NEW YORK LOCAL GOVERNMENT ASSISTANCE CORPORATION

A Component Unit of the State of New York

Basic Financial Statements

2004

NEW YORK
LOCAL GOVERNMENT ASSISTANCE CORPORATION
A Component Unit of the State of New York
Basic Financial Statements
Year Ended March 31, 2004

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KPMG LLP
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Independent Auditors' Report

Board of Directors
New York Local Government Assistance Corporation:

We have audited the accompanying financial statements of the governmental activities (Statement of Net Assets (Deficit) and Statement of Activities) and each major fund, of the New York Local Government Assistance Corporation (Corporation), a blended component Unit of the State of New York, as of and for the year ended March 31, 2004, which collectively comprise the Corporation's basic financial statements, as listed in the accompanying table of contents. These basic financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic 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 and each major fund, of the Corporation as of March 31, 2004, and the respective changes in financial position, for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3-7, 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 inquiries 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated June 25, 2004 on our consideration of the Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 provide an opinion on the internal control over financial reporting or on compliance. The 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.

KPMG LLP

June 25, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the New York Local Government Assistance Corporation's (Corporation) financial performance provides an overview of the Corporation's financial activities for the fiscal year ended March 31, 2004.

FINANCIAL HIGHLIGHTS

- The Corporation's total debt outstanding at year-end was $4.6 billion net of unamortized amounts, an increase of $349 thousand from the prior year.
- The Corporation's outstanding variable interest rate bonds equaled 45% of all its outstanding bonds, however due to the interest rate exchange agreements this has been effectively reduced to 19%.
- The Corporation's net asset deficit decreased by $109 million as a result of this year's operations.
- During the year, the Corporation had revenues of $306 million, which included $296 million in appropriations from New York State.
- The total cost of all the Corporation's operations was $197 million, which includes $192 million for interest on the Corporation's outstanding bonds.
- The Corporation's General Fund reported a deficit this year of $1.2 million and an accumulated surplus of $4.6 million.
- The Corporation's Debt Service Fund reported an operating surplus this year of $122 million, principally reflecting the reduction in debt service principal and interest payments and an increase in State appropriations. The Debt Service Fund reported a fund balance of $454 million, which included $199 million in cash held by a trustee that will be used to pay debt service that is due on April 1, 2004, $256 million in investments and other cash, and $434 thousand in interest receivable. Both the operating surplus and fund balance increase reported in the Debt Service Fund are attributable to the increase in resources recorded in March 2004 which were necessary to make the April 1, 2004 debt service payment.
- The Corporation's $419 million combined capital reserve requirement was met on an amortized cost basis by holding cash and investments with an amortized cost of $249 million and owning a surety bond that will pay up to $170 million through 2021 if needed to pay debt service.
- During the year the Corporation refunded $205 million in bonds as part of a plan to save an estimated $40 million in future cash flow with an estimated present value of $34 million.
- The Corporation's new refunding bonds of $223 million, include $210 million of variable rate bonds. The Corporation entered into two variable rate to fixed rate interest rate exchange agreements totaling $210 million to achieve synthetic fixed rate bonds.

USING THIS ANNUAL REPORT

This annual report consists of four financial statements presented on two pages. The first two financial statements are the Governmental Funds Balance Sheet/Statement of Net Assets (Deficit) found on page 8. The final two financial statements are the Statement of Revenues, Expenditures and Changes in Fund Balances/Statement of Activities found on page 9.

The Statement of Net Assets (Deficit) and the Statement of Activities provide information about the activities of the Corporation as a whole and present a longer term view of the Corporation's finances by focusing on total available resources and changes therein. The fund financial statements tell how services were financed in the short term as well as what remains for future spending. Fund financial statements also report the Corporation's operations in more detail than the Corporation-wide statements by providing information about the Corporation's two major separate funds; the General Fund and the Debt Service Fund.

For the Corporation, the change in the focus between currently spendable resources and total available resources can be identified in the adjustment columns found on each of the financial statements. To arrive at the Statement of Net Assets (Deficit), the accrued interest expense on the Corporation's bonds, the outstanding balance of bonds and certain other adjustments are added to the total column on the Governmental Funds Balance Sheet. This is displayed in the Adjustments column to the left of the Statement of Net Assets (Deficit). To arrive at the Statement of Activities, transactions that have no effect on the Corporation's net assets are eliminated from the Statement of Revenues, Expenditures and Changes in Fund Balances. For the Corporation, transactions not affecting its reported net assets are payments of debt principal, the advance repayment of debt, and expenditures incurred in prior periods. Amounts relating to the aforementioned transactions are displayed in the Adjustments column to the left of the Statement of Activities.

Reporting the Corporation as a Whole

The Statement of Net Assets (Deficit) and the Statement of Activities

These two statements report the Corporation's net assets (deficit) and changes in them. Annual changes in the Corporation's net assets (deficit)—the difference between assets and liabilities—is one way to measure the Corporation's financial health or financial position. Over time, increases or decreases in the Corporation's net assets (deficit) are one indicator of whether its financial health is improving or deteriorating. As the Corporation is entirely dependent on appropriations from the State of New York, in evaluating the financial health of the Corporation, the reader will also need to consider the ability and likelihood of the State to continue to make appropriations to the Corporation to support the debt service on the Corporation's bonds as well as operating expenses.

Reporting the Corporation's Funds

Fund Financial Statements

The fund financial statements provide detailed information about its two distinct funds—not the Corporation as a whole. The fund financial statements are prepared using a different approach than the Corporation-wide financial statements. The Corporation's expenditures are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view (less than one year) of the Corporation's general government operating requirements for the year ended March 31, 2004.

THE CORPORATION AS A WHOLE

The Corporation will annually report a deficit in its net assets. The deficit in the Corporation's net assets arose as it carried out its statutory purpose of eliminating the State's annual short-term borrowing. During the years 1991 through 1995, the Corporation issued long-term obligations to finance State local assistance payments, capital reserve requirements, and costs of debt issuance. This debt will be repaid from appropriations expected to be received from the State in subsequent years. This unrestricted deficit can be expected to continue for as long as the Corporation remains in existence. The following table summarizes the net assets for the current and prior year:

Table 1
Net Assets (Deficit) as of March 31, 2004
(Amounts in thousands)

	2004	2003
Assets:		
Cash and investments	$ 460,930	$ 341,822
Interest receivable	436	703
Unamortized bond issuance costs	16,528	14,820
Total assets	**477,894**	**357,345**
Liabilities:		
Liabilities due within one year	201,791	94,426
Liabilities due in more than one year	4,501,775	4,597,211
Total liabilities	**4,703,566**	**4,691,637**
Net Assets:		
Restricted for debt service	453,922	331,215
Unrestricted (deficit)	(4,679,594)	(4,665,507)
Total net assets (deficit)	**$ (4,225,672)**	**$ (4,334,292)**

The Corporation's combined net deficit decreased by $108.6 million from a year ago—decreasing from a deficit of $4.3 billion to a deficit of $4.2 billion. In comparison, the 2003 net deficit decreased by $12.6 million from the 2002 net deficit. This decrease in the comparative annual net deficit reduction is attributable to utilization of estimated debt service savings from refunding debt in the current year. The following table summarizes the changes in nets assets for the current and prior year:

Table 2
Changes in Net Assets for the fiscal year ended March 31, 2004
(Amounts in thousands)

	2004	2003
General Revenues:		
Appropriation from New York State	$ 295,618	$ 187,498
Investment income	10,439	8,994
Total revenues	**306,057**	**196,492**
Expenses:		
Operations	4,987	3,795
Debt Service	192,450	180,139
Total expenses	**197,437**	**183,934**
Changes in net assets	**108,620**	**12,558**
Net assets (deficit), beginning of year	**(4,334,292)**	**(4,346,850)**
Net assets (deficit), end of year	**$ (4,225,672)**	**$ (4,334,292)**

THE CORPORATION'S FUNDS

As the Corporation completed the year, its governmental funds (as presented in the balance sheet on page 8) reported a combined fund balance of $458.9 million, which was 35.9% higher than the prior year's total of $337.7 million. Included in this year's total change in fund balance is a deficit of $1.2 million in the Corporation's General Fund and an operating surplus of $122.4 million in the Corporation's Debt Service Fund. The primary reason for the Debt Service Fund's surplus was the increase in resources recorded in March 2004 which were necessary to make the April 1, 2004 debt service payment.

Corporation Revenues and Expenditures

During the year, the Corporation received State appropriations of $4 million to its General Fund for its administrative costs. Additionally, the Corporation earned $60 thousand in investment income, which was collectively used to fund $5.2 million in administrative operating costs. The Corporation also received $291.6 million in State appropriations to its Debt Service Fund for payment of debt service on its outstanding bonds and additionally earned $10.4 million in investment income on its reserve funds.

Debt

The Corporation was authorized to issue up to $4.7 billion of debt plus an amount necessary to fund capital reserve requirements, costs of issuance and, in certain cases, capitalized interest. As of March 31, 1996 the Corporation issued all the debt it was authorized to issue. Any future debt issuance would be for refunding purposes. At year end the Corporation had $4.6 billion in bonds outstanding, net of unamortized deferred amounts. This represents a $349 thousand increase from the prior year.

In addition to the debt noted above, the Corporation has $2.6 million in other long-term obligations which represents investment earnings payable to the United States Treasury for arbitrage rebate liabilities, of which $566 thousand is expected to be paid within the next year.

During the year the Corporation refunded $205 million in existing fixed rate bonds by issuing $223 million in refunding bonds at a $53 thousand premium and increasing capital reserve by a net amount of $11 million. The result was to save an estimated $40 million in future cash flow with an estimated present value of $34 million. The immediate effect was a loss of $6 million, which has been deferred and will be amortized into future interest expense. As part of the plan of refunding the Corporation issued $210 million in new variable rate bonds and entered into two variable to fixed rate interest rate exchange agreements (swap agreements) to achieve what is referred to as synthetic fixed rate debt service on the new variable rate bonds. The swap agreements are a hedge against higher future interest rates that could cause an unfavorable increase in the corporation's future debt service if interest rates rise. Under the swap agreement the Corporation continues to be responsible for and service its own variable rate debt, but it also makes or receives payments from counterparties that are based upon market conditions and are structured so that the Corporation's net swap payments and variable rate debt service payments when added together equal debt service payments at the synthetic fixed rate amount. The swap contracts carry certain risks as discussed in note 4 to the financial statements.

As of March 31, 2004, the ratings assigned to the Corporation are as follows: A1 by Moody's Investor Services, AA by Standard and Poor's Investor Services, and A+ by Fitch Investor Services.

DEBT SERVICE COVERAGE RATIO

The Corporation is dependent upon receipts from the State of New York for payment of debt service on its bonds and its operating costs. The State makes its payments from the Local Government Assistance Tax Fund (the Fund), under the custody of the State Comptroller and the Commissioner of Taxation and Finance. The Fund receives receipts collected within the State from the imposition of the sales and use taxes, including interest and penalties (sales tax) at a 1% rate of taxation. If sales tax receipts continue at the same level received during the State's 2003-2004 fiscal year, debt service coverage for the maximum annual debt service and net payments under interest rate exchange agreements on Corporation's outstanding bonds, including remarketing agent and broker-dealer costs and letter of credit fees, would be approximately 6.1 times.

CONTACTING THE CORPORATION'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the Corporation's finances and to show the Corporation's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact the Corporation's Office of Public Information at 110 State Street, 15th Floor, Albany, New York 12236.

NEW YORK
LOCAL GOVERNMENT ASSISTANCE CORPORATION
Governmental Funds Balance Sheet/Statement of Net Assets (Deficit)

March 31, 2004
(Amounts in thousands)

	General Fund	Debt Service Fund	Total	Adjustments (Note 6)	Statement of Net Assets (deficit)
Assets					
Cash and investments	$ 6,214	$ 454,716	$ 460,930	$ —	$ 460,930
Interest receivable	2	434	436	—	436
Unamortized bond issuance costs	—	—	—	16,528	16,528
Total assets	**$ 6,216**	**$ 455,150**	**$ 461,366**	**16,528**	**477,894**
Liabilities					
Accounts payable	$ 1,621	$ 794	$ 2,415	—	2,415
Accrued interest payable	—	—	—	78,944	78,944
Long-term liabilities:					
Due within one year	—	—	—	120,432	120,432
Due after one year :					
Bonds Payable, net	—	—	—	4,586,103	4,586,103
Aribitrage Rebate	—	—	—	2,049	2,049
Deferred loss on refunded bonds	—	—	—	(86,377)	(86,377)
Total liabilities	**1,621**	**794**	**2,415**	**4,701,151**	**4,703,566**
Fund Balances/Net Assets (deficit)					
Reserved for debt service	—	453,922	453,922	(453,922)	—
Unreserved	4,595	434	5,029	(5,029)	—
Total fund balances	**4,595**	**454,356**	**458,951**	**(458,951)**	**—**
Total liabilities and fund balances	**$ 6,216**	**$ 455,150**	**$ 461,366**		
Net assets (deficit):					
Restricted for debt service				453,922	453,922
Unrestricted (deficit)				(4,679,594)	(4,679,594)
Total net assets (deficit)				**$ (4,225,672)**	**$ (4,225,672)**

See accompanying notes to the basic financial statements.

NEW YORK
LOCAL GOVERNMENT ASSISTANCE CORPORATION
Statement of Revenues, Expenditures and Changes in Fund Balances/Statement of Activities

Year Ended March 31, 2004
(Amounts in thousands)

	General Fund	Debt Service Fund	Total	Adjustments (Note 7)	Statement of Activities
General Revenues:					
Appropriation from New York State	$ 4,000	$ 291,618	$ 295,618	$ —	$ 295,618
Investment income	60	10,379	10,439	—	10,439
Total revenues	**4,060**	**301,997**	**306,057**	—	**306,057**
Expenditures/Expenses:					
Operations	5,240	3,335	8,575	(3,588)	4,987
Debt service					
Principal	—	24,900	24,900	(24,900)	—
Interest	—	163,794	163,794	28,656	192,450
Total expenditures/expenses	**5,240**	**192,029**	**197,269**	**168**	**197,437**
Excess (deficiency) of revenues over expenditures	**(1,180)**	**109,968**	**108,788**	**(168)**	**—**
Other financing sources and uses					
Issuance of refunding bonds	—	223,394	223,394	(223,394)	—
Payments to refunding bond escrow agent	—	(210,919)	(210,919)	210,919	—
Net Other Financing Sources and Uses	**—**	**12,475**	**12,475**	**(12,475)**	**—**
Net change in fund balance	**(1,180)**	**122,443**	**121,263**	**(108,788)**	**—**
Change in net assets (defcit)	**—**	**—**	**—**	**108,620**	**108,620**
Fund balances/net assets (deficit):					
Beginning of year	5,775	331,913	337,688	(4,671,980)	(4,334,292)
End of year	**$ 4,595**	**$ 454,356**	**$ 458,951**	**$ (4,684,623)**	**$ (4,225,672)**

See accompanying notes to the basic financial statements.

(1) Summary of Significant Accounting Policies

(a) Organization

The New York Local Government Assistance Corporation (Corporation) was established by Chapter 220, of the Laws of 1990 (as amended by Chapter 2, Laws of 1991) to issue up to $4.7 billion in long-term debt, subject to annual authorization by the State Legislature, in order to finance certain local assistance payments, and amounts necessary to fund a capital reserve account, costs of issuance and up to six months of capitalized interest. Issuance of the $4.7 billion bond authorization eliminated the need for New York State's (State) annual "Spring Borrowing". Prior to the creation of the Corporation, certain large payments due to the State's local government units were made in the first quarter of the State's fiscal year, particularly in support of primary and secondary education, while revenues were received more evenly throughout the fiscal year. To meet these payments, the State issued short-term tax and revenue anticipation notes referred to as the annual Spring Borrowing. Primarily as a result of issuances by the Corporation, there was no Spring Borrowing in the State's 1995 through 2004 fiscal years and the State does not project the need for a Spring Borrowing in its 2005 fiscal year. The fiscal year ended March 31, 2004 was the fourteenth year of the Corporation's existence. The Corporation is a blended component unit of the State and continued operations are contingent upon the annual appropriation received from the State.

Payments of debt service on the Corporation's bonds will be made from appropriations received from the State. Pursuant to the Act establishing the Corporation, the State deposits 1 cent of the State's 4.25 cents sales and use tax into a special fund (the Local Government Assistance Tax Fund) which is to be used by the State to make payments to the Corporation. Amounts in excess of the Corporation's needs are transferred from the Local Government Assistance Tax Fund to the State's General Fund after the Corporation's requirements have been met as provided by statute. State payments to the Corporation are subject to annual appropriations by the State Legislature. The Corporation's bondholders do not have a lien on monies deposited in the Local Government Assistance Tax Fund.

(b) Basis of Presentation

The Corporation has prepared its financial statements in accordance with accounting principles generally accepted in the United States of America. The Corporation has prepared corporation-wide financial statements titled "Statement of Net Assets (Deficit)" and "Statement of Activities" as well as the required supplementary information titled "Management's Discussion and Analysis" which precedes the financial statements. The Corporation also prepares the fund financial statements, which are the "Governmental Funds Balance Sheet", and "Statement of Revenues, Expenditures and Changes in Fund Balance." The basic financial statements include both the corporation-wide and the fund financial statements, which have been combined together and presented on the same pages.

The Corporation follows the principles of fund accounting in that each segment of operations is represented under a discrete fund presentation in the fund financial statements. The Corporation uses funds to report its financial position and results of operations. The General Fund consists of the Operating Account, Cost of Issuance Accounts for new issues and the Local Assistance Payment

Account while the Debt Service Fund consists of the Debt Service Account, the Capital Reserve Account, the Rebate Account, and the cost of issuance account for refunding issues. The General Fund is used to account for all financial transactions of the Corporation except for debt service related transactions which are accounted for in the Debt Service Fund. The Rebate Account within the Debt Service Fund will be used to remit arbitrage earnings to the United States Department of the Treasury, when necessary, in accordance with the Internal Revenue Code.

(c) Basis of Accounting

The Corporation utilizes the modified accrual basis of accounting, which focuses on changes in current financial resources, in the preparation of the fund financial statements. Under the modified accrual basis of accounting, revenues and related receivables are recorded in the accounting period that they become both measurable and available. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. Expenditures and related liabilities are recorded in the accounting period the liability is incurred and payment is due, except for principal and interest on long-term debt and estimated other long-term liabilities which are recorded only when payment is due.

Operations expenditures are direct costs incurred by the Corporation, such as legal fees, financial advisory fees, printing costs, trustee fees, letter of credit fees, remarketing agent fees, arbitrage rebate payments, and other related costs. Operations expenditures are paid from either bond proceeds or monies received from the State. Administrative staff support is provided by the State at no charge to the Corporation.

The Corporation utilizes the full accrual basis of accounting, which focuses on changes in total economic resources, in the preparation of the corporation-wide financial statements. Under the full accrual basis of accounting, changes in long-term assets and liabilities are incorporated into the financial statements. Since the fund financial statements are prepared on a different measurement focus and basis of accounting than the corporation-wide financial statements, an Adjustments column is presented to convert the fund basis financial statements into the corporation-wide financial statements.

The Corporation amortizes bond premiums under the bonds outstanding method, which relates amortization to the retirement of the bonds they are associated with. In addition, the Corporation defers and amortizes issuance costs under the bonds outstanding method. Interest on capital appreciation bonds is accreted using the effective interest rate method.

(d) Municipal Assistance Corporation Refinancing Act

Chapters 62 and Chapter 63 of the Laws of 2003 enacted, among other provisions, the Municipal Assistance Refinancing Act (Act), effective July 1, 2003 and deemed repealed July 1, 2034. The Act created an incentive for the State to seek an appropriation to provide $170 million per year, from the Local Government Assistance Tax Fund (Fund) to the City of New York (City) for each of the City's fiscal years beginning July 1, 2003 and ending June 30, 2034. The Act requires the Corporation to annually certify $170 million, and subject to annual appropriation, make a series of payments to the City or the Mayor's assignee in each City fiscal year beginning July 1, 2003 and ending June 30, 2034 totaling $5.27 billion.

The Act was established with the expectation that the City, acting through the Mayor, would assign the annual payments from the State to a newly created not-for-profit corporation that would issue bonds and use those proceeds to refinance all existing debt of the Municipal Assistance Corporation for the City of New York (MAC) due in the near term (approximating $2.5 billion at the time of the Act). Subsequent to the Act, the City created the Sales Tax Asset Receivable Corporation (STARC) to securitize the annual payments and refinance the existing MAC bonds with the proceeds, as intended. The annual expected payments of $170 million would be used by the City to pay the debt service on the refinanced debt. By law the Fund receives one cent (23.5%) of the State's Consumption and Use Tax receipts (approximately $2.3 billion during 2004). The Fund receipts not needed by the Corporation for its purposes are transferred to the State's General Fund. Based on current law, this transfer can only occur after an appropriation is enacted and the Corporation receives the amounts it has certified a need for, which now also includes the annual payment to the City or its assignee. Until the Corporation receives all the funds it has certified a need for, no excess sales tax receipts can be transferred from the Fund to the State's General Fund.

The Corporation filed a complaint in New York State Supreme Court in August 2003 seeking a court determination that the statute requiring a certification and possible payment by the Corporation to the City of New York or its assignee was invalid. Ultimately, the New York State Court of Appeals found the statute to be valid but that it does require an annual appropriation to make any payments. The court further found that any annual payment could not interfere with the Corporation bondholders' rights.

In May 2004, the Corporation amended its General Bond Resolution and General Subordinate Lien Bond Resolution ("the Resolutions") to make clear that any failure to certify or make payments to the City or its assignee has no impact on the Corporation's own bondholders; and that if any such act or omission were to occur with respect to any possible STARC bonds, that act or omission would not constitute an Event of Default with respect to the Corporation bonds. In June 2004, the Corporation's Trustee, The Bank of New York, notified the Corporation's bondholders of these amendments.

(e) Accounting Changes

The Corporation adopted Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*. Statement No. 40 requires further disclosure related to common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk to be disclosed in the footnotes. As an element of interest rate risk, this Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. In addition, the Corporation followed the provisions of GASB Technical Bulletin No. 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets.*

(2) Cash and Investments

The Corporation's trustee holds investments for each of the funds included in the financial statements. The following are authorized investments for the Corporation's funds: direct bond obligations of the United States, direct and general obligations of New York State, bank certificates of deposit insured by the FDIC, any bank or trust company repurchase agreement secured by one or more of the above securities and general obligation bonds and notes of any state maintaining the highest rating from the major rating services. All investments are insured, registered, or held by the Corporation's trustee in the Corporation's name. The following table represents investments of the Corporation by investment type with related reported amounts which are equal to fair values (excluding accrued interest) at March 31, 2004 (amounts in thousands):

		Investment Maturities	
Investment Type	**Reported Amount**	**Less than 1 Year**	**1-5 Years**
Repurchase agreements	$ 69,694	$ 69,694	$ -
U.S. Treasury Notes	187,148	56,725	130,423
Totals............................	**$ 256,842**	**$ 126,419**	**$ 130,423**

The Corporation reports its investments with an original maturity of greater than one year at quoted market price (fair value) and reports investments with an original maturity of one year or less at cost. The Corporation experienced a net decrease in the fair value of its investments during the year of $884 thousand which has been reflected in the amount of investment income reported by the Corporation. This amount takes into account all changes in fair value (including purchases and sales) that occurred during the year.

The Corporation's repurchase agreements are collateralized by U.S. Treasury Notes with market values which are equal to or greater than the reported amount. Collateral in support of the investments is held by the trustee in the name of the Corporation. Pursuant to the Corporation's General Bond Resolution, the Corporation's trustee is required to transfer available debt service funds to a separate account on the business day preceding a debt service payment date. This transfer occurred on March 31, 2004 and the resulting transfer of $198.9 million is included in cash and investments.

(3) Bonds Payable

The Corporation is authorized to issue up to $4.7 billion in bonds plus an amount necessary to fund a capital reserve, costs of issuance, and in certain cases, capitalized interest. As of March 31, 1996 the Corporation had issued all of its authorization. Under existing statutes any issuance of bonds by the Corporation in the future will be for refunding purposes only.

As of March 31, 2004 the Corporation had $2.1 billion of variable interest rate debt in twenty-three series of bonds outstanding as follows (rates include remarketing agent, broker-dealer and letter of credit fees):

Series	Outstanding (thousands)	Interest Rate at 3/31/2004	Current Interest Rate Mode
1993A	$ 233,400	1.51%	Weekly
1994B	132,000	1.51%	Weekly
1995B	84,100	1.46%	Weekly
1995C	85,800	1.46%	Weekly
1995D	83,700	1.43%	Weekly
1995E	83,800	1.47%	Weekly
1995F	83,800	1.47%	Weekly
1995G	86,000	1.43%	Weekly
2003A-BV	188,320	1.27%	Weekly
2003A-3V	137,500	1.39%	Weekly
2003A-4V	137,500	1.39%	Weekly
2003A-5V	91,665	1.33%	Weekly
2003A-6V	100,000	1.36%	Weekly
2003A-7V	50,780	1.34%	Weekly
2003A-8V	40,885	1.36%	Weekly
2003A-9V	63,350	1.15%	Auction
2003A-10V	63,325	1.15%	Auction
2003A-11V	63,350	1.13%	Auction
2003A-12V	63,325	1.15%	Auction
2004A-AV	52,600	1.20%	Auction
2004A-BV	52,625	1.20%	Auction
2004A-CV	52,600	1.15%	Auction
2004A-DV	52,625	1.15%	Auction

The interest rates on variable interest rate bonds in the weekly interest rate mode are reset at rates determined by the Corporation's remarketing agents. The interest rates on variable interest rate bonds in the auction rate mode are determined by the Corporation's auction agent in accordance with the auction rate procedures established by Corporate resolution. The mode of interest of each of the variable rate bonds may be changed by the Corporation from or to the daily rate mode, weekly rate mode, long-term rate mode and also to fixed rate mode. The banks securing the Series 1993A and Series 1994B variable interest rate bonds have joint and several interest in the letters of credit issued to the trustee. The Series 1995B through Series 1995G variable interest rate bonds are individually secured by letters of credit with three banks (each bank holds a letter of credit for two separately secured series). The trustee is authorized to draw on each of the credit facility banks for the entire principal amount of variable interest rate bonds outstanding of each series, plus 70 days of interest calculated at a rate of 12%. The letters of credit securing the Series 1993A variable interest rate bonds and the Series 1994B variable interest rate bonds expire on July 1, 2007. The letters of credit securing the Series 1995B through Series 1995G variable interest rate bonds expire on July 6, 2006. The Series 2003A-BV through Series 2003A-8V are secured by bank Standby Bond Purchase Agreements which expire on February 20, 2006. The amount available under the Standby Bond Purchase Agreement supporting the Series 2003A-BV through Series 2003A-8V is equal to the bond purchase price and up to 35 days interest at an annual rate of 12%. The Series 2003A-9V through Series 2003A-12V bonds and the Series 2004A-AV through Series 2004A-DV bonds, currently in the auction rate mode, do not require a letter of credit or bank standby bond purchase agreement because investors do not have the right to "demand or put" the bonds back to LGAC as is the case with all the variable rate bonds in the weekly interest mode.

The State has dedicated a portion of its sales and use tax revenues which will be used by the State to make payments to the Corporation pursuant to a payment agreement between the State Director of the Budget and the Corporation for the purpose of funding the Corporation's debt service. Subject to appropriation, the State will make these payments to the Corporation five days prior to the debt service due date. The $188.8 million representing 2004 debt service payments is comprised of $24.9 million in principal and $163.9 million in interest including amounts paid to escrow agents from released capital reserve funds.

The Corporation's general bond resolution requires that one or more capital reserve accounts be established and funded in an amount equal on an amortized cost basis to the maximum annual amount on Senior Lien Bonds and half the maximum annual amount on Subordinate Lien Bonds of principal, sinking fund installments or redemption price of and interest on all bonds outstanding or on any related reimbursement obligations, coming due during the then current or any succeeding fiscal year. The Corporation may also fund a capital reserve account with a surety bond or other similar instrument. The Corporation has established two separate capital reserve funds to support bonds based upon the priority of their lien against funds of the Corporation—bonds holding a first lien (Senior Lien) and bonds holding a subordinate lien (Subordinate Lien). The Senior Lien capital reserve fund requirement is met by a surety bond of $170 million, expiring on April 1, 2021, and cash and investments with an amortized cost of $198.9 million. The Senior Lien Capital Reserve Account had investments which have been reported in the financial statements at their fair value of $199.6 million. The Subordinate Lien capital reserve fund requirement is met by cash and investments with an amortized cost of $49.9 million. The Subordinate Lien Capital Reserve Account had investments which have been reported in the financial statements at their fair value of $50.1 million. The cash and investments of both the Senior Lien and Subordinate Lien Capital Reserve Accounts are reported as a part of cash and investments in the Debt Service Fund with a corresponding reservation of fund balance.

The Corporation has entered into interest rate exchange agreements (swap agreements), as disclosed under Note 4 "Interest Rate Swap Agreements". The effect of these swap agreements is to change the effective amount of interest the Corporation pays on a portion of its variable rate bonds totaling $1 billion in 2003 and $210 million in 2004 in principal, to fixed rates. Estimated annual debt service and net swap payments required to maturity for all of the Corporation's bonds are as follows (amounts in thousands):

Fiscal Year	Principal	Interest	Net Swap Amount	Total
2005	$ 119,985	$ 148,163	$ 27,357	$ 295,505
2006	140,085	143,675	30,075	313,835
2007	143,515	138,702	30,075	312,292
2008	182,080	133,478	30,016	345,574
2009	200,045	127,265	30,110	357,420
2010-2014..........	1,161,485	502,144	150,357	1,813,986
2015-2019..........	1,468,500	257,996	124,604	1,851,100
2020-2024..........	1,228,070	55,295	36,795	1,320,160
2025-2026..........	102,860	1,327	382	104,569
Totals...............	**$ 4,746,625**	**$ 1,508,045**	**$ 459,771**	**$ 6,714,441**

Future debt service is calculated using rates in effect at March 31, 2004 for variable rate bonds. The net swap payment amounts were calculated by subtracting the future variable rate interest payments subject to swap agreements from the synthetic fixed rate amount intended to be achieved by the swap agreements.

The actual amount of net swap payments is affected by changes in a published index—the London Interbank Offering Rate (LIBOR). At March 31, 2004 this index was outside a favorable range for the Corporation and if this condition were to continue the effect would be to require the Corporation to make net swap payments greater than the amount shown above.

The Corporation is in compliance with all significant limitations and restrictions related to bonds payable.

During its fiscal year ended March 31, 2004 the Corporation issued $223 million par amount of new bonds, including four series of variable rate bonds totaling $210 million to advance refund existing fixed rate bonds. In separate but simultaneous transactions executed as part of the plan of refunding the Corporation entered into Interest Rate Exchange Agreements to exchange or swap its new variable rate debt service for effectively fixed rate debt service. The effect of these transactions combined was to lower the Corporation's estimated future debt service and to limit the Corporation's exposure to effects of market interest rate changes on variable rate debt. The substance of the combined transactions were such that the Corporation refunded $205 million in fixed rate bonds with $223 million in bonds requiring lower estimated debt service at effectively fixed rates. At the time of the transaction, this resulted in an estimated $40 million in future cash flow savings and an estimated present value gain of $34 million. Actual future cash flow savings and present value savings may be either more or less due to unfavorable future conditions including the unscheduled termination of one or more of the swaps, greater than anticipated net swap payments required by unfavorable circumstances effecting the swaps, and risks that a counter party to the swap may fail to perform. At March 31, 2004 market conditions required the Corporation to make net swap payments that exceeded amounts anticipated in the calculation of cash flow savings and present value savings above.

This refunding transaction, while resulting in lower estimated future debt service costs, resulted in a loss in the year it occurred equivalent to the difference between the carrying amount of the bonds refunded ($205 million) and their reacquisition price ($211 million). This loss of $6 million has been deferred and will be amortized into future interest costs over the shorter of the life of the new bonds or the old bonds using the bonds outstanding method. This period is the same and is 17 years ending April 1, 2021.

(4) Interest Rate Swap Agreements

Objective of the Interest Rate Swap Agreements

As a means to lower its borrowing costs, when compared against fixed-rate bonds at the time of issuance in February 2003, the Corporation entered into four interest rate swaps in connection with its issuance of $1 billion variable-rate revenue bonds (Series 2003A-BV through Series 2003A-12V). In February 2004, the Corporation entered into two additional interest rate swaps in connection with its issuance of $210 million variable-rate revenue bonds (Series 2004A-AV through Series 2004A-DV).

The intention of the swap agreements was to effectively change the Corporation's interest rate on the bonds to a fixed rate of approximately 3.57% for the 2003 bond issues and 3.46% for the 2004 bond issues, including support costs and bond insurance fees. The 2004 bonds and swap agreements were part of the refunding transaction described in note 3 above.

Terms of the Interest Rate Swap Agreements

The following table includes the terms for each of the Corporation's individual swap transactions:

Terms	2003	2004
Corresponding bond series	2003A-BV to 2003A-12V	2004A-AV to 2004A-DV
Final maturity	April 1, 2024	April 1, 2021
Swap's notional amount	$1 billion	$210 million
Variable-rate bonds	$1 billion	$210 million
Fixed payment rates paid to counterparties	3.15% to 3.26%	3.19% to 3.22%
Variable payments received computed as	65% of one month LIBOR	65% of one month LIBOR
Bonds and related swap agreements mature on	April 1, 2024	April 1, 2021

The variable rates on the bonds are determined by remarketing agents for bonds in the weekly interest rate mode and by auction rate agents for bonds in the auction rate mode.

As of March 31, 2004 average rates were as follows:

	Terms	Rates 2003	Rates 2004
Interest rate swap			
Effective fixed payment to counterparty	Fixed	3.57%	3.46%
Variable payment from counterparty	65% of LIBOR	(1.01%)	(1.15%)
Net interest rate swap payments		**2.56%**	**2.31%**
Average variable-rate bond coupon payments	Remarketing/Auction Agent	1.29%	1.18%
Approximate Synthetic interest rate on bonds		**3.85%**	**3.49%**

Fair Value of the Interest Rate Swap Agreements

Due to the fact that interest rates have declined since execution of the swaps, the swaps have an estimated negative fair value equal to their termination cost of $16.5 million at March 31, 2004. The swaps estimated negative fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating a lower synthetic fixed interest rate. Because the coupons on the Corporation's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

Credit Risk of the Interest Rate Swap Agreements

The swap contracts require each counterparty shall have credit ratings from at least one nationally recognized statistical rating agency that is within the two highest investment grade categories and ratings which are obtained from any other nationally recognized statistical rating agencies for such counterparty shall also be within the three highest investment grade categories, or the payment obligations of the counterparty shall be unconditionally guaranteed by an entity with such credit ratings. The swap agreements also require that should the credit rating of a counterparty fall below the rating required, that the obligations of such counterparty shall be fully and continuously collateralized by direct obligations of, or obligations the principal and interest on which are guaranteed by, the United States of America, with a net market value of at least 102% of the net market value of the contract to the Corporation and such collateral shall be deposited with the Corporation or its agent.

As of March 31, 2004 the Corporation was not exposed to credit risk because the swaps had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the Corporation would be exposed to credit risk in the amount of the fair value of the swap. The lowest ratings of the six counterparties were AA- by Fitch Ratings, AA- by Standard & Poor's, and Aa3 by Moody's Investors Service as of March 31, 2004.

Basis Risk of the Interest Rate Swap Agreements

The swap agreements expose the Corporation to basis risk should the relationship between LIBOR and actual variable rate payments converge, changing the synthetic rate on the bonds. The effect of this difference in basis is indicated by the difference between the intended synthetic rate (approximately 3.57% for 2003 and 3.46% for 2004) and the actual synthetic rate resulting from future market conditions.

Termination Risk of the Interest Rate Swap Agreements

The swap contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The schedule to the Master Agreement includes "additional termination events", providing that the swaps may be terminated if either the Corporation's or a counterparty's credit quality rating falls below certain levels. The Corporation or the counterparties may terminate the swap agreements if the other party fails to perform under the terms of the contract. If one or more of the swap agreements is terminated, the related variable-rate bonds would no longer be hedged and the Corporation would no longer effectively be paying a synthetic fixed rate with respect to those bonds. Also, if at the time of termination the swap has a negative fair value, the corporation would be liable to the counterparty for a payment equal to the swaps' fair value.

(5) Changes in Long-Term Liabilities

Long-term liability activity for the year ended March 31, 2004 was as follows (amounts in thousands):

	Beginning Balance	Additions	Deletions	Ending Balance	Amounts Due within One Year
Bonds payable	$ 4,752,975	$ 223,340	$ 229,690	$ 4,746,625	$ 119,985
Unamortized premium	26,358	53	-	26,411	1
Unaccreted discount on bonds	(79,722)	12,775	-	(66,947)	-
Deferred loss on advance refunding of bonds	(80,368)	(6,129)	-	(86,497)	(120)
Net bonds payable	**4,619,243**	**230,039**	**229,690**	**4,619,592**	**119,866**
Other Liability:					
Arbitrage rebate liability	4,495	-	1,880	2,615	566
Long-term liability activity	**$ 4,623,738**	**$ 230,039**	**$ 231,570**	**$ 4,622,207**	**$ 120,432**

(6) Explanation of Certain Differences between the Governmental Funds Balance Sheet and the Statement of Net Assets (Deficit).

Long-term liabilities of the Corporation's activities are not due and payable in the current period and therefore are not reported as fund liabilities. All liabilities, both current and long-term, are reported in the Statement of Net Assets (Deficit). Balances at March 31, 2004 were (amounts in thousands):

Bonds payable, net	$	4,619,592
Interest on bonds payable		78,944
Unamortized bond issuance costs		(16,528)
Arbitrage rebate liability not due and payable at year-end		2,615
Net adjustment	**$**	**4,684,623**

(7) Explanation of Certain Differences between the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances and the Statement of Activities.

Repayment of bond principal and payment of bond issuance costs are reported as an expenditure in the governmental funds and therefore contributes to the change in fund balance. In the Statement of Net Assets (Deficit), however, repaying bond principal decreases long-term liabilities and payment of bond issuance costs becomes an asset to be deferred over the life of the bonds and does not affect the statement of activities. Similarly, recognition of revenues and expenditures not expected to be received or paid in the current year will not affect the fund balance reported for the governmental funds. In the Statement of Activities prepared on the full accrual basis, however, all revenues and expenses are recognized in the year they are earned or incurred regardless of when they are paid and will therefore be reflected in the Statement of Activities. These differences in measurement recognition affect both the reported fund balance and reported net assets. Adjustments required to be made to the reported governmental funds expenditures to arrive at the statement of activities are as follows (amounts in thousands):

Adjustment to expenditures		
Repayment of bond principal:		
To bondholders for repayment of debt	$	(24,900)
Expense for bond issue costs to be amortized over the life on the bonds		(1,708)
Adjustment for arbitrage rebate expense not due at year-end		(1,880)
Net adjustment to arrive at interest expense		28,656
Net adjustment to expenditures	$	168