

**KENTUCKY ASSET/LIABILITY COMMISSION  
MINUTES**

**MAY 22, 2000**

The Kentucky Asset/Liability Commission meeting was called to order by Chairman John P. McCarty in Room 264 of the Capitol Annex Building, Frankfort, Kentucky, on Monday, May 22, 2000 at 2:15 p.m.

Members present were as follows: John P. McCarty, Secretary, Finance and Administration Cabinet; James Ramsey, State Budget Director; Victor Fox, proxy for Ben Chandler, Attorney General; Gene Harrell; proxy for Jonathan Miller, State Treasurer; and Michael Haydon, Secretary, Revenue Cabinet.

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

Secretary McCarty called for a motion to approve the minutes of September 24, 1999 meeting. A motion was made and seconded to approve the minutes. Motion **CARRIED**.

Secretary McCarty introduced Resolution 00-01, which reads as follows:

**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 \$550,700,000 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; AND AUTHORIZING A TRUST INDENTURE SECURING SUCH NOTES.**

Gordon L. Mullis, Executive Director, Office of Financial Management introduced his staff that were present to the Board: Tom Howard, Deputy Executive Director, who does most of the "heavy lifting"; Terri Fugate, Nora Marshall and the newest staff member, Jason Hamilton. Mr. Mullis reported that the staff has done a lot of work developing the tables, charts and daily cash estimates that are used to size the TRAN program and determine the feasibility and timing, especially of a second tranche. Mr. Mullis stated this all came about in 1997 with the creation of the Asset/Liability Commission in its capability to issue both tax and revenue anticipation notes as well as project notes. Mr. Mullis indicated that there is another capability, that may never be used, the funding notes for judgements and liabilities. The financing team for the FY 2001 TRAN are listed within the agenda book under tab A under the Preliminary Tax and Revenue Anticipation Note Program Information. Salomon Smith Barney is the underwriter; Brown, Todd and Heyburn is underwriter's counsel; and Peck, Shaffer and Williams is bond counsel.

Mr. Mullis stated that the critical part of the TRAN program, as far as sizing and timing, is the cash flow analysis. Mr. Mullis then asked Ms. Fugate to give an overview of the cash-flow projections for sizing the 2000 TRAN.

Ms. Fugate began her presentation by referencing the resolution authorizing the issuance of General Fund Tax and Revenue Anticipation Notes not-to-exceed \$550,700,000, found under tab B of the Agenda book, and the supporting documents, under tab A, and generally stated why the Commonwealth issues TRANs. Historically, the General Fund for the first part of the fiscal year spends more than it brings in, until spring when revenues increase and out pace expenditures putting the General Fund back into a positive cash position. She then provided everyone with a handout summarizing the history of the TRAN program from its inception in fiscal year 1998 through the fiscal year 2001 projections. The handout highlighted the incremental earnings of each TRAN and the dates each expenditure test was met. Ms. Fugate stated that the IRS expenditure test is a very important part of the TRAN analysis. The General Fund has six (6) months to go negative enough to spend 90% of the TRAN proceeds. She indicated that in prior years, especially the first year, we held our breath until November 10 when we finally met that test. The penalty if we don't meet the test would be to rebate to the IRS part of the investment earnings, but not the full amount. Effectively the state has to give back everything above the arbitrage yield if you are unable to meet the test.

The staff is cautious in sizing the TRAN but is getting a little more comfortable each year and increasing the initial size of the TRAN to maximize the earnings over the period. Last year we came back to the market in November and issued a second tranche, which shortened the time for earnings. The Series B TRAN in FY 2000 met its expenditure test on the very same day it was issued. ALCo has issued a second tranche the previous two years. Mr. Mullis noted that a base amount of earnings are included as part of the official revenue estimate, as an investment income component.

Resolution 00-01 authorizes the total anticipated borrowings for the fiscal year. The projections for FY 2001 support the issuance of approximately \$400,000,000 as Series A in July. The not-to-exceed \$550,700,000 authorization will allow us to get right back in the market once we meet the expenditure test and issue the second tranche for the remaining authorization if desired.

Ms. Fugate stated we would like to price early in June and settle on the first business day of the new fiscal year, which will be July 3, 2000. The reason we are pricing earlier this year is at the recommendation of our underwriters, which have suggested that we take advantage of cash in the money market funds, which are the largest purchasers of these type securities the TRAN will mature on June 27, 2001.

Ms. Fugate concluded with an overview of the supporting documents found behind tab A. Table 2, FY 2001-Projected Revenues and Expenditures, assumed for the TRAN Series A a coupon rate of 5.5% with a yield of 4.85% and investment income at 7.00%. Seventy-five percent of the Budget Reserve Trust Fund, \$179,462,600, will be restricted and not available to meet General

Fund operating needs. FY 2001 Daily Cash Estimates suggest the expenditure test will be met on October 9 with a maximum FY deficit on November 16.

Secretary McCarty asked for questions of the TRAN program. Mr. Haydon asked what was done prior to the program. Mr. Mullis responded that we borrowed from ourselves, when the General Fund went negative we would have to go to other funds and borrow at the yield on the state's investment pools.

Secretary McCarty called for additional questions, being none he called for a motion to approve Resolution 00-01 in the amount not to exceed \$550,700,000 of TRAN notes for the purpose of funding expenditure demands on the General Fund of the Commonwealth of Kentucky. Mr. Ramsey made a motion to adopt Resolution 00-01. Mr. Fox seconded the motion. Resolution 00-01 was **ADOPTED**

Secretary McCarty introduced the next item on the agenda, which was a presentation by Tom Howard reviewing ALCo debt outstanding, which is found under tab C.

Mr. Howard stated the current year TRAN 99 Series A & B will mature on June 28, 2000 and will be replaced with the new TRAN under Resolution 00-01, Series A on July 3, 2000. The staff will report the terms and conditions of the sale once it has been completed. The Debt Summary also lists the project notes supported by various fund sources (General Fund, Agency Fund and Road Fund). Mr. Howard noted the 1998 General Fund Series, the first project note program, was converted to permanent financing in February 2000 with the issuance of State Property and Buildings Commission Project 65 Revenue Bonds. The 1998 General Fund Second Series, which funded grant payments from the surplus expenditure plan in the 1998-2000 budget, has been converted to permanent financing by State Property and Buildings Commission Project 64 which sold in September 1999. The 1999 General Fund First Series, which funded university equipment, were sold by ALCo in final form as fixed rate notes in March 1999, as seven (7) year serial maturities. The 1999 General Fund Second, Third and Fourth Series Project Notes are all currently outstanding with approximately \$20,000,000 issued under each indenture. A number of the projects are currently in the bid process or going to be bid very shortly and those expenditures will start to grow. Given the current budget for new debt of approximately one billion dollars, the staff feels it is prudent to begin converting these existing series to permanent financing to make way for the new projects that will be coming online in the near future. A systematic approach will be taken to convert the existing series, driven by the credit facilities termination dates and not so much the maturity dates of the individual indentures themselves. For example, the 1999 General Fund Fourth Series will be the first issue converted because the credit facility expires November 1, 2000. Salomon Smith Barney, will do that transaction in late August or early September. We will work backwards and convert the 1999 General Fund Third Series with PaineWebber in the fall and then the Second Series, hopefully in the spring of 2001 with Merrill Lynch. This is the current estimated schedule and will take advantage of the 90-day arbitrage window that is available on current refundings.

With respect to the Road Fund, the 1999 First Series, \$78,000,000 was authorized and \$75,000,000 is outstanding. About \$40-45 million of bond proceeds have been spent. The

Turnpike Authority in the near future will convert those notes to bonds. The balance of the \$200,000,000 road authorization in the current biennium, of \$125,000,000, is financed by the 1999 Road Fund Second Series, against which we have drawn \$25,000,000. The staff will watch construction expenditures against the First Series and when those are above the First Series then additional Second Series funds will be raised in the short-term market to maximize arbitrage opportunities.

The Agency Fund projects to be permanently funded by the State Property and Buildings Commission Project 66, are the University of Kentucky Stadium, Kentucky Higher Education Association Authority (KHEAA) office building, and the Eastern Kentucky University (EKU) Law Enforcement Training Facility. The UK stadium project is complete, ECU has been bid and expected to begin construction in July and the KHEAA site has been selected. Given the volatility in interest rates we felt it was good to go ahead from an agency budget perspective to fix those out. Additionally, the \$3,045,000 Morehead housing and dining project initially funded by the 1998 Agency Fund Project Notes is currently being converted to permanent financing. All of this activity will significantly decrease the 1998 Agency Fund Project Notes outstanding to \$15,000,000 for the UK housing and dining and Aging Allied Health Building. The timetable for conversion to permanent financing of that tranche of notes has not been established, but will be at the university's discretion.

Mr. Howard asked if there were any questions. Secretary McCarty noted from looking at the Project Notes since the establishment of ALCO we have been able to maximize the advantage of the market rates and take advantage of the arbitrage window. Mr. Howard noted that the ALCO program will provide over \$25,000,000 in debt service lapse in FY00, which would not have been possible previously. Mr. Howard also commented that interest rates have been very favorable for us the past few years but trending upward recently. On the surface rising rates appear to be a bad thing, but our investments are so short term oriented that our investment earning are going up as well; therefore, on a cash flow basis rising rates are not necessarily bad from an overall balance sheet perspective.

Secretary McCarty called for questions regarding the debt summary. No questions were presented.

With no further business before the Commission, the meeting was adjourned at 2:45 p.m.

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Secretary, Asset/Liability Commission