Semi-Annual Report

of the
Kentucky Asset/Liability Commission

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Commonwealth of Kentucky

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Finance and Administration Cabinet

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Office of Financial Management

For the period ending December 31, 2007

This report may be viewed at

http://finance.ky.gov/ourcabinet/caboff/OOC/ofm/debt/AlcoSemiAnnualRpt.htm

TABLE OF CONTENTS

Investment Management 1

Debt Management. 5

Financial Agreements 6

Asset/Liability Model 8

Summary 13

Appendix

Swap Summary . . . . A

Appropriation Supported Debt. . . . . B

ALCo Project Notes Outstanding C

Project List . . . . D

INTRODUCTION

This is the Kentucky Asset/Liability Commission's (ALCo) twenty-second semi-annual report pursuant to KRS 56.863 (11) for the period beginning July 1, 2007 through December 31, 2007. 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 experiences slow growth.
- Sub-prime mortgage market dramatically deteriorates.
- War in the Middle East continues.
- The Dow Jones Industrial Average finishes the year at 13,265 down 144 points from June 2007.
- Fed Funds rate decreases to 4.25 percent after three cuts during the period.
- The credit rating agencies review monoline bond insurers for downgrade.

On the state level

- Continued implementation of the two largest bond authorizations in the history of the Commonwealth with addition of $100 million Energy Bonds authorized in 2007 Special Session.
- First half of the fiscal year 2008 General Fund revenues decreased 0.4 percent compared to the same period in fiscal year 2007.

INVESTMENT MANAGEMENT

MARKET OVERVIEW

In the June 30, 2007 ALCo report, the discussion centered on the building problems in the domestic mortgage market. In the six months since then, the problems have deepened. Basically, the underwriting standards used to originate loans during 2005, 2006 and the beginning of 2007 weakened versus previous standards. This resulted in increased credit losses on the mortgages through delinquent payments and foreclosures.

Many of these loans were pooled into various forms of mortgage and asset backed securities and into collateralized debt obligations. As the weakness in the underlying mortgage loans became evident, the prices of the securities sank. As the prices sank, various leveraged holders of these securities, including structured investment vehicles and hedge funds, were forced to liquidate. This creates a vicious cycle in which a drop in prices leads to forced sales which causes a further drop in prices which then leads to further forced sales.

The weakness in the mortgage market created a "contagion" effect which spilled over into other credit markets. As the price for risk adjusted upwards, the price of all assets with a credit exposure declined. Further damage was experienced by the brokerage community with roughly $140 billion in losses announced so far. The monoline bond insurers also experienced substantial write-downs which may result in downgrades by the credit rating agencies. The losses have extended to other investors with the Florida state-run Local Government Investment Pool being the most publicized.

The Federal Reserve has responded by reducing the Fed Funds rate from 5.25 percent as of June 30, 2007, down to 4.25 percent at the end of the year, and even further to 3.00 percent by the end of January 2008. In cooperation with other central banks, massive amounts of liquidity have been pumped into the system to protect the financial markets. The Federal Reserve has even created an unprecedented liquidity facility called a Term Auction Facility in which they loan funds at favorable rates to undisclosed parties while accepting a wide variety of collateral.

The problems that Wall Street has been experiencing are now spilling over into Main Street. While the Federal Reserve disagrees, some analysts believe that the economy has fallen into a recession in December. A number of economic statistics are showing substantial declines:

- The annual growth rate in Retail Sales (*RSTAYOY*) has fallen from a high of 9.0 percent in July 2005, to only 4.1 percent in December 2007. For the month of December, there was a decline of .4 percent versus November.
- The Unemployment Rate (*USURTOT*) has risen from 4.40 percent in March 2007 to 5.0 percent in December 2007.
- Non-Farm Payroll (*NFP TCH*) growth averaged 175,000 new jobs per month in 2006 versus 82,000 per month during the second half of 2007.
- The annual increase in Industrial Production (*IP YOY*) has fallen from a peak of 6.0 percent in September 2006 to only 1.8 percent in December 2007.
- The annual growth in real Gross Domestic Product (*GDP CYOY*) has fallen from a post 2001 recession peak of 4.1 percent in the second quarter of 2004 to only 2.5 percent during the fourth quarter of 2007.

In conclusion, the last six months have been a tumultuous time in the credit markets. The turmoil in the credit markets has spread into the real economy causing a considerable slow down. Federal Reserve Chairman Bernanke will attempt to engineer a soft landing (no recession) while continuing to deal with a liquidity and credit crunch in the financial markets.

PORTFOLIO MANAGEMENT

For the six months ended December 31, 2007, the Commonwealth's investment portfolio averaged $3.7 billion. As of December 31, 2007, the portfolio was invested in U.S. Treasury Securities (14 percent), U.S. Agency Securities (18 percent), Mortgage Pass Through Securities (2 percent), Collateralized Mortgage Obligations (10 percent), Repurchase Agreements (20 percent), Municipal Securities (7 percent), Corporate Securities (6 percent), Asset-Backed Securities (14 percent), and Money Market Securities (9 percent). The portfolio had a market yield of 4.65 percent and an effective duration of .82 years.

The total portfolio is broken down into five investment pools. The pool balances as of December 31, 2007, were: Short Term Pool - $1,437 million, Intermediate Term Pool - $1,727 million, Bond Proceeds Pool - $367 million, TRAN Pool - $362 million, and UK Hospital Pool - $158 million.

Total investment income from all investments, on a cash basis, for the six months ended December 31, 2007, was $84.0 million versus $67.8 million for the six months ended December 31, 2006.

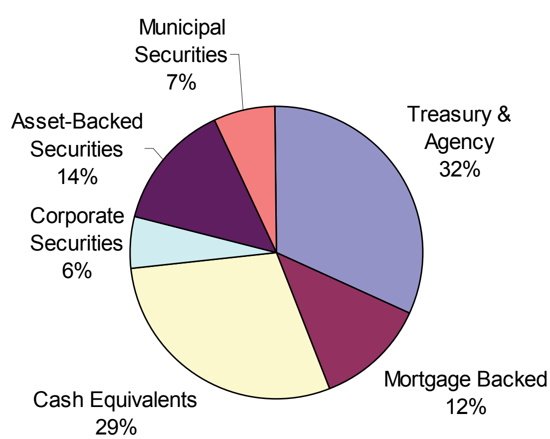
On a full mark-to-market basis, investment income was $119.1 million for the six months ended December 31, 2007 versus $105.6 million for the six months ended December 31, 2006. The higher income levels for the six months ended December 31, 2007, were primarily due to a more favorable interest rate environment.

TAX-EXEMPT INTEREST RATES AND RELATIONSHIPS

The Bond Buyer 20 year General Obligation Index averaged 4.40 percent for the calendar year 2007. The high was 4.81 percent in August and the low was 4.08 percent in March with the year end at 4.45 percent.

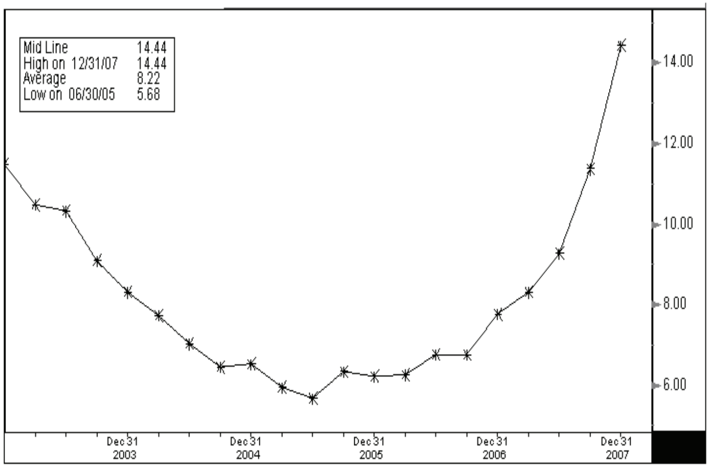
The Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index averaged 3.63 percent for the calendar year 2007. The high was 3.95 percent in August and the low was 3.09 percent in December and ended the year at 3.41 percent. The 30-day USD London Interbank Offered Rate (LIBOR) averaged 5.25 percent for the year. The low was 4.60 percent in December, the high was 5.82 percent in September, and the year ended at 4.60 percent. SIFMA traded as high as 75 percent of 30-day LIBOR in September and as low as 62 percent in December with an average of 69 percent for the year. The year ended with SIFMA as 70 percent of LIBOR.

Portfolio Management
as of December 31, 2007



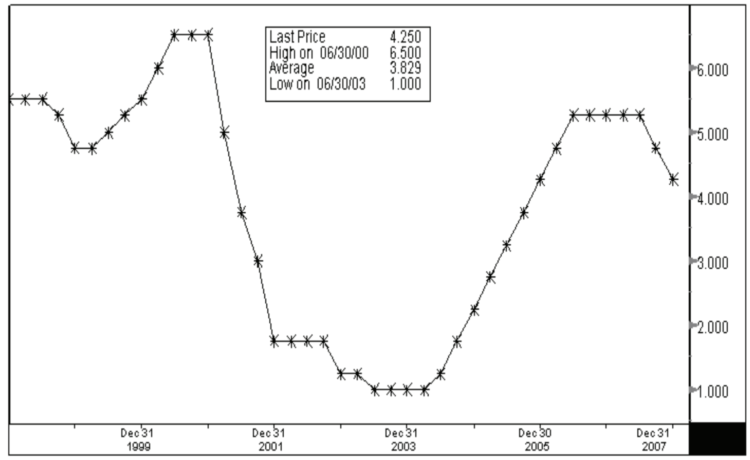
Seriously Delinquent Subprime Loans FORLSUSD INDEX

Range 12/31/02 12/31/07 Period Quarterly



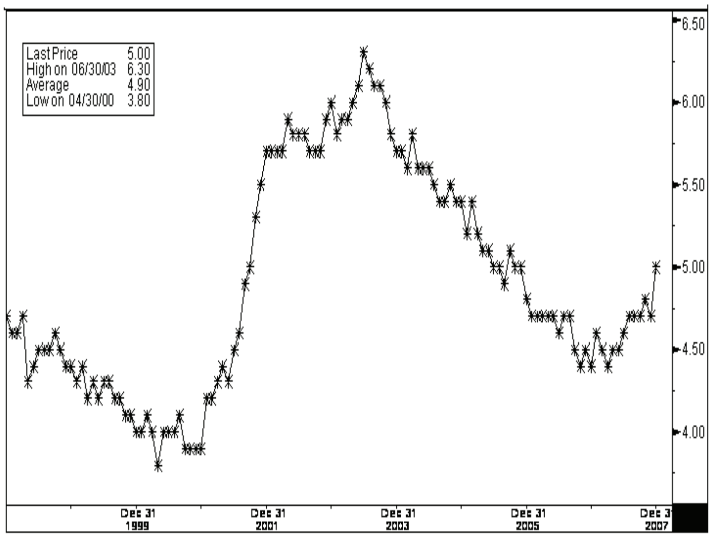
Federal Funds Target Rate FDTR INDEX

Range 12/31/97 - 12/31/07 Period Quarterly



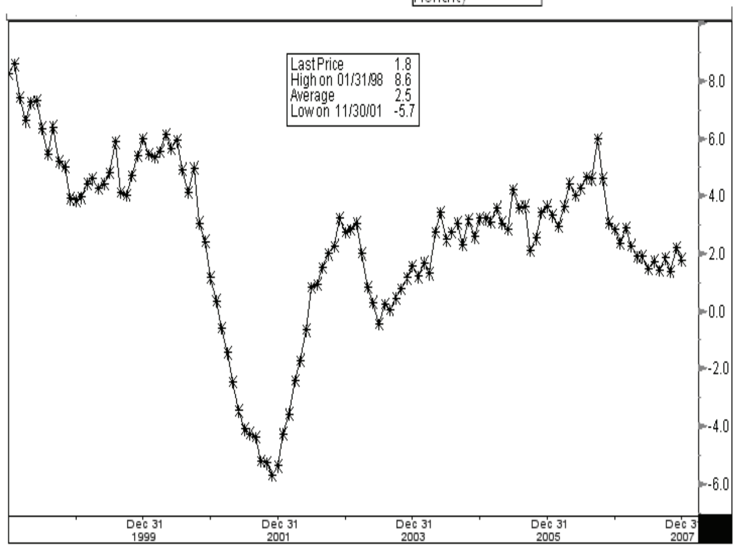
Unemployment Rate USURTOT INDEX

Range 12/31/97 12/31/07 Period Monthly



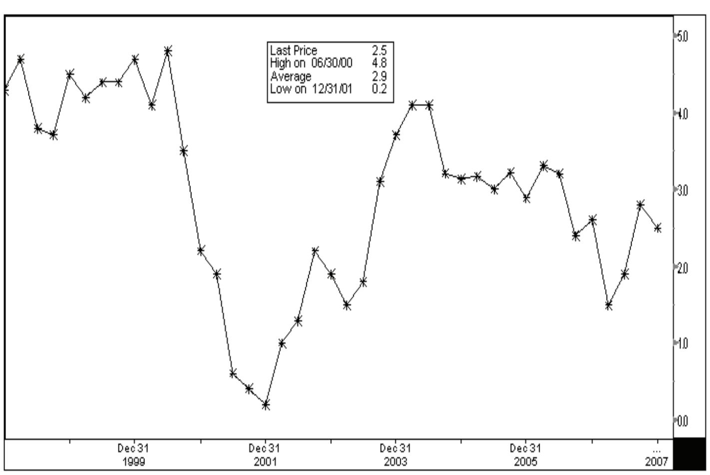
Industrial Production IP YOY INDEX

Range 12/31/97 - 12/31/07 Period Monthly



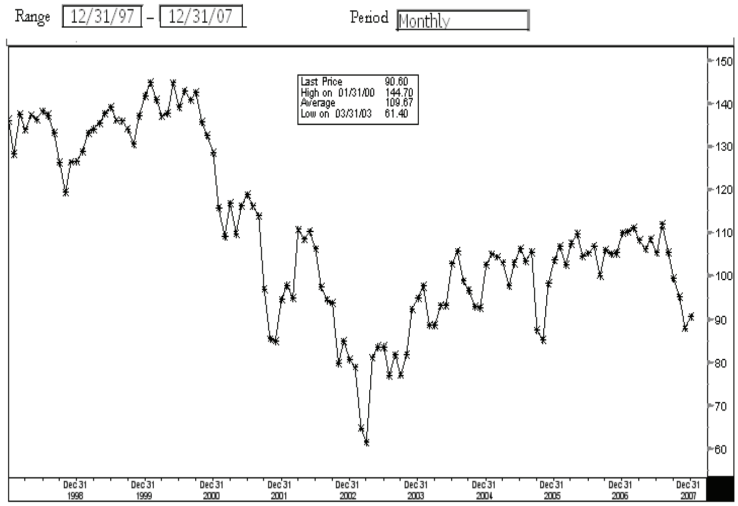
Real Gross Domestic Product GDP CYOY INDEX

Range 12/31/97 – 12/31/07 Period Quarterly



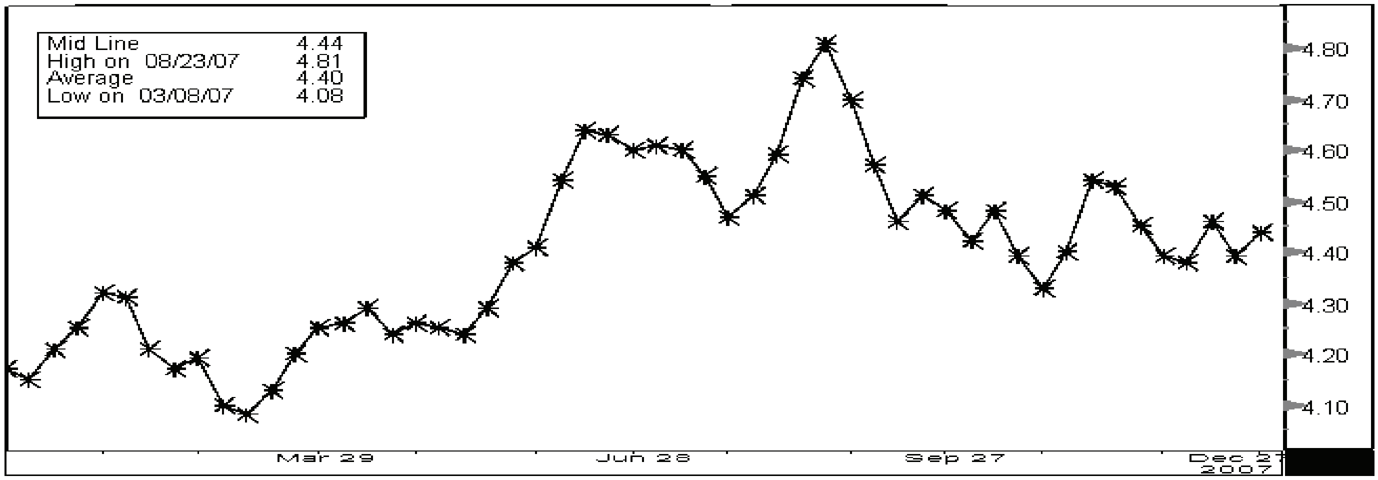
Consumer Confidence CONCCONF INDEX

Range 12/31/97 - 12/31/07 Period Monthly



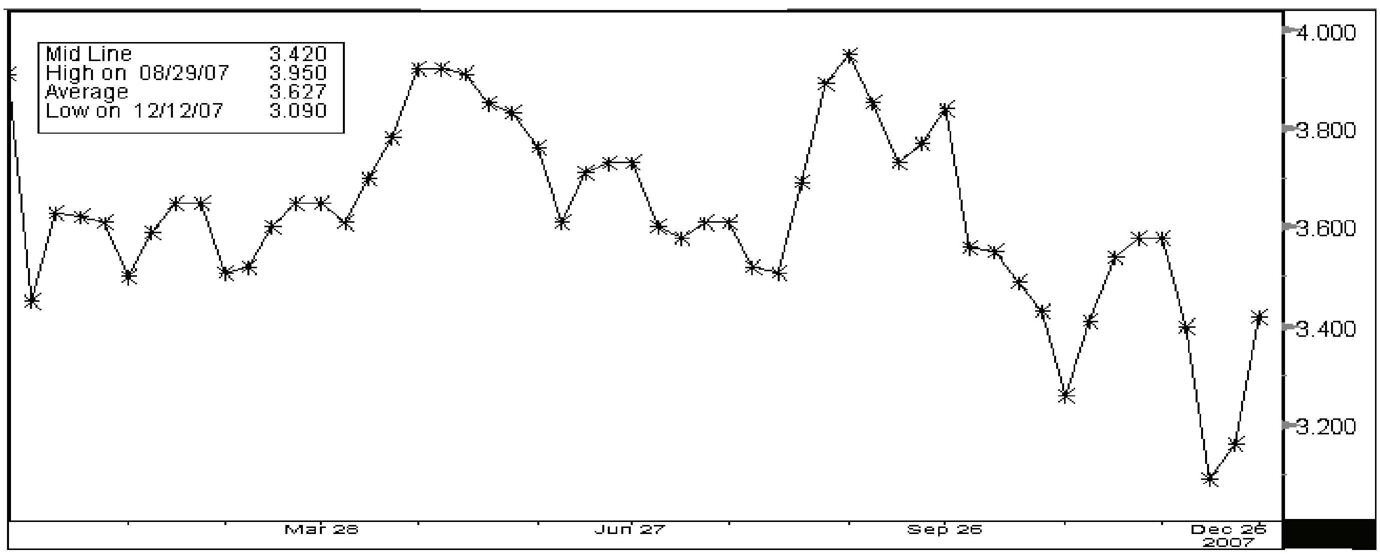
Bond Buyer 20-year General Obligation Index

Range 12/28/06 - 12/27/07 | Period Weekly



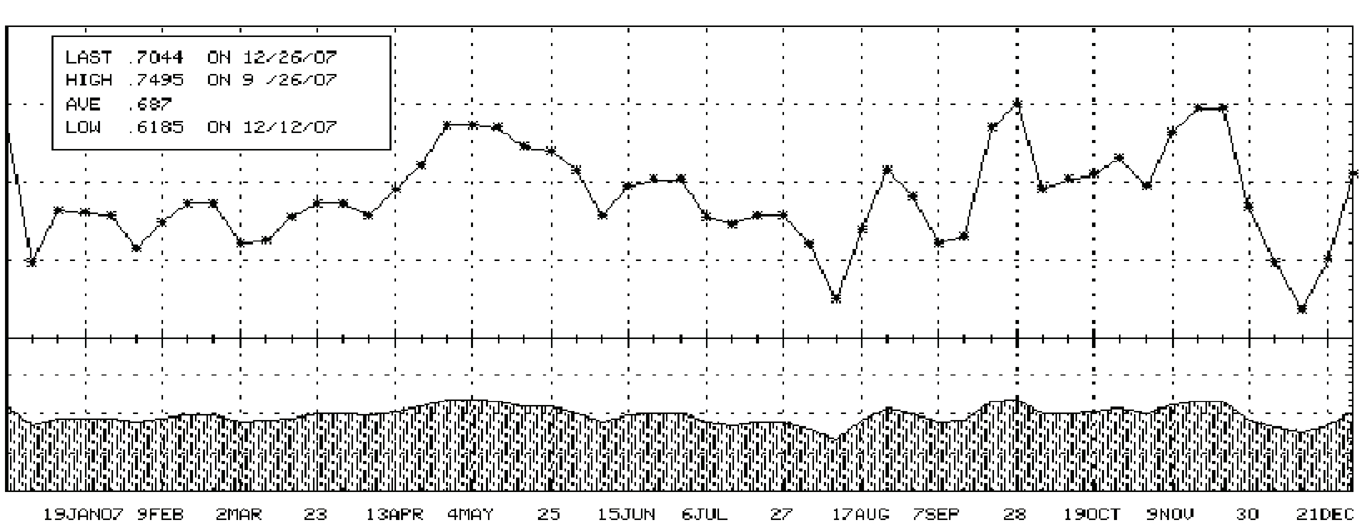
Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index

Range 12/27/06 – 12/26/07 | Period Weekly



Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index as a percent of one month LIBOR

Range 12/27/06 to 12/26/07



DEBT MANAGEMENT

The 2005 Kentucky General Assembly enacted a State Budget for the biennium ending June 30, 2006, which authorized $2.056 billion of bond funded capital projects. The General Fund authorization was $1,204 million; the Road Fund authorization was $450 million; Agency Funds were authorized at $251.7 million; and $150 million was authorized to be supported by the Federal Highway Trust Funds (FHTF). Bonds have been issued for the Agency Fund, Road Fund and FHTF authorizations.

The 2006 General Assembly adopted a State Budget for the biennium ending June 30, 2008, which authorized an additional $2.3 billion of capital projects to be funded with debt. The General Fund authorization was $1,392.9 million; the Agency Fund authorizations were $267.5 million; while the Road Fund and FHTF authorizations were $350 million and $290 million, respectively. ALCo issued notes for the Road Fund and FHTF in September 2007.

Additionally, the 2007 Special Session authorized $100 million of General Fund supported Energy Bonds. A considerable amount of the General Fund bond projects from the above authorizations were permanently funded by calendar year end 2007. Interim note financing is available for the remaining projects. The timing of permanent financing is uncertain and dependent on expenditure needs.

RATINGS UPDATE

The rating agencies continually monitor the Commonwealth's performance in areas such as revenue, the economy and debt management. The recent softening in the economy may put pressure on the state's ratings.

In January 2007, S&P revised its outlook from "stable" to "positive", for Kentucky's "AA-" issuer credit rating and the State Property and Buildings Commission's (SPBC) "A+" rating, based on the state's positive economic and revenue growth, steadily replenishing reserves, and the expectation that the state will devise a long-term plan addressing rising pension and health care liabilities.

In February 2007, Moody's Investors Service revised from "negative to "stable", the outlook on the Commonwealth's "Aa2" issuer rating and SPBC rating of "Aa3", reflecting a trend of state economic recovery and strengthened finances that have improved the Commonwealth's fiscal condition. Moody's expects that with a continuation of these trends, combined with the state's active financial management, Kentucky will maintain a strong fiscal condition resulting in an improved structural budget balance over the near-term.

FitchRatings, for similar reasons, assigned an initial "stable" outlook to the SPBC ratings of "AA-" in February 2007.

TAX AND REVENUE ANTICIPATION NOTES (TRAN)

2007 TRAN. Originally, TRANs were issued at tremendous rate advantages to taxable reinvestment rates, often producing 2 percent excess returns when the General Fund had excess cash and significantly lowering the borrowing cost when the balances were negative. ALCo authorized the 2007 (FY2008) TRAN program in an amount not to exceed $600 million. On July 3, 2007, $350 million was delivered to mature on June 26, 2008. The 2007 Series A TRANs were sold by Citigroup Global Markets Inc. on June 26, 2007. The fixed rate notes carry a coupon of 4.50 percent to yield 3.71 percent. The net benefit to the General Fund for the fiscal year is expected to be approximately $5.5 million.

ALCo entered into an Interest Rate Swap with UBS to partially hedge the 2007 TRAN. The Commonwealth will receive a 5.346 percent fixed rate on $350 million notional amount (1.64 percent above cost of funds) while paying one month LIBOR. The swap maturity date matches the life of the TRAN.

FINANCIAL AGREEMENTS

As of December 31, 2007, ALCo had four financial agreements outstanding, with a net notional amount exposure of $300 million. Eight swaps were terminated and two additional financial agreements were executed during the period. The terms of the continuing transactions are detailed in Appendix A.

General Fund

In August 2007, to protect against a continued volatility in interest rates, ALCo competitively bid and subsequently entered into two (2) $150 million interest rate swap transactions with two counterparties to hedge the future issuance of $300 million of permanent tax-exempt bonds for General Fund authorized but unissued projects. The 2008 and 2009 forward-starting swap agreements feature mandatory early termination dates of November 3, 2008 and November 2, 2009, respectively. The hedges allow for a portion of the fiscal year 2009 and fiscal year 2010 debt service to be appropriated at a lower rate than the budgeted template rate of 5.85 percent. This results in annual savings (reduction in appropriation) to the General Fund. Citigroup is the single counterparty on the 2008 swap and UBS is the single counterparty on the 2009 swap.

The ALCo swaps, which total $300 million, hedge roughly one quarter of currently authorized but unissued General Fund supported debt.

Road Fund

Of the outstanding Road Fund financial agreements, the first item is a Total Return swap related to the $56,485,000 July 1, 2009 maturity of the Turnpike Authority of Kentucky (TAK) Resource Recovery 1985 Series A Bonds, which bears interest at 6 percent. Staff worked for approximately 18 months to develop this transaction with Morgan Stanley (MS) and finally executed the trade in April 2001.

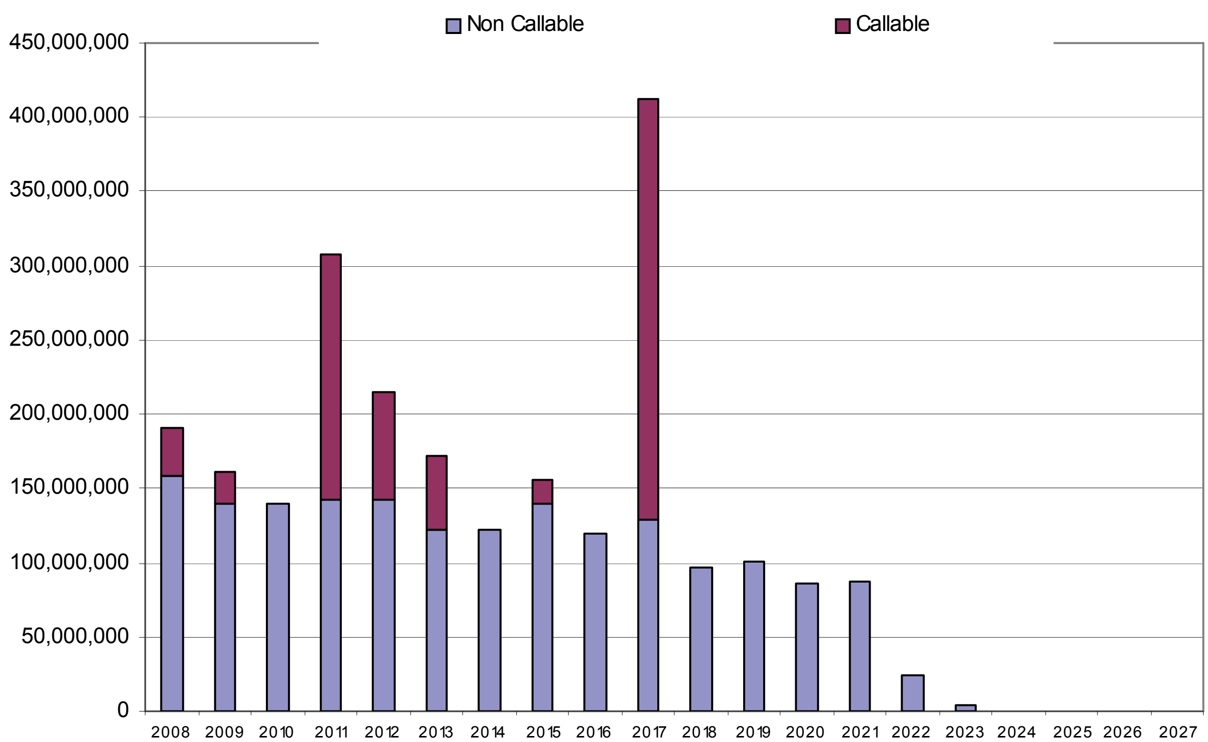
The 1985A bonds could not be economically refunded, despite a very low interest rate environment due to the enormous transferred proceeds penalty associated with the Debt Service Reserve Fund (DSRF) which is earning approximately 10 percent. MS, bond counsel and the Commonwealth developed a structure whereby the bonds would be called, but not redeemed. Once called, the bonds were sold to MS. ALCo then entered into a total rate of return swap, whereby MS pays ALCo 6 percent (the coupon on the bonds) and ALCo pays to MS, SIFMA plus a spread (originally 58 basis points) to cover expenses. This transaction provided the synthetic variable rate exposure to offset the asset sensitivity in the balance sheet, i.e. sensitivity to declining interest rates. Rates continued to steadily decline, putting the trade in a very favorable position. Shortly after the events of September 11, 2001, interest rates tumbled dramatically and on September 27, 2001, staff entered into an offsetting trade, locking in a guaranteed spread of 213 basis points. The reversal rate (rate ALCo agrees to pay MS) was 3.87 percent versus the original fixed receiver rate of 6 percent from MS. ALCo has received $6 million under the terms of the agreements since inception. The expected total benefit from this transaction to maturity is $7.5 million.

Since the two transactions offset each other for a net notional amount of zero, ALCo collects the difference between the two payments and deposits the proceeds into a swap account held for the benefit of the Road Fund. This account also secures future payments to MS under the agreement, if necessary. ALCo is obligated under the agreement to accumulate a minimum balance of $3 million in the swap account. Once cumulative deposits achieve that level, excess funds are available to offset debt service payments. In June 2007, approximately $2.6 million in excess funds were transferred from the swap account to the Road Fund and subsequently used to pay debt service.

Since the bonds are still outstanding and TAK retains the right to call the bonds at face value (par), the termination value of the swap is essentially the present value of the fixed expenses (13 basis points). In the event that rates rise above the coupon on the bonds, the transaction would be terminated and the bonds would be resold to the marketplace. If the value of the bonds in the market is below par, then ALCo would make a payment from the swap account to MS equal to the difference between the then market value and par. Alternatively, the Road Fund could purchase the bonds as an investment at par. The Road Fund and the TAK get the best of both worlds with this transaction in that they retain the highly valuable DSRF earning 10 percent and lower the cost of borrowing as long as interest rates stay low. In the event that the interest rates rise dramatically, then the investment portfolio of the Road Fund will earn significantly more than projected so long as the Road Fund maintains an investable balance equal to or greater than the notional amount of the transaction.

For tax purposes, the Total Return Swap must terminate prior to the final maturity of the bonds. The original end date for the Total Return Swap was July 1, 2007. In late June 2007, ALCo extended the Total Return Swap with MS through January 1, 2009 at a reduced spread to SIFMA of 37 basis points. At the end of this term, depending upon market conditions at the time, the fixed receiver swap may be terminated.

Call Analysis by Call Date
State Property and Buildings Commission Bonds



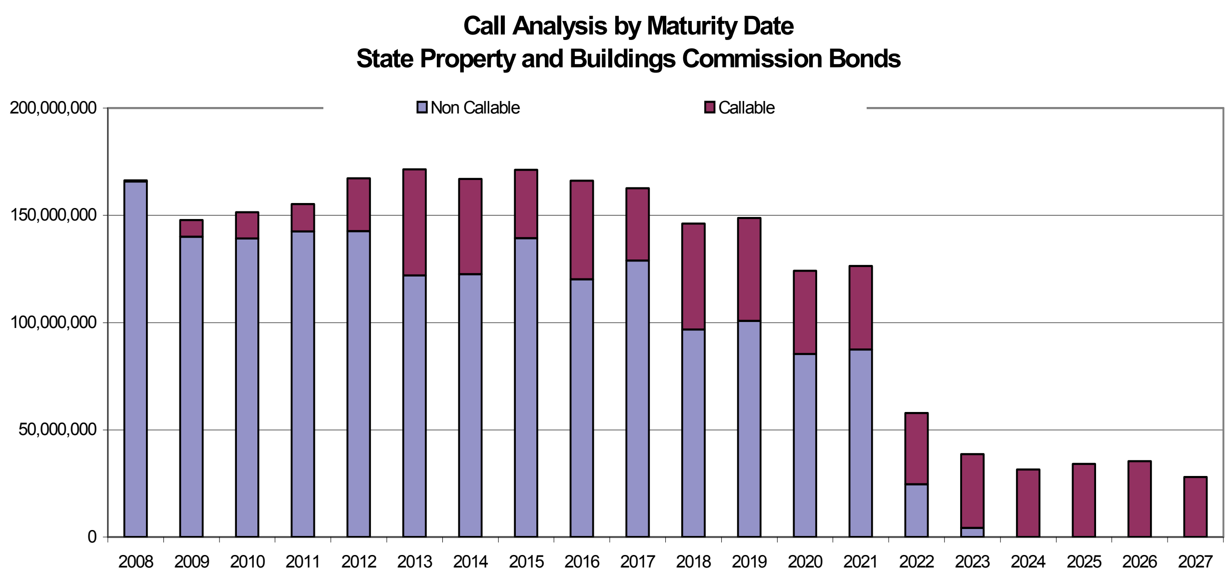
ASSET/LIABILITY MODEL

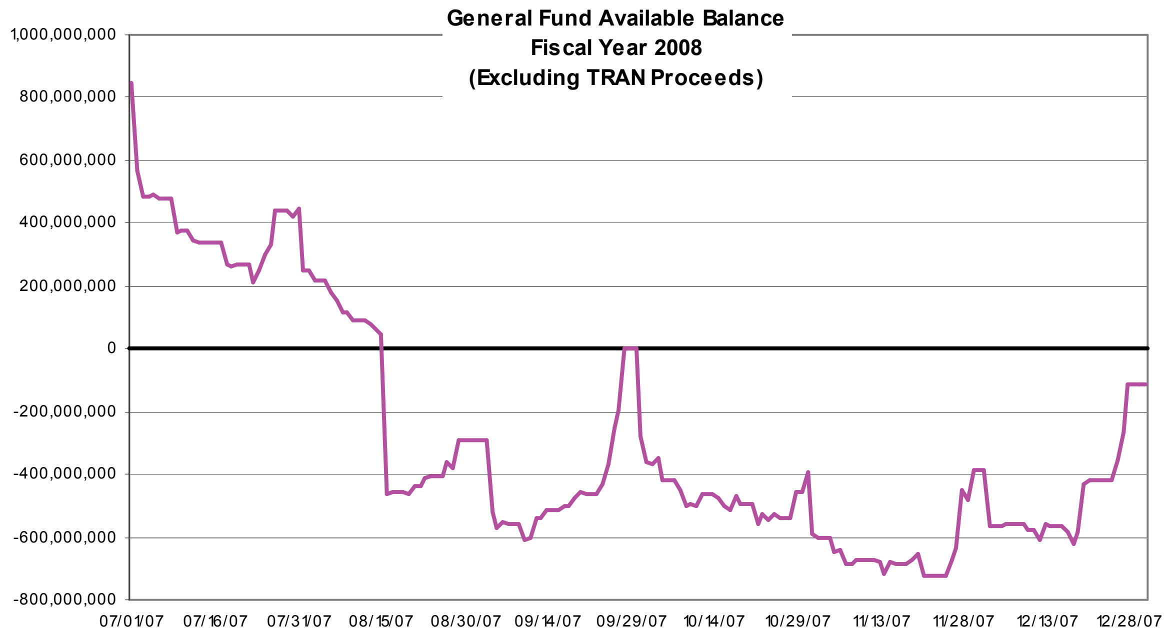
General Fund

The total SPBC debt portfolio as of December 31, 2007 had $2,398 million of bonds outstanding with a weighted average coupon of 4.98 percent, modified duration of 5.49 years, and a yield at market of 3.83 percent. The market yield decreased by 9 basis points from the prior reporting period while modified duration decreased by 0.07 years. The average coupon reflects investor preference for callable premium bonds in the current market at a yield lower than par or discount coupon bonds. The $635 million callable portion had a weighted average coupon of 5.00 percent. There is $25 million currently callable in calendar year 2008, consisting of unrefunded SPBC Project 57 and Project 60 bonds.

The SPBC General Fund debt structure has 33 percent of principal maturing in 5 years and 68 percent of principal maturing in 10 years. Strong consideration should be given to rebalancing the portfolio as this is significantly above the upper range of the rating agencies proposed targets of 27-30 percent due in 5 years and 55-60 percent maturing within 10 years.

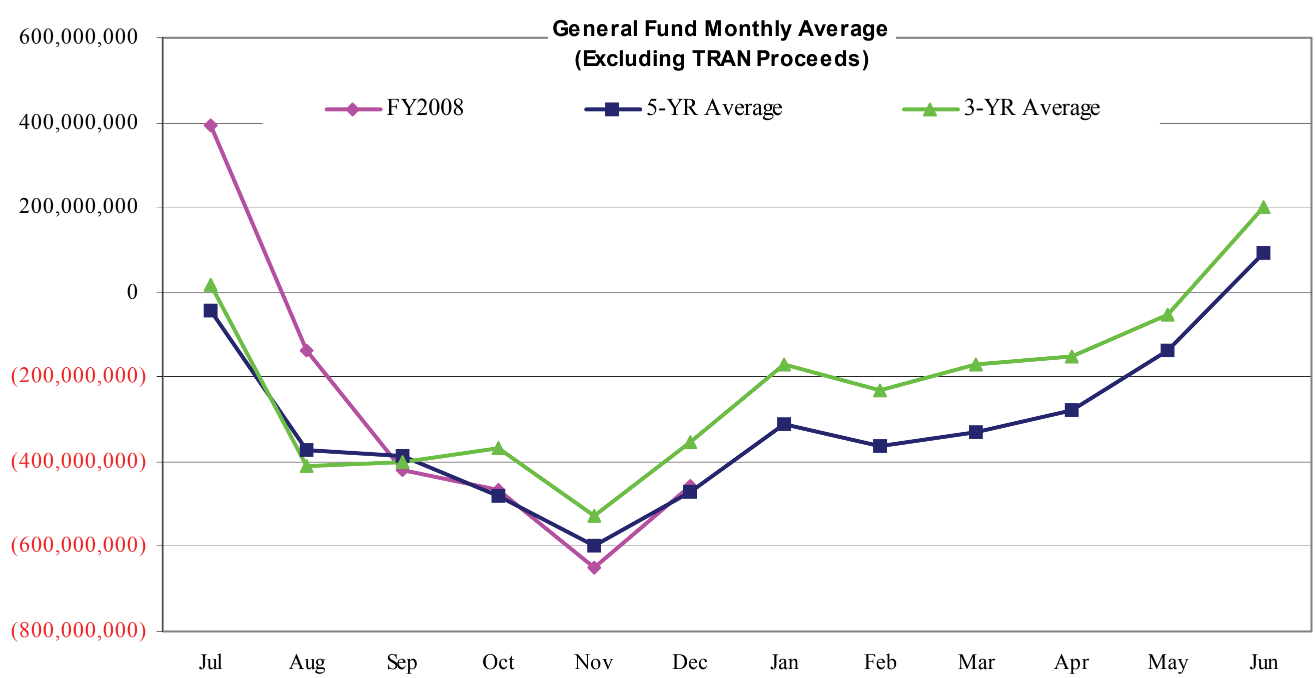
The General Fund had a high balance of $848 million on July 1, 2007 and a low of negative $721 million on November 21, 2007. The average and median balances were a negative $287 million and a negative $454 million, respectfully. Since the General Fund continued to have a negative available cash balance for most of the fiscal year, there is little, if anything, that can be done from an asset management viewpoint beyond current actions.





From a liability management perspective, total General Fund debt service, net of reserve fund credits is expected to be $436 million for fiscal year 2008. Net interest margin will continue to be negative due to low cash balances versus outstanding fixed rate debt, low level of interest rates as well as the callability of the debt portfolio.

ALCo Project Notes, 2005 General Fund Second Series. Late in 2005, the remaining $640 million General Fund supported bond projects authorized by the 2005 General Assembly, but not yet permanently financed, were placed under an ALCo interim plan of finance. The 2005 General Fund Second Series Note program provides a funding mechanism that allows state agencies and universities to move forward with their General Fund supported bond projects prior to their need for permanent financing. Subsequently, ALCo adopted resolutions to place the General Fund supported bond projects, authorized by the 2006 and 2007 General Assemblies, under the same ALCo interim financing plan. The maximum authorized amount of notes outstanding under the program was increased from $750,000,000 to $1,400,000,000. The projects were placed under the program because they are not expected, at this time, to meet the Internal Revenue Service spend-down requirements of a traditional bond issue. ALCo will monitor project expenditures and direct the issuance of notes as needed to meet current capital needs.



An initial tax-exempt tranche of $100,000,000, in two Series, was delivered on November 2, 2005. JP Morgan and UBS each provided remarketing services for the two separate $50 million Note Series, both issued in the commercial paper rate mode. The Note Series are each supported by a standby note purchase agreement provided by Dexia Credit Local (a leading European bank based in France) acting through its New York branch. The liquidity facility expires on October 31, 2008, unless extended.

A second tax-exempt tranche of $100,000,000, in two Series, was delivered on January 25, 2007. The two separate $50 million Note Series again were issued in the commercial paper mode and are serviced by JP Morgan, UBS and Dexia.

In February 2007, SPBC issued its Revenue and Revenue Refunding Bonds, Project 87, which currently refunded the first $100,000,000 tranche of ALCo 2005 General Fund Second Series Notes, a $5 million project previously funded with ALCo Agency Fund Notes and select maturities of SPBC 57. SPBC 87 permanently financed a total of $278,441,000 of General Fund supported bond projects authorized by the 2005 and 2006 General Assemblies.

A third tranche of $100,000,000 was issued in two Series and delivered on June 26, 2007. All of the tax-exempt notes remain in the commercial paper mode and are remarketed by JP Morgan and UBS and supported by Dexia. Remarketing information and the cost of capital to date is provided in Appendix C. As of December 31, 2007, $200 million of notes were outstanding under the interim financing program. The commercial paper note program has provided an attractive level of financing at remarketing rates below 3.75 percent which is well below the current budgeted template rate of 5.85 percent. The exceptionally low liquidity facility fee of 0.075 percent would be much higher if bid in today's market.

SPBC 88. In November 2007, SPBC issued $267,055,000 Revenue Bonds, Project 88, which were to currently refund the second $100,000,000 tranche of ALCo 2005 General Fund Second Series Notes on redemption dates in February 2008. SPBC 88 permanently finances $277,821,000 of General Fund supported bond projects. See the Project List in Appendix D.

With the delivery of SPBC 88, the forward starting swaps that featured a mandatory early termination date of February 2008 were terminated with a payment of $1,939,000 from bond proceeds. The hedge, with a net notional amount of $150 million, served its purpose to protect against a volatile rate environment.

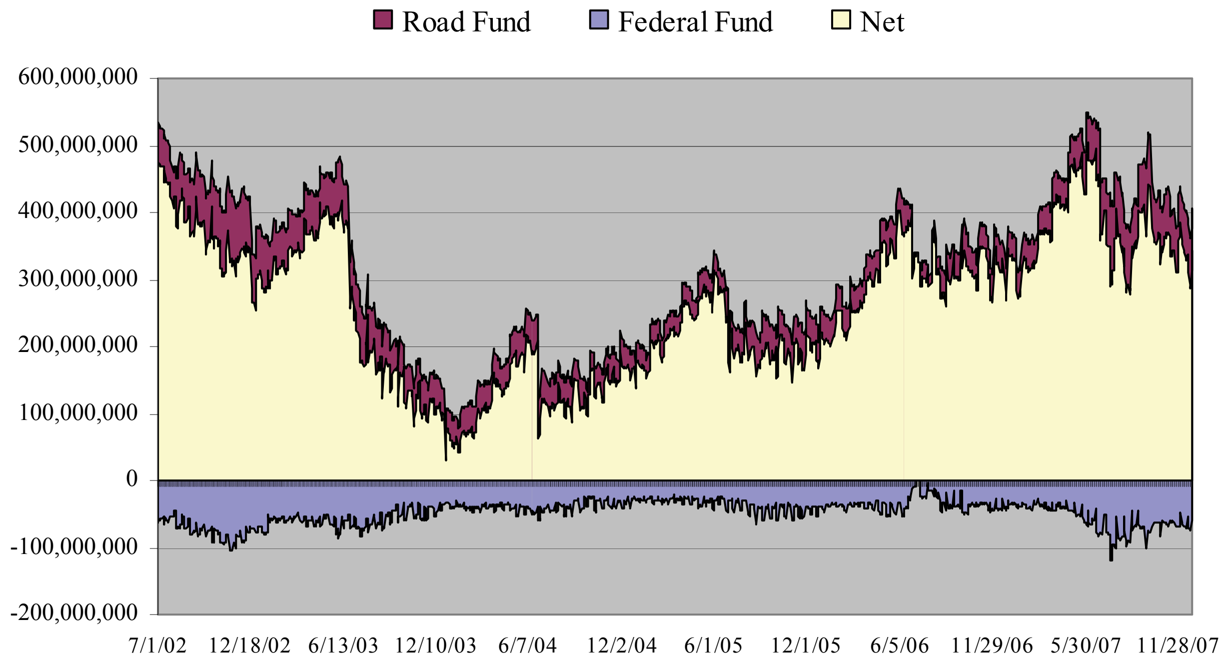
SPBC 88 bonds were purchased by Citigroup at a competitive sale at an all-in TIC of 4.347 percent. This was the first time in over ten years that the competitive structure was utilized by SPBC. First Southwest Company served as financial advisor. Demand for the offering was strong even in a challenging market with 9 bidders. The structure of the sale provided insights into the strength and value of the SPBC credit and a comparison to negotiated deals for SPBC and other issuers.

ALCo Project Notes, 2005 General Fund First Series. Project proceeds of $81,850,000 ALCo 2005 General Fund First Series delivered on June 8, 2005 to provide for the financing of the Phase II Tobacco Settlement Payments were returned to the state in late 2005. The proceeds have been yield restricted and applied to General Fund supported bond projects, specifically the infrastructure for economic development fund for tobacco counties. As of December 31, 2007, $49 million of the proceeds had been expended on projects.

Road Fund

In September 2007, ALCo issued $150 million of the $350 million of Road Fund Supported Economic Development Bonds authorized by the 2006 General Assembly. The interim financing program provides for notes not to exceed $350 million to be issued in anticipation of permanent financing by TAK. The Notes are secured by a standby note purchase agreement provided by Dexia at the same low fee as General Fund Note

Road Fund Available Balance
Fiscal Year 2003-08 as of 12/31/07



Program. JP Morgan provides remarketing for the Notes which are in the commercial paper mode. Appendix C provides cost of capital to date.

The Road Fund average daily cash balance for the first half of fiscal year 2008 was $426 million compared to $344 million for the first half of fiscal year 2007. The Road Fund cash was invested in the Intermediate Term Investment Pool which had a duration of 1.33 years as of December 31, 2007. The Road Fund earned $7.9 million on a cash basis for fiscal year-to-date 2008 versus $6.9 million for the same period in fiscal year 2007. The expected spend down of existing resources limits the opportunity to implement additional asset liability management strategies at this time.

As of December 31, 2007, the Road Fund had $948 million of bonds outstanding with a weighted average coupon of 4.74 percent, modified duration of 3.57 years, and a yield at market of 3.26 percent. Selected maturities of the Resource Recovery 1985A with the most economical value are associated with the financial agreements previously identified.

Road Fund debt service, net of reserve fund credits for fiscal year 2008, is expected to be $156 million, resulting in a net interest margin (investment income earned less debt service paid) of negative $148 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. While cash balances have improved, they are not sufficient to offset interest expenses.

Agency Fund

ALCo University of Kentucky General Receipts Project Notes. ALCo has issued multiple series of notes under the University of Kentucky's General Receipts Indenture. The $77,905,000 2007 Series A Notes provided $75,000,000 of the cost of expanding and renovating the existing University Hospital. The 2007 Series A Notes were issued in 2006 with delivery a year later on November 1, 2007. The $80,245,000 2007 Series B Notes were issued in November 2007 to fund an additional $75,000,000 for the Hospital project. The all-in TIC on the deals were 4.42 percent and 4.59 percent, respectively.

The 20 year bonds have a 10 year call option. The first principal payment is due October 1, 2010. MS served as underwriter on both issues. AMBAC is the bond insurer on the 2007 Series A. The 2007 Series B are uninsured. The University of Kentucky General Receipts obligations are rated Aa3 by Moody's and AA– by S & P.

ALCo Project Notes, 2005 Agency Fund Second Series. The ALCo Agency Fund Note Program has allowed various state universities and state agencies to have access to interim financing for their Agency Fund supported bond projects.

On November 27, 2007, the Kentucky River Authority completed a financing in the amount of $14,025,000 designated Series A-5 with an initial rate of 4.03 percent based on SIFMA plus 45 basis points. The private placement Notes with Citigroup were rated A+ by S & P.

ALCo Federal Highway Trust Fund Notes. The 2005 General Assembly authorized $150 million of bonds and the 2006 General Assembly authorized an additional $290 million of bonds for the Transportation Cabinet's (KYTC) planned initiative to widen certain sections of Interstate 64, Interstate 65, and Interstate 75. ALCo issued the first of the FHTF Notes in June 2005. KYTC anticipating it would expend the remaining funds from the 2005 transaction by September 2007, notified OFM in May 2007 that they would like to begin planning for the issuance of the remaining $290 million or some portion thereof.

The 2007 FHTF Notes in the amount of $277,910,000 were delivered in mid-September at an all-in TIC of 4.22 percent. The deposit of $290 million assured the continuation of the project without disruption. The Notes, other than the 2018 and 2019 maturities with 5.25 percent coupon, have a ten year call option. The Notes, insured by MBIA, have a final maturity of 2019. The 2007 Notes were structured around the existing 2005 Notes to allow for an overall level repayment. Fitch, Moody's and S&P have assigned underlying ratings of AA-, Aa3, and AA-, respectively.

SUMMARY

ALCo's approach to managing the Commonwealth's interest-sensitive assets and interest-sensitive liabilities continues to produce excellent results.

Investments. At fiscal year 2003, incremental returns derived from new investment asset classes reached $27 million since inception. The program continues but is no longer monitored for incremental value.

Cash Management. Cash management improved dramatically with the implementation of the General Fund TRAN program producing $3.2 million in fiscal year 1998, $4.7 million in fiscal year 1999 and $7.3 million in fiscal year 2000. Economic benefit for fiscal year 2001 was $6.5 million, fiscal year 2002 was $4.3 million and fiscal year 2003 was $0.3 million. No TRAN was issued in fiscal year 2004. In fiscal year 2005, the TRAN provided $2.8 million net benefit and $6 million in fiscal year 2006. Net income for the fiscal year 2007 TRAN produced $2.8 million and the fiscal year 2008 TRAN is expected to produce $5.5 million for a cumulative benefit of $43 million.

Debt Management. Debt service savings have contributed an estimated $440 million in value added since inception. 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 products.

Total value added since inception is in excess of $510 million.

Appendix

APPENDIX A
SWAP SUMMARY

ALCo Financial Agreements	SPBC Nov. 2008 Hedge	SPBC Nov. 2009 Hedge	TAK RR 85A Total Return	TAK RR 85A Fixed
Fund Source	General Fund	General Fund	Road Fund	Road Fund
Hedge	Net Interest Margin	Net Interest Margin	Net Interest Margin	Total Return
Counter-Party	Citibank	UBS	Morgan Stanley	Morgan Stanley
Counter-Party Ratings *(Moody's / S&P / Fitch)*	Aa1/AA/AA	Aa2/AA+/AA+	Aa3/AA-/AA-	Aa3/AA-/AA-
Termination Trigger	A3/A-	A3/A-	BBB-/Baa3	BBB-/Baa3
Swap Type	Fixed Pay	Fixed Pay	Variable Pay	Fixed Pay
Benchmark	SIFMA	SIFMA	SIFMA	SIFMA
Reset	Weekly	Weekly	Weekly	Weekly
Notional Amount	150,000,000	150,000,000	56,485,000	56,485,000
Amortize (yes/no)	yes	yes	no	no
Execution Date	8/2/2007	8/2/2007	4/23/2001	9/20/2001
Start Date	11/3/2008	11/2/2009	5/24/2001	9/27/2001
Mandatory Early Termination	11/3/2008	11/2/2009		
Cash Settlement Payment Date	11/14/2008	11/16/2009		
End Date	11/1/2028	11/1/2029	1/1/2009	7/1/2009
Fixed Rate pay-(rec)	4.178%	4.276%	(6.000%)	3.870%
Day Count	30/360	30/360	30/360	30/360
Payment Dates	May 1 & Nov. 1	May 1 & Nov. 1	Jan. 1 & July 1	Jan. 1 & July 1
Security Provisions	Bonds payable from General Fund		Road Fund Investment	
Current Market Valuation December 31, 2007 (negative indicates payment by ALCo)	(6,901,773)	(6,221,147)	0	0
Interest Earnings				
Cumulative Prior Periods			147,727	5,372,159
Current Period - 12/31/2007			0.00	492,645
Total	not applicable	not applicable	147,727	5,864,803

Swap Summary
As of December 31, 2007:

	Total Notional Amount Executed		Net Exposure Notional Amount	
	General Fund	Road Fund	General Fund	Road Fund
	300,000,000	112,970,000	300,000,000	0

Total Notional Amount Executed by Counter Party

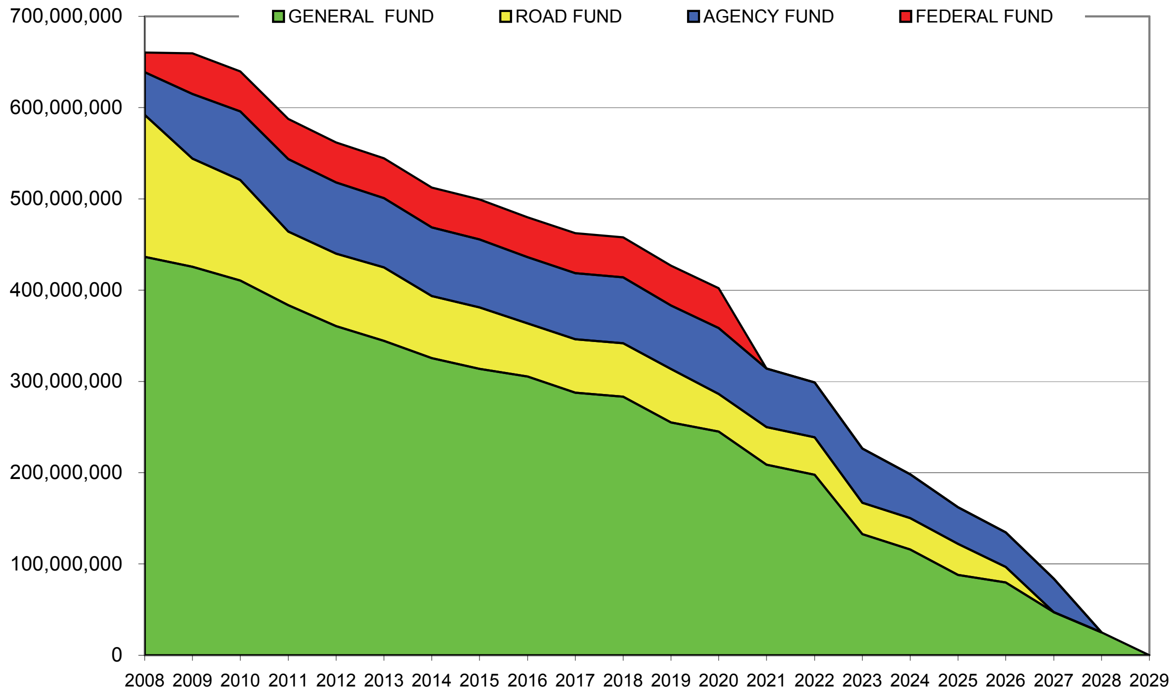
Morgan Stanley	Citibank	UBS
112,970,000	150,000,000	150,000,000

	Debt		10 Percent Net Exposure	
	General Fund	Road Fund	General Fund	Road Fund
Bonds Outstanding	2,591,910,000	948,091,895	259,191,000	94,809,189
Authorized but Unissued	1,330,933,000	350,000,000	133,093,300	35,000,000
Total	3,922,843,000	1,298,091,895	392,284,300	129,809,189

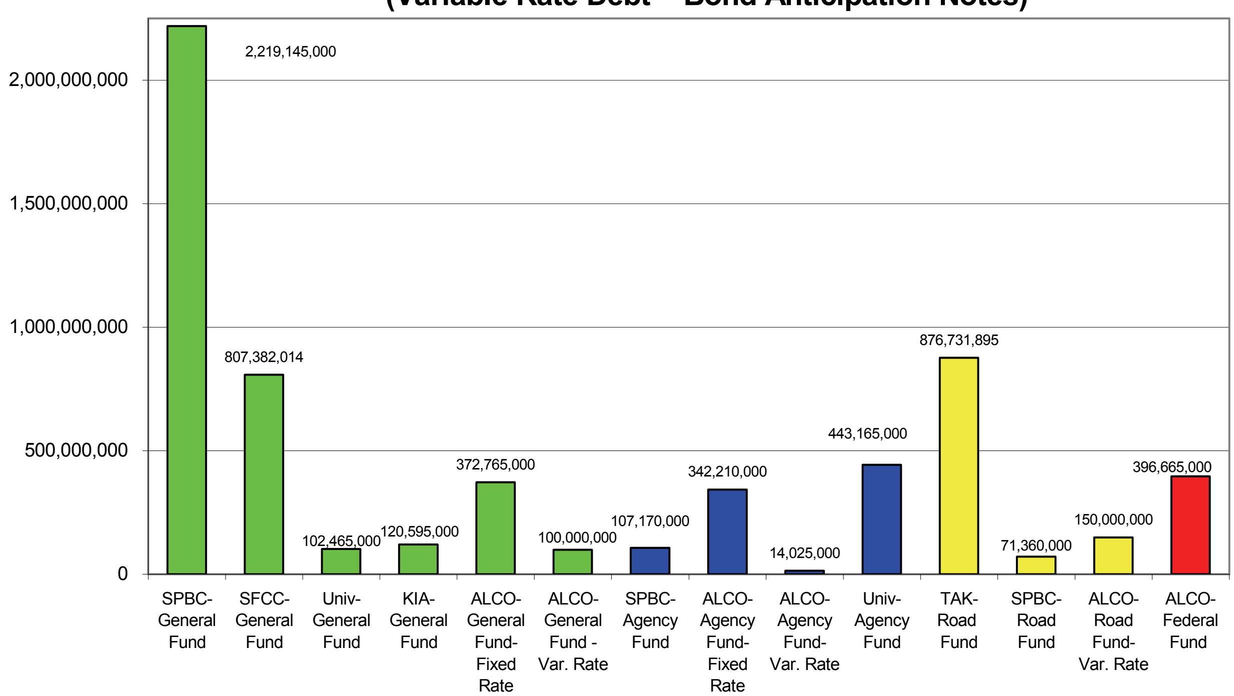
Investment Pool Balance		10 Percent Investment Portfolio	
Other Funds	Net Road Fund	Other Funds	Net Road Fund
3,705,017,406	344,734,583	370,501,741	34,473,458

APPENDIX B

Appropriation Supported Debt Service
by Fund Source
as of 12/31/07
(Fixed Rate Only)



Appropriation Debt Principal Outstanding
by Fund Source
as of 12/31/07
(Variable Rate Debt = Bond Anticipation Notes)



APPENDIX C

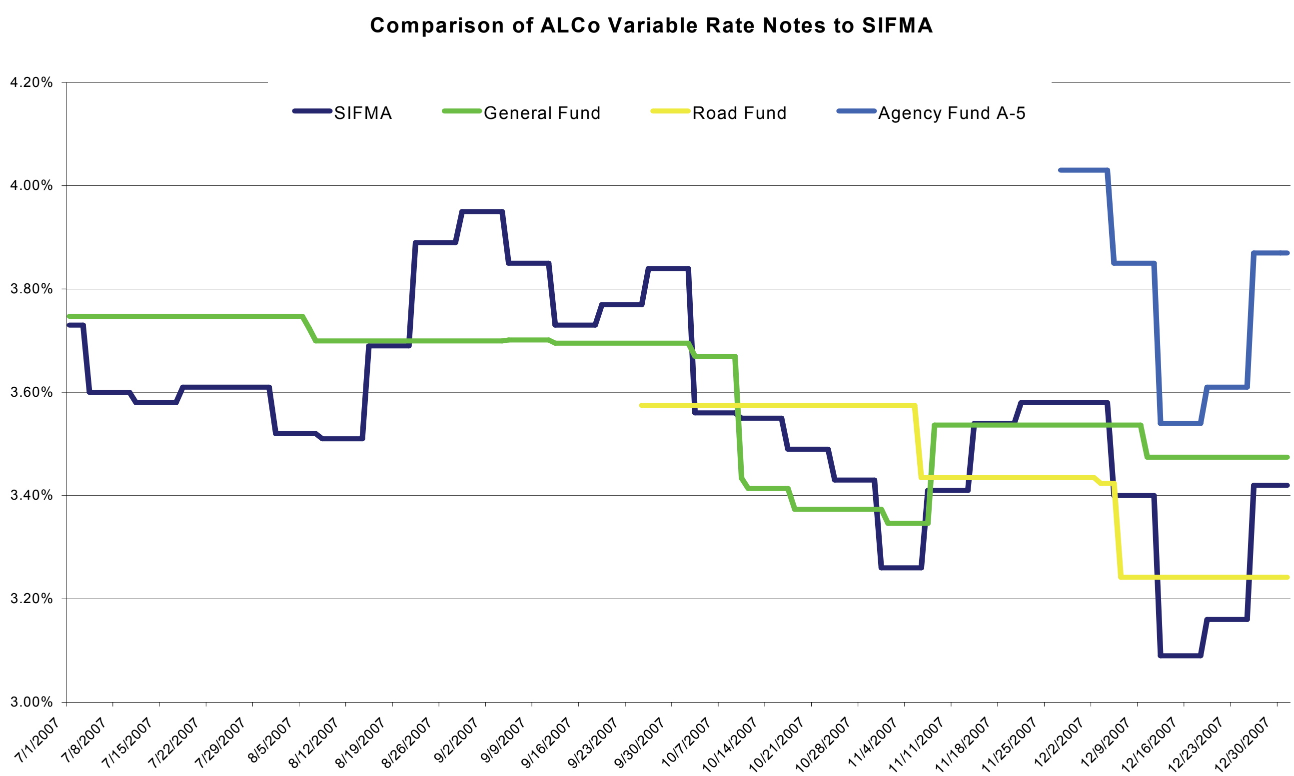
COMMONWEALTH OF KENTUCKY
ASSET/LIABILITY COMMISSION
SCHEDULE OF NOTES OUTSTANDING
as of 12/31/2007

FUND TYPE SERIES TITLE		AMOUNT ISSUED	DATE OF ISSUE	MATURITY DATE	PRINCIPAL OUTSTANDING
General Fund Project Notes					
2001 1st Series		$37,450,000	2/2001	2/2008	$6,095,000
2003 Series A		$171,260,000	7/2003	7/2013	$52,985,000
2005 1st Series		$81,850,000	6/2005	5/2025	$76,150,000
2005 2nd Series		$300,000,000	11/2005	11/2025	$200,000,000
2007 FRN		$243,080,000	5/2007	11/2027	$237,535,000
	FUND TOTAL	**$833,640,000**			**$572,765,000**
Agency Fund Project Notes					
2005 1st Series		$11,275,000	6/2005	6/2025	$10,890,000
2005 Series A-UK Gen Recpts		$107,540,000	11/2005	10/2025	$107,540,000
2006 Series A, B-UK Gen Recpts		$68,525,000	10/2006	10/2022	$65,630,000
2007 Series A-UK Gen Recpts		$77,905,000	11/2007	10/2027	$77,905,000
2007 Series B-UK Gen Recpts		$80,245,000	11/2007	10/2027	$80,245,000
2005 2nd Series:					
Series A-1	Econ Dev	$5,085,000	12/2005	4/2009	$0
Series A-2	UL	$10,530,000	12/2005	4/2009	$0
Series A-3	NKU	$14,750,000	3/2006	4/2009	$0
Series A-4	WKU	$2,665,000	6/2006	4/2009	$0
Series A-5	KY River Authority	$14,025,000	11/2007	4/2009	$14,025,000
	FUND TOTAL	**$392,545,000**			**$356,235,000**
Road Fund Project Notes					
2007 First Series		$150,000,000	9/2007	6/2028	$150,000,000
	FUND TOTAL	**$150,000,000**			**$150,000,000**
Federal Hwy Trust Fund Project Notes					
2005 1st Series		$139,635,000	6/2005	9/2017	$118,755,000
2007 1st Series		$277,910,000	9/2007	9/2019	$277,910,000
	FUND TOTAL	**$417,545,000**			**$396,665,000**
PROJECT NOTES TOTAL		**$1,793,730,000**			**$1,475,665,000**
TRAN 2007		$350,000,000	7/2007	6/2008	$350,000,000
	TRAN TOTAL	**$350,000,000**			**$350,000,000**

Kentucky Asset/Liability Commission
Outstanding Variable Rate Debt
Weighted Average Yields - Cost of Capital

December 31, 2007	2005 General Fund Second commercial paper			2007 Road Fund First commercial paper	2005 Agency Fund Second [1] SIFMA + 0.45% weekly reset
	Series A-1	Series A-2	**Total**	Series A	Series A-5
Program Size	*not to exceed $1,400,000,000*			*not to exceed $350 million*	*not to exceed $250 million*
Amount Issued	$150,000,000	$150,000,000	**$300,000,000**	$150,000,000	$14,025,000
Amount Outstanding	$100,000,000	$100,000,000	**$200,000,000**	$150,000,000	$14,025,000
Initial Date of Issue	2-Nov-05	2-Nov-05		25-Sep-07	27-Nov-07
Agency	- - -	various	- - -	Transportation	KY River Authority
Project Amount Authorized	- - -	$1,330,933,000	- - -	$350,000,000	$33,200,000
SIFMA	3.494%	3.494%		3.454%	3.335%
Average Notes Outstanding	$69,518,378	$68,359,442	**$137,877,820**	$150,000,000	$14,025,000
Inception Weighted Yields	3.476%	3.472%	**3.474%**	3.445%	3.785%
Cost of Issuance					0.109%
Remarketing Fee	0.050%	0.050%	**0.050%**	0.050%	-
Liquidity Facility Fee	0.075%	0.075%	**0.075%**	0.075%	-
Average Cost of Funds	**3.601%**	**3.597%**	**3.599%**	**3.570%**	**3.894%**

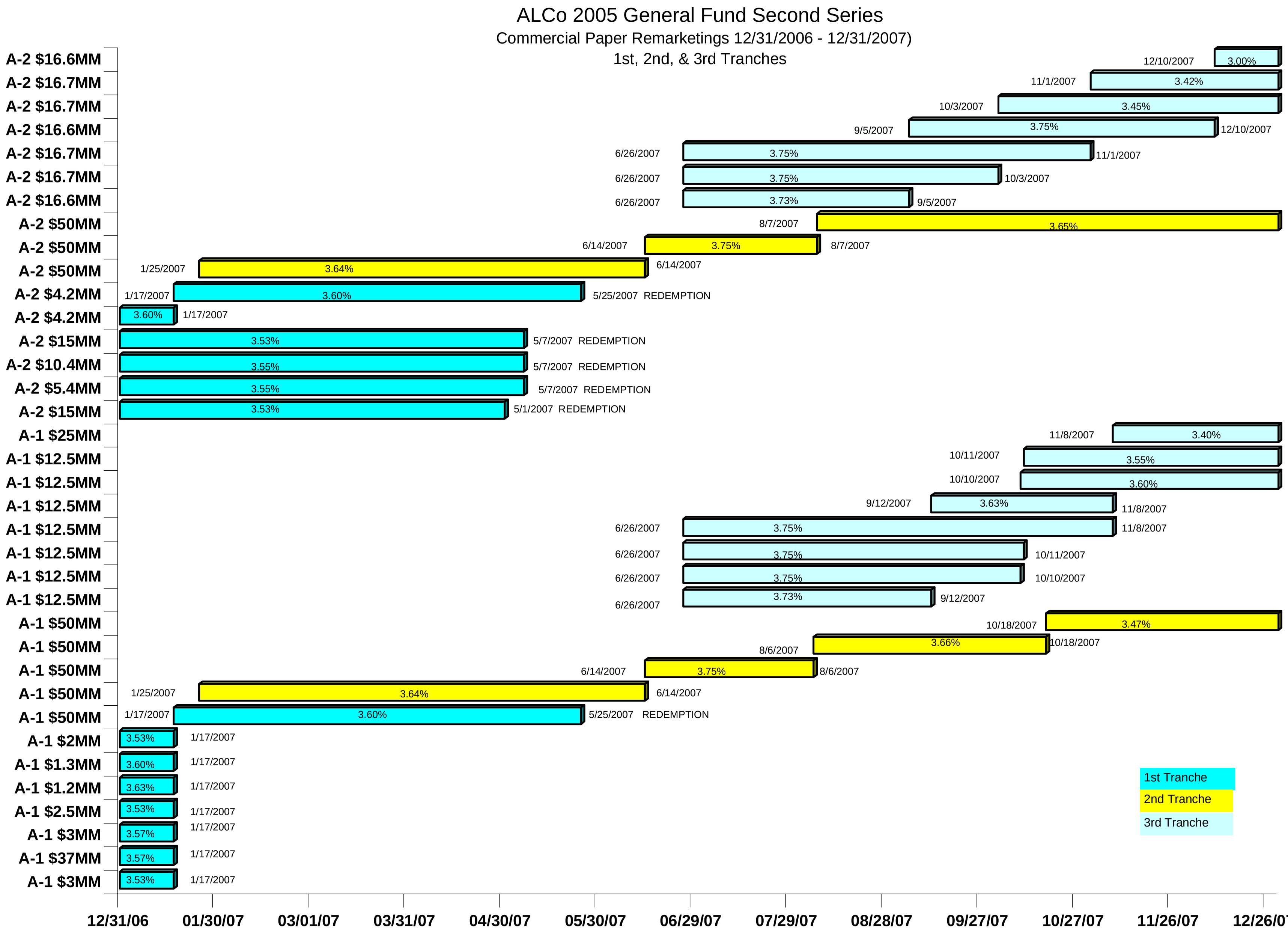
(1) Agency Fund 2005 Second Series:
Trustee fee of $6,000 distributed evenly to each series
Fees allocated as percentage of Total Authorized Amount for each respective project
Series A-5 has been rated A+ by S&P.



Kentucky Asset/Liability Commission
Redeemed Variable Rate Debt
Weighted Average Yields - Cost of Capital

December 31, 2007	**2005 Agency Fund Second** [1] **SIFMA + 0.45% weekly reset**	
	Series A-3	Series A-4
Program Size	*not to exceed $250 million*	
Amount Issued	$14,750,000	$2,665,000
Amount Outstanding	$0	$0
Initial Date of Issue	20-Mar-06	29-Jun-06
Agency	NKU	WKU
Project Amount Authorized	$14,750,000	$28,500,000
Final Redemption Date	7/5/2007	7/5/2007
SIFMA	3.598%	3.629%
Average Notes Outstanding	$8,997,863	$2,665,000
Inception Weighted Yields	4.048%	4.079%
Cost of Issuance	0.140%	0.117%
Remarketing Fee	-	-
Liquidity Facility Fee	-	-
Average Cost of Funds	**4.188%**	**4.197%**

(1) Agency Fund 2005 Second Series:
Trustee fee of $6,000 distributed evenly to each series
Fees allocated as percentage of Total Authorized Amount for each respective project
Each Series has been rated A1 by Moody's.


ALCo 2005 General Fund Second Series
Commercial Paper Remarketings 12/31/2006 - 12/31/2007)
1st, 2nd, & 3rd Tranches
A-2 $16.6MM
A-2 $16.7MM
A-2 $16.7MM
A-2 $16.6MM
A-2 $16.7MM
A-2 $16.7MM
A-2 $16.6MM
A-2 $50MM
A-2 $50MM
A-2 $50MM
A-2 $4.2MM
A-2 $4.2MM
A-2 $15MM
A-2 $10.4MM
A-2 $5.4MM
A-2 $15MM
A-1 $25MM
A-1 $12.5MM
A-1 $12.5MM
A-1 $12.5MM
A-1 $12.5MM
A-1 $12.5MM
A-1 $12.5MM
A-1 $12.5MM
A-1 $50MM
A-1 $50MM
A-1 $50MM
A-1 $50MM
A-1 $50MM
A-1 $2MM
A-1 $1.3MM
A-1 $1.2MM
A-1 $2.5MM
A-1 $3MM
A-1 $37MM
A-1 $3MM
12/10/2007 3.00%
11/1/2007 3.42%
10/3/2007 3.45%
9/5/2007 3.75% 12/10/2007
6/26/2007 3.75% 11/1/2007
6/26/2007 3.75% 10/3/2007
6/26/2007 3.73% 9/5/2007
8/7/2007 3.65%
6/14/2007 3.75% 8/7/2007
1/25/2007 3.64% 6/14/2007
1/17/2007 3.60% 5/25/2007 REDEMPTION
3.60% 1/17/2007
3.53% 5/7/2007 REDEMPTION
3.55% 5/7/2007 REDEMPTION
3.55% 5/7/2007 REDEMPTION
3.53% 5/1/2007 REDEMPTION
11/8/2007 3.40%
10/11/2007 3.55%
10/10/2007 3.60%
9/12/2007 3.63% 11/8/2007
6/26/2007 3.75% 11/8/2007
6/26/2007 3.75% 10/11/2007
6/26/2007 3.75% 10/10/2007
6/26/2007 3.73% 9/12/2007
10/18/2007 3.47%
8/6/2007 3.66% 10/18/2007
6/14/2007 3.75% 8/6/2007
1/25/2007 3.64% 6/14/2007
1/17/2007 3.60% 5/25/2007 REDEMPTION
3.53% 1/17/2007
3.60% 1/17/2007
3.63% 1/17/2007
3.53% 1/17/2007
3.57% 1/17/2007
3.57% 1/17/2007
3.53% 1/17/2007
12/31/06
01/30/07
03/01/07
03/31/07
04/30/07
05/30/07
06/29/07
07/29/07
08/28/07
09/27/07
10/27/07
11/26/07
12/26/07
1st Tranche
2nd Tranche
3rd Tranche

APPENDIX D

PROJECT LIST

General Fund supported Bonds Authorized by the General Assembly permanently financed within the reporting period.

State Property and Buildings Commission Revenue Bonds, Project No. 88

Agency	Project Title	Amount [1]
Commerce Cabinet		
	State Fair Board - Replace Roof for Pavilion	$1,250,000
	Kentucky Historical Society - Perryville Battlefield	617,000
Council on Postsecondary Education		
	Eastern Kentucky University - Science Complex	5,000,000
	Eastern Kentucky University - Manchester Postsecondary Education Center	9,000,000
	Morehead State University - NASA Space Science Center	12,200,000
	Morehead State University - Design Health Science Classroom Building	1,500,000
	KCTCS - Gateway CTC - Expand Edgewood Campus	15,477,000
	KCTCS - Jefferson Community College Building - Design	600,000
	KCTCS - Somerset Aviation	1,650,000
	KCTCS - Ashland Technology Center	18,030,000
Education Cabinet		
	Department of Education- Rockcastle County Vocational & Technical Center	1,500,000
	Department of Education- Education Technology Pool	50,000,000
Finance and Administration Cabinet		
	Commonwealth Office of Technology - UCJIS - Court Improvements (E-Warrants)	4,500,000
	Commonwealth Office of Technology - Data Center Readiness	1,400,000
	Department of Revenue - Collection System Interface Phase I	1,500,000
	Facilities and Support Services – Improve Site Infrastructure – Ky Capitol Complex II	6,000,000
	Facilities and Support Services - Renovate Ky State Office Building	13,600,000
Governor's Office for Local Development		
	Ky Infrastructure Authority - Infrastructure for Econ Dev Fund for Coal-Producing Counties	47,000,000 [2]
	Ky Infrastructure Authority - Infrastructure for Econ Dev Fund for Non-Coal Producing Counties	37,500,000 [2]
	Ky Infrastructure Authority - Infrastructure for Econ Dev Fund for Coal-Producing Counties	25,000,000 [2]
	KIA Fund A - Federally Assisted Wastewater Program	6,200,000 [3]
	KIA Fund F - Drinking Water Revolving Loan Program	6,600,000 [3]
	Owenton/Owen County Natural Gas Line Project	5,000,000
Governor's Office of Agricultural Policy		
	Agriculture Development Board - Kentucky Agriculture Finance Corporation - Loan Pool	5,000,000 [2]
Justice and Public Safety Cabinet		
	Department of Corrections - Renovate Lonnie Watson Building - KCIW	1,697,000
TOTAL		$277,821,000

(1) Excludes allocable costs of issuance.

(2) Less than full Authorization.

(3) 2005 and 2006 Authorizations.