Semi-Annual Report of the Kentucky Asset/Liability Commission

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For the period ending June 30, 2015

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-seventh semi-annual report pursuant to KRS 56.863 (11) for the period beginning January 1, 2015 through June 30, 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 strong economic growth trend in 2014 weakened during the first quarter of 2015, partly due to weather, but rebounded during the second quarter and appears poised to strengthen during the second half of the year.
- A great deal of uncertainty was generated during the year from international events, primarily Greece. At the end of fiscal year, Greece appeared to be on the brink of default and expulsion from the Euro Zone. Temporary solutions were agreed to in July.
- Consumer spending demonstrated an upward trend during the first half of 2015 as the impact of lower gas prices and gradually increasing real hourly wages were felt. This trend looks likely to accelerate in the second half of the year.
- Speculation was rampant during the first half of the year regarding the timing of the Federal Reserve's interest rate normalization by raising the fed funds rate above zero. While the first increase has not been implemented, most believe an increase will happen in CY 2015 after almost a decade at near zero rates.

On the state level

- General Fund receipts totaled $9.966 billion for Fiscal Year (FY) 2015. General Fund receipts increased 5.3% for FY 2015 over the same period in FY 2014. General Fund receipts for FY 2015 were $165.4 million, or 1.7%, more than the official revenue estimate which projected 3.6% growth.
- Road Fund receipts for FY 2015 totaled $1.527 billion. Road Fund receipts decreased 2.2% for FY 2015 over the same period in FY 2014. Road Fund receipts for FY 2015 fell short of the official revenue estimate by $20 million, or 1.3%.
- Kentucky's seasonally adjusted unemployment rate stood at 5.1% at the end of June 2015, down from 7.4% one year ago.
- Implementation of bond authorizations from prior-year sessions of the General Assembly continues and is coming to a close as projects reach completion.

INVESTMENT MANAGEMENT

MARKET OVERVIEW

The Bureau of Economic Analysis seasonally adjusts the quarterly real gross domestic product growth statistics. This seasonal adjustment should eliminate the effect of snow and ice storms reducing first quarter economic activity. However, in 15 of the last 29 years, the first quarter growth rate is the slowest quarter during the year. This year looks to repeat the pattern. After growth averaged nearly 3.7% for the last 9 months of 2014, the rate of growth fell to only 0.6% during the first quarter of calendar 2015. The rate bounced to 3.7% in the second quarter and appears poised for strong growth through the rest of the year.

There were three primary themes running through the economy during the six months ended June 30. First, the drop in energy prices plus the strength of the dollar during 2014 was expected to feed into declining industrial production quickly, to be offset later by growth in consumption as consumers began spending money saved at the gas pumps. Second, when will the Federal Reserve raise interest rates? And finally, will the turmoil in Greece and Europe further damage the world economy?

On the first topic, oil prices were relatively stable during the six months ended June 30, while the dollar continued to appreciate. A drop in oil prices normally translates quickly into a reduction in capital investment by the oil drilling and related industry and that is what happened. As shown on the Industrial Production chart on page 9, production declined every month from January through May with some rebounding in June. An interest point is that mining production dropped rapidly while other manufacturing did not do as badly. The Coal Production chart on page 10 shows the decline in coal mining during the relevant time period.

As mentioned earlier, the drop in energy prices rapidly impacts capital spending decisions by companies but impacts individual spending decisions slower as people "get used" to lower gas prices. This is clearly shown in the personal consumption index. This is the broadest measure of consumption covering roughly 70% of the overall economy. Consumption had been growing since about 2012 but experienced a drop in the 1st quarter of 2015 (primarily weather related). It bounced back quickly in the 2nd quarter and is expected to continue to grow through second half of the year.

The second theme over the past 6 months concerns the timing of the Federal Reserve's action to "lift off" rates from emergency levels. In December of 2008, during the worst of the financial crisis, the Federal Open Market Committee (FOMC) dropped fed funds to emergency levels of between 0% and 0.25% and have held them there ever since. The Fed has been preparing the market for first steps towards normalizing the rates. At the beginning of the year, most people believed that the first move up would occur in March or June and the ultimate target was 3.0%. However, first quarter weakness has pushed that timeframe back. Most, not all, economists are predicting a first move in September with a final target of 2.5% to 2.75%. (The significance of the months is driven by meeting with a press conference, not quarter ends.) This theme will continue through the rest of the year.

The third theme driving the markets is the economic turmoil coming from Greece. It has become apparent that Greece was spending considerably more than they could afford for an extended period of time. The financial crisis brought the situation to light. Since then, Europe has developed a series of bailout packages matched to austerity measures to try

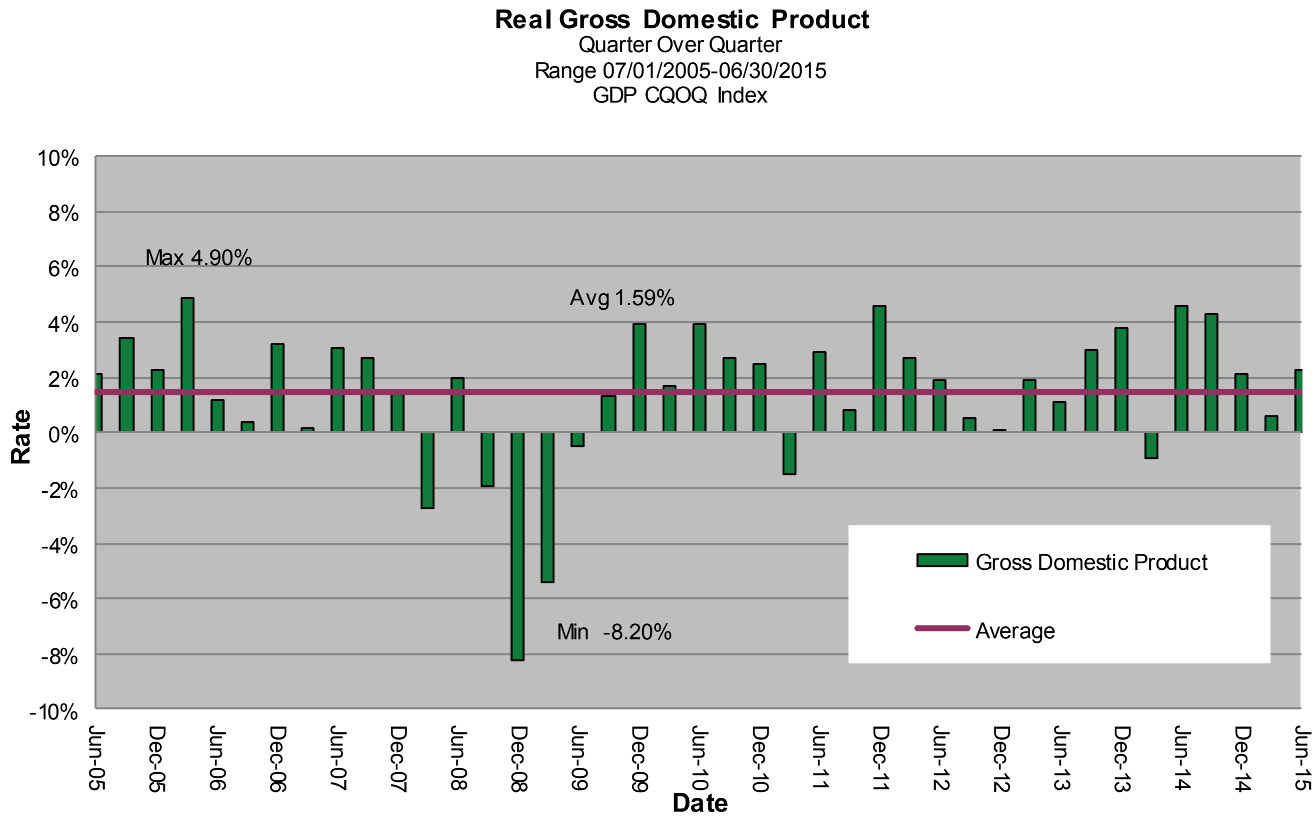
INVESTMENT MANAGEMENT

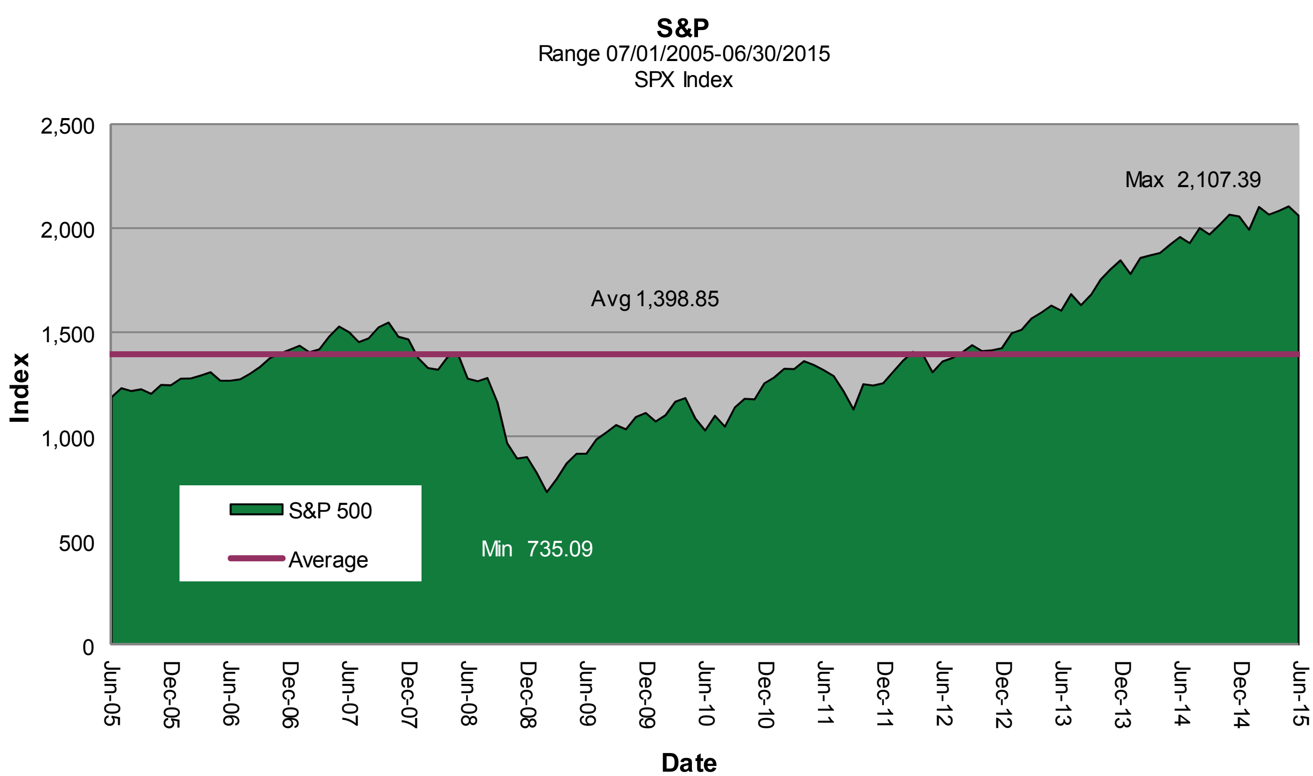
to salvage the Greek economy. So far, they have not succeeded. The situation was approaching a breaking point at June 30 as speculation of a default by Greece are countered by threats to eject them from the European Currency Union. (A temporary resolution to this situation was agreed to in July.)

One other encouraging factor during the past six months is the growth in hourly earnings. As part of the monthly employment report, the Labor Department also reports on average hourly earnings. This statistic is very volatile with the month over month percentage change ranging from -0.2% to 0.6% over the last 10 years. The encouraging point is that on a smoothed basis, the 6 month average has stepped meaningfully over 0.2% for the first time since 2009. When matched with fallen gas prices, this bodes well for the economy going forward.

INVESTMENT MANAGEMENT

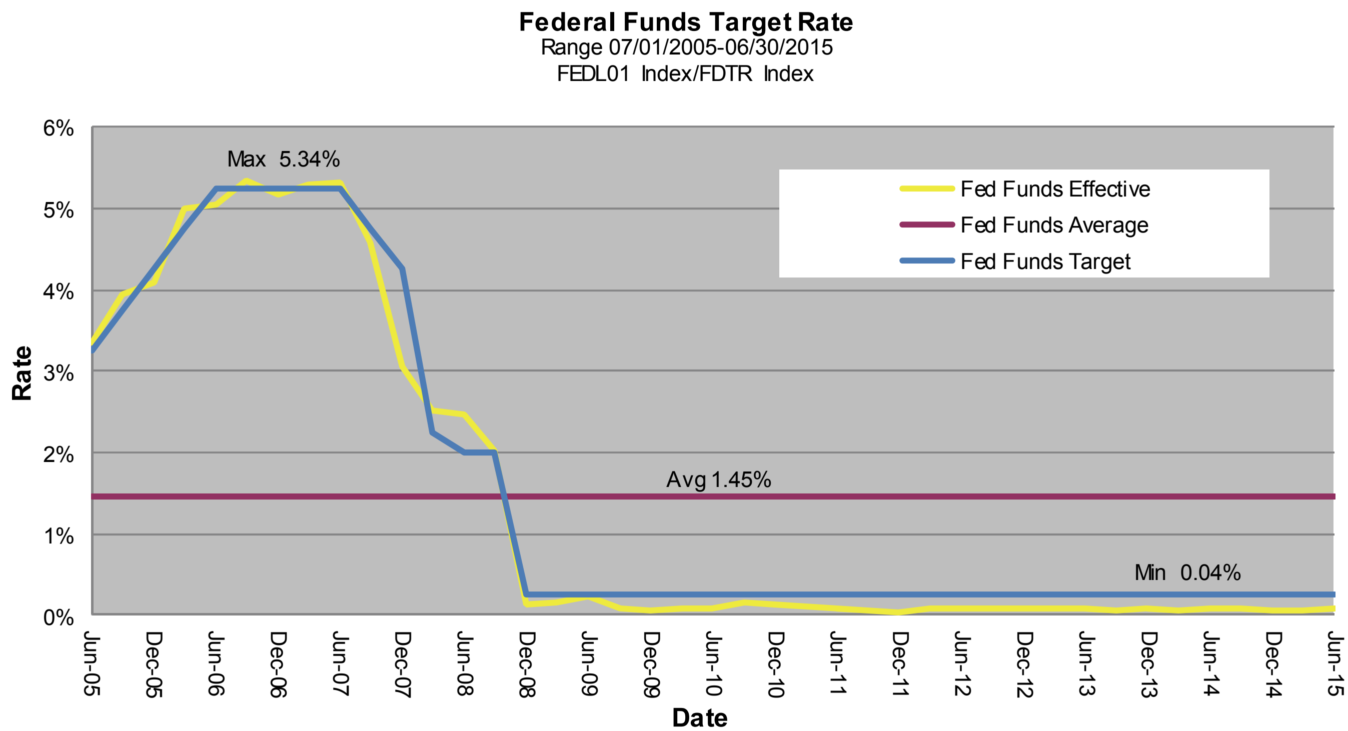
Real Gross Domestic Product & S&P 500

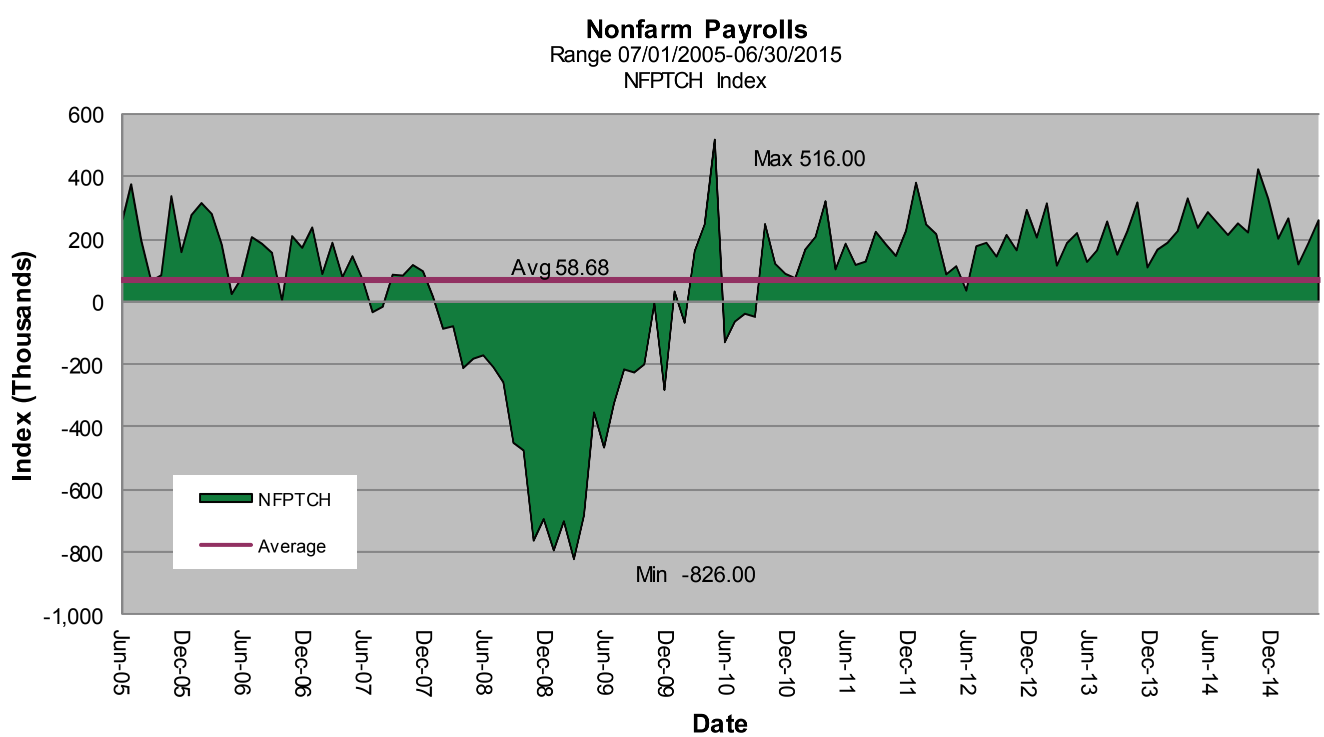




INVESTMENT MANAGEMENT

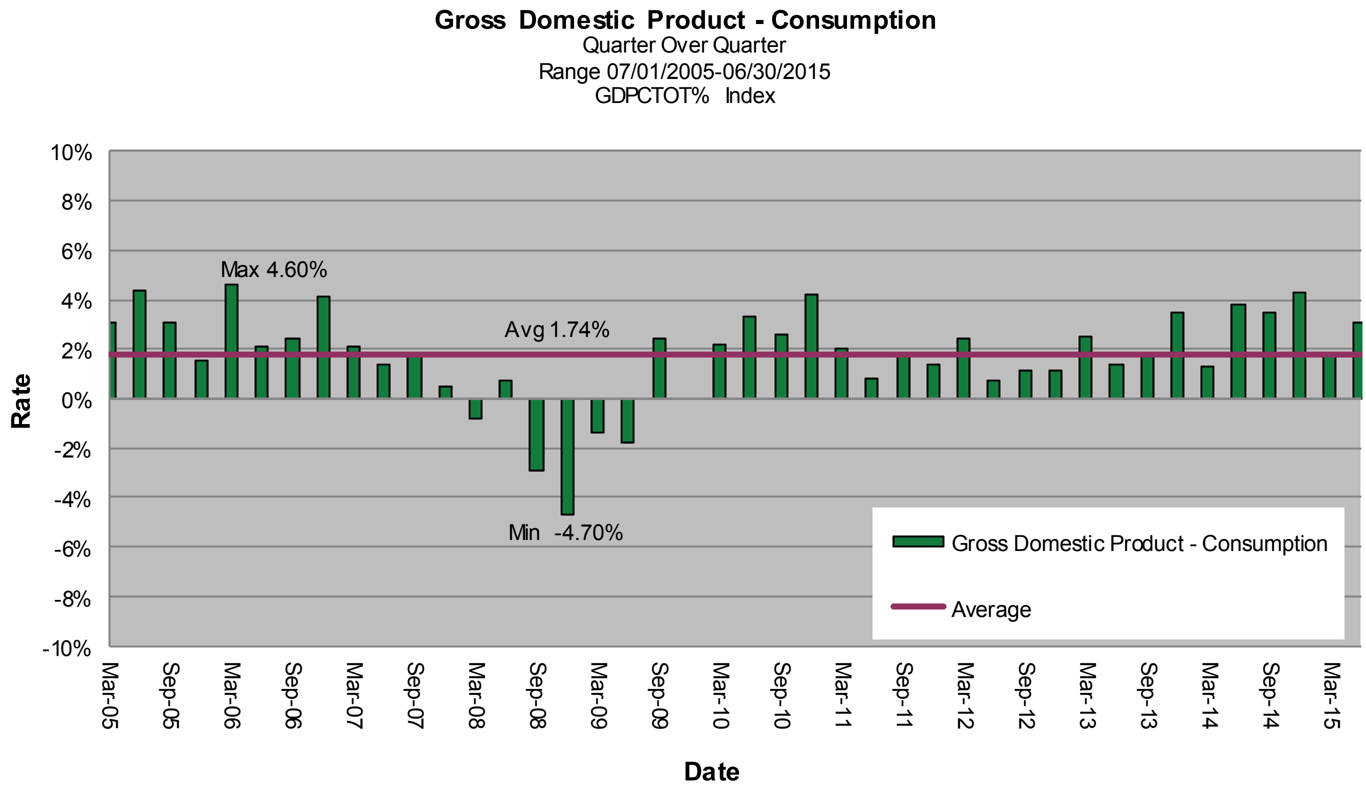
Federal Funds Target Rate & NonFarm Payrolls

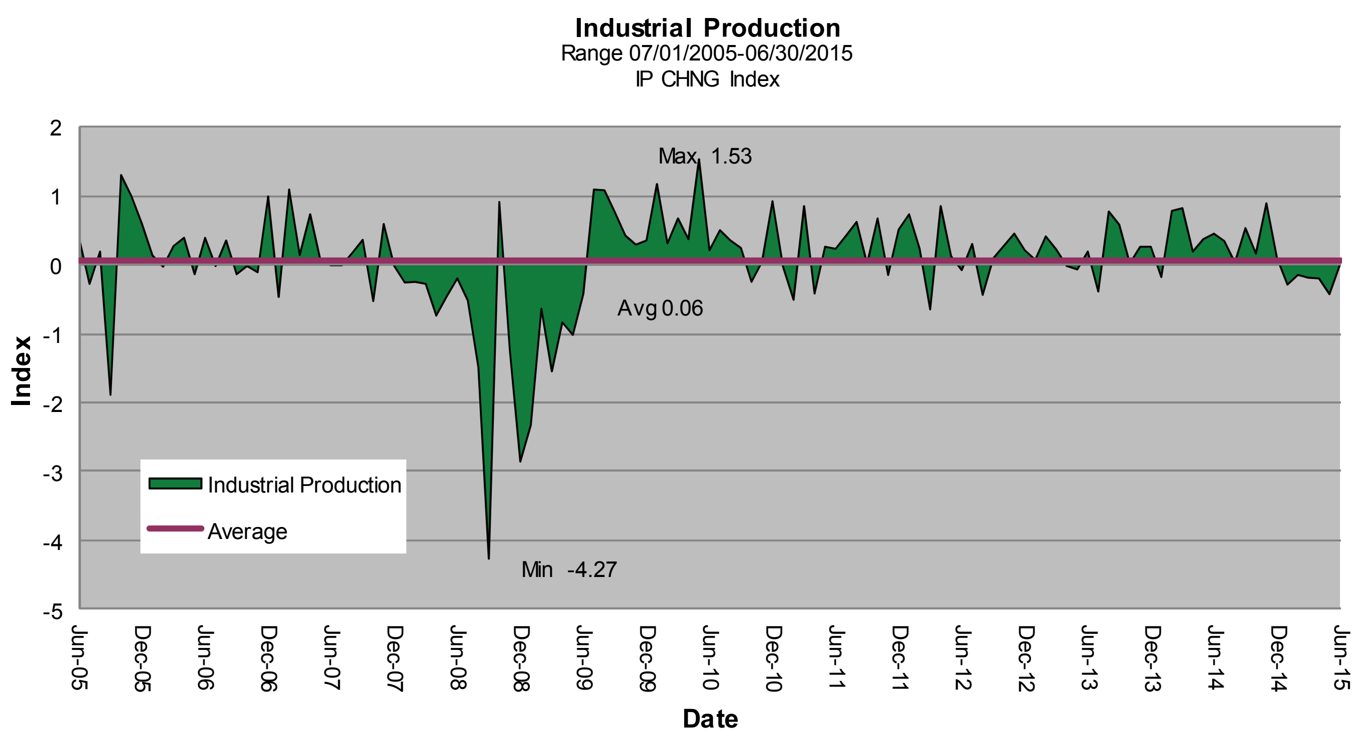




INVESTMENT MANAGEMENT

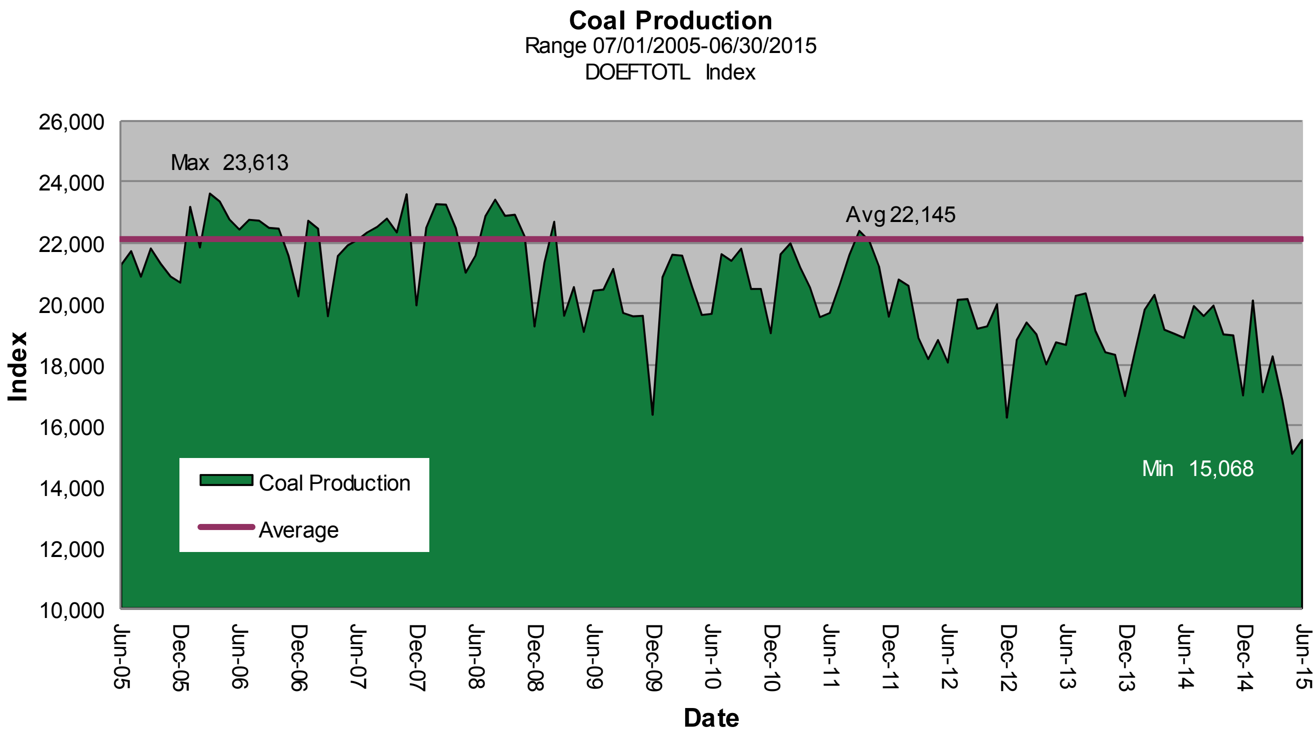
GDP & Industrial Production

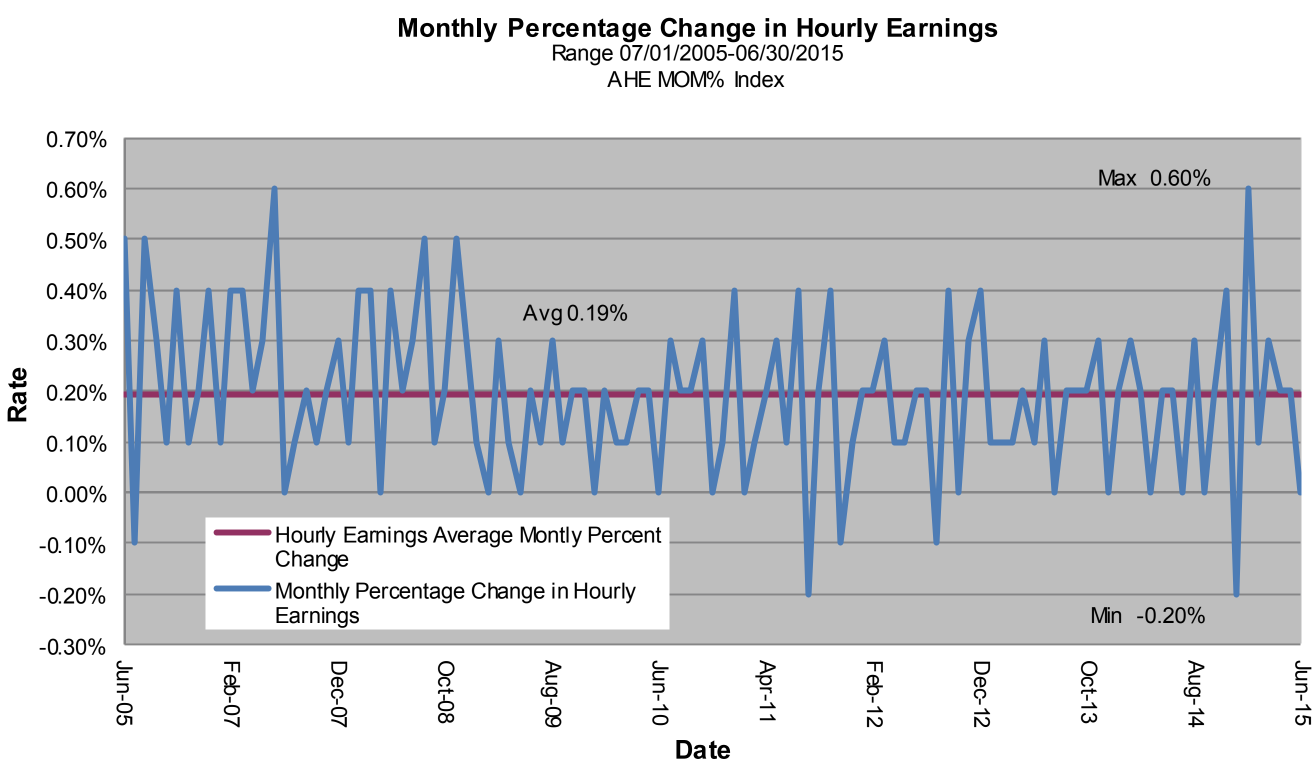




INVESTMENT MANAGEMENT

Coal Production & Hourly Earnings





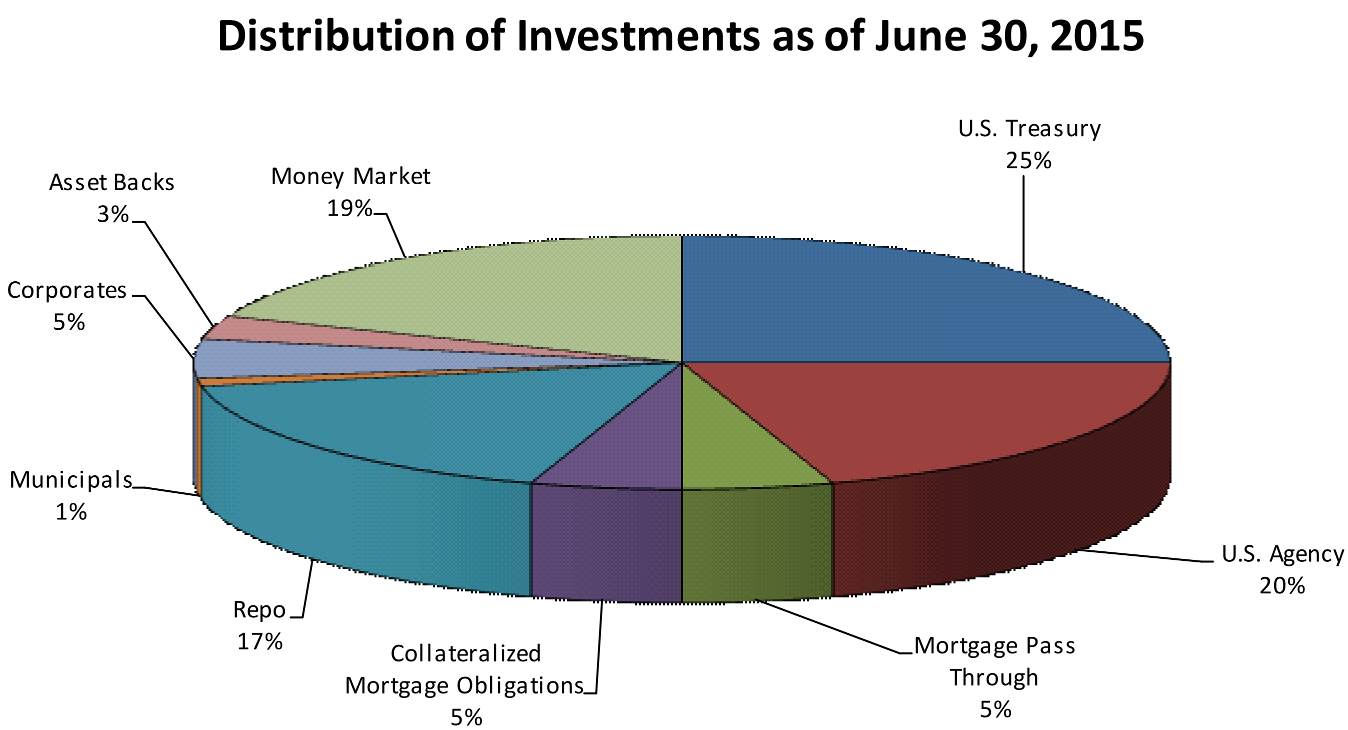
INVESTMENT MANAGEMENT

PORTFOLIO MANAGEMENT

For fiscal year 2015, the Commonwealth's investment portfolio averaged $3.6 billion. As of June 30, 2015, the portfolio was invested in U.S. Treasury Securities (25 percent), U.S. Agency Securities (20 percent), Mortgage Pass Through Securities (5 percent), Collateralized Mortgage Obligations (5 percent), Repurchase Agreements (17 percent), Municipal Securities (1 percent), Corporate Securities (5 percent), Asset-Backed Securities (3 percent), and Money Market Securities (19 percent). The portfolio had a market yield of 0.39 percent and an effective duration of 0.61 years.

The total portfolio is broken down into four investment pools. The pool balances as of June 30, 2015, were: Short Term Pool—$379 million, Limited Term Pool—$1,461 million, Intermediate Term Pool—$2,168 million, and Bridges Pool - $233 million.

For fiscal year 2015, total investment income was $17.5 million compared to $19.7 for fiscal year 2014.

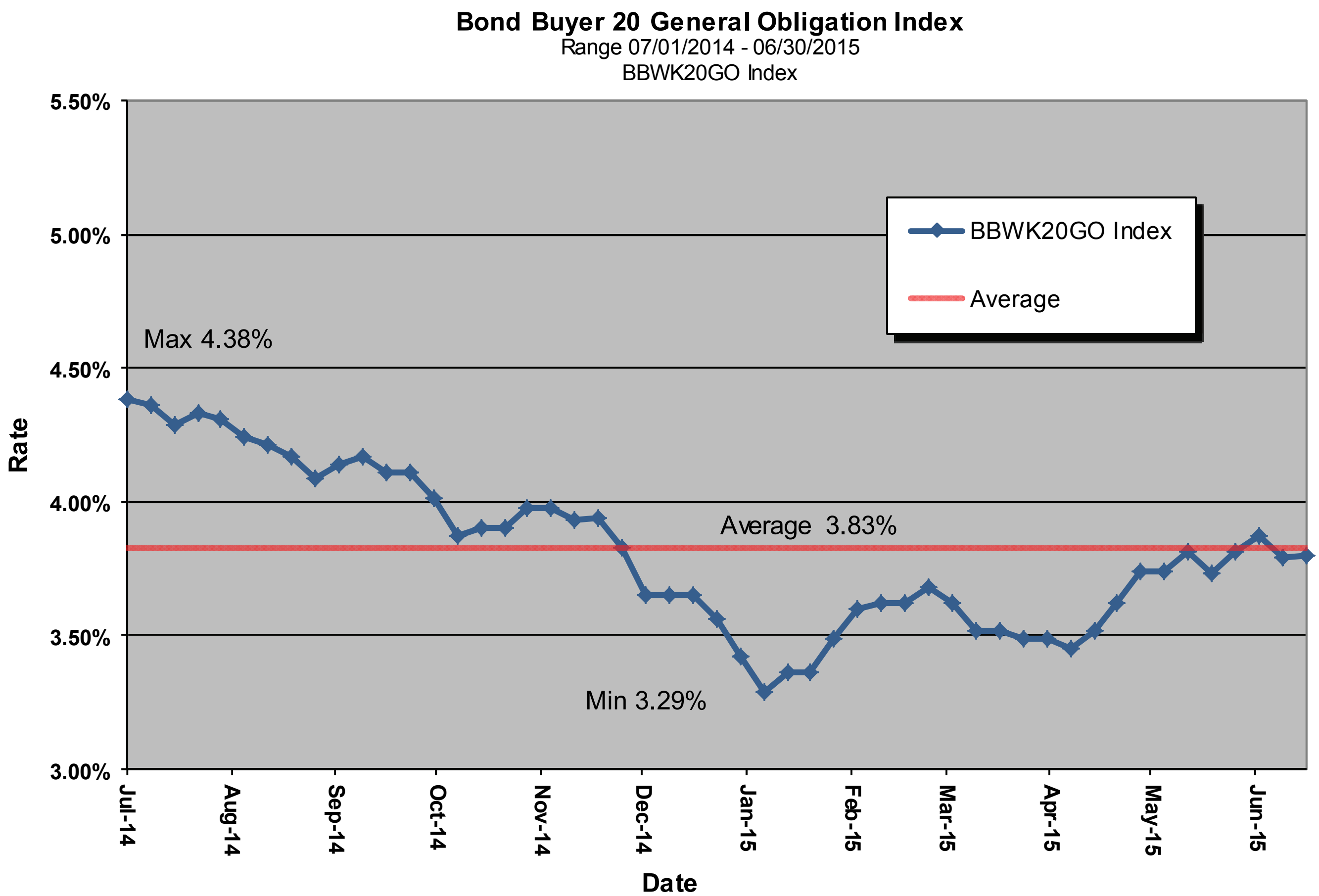


INVESTMENT MANAGEMENT

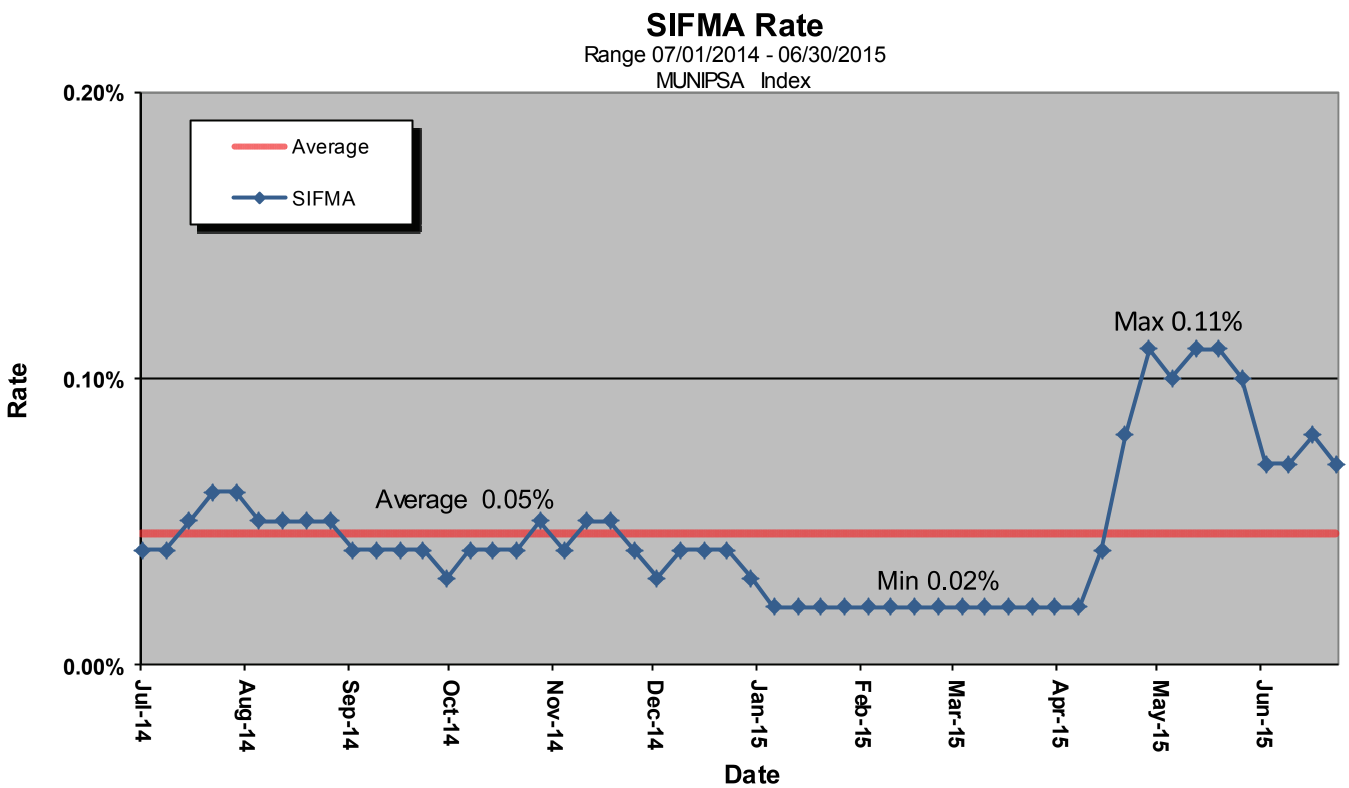
Tax-Exempt Interest Rates and Relationships

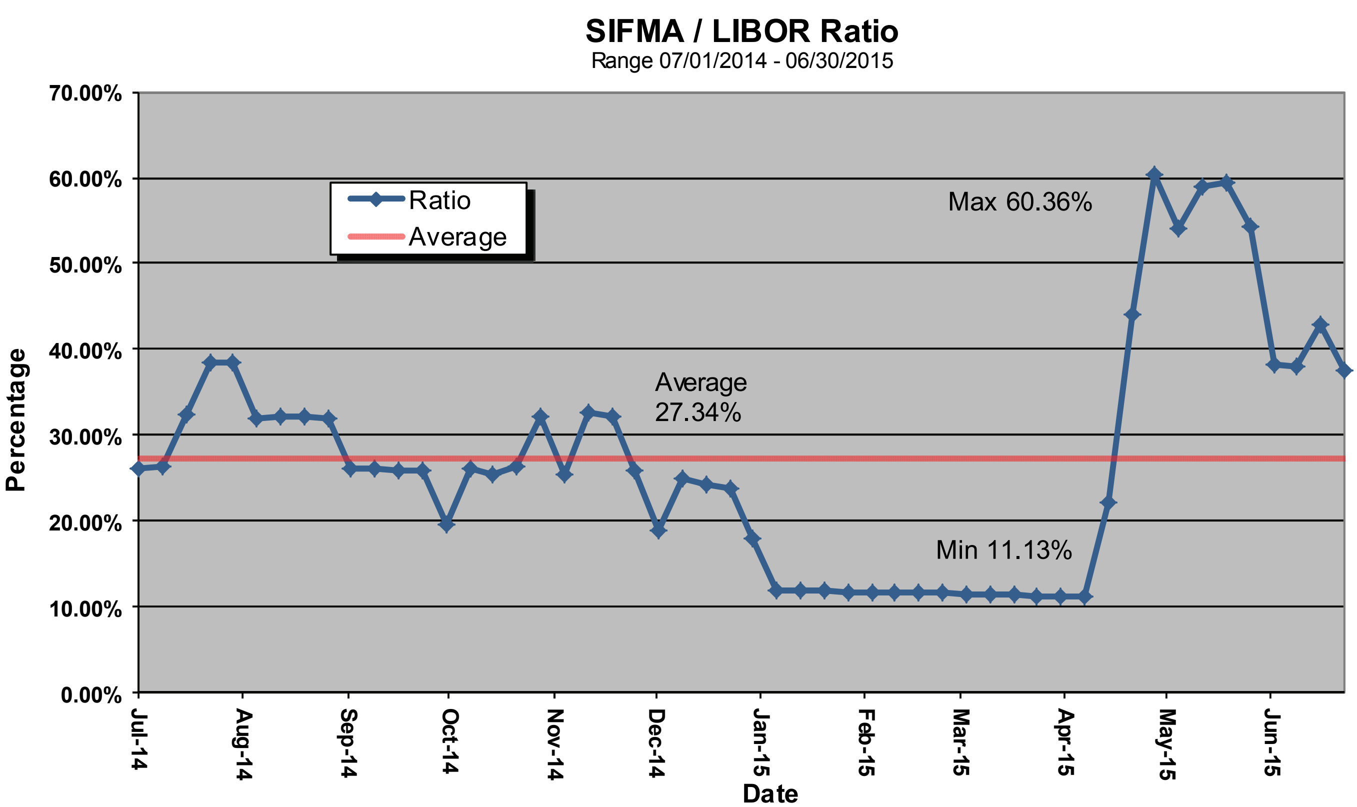
The Bond Buyer 20 General Obligation Index averaged 3.83% for Fiscal Year 2015. The high was 4.38% in July 2014 and the low was 3.29% in January 2015.

The Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index averaged 0.05% for Fiscal Year 2015. The high was 0.11% in May 2015; the low was 0.02% in the third quarter of Fiscal Year 2015. The 30-day USD London Interbank Offered Rate (LIBOR) averaged 0.167% for Fiscal Year 2015. The high was 0.187% in June of 2015 and the low was 0.152% in both July and October of 2014. During the year, SIFMA traded at a high of 60.36% of the 30-day LIBOR in April 2015, at a low of 11.13% also in April 2015, and at an average of 27.34% for the Fiscal Year. The Fiscal Year ended with SIFMA at 37.51% of the 30-day LIBOR.



SIFMA & SIFMA/LIBOR Ratio





CREDIT MANAGEMENT

MID-YEAR REFLECTION

Remaining Year Outlook

After the transitional year of 2014, 2015 is setting up to be an inflection point for Investment Grade ("IG") credit investors, as mounting headwinds and fading tailwinds create a more volatile environment. A binary outcome for credit spreads seems possible as we expect better growth and tame inflation to provide economic support to some credits, while lower energy and metal prices are likely to weigh heavily on commodity based sectors and countries. With spreads wider compared to end of 2014, the potential for a recovery is greater; however, underlying fundamentals and technicals suggest the market is still struggling under the weight of record supply and a rapidly shifting macro backdrop.

On average, IG spreads look most likely to finish 2015 a bit wider than where they started the year (+15-20 bps to 140-145 bps), but within the full-year breakeven. Spreads could widen toward 185 bps if fundamentals deteriorate significantly; conversely, spreads could snap back toward 120 bps if slow growth and low inflation allow for global central banks to maintain easy monetary policy.

Despite projections for continued economic growth in 2015, corporate credit fundamentals continue to erode as the drivers of growth shift from commodity producers to commodity users while shareholder friendly activity pushes leverage higher. Household consumption should get a boost due to lower energy prices, and low inflation should keep bond yields in check with the Fed in "go-slow" mode. However, rates are expected to rise this year with the Fed likely to tighten policy in September or December and U.S. Treasury 10-year yields expected to rise modestly toward 2.8% by year end. As result, corporate America is likely to remain on a borrowing binge that drives debt-fueled spending and weighs on balance sheets. Greater sector dispersion and greater spread volatility should be expected in this environment. The combination of higher yields and wider spreads suggests that IG corporate credit is likely to generate a negative total return over the course of the full year and an excess return to Treasuries of about 10bps.

IG corporate bond issuance in 2015 is likely to reach a new record of $1.2 trillion, topping $1.0 trillion for the fourth consecutive year as M&A activity, share buybacks and capital spending are all funded with low cost debt financing. With about $575 billion of debt scheduled to mature and an additional $175 billion in coupon flow, institutional and retail demand should be sufficient to meet the remaining requirements of issuers.

Corporate Credit Fundamentals

The credit quality of the nonfinancial corporate sector remains healthy overall, despite having deteriorated slightly since late 2011. Corporate debt levels have been hitting record highs as companies take advantage of the low yield environment to fund increased capital investment and shareholder remuneration, including dividends and share buybacks. As a result, leverage has been trending higher during the past two years.

This increase in leverage is mitigated by several factors. First, much of the corporate releveraging is occurring in industries with the balance sheet strength to absorb higher debt levels, such as pharmaceuticals and technology. Second, corporate liquidity remains strong with cash balances at historic highs, low financing costs supporting healthy interest-coverage ratios, and near-term debt maturities having been refinanced with longer-dated issues. Finally, profit margins are hovering near post crisis peaks, enabling profitability to remain strong on modestly growing revenues.

CREDIT MANAGEMENT

CREDIT PROCESS

OFM 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.

Default Monitoring

The Bloomberg credit risk model is our main tool for default monitoring. The default likelihood model is based on the Merton 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 the approved list and their peers enabling us to track market activity in selected names including Credit Default Swaps (CDS).

Industry/Company Analysis

OFM uses 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. During the first six months of 2015, we've added Texas Instruments, Home Depot and Costco. We've removed Sumitomo Corp, McDonald's, Barclays Capital and Deutsche Bank Ag due to downgrades. 3M Co, Google, UPS, Travelers, Colgate-Palmolive and Honeywell International were removed because these companies are very strong financially and they do not issue enough debt. The Approved List as of June 2015 may be found in Appendix A.

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 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 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, Agency Restricted Fund, and Federal 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 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, $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 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.

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 Phase I E-Case and Docket Management system capital project totaling $28.1 million to be issued through Kentucky State Property and Buildings Commission or the Kentucky Asset/Liability Commission. An interim loan through the State's Master Lease program has been put in place for a portion of this authorization until the project is ready for permanent financing.

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

DEBT MANAGEMENT

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.

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 bond authorizations of the General Assembly prior to and including the 2015 Regular Session totals $1,783.73 million. Of these prior authorizations, $834.44 million is General Fund supported, $551.79 million is Agency Restricted Fund supported, $217.5 million is supported by Road Fund appropriations and $180 million is Federal Highway Trust Fund supported. The table below summarizes, in aggregate, the information in connection with authorized but unissued debt of the Commonwealth as of June 30, 2015.

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.

Summary of Authorized but Unissued Debt by Fund Type
as of June 30, 2015

Legislative Session (Year)	General Fund (millions)	Agency Fund (millions)	Road Fund (millions)	Federal Fund (millions)	TOTAL (millions)
2010 and prior	$58.95	$17.50	$200.00	$180.00	$456.44
2012	18.17	0.00	12.50		30.67
2013		37.70			37.70
2014	624.82	496.59	5.00		1,126.42
2015	132.50				132.50
TOTAL	$834.44	$551.79	$217.50	$180.00	$1,783.73

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. Unemployment and the softening in the national and state economies over the past few years in addition to pension unfunded liabilities questions have continued to put pressure on the Commonwealth's credit ratings.

In June 2015, Standard & Poor's (S & P) lowered the Turnpike Authority of Kentucky bonds from AA+ to AA. The cause for the change was cited as lower available revenue and coverage as a result of declining oil prices and tax changes and S&P's view that lawmakers in Kentucky have yet to make meaningful progress in addressing its long-term pension liability profile. Except as discussed above, during the reporting period, the ratings below were either affirmed or remained unchanged from previous reporting periods.

The ratings picture as of June 30, 2015 is:

ACTIVE DEBT ISSUING ENTITIES

ENTITY	STATUTORY AUTHORITY/PURPOSE	DEBT LIMITATIONS	RATINGS*
State Property and Buildings Commission	**KRS 56.450** Provide financing for capital construction projects and financing programs approved by the General Assembly.	Cannot incur debt without prior approval of projects and appropriation of debt service by General Assembly.	Aa3/A+/A+
Kentucky Asset/Liability Commission	**KRS 56.860** Provide financing of capital projects and cash flow borrowings to meet working capital needs of the state.	Cannot incur debt without prior approval of projects and appropriation of debt service by General Assembly, exclusive of cash flow borrowings within a fiscal year.	Varies
Turnpike Authority of Kentucky	**KRS 175.410-175.990** Construct, maintain, repair, and operate Turnpike projects, resource recovery roads and economic development roads.	Cannot incur debt without prior approval of projects and appropriation of debt service by General Assembly	Aa2/AA/A+

* Ratings, where applicable, include Moody's, Standard & Poor's, and Fitch. Certain State Property and Buildings Commission Agency and Road Fund Revenue Bonds may have ratings different from those identified above.

* On February 18, 2014, Moody's downgraded certain stand-alone GARVEEs, issued by the Kentucky Asset/Liability Commission, backed by appropriations from the Federal Highway Trust Fund from "Aa3" to "A1" with a negative outlook. On June 16, 2014, Moody's downgraded certain GARVEEs, issued by the Kentucky Asset/Liability Commission, backed by appropriations from the Federal Highway Trust Fund from "A1" to "A2" and changed the outlook from negative to stable.

* On June 15, 2015, Standard & Poor's downgraded the Turnpike Authority of Kentucky's Road Fund appropriation-supported obligations from "AA+" to "AA"

DEBT MANAGEMENT

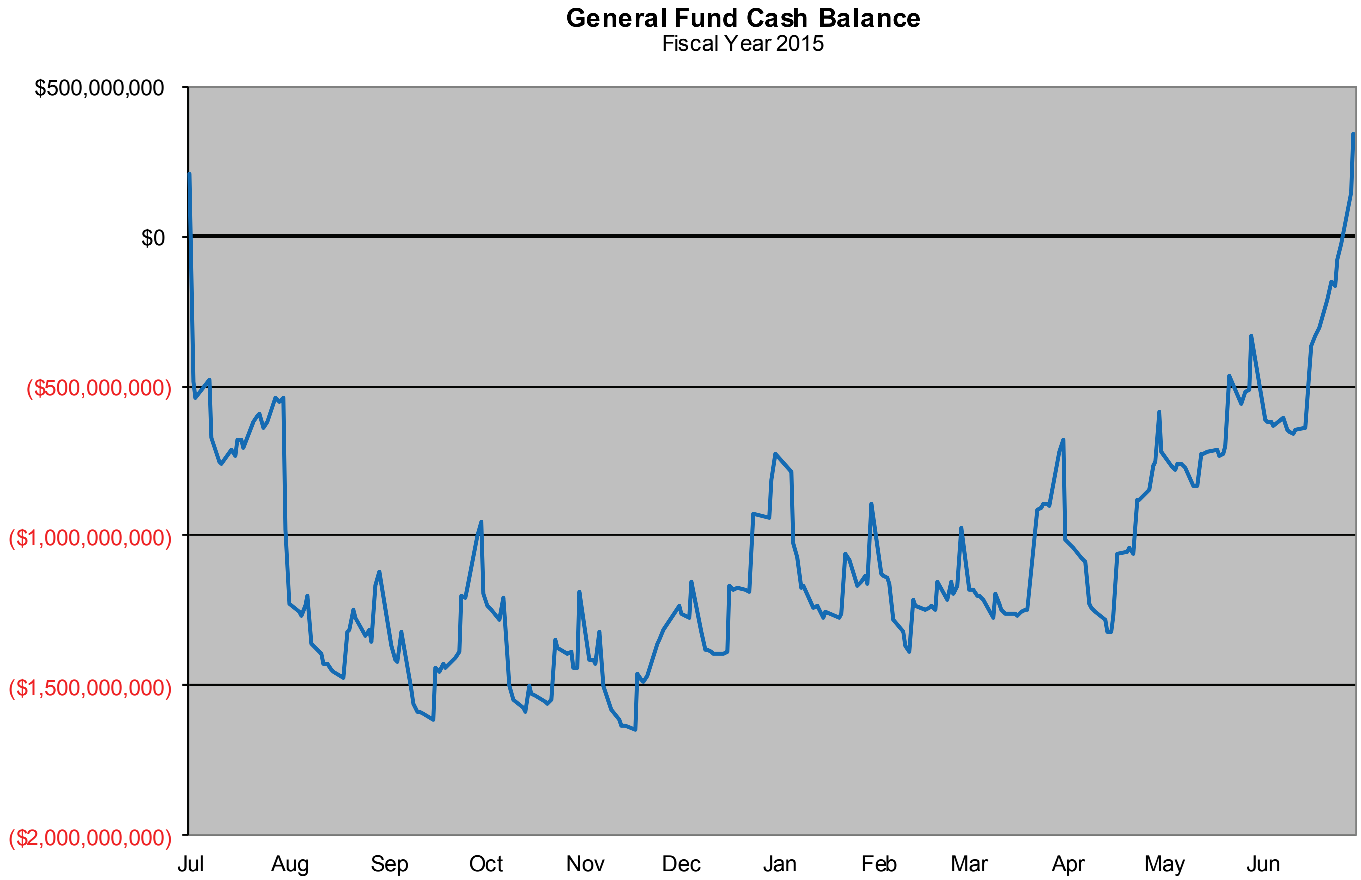
Tax and Revenue Anticipation Notes (TRAN)

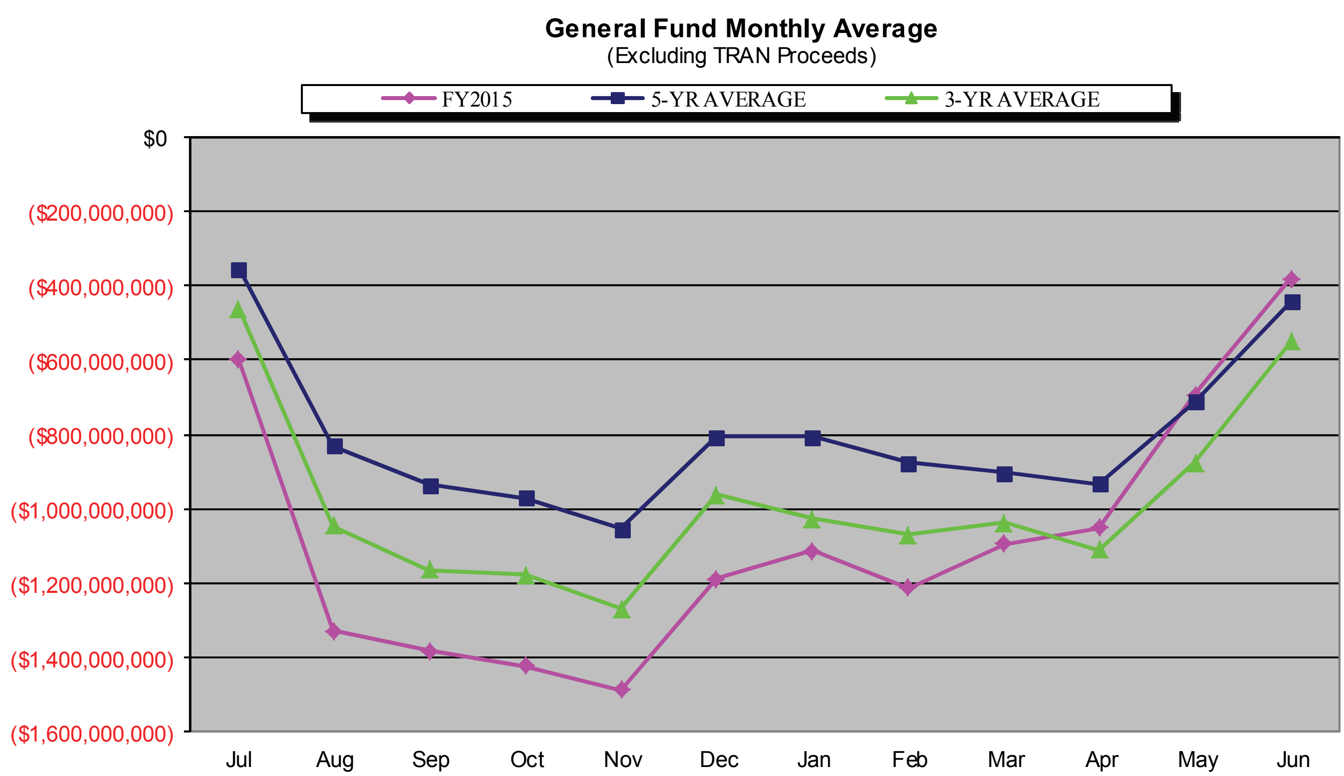
No General Fund TRAN was issued for Fiscal Year 2015. As in the previous five fiscal years, current reinvestment yields on TRAN proceeds would not be significantly higher than the cost of funds for a TRAN. At this time, borrowing internally from the state investment pools continues to be the most efficient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

($ in millions)

DEBT MANAGEMENT





DEBT MANAGEMENT

FINANCIAL AGREEMENTS

As of June 30, 2015, ALCo had four financial agreements outstanding, with a net notional exposure amount of $198.325 million. These financial agreements are described in the section below and the terms of these transactions are detailed in Appendix B. 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 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 downgraded Deutsche Bank senior long-term debt and deposit ratings from A2 to A3 in July 2014. This rating was reaffirmed in May 2015. In June 2015, S&P downgraded the Deutsche Bank AG long-term rating to BBB+ from A and the short-term rating to A-2 from A-1.

Details related to the interest rate swaps as of June 30, 2015 are presented in Appendix B.

DEBT MANAGEMENT

ASSET/LIABILITY MODEL

General Fund

The total SPBC debt portfolio as of June 30, 2015 had $3.754 billion of bonds outstanding with a weighted average coupon of 5.11 percent and a weighted average life of 6.79 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 $1.142 billion callable portion had a weighted average coupon of 5.10 percent.

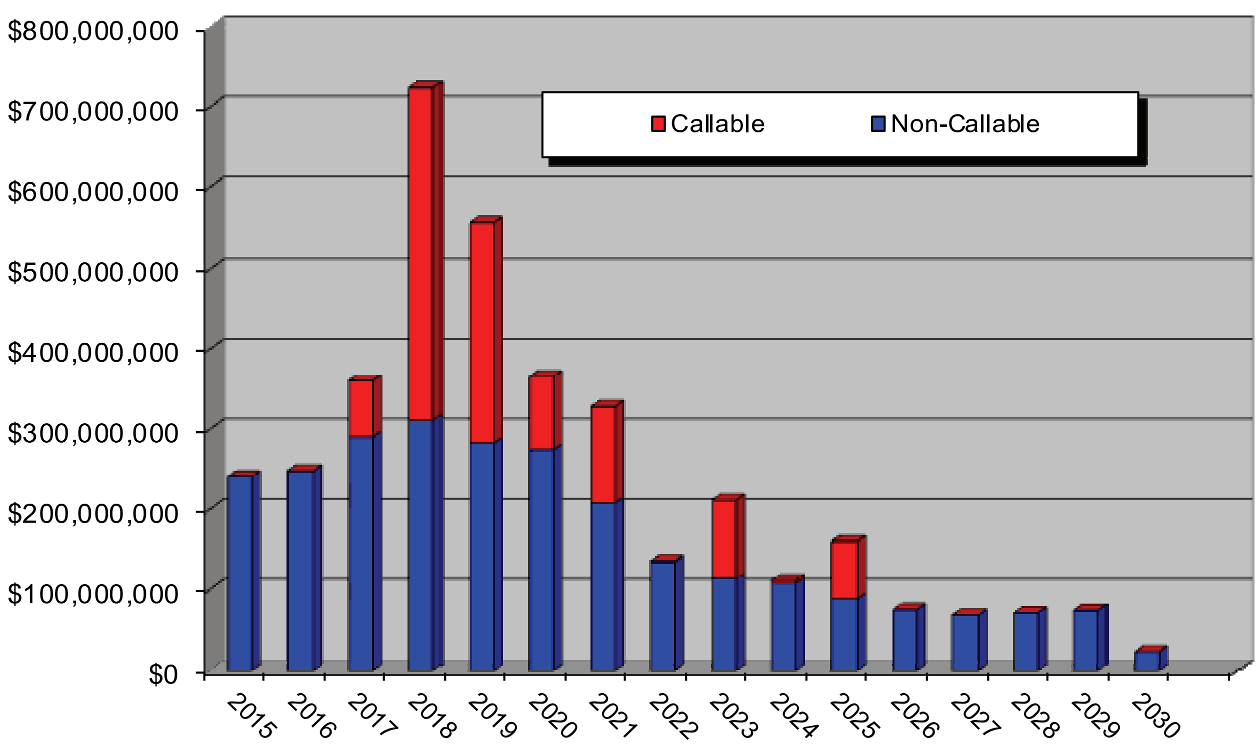
The SPBC debt structure has 39 percent of principal maturing in 5 years and 78 percent of principal maturing in 10 years. The ratios are outside of the rating agencies' proposed target of 27-30 percent due in 5 years and 55-60 percent maturing within 10 years.

The General Fund had a high balance of $348.2 million at the end of Fiscal Year 2015 and a low of negative $1.651 billion on November 17, 2014.

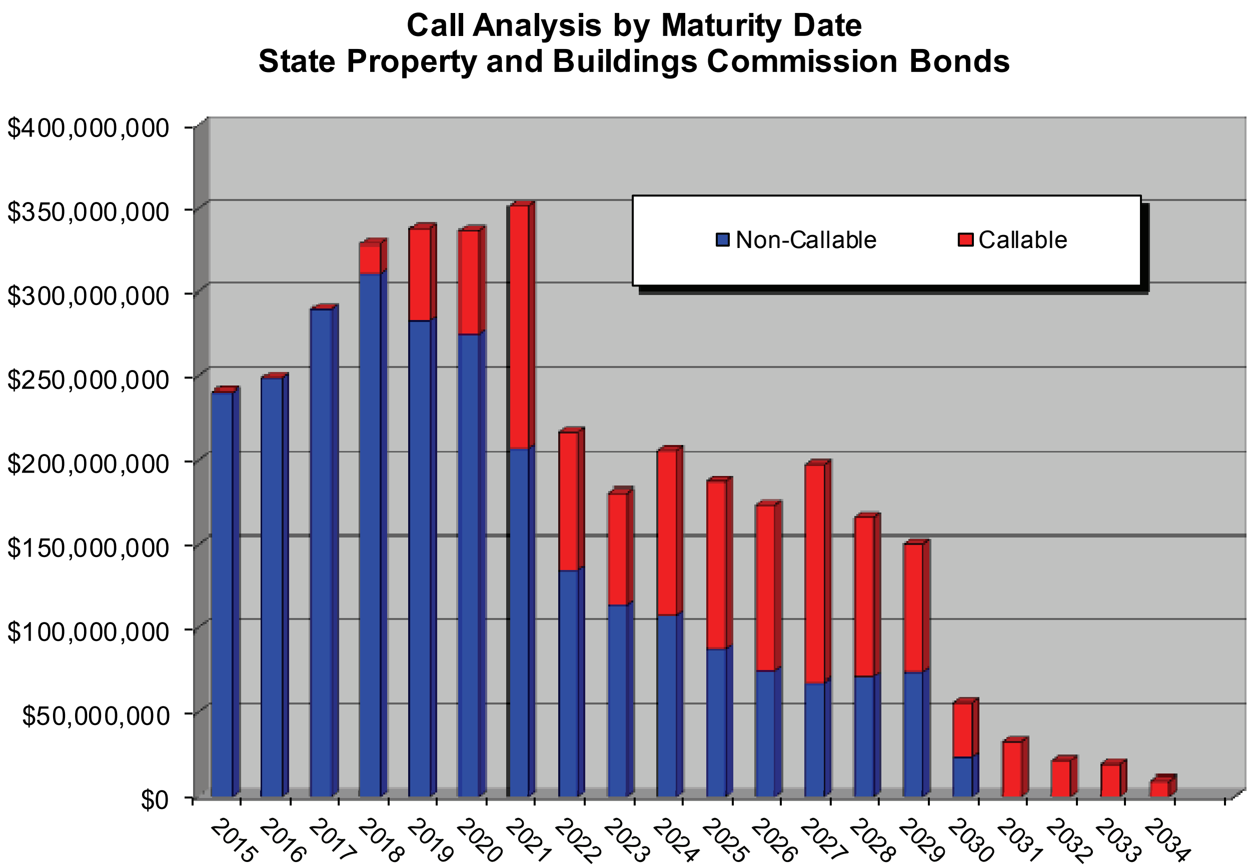
The average and median balances were a negative $1.073 billion and a negative $1.192 billion, respectively. Since the General Fund continued to have a negative available cash balance for the fiscal year to date, there is little, if anything, that can be done from an asset management point of view beyond current actions.

From a liability management perspective, total General Fund debt service, net of credits was $682.0 million for Fiscal Year 2015. In addition, General Fund debt service of $11.3 million was 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 callability of the debt portfolio.

Call Analysis by Call Date
State Property and Buildings Commission Bonds



DEBT MANAGEMENT



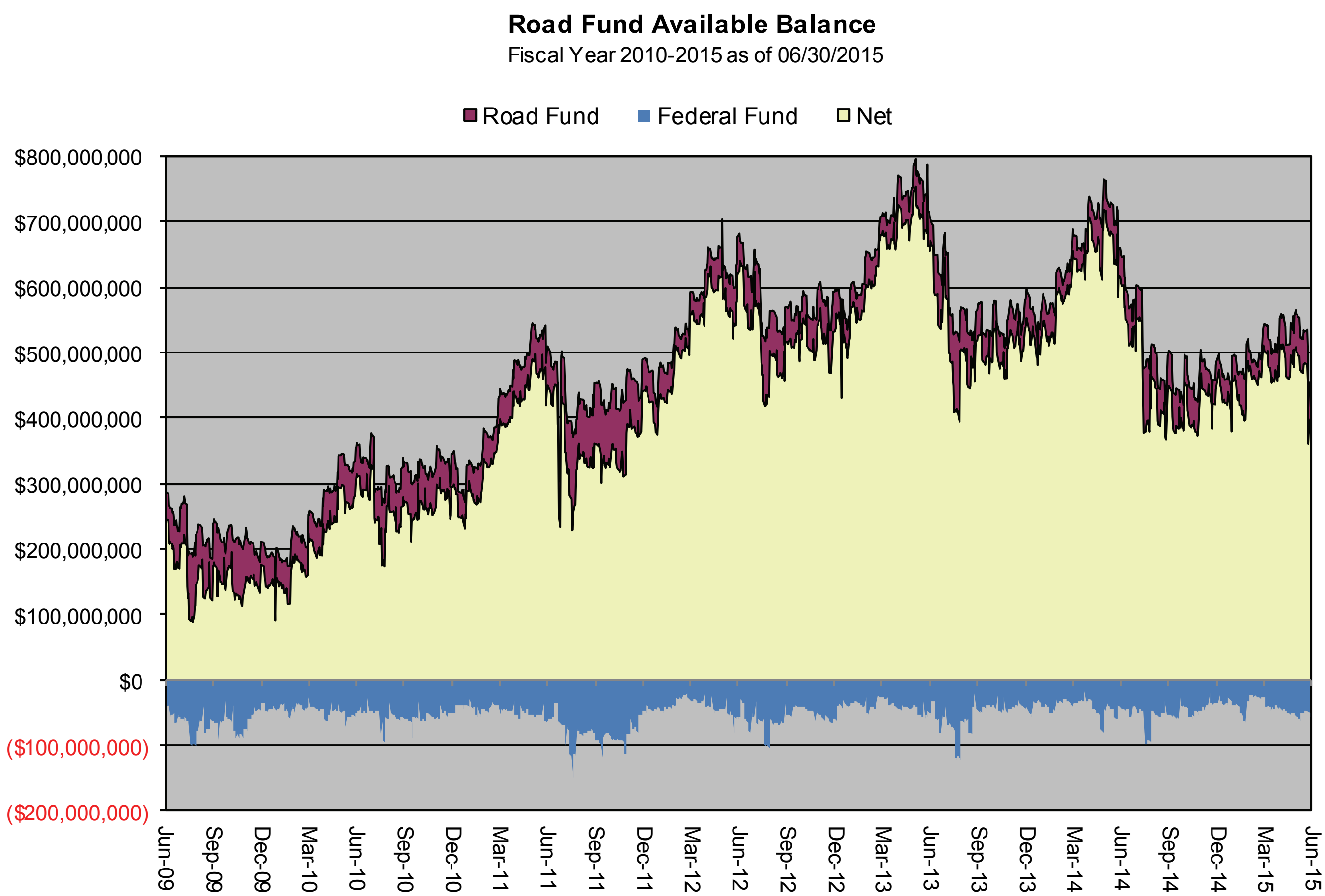
DEBT MANAGEMENT

Road Fund

The Road Fund average daily cash balance for Fiscal Year 2015 was $453.2 million compared to $606.7 million for Fiscal Year 2014. The Road Fund cash was invested in the Intermediate Term Investment Pool which had a duration of 1.07 years as of June 30, 2015. The Road Fund earned $2.9 million on a cash basis for Fiscal Year 2015 versus $4 million for Fiscal Year 2014. The continued relatively low level of investable balances at certain times during the fiscal year limits the investment opportunities.

As of June 30, 2015, the Turnpike Authority of Kentucky (TAK) had $1.371 billion of bonds outstanding with a weighted average coupon of 4.82 percent and an average life of 8.18 years.

Road Fund debt service paid in Fiscal Year 2015 was $160.1 million, resulting in a net interest margin (investment income earned year-to-date less debt service paid) of negative $157.2 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.



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 five 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 JUNE 25, 2015

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

	Removed:
Healthcare of Ontario Pension Plan (HOOP)	Sumitomo Corp - Rating Downgrade
Wedbush Securities Inc.	McDonald's Corp - Rating Downgrade
Home Depot Inc.	Barclays Capital Inc - Rating Downgrade
Costco Wholesale Corp	Deutsche Bank AG - Rating Downgrade
Toronto-Dominion Bank/The	3M Co
	Google Inc
	United Parcel Service
	Travelers Cos Inc/The
	Colgate-Palmolive Co
	Honeywell International Inc

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 positions.

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 / Fitch)*	A3/BBB+/A	A3/BBB+/A	A3/BBB+/A	A3/BBB/A
Termination Trigger	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	7,490,000	53,900,000	65,550,000	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, 2015 (negative indicates payment owed by ALCo if terminated)	(352,359)	(7,356,410)	(6,987,070)	(12,044,344)
Interest Earnings (not applicable)				
Total	not applicable	not applicable	not applicable	not applicable

Swap Summary

As of December 31, 2014

Total Notional Amount Executed		Net Exposure Notional Amount	
General Fund	Road Fund	General Fund	Road Fund
243,080,000	0	198,325,000	0

Total Notional Amount Executed by Counter Party

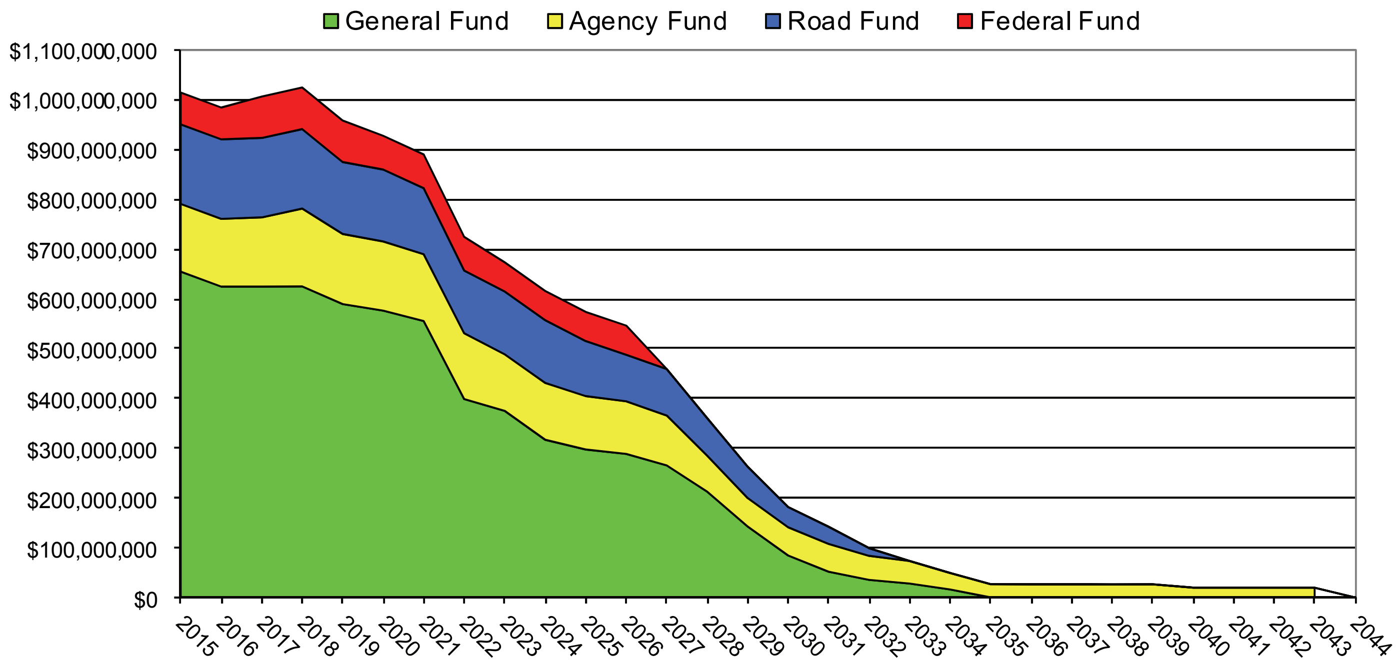
Deutsche Bank (assigned from Citibank on 2/14/2011)

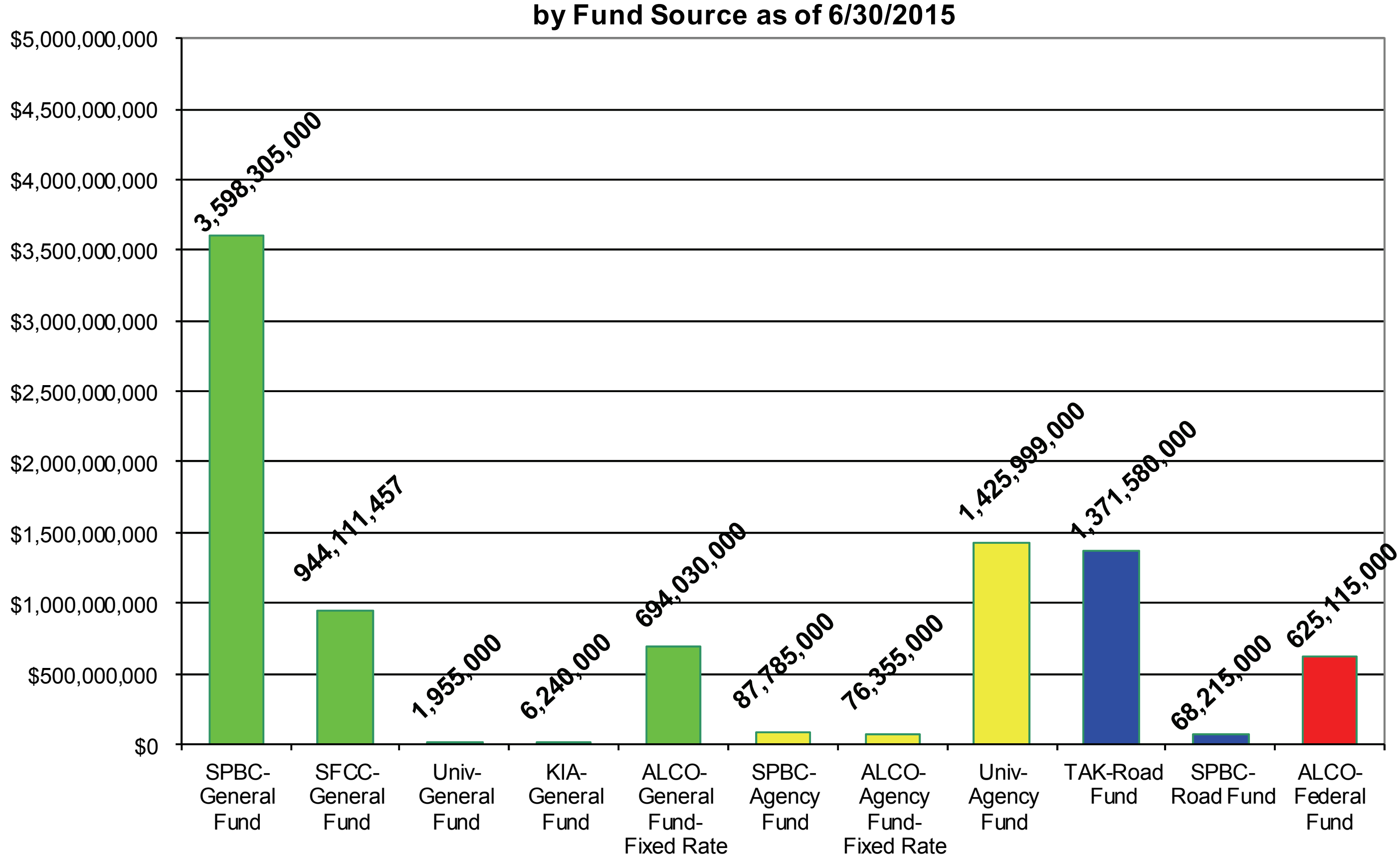
243,080,000

	Debt		10 Percent Net Exposures	
	General Fund	Road Fund	General Fund	Road Fund
Bonds Outstanding	4,292,335,000	1,439,795,000	429,233,500	143,979,500
Authorized but Unissued	834,442,200	217,500,000	83,444,220	21,750,000
Total	5,126,777,200	1,657,295,000	512,677,720	165,729,500

Investment Pool Balances		10 Percent Investment Portfolio	
Other Funds	Net Road Fund	Other Funds	Net Road Fund
3,608,933,558	399,571,392	360,893,356	39,957,139

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 6/30/2015

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	$198,325,000
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**			**$694,030,000**
Agency Fund Project Notes					
2005 1st Series		$11,275,000	6/2005	6/2025	$7,160,000
2005 Series A-UK Gen Recpts		$107,540,000	11/2005	10/2015	$5,635,000
2006 Series A-UK Gen Recpts		$66,305,000	10/2006	10/2022	$40,480,000
2007 Series A-UK Gen Recpts		$77,905,000	11/2007	10/2027	$11,095,000
2007 Series B-UK Gen Recpts		$80,245,000	11/2007	10/2027	$11,985,000
	FUND TOTAL	**$343,270,000**			**$76,355,000**
Federal Hwy Trust Fund Project Notes					
2007 1st Series		$277,910,000	9/2007	9/2019	$150,920,000
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	$171,940,000
	FUND TOTAL	**$752,105,000**			**$625,115,000**
ALCo NOTES TOTAL		**$2,229,115,000**			**$1,395,500,000**

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Creating Financial Value for the Commonwealth