

Kentucky Asset/Liability Commission
Minutes
September 10, 2002

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 Tuesday, September 10, 2002, at 10:15 a.m.

Members present included: T. Kevin Flanery, Secretary, Finance and Administration Cabinet; Cindy James, proxy for Ben Chandler, Attorney General; Eugene Harrell, proxy for State Treasurer Jonathan Miller; Allen Holt, proxy for James R. Ramsey, State Budget Director. Kevin Mason, Legislative Research Commission, was also present.

Secretary Flanery called for a motion to approve the minutes of the June 11, 2002 meeting. A motion to approve the minutes of the June 11, 2002 meeting was made by Mr. Harrell and seconded by Mr. Holt. Motion **CARRIED**.

Secretary Flanery introduced Resolution 2002-04:

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 \$850,000,000 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.

Secretary Flanery stated that Resolution 2002-04 would have been presented for approval earlier this year but was delayed due to the lack of a legislatively enacted budget and the circumstances surrounding the current spending plan.

Mr. Gordon L. Mullis, Executive Director, Office of Financial Management, indicated that Resolution 2002-04 is the traditional resolution presented for adoption each year to raise money for the cash flow management of the Commonwealth. The principal amount of the Resolution is not to exceed \$850,000,000 and is based on a calculation of the maximum deficit that the Commonwealth will achieve during the fiscal year without such a borrowing then sized to meet IRS requirements. Even with adoption of the Resolution it is not clear at this time whether any notes or the TRAN will be issued. Mr. Mullis indicated the decision to issue notes or the TRAN will depend on the rating agencies. Mr. Mullis indicated that the Resolution also permits a swap that is slightly different than past resolutions. The swap is being proposed to assist in managing the interest rate component of the borrowing. He continued that the ability to have a variable rate component in the borrowing plan proved to be an extremely "real-dollar" valuable tool last year. Mr. Mullis also stated that the structure being contemplated this year will include variable, fixed, and swap components to manage the overall cost in the present environment.

Secretary Flanery reiterated that this transaction is a cash flow borrowing at tax-exempt rates to avoid inter-fund borrowing at higher rates. It is a cost avoidance measure in every instance and a money-making endeavor in some instances. However, it is unlikely that it will produce excess revenues.

Secretary Flanery also indicated that if the cost is not avoided, the Commonwealth would have to find funds at the end of the fiscal year to cover the cost of using internal funds. The program has been very successful since 1997 and has been a tremendous asset to the Commonwealth.

Mr. Mullis indicated that the underwriter for the issuance of bonds would be Salomon Smith Barney ("SSB") and bond counsel is Peck, Shaffer & Williams. Frost Brown Todd is bond counsel for SSB. Staff is prepared to take the necessary action to place this issuance into the marketplace, close the issue and deposit funds to the General Fund by the end of September 2002. Based on seasonal patterns, the lowest deficit will occur in December. OFM fully expects to achieve the target needed in order to retain earnings. Mr. Mullis stated that calculations indicate that the inability to issue the TRAN will cost the General Fund over \$8 million for the remainder of the year.

Mr. Allen Holt, proxy for James Ramsey, State Budget Director, asked what the cost to the Commonwealth would be if the Commission did not adopt Resolution 2002-04.

Mr. Tom Howard, Deputy Executive Director of the Office of Financial Management, indicated that the cost to the Commonwealth would be an extra \$8 million for the remainder of the year in addition to the interest on the TRAN.

Mr. Mullis continued that the \$8 million is the principal rationale for moving forward with this transaction. He further indicated that the meeting with the rating agencies appeared to be successful and that if two of the three agencies rate the issue at an appropriate level, OFM staff will move forward with the transaction. If the ratings are not appropriate, an alternative strategy would be considered. The proposed Resolution, however, offers the most cost-effective borrowing alternative. Mr. Mullis indicated the current all-in total interest cost is approximately 1.50 basis points.

Mr. Mullis felt it was important for the rating agencies to understand that the TRAN is not traditional debt because it is borrowed and repaid in the same fiscal year. The lack of a legislatively enacted budget and the possibility that the spending plan will not be upheld in court has been a source of concern for the rating agencies. Mr. Mullis stated that the statutes provide for the borrowing and for repayment which does not require a budget appropriation.

Mr. Holt asked if there was a better margin of error than last year. Mr. Mullis indicated that there is no margin of error. The TRAN produces zero revenue and the investment income of the Commonwealth will be very low because there is no cash in the General Fund. The balance in the General Fund is extremely negative because the TRAN income has not been deposited into the General Fund. Mr. Mullis further indicated that there was not sufficient cash to pay the accruals.

Mr. Holt asked if funds would be available to pay the interest. Mr. Mullis indicated that even last year the interest was paid by utilizing other available funds.

Mr. Howard presented an historical overview of the General Fund Tax and Anticipation Note program. A copy of the information discussed is attached to the minutes. He further indicated that the negative balances in the General Fund will result in serious cash flow issues and the issuance of the TRAN will help to alleviate some of those issues.

Mr. Mullis further stated that passage of Resolution 2002-04 was recommended by OFM staff.

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A motion was made by Allen Holt and seconded by Cindy James to adopt Resolution 2002-04.
Resolution ADOPTED.

Mr. Mullis indicated there was no further business to discuss, but if any Commission member wanted to discuss the transaction in further detail OFM staff would be available to do so.

With no further business before the Commission, a motion was made by Mr. Holt and seconded by Mr. Harrell to adjourn the meeting. **Motion CARRIED** and meeting was adjourned at 10:45 a.m.

Respectfully submitted,

Gordon L. Mullis
Secretary