

KENTUCKY ASSET/LIABILITY COMMISSION
MINUTES
May 11, 2004

The Kentucky Asset/Liability Commission ("the Commission") meeting was called to order by acting Chairman George R. Burgess, Jr., proxy for Robbie Rudolph, Secretary, Finance and Administration Cabinet in Room 264 of the Capitol Annex on May 11, 2004 at 2:30 p.m.

Members present were Eugene Harrell, proxy for Treasurer Jonathan Miller; Bonnie Howell, proxy for Attorney General Greg Stumbo; and Allen Holt, proxy for Brad Cowgill, State Budget Director.

Mr. Burgess declared that a quorum was present and that the press had been notified of the meeting. A motion was made by Mr. Harrell and seconded by Mr. Holt to approve the minutes of the March 15, 2004 meeting. **Motion CARRIED.**

Mr. Tom Howard stated that the first item to be discussed would be Item 7 of the agenda, the Tax and Revenue Anticipation Note ("TRAN") Update. Mr. Howard further stated that this discussion would set the stage for approval of the Resolutions. Mr. Howard stated that, with the exception of last year, the Commission has issued a TRAN every year since 1997 to fund the cash flow needs of the General Fund and provide incremental earnings to supplement General Fund revenues. Mr. Howard stated that recent market movement has made it feasible to issue another TRAN. Mr. Howard indicated that as a result of the anticipated TRAN, staff has prepared the necessary Resolutions and will give a snapshot of the market to explain why this transaction would be of benefit to the Commonwealth.

Ms. Terri Fugate, Financial Analyst, Office of Financial Management, discussed projected General Fund cash flows for FY 2005. Ms. Fugate indicated that the absence of a legislatively enacted budget made it difficult because projections were made on assumptions. Ms. Fugate stated that the cash flow was based on the budget that was recommended by the Governor in January. Ms. Fugate continued that 11 years of cash flow data is used to project the General Fund daily cash balances, but an emphasis is placed on data from the late 1990s to present. Ms. Fugate indicated that the minimum balance is reached in October, November and December, with the maximum deficit amount of \$701,145,826 realized in December. Ms. Fugate indicated that using that assumption, the maximum TRAN issued could be \$779,050,917 and would meet the expenditure requirement. Ms. Fugate stated that if a budget or a spending plan was approved before the TRAN was issued, then numbers and charts would be revised.

Mr. Howard stated that the model had been accurate the past year. Ms. Fugate agreed that it had been more accurate this year than in previous years.

Ms. Howell asked what caused the projected spike in cash flows for June 2005. Ms. Fugate indicated that expenditures are front loaded early in the fiscal year and June receipts push the balance above zero by the end of the fiscal year. Ms. Howell asked if the current year trend is similar to what was shown. Ms. Fugate indicated that the current trend shows an

increased negative balance until the first of the calendar year and then the negative balance begins to decrease with a positive balance at the end of the year. Ms. Howell asked what the level of TRAN for the current fiscal year was. Mr. Howard indicated that a TRAN was not issued in the current year because it was more economical to fund internally versus an external borrowing. Mr. Howard continued that with rising interest rates and the changing relationship between tax-exempt bonds and taxable bonds it may become economical to issue a TRAN. Mr. Howard stated that the last TRAN was \$250,000,000 floating rate notes and \$250,000,000 fixed rate notes.

Ms. Howell asked what happens when a TRAN is issued and there is not a positive balance in June. Mr. Howard stated that if the General Fund did not reach a positive balance in June, the budget would not be balanced and it would be necessary to borrow funds from internal resources to balance the budget. Mr. Howard continued that the Governor would have to issue an Executive Order to balance the budget to zero. Mr. Howard continued that the TRAN funds only a portion of the authorized expenditures. Mr. Howard stated that General Fund projected revenues for the fiscal year would be \$7 billion dollars and only \$500-\$600 million, \$800 million at the most, would be borrowed. Mr. Howard stated that June receipts are historically \$600+ million. He continued that if all of the appropriation was spent at June 1, all of receipts collected in June could be used to pay off the TRAN. Mr. Howard indicated that the bulk of the taxes collected in June are sales and use tax and quarterly payments for fiscal year end. He also stated that agencies tend to pay expenses in late May and early June before the fiscal year ends.

Mr. Holt indicated that in 2001 the Commission was faced with a similar problem but was able to reach a positive balance in the worst conditions in the Commonwealth's history. Ms. Howell asked what the assumptions were based upon. Mr. Howard indicated the assumptions were based on consensus forecasting revenue estimates and current expected budget plan. Mr. Howard stated that expenditures are not tied to the TRAN, which is actually a pledge of General Fund receipts. Mr. Howard indicated that either the funds would be impounded before being deposited into the state system or the TRAN proceeds would be deposited in a separate account where the principal and the interest earned would be available to pay off the noteholders on the due date. Mr. Howard added that the principal plus the interest is then moved to the trustee to pay the TRAN and the remaining profit is moved by journal voucher to the General Fund.

Ms. Howell asked if the expenditure pattern was based on the Governor's Executive Budget. Ms. Fugate indicated that was correct. Mr. Howard reiterated that while approximately \$800 million in TRANs could be issued, it is expected that only \$500-\$600 million in assets could actually be purchased with a sufficient spread to make this an economically feasible transaction. Mr. Howard also stated that the TRAN has always met federal criteria.

Mr. Steve Jones, portfolio administrator for the Office of Financial Management, indicated that currently the rate on a one-year fixed rate TRAN would be 1.40 percent with 10 basis points cost of issuance. Mr. Jones proposed an interest rate swap with a fixed rate of 2.06 percent which would be a spread of 56 basis points. Mr. Jones indicated that one month LIBOR flat would be paid out on the interest rate swap and assumed that one month

LIBOR flat would be earned on the assets which would result in the earnings of 56 basis points. Mr. Jones indicated that 56 basis points on \$500 million dollars would be \$2.8 million. Mr. Jones pointed out that in June the pricing would most likely be different. Mr. Jones continued that it is expected that the Federal Reserve will raise interest rates at their meeting in June and it is likely that the rise in the interest rate will have a positive effect on the swap.

Mr. Howard stated that the current advantage of the proposed transaction is that the transaction is 100 percent fixed rate and the cost can be anticipated, which limits the basis risk. Mr. Howard indicated that typically when interest rates rise, the ratio between tax exempt and taxable begins to decompress which provides some ratio benefit that could widen the spread.

Mr. Holt asked if it would be more beneficial to postpone the TRAN for a few months. Mr. Jones indicated that the swap would already be priced into the one-year fixed rate if the Federal Reserve moved. He further stated that if the transaction is postponed and the Fed doesn't move as quickly as the market reacts, the potential exists for the transaction to lose money. Mr. Howard pointed out that typically a level of benefit is targeted and locked up for the entire period of the TRAN. Mr. Howard indicated that the proposed schedule would be to sell the first or second week of June, prior to the Fed meeting with settlement on July 1.

Mr. Howard indicated that staff is seeking approval for Resolution 2004-02:

A RESOLUTION PROVIDING FOR THE AUTHORIZATION, ISSUANCE, SALE AND DELIVERY OF GENERAL FUND TAX AND REVENUE ANTICIPATION NOTES, OF THE KENTUCKY ASSET/LIABILITY COMMISSION IN AN AGGREGATE PRINCIPAL AMOUNT NOT TO EXCEED \$800,000,000 FOR THE PURPOSE OF FUNDING EXPENDITURE DEMANDS ON THE GENERAL FUND OF THE COMMONWEALTH OF KENTUCKY; AUTHORIZING A PLEDGE OF AND LIEN ON REVENUES REQUIRED TO BE DEPOSITED TO THE GENERAL FUND TO SECURE SUCH NOTES; AUTHORIZING A TRUST INDENTURE SECURING SUCH NOTES; AND AUTHORIZING A FINANCIAL (SWAP) AGREEMENT.

With no further discussion, a motion was made by Mr. Holt and seconded by Mr. Harrell to adopt Resolution 2004-2. **Motion carried and Resolution 2004-02 was ADOPTED.**

Mr. Burgess introduced Resolution 2004-03:

A RESOLUTION APPROVING THE EXECUTION AND DELIVERY OF A FINANCIAL (SWAP) AGREEMENT IN CONNECTION WITH THE SALE OF ECONOMIC DEVELOPMENT ROAD REVENUE REFUNDING BONDS

(REVITALIZATION PROJECTS) OF THE TURNPIKE AUTHORITY OF KENTUCKY; AUTHORIZING A FINANCING/LEASE AGREEMENT; AUTHORIZING THE OFFICE OF FINANCIAL MANAGEMENT TO TAKE ALL NECESSARY ACTIONS; AND TAKING OTHER RELATED ACTION.

Mr. Howard stated that the Turnpike Authority of Kentucky met on May 4, 2004 and authorized the refunding of the 1993, 1995 and the 2000 Series of Economic Development Road Revenue Bonds. Mr. Howard indicated that staff proposes to create a delayed start refunding of the 1995 bonds that would be delivered on or before July 1, 2005 and would result in approximately three percent economic savings, or \$1,000,000 on a \$33,000,000 transaction. Mr. Howard stated that under current tax law, a refunding could not be initiated more than 90 days prior to the call date. Mr. Howard informed the Commission that the Turnpike Authority was interested in locking in a forward rate through an interest rate swap. Mr. Howard stated that the Turnpike Authority would issue auction rate securities that would be reset every 28 or 35 days and ALCo will enter into an interest rate swap at a guaranteed fixed rate. Mr. Howard stated that the Turnpike Authority approved the transaction and is making application to the Commission to enter into a synthetic rate transaction against the auction rate securities. Mr. Howard stated staff is seeking approval from the Commission to move forward on their behalf.

A motion was made by Ms. Howell and seconded by Mr. Harrell to adopt Resolution 2004-03. **Motion carried and Resolution 2004-03 was ADOPTED.**

Mr. Burgess introduced Resolution 2004-04:

A RESOLUTION AUTHORIZING THE EXECUTION AND DELIVERY OF A SUPPLEMENTAL TRUST INDENTURE RELATING TO PROJECT NOTES, 2002 AGENCY FUND SERIES OF THE KENTUCKY ASSET/LIABILITY COMMISSION; AUTHORIZING THE EXECUTION OF A FIRST SUPPLEMENTAL TRUST INDENTURE; AND TAKING THE RELATED ACTION.

Mr. Howard indicated that Resolution 2004-04 authorized the execution and delivery of a supplemental trust indenture related to Agency Fund supported Project Notes approved by the Commission in 2002. Mr. Howard indicated the transaction captures certain line item Agency Fund projects and Agency Bond Pool projects previously authorized by the General Assembly. Mr. Howard indicated that in order to eliminate the need to reauthorize the items in the coming budget, staff was asked to supplement the existing indenture, which would put the projects under a plan of finance. Mr. Howard indicated that this action would not permit the sale of bonds beyond June 30, 2004 without a legislatively enacted budget. Mr. Howard stated that this action preserves the prior budget authorization of the projects. Mr.

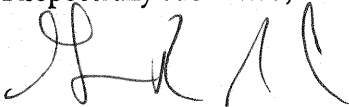
Howard indicated the projects to be included are various University of Kentucky and University of Louisville projects and one Kentucky State University project.

A motion was made by Mr. Holt and seconded by Ms. Howell to adopt Resolution 2004-04. **Motion carried and Resolution 2004-04 was ADOPTED.**

Mr. Howard informed the Commission that the General Assembly passed House Bill 418. Mr. Howard explained that this would allow the Commission to issue Grant Anticipation Revenue Vehicle ("GARVEE") bonds to fund certain federal highway projects for the Transportation Cabinet when a budget is enacted.

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "G. R. Burgess, Jr.", written in a cursive style.

George R. Burgess, Jr.
Secretary