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Kentucky Housing Corporation
Audited Financial Statements and Supplemental Combining Information

June 30, 2010

CONTENTS

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Independent Auditors' Report

Board of Directors
Kentucky Housing Corporation
Frankfort, Kentucky

We have audited the accompanying financial statements of the governmental activities, the business-type activities, and the individual fund information of the Kentucky Housing Corporation (the "Corporation"), a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2010, which collectively comprise the Corporation's basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express opinions on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, and the individual fund information of the Corporation as of June 30, 2010, and the respective changes in financial position and cash flows of its proprietary funds for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note R to the financial statements, the Corporation adopted the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments, and GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions* in 2010.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 22, 2010 on our consideration of the Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis (Unaudited) on pages 3 through 14 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the Corporation's basic financial statements. The supplemental combining information on pages 47 through 50 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the Corporation's basic financial statements taken as a whole.

Mountjoy Chilton Medley LLP

Frankfort, Kentucky
September 22, 2010

Management's discussion and analysis of Kentucky Housing Corporation's financial performance provides an overview of the Corporation's financial activities for the fiscal year ended June 30, 2010. It should be read in conjunction with the Corporation's financial statements.

Financial Highlights

- Corporation-Wide net assets increased by 14% or $42.1 million as a result of fiscal year 2010 operations and an increase in the market value of investments and mortgage-backed securities (MBS's) of $42.8 million.
- Volatile financial and mortgage loan markets, the tightening between taxable and tax-exempt borrowing interest rates, depressed short-term investment rates, and the pricing of mortgage products created significant challenges for the Corporation to maintain profitability as well as competitiveness in the mortgage market during fiscal year 2010.
- Government Accounting Standards require investment securities, including MBS's, to be reported at their current fair market value. As previously noted, declining interest rates resulted in increases to the fair market value of investment securities and MBS's of $42.8 million.
- Short-term interest rates continued to be near historically low levels throughout the entire fiscal year resulting in a significant reduction in investment earnings.

Overview of the Financial Statements

The financial statements consist of four parts – this management's discussion and analysis, the basic financial statements, the notes to the financial statements and supplemental combining information. The basic financial statements include two different series of statements that present the Corporation's financial position and performance.

- Corporation-Wide financial statements consist of a Statement of Net Assets and a Statement of Activities. These statements display information about the Corporation as a whole and are presented using the economic resources measurement focus and the accrual basis of accounting as used by private-sector businesses. Activities of the Corporation are distinguished as being either "governmental" or "business-type" activities.

- Fund financial statements report additional and detailed information about the Corporation.

Governmental activities are reported under Governmental Funds financial statements. These statements consist of a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances. Governmental Funds statements are presented using the current financial resources measurement focus and the modified accrual basis of accounting used predominately in the public-sector.

Continued

Business-type activities are reported under Proprietary Funds financial statements. These statements consist of a Statement of Net Assets, a Statement of Revenues, Expenses and Changes in Net Assets and a Statement of Cash Flows. Proprietary Funds statements are also presented using the economic resources measurement focus and the accrual basis of accounting.

Corporation-Wide Financial Statements – Pages 15 and 16

The Kentucky Housing Corporation was created by state statute in 1972 as a de jure municipal corporation and political subdivision of the Commonwealth of Kentucky. The Corporation was created to serve a public purpose by increasing the supply of safe, decent and affordable residential housing.

The Corporation operates a number of programs consistent with the mandate to produce residential housing. Several programs are identified within the financial statements as governmental activities because they are financed with intergovernmental revenues. Significant governmental activities financed by the federal government include the Department of Housing and Urban Development's ("HUD") Home Investment Partnerships Program ("HOME") and HUD's Section 8 rental assistance programs ("Section 8"). Significant governmental activities financed by the Commonwealth of Kentucky include the Affordable Housing Trust Fund, which provides funding to assist very-low income persons in meeting their basic housing needs.

The Corporation also operates a number of programs that are identified as business-type activities. These activities include providing below-market interest rate financing to qualified homebuyers and developers of affordable rental housing, mortgage loan servicing and the administration of the Federal Housing Credit.

The Corporation-Wide financial statements separately present the governmental and business-type activities of the Corporation. The nature of the Corporation's governmental activities is such that substantially all funds flow through the Corporation to ultimate program recipients. As a result, the Balance Sheet related to governmental activities shows a relatively small amount of assets, representing monies received by the Corporation but unexpended for each respective program's purpose. Conversely, the business-type activities of the Corporation create the vast majority of the Corporation's assets, liabilities and net assets as reflected in the Statement of Net Assets. The overall financial condition of the Corporation can thus be best evaluated through the analysis of business-type activities described in pages 8-12 of this document and under the Proprietary Funds' financial statements on pages 19-23.

The Statement of Activities shows the financial performance of each significant governmental and business-type activity operated by the Corporation over the past year. The expenses and revenues associated with each activity are shown as well as a net amount showing whether revenues exceeded expenses. The net revenue of all governmental activities (after transfers) results in an increase (decrease) in the net assets (fund balances) that are to be expended for program purposes. The net revenue (profit) of all business-type activities results in an increase in the net assets (wealth) of the Corporation.

Continued

The combined net assets of the Corporation increased by $42.1 million from June 30, 2009 to June 30, 2010. Table 1 shows condensed financial information from the Statement of Net Assets:

Table 1
Net Assets
(in millions)

	Governmental Activities		Business-Type Activities		Total Corporation	
	2010	**2009 (Restated)**	**2010**	**2009 (Restated)**	**2010**	**2009 (Restated)**
Current assets	$12.6	$ 13.0	$ 446.3	$ 381.6	$ 458.9	$ 394.6
Non-current assets			2,291.4	2,230.6	2,291.4	2,230.6
Total Assets	12.6	13.0	2,737.7	2,612.2	2,750.3	2,625.2
Current liabilities	(3.0)	(3.6)	(190.1)	(175.3)	(193.1)	(178.9)
Non-current liabilities			(2,222.6)	(2,153.8)	(2,222.6)	(2,153.8)
Total Liabilities	(3.0)	(3.6)	(2,412.7)	(2,329.1)	(2,415.7)	(2,332.7)
Net assets:						
Invested in capital assets			4.5	4.6	4.5	4.6
Restricted	9.6	9.4	271.3	230.7	280.9	240.1
Unrestricted			49.2	47.8	49.2	47.8
Total Net Assets	$ 9.6	$ 9.4	$ 325.0	$ 283.1	$ 334.6	$ 292.5

Net assets of the Corporation's governmental activities increased from $9.4 million to $9.6 million. All assets of the Corporation's governmental activities are restricted for program purposes. Assets subject to immediate disbursement are classified as current liabilities and remaining assets are classified as restricted net assets (fund balances). The increase in net assets indicates that revenues received from other governments exceeded program grants, operating expenditures and transfers.

The net assets of the Corporation's business-type activities increased from $283.1 million to $325.0 million as a result of a $42.8 million increase in the market value of investments and MBS's and a $1.2 million increase in the fair market value of swaps, both of which were offset by a $2.1 million loss from general operations. The Corporation's primary business-type activity is the bond-financed loan program. Bond proceeds are used to fund qualifying single-family residential mortgage loans as well as to originate and fund mortgage loans to developers of multi-family housing. The Corporation's objective is to achieve a year-over-year increase in business-type net assets exclusive of the adjustment to all investments held by the Corporation to their fair market value, resulting in an increase or decrease to business-type revenue and business-type cash and investments. The change in net assets is more fully described under "Proprietary Funds."

Continued

Comparisons in the changes in net assets between fiscal years 2009 and 2010 provide additional insight on the Corporation's operating performance. Table 2 condenses Statement of Activities financial information.

Table 2
Changes in Net Assets
(in millions)

	Governmental Activities		Business-Type Activities		Total Corporation	
	2010	(Restated) **2009**	**2010**	(Restated) **2009**	**2010**	(Restated) **2009**
Revenues						
Operating revenues	$ 10.8	$ 8.7	$ 174.5	$ 155.6	$185.3	$ 164.3
Operating grants	204.2	163.0			204.2	163.0
Total Revenues	215.0	171.7	174.5	155.6	389.5	327.3
Program Expenses						
Rental subsidy administration	140.3	132.5			140.3	132.5
Weatherization program	21.1	2.3			21.1	2.3
HOME program	19.3	19.0			19.3	19.0
Other federal and state programs	31.0	15.8			31.0	15.8
Administrative			13.2	13.6	13.2	13.6
Bond financed loan programs			113.0	120.8	113.0	120.8
Loan servicing			6.3	6.0	6.3	6.0
Other loan and housing Credit programs			3.2	2.2	3.2	2.2
Total Program Expenses	211.7	169.6	135.7	142.6	347.4	312.2
Excess before transfers	3.3	2.1	38.8	13.0	42.1	15.1
Transfers	(3.1)	(1.9)	3.1	1.9		
Increase in Net Assets	$ .2	$ .2	$ 41.9	$ 14.9	$ 42.1	$ 15.1

Total revenues for governmental activities were $215.0 million during fiscal year 2010, a $43.3 million increase from the $171.7 million in revenues in fiscal year 2009. The increase was due to a $41.2 million increase in operating grants and a $2.1 million increase in charges for services. Operating grants include federal funding for Section 8 ($134.7 million), HOME ($18.1 million) and Weatherization ($20.5 million), which represent 85% of total operating grant revenues.

Continued

The Corporation receives fees or charges for services for federal program administration. These revenues increased from $8.7 million in 2009 to $10.8 million during fiscal year 2010. A substantial amount of the fees earned in excess of operating costs are transferred from the governmental funds to the proprietary funds of the Corporation. During 2010, $10.8 million in fee revenue was received and $7.9 million in operating expenses were incurred thereby enabling a $3.1 million transfer, or a $1.2 million increase from the $1.9 million similarly derived and transferred in 2009.

Program expenses for governmental activities increased during 2010 by $42.1 million. Program expenses for governmental activities during 2010 were $211.77 million, comprised of grants of $203.8 million and operating expenses of $7.9 million, as discussed above. In fiscal 2009, total program expenses were $169.6 million with grants of $162.9 million and operating expenses of $6.7 million.

Total revenues for business-type activities were $174.5 million during fiscal year 2010, an $18.9 million increase from the $155.6 million of revenues in fiscal year 2009. For fiscal 2010, there was a $42.8 million increase in the market value of investments versus a $23.7 million increase for 2009. This $19.1 million positive variance between 2009 and 2010 is the significant cause for the increase in revenues. Interest earnings from loans, mortgage-backed securities and other investments decreased $3.6 million, other income increased $.8 million and the change in the fair market value of swaps increased $2.6 million.

Program expenses for business-type activities decreased $6.9 million from $142.6 million in 2009 to $135.7 million in 2010. Bond financed loan program expenses decreased by $7.8 million, administrative expenses, or expenses not directly attributable to programs, decreased by $0.4 million, loan servicing expenses increased by $.3 million and other loan program expenses increased by $1.0 million. The line items related to these expenses are presented in detail in Table 2.

The excess of revenues over expenses for business-type activities was $38.8 million in 2010 compared to $13.0 million in 2009, an increase of $25.8 million from 2009. As described above and in additional detail under "Proprietary Funds," the increase is due to an $18.9 million increase in revenues and a $6.9 million decrease in expenses. Transfers-in were $3.1 million in 2010 compared to $1.9 million in 2009, an increase of $1.2 million. Such changes in revenues, expenses and transfers resulted in an increase in business-type net assets of $27.0 million.

Continued

Fund Financial Statements

The following section provides a discussion and analysis of the Corporation's fund financial statements.

Governmental Funds – Pages 17 and 18

Each of the columns presented in the governmental funds financial statements represent an independent program operated by the Corporation. A description of each program can be found under Note A of the "Notes to the Financial Statements." Other Housing Funds include several independent programs, each of which does not meet the criteria for separate financial reporting.

The current assets of each governmental fund are held pending disbursement for program purposes. Most program disbursements are in the form of a grant or subsidy to program recipients. However, certain disbursements under the Affordable Housing Trust Fund, the HOME Program and the Treasury Housing Credit program are in the form of loans. Because of the extended loan terms, minimal interest rates and the credit risks associated with these loans, loan loss provisions have been established at 100%. As of June 30, 2010, the Corporation retained $12.6 million for program purposes and had $3.0 million classified as program advances resulting in a total of $9.6 million classified as restricted fund balances.

During fiscal year 2010, the Affordable Housing Trust Fund had revenues greater than expended funds of $.1 million, thereby increasing the program's fund balances. Rental Assistance programs operated in such a manner that most revenues were either expended for the programs, $134.7 million, or transferred to proprietary funds, $2.8 million. Similarly, all HOME program revenues, $19.4 million, were expensed in an equal amount in 2010. Finally, revenues of the Other Housing Funds exceeded expenses by $.3 million with transfers to proprietary of funds of $.3 million, essentially resulting in no change to the fund balance of Other Housing Funds.

Proprietary Funds – Pages 19 through 23

The significant portion of the Corporation's financial resources and activities is reported in the proprietary fund financial statements. Proprietary funds account for over 99% of Corporate assets, 94% of non-grant revenues, 94% of operating expenses and 100% of the Corporation's net worth.

Proprietary funds are organized in accordance with the restrictions described under Note B of the "Notes to the Financial Statements." Our discussion and analysis of proprietary funds will focus on the combined totals of the four separate funds. Primary attention, however, will be given to the financial condition and performance of the Housing Revenue Bond Funds which comprise 94% of the total assets, 92% of total revenues, and 81% of the net assets of proprietary fund combined totals.

Continued

The Corporation's primary business-type activity involves the issuance of mortgage revenue bonds and the use of bond proceeds to fund qualifying residential single-family and multi-family mortgage loans. The federal tax code, with certain exceptions, limits the allowable spread between the Corporation's cost of funds and the interest rate charged to customers to 1.125%. This spread allows the Corporation to cover bond interest, operating costs and to earn a profit. Furthermore, the yield on investment securities cannot exceed the bond yield of the tax-exempt bond issuance with any excess earnings subject to rebate to the federal treasury.

The ultimate purpose of the program is to convert bond proceeds into qualifying mortgage loans. However, in the operation of the program the Corporation maintains a significant amount of cash and investment securities as follows:

- Debt Service Reserve Fund maintains deposits to provide additional security and a source of liquidity to bond investors. Deposits must be maintained at the level required under the Corporation's bond indenture.

- Bond Proceeds Fund maintains undisbursed monies being held pending the purchase of mortgage loans.

- Debt Service Fund maintains interest income earned from mortgages and investments and regularly scheduled payments of loan principal pending the semi-annual payment of debt service to investors.

- Recoveries of Principal Fund and Redemption Fund maintain monies received from mortgagors resulting from the payoff of mortgage loans pending either disbursement into newly originated mortgage loans or the early retirement of bonds.

Refer to the "Supplemental Combining Information – Housing Revenue Bond Funds" for additional detail.

Continued

Condensed financial information from the Statement of Net Assets follows in Table 3.

Table 3
Proprietary Funds
Asset, Liabilities and Net Asset Changes
(in millions)

	2010	(Restated) 2009	Change
Program-Purpose Assets			
Mortgage loans	$ 1,398.4	$ 1,602.8	$ (204.4)
Mortgage-backed securities	794.0	537.2	256.8
Housing construction loans	3.4	3.5	(.1)
Other loans	11.2	12.3	(1.1)
Total Program-Purpose Assets	2,207.0	2,155.8	51.2
Cash and Investments	465.1	391.7	73.4
Other assets	65.6	64.7	.9
Total Assets	2,737.7	2,612.2	125.5
Bonds payable	(2,240.5)	(2,175.4)	(65.1)
Other liabilities	(172.2)	(153.7)	(18.5)
Total Liabilities	(2,412.7)	(2,329.1)	(83.6)
Net Assets	$ 325.0	$ 283.1	$ 41.9

Mortgage loans, mortgaged-backed securities, housing construction loans and other loans increased by $51.2 million or 2% during 2010. Total program-purpose assets at June 30, 2010 were $2.21 billion.

The increase was the result of mortgage loan fundings of $251.0 million, mortgage loan repayments of $149.2 million, conversion of mortgage loans to mortgage-backed securities of $303.6 million, a loan loss provision increase of $1.5 million, an accrued mortgage loan interest decrease of $1.1 million, plus net increases in mortgage-backed securities, housing construction loans and other loans of $255.6 million.

Continued

During 2010, the Corporation issued short- and long-term bonds and incurred other short-term debt (lines of credit) in the amount of $351.4 million. This includes Housing Revenue Bonds issued of $280.0 million, plus bond premiums received of $1.4 million. Total bond and line-of-credit principal repayments were $262.6 million and the change in net unamortized bond premium was $1.0 million. As a result of this activity, bonds outstanding increased $65.0 million and short-term debt increased by $22.8 million. The Corporation's Housing Revenue Bond Fund has continuously maintained a AAA rating from Standard & Poor's Ratings Service since 1991 and a Aaa rating from Moody's Investors Service since 1993.

The following Table 4 provides condensed financial information from the Statement of Revenues, Expenses and Changes in Net Assets.

Table 4
Proprietary Funds
Revenues and Expense Changes
(in millions)

	2010	(Restated)	Change
Interest income--loans	$ 86.9	$ 86.8	$ 0.1
Interest income--mortgage-backed securities	28.3	31.3	(3.0)
Interest income--investment securities	2.7	3.4	(0.7)
Total interest income	117.9	121.5	(3.6)
Interest expense	(97.4)	(106.4)	9.0
Net Interest	20.5	15.1	5.4
Increase in fair value of marketable securities	42.8	23.7	19.1
Increase (decrease) in fair value of swaps	1.2	(1.4)	2.6
Provision for loan losses	(1.7)	(1.2)	(0.5)
Net Investment Income	62.8	36.2	26.6
Other income	12.6	11.8	0.8
General and administrative expenses	(19.2)	(18.0)	(1.2)
Other expenses	(17.4)	(17.0)	(0.4)
Interfund transfers	3.1	1.9	1.2
Changes in Net Assets	$ 41.9	$ 14.9	$ 27.0

Continued

Net assets increased to $41.9 million in 2010, a $27.0 million increase from the $14.9 million increase in 2009. The increase from 2009 is attributable to several factors. One difference relates to the fair value of investment securities which increased by $42.8 million in 2010 as compared to a $23.7 million increase in 2009, an overall increase of $19.1 million. Generally, investment securities the Corporation holds, specifically its mortgage-backed securities, will increase in value as market interest rates decline. These gains, recognized for accounting purposes, are unrealized until such time that investment securities are sold or, for mortgage-backed securities, are paid down. The Corporation has the ability to hold investment securities until maturity.

Secondly, net interest, the difference between interest income and interest expense, increased by $5.4 million from $15.1 million in 2009 to $21.9 million in 2010. Other (fee) income increased $.8 million from $11.8 million in 2009 to $12.6 million in 2010. The change in fair value of swaps increased from a negative $1.4 million in 2009 to a positive $1.2 million in 2010, an increase of $2.6 million. The provision for loan losses increased by $.5 million, from $1.2 million in 2009 to $1.7 million in 2010.

Also, other expenses, including grants, loan servicing expenses and the expensing of debt issuance costs and servicing release premiums, increased by $.4 million from $17.0 million in 2009 to $17.4 million in 2010. General and administrative expenses increased by $1.2 million from $18.0 million in 2009 to $19.2 million in 2010.

Finally, changes in net assets were impacted by interfund transfers of $3.1 million, an increase of $1.2 million from the $1.9 million transferred in 2009. (See "Governmental Funds" for additional information on interfund transfers.)

Financial Outlook

The Corporation's future financial position and performance is dependent on a number of economic, regulatory and financial conditions along with management's consideration of and response to those conditions. The Corporation experienced mortgage loan production of $251 million in 2010 and was able to issue $100 million of Housing Revenue Bonds to the public market. The primary driver of loan production can be attributed to tax credit legislation enacted by Congress in The Housing and Economic Recovery Act of 2008, The Worker, Homeownership and Business Assistance Act of 2009, and The American Recovery and Reinvestment Act of 2009. This legislation offered first-time homebuyers a tax credit in the amount of $8,000 for entering into a binding contract to buy a principal residence on or before April 30, 2010 and close on the home by June 30, 2010.

The Corporation's credit strength continued to be received favorably by both the retail and institutional investment community. This strong demand resulted in lower yields for the Corporation's bonds. The Corporation was able to achieve its full allowable tax-exempt spread of 1.125% on its loan production on the $100 million bonds sold to the public.

Continued

During fiscal year 2010, the Corporation entered into the New Issue Bond Purchase Program ("NIBP"). The NIBP is a joint initiative with The U.S. Department of Treasury, Department of Housing and Urban Development, Federal Housing Finance Agency, Fannie Mae and Freddie Mac to maintain the viability of Housing Finance Agency ("HFA") lending programs and infrastructure. As part of the NIBP, the Corporation is able to receive $180 million in long-term funding at an interest rate equal to the 10 year U.S. Treasury yield plus 60 basis points. With the Corporation's AAA rating, it received the most favorable pricing offered within the program. Recent changes made to the NIBP have established a maximum interest rate of 3.81% for the Corporation's NIBP funding. The Corporation drew $60 million in NIBP funds during fiscal year 2010.

The Corporation continued to mitigate the analytical financial stress of holding whole conventional loans by pooling them into MBS's. The Corporation previously pooled whole loans with Federal National Mortgage Association ("FNMA") pursuant to a negotiated affinity. In fiscal year 2010, the Corporation began pooling whole loans with the Government National Mortgage Association ("GNMA"). All of the pooled loans are underwritten to the Corporation's standards and are serviced by the Corporation. In addition, the Corporation acts as sole investor in each of the pools. The Corporation pays a guarantee fee to GNMA which provides for no recourse to the Corporation in the event of loan default. The loans pooled into GNMA MBS's are full recourse to GNMA and principal and interest is guaranteed. The Corporation pooled $303.6 million in GNMA MBS's during fiscal year 2010. As of June 30, 2010 the corporation held FNMA MBS pools with a market value of $463.6 million and GNMA MBS pools with a market value of $329.1 million. The primary risk to the Corporation, in the absence of the guarantees, would be the increased responsibility regarding loans in default and potential increased financial stress during certain rating agency analyses.

The Corporation's ability to issue tax-exempt debt is also limited by federal tax law. Annually prescribed amounts of "private activity bond authority" are allocated to each state. In fiscal year 2010, the Commonwealth of Kentucky allocated 60 percent to state issuers and 40 percent to local issuers. In fiscal year 2010, the Corporation received an allocation of $116 million, approximately 50 percent of the state issuer pool. The Corporation also received an additional $41 million from unused authority allocated to local issuers. After the issuance of 2010 Series B bonds, the Corporation has $164 million in bonding authority to use to fund its mortgage loan programs. These amounts assure the Corporation of sufficient tax-exempt resources to fund single family and multifamily loan production. During years when bond cap was not available in amounts to match production demand, the Corporation used alternative means of funding production, including the issuance of variable rate and taxable housing bonds, along with interest rate swaps. The current level of tax-exempt authority reduces the need to issue taxable bonds as a means to meet mortgage loan demand.

As of June 30, 2010, the total amount of variable rate debt to total debt was $273 million of the $2.24 billion total long-term debt portfolio, or 12.2%. The Corporation mitigates interest rate risk with interest rate swaps on $207.1 million of its variable rate debt. Only one swap, 2006 Series W, has been deemed ineffective under GASB 53. The Corporation continues to manage its balance sheet with redemption and bond structure strategies.

Continued

Asset default poses a smaller risk to the Corporation because of conservative bond covenants in effect. All investment securities are either instruments of the federal government or federal agencies or repurchase agreements fully collateralized by federal government or agency obligations. Further, the substantial portions of mortgage loans held in the portfolio are insured by federal agencies. Mortgage loans held in GNMA MBS's are guaranteed as to principal and interest by GNMA while $310.7 million of the book value of the FNMA MBS's are fully guaranteed by FNMA. Additional information on the Corporation's allowance for loan losses can be found in Notes D, E and F in the "Notes to Financial Statements".

The Corporation's governmental activities are made possible through intergovernmental revenues made available from the federal government and the Commonwealth of Kentucky. The Corporation's ability to expand or continue these programs is subject to the statutory authority and the budget appropriations of those governments.

During fiscal year 2010, the Corporation benefited from improving bond market conditions and federal legislation aimed to help the home buyer and HFA's. The Corporation continues to face a difficult economic environment including but not limited to rising unemployment resulting in increased delinquencies and foreclosures. During this time, the Commonwealth of Kentucky has experienced historic levels of unemployment which has contributed to a significant increase in delinquency and foreclosure levels on the Corporation's single family mortgage loan portfolio. While this continues to be a problem, the Corporation continues to proactively address this issue by working with its borrowers through various loss mitigation techniques and other efforts designed to address these issues. The Corporation implemented new policies to address the increasing delinquencies while maintaining the financial strength and integrity of the Housing Revenue Bond Resolution.

In spite of the above unanticipated challenges, the Corporation was able to continue in all of its lines of business and, as a result of its significant wealth, had the necessary resources and liquidity to cover unanticipated costs. Although some HFA's faced increased scrutiny from the rating agencies, the Corporation has maintained its triple-A ratings from Moody's and Standard & Poor's.

The Corporation continues to serve the ongoing portion of the population who are looking to become first-time homebuyers with aggressive rates and down-payment assistance. However due to the expiration of the federal income tax credit combined with increased deterioration of the overall economy, production levels have slowed substantially. In the upcoming fiscal year, the Corporation plans to expand its services to offer products to second-time home buyers and the refinance market. With aggressive balance sheet management, low funding costs and additional product lines, management has positioned the Corporation for sustainability during this difficult economic environment.

Contacting the Corporation's Financial Management

This report is designed to provide our stakeholders with the information needed to understand the Corporation's financial condition and results of operations for the fiscal year ended June 30, 2010. Questions and inquiries may be directed to John D. Herald, Chief Financial Officer at Kentucky Housing Corporation, 1231 Louisville Road, Frankfort, Kentucky 40601. Telephone: (502) 564-7630, x354, fax: (502) 564-7322, e-mail: jherald@kyhousing.org.

Corporation-Wide Statement of Net Assets

Kentucky Housing Corporation

June 30, 2010
(dollars in thousands)

ASSETS	Governmental Activities	Business-Type Activities	Combined Totals
Current Assets			
Cash and cash equivalents	$ 6,058	$ 62,982	$ 69,040
Investment securities	6,424	317,509	323,933
Mortgage-backed securities		17,525	17,525
Housing mortgage loans		37,999	37,999
Housing construction loans		3,368	3,368
Other loans		1,015	1,015
Accounts receivable and other assets	888	5,057	5,945
Interfund accounts	(820)	820	
Total Current Assets	12,550	446,275	458,825
Noncurrent Assets			
Investment securities		84,648	84,648
Mortgage-backed securities		776,519	776,519
Housing mortgage loans		1,360,368	1,360,368
Other loans		10,175	10,175
Unamortized debt issuance costs		17,022	17,022
Capital assets		4,453	4,453
Deferred servicing costs and other assets		22,835	22,835
Deferred outflow of resources - interest rate swaps		15,457	15,457
Total Noncurrent Assets		2,291,477	2,291,477
Total Assets	12,550	2,737,752	2,750,302
LIABILITIES			
Current Liabilities			
Lines of credit		39,940	39,940
Accounts payable and other liabilities		1,836	1,836
Accrued interest payable		47,522	47,522
Program advances	2,999		2,999
Escrows and project reserves		49,367	49,367
Revenue bonds, due within one year		51,525	51,525
Total Current Liabilities	2,999	190,190	193,189
Noncurrent Liabilities			
Revenue bonds, due after one year		2,188,952	2,188,952
Other noncurrent liabilities		16,092	16,092
Derivative instrument - interest rate swap		17,552	17,552
Total Noncurrent Liabilities		2,222,596	2,222,596
Total Liabilities	2,999	2,412,786	2,415,785
NET ASSETS			
Invested in capital assets		4,453	4,453
Restricted by			
Revenue bond indenture		264,076	264,076
Enabling legislation		7,176	7,176
Program requirements	9,551		9,551
Unrestricted		49,261	49,261
Total Net Assets	$ 9,551	$ 324,966	$ 334,517

See Notes to Financial Statements

Corporation-Wide Statement of Activities

Kentucky Housing Corporation

Year Ended June 30, 2010
(dollars in thousands)

	Direct Expenses		Program Revenues		Net (Expense) Revenues and Changes in Net Assets		
Functions/Activities	**Grants**	**Operating**	**Charges for Services**	**Operating Grants**	**Governmental Activities**	**Business-Type Activities**	**Total**
Governmental Activities							
Rental subsidy administration	$134,716	$ 5,584	$ 8,427	$ 134,716	$ 2,843		$ 2,843
· HOME program	18,120	1,216	1,216	18,120	-		-
Treasury Housing Credit	11,872			11,872	-		-
Weatherization	20,463	627	627	20,463	-		-
Other federal and state housing programs	18,687	484	484	19,065	378		378
Total Governmental Activities	203,858	7,911	10,754	204,236	3,221		3,221
Business-Type Activities							
Administrative	3,285	9,881	727			$ (12,439)	(12,439)
Bond financed loan programs		112,960	162,090			49,130	49,130
Loan servicing		6,285	7,924			1,639	1,639
Other loan and housing credit programs	46	3,184	3,742			512	512
Total Business-Type Activities	3,331	132,310	174,483			38,842	38,842
Total Activities	$207,189	$ 140,221	$ 185,237	$ 204,236	3,221	38,842	42,063
Transfers					(3,093)	3,093	
Change in Net Assets					128	41,935	42,063
Net Assets, Beginning of Year (Restated)					9,423	283,031	292,454
Net Assets, End of Year					$ 9,551	$ 324,966	$ 334,517

See Notes to Financial Statements

Balance Sheet – Governmental Funds

Kentucky Housing Corporation

June 30, 2010
(dollars in thousands)

ASSETS	Affordable Housing Trust Fund	HOME Program	Treasury Housing Credit	Weatherization Assistance	Rental Assistance	Other Housing Funds	Combined Totals
Current Assets							
Cash and cash equivalents	$ 2,234	$ 184			$ 2,758	$ 882	$ 6,058
Investment securities	6,376					48	6,424
Accounts receivable and other assets		95		$ 146	554	92	888
Interfund accounts		(95)		(146)	(557)	(21)	(820)
Total Current Assets	8,610	184		-	2,755	1,001	12,550
Noncurrent Assets							
Program loans	7,250	71,933	$ 11,872				91,055
Less loan loss provision	(7,250)	(71,933)	(11,872)				(91,055)
Total Noncurrent Assets							
Total Assets	$ 8,610	$ 184		$ -	$ 2,755	$ 1,001	$ 12,550
LIABILITIES							
Current Liabilities							
Program advances	$ 30	$ 184			$ 2,755	$ 30	$ 2,999
FUND BALANCES							
Restricted by program requirements	$ 8,580					971	9,551
Total Liabilities and Fund Balances	$ 8,610	$ 184			$ 2,755	$ 1,001	$ 12,550

See Notes to Financial Statements

Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds

Kentucky Housing Corporation

Year Ended June 30, 2010
(dollars in thousands)

	Affordable Housing Trust Fund	HOME Program	Treasury Housing Credit	Weatherization Assistance	Rental Assistance	Other Housing Funds	Combined Totals
Revenues							
Federal and state administrative fees		$ 1,216		$ 627	$ 8,427	$ 484	$ 10,754
Pass-through grant revenues	$ 5,941	18,120	$ 11,872	20,463	134,716	13,124	204,236
Total Revenues	5,941	19,336	11,872	21,090	143,143	13,608	214,990
Expenditures							
General and administrative		1,216		627	5,584	484	7,911
Pass-through grant expenditures	5,810	18,120	11,872	20,463	134,716	12,877	203,858
Total Expenditures	5,810	19,336	11,872	21,090	140,300	13,361	211,769
Revenues in Excess of Expenditures	131				2,843	247	3,221
Interfund Transfers					(2,843)	(250)	(3,093)
Net Change in Fund Balances	131					(3)	128
Fund Balances, Beginning of Year	8,449					974	9,423
Fund Balances, End of Year	$ 8,580	$	$	$	$	$ 971	$ 9,551

See Notes to Financial Statements

Statement of Net Assets – Proprietary Funds

Kentucky Housing Corporation

June 30, 2010
(dollars in thousands)

ASSETS	General Funds	Housing Revenue Bond Funds	Housing Development Fund	Combined Totals
Current Assets				
Cash and cash equivalents	$ 55,148	$ 3,819	$ 4,015	$ 62,982
Investment securities	2,465	314,480	564	317,509
Mortgage-backed securities		17,525		17,525
Housing mortgage loans	2,373	35,626		37,999
Housing construction loans	771		2,597	3,368
Other loans	1,015			1,015
Accounts receivable and other assets	4,445	612		5,057
Interfund accounts	36,364	(35,544)		820
Total Current Assets	102,581	336,518	7,176	446,275
Noncurrent Assets				
Investment securities		84,648		84,648
Mortgage-backed securities	39	776,480		776,519
Housing mortgage loans	42,508	1,317,860		1,360,368
Other loans	10,175			10,175
Unamortized debt issuance costs		17,022		17,022
Capital assets	4,453			4,453
Deferred servicing costs and other assets	10	22,825		22,835
Deferred outfow of resources - interest rate swaps		15,457		15,457
Total Noncurrent Assets	57,185	2,234,292		2,291,477
Total Assets	159,766	2,570,810	7,176	2,737,752

Continued
See Notes to Financial Statements

Kentucky Housing Corporation

June 30, 2010
(dollars in thousands)

LIABILITIES	General Funds	Housing Revenue Bond Funds	Housing Development Fund	Combined Totals
Current Liabilities				
Lines of credit	39,940			39,940
Accounts payable and other liabilities	653	1,183		1,836
Accrued interest payable		47,522		47,522
Escrows and project reserves	49,367			49,367
Revenue bonds, due within one year		51,525		51,525
Total Current Liabilities	89,960	100,230		190,190
Noncurrent Liabilities				
Revenue bonds, due after one year		2,188,952		2,188,952
Other noncurrent liabilities	16,092			16,092
Derivative instrument - interest rate swap		17,552		17,552
Total Noncurrent Liabilities	16,092	2,206,504		2,222,596
Total Liabilities	106,052	2,306,734		2,412,786
NET ASSETS				
Invested in capital assets	4,453			4,453
Restricted by				
Revenue bond indenture		264,076		264,076
Enabling legislation			7,176	7,176
Unrestricted	49,261			49,261
Total Net Assets	$ 53,714	$ 264,076	$ 7,176	$ 324,966

See Notes to Financial Statements

Statement of Revenues, Expenses and Changes in Net Assets – Proprietary Funds

Kentucky Housing Corporation

Year Ended June 30, 2010
(dollars in thousands)

	General Funds	Housing Revenue Bond Funds	Housing Development Fund	Combined Totals
Operating Revenues				
Interest and fee income				
Housing mortgage and construction loans	$ 2,067	$ 84,759	$ 70	$ 86,896
Mortgage-backed securities		28,293		28,293
Marketable securities	6	2,722	1	2,729
Net increase in fair value of marketable securities		42,776		42,776
Net increase in fair value of swaps		1,226		1,226
Fees, charges and other income	12,563			12,563
Total Operating Revenues	14,636	159,776	71	174,483
Operating Expenses				
Interest on revenue bonds and notes payable	254	97,154		97,408
Provision for losses on loans	1,356	326	11	1,693
General and administrative	19,178			19,178
Housing assistance grants	3,285		46	3,331
Mortgage loan servicers' fees	2	5,343		5,345
Amortization of lender compensation	4	7,081		7,085
Amortization of debt issuance costs		1,242		1,242
Early extinguishment of debt		359		359
Total Operating Expenses	24,079	111,505	57	135,641
Operating Income (Loss)	(9,443)	48,271	14	38,842
Interfund Transfers	10,700	(7,607)		3,093
Change in Net Assets	1,257	40,664	14	41,935
Net Assets, Beginning of Year (Restated)	52,457	223,412	7,162	283,031
Net Assets, End of Year	$53,714	$ 264,076	$ 7,176	$ 324,966

See Notes to Financial Statements

Statement of Cash Flows – Proprietary Funds

Kentucky Housing Corporation

Year Ended June 30, 2010
(dollars in thousands)

	General Funds	Housing Revenue Bond Funds	Housing Development Fund	Combined Totals
Cash Flows From Operating Activities				
Interest income on loans	$ 1,852	$ 84,759	$ 70	$ 86,681
Fees, charges and other income	11,527			11,527
Personnel costs	(4,506)			(4,506)
Operating expenses	(14,790)	(10,928)		(25,718)
Housing assistance grants	(3,285)		(46)	(3,331)
Fundings of housing mortgage loans	(14,280)	(236,680)		(250,960)
Repayments on housing mortgage loans	12,134	137,042		149,176
Conversion of mortgage loans to mortgage-backed securities		303,582		303,582
Net changes in housing construction loans	(47)		185	138
Other, net	(30,843)	32,361	(7)	1,511
Net Cash Provided By (Used In) Operating Activities	(42,238)	310,136	202	268,100
Cash Flows From Noncapital Financing Activities				
Proceeds from lines of credit and issuance of revenue bonds	70,000	281,366		351,366
Payments for debt issuance costs		(1,653)		(1,653)
Principal payments on lines of credit and revenue bonds	(47,159)	(215,390)		(262,549)
Interest payments on revenue bonds and lines of credit	(254)	(102,008)		(102,262)
Changes in escrows and project reserves	731			731
Interfund transfers	10,700	(7,607)		3,093
Net Cash Provided By (Used In) Noncapital Financing Activities	34,018	(45,292)		(11,274)
Cash Flows From Capital and Related Financing Activities				
Acquisition of capital assets	(347)			(347)
Cash Flows From Investing Activities				
Purchases of investments and mortgage-backed securities	(13,879)	(2,183,717)		(2,197,596)
Conversion of mortgage loans to mortgage-backed securities		(303,582)		(303,582)
Sales of investments and mortgage-backed securities	27,416	2,191,229	3,300	2,221,945
Interest received on investments and mortgage-backed securities	7	30,105	1	30,113
Net Cash Provided By (Used In) Investing Activities	13,544	(265,965)	3,301	(249,120)
Net Increase (Decrease) in Cash and Cash Equivalents	4,977	(1,121)	3,503	7,359
Cash and Cash Equivalents, Beginning of Year	50,171	4,940	512	55,623
Cash and Cash Equivalents, End of Year	$ 55,148	$ 3,819	$ 4,015	$ 62,982

See Notes to Financial Statements

Kentucky Housing Corporation

Year Ended June 30, 2010
(dollars in thousands)

	General Funds	Housing Revenue Bond Funds	Housing Development Fund	Combined Totals
Reconciliation of Operating Income (Loss) to Net Cash Provided By (Used In) Operating Activities				
Operating income (loss)	$ (9,443)	$ 48,271	$ 14	$ 38,842
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:				
Amortization of deferred costs	4	8,323		8,327
Other amortization	(81)			(81)
Provision for losses on loans	1,356	326	11	1,693
Depreciation expense	520			520
Interest expense on revenue bonds and lines of credit	254	97,154		97,408
Interest income on mortgage-backed securities		(28,293)		(28,293)
Interest income on marketable securities	(6)	(2,722)	(1)	(2,729)
Net (increase) decrease in fair value of marketable securities		(42,776)		(42,776)
Net (increase) decrease in fair value of swaps		(1,226)		(1,226)
Early Extinguishment of Debt		359		359
Changes in operating assets and liabilities				
Fundings of housing mortgage loans	(14,280)	(236,680)		(250,960)
Repayments on housing mortgage loans	12,134	137,042		149,176
Conversion of mortgage loans to mortgage backed securities		303,582		303,582
Housing construction loans	(47)		185	138
Other, net	(32,649)	26,776	(7)	(5,880)
Net Cash Provided By (Used In) Operating Activities	$ (42,238)	$ 310,136	$ 202	$ 268,100

See Notes to Financial Statements

Note A--Compliance with Enabling Legislation and Bond Resolutions

The Kentucky Housing Corporation (the "Corporation") was established in 1972 by the Kentucky General Assembly under the provisions of the Kentucky Housing Corporation Act (the "Act"). The Act, as amended, authorizes the Corporation to issue bonds and notes, the cumulative outstanding indebtedness of which does not exceed $5,000,000. The Act and the Bond Resolutions adopted by the Corporation contain provisions establishing funds and accounts for the segregation and restriction of assets and also restrict the use of the proceeds of bonds as well as other funds received. Further, the Act and the Bond Resolutions authorize the Corporation to invest in obligations of the United States, the Commonwealth of Kentucky (the "Commonwealth"), or their agencies or instrumentalities.

The Corporation primarily makes first mortgage loans to finance single-family and multi-family housing units within Kentucky. Loans are made to first-time home buyers meeting certain low-to-moderate income guidelines. Substantially all assets of the Corporation are held by banks as trustees and are pledged as collateral for the Corporation's bonds.

The Corporation also administers various programs for federal and state agencies. Funds held for these programs are restricted as to use by statutes, contracts or other agreements.

Note B--Summary of Significant Accounting Policies

Basis of Presentation--The Corporation's basic financial statements are prepared in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis – for State and Local Governments* and related statements, and are comprised of three components: 1) Corporation-Wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. The Corporation-Wide financial statements are comprised of a statement of net assets and a statement of activities. Prepared using the economic resources measurement focus and the accrual basis of accounting, these statements reflect all of the assets, liabilities, revenues, expenses, gains and losses of the Corporation's governmental and business-type activities. The Corporation's governmental activities reflect the administration of the various programs for the Commonwealth and the federal government. The Corporation's business-type activities include the Corporation's single and multi-family loan programs and other lender services.

The Corporation's fund financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to governmental entities, which provides that accounting systems be organized by funds to account for specific activities consistent with legal and operating requirements. The Corporation's governmental funds financial statements are prepared utilizing the current financial economic resources measurement focus and the modified accrual basis of accounting, and include the activities of administering rental subsidy and other federal and state housing programs for the Commonwealth and U.S. Department of Housing and Urban Development ("HUD"). Financial activities operated similarly to private business

Continued

Note B--Summary of Significant Accounting Policies--Continued

enterprises and financed through fees and charges assessed primarily to users of the Corporation's loan and other lender services are presented as proprietary funds.

The Corporation follows all applicable GASB pronouncements as well as Financial Accounting Standards Board pronouncements and Accounting Principles Board Opinions, issued on or before November 30, 1989 for its proprietary fund, unless those pronouncements conflict with or contradict GASB pronouncements.

The Corporation is a component unit of the Commonwealth and, as such, its financial statements are included in the Commonwealth's Comprehensive Annual Financial Report.

The Corporation's governmental funds (special revenue funds) are:

Affordable Housing Trust Fund: This fund accounts for resources made available in the form of grants or loans to local governments, nonprofits and regional or statewide housing assistance organizations to provide housing to very low-income Kentucky residents with critical housing needs. The fund's resources are primarily provided by a portion of the fees received by county clerks for recording and indexing various documents. Such allocation of resources was approved by the Kentucky General Assembly in 2006.

HOME Program: This fund accounts for resources made available from the federal government through its Home Investment Partnerships Program ("HOME") to help local governments, nonprofits, private developers, community housing development organizations and individuals to provide safe, decent and affordable housing. Resources are made available to these entities and individuals through both grants and loans. Additional funds are also currently available through the Tax Credit Assistance Program ("TCAP"), which is a part of the American Recovery and Reinvestment Act ("ARRA"). TCAP provides funding for capital investment in Low Income Tax Credit projects and will be used to fill gaps caused by the collapse of the tax credit equity market, to assist stalled development projects, and to stimulate economic activity that would most notably take the form of job creation.

Housing Tax Credits: This fund accounts for resources made available through the United States Department of Treasury ("Treasury") via Section 1602 of ARRA. Under Section 1602 the Treasury may issue cash assistance to state housing credit agencies in exchange for low income housing tax credits initially allocated in 2008 and 2009. These resources are secured by deferred, forgivable at maturity mortgage loans.

Weatherization Assistance: This fund accounts for resources made available from the federal government to assist eligible individuals in reducing their utility costs and improving the safety of their homes through energy efficiency measures. This program was previously administered in Kentucky by the Cabinet for Health and Family Services and was transferred to the Corporation in April 2009.

Continued

Note B--Summary of Significant Accounting Policies--Continued

Rental Assistance: This fund accounts for resources made available from the federal government to assist eligible individuals to rent decent, safe and affordable housing and to assure that property owners provide safe, affordable housing to recipients according to guidelines established by HUD.

Other Housing Funds: This fund accounts for other minor housing assistance program funds made available through various federal and state resources.

The Corporation's proprietary funds are:

General Funds: These funds account for (1) activities related to the development and administration of corporate financial programs, (2) corporate-owned assets and (3) any activities and related revenues and expenses of the Corporation not applicable to the other funds. Net assets within the General Funds are generally unrestricted.

Housing Revenue Bond Funds: These funds account for the proceeds from the sale of Housing Revenue Bonds, the debt service requirements of the bond indebtedness, and mortgage loans made from bond proceeds to finance the purchase of single-family residential housing as well as the construction and long-term financing of multi-family residential housing. Net assets are restricted as to use by the terms of the Housing Revenue Bond Indentures.

Housing Development Fund: This fund accounts for construction loan proceeds for the production of both single-family and multi-family residential loans, as well as any investments made with proceeds currently not loaned. Net assets are restricted to use within the fund by the enabling legislation that created the fund.

Cash and Cash Equivalents--Cash consists of cash held by depository institutions and a trustee in the Corporation's name as well as amounts collected by loan servicers but not yet remitted to the trustee. The Corporation's cash and cash equivalents include money market funds and investments with original maturities of three months or less at the purchase date.

Investment and Mortgage-Backed Securities--Investment and mortgage-backed securities are stated at fair value based on quoted market prices. Unrealized gains (losses) due to changes in the fair value of investment and mortgage-backed securities are reported under the caption operating revenues in the Corporation's statement of revenues, expenses and changes in net assets.

The Corporation securitizes a large portion of its conventionally insured housing mortgage loans by converting them into mortgage-backed securities through both FNMA and GNMA, already defined. The Corporation retains the servicing rights to the housing mortgage loans, and is subject to recourse provisions covering a portion of these housing mortgage loans (as described in Note D). In accordance with Financial Accounting Statements Board ("FASB") Statement No. 140, *Accounting*

Continued

Note B--Summary of Significant Accounting Policies--Continued

for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (as Amended), these securitization transactions do not qualify to be accounted for as sales of housing mortgage loans.

Loans and Allowance for Loan Losses--Housing mortgage loans, housing construction loans and other loans are stated at remaining principal balances, plus accrued interest, less allowance for loan losses.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb losses on existing loans that may become uncollectible, based on evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, loan guarantees, review of specific problem loans, and current economic conditions that may affect the borrower's ability to pay. Accrual of interest is discontinued on a loan when management believes, after considering the economic climate, business conditions, and collection efforts, that the borrower's financial condition is such that collection of interest is doubtful.

Debt Issuance Costs and Bond Premiums and Discounts--Debt issuance costs and bond premiums and discounts on revenue bonds are deferred and amortized by the effective interest method over the term of the related debt. Revenue bonds payable are reported net of the applicable bond premium or discount. Debt issuance costs are included as deferred charges under unamortized debt issuance costs.

Capital Assets--Capital assets are stated at cost less accumulated depreciation and are reported in the Business-Type Activities column in the Corporation-Wide Statement of Net Assets. Maintenance, repairs, and minor replacements are charged to expense as incurred; major improvements are capitalized. The cost of assets sold or retired and the related accumulated depreciation are eliminated from the accounts and any resulting gain or loss is included in income. Depreciation is computed on the straight-line method over the following estimated useful lives of the assets.

Buildings	30 to 40 years
Equipment	3 to 10 years

Debt Refundings--The Corporation accounts for debt refundings in accordance with GASB Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*. This statement requires accounting gains and losses that result from debt refundings to be deferred and amortized over the life of the new debt or the retired debt, whichever is the shorter period, using the effective interest method. Such losses are the recognition of previously

Continued

Note B--Summary of Significant Accounting Policies--Continued

unamortized debt issuance costs. The Corporation had deferred losses of $949 at June 30, 2010, net of amortization of $232. Such deferred losses are reported with unamortized debt issuance costs on the statements of net assets.

Origination and Commitment Fees--Origination fees relating to permanently financed multi-family loans are deferred and amortized over the lives of the related loans as an adjustment to the yield, using a method that approximates the level yield method. Commitment fees charged to mortgage originators to reserve funds for permanently financed single-family loans are deferred and amortized ratably over the lives of the related loans.

Interfund Eliminations--Interfund receivables and payables arising primarily from allocations of administrative charges among the appropriate funds, are eliminated in the governmental and business-type activities columns of the Corporation-Wide statement of net assets. Net residual amounts due between governmental and business-type activities are reflected as receivable (payable) for internal balances.

Program Revenues--Program revenues in the Corporation-Wide statement of activities are reported in two categories including (1) charges for services and (2) program-specific operating grants and contributions. Charges for services include all revenues from loans, investments, servicing, financing, and program administration fees received in connection with administering the Corporation's various loan programs. Program-specific operating grants and contributions include revenues from mandatory and voluntary nonexchange transactions with other governments and organizations that are restricted for use in a particular program. Program-specific operating grants and contributions include the interest earned on unspent grant proceeds.

Revenue and Expense Recognition of Proprietary Funds--The Corporation records all revenues derived from and related expenses incurred for loans, investments, servicing, financing and program administration as operating revenues and expenses since they are generated from the Corporation's daily operations needed to carryout its statutory purpose.

Use of Estimates--The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting periods. Estimates used in the preparation of the financial statements are based on various factors including the current interest rate environment and the general strength of Kentucky's economy. Changes in the overall interest rate environment can significantly affect the carrying value of the Corporation's investments and mortgage-backed securities. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the fair value of investment and mortgage-backed securities. Actual results could differ from those estimates.

(dollars in thousands)

Note C--Cash, Cash Equivalents and Investments

The Corporation has adopted GASB Statement No. 40, *Deposits and Investment Risk Disclosures*, which requires disclosure of various investment-related risks, including custodial credit risk, interest rate risk, credit risk, concentration of credit risk, and foreign currency risk.

Kentucky Revised Statutes authorize the Corporation to invest in obligations guaranteed by the Commonwealth of Kentucky, the United States, or their agencies, provided however, that the return on such investments shall not violate any rulings of the Internal Revenue Service regarding the investment of the proceeds of any federally tax-exempt bond issue.

Cash and Cash Equivalents--At June 30, 2010, the carrying amount of the Corporation's cash and cash equivalents was $69,040 and the bank balance was $66,496. The difference between the carrying amount and the bank balance is a result of transactions in transit. Of the $66,496 bank balance, $11,995 was covered by federal depository insurance and $54,501 was collateralized. For the funds collateralized by the financial institutions, the collateral equals or exceeds at least 102 percent (102%) of the value of the uninsured funds on deposit as required by the Corporation's investment policies, and the collateral is held by the financial institutions or a third party in the name of the Corporation.

Investment and Mortgage-Backed Securities--At June 30, 2010 the Corporation had the following investment and mortgage-backed securities:

Investment Type	Fair Value	Effective Duration (in Years)
U.S. Treasuries	$ 170,690	0.94
Mortgage-backed securities	794,045	0.54
U.S. government-sponsored enterprises	33,989	0.02
Certificates of deposit	1,128	0.00
Repurchase agreements	202,773	0.00
Total Investment and Mortgage-Backed Securities	1,202,625	
Less amounts shown as current assets	341,458	
Noncurrent Investment and Mortgage-Backed Securities	$ 861,167	
Portfolio effective duration		1.51

Continued

(dollars in thousands)

Note C--Cash, Cash Equivalents and Investments--Continued

Interest Rate Risk--In general, the Corporation's investment strategy is designed to match the life of the asset with the date of its related liability. With this strategy, investments would be expected to reach maturity with limited realized gains or losses. The Corporation's investment policy does allow trades of existing securities in circumstances where extension or contraction of maturity date or conversion from one allowable investment to another produces additional value through increased yield or capital gains.

The fair value of the Corporation's investments in mortgage-backed securities is highly sensitive to volatility in interest rates.

Credit Risk--The Corporation's investment policy defines the types of investments available to the Corporation. Investments, including the underlying securities for repurchase agreements, are held by the Corporation's trustee in the Corporation's name. The Corporation's investments are rated as follows by Moody's Investors Service at June 30, 2010:

Investment Type	Moody's Rating
Mortgage-backed securities	Aaa
U.S. Treasuries	Aaa
U.S. government-sponsored enterprises	Aaa
Certificates of deposit	Not rated
Repurchase agreements	Not rated

Custodial Credit Risk--For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Corporation would not be able to recover the value of its investments or collateral securities that are in possession of an outside party. Substantially all of the Corporation's investments are held in the name of the Corporation by a trustee.

Concentration of Credit Risk--The Corporation's investment policy places no limit on the amount the Corporation may invest in any one issuer. Investments in issuers exceeding five percent (5%) of the Corporation's portfolio at June 30, 2010 consist of the following:

Issuer	Fair Value	Percentage of Portfolio
Fannie Mae	$ 478,953	40%
GNMA	329,054	27%
U.S. Treasury	170,690	14%
Dreyfus	202,773	17%

Continued

(dollars in thousands)

Note C--Cash, Cash Equivalents and Investments--Continued

The pooled mortgages securitized as Fannie Mae investments with a fair value of $463,602 had a book value of $432,581 at June 30, 2010. Of the $432,581, $67,360 with full recourse to the Corporation with a five percent stop loss provision in place and $49,530 is with full recourse to the Corporation. The remaining balance of $315,691 is without recourse to the Corporation.

The pooled mortgages securities as GNMA investments with a fair value of $330,442 had a book value of $304,864 at June 30, 2010. This entire balance is without recourse to the Corporation.

Note D--Housing Mortgage Loans

At June 30, 2010, housing mortgage loans consist of the following:

Housing Revenue Bond Funds:	
Single-family (A)	$1,301,159
Multi-family (B)	48,879
Total Housing Revenue Bond Funds	1,350,038
General Housing Assistance Funds (C)	49,817
Total Principal	1,399,855
Add accrued interest receivable on loans	5,863
Total Principal and Accrued Interest	1,405,718
Less allowance for loan losses	7,351
Net Housing Mortgage Loans	1,398,367
Less amount shown as current assets	37,999
Noncurrent Housing Mortgage Loans	$1,360,368

(A) Includes $1,253,974 in federally insured or guaranteed loans, $22,840 of non-insured loans with initial loan-to-value ratios less than 90%, and $24,345 of loans covered by private mortgage insurance.

(B) Includes $43,243 in federally insured or guaranteed loans and $5,636 in non-insured loans.

(C) Includes $8,505 in federally insured or guaranteed loans, $34 in privately insured loans and $41,278 in non-insured loans.

(dollars in thousands)

Note E--Housing Construction Loans

Housing construction loans are primarily secured by first mortgages and are repayable at maturity or at the date of the sale of the property, whichever occurs first. Such loans are net of an allowance for loan losses of $931.

Note F--Other Loans

Other loans are primarily non-secured loans made to agencies, organizations, and individuals to construct or preserve affordable housing in Kentucky. Such loans are net of an allowance for loan losses of $2,387.

Note G--Loan Commitments

At June 30, 2010, the Corporation is committed to make housing mortgage loans and housing construction loans totaling $19,541 and $1,707, respectively.

Note H--Capital Assets

Major classes of capital assets at June 30, 2010 and activity during the year then ended are as follows:

Business-Type Activities	Balance July 1, 2009	Additions	Retirements and Dispositions	Balance June 30, 2010
Land	$ 1,076	$ 13	$	$ 1,089
Buildings	5,036			5,036
Equipment	4,726	334	460	4,600
Less accumulated depreciation	(6,212)	(520)	(460)	(6,272)
Net Capital Assets	$ 4,626	$ (173)	$	$ 4,453

All depreciation expense was incurred for business-type activities and was included in the administrative function category in the Corporation-Wide statement of activities.

(dollars in thousands)

Note I--Lines of Credit

The Corporation's lines of credit at June 30, 2010 and activity during the year then ended are as follows:

Business-Type Activities	Balance July 1, 2009	Borrowings	Repayments and Dispositions	Balance June 30, 2010
Loan Refunding Line of Credit	$ 719	$ -	$ 719	$ -
Loan Warehousing Line of Credit 1	16,380	30,000	46,380	-
Loan Warehousing Line of Credit 2		40,000	60	39,940
	$ 17,099	$ 70,000	$ 47,159	$ 39,940

The Loan Refunding Line of Credit matured January 1, 2010.

The Loan Warehousing Lines of Credit 1 and 2 are used only for the purchase of mortgage loans. Borrowings are repaid upon the next issuance of Housing Revenue Bonds. Line 1 provided for borrowings up to $40,000, bears interest at the one-month LIBOR plus 100 basis points, and matured March 1, 2010. Line 2 provides for borrowings up to $40,000, bears interest at the one-month LIBOR plus 75 basis points, and matures March 7, 2011. At June 30, 2010 this interest rate was 1.097%.

(dollars in thousands)

Note J--Revenue Bonds

Revenue bonds at June 30, 2010 and the activity for the year then ended consist of the following:

	Original Face Amount	Balance July 1, 2009	Issued	Repaid/ Retired	Balance June 30, 2010	Amount Due Within One Year
Housing Revenue Bonds:						
1997 Series D:						
2011-2031, 5.25% to 5.60%	$ 22,550	$ 5,125		$ 1,450	$ 3,675	$ 90
1997 Series E:						
2011-2015, 5.05% to 5.35%	5,340	1,320		1,320		
1998 Series A:						
2011-2018, 5.125%	10,845	3,780		1,450	2,330	955
1998 Series B:						
2012-2031, 5.00% to 5.30%	29,155	17,750		835	16,915	
1998 Series D:						
2011-2039, 5.00% to 5.125%	8,205	3,480		95	3,385	100
1998 Series E:						
2014-2031, 4.75% to 5.00%	6,290	6,290			6,290	
1998 Series F:						
2019-2031, 5.00%	64,565	40,135		3,450	36,685	
1998 Series G:						
2011-2020, 5.55%	26,375	8,360		4,055	4,305	365
1999 Series A:						
2014-2031, 5.00% to 5.20%	13,300	13,300			13,300	
1999 Series B:						
2011-2023, 4.75% to 5.20%	41,700	20,410		4,005	16,405	215
1999 Series E:						
2011-2020, 5.50%	17,965	4,130		900	3,230	10
1999 Series H:						
2015-2021, 5.85%	65,485	17,215		580	16,635	
2000 Series B:						
2021-2026, 6.05%	76,995	22,450		1,440	21,010	
2000 Series C:						
2028-2034, 5.95%	10,395	10,395			10,395	
2000 Series F:						
2021-2027, 5.85%	47,270	15,695		2,640	13,055	
2001 Series B:						
2011-2012, 4.95% to 5.15%	38,770	1,605		1,605		
2001 Series C:						
2022-2034, 5.55%	14,145	13,985		1,645	12,340	
2001 Series D:						
2011-2023, 4.85%	21,210	5,650		560	5,090	320
2001 Series E:						
2011-2021, variable	10,000	3,270		210	3,060	210
2001 Series F:						
2011-2032, 4.55% to 5.45%	50,000	19,265		2,940	16,325	1,040

Continued

(dollars in thousands)

Note J--Revenue Bonds--Continued

	Original Face Amount	Balance July 1, 2009	Issued	Repaid/ Retired	Balance June 30, 2010	Amount Due Within One Year
Housing Revenue Bonds-Continued						
2002 Series A:						
2011-2031, 4.45% to 5.50%	55,000	28,980		5,490	23,490	1,080
2002 Series C:						
2011-2028, 4.15% to 5.375%	21,220	17,790		1,500	16,290	630
2002 Series D:						
2011-2033, 4.10% to 5.375%	50,000	43,915		3,950	39,965	1,050
2002 Series E:						
2011-2033, 3.60% to 5.05%	40,000	35,770		2,755	33,015	820
2002 Series F:						
2011-2034, 3.90% to 5.25%	30,000	26,540		2,370	24,170	725
2002 Series G:						
2015-2023, variable	5,000	5,000			5,000	
2003 Series A:						
2011-2034, 3.10% to 4.75%	35,000	31,630		1,145	30,485	750
2003 Series B:						
2011-2034, 3.45% to 4.80%	55,000	41,650		3,130	38,520	1,210
2003 Series C:						
2016-2025, 3.80% to 4.55%	16,720	16,720		125	16,595	
2003 Series D:						
2011-2034, 3.65% to 5.10%	45,000	33,810		2,930	30,880	920
2003 Series E:						
2017-2034, variable	5,000	5,000			5,000	
2003 Series F:						
2011-2034, 3.35% to 4.95%	155,140	110,020		19,080	90,940	9,600
2003 Series G:						
2011-2034, 3.40% to 5.00%	45,000	34,500		3,465	31,035	950
2004 Series A:						
2011-2018, 3.50% to 4.55%	17,175	17,175		1,595	15,580	2,210
2004 Series B:						
2018-2025, 5.00%	22,825	9,780		2,115	7,665	
2004 Series C:						
2026-2035, variable	10,000	10,000			10,000	
2004 Series D:						
2011-2035, 3.75% to 5.05%	55,000	44,425		4,915	39,510	1,220
2004 Series E:						
2030-2035, variable	5,000	5,000			5,000	
2004 Series F:						
2011-2035, 3.55% to 4.90%	45,000	35,860		2,455	33,405	910

Continued

(dollars in thousands)

Note J--Revenue Bonds--Continued

	Original Face Amount	Balance July 1, 2009	Issued	Repaid/ Retired	Balance June 30, 2010	Amount Due Within One Year
Housing Revenue Bonds-Continued						
2004 Series G:						
2011-2017, 3.15% to 4.05%	10,225	7,380		870	6,510	895
2004 Series H:						
2017-2036, 4.00% to 4.90%	29,775	24,060		1,690	22,370	
2004 Series I:						
2018-2036, variable	5,000	5,000			5,000	
2005 Series A:						
2011-2032, 3.50% to 4.75%	18,670	17,230		1,530	15,700	275
2005 Series B:						
2011-2033, variable	16,330	12,505		1,420	11,085	205
2005 Series C:						
2011-2031, 3.30% to 4.50%	22,215	19,415		960	18,455	1,010
2005 Series D:						
2019-2036, 4.60% to 5.00%	37,785	29,270		3,895	25,375	
2005 Series E:						
2011-2036, 3.45% to 5.00%	80,000	69,585		6,610	62,975	1,395
2005 Series F:						
2011-2016, 4.45% to 4.78%	20,000	14,370		2,305	12,065	2,315
2005 Series G:						
2016-2031, 4.20% to 5.00%	37,390	31,060		3,240	27,820	
2005 Series H:						
2017-2037, variable	21,925	21,925			21,925	
2005 Series I:						
2011-2017, 4.73% to 5.04%	22,940	17,255		2,675	14,580	2,600
2005 Series J:						
2014-2035, 3.70% to 4.70%	8,775	8,775			8,775	
2005 Series K:						
2017-2037, 4.90% to 5.00%	8,040	5,165		2,375	2,790	
2005 Series L:						
2017-2037, variable	20,000	20,000			20,000	
2006 Series A:						
2014-2035, 4.00% to 4.85%	8,775	8,775			8,775	
2006 Series B:						
2016-2037, 4.80% to 5.25%	15,420	12,270		1,855	10,415	
2006 Series C:						
2024-2037, variable	15,425	15,425			15,425	
2006 Series D:						
2011-2016, 4.97% to 5.24%	20,000	14,830		2,640	12,190	2,570

Continued

(dollars in thousands)

Note J--Revenue Bonds--Continued

	Original Face Amount	Balance July 1, 2009	Issued	Repaid/ Retired	Balance June 30, 2010	Amount Due Within One Year
Housing Revenue Bonds-Continued						
2006 Series E:						
2011-2037, 3.85% to 5.00%	27,140	26,010		920	25,090	70
2006 Series F:						
2017-2030, variable	20,540	20,540			20,540	
2006 Series G:						
2011-2035, 5.11% to 5.52%	37,220	25,220		6,965	18,255	1,235
2006 Series H:						
2017-2037, 4.65% to 5.00%	41,495	38,970		2,400	36,570	
2006 Series I:						
2019-2032, variable	23,750	23,750			23,750	
2006 Series J:						
2011-2035, 5.47% to 5.92%	29,390	22,550		6,830	15,720	1,360
2006 Series K:						
2014-2034, 4.05% to 4.80%	9,585	9,585			9,585	
2006 Series L:						
2011-2037, 4.20% to 5.50%	19,085	15,495		3,900	11,595	180
2006 Series M:						
2017-2033, variable	21,000	21,000			21,000	
2006 Series N:						
2011-2017, 5.64 to 6.06%	8,965	7,165		2,855	4,310	650
2006 Series O:						
2017-2036, variable	29,035	28,595		4,305	24,290	
2006 Series P:						
2014-2035, 3.80% to 4.60%	8,210	8,210			8,210	
2006 Series Q:						
2011-2038, 3.95% to 4.90%	41,790	39,475		2,630	36,845	680
2006 Series R:						
2011-2038, 5.265% to 5.816%	21,700	17,805		6,185	11,620	385
2006 Series S:						
2011-2037, 5.88%	15,000	12,975		3,495	9,480	130
2006 Series T:						
2017-2038, variable	23,300	23,300		3,295	20,005	
2006 Series U:						
2011-2038, 3.90% to 4.90%	45,000	43,955		595	43,360	630
2006 Series V:						
2012-2015, 5.33%	6,620	5,550		3,955	1,595	
2006 Series W:						
2017-2038, variable	38,380	35,540		6,460	29,080	

Continued

(dollars in thousands)

Note J--Revenue Bonds--Continued

	Original Face Amount	Balance July 1, 2009	Issued	Repaid/ Retired	Balance June 30, 2010	Amount Due Within One Year
Housing Revenue Bonds-Continued						
2007 Series A:						
2011-2038, 3.85% to 4.65%	39,545	38,685		570	38,115	530
2007 Series B:						
2011-2038, 4.98% to 5.58%	38,000	33,310		6,060	27,250	530
2007 Series C:						
2011-2038, 3.95% to 4.80%	50,000	48,990		635	48,355	675
2007 Series D:						
2011-2038, 5.345% to 5.745%	30,000	25,715		5,995	19,720	35
2007 Series E:						
2011-2038, 3.95% to 4.85%	45,000	44,240		625	43,615	605
2007 Series F:						
2011-2038, 4.991% to 5.53%	30,000	26,595		4,070	22,525	430
2007 Series G:						
2014-2035, 3.90% to 4.75%	6,285	6,285			6,285	
2007 Series H:						
2011-2038, 4.125% to 5.00%	34,965	33,940		2,160	31,780	
2007 Series I:						
2011-2038, 5.279% to 5.77%	16,620	15,765		2,850	12,915	465
2007 Series J:						
2018-2038, variable	17,130	16,320		1,685	14,635	
2007 Series K:						
2014-2035, 4.00% to 5.00%	7,405	7,405			7,405	
2007 Series L:						
2011-2038, 3.95% to 5.50%	25,485	24,975		1,430	23,545	170
2007 Series M:						
2011-2037, 5.07% to 6.06%	27,000	25,275		4,455	20,820	615
2007 Series N:						
2011-2038, 3.85% to 5.125%	40,000	39,585		2,100	37,485	255
2007 Series O:						
2011-2038, variable	10,000	9,490		955	8,535	125
2008 Series A:						
2011-2038, 2.80% to 5.30%	39,270	38,855		1,985	36,870	500
2008 Series B:						
2011-2038, variable	10,000	9,905		150	9,755	160
2008 Series C:						
2013-2034, 3.45% to 5.00%	14,230	14,230			14,230	
2008 Series D:						
2011-2039, 3.75% to 5.65%	35,770	35,400		1,880	33,520	785
2008 Series E:						
2011-2039, 2.45% to 5.45%	60,000	60,000		2,845	57,155	810

Continued

(dollars in thousands)

Note J--Revenue Bonds--Continued

	Original Face Amount	Balance July 1, 2009	Issued	Repaid/ Retired	Balance June 30, 2010	Amount Due Within One Year
Housing Revenue Bonds-Continued						
2008 Series F:						
2020-2038, 5.625%	10,000	10,000		1,170	8,830	
2009 Series A:						
2011-2040, 1.65% to 5.75%	40,000	40,000		550	39,450	735
2009 Series B:						
2011-2040, 1.05% to 5.15%	60,000		60,000	165	59,835	1,155
2009 Series C:						
2042, variable	120,000		120,000		120,000	
2009 Series C, Sub series C-1:						
2027-2042, 3.81%	60,000		60,000		60,000	
2010 Series A:						
2011-2027, 0.50% to 5.00%	40,000		40,000		40,000	980
Total Housing Revenue Bonds	$ 3,086,240	2,172,125	$ 280,000	$ 215,390	2,236,735	$ 51,525
Unamortized premium		3,293			3,742	
Net Revenue Bonds		$ 2,175,418			$ 2,240,477	

As indicated above, several bond issues have a variable rate of interest. This rate is determined periodically by the bond remarketing agent as the minimum interest rate that would result in the sale of the variable-rate bonds at a price equal to the principal amount plus accrued interest thereon (not to exceed 10% on tax-exempt variable-rate bonds, and not to exceed a range of 18% to 21% on taxable variable-rate bonds).

Continued

(dollars in thousands)

Note J--Revenue Bonds--Continued

The revenue bonds are collateralized by the underlying mortgages financed by the proceeds from the revenue bonds, and by the pledge of the principal and interest collections received from these mortgages.

The Housing Revenue Bond principal maturities and sinking fund requirements are as follows:

	Amortization of Principal	Interest Expense	Total Debt Service
Fiscal years ending June 30,			
2011	$ 51,525	$ 99,642	$ 151,167
2012	57,905	98,407	156,312
2013	60,050	96,070	156,120
2014	58,805	93,520	152,325
2015	61,315	90,938	152,253
Five years ending June 30,			
2016-2020	336,240	410,437	746,677
2021-2025	385,010	323,481	708,491
2026-2030	420,645	226,924	647,569
2031-2035	467,415	114,968	582,383
2036-2040	215,035	19,551	234,586
Thereafter	122,790	82	122,872
	$ 2,236,735	$ 1,574,020	$ 3,810,755

The Corporation has routinely exercised early redemption options and has retired various bonds prior to their scheduled maturity dates with funds available for that purpose.

Interest expense was entirely incurred in business-type activities and was included in the bond financed loan programs function and administrative function in the Corporation-Wide statement of activities.

(dollars in thousands)

Note K--Interest Rate Swap Agreements

Summary of Derivative Instruments - The Corporation has entered into ten multiple pay-fixed, receive-variable interest rate swap agreements ("swaps") in order to hedge the interest rate exposure associated with variable rate debt and to reduce borrowing costs. Each of these swaps are cash flow hedges issued in conjunction with the business-type activities of the mortgage revenue bond program.

As of June 30, 2010, nine of the ten swaps were determined to be effective hedges, while the 2006 W swap has been deemed ineffective for the purposes of GASB 53 (see Note R). The effectively hedged swaps, which have a notional amount of $168,255, decreased in fair value by $462 and this amount is classified as a deferred inflow of resources. The fair value of the effectively hedged swaps is classified as a derivative instrument and has a negative aggregate fair value of $15,457 and is included in noncurrent liabilities and as a noncurrent asset as a deferred outflow of resources.

As noted above the 2006 W swap has been deemed ineffective for purposes of GASB 53. This swap has a notional amount of $26,550 and had an increase in fair value of $1,226. The increase is recorded as investment revenue for the year ended June 30, 2010. The total negative fair value of $2,095 is classified as a noncurrent liability.

Objective –These agreements provide for reductions in the notional amount of the swaps to coincide with expected reductions in the outstanding amount of the associated bonds.

Terms - The following table displays the terms of each derivative:

Bond	Effective	Notional Amount		Maturity	Pay-Fixed	Receive	Optional
Series	Date	Original	Outstanding	Date	Rate	Variable Rate	Call Dates
2005 Series B	4/7/2005	16,330	11,685	1/1/2032	3.188%	62% 3M LIBOR + 28 bp	1/1/2016
2005 Series H	10/11/2005	21,925	21,925	7/1/2036	3.725%	62% 1M LIBOR + 28 bp	1/1/2015
2005 Series L	12/1/2005	20,000	20,000	7/1/2036	3.627%	62% 1M LIBOR + 28 bp	1/1/2016
2006 Series C	1/26/2006	15,425	15,425	7/1/2036	3.914%	62% 1M LIBOR + 28 bp	1/1/2016
2006 Series F	4/11/2006	20,540	20,540	7/1/2029	3.764%	62% 1M LIBOR + 28 bp	7/1/2016
2006 Series I	6/8/2006	23,750	23,750	1/1/2032	4.127%	62% 1M LIBOR + 35 bp	7/1/2016
2006 Series M	8/9/2006	21,000	21,000	1/1/2033	4.178%	62% 1M LIBOR + 35 bp	7/1/2016
2006 Series O	8/9/2006	29,035	18,645	1/1/2017	5.700%	100% 1M LIBOR	N/A
2006 Series T	9/27/2006	23,300	15,285	1/1/2016	5.337%	100% 1M LIBOR	N/A
2006 Series W	11/29/2006	38,380	26,550	1/1/2016	5.318%	100% 1M LIBOR	N/A

Continued

Note K--Interest Rate Swap Agreements—Continued

Other than the optional call dates noted above, the swaps do not contain any other embedded options.

Risks - Credit risk is the risk that a counterparty will not fulfill its obligation. As of June 30, 2010, the swaps had a negative fair value of $17,552. To mitigate the potential for credit risk, the Corporation has contracted with A2/A/A and Aa3/A+/A+ rated counterparties.

Merrill Lynch Capital Services, Inc. (A2/A/A) serves as the counterparty for nine of KHC's derivative instruments and accounts for $168,255 of the total notional amount outstanding for all swaps. Furthermore, each of these instruments are guaranteed by Merrill Lynch Derivative Products AG, which is rated Aa3/AAA/AAA.

UBS AG (Aa3/A+/A+) serves as the counterparty for the remaining swap and accounts for $26,550 of the total notional amount outstanding.

The Corporation did not require or post collateral in relation to the above derivative instruments.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair values of the interest rate swaps. As each swap uses LIBOR as the basis to calculate the receive-variable rate, the Corporation is exposed to interest rate risk. The fair value (liability) of the swaps will generally decline with a decrease in interest rates and increase when interest rates increase. These changes in valuation do not affect the Corporation's cash flow.

Basis Risk is the risk that a counterparty's variable rate swap payments do not correspond to actual variable rate bond payments. When variable rate payments and variable rate swap receipts materially differ, the anticipated cost savings from entering into swaps may not be realized. The Corporation attempts to minimize the mismatch of these cash flows through the selection of a variable-received swap rate index that has demonstrated a historical trading differential similar to the underlying variable rate bonds. The terms and the potential mismatch of interest rates is shown in the table above.

Termination risk is the risk that an unscheduled end of a swap agreement will result in unintended unhedged variable rate debt outstanding and/or a termination payment will either be owing or due. The Corporation views the potential for termination to be remote; however, contingency plans for the financing of a termination payment or replacement of the swap are in place.

Rollover risk is the risk that a swap agreement does not extend to the maturity of the debt, thereby creating unhedged variable rate debt. The 2006 Series O, 2006 Series T, and 2006 Series W swaps have maturity dates of January 2017, January 2016, and January 2016, respectively. The maturity date for the debt associated with these swaps mature in January 2036, July 2037, and July 2037, respectively.

Continued

(dollars in thousands)

Note K--Interest Rate Swap Agreements—Continued

Market-access risk is the risk that the Corporation will not be able to enter credit markets or that credit markets will become more costly. The Corporation has evaluated this risk and determined that the swaps do not create any material market-access risk.

Associated Debt – As detailed above, the interest rate swaps are associated with certain debt obligations of the Corporation. On each debt service date, the Corporation pays or receives a net swap payment in conjunction with each swap. The net swap payment is the difference between the fixed rate interest paid to the counterparty and the variable rate interest received by the counterparty.

As of June 30, 2010, debt service requirements of the associated bond series and net swap payments were as follows, assuming interest rates in effect at June 30, 2010:

	Principal	Interest	Net Swap Payments	Total
2011	$ 205	$ 739	$ 6,986	$ 7,930
2012	435	738	6,276	7,449
2013	460	737	5,672	6,869
2014	370	736	5,156	6,262
2015	215	735	4,724	5,674
2016-2020	21,180	3,534	20,414	45,128
2021-2025	45,105	2,931	16,037	64,073
2026-2030	58,090	2,017	9,605	69,712
2031-2035	61,080	989	3,895	65,964
Thereafter	19,960	106	197	20,263
	$ 207,100	$ 13,262	$ 78,962	$ 299,324

Note L--Conduit Debt Obligations

The Corporation uses its tax-exempt debt issuing authority to provide financial assistance to private-sector developers for the acquisition and rehabilitation, or the construction of multi-family housing projects serving low-to-moderate income households.

The debt is collateralized by revenues generated by the properties financed and is repayable solely from payments received on the underlying mortgage loans and any specific third-party credit enhancement associated with the individual financings.

Through June 30, 2010, conduit debt obligations have been issued for 17 multi-family projects totaling approximately $144,573. The debt does not constitute a liability or a pledge of faith and credit of the Corporation and, accordingly, has not been reported in the Corporation-Wide financial statements.

Note M--Retirement Plan

Plan Description--All full-time and eligible part-time employees of the Corporation participate in the Kentucky Employees Retirement System ("KERS" or "the Plan"), a cost-sharing, multiple-employer defined benefit pension plan administered by the Kentucky Retirement System, an agency of the Commonwealth. Kentucky Revised Statute Section 61.645 assigns the authority to establish and amend benefit provisions to the Kentucky Retirement System Board of Trustees. The KERS issues a publicly available financial report that includes financial statements and required supplementary information for the KERS. The report may be obtained by writing to Kentucky Retirement System, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601.

Funding Policy--Plan members, depending on their beginning date of participation, are required to contribute 5% or 6% of their annual covered salary and the Corporation is required to contribute at an actuarially determined rate. The Corporation's rate was 11.61% and 10.01% for the years ended June 30, 2010 and 2009, respectively. Subsequent to June 30, 2010, the rate was 16.98%. The contribution requirements of Plan members and the Corporation may be amended by the Kentucky Retirement System Board of Trustees. The Corporation's required contributions to KERS for the years ended June 30, 2010, 2009 and 2008 were $1,751, $1,397 and $1,151, respectively, and were fully paid to the Plan.

On June 27, 2008 House Bill 1, the Pension Reform legislation, was signed into law. This legislation significantly impacts retirement benefits for employees who began participating in KERS on or after September 1, 2008. The law also has provisions that affected employees and retirees covered by KERS prior to September 1, 2008. Employees who began participation in KERS on or after September 1, 2008 are required to contribute 6% of their annual covered salary. Employers, including the Corporation, continue to be required to contribute at an actuarially determined rate. House Bill 1 contained a provision expressing the intent of the General Assembly to gradually increase the employer contributions to the KERS beginning July 1, 2010. If in the future the General Assembly adheres to this schedule, all participating agencies will be required to pay the full employer contribution by 2025. The financial impact to the Corporation in these future years is not yet known.

Note N--Post-Employment Health Care Benefits

Retired Corporation employees receive some health care benefits depending on their length of service. In accordance with Kentucky Revised Statutes, these benefits are provided and advanced-funded on an actuarially determined basis through the KERS. Kentucky Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the KERS. The report may be obtained by writing to Kentucky Retirement System, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky 40601.

Note O--Risk Management

The Corporation is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by various commercial insurance policies. There have been no reductions in insurance coverage during the year ended June 30, 2010. Settlements have not exceeded insurance coverage.

Note P--Subsequent Events

The Corporation evaluated events occurring between the end of its most recent fiscal year and September 22, 2010, the date the financial statements were issued.

On July 14, 2010, the Corporation executed a bond purchase agreement for the issuance of $40,000 of 2010 Series B, $10,000 of Series C, $60,000 of Series C-2, $46,000 of Series D and $20,000 of Series E Housing Revenue Bonds. This transaction closed on August 12, 2010.

This bond issue will be used to finance mortgage loans for persons and families of lower and moderate income and to retire balances outstanding under a bank line of credit used for interim purchases of single-family loans.

Note Q--Contingencies

In the normal course of operations, the Corporation receives funding from federal and state government agencies. These funds are to be used for designated purposes only. For government agency grants, if the grantor's review indicates that the funds have not been used for the intended purpose, the grantor may request a refund of monies advanced or refuse to reimburse the Corporation for its disbursements. The amount of such future refunds and unreimbursed disbursements, if any, is not expected to be significant. Continuation of the Corporation's grant programs is predicated upon the grantor's satisfaction that the funds provided are being spent as intended and the grantors' intent to continue their programs.

In addition, the Corporation operates in a heavily regulated environment. The operations of the Corporation are subject to the administrative directives, rules, and regulations of federal and state legislative and regulatory agencies, including, but not limited to, HUD. Such administrative directives, rules, and regulations are subject to change by an act of Congress or an administrative change mandated by HUD. Such changes may occur with little or inadequate funding to pay for the related cost, including the additional administrative burden to comply with a change.

Note R – Implementation of Accounting Principles

Effective July 1, 20019 the Corporation adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.* GASB 53 requires that derivative instruments be reported at fair value on the statement of net assets. Derivative instruments associated with hedgeable items, in this case interest rate swaps, that are determined to be effective in reducing exposures to identified financial risks are considered hedging derivative instruments. Effectiveness is determined by considering whether the changes in cash flows or fair values of the potential hedging derivative instrument substantially offset the changes in cash flows or fair values of the hedgeable item. In these instances, hedge accounting should be applied. Under hedge accounting, the changes in fair values of the hedging derivative instrument are reported as either deferred inflows or deferred outflows in the government's statement of net assets. Changes in the fair value of ineffective hedges are reported as investment revenue/loss on the statement of activities. Prior to the implementation of GASB 53, these derivatives were reported as a footnote disclosure. The cumulative effect of adopting this accounting principle represents an increase in noncurrent liabilities and a subsequent decrease in net assets of $3,321 for business-type activities. Business-type net assets at June 30, 2009 were previously reported as $286,352; after restatement the business-type net assets as June 30, 2009 are reported as $283,031.

Effective for the fiscal year ended June 30, 2010 the Corporation adopted the provisions of GASB No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions.* This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in the governmental funds.

The initial distinction that is made in reporting fund balance information is identifying amounts that are considered nonspendable versus those that are spendable. Within the classification of spendable fund balance the Statement also provides for additional classifications as restricted, committed, assigned and unassigned based on the relative strength of the constraints that control how specific amounts can be spent.

Due to the fact that the Corporation's governmental funds are special revenue funds that account for intragovernmental revenues received under the terms of grant agreements and the related grant expenditures, all governmental accounts are classified as restricted.

Supplemental Combining Information
Housing Revenue Bond Funds

Combining Statement of Net Assets – Housing Revenue Bond Funds

Kentucky Housing Corporation

June 30, 2010
(dollars in thousands)

ASSETS	Bond Proceeds Fund	Recoveries of Principal Fund	Bond Debt Service Fund	Bond Debt Service Reserve Fund	Trust Fund	Redemption Fund	Combined Totals
Current Assets							
Cash and cash equivalents	$ (10,980)	$ 9,239	$ 5,481		$ 79		$ 3,819
Investment securities	137,184	24,684	96,196	$ 36,072	1,159	$ 19,185	314,480
Mortgage-backed securities	15,962			1,563			17,525
Housing mortgage loans	33,858				1,768		35,626
Account receivable and other assets			612				612
Interfund accounts	(36,459)		1,016			$ (101)	(35,544)
Total Current Assets	139,565	33,923	103,305	37,635	3,006	19,084	336,518
Noncurrent Assets							
Investment securities				84,648			84,648
Mortgage-backed securities	707,231			69,249			776,480
Housing mortgage loans	1,280,853				37,007		1,317,860
Unamortized debt issuance costs	17,022						17,022
Deferred servicing costs and other assets	22,722				103		22,825
Deferred outfow of resources - interest rate swaps			15,457				15,457
Total Noncurrent Assets	2,027,828		15,457	153,897	37,110		2,234,292
Total Assets	2,167,393	33,923	118,762	191,532	40,116	19,084	2,570,810
LIABILITIES							
Current Liabilities							
Accounts payable and other liabilities	1,183						1,183
Accrued interest payable			47,522				47,522
Revenue bonds - current portion	51,525						51,525
Total Current Liabilities	52,708		47,522				100,230
Noncurrent Liabilities							
Revenue bonds	2,188,952						2,188,952
Derivative instrument - interest rate swap			17,552				17,552
Total Noncurrent Liabilities	2,188,952		17,552				2,206,504
Total Liabilities	2,241,660		65,074				2,306,734
NET ASSETS							
Restricted by revenue bond indenture	$ (74,267)	$ 33,923	$ 53,688	$ 191,532	$ 40,116	$ 19,084	$ 264,076

See Independent Auditors' Report

Kentucky Housing Corporation

Year Ended June 30, 2010
(dollars in thousands)

	Bond Proceeds Fund	Recoveries of Principal Fund	Bond Debt Service Fund	Bond Debt Service Reserve Fund	Trust Fund	General Revenue Fund	Redemption Fund	Combined Totals
Operating Revenues								
Interest and fee income								
Housing mortgage loans	$ 84,190				$ 569			$ 84,759
Mortgage-backed securities	24,305			$ 3,988				28,293
Marketable securities	109	$ 81	$ 7	2,497		$ 28		2,722
Net increase in fair value of marketable securities	37,439			5,337				42,776
Net increase in fair value of swaps			1,226					1,226
Total Operating Revenues	146,043	81	1,233	11,822	569	28	-	159,776
Operating Expenses								
Interest on revenue bonds			97,154					97,154
Provision for losses on loans	326							326
Mortgage loan servicers' fees	5,198				145			5,343
Amortization of lender compensation	7,028				53			7,081
Amortization of debt issuance costs	1,242							1,242
Early extinguishment of debt	359							359
Total Operating Expenses	14,153		97,154		198			111,505
Operating Income (Loss)	131,890	81	(95,921)	11,822	371	28	-	48,271
Interfund Transfers	(71,558)	(70,758)	117,183		(2,241)	(28)	$ 19,795	(7,607)
Change in Net Assets	60,332	(70,677)	21,262	11,822	(1,870)		19,795	40,664
Net Assets, Beginning of Year (Restated)	(134,599)	104,600	32,426	179,710	41,986		(711)	223,412
Net Assets, End of Year	$ (74,267)	$ 33,923	$ 53,688	$ 191,532	$ 40,116	$	$ 19,084	$ 264,076

See Independent Auditors' Report

Combining Statement of Cash Flows – Housing Revenue Bond Funds

Kentucky Housing Corporation

Year Ended June 30, 2010
(dollars in thousands)

	Bond Proceeds Fund	Recoveries of Principal Fund	Bond Debt Service Fund	Bond Debt Service Reserve Fund	Trust Fund	General Revenue Fund	Redemption Fund	Combined Totals
Cash Flows From Operating Activities								
Interest income on loans	$ 84,190				$ 569			$ 84,759
Operating expenses	(10,783)				(145)			(10,928)
Fundings of housing mortgage loans	(235,694)				(986)			(236,680)
Repayments on housing mortgage loans	133,601				3,441			137,042
Conversion of mortgage loans to mortgage-backed securities	303,582							303,582
Other, net	37,597	(3,016)	(1,628)	27	(9)		(610)	32,361
Net Cash Provided By (Used In) Operating Activities	312,493	(3,016)	(1,628)	27	2,870		(610)	310,136
Cash Flows From Noncapital Financing Activities								
Proceeds from issuance of revenue bonds	281,366							281,366
Payments for debt issuance costs	(1,653)							(1,653)
Principal payments on revenue bonds			(215,390)					(215,390)
Interest payments on revenue bonds			(102,008)					(102,008)
Interfund transfers - loan collections and investment income	(314,899)	137,061	172,586		(2,241)	$ (28)	-	(7,521)
Interfund transfers - purchase of mortgage loans	27,991	(27,991)						
Interfund transfers - refunding line of credit		(155)	(541)				610	(86)
Interfund transfers - retirement of debt		(179,673)	160,488				19,185	
Net Cash Provided By (Used In) Noncapital Financing Activities	(7,195)	(70,758)	15,135	-	(2,241)	(28)	19,795	(45,292)
Cash Flows From Investing Activities								
Purchases of investments and mortgage-backed securities	(1,385,893)	(255,858)	(263,884)	(136,918)	(1,828)		(139,336)	(2,183,717)
Conversion of mortgage loans to mortgage-backed securities	(303,582)							(303,582)
Sales of investments and mortgage-backed securities	1,361,060	330,402	248,190	130,294	1,132		120,151	2,191,229
Interest received on investments and mortgage-backed securities	23,378	89	13	6,597		28		30,105
Net Cash Provided By (Used In) Investing Activities	(305,037)	74,633	(15,681)	(27)	(696)	28	(19,185)	(265,965)
Net Increase (Decrease) in Cash and Cash Equivalents	261	859	(2,174)		(67)			(1,121)
Cash and Cash Equivalents, Beginning of Year	(11,241)	8,380	7,655		146		-	4,940
Cash and Cash Equivalents, End of Year	$ (10,980)	$ 9,239	$ 5,481	$	$ 79	$	$ -	$ 3,819

Continued

Kentucky Housing Corporation

Year Ended June 30, 2010

(dollars in thousands)

	Bond Proceeds Fund	Recoveries of Principal Fund	Bond Debt Service Fund	Bond Debt Service Reserve Fund	Trust Fund	General Revenue Fund	Redemption Fund	Combined Totals
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities								
Operating income (loss)	$ 131,890	$ 81	$ (95,921)	$ 11,822	$ 371	$ 28		$ 48,271
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities								
Amortization of deferred costs	8,270				53			8,323
Provision for losses on loans	326							326
Interest expense on revenue bonds			97,154					97,154
Interest income on mortgage-backed securities	(24,305)			(3,988)				(28,293)
Interest income on marketable securities	(109)	(81)	(7)	(2,497)		(28)		(2,722)
Net increase in fair value of marketable securities	(37,439)			(5,337)				(42,776)
Net increase in fair value of swaps			(1,226)					(1,226)
Early Extinguishment of Debt	359							359
Changes in operating assets and liabilities								
Fundings of housing mortgage loans	(235,694)				(986)			(236,680)
Repayments on housing mortgage loans	133,601				3,441			137,042
Conversion of mortgage loans to mortgage-backed securities	303,582							303,582
Other, net	32,012	(3,016)	(1,628)	27	(9)		$ (610)	26,776
Net Cash Provided By (Used In) Operating Activities	$ 312,493	$ (3,016)	$ (1,628)	$ 27	$ 2,870	$	$ (610)	$ 310,136

Report on Internal Control Over Financial Reporting and on Compliance And Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Mountjoy
Chilton
Medley

Report on Internal Control
Over Financial Reporting and on Compliance
And Other Matters Based on an Audit of
Financial Statements Performed in Accordance
With *Government Auditing Standards*

Board of Directors
Kentucky Housing Corporation
Frankfort, Kentucky

We have audited the financial statements of the governmental activities, the business-type activities and the individual fund information of the Kentucky Housing Corporation (the "Corporation"), a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2010, which collectively comprise the Corporation's basic financial statements and have issued our report thereon dated September 22, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Corporation's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency or combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain other matters that we reported to management of the Corporation in a separate letter dated September 22, 2010.

This report is intended solely for the information and use of the Board of Directors, management, the Auditor of Public Accounts, federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and the distribution is unlimited.

Mountjoy Chilton Medley LLP

Frankfort, Kentucky
September 22, 2010