

**KENTUCKY ASSET/LIABILITY COMMISSION
MINUTES**

APRIL 12, 2001

The Kentucky Asset/Liability Commission (“ALCo”) meeting was called to order by Chairman T. Kevin Flanery in Room 264 of the Capitol Annex Building, Frankfort, Kentucky, on Thursday, April 12, 2001 at 2:00 p.m.

Members present were as follows: T. Kevin Flanery, Secretary, Finance and Administration Cabinet; Mary Lassiter, proxy for James Ramsey, State Budget Director; John Cubine, proxy for Ben Chandler, Attorney General; Gene Harrell, proxy for Jonathan Miller, State Treasurer; and Alex Rose, proxy for Michael Haydon, Secretary, Revenue Cabinet.

Secretary Flanery verified with the staff that a quorum was present and the press had been notified of the meeting.

Secretary Flanery called for a motion to approve the minutes of the January 8, 2001 meeting. A motion for approval was made by Mr. Rose and seconded by Mr. Harrell. Motion **CARRIED**.

Secretary Flanery introduced Resolution 2001-02, which reads as follows:

A RESOLUTION APPROVING THE EXECUTION AND DELIVERY OF A FINANCIAL (SWAP) AGREEMENT IN CONNECTION WITH THE SALE OF RESOURCE RECOVERY ROAD REVENUE REFUNDING BONDS, 1985 SERIES A, OF THE TURNPIKE AUTHORITY OF KENTUCKY; AUTHORIZING THE OFFICE OF FINANCIAL MANAGEMENT TO TAKE ALL NECESSARY ACTIONS; AND TAKING OTHER RELATED ACTION.

Mr. Gordon L. Mullis, Executive Director, Office of Financial Management explained to the Commission that in 1997 with the creation of the Asset/Liability Commission, one of the specific things that was in the enabling legislation was the authorization to enter into “Financial Agreements” such as interest rate SWAP agreements. Financial Agreements should not be confused with “Financing Agreements,” which are lease payment mechanisms to fund debt service associated with the Commission’s Project Note Program. This was the first time a Kentucky State government agency had the specific authorization to enter into the International SWAP Dealers Association (“ISDA”) documentation that underlies a Swap transaction. The reason for entering into Financial Agreements is to more efficiently manage the net interest cost and net interest exposure of the Commonwealth. Over the last 12 –18 months Morgan Stanley Dean Witter has been reviewing with staff outstanding issues of the Turnpike Authority, specifically certain maturities of the 1985 Resource Recovery Bonds. Morgan Stanley Dean Witter proposed that ALCo and the Road Fund could achieve savings from the 2009 maturity of the 1985 Resource Recovery Bonds without actually refunding them by entering into a SWAP with Morgan Stanley Dean Witter. To facilitate the transaction the Turnpike Authority of

Kentucky has approved calling the bonds and placing them into a trust created by Morgan Stanley Dean Witter. The trust will split the bond into two components; a floating rate instrument and a residual bond. The savings are extracted by entering into a SWAP that passes the value of the residual bond to the Commission. The SWAP is priced at BMA + 58 basis points. BMA is the benchmark short-term tax-exempt interest rate. If ALCo executed the transaction today based on last weeks BMA rate the Commonwealth's cost would be approximately 3.77 percent. This transaction does not change TAK's debt service request for the identified bond. The appropriation is the exact amount that they have always requested and will continue to request until the final maturity of the bonds. The transaction value lies in the difference between the floating rate and the 6% debt service appropriation. The differential between the two rates will remain in a Road Fund SWAP account for the benefit of the Road Fund during the term of this transaction. Staff estimates the account will earn approximately \$8 million over the course of the transaction. This money will not be available until the later part of this transaction due to the nature of the marketplace and the covenants of the agreement, which requires that the Commonwealth attempts to maintain a \$3 million balance in the account. This transaction is structured in such a way as to hold harmless the TAK. If the Trust is ever broken for any reason there is a method to establish an alternative trust or provide for the acquisition of the bonds by the Commonwealth so that the Road Fund and the TAK incur only the opportunity cost of the associated reinvestment risk.

Mr. Tom Howard, Deputy Executive Director, Office of Financial Management explained to the Commission that these bonds can't be refunded because there is a debt service reserve fund that is earning approximately 10 percent. If those bonds are refunded then proceeds of the prior reserve have to be transferred and become yield restricted at the new yield; therefore losing the 10% yield and earning a new yield of 4.5%. The SWAP transaction is the only way to protect the reserve fund earnings and still take advantage of lower interest rates. Mr. Howard directed the Commission to look at the chart found in the Board book for further explanation.

Secretary Flanery asked the Commission members if there were any questions, there being none, Mr. Rose made the motion to approve and Mr. Cubine seconded the motion. Motion **CARRIED.**

Ms. Terri Fugate, Analyst, Office of Financial Management presented an update on the Tax and Revenue Anticipation Notes (TRAN). Ms. Fugate referenced the charts found in the board book. Secretary Flanery asked Ms. Fugate about the chart detailing the history of the TRAN program, specifically about the current fiscal year earnings. Ms. Fugate responded that we expect to meet the earnings budgeted. Mr. Mullis commented to the Commission that the General Fund hasn't earned as much income from the TRAN because General Fund cash balances have been lower than expected.

Ms. Lassiter commented that the General Fund Monthly Average from January through March of 2001 is negatively sloped unlike prior years where the line tended to flatten out. Mr. Mullis indicated that staff hasn't had the opportunity to analyze but will in planning the next TRAN.

Mr. Howard commented that the remaining General Fund supported and Agency Fund supported ALCo notes outstanding have been converted to permanent financing through SPBC Projects 69 & 70. All of the 1998 bond authorizations have been financed and a portion of the 2000. Staff will be looking to finance the remaining 2000 authorized bond projects as construction progresses. Secretary Flanery commented that this will give the Commonwealth a rhythm as to how things will work over the next biennium.

Mr. Mullis informed the Commission that the ALCo Semi-Annual Report has been released and if they had not received a copy, please let staff know. He informed the Commission members that this report is for the period ending December 31, 2000. The June 30, 2001 report will reflect the conversion of all variable Agency Fund, General Fund and Road Fund Project Notes to permanent financing. Mr. Mullis commended the debt staff and administrative staff for their hard work on the preparation of the report. He also commented that it can be found on the internet at the OFM website. The Summary states, ALCo has added value of over \$100 million to the Commonwealth since inception. Mr. Mullis commented that ALCo is working as was anticipated.

Mr. Howard informed the Commission that Merrill Lynch pulled its commitment to certain segments of the Public Finance Market. Going forward the Commission will have three (3) remarketing agents in the rotating pool instead of four (4).

With no further business before the Commission the meeting was adjourned at 2:15 p.m.

Secretary, Kentucky Asset/Liability Commission