SEMI– ANNUAL REPORT

June 30, 2004

Kentucky Asset/Liability Commission

Prepared by
Office of Financial Management

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INTRODUCTION

This is the Kentucky Asset/Liability Commission's ("ALCo") fifteenth semi-annual report pursuant to KRS 56.863 (11) for the period beginning January 1, 2004 through June 30, 2004. This report may be viewed in color at http://ofm.state.ky.us/alcosemi-reports.html.

There were several factors which had an impact on activity during the reporting period. The key themes were:

On the national level

- War in the Middle East continues.
- U. S. economy begins to show signs of rebounding.
- State governments display revenue growth.
- The Dow Jones Industrial Average decreased slightly from December 2003 and finished the fiscal year at 10,435.

On the state level

- Significant refunding of existing debt.
- Ratings for appropriation supported debt are put on watch for possible downgrade.
- Fiscal year 2004 General Fund revenues increase 2.9 percent over fiscal year 2003.

INVESTMENT MANAGEMENT

Market Overview

The last half of calendar year 2003 showed strong economic growth as measured by the Real Gross Domestic Product ("GDP"), but limited growth in employment leading many people to comment on the "jobless recovery". This situation changed in the first half of 2004. The rate of growth in GDP has slowed somewhat from 4.5 percent in the first quarter to 2.8 percent during the second quarter. At the same time, employment has shown strong gains as 1.1 million jobs have been created through May at a monthly average of 225,000. The employment growth cooled off during June as only 96,000 jobs were created.

Alan Greenspan, Chairman of the Federal Reserve Board, declared the June slow-down to be a "soft patch" due to "transitory factors". These "transitory factors" are primarily the price of oil. The spot price of West Texas Crude reached a peak of $42.33 per barrel on June 1, 2004. (It rose even further after the end of the quarter, hitting a high of $48.70 on August 19.) The average during this period was $36.84 compared to an average of $21.31 over the previous 10 years.

This increase in the price of crude oil has impacted consumers at the gas pumps as the price of gas has increased during this time period. On a percentage basis, the price of gas is up even more than oil due to capacity constraints at oil refineries. If Mr. Greenspan is correct that this hike is transitory, then there should be limited impact on the U.S. economy. OPEC, especially Saudi Arabia, has indicated a willingness to increase production to push the price of oil back down.

However, there are some indications that this may be the beginning of a longer term trend. Over the past several years, China has moved from self-sufficiency in energy production to a new importer. Great Britain is expected to change from a net exporter to a net importer of crude oil. If strong growth continues in these nations, especially China, as well as some others, the demand curve may shift materially higher resulting in a long lasting increase in the price of crude oil. The price of long-dated futures on oil and gas support this contention.

The potential impact of substantial, long-standing increase in energy prices on the U.S. economy is difficult to judge as there are two competing theories. Some people compare an increase in gas prices to an increase in taxes. It will simply shift overall spending towards oil companies and away from the rest of the economy. To deal with this situation, the Federal Reserve should lower interest rates to stimulate enough growth to offset the slower spending on the rest of the economy.

The second theory is that an increase in oil prices is an inflationary event. Because energy affects the price of almost everything else in the economy, companies will raise prices to offset the increase in their cost structure. Another name for a generalized increase in prices is inflation. To deal with this situation, the Federal Reserve should increase interest rates to return the nation to price stability. There are valid points to both of these arguments, and it is difficult to predict the ultimate impact.

The Federal Reserve has changed its stance during the first half of the year. At the December 9, 2003 meeting, the Fed announced that the current 1.0 percent Fed funds target could be "maintained for a considerable period". At the June 30, 2004 meeting, the committee raised the Fed funds target to 1.25 percent and stated that current "policy accommodation can be removed at a pace that is likely to be measured". What does this mean? Basically, a Fed funds rate of 1.0 percent with inflation, depending on how you measure it, of 1.5 percent to 2.0 percent results in negative real cost of money. This is highly stimulative. A neutral policy will have nominal funds in a 3 to 4 percent range with inflation at about 2 percent resulting in real cost of money of 1 to 2 percent. The Fed has begun moving monetary policy from the highly stimulative negative real rate to a more neutral rate. The market consensus is that rates will rise 0.25 percent per meeting until the end of this year when funds will be 2.25 percent. Most pundits believe that rates will continue to rise next year but those forecasts are much more uncertain.

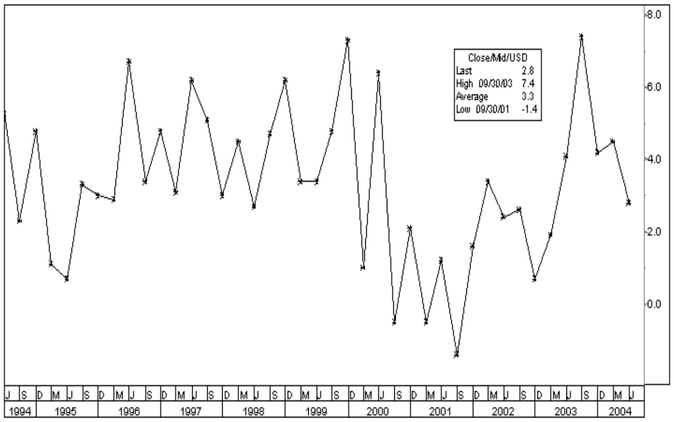
One of the leading factors in anticipating future interest rate movements is expected future inflation rates. As measured by the Consumer Price Index ("CPI"), inflation has moved up during the past 6 months. The year-over-year change in the CPI reached a secular low of 1.7 percent in February. It has then moved steadily up to 3.3 percent in June. However, the core CPI, which excludes the volatile food and energy sector shows a more benign movement. The year-over-year change reached a low of 1.1 percent in November and stayed at that level through January. It has since risen but to only 1.9 percent in June. Other inflation measures show a similar pattern with increases during 2004, but none are showing an escalating spiral. Bottom line, inflation has moved from a point that was probably too low around the beginning of this year up to a level that is more consistent with the Federal Reserve's opinion of price stability. Further increased inflation could provoke a stronger response from the Fed and the markets in general.

Gross Domestic Product

QUARTER-OVER-QUARTER INDEX

GDP CQOQ Index

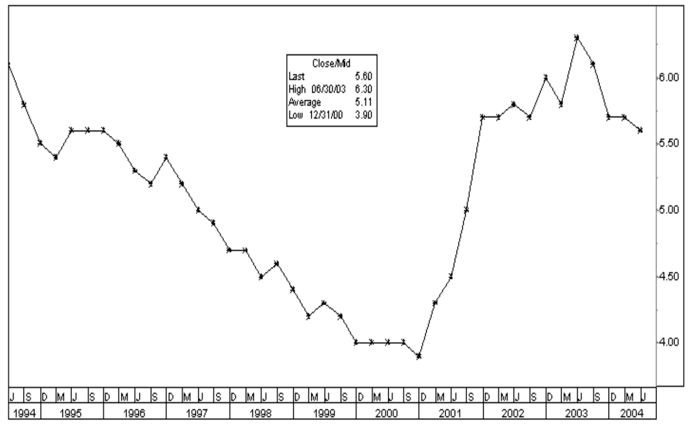
Range 6/30/94 - 6/30/04 Period Q Quarterly



Unemployment Rate

USURTOT Index

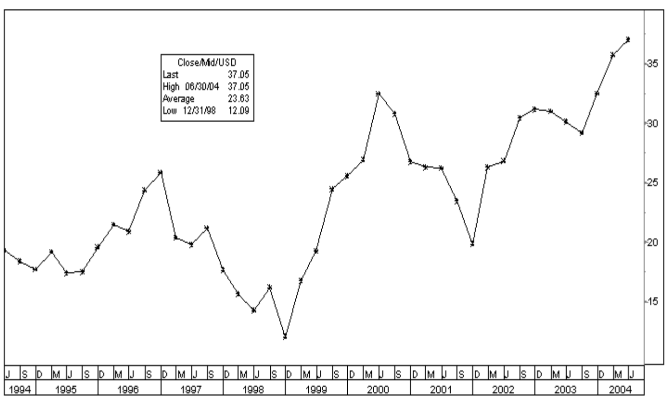
Range 6/30/94 - 6/30/04 Period Q Quarterly



West Texas Crude Oil Prices

USCRWTIC Index

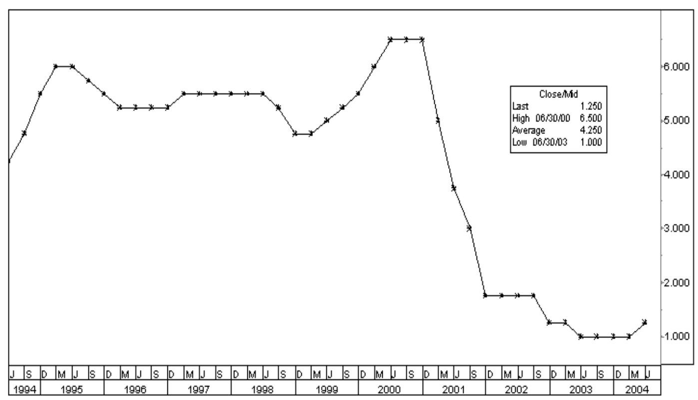
Range 6/30/94 - 6/30/04 Period Q Quarterly



Federal Funds Target Rate

FDTR Index

Range 6/30/94 - 6/30/04 Period Q Quarterly

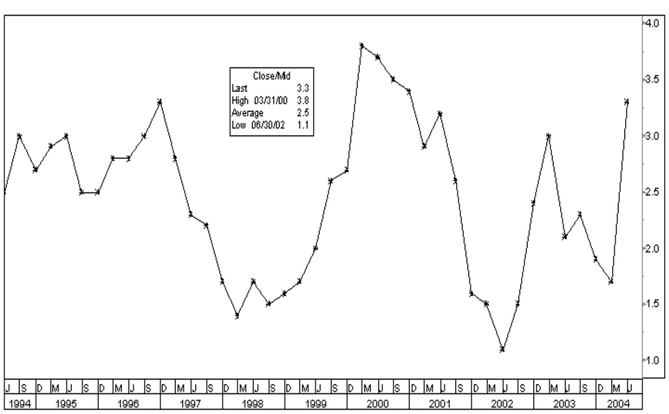


Consumer Price Index

YEAR-OVER-YEAR INDEX

CPI YOY Index

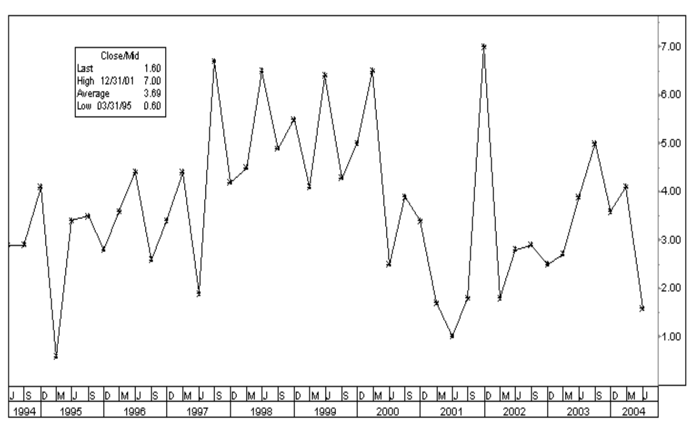
Range 6/30/94 - 6/30/04 Period Q Quarterly



Personal Consumption

GDPCTOT% Index

Range 6/30/94 - 6/30/04 Period Q Quarterly



Portfolio Management

For fiscal year 2004, the Commonwealth's investment portfolio averaged $2.4 billion. As of June 30, 2004, the portfolio was invested in U.S. Treasury Securities (13 percent), U.S. Agency Securities (30 percent), Mortgage Pass-Through Securities (1 percent), Collateralized Mortgage Obligations (5 percent), Repurchase Agreements (26 percent), Municipal Securities (6 percent), Corporate Securities (6 percent), Asset-Backed Securities (3 percent) and Money Market Securities (10 percent). The portfolio had a market yield of 2.26 percent and an effective duration of 1.19 years.

The total portfolio is broken down into three investment pools. The pools' balances as of June 30, 2004, were Short Term Pool - $1,104 million, Intermediate Term Pool - $1,143 million and Bond Proceeds Pool - $591 million.

Total investment income from all investments, on a cash basis, for fiscal year 2004 was $75 million versus $145 million for fiscal year 2003. On a full mark-to-market basis, investment income was $23.9 million for fiscal year 2004, versus $149 million for fiscal year 2003.

The decline in cash income from 2003 to 2004 occurred for three primary reasons. First, substantial funds were transferred from the Intermediate Term Pool to the Short Term Pool. Investments in the shorter term pools earn lower, but more stable, levels of cash income. Second, the average level of interest rates was lower during 2004 than 2003. Fed funds averaged roughly 1.42 percent during 2003 versus 1.00 percent for the first half of calendar year 2004. Because the Short Term Pool basically earns a little more than Fed funds, this substantially reduced the cash earnings during the year. Finally, the funds available for investment declined from an average of $2.9 billion during fiscal year 2003 to $2.4 billion during fiscal year 2004.

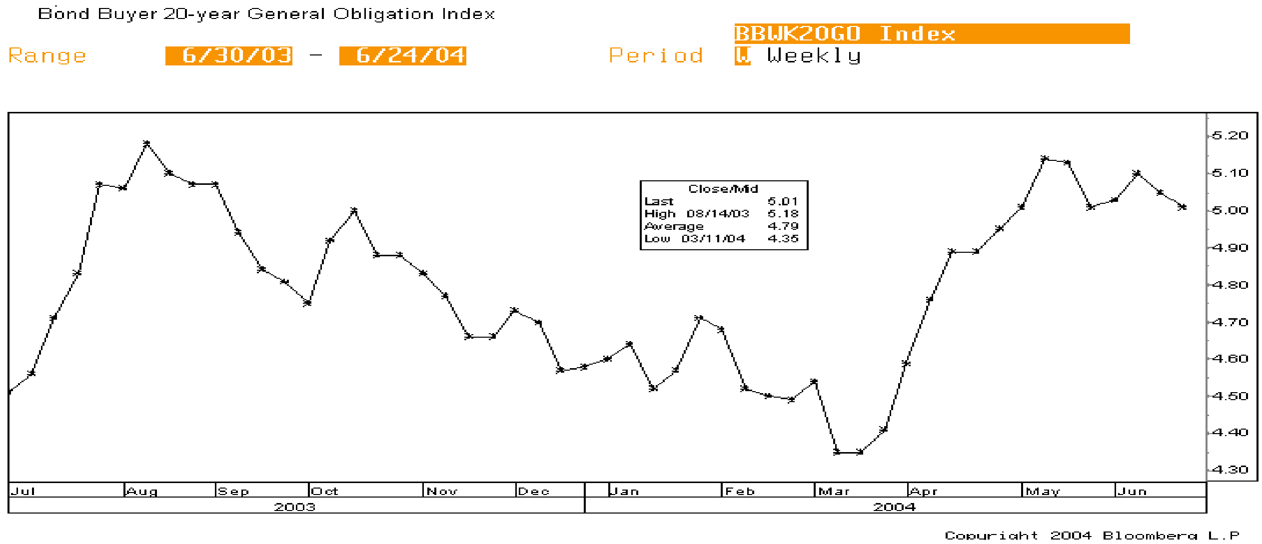
The decline in mark-to-market earnings occurred partially for the same reasons as cash earnings. However, an additional factor also hurt the market earnings. While the average level of interest rates was lower in 2004 than 2003, rates had increased by June 30, 2004, compared to June 30, 2003. The yield on 2 and 5 year Treasuries increased roughly 135 basis points. The yield on the 3 year Treasury increased by nearly 150 basis points. Prices and yields are inversely related, meaning that as yields increase, prices decline. This led to a decline in the market value of mark-to-market accounts. Unrealized capital gains for the Intermediate and Bond Proceeds pool of $55 million at the end of fiscal year 2003, declined to a capital loss of $5 million at the end of fiscal year 2004.

Tax-exempt Interest Rates and Relationships

The Bond Buyer 20-year General Obligation Index averaged 4.75 percent for the six-month period and 4.79 percent for the fiscal year 2004. The fiscal year high was 5.18 percent in August 2003 and the low was 4.35 percent in March 2004.

The Bond Market Association ("BMA") Municipal Swap Index averaged 1.00 percent for the reporting period and 0.98 percent for the fiscal year. The fiscal year high was 1.23 percent in December 2003 and the low was 0.70 percent in July 2003. The 30-day USD London Interbank Offered Rate ("LIBOR") averaged 1.13 percent for the period and 1.12 percent for the fiscal year. The fiscal year high was 1.37 percent in June 2004 and the low was 1.09 percent in April 2004. BMA traded as high as 107.9 percent of 30-day LIBOR in December 2003 and as low as 63.2 percent in July 2003. BMA averaged 87.1 percent for the fiscal year and ended the fiscal year at 81.2 percent.

Tax exempt ratios remained at relatively high levels throughout the first half of 2004 versus taxable counterparts across the yield curve due to the low absolute level of interest rates. Yield volatility was quite high during the period permitting nimble issuers the ability to lock in U.S. Treasury State and Local Government Series Securities ("SLGS") at attractive rates (option to lock in the previous days closing yields for up to 60 days). Yield compression, as evidenced by the high ratio levels, results in negative carry in most refunding bond escrows. Additionally, the IRS and the Bureau of Public Debt amended the regulations such that issuers of tax-exempt debt can cancel existing SLGS and replace them with higher yield securities up to the allowable yield on the bonds, with a ten basis point charge. When interest rates rise sufficiently, issuers like the State Property and Buildings Commission ("SPBC") may be able to recoup all or a portion of the negative carry in certain refunding bond escrows. The IRS, however, is planning to eliminate this option in the near future which will eliminate issuers' ability to take advantage of this feature. Fortunately, staff monitored this situation closely and was able to seize the opportunity while these types of escrow restructuring transactions were still permitted.



Bond Buyer 20-year General Obligation Index
Range 6/30/03 - 6/24/04
Period W Weekly
BBWK20GO Index
Close/Mid
Last 5.01
High 08/14/03 5.18
Average 4.79
Low 03/11/04 4.35
5.20
5.10
5.00
4.90
4.80
4.70
4.60
4.50
4.40
4.30
Jul Aug Sep Oct Nov Dec Jan Feb Mar Apr May Jun
2003
2004
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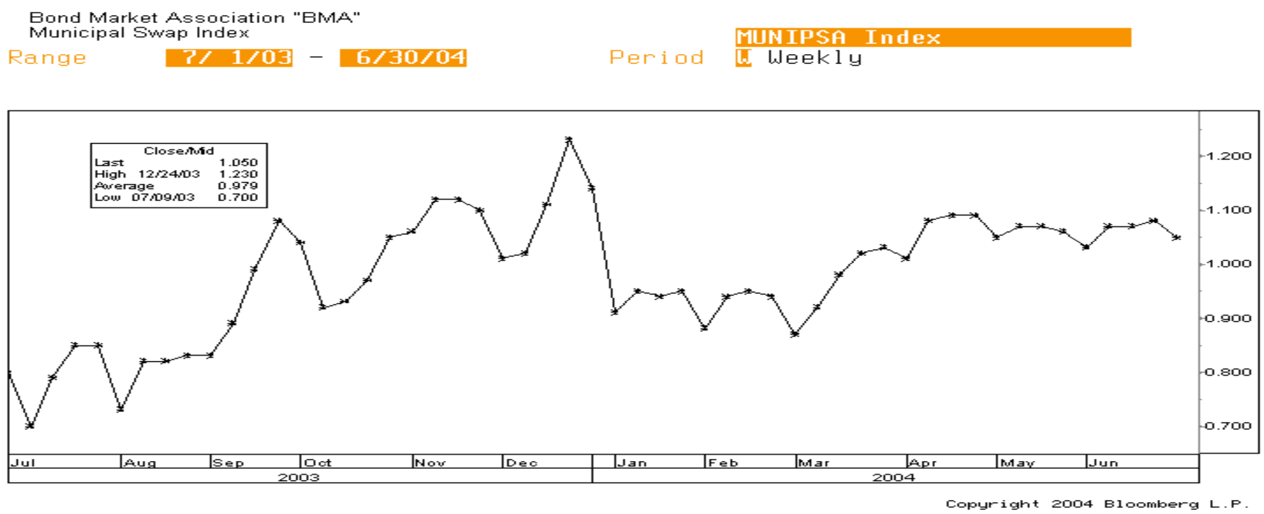

Bond Market Association "BMA"
Municipal Swap Index
Range 7/ 1/03 - 6/30/04
Period W Weekly
MUNIPSA Index
Close/Mid
Last 1.050
High 12/24/03 1.230
Average 0.979
Low 07/09/03 0.700
1.200
1.100
1.000
0.900
0.800
0.700
Jul Aug Sep Oct Nov Dec Jan Feb Mar Apr May Jun
2003
2004
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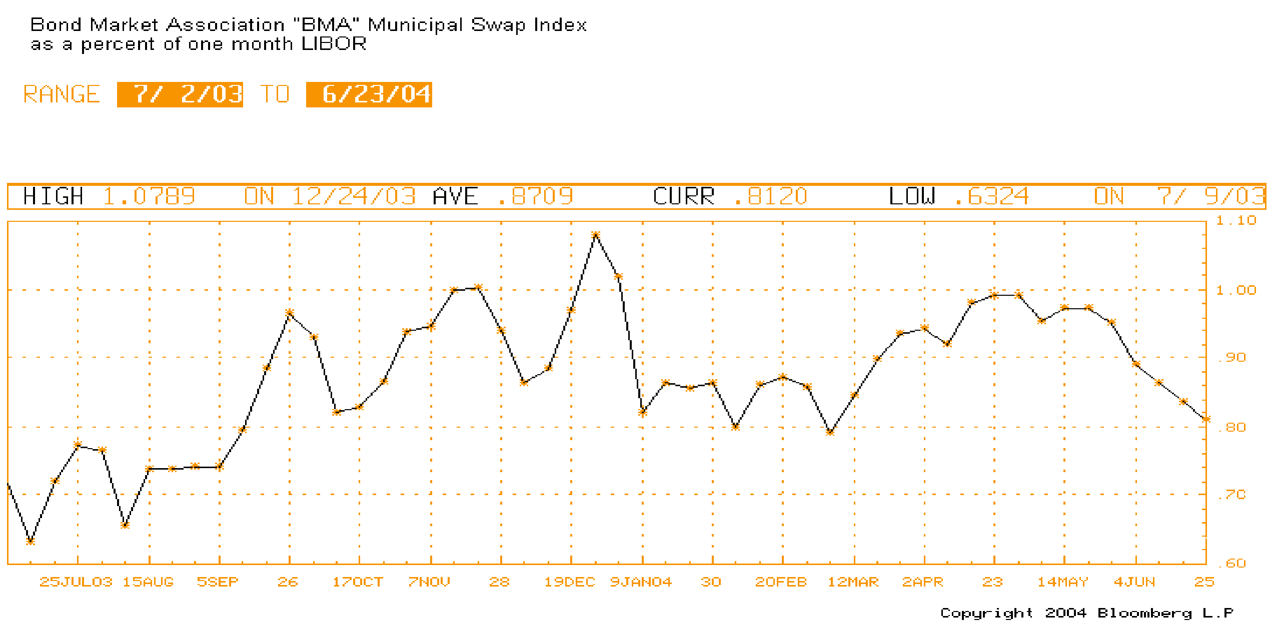

Bond Market Association "BMA" Municipal Swap Index
as a percent of one month LIBOR
RANGE 7/ 2/03 TO 6/23/04
HIGH 1.0789 ON 12/24/03 AVE .8709 CURR .8120 LOW .6324 ON 7/ 9/03
1.10
1.00
.90
.80
.70
.60
25JUL03 15AUG 5SEP 26 17OCT 7NOV 28 19DEC 9JAN04 30 20FEB 12MAR 2APR 23 14MAY 4JUN 25
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DEBT MANAGEMENT

The Office of Financial Management developed a comprehensive debt plan for newly authorized debt in fiscal year 2004 that:

- Provided cash to fund eligible projects in a timely manner consistent with constraints established in House Bill 269;
- Achieved the lowest borrowing cost over the life of the obligation, consistent with risk tolerance;
- Minimized budgetary complications;
- Executed significant economic refundings to help alleviate structural imbalances projected for fiscal year 2005; and
- Maintained existing ratings.

STATE PROPERTY AND BUILDINGS COMMISSION
RECENT BOND ISSUE SUMMARY

Fund Source:	General Fund SPBC 82	General Fund SPBC 83
Par Amount:	$389,835,000	$195,910,000
Sale Date:	January 28, 2004	March 24, 2004
Settlement Date:	February 25, 2004	April 28, 2004
Final Maturity:	October 1, 2019	October 1, 2020
NIC:	4.110%	4.084%
TIC:	3.870%	3.838%
All-In TIC:	3.878%	3.846%
Bond Buyer Index (BBI):	4.71%	4.41%
Coupon on Last Maturity:	5.25%	3.90% (Retail) 5.25% (Institutional)
Total Debt Service:	$623,610,289	$332,161,284
Max. Annual Debt Service:	$83,262,131	$53,248,685
Bond Insurance:	FSA	AMBAC
Underwriter:	Morgan Stanley	UBS Financial Services
Par Amount of Refunded Bonds:	$408,930,000	$199,130,000
Avg. Coupon of Refunded Bonds:	5.359%	5.073%
Net PV Savings:	$13,047,080	$7,631,422
PV Savings as a % of Refunded Par:	3.190%	3.832%

SPBC issued Project 82 and Project 83 during the reporting period for a total par amount of bonds of $585,745,000.

SPBC 82

SPBC partially refunded ten series of SPBC General Fund supported bonds. The refunding generated net present value savings of $13,047,080 or 3.19 percent of refunded par. The transaction was a Financial Security Assurance, Inc. ("FSA") insured, 15 year, fixed rate transaction. A portion of the bonds were issued to refund the remaining outstanding University of Kentucky Community Colleges' debt, which was supported by General Fund appropriations.

SPBC 82
Escrow Restructuring

$453,903,685 of SLGS were purchased for the related escrows in the SPBC 82 transaction. The escrows had contained over $3,900,000 of negative arbitrage. On April 29, 2004, the Bureau of Public Debt granted SPBC a 90-day waiver from CFR Section 344.5(a)(2) which states that a notice of redemption for SLGS prior to maturity could not be cancelled. SPBC subsequently redeemed the existing SLGS portfolio and resubscribed to purchase a higher yielding escrow. The transaction was closed on July 6, 2004 with a total net benefit of $3,867,145. The proceeds were deposited into the SPBC 82 Bond Service Fund and used to offset the next debt service payment associated with the SPBC 82 bonds, thus resulting in a reduction of the General Fund debt service required for fiscal year 2005.

SPBC 83

SPBC 83 partially refunded seven series of SPBC General Fund supported bonds generating net present value savings of $7,631,442 or 3.83 percent of refunded par. The transaction was an AMBAC insured, 16-year, fixed rate transaction.

Ratings Update

The rating community has not taken any action since October 2002 when Standard and Poor's ("S & P") downgraded the state appropriation debt from "AA-" to "A+" with a stable outlook. Although S & P placed the Commonwealth's appropriation supported debt on Credit Watch with negative outlook in June 2004 based upon the lack of a legislatively enacted budget, S & P promptly removed the state from the Credit Watch with negative outlook once the Franklin Circuit Court indicated that the Commonwealth would operate on Governor Fletcher's Public Services Continuation Plan. Moody's rates the state's appropriation supported debt "Aa3" with negative outlook and placed the state on WatchList for possible downgrade in late May 2004, again based on the budget situation. Fitch assigns an "AA-" with no expression concerning the outlook. Pending resolution of the budget situation, it is not anticipated that the state will experience a change in its credit profile. Additionally, bond insurers may be hesitant to insure our state appropriation credits as was the experience of the Kentucky Infrastructure Authority Fund A (Wastewater) and Fund F (Drinking Water) program issues in June 2004. Given the small issue size ($11,300,000), this had no real impact on total interest expense; however, that may not be the situation going forward.

As outlined in the previous report, rating agency concerns continue to focus on a structurally balanced budget, lack of liquidity and further commitment to replenishing the Budget Reserve Trust Fund in the 2004-06 biennial budget.

Tax and Revenue Anticipation Notes

2004 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 2004 (FY 2005) TRAN program in an amount not to exceed $800 million. On July 13, 2004, $500 million were delivered to mature on June 29, 2005. The 2004 Series A TRANs were sold by Citigroup Global Markets Inc. on July 8, 2004. The fixed rate notes carry a coupon of 3.00 percent to yield 1.55 percent. Net benefit is expected to be approximately $3 million to the General Fund.

Project Notes. There were no ALCo Project Notes issued during the reporting period. However, an existing plan of finance was amended to provide for the future financing of the existing balance of the University Agency Bond Pool and unissued economic development project authorizations in House Bill 269 once a new budget is adopted.

Table of Outstanding ALCo Notes as of June 30, 2004

2001 General Fund Series	$ 22,790,000	Final Maturity 2/01/08
2003 General Fund Series	$164,180,000	Final Maturity 7/15/13
Total	**$186,970,000**	

FINANCIAL AGREEMENTS

As of June 30, 2004, ALCo had four financial agreements outstanding, but a net notional amount exposure of zero. These transactions are detailed in Appendix A. One additional Financial Agreement was executed on August 11, 2004, after the reporting period, for the Turnpike Authority of Kentucky ("TAK"), which was contemplated by a May 2004 ALCo Resolution.

Of the continuing outstanding financial agreement transactions, the first item is a total return swap related to the $56,485,000 July 1, 2009 maturity of the 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, BMA (short-term tax-exempt municipal index) plus a spread (currently 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. During the first few weeks of the trade, ALCo booked $147,727 in earnings on the first payment date of July 1, 2001. 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 just under $3.0 million under the terms of the agreements since inception. The expected total benefit from this transaction to maturity is $7.46 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 have achieved that level, funds may be available to offset future debt service payments. Since the bonds are still outstanding and the 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 short-term tax-exempt 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 are 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 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. Market conditions permitting, a similar type trade would be reestablished for a short period or terminated.

ALCo also entered into an identical transaction with MS for the 5.50 percent bonds due July 1, 2007 of the TAK Toll Road 1986 Series A Bonds with a par amount of $50,920,000. The Toll Road DSRF earns a bit less than the Resource Recovery 1985A bonds and the coupon on the outstanding bonds is also less, but the mechanics are the same.

On July 24, 2001, MS agreed to enter into a total return swap whereby MS would pay ALCo beginning on January 3, 2002, 5.50 percent in exchange for BMA plus 45 basis points (to cover expenses). The trade could not be executed until December 7, 2001, after the call notice for the bonds had been issued. ALCo agreed to pay MS 4.15 percent in exchange for BMA plus 45 basis points, locking in a guaranteed spread of 135 basis points as long as BMA plus 45 basis points remain below the coupon of the bonds of 5.50 percent.

During fiscal year 2003, the Federal Highway Administration awarded the state Transportation Cabinet approximately $13 million, the estimated remaining principal amount of the Toll Road Bonds related to the Toll Roads known as the Hal Rogers Daniel Boone Parkway and the Louie B. Nunn Cumberland Parkway. The award was granted with the understanding that the tolls would no longer be collected and the toll booths removed on these two roads. On July 1, 2003, the Total Return and Fixed Swap transactions were adjusted due to the $12,195,000 partial redemption of the 2007 term maturity of the Toll Road 1986 Series A Bonds. The

$50,920,000 original notional amount was reduced to $38,725,000, with no obligation due from either party with respect to the unwound notional amount as the partial termination occurred on an interest payment date. A swap termination payment on the fixed portion in the amount of $705,000 was paid to MS. The revised present value savings level, factoring in all expenses, is approximately $1.6 million. The net notional amount exposure remains at zero and the market value is par as in the previously described transaction. ALCo has received over $1 million to date.

ALCo entered into a Financial Agreement with MS on August 11, 2004 to synthetically refund on a current basis the TAK Economic Development (Revitalization Projects) 1995 bonds. The trade is to be effective July 1, 2005 for a notional amount of $33,590,000 amortized through 2015. ALCo and TAK agree to pay MS 3.64 percent plus expenses estimated to be 31 basis points. In exchange, MS will pay the Authority BMA, which will closely track the debt service on any variable rate bonds that may be issued as a result of this transaction. The present value of the transaction is expected to be $1,145,472 or 3.50 percent of the refunded bonds on the call date of July 1, 2005.

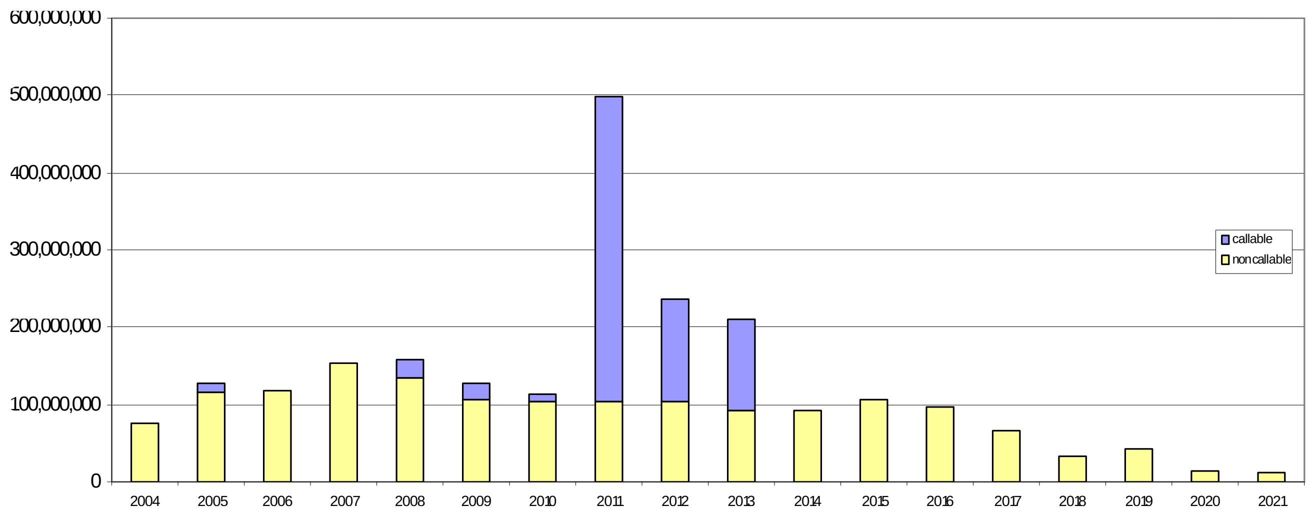
ASSET/LIABILITY MODEL

General Fund

The SPBC debt portfolio as of June 30, 2004, had $2,243 million of bonds outstanding with a weighted average coupon of 5.19 percent, modified duration of 4.85 years, and a yield at market of 2.88 percent. The market yield increased by 24 basis points from the prior reporting period while modified duration decreased by .22 years reflecting maturing debt. The callable portion was $712 million and had an average coupon of 5.10 percent. The average coupon reflects investor preference for premium bonds in the current market. The bulk of the bonds used to finance House Bill 269 projects carried premium coupons as investors purchased those securities at a yield lower than corresponding par in discount coupons. There are no 2004 currently callable bonds which can be refunded. SPBC 82 & 83 bonds, as previously discussed, refunded a variety of advance refundable bonds from SPBC 57, 59, 60, 63, 64, 67, 68, 69A, 72, 74, 77 and 79 and defeased certain non-callable bonds maturing in 2004 and 2005.

The SPBC General Fund debt structure has 27 percent of principal maturing in 5 years and 54 percent of principal maturing within 10 years. This is very close to the rating agencies proposed targets of 27-30 percent due in 5 years and 55-60 percent maturing within 10 years.

Call Analysis
State Property and Buildings Commission Bonds

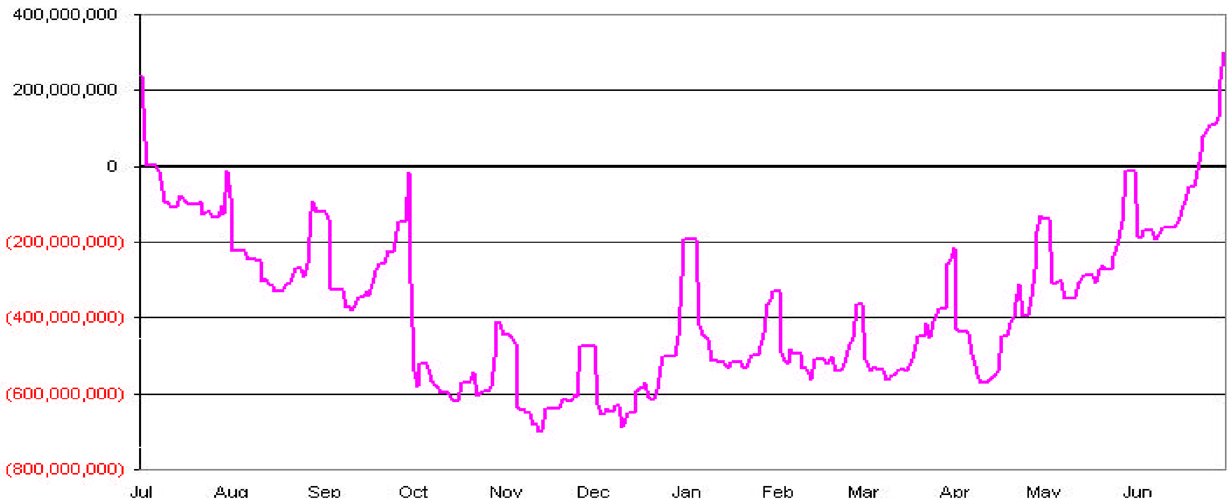


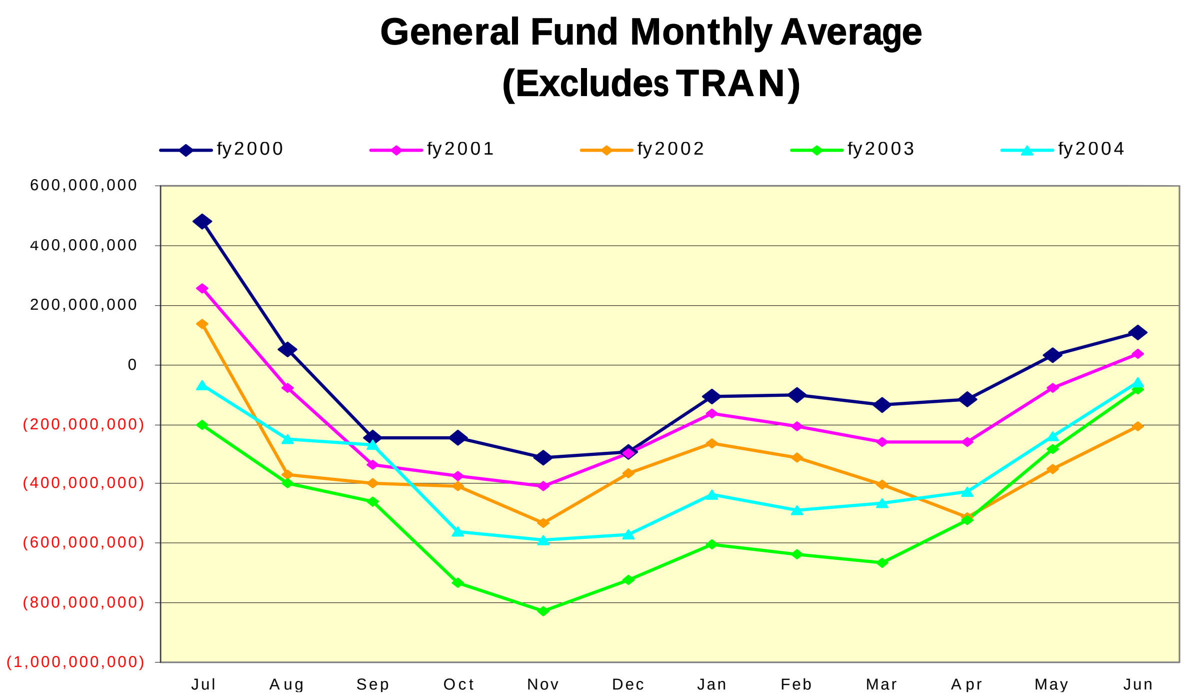
The General Fund had a high balance of $299 million on June 30, 2004, and a low of negative $701 million on November 12, 2003. The average and median balances were a negative $368 million and a negative $393 million, respectfully. Since the General Fund continued to have a negative available cash balance 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, was $386 million for fiscal year 2004.

Net Interest Margin will continue to be negative due to significant fixed rate debt issuance, compressed yield ratios, overall level of investable asset and interest rates as well as the callability of the debt portfolio.

General Fund Available Balance
Fiscal Year 2004
(Excludes TRAN)





Road Fund

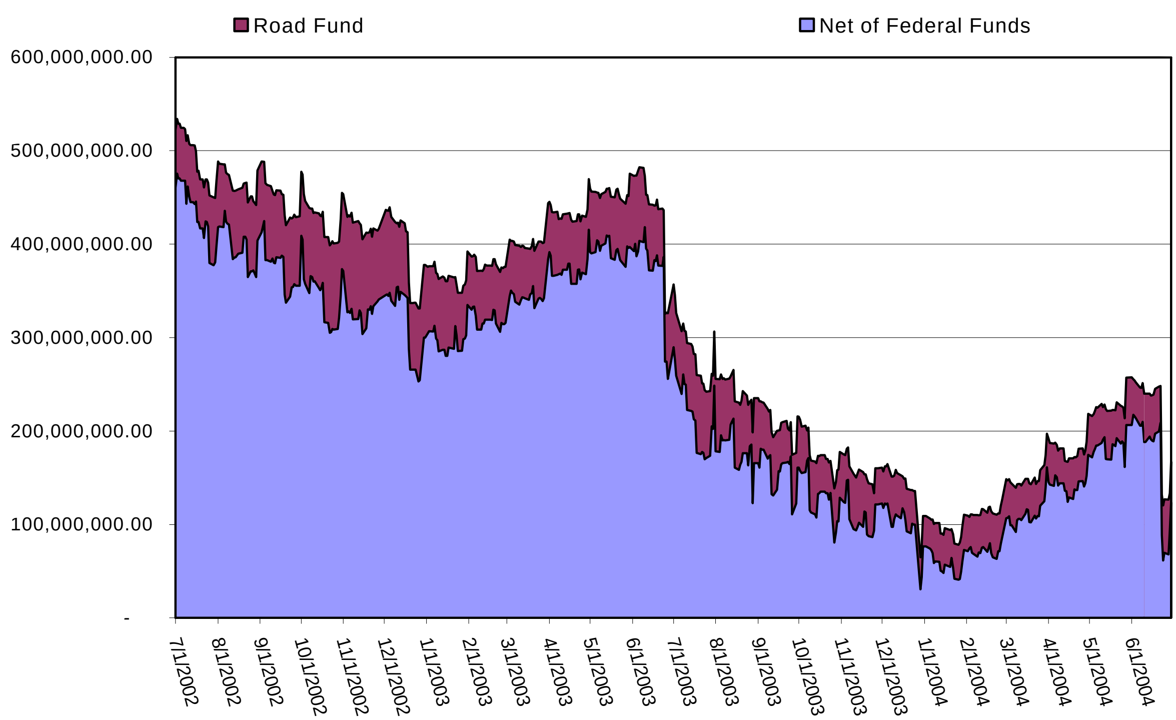
The Road Fund average daily cash balance for fiscal year 2004 was $184 million compared to $426 million for fiscal year 2003. The Road Fund cash was invested in the Intermediate Term Investment Pool which had a duration of 1.94 years as of June 30, 2004. The Road Fund earned $7.5 million on a cash basis for fiscal year 2004 versus $29 million for fiscal year 2003. The significant decline in cash balances limited the opportunity to implement asset liability management strategies.

As of June 30, 2004, TAK had $708 million of bonds outstanding with a weighted average coupon of 5.21 percent, modified duration of 3.60 years, and yield at market of 2.43 percent. Selected maturities of the Resource Recovery 1985A and Toll Road 1986A bonds with the most economical value were previously synthetically refunded with financial agreements as identified previously. TAK authorized in May 2004 for its Economic Development (Revitalization Projects) Road Revenue Bonds, the current refunding of the 1993 bonds, a delayed start refunding of its 1995 bonds callable on July 1, 2005 and an advance refunding of its 2000 bonds. The 1993 Series were currently callable and the transaction refunded $16,905,000 with present value savings of $1,046,793 or 6.19 percent of refunded bonds.

A financial agreement was executed to synthetically refund its 1995 bonds (See Financial Agreements discussion) which is expected to generate $1.145 million of present value savings of the refunded par amount. TAK also advance refunded a portion of its 2000 Series bonds with present value savings of 3.00 percent of refunded par or approximately $1.2 million. The latter transaction was sold in late August 2004 during the next reporting period.

Road Fund debt service paid, net of reserve fund credits, during fiscal year 2004 was $171.2 million resulting in a net interest margin (investment income earned less debt service paid) of negative $163.7 million. The negative amount stems from lower investable balances and a general decrease in interest rates on the investment side and limited callability of fixed rate obligations on the liability side. As the Road Fund has experienced in recent years, this trend can reverse itself very quickly if interest rates rise dramatically. The depletion of cash balances will make returning to positive territory a difficult hurdle.

Road Fund Available Balance



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 end 2003, incremental returns derived from new investment asset classes reached $26.9 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 for fiscal year 2004. The fiscal year 2005 TRAN is expected to produce approximately $3 million in benefits for a cumulative benefit of $29.3 million.

Debt Management. Debt service savings have contributed an estimated $255 million in value added since inception.

⇒ Synthetic advanced refunding of SPBC 40 (Second Series) using a delayed start interest rate swap produced $1.1 million in present value savings.

⇒ Synthetic refunding of TAK Resource Recovery 1985 Series A bonds has accumulated $3.0 million to date of which $438,967 is attributable to the current period.

⇒ Synthetic refunding of TAK Toll Road 1986 Series A bonds has provided $1 million to date of which $177,901 was earned during the current period.

⇒ Application of Medium Term Notes structure and financial agreement strategies resulted in present value savings of $6.6 million for SPBC refundings.

⇒ Wrapping debt service for taxable SPBC 78 with tax-exempt SPBC 79 saved $7.6 million on a present value basis.

⇒ SPBC 82 and SPBC 83 generated $20.7 million in present value savings.

⇒ Lapsed General Fund debt service for fiscal year 1999 was $10.5 million, fiscal year 2000 was $29 million, fiscal year 2001 was $76.5 million, fiscal year 2002 was $104 million, fiscal year 2003 was $13.4 million and fiscal year 2004 was $21.6 million. The total of $255.2 million reflects the savings from the actual versus budgeted debt service.

Total value added since inception in excess of $351.4 million.

APPENDIX

APPENDIX A
Swap Summary

APPENDIX B
Appropriation Supported Debt Service by Fund Source
As of June 30, 2004

APPENDIX C
Appropriation Debt Principal Outstanding by Fund Source
As of June 30, 2004

APPENDIX A

Swap Summary

	TAK RR 85A Total Return	TAK RR 85A Fixed	TAK TR 86A Total Return	TAK TR 86A Fixed
Fund Source	Road Fund	Road Fund	Road Fund	Road Fund
Hedge	Net Interest Margin	Total Return	Net Interest Margin	Total Return
Counter-Party	Morgan Stanley	Morgan Stanley	Morgan Stanley	Morgan Stanley
Counter-Party Ratings*	Aa3/AA-/AA	Aa3/AA-/AA	Aa3/AA-/AA	Aa3/AA-/AA
Termination Trigger	BBB-/Baa3	BBB-/Baa3	BBB-/Baa3	BBB-/Baa3
Swap Type	Variable Pay	Fixed Pay	Variable Pay	Fixed Pay
Benchmark	BMA	BMA	BMA	BMA
Reset	Weekly	Weekly	Weekly	Weekly
Notional Amount	56,485,000	56,485,000	38,725,000	38,725,000
Amortize (yes/no)	no	no	yes	yes
Execution Date	4/23/2001	9/20/2001	7/24/2001	7/24/2001
Start Date	5/24/2001	9/27/2001	1/3/2002	1/3/2002
End Date	7/1/2007	7/1/2009	7/1/2005	7/1/2007
Fixed Rate pay-(rec)	(6.000%)	3.870%	(5.50%)	4.150%
Day Count	30/360	30/360	30/360	30/360
Payment Dates	Jan. 1 & July 1	Jan. 1 & July 1	Jan. 1 & July 1	Jan. 1 & July 1
Security Provisions	Road Fund Inv.	Road Fund Inv.	Road Fund Inv.	Road Fund Inv.
Current Market Valuation June 30, 2004	0.00	0.00	0.00	0.00
Interest Earnings				
Cumulative Prior Periods	147,727	2,372,049	0.00	859,930
Current Period - 6/30/2004	0.00	438,967	0.00	177,901
Total	147,727	2,811,016	0.00	1,037,831

* *Moody's, S&P, Fitch*

As of June 30, 2004:

	Fund Source Total		Counter Party
Total Notional Amount Executed	General Fund	Road Fund	Morgan Stanley
	0	190,420,000	190,420,000

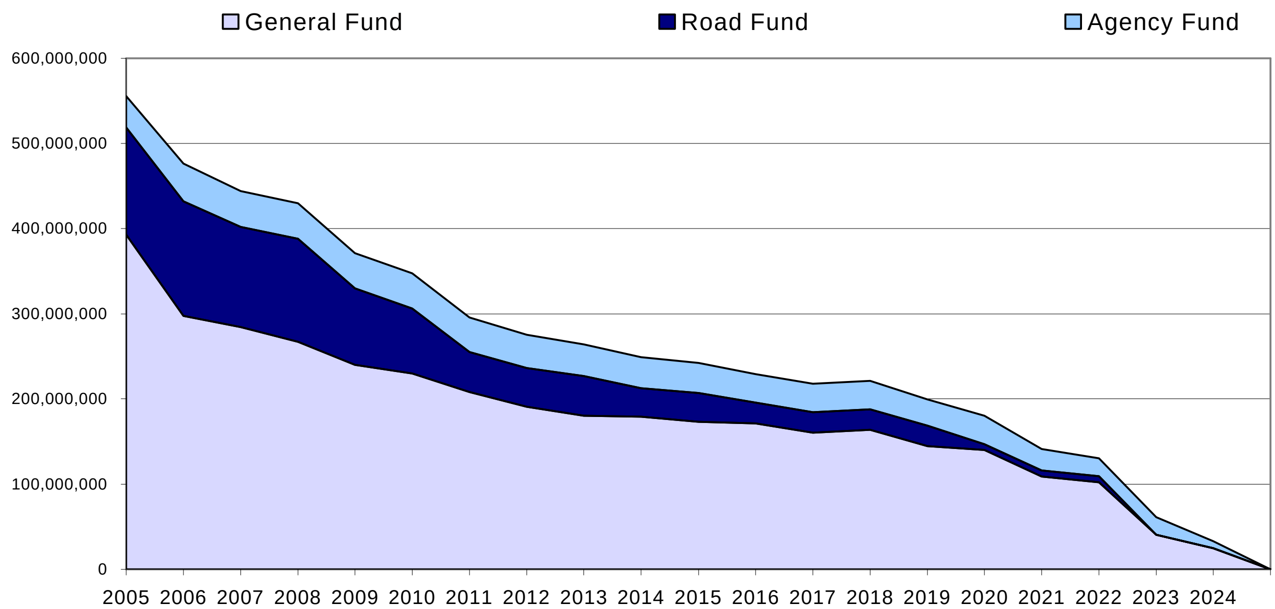
	Fund Source		Counter Party
Net Exposure Notional Amount	General Fund	Road Fund	Morgan Stanley
	0	0	0

	Debt Outstanding		10 Percent	
10 Percent Net Exposure	General Fund	Road Fund	General Fund	Road Fund
	2,219,778,258	792,988,526	221,977,826	79,298,853

	Investment Pool Balance		10 Percent	
10 Percent Investment Portfolio	Other Funds	Net Road Fund	Other Funds	Net Road Fund
	2,714,708,566	123,356,940	271,470,857	12,335,694

APPENDIX B

Appropriation Supported Debt Service by Fund Source
as of 06/30/04



APPENDIX C

Appropriation Debt Principal Outstanding by Fund Source
as of 06/30/04