

KENTUCKY ASSET/LIABILITY COMMISSION
MINUTES
April 16, 2007

A meeting of the Kentucky Asset/Liability Commission ("ALCo") was called to order by Mike Burnside, Deputy Secretary, Finance and Administration Cabinet and proxy for John Farris, Secretary, Finance and Administration Cabinet on Monday, April 16, 2007 at 9:30 a.m. in Room 76 of the Capitol Annex in Frankfort, Kentucky. Other members present were: Bonnie Howell, proxy for Attorney General Greg Stumbo; Eugene Harrell, proxy for Jonathan Miller, State Treasurer; Allen Holt, proxy for Brad Cowgill, State Budget Director; and Ed Ross, Executive Director, Office of the Controller.

Chairman Burnside verified with staff that a quorum was present and the press was notified of the meeting.

A motion was made by Ed Ross and seconded by Bonnie Howell to approve the minutes of the September 18, 2007 meeting. Motion carried and the minutes were approved.

Chairman Burnside asked F. Thomas Howard, Executive Director, Office of Financial Management to discuss the Derivatives Policy. Mr. Howard stated that members were provided with the derivatives policy at the September 2006 meeting. Mr. Howard indicated the policy was tailored after a policy used by the Kentucky Housing Corporation. He indicated that since that time, the policy has been revised again and additional changes appropriate to ALCo were made.

Ms. Howell asked how staff tracked the earnings from derivatives. Mr. Howard indicated that the earnings are published every six months in the Semi-Annual Report.

Mr. Holt asked if anyone other than the Kentucky Housing Corporation provided any negative feedback on the policy. Mr. Howard indicated that it was actually conforming changes to the policy rather than negative feedback. Mr. Howard stated that the policy was shared with counterparties for suggestions but most changes were grammatical.

Mr. Ross asked how the exposure limits were tracked. Mr. Howard noted that exposure limits were tracked every quarter through Bond Edge and Bloomberg software to estimate market value of the portfolio. He noted that information was kept in house and reported semiannually. He added that if staff had a question concerning a derivatives value, an outside counterparty would be used to value the derivative.

Mr. Holt asked if the policy had to be approved by the State Investment Commission. Mr. Howard indicated that it did not. He added that State Investment Commission would be made aware of the policy.

A motion was made by Mr. Holt and seconded by Mr. Harrell to approve the derivatives policy. Motion carried and the derivatives policy was approved.

Chairman Burnside introduced Resolution 2007-01:

A RESOLUTION AUTHORIZING ONE OR MORE FINANCIAL (SWAP) AGREEMENTS; AUTHORIZING THE ISSUANCE, SALE AND DELIVERY OF AN AGGREGATE PRINCIPAL AMOUNT OF NOT TO EXCEED \$350,000,000 OF FLOATING RATE NOTES, 2007 GENERAL FUND FIRST SERIES, OF THE KENTUCKY ASSET/LIABILITY COMMISSION FOR THE PURPOSE OF PROVIDING FINANCING FOR AN AUTHORIZED PROJECT; AND AUTHORIZING A TRUST INDENTURE, FINANCING AGREEMENT, NOTE PURCHASE AGREEMENT, ESCROW AGREEMENT, PRELIMINARY OFFICIAL STATEMENT, OFFICIAL STATEMENT AND OTHER AGREEMENTS THAT MAY BE ENTERED INTO, ALL RELATED TO SUCH NOTES.

Brett Antle, Financial Analyst, Office of Financial Management, informed the Commission that Resolution 2007-01 authorized the issuance of 2007 General Fund First Series Floating Rate Notes in an amount not to exceed \$350 million. Mr. Antle stated that proceeds from the bonds would be used to permanently finance two projects authorized by the 2006 General Assembly in House Bill 380. He indicated that \$75 million would be used to finance the Louisville Arena Project and \$25 million for the Petroleum Storage Tank Environmental Assurance Fund. Mr. Antle also stated that the remaining proceeds would be used to advance refund portions of State Property and Buildings Commission Project 79 and Project 85. Mr. Antle indicated that the Notes would be issued on a variable rate basis. He added that the Notes would be issued with an option for a ten-year call date and a final maturity of November 1, 2027. Mr. Antle noted that an interest rate swap would be integrated into the Notes.

Mr. Howard stated that this transaction would offer the Commonwealth the ability to refund existing bonds that would not otherwise be refundable and allows the Commonwealth an opportunity to lock in a par-based structured coupon for the life of the loan. Mr. Howard stated that another advantage was that this particular transaction had no basis risk between the swap and the variable rate floating payment. He added that the transaction requires no liquidity facility. He stated that the transaction allows the Commonwealth a competitively priced product and the ability to derive savings that otherwise would not be realized from other types of derivatives structures. Mr. Howard noted that the handout (attached) describes the risk and analyzes each risk versus the floating rate note structure. Mr. Howard noted that this type of product has been used in the student loan and taxable markets for quite some time on a taxable basis but recently was adapted to the tax exempt market.

Mr. Ross asked what the costs associated with passing on the tax risk were. Mr. Howard indicated that investors are expecting that tax rates will not decrease and the state's sovereign credit is strong and so the spread has actually decreased. He added that the cost associated with the risk is minimal and pointed out that the Commonwealth presently has a considerable amount of tax risk in the amount of authorized but unissued debt. Mr. Howard stated that

April 16, 2007

spreads are expected to be 67 percent of LIBOR plus 55 basis points and will produce a present value savings of approximately 2.25 percent or an estimated \$3.5 million to the General Fund that would not otherwise be derived from a standard structure.

A motion was made by Ms. Howell and seconded by Mr. Ross to adopt Resolution 2007-01. Motion carried and Resolution 2007-01 was ADOPTED.

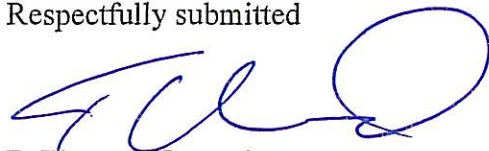
Terri Fugate, Deputy Executive Director, Office of Financial Management presented a report on the issuance of Kentucky Asset/Liability Commission General Receipts Project Notes, 2006 Series A, 2006 Series B and 2007 Series A. Ms. Fugate indicated that the 2006 General Assembly approved \$150 million for Phase II of the University hospital. She stated that the transaction was priced in October 2006 and will close November 1, 2007. Ms. Fugate noted that at the same time, refunding opportunities were identified: (1) the UK Housing and Dining Systems bonds were refunded in full and (2) State Properties and Buildings Commission Project 70 Agency Fund bonds were partially refunded. Ms. Fugate informed the members that the all-in TIC for the transaction was 4.3 percent and the present value savings on the refunding component was \$646,000.

Ms. Fugate continued with an update on the TRAN. She informed the members that a term sheet on the \$150 million outstanding TRAN was located behind Attachment E. Ms. Fugate indicated that the General Fund started the year with a balance on July 1 of \$800 million which was much larger than previous years. She pointed out that the balance dropped to negative \$520 million in November 2006. Ms. Fugate added that year to date the General Fund monthly average is higher than in previous years but continues to follow the highs and lows of previous years. Ms. Fugate stated that the expenditure target for the TRAN was met in August 2006 and the total earnings to date is \$1.9 million.

The next item on the agenda was an update on the Semi-Annual Report and Ms. Fugate informed the members that the report was completed and distributed on March 30, 2007. Ms. Fugate added that the report covers the period July 1, 2006 through December 31, 2006 and contains information on items discussed on the agenda as well as the ALCo 2005 General Fund Second Series Project Notes

With no further business before the Commission, a motion was made by Mr. Harrell to adjourn the meeting. Motion carried and the meeting was adjourned.

Respectfully submitted



F. Thomas Howard
Secretary