

**City of Morehead, Kentucky
Kentucky League of Cities Funding Trust
Lease Program Revenue Bonds,
Variable Rate Series 2004A
Financial Statements
Years Ended June 30, 2009 and 2008**

**City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A**

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Mountjoy
Chilton
Medley

Independent Auditor's Report on Financial Statements

To the Board of Directors
Kentucky League of Cities Funding Trust

We have audited the accompanying statements of financial position of the Trust Estate of the City of Morehead, Kentucky, Kentucky League of Cities Funding Trust Lease Program Revenue Bonds, Variable Rate Series 2004A as of June 30, 2009 and 2008, and the related statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Kentucky League of Cities. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraphs, we conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The Trust Estate did not account for changes in the fair value of interest rate exchange agreements for the year ended June 30, 2008. We were unable to satisfy ourselves in regard to the fair value of the interest rate exchange agreements as of June 30, 2008.

As further explained in Note L to the financial statements, the Trust Estate records a participant's share of issuance costs to originate a lease as income in the accompanying statements of activities and changes in net assets in the year the lease is closed. In our opinion, these costs should be capitalized and amortized over the life of the lease using the effective interest method in order to conform with accounting principles generally accepted in the United States of America.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to satisfy ourselves about the fair value of the interest rate exchange agreements as of June 30, 2008 and the effects of not capitalizing and amortizing issuance costs of the participants, the financial statements referred to above present fairly, in all material respects, the financial position of the Trust Estate of the City of Morehead, Kentucky, Kentucky League of Cities Funding Trust Lease Program Revenue Bonds, Variable Rate Series 2004A as of June 30, 2009 and 2008, and the results of its activities and changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Mountjoy Chilton Medley LLP
Louisville, Kentucky
September 14, 2010

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Statements of Financial Position
June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Assets		
Cash and cash equivalents	\$ 139,667	\$ 122,461
Investment agreement	6,847,302	5,415,000
Accrued investment income receivable	4,124	8,478
Accrued interest and fees receivable-leases	83,372	47,786
Other receivables	-	107,499
Lease agreement receivables	35,476,871	37,916,905
Lease agreement receivables-unrealized appreciation in fair value	753,063	41,210
Costs of issuance, net	<u>352,906</u>	<u>381,246</u>
Total Assets	<u>\$ 43,657,305</u>	<u>\$ 44,040,585</u>
Liabilities and Net Assets		
Liabilities		
Accounts payable	\$ 112,389	\$ 76,819
Accrued interest payable	55,937	99,532
Interest rate exchanges	753,063	41,210
Accrued arbitrage	25,533	20,211
Bonds payable	<u>42,325,000</u>	<u>43,420,000</u>
Total Liabilities	43,271,922	43,657,772
Commitments and Contingencies		
Net Assets, unrestricted	<u>385,383</u>	<u>382,813</u>
Total Liabilities and Net Assets	<u>\$ 43,657,305</u>	<u>\$ 44,040,585</u>

The accompanying notes are an integral part of these financial statements.

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Statements of Activities and Changes in Net Assets
Years Ended June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Revenues		
Income from lease agreement receivables	\$ 1,259,668	\$ 1,707,205
Investment income	108,988	219,063
	<u>1,368,656</u>	<u>1,926,268</u>
Total Revenues	1,368,656	1,926,268
Expenses		
Administrative and trustee fees	169,747	129,368
Letter of credit fees	172,774	183,819
Remarketing fees	35,471	34,763
Municipal debt fee	4,000	3,500
Arbitrage rebate	5,322	5,655
Interest expense	978,772	1,549,630
	<u>1,366,086</u>	<u>1,906,735</u>
Total Expenses	1,366,086	1,906,735
Change in Net Assets	2,570	19,533
Net Assets at Beginning of Year	<u>382,813</u>	<u>363,280</u>
Net Assets at End of Year	<u><u>\$ 385,383</u></u>	<u><u>\$ 382,813</u></u>

The accompanying notes are an integral part of these financial statements.

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Statements of Cash Flows
Years Ended June 30, 2009 and 2008

	<u>2009</u>	<u>2008</u>
Cash Flows from Operating Activities		
Change in net assets	\$ 2,570	\$ 19,533
Adjustments to reconcile change in net assets to net cash provided (used) by operating activities:		
Amortization of costs of issuance	28,340	31,304
Changes in:		
Accrued investment income receivable	4,354	11,597
Accrued interest and fees receivable-leases	(35,586)	15,655
Other receivables	107,499	(107,499)
Accounts payable	35,570	(4,543)
Accrued interest payable	(43,595)	(50,081)
Accrued arbitrage	5,322	5,655
	<u>104,474</u>	<u>(78,379)</u>
Cash Flows from Investing Activities		
Proceeds from lease agreements	2,440,034	2,946,682
Net purchases under investment agreement	<u>(1,432,302)</u>	<u>(232,000)</u>
	1,007,732	2,714,682
Cash Flows from Financing Activities		
Principal payments on bonds	<u>(1,095,000)</u>	<u>(3,366,000)</u>
Cash Used by Financing Activities	<u>(1,095,000)</u>	<u>(3,366,000)</u>
Increase (Decrease) in Cash and Cash Equivalents	17,206	(729,697)
Cash and Cash Equivalents at Beginning of Year	<u>122,461</u>	<u>852,158</u>
Cash and Cash Equivalents at End of Year	<u>\$ 139,667</u>	<u>\$ 122,461</u>
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest on bonds	\$ 994,027	\$ 1,568,407
Noncash investing activities:		
Change in the fair value of lease agreement receivables and related interest rate exchanges	711,853	-

The accompanying notes are an integral part of these financial statements.

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Notes to Financial Statements
June 30, 2009 and 2008

Note A - Nature of the Organization and Operations

General: The Kentucky League of Cities is a voluntary association of cities created in 1927 to assist municipal officials in representing the interest of cities and to provide services to members fostering improved municipal government in Kentucky.

The Financial Services Department of the Kentucky League of Cities provides tax-exempt financing to Kentucky cities. By taking advantage of economies of scale through tax-exempt bond pools, the Financial Services Department provides its members access to low interest rate loans to fund capital improvement projects and equipment purchases ("the lease program").

In December 1992, certain governmental agencies of the state entered into an Interlocal Cooperation Agreement pursuant to KRS 65.210 through 65.300, KRS 58.010 through 58.140, and KRS 65.940 through 65.956 ("the Act"), which authorized the creation of the Kentucky League of Cities Funding Trust ("the Funding Trust"). The Funding Trust issues tax-exempt bonds in order to provide funding for leases to participating members at variable rates of interest.

The Funding Trust is governed by a Board of Trustees consisting of five members. At the time of appointment, each member of the Board of Trustees must be an elected official of a Kentucky city.

Trust Estate: In June 2004, the City of Morehead, Kentucky ("the Issuer") issued \$50,000,000 Kentucky League of Cities Funding Trust Lease Program Revenue Bonds, Variable Rate Series 2004A ("the Bonds") to facilitate the purposes of the lease program.

The Trust Estate is defined as all the rights, title, and interest of the Issuer and the Funding Trust in and to (i) the leases, (ii) any interest rate exchange agreements, (iii) the lease rental payments due under the leases, (iv) the collateral documents related thereto, if any, (v) all monies and securities, including earnings thereon, held in the funds and accounts created in the Trust Indenture other than the Rebate Account and the Program Discretionary Account (through June 30, 2009, no amounts have been deposited in either the Rebate Account or the Program Discretionary Account) and (vi) all property, rights, and assets of any kind and nature that are now or hereafter from time to time pledged, assigned, or transferred as and for security under the Trust Indenture by the Issuer or the Funding Trust or by anyone on their behalf or with written consent.

Distributions on Termination: Upon ultimate termination of the Trust Estate (no later than June 2034), any assets remaining after satisfaction of all Trust Estate liabilities will be returned to the program participants on a pro rata basis.

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Notes to Financial Statements (Continued)
June 30, 2009 and 2008

Note B - Contractual Agreements

Administrative Services: Pursuant to the June 2004 program administration agreement, the Kentucky League of Cities ("the Program Administrator") provides administrative services to the Funding Trust. These administrative services include professional, administrative, and financial functions, including providing personnel necessary for the orderly and proper administration of the Funding Trust and its lease program. The Program Administrator bills the Trust Estate an administration fee for providing these services. The administration fee is equal to .25% of the aggregate unpaid principal components of all lease rental payments. The fee is payable from and only to the extent funds are available in the Revenue Account or otherwise available from the Trust Estate. The costs of these services are included as a component of administrative and trustee fees in the accompanying statement of activities and changes in net assets.

This program administration agreement expires upon the earlier of the date the Bonds are fully redeemed or the date specified by 30 days prior written notice of termination delivered by the Funding Trust to the Program Administrator.

Trustee Services: Under the terms of the June 2004 Trust Indenture, U.S. Bank National Association ("U.S. Bank"), acts as Trustee for the Trust Estate and, as such, holds investments, receives lease rental payments, maintains appropriate books and records to account for all funds established under the Trust Indenture, and conducts other transactions as directed by the Program Administrator. In return for the services provided by the Trustee, the Trust Estate pays an annual fee of \$10,000 plus \$200 per lease agreement outstanding. This annual fee is a component of administrative and trustee fees in the accompanying statement of activities and changes in net assets.

Credit Facility: The Funding Trust and U.S. Bank are party to a June 2004 Letter of Credit and Reimbursement Agreement ("the Agreement"). Concurrent with the Agreement, U.S. Bank issued an irrevocable transferable direct pay letter of credit in favor of the Funding Trust which the Letter of Credit is used by the Funding Trust to facilitate the redemption of the Bonds immediately prior to their remarketing (see Bond Remarketing). The initial term of the Credit Facility expired in June 2007. The Credit Facility automatically extends for periods of three years beyond the June 2007 expiration date unless ninety days prior to the expiration date U.S. Bank notifies the Trustee that U.S. Bank does not intend to extend the date. As of June 30, 2009, the expiration date has been extended to June 2010. In no case shall any such renewal or extension extend the termination date beyond June 2034. At June 30, 2009 and 2008 the funds available to be drawn on the letter of credit are \$42,846,815 and \$43,955,315, respectively. As of June 30, 2009 and 2008, no balance is outstanding on the letter of credit.

In return for the Letter of Credit and Reimbursement Agreement, the Trust Estate paid a one-time commitment fee in the amount of \$10,000. The Trust Estate also pays an annual letter of credit fee to U.S. Bank equal to .4% of the maximum amount available to be drawn at such time under the letter of credit, a drawing fee of \$50 per disbursement made by U.S. Bank, and a transfer fee of \$2,500 if the Issuer requests a transfer of the letter of credit to a successor Trustee.

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Notes to Financial Statements (Continued)
June 30, 2009 and 2008

Note B - Contractual Agreements (Continued)

Bond Remarketing: As further discussed in Note H, the Bonds, in the Variable Rate Bond form, are considered Weekly Rate Bonds with the ability to be converted to Daily Rate Bonds, Adjustable Rate Bonds, or Fixed Rate Bonds.

The Funding Trust and Fifth Third Securities, Inc. ("Fifth Third" or "Remarketing Agent") are party to a June 2004 remarketing agreement. Under the terms of the remarketing agreement, Fifth Third has agreed to use its best efforts to remarket the Bonds. These Bonds are to be sold at the most favorable interest rates and terms that will result in a sale price equal to the principal amount of the Bonds sold, together with accrued interest, if any, thereon. Proceeds from the Bonds are used to repay draws on the letter of credit (see Credit Facility).

Under the remarketing agreement, the Trust Estate paid a one-time fee of \$205,000 for services related to the competitive sale of the Bonds. This one-time fee is being amortized over the remaining life of the bonds. Additionally, the Trust Estate pays to Fifth Third annual remarketing fees equal to .1% of the principal amount of the outstanding Bonds through June 2005 and remarketing fees equal to .08% of the principal amount of the outstanding Bonds thereafter.

This remarketing agreement shall continue to be in effect up until and including the earlier of the date of final payment on the Bonds or any date on which all Bonds bear interest at the Fixed Rate to maturity. The Remarketing Agent may be removed or replaced at any time by the Funding Trust or the Issuer upon providing 30 days prior written notice.

Paying Agent: Cede & Co. (partnership nominee of The Depository Trust Company) currently serves as the paying agent under the terms set forth in the Trust Indenture. Cede & Co. receives funds from the Trustee as well as from draws on the letter of credit and disburses such funds to the bondholders in payment of the Trust Estate's principal and interest obligations.

Note C - Summary of Significant Accounting Policies

1. Basis of Presentation: The financial statements of the Trust Estate have been prepared on the accrual basis of accounting. The significant accounting policies are described below to enhance the usefulness of the financial statements to the reader.
2. Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Accordingly, actual results could differ from those estimates.

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Notes to Financial Statements (Continued)
June 30, 2009 and 2008

Note C - Summary of Significant Accounting Policies (Continued)

3. Investments Held by the Trustee: All invested funds are held by the Trustee. The Trustee is mandated by the Trust Indenture as to the types of investments in which the Trust Estate can be invested. Statement of Financial Accounting Standards No. 124 ("SFAS No. 124"), *Accounting for Certain Investments Held by Not-for-Profit Organizations*, requires that investments in equity securities with readily determinable fair values and all investments in debt securities be measured at fair value in the financial statements of not-for-profit organizations. Accordingly, all invested funds held by the Trustee are stated at fair value based on the Trustee's independent valuation service.
4. Cash and Cash Equivalents: The Funding Trust considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents. The Trust regularly maintains cash in excess of federally insured limits. Accordingly, at various times during the years ended June 30, 2009 and 2008, the balances were uninsured and uncollateralized.
5. Lease Agreement Receivables: Lease agreement receivables represent the principal obligation of the lease program participants. Accordingly, the lease agreement receivables balance as of June 30, 2009 and 2008 are stated at the amount the Funding Trust expects to collect on the outstanding balances. Lease agreement receivables are written off as uncollectible if no payment is received after all collection efforts have been exhausted. Receivables are reviewed for collectability when they become past due and an allowance for doubtful accounts is established, if deemed necessary. An allowance for uncollectible balances is not reflected in these financial statements because the Funding Trust considers all balances to be fully collectible.

Any lease rental payment that is not paid within ten days of the date due bears interest at the late payment rate as defined in the lease agreement. Failure by the lessee to pay any lease rental payments at the time specified in the lease agreement is considered a default. There was one lease that was in default as of June 30, 2009. This lease is current as of the date of the audit report.

The income from the lease agreement receivables is representative of the interest income on the leases recognized under the effective interest method and the participants' share of the administrative, credit, issue, and fiduciary fees of the lease program.

Pursuant to the terms of the lease agreement, the lessee, after notice from the Funding Trust, will make payment based upon the actual variable rate as defined and as required in the lease agreement.

6. Costs of Issuance: Costs of issuance related to the bond issuance are amortized over the life of the bond issue (30 years) using the effective interest method. Interest expense on the bond issuance amortization was \$28,340 and \$31,304 the years ended June 30, 2009 and 2008, respectively. Amortization for each of the next five succeeding fiscal year ends is expected to be approximately \$27,100, \$26,000, \$24,900, \$23,900, and \$22,800 for the years ended June 30, 2010 through 2014, respectively.

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Notes to Financial Statements (Continued)
June 30, 2009 and 2008

Note C - Summary of Significant Accounting Policies (Continued)

7. Net Assets: There are no donor-imposed restrictions on the net assets of the Trust Estate, and thus the net assets are considered "unrestricted" as defined by Statement of Financial Accounting Standards No. 117, *Financial Statements of Not-for-Profit Organizations*.
8. Interest Rate Exchange Agreements: The Trust accounts for interest rate exchange agreements in accordance with Statement of Financial Accounting Standards No. 133 ("SFAS 133"), *Accounting for Derivative Instruments and Hedging Activities*. Statement 133, establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded in the statement of financial position as either an asset or liability measured at its fair value. The Trust Estate did not adjust for changes in the fair value of interest rate exchange agreements for the year ended June 30, 2008.

Note D - Fair Value of Financial Instruments

The Financial Accounting Standards Board ("FASB") issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"), which defines fair value, provides a framework for measuring fair value, and expands disclosures required for fair value measurements. SFAS 157 also establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels. These levels, in order of highest to lowest priority, are described below:

Level 1 - Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 - Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 includes values determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting the Funding Trust's own assumptions.

SFAS 157 was adopted by the Funding Trust for financial assets and liabilities as of July 1, 2008. The availability of observable inputs can vary from instrument to instrument and is affected by a wide variety of factors, including, for example, the type of instrument, the liquidity of the markets, and other characteristics particular to the instrument. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires more judgment. Accordingly, the degree of judgment exercised in determining fair value is greatest for instruments categorized in Level 3.

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Notes to Financial Statements (Continued)
June 30, 2009 and 2008

Note D - Fair Value of Financial Instruments (Continued)

The following is a description of the valuation methodologies used for assets and liabilities of the Trust Estate measured at fair value:

Cash Equivalents: Many of the Trust Estate's cash equivalents have short-term maturities or have interest rates which vary in the short-term. The fair values of such instruments approximate their respective carrying values (Level 1).

Interest Rate Exchange Agreements: The Trust Estate has entered into interest rate exchange agreements to hedge against changes in the fair value of underlying lease receivables (see Note I). These are over-the-counter agreements and identical agreements may not be available on the active market. The swap values are determined based on comparing the Securities Industry and Financial Markets Association ("SIFMA") Municipal Swap Index forward rate curve with the fixed rates on the lease receivables. The fair values of the swap contracts approximate the carrying value of these financial instruments (Level 2).

Investment Agreement: The investment agreement (see Note F) was negotiated and entered into in connection with specific financing transactions. Due to the uniqueness of this arrangement, the lack of transferability, and the fact that the principal amount invested, in most cases, fluctuates over the term of the agreement, there are no identical instruments traded in active markets. The agreement is collateralized by obligations issued or guaranteed by the United States government and its agencies for which quoted prices in active markets are available. Accordingly, fair value of the instrument approximates the respective carrying value (Level 2).

Letter of Credit and Reimbursement Agreement: As described in Note B, the Funding Trust and US Bank are party to a Letter of Credit and Reimbursement Agreement to provide additional collateral for the Bonds outstanding. This Agreement is integral to the bond issue and, as such, cannot be marketed separately. It is the opinion of management that any fair value related to these agreements has already been included in the fair values of the related Bonds.

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Notes to Financial Statements (Continued)
June 30, 2009 and 2008

Note D - Fair Value of Financial Instruments (Continued)

The following table summarizes the Trust Estate's assets and liabilities measured at fair value as of June 30, 2009:

Assets

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Cash Equivalents	\$ 139,667	\$ -	\$ 139,667
Investment Agreement	-	6,847,302	6,847,302
	<u>\$ 139,667</u>	<u>\$ 6,847,302</u>	<u>\$ 6,986,969</u>

Liabilities

Interest Rate Exchanges	<u>\$ -</u>	<u>\$ 753,063</u>	<u>\$ 753,063</u>
	<u>\$ -</u>	<u>\$ 753,063</u>	<u>\$ 753,063</u>

Note E - Concentrations of Credit Risk

Financial instruments that potentially subject the Trust Estate to concentrations of credit risk consist primarily of temporary cash investments, the investment agreement, and the lease agreement receivables.

As indicated in Note F, the Trust Estate's temporary cash investments are maintained by the Trustee and are invested in a single money market fund. An investment in the fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The Funding Trust considers the risk associated with these uninsured and un-guaranteed balances to be minimal. The Funding Trust does not require collateral or any other security to support such temporary cash investments.

The investment agreement (see Note F) held by the Trustee is uninsured and unregistered. However, the governmental securities underlying the agreement are registered. The investment agreement is collateralized in obligations of the United States and its agencies. Such collateral is held in the Trustee's name by a custodial agent (The Bank of New York) for the term of the agreement.

As indicated in Note G, the lease agreement receivables represent the obligations of the lease program participants. Under Kentucky law, such program participants cannot commit to long-term debt, and therefore, lease rental payments are subject to annual appropriation. Historically, program participants have not defaulted or withdrawn from such long-term lease agreements. The Funding Trust believes that certain processes and precedents are in place to provide reasonable assurance that the leases will be honored by the program participants as long-term, non-cancelable agreements.

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Notes to Financial Statements (Continued)
June 30, 2009 and 2008

Note F - Trust Estate Accounts

Pursuant to the issue of the City of Morehead, Kentucky, Kentucky League of Cities Funding Trust Lease Program Revenue Bonds, Variable Rate Series 2004A, the Funding Trust entered into a Trust Indenture Agreement with National City Bank & Trust Company (which was transferred to U.S. Bank). The Trust Indenture provides for the issuance of the Bonds and the establishment of the following accounts to be held by the Trustee.

Bond Proceeds Account: This account was initially funded by the \$50,000,000 bond proceeds. The account subsequently funded the Project Account (\$44,305,000), the Expense Account, Fiduciary Fees (\$178,000), Costs of Issuance (\$517,000), and the Debt Service Reserve Account (\$5,000,000). The account is currently funded by the investment earnings of the Project and Debt Service Reserve Accounts. The account transfers amounts to the Revenue Account at the times and in the amounts required to pay the administrative expenses and the fiduciary fees related to, and interest on, the Bonds.

Project Account: This account was established from bond proceeds to fund the lease program. In connection with each closing for a lessee, the Trustee creates in the Project Account a Lessee Acquisition Account for the lessee and, upon the submission by the lessee of the documents required by and upon the terms and conditions of the lease agreement, the Trustee deposits in a Lessee Acquisition Account an amount equal to the aggregate principal component of lease rental payments under such lease.

The funds in the Lessee Acquisition Accounts are disbursed to acquire, install, or construct the projects to be leased to the lessee or refund, refinance, and reimburse the lessee for outstanding indebtedness incurred or advancements made for the costs of the project, subject to the limitations set forth in the Trust Indenture regarding refunding, refinancing, and reimbursement. Legal title to the project and all interests therein are held by the lessee subject to the Funding Trusts rights under the provisions of the lease agreement.

Redemption Account: This account is funded by the principal component of any lease rental payment that is not related to a draw on the Debt Service Reserve Account, to the extent deemed necessary by the Trustee, in accounts thereof, for particular Bonds to be redeemed.

Revenue Account: This account is funded by the portion of all lease rental payments representative of interest and the administrative, credit, and fiduciary fees which are required by the provisions of the leases to be deposited in the Revenue Account, and any other amounts received by it under the Trust Indenture which are not required to be otherwise deposited into other accounts. The account disburses monies to pay interest on the Bonds, the credit and fiduciary fees pertaining to the Bonds, and the administrative expenses and fiduciary fees in excess of the amounts disbursed from the Expense Account.

Expense Accounts: These accounts were established from bond proceeds for the purpose of paying the costs of issuance and subsequent administrative expenses and fiduciary fees, until exhausted.

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Notes to Financial Statements (Continued)
June 30, 2009 and 2008

Note F - Trust Estate Accounts (Continued)

Program Discretionary Account: This account represents any excess monies as a result of the assets of the Trust Estate exceeding the liabilities against the Trust Estate. Monies in the Program Discretionary Account are disbursed on the direction of the Funding Trust for purposes specified by the Funding Trust. Through June 30, 2009, no amounts have been deposited into this account.

Prepayment Account: This account is used to hold lessees' optional lease prepayments. The principal component of each prepayment will be transferred to the Redemption Account to redeem the portion of the Bonds associated with the lessees' prepayment. Through June 30, 2009, no amounts have been deposited into this account.

Debt Service Reserve Account: This account was established from bond proceeds to be applied if there is a deficiency in the amount available in the Revenue Account to pay interest or the Redemption Account to pay principal on the Bonds (or in either case to reimburse the Credit Facility Provider for such payment).

The Trust Estate accounts at June 30, 2009 are summarized as follows:

	Cash and Cash Equivalents	Investment Agreement	Total
Redemption Account	\$ 104,159	\$ 1,594,224	\$ 1,698,383
Revenue Account	35,508	253,078	288,586
Debt Service Reserve Account	-	5,000,000	5,000,000
	<u>\$ 139,667</u>	<u>\$ 6,847,302</u>	<u>\$ 6,986,969</u>

The Trust Estate accounts at June 30, 2008 are summarized as follows:

	Cash and Cash Equivalents	Investment Agreement	Total
Project Account	\$ 489	\$ -	\$ 489
Redemption Account	195	357,500	357,695
Revenue Account	121,777	57,500	179,277
Debt Service Reserve Account	-	5,000,000	5,000,000
	<u>\$ 122,461</u>	<u>\$ 5,415,000</u>	<u>\$ 5,537,461</u>

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
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Notes to Financial Statements (Continued)
June 30, 2009 and 2008

Note F - Trust Estate Accounts (Continued)

At June 30, 2009 and 2008, the balance in the Redemption, Revenue and Debt Service Reserve Accounts held by the Trustee in the Trustee's name on behalf of the Funding Trust pursuant to the terms of an investment agreement with FSA Capital, totals \$6,847,302 and \$5,415,000, respectively.

Pursuant to the terms of this investment agreement, the Trust Estate receives investment income equal to the interest cost of the outstanding Bonds (the bond rate) plus .37% per annum on Project Account investments, the bond rate plus 1.75% per annum on Expense Account investments, the bond rate plus .49% per annum on Debt Service Account investments, the bond rate plus .44% per annum on the Redemption account and the bond rate plus .44% per annum on the Revenue Account. These interest rate spreads are guaranteed by FSA Capital Management. The bond rate is the variable rate applicable to the Bonds.

As of June 30, 2009 and 2008, the remaining Trust Estate funds are invested in securities of the First American Government Obligations Fund, a money market fund investing exclusively in United States treasuries and government agency securities.

Note G - Lease Agreement Receivables

Lease agreement receivables represent the obligation of the lease program participants and provide for payment by the participants to the Trust Estate of monies sufficient to pay, when due, the principal and interest on the Bonds and the costs associated with the lease program. All leases are variable rate leases. The lease rental payment is computed with respect to the variable rate bonds and the interest rate in effect on the first day of each week during the lease term, unless the lessee elects to have the interest rate converted to a fixed rate upon the terms and conditions of an interest rate exchange agreement (see Note I). The Funding Trust could originate leases during a three-year period that ended in June 2007. The lease agreement receivables at June 30, 2009 and 2008 are \$35,476,871 and \$37,916,905, respectively.

Future minimum lease rental payments required under the lease agreement receivables at June 30, 2009 are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2010	\$ 2,486,794
2011	2,717,171
2012	2,214,493
2013	1,604,401
2014	1,610,734
Thereafter	<u>24,843,278</u>
	<u><u>\$ 35,476,871</u></u>

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Notes to Financial Statements (Continued)
June 30, 2009 and 2008

Note G - Lease Agreement Receivables (Continued)

As of June 30, 2009, lease rental payments associated with one lease had not been received as scheduled under the lease agreement. Subsequent to year-end, the payments were collected.

Note H - Bonds Payable

In June 2004, the City of Morehead, Kentucky issued \$50,000,000 Kentucky League of Cities Funding Trust Lease Program Revenue Bonds, Variable Rate Series 2004A. The Bonds were issued as fully registered Bonds without coupons and will mature in June 2034, subject to mandatory and optional redemption prior to maturity (as described below). The Bonds are not general obligations of the Issuer or the Funding Trust but are special and limited obligations payable solely from the Trust Estate.

The Bonds were initially offered as Weekly Rate Bonds. Weekly Rate Bonds can be converted to Daily Rate Bonds, Adjustable Rate Bonds, or Fixed Rate Bonds.

Daily Rate Bonds, Weekly Rate Bonds, and Adjustable Rate Bonds are subject to optional redemption on their respective interest payment dates, on the first business day of each month for Daily and Weekly Rate Bonds and on each September 1 and March 1 (or, if not a business day, then the next business day) for Adjustable Rate Bonds. Fixed Rate Bonds are subject to optional redemption on any date beginning on the interest payment date, each September 1 or March 1, which is at least ten years from the fixed rate conversion date.

Daily Rate Bonds, Weekly Rate Bonds, and Adjustable Rate Bonds are subject to mandatory redemption in part on the first September 1 succeeding each scheduled payment date for a principal component of a lease rental payment under a variable rate lease in an amount equal to such principal component plus accrued interest, if any. Bonds which have been converted to Fixed Rate Bonds upon closing of a lease are subject to mandatory redemption in part on the first interest payment date for such Bonds succeeding each scheduled payment date for a principal component of a lease rental payment under the correlative lease in an amount equal to such principal component plus accrued interest, if any. The Bonds, other than Fixed Rate Bonds, are subject to extraordinary mandatory redemption at a redemption price equal to the principal amount of the Bonds to be redeemed, plus payment of the interest due thereon, on the first interest payment date for Daily or Weekly Rate Bonds occurring at least thirty days after the transfer of moneys from the Project and Debt Service Reserve Accounts due to the failure to originate leases in an aggregate principal amount equal to the amount so transferred.

When the Daily Rate Bonds, Weekly Rate Bonds, and the Adjustable Rate Bonds are redeemed, the Remarketing Agent (see Note B) will use its best efforts to remarket the Bonds to be purchased on a purchase date described in the Trust Indenture. The Bonds may not be remarketed beyond the final maturity date (June 2034).

The assets of the Trust Estate (see Trust Estate as defined in Note A) are pledged to secure repayment of the Bonds. Repayment of the Bonds is supported by the Credit Facility agreement described in Note B.

City of Morehead, Kentucky
Kentucky League of Cities Funding Trust Lease Program
Revenue Bonds, Variable Rate Series 2004A
Notes to Financial Statements (Continued)
June 30, 2009 and 2008

Note H - Bonds Payable (Continued)

The bond rate is the minimum rate of interest established weekly by the Remarketing Agent to enable the Bonds to be marketable. This rate is generally comparable to the Securities Industry and Financial Markets Association ("SIFMA") Municipal Swap Index. During the year ended June 30, 2009, the variable interest rate on the Bonds outstanding ranged from 0.30% to 8.00%. During the year ended June 30, 2008, the variable interest rate on the Bonds outstanding ranged from 1.48% to 4.02%.

Note I - Interest Rate Exchange Agreements

The Funding Trust utilizes interest rate exchanges to provide fixed rate leases without bearing interest rate risk (see also Note G). Under the terms of the agreements, the Funding Trust pays to the exchange counterparty the agreed fixed rate and receives interest based upon an agreed variable indexed rate. These interest rate exchange agreements have been designated by the Funding Trust as fair value hedges of the underlying changes in the fair value of the leases receivable. The net interest payments made (received) under the swap exchanges (settlements) are included as a component of interest expense (income).

Under the lease agreement, the lessee is ultimately responsible for any payments associated with the early termination of an interest rate exchange agreement. Changes in the fair value of the exchange instruments result in offsetting changes to the carrying value of the underlying lease instruments.

As of June 30, 2009, the Funding Trust had 14 interest rate exchange agreements under agreements executed with US Bank. As of June 30, 2008, the Funding Trust had eleven such agreements. The Funding Trust pays a fixed rate that varies from 3% to 4.18% and receives a variable rate tied to the SIFMA Municipal Swap Index. During 2009 and 2008, the Trust Estate made net settlement payments under these exchange agreements totaling approximately \$340,345 and \$2,787, respectively.

As of June 30, 2009 and 2008, the fair value of the interest rate exchange agreements was negative \$753,063 and \$41,210, respectively. Accordingly, the accompanying statements of financial position as of June 30, 2009 and 2008 reflect a liability to the exchange counterparty of \$753,063 and \$41,210, respectively, and a corresponding adjustment to the fair value of leases receivable of \$753,063 and \$41,210, respectively. There was no gain or loss due to hedge ineffectiveness for the year ended June 30, 2009.

The Trust Estate did not account for the activity related to the interest rate exchange agreements during the year ended June 30, 2008.

The Funding Trust is exposed to credit losses in the event of non-performance by the exchange counterparty. However, the Funding Trust anticipates that the exchange counterparty will be able to satisfy any obligations under the agreement. The Funding Trust does not obtain collateral or other security to support such derivative financial instruments, however, the Trustee does monitor the credit standing of the exchange counterparty.

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June 30, 2009 and 2008

Note J - Tax Status

All funds are considered the property of the agencies participating in the lease program. The Funding Trust intends to be an instrument of the participating agencies and will only execute essential government functions. The income of the Trust Estate will accrue to the benefit of the participating agencies. As such, the income of the Trust Estate is exempt from federal and state income taxes. Accordingly, no provision for income taxes has been made in the accompanying financial statements.

The Bonds are subject to the arbitrage rebate regulations included in the Internal Revenue Code. These regulations require nonexempt arbitrage earnings to be rebated to the United States to prevent a bond issuance from being classified as arbitrage bonds. The regulations include certain exceptions to the rebate payments. Accrued arbitrage rebates at June 30, 2009 and 2008 are \$25,533 and \$20,211, respectively.

Note K - Related Party Transactions

The Trust Estate pays administrative fees to the Kentucky League of Cities as Program Administrator. During the year ended June 30, 2009 and 2008 administrative fees paid to the Kentucky League of Cities were \$134,797 and \$99,968, respectively. At June 30, 2009, total administrative fees included in accounts payable are \$32,506. There were no administrative fees included in accounts payable at June 30, 2008.

Note L - Departure from U.S. Generally Accepted Accounting Principles

The Trust Estate records a participant's share of issuance costs to originate a lease as income in the year the lease is closed. This income is recorded in the accompanying statement of activities and changes in net assets. A participant's share of issuance costs should be capitalized and amortized over the life of the lease using the effective interest method in order to conform with accounting principles generally accepted in the United States of America. If the participants' share of issuance costs were capitalized, the following accounts would be increased (decreased):

	2009	2008
Liabilities:		
Costs of issuance	\$ 718,925	\$ 803,767
Net Assets:		
Net Assets, unrestricted	(718,925)	(803,767)
Change in net assets:		
Income from lease agreement receivables	84,842	65,787

City of Morehead, Kentucky
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Notes to Financial Statements (Continued)
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Note M - New Accounting Pronouncements

In June 2006, the FASB issued interpretation No. 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Implementation of FIN 48 has been deferred for nonpublic enterprises and becomes effective for fiscal years beginning after December 15, 2008. The Trust Estate has elected to defer adoption of FIN 48 until fiscal 2010 and has not determined the impact, if any, of adopting FIN 48.

The Trust Estate's policy for evaluating uncertain tax positions is to evaluate the facts and circumstances associated with the specific tax position giving rise to the uncertainty and to consider the likelihood of success. Currently, the Trust Estate records a provision for uncertain tax positions when a loss is probable and reasonably estimable.

In March 2008 the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133*. SFAS 161 amends and expands the disclosure requirements of SFAS 133 with the intent to provide users of financial statements with an enhanced understanding of 1) how and why an entity uses derivative instruments; 2) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations; and 3) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. To meet those objectives, SFAS 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS 161 is effective for fiscal years beginning after November 15, 2008. The Trust Estate is currently considering the impact, if any, the adoption of SFAS 161 will have on the financial statements.

Note N - Subsequent Events

Subsequent to year end, the Letter of Credit and Reimbursement Agreement with US Bank was amended to increase annual fees to .77% of the maximum amount available to be drawn at such time under the letter of credit, less the amount corresponding to the principal balance outstanding on fixed rate leases, for the period July 1, 2009 through December 31, 2009; 1.1% of the maximum amount available to be drawn at such time under the letter of credit, less the amount corresponding to the principal balance outstanding on fixed rate leases, for the period January 1, 2010 through December 31, 2010; and 1.25% of the maximum amount available to be drawn at such time under the letter of credit, less the amount corresponding to the principal balance outstanding on fixed rate leases, for the period January 1, 2011 through the termination of the agreement. The letter of credit fee for the amount available to be drawn under the letter of credit agreement corresponding to the principal balance outstanding on fixed rate leases will remain at .4% through the termination of the agreement. The effective date of the amendment is July 1, 2009. The letter of credit was also extended to June 2013 subsequent to year end.

Subsequent events for the Trust Estate have been considered through the date of the Independent Auditor's Report, which represents the date which the financial statements were available to be issued.