Semi-Annual Report
Kentucky Asset/Liability Commission

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Finance and Administration Cabinet

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For the period ending June 30, 2005

This report may be viewed at

http://finance.ky.gov/ourcabinet/caboff/OOC/ofmdebt.htm

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Introduction

This is the Kentucky Asset/Liability Commission's ("ALCo") seventeenth semi-annual report pursuant to KRS 56.863(11) for the period beginning January 1, 2005 through June 30, 2005.

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
- U. S. economy exhibits strong growth.
- War in the Middle East continues.
- The Dow Jones Industrial Average finishes the period at 10,275 down 508 points from December 2004.
- Fed continues to raise short-term interest rates at a measured pace.

On the state level
- Trend of late budget adoption continues.
- Largest bond authorization in the history of the Commonwealth in the amount $2,056,315,300.
- Supreme Court renders a decision on Governor's ability to operate government without a legislatively enacted budget.
- FY 2005 General Fund revenues increased 9.6 percent over fiscal year 2004.

Investment Management

Market Overview. The fiscal year 2005 has experienced unique changes in interest rates. In 2001, the Federal Open Market Committee (FOMC) reduced the Federal Funds Rate in steps from 6.00 percent to 1.75 percent in response to the mild spring recession and the September 11th terrorist attack. Subsequently, the FOMC lowered Fed Funds further to a 50-year-low of 1.00 percent on June 25, 2003.

Beginning on June 30, 2004, the FOMC changed its stance stating that "policy accommodation can be removed at a pace that is likely to be measured". This is "Fed-speak" for raising the Fed Funds Rate. At that meeting, and every subsequent meeting, the FOMC has raised Fed Funds by 25 basis points to the current level of 3.25 percent. In most public discussion and statements, members of the committee indicate that the rate will continue to rise at a "measured pace" until something changes.

What is remarkable and nearly unprecedented about this tightening cycle is the change in longer term rates. Historically, the bond market has anticipated tightening cycles. Longer term interest rates have begun to rise before the FOMC makes its first move, and continue to rise through most of the cycle, frequently reaching a peak several months prior to the peak in Fed Funds.

During this tightening cycle, longer term interest rates have not risen along with the short term rates. The rate on 10-year Treasuries, for example, reached a high of 4.872 percent on June 14, 2004, just before the beginning of the tightening cycle. By June 30, 2004, the day of the first hike

in Fed Funds, the 10-year Treasury rate had fallen to 4.583 percent. Since then, the 10-year Treasury rate has gradually drifted lower to close the fiscal year at 3.915 percent. This extraordinary situation begs two questions. Why is it happening, and what are the consequences?

First, why is it happening? There are several theories but none have been commonly accepted as conclusive. First, demand seems to have increased for longer dated bonds such as the 10-year Treasury. The United States is considering, and the European Union has passed, regulations on defined benefit pension plans which force them to invest a larger percentage of their assets in long dated bonds. Several Asian countries, most notably Japan and China, are running substantial trade surpluses with the US. The dollars received by the foreign countries in exchange for these US imports are being recycled into US bonds, including long dated bonds. A number of hedge funds also seem to be buying long bonds in an effort to cash-in on these two movements.

Next, the supply of longer dated bonds is historically limited. The US does not issue bonds with more than 10 years to maturity. Very few European governments issue bonds with long maturities. Limited supply from the two principal issuers makes these bonds more valuable, resulting in a lower yield. This situation is changing. The US Treasury has announced that they will begin issuing 30-year Treasuries in February of 2006, and several European nations have recently issued or announced plans to issue 50-year bonds.

Finally, expectations for future inflation remain low even in light of recent increases in gas and oil prices. Theoretically, the yield on a bond should be the sum of inflation expectations, the risk-free real rate, and any risk or liquidity premiums. In other words, if inflation expectations are high, the yield on bonds will be high. Determining the market's expectations is an imprecise science, at best, but, in this case, there is a method that provides a good indication. The Treasury issues 10-year maturity bonds quarterly. In addition, they issue 10-year inflation linked notes semi-annually. The difference in the yield on these two securities gives a good indication of the market's consensus expectation for inflation. On July 15, 2005, the spread between these two securities stood at 2.21 percent which means that the market expects inflation of roughly 2.25 percent over the next 10 years. Adding this to an expected Real Return of roughly 1.75 percent justifies the yield on 10-year bonds of about 4.00 percent, which was the status at the end of the fiscal year.

So what does all of this mean going forward? The largest area of concern is the housing market. Mortgage loan rates are primarily tied to longer term bond rates. Because long term bonds, especially the 10-year Treasury, remain at relatively low levels, mortgage rates have remained at low levels. These low mortgage rates are fueling substantial increases in the value of housing. According to the Freddie Mac's Conventional Mortgage Home Price Index, prices have risen over 13 percent during the last 12 months. This compares with a 10-year average of slightly under 7 percent. Prices in certain areas are growing even faster, with Arizona and Nevada leading the way at over 28 percent, while several other areas are growing nearly 25 percent including California, Florida and the District of Columbia. (Kentucky is at 6.05 percent.)

Price appreciation at this level is clearly unsustainable and is considered by many to be a bubble, even worse than tech stocks in the 1990's and 2000. The Federal Reserve is trying to slow this level of appreciation without "popping" the bubble. The two tools being used are increases in Fed

Funds and "talking" the banking system into tightening credit standards and hence generating fewer mortgage loans. The risk to the economy is that this growth in wealth has allowed people to cash in their appreciation through refinancing and home equity loans leading to strong consumer spending. If the price appreciation stops or even turns negative, consumer spending and the economy as a whole will be dramatically impacted.

Portfolio Management. For the fiscal year ending June 30, 2005, the Commonwealth's investment portfolio averaged $3.1 billion. As of June 30, 2005, the portfolio was invested in U.S. Treasury Securities (11 percent), U.S. Agency Securities (23 percent), Mortgage Pass-Through Securities (1 percent), Collateralized Mortgage Obligations (5 percent), Repurchase Agreements (23 percent), Municipal Securities (5 percent), Corporate Securities (7 percent), Asset-Backed Securities (4 percent) and Money Market Securities (21 percent). The portfolio had a market yield of 3.19 percent and an effective duration of 0.85 years.

The total portfolio is broken down into four investment pools. The pool balances as of June 30, 2005, were Short Term Pool - $1,485 million, Intermediate Term Pool - $1,635 million, and Bond Proceeds Pool - $296 million. Total investment income from all investments, on a cash basis, for the year ended June 30, 2005, was $83.7 million versus $75 million for the previous fiscal year. On a full mark-to-market basis, investment income was $81 million for the year ended June 30, 2005, versus $23.9 million for the previous year.

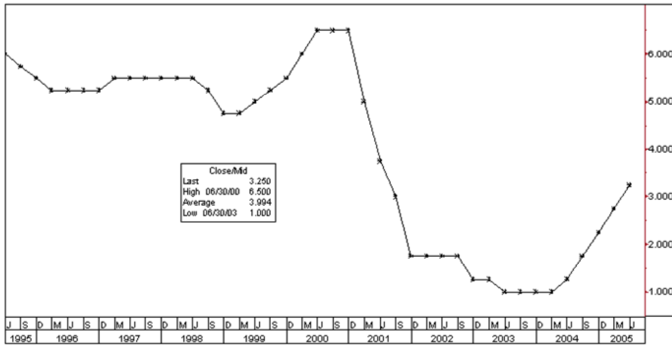
The substantial increase in investment income from fiscal year 2004 to 2005 is due to two primary factors. First, the average balance of investments increased nearly 30 percent from $2.4 to $3.1 billion. Second, the interest rate environment improved markedly. Federal Funds were set at 1.00 percent throughout almost all of 2004. They rose throughout all of 2005 ending the fiscal year at 3.25 percent. Additionally, the 5-year Treasury rate rose 135 basis points during fiscal year 2004 but was roughly unchanged from the beginning to the end of fiscal year 2005. Market value, and investment income, move inversely with longer term rates, so the increase in 2004 hurt investment income but was not a factor in 2005.

Tax-exempt Interest Rates and Relationships. The Bond Buyer 20-year General Obligation Index averaged 4.40 percent for the six-month period and 4.51 percent for fiscal year 2005. The fiscal year high was 4.98 percent in July 2004, and the low was 4.18 percent in June 2005.

The Bond Market Association ("BMA") Municipal Swap Index averaged 2.26 percent for the reporting period and 1.84 percent for the fiscal year. The fiscal year high was 3.00 percent in May 2005, and the low was 1.00 percent in July 2004. The 30-day USD London Interbank Offered Rate ("LIBOR") averaged 2.88 percent for the period and 2.36 percent for the fiscal year. The fiscal year high was 3.34 percent in June 2005, and the low was 1.35 percent in July 2004. BMA traded as high as 98 percent of 30-day LIBOR in April 2005 and as low as 60.3 percent in December 2004. BMA averaged 78 percent for the fiscal year and ended the fiscal year at 68.3 percent.

Federal Funds Target Rate

Range 6/30/95 - 6/30/05 Period Q Quarterly FDTR Index



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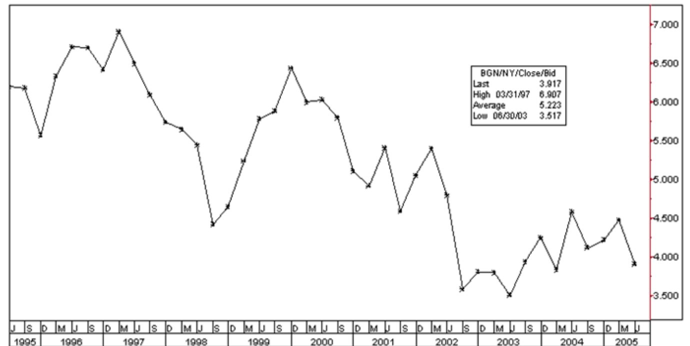
10-year Treasury Rates

Range 6/30/95 - 6/30/05 Period Q Quarterly GT10 Govt



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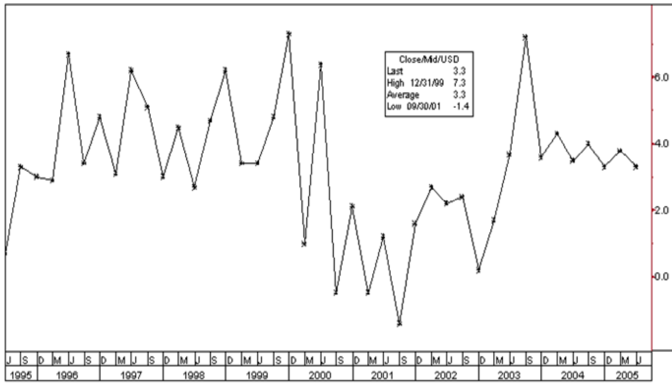
Gross Domestic Product
QUARTER-OVER-QUARTER INDEX

Range 6/30/95 - 6/30/05 Period Q Quarterly GDP CQOQ Index



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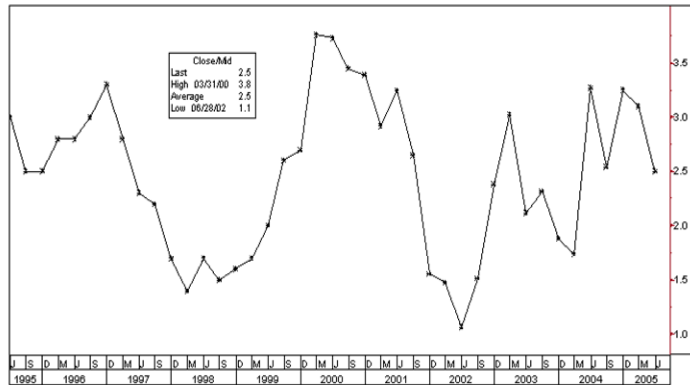
Consumer Price Index
YEAR-OVER-YEAR INDEX

Range 6/30/95 - 6/30/05 Period Q Quarterly CPI YOY Index



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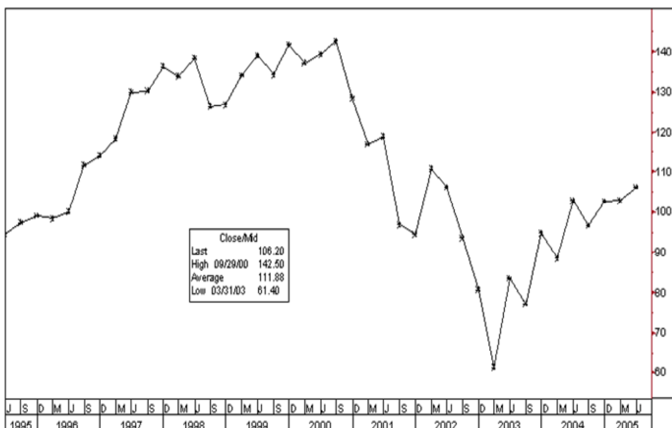
Consumer Confidence

Range 6/30/95 - 6/30/05 Period Q Quarterly CONCCONF Index



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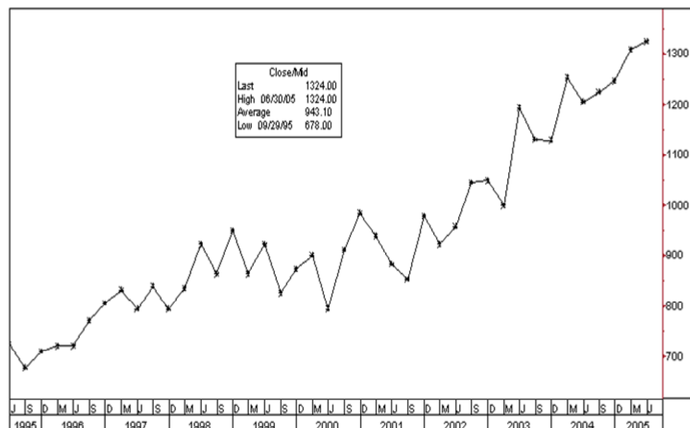
New Home Sales

Range 6/30/95 - 6/30/05 Period Q Quarterly NHSLTOT Index



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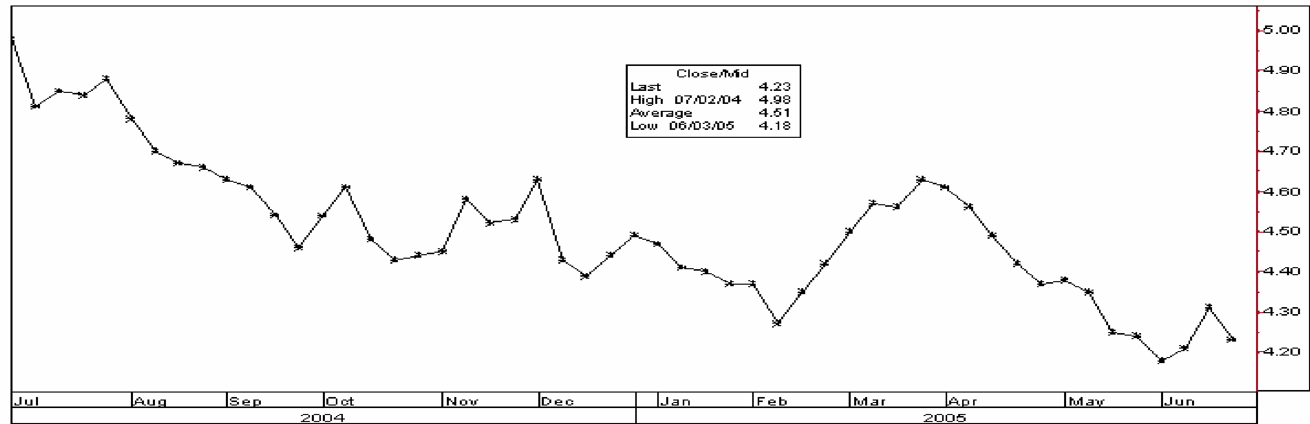
Bond Buyer 20-year General Obligation Index

Range 6/30/04 - 6/24/05 Period W Weekly

BBWK20GO Index



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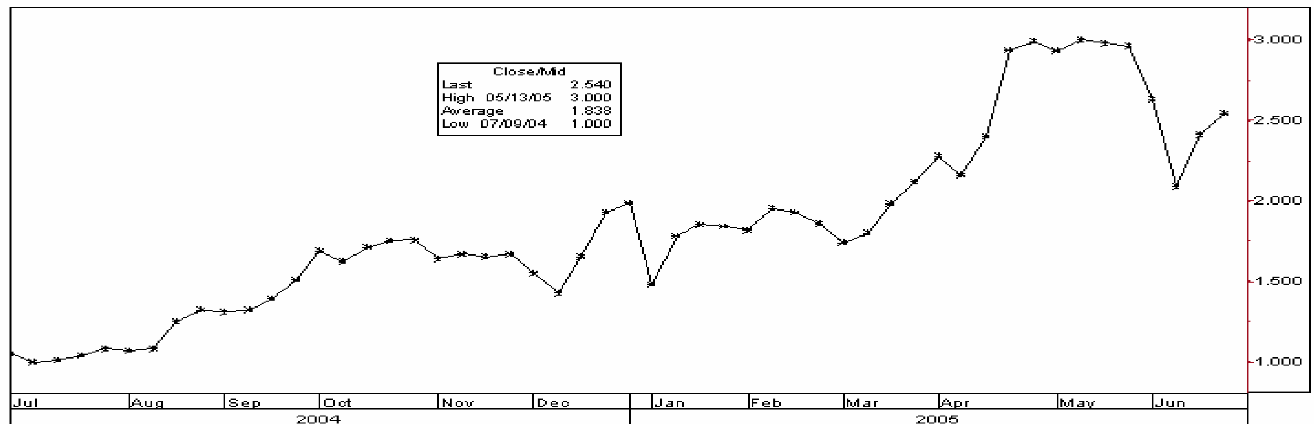
Bond Market Association "BMA"
Municipal Swap Index

Range 6/30/04 - 6/24/05 Period W Weekly

MUNIPSA Index



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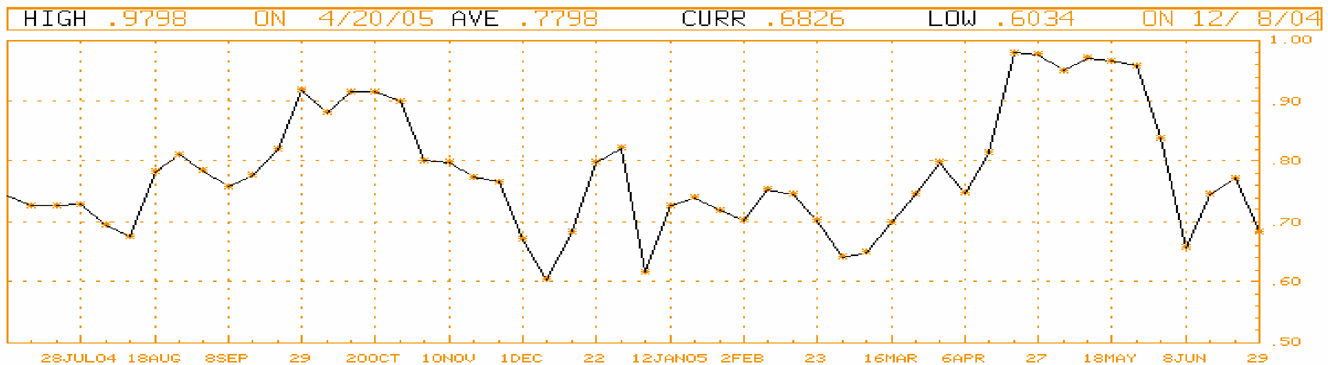
Bond Market Association "BMA" Municipal Swap Index
as a Percent of One Month LIBOR

RANGE 7/ 7/04 TO 6/29/05



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Debt Management

The 2005 Kentucky General Assembly authorized debt financing for projects totaling $2,056,315,300 to support various capital initiatives of the Commonwealth. Of the total authorization, $1,204,589,300 is General Fund supported, $251,726,000 is Agency Fund supported, $450,000,000 is Road Fund supported, and $150,000,000 is Federal Highway Trust Fund supported. It is anticipated that the projects will be funded in whole or in part prior to June 30, 2006.

Ratings Update.

The rating community has not taken any action since October 2002 when Standard & Poor's ("S & P") downgraded the state appropriation debt from "AA-" to "A+" with a stable outlook. Moody's rates the state's appropriation supported debt "Aa3" with negative outlook. Fitch Ratings assigns an "AA-" with no expression concerning the outlook. The newly implemented Federal Highway Trust Fund supported Grant Anticipation Revenue Vehicle (GARVEE) program, for which bonds were issued in June 2005, was assigned ratings of "AA-", "Aa3" and "AA-" by S & P, Moody's and Fitch, respectively. The ratings reflect strong coverage ratios and additional bonds test.

Tax and Revenue Anticipation Notes.

2005 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 2005 (FY2006) TRAN program in an amount not to exceed $800 million. On July 1, 2005, $600 million was delivered to mature on June 28, 2006. The 2005 Series A TRANs were sold by Citigroup Global Markets Inc. on June 23, 2005. The fixed rate notes carry a coupon of 4.00 percent to yield 2.67 percent. Net benefit is expected to be approximately $6.2 million to the General Fund.

ALCo entered into an Interest Rate Swap with UBS Financial Services Inc. to partially hedge the TRANs. In this transaction, the Commonwealth will receive a 3.81 percent fixed rate on $538 million notional amount. This rate will provide a spread of over 1.00 percent. The Commonwealth will pay 1-month LIBOR on the notional amount. The start date for the swap was July 1, 2005 with a maturity of June 28, 2006.

Table of Outstanding ALCo Notes as of June 30, 2005
(Excluding TRANS)

Series	Amount		
2001 General Fund Series	$ 17,475,000	Final Maturity	2/01/08
2003 General Fund Series	$123,755,000	Final Maturity	7/15/13
2005 General Fund Series	$ 81,850,000	Final Maturity	5/01/25
2005 Agency Fund Series	$ 11,275,000	Final Maturity	6/01/25
2005 FHTF Series	$139,635,000	Final Maturity	9/01/17
TOTAL	**$373,990,000**		

Financial Agreements

As of June 30, 2005, ALCo had four financial agreements outstanding, with a net notional amount exposure of zero. These transactions are detailed in Appendix A. The only Financial Agreement executed during the period was for the Turnpike Authority of Kentucky ("TAK") as an extension of the TAK Toll Road 1986 transaction to become effective July 1, 2005.

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. 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 $3.68 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.

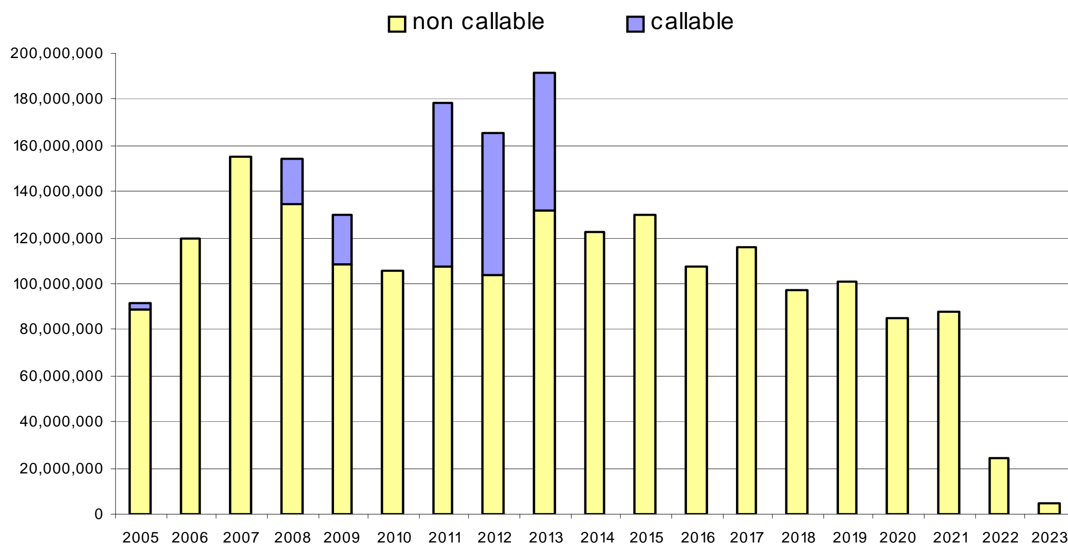
In 2003, the Federal Highway Administration awarded the state Transportation Cabinet approximately $13 million, the estimated remaining principal amount of the Toll Road Bonds related to the Toll Roads known as the Hal Rogers Daniel Boone Parkway and the Louie B. Nunn Cumberland Parkway. The award was 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 $1.38 million to date. The first leg of the original total return transaction matured on July 1, 2005, and as a result, the trade was extended in June 2005 to January 1, 2007 at which time the transaction is expected to be terminated.

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 was to be effective July 1, 2005 for a notional amount of $33,590,000 amortized through 2015. ALCo and TAK agreed to pay MS 3.64 percent plus expenses estimated to be 31 basis points. In exchange, MS would pay the Authority BMA, which would closely track the debt service on any variable rate bonds that would be issued as a result of this transaction. As a result of favorable market conditions, the large $450 million authorization of Road Fund supported bonds and the subsequent sale by TAK of one-half of that authorization as 2005 Series B Bonds, it was decided to terminate the swap. TAK issued fixed rate refunding bonds as 2005 Series A. The transaction resulted in greater than expected savings of $1.5 million when compared to the original projection of $1.1 million when the swap was executed. This is due to a favorable movement in the basis between the tax-exempt cash and swap markets.

Asset/Liability Model

General Fund

The State Property and Buildings Commission ("SPBC") debt portfolio as of June 30, 2005 had $2,149 million of bonds outstanding with a weighted average coupon of 5.23 percent, modified duration of 4.38 years, and a yield at market of 3.35 percent. The market yield increased by 21 basis points from the prior reporting period while modified duration decreased by .22 years reflecting maturing debt. The callable portion was $236 million and had an average coupon of 5.05 percent. The average coupon reflects investor preference for premium bonds in the current market at a yield lower than corresponding par or discount coupon bonds.

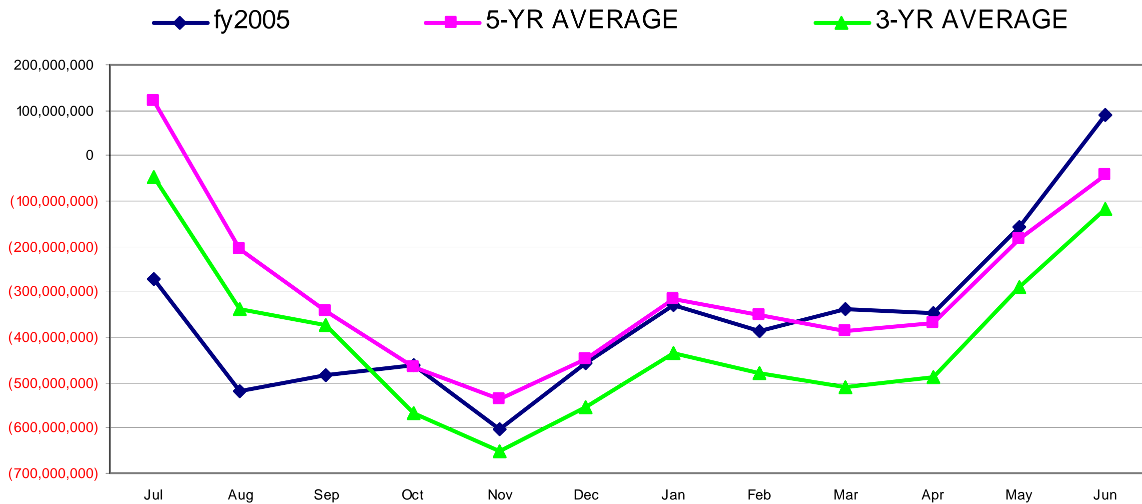


The SPBC General Fund debt structure has 29 percent of principal maturing in 5 years and 59 percent of principal maturing within 10 years. This is within the rating agencies' proposed targets of 27-30 percent due in 5 years and 55-60 percent maturing within 10 years.

The General Fund for the fiscal year had a high balance of $555 million on June 30, 2005, and a low of negative $679 million on November 11, 2004. The average and median balances were a negative $355 million and a negative $405 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 $377 million for fiscal year 2005.

Net Interest Margin will continue to be negative due to low cash balances versus outstanding fixed rate debt, compressed yield ratios, and a low level of interest rates as well as the callability of the debt portfolio.



SPBC 84. SPBC partially refunded five series of SPBC General Fund supported bonds generating net present value savings of $7 million or 3.86 percent of refunded bonds. The Bonds were delivered on March 23, 2005. The transaction was insured by MBIA Insurance Corporation ("MBIA"), and has extraordinary redemption provisions with a final maturity of August 1, 2023.

ALCo General Fund Notes. The $81,850,000 ALCo Project Notes, 2005 General Fund First Series provided financing for the General Fund supported Phase II Tobacco Settlement Payments authorized by the 2005 General Assembly. The Notes were delivered on June 8, 2005, have a ten-year call and a final maturity of May 1, 2025, and are insured by MBIA.

The 2005 General Assembly authorized $1,205 million General Fund supported debt for capital projects. To manage this large General Fund authorization, SPBC is to issue bonds for an initial project amount of $230 million in September 2005 for capital projects which are ready to expend proceeds. The remaining balance of authorized General Fund bond supported projects will be placed under an ALCo General Fund interim financing note program. Bond anticipation notes may be issued beginning in fall 2005, allowing state universities and state agencies to draw funds as needed.

Road Fund

The Road Fund average daily cash balance for fiscal year 2005 was $218 million compared to $184 million for fiscal year 2004. The Road Fund cash was invested in the Intermediate Term Investment Pool which had a duration of 1.32 years as of June 30, 2005. The Road Fund earned $5.5 million on a cash basis for fiscal year 2005 versus $7.5 million for fiscal year 2004. The low level of balances and debt authorization limited the opportunity to implement new asset liability management strategies. The GARVEE authorization of $150 million and one-half of the $450 million traditional Road Fund authorization were sold by June 30, 2005. The balance of the Road Fund authorization may be captured in an ALCo Road Fund interim plan of finance. The project will be permanently financed once expenditures reach a sufficient level on the 2005 Series B Bonds.

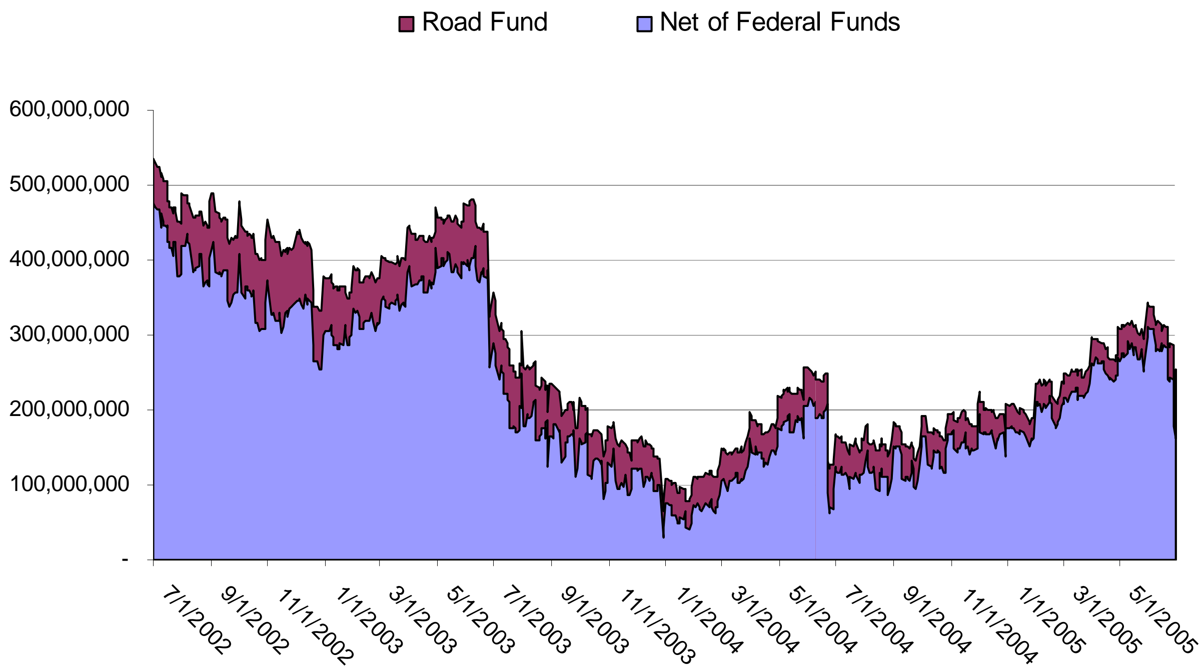
As of June 30, 2005, TAK had $833 million of bonds outstanding with a weighted average coupon of 4.82 percent, modified duration of 4.0 years, and yield at market of 3.29 percent. Selected maturities of the Resource Recovery 1985A and Toll Road 1986A bonds with the most economical value were previously synthetically refunded with financial agreements as identified previously. The currently callable 1995 Economic Development Road Revenue Bonds were synthetically and subsequently traditionally refunded as previously described.

TAK 2005 A & B. TAK issued $247,080,000 of Economic Development Road Revenue and Road Refunding Bonds (Revitalization Projects) consisting of $33,330,000 Economic Development Road Revenue Refunding Bonds, 2005 Series A and $213,750,000 Economic Development Road Revenue Bonds, 2005 Series B in fiscal year 2005. The 2005 Series A Bonds refunded all of the Authority's currently callable Economic Development Road Revenue Bonds (Revitalization Projects), Series 1995 having an aggregate principal amount of $32,710,000. The refunding generated net present value savings to the Road Fund of $1.5 million or 4.58 percent of the refunded bonds. The 2005 Series A bonds were delivered on April 27, 2005, are noncallable with a final maturity of July 1, 2015, and the later maturities are insured by the Financial Guaranty Insurance Company.

The 2005 Series B bond proceeds of $225 million will be used for Revitalization Projects, which include street and highway improvements that are a part of a local roads bond program authorized by the 2005 General Assembly. The 2005 Series B bonds were also delivered on April 27, 2005. The 2005 Series B bonds have a ten-year call, a final maturity of July 1, 2025, and later maturities are insured by Ambac Assurance Corporation.

ALCo Federal Highway Trust Fund Notes. The $139,635,000 ALCo Project Notes, 2005 Federal Highway Trust Fund First Series provided $150 million financing for interstate improvements on I-65, I-75, and I-64. The GARVEE Notes were delivered on June 8, 2005, have a ten-year call feature, a final maturity of September 1, 2017, and are insured by MBIA.

Road Fund debt service paid, net of reserve fund credits in fiscal year 2005, was $124 million resulting in a net interest margin (investment income earned less debt service paid) of negative $118 million. The negative amount stems from the level of investable balances and a general low level of interest rates on the investment side and 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 Agency Fund Notes. The $11,275,000 ALCo Project Notes, 2005 Agency Fund First Series provided financing for the taxable Agency Fund supported Military Affairs-Bluegrass Station Hangar/Warehouse project authorized by the 2005 General Assembly. The Notes were delivered on June 8, 2005, have a ten-year call option and a final maturity of June 1, 2025, and are insured by MBIA.

The 2005 General Assembly total debt authorization for Agency Fund bond supported capital projects was $251,726,000. A small portion of these capital projects have already been financed. However, the remaining portion of these projects is expected to be placed under an ALCo Agency Fund interim financing program which will allow the state universities and state agencies to receive funding for their projects as needed. The program is expected to become available in the fall 2005.

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 $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 for fiscal year 2004. In fiscal year 2005, the TRAN provided $2.8 million net benefit. The fiscal year 2006 TRAN is expected to produce approximately $6.2 million in benefits for a cumulative benefit of $35 million.

Debt Management. Debt service savings have contributed an estimated $316 million in value added since inception.

Total value added since inception is in excess of $378 million.

APPENDIX

APPENDIX A

SWAP SUMMARY

	TAK RR 85A Total Return	TAK RR 85A Fixed	TAK TR 86A Total Return[1]	TAK TR 86A Fixed	TAK ED 95 Fixed[2]
Fund Source	Road Fund	Road Fund	Road Fund	Road Fund	Road Fund
Hedge	Net Interest Margin	Total Return	Net Interest Margin	Total Return	Hedge
Counter-Party	Morgan Stanley	Morgan Stanley	Morgan Stanley	Morgan Stanley	Morgan Stanley
Counter-Party Ratings*	Aa3/A+/AA-	Aa3/A+/AA-	Aa3/A+/AA-	Aa3/A+/AA-	Aa3/A+/AA-
Termination Trigger	BBB-/Baa3	BBB-/Baa3	BBB-/Baa3	BBB-/Baa3	BBB-/Baa3
Swap Type	Variable Pay	Fixed Pay	Variable Pay	Fixed Pay	Fixed Pay
Benchmark	BMA	BMA	BMA	BMA	BMA
Reset	Weekly	Weekly	Weekly	Weekly	Weekly
Notional Amount	56,485,000	56,485,000	30,695,000	30,695,000	33,590,000
Amortize (yes/no)	no	no	yes	yes	yes
Execution Date	4/23/2001	9/20/2001	7/24/2001	7/24/2001	8/11/2004
Start Date	5/24/2001	9/27/2001	1/3/2002	1/3/2002	7/1/2005
End Date	7/1/2007	7/1/2009	1/1/2007	7/1/2007	7/1/2015
Fixed Rate pay-(rec)	(6.000%)	3.870%	(5.50%)	4.150%	3.950%
Day Count	30/360	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	Jan. 1 & July 1
Security Provisions	Road Fund Inv.	Road Fund Inv.	Road Fund Inv.	Road Fund Inv.	Road Fund DS
Current Market Valuation June 30, 2005	0.00	0.00	0.00	0.00	terminated
Interest Earnings					
Cumulative Prior Periods	147,727	3,237,753	0.00	1,206,907	0.00
Current Period - 6/30/2005	0.00	441,893	0.00	173,095	-219,000
Total	147,727	3,679,646	0.00	1,380,003	-219,000

Moody's, S&P, Fitch
[1] *Extended End Date to January 1, 2007*
[2] *Terminated on April 27, 2005 with $219,000 payment as priced on April 13, 2005.*

As of June 30, 2005:

Total Notional Amount Executed

Fund Source Total		Counter Party
General Fund	Road Fund	Morgan Stanley
0	174,360,000	174,360,000

Net Exposure Notional Amount

Fund Source		Counter Party
General Fund	Road Fund	Morgan Stanley
0	0	0

10 Percent Net Exposure

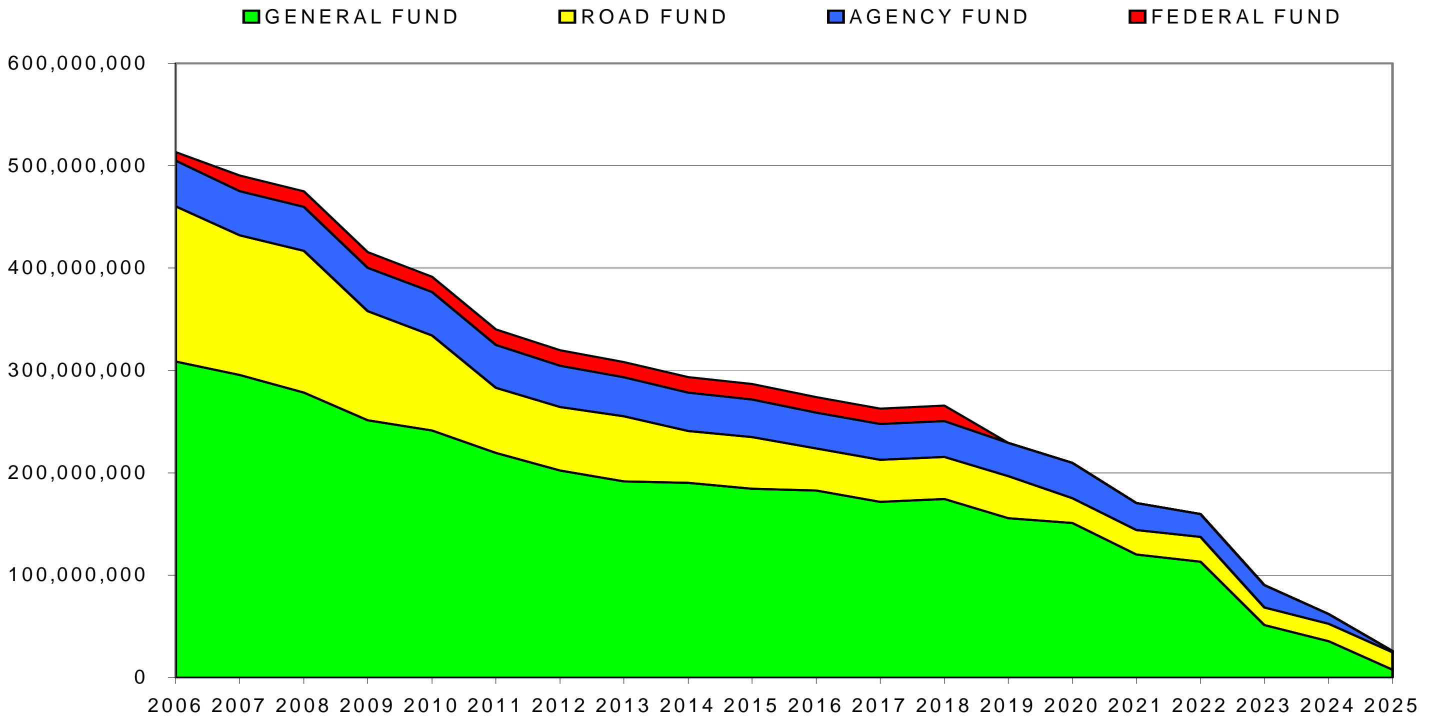
Debt Outstanding		10 Percent	
General Fund	Road Fund	General Fund	Road Fund
2,169,308,460	914,621,764	216,930,846	91,462,176

10 Percent Investment Portfolio

Investment Pool Balance		10 Percent	
Other Funds	Net Road Fund	Other Funds	Net Road Fund
3,193,285,395	223,045,473	319,328,540	22,304,547

APPENDIX B

Appropriation Supported Debt Service by Fund Source as of 06/30/05



APPENDIX C

Appropriation Debt Principal Outstanding by Fund Source as of 06/30/05