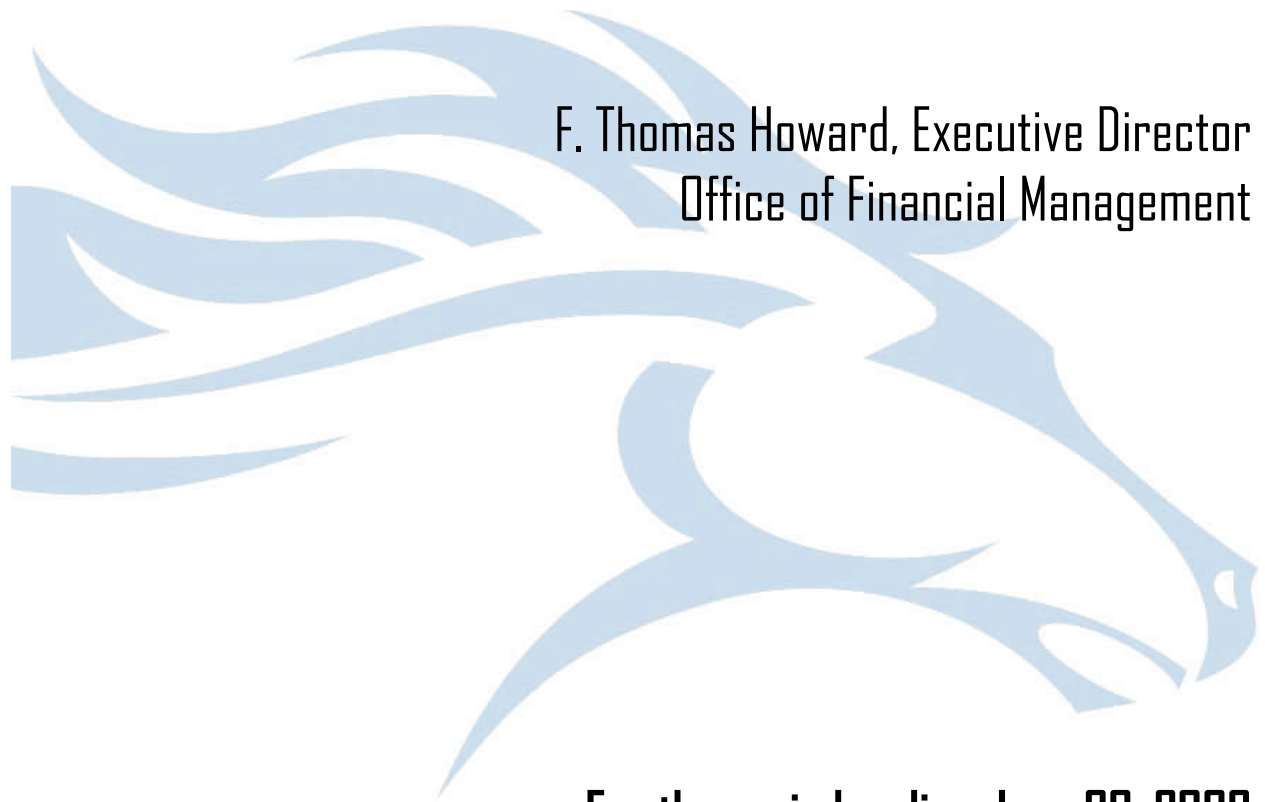


Semi-Annual Report **Kentucky Asset/Liability Commission**

Ernie Fletcher, Governor
Commonwealth of Kentucky

John Farris, Secretary
Finance and Administration Cabinet

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Office of Financial Management



For the period ending June 30, 2006

This report may be viewed at

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

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INTRODUCTION

This is the Kentucky Asset/Liability Commission's ("ALCo") nineteenth semi-annual report pursuant to KRS 56.863 (11) for the period beginning January 1, 2006 through June 30, 2006. 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 continues to exhibit solid growth.
- War in the Middle East continues.
- The Dow Jones Industrial Average finishes the fiscal year at 11,150 up 433 points from December 2005.
- Ben Bernanke begins tenure as chair of Federal Reserve.
- Fed continues to raise short-term interest rates at a measured pace.

On the state level

- Passage of the largest bond authorization in the Commonwealth's history, eclipses 2005 record.
- Fiscal year 2006 General Fund revenues increased 9.6 percent over fiscal year 2005.

INVESTMENT MANAGEMENT

Market Overview. On June 30, 2004, the Federal Reserve Open Market Committee voted to increase the Federal Funds rate by 25 basis points to 1.25 percent. Over the next two years, the FOMC continued to increase Fed Funds by 25 basis points at each meeting bringing it to 5.25 percent at the June 29, 2006, meeting. Even through a change in Federal Reserve Chairmen from Alan Greenspan to Ben Bernanke, this steady and predictable course continued. They are now at or near a turning point as the Committee believes that the future course “will depend on the evolution of the outlook for both inflation and economic growth, as implied by incoming information”.

Four words in this quote mark a substantial change in the approach the FOMC uses for deciding monetary policy: “evolution of the outlook”. In the past, the Committee has largely decided the course of monetary policy by examining the current level of growth and inflation, and the potential risks to that level. Now the Committee is targeting the future expectation for the path of inflation and growth. This change reflects the recognition that monetary policy affects the economy with a time lag that is both variable and immeasurable. Most economists place the lag time at 6 to 18 months. Going forward, it will become more important to examine the FOMC’s projection of inflation and growth rather than the current level.

The first consideration is inflation. The FOMC’s preferred inflation measure is the Core PCE (Personnel Consumption Expenditure) Price Index. This index of inflation measures the change in the price of goods and services actually purchased by consumers, excluding food and energy. In contrast, CPI (Consumer Price Index) measures the change in price of a large basket of goods. The year over year Core PCE Price Index reached a cyclical low of 1.30 percent in the third quarter of 2003. It has reached a cyclical high of 2.27 percent in the second quarter of 2006. According to the Monetary Policy Report presented to Congress on July 19, 2006, the FOMC expects it to remain in the 2.25 percent to 2.50 percent range through the rest of 2006. In 2007, it is expected to fall to the 2.00 percent to 2.25 percent range. While the FOMC has not quantified its comfort zone for inflation, most likely 2.00 percent is pretty close.

The next consideration is growth. The broadest measure of growth is the change in Real GDP (Gross Domestic Product). Real GDP growth, year over year, has been running at about 3.0 percent to 3.5 percent from the middle of 2003 through the end of 2005. In the first quarter of 2006, it accelerated to 3.7 percent and has slowed back to 3.5 percent in the second quarter. (Please note, this is the year over year measure, not the Headline number which was 5.6 percent in the 1st quarter and 2.5 percent in the second quarter of this year.) The FOMC is projecting the rate of growth to fall into the 3.25 percent to 3.50 percent range during the last half of 2006 and to reach the 3.00 percent to 3.25 percent range during 2007.

Looking at these two statistics together paints a fairly positive forecast. Long term non-inflationary trend GDP growth is believed to be about 3.0 percent to 3.50 percent while most economists believe the FOMC is comfortable with inflation in the 1.0 percent to 2.0 percent range. The current forecasts are within or at least close to these ranges. The Fed should be on hold, or at least have few changes over the next six months.

Portfolio Management. For the fiscal year ended June 30, 2006, the Commonwealth's investment portfolio averaged \$3.998 billion. As of June 30, 2006, the portfolio was invested in U.S. Treasury Securities (8 percent), U.S. Agency Securities (25 percent), Mortgage Pass Through Securities (3 percent), Collateralized Mortgage Obligations (5 percent), Repurchase Agreements (18 percent), Municipal Securities (6 percent), Corporate Securities (7 percent), Asset-Backed Securities (11 percent) and Money Market Securities (17 percent). The portfolio had a market yield of 5.39 percent and an effective duration of 0.70 years.

The total portfolio is broken down into five investment pools. The pool balances as of June 30, 2006 were: Short Term Pool - \$2,033 million, Intermediate Term Pool - \$1,744 million, Bond Proceeds Pool - \$330 million, TRAN Pool - \$6 million, and UK Hospital Pool - \$85 million. Total investment income from all investments, on a cash basis, for the fiscal year ended June 30, 2006 was \$130.2 million versus \$83.7 million for the year ended June 30, 2005. On a full mark-to-market basis, investment income was \$132.8 million for the fiscal year ended June 30, 2006, versus \$81 million for the same period in 2005.

The two measures of income increased substantially from the previous fiscal year for two primary reasons. First, the average balance of the investment portfolios invested increased by roughly \$900 million from \$3.1 billion to nearly \$4.0 billion from fiscal year 2005 to 2006. Second, the interest rate environment was substantially higher in fiscal year 2006 than in fiscal year 2005. For example, the average rate on the two-year Treasury went from 3.10 percent in fiscal year 2005 to 4.47 percent in fiscal year 2006.

Tax-exempt Interest Rates and Relationships. The Bond Buyer 20-year General Obligation Index averaged 4.50 percent for the six-month period and 4.45 percent for fiscal year 2006. The fiscal year high was 4.71 percent in June 2006 and the low was 4.18 percent in September 2005.

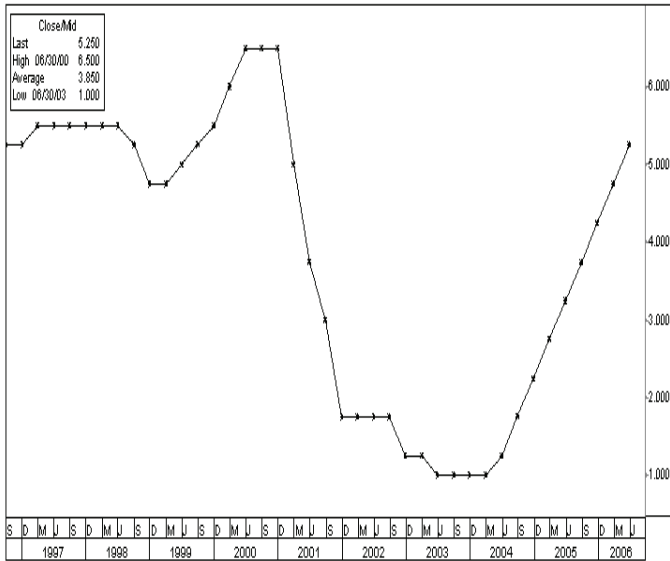
The Bond Market Association ("BMA") Municipal Swap Index averaged 3.33 percent for the reporting period and 3.00 percent for the fiscal year. The fiscal year high was 3.97 percent in June 2006 and the low was 1.97 percent in July 2005. The 30-day USD London Interbank Offered Rate ("LIBOR") averaged 4.85 percent for the period and 4.36 percent for the fiscal year. The fiscal year low was 3.34 percent in July 2005 and the high was 5.35 percent in June 2006. During the fiscal year, BMA traded as high as 80 percent of 30-day LIBOR in December 2005 and as low as 59 percent in August 2005. BMA averaged 69 percent for the fiscal year and ended the fiscal year at 74 percent.

Federal Funds Target Rate

Range 6/30/96 - 6/30/06

FDTR Index

Period Q Quarterly



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Real Gross Domestic Product

YEAR-OVER-YEAR INDEX

Range 6/30/96 - 6/30/06

GDP CYOY Index

Period Q Quarterly



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Core Personnel Consumption Expenditure Price

QUARTER-OVER-QUARTER INDEX

Range 6/30/96 - 6/30/06

GDPCCPEY Index

Period Q Quarterly



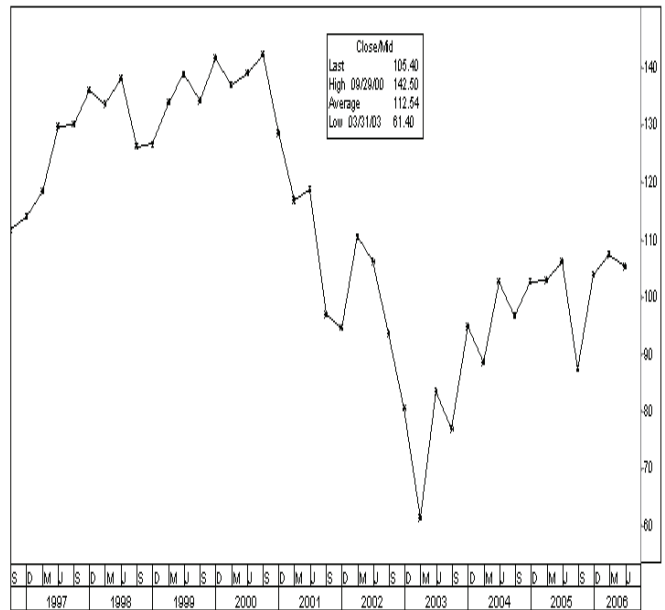
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Consumer Confidence

Range 6/30/96 - 6/30/06

CONCCONF Index

Period Q Quarterly

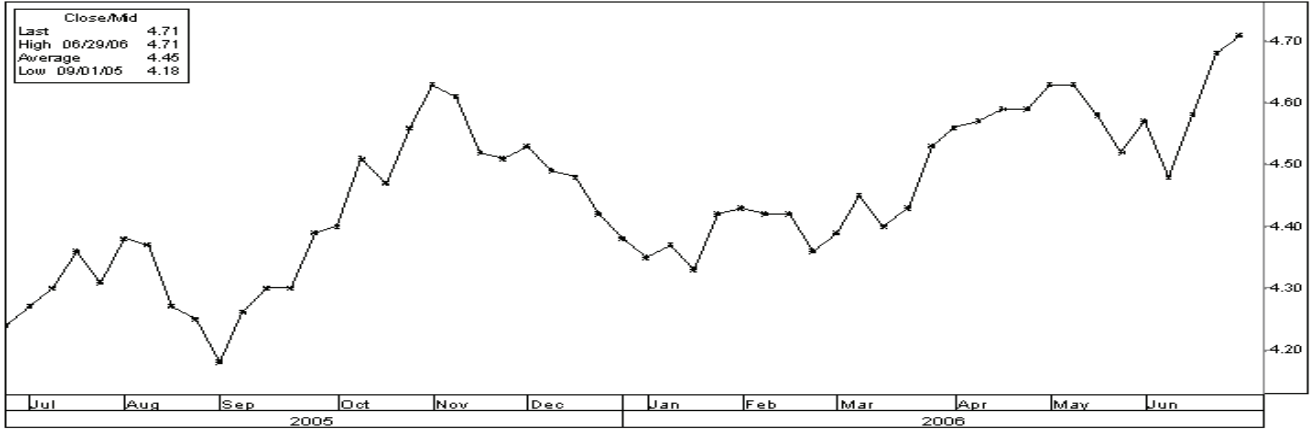


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Bond Buyer 20-year General Obligation Index

Range **6/30/05** - **6/29/06**

Period **BBWK20GO Index**
Weekly

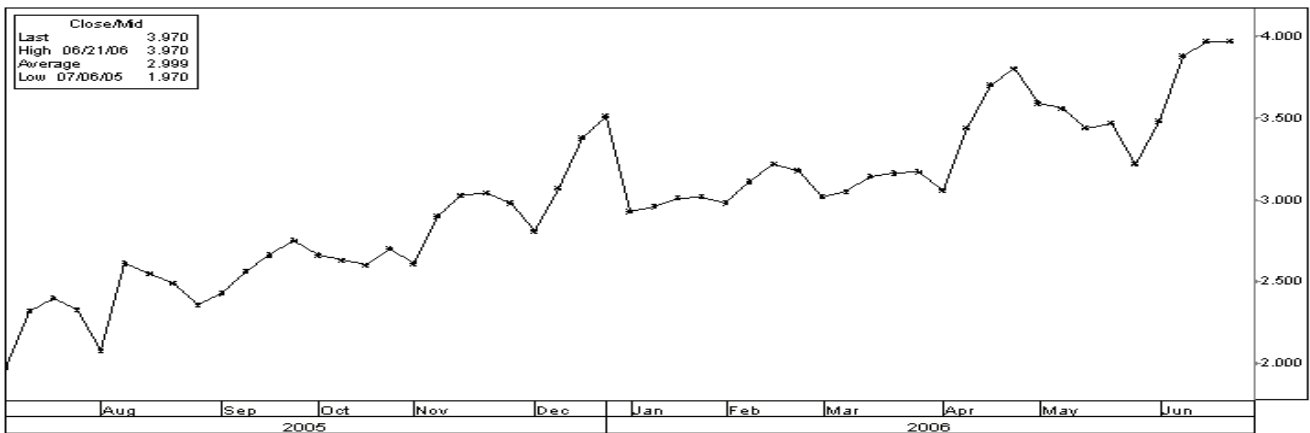


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Bond Market Association "BMA"
Municipal Swap Index

Range **7/ 6/05** - **6/28/06**

Period **MUNIPSA Index**
Weekly

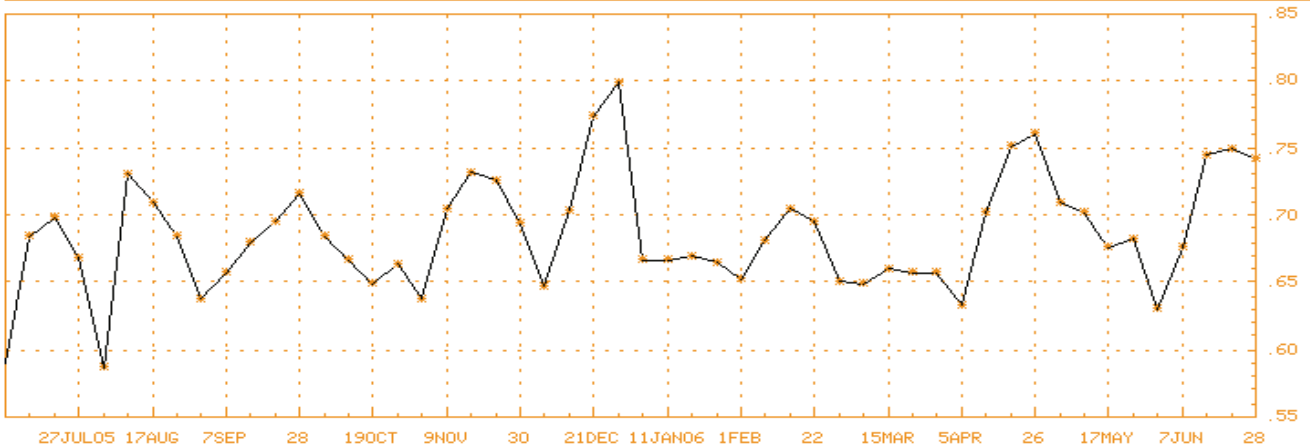


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Bond Market Association "BMA" Municipal Swap Index
as a Percent of One Month LIBOR

RANGE **7/ 6/05** TO **6/28/06**

HIGH **.7998** ON **12/28/05** AVE **.6855** CURR **.7421** LOW **.5859** ON **8/ 3/05**



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DEBT MANAGEMENT

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

The 2006 General Assembly adopted a State Budget for the biennium ending June 30, 2008 which authorized an additional \$2.3 billion of capital projects to be funded with debt. The General Fund authorization is \$1,392.9 million; the Agency Fund authorizations total \$267.5 million; while the Road Fund and Federal Highway Trust Fund authorizations are \$350 million and \$290 million, respectively. The timing of the issuance of obligations is uncertain.

Ratings Update

Although each state is unique and operates differently, several factors can affect the state's ratings positively or negatively from the perspective of the rating community. Enhancements include an additional bonds test, strong coverage ratios of debt service obligations from revenues, dedicated revenues provided for bond payments, high level financial control including close revenue monitoring, continuous strengthening of state revenues and rebuilding of reserves, strong per capita income and debt ratios, the ability to pass a timely and structurally balanced budget, establishing the essential nature of projects and strong state support, and continuous revenue growth over fiscal years. The absence or lack of accomplishment in the above areas could, however, hinder the state's ratings. In addition, the state's future capital needs, continued reliance on manufacturing sector, the debt burden on the operating budget, and pension funding ratios are also factors which could negatively affect state ratings.

An upgrade resulted when Standard & Poor's ("S & P") considered these and other factors in their review of the TAK Economic Development Road Revenue Bonds (Revitalization Projects) program in early 2006. TAK's rating was raised from A+ to AA reflecting the strong coverage of debt service obligations from constitutionally dedicated Road Fund revenue and the limited borrowing above existing levels.

Tax and Revenue Anticipation Notes

2006 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 2006 (FY2007) TRAN program in an amount not to exceed \$600 million. On July 3, 2006, \$150 million was delivered to mature on June 28, 2007. The 2006 Series A TRANs were sold by Citigroup Global Markets Inc. on June 21, 2006. The fixed rate notes carry a coupon of 4.50 percent to yield 3.70 percent. The net benefit to the General Fund is expected to be approximately \$2.5 million. The \$600 million 2005 TRAN provided a net benefit of \$6 million to the General Fund in FY 2006.

ALCo entered into an Interest Rate Swap with JP Morgan Chase Bank, N.A. to partially hedge the 2006 TRAN. The Commonwealth will receive a 5.61 percent fixed rate on \$150 million notional amount (1.75 percent above cost of funds) while paying one-month LIBOR. The start date for the swap was July 3, 2006 with a maturity of June 28, 2007.

FINANCIAL AGREEMENTS

As of June 30, 2006, ALCo had six financial agreements outstanding, with a net notional amount exposure of \$160 million. The terms of these transactions are detailed in Appendix A. There were two Financial Agreements executed during the period, each with three counterparties.

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 \$4.6 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 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 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 \$1.6 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 to January 1, 2007 at which time the transaction is expected to be terminated.

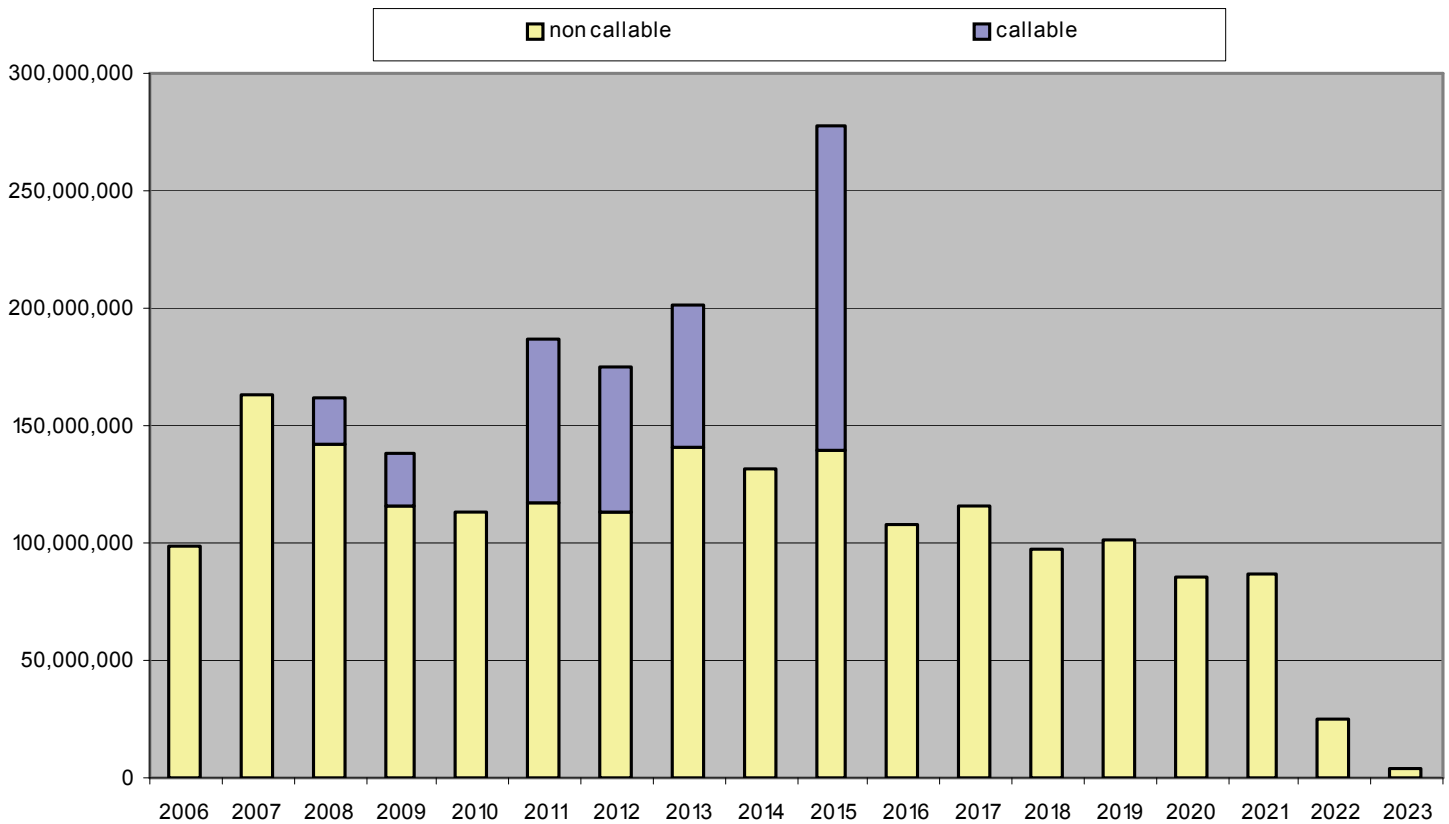
In January 2006, to protect against a continued rise in interest rates, ALCo competitively bid and subsequently entered into two (2) \$80 million interest rate swap transactions with three counterparties to hedge the future issuance of \$300 million of permanent tax-exempt bonds for General Fund authorized but unissued projects. The 2007 and 2008 forward-starting swap agreements feature mandatory early termination dates of February 14, 2007 and February 13, 2008, respectively. The hedge allowed the fiscal year 2007 and fiscal year 2008 debt service to be appropriated at 4.40 percent rather than the budgeted template rate of 6.50 percent. This resulted in annual savings (reduction in appropriation) to the General Fund of \$4,445,000. In September 2006, the 2008 swap was converted from LIBOR to BMA to limit basis risk resulting in further savings to the General Fund. UBS, Citigroup and JP Morgan are counterparties in these transactions.

ASSET/LIABILITY MODEL

GENERAL FUND

The State Property and Buildings Commission (“SPBC”) debt portfolio as of June 30, 2006 had \$2,259 million of bonds outstanding with a weighted average coupon of 5.25 percent, modified duration of 4.08 years, and a yield at market of 3.64 percent. The market yield decreased by 7 basis points from the prior reporting period while modified duration increased by 1.23 years. The callable portion was \$371 million and had an average coupon of 5.01 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.

Call Analysis
State Property and Buildings Commission Bonds

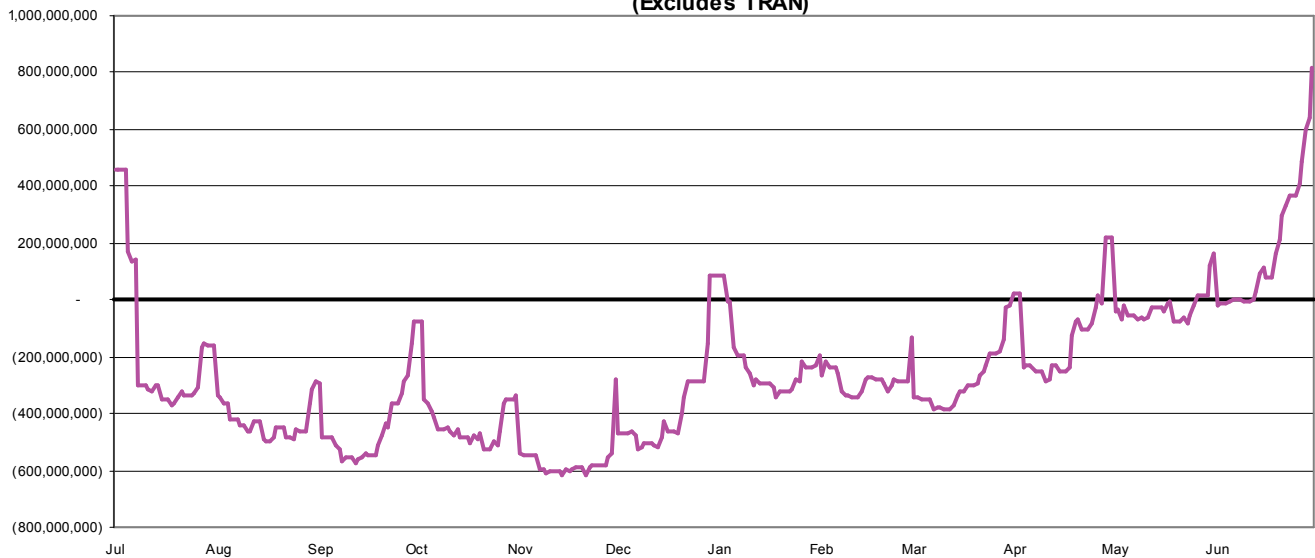


The SPBC General Fund debt structure has 30 percent of principal maturing in 5 years and 61 percent of principal maturing within 10 years. This is at the upper range of the rating agencies’ proposed targets of 27-30 percent due in 5 years and 55-60 percent maturing within 10 years.

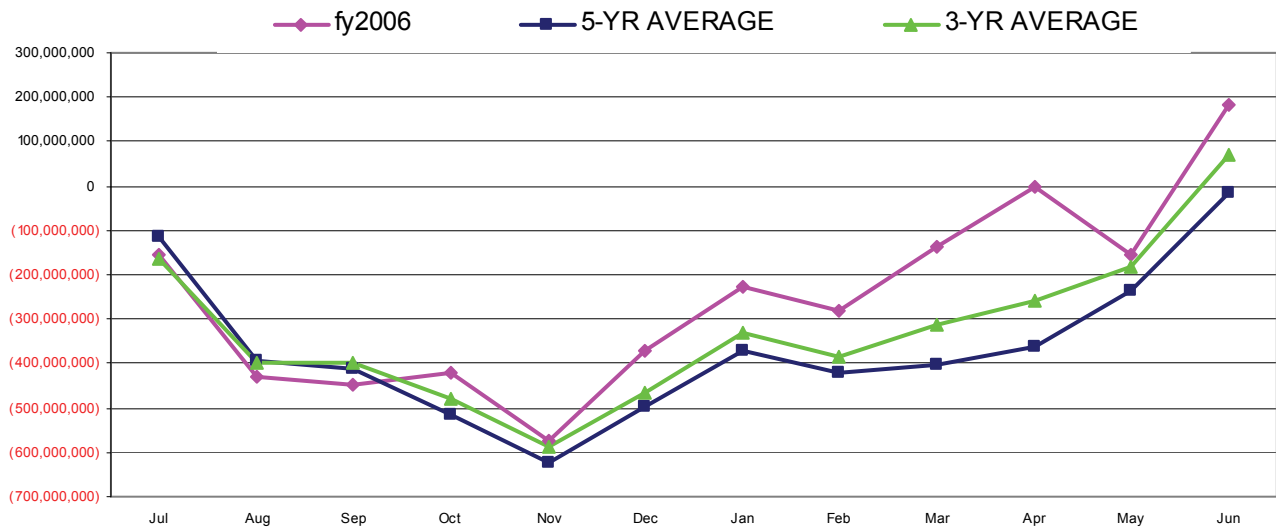
The General Fund had a high balance of \$820 million on June 30, 2006 and a low of negative \$618 million on November 14, 2005. The average and median balances were a negative \$263 million and \$302 million, respectively. Since the General Fund continued to have a negative available cash balance for 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 \$398 million for fiscal year 2006. Net interest margin will continue to be negative due to low cash balances versus outstanding fixed rate debt, compressed yield ratios, relatively low level of interest rates as well as the callability of the debt portfolio and high debt authorizations.

GENERAL FUND AVAILABLE BALANCE
Fiscal Year 2006
(Excludes TRAN)



GENERAL FUND MONTHLY AVERAGE
(Excluding TRAN Proceeds)



ALCo Project Notes, 2005 General Fund Second Series

The remaining \$640 million General Fund supported bond projects, authorized by the 2005 General Assembly but not yet permanently financed, were placed under an ALCo interim plan of finance. The 2005 General Fund Second Series Note program, not to exceed \$750 million, allows state agencies and universities to move forward with their capital projects. The projects were placed under the program because they are not expected to meet the IRS spend-down requirements of a traditional bond issue. OFM will monitor the expenditures and direct the issuance of notes as needed. An initial tax-exempt tranche of \$100,000,000, in two Series, was delivered on November 2, 2005. As of June 30, 2006, \$43 million had been expended on the projects. The Note Series are supported by standby note purchase agreements provided by Dexia Credit Local, a leading European bank based in France. JP Morgan and UBS each provide remarketing services for the two separate \$50 million Note Series, both initially issued in the commercial paper rate mode. JP Morgan issued \$7 million at 2.82 percent to February 15, 2006 and \$43 million at 3.15 percent to October 12, 2006. UBS sold \$50 million at 3.15 percent to October 11, 2006. Additional remarketings and the cost of capital to date is provided in Appendix C.

ALCo Project Notes, 2005 General Fund First Series

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

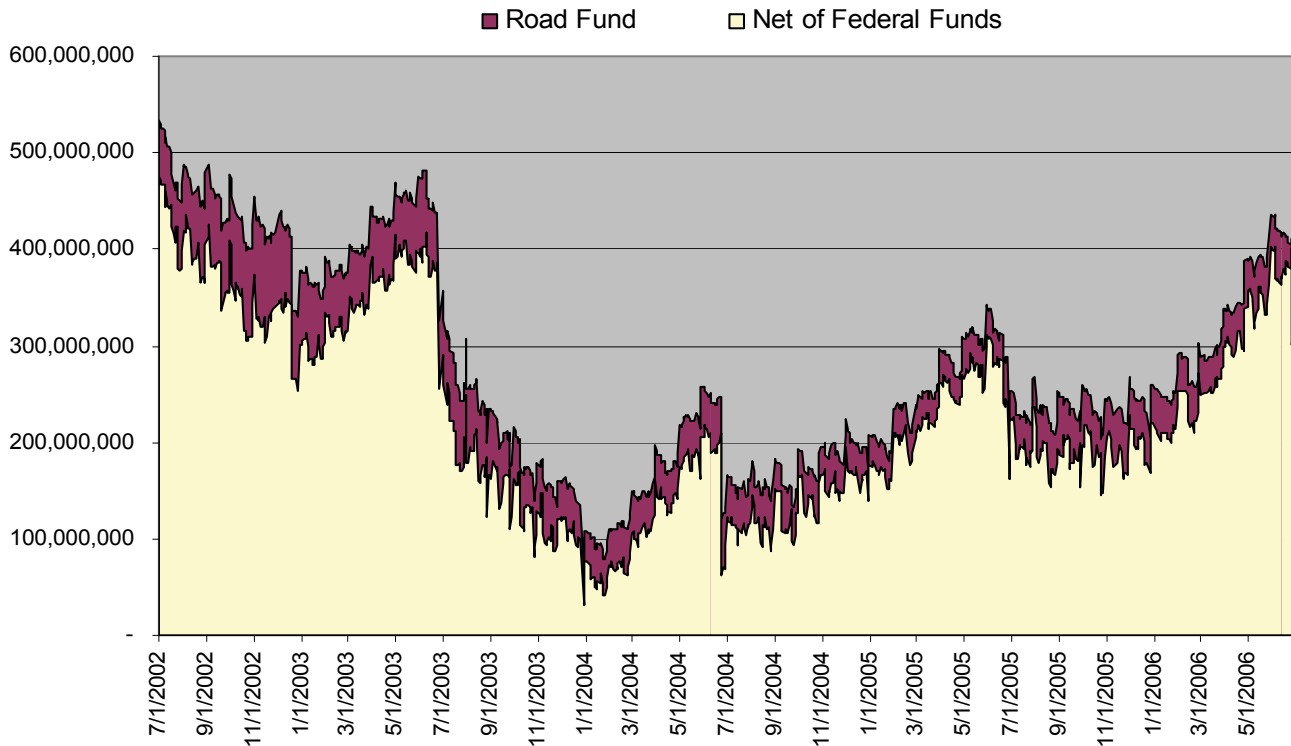
ROAD FUND

The Road Fund average daily cash balance for fiscal year 2006 was \$281 million compared to \$218 million for fiscal year 2005. The Road Fund cash was invested in the Intermediate Term Investment Pool which had a duration of 1.30 years as of June 30, 2006. The Road Fund earned \$6.4 million on a cash basis for fiscal year 2006 versus \$5.5 million for fiscal year 2005. The current level of balances versus significant debt authorizations limited the opportunity to implement new asset liability management strategies at this time.

As of June 30, 2006, TAK had \$976 million of bonds outstanding with a weighted average coupon of 4.86 percent, modified duration of 4.19 years, and yield at market of 3.75 percent.

Road Fund debt service paid, net of reserve fund credits for fiscal year 2006, was \$151.8 million resulting in a net interest margin (investment income earned less debt service paid) of negative \$145.5 million. The negative amount stems from the level of investable balances and 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.

**Road Fund Available Balance
Fiscal Years 2003-06**



TAK 2006 A & B

TAK issued the remaining 2005 Road Fund bond authorization with the \$221,235,000 Economic Development Road Revenue Bonds (Revitalization Projects) 2006 Series A and B. These Revitalization Projects include street and highway improvements that are a part of a local roads bond program. This transaction was sold in February 2006 with a Series A current delivery in March 2006 and a Series B forward delivery in June 2006. Select maturities are insured by Ambac Assurance Corporation. The bonds are callable on or after July 1, 2016 at par. The 20-year level debt has a final maturity of July 1, 2026 and an all-in TIC of 4.37 percent.

AGENCY FUND

ALCo Project Notes, 2005 Agency Fund Second Series

Agency Fund supported bond projects not already financed by the university, ALCo and SPBC have been placed under a plan of finance. The ALCo Agency Fund Second Series interim financing note program allows various state universities and state agencies to receive funding for their projects as needed. The Program's initial draws were for projects for the Cabinet for Economic Development (Series A-1) and for the University of Louisville (Series A-2), both delivered on December 15, 2005. Additional draws from the program have been for projects for Northern

Kentucky University (Series A-3) delivered on March 20, 2006 and for Western Kentucky University (Series A-4) delivered on June 29, 2006. The Notes have a variable interest rate, reset weekly, based on a fixed spread to BMA to be determined by the rating assigned to the Note Series. The private placement of the Notes is with Citigroup Global Markets, Inc. At June 30, 2006, \$24,280,000 was outstanding under the not to exceed \$250,000,000 Note Program. Presently all outstanding series have received ratings of A1 by Moody's and have been priced at BMA plus 45 basis points.

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 achieved \$6 million in net income. The fiscal year 2007 TRAN is expected to produce net income of approximately \$2.5 million for a cumulative benefit of \$38 million.

Debt Management. Debt service savings have contributed an estimated \$367 million in value added since inception.

Total value added since inception is in excess of \$432 million.

APPENDIX



APPENDIX A SWAP SUMMARY

General Fund Financial Agreements	\$80,000,000			\$80,000,000		
Notional Amount	40,000,000	20,000,000	20,000,000	40,000,000	20,000,000	20,000,000
Fund Source	----- General Fund -----			----- General Fund -----		
Hedge	----- Net Interest Margin -----			----- Net Interest Margin -----		
Counter-Party	UBS	Citibank	JPMorgan	UBS	Citibank	JPMorgan
Counter-Party Ratings*	Aa2/AA+/ AA+	Aa1/AA/AA+	Aa3/A+/A+	Aa2/AA+/ AA+	Aa1/AA/AA+	Aa3/A+/A+
Termination Trigger	A3/A-	Baa3/BBB-	Baa3/BBB-	A3/A-	Baa3/BBB-	Baa3/BBB-
Swap Type	----- Fixed Pay -----			----- Fixed Pay -----		
Benchmark	----- 3 month LIBOR -----			----- 3 month LIBOR -----		
Reset	----- Weekly -----			----- Weekly -----		
Amortize (yes/no)	----- yes -----			----- yes -----		
Execution Date	----- 1/10/2006 -----			----- 1/10/2006 -----		
Start Date	----- 2/14/2007 -----			----- 2/13/2008 -----		
Mandatory Early Termination	----- 2/14/2007 -----			----- 2/13/2008 -----		
Cash Settlement Payment Date	----- 2/28/2007 -----			----- 2/27/2008 -----		
End Date	----- 2/14/2027 -----			----- 2/13/2028 -----		
Fixed Rate pay-(rec)	----- 5.008% -----			----- 5.038% -----		
Day Count	----- 30/360 -----			----- 30/360 -----		
Payment Dates	----- quarterly -----			----- quarterly -----		
Security Provisions	Bonds payable from General Fund			Bonds payable from General Fund		
Current Market Valuation June 30, 2006	2,313,607	1,145,673	1,152,470	2,165,313	1,072,465	1,079,969

* Moody's, S&P, Fitch

Road Fund
Financial Agreements

	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/A+/AA-	Aa3/A+/AA-	Aa3/A+/AA-	Aa3/A+/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	29,615,000	29,615,000
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	1/1/2007	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, 2006	0.00	0.00	0.00	0.00
Interest Earnings				
Cumulative Prior Periods	147,727	4,110,499	0.00	1,516,524
Current Period - 06/30/2006	0.00	370,707	0.00	134,559
Total	147,727	4,481,206	0.00	1,651,082

* Moody's, S&P, Fitch

Swap Summary
As of June 30, 2006:

<u>Total Notional Amount Executed</u>		<u>Net Exposure Notional Amount</u>	
<u>General Fund</u>	<u>Road Fund</u>	<u>General Fund</u>	<u>Road Fund</u>
160,000,000	172,200,000	160,000,000	0

Total Notional Amount Executed by Counter Party

<u>Morgan Stanley</u>	<u>UBS</u>	<u>Citibank</u>	<u>JPMorgan</u>
172,200,000	80,000,000	40,000,000	40,000,000

Debt Outstanding

<u>General Fund</u>	<u>Road Fund</u>
2,334,752,746	1,054,282,447

10 Percent Net Exposure

<u>General Fund</u>	<u>Road Fund</u>
233,475,275	105,428,245

Investment Pool Balance

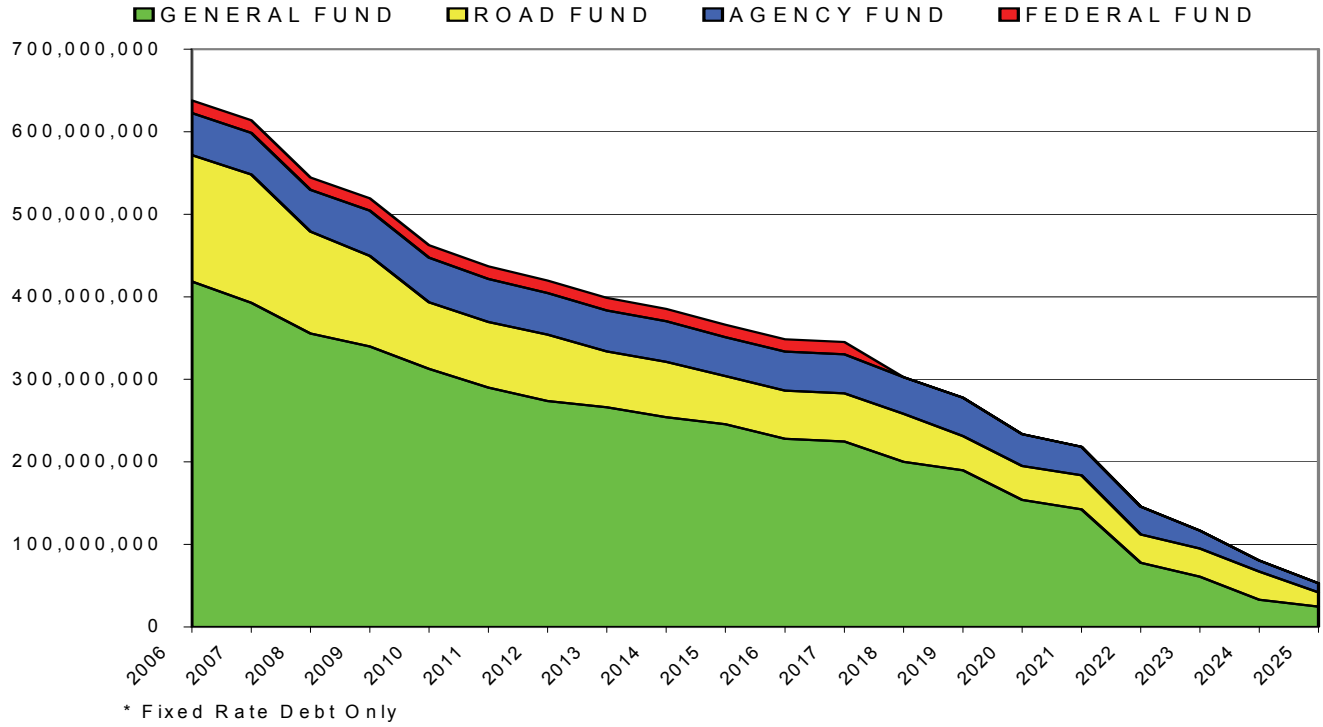
<u>Other Funds</u>	<u>Net Road Fund</u>
3,865,511,619	333,128,910

10 Percent Investment Portfolio

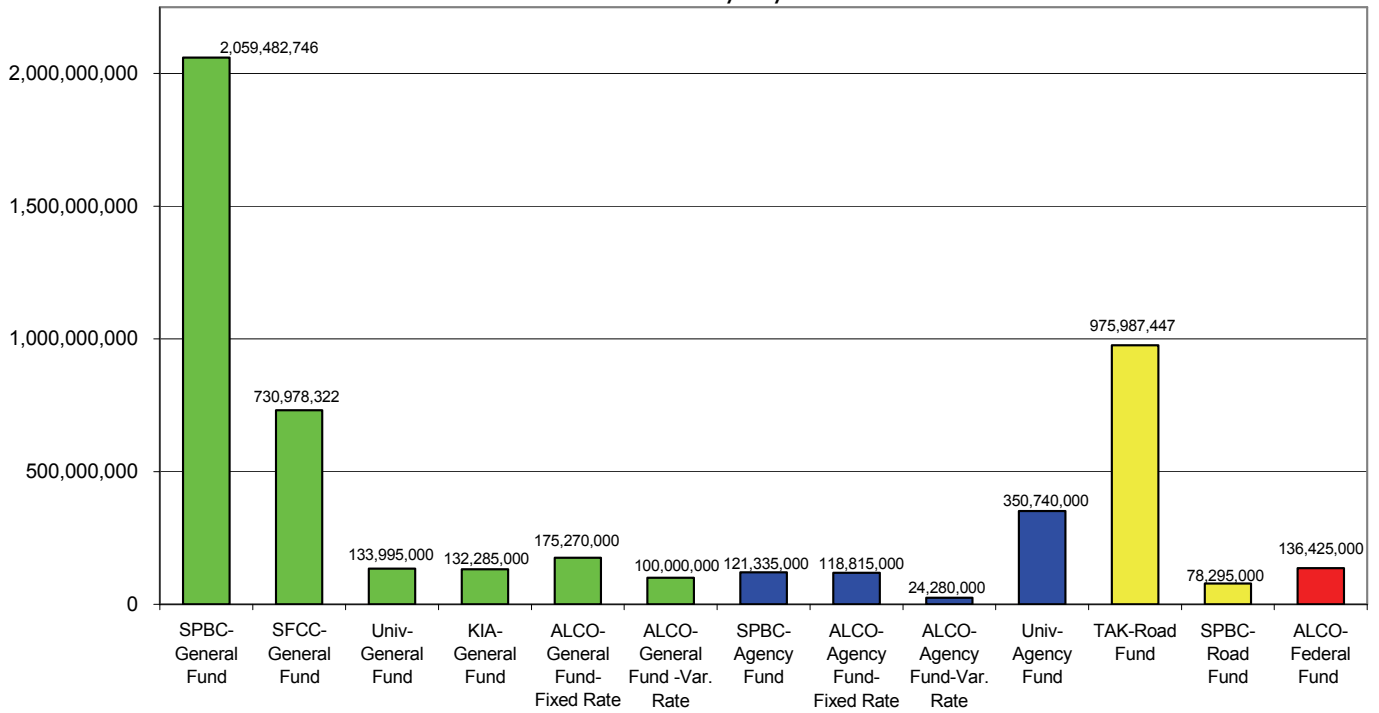
<u>Other Funds</u>	<u>Net Road Fund</u>
386,551,162	33,312,891

APPENDIX B

Appropriation Supported Debt Service by Fund Source As of 06/30/06



Appropriation Debt Principal Outstanding by Fund Source As of 06/30/06



* Variable Rate Debt=Bond Anticipation Notes

APPENDIX C

**COMMONWEALTH OF KENTUCKY
ASSET/LIABILITY COMMISSION
SCHEDULE OF NOTES OUTSTANDING
as of 6/30/2006**

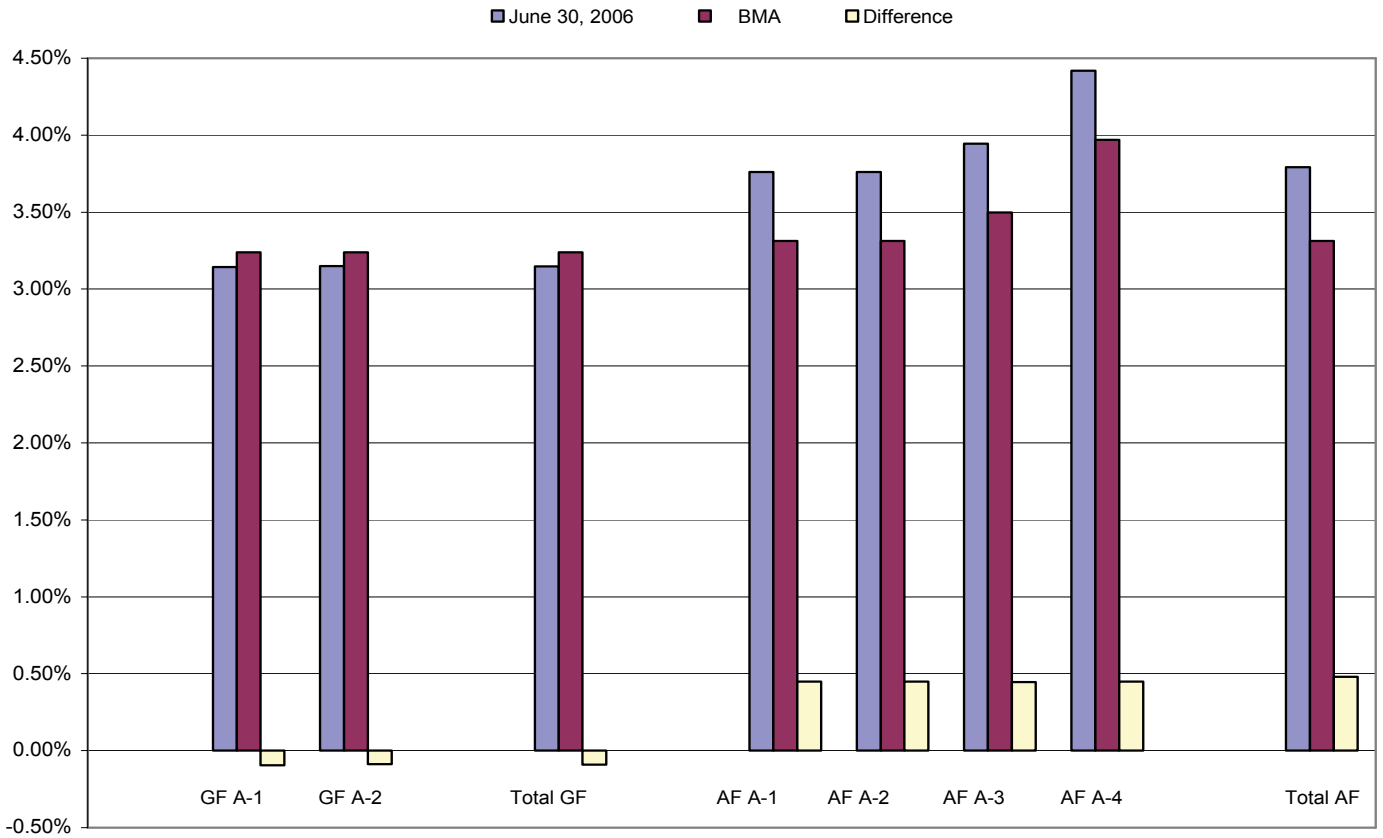
FUND TYPE SERIES TITLE	AMOUNT ISSUED	DATE OF ISSUE	MATURITY DATE	PRINCIPAL OUTSTANDING
General Fund Project Notes				
2001 1st Series	\$37,450,000	2/2001	2/2008	\$11,925,000
2003 Series A	\$171,260,000	7/2003	7/2013	\$84,485,000
2005 1st Series	\$81,850,000	6/2005	5/2025	\$78,860,000
2005 2nd Series	\$100,000,000	11/2005	11/2025	\$100,000,000
FUND TOTAL	\$390,560,000			\$275,270,000
Agency Fund Project Notes				
2005 1st Series	\$11,275,000	6/2005	6/2025	\$11,275,000
2005 Series A-UK Gen Recpts	\$107,540,000	11/2005	11/2025	\$107,540,000
2005 2nd Series				
Series A-1 Econ Dev	\$5,085,000	12/2005	4/2009	\$5,085,000
Series A-2 UL	\$10,530,000	12/2005	4/2009	\$10,530,000
Series A-3 NKU	\$6,000,000	3/2006	4/2009	\$6,000,000
Series A-4 WKU	\$2,665,000	6/2006	4/2009	\$2,665,000
FUND TOTAL	\$143,095,000			\$143,095,000
Federal Hwy Trust Fund Project Notes				
2005 1st Series	\$139,635,000	6/2005	9/2017	\$136,425,000
FUND TOTAL	\$139,635,000			\$136,425,000
TRAN 2006	\$150,000,000	7/2006	6/2007	\$150,000,000
FUND TOTAL	\$150,000,000			\$150,000,000
ALCo TOTAL	\$823,290,000			\$704,790,000

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

	2005 General Fund Second commercial paper		2005 Agency Fund Second ⁽¹⁾ BMA + 0.45% weekly reset			
	Series A-1	Series A-2	Series A-1	Series A-2	Series A-3	Series A-4
Program Size		not to exceed \$750 million		not to exceed \$250 million		
Amount Issued	\$50,000,000	\$50,000,000	\$5,085,000	\$10,530,000	\$6,000,000	\$2,665,000
Amount Outstanding	\$50,000,000	\$50,000,000	\$5,085,000	\$10,530,000	\$6,000,000	\$2,665,000
Initial Date of Issue	2-Nov-05	2-Nov-05	15-Dec-05	15-Dec-05	20-Mar-06	29-Jun-06
Agency	---	various	Econ Dev	UL	NKU	WKU
Project Amount Authorized	---	\$639,454,000	\$5,000,000	\$32,827,000	\$14,750,000	\$28,500,000
June 30, 2006						
Average Notes Outstanding	3.238%	3.238%	3.312%	3.312%	3.498%	3.970%
Inception Weighted Yields	3.144%	3.150%	3.761%	3.761%	3.945%	4.420%
Cost of Issuance	0.050%	0.050%	0.207%	0.115%	0.142%	0.118%
Remarketing Fee	0.075%	0.075%	-	-	-	-
Liquidity Facility Fee			-	-	-	-
Average Cost of Funds	3.269%	3.275%	3.968%	3.876%	4.086%	4.538%
December 31, 2005						
Average Notes Outstanding	3.005%	3.005%	3.288%	3.288%		
Inception Weighted Yields	3.104%	3.150%	3.725%	3.725%		
Cost of Issuance	0.050%	0.050%	0.207%	0.115%		
Remarketing Fee	0.075%	0.075%	-	-		
Liquidity Facility Fee			-	-		
Average Cost of Funds	3.229%	3.275%	3.932%	3.841%		3.870%

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

Comparison of ALCo variable rate notes to BMA



ALCo 2005 General Fund Second commercial paper remarketing

