Semi-Annual Report

of the

Kentucky Asset/Liability Commission

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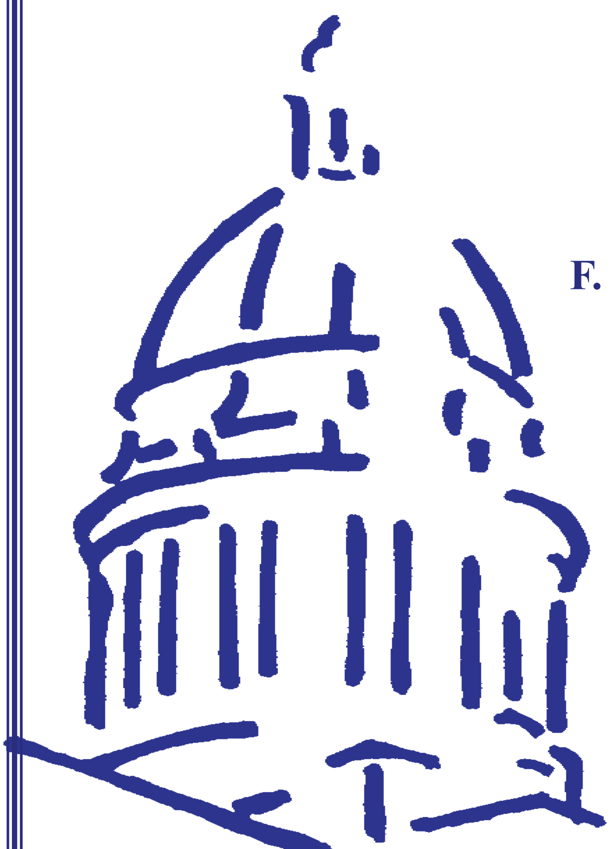

For the period ending June 30, 2007

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") twenty-first semi-annual report pursuant to KRS 56.863 (11) for the period beginning January 1, 2007 through June 30, 2007. Several factors on both the state and national level had an impact on activity during the reporting period. The most significant factors were:

On the national level

- U. S. economy experiences moderate growth.
- War in the Middle East continues.
- Dramatic increase in sub-prime mortgage delinquencies.
- The Dow Jones Industrial Average finishes the fiscal year at 13,408 up 945 points from December 2006.
- Fed funds rate remains unchanged at June 30, 2007.

On the state level

- Continued implementation of the two largest bond authorizations in the history of the Commonwealth.
- Fiscal year 2007 General Fund revenues increased 2.4 percent over fiscal year 2006.

Investment Management

Market Overview

In the last report, problems in the sub-prime mortgage lending markets were identified. During the boom of the last several years, certain mortgage lenders extended credit to "sub-prime" borrowers. Sub-prime mortgages are made to people who are unable to qualify for "Prime" mortgages due to income, credit or other issues. The terms of the loans assumed that the borrower would be able to refinance as the value of the home increased along with the overall market. As mortgage rates have increased, the home appreciation rate has declined and actually turned negative in some markets. These sub-prime borrowers are no longer able to refinance since the values of the homes have not increased. The level of sub-prime delinquencies has shown a dramatic increase. From a low of 5.68 percent in the second quarter of 2005, the number of sub-prime mortgages more than 90 days delinquent has increased to 9.27 percent in the second quarter of calendar 2007. The level is even higher when considering sub-prime adjustable rate mortgages.

The credit experience with these loans is beginning to affect the rest of the financial world. Many of these loans are packaged into large pools and funded by selling either Asset-Backed Securities (ABS) or Collateralized Debt Obligations (CDO) to the financial market. Some form of credit support is added to the deal which allows much of the ABS or CDO debt to receive the highest AAA credit rating from the rating agencies. Certain of those ratings are now in doubt.

Many of the buyers of these securities use leverage to fund the purchase. They use the securities as collateral to borrow funds which are used to purchase more of the securities. Problems occur if the market value of the securities declines triggering "margin calls" from the lenders. This can force the investor to sell the securities to generate cash to pay off the loan. It appears that a number of leveraged buyers may soon be forced to liquidate these securities in a stampede out of the market.

The Federal Reserve is continuously vigilant about the possibility of such a stampede creating a "systemic event" which damages the financial system. To date, the Fed does not seem worried about this possibility. At the June 28, 2007 Federal Open Market Committee meeting, the Fed stated that "Economic growth appears to have been moderate … despite the ongoing adjustment in the housing sector." They maintained the target for Fed Funds at 5.25 percent as they have for the past year.

To date, the sub-prime problems have not affected the broader economy. In response to pervious Fed Fund increases, year over year growth in Gross Domestic Product has slowed to 1.9 percent in the second quarter of 2007 from approximately 3.0 percent during most of 2005. Year over year growth of Consumer Spending was 5.2 percent in June of 2007, which is only slightly below the average of 5.4 percent over the last 6 years.

As the Fed explained in their most recent statement, "readings on core inflation have improved modestly in recent months", but are still slightly above the comfort zone. The Core Consumer Price Index, excluding food and energy, has dropped from 2.9 percent in September of 2006 to 2.2 percent in June of 2007. Most experts believe the top end of the comfort zone is 2.0 percent, although the Fed has not confirmed this target. Current expectations are for no changes in the Fed Funds rate unless the sub-prime mess begins to affect the broader economy.

Portfolio Management

For the fiscal year ending June 30, 2007, the Commonwealth's investment portfolio averaged \$3.7 billion. As of June 30, 2007, the portfolio was invested in U. S. Treasury Securities (8 percent), U. S. Agency Securities (18 percent), Mortgage Pass Through Securities (2 percent), Collateralized Mortgage Obligations (6 percent), Repurchase Agreements (20 percent), Municipal Securities (6 percent), Corporate Securities (6 percent), Asset-Backed Securities (11 percent) and Money Market Securities (23 percent). The portfolio had a market yield of 5.36 percent and an effective duration of .59 years.

The total portfolio is broken down into five investment pools. The pool balances as of June 30, 2007 were: Short Term Pool - $2,129 million, Intermediate Term Pool - $1,528 million, Bond Proceeds Pool - $412 million, TRAN Pool - $232 million, and UK Hospital Pool - $44 million.

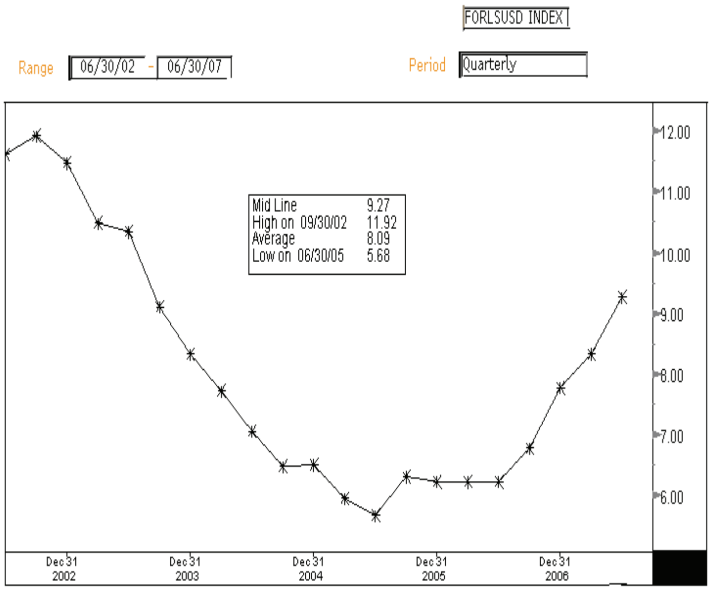
Total investment income from all investments, on a cash basis, for the fiscal year ended June 30, 2007, was $256.2 million versus $130.2 million for the fiscal year ended June 30, 2006. On a full mark-to-market basis, investment income was $221.8 million for the fiscal year ended June 30, 2007, versus $132.8 million for fiscal year 2006. These increases are due to a combination of higher balances and higher interest rates.

TAX-EXEMPT INTEREST RATES AND RELATIONSHIPS

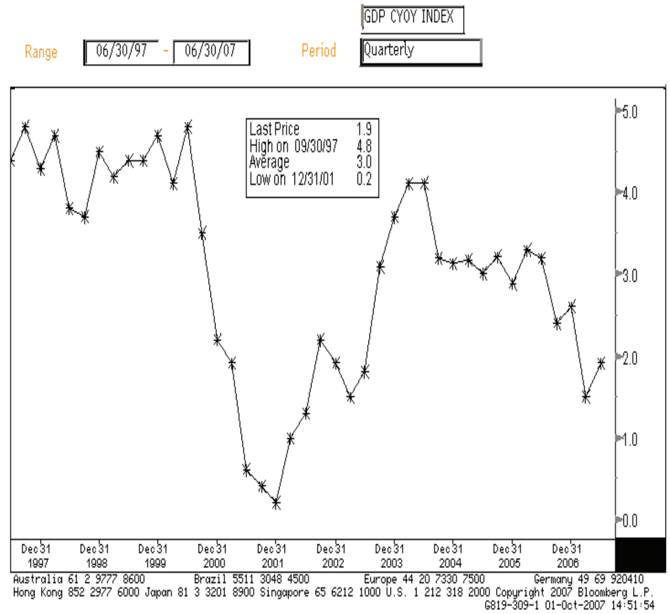
The Bond Buyer 20 year General Obligation Index averaged 4.29 percent for six-month period and 4.30 percent for fiscal year 2007. The fiscal year high was 4.69 percent in July 2006 and the low was 4.03 percent in December 2006.

The Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index averaged 3.68 percent for the reporting period and 3.62 percent for the fiscal year. The fiscal year high was 3.92 percent in April 2007 and the low was 3.35 percent in September 2006. The 30-day USD London Interbank Offered Rate ("LIBOR") averaged 5.32 percent for the period and 5.33 percent for the fiscal year. The fiscal year low was 5.32 percent in July 2007 and the high was 5.42 percent in August 2006. During the fiscal year, SIFMA traded as high as 73 percent of 30-day LIBOR in April 2007 and as low as 63 percent in September 2006. The SIFMA as a percent of LIBOR averaged 68 percent for the fiscal year and ended the fiscal year at 70 percent.

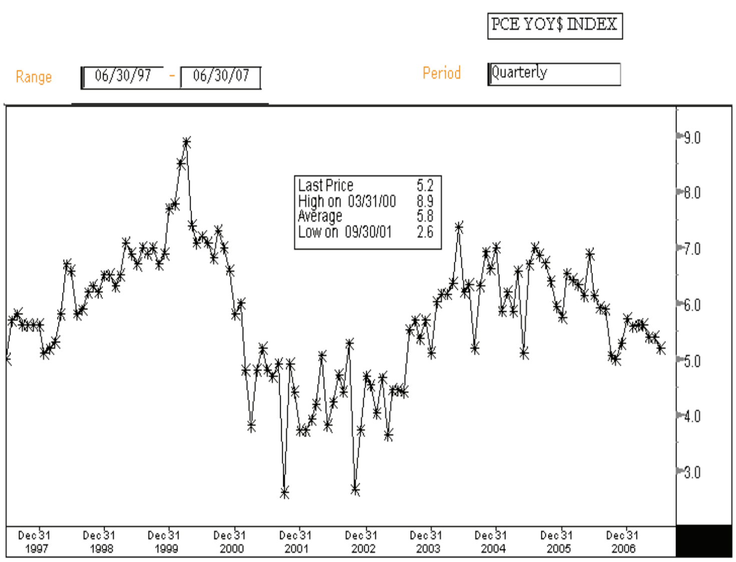
Seriously Delinquent Subprime Loans



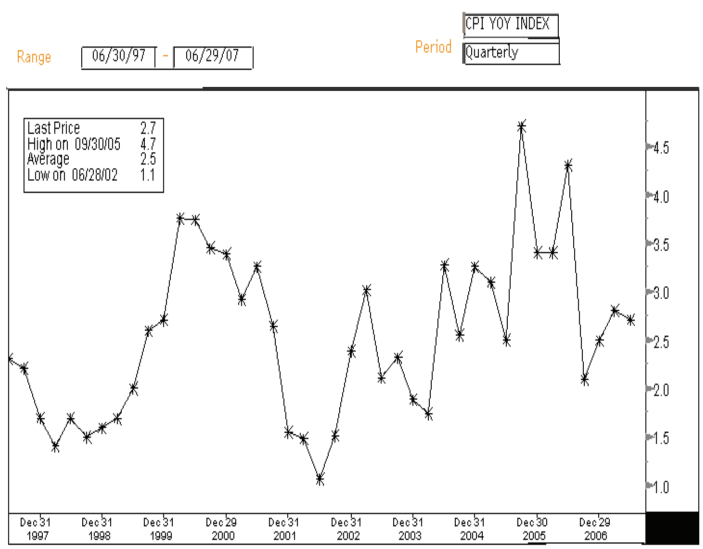
Real Gross Domestic Product



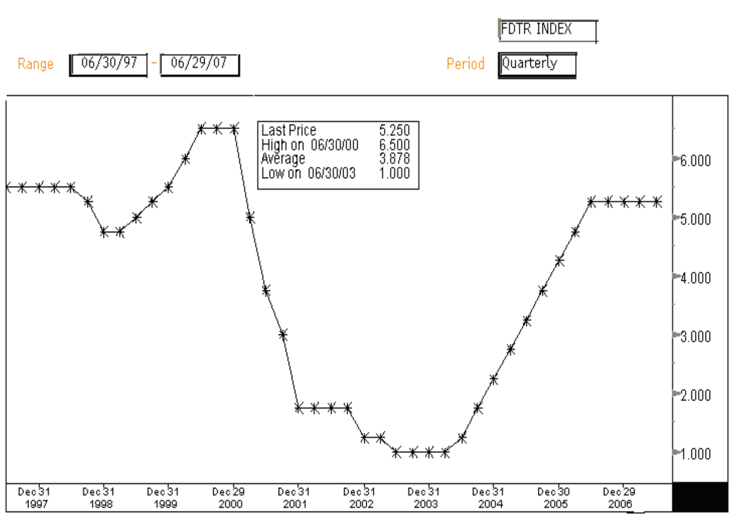
US Personal Consumption Expendtiures Nominal Dollars



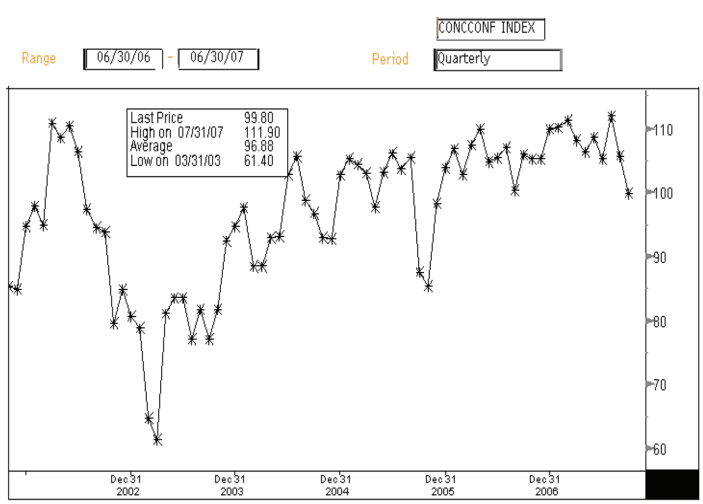
US Consumer Price Index Urban Consumer Less Food and Energy
YEAR - OVER - YEAR INDEX



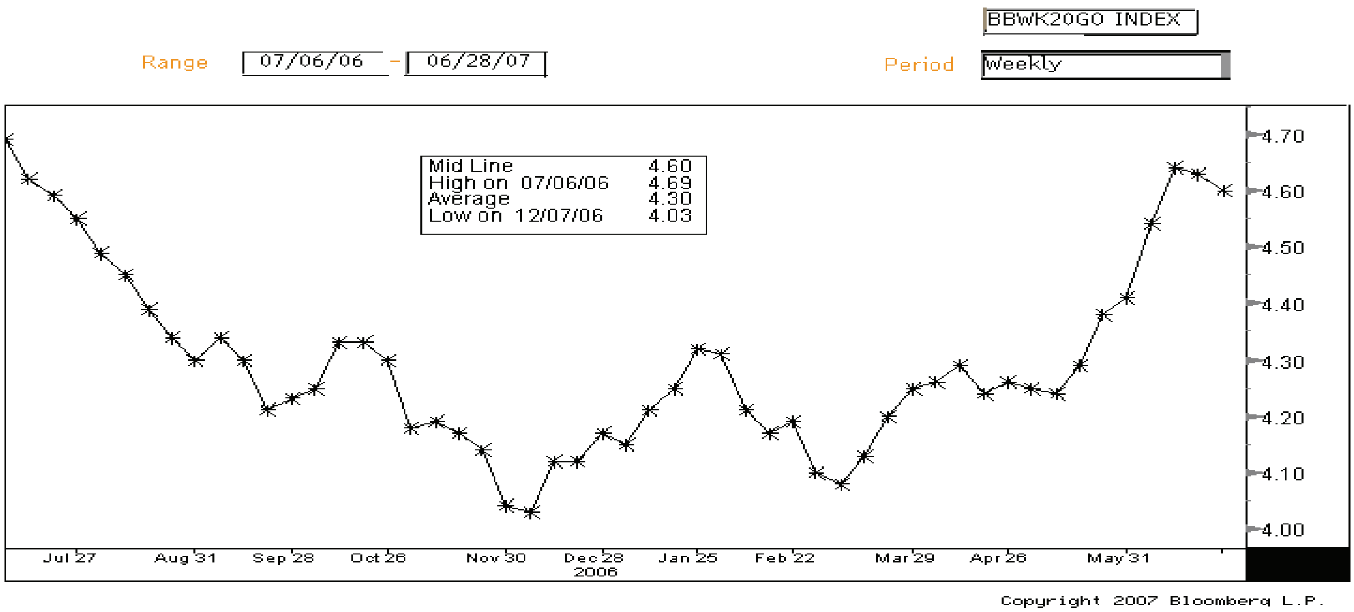
Federal Funds Target Rate



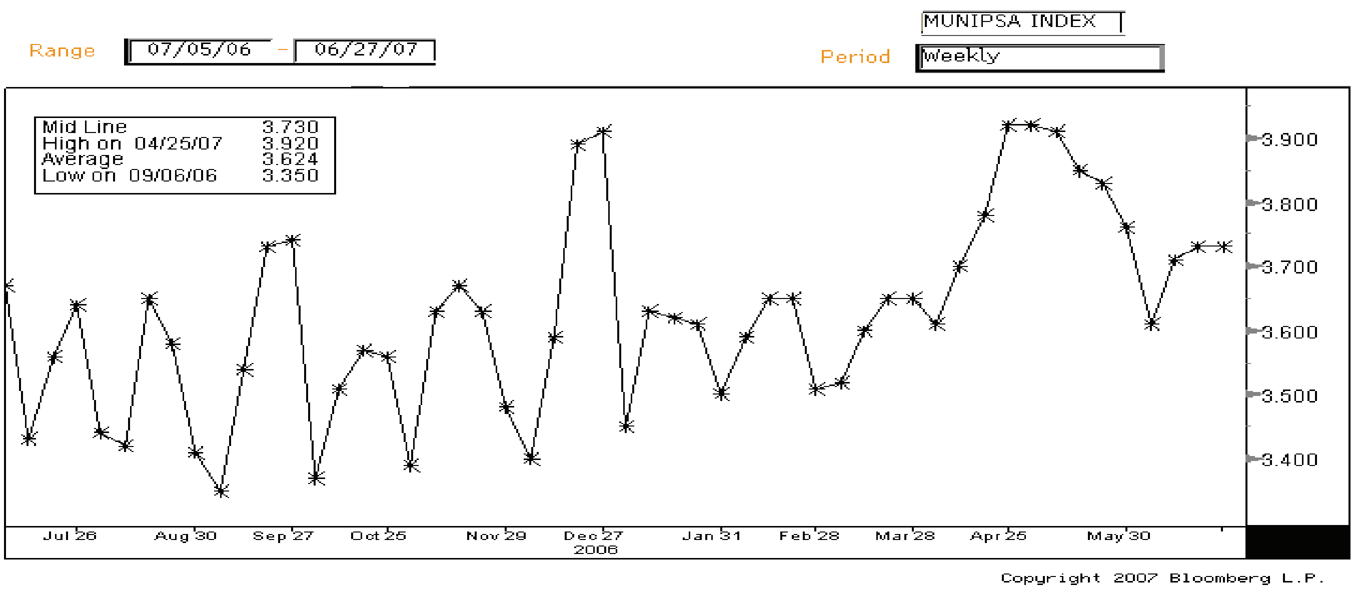
Consumer Confidence



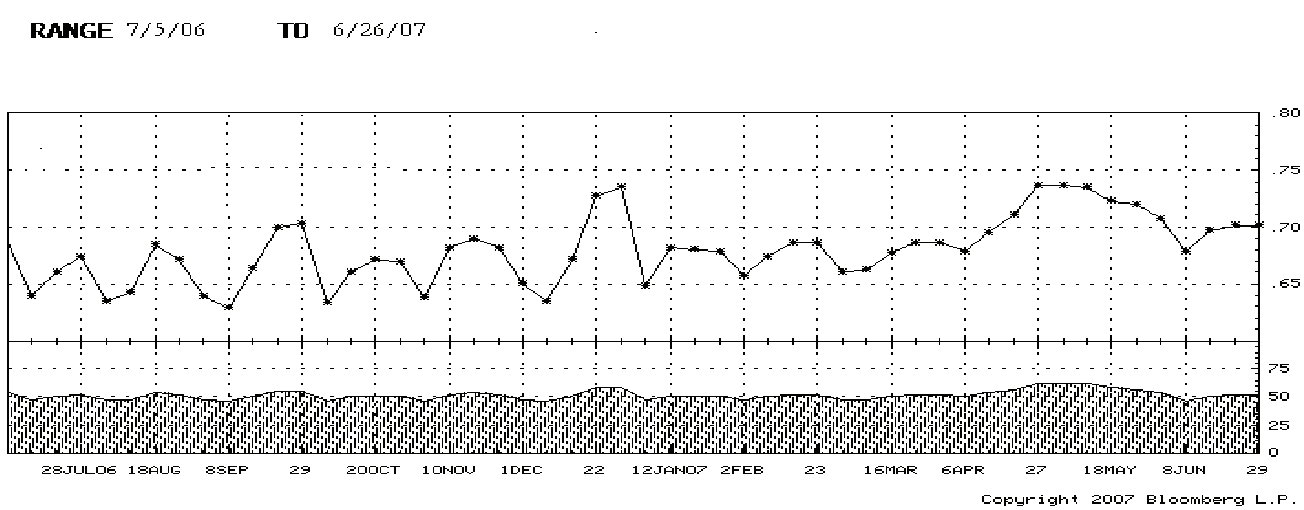
Bond Buyer 20-year General Obligation Index



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



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



DEBT MANAGEMENT

The 2005 Kentucky General Assembly enacted a State Budget for the biennium ending June 30, 2006, which authorized $2.056 billion of bond funded capital projects. The General Fund authorization was $1,204 million; the Road Fund authorization was $450 million; Agency Funds were authorized at $251.7 million; and $150 million was authorized to be supported by the Federal Highway Trust Funds ("FHTF"). Bonds have been issued for the Agency Fund, Road Fund and FHTF authorizations. A substantial amount of the General Fund projects were permanently funded by fiscal year end 2007. Interim note financing is available for the remaining projects.

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 FHTF authorizations are $350 million and $290 million, respectively. ALCo issued notes for the Road Fund and FHTF in September 2007. The timing of financing is uncertain for the bulk of the obligations and dependent on expenditure needs.

RATINGS UPDATE

The rating agencies continually monitor the Commonwealth's performance in areas such as revenue, the economy and debt management. Early in calendar 2007, the rating agencies announced improvements in the state's rating outlook based on these ongoing reviews.

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

Moody's Investors Service ("Moody's") revised, to stable from negative, the outlook on the Commonwealth's "Aa2" issuer rating and SPBC 87 appropriation debt rating of "Aa3" in February 2007. The revised outlook reflected a trend of state economic recovery and strengthened finances that have improved the Commonwealth's fiscal condition. Moody's expects that with a continuation of these trends, combined with the state's active financial management, Kentucky will maintain a strong fiscal condition resulting in an improved structural budget balance over the near-term.

Fitch Ratings ("Fitch"), in February 2007, joined the other firms' practice of assigning outlooks. Fitch views rating outlooks as an indication of the likelihood of a rating change over the next one to two years. Fitch assigned an initial rating outlook of stable to the SPBC lease obligations and affirmed the underlying ratings of "AA-".

TAX AND REVENUE ANTICIPATION NOTES

2007 TRAN. Originally, TRANS were issued at tremendous rate advantages to taxable reinvestment rates, often producing 2 percent excess returns when the General Fund had excess cash and significantly lowering the borrowing cost when the balances were negative. The $150 million 2006 TRAN provided a net benefit of $2.8 million to the General Fund in fiscal year 2007. ALCo authorized the 2007 (FY2008) TRAN program in an amount not to exceed $600 million. On July 3, 2007, $350 million was delivered to mature on June 26, 2008. The 2007 Series A TRANs were sold by Citigroup Global Markets Inc. on June 26, 2007. The fixed rate notes carry a coupon of 4.50 percent to yield 3.71 percent. The net benefit to the General Fund is expected to be approximately $5.5 million.

ALCo entered into an Interest Rate Swap with UBS to partially hedge the 2007 TRAN. The Commonwealth will receive a 5.346 percent fixed rate on

$350 million notional amount (1.64 percent above cost of funds) while paying one-month LIBOR. The swap dates match up with the life of the TRAN.

FINANCIAL AGREEMENTS

As of June 30, 2007, ALCo had seven financial agreements outstanding, with a net notional amount exposure of $150 million. There were no additional financial agreements executed during the period. The terms of these transactions are detailed in Appendix A.

General Fund

In January 2006, to protect against a 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 featured mandatory early termination dates of February 14, 2007 and February 13, 2008, respectively. The hedges 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 SIFMA to limit the basis risk between the taxable and tax-exempt yield curves. This conversion was accomplished by first executing a second $80 million LIBOR based interest rate swap with ALCo now receiving the fixed receiver rate. This transaction effectively offset the original LIBOR swap and allowed ALCo to lock in a spread of 29.5 basis points between the fixed rate legs of the two swaps. Secondly, a $150 million SIFMA based interest rate swap was executed with ALCo paying a fixed rate of 4.085 percent. These transactions resulted in further annual savings (reduction in appropriation) to the General Fund of $335,000. Each of these transactions was competitively bid. UBS, Citigroup and JP Morgan are counterparties to these transactions.

In November 2006, the 2007 swap was converted from LIBOR to SIFMA as well, once again to limit basis risk and to lock in a fixed spread providing further savings to the General Fund. Each transaction was competitively bid. UBS, Citigroup and JP Morgan were counterparties in these transactions.

On February 14, 2007, the 2007 swaps were terminated and the resulting net savings amount of $596,500 was used to reduce the amount of SPBC 87 bonds sold that same day to permanently finance General Fund supported bond projects.

Subsequent to June 30, 2007:

- In August 2007, ALCo competitively bid and subsequently entered into two additional $150 million interest rate swap transactions to hedge the future issuance of $300 million of permanent tax-exempt bonds for General Fund authorized but unissued projects. These forward-starting swaps are similar to the previous ones discussed above and feature mandatory early termination dates of November 3, 2008 and November 2, 2009. These hedges will allow fiscal year 2009 and fiscal year 2010 debt service for $300 million of currently authorized projects to be appropriated at approximately 4.23 percent rather than the budgeted template rate of 6.0 percent (estimated). The result will be annual savings (reduction in appropriation) to the General Fund of approximately $3,405,000. Citigroup is the single counterparty on the November 2008 swap and UBS is the single counterparty on the November 2009 swap.

  With the addition of these two swaps, ALCo has in place hedges which total $450 million, or roughly one third of currently authorized but unissued General Fund supported debt.

Road Fund

Of the outstanding Road Fund financial agreements, the first item is a Total Return swap related to the $56,485,000 July 1, 2009 maturity of the Turnpike Authority of Kentucky ("TAK") Resource Recovery 1985 Series A Bonds, which bears interest at 6 percent. Staff worked for approximately 18 months to develop this transaction with Morgan Stanley ("MS") and finally executed the trade in April 2001. The 1985A Bonds could not be economically refunded, despite a very low interest rate environment, due to the enormous transferred proceeds penalty associated with the Debt Service Reserve Fund ("DSRF") which is earning approximately 10 percent. MS, bond counsel and the Commonwealth developed a structure whereby the bonds would be called, but not redeemed. Once called, the bonds were sold to MS. ALCo then entered into a total rate of return swap, whereby MS pays ALCo 6 percent (the coupon on the bonds) and ALCo pays to MS, SIFMA (formerly BMA, short-term tax-exempt municipal index) plus a spread (originally 58 basis points) to cover expenses. This transaction provided the synthetic variable rate exposure to offset the asset sensitivity in the balance sheet, i.e. sensitivity to declining interest rates. Rates continued to steadily decline, putting the trade in a very favorable position. Shortly after the events of September 11, 2001, interest rates tumbled dramatically and on September 27, 2001, staff entered into an offsetting trade, locking in a guaranteed spread of 213 basis points. The reversal rate (rate ALCo agrees to pay MS) was 3.87 percent versus the original fixed receiver rate of 6 percent from MS. ALCo has received $5.5 million under the terms of the agreements since inception. The expected total benefit from this transaction to maturity is approximately $7.5 million.

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

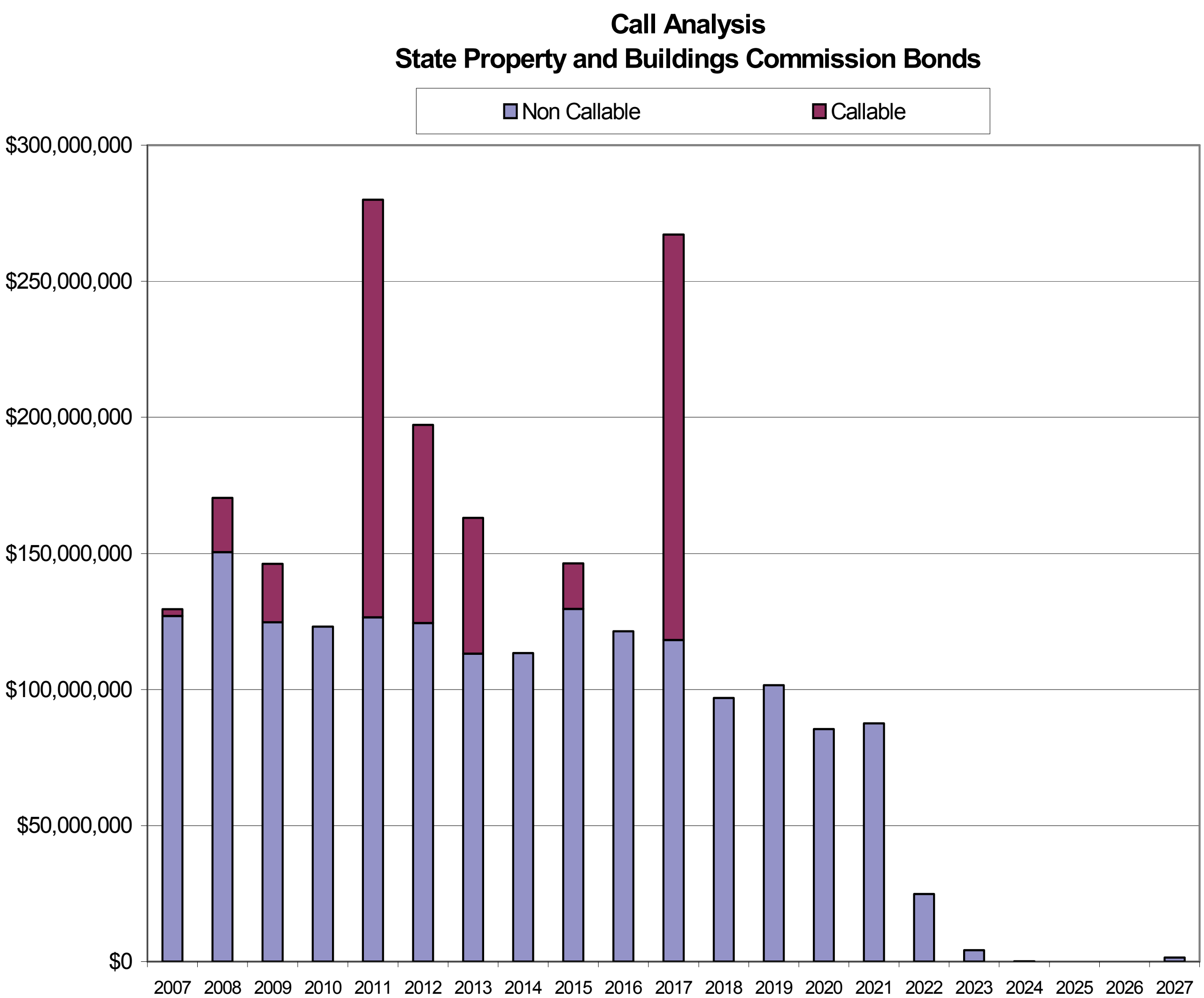
Since the bonds are still outstanding and the TAK retains the right to call the bonds at face value (par), the termination value of the swap is essentially the present value of the fixed expenses. In the event that rates rise above the coupon on the bonds, the transaction would be terminated and the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

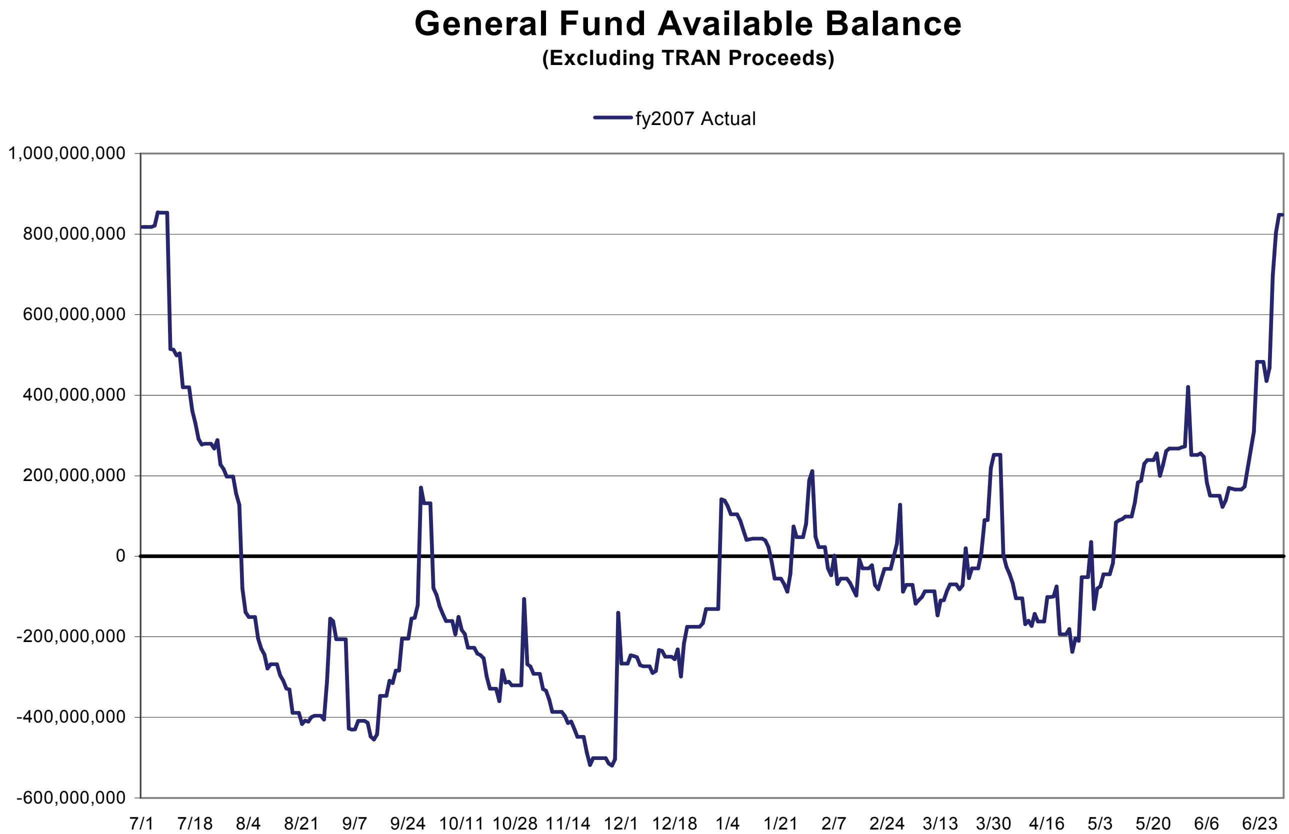
For tax purposes, the Total Return Swap must terminate prior to the final maturity of the bonds. The original end date for the Total Return Swap was July 1, 2007. In late June 2007, ALCo extended the Total Return Swap with MS through January 1, 2009 at a reduced spread to SIFMA of 37 basis points. At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

ASSET/LIABILITY MODEL

General Fund

The total SPBC debt portfolio as of June 30, 2007 had $2,260 million of bonds outstanding with a weighted average coupon of 4.99 percent, modified duration of 5.56 years, and a yield at market of 3.92 percent. The market yield increased by 25 basis points from the prior reporting period while modified duration increased by 2.0 years. The average coupon reflects investor preference for callable premium bonds in the current market at a yield lower than corresponding par or discount coupon bonds. The $486 million callable portion had an average coupon of 5.00 percent. The SPBC General Fund debt structure has 32 percent of principal maturing in 5 years and 66 percent of principal maturing within 10 years. This is just above the upper range of the rating agencies' proposed targets of 27-30 percent due in 5 years and 55-60 percent maturing within 10 years. Consideration should be given to rebalancing the portfolio.

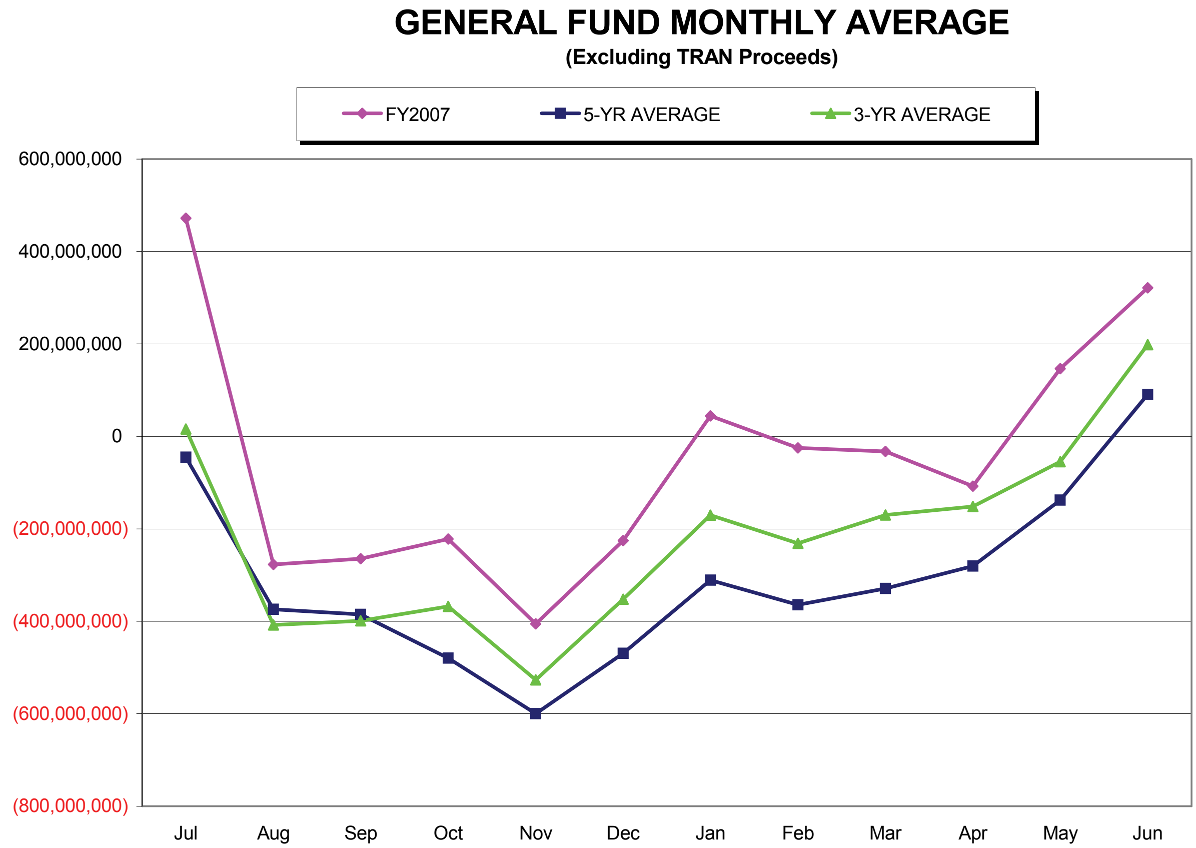




The General Fund had a high balance of $854 million on July 6, 2006 and a low of negative $520 million on November 28, 2006. The average and median balances were a negative $47 million and a negative $82 million, respectfully. Since the General Fund continued to have a negative available cash balance 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 $428 million for fiscal year 2007. Net Interest Margin will continue to be negative due to low cash balances versus outstanding fixed rate debt, low level of interest rates as well as the callability of the debt portfolio.

ALCo Project Notes, 2005 General Fund Second Series. Late in 2005, the remaining $640 million General Fund supported bond projects authorized by the 2005 General Assembly, but not yet permanently financed, were placed under an ALCo interim plan of finance. The 2005 General Fund Second Series Note program provides a funding mechanism that allows state agencies and universities to move forward with their capital projects prior to their need for permanent financing. In 2006, ALCo adopted resolutions to place the $1,243 million General Fund supported bond projects, authorized by the 2006 General Assembly, under the same ALCo interim financing plan. The maximum authorized amount of notes outstanding under the program was increased from $750,000,000 to $950,000,000. The projects were placed under the program because they are not



expected, at this time, to meet the Internal Revenue Service ("IRS") spend-down requirements of a traditional bond issue. OFM will monitor project expenditures and direct the issuance of notes as needed to meet current capital needs.

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

A second tax-exempt tranche of $100,000,000, in two Series, was delivered on January 17, 2007. The two separate $50 million Note Series again were issued in the commercial paper mode and are serviced by JP Morgan, UBS and Dexia.

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

A third tranche of $100,000,000 was issued in two Series and delivered on June 26, 2007. The tax-exempt notes in the commercial paper mode are remarketed by JP Morgan and UBS and supported by Dexia. Remarketing information and the cost of capital to date is provided in Appendix C. As of June 30, 2007, $200 million of notes were outstanding and the bond projects remaining under the interim financing program had expended $132 million.

ALCo Project Notes, 2005 General Fund First Series. Project proceeds of $81,850,000 ALCo 2005 General Fund First Series delivered on June 8, 2005 to provide for the financing of the Phase II Tobacco Settlement Payments were returned to the state in late 2005. The proceeds have been yield restricted and applied to General Fund supported bond projects, specifically the infrastructure for economic development fund for tobacco counties. As of June 30, 2007, $30 million of the proceeds had been expended on projects.

ALCo General Fund Floating Rate Project Notes, 2007 Series A and B. In December 2006, ALCo began studying various refunding scenarios for SPBC bonds using LIBOR based Floating Rate Notes ("FRNs"). LIBOR FRNs were a new structure in the municipal market and under market conditions at that time had the potential to save the state upwards of 10 basis points on a refunding transaction compared to traditional non-callable fixed rate bonds.

The first LIBOR based FRN transaction in the municipal market occurred in late November 2006 with the City of Detroit Sewage Disposal System selling a $370 million refunding transaction. Immediately afterwards, there were several new FRN transactions brought to the municipal market, initially by healthcare and energy issuers.

The basic structure of a LIBOR FRN transaction entails an issuer selling one or more notes with long term stated maturities. The par amount of notes outstanding will generally amortize each year through mandatory sinking fund redemptions. Interest on the notes resets periodically and is based on a percentage of a LIBOR index (3 month LIBOR being the standard) plus a fixed spread.

Interest is generally paid quarterly or semi-annually. The issuer then enters into an interest rate swap with a counterparty whereby the issuer receives a floating rate of interest based on the same terms and notional amounts as the FRNs, and pays a fixed rate. This structure provides the issuer with a synthetic fixed rate for the life of the notes. In addition, if structured to nearly or exactly match the notes, the interest rate swap will receive integrated or super-integrated tax status from the IRS allowing the arbitrage rate on the issue to be locked in at the time of sale similar to a standard fixed rate bond structure.

In addition to providing a cheaper cost of funds, the benefits of an FRN transaction to the Commonwealth were 1) the ability to diversify the state's debt portfolio away from heavily weighted callable premium coupon structures which have been the standard for several years in the municipal market, 2) the ability to diversify the types of risk associated with the portfolio (counterparty risk rather than tax risk), and 3) the ability to maintain the 10 year optional call on the notes to protect the state's safe harbor under the IRS code. Also, unlike other types of variable rate structures, FRNs have no buyer put option so there is no need for a liquidity provider and since the interest rate is index based there is also no need for remarketing agent services.

One risk that ALCo considered thoroughly was that the swap would be executed on a non-callable basis (executing the swap on a callable basis eliminated the economic benefit of the structure). If notes had to be called at some point in the future, the state could be left with a mismatched hedge. However, ALCo felt that this risk was mitigated by the limited number of projects under the potential refunding and new money scenarios, as well as the state's ability to simply unwind the swap (or some portion of it) at market at the time any notes were called. The swap could remain in place given the low cost of funding. A portion of the swap could be allocated to cover other floating rate debt, although it would not be integrated for tax purposes.

Citigroup, as the managing underwriter, began in April 2007 structuring the transaction to incorporate refundings of various SPBC Project 79 and Project 85 bond maturities along with a $100 million new money component to fund two projects authorized by the 2006 General Assembly

See Project List in Appendix D. FGIC was selected to insure the payments due under the swap as well as the notes.

By mid-April 2007, long term interest rates began to rise creating a more positively sloped muni-curve, but widening out spreads at which FRN transactions could be sold. The third week of May 2007, ALCo priced the FRN transaction and negotiated the associated interest rate swap with Citigroup. The interest rate on the resulting four term notes was based on 67 percent of three-month LIBOR plus the per annum spreads as follows:

Maturity	Par Amount	Average Life (years)	Per Annum Spread
2017	$25,210,000	5.786	+40
2027	$75,625,000	11.856	+53
2021	$71,310,000	11.734	+52
2025	$70,935,000	16.833	+55
Total	**$243,080,000**		

The refunding portion provided net present value savings of $3.4 million of 2.6 percent of refunded bonds. The all-in true-interest rate for the super-integrated transaction was 4.17 percent. Subsequent to the ALCo FRN transaction, long term interest rates continued to rise. This along with the approximately $4 billion on FRNs coming to market during the month of May 2007 has caused spreads on this type of structure to widen substantially thus nearly eliminating new FRN type structures from the current municipal market (other than energy and health care issuers).

Road Fund

ALCo, subsequent to the reporting period, issued $150 million of the $350 million of Road Fund Supported Economic Development Bonds authorized by the 2006 General Assembly. The interim financing program provides for notes not to exceed $350 million.

The Road Fund average daily cash balance for the fiscal year 2007 was $392 million compared to $281 million for fiscal year 2006. The Road Fund cash was invested in the Intermediate Term Investment Pool which had a duration of 1.18 years as of June 30, 2007. The Road Fund earned $16 million on a cash basis for fiscal year 2007 versus $6.4 million for fiscal year 2006.

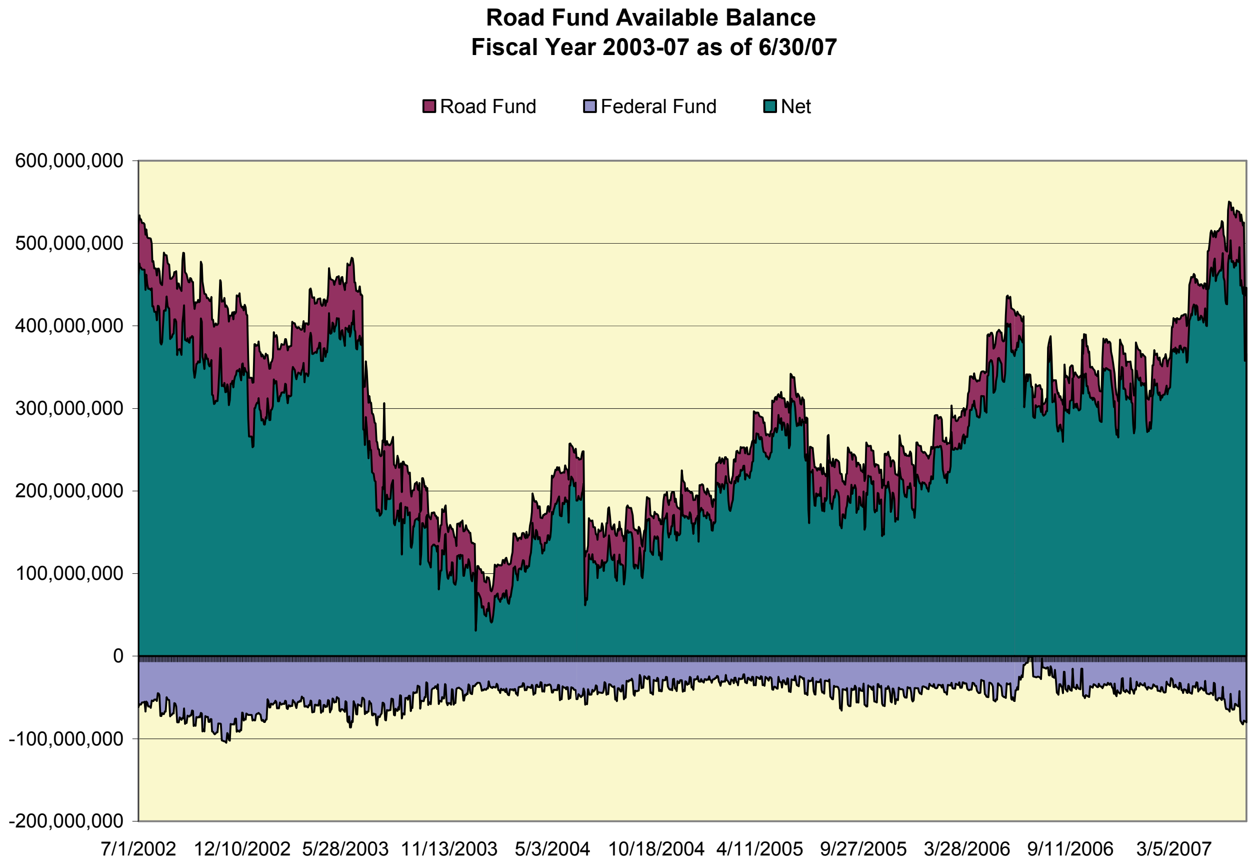
As of June 30, 2007, TAK had $1,080 million of bonds outstanding with a weighted average coupon of 4.71 percent, modified duration of 4.00 years, and a yield at market of 3.78 percent. Selected maturities of the Resource Recovery 1985 A with the most economical value are associated with the financial agreements identified previously.

The final Road Fund debt service for the Toll Road 1986A bonds was paid by the Debt Service Reserve July 1, 2007.

Road Fund debt service paid, net of reserve fund credits for fiscal year 2007 was $153 million, resulting in a net interest margin (investment income earned less debt service paid) of negative $137 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 University of Kentucky General Receipts Project Notes. In October of 2006, ALCo issued notes under the University of Kentucky's General Receipts Indenture. The $77,905,000 General Receipts Project Notes, 2007 Series A were issued to fund $75,000,000 of the cost of expanding and renovating the existing University Hospital. The 2007 Series A Notes were issued on a forward delivery basis with delivery expected on November 1, 2007.



ALCo Project Notes, 2005 Agency Fund Second Series. Agency Fund supported bond projects not already financed by a university, ALCo or SPBC were placed under an ALCo interim plan of finance. The ALCo Agency Fund Second Series 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 on the program were for projects for Northern Kentucky University [Series A-3] delivered on March 20, 2006 with subsequent draws delivered on October 4, 2006 [Series A-3 (1)] and April 24, 2007 [Series A-3 (2)]. Western Kentucky University [Series A-4] had its first draw against the program on June 29, 2006. The Notes have a variable interest rate, reset weekly based on a fixed spread to SIFMA to be determined by the rating assigned to the Note Series. The private placement of the Notes is with Citigroup. At June 30, 2007, no Notes were outstanding under the not to exceed $250,000,000 Note Program. The $5,085,000 principal outstanding for the Series A-1 Notes was refunded by SPBC 87 in February 2007. The University of Louisville made a principal payment of $1,300,000 on the Series A-2 Notes on January 4, 2007. The remaining balance of $8,380,000 was refunded by the University of Louisville's first General Receipts bond issue in March 2007. Northern Kentucky University and Western Kentucky University also refunded their respective Notes with General Receipts bonds in July 2007. Presently, all the series have received ratings of A1 by Moody's and have been priced at SIFMA 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 2003, incremental returns derived from new investment asset classes reached $27 million since inception. The program continues but is no longer monitored for incremental value.

Cash Management. Cash management improved dramatically with the implementation of the General Fund TRAN program producing $3.2 million in fiscal year 1998, $4.7 million in fiscal year 1999 and $7.3 million in fiscal year 2000. Economic benefit for fiscal year 2001 was $6.5 million, fiscal year 2002 was $4.3 million and fiscal year 2003 was $0.3 million. No TRAN was issued in fiscal year 2004. In fiscal year 2005, the TRAN provided $2.8 million net benefit and $6 million in fiscal year 2006. In fiscal year 2007, the TRAN produced a net income of $2.8 million and $5.5 million is expected from the fiscal year 2008 TRAN for a cumulative benefit of $44 million.

Debt Management. Debt service savings have contributed an estimated $439 million in value added since inception. ALCo continues to analyze potential opportunities for savings and to evaluate new financing structures which offer the Commonwealth the ability to diversify risk within its portfolio while taking advantage of market demand for various new products.

Total value added since inception is in excess of $509 million.

Appendix

APPENDIX A
SWAP SUMMARY

ALCo General Fund	LIBOR			reverse LIBOR			BMA	
2008 Financial Agreements	$80,000,000			$80,000,000			$150,000,000	
Notional Amount	40,000,000	20,000,000	20,000,000	40,000,000	20,000,000	20,000,000	75,000,000	75,000,000
Fund Source	----------	General Fund	----------	----------	General Fund	----------	General Fund	
Hedge	----------	Net Interest Margin	----------	----------	Net Interest Margin	----------	Net Interest Margin	
Counter-Party	UBS	Citibank	JPMorgan	UBS	Citibank	JPMorgan	UBS	Citibank
Counter-Party Ratings*	Aa2/AA+/AA+	Aa1/AA/AA+	Aa3/A+/A+	Aa2/AA+/AA+	Aa1/AA/AA+	Aa3/A+/A+	Aa2/AA+/AA+	Aa1/AA/AA+
Termination Trigger	A3/A-	Baa3/BBB-	Baa3/BBB-	A3/A-	Baa3/BBB-	Baa3/BBB-	A3/A-	Baa3/BBB-
Swap Type	----------	Fixed Pay	----------	----------	Floating Rate Payer	----------	Fixed Pay	
Benchmark	----------	3 month LIBOR	----------	----------	3 month LIBOR	----------	BMA	
Reset	----------	Weekly	----------	----------	Weekly	----------	Weekly	
Amortize (yes/no)	----------	yes	----------	----------	yes	----------	yes	
Execution Date	----------	1/10/2006	----------	----------	9/15/2006	----------	9/15/2006	
Start Date	----------	2/13/2008	----------	----------	2/13/2008	----------	2/13/2008	
Mandatory Early Termination	----------	2/13/2008	----------	----------	2/13/2008	----------	2/13/2008	
Cash Settlement Payment Date	----------	2/27/2008	----------	----------	2/27/2008	----------	2/27/2008	
End Date	----------	2/13/2028	----------	----------	2/13/2028	----------	2/13/2028	
Fixed Rate pay-(rec)	----------	5.038%	----------	-5.335%	-5.340%	-5.323%	4.085%	
Day Count	----------	30/360	----------	----------	30/360	----------	30/360	
Payment Dates	----------	quarterly	----------	----------	quarterly	----------	quarterly	
Security Provisions	Bonds payable from General Fund			Bonds payable from General Fund			Bonds payable from General Fund	

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

Road Fund

Financial Agreements

Financial Agreements	TAK RR 85A Total Return	TAK RR 85A Fixed
Fund Source	Road Fund	Road Fund
Hedge	Net Interest Margin	Total Return
Counter-Party	Morgan Stanley	Morgan Stanley
Counter-Party Ratings*	Aa3/AA-/AA-	Aa3/AA-/AA-
Termination Trigger	BBB-/Baa3	BBB-/Baa3
Swap Type	Variable Pay	Fixed Pay
Benchmark	SIFMA	SIFMA
Reset	Weekly	Weekly
Notional Amount	56,485,000	56,485,000
Amortize (yes/no)	no	no
Execution Date	4/23/2001	9/20/2001
Start Date	5/24/2001	9/27/2001
End Date**	1/1/2009	7/1/2009
Fixed Rate pay-(rec)	(6.000%)	3.870%
Day Count	30/360	30/360
Payment Dates	Jan. 1 & July 1	Jan. 1 & July 1
Security Provisions	Road Fund Inv.	Road Fund Inv.
Current Market Valuation March 31, 2007	0.00	0.00
Interest Earnings		
Cumulative Prior Periods	147,727	4,913,974
Current Period - 6/30/2007	0.00	458,185
Total	147,727	5,372,159

* *Moody's, S&P, Fitch*
S&P upgraded Morgan Stanley from A+ to AA- in July 2007

* *In June 2007, ALCo renewed the Total Return swap with MS until January 1, 2009 (previous End Date was July 1, 2007)*

Swap Summary

As of June 30, 2007:

	Total Notional Amount Executed		Net Exposure Notional Amount	
	General Fund	Road Fund	General Fund	Road Fund
	310,000,000	112,970,000	150,000,000	0

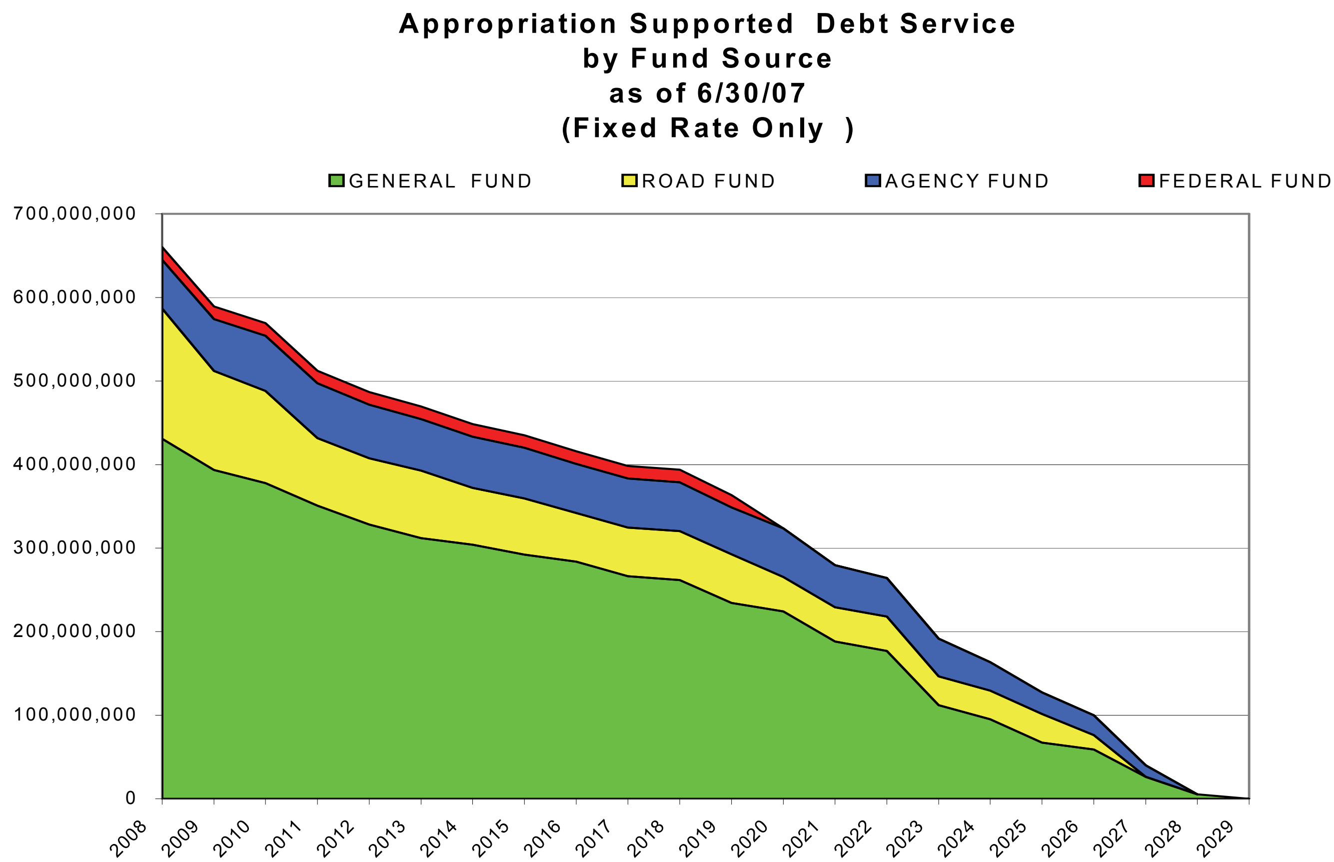
Total Notional Amount Executed by Counter Party

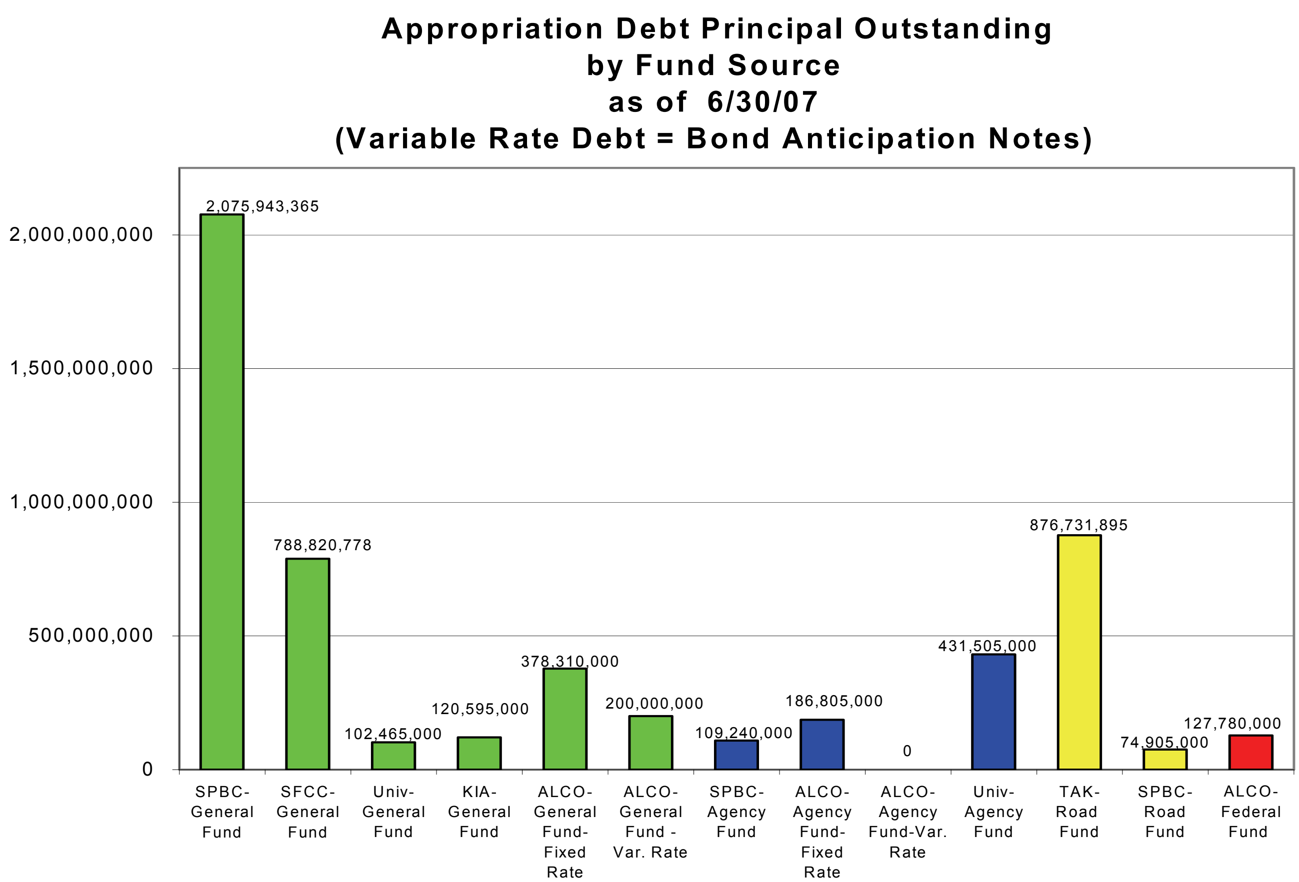
Morgan Stanley	UBS	Citibank	JPMorgan
112,970,000	155,000,000	115,000,000	40,000,000

	Debt		10 Percent Net Exposure	
	General Fund	Road Fund	General Fund	Road Fund
Bonds Outstanding	2,454,253,365	916,811,344	245,425,337	91,681,134
Authorized but Unissued	1,508,754,000	350,000,000	150,875,400	35,000,000
Total	3,963,007,365	1,266,811,344	396,300,737	126,681,134

Investment Pool Balance		10 Percent Investment Portfolio	
Other Funds	Net Road Fund	Other Funds	Net Road Fund
3,888,672,746	457,105,013	388,867,275	45,710,501

APPENDIX B


Appropriation Supported Debt Service
by Fund Source
as of 6/30/07
(Fixed Rate Only)
GENERAL FUND
ROAD FUND
AGENCY FUND
FEDERAL FUND
700,000,000
600,000,000
500,000,000
400,000,000
300,000,000
200,000,000
100,000,000
0
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
2026
2027
2028
2029


Appropriation Debt Principal Outstanding
by Fund Source
as of 6/30/07
(Variable Rate Debt = Bond Anticipation Notes)
2,000,000,000
1,500,000,000
1,000,000,000
500,000,000
0
2,075,943,365
788,820,778
102,465,000
120,595,000
378,310,000
200,000,000
109,240,000
186,805,000
0
431,505,000
876,731,895
74,905,000
127,780,000
SPBC-General Fund
SFCC-General Fund
Univ-General Fund
KIA-General Fund
ALCO-General Fund-Fixed Rate
ALCO-General Fund - Var. Rate
SPBC-Agency Fund
ALCO-Agency Fund-Fixed Rate
ALCO-Agency Fund-Var. Rate
Univ-Agency Fund
TAK-Road Fund
SPBC-Road Fund
ALCO-Federal Fund

APPENDIX C

COMMONWEALTH OF KENTUCKY
ASSET/LIABILITY COMMISSION
SCHEDULE OF NOTES OUTSTANDING
as of 6/30/2007

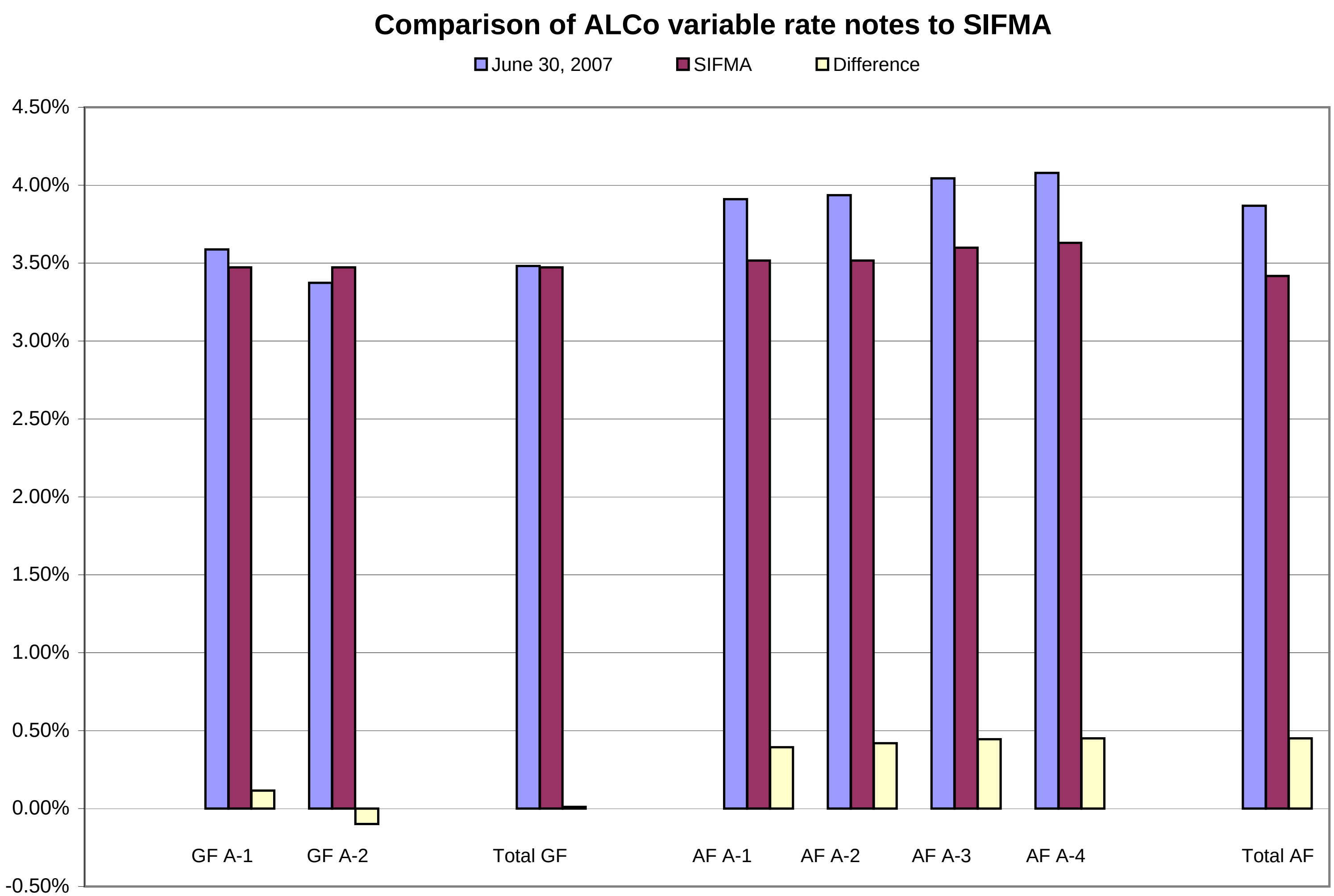
FUND TYPE SERIES TITLE		AMOUNT ISSUED	DATE OF ISSUE	MATURITY DATE	PRINCIPAL OUTSTANDING
General Fund Project Notes					
2001 1st Series		$37,450,000	2/2001	2/2008	$6,095,000
2003 Series A		$171,260,000	7/2003	7/2013	$52,985,000
2005 1st Series		$81,850,000	6/2005	5/2025	$76,150,000
2005 2nd Series		$300,000,000	11/2005	11/2025	$200,000,000
2007 Floating Rate Notes (FRNs)		$243,080,000	5/2007	11/2027	$243,080,000
	FUND TOTAL	**$833,640,000**			**$578,310,000**
Agency Fund Project Notes*					
2005 1st Series		$11,275,000	6/2005	6/2025	$10,890,000
2005 Series A-UK General Receipts		$107,540,000	11/2005	11/2025	$107,540,000
2006 Series-UK General Receipts		$68,525,000	10/2006	10/2022	$68,375,000
2005 2nd Series					
Series A-1	Econ Dev	$5,085,000	12/2005	4/2009	$0
Series A-2	UL	$10,530,000	12/2005	4/2009	$0
Series A-3	NKU	$14,750,000	3/2006	4/2009	$14,750,000
Series A-4	WKU	$2,665,000	6/2006	4/2009	$2,665,000
	FUND TOTAL	**$220,370,000**			**$204,220,000**
Federal Hwy Trust Fund Project Notes					
2005 1st Series		$139,635,000	6/2005	9/2017	$127,780,000
	FUND TOTAL	**$139,635,000**			**$127,780,000**
ALCo TOTAL		**$1,193,645,000**			**$910,310,000**

*Excludes the $77,905,000 ALCo 2007 Series A-UK General Receipts Project Notes which were issued on a forward delivery basis in October 2006 with an expected delivery date of November 1, 2007.

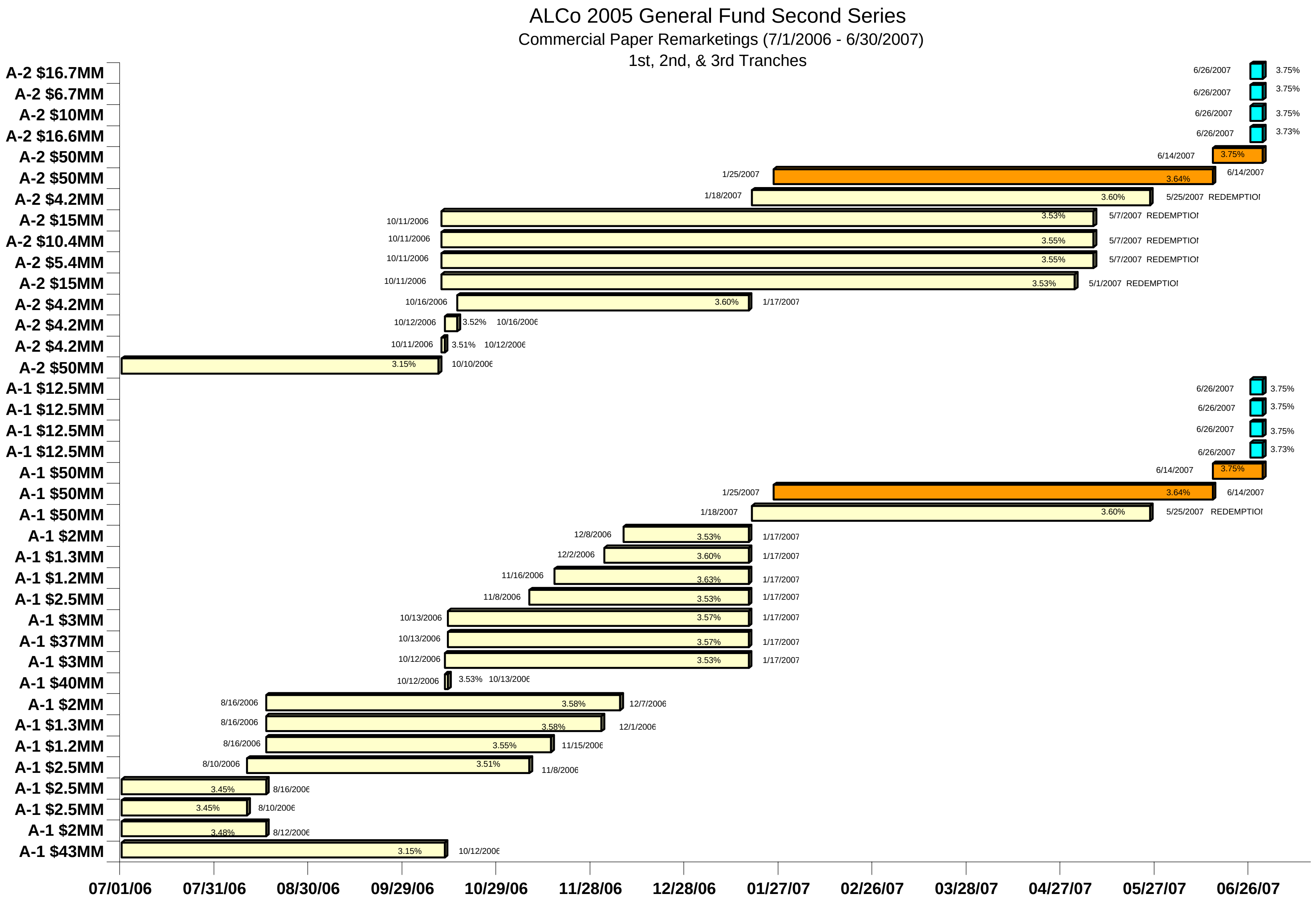
Kentucky Asset/Liability Commission
Variable Rate Debt
Weighted Average Yields - Cost of Capital

	2005 General Fund Second commercial paper			**2005 Agency Fund Second [1]** SIFMA + 0.45% weekly reset				
	Series A-1	Series A-2	**Total**	Series A-1	Series A-2	Series A-3	Series A-4	**Total**
Program Size	*not to exceed $950 million*			*not to exceed $250 million*				
Amount Issued	$150,000,000	$150,000,000	**$300,000,000**	$5,085,000	$10,530,000	$14,750,000	$2,665,000	**$33,030,000**
Amount Outstanding	$100,000,000	$100,000,000	**$200,000,000**	$0	$0	$14,750,000	$2,665,000	**$17,415,000**
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	- - -	$726,454,000	- - -	$5,000,000	$32,827,000	$14,750,000	$28,500,000	**$81,077,000**
June 30, 2007								
SIFMA	3.472%	3.472%		3.516%	3.516%	3.598%	3.629%	
Average Notes Outstanding	$60,247,934	$58,736,529	**$118,984,463**	$5,085,000	$9,715,347	$8,997,863	$2,665,000	**$21,954,110**
Inception Weighted Yields	3.399%	3.374%	**3.386%**	3.910%	3.935%	4.043%	4.079%	**3.867%**
Cost of Issuance				0.207%	0.115%	0.142%	0.118%	**0.127%**
Remarketing Fee	0.050%	0.050%	**0.050%**	-	-	-	-	**-**
Liquidity Facility Fee	0.075%	0.075%	**0.075%**	-	-	-	-	**-**
Average Cost of Funds	**3.524%**	**3.499%**	**3.511%**	**4.117%**	**4.051%**	**4.185%**	**4.198%**	**3.994%**
June 30, 2006								
SIFMA	3.238%	3.238%		3.311%	3.311%	3.495%	3.970%	
Average Notes Outstanding	$50,000,000	$50,000,000	**$100,000,000**	$5,085,000	$10,530,000	$6,000,000	$2,665,000	**$24,280,000**
Inception Weighted Yields	3.138%	3.150%	**3.144%**	3.761%	3.761%	3.945%	4.420%	**3.792%**
Cost of Issuance				0.207%	0.115%	0.142%	0.118%	**0.127%**
Remarketing Fee	0.050%	0.050%	**0.050%**	-	-			**-**
Liquidity Facility Fee	0.075%	0.075%	**0.075%**	-	-			**-**
Average Cost of Funds	**3.263%**	**3.275%**	**3.269%**	**3.968%**	**3.876%**	**4.086%**	**4.538%**	**3.919%**

(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 SIFMA
June 30, 2007
SIFMA
Difference
4.50%
4.00%
3.50%
3.00%
2.50%
2.00%
1.50%
1.00%
0.50%
0.00%
-0.50%
GF A-1
GF A-2
Total GF
AF A-1
AF A-2
AF A-3
AF A-4
Total AF


ALCo 2005 General Fund Second Series
Commercial Paper Remarketings (7/1/2006 - 6/30/2007)
1st, 2nd, & 3rd Tranches
A-2 $16.7MM
A-2 $6.7MM
A-2 $10MM
A-2 $16.6MM
A-2 $50MM
A-2 $50MM
A-2 $4.2MM
A-2 $15MM
A-2 $10.4MM
A-2 $5.4MM
A-2 $15MM
A-2 $4.2MM
A-2 $4.2MM
A-2 $4.2MM
A-2 $50MM
A-1 $12.5MM
A-1 $12.5MM
A-1 $12.5MM
A-1 $12.5MM
A-1 $50MM
A-1 $50MM
A-1 $50MM
A-1 $2MM
A-1 $1.3MM
A-1 $1.2MM
A-1 $2.5MM
A-1 $3MM
A-1 $37MM
A-1 $3MM
A-1 $40MM
A-1 $2MM
A-1 $1.3MM
A-1 $1.2MM
A-1 $2.5MM
A-1 $2.5MM
A-1 $2.5MM
A-1 $2MM
A-1 $43MM
07/01/06
07/31/06
08/30/06
09/29/06
10/29/06
11/28/06
12/28/06
01/27/07
02/26/07
03/28/07
04/27/07
05/27/07
06/26/07

APPENDIX D

PROJECT LIST

General Fund supported Bonds Authorized by the 2005 and 2006 General Assembly permanently financed within the reporting period.

Kentucky Asset/Liability Commission General Fund Floating Rate Project Notes

Agency	Project Title	Amount [1]
Enviromental and Public Protection Cabinet	Petroleum Storage Tank Environmental Assurance Fund	25,000,000
Finance and Administration Cabinet	Louisville Arena	75,000,000
		$ 100,000,000
TOTAL		

[1] Excludes allocable costs of issuance.