the mandate of protecting the market from systemic risks. The Fed's approach on the dual mandate is that future inflation is largely driven by a combination of inflation expectations and slack in the labor market. Their view is that volatile items such as the price of oil or strength of the dollar, exert "transitory" effects that have short run, but not long term, impacts on inflation. This approach is questioned by the market as it has indicated for several years that inflation will move towards 2.0% over the intermediate term. The expectation has not been reached.

The Fed's preferred measure of inflation is the GDP Personal Consumption Core Price Index (page 9) which excludes the volatile food and energy sectors. Most people are more familiar with the Core CPI or Consumer Price Index (page 9). Both of these measures refer to the same survey items, but the weightings are different. The CPI is more heavily influenced by implied rental cost of owning a home. Both of these surveys generally show the same pattern. Inflation reached a low point in 2010 gradually rebounding to around 2.00% in 2012 and then moderating slower. Both are generally showing some strengthening since then with CPI actually reaching 2.1% year over year in December. Both are showing signs of further increases as weak month over month numbers from a year ago drop off the year over year numbers.

A key part of the Fed's belief that inflation will rise over the intermediate term is labor market tightness. There are a number of measures of labor market tightness with the unemployment rate, currently at 5.0%, being the most well know. However, Average Hourly Earnings (page 10), released by the Bureau of Labor Statistics at the same time as the unemployment rate is also important for this discussion. This is the growth rate, not adjusted for inflation, of the average hourly wage for all individuals employed in the country. This chart clearly shows stagnation back to around 2010 with accelerating growth throughout most of 2015. In fact the 5 year high rate of 2.7% was the December, 2015 print.

This statistic is important because it should be a leading indicator for consumer spending which makes up roughly 70% of the economy. Adding to that is the well documented declines in energy costs. Consumers have growing paychecks and are saving on filling up their gas tanks. This should lead to increased consumer spending. However, various measures of consumer spending and retail sales (page 10) are not showing improvement.

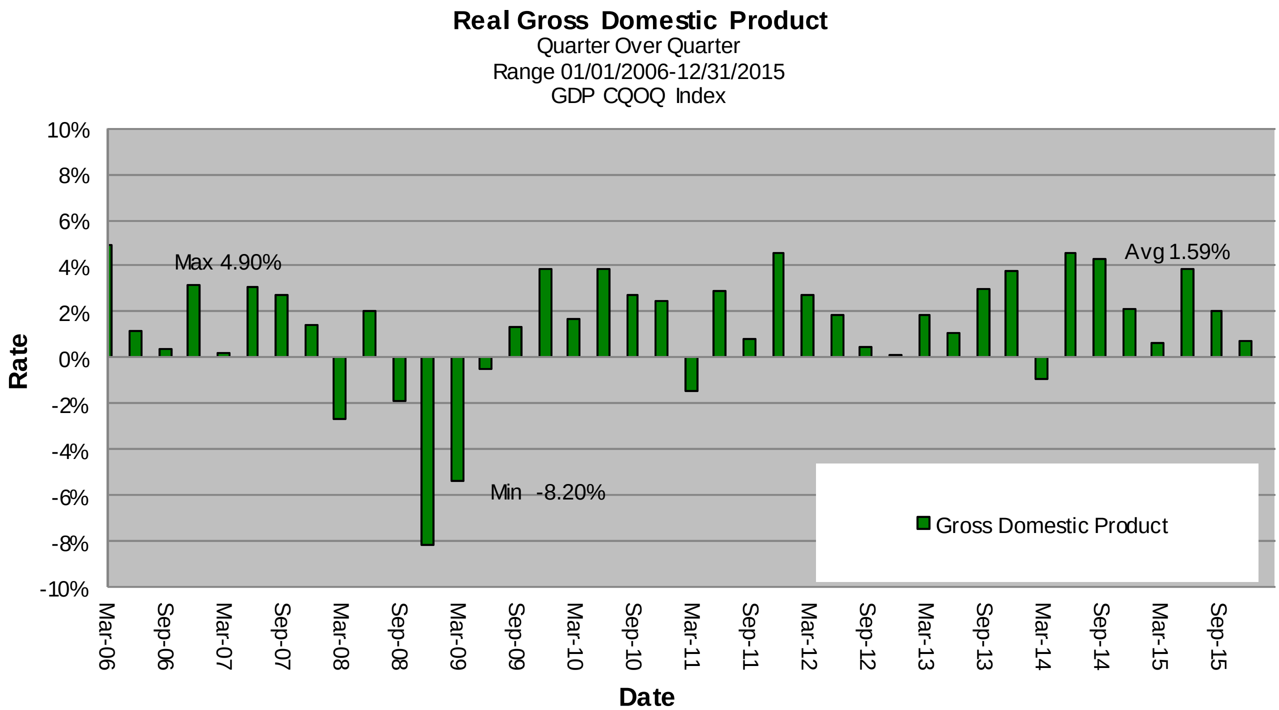
When looking at the overall economy, real Gross Domestic Product only increased 1.0%

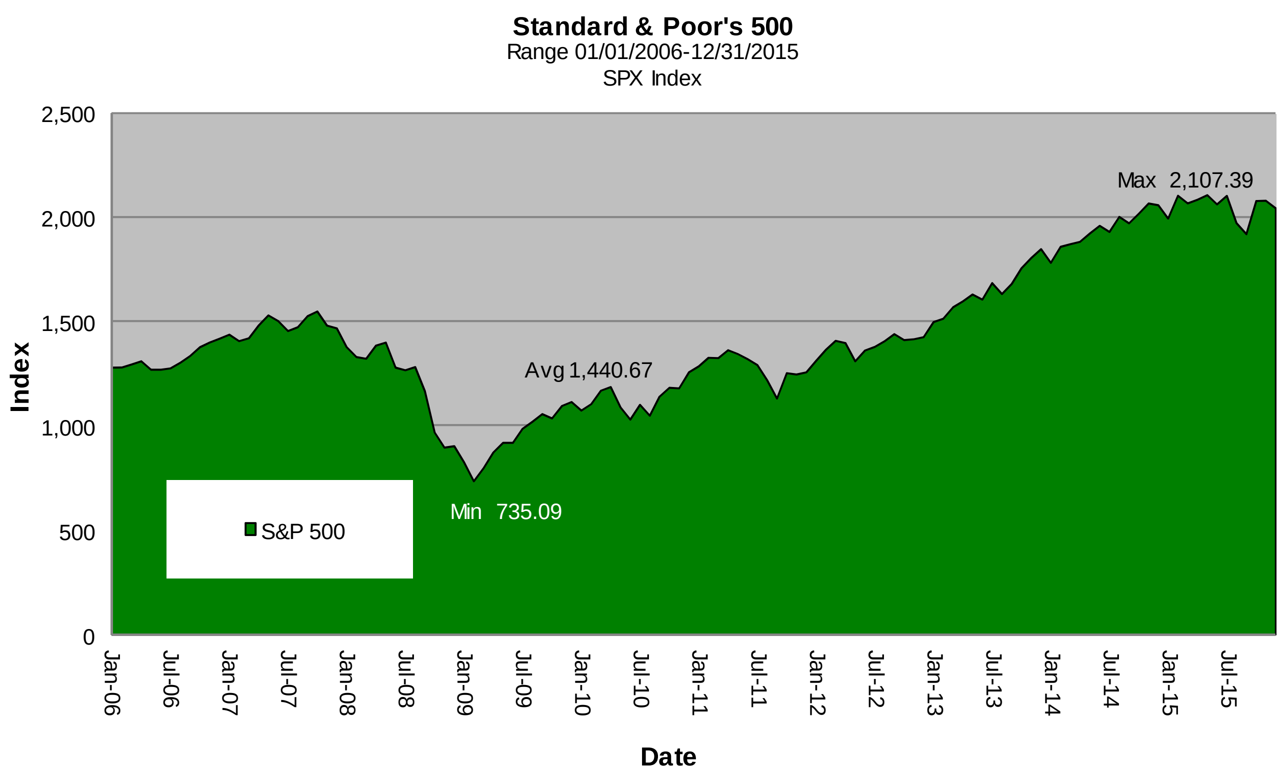
INVESTMENT MANAGEMENT

in the 4th quarter. For all of 2015, the economy only grew 1.875% after growing over 2.5% in 2014. Many statistics, including inflation and employment, are indicating that the economy should be growing faster than it actually is. The Fed is looking at those statistics and seeing the coming economic improvements leading to increases in interest rates. The markets are looking at the top line figures, and at problems elsewhere in the world, and are seeing considerable headwinds requiring lower interest rates. Because of these conflicting views, it appears there will be more volatility over the next year.

INVESTMENT MANAGEMENT

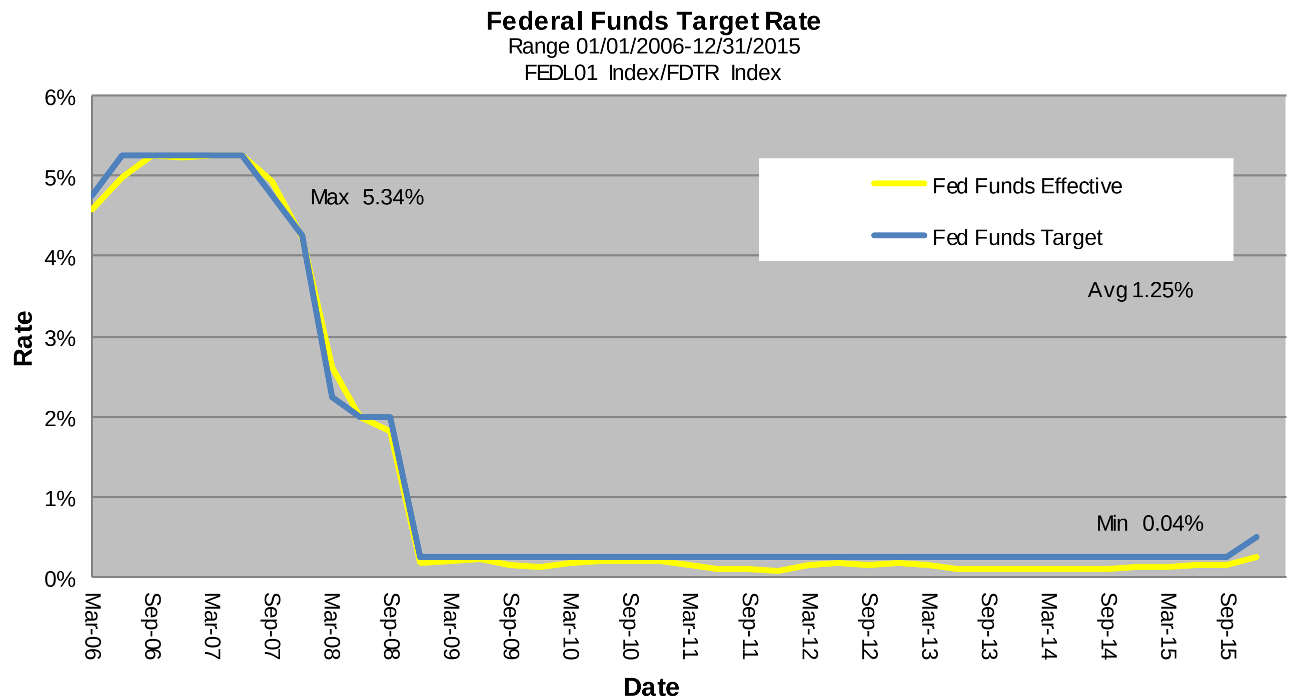
Real Gross Domestic Product & Standard & Poor's 500

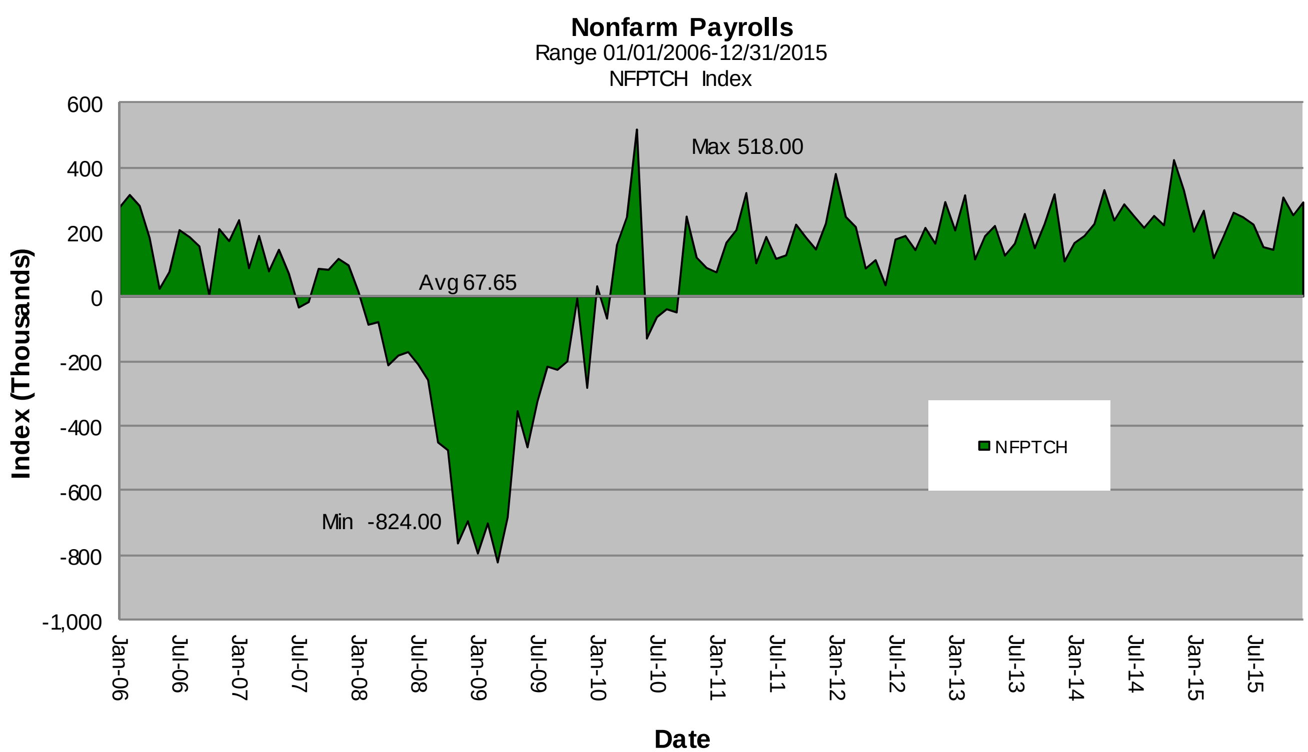




INVESTMENT MANAGEMENT

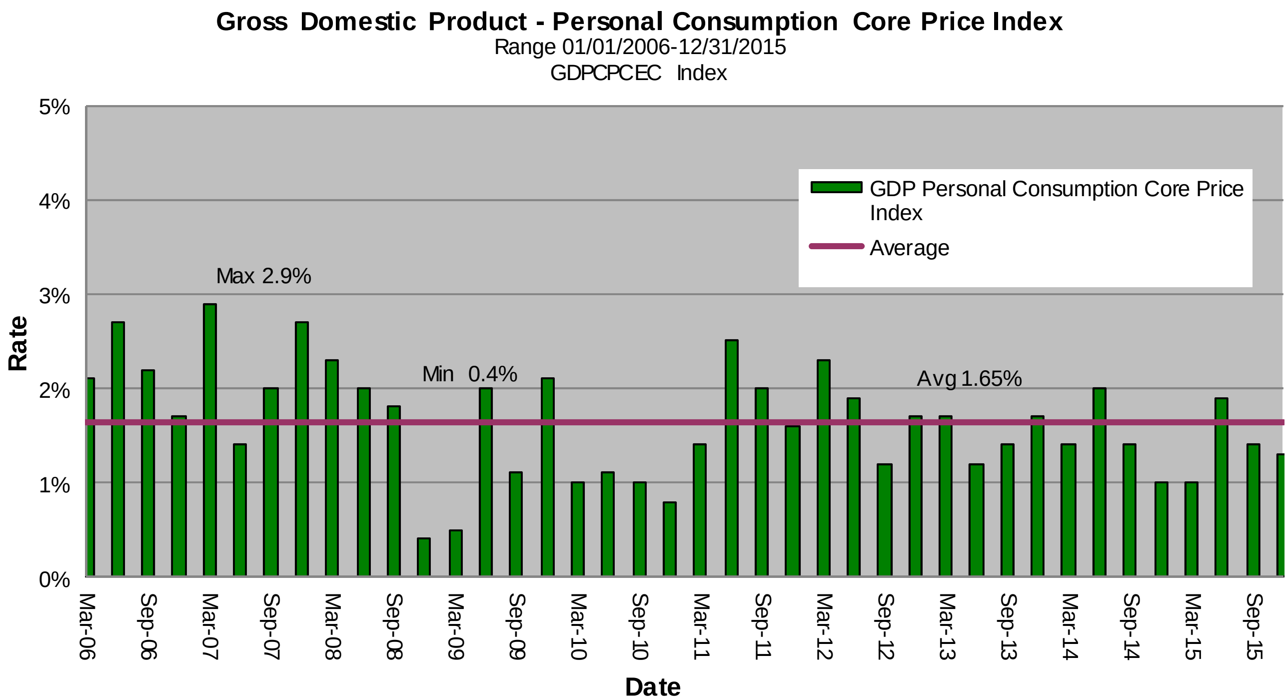
Federal Funds Target Rate & NonFarm Payrolls

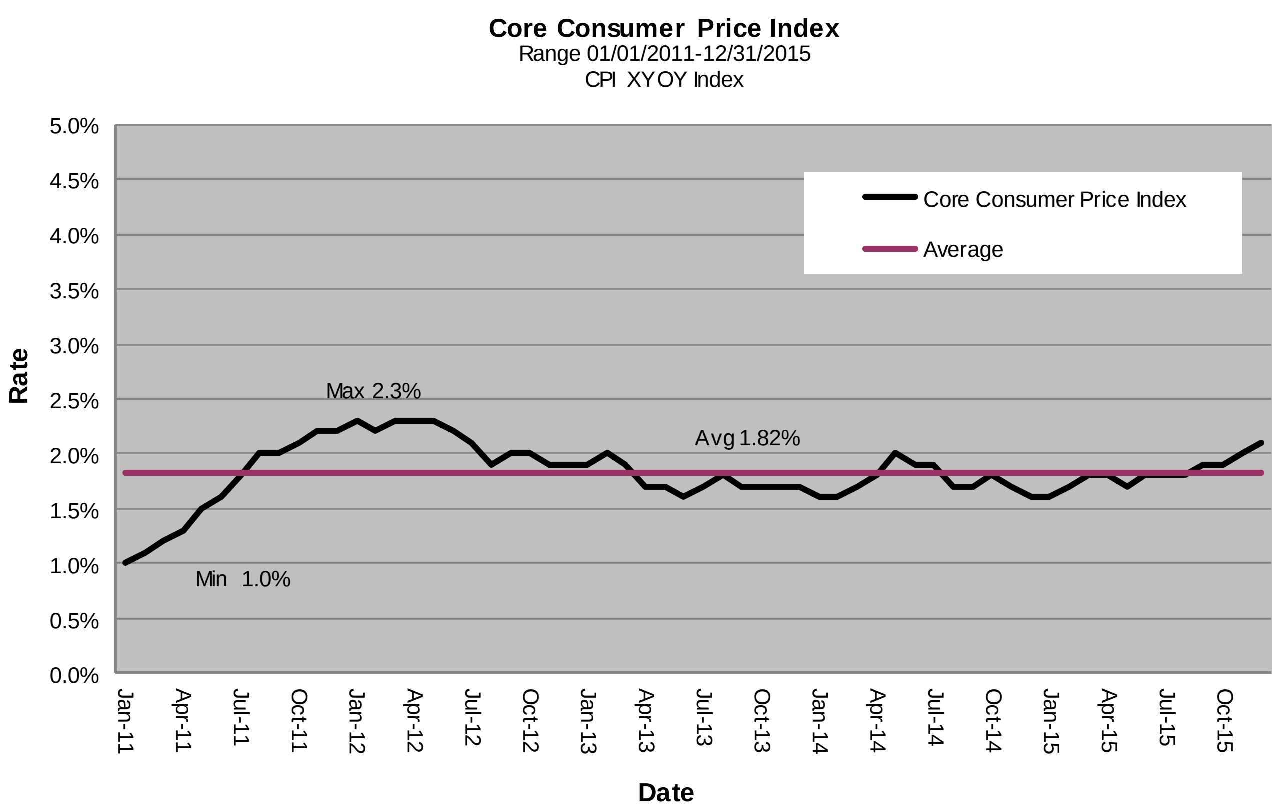




INVESTMENT MANAGEMENT

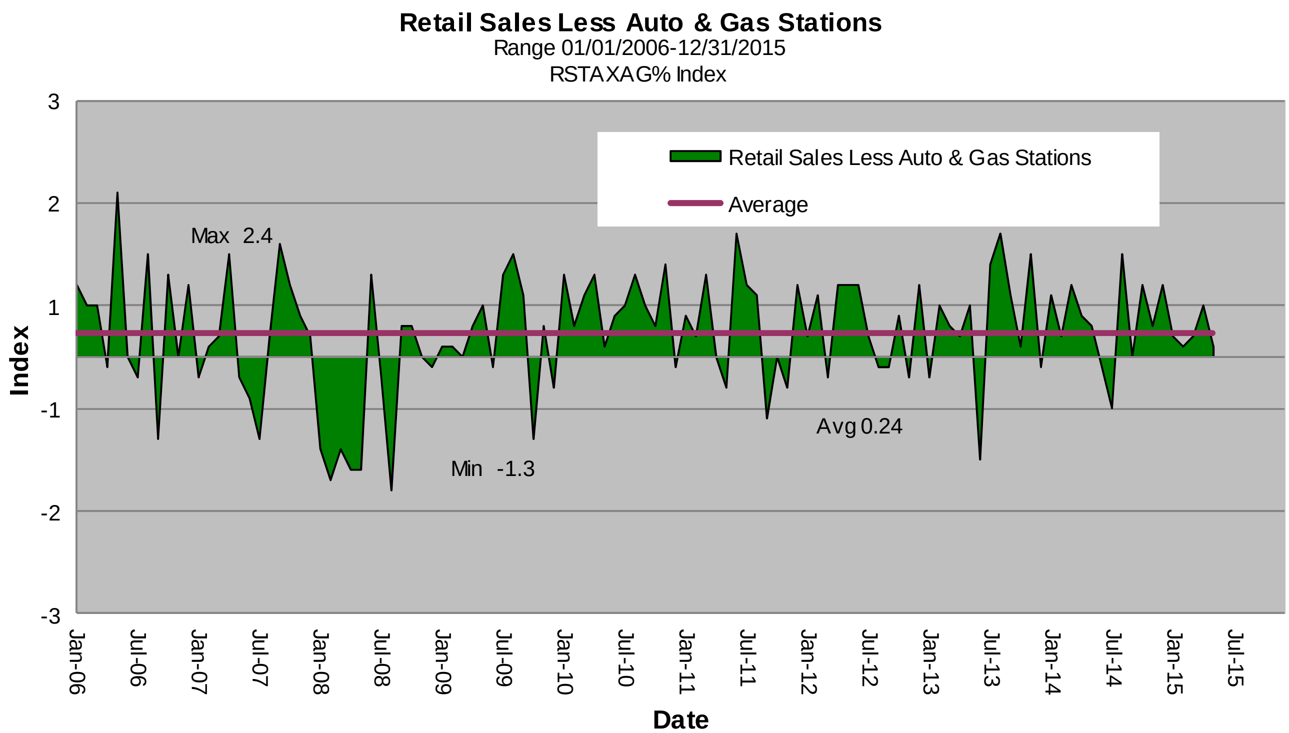
GDP & Core Consumer Price Index

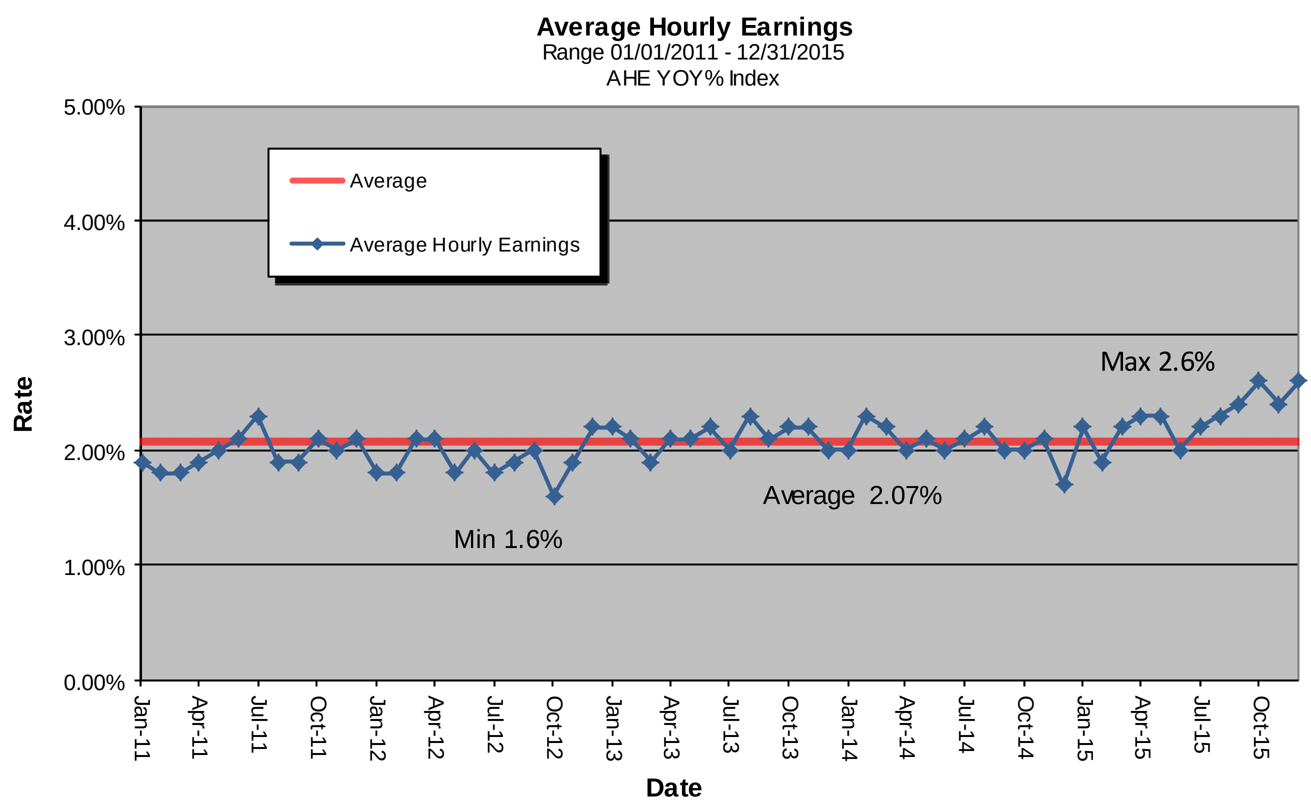




INVESTMENT MANAGEMENT

Consumer Spending & Hourly Earnings





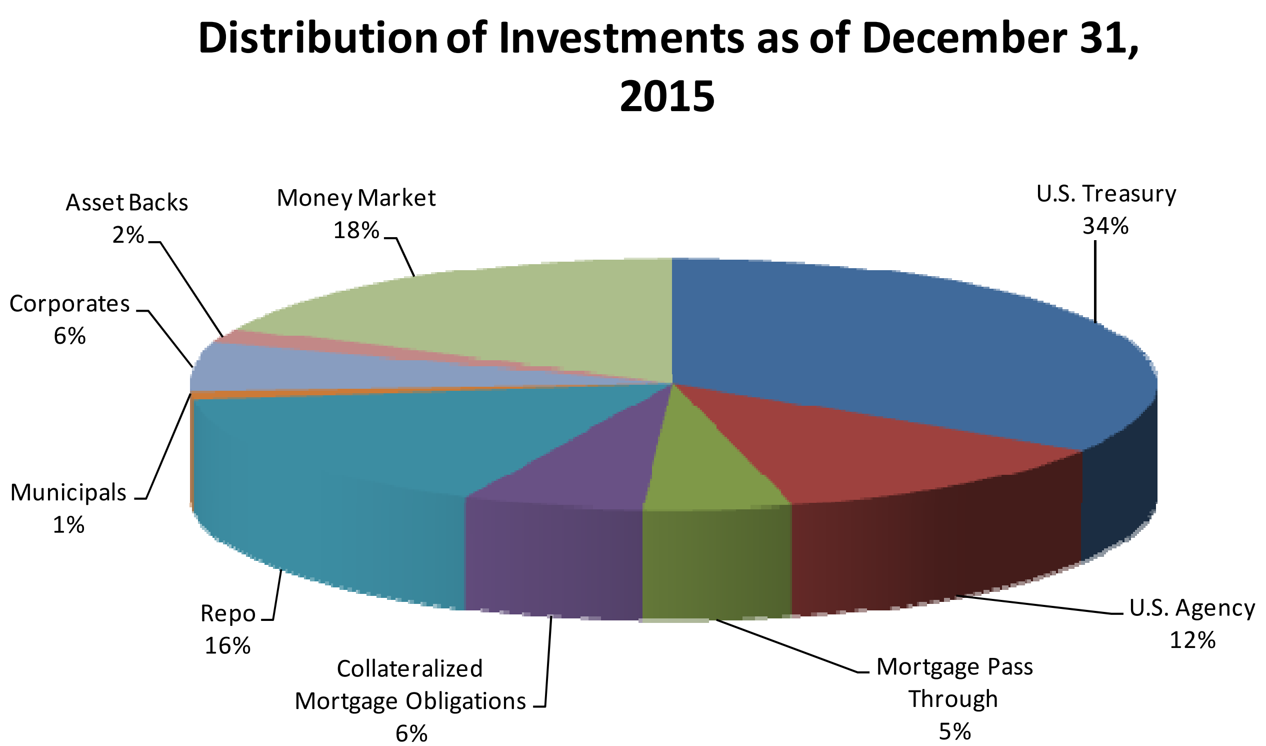
INVESTMENT MANAGEMENT

PORTFOLIO MANAGEMENT

For six months ended December 31, 2015, the Commonwealth's investment portfolio averaged $3.2 billion. As of December 31, 2015, the portfolio was invested in U.S. Treasury Securities (34 percent), U.S. Agency Securities (12 percent), Mortgage Pass Through Securities (5 percent), Collateralized Mortgage Obligations (6 percent), Repurchase Agreements (16 percent), Municipal Securities (1 percent), Corporate Securities (6 percent), Asset-Backed Securities (2 percent), and Money Market Securities (18 percent). The portfolio had a market yield of 0.66 percent and an effective duration of 0.76 years.

The total portfolio is broken down into four investment pools. The pool balances as of December 31, 2015, were: Short Term Pool - $7.94 million, Limited Term Pool - $1,320 million, Intermediate Term Pool - $2,204 million, and Bridges Pool - $142 million.

For the six months ended December 31 2015, total investment income was $2.8 million compared to $6.6 million for the six months ended December 31, 2014.

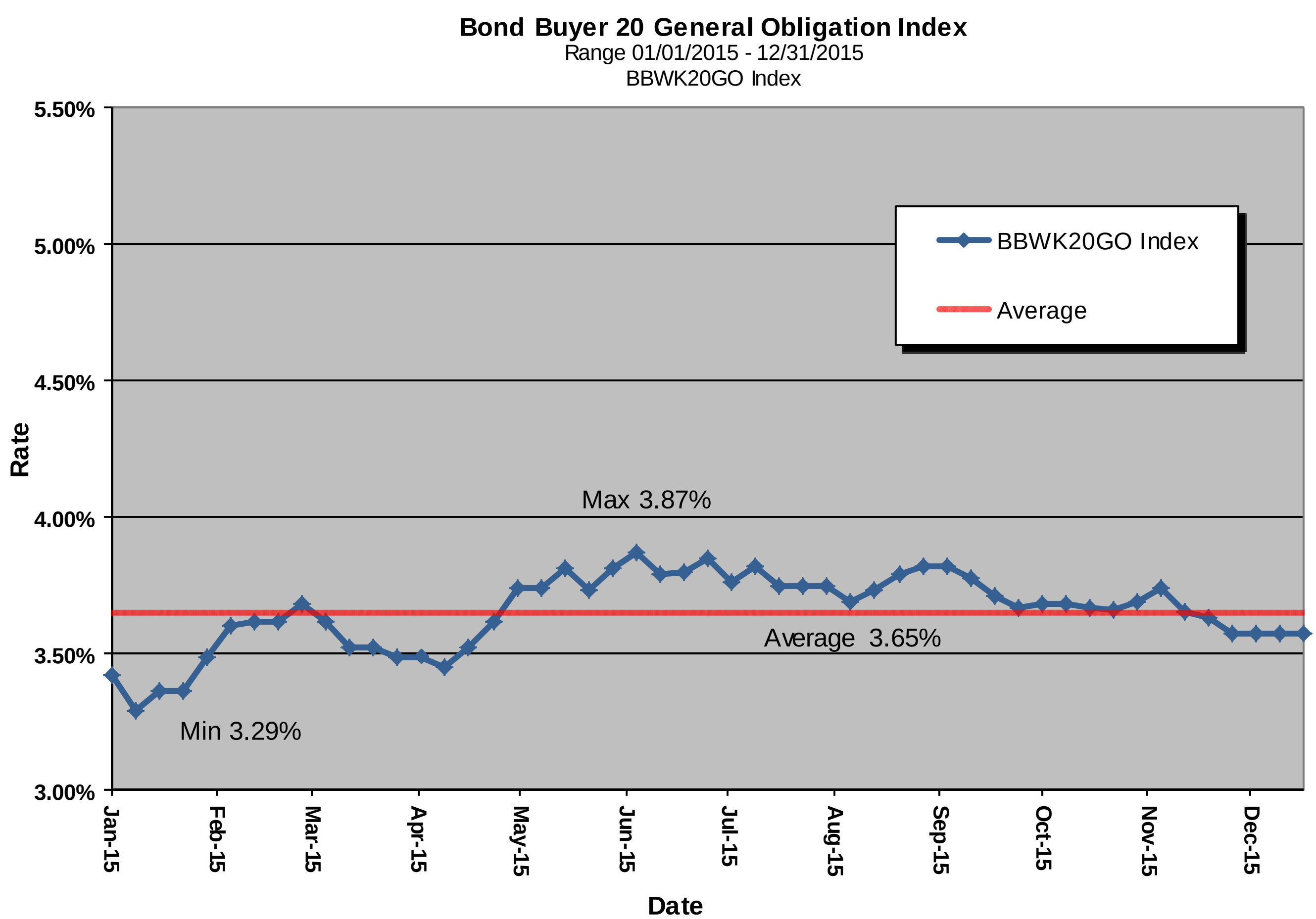


INVESTMENT MANAGEMENT

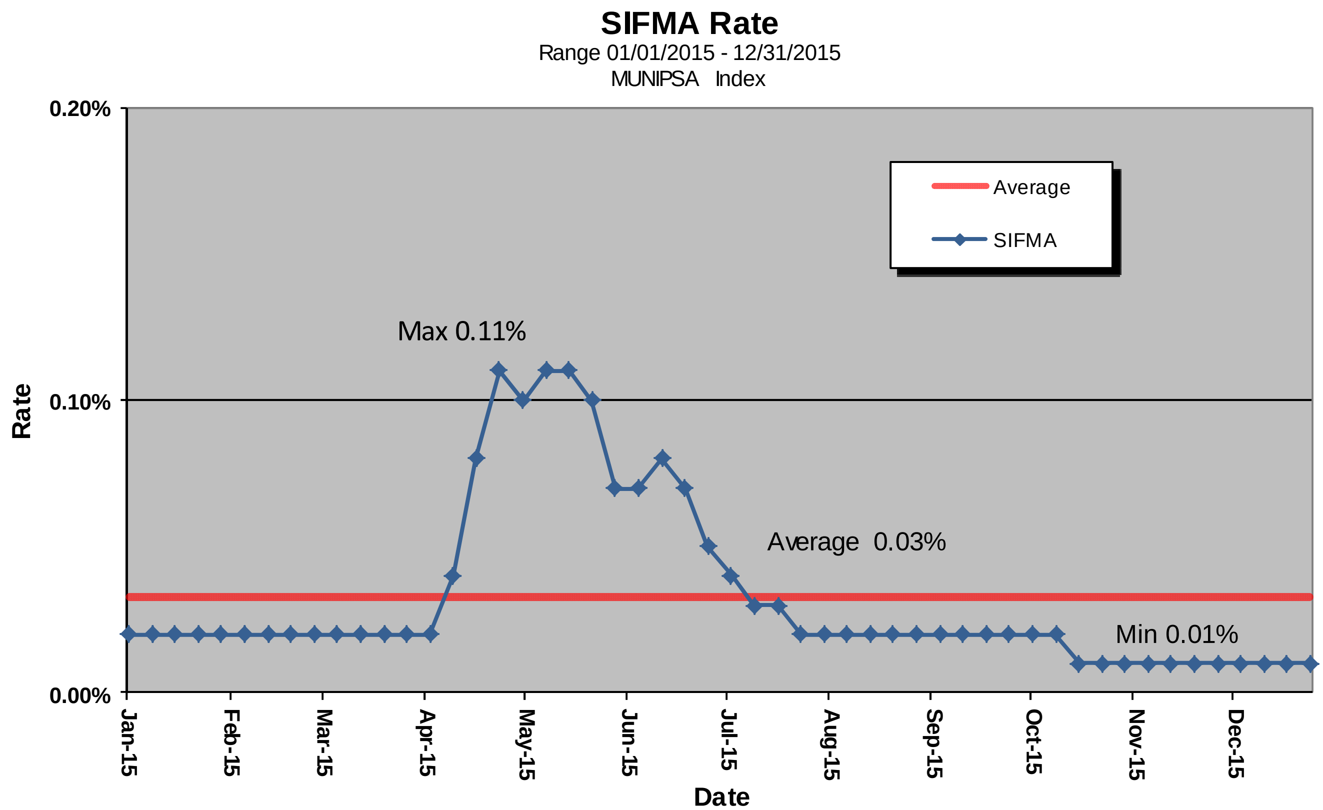
Tax-Exempt Interest Rates and Relationships

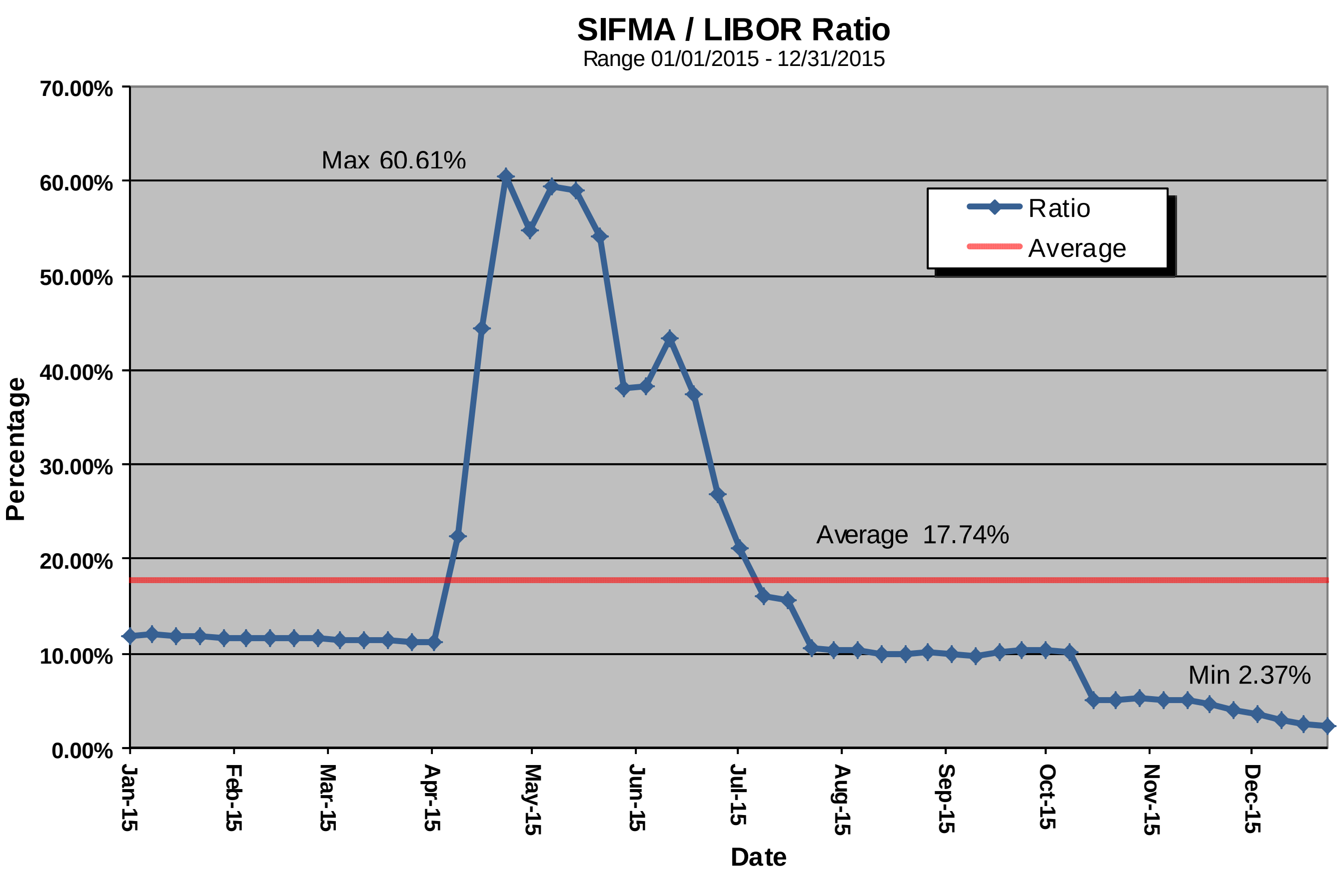
The Bond Buyer 20 General Obligation Index averaged 3.65% for Calendar Year 2015. The high was 3.87% in June 2015 and the low was 3.29% in January 2015.

The Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index averaged 0.03% for Calendar Year 2015. The high was 0.11% in both April and May of 2015; the low was 0.01% in the fourth quarter of Calendar Year 2015. The 30-day USD London Interbank Offered Rate (LIBOR) averaged 0.2% for Calendar Year 2015. The high was 0.422% in December of 2015 and the low was 0.167% in January 2015. During the year, SIFMA traded at a high of 60.61% of the 30-day LIBOR in April 2015, at a low of 2.37% in December 2015, and at an average of 17.74% for the Calendar Year. The Calendar Year ended with SIFMA at 2.37% of the 30-day LIBOR.



SIFMA & SIFMA/LIBOR Ratio





CREDIT MANAGEMENT

Credit: 2015 Recap and 2016 Outlook

Investment Grade (IG) corporates generated an excess return of -158 basis points in 2015 as spreads finished the year 32 basis points wider with total return for IG Corporates in 2015 at -0.74%. The higher quality portions of the market materially outperformed BBBs as excess returns for A-rated credit was only -42 basis points, AA-rated 17 basis points compared to BBBs posting -333 basis points. Total return in 2015 for A-rated credit was 0.48%, AA-rated credit 1.19% and BBB-rated credit -2.52%.

Corporate bonds struggled to breakeven in 2015, as the plunge in global commodity prices, the stronger dollar and weaker credit fundamentals widened spreads toward levels during the last recession. Based on daily correlations, oil and the dollar outweighed interest rates in influencing the path of credit spreads in 2015 and will be worth monitoring in 2016. If the FOMC continues raising interest rates, history shows credit spreads tend to narrow when the Treasury yield curve flattens in response to gradual policy tightening by the Fed in addition to reduce supply coming to market.

Balance sheet analysis will matter more as the credit cycle begins to show signs of peaking. Wider trends on credit spreads and the deterioration in the upgrade-to-downgrade ratio both suggest the credit cycle may have peaked in 2015. Going forward, credit will be influenced by GDP and the decisions to fund Mergers and Acquisitions as well as equity share buybacks with debt. Leveraged companies may be more affected by higher borrowing costs and liquidity risk than less leveraged peers. Probability of defaults are more likely in high yield energy and basic materials sectors and less likely in technology and consumer staples. Earnings Before Interest, Taxes, Depreciation and Amortization (EDITDA) has deteriorated over 2015. In general, EDITDA has fallen about 10% while debt has risen 5% on average. Companies rated in the single A category saw their Debt-to-EBITDA ratios increase from 1.8x to 2.0x on average. The higher leverage could eventually affect credit ratings of more companies. According to Moody's, there were 3% more downgrades than upgrades in 2015 and expect the downgrade risk to remain for 2016.

Supply issuance is expected to continue its streak of record breaking years with approximately $1.3 trillion of issuance expected. The main drivers for issuance continues to be merger and acquisitions and equity share buybacks with the addition of regulatory issuance from the banking sector. Financial sector issuance could increase in 2016 because banks designated systemically important by regulators may need to issue high-quality senior debt to meet Total Loss-Absorbing Capacity (TLAC) thresholds. Strong demand from international buyers and the potential for increased demand from institutional investors in a rising rate environment should be enough to absorb increased debt issuance.

Credit Process

Our credit strategy invests in creditworthy corporate issuers having a long-term rating of A3/A-/A- or better as rated by Moody's, S&P or Fitch. The strategy focuses on adding value through a disciplined approach in the credit selection process. With independent research and prudent diversification with respect to industries and issuers, our goal is to deliver consistent longer term investment performance over U.S. Treasuries.

<u>Default Monitoring</u>

The Bloomberg credit risk model is our main tool for default monitoring. The default likelihood model is based on the Merton

CREDIT MANAGEMENT

distance-to-default (DD) measure, along with additional economically and statistically relevant factors. Firms are assigned a default risk measure as a high-level summary of their credit health using an explicit mapping from default likelihood to default risk.

A daily report is generated using our approved list and their peers enabling us to track market activity in selected names including Credit Default Swaps (CDS).

Industry/Company Analysis

We use a combination top-down & bottom-up approach for investing. The top-down approach refers to understanding the current (and future) business cycle or the "big picture" of the economy and financial world in order to identify attractive industries. Once industries are identified, a bottom-up approach is implemented where we focus on specific company fundamentals, picking the strongest companies within a sector.

Fundamental analysis is then performed looking at competitive position, market share, operating history/trends, management strategy/execution and financial statement ratio analysis.

Approved List

Once analysis has been completed, the State Investment Commission approves the list on a quarterly basis. For the second half of 2015, no changes were made to the approved list. Microsoft (Aaa/AAA/AA+) and Chevron (Aa1/AA/WD) came to market with new issuance during the fourth quarter and OFM purchased $15 million of each issue with a spread to Treasuries of 30 and 45 basis points, respectively. Our Approved List as of November 2015 may be found in Appendix A.

DEBT MANAGEMENT

The 2010 Extraordinary (Special) Session of the General Assembly delivered House Bill 1 (Executive Branch Budget other than Transportation Cabinet) 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 authorized bond financing for projects totaling $1,980.2 million to support various capital initiatives of the Commonwealth. Of the total authorization, $507.4 million is General Fund supported, $515.3 million is Agency Restricted Fund supported, $522.5 million is supported by Road Fund appropriations and $435 million is Federal Highway Trust Fund supported through Grant Anticipation Revenue Vehicle Bonds designated for the US-68/KY-80 Lake Barkley and Kentucky Lake Bridges Project and the Louisville-Southern Indiana Ohio River Bridges Project. A portion of the General Fund, Agency Restricted Fund, Road Fund and Federal Highway Trust Fund authorizations 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 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 authorized 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. A portion of the General Fund authorization and the total 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 authorized 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 $9.6 million is still authorized to be issued.

The 2014 Regular Session of the General Assembly delivered House Bill 235 (Executive Branch Budget other than Transportation Cabinet) to the Governor on March 31, 2014 and House Bill 236 (Kentucky Transportation Cabinet Budget) to the Governor on April 15, 2014, establishing an Executive Branch Budget for the biennium ending June 30, 2016. Governor Beshear took final action on House Bill 235 on April 11, 2014 and took final action on House Bill 236 on April 25, 2014. Together, the bills authorize bond financing for projects totaling a net amount of $1,364.05 million to support various capital initiatives of the Commonwealth due to $105 million in previously authorized debt that was de-authorized in House Bill 235. Of the total authorization, $742.77 million is General Fund supported, $721.28 million is supported by Agency Restricted Fund appropriations, and $5.0 million is Road Fund supported. A portion of the General Fund and Agency Restricted Fund authorizations listed above have been permanently financed.

DEBT MANAGEMENT

The 2015 Regular Session of the General Assembly delivered House Bill 298 to the Governor on March 4, 2015 authorizing a general fund bond supported project for the University of Kentucky for the financing of a Research Building totaling $132.5 million. Governor Beshear took final action on House Bill 298 on March 9, 2015. The full appropriation is still authorized to be issued.

The balance of prior bond authorizations of the General Assembly dating from 2006 through 2015 totals $1,435.13 million. Of these prior authorizations, $714.44 million is General Fund supported, $523.69 million is Agency Restricted Fund supported, $137.5 million is supported by Road Fund appropriations and $59.50 million is Federal Highway Trust Fund supported. At this time, the Commonwealth does not have plans to use the remaining authorization from the Federal Highway Trust Fund.

The following table summarizes, in aggregate, the information in connection with authorized but unissued debt of the Commission as described in this section.

State Property and Buildings Commission
Summary of Authorized but Unissued Debt by Fund Type
as of December 31, 2015

Legislative Session (Year)	General Fund (millions)	Agency Fund (millions)	Road Fund (millions)	Federal Fund (millions)	TOTAL (millions)
2010 and prior	$53.46	$17.50	$125.00	$59.50	$255.46
2012	23.39	0.00	12.50	0.00	35.89
2013	0.00	9.60	0.00	0.00	9.60
2014	505.09	496.59	0.00	0.00	1,001.68
2015	132.50	0.00	0.00	0.00	132.50
TOTAL	$714.44	$523.69	$137.50	$59.50	$1,435.13

The Kentucky General Assembly may authorize debt financing to support various capital initiatives of the Commonwealth in future sessions. Bonds may also be issued to refund outstanding Commission or Kentucky Asset/Liability Commission (“ALCo”) bonds and notes.

DEBT MANAGEMENT

Ratings Update

The rating agencies continually monitor the Commonwealth's budgetary policies and actual performance in areas such as revenue, the economy, pensions, and debt management. Pension obligation questions have continued to put pressure on the Commonwealth's credit ratings and are the main credit driver for both investors and rating agencies.

In September 2015, Standard & Poor's (S & P) lowered its issuer credit rating on Kentucky to 'A+' from 'AA-' and its rating on the Commonwealth's appropriation debt to 'A' from 'A+'. The cause for the change was cited as S & P's view that Kentucky's substantially underfunded pension liabilities are the result of chronic underfunding and it places long-term pressures on the state's finances.

Except as discussed above, during the reporting period, the ratings below were either affirmed or remained unchanged from previous reporting periods.

The ratings picture at December 31, 2015 was:

	Moody's	S & P	Fitch
General Obligation Issuer Rating	Aa2	A+	AA-
General Fund Appropriation Rating	Aa3	A	A+
Road Fund Appropriation Rating	Aa2	AA	A+
Federal Highway Trust Fund Appropriation Rating	A2	AA	A+

DEBT MANAGEMENT

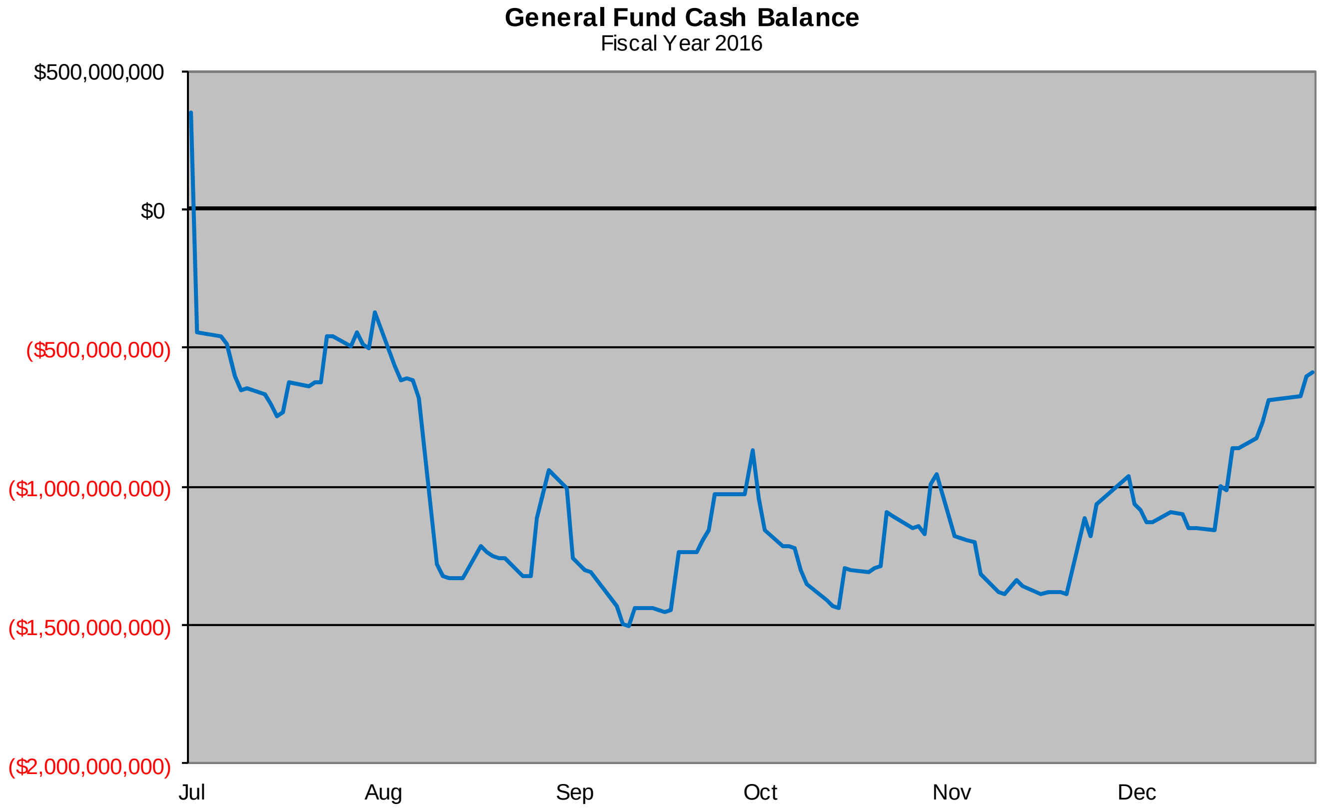
Tax and Revenue Anticipation Notes (TRAN)

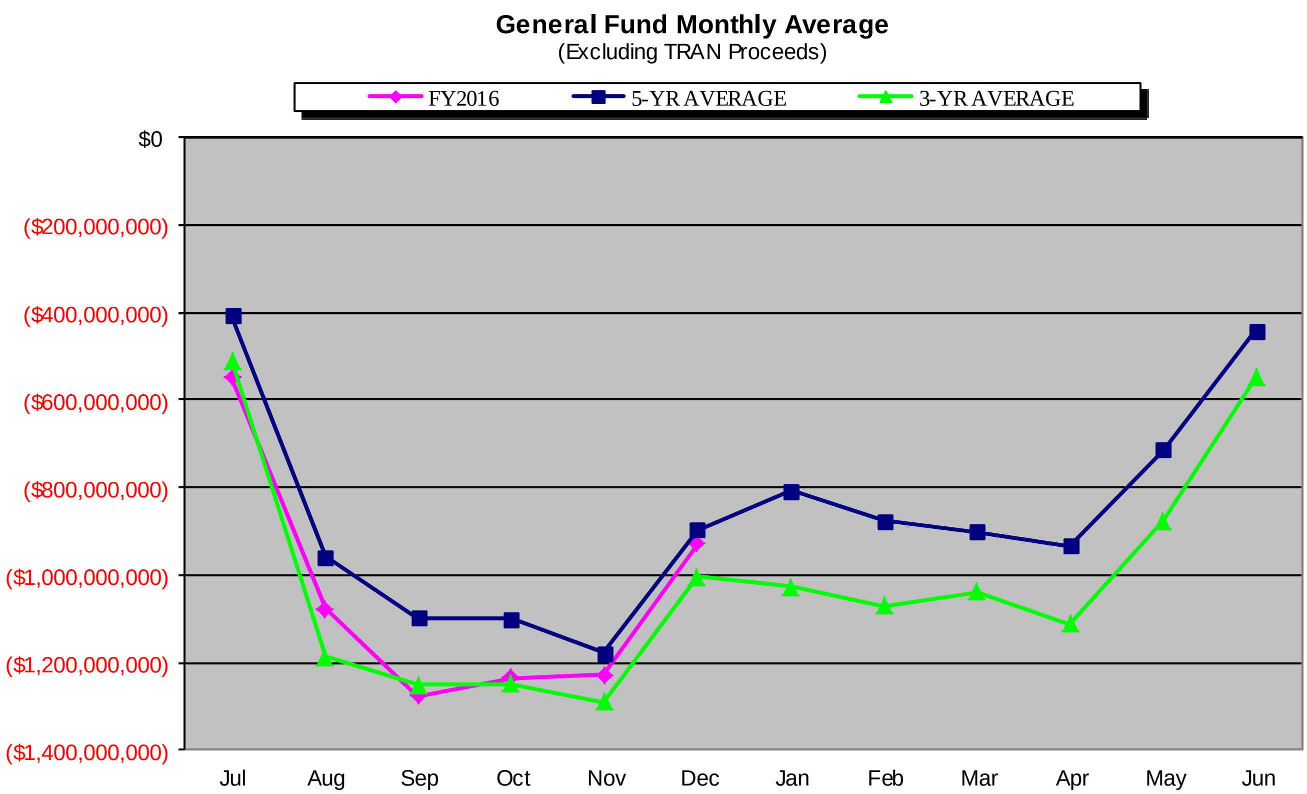
No General Fund TRAN was issued for Fiscal Year 2016. As in the previous six fiscal years, current reinvestment yields on TRAN proceeds would not be significantly higher than the cost of funds for a TRAN. At this time, borrowing internally from the state investment pools continues to be the most efficient 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
2015	NA	NA
2016	NA	NA

($ in millions)

DEBT MANAGEMENT





DEBT MANAGEMENT

FINANCIAL AGREEMENTS

As of December 31 2015, ALCo had four financial agreements outstanding, with a net notional exposure amount of $191,780,000. 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 (Fitch rating is not required under the agreement). 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 A3 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 were identical to the original swaps, with two exceptions; 1) the new swaps were not insured and there were no insurer provisions contained in the new agreements, and 2) the credit rating triggers under the automatic termination provisions were now symmetrical for both counterparties (ALCo and Deutsche Bank) at A3/A-. Under the original swaps, ALCo's credit rating triggers were 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. On July 10, 2014, the credit rating triggers were lowered to Baa3/BBB- for both counterparties. Moody's ratings as of December 31, 2015 for Deutsche Bank senior long-term debt and deposit ratings were A3. ALCo continues to monitor the credit for compliance with terms of the agreement.

Details related to the interest rate swaps as of December 31, 2015 are presented in Appendix B.

DEBT MANAGEMENT

ASSET/LIABILITY MODEL

General Fund

The total SPBC debt portfolio as of December 31, 2015 had $3.654 billion of bonds outstanding with a weighted average coupon of 5.1 percent and a weighted average life of 6.86 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 $1.211 billion callable portion had a weighted average coupon of 5.06 percent.

The SPBC debt structure has 43 percent of principal maturing in 5 years and 72 percent of principal maturing in 10 years. The ratios are above of the rating agencies' proposed target of 27-30 percent due in 5 years and 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 $348.2 million at the beginning of Fiscal Year 2016 and a low of negative $1.503 billion on September 10, 2015.

The average and median balances were a negative $1.043 billion and a negative $1.147 billion, respectively. Since the General Fund continued to have a negative available cash balance for the fiscal year to date, 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 is expected to be $654.8 million for Fiscal Year 2016. In addition, General Fund debt service of $11.3 million is expected to be provided for the Eastern State Hospital financing that was issued through the Lexington-Fayette Urban County Government in 2011. 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 "ability to call" of the debt portfolio.

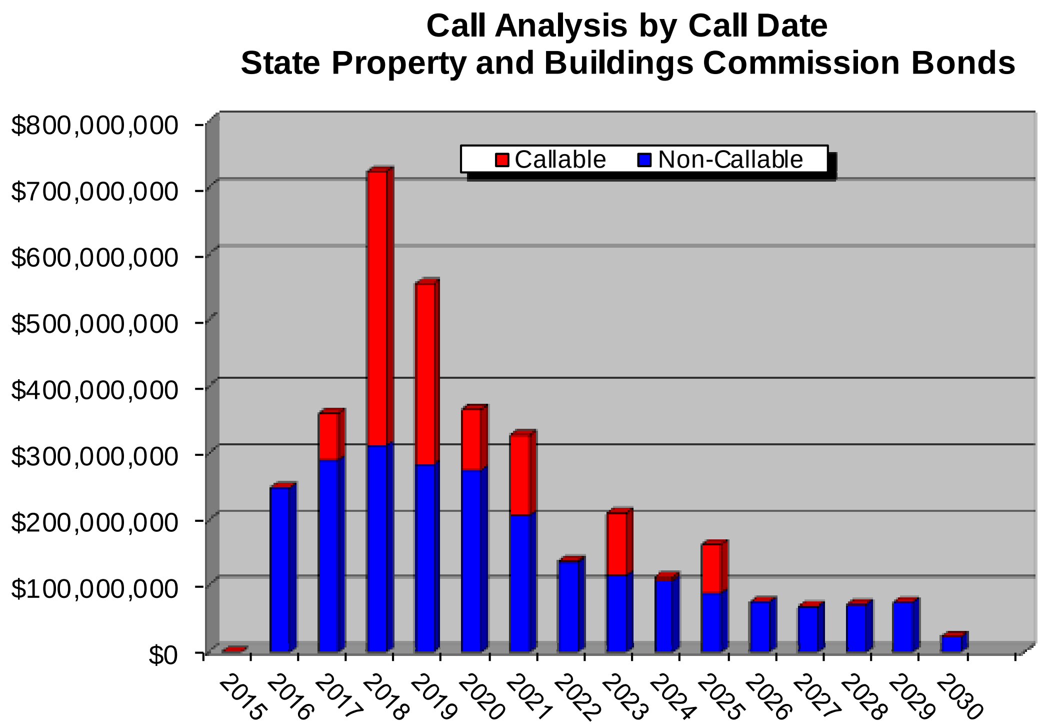
SPBC Project 110

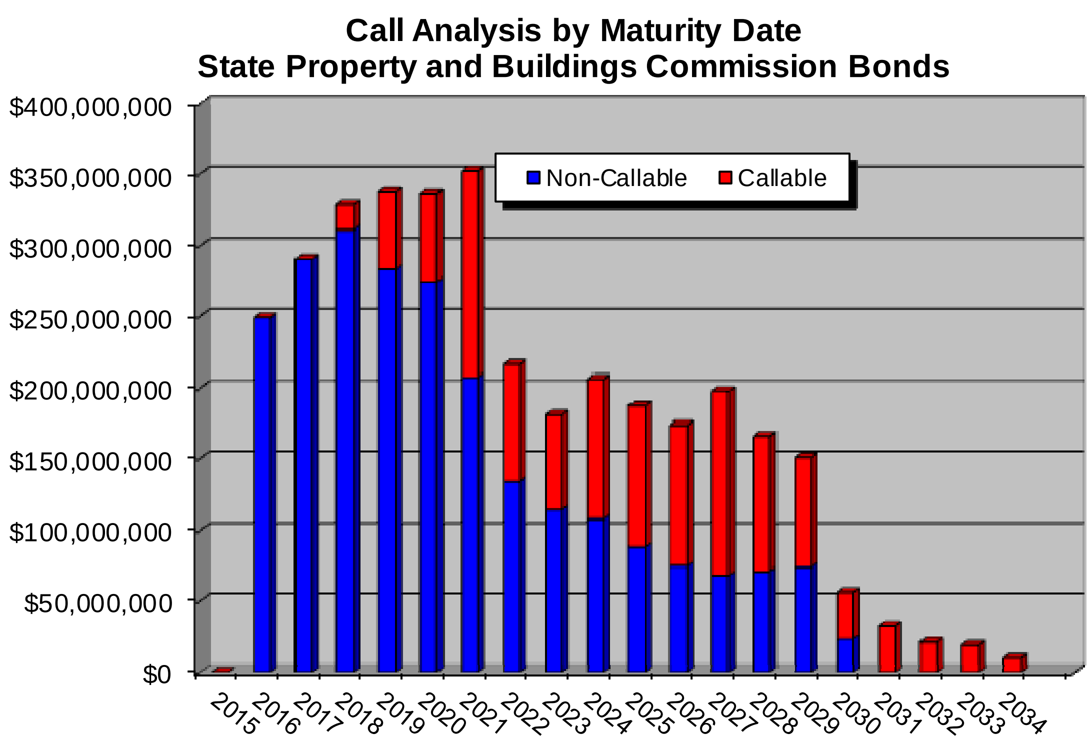
In early December, 2015, SPBC issued SPBC Revenue and Revenue Refunding Bonds, Project No. 110, as a single series General Fund transaction for $115,660,000. The transaction (1) provided permanent financing for approximately $120.0 million of various General Fund supported capital projects authorized by the General Assembly of the Commonwealth of Kentucky, (2) refunded Drinking Water Revolving Fund, 2004 Series C & Waste Water Revolving Fund, 2004 Series I of the Kentucky Infrastructure Authority; and, (3) paid costs of issuance.

The SPBC Project No. 110 bonds received ratings of Aa3/A/A+ from Moody's, Standard & Poor's Ratings Services, and Fitch Ratings, respectively. All rating actions had a stable outlook.

The SPBC 110 transaction took advantage of the market's low rate environment and achieved an All-In True Interest Cost of 3.406% with an average life of 11.197 years to provide $789,666 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 Dinsmore and Shohl, LLP as bond counsel. The transaction closed on December 3, 2015.

DEBT MANAGEMENT





DEBT MANAGEMENT

Road Fund

The Road Fund average daily cash balance for the first half of Fiscal Year 2016 was $242 million compared to $445 million for the first half of Fiscal Year 2015. The Road Fund cash was invested in the Intermediate Term Investment Pool which had a duration of 1.17 years as of December 31, 2015. The Road Fund earned $0.241 million on a cash basis for the first half of Fiscal Year 2016 versus $1.3 million for the first half of Fiscal Year 2015. The continued relatively low level of investable balances at certain times during the fiscal year limits the investment opportunities.

As of December 31, 2015, the Turnpike Authority of Kentucky (TAK) had $1.428 billion of bonds outstanding with a weighted average coupon of 4.84 percent and an average life of 7.83 years.

Road Fund debt service paid in Fiscal Year 2016 is expected to be $161.97 million, resulting in a net interest margin (investment income earned year-to-date less debt service paid) of negative $161.74 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.

TAK 2015 Series A and B

On July 22, 2015, the Turnpike Authority of Kentucky ("TAK") closed a $190,885,000 issuance which consisted of $68,880,000 Economic Development Road Revenue Bonds (Revitalization Projects), 2015 Series A; and $122,005,000 Economic Development Road Revenue Refunding Bonds (Revitalization Projects), 2015 Series B. The proceeds of the bonds were used to pay the costs of certain additions and improvements to the Kentucky Economic Development Road System (Revitalization Projects), advance refund the Authority's Economic Development Road Revenue Bonds (Revitalization Projects), 2006 Series A and B for economic savings, and to pay for costs of issuance. The bond proceeds represented $75 million of a $400 million authorization by the 2010 Extraordinary Session of the General Assembly. The projects were highway projects approved within the Transportation Cabinet's Six-Year Highway Plan.

The transaction was sold on a negotiated basis on June 16, 2015 with Morgan Stanley. acting as senior manager and Dinsmore & Shohl serving as bond counsel. Frost Brown Todd LLC was underwriter's counsel.

The Series A portion of the debt service was 20-year, level debt, tax-exempt financing with an All -In TIC of 3.496%, an average life of 12.189 years, a 10-year par call, and a final maturity of July 1, 2035. The Series B portion of the debt service was essentially a 10-year, level debt, tax-exempt financing with an All-In TIC of 2.484% and an average life of 6.82 years. The refunding yielded an 9.25% savings of refunded bonds which represented nearly $12.4 million in net present value savings. The bonds received ratings of Aa2/AA/A+ from Moody's, S&P and Fitch, respectively.

SPBC 111

On December 3, 2015, the State Property and Buildings Commission of Kentucky ("SPBC") closed $4,960,000 of Road Fund Revenue Bonds, Project No. 111. The proceeds of the bonds were used to pay the costs of acquiring, constructing, installing and equipping the replacement of the existing C-1 maintenance facility in Franklin County. The new facility will be located on 14 acres of land currently owned by the Transportation Cabinet in Frankfort, Kentucky, as authorized in House Bill 236 of the 2014 Regular Session of the Kentucky General Assembly.

DEBT MANAGEMENT

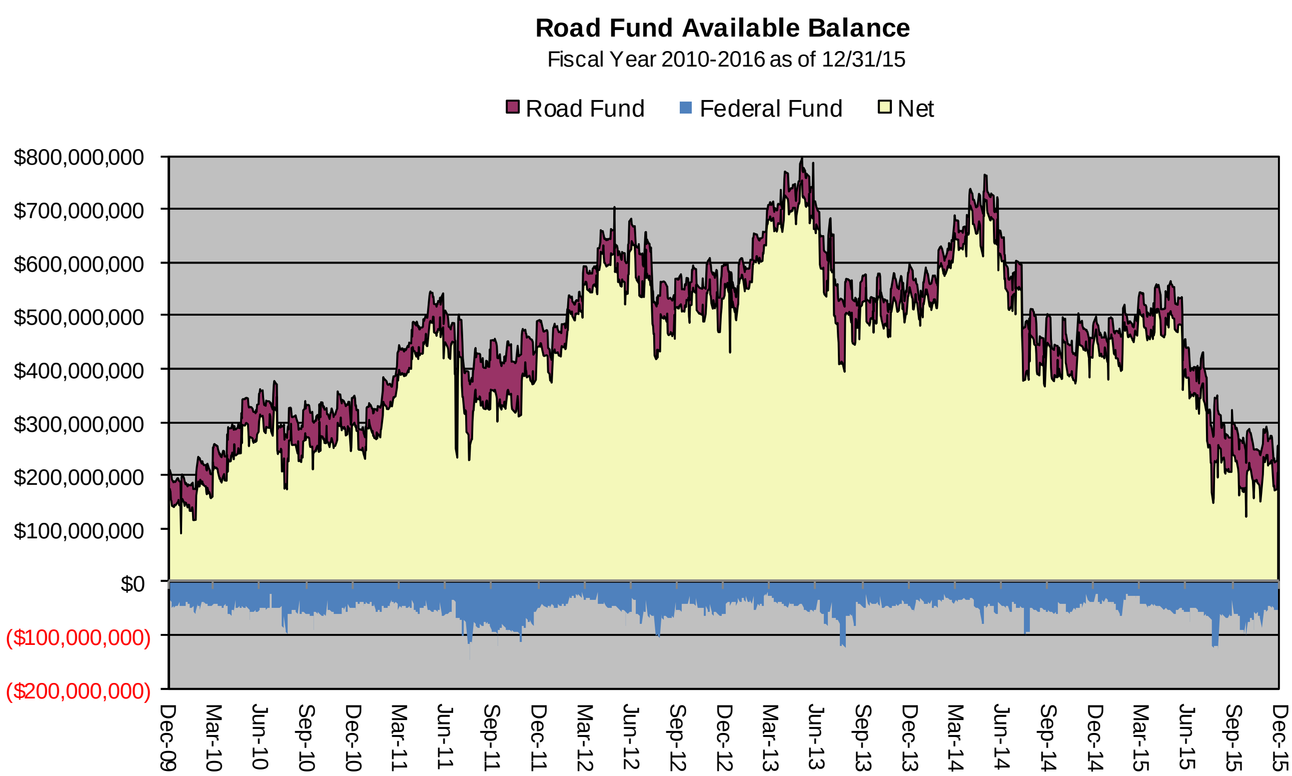
The transaction was sold on a negotiated basis on November 19, 2015 with Citigroup acting as senior manager and Dinsmore & Shohl serving as bond counsel. Stites & Harbison, PLLC was underwriter's counsel.

The debt service was 20-year, level debt, tax-exempt financing with an All-In TIC of 3.322%, an average life of 11.499 years, a 10-year par call, and a final maturity of November 1, 2035. The bonds received ratings of Aa2/A/A+ from Moody's, S&P and Fitch, respectively.

ALCo 2015 GARVEEs

In mid October, ALCo issued Project Notes, 2015 Federal Highway Trust Fund First Series A (GARVEEs) in the amount of $106,850,000. The proceeds of the notes will provide permanent financing for the remaining project cost ($120.5 million) for the US-68/KY-80 Lake Barkley and Kentucky Lake Bridges Project and the costs of issuing the 2015 Notes. The financing for this project was authorized by House Bill 3 of the 2010 Extraordinary Session of the General Assembly.

The Notes received ratings of A2/AA/A+ from Moody's, S&P and Fitch, respectively. The transaction was sold via negotiated sale with Citigroup serving as senior managing underwriter and Kutak Rock LLP as bond counsel. The transaction achieved attractive rates with an All-In True Interest Cost of 2.60% with an average life on the notes of 6.891 years. The transaction closed on October 15, 2015.



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 six 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

Corporate Credits Approved For Purchase
As Of November 24, 2015

Company Name	Repurchase Agreements	Debt	Company Name	Repurchase Agreements	Debt
Apple Inc		Yes	Johnson & Johnson		Yes
Bank of America N.A.	Yes	No	JPMorgan Chase & Co	No	Yes
Bank of Montreal	Yes	Yes	Lloyds Bank PLC		Yes
Bank of Nova Scotia	Yes	Yes	Merck & Co. Inc.		Yes
Bank of Tokyo-Mitsubishi UFJ L		Yes	Microsoft Corp		Yes
BB&T Corp		Yes	Navy Federal Credit Union	Yes	No
Berkshire Hathaway Inc		Yes	Oracle Corp		Yes
BNP Paribas Securities Corp	Yes	Yes	PepsiCo Inc		Yes
BNY Mellon NA		Yes	Pfizer Inc		Yes
Boeing Co/The		Yes	PNC Bank NA		Yes
BP PLC		Yes	Procter & Gamble Co/The		Yes
Canadian Imperial Bank of Comm		Yes	Protective Life Insurance Co.	Yes	No
Caterpillar Inc		Yes	Royal Bank of Canada	Yes	Yes
Chevron Corp		Yes	Royal Dutch Shell PLC		Yes
Cisco Systems Inc		Yes	State Street Corp		Yes
Cooperatieve Centrale Raiffeis		Yes	Sumitomo Mitsui Trust Bank		Yes
Costco Wholesale Corp		Yes	Swedbank AB		Yes
Deere & Co		Yes	Texas Instruments Inc.		Yes
Exxon Mobil Corp		Yes	Toronto-Dominion Bank/The		Yes
General Electric Co		Yes	Total SA		Yes
Healthcare of Ontario Pension Plan (HOOPP)	Yes	No	Toyota Motor Corp		Yes
Honda Motor Co Ltd		Yes	UBS AG (U.S.)		Yes
Home Depot Inc		Yes	US Bank NA		Yes
HSBC Bank USA NA		Yes	Wal-Mart Stores Inc		Yes
IBRD - World Bank	Yes	Sov	Walt Disney Co/The		Yes
Intel Corp		Yes	Wedbush Securities Inc.	Yes	No
Intl Business Machines Corp		Yes	Wells Fargo & Co		Yes
Invesco Mortgage REIT	Yes	No			

*Addition:
None

Removed:
None

Any corporates held as of 3/11/2013 are grandfathered. The positions may be held until maturity but no additions may be made to the position.

APPENDIX A

Securities Lending Agent Approved Counterparties

As Of November 24, 2015

Company Name	Securities Lending	REPO
Alaska USA Federal Credit Union	Yes	Yes
Alaska USA Trust Company	Yes	Yes
BMO Capital Markets Corp	Yes	No
Bank of Nova Scotia	Yes	No
Barclays Capital, Inc	Yes	Yes
BNP Paribas Prime Brokerage, Inc.	Yes	No
BNP Paribas Securities Corp.	Yes	No
Cantor Fitzgerald & Co.	Yes	Yes
Citigroup Global Markets Inc	Yes	Yes
Credit Suisse Securities (USA) LLC	Yes	Yes
CYS Investments, Inc.	Yes	Yes
Daiwa Capital Markets America Inc	Yes	Yes
Deutsche Bank Securities Inc.	Yes	Yes
Dynex Capital Inc.	Yes	Yes
Goldman Sachs and Company	Yes	Yes
Hatteras Financial Corp	Yes	Yes
HSBC Securities (USA) Inc	Yes	Yes
ING Financial Markets LLC	Yes	Yes
Jefferies LLC	Yes	Yes
JP Morgan Securities LLC	Yes	No
Merrill Lynch Pierce Fenner & Smith Inc	Yes	Yes
Mizuho Securities USA, Inc	Yes	Yes
Morgan Stanley & Co. LLC	Yes	Yes
Nomura Securities International Inc	Yes	Yes
Pershing LLC	Yes	Yes
Redwood Trust	Yes	Yes
RBC Capital Markets LLC	Yes	No
RBS Securities Inc.	Yes	Yes
SG Americas Securities LLC	Yes	Yes
Societe Generale	Yes	Yes
TD Securities (USA), Inc	Yes	Yes
Two Harbors Investment Corp	Yes	Yes
UBS Securities LLC	Yes	Yes
Wells Fargo Securities LLC	Yes	Yes

APPENDIX B

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)*	A3/BBB+	A3/BBB+	A3/BBB+	A3/BBB+
Termination Trigger *(Moody's / S&P)*	Baa3/BBB-	Baa3/BBB-	Baa3/BBB-	Baa3/BBB-
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	5,395,000	50,690,000	64,760,000	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 December 31, 2015 (negative indicates payment owed by ALCo if terminated)	(228,447)	(7,339,872)	(6,362,735)	(12,451,307)
Interest Earnings	not applicable	not applicable	not applicable	not applicable
Total	not applicable	not applicable	not applicable	not applicable

Swap Summary
As of December 31, 2015:

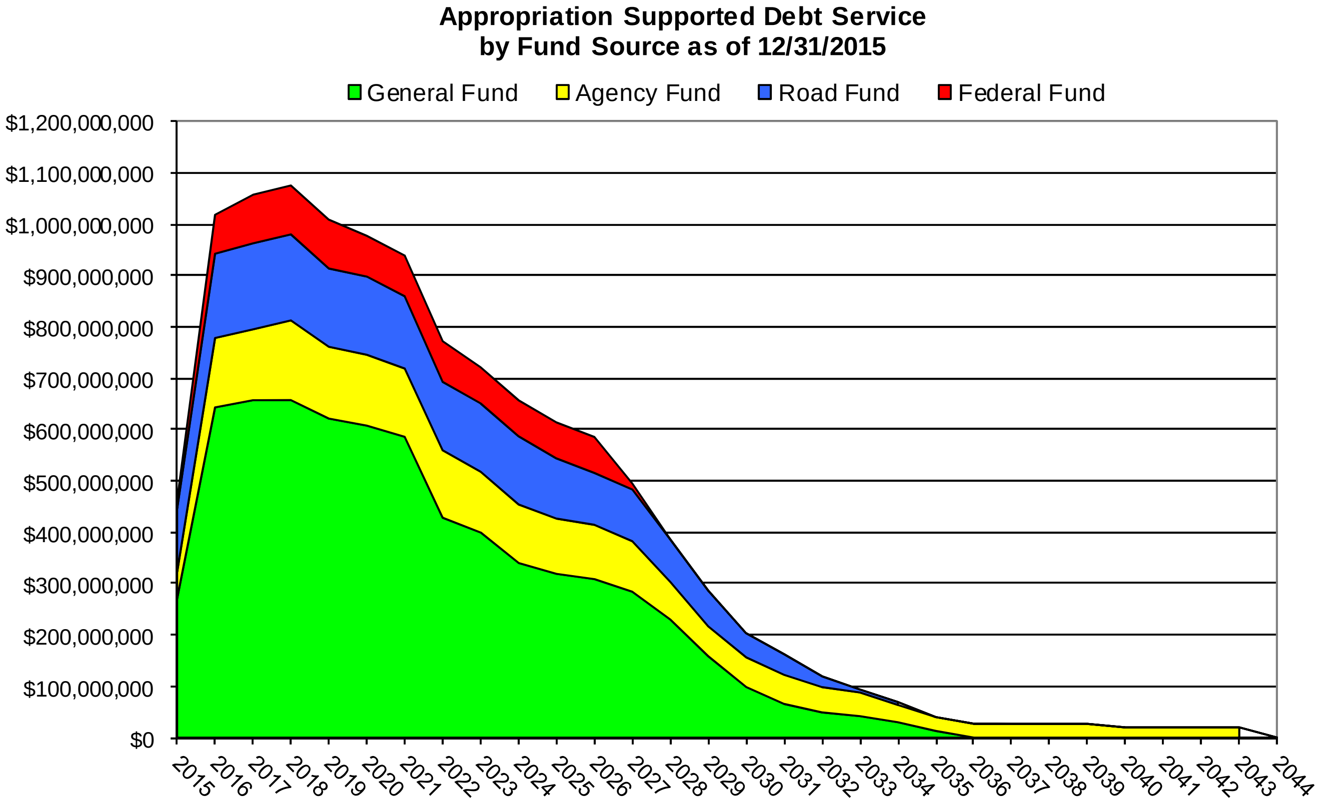
Total Notional Amount Executed		Net Exposure Notional Amount	
General Fund	Road Fund	General Fund	Road Fund
243,080,000	0	191,780,000	0

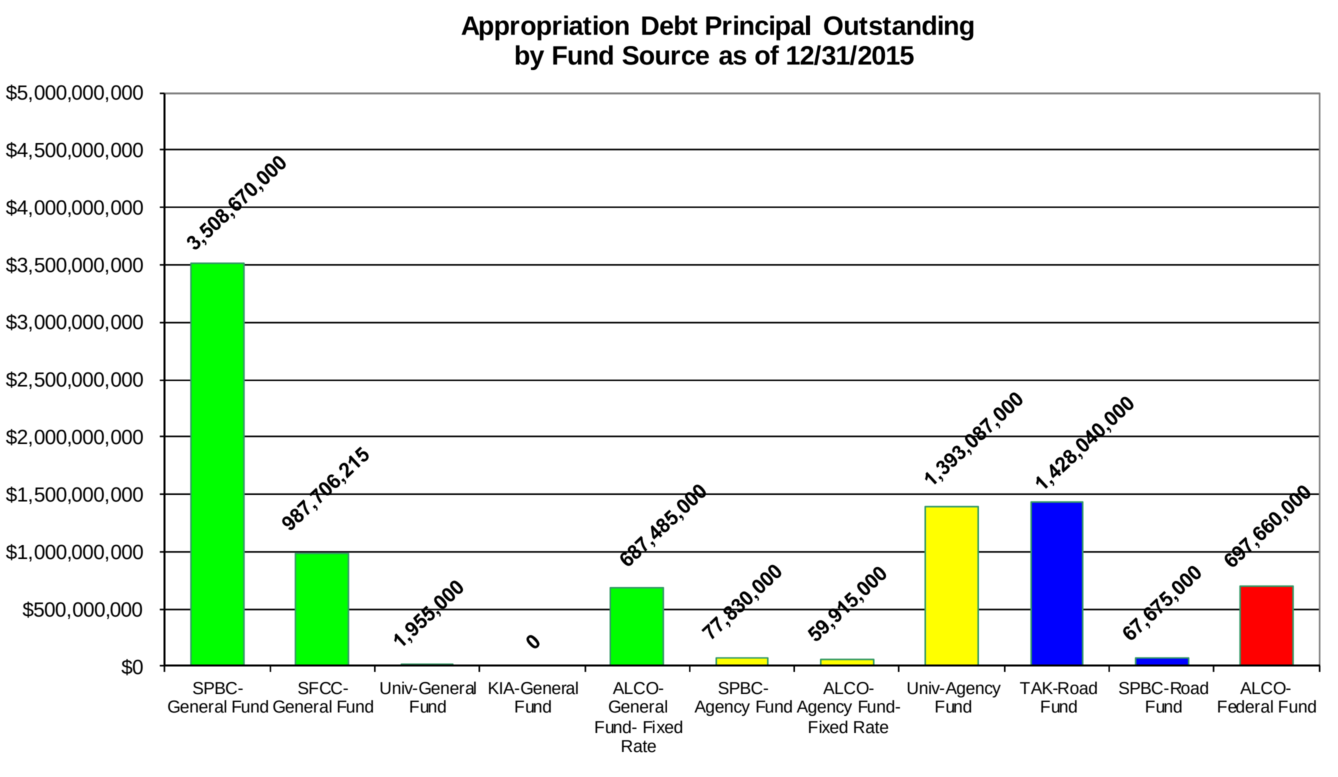
Total Notional Amount Executed by Counter Party
Deutsche Bank (assigned from Citibank on 2/14/2011)
243,080,000

	Debt		10 Percent Net Exposure	
	General Fund	Road Fund	General Fund	Road Fund
Bonds Outstanding	4,196,155,000	1,495,715,000	419,615,500	149,571,500
Authorized but Unissued	714,442,200	137,500,000	71,444,220	13,750,000
Total	4,910,597,200	1,633,215,000	491,059,720	163,321,500

Investment Pool Balance		10 Percent Investment Portfolio	
Other Funds	Net Road Fund	Other Funds	Net Road Fund
3,533,796,353	206,483,468	353,379,635	20,648,347

APPENDIX C





*This data does not include debt issued for judicial center projects and paid for by the Administrative Office of the Courts in the Court of Justice or debt issued by the Lexington -Fayette Urban County Government for the Eastern State Hospital.

APPENDIX D

COMMONWEALTH OF KENTUCKY
ASSET/LIABILITY COMMISSION
SCHEDULE OF NOTES OUTSTANDING
AS OF 12/31/2015

FUND TYPE SERIES TITLE		AMOUNT ISSUED	DATE OF ISSUE	MATURITY DATE	PRINCIPAL OUTSTANDING
General Fund Project & Funding Notes					
2007 A, B Series		$243,080,000	5/2007	11/2027	$191,780,000
2010 1st Series-KTRS Funding Notes		$467,555,000	8/2010	4/2020	$186,905,000
2011 1st Series-KTRS Funding Notes		$269,815,000	3/2011	4/2022	$184,185,000
2013 1st Series-KTRS Funding Notes		$153,290,000	2/2013	4/2023	$124,615,000
	FUND TOTAL	**$1,133,740,000**			**$687,485,000**
Agency Fund Project Notes					
2005 1st Series		$11,275,000	6/2005	6/2025	$7,160,000
2006 Series A-UK Gen Recpts		$66,305,000	10/2006	10/2022	$35,985,000
2007 Series A-UK Gen Recpts		$77,905,000	11/2007	10/2017	$7,580,000
2007 Series B-UK Gen Recpts		$80,245,000	11/2007	10/2018	$9,190,000
	FUND TOTAL	**$235,730,000**			**$59,915,000**
Federal Hwy Trust Fund Project Notes					
2007 1st Series		$277,910,000	9/2007	9/2019	$129,250,000
2010 1st Series		$89,710,000	3/2010	9/2022	$89,710,000
2013 1st Series		$212,545,000	8/2013	9/2025	$212,545,000
2014 1st Series		$171,940,000	3/2014	9/2026	$159,305,000
2015 1st Series		$106,850,000	10/2015	9/2027	$106,850,000
	FUND TOTAL	**$858,955,000**			**$697,660,000**
ALCo NOTES TOTAL		**$2,228,425,000**			**$1,445,060,000**

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REPORT PREPARED BY:

OFFICE OF FINANCIAL MANAGEMENT

Commonwealth of Kentucky

702 Capital Ave Ste 76

Frankfort, KY 40601

Phone: 502-564-2924

Fax: 502-564-7416

Creating Financial Value for the Commonwealth

Cover Photos contributed by
Marcia Adams and Brian Kiser