

In the opinion of Bond Counsel, interest on the Bonds (as defined herein) is not includable in gross income for purposes of federal income taxation under existing statutes, regulations, rulings and court decisions, subject to the condition described in "Tax Exemption and Other Tax Matters" herein. Interest on the Bonds is not treated as an item of tax preference under Section 57 of the Internal Revenue Code of 1986, as amended (the "Code") for purposes of the individual and corporate alternative minimum taxes. However, under the Code, such interest may be subject to certain other taxes affecting corporate holders of the Bonds. Under the existing laws of the Commonwealth of Pennsylvania, interest on the Bonds will be free from Pennsylvania personal income taxation and Pennsylvania corporate net income taxation but such exemption does not extend to gift, estate, succession or inheritance taxes or any other taxes not levied or assessed directly on the Bonds or the interest thereon. For a more complete discussion, see "Tax Exemption and Other Tax Matters" herein.



\$834,945,000
Commonwealth of Pennsylvania
General Obligation Bonds
\$545,000,000 First Series of 2014
\$289,945,000 First Refunding Series of 2014

Dated: Date of Issuance and Delivery

Due: As shown below

The Bonds hereafter defined will be issued only in book-entry form initially registered in the name of Cede & Co., as nominee for The Depository Trust Company ("DTC"), New York, New York. DTC will act as securities depository for the Bonds. Interest on the Bonds will be payable semi-annually on June 15 and December 15, commencing December 15, 2014 for the First Series of 2014 Bonds (the "First Series Bonds") and on January 1 and July 1, commencing January 1, 2015 for the First Refunding Series of 2014 Bonds (the "First Refunding Series Bonds", together with the First Series Bonds, the "Bonds"). Wells Fargo Bank, National Association, Philadelphia, Pennsylvania, is the Loan and Transfer Agent for the Bonds. Principal of and interest and redemption premium, if any, on the Bonds are payable to Cede & Co. See "THE BONDS – Book-Entry Only System."

The First Series Bonds are subject to redemption as set forth herein. See "THE BONDS – Optional Redemption."

The First Refunding Series Bonds are not subject to redemption prior to maturity.

The Bonds are direct and general obligations of the Commonwealth and the full faith and credit of the Commonwealth are pledged for the payment of principal of and interest on the Bonds.

This cover page contains certain information for quick reference only. It is not a summary of the issue. Investors must read the entire Official Statement to obtain information essential to the making of an informed investment decision regarding the Bonds.

See "COMMONWEALTH FINANCIAL PERFORMANCE-Recent Developments" herein for information available to the Commonwealth on May 1, 2014 with respect to General Fund receipts below their estimates.

The Bonds are offered when, as and if issued, and are subject to the receipt of the legal opinions of the Attorney General of the Commonwealth of Pennsylvania and of Saul Ewing LLP, Harrisburg and Philadelphia, Pennsylvania, Bond Counsel. The Commonwealth expects that the Bonds will be available in definitive form for delivery through the facilities of DTC on or about May 15, 2014.

Dated: April 29, 2014 (except for "COMMONWEALTH FINANCIAL PERFORMANCE-Recent Developments" and references to recent developments as underlined throughout, dated May 1, 2014).

\$834,945,000
Commonwealth of Pennsylvania
General Obligation Bonds

\$545,000,000 First Series of 2014

MATURITY SCHEDULE

(Base CUSIP Number*: 70914P)

| <u>Due June 15</u> | <u>Principal Amount</u> | <u>Interest Rate</u> | <u>Yield</u> | <u>CUSIP Number*</u> | <u>Due June 15</u> | <u>Principal Amount</u> | <u>Interest Rate</u> | <u>Yield</u> | <u>CUSIP Number*</u> |
|------------------------|-----------------------------|--------------------------|--------------|--------------------------|------------------------|-----------------------------|--------------------------|--------------|--------------------------|
| 2015 | \$14,385,000 | 5.000% | 0.200% | VE9 | 2025 | \$26,955,000 | 5.000% | 2.650%** | VQ2 |
| 2016 | 17,375,000 | 5.000 | 0.470 | VF6 | 2026 | 28,300,000 | 5.000 | 2.770** | VR0 |
| 2017 | 18,245,000 | 5.000 | 0.750 | VG4 | 2027 | 29,715,000 | 5.000 | 2.880** | VS8 |
| 2018 | 19,155,000 | 5.000 | 1.040 | VH2 | 2028 | 31,205,000 | 3.000 | 3.100 | VT6 |
| 2019 | 20,115,000 | 5.000 | 1.360 | VJ8 | 2029 | 32,765,000 | 5.000 | 3.080** | VU3 |
| 2020 | 21,120,000 | 5.000 | 1.660 | VK5 | 2030 | 34,400,000 | 4.000 | 3.510** | VV1 |
| 2021 | 22,175,000 | 5.000 | 1.960 | VL3 | 2031 | 36,120,000 | 4.000 | 3.590** | VW9 |
| 2022 | 23,285,000 | 5.000 | 2.200 | VM1 | 2032 | 37,925,000 | 4.000 | 3.670** | VX7 |
| 2023 | 24,450,000 | 5.000 | 2.400 | VN9 | 2033 | 39,825,000 | 4.000 | 3.750** | VY5 |
| 2024 | 25,670,000 | 5.000 | 2.530 | VP4 | 2034 | 41,815,000 | 5.000 | 3.430** | VZ2 |

\$289,945,000 First Refunding Series of 2014

MATURITY SCHEDULE

(Base CUSIP Number*: 70914P)

| <u>Due January 1</u> | <u>Principal Amount</u> | <u>Interest Rate</u> | <u>Yield</u> | <u>CUSIP Number*</u> | <u>Due July 1</u> | <u>Principal Amount</u> | <u>Interest Rate</u> | <u>Yield</u> | <u>CUSIP Number*</u> |
|--------------------------|-----------------------------|--------------------------|--------------|--------------------------|-----------------------|-----------------------------|--------------------------|--------------|--------------------------|
| 2015 | \$50,000 | 5.000% | 0.200% | WA6 | | | | | |
| 2015 | \$36,525,000 | 5.000% | 0.210% | WB4 | 2020 | \$20,925,000 | 5.000% | 1.680% | WG3 |
| 2016 | 40,470,000 | 5.000 | 0.480 | WC2 | 2021 | 38,955,000 | 5.000 | 1.960 | WH1 |
| 2017 | 17,940,000 | 5.000 | 0.750 | WD0 | 2022 | 54,265,000 | 5.000 | 2.200 | WJ7 |
| 2018 | 16,810,000 | 5.000 | 1.040 | WE8 | 2023 | 14,415,000 | 5.000 | 2.400 | WK4 |
| 2019 | 2,635,000 | 5.000 | 1.360 | WF5 | 2024 | 46,955,000 | 5.000 | 2.530 | WL2 |

* The above CUSIP (Committee on Uniform Securities Identification Procedures) numbers have been assigned by an organization not affiliated with the Commonwealth and the Commonwealth is not responsible for the selection or use of the CUSIP numbers. The CUSIP numbers are included solely for the convenience of bondholders and no representation is made as to the correctness of such CUSIP numbers. CUSIP numbers assigned to securities may be changed during the term of such securities based on a number of factors including, but not limited to, the refunding or defeasance of such issue or the use of secondary market financial products. The Commonwealth has not agreed to, and there is no duty or obligation to, update this Official Statement to reflect any change or correction in the CUSIP numbers set forth above.

** Yield to first optional redemption date of June 15, 2024.



THE ISSUING OFFICIALS

Governor.....TOM CORBETT
State Treasurer.....ROBERT M. McCORD
Auditor General.....EUGENE A. DePASQUALE

OFFICE OF THE BUDGET

Secretary.....CHARLES B. ZOGBY

Attorney General of the Commonwealth of Pennsylvania:

Kathleen Kane

Bond Counsel:

Saul Ewing LLP
Harrisburg and Philadelphia, Pennsylvania

Special Disclosure Counsel:

Obermayer Rebmann, Maxwell & Hippel LLP
Philadelphia, Pennsylvania

No dealer, broker, salesperson or other person has been authorized to give any information or to make any representations, other than as contained in this Official Statement, in connection with the offering contained herein, and, if given or made, such other information or representations must not be relied upon as having been authorized by the Commonwealth of Pennsylvania. This Official Statement does not constitute an offer to sell, or a solicitation of an offer to buy, nor shall there be any sale of the Bonds by any person in any jurisdiction where such sale would be unlawful.

Except as otherwise noted, the information herein speaks as of its date and is as of the date of this Official Statement and is subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, in any circumstances, create any implication that there has been no change in the affairs of the Commonwealth of Pennsylvania since the date hereof.

The order and placement of the information this Official Statement, including the Appendices hereto and the information incorporated herein by reference, are not to be deemed to be a determination of relevance, materiality or importance, and this Official Statement, including the Appendices, and the information incorporated herein by reference, must be considered in its entirety.

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SUMMARY INFORMATION

THIS SUMMARY STATEMENT IS SUBJECT IN ALL RESPECTS TO THE MORE COMPLETE INFORMATION CONTAINED IN THIS OFFICIAL STATEMENT. OFFERING OF THE BONDS TO THE POTENTIAL PURCHASERS IS MADE ONLY BY MEANS OF THIS ENTIRE OFFICIAL STATEMENT, INCLUDING THE COVER AND APPENDICES HERETO AND THE INFORMATION INCORPORATED BY REFERENCE.

Issuer Commonwealth of Pennsylvania

Offering..... \$834,945,000 Commonwealth of Pennsylvania, General Obligation Bonds, consisting of \$545,000,000 First Series of 2014 (the “First Series Bonds”) and \$289,945,000 First Refunding Series of 2014 (the “First Refunding Series Bonds”) and collectively with the First Series Bonds, the “Bonds”).

Dated Date Date of Issuance and Delivery

Security General Obligations of the Commonwealth of Pennsylvania; full faith and credit pledged

Use of Proceeds..... The Commonwealth of Pennsylvania is issuing the Bonds for the following purpose:

| <u>Purpose</u> | <u>Principal Amount</u> |
|-------------------------------------|-------------------------|
| First Series Bonds | |
| Capital Facilities Projects | \$515,000,000 |
| Pennworks | \$30,000,000 |
| First Refunding Series Bonds | |
| Refunding | \$289,945,000 |

Redemption..... The First Series Bonds maturing on or after June 15, 2025 are subject to optional redemption in whole or in part (and if in part, in part within one or more maturities) at any time on and after June 15, 2024 at a redemption price equal to the principal amount thereof, plus accrued interest to the date fixed for redemption.

The First Refunding Series Bonds are not subject to redemption prior to maturity.

Authorized Denominations.... \$5,000 or integral multiples thereof.

Form of Bonds..... Bonds are issued in fully registered form through a book-entry only system.

Loan & Transfer Agent Wells Fargo Bank, National Association, Philadelphia, Pennsylvania.

Legal Opinions Saul Ewing LLP, Bond Counsel.
Kathleen Kane, Attorney General of the Commonwealth of Pennsylvania.

Bond Ratings Fitch Ratings..... AA (outlook “Negative”)
Moody’s Investors ServiceAa2 (outlook “Stable”)
Standard & Poor’s Rating Services..... AA (outlook “Negative”)
(a division of the McGraw-Hill Companies)

Official Statement
\$834,945,000
Commonwealth of Pennsylvania
General Obligation Bonds
\$545,000,000 First Series of 2014
\$289,945,000 First Refunding Series of 2014

INTRODUCTION

This Official Statement of the Commonwealth of Pennsylvania (the “Commonwealth”), including the cover page and appendices, presents certain information in connection with the issuance of \$834,945,000 Commonwealth of Pennsylvania, General Obligation Bonds, consisting of \$545,000,000 First Series of 2014 (the “First Series Bonds”) and \$289,945,000 First Refunding Series of 2014 (the “First Refunding Series Bonds” and collectively with the First Series Bonds, the “Bonds”). The Bonds are being issued to provide funds for and toward the costs of various capital projects and the refunding of certain previously issued bonds. See “USE OF PROCEEDS.”

The Bonds are general obligations of the Commonwealth to which the full faith and credit of the Commonwealth are pledged. See “SECURITY AND SOURCE OF PAYMENT FOR BONDS.” Principal of and interest payments on the Bonds will be paid from the General Fund. See “COMMONWEALTH FINANCIAL PERFORMANCE” and “COMMONWEALTH FINANCIAL STRUCTURE AND PROCEDURES.”

When issued, the Bonds will be registered in the name of Cede & Co., as nominee for The Depository Trust Company, securities depository for the Bonds under a book-entry only registration system. See “THE BONDS — Book-Entry Only System” and Appendix D.

The Bonds are authorized investments for fiduciaries and personal representatives, as defined in the Probate, Estates and Fiduciaries Code within the Commonwealth; are legal investments for Pennsylvania banks, trust companies, bank and trust companies, savings banks, and insurance companies; and are acceptable as security for deposits of the funds of the Commonwealth. See “LEGALITY FOR INVESTMENT.”

Except where otherwise expressly noted, the financial and other information provided in this Official Statement is generally derived from the records of the Commonwealth. All financial information should be considered as unaudited unless otherwise specifically identified. All estimates and assumptions are based on the best information available to the Commonwealth but do not constitute factual information. All estimates of future performance or events constituting “forward-looking statements” may or may not be realized because of a wide variety of economic and other circumstances. Included in such forward-looking statements are numbers and other information from budgets for current and future fiscal years. The references to, and summaries of, constitutional and statutory provisions of the Commonwealth and to bond resolutions and other documents are qualified in their entirety by reference to the complete text of such documents and to any judicial interpretations thereof.

THE BONDS

Description of the Bonds

The First Series Bonds will be dated the date of issuance and delivery, will bear interest initially from such date, at the rate per annum for each maturity as specified on the inside cover page hereof, will be payable semi-annually on each December 15 and June 15, commencing December 15, 2014, calculated on the basis of a 360-day year of twelve 30-day months, and will mature in the amounts and on the dates as set forth on the inside cover page hereof.

The First Refunding Series Bonds will be dated the date of issuance and delivery, will bear interest initially from such date, at the rate per annum for each maturity as specified on the inside cover page hereof, will be payable semi-annually on each January 1 and July 1, commencing January 1, 2015, calculated on the basis of a 360-day year of twelve 30-day months, and will mature in the amounts and on the dates as set forth on the inside cover page hereof.

The Resolutions (as hereinafter defined) and all provisions thereof are incorporated by reference in the text of the Bonds, including, without limitation, those provisions setting forth the conditions under which the Resolutions may be modified. The Bonds provide that each registered owner, Beneficial Owner, DTC Participant or Indirect Participant (as hereinafter defined) in DTC, by acceptance of a Bond (including receipt of a book-entry credit evidencing an interest therein), assents to all of such provisions as an explicit and material portion of the consideration running to the Commonwealth to induce it to adopt the Resolutions and to issue such Bonds. Copies of the Resolutions, including the full text of the forms of the Bonds, are on file at the designated office in Philadelphia, Pennsylvania of Wells Fargo Bank, National Association (“Loan and Transfer Agent”).

Interest on the Bonds will be payable by check or draft mailed or other transfer made to the persons in whose names the Bonds shall be registered at the close of business on (i) in the case of the First Series Bonds the last day, and (ii) in the case of the First Refunding Series Bonds, the fifteenth day, (whether or not a business day) of the calendar month next preceding each interest payment date (in each case, the “Record Date”). Any interest on any Bond not timely paid or duly provided for shall cease to be payable to the person who is the registered owner as of the regular Record Date, and shall be payable to the person who is the registered owner at the close of business on a special record date for the payment of such defaulted interest. A special record date shall be a date not more than fifteen nor less than ten days prior to the date of the proposed payment and shall be fixed by the Loan and Transfer Agent whenever moneys become available for payment of the defaulted interest. Notice of a special record date shall be given to registered owners of the Bonds not less than fifteen days prior thereto.

Whenever the due date for payment of interest on or principal of the Bonds or the date fixed for redemption of any Bond shall be a Saturday, a Sunday, a legal holiday or a day on which banks in the Commonwealth are required or authorized by law (including by executive order) to close, then payment of such interest, principal or redemption price need not be made on such date, but may be made on the next succeeding day which is not a Saturday, a Sunday, a legal holiday, or a day upon which banks in the Commonwealth are required or authorized by law (including by executive order) to close, with the same force and effect as if made on the due date for such payment of principal, interest or redemption price, and no interest shall accrue thereon for any period after such due date.

Book-Entry Only System

The Depository Trust Company, New York, New York (“DTC”) will act as securities depository for the Bonds pursuant to a book-entry only system. Information regarding DTC and its book-entry system, provided by DTC, appears as Appendix D. Such information has been provided by DTC, and the Commonwealth does not assume any responsibility for the accuracy or completeness of such information. The Commonwealth may decide to discontinue use of the system of book-entry transfers through DTC (or another securities depository). In that event, Bond certificates will be printed and delivered.

For so long as the Bonds are registered in the name of DTC, or its nominee Cede & Co., the Commonwealth and the Loan and Transfer Agent will treat Cede & Co. as the registered owner of the Bonds for all purposes, including payments, notices and voting.

Neither the Commonwealth nor the Loan and Transfer Agent shall have any responsibility or obligation to any Direct or Indirect Participant or Beneficial Owner (as defined in Appendix D) with respect to (i) the accuracy of any records maintained by DTC or any Direct or Indirect Participant with respect to any beneficial ownership interest in any Bonds; (ii) the payment by any Direct or Indirect Participant of any amount due to any Beneficial Owner in respect of the principal of, premium, if any, and interest on the Bonds; (iii) the delivery or timeliness of delivery by any Direct or Indirect Participant of any notice to any Beneficial Owner with respect to the Bonds, including, without limitation, any notice of redemption; or (iv) other action taken by DTC or Cede & Co., including the effectiveness of any action taken pursuant to an Omnibus Proxy.

Payments made by or on behalf of the Commonwealth to DTC or its nominee shall satisfy the Commonwealth’s payment obligations with respect to the Bonds to the extent of such payments.

Optional Redemption

First Series Bonds

The First Series Bonds maturing in the years 2015 through 2024, inclusive, are not subject to redemption prior to maturity. The First Series Bonds, or portions thereof in integral multiples of \$5,000, maturing on and after June 15, 2025, are subject to redemption at the option of the Commonwealth prior to scheduled maturity on and after June 15, 2024, as a whole or in part (and if in part, within one or more maturities) at any time and from time to time, in any order of maturity determined by the Commonwealth and by lot within a maturity in such manner as the Commonwealth in its discretion may determine, on at least 30 days (but not more than 60 days) notice, at a redemption price equal to par (100% of stated principal amount) plus accrued interest to the date fixed for redemption.

First Refunding Series Bonds

The First Refunding Series Bonds are not subject to redemption prior to maturity.

Notice of Redemption

As long as the First Series Bonds are registered pursuant to a book-entry only system, notice of redemption will be given, as required by DTC's (or any successor depository's) procedures, to DTC, its nominee, or successor securities depository, as registered owner of the First Series Bonds. So long as Cede & Co. is the registered owner of the First Series Bonds, the Commonwealth will not be responsible for mailing notices of redemption to anyone other than DTC or its nominee.

Notice of redemption shall be given by the Loan and Transfer Agent via first-class mail not less than 30 days, nor more than 60 days, prior to the date fixed for redemption to the persons in whose names the First Series Bonds to be redeemed are registered at the close of business on the fifth (5th) business day prior to such mailings; provided, however, that any defect in the notice or in the mailing thereof with respect to any registered owner shall not affect the validity of the proceedings for such redemption as to any other registered owner. Deposit of any such notice in the United States mail shall constitute constructive receipt of such notice by the registered owner to whom such notice is sent. Notice having been given as aforesaid and provision having been made for redemption from funds on deposit with the Loan and Transfer Agent, no interest on First Series Bonds, or portions thereof, called for redemption shall accrue after the date fixed for redemption, and the registered holders of the First Series Bonds, or portions thereof, called for redemption shall thereafter have no further right except to receive payment of the redemption price plus accrued interest to the redemption date.

In addition to the notice of redemption to the registered owners of the First Series Bonds, the Loan and Transfer Agent shall cause copies of the original redemption notice to be sent by facsimile transmission, overnight delivery or certified mail with return receipt requested (or other similar means that can provide evidence of receipt) to all registered securities depositories then in the business of holding obligations similar to the First Series Bonds, and to two or more national information services that disseminate redemption information; provided however, that failure to send such copies of the original redemption notice or any defect therein shall not affect the validity of the redemption proceedings.

SECURITY AND SOURCE OF PAYMENT FOR BONDS

The Bonds are direct and general obligations of the Commonwealth to which the full faith and credit of the Commonwealth have been pledged for the payment of the interest thereon as it becomes due and the payment of the principal thereof at maturity or prior redemption. The various acts authorizing the incurrence of debt by the Commonwealth require the General Assembly to appropriate annually the moneys necessary to pay such interest and principal for which other provisions are not made. See the statutes described in the subsection "Authorization" below. Principal of and interest payments on the Bonds will be made from the General Fund.

The Constitution of the Commonwealth of Pennsylvania (the "Constitution") places a claim on revenues of the Commonwealth as security for the payment of principal of and interest on all debt of the Commonwealth. Article VIII, Section 7(d) of the Constitution provides that, if sufficient funds are not appropriated for the timely payment of the interest on and principal of all Commonwealth debt, the State Treasurer shall set apart from the first revenues thereafter

received applicable to the appropriate fund, a sum sufficient to pay such interest and principal, and shall so apply the money so set apart.

The State Treasurer may be required to set aside and apply such revenues at the suit of any holder of Commonwealth obligations.

For a description of the constitutional provisions relating to the Bonds, see Appendix E. The proposed form of the opinion of the Attorney General is set forth in Appendix F and the proposed form of the opinion of Bond Counsel is set forth in Appendix G.

Authorization

The Bonds are authorized and issued pursuant to and in full compliance with the provisions, restrictions and limitations of Section 7 of Article VIII of the Constitution; the laws of the Commonwealth, including the Capital Facilities Debt Enabling Act, Act No. 1999-1, approved February 9, 1999, as amended by Act No. 2002-130, approved October 28, 2002; Act No. 2003-49, approved December 23, 2003; Act No. 2004-67, approved July 4, 2004; Act No. 2005-87, approved December 22, 2005; Act No. 2008-48, approved July 4, 2008; Act No. 2010-48, approved July 7, 2010 and Act No. 2013-77, approved October 25, 2013 (the “Capital Facilities Debt Enabling Act”), annual capital budget bills and various bond authorization bills enacted by the General Assembly, including but not limited to, the Capital Budget Act of 2013-2014, Act No. 2013-69, approved July 9, 2013 (the “Capital Budget Act”).

Debt Limits

The Constitution (Article VIII, Section 7(a)) permits debt to be incurred (i) for purposes itemized in law and approved by voter referendum, (ii) without approval of the electorate for the rehabilitation of areas affected by man-made or natural disasters, and (iii) without approval of the electorate for capital facilities projects specifically itemized in a capital budget if such debt does not cause the amount of all net debt outstanding (as defined for purposes of that Section) to exceed one and three quarters times (1.75x) the average of the annual tax revenues of the Commonwealth deposited in all funds in the previous five fiscal years, as certified by the Auditor General (the “Constitutional Debt Limit”). The most recent semi-annual computation of the Constitutional Debt Limit and the amount of net debt outstanding subject to such limit is shown in Table 1:

Table 1
Constitutional Debt Limit^(a)
February 28, 2014
(In Millions)

| | |
|--|--------------------|
| Average Annual Tax Revenues FYs ended June 30, 2009-2013.. | \$ 34,173.8 |
| Times 1.75..... | 59,804.1 |
| Less: Net Debt Outstanding ^(b) | <u>9,803.5</u> |
| Debt Issuable Within Limit | <u>\$ 50,000.6</u> |

^(a) As certified by the Auditor General on March 1, 2014 (Appendix A).

^(b) After credit for refunded debt.

The capital debt authorizations for the various categories of capital facilities projects are shown in Table 2.

Table 2
Aggregate Capital Debt Authorization
(In Millions)

| <u>Capital Facilities Projects Category</u> | <u>Debt Authorized</u> | <u>Issued^(a)</u> | <u>Authorized But Unissued</u> | <u>Pro Forma Remaining Debt Authorized After Issuance Of the Bonds</u> |
|--|-------------------------------|------------------------------------|---------------------------------------|---|
| Buildings and Structures | \$ 36,352.2 | \$ 10,496.5 | \$ 25,855.7 | \$ 25,558.7 |
| Furniture and Equipment..... | 1,408.8 | 491.5 | 917.3 | 912.3 |
| Transportation Assistance | 12,663.8 | 3,606.9 | 9,056.9 | 8,976.9 |
| Redevelopment Assistance..... | 43,441.9 | 4,024.8 | 39,417.1 | 39,302.1 |
| Community Colleges..... | 35.8 | 28.0 | 7.8 | 7.8 |
| Highway and Highway Bridge | 24,687.0 | 2,769.5 | 21,917.5 | 21,899.5 |
| Flood Control | <u>556.6</u> | <u>65.8</u> | <u>490.8</u> | <u>490.8</u> |
| Total..... | <u>\$ 119,146.1</u> | <u>\$ 21,483.0</u> | <u>\$ 97,663.1</u> | <u>\$ 97,148.1</u> |

^(a) Original issuance amounts; not all are presently outstanding.

The amount of debt that may be issued in any given fiscal year for capital projects authorized in current or previous capital budgets is enacted annually by the General Assembly and approved by the Governor. The maximum amount of debt currently authorized by the fiscal year 2014 capital budget is as shown in Table 3.

Table 3
Fiscal Year 2014 Capital Budget Debt Limits^(a)
(In Millions)

| <u>Capital Facilities Projects Category</u> | <u>Limits</u> | <u>Issued to Date</u> | <u>Remaining Issuable Within Limit</u> | <u>Pro Forma Remaining Debt Authorized After Issuance Of the Bonds</u> |
|--|----------------------|------------------------------|---|---|
| Buildings and Structures | \$ 695.0 | \$ 398.0 | \$ 297.0 | \$ 0.0 |
| Furniture and Equipment..... | 10.0 | 5.0 | 5.0 | 0.0 |
| Transportation Assistance | 180.0 | 100.0 | 80.0 | 0.0 |
| Redevelopment Assistance..... | 340.0 | 225.0 | 115.0 | 0.0 |
| Flood Control | 10.0 | 0.0 | 10.0 | 10.0 |
| Highway | 0.0 | 0.0 | 0.0 | 0.0 |
| Bridge..... | <u>40.0</u> | <u>22.0</u> | <u>18.0</u> | <u>0.0</u> |
| Total | <u>\$ 1,275.0</u> | <u>\$ 750.0</u> | <u>\$ 525.0</u> | <u>\$ 10.0</u> |

^(a) The fiscal year 2014 capital budget debt limits became effective on July 9, 2013, and will remain in force until enactment of the fiscal year 2015 capital budget debt act.

Upon issuance of \$515.0 million aggregate principal amount of the First Series Bonds under the 2014 Capital Budget, \$10.0 million principal amount of debt will remain authorized and unissued thereunder. See “USE OF PROCEEDS-Capital Facilities.”

The Pennworks Acts authorized the issuance of \$250.0 million aggregate principal of debt for the purpose of making grants and loans for construction, expansion or improvement of water and wastewater infrastructure, including water supply and sewage treatment systems. See “USE OF PROCEEDS - Pennworks.” To date, \$211.275 million principal amount of bonds have been issued pursuant to the authority of the Pennworks Acts. Upon the issuance of \$30.0 million of the First Series Bonds pursuant to the Pennworks Act, \$8.725 million principal amount of debt will remain authorized and unissued thereunder.

For a discussion of the Commonwealth’s outstanding debt and projected future issuance of general obligation debt, see “OUTSTANDING INDEBTEDNESS OF THE COMMONWEALTH.”

USE OF PROCEEDS

The Commonwealth is issuing the Bonds for the following purposes:

- (i) \$515,000,000 aggregate principal amount of the First Series Bonds will be issued to provide for the construction, acquisition and major rehabilitation of capital facilities projects as described below under “Capital Facilities”;
- (ii) \$30,000,000 aggregate principal amount of the First Series Bonds will be issued to provide for Pennworks Acts grants/loans described below under “Pennworks Projects (Grants)”, and;
- (iii) Refunding.

The proceeds received from the sale of the First Series Bonds (including net bond premium, if any), after paying the costs of issuance, will be applied by the Commonwealth to fund the programs described below.

Capital Facilities

A portion of the proceeds of the First Series Bonds will be deposited into the Capital Facilities Fund and applied: 1) to defray the costs of issuance of the First Series Bonds and; 2) to the financial costs of various capital facilities projects of the Commonwealth. Of the combined \$515,000,000 aggregate principal amount of the First Series Bonds issued for capital facilities: (i) \$297,000,000 aggregate principal amount of the First Series Bonds shall be allocated to the Department of General Services and used to pay for the construction and major rehabilitation of public buildings for the Commonwealth and its institutions; (ii) \$115,000,000 aggregate principal amount of the First Series Bonds shall be allocated to the Department of Community and Economic Development to fund redevelopment assistance projects; (iii) \$98,000,000 (\$80,000,000 Transportation Assistance and \$18,000,000 Bridge) aggregate principal amount of the First Series Bonds shall be allocated to the Department of Transportation to fund transportation assistance projects and bridge projects; and (iv) \$5,000,000 aggregate principal amount of the First Series Bonds is to be allocated to the Department of General Services and used to pay for original furniture and equipment projects. Pending application to the above purposes, the proceeds of the First Series Bonds allocated to these purposes will be held by the State Treasurer in the Capital Facilities Fund and invested in accordance with applicable state and federal laws.

Pennworks Projects (Grants)

A portion of the proceeds of the First Series Bonds is dedicated to the purposes of the Pennworks Acts and to pay the costs of issuance of the First Series Bonds allocated to such purposes. The proceeds from \$30,000,000 aggregate principal amount of the First Series Bonds to be issued for the Pennworks Acts will be deposited into the Water Supply and Wastewater Treatment Fund (established pursuant to the Pennworks Acts) and applied to defray the financial costs to making grants to local governments and authorities for construction, expansion or improvement of water and wastewater infrastructure, including water supply and sewage treatment systems. Pending application to the above purposes, the proceeds of the First Series Bonds allocated to these purposes will be held by the State Treasurer in the Water Supply and Wastewater Treatment Fund and invested in accordance with applicable state and federal laws.

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Plan of Refunding

The Refunded Bonds are as follows:

| <u>Principal Amount to be Refunded</u> | <u>Bond Series</u> | <u>Date of Issue</u> | <u>Bonds Maturing on</u> | <u>Date of Redemption</u> |
|--|-------------------------|----------------------|-------------------------------------|---------------------------|
| \$30,595,000 | Second Series of 2003 | June 10, 2003 | July 1, 2015 | June 14, 2014 |
| \$30,375,000 | First Series of 2004 | February 26, 2004 | February 1, 2015-2017 | June 14, 2014 |
| \$15,825,000 | Fourth Series of 2004 | December 21, 2004 | July 1, 2024 | July 1, 2014 |
| \$27,190,000 | First Series of 2005 | June 9, 2005 | July 1, 2022-2023 | July 1, 2015 |
| \$150,880,000 | Second Series of 2005 | December 15, 2005 | January 1, 2017, 2022-2023 and 2025 | January 1, 2016 |
| \$38,710,000 | First Series of 2006 | June 8, 2006 | October 1, 2017 and 2020 | October 1, 2016 |
| \$16,775,000 | First Series of 2007 A | June 7, 2007 | November 1, 2018 | November 1, 2017 |
| \$1,395,000 | First Series of 2007 B | June 7, 2007 | November 1, 2019 | November 1, 2017 |
| \$1,185,000 | Second Series of 2007 B | December 20, 2007 | August 1, 2019 | August 1, 2017 |

This refunding in advance of the Refunded Bonds will be accomplished by applying a portion of the proceeds from the sale of the First Series Refunding Bonds to the purchase of certain direct obligations of the U. S. Government to be held in escrow (the “Escrow Obligations”), in an aggregate principal amount which at all times shall be sufficient, together with the interest to accrue thereon, to pay the principal of Refunded Bonds, the redemption premium, if any, and the interest due and to become due thereon before and on the respective redemption dates as shown above (the “Required Deposit”). Such Escrow Obligations will be deposited with the State Treasurer of the Commonwealth of Pennsylvania, to be applied solely to the payment of the principal and redemption price of and interest on Refunded Bonds on the maturity or redemption dates shown above. Initially, the Escrow Obligations are expected to consist of direct obligations of the United States Treasury. Applicable law and the Resolutions permit the State Treasurer to substitute new Escrow Obligations meeting the requirements of the Required Deposit at the time of any such substitution upon fulfillment of certain conditions, including the receipt of an opinion of Bond Counsel and certain certifications. The refunding of the Refunded Bonds will take place as described above only if the First Series Refunding Bonds are issued. The Commonwealth will send out required notices of redemption as provided in the documentation relating to the Refunded Bonds, as appropriate, and holders of the Refunded Bonds should rely solely on such redemption notices.

COMMONWEALTH GOVERNMENT

The Commonwealth is organized into three separate branches of government — executive, legislative and judicial — as defined in the Pennsylvania Constitution. Five officials of the Commonwealth’s executive branch are elected in statewide elections for four-year terms expiring on the dates shown below.

| <u>Name</u> | <u>Office</u> | <u>Term Expires</u> |
|----------------------|---------------------|---------------------|
| Tom Corbett | Governor | January 20, 2015 |
| James Cawley | Lieutenant Governor | January 20, 2015 |
| Kathleen Kane | Attorney General | January 17, 2017 |
| Robert M. McCord | State Treasurer | January 17, 2017 |
| Eugene A. DePasquale | Auditor General | January 17, 2017 |

Commonwealth Employees

Employees are permitted to organize and bargain collectively. As of July 2013, 82 percent of the full-time salaried employees under the Governor’s jurisdiction were covered by collective bargaining agreements or memoranda of understanding. Approximately 43 percent of state employees are represented by the American Federation of State, County and Municipal Employees (“AFSCME”). Approximately 61 percent of state employees, represented by AFSCME, Pennsylvania Social Services Union and other unions, are covered by contracts that took effect July 1, 2011 and expire on June 30, 2015. Each of these contracts provide for a pay freeze in the first year of the contract and general pay increases totaling four percent over the balance of their term. Interest arbitration awards typically dictate the salary increase to be provided to employees covered by four other unions. In this case, the Commonwealth reached an agreement with one of these unions (short of interest arbitration) that provided a four-year contract commencing on July 1, 2012 that grants general pay increases totaling four percent over the contract term. The contract terms of the other three unions were determined through the interest arbitration process. One of those awards provided for a three year contract commencing on July 1, 2011 which similarly provides for general pay increases totaling four percent over the term of contract. Said contract expires on June 30, 2014 and the parties are currently in negotiations over a successor agreement. The second interest arbitration unit was issued an award providing a four year contract commencing July 1, 2011 which affords general pay increases totaling five and a half percent over the term of such contract. The remaining interest arbitration unit was awarded a five-year contract expiring on June 30, 2017 which provides for a general pay increase totaling eleven percent over the term of the contract. Table 4, listed below, presents the number of approved and filled positions under the Governor’s jurisdiction on July 1st of the years 2008 through 2013.

Table 4
Filled Salaried Positions and Employees
Under the Governor’s Jurisdiction^(a)
2008-2013

| As of July 1 | Total Full and Part Time Filled Salaried Positions | Total Full Time Salaried Employees | Civil Service Salaried Positions | Civil Service As a % of Total Filled Salaried Positions |
|-------------------------|---|---|---|--|
| 2008 | 77,531 | 77,259 | 53,141 | 68.5 |
| 2009 | 77,248 | 76,979 | 52,905 | 68.5 |
| 2010 | 76,110 | 75,878 | 52,512 | 69.0 |
| 2011 | 74,086 | 73,874 | 50,991 | 68.8 |
| 2012 | 75,540 | 74,336 | 51,226 | 68.7 |
| 2013 | 72,768 | 72,574 | 49,898 | 68.6 |

^(a) Excludes employees of the legislative and judicial branches, the Department of the Auditor General, the Treasury Department, the State System of Higher Education and independent agencies, boards and commissions.
Source: Office of Administration, 2014 State Government Workforce Statistics.

COMMONWEALTH FINANCIAL STRUCTURE AND PROCEDURES

The Pennsylvania Constitution and the laws of the Commonwealth require all payments from the State Treasury, with the exception of refunds of taxes, licenses, fees and other charges, to be made only by duly enacted appropriations. Amounts appropriated from a fund may not exceed its actual and estimated revenues for the fiscal year plus any unappropriated surplus available. Appropriations from the principal operating funds of the Commonwealth (the General Fund, the Motor License Fund and the State Lottery Fund) are generally made for one fiscal year and are returned to the unappropriated surplus of the fund (a lapse) if not spent or encumbered by the end of the fiscal year. The Commonwealth’s fiscal year begins July 1 and ends June 30. (Fiscal year 2013 refers to the fiscal year ended June 30, 2013.) See Appendix C for a further description of the fiscal administration of the Commonwealth.

Description of Funds

The Commonwealth utilizes the fund method of accounting. For purposes of governmental accounting, a “fund” is defined as an independent fiscal and accounting entity with a self-balancing set of accounts. Each fund records the cash and/or other resources together with all related liabilities and equities that are segregated for the purpose of the

fund. In the Commonwealth, funds are established by legislative enactment or in certain limited cases by administrative action. Over 150 funds have been established and currently exist for the purpose of recording the receipt and disbursement of moneys received by the Commonwealth. Annual budgets are adopted each fiscal year for the principal operating funds of the Commonwealth and several other special revenue funds. Expenditures and encumbrances against these funds may be made only pursuant to appropriation measures enacted by the General Assembly and approved by the Governor.

The General Fund, the Commonwealth's largest operating fund, receives all tax revenues, non-tax revenues and federal grants and entitlements that are not specified by law to be deposited elsewhere. The majority of the Commonwealth's operating and administrative expenses are payable from the General Fund. Debt service on all bond indebtedness of the Commonwealth, except that issued for highway purposes or for the benefit of other special revenue funds, is payable from the General Fund.

The Motor License Fund receives all tax and fee revenues relating to motor fuels and vehicles except the revenues from the one-half cent per gallon of the liquid fuels tax, which are deposited in the Liquid Fuels Tax Fund for distribution to local municipalities. All revenues relating to motor fuels and vehicles are required by the Constitution to be used only for highway purposes. Most federal aid revenues designated for transportation programs and tax revenues relating to aviation fuels are also deposited in the Motor License Fund. Operating and administrative costs for the Department of Transportation and other Commonwealth departments conducting transportation related programs, including the highway patrol activities of the Pennsylvania State Police, are also paid from the Motor License Fund. Debt service on bonds issued by the Commonwealth for highway purposes is payable from the Motor License Fund.

Other special revenue funds have been established by law to receive specified revenues that are appropriated to departments, boards and/or commissions for payment of their operating and administrative costs. Such funds include the Game, Fish, Boat, Banking Department, Milk Marketing, State Farm Products Show, Environmental Stewardship, State Racing, and Tobacco Settlement Funds. Some of these special revenue funds are required to transfer excess revenues to the General Fund, and some receive funding, in addition to their specified revenues, through appropriations from the General Fund.

The Tobacco Settlement Fund is a special revenue fund established to receive tobacco litigation settlement payments paid to the Commonwealth. The Commonwealth is one of forty-six states that settled certain smoking-related litigation in a November 1998 master settlement agreement with participating tobacco product manufacturers (the "Tobacco MSA"). Under the Tobacco MSA, the Commonwealth is entitled to receive a portion of payments made pursuant to the Tobacco MSA by tobacco product manufacturers participating in the Tobacco MSA. Most revenues to the Tobacco Settlement Fund are subject to annual appropriation by the General Assembly and approval by the Governor.

The Budget Stabilization Reserve Fund is a special revenue fund designated to receive a statutorily determined portion of the budgetary basis fiscal year-end surplus of the General Fund, as was its predecessor fund, the Tax Stabilization Reserve Fund. The Budget Stabilization Reserve Fund was established in July 2002 after the Tax Stabilization Reserve Fund was abolished and its balance transferred to the General Fund for the 2002 fiscal year budget. The Budget Stabilization Reserve Fund is to be used for emergencies threatening the health, safety or welfare of citizens or during downturns in the economy that result in significant unanticipated revenue shortfalls not able to be addressed through the normal budget process. Assets of the Budget Stabilization Reserve Fund may be used upon recommendation by the Governor and an approving vote by two-thirds of the members of each house of the General Assembly. For GAAP (as defined below) reporting purposes, the Budget Stabilization Reserve Fund (previously designated the Tax Stabilization Reserve Fund) has been reported as a fund balance reservation in the General Fund (governmental fund category) since fiscal year 1999. Prior to that fiscal year, the Tax Stabilization Reserve Fund was reported, on a GAAP basis, as a designation of the General Fund unreserved fund balance. See "Budget Stabilization Reserve Fund and Tax Stabilization Reserve Fund" below.

The Commonwealth maintains trust and agency funds that are used to administer funds received pursuant to a specific bequest or as an agent for other governmental units or individuals.

Enterprise funds are maintained for departments or programs operated like private enterprises. Two of the largest of such funds are the State Stores Fund and the State Lottery Fund. The State Stores Fund is used for the receipts and disbursements of the Commonwealth's liquor store system. Sale and distribution of all liquor within Pennsylvania is a government enterprise. The State Lottery Fund is also an enterprise fund for the receipt of all revenues from lottery ticket sales and lottery licenses and fees. Its revenues, after payment of prizes and all other costs, are dedicated to paying the costs of programs benefiting the elderly and handicapped in Pennsylvania.

In addition, the Commonwealth maintains funds classified as working capital, bond, and sinking funds for specified purposes.

Accounting Practices

Financial information for the principal operating funds of the Commonwealth is maintained on a budgetary basis of accounting. The Commonwealth also prepares annual financial statements in accordance with generally accepted accounting principles ("GAAP"). Annual financial statements prepared in accordance with GAAP are audited jointly by the Department of the Auditor General and an independent public accounting firm.

Budgetary Basis

A budgetary basis of accounting is used for ensuring compliance with the enacted operating budget and is governed by applicable statutes of the Commonwealth and by administrative procedures. The Constitution provides that operating budget appropriations shall not exceed the actual and estimated revenues and unappropriated surplus available in the fiscal year for which funds are appropriated. Annual budgets are enacted for the General Fund and certain special revenue funds that together represent the majority of expenditures of the Commonwealth. The annual budget classifies fund revenues as Commonwealth revenues, augmentations, federal revenues, or restricted receipts and revenues. Commonwealth revenues are revenues from taxes and from non-tax sources such as licenses and fee charges, penalties, interest, investment income and other miscellaneous sources. Augmentations consist of departmental and institutional billings that supplement an appropriation of Commonwealth revenues, thereby increasing authorized spending. For example, patient billings for services at Commonwealth-owned institutions are augmentations that supplement Commonwealth revenues appropriated to each institution for operating costs. Federal revenues are those federal aid receipts that pay for or reimburse the Commonwealth for funds disbursed for federally assisted programs. Restricted receipts and revenues are funds that are restricted to a specific use or uses by state law, administrative decision, or the provider of the funds. Only Commonwealth revenues and expenditures from these revenues are included in the computation made to determine whether an enacted budget is constitutionally balanced. Augmenting revenues and federal revenues are considered to be self-balancing with expenditures from their respective revenue sources.

The Commonwealth's budgetary basis financial reports for its governmental funds are based on a modified cash basis of accounting as opposed to the modified accrual basis prescribed by GAAP. Under the Commonwealth's budgetary basis of accounting, tax receipts, non-tax revenues, augmentations and all other receipts are recorded at the time cash is received. An adjustment is made at fiscal year-end to include accrued unrealized revenue; that is, revenues earned but not collected. Revenues accrued include estimated receipts from (i) sales and use, personal income, realty transfer, inheritance, cigarette, liquor, liquid fuel, fuels, and oil company franchise taxes, and interest earnings, and (ii) federal government commitments to the Commonwealth. Expenditures are recorded at the time payment requisitions and invoices are submitted to the Treasury Department for payment. Appropriated amounts are reserved for payment of contracts for the delivery of goods or services to the Commonwealth through an encumbrance process. Unencumbered appropriated funds are automatically lapsed at fiscal year-end and are available for re-appropriation. Estimated encumbrances are established at fiscal year-end to pay certain direct expenditures for salaries, wages, travel, and utility costs payable against current year appropriations but disbursed in the subsequent fiscal year. Recording of the applicable expenditure liquidates the encumbered amount. Over-estimates of fiscal year-end encumbrances are lapsed in the subsequent fiscal year and under-estimates are charged to a subsequent fiscal year appropriation. Appropriation encumbrances are shown on the Commonwealth's balance sheet as a reservation of fund balance.

Other reservations of fund balance include (i) the unexpended balance of continuing appropriations (that is, appropriations that do not lapse at fiscal year-end), and (ii) requested appropriation supplements and deficiency

appropriations. Revenues dedicated for specific purposes and remaining unexpended at the fiscal year-end are likewise reserved.

GAAP Financial Reporting

At fiscal year-end, budgetary basis fund financial information, both revenues and expenditures, is adjusted to reflect appropriate accruals for financial reporting in conformity with GAAP. The Commonwealth is not required to prepare GAAP financial statements and does not prepare them on an interim basis. GAAP fund financial reporting requires a modified accrual basis of accounting for governmental funds, while proprietary and fiduciary funds are reported on the accrual basis of accounting.

Fund financial statements of the Commonwealth prepared under GAAP differ from those traditionally prepared on a budgetary basis for several reasons. Among other differences, the GAAP fund financial statements (i) generally recognize revenues when they become measurable and available rather than when cash is received, (ii) report expenditures when goods and services are received and a liability incurred rather than when cash is disbursed, (iii) include a combined balance sheet for the Commonwealth presented by GAAP fund type rather than by Commonwealth fund, and (iv) include activities of all funds in the reporting entity, including agencies and authorities usually considered as independent of the Commonwealth for budgetary purposes. Adjustments to budgetary basis revenues and expenditures required to conform to GAAP accounting generally require including (i) corporation, sales, and personal income tax accruals, (ii) tax refunds payable and tax credits, and (iii) expenditures incurred but not yet posted as expenditures or not covered by appropriations.

An independent public accounting firm and the Department of the Auditor General jointly audit the Commonwealth's annual GAAP basis financial statements. The Commonwealth's independent public accounting firm, KPMG LLP, has not been engaged to perform and has not performed, since the date of its report on the Commonwealth's Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2013, which is incorporated herein by reference, any procedures on the financial statements addressed in that report nor has it performed any other procedures specifically relating to this Official Statement. The audited Basic Financial Statements are a component of the Commonwealth's Comprehensive Annual Financial Report ("CAFR"). The CAFRs for recent fiscal years, including the fiscal year ended June 30, 2013, have been filed with the Municipal Securities Rulemaking Board via its Electronic Municipal Market Access system ("EMMA") and are available from EMMA (<http://www.emma.msrb.org>) and at the Budget & Financial Reports section of the Office of the Budget's web site - www.budget.state.pa.us - and such CAFRs are incorporated herein by reference.

New Governmental Accounting and Reporting Standards

In February 2009, the Governmental Accounting Standards Board (GASB) issued Statement No. 54, "Fund Balance Reporting and Governmental Fund Type Definitions." GASB Statement No. 54 changes the existing categories within governmental funds fund balances from the former Reserved, Unreserved and, within Unreserved, Designated and Undesignated fund balances, to the new Nonspendable and Spendable and, within Spendable, Restricted, Committed, Assigned and Unassigned categories. Also, governmental funds fund type classifications are clarified. As further disclosed in Note B to the June 30, 2011 CAFR, the Commonwealth's implementation of GASB Statement No. 54 did not change any individual governmental fund's fund balance but did change the categories reported within fund balance and did change fund type classification for 41 former Special Revenue funds. Effective July 1, 2010 the Commonwealth implemented GASB Statement No. 54 and the changes caused thereby may hamper the comparability of GAAP basis financial information, particularly as it relates to fund balances, for fiscal years beginning July 1, 2010 and later to financial reports for years prior to the implementation of GASB Statement No. 54. Note B to the financial statements in the June 30, 2011 CAFR provides a detailed explanation of the nature and amount of restatements of fund balances attributable to the implementation of GASB Statement No. 54.

Investment of Funds

The Treasury Department is responsible for the deposit and investment of most funds belonging to the Commonwealth, including the proceeds of the Bonds and the funds held for the payment of interest on and maturing principal of the Bonds. The Commonwealth's Fiscal Code contains statutory limitations on the investment of funds by the Treasury Department. The Board of Finance and Revenue, a three-member board of state officials chaired by the

State Treasurer, is authorized to establish the aggregate amount of funds that may be invested in some of the various categories of permitted investments. The State Treasurer ultimately determines the asset allocation and selects the investments within the parameters of the law.

The Commonwealth's Fiscal Code permits investments in the following types of securities: (i) United States Treasury securities and United States Agency securities maturing within two years of issue; (ii) commercial paper issued by industrial, common carrier or finance companies rated "Prime One" or its equivalent; (iii) certificates of deposit of Pennsylvania-based commercial banks, savings banks or savings and loans; (iv) repurchase obligations secured by Federal obligations; (v) banker's acceptances written by domestic commercial banks with a Moody's Investors Service "AA" rating or the equivalent rating by Standard & Poor's Financial Services or Fitch's Rating Service; and (vi) other non-equity investments not to exceed ten percent of assets subject to a "prudent investor" test. The Treasury Department maintains additional investment restrictions contained in its Investment Policy Guidelines. A summary of the Investment Policy Guidelines and a report on investment activity and performance of funds invested by the Treasury Department are contained in a report periodically prepared and publicly distributed by the Treasury Department.

The State Treasurer has been legislatively authorized to invest Commonwealth moneys in securities under the "prudent investor" standard since June 1999. The common investment pool operated by the State Treasurer for the investment of operating funds of the Commonwealth maintains a portion of its investments in securities subject to this test. The legislative authorization to invest in such securities presently expires on December 31, 2014.

Budget Stabilization Reserve Fund and Tax Stabilization Reserve Fund

Legislation enacted with the adoption of the fiscal year 2003 budget abolished the Tax Stabilization Reserve Fund and transferred its balance of \$1,038 million to the General Fund. That legislation also established a new reserve fund named the Budget Stabilization Reserve Fund and initially directed \$300 million of funding from the General Fund be deposited to such fund during fiscal year 2003. Subsequently, the General Assembly repealed the \$300 million transfer allowing that amount to remain in the General Fund to help offset anticipated revenue shortfalls to the fiscal year 2003 budget.

At present, the Commonwealth has a virtually zero balance in the Budget Stabilization Reserve Fund. Based on estimates for fiscal year 2014, the Commonwealth projects a preliminary fiscal year 2014 ending balance of 216 million. **See, however, "COMMONWEALTH FINANCIAL PERFORMANCE-Recent Developments" on May 1, 2014.** The Governor has proposed suspending any statutory transfer for fiscal year 2014 due to expected low end-of-year balance. Such suspension will require the approval by the General Assembly.

Balances in the Budget Stabilization Reserve Fund are to be used only when emergencies involving the health, safety or welfare of the residents of the Commonwealth or downturns in the economy resulting in significant unanticipated revenue shortfalls cannot be dealt with through the normal budget process. Funds in the Budget Stabilization Reserve Fund may be appropriated only upon the recommendation of the Governor and the approval of a separate appropriation bill by a vote of two-thirds of the members of both houses of the General Assembly. Any funds appropriated from the Budget Stabilization Reserve Fund that are unspent are returned to the Budget Stabilization Reserve Fund.

COMMONWEALTH FINANCIAL PERFORMANCE

Recent Developments

On February 4, 2014, the Governor submitted to the General Assembly his proposed fiscal year 2015 budget. See "Fiscal Year 2015 Proposed Budget". The budget document and related information is available on the Governor's Budget Office web page at www.budget.state.pa.us.

Revised estimates for fiscal year 2014 were also incorporated in the Governor's fiscal year 2015 proposed budget on February 2, 2014 which, based on estimated supplemental appropriations, lapses and revised estimates of expenditures and revenues and suspension of unappropriated balance for fiscal year 2014, gave rise to a projected fiscal year 2014 ending unappropriated fund balance of \$215.9 million for the General Fund. See "Fiscal Year Enacted 2014 Budget."

However, based upon information available on May 1, 2014 to the Commonwealth, total General Fund revenue collected for April was \$3.4 billion, \$328.292 million or 8.8% below estimate. Fiscal year-to-date General Fund revenue is \$23.9 billion or \$504.546 million or 1.7% below estimate, adjusting for an early State Store Fund profit transfer. April revenues for corporate taxes and personal income taxes are calculated to be \$94.686 million and \$185.661 million below the monthly estimates respectively. Sales and use tax for the month of April was above estimate by \$4.346 million.

According to the Department of Revenue, the impacts of the federal tax increases effective January 1, 2013 have had a larger than anticipated impact on April 2014 receipts. It appears the shift in recognizing capital gains and dividend payments into 2012 was of a magnitude much greater than estimated. Personal income tax receipts were 19% below estimate for the month of April. To further explain the situation, the Department of Revenue cites national wage and salary growth was significantly below economic forecasts, as was gross domestic product for the first quarter, which was estimated to grow at 3.5% but actual growth was reported at only 0.1%.

The Commonwealth has been taking actions to mitigate the impact of less than anticipated revenues by increasing current and prior year lapses, freezing funds, slowing hiring, and clarifying tax guidance on a certain tax to recoup unintended leakage in collection. Over the next two months, the Administration will work with the General Assembly to enact a 2014-15 budget that is balanced, and by definition, would have to take into account any negative balance, if any which might be brought forward from 2013-14.

Introduction

The most recent Commonwealth audited financial statements are available in the CAFR of the Commonwealth for the fiscal year ended June 30, 2013 (“fiscal year 2013”), which was issued on December 13, 2013 and was filed with EMMA on January 17, 2014.

Copies of CAFRs up to fiscal year ending 2013 issued by the Commonwealth are available from (i) the Secretary of the Budget, Mr. Charles Zogby, Attn: Mr. Mike Higgins, 555 Walnut Street, 9th Floor, Harrisburg, Pennsylvania 17101 (Telephone (717) 425-6736), and (iii) the Financial Reports section of the Office of the Budget’s web site at www.budget.state.pa.us, which CAFRs are incorporated herein by reference. The basic financial statements for fiscal year 2013 are incorporated herein by reference. This means that (i) the incorporated information is considered part of this Official Statement, and (ii) such information should be reviewed by prospective purchasers of the Bonds as a part of their review of this entire Official Statement.

Government-Wide Financial Data (GAAP Basis)

Government-wide financial statements report financial position and results of activity for the Commonwealth as a whole. Government-wide statements do not report information fund-by-fund; rather, they reveal information for all governmental activities and all business-type activities in separate columns. In government-wide statements, for both governmental and business-type activities, the economic resources measurement focus and accrual basis of accounting are used, with revenues and expenses recognized when they occur, rather than when cash is received or paid. This treatment results in including in assets an estimate of the total amount of receivables due at fiscal year-end that are expected to be collected in the future. Capital assets are reported with acquisition or construction costs being reported when the assets are placed in service less accumulated depreciation. Reported liabilities include all liabilities, regardless of when payment is due, including bond principal, employee disability claims liability, and employee compensated absence liabilities.

Table 5 presents condensed comparative financial statement information derived from the Commonwealth’s government-wide June 30 Statement of Net Position for the years indicated and includes amounts for the “primary government” only.

Table 5**Government-wide Condensed Statement of Net Position
as of June 30, 2012 and 2013**

(Amounts in millions)

| | Governmental Activities | | Business-Type Activities | | Total Primary Government | |
|--------------------------------------|-------------------------|---------------|--------------------------|----------------|--------------------------|---------------|
| | 2013 | 2012 | 2013 | 2012 | 2013 | 2012 |
| Assets: | | | | | | |
| Cash and investments..... | \$ 9,818 | \$ 9,966 | \$ 5,815 | \$ 4,159 | \$ 15,633 | \$ 14,125 |
| Capital assets (net)..... | 33,162 | 31,872 | 480 | 77 | 33,642 | 31,949 |
| All other assets..... | 7,776 | 7,383 | 1,978 | 1,596 | 9,754 | 8,979 |
| Total assets..... | 50,756 | 49,221 | 8,273 | 5,832 | 59,029 | 55,053 |
| Liabilities: | | | | | | |
| Accounts payable..... | 6,268 | 5,999 | 908 | 858 | 7,176 | 6,857 |
| All other current liabilities..... | 3,604 | 3,696 | 1,033 | 3,504 | 4,637 | 7,200 |
| Bonds payable, non-current..... | 11,224 | 10,771 | 4,754 | - | 15,978 | 10,771 |
| All other long-term liabilities..... | 5,337 | 5,072 | 2,777 | 2,628 | 8,114 | 7,700 |
| Total liabilities..... | 26,433 | 25,538 | 9,472 | 6,990 | 35,905 | 32,528 |
| Net position: | | | | | | |
| Net invested in capital assets..... | 27,775 | 26,581 | 465 | 77 | 28,240 | 26,658 |
| Restricted..... | 2,235 | 2,562 | 748 | 679 | 2,983 | 3,241 |
| Deficit..... | (5,687) | (5,460) | (2,412) | (1,914) | (8,099) | (7,374) |
| Total net position..... | 24,323 | 23,683 | (1,199) | (1,158) | 23,124 | 22,525 |

Source: Comprehensive Annual Financial Report, fiscal year ended June 30, 2013.

During the fiscal year ended June 30, 2013, the overall financial position (net position) of the Commonwealth's primary government, including both governmental and business-type activities, increased \$600 million, or 2.6 percent of total beginning net position of \$22,500 million. For governmental activities, the increase in net position was \$600 million to \$24,300 million representing a 2.7 percent increase over the prior year. The increase in net position is attributable to increased net investments in capital assets.

An overall surplus of \$24,300 million is reported for Governmental Activities; however, the majority of the surplus is related to net investment in capital which is unavailable to utilize in satisfying the Commonwealth's day-to-day expenses. The increase in net investment in capital assets reflects the Commonwealth's investment in highway and bridge infrastructure as well as land, building, right-of-way and waterway improvements. Decreases in the restricted net position balances are primarily due to changes in transportation programs related to increases in highway and bridge expenses. The increase in the unrestricted net position deficit is mainly attributable to increases in other post-employment benefit liability and the employer share of retirement expenses, and the inclusion of the Commonwealth Financing Authority ("CFA") as a blended component unit within the business-type activities. The CFA reported a net position deficit of \$760 million.

Financial Data for Governmental Fund Types (GAAP Basis)

Governmental fund financial statements provide fund-specific information about the General Fund, the Motor License Fund, and the Tobacco Settlement Fund (initially reported for fiscal year 2002) and for other Commonwealth funds categorized as governmental funds and reported as such in the General Purpose Financial Statements of prior fiscal years. Where government-wide financial statements cover the entirety of the Commonwealth, fund financial statements provide a more detailed view of the major individual funds established by the Commonwealth. Fund financial statements further differ from government-wide statements in the use by the latter of the current financial resources measurement focus and the modified accrual basis of accounting.

The governmental funds balance sheet reports total fund balances for all governmental funds. Assets of the Commonwealth's governmental funds (the General Fund, and the Motor License Fund are major governmental funds)

as of June 30, 2013 were \$17,564.6 million. Liabilities for the same date totaled \$11,751.4 million, leaving a fund balance of \$5,813.2 million, a decrease of \$87.6 million from the restated fund balance at June 30, 2012. On a fund specific basis, the fund balance for the General Fund increased by \$312.9 million, the fund balance for the Motor License Fund decreased by \$129.7 million and the fund balance for aggregated non-major funds (including the Tobacco Settlement Fund) decreased by \$270.8 million. See “General Fund – Fiscal Year 2013 Financial Results.”

To help understand the relationship between the Commonwealth’s GAAP fund balance (fund perspective) for governmental funds and the Commonwealth’s governmental net assets (government-wide perspective) under the new presentation of financial information, the following reconciliation is presented:

Table 6
Reconciliation of the Balance Sheet
Governmental Funds (Fund Perspective) to
the Statement of Net Position - Governmental Activities
June 30, 2013
(In Thousands)

| | |
|--|----------------------|
| Fund Balances - Governmental Funds | |
| General Fund..... | \$ 1,566,010 |
| Motor License Fund..... | 1,063,322 |
| Nonmajor Funds..... | 3,183,836 |
| Total Fund Balance - Governmental Funds..... | \$ 5,813,168 |
| Plus: Capital Assets, including infrastructure..... | \$ 53,021,386 |
| Less: Accumulated depreciation..... | (19,901,376) |
| Plus: Deferred revenue..... | 2,182,705 |
| Plus: Additional accrued receivables..... | 6,017 |
| Plus: Net assets of internal service funds..... | 93,347 |
| Plus: Inventories..... | 100,979 |
| Less: Long-term liabilities..... | (16,992,263) |
| Total Net Position - Governmental Activities..... | \$ 24,323,963 |

Source: Comprehensive Annual Financial Report, fiscal year ended June 30, 2013.

More detailed information with respect to the General Fund and the Motor License Fund, major operating funds that are categorized as governmental funds, is presented in Table 7 (General Fund) and in Table 9 (Motor License Fund).

The financial tables that follow containing GAAP basis financial data are unaudited but are derived from the Commonwealth’s audited financial statements. The discussion of financial performance on a budgetary basis for prior fiscal years is based on an analysis of budget numbers and not on numbers prepared in accordance with GAAP. Likewise, the discussion of the financial figures for the enacted budget for fiscal year 2014 and the proposed fiscal 2015 budget reflects a budgetary basis analysis rather than a GAAP basis analysis.

General Fund

Financial Results for Recent Fiscal Years (GAAP Basis)

During the five-year period from fiscal year 2009 through fiscal year 2013, total revenues and other sources increased by an average of 3.7 percent annually. Tax revenues during this same period increased by an annual average of 3.4 percent. During the past several fiscal years, fees and license income and other financing sources such as transfers from other funds have continued to become a larger portion of income to the General Fund. Expenditures and other uses during the fiscal years 2009 through 2013 rose at an average annual rate of 3.1 percent. Expenditures for the protection of persons and property during this period increased at an average annual rate of 2.1 percent; public education expenditures during this period decreased at an average annual rate of 0.2 percent; health and human services expenditures increased at an average annual rate of 3.7 percent; and capital outlays increased at an average annual rate of 37.5 percent. Commonwealth expenditures for direction and support services (state employees and government administration) increased at an average annual rate of 3.3 percent during the fiscal years 2009 through 2013. The fund balance at June 30, 2013 totaled \$1,566.0 million, an increase of \$306.7 million from the balance at June 30, 2012. As

mentioned previously, (See “New Governmental Accounting and Reporting Standards”) the Commonwealth implemented GASB Statement No. 54 which addressed the reporting of fund balances. This implementation affects the comparability of fund balances for the fiscal year ended June 30, 2012 and subsequent years to those of prior years. Table 7 below presents fund balance information for fiscal years 2009 and 2010 according to the prior standards as well as the fund balance for the fiscal years 2011 through 2013 according to GASB Statement No. 54.

Table 7, on the following page, presents a summary of revenues and expenditures (GAAP basis) for the General Fund, (including the Budget Stabilization Reserve Fund) for the fiscal years 2009 through 2013.

Table 7
Results of Operations—General Fund
GAAP Basis—Unaudited
(In Thousands)

| | Fiscal Year Ended June 30 | | | | |
|--|---------------------------|----------------------|----------------------|----------------------|----------------------|
| | 2009 | 2010 | 2011 | 2012 | 2013 |
| Fund Balance — Beginning of Period | \$ 2,974,101 | \$ 515,178 | \$ 284,803 | \$ 1,621,435 | \$ 1,259,295 |
| Restatements..... | - | - | 280,420 | - | (6,165) |
| Fund Balance — Beginning of Period, as Restated..... | \$ 2,974,101 | \$ 515,178 | \$ 565,223 | \$ 1,621,435 | \$ 1,253,130 |
| Revenues: | | | | | |
| Taxes..... | \$ 24,117,729 | \$ 24,284,811 | \$ 25,883,652 | \$ 26,577,129 | \$ 27,574,159 |
| Licenses and fees..... | 385,330 | 607,334 | 466,089 | 526,547 | 587,720 |
| Intergovernmental..... | 17,897,156 | 21,847,421 | 23,597,695 | 20,276,131 | 20,151,590 |
| Charges for sales and services..... | 1,191,920 | 984,762 | 1,438,536 | 1,449,895 | 1,451,899 |
| Other revenues..... | 21,463 | 221,264 | 228,079 | 353,198 | 408,449 |
| Other Financing Sources: | | | | | |
| Operating transfers in..... | 189,329 | 738,871 | 1,063,293 | 424,622 | 450,234 |
| Bonds issued and bond premiums..... | - | - | - | 51,847 | - |
| Other additions..... | 3,638 | - | - | 108,263 | 1,251 |
| TOTAL REVENUES AND OTHER SOURCES..... | \$ 43,806,565 | \$ 48,684,463 | \$ 52,677,344 | \$ 49,767,632 | \$ 50,625,302 |
| Expenditures: | | | | | |
| Direction and supportive services..... | \$ 781,581 | \$ 1,032,744 | \$ 837,264 | \$ 942,668 | \$ 888,592 |
| Protection of persons and property..... | 3,897,371 | 4,126,432 | 4,161,954 | 4,035,121 | 4,343,958 |
| Health and human services..... | 25,687,548 | 27,446,383 | 29,861,234 | 30,030,822 | 29,766,550 |
| Public education..... | 13,340,204 | 13,813,506 | 14,197,883 | 12,735,771 | 13,226,745 |
| Recreation and cultural enrichment..... | 341,283 | 291,412 | 243,606 | 242,218 | 234,799 |
| Economic development..... | 1,115,359 | 1,025,104 | 962,010 | 744,342 | 473,059 |
| Transportation..... | 48,969 | 59,121 | 48,003 | 42,962 | 14,396 |
| Capital outlay..... | 34,551 | 70,341 | 285,910 | 232,622 | 123,486 |
| Debt service..... | 144 | 526 | - | 26,325 | 25,479 |
| Other Uses: | | | | | |
| Operating transfers out..... | 1,018,478 | 1,049,269 | 1,023,268 | 1,096,921 | 1,215,358 |
| TOTAL EXPENDITURES AND OTHER USES | \$ 46,265,488 | \$ 48,914,838 | \$ 51,621,132 | \$ 50,129,772 | \$ 50,312,422 |
| REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURE AND OTHER USES..... | (2,458,923) | (230,375) | 1,056,212 | (362,140) | 312,880 |
| Fund Balance — End of Period | \$ 515,178 | \$ 284,803 | \$ 1,621,435 | \$ 1,259,295 | \$ 1,566,010 |
| Components of Fund Balance | | | | | |
| Reserved for encumbrances..... | \$ 785,864 | \$ 806,181 | - | - | - |
| Reserved for advances and other..... | 2,270,413 | 913,303 | - | - | - |
| Unreserved — designated..... | - | - | - | - | - |
| Unreserved — undesignated..... | (2,541,099) | (1,434,681) | - | - | - |
| Nonspendable..... | - | - | \$ 123,156 | \$ 240,975 | \$ 223,930 |
| Restricted..... | - | - | 756,141 | - | 76 |
| Committed..... | - | - | 1,063,613 | 1,276,671 | 1,334,872 |
| Assigned..... | - | - | - | - | 7,132 |
| Unassigned deficit..... | - | - | (321,475) | (258,351) | - |
| TOTAL FUND BALANCE..... | \$ 515,178 | \$ 284,803 | \$ 1,621,435 | \$ 1,259,295 | \$ 1,566,010 |

Source: Compiled from Office of the Budget, Comprehensive Annual Financial Report for fiscal years ended June 30, 2009 through 2013. See preceding text for discussion of changes in presentation of data resulting from adoption of new governmental accounting and reporting standards.

Fiscal Year 2011 Financial Results

GAAP Basis. Effective on July 1, 2010, the Commonwealth implemented GASB Statement No. 54 that resulted in the reclassification of 41 special revenue funds. As a result of the reclassification, the fund balance of the General Fund at June 30, 2010 was restated to \$565.2 million, an increase of \$280.2 million. At June 30, 2011, the General Fund reported a fund balance of \$1,621 million, an increase of \$1,019 million from the restated fund balance at June 30, 2010. On a net basis, total assets increased by \$593 million to \$10,839.0 million. Liabilities decreased by \$426 million to \$9,218 million.

General Fund tax revenues increased overall by \$1,599 million (6.58 percent) during the fiscal year ended June 30, 2011. This overall increase is attributable to all tax types except Realty Transfer taxes, which decreased by \$14 million. Corporation taxes increased by \$493 million, an increase of 11.92 percent, aided by one-time revenues of \$176 million. Reported Sales and Use Tax revenues increased by \$302 million that included the effect of payment changes that accelerated remittances of Sales taxes by vendors. Reported Other taxes increased by \$128 million over the prior fiscal year due primarily to increases in the Department of Revenue's Enhanced Revenue Collection program (\$79 million), \$23 million from the Medicaid Managed Care Gross Receipts Tax and \$30 million resulting from a current fiscal year reclassification.

Intergovernmental revenues increased by \$1,700 million, net, resulting primarily from non-ARRA Federal participation (\$1,376 million) as follows: a \$1,264 million increase related to significantly higher year over year expenditures for Department of Public Welfare medical assistance and other types of health and human services expenditures; a \$337 million increase for education programs; partially offset by \$80 million decreases in non-ARRA Federal participation for both Department of Community and Economic Development and Department of Environmental Protection and a \$65 million decrease for Department of Military and Veterans Affairs. For ARRA Federal participation (\$267 million): a \$145 million increase for Department of Public Welfare Medical Assistance and other types of health and human services expenditures, an \$111 million increase for education programs, a \$35 million increase for the Department of Environmental Protection and a \$17 million increase for the Department of Military and Veterans Affairs; partially offset by a \$27 million decrease for higher education and a \$14 million decrease for the Department of Community and Economic Development.

Charges for sales and services revenues increased by \$453 million, net, from the prior fiscal year due primarily to: Department of Public Welfare (\$418 million increase, net) for first-year quality care assessments (\$538 million), accrued revenues (\$64 million), and intergovernmental transfer (\$30 million), partially offset by lower capitation managed care assessments (\$170 million), and lower net nursing home assessments (\$52 million); \$152 million related to prior year active employee healthcare expenditures; and \$42 million of recurring payroll-related revenues. The net increase of \$629 million was partially offset by lower revenue accruals as of June 30, 2011 (\$166 million).

Combined licenses/fees/investment and other revenues decreased by \$135 million, net, primarily due to: 1) prior fiscal year one-time licenses/fees revenues for Table Game Authorization Fees, amounting to \$165 million, partially offset by fiscal year 2011 net increases of \$22 million; 2) an increase for investment income of \$8 million; and 3) net decreases for Other revenues of \$33 million. These net decreases (\$168 million) were partially offset by amounts newly reported as part of the General Fund of \$34 million.

Total General Fund expenditures increased by 5.7 percent during the fiscal year ended June 30, 2011, by over \$2,700 million.

Reported expenditures for health and human services expenditures increased by \$2,414 million, due primarily to higher aggregate need for medical assistance, and income and/or cash grant assistance to individuals (\$3,279 million). Of this increase, expenditures for Food Stamps increased by \$308 million. The \$3,279 million increase was partially offset by an \$889 million decrease in year over year accrued expenditures. Expenditures for the Pharmaceutical Assistance Contract for the Elderly (PACE) program, which are newly reported as part of the General Fund, amounted to \$243 million. Expenditures for the administration of the unemployment compensation benefits program increased by \$41 million. Labor and Industry expenditures decreased by \$209 million, primarily due to a fiscal year 2011 reclassification from this category to capital outlay.

Public education expenditures increased by \$384 million, net, due primarily to new Federally-funded (non-ARRA) basic education expenditures of \$387 million, partially offset by a reduction in state-funded basic education expenditures of \$140 million for a net year over year increase in basic education subsidies of \$247 million; increased ARRA Federally-funded expenditures of \$129 million; increased public school employee retirement (employer share) of \$57 million; and increased expenditures for food and nutrition programs of \$23 million. These increases (\$456 million) were partially offset by a net decrease in accrued expenditures (\$109 million) as of June 30 and net expenditure increases in a variety of programs (\$81 million). In addition, higher education subsidies decreased by nearly \$44 million.

Capital outlay expenditures increased by \$216 million, based on year over year capital asset acquisition increases at state agencies as follows: Labor and Industry (\$224 million), Pennsylvania Judiciary (\$26 million), Public Welfare (\$16 million) and Revenue (\$10 million). These increases were partially offset by decreases in numerous other state agencies amounting to \$60 million.

Direction and supportive services expenditures decreased by \$196 million, on a net basis, due primarily to a \$158 million increase in expenditures for active employee healthcare in the prior fiscal year which did not recur during fiscal year 2011, plus a separate fiscal year 2011 expenditure decrease of \$72 million for active employee healthcare. These two decreases were partially offset by a \$25 million increase in expenditures related to annuitant healthcare during fiscal year 2011.

Protection of persons and property expenditures increased by \$36 million, on a net basis, primarily because of higher expenditures for state agencies as follows: Corrections -- personnel (\$50 million) and contracted services (\$50 million); Environmental Protection -- increases in grants and subsidies (\$48 million); Emergency Management— increases in grants and subsidies (\$31 million); and Executive Offices -- higher accrued expenditures (\$27 million), all of which were partially offset by other reductions. These net increases were also partially offset by expenditure decreases for the Department of Military and Veterans Affairs -- lower accrued expenditures (over \$111 million), Labor and Industry -- lower accrued expenditures (\$28 million); the Pennsylvania Judiciary (over \$35 million); and Department of State -- a net decrease in accrued expenditures and grants and subsidies (\$23 million).

Reported Transfers to the General Fund increased by \$324 million primarily because of a \$244 million increase in Transfers from the Tobacco Settlement Fund, a \$200 million increase from the State Lottery Fund to the PACE program (now financially reported as part of the General Fund), and increases from several other funds during the fiscal year ended June 30, 2011.

Reported Transfers from the General Fund decreased by \$26 million, net, primarily because of a \$46.4 million decrease to the Community College Capital Fund, increases by several other funds, and partially offset by a \$42.3 million increase to debt service funds during the fiscal year ended June 30, 2011.

Budgetary Basis. Actual General Fund revenues of the Commonwealth were above the certified estimate by \$785.5 million or 2.9 percent during fiscal year 2011, the first time since fiscal year 2008. Final Commonwealth General Fund revenues for the fiscal year totaled \$27,497.2 million. Total fiscal year 2011 revenues, net of reserves for tax refunds and including public health and human services assessments, totaled \$26,983.8 million. Total expenditures, net of appropriation lapses and including public health and human services assessments and expenditures from additional sources (federal ARRA funding), were \$25,616.8 million, resulting in a preliminary operating balance for fiscal year 2011 of \$1,367.0 million. However, after accounting for a negative fiscal year 2010 beginning balance of \$294.2 million, the Commonwealth ended fiscal year 2011 with an unappropriated surplus balance of \$1,072.8 million.

Revenues available to the Commonwealth, net of reserves for tax refunds and transfers from the Budget Stabilization Reserve Fund but including public health and human service assessments, decreased \$184.8 million or 0.7 percent during fiscal year 2011. Public health and human service assessments decreased \$8.8 million during fiscal year 2011 to \$636.6 million.

General Fund revenues decreased \$150.9 million or 0.5 percent during fiscal year 2011 when measured on a year-over-year basis as compared to fiscal year 2010. However, this decline was due primarily to the use of the Budget Stabilization Reserve Fund and other such one-time balance transfers utilized during the 2010 fiscal year. Tax revenue collections grew \$1,550.7 million or 6.2 percent on a year-over-year basis from fiscal year 2010 to fiscal year 2011

while non-tax revenue collections declined \$1,701.6 million or 62.1 percent. Corporate tax receipts were \$398.6 million above fiscal year 2010 levels. Year-over-year growth in corporate taxes was 15.6 percent during fiscal year 2011 as corporate net income tax collections increased 19.0 percent and capital stock and franchise tax receipts increased 7.6 percent while collections from the gross receipts tax declined 4.8 percent. Personal income taxes were \$467.0 million above fiscal year 2010 actual collection, year-over-year growth in personal income tax receipts was 4.7 percent. Sales and use taxes receipts were \$561.0 million greater during fiscal year 2011 than during the prior fiscal year, a growth rate of 7.0 percent. Sales tax collections increased during fiscal year 2011 as motor vehicle sales tax collections grew 6.7 percent and non-motor vehicle sales tax receipts increased 7.0 percent during fiscal year 2011. Cigarette tax collections grew 10.2 percent during fiscal year 2011 and inheritance tax collections grew 6.8 percent. The continued weakness in the national housing market led to realty transfer tax revenues declining 5.7 percent during fiscal year 2011. Non-tax revenues of the Commonwealth declined 62.1 percent during fiscal year 2011, due primarily to the utilization of one-time revenues during the prior fiscal year. Reserves for tax refunds in fiscal year 2011 were \$1,150 million, an increase of 2.2 percent from fiscal year 2010 reserve levels.

Fiscal year 2011 appropriations from Commonwealth revenues, including supplemental appropriations and federal ARRA funding and net of appropriation lapses, totaled \$28,321.3 million, an increase of \$485.4 million or 1.7 percent from fiscal year 2010 expenditures. Fiscal year 2011 ARRA funding and appropriation lapses increased to \$3,341.1 million from \$3,063.0 million in fiscal year 2010, an increase of 9.1 percent. A total of \$275.2 million in appropriations were lapsed in fiscal year 2011, and the fiscal year 2011 budget contained a slightly reduced level of public health and human services assessments, \$636.6 million, which were utilized to cover a portion of medical assistance and long-term care costs. These assessments replaced \$636.6 million of General Fund medical assistance and long-term care costs in fiscal year 2011, compared to \$645.4 million in fiscal year 2010, a decrease of 1.4 percent.

Commonwealth General Fund appropriations for fiscal year 2011 totaled \$28,019.8 million, an increase of \$379.3 million or 1.4 percent from fiscal year 2010 levels. A total of \$3,055.0 million in operating appropriations were offset with federal funds, mainly ARRA, during fiscal year 2010. The Basic Education Funding subsidy to local school districts increased by \$250.0 million or 4.5 percent. Funding for higher education programs was reduced by \$19.1 million, or 1.0 percent. Commonwealth contributions to the Public School Employees Retirement System decreased \$55 million or 16.1 percent from fiscal year 2010 levels. Spending for the Department of Corrections increased \$82.0 million or 4.6 percent during fiscal year 2011 and medical assistance and human services spending increased by \$81.4 million or 0.8 percent during fiscal year 2010.

The ending unappropriated balance was \$1,072.8 million for fiscal year 2011. Under provisions of ARRA, the Commonwealth was prohibited from depositing any funds into the Budget Stabilization Reserve Fund. In June 2011, the statutory transfer of 25 percent of the Commonwealth's unappropriated surplus balance was suspended for one year.

Fiscal Year 2012 Financial Results

GAAP Basis. At June 30, 2012, the General Fund reported a fund balance of \$1,259.3 million, a decrease of \$362.1 million from the reported \$1,621.4 million fund balance at June 30, 2011 reflecting the decline in program revenue as well as increases in expenditures for social service programs. On a net basis, total assets increased by \$261.0 million to \$11,100.9 million. Liabilities increased by \$623.2 million to \$9,841.6 million.

General Fund tax revenues increased overall by \$693 million (2.68 percent) during the fiscal year ended June 30, 2012. This overall increase is attributable to all tax types except the Corporation taxes and Cigarette taxes, which decreased by \$154 million and \$23 million from the prior fiscal year. Personal Income Taxes increased by 3.1 percent and Sales and Use Tax revenues increased by \$363 million (4.4 percent) as the economy in the Commonwealth showed improvement. Tax collections during the fiscal year, before adding net tax accrual and subtracting tax refunds/credits, increased \$306 million (3.1 percent). Corporation taxes decreased by \$154 million, a decrease of 3.3 percent, due primarily to the continuing phase-out of the Capital Stock and Franchise tax. Reported Other taxes increased by \$135 million, net, over the prior fiscal year.

Intergovernmental revenues decreased by \$3,322 million, net, resulting primarily from the phase-out of Federal ARRA participation. Charges for sales and services revenues increased by \$11 million, net, from the prior fiscal year. Combined licenses/fees/investment and other revenues increased by \$186 million.

Total General Fund expenditures decreased by 2.9 percent during the fiscal year ended June 30, 2012, by nearly \$1,500 million reflecting the phase-out of the Federal ARRA grants. The largest decline of Federal support was for education and economic development programs.

Public education expenditures decreased by a net \$1,462 million, due primarily to the phase-out of Federally-funded (ARRA and the Education Jobs Fund) grants for basic education. Expenditures for economic development decreased \$218 million from the prior year. Reported health and human services expenditures increased by \$170 million. Direction and supportive services expenditures increased by \$105 million, on a net basis, due primarily to an increase in expenditures for active employee healthcare.

As result of the Commonwealth's implementation of GASB Statement No. 54, the total reported fund balance of \$1,259.3 million at June 30, 2012 included amounts that were formerly reported as part of Special Revenue funds.

Budgetary Basis. The subdued level of the economic recovery from the most recent national recession continued to affect the Commonwealth's revenue receipts during fiscal year 2012. General Fund revenues of the Commonwealth were below the certified estimate by \$162.8 million or 0.6 percent during fiscal year 2012. Final Commonwealth General Fund revenues for the fiscal year totaled \$27,678.0 million. Total fiscal year 2012 revenues, net of reserves for tax refunds and including public health and human services assessments, totaled \$27,101.3 million. Total expenditures, net of appropriation lapses and including public health and human services assessments and expenditures from additional sources, were \$27,534.4 million, resulting in a preliminary operating deficit for fiscal year 2012 of \$433.3 million. However, after accounting for a positive fiscal year 2012 beginning balance of \$1,072.8 million, the Commonwealth ended fiscal year 2012 with an unappropriated surplus balance of \$659.0 million, which was the second largest (following the \$1,072.8 million ending balance from fiscal year 2011) such unappropriated ending balance since prior to the 2001 recession. (See "Table 8").

General Fund revenues increased \$180.8 million or 0.7 percent during fiscal year 2012 when measured on a year-over-year basis as compared to fiscal year 2011. Tax revenue collections grew \$687.8 million or 2.6 percent on a year-over-year basis from fiscal year 2011 to fiscal year 2012 while non-tax revenue collections declined \$507.2 million or 48.9 percent, primarily from a reduction in balance transfers from fiscal year 2011 to fiscal year 2012. Corporate tax receipts were \$91.2 million lower than fiscal year 2011 levels. Year-over-year growth in corporate taxes was -3.1 percent during fiscal year 2012 as corporate net income tax collections decreased 5.1 percent and capital stock and franchise tax receipts increased 2.2 percent while collections from the gross receipts tax increased 8.6 percent on a year-over-year basis. Personal income taxes were \$364.8 million above fiscal year 2011 actual collection and the year-over-year growth in personal income tax receipts was 3.5 percent. Personal income tax collections attributable to withholding increased by 3.5 percent or \$282.9 million during fiscal year 2012 and tax collections from the non-withholding portion of the personal income tax increased 3.4 percent or \$81.9 million on a year-over-year basis. Sales and use taxes receipts were \$182.1 million greater during fiscal year 2012 than during the prior fiscal year, a growth rate of 2.1 percent. Sales tax collections increased during fiscal year 2012 as motor vehicle sales tax collections grew 9.2 percent and non-motor vehicle sales tax receipts increased 1.1 percent during fiscal year 2012. Cigarette tax collections declined 0.5 percent during fiscal year 2012 and inheritance tax collections grew 2.8 percent. Realty transfer tax revenues grew 4.7 percent during fiscal year 2012 after having declined in 2011. Non-tax revenues of the Commonwealth declined 48.9 percent during fiscal year 2012, due primarily to the decreased utilization of one-time revenues during the prior fiscal year. Reserves for tax refunds in fiscal year 2012 were \$1,275 million, an increase of 10.9 percent from fiscal year 2011 reserve levels.

Fiscal year 2012 appropriations from Commonwealth revenues, including supplemental appropriations and net of appropriation lapses, totaled \$27,534.4 million. A total of \$188.7 million in appropriations were lapsed in fiscal year 2013, and the fiscal year 2013 budget contained a lower level of public health and human services assessments, \$629.5 million, which were utilized to cover a portion of medical assistance and long-term care costs.

Commonwealth General Fund appropriations for fiscal year 2012 totaled \$27,185.6 million, a decrease of \$1,135.7 million or 4.0 percent from fiscal year 2011 levels. The Basic Education Funding subsidy to local school districts declined 7.3 percent from the prior year. Funding for higher education programs was reduced by approximately 20 percent. Commonwealth contributions to the Public School Employees Retirement System increased 108.7 percent from fiscal year 2011 levels. Spending for the Department of Corrections was held flat at fiscal year 2011

levels during fiscal year 2012 and medical assistance and human services spending decreased by \$54.6 million or 0.5 percent during fiscal year 2012.

The ending unappropriated balance was \$659.2 million for fiscal year 2012. Again in June 2012, the statutory transfer of 25 percent of the Commonwealth's unappropriated surplus balance was suspended for one year.

Fiscal Year 2013 Financial Results

GAAP Basis. At June 30, 2013, the General Fund reported a fund balance of \$1,566.0 million, a decrease of \$312.9 million from the restated \$1,253.1 million fund balance at June 30, 2012. Total assets increased \$457.0 million to \$11,556.9 million largely attributable to receivables in public welfare programs. A majority of the increase is due to the expansion of the Managed Care Organizations that increased the monthly outstanding balances due from the federal government. Liabilities increased by \$150.9 million to \$9,990.9 million. The increased liabilities are a consequence of payables activity related to the expansion of the Managed Care Organizations previously mentioned. Netting against this increase was a decrease in medical assistance paid to local education agencies.

Total revenues increased by \$991 million reflecting an overall improvement in the economy. Personal income tax revenue was the largest contributing factor, increasing by \$655 million. Corporation income tax also contributed to this positively by adding a \$251 million year over year increase. Act 46 of 2010 created the Enhanced Revenue Collection Account which resulted in enhanced revenue collections and refunds avoided by expanding tax return review and tax collection activities. Both revenue streams were improved by Act 46.

Total General Fund expenditures and other uses increased by 0.4 percent during the fiscal year ended June 30, 2013, to \$1,215.4 million. Total expenditures increased by a net of \$65 million. The largest increases were in public education (\$491 million) and protection of persons and property (\$409 million) programs. The significant decreases were in economic development (\$271 million), health and human services (\$291 million) and capital outlay (\$110 million) programs.

Reported health and human services expenditures declined by \$264.3 million, mainly due to federal programs being phased out. There was a decrease in these programs from fiscal 2012 to fiscal 2013. Contributing to the decrease was a reduction of expenditures in the Women, Infants and Children Program, specifically a reduction of rebate expenses. Public education expenditures increased by \$491.9 million, primarily with respect to increases in state subsidies and state contributions for school employee retirement contributions. Protection of persons and property expenditures experienced an increase in expenditures by \$309 million, largely due to an increase in the Commonwealth's employers' share of retirement contributions and grants to municipalities. Expenditures for economic development experienced a decrease in expenditures by \$271.2 million, largely due to a phase out of the federal ARRA grants and a decrease in the state funded redevelopment assistance grants.

Budgetary Basis. General Fund revenues of the Commonwealth were above the certified estimate by \$56.9 million or 0.2 percent for fiscal year 2013. Final Commonwealth General Fund revenues for the fiscal year totaled \$28,646.9 million. Total fiscal year 2013 revenues, net of reserves for tax refunds and including public health and human services assessments, totaled \$27,258.2 million. Total expenditures, net of appropriation lapses and including public health and human services assessments and expenditures from additional sources, were \$27,717.3 million, resulting in a preliminary operating balance for fiscal year 2014 of \$320.3 million. However, after accounting for a positive fiscal year 2013 beginning balance of \$672.5 million, the Commonwealth ended fiscal year 2013 with an unappropriated surplus balance of \$540.9 million, which was the third straight year of securing a significant year-end unappropriated balance. (See "Table 8").

General Fund revenues increased \$968.9 million or 3.5 percent during fiscal year 2013 when measured on a year-over-year basis as compared to fiscal year 2012. Tax revenue collections grew \$918.6 million or 3.4 percent on a year-over-year basis from fiscal year 2012 to fiscal year 2013 while non-tax revenue collections increased \$50.3 million or 9.5 percent, primarily from an increase in escheats from fiscal year 2012 to fiscal year 2013. Corporate tax receipts were \$226.0 million higher than fiscal year 2012 levels. Year-over-year growth in corporate taxes was 4.6 percent during fiscal year 2013 as corporate net income tax collections increased 19.8 percent and financial institutions tax increased 29.0 percent while collections from the capital stock and franchise tax decreased 28.1 percent on a year-over-year basis. Personal income taxes were \$570.7 million above fiscal year 2012 actual collection and the year-over-year

growth in personal income tax receipts was 5.3 percent. Personal income tax collections attributable to withholding increased by 2.7 percent or \$226.6 million during fiscal year 2013 and tax collections from the non-withholding portion of the personal income tax increased 13.7 percent or \$344.1 million on a year-over-year basis. Sales and use taxes receipts were \$121.4 million greater during fiscal year 2013 than during the prior fiscal year, a growth rate of 1.4 percent. Sales tax collections increased during fiscal year 2012 as non-motor vehicle sales tax collections grew 1.5 percent and motor vehicle sales tax receipts increased 0.6 percent during fiscal year 2013. Cigarette tax collections declined 4.3 percent during fiscal year 2013 and inheritance tax collections grew 2.1 percent. Realty transfer tax revenues grew 15.9 percent during fiscal year 2013 – the strongest year of growth since the recession. Non-tax revenues of the Commonwealth increased 9.5 percent during fiscal year 2013, due primarily to large growth in escheats. Reserves for tax refunds in fiscal year 2012 were \$1,275 million, an increase of 10.9 percent from fiscal year 2011 reserve levels.

Commonwealth General Fund appropriations for fiscal year 2013 totaled \$27,717.3 million, an increase of \$686.7 million or 2.5 percent from fiscal year 2012 levels. The Basic Education Funding subsidy to local school districts increased \$49 million (1 percent) from the prior year. Funding for higher education programs was reduced by approximately 20 percent. Commonwealth contributions to the Public School Employees Retirement System increased by \$155.9 million, 30 percent from fiscal year 2012 levels. Growth in spending for the Department of Corrections was held to only a half percent increase, about \$10 million over fiscal year 2012 levels. Department of Public Welfare spending increased by \$117 million, about a 1 percent increase over fiscal year 2012.

The ending unappropriated balance was \$540.9 million for fiscal year 2013. Again in June 2013, the statutory transfer of 25% of the Commonwealth's unappropriated balance was suspended for one year.

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Table 8*
Sources, Uses and Changes in Unappropriated Balance
General Fund and Other Funding Sources – Unaudited Budgetary Basis
Commonwealth Revenues Only

| | (In Thousands) | | |
|---|----------------------------|--------------------------------|--------------------------------------|
| | Actual Fiscal Year 2013 | Estimated Fiscal Year 2014* | Proposed Budget Fiscal Year 2015* |
| Sources: | | | |
| Beginning Balance..... | \$ 672,581 | \$ 545,918 | \$ 215,985 |
| Revenue Receipts..... | 28,646,946 | 29,115,900 | 30,315,100 |
| Revenue Changes..... | | | 225,000 |
| Refunds..... | (1,250,000) | (1,275,000) | (1,310,000) |
| Public Health and Human Services Assessments ^(a) | 629,500 | 686,700 | 741,900 |
| Prior Year Lapses ^(b) | 188,684 | 251,500 | 0 |
| Funds Available..... | \$ 28,887,711 | \$ 29,325,018 | \$ 30,187,985 |
| Uses: | | | |
| Appropriations..... | \$ 27,717,293 | \$ 28,422,469 | \$ 29,419,130 |
| Supplemental Appropriations..... | 0 | 69,864 | 0 |
| Public Health and Human Services Assessments ^(a) | 629,500 | 686,700 | 741,900 |
| Current Year Lapses..... | 0 | (70,000) | 0 |
| Total Expenditures..... | \$ 28,346,793 | \$ 29,109,033 | \$ 30,161,030 |
| Preliminary Balance..... | \$ 540,918 | \$ 215,985 | \$ 26,955 |
| Transfer to Budget Stabilization Fund..... | 0 | 0 | (6,739) |
| Ending Unappropriated Balance..... | \$ 540,918 | \$ 215,985 | \$ 20,216 |

(a) Only includes funds replacing Commonwealth funds. Fiscal year 2013 includes \$151.5 million from a nursing home tax used to augment appropriated funds for long-term care. For fiscal year 2014, this number is \$199.7 million and for fiscal year 2015 it is estimated at \$191 million. Fiscal year 2013 also includes \$369 million from a tax imposed on managed care organizations. For fiscal year 2014 this number is \$337 million and for fiscal year 2015 it is estimated at \$400.9 million. Additionally, fiscal year 2013 includes \$109 million from a Statewide Quality Care Assessment. For fiscal year 2014, this number is \$150 million and for fiscal year 2015 it is estimated at \$150 million as well.

(b) Includes prior year appropriation lapses and federal funds from the American Recovery and Reinvestment Act.

* See “COMMONWEALTH FINANCIAL PERFORMANCE- Recent Developments” on May 1, 2014.

Fiscal Year Enacted 2014 Budget

The enacted fiscal year 2014 budget provides appropriations and executive authorizations, net of lapses and other reductions, totaling \$28,422.3 million of Commonwealth funds against estimated revenues, net of tax refunds and including public health and human services assessments. Enacted General Fund appropriations represented an increase of \$705.1 million, or 2.5 percent on a year-over-year basis, for fiscal year 2014.

General Fund revenues from all sources were estimated to increase \$443.9 million or 1.6 percent on a year-over-year basis for fiscal year 2014 after factoring in planned tax refunds expenditures. The enacted budget does not include any tax increases, but does implement several tax changes intended to catalyze positive economic growth and therefore increase state revenue proposed in the Governor’s Executive Budget. The enacted budget continues the phaseout of the Capital Stock and Franchise Tax, albeit at a reduced pace for two more years, as it was scheduled to be completely phased out in 2013. The enacted budget eliminated the inheritance tax on small businesses. Other major revenue changes include: 1) a \$11.4 million tax revenue reduction associated with an increase in the permitted net operating loss cap from \$3 million to \$4 million; 2) a \$7 million tax revenue increase from a change in the sourcing of sales for corporate net income tax purposes; 3) a \$4.3 million tax revenue increase from an expansion of the realty transfer tax; 4) a \$2.6 million tax revenue increase from changes to the personal income tax treatment of certain “pass through” businesses; 5) a \$29.5 million non-tax revenue increase from a redirection of certain Motor License Fund fines to the General Fund. Other tax-based economic incentives include the creation of the City Revitalization Investment Zones (CRIZ) Program and InnovatePA. The CRIZ Program was created by Act 52 of 2013. The Pennsylvania Department of Revenue, the Pennsylvania Department of Community and Economic Development and the Governor’s Office of Budget are tasked with administration of the CRIZ Program. The focus of the program is to provide opportunity to spur new growth, helping to revive downtowns and create jobs for the residents in the regions. Vacant,

desolate, underutilized or abandoned space will be developed, thereby creating jobs, increasing personal incomes, growing state and local tax revenues, reviving local economies and improving the lives of city residents and visitors. The enacted budget also increases funding for the PA First program by \$8.3 million; this is the Commonwealth's primary business attraction, relocation and expansion incentive tool.

Based on the revised estimates for fiscal year 2014 incorporated in the Governor's fiscal year 2015 proposed budget released February 4, 2014, and assuming the fiscal year 2014 supplemental appropriation requests are enacted, the General Fund is projected to have a fiscal year ending unappropriated fund balance of \$215.9 million, assuming the required transfer of 25 percent of the unappropriated balance was suspended for the fiscal year. **See, however, "COMMONWEALTH FINANCIAL PERFORMANCE-Recent Developments" on May 1, 2014.** The discussion of the 2014 budget in the remainder of this Official Statement utilizes the revised estimated financial data included in the Governor's proposed budget of 2014 of February 4, 2014.

The current fiscal year 2014 General Fund budget aims to keep spending in line with available resources without raising taxes in Pennsylvania. Administrative spending of the Commonwealth was again reduced and included the proposed elimination of more than 900 positions. There are approximately 3,000 fewer Commonwealth employees than there were three years ago.

The enacted 2014 budget includes an increase of over \$122.5 million in Basic Education funding, an increase of 2.3 percent over fiscal year 2013. Total Basic Education formula funding is \$5,500 million for all school districts. In addition, more than \$348 million was appropriated for early childhood programs and \$1,600 million for higher education.

Rising employer contribution rates and costs in accordance with law for the Commonwealth's two pension systems are projected to grow by a factor of three over the next four years, rising from \$1,500 million in fiscal year 2014 to \$4,300 million in fiscal year 2017. Reform of the retirement systems, as proposed and advocated by the Governor, was not enacted. The enacted budget for fiscal year 2014 includes the Commonwealth's component of the pension contribution of the Pennsylvania Public School Employees Retirement System funded at \$1,017 million, an increase of \$161 million or 18.8 percent over fiscal year 2013. **Without reforms, meeting the growing pension contributions in the future will likely require deep cuts in the Commonwealth's General Fund budget as well as the budgets of local school districts.**

Actual revenues to the General Fund through January 2014 are slightly (0.3 percent) below the fiscal year 2014 estimate. The largest shortfalls to the estimate year to date are primarily in the Personal Income (\$100.5 million) and Sales and Use taxes (\$22.4 million) but offset in part by above estimate receipts from Corporate taxes (\$87.9 million) and non-tax sources (\$23.0 million). January year over year revenues to the General Fund are 0.6 percent higher. In February 2014, the Governor's proposed fiscal year 2015 budget included a revision to the individual revenue items comprising General Fund revenues. While there were revisions to various individual revenue item estimates, the total General Fund revenue estimate for fiscal year 2014 was unchanged. **See, however, "COMMONWEALTH FINANCIAL PERFORMANCE-Recent Developments" on May 1, 2014.**

A revised estimate of expenditures for fiscal year 2014 was also included in the proposed fiscal year 2015 proposed budget by the Governor. Supplemental appropriation needs for fiscal year 2014 were identified totaling \$69.9 million, principally for programs of the Department of Public Welfare and the Department of Corrections. These supplemental appropriations are anticipated to be funded by the lapse of an estimated \$70 million from other appropriations that will not be spent during the fiscal year.

The achievement of budgeted results may be adversely affected by a number of trends or events, including developments in the national and state economies. Deficits in the enacted budget can result from failures to timely receive projected revenues, inability to control or reduce expenses as projected, incurrence of unforeseen expenses, imposition of unforeseen obligations, whether of a legislative or litigation nature or resulting from a natural disaster, and a multitude of other causes. Cost cutting and revenue producing measures are less efficacious if imposed later in a fiscal year because of the shorter time period over which they will operate.

Fiscal Year 2015 Proposed Budget

A proposed fiscal year 2015 budget was submitted by the Governor to the General Assembly on February 4, 2014. The budget document and related information is available on the Governor's Budget Office web page at www.budget.state.pa.us. The proposed budget proposes spending of \$29,400 million of Commonwealth funds, an increase of \$925 million, or 3.3 percent over fiscal year 2014. Revenues to support the proposed funding are estimated to be \$30,500 million, a 4.9 percent increase over current estimates for fiscal year 2014. The revenue estimate includes the continuation of the phase-out of the Capital Stock and Franchise Tax, a proposed reduction in the holding period for unclaimed property estimated to increase revenues by \$150 million and the transfer of \$75 million from the Oil and Gas Lease Fund. The proposed budget also includes the transfer of all private equity investments and cash from the Tobacco Settlement Fund and the Health Venture Investment Account to the Public School Employees' Retirement System to augment the appropriated amount for state share of contributions to the Retirement System.

Key priorities proposed for additional funding in the Governor's proposed fiscal year 2015 budget include: (i) spurring job creation, economic growth through economic development investments and continuing business tax reform, (ii) basic education improvements through more than \$400 million in new spending for school districts, and (iii) providing increased access to quality and affordable health care for residents.

In February 2014, the General Assembly began appropriations committee hearings for the fiscal year 2015 budget. Further legislative debate is anticipated before both houses vote to adopt the General Appropriation Bill for the 2015 fiscal year. **See, however, "COMMONWEALTH FINANCIAL PERFORMANCE-Recent Developments" on May 1, 2014.**

The General Assembly may change, eliminate or add amounts and items to the proposed budget submitted by the Governor, and there can be no assurance that the budget, as proposed by the Governor, will be enacted into law by June 30. In the event that the General Assembly fails to pass or the Governor fails to sign an appropriation act prior to July 1 of any fiscal year for that fiscal year, the Pennsylvania Constitution, the laws of Pennsylvania and certain state and federal court decisions provide that the Commonwealth may continue during such periods of an un-budgeted fiscal year to make debt service payments, payments for mandated federal programs such as cash assistance and payments related to the health and safety of the citizens of the Commonwealth such as police and correctional services. Failure, however, of the Governor and the General Assembly to reach agreement on the budget could have adverse effects on the Commonwealth, including, among others, the collection of revenue and completion of the annual audit. See Appendix C for additional information on the budget.

Motor License Fund

The Constitution requires all proceeds of motor fuels taxes, vehicle registration fees, license taxes, operators' license fees and other excise taxes imposed on products used in motor transportation to be used exclusively for construction, reconstruction, maintenance and repair of and safety on highways and bridges and for debt service on obligations incurred for these purposes. The Motor License Fund is the fund through which most such revenues are accounted for and expended. Portions of certain taxes whose receipts are deposited into the Motor License Fund are legislatively restricted to specific transportation programs. These receipts are accounted for in restricted accounts in the Motor License Fund and are not included in the budgetary basis presentations or discussions on the Motor License Fund. The Motor License Fund budgetary basis includes only unrestricted revenue available for annual appropriation for highway and bridge purposes. In contrast, the GAAP basis presentations include restricted account revenues and expenditures.

Financial Results for Recent Fiscal Periods (GAAP Basis)

The fund balance at June 30, 2013, of the Motor License Fund was \$1,063.3 million, a \$129.7 million (10.9 percent) decrease from the June 30, 2012 fund balance. Over the five fiscal years 2009 through 2013, revenues and other sources averaged an annual 0.7 percent increase. Expenditures and other uses during the same period averaged a 0.93 percent annual increase.

Overall, total revenues increased by \$26.9 million during the fiscal year ended June 30, 2013, a 0.5 percent increase from the prior fiscal year. Tax revenues declined \$38.0 million during fiscal year 2013 while licenses and fees revenues increased \$6.9 million. Intergovernmental revenues increased by \$18.2 million during fiscal year 2013. Other

revenues of the Motor License Fund increased \$39.8 million from the prior year, primarily attributable to an increase in investment income as a result of improved market conditions during the fiscal year.

Total expenditures decreased by \$117.3 million during the fiscal year ended June 30, 2013; representing a 2.2 percent decrease from the prior fiscal year. Direction and supportive services expenditures decreased by \$27 million. A portion of this decrease was due to the shift of \$13 million in the appropriations for the Statewide Public Safety Radio System to protection of persons and property as a part of the State Police expenditures. Also contributing to the decrease was a change in the recording of the Liquid Fuels Refunds which amounted to \$14 million. Capital Outlay decreased by \$159 million which is a reflection of a cutback in highway and bridge projects during the fiscal year. This cutback is attributable to the phase out of the FHWA ARRA programs and a year over year reduction in tax receipts.

Table 9, sets forth a condensed summary of revenues and expenditures (presented on a GAAP basis) for the Motor License Fund for the fiscal years 2009 through 2013.

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Table 9
Results of Operations—Motor License Fund
GAAP Basis—Unaudited
(In Thousands)

| | Fiscal Year Ended June 30 | | | | |
|--|---------------------------|---------------------|---------------------|---------------------|---------------------|
| | 2009 | 2010 | 2011 | 2012 | 2013 |
| Fund Balance — Beginning of Period | \$ 1,566,520 | \$ 1,509,732 | \$ 1,661,421 | \$ 1,503,483 | \$ 1,192,998 |
| Restatements..... | 30,059 | - | - | - | - |
| Fund Balance — Beginning of Period, as Restated..... | \$ 1,596,579 | \$ 1,509,732 | \$ 1,661,421 | \$ 1,503,483 | \$ 1,192,998 |
| Revenues: | | | | | |
| Taxes..... | \$ 1,975,678 | \$ 2,045,505 | \$ 2,092,645 | \$ 2,096,222 | \$ 2,058,228 |
| Licenses and fees..... | 874,711 | 851,164 | 899,208 | 913,660 | 920,536 |
| Intergovernmental..... | 2,062,260 | 2,649,613 | 1,791,466 | 1,917,064 | 1,935,313 |
| Other revenues..... | 75,421 | 240,767 | 234,845 | 145,264 | 185,050 |
| Other Financing Sources: | | | | | |
| Operating transfers in..... | - | 5,164 | - | - | 37,327 |
| Other additions..... | - | - | 111 | - | 714 |
| TOTAL REVENUES AND OTHER SOURCES..... | \$ 4,988,070 | \$ 5,792,213 | \$ 5,018,275 | \$ 5,072,210 | \$ 5,137,168 |
| Expenditures: | | | | | |
| Direction and supportive services..... | \$ 71,167 | \$ 61,906 | \$ 50,624 | \$ 58,679 | \$ 31,593 |
| Protection of persons and property..... | 638,844 | 647,735 | 669,213 | 707,229 | 743,349 |
| Public education..... | 806 | 811 | 689 | 595 | 459 |
| Recreation and cultural enrichment..... | 1,390 | 3,263 | 3,421 | 3,855 | 901 |
| Transportation..... | 2,105,489 | 2,372,220 | 1,840,867 | 2,001,559 | 2,036,728 |
| Capital outlay..... | 2,217,691 | 2,502,788 | 2,548,674 | 2,542,787 | 2,384,372 |
| Other Uses: | | | | | |
| Operating transfers out..... | 39,530 | 51,801 | 62,725 | 67,991 | 69,442 |
| TOTAL EXPENDITURES AND OTHER USES | \$ 5,074,917 | \$ 5,640,524 | \$ 5,176,213 | \$ 5,382,695 | \$ 5,266,844 |
| REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURE AND OTHER USES..... | (86,847) | 151,689 | (157,938) | (310,485) | (129,676) |
| Fund Balance — End of Period | \$ 1,509,732 | \$ 1,661,421 | \$ 1,503,483 | \$ 1,192,998 | \$ 1,063,322 |
| Components of Fund Balance | | | | | |
| Reserved for encumbrances..... | \$ 652,352 | \$ 768,916 | \$ - | \$ - | \$ - |
| Reserved for advances and other..... | 10,225 | 116,545 | - | - | - |
| Unreserved - designated - highways..... | 700,018 | 768,710 | - | - | - |
| Unreserved - undesignated..... | 147,137 | 7,250 | - | - | - |
| Restricted..... | - | - | 1,503,483 | 1,192,998 | 1,063,322 |
| TOTAL FUND BALANCE..... | \$ 1,509,732 | \$ 1,661,421 | \$ 1,503,483 | \$ 1,192,998 | \$ 1,063,322 |

Source: Compiled from Office of the Budget, Comprehensive Annual Financial Report for fiscal years ended June 30, 2009 through 2013.

The following budgetary basis information is derived from the Commonwealth's unaudited budgetary basis financial statements.

Fiscal Year 2011 Financial Results

Budgetary Basis. Commonwealth revenues to the Motor License Fund totaled \$2,521.4 million, a decrease of \$119.7 million (4.5 percent) over fiscal year 2010 revenues. Receipts from liquid fuels taxes increased by 2.9 percent while license and fee revenue increased by 4.0 percent. Other revenue receipts decreased by 31.4 percent during fiscal year 2011, due primarily to a decrease in the amount of revenue transferred to the Motor License Fund by the Pennsylvania Turnpike Commission pursuant to Act 44. Fiscal year 2011 Motor License Fund appropriations and

executive authorizations totaled \$2,402.9 million, a decrease of 8.6 percent from fiscal year 2010. The decreased expenditure levels during fiscal year 2011 were the net result of decreased funding made available from Act 44. The Motor License Fund concluded fiscal year 2011 with an unappropriated surplus of \$318.0 million, a net increase of 93 percent.

Fiscal Year 2012 Financial Results

Budgetary Basis. Commonwealth revenues to the Motor License Fund totaled \$2,414.4 million, a decrease of \$107.2 million or 4.3 percent from fiscal year 2011 revenues. Receipts from liquid fuels taxes decreased by 1.2 percent while license and fee revenue increased by 0.1 percent. Other revenue receipts decreased by 27.6 percent during fiscal year 2012, due primarily to a decrease in one-time interest earnings that occurred during fiscal year 2011. Fiscal year 2012 Motor License Fund appropriations and executive authorizations totaled \$2,614.8 million, an increase of 8.8 percent from fiscal year 2011. The Motor License Fund concluded fiscal year 2012 with an unappropriated surplus of \$153.0 million, a net decrease of 51.9 percent. The net decrease in the unappropriated surplus was as result of expenditures exceeding available revenues by \$200 million during fiscal year 2012.

Fiscal Year 2013 Financial Results

Budgetary Basis. Commonwealth revenues to the Motor License Fund totaled \$ 2,416.2 million, an increase of \$2.0 million or 0.1 percent from fiscal year 2012 revenues. Receipts from liquid fuels taxes decreased by 0.1 percent while license and fee revenue remained even with the previous year. Other revenue receipts increased by 1.0 percent over the previous fiscal year. Fiscal year 2013 Motor License Fund appropriations and executive authorizations totaled \$2,503.0 million, a decrease of 4.3 percent from fiscal year 2012. The Motor License Fund concluded fiscal year 2013 with an unappropriated surplus of 107.5 million, a net decrease of 29.7 percent. The net decrease in the unappropriated surplus was as result of expenditures exceeding available revenues by \$86.8 million during fiscal year 2013.

Fiscal Year 2014 Budget

Budgetary Basis. Commonwealth revenues to the Motor License Fund are projected in the mid-year re-estimate to be \$2,470.2 million, an increase of \$54 million or 2.2 percent over fiscal year 2013 revenues. Receipts from liquid fuels tax is expected to rise 8.4 percent over the prior year while license and fee revenues are expected to decrease by 0.7 percent. Additionally, other revenue receipts are projected to decrease by 14.2 percent. Fiscal year 2014 Motor License Fund appropriations and executive authorizations, net of anticipated lapses, are expected to equal \$2,497.6 million, a decrease of 0.2 percent from fiscal year 2013 appropriations less lapses. The Motor License Fund is anticipated to conclude fiscal year 2014 with an unappropriated balance of \$105.6 million, a slight reduction from the fiscal year 2014 opening unappropriated fund balance of \$107.6 million.

Fiscal Year 2015 Proposed Budget

A proposed fiscal year 2015 budget was submitted by the Governor to the General Assembly on February 4, 2014. The budget document and related information is available on the Governor's Budget Office web page at www.budget.state.pa.us. The Governor's proposed budget for fiscal year 2015 recommends \$4,900 million for construction, reconstruction and maintenance of highways and bridges in the Commonwealth. This is an increase of 15 percent from estimated fiscal year 2014 spending, primarily due to the passage of Act 89 of 2013. The increase is supported by proposed bond financing for highway projects.

The General Assembly is considering the Governor's budget proposal through hearings and debate on various bills, including the General Appropriation Bill, required to enact the budget. The General Assembly may change, eliminate or add amounts and items to the proposed budget submitted by the Governor and there can be no assurance that the budget, as proposed by the Governor, will be enacted into law by June 30. See Appendix C for additional information on the budget.

State Lottery Fund

The Commonwealth operates a statewide lottery program that consists of various lottery games using computer sales terminals located throughout the state, and instant games using preprinted tickets. The net proceeds of all lottery game sales, less sales commissions and directly paid prizes, are deposited into the State Lottery Fund.

State Lottery Fund receipts support programs to assist elderly and handicapped individuals, primarily through property tax and rent rebate assistance and a pharmaceutical assistance program to recipients who meet specified income limits, and the provision of free mass transit rides during off-peak hours. Certain administrative costs and the payment to the General Fund of the personal income tax due on lottery prizes, which taxes and costs were previously paid from the State Lottery Fund, are now paid by the General Fund, beginning in fiscal year 2000.

Financial Results for Recent Fiscal Periods (GAAP Basis)

The total net assets of the State Lottery Fund at June 30, 2012, were -\$68.9 million, a \$49.7 million improvement from the June 30, 2011 fund balance of -\$118.6 million. The improvement represents a 41.9 percent increase in total net assets. Over the five fiscal years 2008 through 2012, revenues have averaged an annual 3.4 percent increase while expenditures and other uses during the same period have averaged an annual 1.4 percent annual increase.

During the fiscal year ended June 30, 2013, the net year over year increase in overall gross revenues (\$175.5 million) was primarily attributable to increased Lottery revenues (\$222.5 million). The increase in sales and service revenues resulted from a record sales year during the fiscal year ended June 30, 2013. This is the third year in a row that the Lottery has set a record in total sales. This is attributable in part to a \$170 million increase in instant game sales versus the prior year. Instant game sales account for roughly 62 percent of overall game sales. Lottery sales for fiscal year 2013 continued to reflect the industry trend of increased consumer demand for instant ticket products. Operating expenses and depreciation and amortization increased by \$307 million, due in part to increased sales activity and the corresponding direct costs associated with the sales activity. In addition, there was a substantial increase (\$130 million) in funding provided for the Medical Assistance Long Term Care Program during fiscal year 2013. Investment income and other revenues decreased \$47 million. This decrease is attributable mainly to a decrease in eligible federal reimbursement for the Area Agencies on Aging Medical Assistance Program.

Table 10 sets forth a condensed summary of revenues and expenditures (presented on a GAAP basis) for the State Lottery Fund for fiscal years 2009 through 2013.

Table 10
Results of Operations—State Lottery Fund
GAAP Basis—Unaudited
(In Thousands)

| | Fiscal Year Ended June 30 | | | | |
|--|---------------------------|---------------------|---------------------|---------------------|---------------------|
| | 2009 | 2010 | 2011 | 2012 | 2013 |
| Net Assets - | | | | | |
| Beginning of Period | \$ 135,824 | \$ (144,537) | \$ (166,238) | \$ (118,585) | \$ (68,858) |
| Revenues: | | | | | |
| Lottery revenues..... | 3,087,962 | 3,051,640 | 3,206,588 | 3,476,663 | 3,699,186 |
| Investment income..... | (17,677) | 2,894 | 4,681 | 13,562 | 4,989 |
| Other revenues..... | 110,836 | 113,043 | 114,586 | 114,785 | 76,278 |
| Other Financing Sources: | | | | | |
| Operating transfers in..... | 48,500 | 176,700 | 165,900 | 164,100 | 166,800 |
| TOTAL REVENUES AND OTHER SOURCES..... | \$ 3,229,621 | \$ 3,344,277 | \$ 3,491,755 | \$ 3,769,110 | \$ 3,947,253 |
| Expenditures: | | | | | |
| Operating expenses..... | \$ 3,173,322 | \$ 3,079,378 | \$ 3,036,434 | \$ 3,315,004 | \$ 3,621,866 |
| Depreciation and amortization..... | | | 2,568 | 2,180 | 2,772 |
| Other expenses..... | - | 3 | 116,901 | 112,589 | 107,595 |
| Other Uses: | | | | | |
| Operating transfers out..... | 336,660 | 286,597 | 288,199 | 289,610 | 281,268 |
| TOTAL EXPENDITURES AND OTHER USES | \$ 3,509,982 | \$ 3,365,978 | \$ 3,444,102 | \$ 3,719,383 | \$ 4,013,501 |
| REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURE AND OTHER USES..... | (280,361) | (21,701) | 47,653 | 49,727 | (66,248) |
| Net Assets - End of Period..... | \$ (144,537) | \$ (166,238) | \$ (118,585) | \$ (68,858) | \$ (135,106) |
| Components of Net Assets | | | | | |
| Invested in capital assets, net of debt..... | \$ 12,264 | \$ 8,576 | \$ 11,749 | \$ 16,083 | \$ 19,802 |
| Restricted for elderly programs..... | - | - | - | - | - |
| Deficit..... | (156,801) | (174,814) | (130,334) | (84,941) | (154,908) |
| TOTAL NET ASSETS..... | \$ (144,537) | \$ (166,238) | \$ (118,585) | \$ (68,858) | \$ (135,106) |

Source: Compiled from Office of the Budget, Comprehensive Annual Financial Reports for fiscal years ended June 30, 2009 through 2013

The following budgetary basis information is derived from the Commonwealth's unaudited budgetary basis financial statements.

Fiscal Year 2011 Financial Results

Budgetary Basis. Fiscal year 2011 net revenues from lottery sources, including instant ticket sales and the State's participation in the multi-state Powerball game, increased by 3.4 percent. Total funds available, including prior year lapses and net revenues received by the Lottery Fund during fiscal year 2011 were \$1,704.2 million, while total appropriations, net of current year lapses were \$1,545.2 million. Additionally, fiscal year 2011 expenditures included a transfer of approximately \$178.0 million in long-term care costs from the Commonwealth's General Fund to the State Lottery Fund. The fiscal year-end unappropriated balance and reserve was \$159.0 million, an increase of 56.8 percent.

Fiscal Year 2012 Financial Results

Budgetary Basis. Fiscal year 2012 net revenues from lottery sources, including instant ticket sales and the State's participation in the multi-state Powerball game, increased 0.13%. Total funds available, including prior year lapses and net revenues received by the Lottery Fund during fiscal year 2012 were \$1,706.4 million, while total appropriations, net of current year lapses were \$1,693.6 million. Additionally, fiscal year 2012 expenditures included a transfer of approximately \$178.0 million in long-term care costs from the Commonwealth's General Fund to the State Lottery Fund. The fiscal year-end unappropriated balance and reserve was \$263.3 million, an increase of 65.6 percent.

Fiscal Year 2013 Financial Results

Budgetary Basis. Fiscal year 2013 net revenues from lottery sources, including instant ticket sales and the State's participation in the multi-state Powerball game, increased by 4.1 percent. Total funds available, including prior year lapses and net revenues received by the Lottery Fund during fiscal year 2013 were \$1,776.5 million, while total

appropriations, net of current year lapses were \$1,758.5 million. Additionally, fiscal year 2013 expenditures included a transfer of approximately \$309.0 million in long-term care costs from the Commonwealth's General Fund to the State Lottery Fund. The fiscal year-end unappropriated balance and reserve was \$236.1 million, a decrease of 10.3 percent.

During fiscal year 2013, the Commonwealth, acting through the Office of the Budget and the Department of Revenue, explored the possible private management of the Pennsylvania Lottery and solicited bid proposals. In December 2012, the Commonwealth selected a vendor for the private management of the Lottery and negotiated a contract with the selected vendor. In January 2013, the Pennsylvania Attorney General informed the Office of the Budget that it was rejecting the proposed contract between the Commonwealth and the selected vendor.

Fiscal Year 2014 Enacted Budget

Based on the revised projections for fiscal year 2014 as incorporated in the Governor's proposed fiscal year 2015 budget released on February 4, 2014, the fiscal year 2014 budget anticipates a 4.1 percent increase in revenues from all lottery sources, including instant ticket sales and the State's participation in the multi-state Powerball game. Total funds, including prior year appropriation lapses and net revenues of the State Lottery Fund, are estimated to be \$1,910.1 million in fiscal year 2014, an increase of \$73.5 million from fiscal year 2013 actuals. Appropriations, net of anticipated lapses, are expected to total \$1,821.2 million, representing an increase of \$133.5 million or 7.5 percent from fiscal year 2013 actuals. The 2014 fiscal year-end balance is projected to total \$263.5 million, a decrease of 11.4 percent.

Trend projections for fiscal years beyond fiscal year 2014 show estimated program and administrative costs above estimated net revenues, as the forecasted rate of increase in program expenditures, primarily the long term care costs, is expected to outpace revenues. The estimated expenditures in excess of estimated revenues is expected to be partially funded from a further draw-down of available reserves and balances in the State Lottery Fund. Based upon current projections, higher revenues and/or lower expenditures will be required for the State Lottery Fund to avoid the incurrence of an operating deficit in fiscal years subsequent to fiscal year 2014. The achievement of the budgeted results may be adversely affected by a number of trends or events, including developments in the national and state economy.

Fiscal Year 2015 Proposed Budget

A proposed fiscal year 2015 budget was submitted by the Governor to the General Assembly on February 4, 2014. The budget document and related information is available on the Governor's Budget Office web page at www.budget.state.pa.us. The Governor's proposed fiscal year 2015 budget anticipates a 4.4 percent increase in revenues from lottery sources, including instant ticket sales, the state's participation in three multi-state Powerball game and transfers from the Gaming Fund. Appropriations totaling \$2,076.1 million are recommended for lottery funded programs. The proposed 2015 fiscal year-end balance and reserve is projected to total \$119.1 million, a decrease from the fiscal year 2014 estimate of \$263.5 million.

The General Assembly is considering the Governor's budget proposal through hearings and debate on various bills, including the General Appropriation Bill, required to enact the budget. The General Assembly may change, eliminate or add amounts and items to the proposed budget submitted by the Governor and there can be no assurance that the budget, as proposed by the Governor, will be enacted into law by June 30. See Appendix C for additional information on the budget.

COMMONWEALTH REVENUES AND EXPENDITURES

Recent Receipts and Forecasts

Table 11, on the next page, presents the Commonwealth revenue receipts, including net revenues accrued but not deposited, on a budgetary basis, for the major operating funds of the Commonwealth as actually received for fiscal years 2008 through 2013 and as estimated with respect to the fiscal year 2014 enacted budget.

Table 11
Commonwealth Revenues ^(a)
General Fund, Motor License Fund and State Lottery Fund - Unaudited
Fiscal Year 2008 – Fiscal Year 2013 and Fiscal Year 2014* Estimated
(In Millions)

Fiscal Year Ended June 30

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | Estimated 2014* |
|---------------------------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|--------------------|
| General Fund | | | | | | | |
| Tax Revenues: | | | | | | | |
| Sales and use | \$ 8,496.6 | \$ 8,135.5 | \$ 8,029.2 | \$ 8,590.2 | \$ 8,772.3 | \$ 8,893.7 | \$ 9,228.7 |
| Personal income | 10,907.7 | 10,198.7 | 9,968.7 | 10,435.7 | 10,800.5 | 11,371.2 | 11,727.5 |
| Corporate (b)..... | 3,437.6 | 2,767.6 | 2,552.2 | 2,950.8 | 2,859.6 | 3,025.7 | 2,801.9 |
| Public utility (c)..... | 1,393.6 | 1,418.7 | 1,326.2 | 1,259.6 | 1,358.7 | 1,350.2 | 1,356.8 |
| Inheritance | 828.6 | 772.2 | 753.8 | 805.2 | 827.7 | 845.3 | 882.5 |
| Financial and insurance (d) | 610.1 | 630.0 | 682.3 | 666.2 | 730.9 | 798.4 | 811.2 |
| Cigarette | 784.1 | 754.2 | 976.1 | 1,075.4 | 1,069.9 | 1,024.1 | 995.7 |
| Realty transfer | 429.5 | 294.5 | 296.0 | 279.2 | 292.2 | 338.7 | 399.0 |
| Alcoholic beverages (e) | 277.4 | 292.5 | 297.6 | 307.7 | 324.0 | 336.4 | 353.2 |
| Other | 128.0 | 30.8 | 27.9 | 22.0 | 112.7 | 83.5 | 70.2 |
| TOTAL TAX REVENUES | \$ 27,293.2 | \$ 25,294.7 | \$ 24,910.0 | \$ 26,392.0 | \$ 27,148.5 | \$ 28,067.2 | \$ 28,626.7 |
| Non-Tax Revenues: | | | | | | | |
| Liquor store profits | \$ 80.0 | \$ 125.0 | \$ 105.0 | \$ 105.0 | \$ 80.0 | \$ 80.0 | \$ 80.0 |
| Licenses, fees and miscellaneous..... | 506.3 | 90.2 | 2,606.7 | 915.9 | 383.0 | 444.3 | 334.4 |
| Fines, penalties and interest | 48.6 | 20.1 | 26.5 | 15.7 | 66.4 | 55.4 | 74.8 |
| TOTAL NON-TAX REVENUES | \$ 634.9 | \$ 235.3 | \$ 2,738.2 | \$ 1,036.6 | \$ 529.4 | \$ 579.7 | \$ 489.2 |
| TOTAL GENERAL FUND | \$ 27,928.1 | \$ 25,530.0 | \$ 27,648.2 | \$ 27,428.6 | \$ 27,677.9 | \$ 28,646.9 | \$ 29,115.9 |
| Motor License Fund | | | | | | | |
| Tax Revenues: | | | | | | | |
| Liquid fuels | \$ 591.7 | \$ 520.5 | \$ 548.9 | \$ 568.0 | \$ 561.4 | \$ 576.3 | \$ 564.8 |
| Fuels use | 157.1 | 149.6 | 145.3 | 152.0 | 155.7 | 152.0 | 151.4 |
| Oil company franchise | 447.7 | 452.8 | 448.0 | 455.0 | 457.9 | 445.1 | 457.4 |
| Motorbus & alt fuels..... | 40.0 | 40.3 | 41.7 | 43.7 | 49.0 | 49.7 | 49.6 |
| TOTAL TAX REVENUES | \$ 1,236.5 | \$ 1,163.2 | \$ 1,183.9 | \$ 1,218.7 | \$ 1,224.0 | \$ 1,223.1 | \$ 1,223.2 |
| Non-Tax Revenues: | | | | | | | |
| Licenses and fees | \$ 872.1 | \$ 883.9 | \$ 857.7 | \$ 891.6 | \$ 892.6 | \$ 892.5 | \$ 902.1 |
| Other and miscellaneous..... | 559.4 | 509.7 | 599.5 | 411.1 | 297.6 | 300.6 | 273.8 |
| TOTAL NON-TAX REVENUES | \$ 1,431.5 | \$ 1,393.6 | \$ 1,457.2 | \$ 1,302.7 | \$ 1,190.2 | \$ 1,193.1 | \$ 1,175.9 |
| TOTAL MOTOR LICENSE FUND | \$ 2,668.0 | \$ 2,556.8 | \$ 2,641.1 | \$ 2,521.4 | \$ 2,414.2 | \$ 2,416.2 | \$ 2,399.1 |
| State Lottery Fund | | | | | | | |
| Non-Tax Revenues: | | | | | | | |
| Lottery revenues | \$ 1,405.6 | \$ 1,389.8 | \$ 1,332.6 | \$ 1,389.5 | \$ 1,515.4 | \$ 1,591.7 | \$ 1,690.5 |
| Other and miscellaneous | 34.2 | 21.2 | 177.8 | 171.9 | 178.2 | 166.8 | 169.0 |
| TOTAL NON-TAX REVENUES | \$ 1,439.8 | \$ 1,411.0 | \$ 1,510.4 | \$ 1,561.4 | \$ 1,693.6 | \$ 1,758.5 | \$ 1,859.5 |
| TOTAL STATE LOTTERY FUND | \$ 1,439.8 | \$ 1,411.0 | \$ 1,510.4 | \$ 1,561.4 | \$ 1,693.6 | \$ 1,758.5 | \$ 1,859.5 |

Source: Office of the Budget. Totals may not add due to rounding.

- (a) Budgetary basis including taxes and interest accrued but not deposited by the Commonwealth by June 30 of each fiscal year.
- (b) Includes the corporate net income and the capital stock and franchise taxes.
- (c) Includes the utility gross receipts and utility property taxes.
- (d) Includes the financial institution and insurance premium taxes.
- (e) Includes the liquor and malt beverage taxes.

* See "COMMONWEALTH FINANCIAL PERFORMANCE-Recent Developments" on May 1, 2014.

Table 12 presents a comparison of the actual revenues on a budgetary basis to the official revenue estimate used for budget enactment for the General Fund and the Motor License Fund for fiscal years 2006 through 2013.

Table 12
Commonwealth Revenues — Official Estimate vs. Actual^(a)
General Fund and Motor License Fund – Unaudited
Fiscal Year 2006 — Fiscal Year 2013
(In Millions)

| <u>Fiscal Year Ended June 30</u> | <u>General Fund</u> | | | <u>Motor License Fund</u> | | |
|--------------------------------------|--|---------------|-----------------|--|---------------|-----------------|
| | <u>Official Estimate^(b)</u> | <u>Actual</u> | <u>Variance</u> | <u>Official Estimate^(b)</u> | <u>Actual</u> | <u>Variance</u> |
| 2006 | \$ 24,989.9 | \$ 25,854.3 | \$ 864.4 | \$ 2,229.2 | \$ 2,265.9 | \$ 36.7 |
| 2007 | 26,799.5 | 27,449.3 | 649.8 | 2,322.8 | 2,290.8 | -32.0 |
| 2008 | 27,760.6 | 27,928.1 | 167.5 | 2,757.5 | 2,667.9 | -89.5 |
| 2009 | 28,784.4 | 25,529.8 | -3,254.6 | 2,732.6 | 2,556.8 | -175.8 |
| 2010 | 28,824.7 | 27,648.2 | -1,176.5 | 2,636.1 | 2,641.1 | 5.0 |
| 2011 | 26,711.7 | 27,497.2 | 785.5 | 2,323.6 | 2,521.3 | 197.6 |
| 2012 | 27,840.8 | 27,678.0 | -162.8 | 2,416.4 | 2,414.2 | -2.2 |
| 2013 | 28,590.0 | 28,646.9 | 56.9 | 2,397.0 | 2,416.2 | 19.2 |

Source: Office of the Budget.

^(a) Budgetary basis including taxes and interest accrued but not deposited by the Commonwealth by June 30 of each fiscal year.

^(b) As certified for budget enactment.

Tax Revenues

Tax revenues constitute approximately 98.0 percent of Commonwealth revenues in the General Fund for the fiscal year ended June 30, 2013. The major tax sources for the General Fund of the Commonwealth are the personal income tax, the sales tax, the corporate net income tax, the cigarette tax, and the utility gross receipts tax. Together these five taxes produced 89.1 percent of General Fund tax revenues for the fiscal year ended June 30, 2013.

The major tax sources for the Motor License Fund are the liquid fuels tax and the oil company franchise tax. Together these taxes produce just over 42 percent of Motor License Fund revenues. Portions of certain taxes whose receipts are deposited into the Motor License Fund are legislatively restricted to specific transportation programs. These receipts are accounted for in restricted accounts in the Motor License Fund and are not included in the discussions of the tax revenues of the Motor License Fund.

The major tax sources for the General Fund and the Motor License Fund are described briefly below. The tax receipt amounts in the descriptions are on a budgetary basis.

Personal Income Tax. This tax accounted for \$11,371.2 million or 39.7 percent of fiscal year 2013 General Fund Commonwealth revenues. The tax is levied at a flat rate on the taxable income of all residents and resident trusts and estates and taxable income attributable to Pennsylvania non-resident estates and trusts. The current tax rate of 3.07 percent became effective on January 1, 2004. Credit against the tax is allowed for gross or net income taxes paid to other states by Pennsylvania residents.

Withholding is required by employers from all persons liable for the tax with the size of collections determining the frequency for remittance to the Commonwealth. A declaration and partial payment of the estimated tax are required for those individuals with taxable incomes over \$8,000 per year, other than wages subject to withholding.

Individuals and families meeting qualifying income limits do not pay personal income tax on all or a portion of their taxable income with the exemptions depending on their total income. A qualifying family of four owes no personal income tax on taxable income up to \$32,000 annually.

Sales Tax. This tax accounted for \$8,893.7 million or 31.0 percent of fiscal year 2013 General Fund Commonwealth revenues. The tax is levied at a rate of 6 percent on the sale, use, storage, rental or consumption of tangible personal property, cigarettes, and certain services, and upon the occupancy of hotel rooms. Substantial exemptions from the tax include clothing, food purchased in grocery stores or supermarkets, medical supplies, drugs,

residential use of certain utilities, motor fuels, and machinery, equipment and items used in manufacturing, processing, farming or dairying, and utility service. The tax base was expanded in fiscal year 1992 to include a number of services not previously taxed. Beginning in fiscal year 2004, 0.947 percent of collections are transferred to a special fund for mass transit assistance. Beginning in fiscal year 2008 with the enactment of Act 44 of 2007, an additional 4.4 percent of receipts are transferred for transit assistance purposes.

Sales tax licensees reporting an actual tax liability equal to or greater than \$100,000 for the third calendar quarter of the preceding year must make a payment of 50 percent of the tax liability for the same month of the previous year.

Sales tax licensees reporting an actual tax liability of at least \$25,000 and less than \$100,000 for the third calendar quarter of the preceding year are provided an option for their tax payment - 50 percent of the tax liability for the same month of the previous year or greater than 50 percent of the actual tax liability for the same month in the current year. This option is effective for tax returns due after September 30, 2012.

Corporate Net Income Tax. The Commonwealth received \$2,423.4 million, or 8.5 percent of fiscal year 2013 General Fund Commonwealth revenues, from this tax. Domestic and foreign corporations are subject to the corporate net income tax for the privilege of doing business, carrying on activities, having capital or property employed or used in Pennsylvania, or owning property in Pennsylvania. Limited liability companies and business trusts that are classified as corporations for Federal income tax purposes are also subject to tax. Building and loan associations, banks, saving institutions, trust companies, insurance and surety companies, and nonprofit corporations are exempt from the tax. When less than the entire business of any corporation is transacted within the Commonwealth, the taxable income in Pennsylvania is determined by an apportionment formula. The current tax rate of 9.99 percent became effective for fiscal years beginning on or after January 1, 1995. The previous tax rate of 11.99 percent had been in effect since January 1, 1994.

The corporate net income tax is to be paid in four equal installments throughout the corporation's tax year based on estimated taxes due for the entire tax year. Any remaining portion of taxes due is to be paid with the corporation's annual report due three-and-one-half months following the end of the corporation's tax year.

Gross Receipts Tax. This tax accounted for \$1,306.3 million, or 4.6 percent of fiscal year 2013 General Fund Commonwealth revenues. The gross receipts tax is levied on telephone, telegraph, and mobile telecommunications companies; electric light, water power, and hydroelectric companies; managed care organizations; and pipeline and miscellaneous transportation companies. Municipally owned or operated public utilities may exclude gross receipts derived from business done inside the limits of the municipality

Beginning January 1, 2004, interstate and cellular telecommunications services are subject to the gross receipts tax. The tax rate is 50 mills, which became effective in July 1991, having been raised from its prior tax rate of 44 mills for all utilities except electric utilities, which are taxed at the rate of 59 mills. Revenue from 0.25 mills of the tax is deposited in the Alternative Fuels Incentive Grant Fund. All firms, except public utilities owned or operated by a municipality or a municipal authority, are required to file estimated revenue reports annually, together with the estimated payment of the current year's tax calculated by applying the current tax rate to 90 percent of the tax base for the current year or 100 percent of the liability two years prior, subject to the current rate. The adequacy of these payments is judged retrospectively based on the final return.

Effective for tax years after January 1, 2000, natural gas companies became exempt from the tax. The tax report and estimated payment are required to be made by March 15. The remaining tax is due and payable by the succeeding March 15.

Capital Stock and Franchise Taxes. These taxes generated \$602.2 million for the Commonwealth in fiscal year 2013, or 2.1 percent of General Fund Commonwealth revenues. They are levied on the capital stock value of domestic and foreign corporations doing business or having property or capital employed in Pennsylvania on that portion of capital stock value apportionable to Pennsylvania under a statutory formula.

Capital stock and franchise tax estimated payments must exceed 90 percent of reported annual liability, or 100 percent of the liability two year's prior subject to the current rate. Under current law, the General Fund tax rate for tax years that began in 2013 is 0.89 mills, having been reduced from 1.89 mills effective January 1, 2012. This tax is scheduled to be phased out for taxable years beginning after December 31, 2015 under legislation enacted in 2002 and amended in 2003, 2006, 2009, and 2013.

Cigarette Tax. Collections of this tax totaled \$1,024.1 million in fiscal year 2013, or 3.6 percent of General Fund Commonwealth revenues. The tax is imposed and assessed on the sale or possession of cigarettes and little cigars within the Commonwealth. It is levied on the consumer but is collected by the sale of stamps and meter units to dealers who affix them to each package. The current rate is \$1.60 per package of 20 cigarettes, which was increased by 25 cents in 2009. The 6 percent sales tax is also imposed on the retail sale of cigarettes and is included in the sales tax receipts. A portion of the collections from the tax are transferred to a special fund for children's health insurance and to a special fund for preserving farmland.

Inheritance and Estate Taxes. Collections of these taxes were \$845.3 million in fiscal year 2013, or 3.0 percent of General Fund Commonwealth revenues. The inheritance tax is levied on the value of property transferred to heirs of a deceased person. Prior to July 1, 2000, the tax rate was 6 percent of the value, if passing to lineal heirs, and 15 percent if passing to collateral heirs. Effective July 1, 2000, the tax rate on transfers to parents, grandparents and lineal descendants was lowered to 4.5 percent and a new tax rate of 12 percent on transfers to siblings was established. The estate tax was a "pick-up" tax in the amount of the maximum federal tax credit less State death taxes paid. The federal estate tax credit was phased out between 2002 and 2005. As a result of the American Taxpayer Relief Act of 2012, the federal estate tax credit, and thus Pennsylvania's estate tax, will not return. Counties collect the inheritance and estate tax, which is due within nine months following the death of the person whose property is being transferred.

Insurance Premiums Tax. This tax is levied at the rate of 2 percent of the gross premiums (subject to retaliatory provisions) on all business of domestic and foreign insurance companies transacted within the Commonwealth during each calendar year. Revenues from the two percent tax on foreign fire and casualty companies accrues to special revenue funds while the remaining taxes accrue to the General Fund. The tax on foreign companies is based on the amount of business transacted in Pennsylvania. Marine insurance companies, both domestic and foreign, pay a 5 percent tax on underwriting profits attributable to Pennsylvania in lieu of the gross premium tax.

Estimated payments are due March 15th for the current taxable year and must exceed 90 percent of reported annual liability, or 100 percent of the liability two years prior, subject to the current rate. The adequacy of these payments is judged retrospectively based on the final return. Final payments and reports must be remitted together by April 15th of each year for the previous tax year.

Realty Transfer Tax. This tax is levied at the rate of 1 percent of the value of the real property transferred, as represented by deed, instrument or other writing. The tax is collected by the recorders of deeds in the counties and transmitted to the Commonwealth when collected. Beginning with fiscal year 2008, the transfer to the Keystone Recreation, Park and Conservation Fund of a portion of this tax is 15 percent after having changed several times over the past ten years.

Liquor Tax. This tax is levied at the rate of 18 percent of the net purchase price on all liquor sold by the Pennsylvania Liquor Control Board. Revenues from this tax accrue to the General Fund. The 6 percent sales tax is also imposed on all liquor sold by the Pennsylvania Liquor Control Board and is included in the sales tax receipts.

Financial Institution Taxes. The bank shares tax is levied at the rate of 0.89 percent of the value of shares of state and national banks and domestic title insurance companies, beginning January 1, 2014. This is a reduction from the rate of 1.25 percent. Effective January 1, 2014, each institution computes the tax base on the most recent year-end value of the institution's total bank equity capital, adjusted to exclude the value of United States obligations. Previously, the tax base was computed by averaging an institution's total equity capital for each quarter, adjusted to exclude the value of United States obligations, for the previous six calendar years. Goodwill is also deducted from a bank's equity and total assets when computing the tax base. A payment of the tax for the current year is due by March 15th of that year. Revenues of this tax are deposited into the General Fund. The mutual thrift institutions tax is levied on the taxable net income of such institutions at the rate of 11.5 percent. Revenues of this tax accrue to the General Fund.

Mutual thrift institutions make quarterly estimated payments by applying the current tax rate to 100 percent of the tax base for the second preceding year, or by paying at least 90 percent of the reported annual liability for the current year. Final reports are due 105 days after the close of the fiscal year. Extensions are available for filing reports; however, no extensions are granted for payment of the tax.

Public Utility Realty Tax. The tax is levied on the state taxable value of utility real property belonging to a firm or other entity (i) furnishing utility service and (ii) regulated by the Pennsylvania Public Utility Commission or

similar regulatory body. State taxable value is the current market value derived from assessed values for county real estate tax purposes. Certain items are specifically exempt from the tax. The tax rate for the General Fund portion of the tax is set annually by the Secretary of Revenue. The tax rate is to be set at a rate intended to produce revenues sufficient to reimburse local taxing authorities for foregone property tax revenues. An additional tax rate of 7.6 mills is applied to the tax base and remains in the General Fund. The tax is subject to a tentative payment of the then current year's tax liability. The tentative reports and tax payments are due in May. The remaining tax payments must be paid in September of the following year.

Malt Beverage Tax. This tax is levied on all malt or brewed beverages sold in Pennsylvania. The tax rate is $\frac{2}{3}$ cent per half-pint, 1 cent per pint and \$2.48 per barrel. The various manufacturers pay the tax monthly to the Department of Revenue. Revenues from this tax are deposited into the General Fund.

Liquid Fuels Tax. This tax accounted for \$576.3 million, or 23.9 percent of Motor License Fund Commonwealth revenues in fiscal year 2013. It is an excise tax imposed upon all liquid fuels (primarily gasoline) used or sold within the Commonwealth. The tax is imposed upon and collected by the fuel distributor. After discounts, all monies collected are deposited in the Motor License Fund, except that an amount equal to one-half cent per gallon is deposited in the Liquid Fuels Tax Fund. Fuels sold and delivered to the U.S. government, the Commonwealth and any of its political subdivisions, public authorities, non-profit schools, volunteer fire companies, ambulance services, rescue squads, and fuels sold and delivered in interstate commerce are exempt from payment of the tax. In addition to these exemptions, reimbursement is made for fuels used for certain agricultural purposes. The present rate of the liquid fuels tax is 12 cents per gallon.

Oil Company Franchise Tax. The non-restricted portion of this tax accounted for \$445.1 million, or 18.4 percent of fiscal year 2013 Motor License Fund Commonwealth revenues. The tax rate is 153.5 mills on the revenue received from liquid fuels and 208.5 mills on the revenue received from fuels at the first sale of petroleum products in Pennsylvania used to fuel motor vehicles for public highway use. Petroleum revenue is derived by multiplying total gallons of petroleum products by the average wholesale price as established by the Department of Revenue. Minimum and maximum average wholesale prices are statutorily set at \$0.90 and \$1.25 per gallon, respectively. Only 57 mills from the liquid fuels and fuels rates is deposited in the non-restricted account. The remainder is deposited in restricted accounts. By law, portions of the tax are dedicated to certain highway purposes, including transfers to local governments for roads and highways. Exemptions from the tax are the same as those provided from the liquid fuels tax.

Fuels Tax. This tax accounted for \$152.0 million, or 6.3 percent of fiscal year 2013 Motor License Fund Commonwealth revenues. It is an excise tax imposed on fuels (primarily diesel fuel) used or sold within the Commonwealth. The tax is imposed upon and collected by the distributor. After discounts, all monies collected are deposited in the Motor License Fund, except an amount equal to one-half cent per gallon is placed in the Liquid Fuels Tax Fund for distribution to local governments. The present tax rate is 12 cents per gallon for fuel used in the Commonwealth. Exemptions from the tax are the same as those provided from the liquid fuels tax.

Fuels exempt from this tax are those delivered in interstate commerce, those used by and sold to the Commonwealth and any of its political subdivisions, those sold and delivered to the U.S. government, those (less than 50 gallons) brought into the Commonwealth in the fuel tanks of motor vehicles, those used by public authorities, volunteer fire companies, ambulance services, rescue squads and non-profit schools, and those used for certain agricultural purposes.

Motor Carriers Road Tax. This tax is levied on motor carrier vehicles having a gross weight in excess of 26,000 pounds. All monies collected are deposited in the Motor License Fund. The current rate is 12 cents per gallon, plus an additional factor based on the oil company franchise tax for fuel used within the Commonwealth. In May 1997, the tax rate was reduced by 6 cents to its current level. The revenue lost from the tax reduction is being covered by an additional 55 mills tax rate for the oil company franchise tax. Both the repealed and the new tax portions are dedicated to bridge improvement.

Non-Tax Revenues

Licenses and Fees. License and fee receipts in the General Fund for fiscal year 2013 totaled \$137.0 million, representing 0.5 percent of Commonwealth revenues to the General Fund. Revenues from motor vehicle licenses and

fees in fiscal 2012 were \$892.5 million, representing 36.9 percent of total fiscal year 2013 Motor License Fund Commonwealth revenues.

Miscellaneous Revenue. Revenues from non-tax sources not categorized elsewhere are credited to miscellaneous revenues. Interest earnings on securities and deposits are included in this source. Miscellaneous revenues receipts in the General Fund for fiscal year 2013 totaled \$307.3 million. Receipts from miscellaneous motor vehicle revenues in fiscal 2013 were \$300.6 million, representing 12.4 percent of total fiscal year 2013 Motor License Fund Commonwealth revenues.

State Stores Fund Transfers. This is an amount determined by the Liquor Control Board to be available for transfer to the General Fund. The amount transferred for fiscal year 2013 was \$80.0 million. In Pennsylvania, the distribution and sale of liquor is a state enterprise.

Fines, Penalties and Interest. This revenue source includes all fines, penalties and interest collected in the enforcement of non-tax regulations, such as moving violation surcharges. The amount deposited to the General Fund for fiscal year 2013 was \$55.4 million.

Tobacco Settlement Payments. The Commonwealth's portion of payments made by cigarette manufacturers participating in the Tobacco MSA are deposited in the Tobacco Settlement Fund to be used for certain health-related programs. See "COMMONWEALTH FINANCIAL STRUCTURE AND PROCEDURES – Description of Fund."

Federal Revenues

Receipts by the Commonwealth in its General Fund, Motor License Fund, Tobacco Settlement Fund and State Lottery Fund from the federal government during fiscal year 2012 totaled \$21,700 million, while such federal receipts were \$22,300 million in fiscal year 2013. Anticipated receipts for the fiscal year 2014 budget are \$22,700 million. Approximately \$15,000 million, or 69 percent of total federal revenue to the Commonwealth for fiscal year 2012, was attributable to public health and welfare programs, the largest of which are for the Medical Assistance and Temporary Assistance to Needy Families programs. In fiscal year 2013, \$15,500 million, or 69.5 percent of federal revenues, was attributable to these types of programs. In fiscal year 2014, approximately \$16,200 million or 71.3 percent of federal revenues is expected to be attributable to public health and welfare programs.

Major Commonwealth Expenditures

The Commonwealth's major operating funds—the General Fund, the Motor License Fund and the State Lottery Fund—provide financial resources to operate programs and fund grants. Trends in expenditures from those funds for various program areas are discussed below based on budgetary basis financial statements for fiscal year 2013, and the enacted budget for fiscal year 2014 and the proposed budget for fiscal year 2015. **See, however, "COMMONWEALTH FINANCIAL PERFORMANCE-Recent Developments" on May 1, 2014.**

Education

In fiscal year 2012, expenditures from Commonwealth revenues for education purposes were more than \$10,900 million. The budget for fiscal year 2013 included over \$11,300 million in expenditures from Commonwealth revenues for education purposes, an increase of 4 percent over fiscal year 2012. The enacted budget for fiscal year 2014 includes over \$11,600 million in education funding, an increase of approximately 2.4 percent over fiscal year 2013.

Elementary and Secondary Education. The financing of public elementary and secondary education in Pennsylvania is shared by the Commonwealth and local school districts. There are 500 local school districts in the state. With certain exceptions, each is governed by a locally elected school board responsible for the administration of the public schools in the school district with the authority to levy taxes within the limits prescribed by the Public School Code of 1949, as amended. Funds supplied by the Commonwealth supplement the funds raised locally. Local school districts receive various subsidy payments for basic instruction, vocational education, debt service, pupil transportation, employee retirement programs including Social Security, and various special education programs. The largest such subsidy is the Basic Education subsidy. The enacted budget for fiscal year 2014 increased the state portion of the Basic Education subsidy by \$122.5 million, or 2.27 percent, to more than \$5,520 million. For fiscal year 2014, each school district will receive an amount equal to its 2013 Basic Education Funding allocation. The increase will be distributed to qualifying school districts, based on local wealth, existing tax burden, district size and certain student characteristics.

Certain specialized education programs are operated and administered in Pennsylvania by 29 intermediate units established by the component local school districts. These intermediate units are funded from contributions from member school districts. Programs operated by intermediate units generally are special education programs for the gifted, for individuals with mental and physical disabilities, and for support of nonpublic schools through the provision of auxiliary services and the lending of instructional materials such as textbooks to children attending nonpublic schools in Pennsylvania.

Total Commonwealth expenditures for basic education programs in fiscal year 2012 were more than \$9,200 million, representing nearly 84.4 percent of all Commonwealth expenditures for education in fiscal year 2012. Total budgeted Commonwealth expenditures for basic education programs in fiscal year 2013 were more than \$9,600 million, representing 85 percent of all Commonwealth expenditures for education in fiscal year 2013. The enacted budget for fiscal year 2014 includes more than \$9,900 million for basic education programs.

Table 13
Fall Enrollment in Pennsylvania Public and
Non-Public Elementary Schools and Secondary Schools
School Years 2009-2013
(In Thousands)

| | School Year Ended June | | | | |
|--------------------|------------------------|-------------|-------------|-------------|-------------|
| | <u>2009</u> | <u>2010</u> | <u>2011</u> | <u>2012</u> | <u>2013</u> |
| Elementary Schools | | | | | |
| Public | 922 | 926 | 934 | 930 | 927 |
| Nonpublic | 182 | 173 | 171 | 166 | 161 |
| Secondary Schools | | | | | |
| Public | 863 | 852 | 845 | 833 | 828 |
| Nonpublic | 74 | 73 | 79 | 76 | 74 |
| Total | | | | | |
| Public | 1,785 | 1,778 | 1,779 | 1,763 | 1,755 |
| Nonpublic | <u>256</u> | <u>246</u> | <u>250</u> | <u>242</u> | <u>235</u> |
| Total..... | 2,041 | 2,024 | 2,029 | 2,005 | 1,990 |

Source: Pennsylvania Department of Education.

Higher Education. Higher education in Pennsylvania is provided through 271 degree-granting institutions, which include the fourteen universities of the State System of Higher Education (PASSHE), four State-related universities, community colleges, independent colleges and universities and specialized degree-granting institutions. PASSHE, created in 1982 from the fourteen state-owned colleges, is administered by a Board of Governors whose members are appointed by the Governor and confirmed by the Senate. In fiscal year 2012, nearly \$1,600 million was expended by the Commonwealth for institution and student financial assistance. The budget for fiscal year 2013 included nearly \$1,600 million for higher education. The budget for fiscal year 2014 includes nearly \$1,600 million for higher education.

Table 14
Full-Time Equivalent Enrollment at State-Supported
Institutions of Higher Education
School Years 2009-2013
(In Thousands)

| | School Year Ended June | | | | |
|------------------------------------|-------------------------------|-------------|-------------|-------------|-------------|
| | 2009 | 2010 | 2011 | 2012 | 2013 |
| State System of Higher Education . | 106 | 110 | 112 | 110 | 107 |
| State-Related Universities..... | 153 | 156 | 158 | 157 | 156 |
| Community Colleges | <u>99</u> | <u>106</u> | <u>106</u> | <u>104</u> | <u>102</u> |
| Total | 358 | 372 | 376 | 371 | 365 |

Source: Governor's Executive Budget, various years.

Public Health and Human Services

Fiscal year 2013 public health and human services expenditures were \$30,110 million and are projected to be \$31,360 million in fiscal year 2014. For fiscal year 2015, \$33,860 million is proposed for these purposes. With regard to fiscal year 2014 expenditures, \$11,360 million is expected to be funded from the General Fund, while \$11,790 million is estimated to be provided from the General Fund for fiscal year 2015. Federal funds are expected to increase by \$1,850 million due to implementation of Pennsylvania's Healthy PA program, and augmentations are expected to increase by \$54 million for fiscal year 2015. Public health and human service programs are the largest single component of combined state and federal spending in the Commonwealth's operating budget. The overall budget increase reflects the impact of caseload increases, federal mandates, litigation and continued support of county operated programs for child welfare, mental health and intellectual disabilities.

The Governor's proposed fiscal year 2015 budget includes \$328.1 million of receipts from the Tobacco Settlement Fund to be expended for health care related programs. Federal funds matching the state Tobacco Master Settlement Agreement (MSA) funds are also expected to be provided. However, under the terms of the 1998 settlement that created the Tobacco Settlement Fund, payments by the tobacco companies may, in certain circumstances be reduced, reflecting decline in cigarette sales, and such payments also may be limited, delayed or terminated as a result of bankruptcy or insolvency of tobacco companies or legal challenges to the settlement or to amounts due thereunder. Since fiscal year 2007, receipts from the Tobacco MSA have been reduced as certain tobacco companies decided to withhold or to place into escrow over \$5,500 million in payments to the various states and localities under provisions of the Tobacco MSA. The Commonwealth's share of withheld Tobacco MSA funds totaled over \$323 million. In September 2013, an arbitration panel hearing the non-participating manufacturer (NPM) adjustment dispute with respect to MSA payments received in 2004 issued a decision adverse to the Commonwealth. The Attorney General challenged the decision, and in proceedings before the Philadelphia Court of Common Pleas the Commonwealth's loss was reduced from an estimated \$180 million to \$143 million as a result of the Judge's decision. Funds have been placed in budgetary reserve in 2014 to offset this loss. For fiscal year 2014, receipts from the April 2013 payment were reduced by \$39.0 million to reflect the continuation of the withhold and for fiscal year 2015, estimated receipts from the April 2015 payment are reduced by \$42.1 million.

Programs providing temporary financial assistance and medical assistance comprise the largest portion of public health and human services expenditures. General Fund expenditures for these assistance programs by the Commonwealth amounted to \$6,750 million in fiscal year 2013, while \$6,900 million is budgeted from the General Fund for fiscal year 2014 and \$7,200 million is proposed for fiscal year 2015. A nursing home assessment fee provided a General Fund offset (meaning a reduction in required General Fund appropriations) of \$151.5 million in fiscal year 2013 and is expected to provide a \$199.7 million offset in fiscal year 2014. In fiscal year 2015, the nursing home assessment offset is projected at \$191 million. A Statewide managed care organization Gross Receipts Tax assessment provided a General Fund offset of \$369 million in fiscal year 2013 and is expected to provide a \$337 million offset in fiscal year 2014. In fiscal year 2015, the Statewide managed care organization Gross Receipts Tax assessment offset is

projected at \$401 million. In addition, a Statewide Quality Care assessment provided a \$109 million offset in fiscal year 2013 and is expected to provide a \$150 million offset in fiscal year 2014. In fiscal year 2015, the Statewide Quality Care assessment offset is projected at \$150 million. For 2015 approximately 34.8 percent of the total cost of assistance to the economically needy will be supported by Commonwealth funds appropriated from the General Fund. The balance is provided from reimbursements by the federal government and through various program collection activities conducted by the Commonwealth.

Medical assistance continues to be a growing component of public health and human services expenditures. Despite implementation of Commonwealth initiatives to restrain costs, the program continues to grow due to an expanding caseload, technology improvements and general medical inflation. Expenditures for medical assistance increased during the period from fiscal years 2003 through 2014 by an average annual rate of 7.2 percent. Fiscal year 2014 expenditures from Commonwealth funds are projected to be \$6,620 million and the proposed budget for fiscal year 2015 provides \$6,960 million, an increase of 5.1 percent from the prior fiscal year due to a decrease in the Federal Medical Assistance Percentage. Income maintenance cash assistance payments to families in transition to independence are estimated at \$1,070 million for fiscal year 2014, of which \$209.3 million is from the General Fund. The proposed budget for fiscal year 2015 includes a total of \$1,060 million, for such purpose with \$213.1 million provided from the General Fund. Cash assistance is time-limited and requires participation in work activities to maintain eligibility. The 2013 budget eliminated the cash assistance benefits provided through the General Assistance program. These benefits were funded exclusively with state funds.

Transportation

The Commonwealth is responsible for the construction, restoration and maintenance of the highways and bridges in the 40,000 mile state highway system, including certain city streets that are a part of the state highway system. Assistance for the maintenance and construction of local roads and bridges is provided to municipalities through grants of financial aid. Highway maintenance costs, construction costs and assistance grants are paid from the Motor License Fund. Other special funds, including the Public Transportation Assistance Fund, the Public Transportation Trust Fund and the State Lottery Fund, provide funding for mass transit programs.

Act 89 of 2013, provided dedicated additional funding for highway and bridges through the incremental uncapping of the Oil Company Franchise Tax (OCFT) and the indexing of vehicle and driver services fees. Act 89 also restructured the Act 44 of 2007 Pennsylvania Turnpike Commission payment distributions. Beginning in fiscal year 2015, the current annual \$200 million highway and bridge distribution will be redirected to mass transit resulting in annual distributions to mass transit of \$450 million.

In addition to its unrestricted state funds, the Motor License Fund includes five restricted revenue accounts funded by state revenues legislatively dedicated to specific purposes. Some of the restricted purposes funded from these accounts also receive funding by annual appropriations of unrestricted Motor License Fund revenues. Programs receiving funds from a restricted account include highway bridges, highway construction and maintenance, grants to municipalities for highways and bridges, and airport development.

Total funding for the Commonwealth's highway and bridge program for fiscal year 2013 was \$2,006 million. The funding increased to \$2,079 million in fiscal year 2014 and is proposed to increase to \$2,506 million in fiscal year 2015.

Support of highway and bridge expenditures by local governments through grants paid from the Motor License Fund and restricted revenues was \$409.5 million in fiscal year 2013 and is projected to be \$437.9 million in fiscal year 2014. In fiscal year 2015, proposed grants to local governments are projected to increase to \$513.6 million.

In addition to its support of the highway system, the Commonwealth provides subsidies for mass transit systems including passenger rail and bus service.

In fiscal year 2008, the funding mechanisms for mass transit in the Commonwealth were changed with the enactment of Act 44. Mass transit funding was shifted from the General Fund to a combination of sources of revenue primarily going into a Public Transportation Trust Fund established by Act 44. The Public Transportation Trust Fund was created to provide a long-term, predictable and growing source of revenues for public transportation systems. Act

89 of 2013 increased funding and revenue sources for the Public Transportation Trust Fund. Revenues come from scheduled payments by the Pennsylvania Turnpike Commission, a portion of the Sales and Use Tax, certain motor vehicle fees, vehicle code fines and surcharges, and transfers from the Public Transportation Assistance Fund and the Lottery Fund. This funding supports mass transit programs statewide, providing financial assistance for operating costs, capital costs, and certain administrative costs for the Department of Transportation. For fiscal year 2013, Commonwealth funding available for mass transit was \$1,099 million. Funding for mass transit increased in fiscal year 2014 to \$1,180 million. The proposed fiscal year 2015 budget funding for mass transit increases to \$1,443 million.

Act 89 created the Multimodal Transportation Fund to provide additional funding for freight and passenger rail, ports, aviation, bicycle and pedestrian facilities, and other modes of transportation. Revenues deposited into the Multimodal Transportation Fund include payments from the Pennsylvania Turnpike Commission, a portion of certain motor vehicle fees and beginning in fiscal year 2016, a portion of the Oil Company Franchise Tax. For fiscal year 2014, Commonwealth funding available for multimodal transportation is \$30 million. The proposed fiscal year 2015 budget funding increases to \$97 million.

The Commonwealth's current aviation program funds the development of public airport facilities through grants providing for airport development, runway rehabilitation, and real estate tax rebates for public use airports. Taxes levied on aviation and jet fuel provide revenues for a restricted account for aviation programs in the Motor License Fund. In fiscal year 2013, \$11.3 million was expended from aviation restricted accounts. In fiscal year 2014, \$10.4 million is available for such purposes. A total of \$10.4 million is proposed for fiscal year 2015.

The Commonwealth is not responsible for the toll roads and bridges in Pennsylvania. These are under the jurisdiction of various authorities and commissions. See "GOVERNMENT AUTHORITIES AND OTHER ORGANIZATIONS."

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OUTSTANDING INDEBTEDNESS OF THE COMMONWEALTH

General

The Constitution permits the Commonwealth to incur the following types of debt: (i) debt to suppress insurrection or rehabilitate areas affected by disaster, (ii) electorate-approved debt, (iii) debt for capital projects subject to an aggregate debt limit of 1.75 times the annual average tax revenues of the preceding five fiscal years, and (iv) tax anticipation notes payable in the fiscal year of issuance. All debt, except debt incurred through the issuance of tax anticipation notes must be amortized in substantial and regular amounts. See Appendix E for the text of selected constitutional provisions relating to the finances of the Commonwealth.

Debt service on Commonwealth general obligation debt is paid from appropriations out of the General Fund except for debt issued for highway purposes, which is paid from Motor License Fund appropriations.

Table 15
General Obligation Debt Outstanding^(a)
Fiscal Years 2003-2013
(In Millions)

| <u>At June 30</u> | <u>General Obligation Debt Outstanding</u> |
|-------------------|--|
| 2003..... | \$ 6,767.2 |
| 2004..... | 6,892.6 |
| 2005..... | 6,747.4 |
| 2006..... | 7,287.0 |
| 2007..... | 7,834.0 |
| 2008..... | 8,177.0 |
| 2009..... | 8,653.7 |
| 2010..... | 9,891.7 |
| 2011..... | 9,872.1 |
| 2012..... | 10,727.5 |
| 2013..... | 10,860.3 |

^(a) Net of sinking fund balances.

Net outstanding general obligation debt totaled \$10,860.3 million at June 30, 2013, an increase of \$132.8 million from June 30, 2012. Over the 10-year period ended June 30, 2013, total net outstanding general obligation debt increased at an annual rate of 4.8 percent. Within the most recent 5-year period, outstanding general obligation debt has increased at an annual rate of 5.8 percent.

General obligation debt for non-highway purposes of \$10,150.0 million was outstanding on June 30, 2013. Outstanding debt for these purposes increased by a net \$67.2 million since June 30, 2012. For the period ended June 30, 2013, the 10-year and 5-year average annual compound growth rate for total outstanding debt for non-highway purposes has been 4.5 percent and 4.6 percent respectively. In its current debt financing plan, Commonwealth infrastructure investment projects include improvement and rehabilitation of existing capital facilities and construction of new facilities, such as public buildings, prisons and parks, transit facilities, economic development and community facilities, and environmental remediation projects.

Outstanding general obligation debt for highway purposes was \$710.4 million on June 30, 2013, an increase of \$65.6 million from June 30, 2012. Highway outstanding debt grew over the most recent 10-year and 5-year periods ended June 30, 2013, by the annual average rates of 11.8 percent and 52.1 percent respectively. A previous decline in outstanding highway debt was due to the policy begun in 1980 of funding highway capital projects with current revenues except for very limited exceptions. However, beginning with the enacted fiscal year 2009 budget, the Commonwealth initiated a multi-year plan to issue an average of \$200 million in general obligation bonds annually to accelerate the rehabilitation of a portion of the Commonwealth's 6,000 structurally deficient bridges. Funding to

support the proposed debt issuance was being initially provided from an existing restricted account rather than from general revenues of the Motor License Fund or the General Fund. During the 2010 fiscal year, the Commonwealth issued \$200 million in general obligation bonds in order to jumpstart its bridge rehabilitation program. During fiscal years 2011, 2012, and 2013 the Commonwealth issued \$130 million, \$120 million, and \$85 million respectively in general obligation debt for the bridge rehabilitation program and the fiscal year 2014 budget includes \$40 million in such general obligation debt authority.

Table 16, below, shows selected debt ratios for the Commonwealth for fiscal year 2003 and for fiscal years 2009 through 2013. Table 16 contains corrections to certain prior fiscal year data as well as a revision in the methodology to account for debt service payments to include funding from all sources rather than debt service as paid from appropriations (resulting in some information in Table 16 being different from that appearing in previous Official Statements of the Commonwealth).

Table 16
Selected Debt Ratios
Fiscal Years 2003 and 2009 through 2013

| | (In Millions) | | | | | |
|---|---------------|------------|------------|------------|------------|------------|
| | 2003 | 2009 | 2010 | 2011 | 2012 | 2013 |
| Net Outstanding Debt (Millions) | | | | | | |
| General Obligation Debt(a)..... | \$ 6,767 | \$ 8,653 | \$ 9,893 | \$ 9,872 | \$ 10,728 | \$ 10,860 |
| Lease Payment Obligations(b)..... | 648 | 1,342 | 1,871 | 2,210 | 2,249 | 2,231 |
| Total..... | \$ 7,415 | \$ 9,995 | \$ 11,764 | \$ 12,082 | \$ 12,977 | \$ 13,091 |
| % Increase (Decrease) over prior year..... | 9.9% | 7.3% | 17.7% | 2.7% | 7.4% | 0.9% |
| Population (Thousands) | | | | | | |
| Population..... | 12,357 | 12,604 | 12,711 | 12,743 | 12,763 | 12,763 |
| Per Capita Debt..... | \$ 600 | \$ 793 | \$ 925 | \$ 948 | \$ 1,017 | \$ 1,026 |
| Personal Income (Millions) | | | | | | |
| Personal Income..... | \$ 399,547 | \$ 496,664 | \$ 514,352 | \$ 538,909 | \$ 556,692 | \$ 556,692 |
| Debt as a % of Personal Income..... | 1.9% | 2.0% | 2.3% | 2.2% | 2.3% | 2.4% |
| Debt Service (Millions)(c) | | | | | | |
| Highway Bonds(d)..... | \$ 62 | \$ 26 | \$ 36 | \$ 46 | \$ 57 | \$ 52 |
| All Other Bonds..... | 701 | 975 | 996 | 1,129 | 1,146 | 1,223 |
| Lease Payments..... | 73 | 74 | 92 | 127 | 137 | 156 |
| Total..... | \$ 836 | \$ 1,075 | \$ 1,124 | \$ 1,302 | \$ 1,340 | \$ 1,431 |
| Increase (Decrease) Over Prior Year | | | | | | |
| Cash Revenues (Million)(e) | 0.7% | 7.5% | 4.6% | 15.8% | 2.9% | 6.8% |
| Motor License Fund..... | | | | | | |
| Motor License Fund..... | \$ 1,999 | \$ 2,635 | \$ 2,641 | \$ 2,521 | \$ 2,414 | \$ 2,416 |
| General Fund..... | | | | | | |
| General Fund..... | 21,315 | 25,529 | 27,648 | 27,497 | 27,678 | 28,647 |
| Total..... | \$ 23,314 | \$ 28,164 | \$ 30,289 | \$ 30,018 | \$ 30,092 | \$ 31,063 |
| % Increase (Decrease) over prior year..... | 5.9% | (8.0%) | 7.6% | (0.9%) | 0.3% | 3.2% |
| Highway Bond Debt Service as a % of Motor License | | | | | | |
| Fund Revenues..... | 3.1% | 1.0% | 1.4% | 1.8% | 2.4% | 2.2% |
| All Other Bond Debt Service and Lease Payments as a | | | | | | |
| % of General Fund Revenues..... | 3.6% | 4.1% | 3.9% | 4.6% | 4.6% | 4.8% |
| Total Debt Service and Lease Payments as a % of Motor | | | | | | |
| License and General Fund Revenues..... | 3.6% | 3.8% | 3.7% | 4.3% | 4.5% | 4.6% |

(a) Net of all sinking fund balances. Includes bond anticipation notes.

(b) Includes unduplicated data of issues contained in Table 20.

(c) As paid from appropriations, available funds and/or sinking fund balances.

(d) Highway Bonds, interest portion of Advance Construction Bonds, Highway Public Improvement Bonds, State Highway and Bridge Authority Bonds, General Authority Rentals, and Highway Bridge Improvement Bonds.

(e) Commonwealth revenues only.

General Obligation Debt Outstanding

As of June 30, 2013, the Commonwealth had the following amount of general obligation debt outstanding:

Table 17
General Obligation Debt Outstanding as of June 30, 2013^(a)

(In Thousands)

| | Debt Outstanding ^(b) | Less: Refunding Escrow ^(c) | Less: Sinking Fund ^(d) | Net Debt Outstanding |
|--|------------------------------------|---|--------------------------------------|-----------------------------|
| Capital Projects Debt: | | | | |
| Capital Facilities Bonds..... | \$ 7,122,575 | \$ (1,012,265) | \$ (34,771) | \$ 6,075,539 |
| Highway Bonds(e)..... | 705,400 | - | - | 705,400 |
| Refunding Bonds(e) | <u>2,745,945</u> | <u>-</u> | <u>-</u> | <u>2,745,945</u> |
| Total Capital Projects Debt Outstanding..... | <u>\$ 10,573,920</u> | <u>\$ (1,012,265)</u> | <u>\$ (34,771)</u> | <u>\$ 9,526,884</u> |
| Electorate Approved Debt: | | | | |
| PA Economic Revitalization Bonds..... | - | - | - | - |
| Land & Water Development Bonds..... | - | - | (9) | (9) |
| Nursing Home Loan Development Bonds..... | - | - | - | - |
| Volunteer Companies' Loan Bonds..... | - | - | - | - |
| Vietnam Veterans Compensation Bonds..... | - | - | - | - |
| Water Facilities Restoration-1981 Referendum..... | - | - | - | - |
| Pennvest—1988 Referendum Bonds..... | 24,920 | (7,380) | (1,481) | 16,059 |
| Pennvest—1992 Referendum Bonds..... | 199,975 | (9,730) | - | 190,245 |
| Agricultural Conservation Easement Bonds..... | - | - | - | - |
| Local Criminal Justice Bonds..... | 3,765 | (1,850) | (566) | 1,349 |
| Keystone Recreation, Parks & Conservation Bonds..... | - | - | - | - |
| Growing Greener Bonds..... | 485,230 | (44,520) | (1) | 440,709 |
| Water Supply and Wastewater Treatment Bonds..... | 175,905 | (18,335) | - | 157,570 |
| Persian Gulf Conflict Veterans..... | 5,880 | (760) | - | 5,120 |
| Water and Sewer Assistance..... | <u>352,765</u> | <u>-</u> | <u>-</u> | <u>352,765</u> |
| Total Electorate Approved Debt Outstanding..... | <u>\$ 1,248,440</u> | <u>\$ (82,575)</u> | <u>\$ (2,057)</u> | <u>\$ 1,163,808</u> |
| Other Bonded Debt: | | | | |
| Disaster Relief Bonds..... | - | - | - | - |
| Refunding Bonds..... | <u>169,645</u> | <u>-</u> | <u>-</u> | <u>169,645</u> |
| Total Other Bonded Debt Outstanding..... | <u>\$ 169,645</u> | <u>-</u> | <u>-</u> | <u>\$ 169,645</u> |
| Total General Obligation Debt Outstanding..... | <u>\$ 11,992,005</u> | <u>\$ (1,094,840)</u> | <u>\$ (36,828)</u> | <u>\$ 10,860,337</u> |

^(a) Reserved

^(b) Accreted value of capital appreciation bonds included.

^(c) Principal amount of bonds refunded to be paid from escrowed bond proceeds in State Treasurer escrow account.

^(d) Funds already deposited in sinking funds.

^(e) Refunding Bonds in the principal amount of \$65.0 million have refunded prior bonds issued as Highway Bonds. Debt service on these Refunding Bonds remains payable from the Motor License Fund.

Debt service payable during each fiscal year on outstanding general obligation debt, net of refunding escrow amounts, as of December 31, 2013, for the years shown is as follows on the next page:

Table 18
Bond Debt Service
(In Thousands)

| <u>Fiscal Year Ending June 30</u> | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|-----------------------------------|----------------------|---------------------|----------------------|
| 2014 | \$ 752,105 | \$ 533,885 | \$ 1,285,990 |
| 2015 | 728,360 | 520,191 | 1,248,551 |
| 2016 | 710,855 | 484,312 | 1,195,167 |
| 2017 | 689,695 | 449,724 | 1,139,419 |
| 2018 | 696,190 | 414,513 | 1,110,703 |
| 2019 | 705,995 | 378,671 | 1,084,666 |
| 2020 | 690,410 | 343,582 | 1,033,992 |
| 2021 | 684,410 | 311,189 | 995,599 |
| 2022 | 682,495 | 280,029 | 962,524 |
| 2023 | 648,940 | 248,437 | 897,377 |
| 2024 | 647,500 | 217,612 | 865,112 |
| 2025 | 621,140 | 187,749 | 808,889 |
| 2026 | 636,330 | 157,436 | 793,766 |
| 2027 | 604,590 | 126,200 | 730,790 |
| 2028 | 549,655 | 97,181 | 646,836 |
| 2029 | 474,675 | 71,275 | 545,950 |
| 2030 | 413,975 | 48,280 | 462,255 |
| 2031 | 282,830 | 27,664 | 310,494 |
| 2032 | 242,575 | 16,066 | 258,641 |
| 2033 | 126,570 | 6,769 | 133,339 |
| 2034 | 57,870 | 1,266 | 59,136 |
| Grand Total | \$ 11,640,165 | \$ 4,922,032 | \$ 16,569,197 |

Totals may not add due to rounding.

Nature of Commonwealth Debt

Capital Projects Debt. The Commonwealth may incur debt to fund capital projects for community colleges, highways, bridge projects, public improvements, transportation assistance, flood control, and redevelopment assistance. Before a project may be funded, it must be itemized in a capital budget bill adopted by the General Assembly. An annual capital budget bill states the maximum amount of debt for capital projects that may be incurred during the current fiscal year for projects authorized in the current or previous years' capital budget bills. Capital projects debt is subject to a constitutional limit on debt.

Once capital projects debt has been authorized by the necessary legislation, issuance authority rests with at least two of the three Issuing Officials (the Governor, the State Treasurer and the Auditor General), one of whom must be the Governor.

Electorate-Approved Debt. The issuance of electorate-approved debt is subject to the enactment of legislation that places on the ballot the question of whether debt shall be incurred. The legislation authorizing the referendum must state the purposes for which the debt is to be authorized and, as a matter of practice, includes a maximum amount of funds to be borrowed. Upon electorate approval and enactment of legislation implementing the proposed debt-funded program, bonds may be issued. All such authorizing legislation to date has given issuance authority to at least two of the Issuing Officials, one of whom must be the Governor.

Other Bonded Debt. Debt issued to rehabilitate areas affected by disasters is authorized by specific legislation. Authorizing legislation has given issuance authority to two of the Issuing Officials, one of whom must be the Governor.

Tax Anticipation Notes. Due to the timing of major tax payment dates, the Commonwealth's General Fund cash receipts are generally concentrated in the last four months of the fiscal year, from March through June. Disbursements are distributed more evenly throughout the fiscal year. As a result, operating cash shortages can occur

during certain months of the fiscal year. When necessary, the Commonwealth engages in short-term borrowing to fund expenses within the fiscal year through the sale of tax anticipation notes. The authority to issue such notes rests with the Issuing Officials.

The Commonwealth may issue tax anticipation notes only for the account of the General Fund or the Motor License Fund or both such funds. The principal amount issued, when added to already outstanding amounts, may not exceed in the aggregate 20 percent of the revenues estimated to accrue to the appropriate fund or funds in the fiscal year.

Tax anticipation notes must mature within the fiscal year in which they are issued. The Commonwealth is not permitted to fund deficits between fiscal years with any form of debt. Any year-end deficit balances must be funded in the succeeding fiscal year budget.

Currently, the Commonwealth has no tax anticipation notes outstanding. The Commonwealth will continue to actively monitor its daily operating liquidity to determine the amount of tax anticipation notes required, if any, during the latter part of fiscal year 2014.

Bond Anticipation Notes. Pending the issuance of bonds, the Commonwealth may issue bond anticipation notes subject to the same statutory and constitutional limitations generally imposed on bonds. The term of such borrowings may not exceed three years. Issuing authority rests with the Issuing Officials. No bond anticipation notes are outstanding.

Projected Issuance of Long-Term Debt

Table 19 shows projected future issuance of new-money bonds (or bond anticipation notes) through fiscal year 2019 as currently estimated, based on current authorizations. Included in Table 19 are bonds expected to be issued under three bond referenda proposed by the Governor and enacted by the General Assembly in 2004, 2005 and 2008. Not included however, are bonds authorized under the economic stimulus program of the Commonwealth Financing Authority. Actual issuance of bonds will be affected by a number of economic and other factors and may vary significantly from the Table 19 projection.

Table 19
Projected Bond Issuance and Principal Retirements
Fiscal Years 2015-2019^(a)
(In Millions)

| | Fiscal Year Ending June 30 | | | | |
|--|-----------------------------------|--------------------|--------------------|--------------------|--------------------|
| | <u>2015</u> | <u>2016</u> | <u>2017</u> | <u>2018</u> | <u>2019</u> |
| Capital Facilities ^(b) | | | | | |
| Buildings and Structures..... | \$ 725 | \$ 600 | \$ 550 | \$ 565 | \$ 450 |
| Furniture and Equipment..... | 50 | 20 | 20 | 20 | 20 |
| Transportation Assistance | 175 | 175 | 175 | 175 | 175 |
| Redevelopment Assistance | 335 | 300 | 330 | 300 | 185 |
| Flood Control | 10 | 10 | 10 | 10 | 10 |
| Highway and Bridge Projects | 195 | 113 | 87 | 62 | 25 |
| Special Purpose: | | | | | |
| Pennvest — 1988, 1992 & 2008 Referenda..... | 26 | 0 | 0 | 0 | 0 |
| Water and Wastewater Referendum ^(a) | 0 | 0 | 15 | 15 | 8 |
| Growing Greener II Referendum ^(a) | <u>25</u> | <u>0</u> | <u>0</u> | <u>0</u> | <u>0</u> |
| Total Projected Issuance..... | <u>\$ 1,541</u> | <u>\$ 1,218</u> | <u>\$ 1,187</u> | <u>\$ 1,147</u> | <u>\$ 873</u> |
| Principal Retirement ^(c) | <u>\$ 745.9</u> | <u>\$ 778.3</u> | <u>\$ 798.3</u> | <u>\$ 847.2</u> | <u>\$ 900.2</u> |

Totals may not add due to rounding.

^(a) As proposed in the fiscal year 2015 budget.

^(b) Includes issuance for new projects and for projects previously authorized.

^(c) On bonded debt outstanding and pro forma for projected bond issuances.

OTHER STATE-RELATED OBLIGATIONS

Moral Obligations

Moral obligation financing is a financing arrangement in which designated officials of the Commonwealth, its departments or agencies agree, when necessary, to request the General Assembly to appropriate funds as may be required to make up any deficiency in a debt service reserve fund established to assure payment of obligations issued under such an arrangement. The General Assembly is not required to approve such appropriation requests.

Pennsylvania Housing Finance Agency ("PHFA"). The PHFA is a state-created agency that provides financing for housing for lower and moderate income families in the Commonwealth. The bonds, but not the notes, of the PHFA are partially secured by a capital reserve fund required to be maintained by the PHFA in an amount equal to the maximum annual debt service on its outstanding bonds in any succeeding calendar year. If there is a potential deficiency in the capital reserve fund or if funds are necessary to avoid default on interest, principal or sinking fund payments on bonds or notes of PHFA, the statute creating PHFA provides a mechanism for obtaining additional funds. That mechanism directs the Governor, upon notification from PHFA, to place in the budget of the Commonwealth for the next succeeding year an amount sufficient to make up any such deficiency or to avoid any such default. The budget as finally adopted by the General Assembly may or may not include the amount so placed therein by the Governor. PHFA is not permitted to borrow additional funds so long as any deficiency exists in the capital reserve fund. No deficiency exists currently.

According to PHFA, as of December 31, 2013, PHFA had \$3,526.1 million of revenue bonds outstanding.

Lease Financing

The Commonwealth, through several of its departments and agencies, leases various real property and equipment. Some leases and the lease payments thereunder are, with the Commonwealth's approval, pledged as security for debt obligations issued by certain public authorities or other entities within the state. All lease payments payable by Commonwealth departments and agencies are subject to and dependent upon an annual spending authorization approved through the Commonwealth's annual budget process. The Commonwealth is not required by law to appropriate or otherwise provide moneys from which the lease payments are to be paid. The obligations to be paid from such lease payments are not bonded debt of the Commonwealth.

Table 20 contains summary information on material obligations secured by lease payments of Commonwealth departments and agencies payable from the General Fund or other budgeted special funds.

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Table 20
Obligations Secured By Commonwealth
Lease Payments
(In Thousands)

| <u>Lessor</u> | <u>Purpose</u> | <u>Maximum Annual Lease Payment</u> | <u>Principal Amount Outstanding as of 12/31/2013</u> | <u>Final Maturity</u> |
|--|-------------------|---|--|---------------------------|
| Harristown Development Corporation | Office Space | \$ 6,300 | \$ 21,050 | May 1, 2025 |
| Philadelphia Regional Port Authority | Port Facilities | 4,601 | 25,800 | Sept. 1, 2020 |
| Sports & Exhibition Authority of Pittsburgh and Allegheny County | Public Auditorium | 19,100 | 297,519 | Nov. 1, 2039 |
| CAFCO-PA Leasing I, LLC | Prison Facilities | 3,770 | 9,035 | June 1, 2016 |
| NORESCO, LLC | Equipment | 2,158 | 14,865 | Oct. 1, 2026 |
| NORESCO, LLC | Equipment | 1,559 | 11,325 | Oct. 1, 2027 |
| NORESCO/Johnson Controls | Equipment | 8,416 | 76,505 | Apr. 1, 2027 |
| Pennsylvania Economic Development Finance Authority | Convention Center | 26,641 | 257,360 | June 15, 2039 |
| Pennsylvania Economic Development Finance Authority | Office Space | 18,123 | 105,775 | Mar. 1, 2034 |

The Harristown Development Corporation leases office space to the Commonwealth in the city of Harrisburg. Refunding certificates of participation in the principal amount of \$17,025,000 were issued in May 2013, representing undivided rights in the lease payments by the Commonwealth to the Harristown Development Corporation for nearly one million square feet of office space occupied by Commonwealth departments and agencies since 1978.

The Commonwealth has also leased port facilities of the Philadelphia Regional Port Authority (“PRPA”) to encourage trade through the Port of Philadelphia. Lease revenue bonds of PRPA in the amount of \$53.9 million were issued by that authority in August 2003 to refund all outstanding PRPA Series 1993 Bonds. Lease revenue bonds of PRPA in the amount of \$41.9 million were issued by that authority in September 2008 to refund the outstanding PRPA Series 2003 Bonds. These bonds are payable from lease payments made by the Commonwealth from an annual appropriation authorizing payments to PRPA.

In 2009, the Commonwealth executed an annually renewable lease purchase agreement with CAFCO-PA Leasing I, LLC, a Colorado limited liability company to assist the Commonwealth, acting through its Department of Correction, to acquire certain modular prison dormitory facilities. Certificates of participation in the amount of \$19,300,000 were issued in December 2009. The certificates of participation are payable from lease payments made by the Commonwealth from an annual appropriation to its Department of Corrections.

In 2010, the Commonwealth executed an installment purchase agreement with Noresco, LLC, a Massachusetts limited liability company. The purpose of the installment purchase agreement is to assist the Commonwealth, acting through its Department of Public Welfare, to acquire certain energy-savings improvements at its Ebensburg facility. Certificates of participation in the amount of \$15,580,000 were issued in March 2010 and are payable from lease payments made by the Commonwealth from an annual appropriation to its Department of Public Welfare. The Commonwealth has also issued additional installment purchase agreements with Noresco and Johnson Controls. Certificates of participation in the amount of \$86,850,000 were issued in October 2010 and are payable by the Commonwealth from annual appropriations to its Departments of General Services, Corrections and Public Welfare. Certificates of participation in the amount of \$12,385,000 were issued in December 2010 and are payable by the Commonwealth from annual appropriations to its Departments of General Services and Public Welfare. The purpose of

the additional installment purchase agreements was to assist the Commonwealth, acting through various departments, to acquire certain energy-savings improvements.

On March 1, 2009, the Commonwealth entered into a 25 year master lease agreement for certain office space within the Forum Place complex in the city of Harrisburg. The master lease covered 375,000 square feet of office space and had a term through February 28, 2034. In January 2012, PEDFA (defined below) issued lease revenue bonds in the principal amount of \$107,360,000 to acquire the Forum Place complex from the then-controlling majority holder of the defaulted 1998 Dauphin County General Authority Bonds. Contemporaneous with the issuance of the PEDFA bonds to acquire the Forum Place, the Capital Region Economic Development Corporation (CREDC) entered into an agreement with both the Commonwealth and PEDFA in which the Commonwealth leases approximately 375,000 square feet of office space and 500,000 square feet of parking space in the Forum Place complex from CREDC. The PEDFA Bonds are payable from lease payments made by the Commonwealth to CREDC from an annual appropriation authorizing payments to various Commonwealth agencies occupying the leased space.

Lease for Pittsburgh Penguins Arena

In October 2007, the Commonwealth and the Sports and Exhibition Authority of Pittsburgh and Allegheny County (the "SEA") entered into a lease agreement (the "Arena Lease") that, while not creating indebtedness of the Commonwealth, creates a "subject to appropriation" obligation of the Commonwealth. The SEA, a joint public benefit authority, issued in October 2007 its \$313.3 million Commonwealth Lease Revenue Bonds (the "Arena Bonds") to finance a multi-purpose arena (the "Arena"), to serve as the home of the Pittsburgh Penguins (the "Penguins"), a hockey team in the National Hockey League. The Arena Bonds are not debt of the Commonwealth but are limited obligations of the SEA payable solely from the special revenues pledged therefore. These special revenues include annually (1) \$4.1 million from a lease with the Penguins, (2) not less than \$7.5 million from the operator of a casino located in the City of Pittsburgh, and (3) \$7.5 million from the Commonwealth's Economic Development and Tourism Fund (the "Development and Tourism Fund"). The Development and Tourism Fund is funded with an assessment of five percent of the gross terminal revenue of all total wagers received by all slot machines in the Commonwealth less cash payments.

While the special revenues currently are projected to be adequate to pay all debt service on the Arena Bonds, to the extent such revenues are in any year inadequate to cover debt service, the Commonwealth is obligated under the Arena Lease to fund such deficiency, subject in all cases to appropriation by the General Assembly. The maximum annual amount payable by the Commonwealth under the Arena Lease is \$19.1 million. In December 2009, the Commonwealth was notified by the SEA that an additional \$2.8 million would be required in fiscal year 2010 to support debt service. In compliance with its obligations under the Arena Lease, the Commonwealth included an appropriation request for \$2.8 million from the Pennsylvania Gaming and Economic Development Tourism Fund in its fiscal year 2010 budget. Subsequent to the fiscal year 2010 budget, the Commonwealth has been annually notified by the SEA that additional funds would be required to support debt service. In each subsequent year, the Commonwealth included the appropriation request in the appropriate fiscal year budget. In fiscal year 2011, the actual amount appropriated to support the SEA debt service was \$163,885.00 and in fiscal year 2012 it was \$96,470.00.

During April 2010, the SEA issued \$17.36 million in additional Commonwealth Lease Revenue Bonds (the "Supplemental Arena Bonds") to complete the Arena. The Supplemental Arena Bonds do not constitute debt of the Commonwealth but are limited obligations of the SEA payable solely from the special revenues pledged therefor. As with the Arena Bonds, the Commonwealth is obligated under the Arena Lease, as amended, to fund any deficiency in special revenues necessary to pay debt service on the Supplemental Arena Bonds, subject in all cases to appropriation by the General Assembly.

Pennsylvania Convention Center

In April 2010, the Commonwealth acquired (through ownership and a long-term leasehold interest) the Pennsylvania Convention Center located in Philadelphia, Pennsylvania and the expansion thereto that was recently constructed. Such acquisition was financed through the issuance by PEDFA (defined below) of \$281.075 million of revenue bonds (the "Convention Center Bonds"). The Commonwealth, the City of Philadelphia (the "City") and the Pennsylvania Convention Center Authority (the "Convention Center Authority") entered into an Operating Agreement (the "Operating Agreement") in connection with the issuance of the Convention Center Bonds and the acquisition of the

Pennsylvania Convention Center which provides for the operation of the Pennsylvania Convention Center by the Convention Center Authority (which also leases the facility), for the City to make an annual payment of \$15 million plus a percentage of its Hotel Room Rental Tax and Hospitality Promotion Tax revenues to support operations of the Pennsylvania Convention Center and for the Commonwealth to make payments to finance operating deficits and operating and capital reserve deposits of the Pennsylvania Convention Center and to pay debt service on the Convention Center Bonds. The Commonwealth also entered into a Grant Agreement (the "Grant Agreement") with PEDFA and U.S. Bank National Association, as trustee for the Convention Center Bonds, with respect to the obligations of the Commonwealth to make the payments required under the Operating Agreement and related amounts due with respect to the Pennsylvania Convention Center and the Convention Center Bonds.

The obligations of the Commonwealth under the Operating Agreement and the Grant Agreement do not create indebtedness of the Commonwealth but are payable from (1) funds available in the Gaming Economic Development and Tourism Fund and (2) other funds of the Commonwealth, subject to annual appropriation by the state legislature. Payments from the Gaming Economic Development and Tourism Fund of up to \$64,000,000 per year for up to 30 years (but not exceeding \$880 million in the aggregate) have been appropriated by the General Assembly (by Act 53 of 2007, ("Act 53")) for the payment of debt issued with regard to the Pennsylvania Convention Center and for operating expenses of the Pennsylvania Convention Center; however, there is no requirement in Act 53 or otherwise that funds in the Gaming Economic Development and Tourism Fund be so applied. Moneys in the Gaming Economic Development and Tourism Fund have also been appropriated by the General Assembly to a number of other projects and could be appropriated to additional projects in the future. The Gaming Economic Development and Tourism Fund is funded with an assessment of five percent of the gross terminal revenue of all total wagers received by all slot machines in the Commonwealth less cash payments. While the Gaming Economic Development and Tourism Fund is projected to continue to have sufficient revenues to pay its current appropriated obligations, there can be no absolute assurance that the Gaming Economic Development and Tourism Fund in any future fiscal year will receive sufficient receipts to pay its appropriated obligations.

Any payments due from the Commonwealth under the Operating Agreement and the Grant Agreement and which are not paid from the Gaming Economic Development and Tourism Fund are subject to annual appropriation by the General Assembly. The Commonwealth currently projects that payments materially in excess of the aggregate \$880 million appropriated from the Gaming Economic Development and Tourism Fund will be required to be paid by it to satisfy the Commonwealth's obligations under the Operating Agreement and the Grant Agreement over the terms of such agreements.

Commonwealth Financing Authority

The Commonwealth Financing Authority (the "CFA"), was established in April 2004 with the enactment of legislation establishing the CFA as an independent authority and an instrumentality of the Commonwealth. The CFA is authorized to issue limited obligation revenue bonds and other types of limited obligation revenue financing for the purposes of promoting the health, safety, employment, business opportunities, economic activity and general welfare of the Commonwealth and its citizens through loans, grants, guarantees, leases, lines and letters of credit and other financing arrangements to benefit both for-profit and non-profit entities. The CFA's bonds and financings are to be secured by revenues and accounts of the CFA, including funds appropriated to CFA from general revenues of the Commonwealth for repayment of CFA obligations. The obligations of the CFA do not constitute a debt or liability of the Commonwealth.

Since November 2005, the CFA has completed multiple bond issues to fund programs established by its original economic stimulus mission of April 2004.

As part of the enactment process for the fiscal year 2009 budget, the General Assembly enacted and on July 9, 2008, the Governor signed into law Act 63 of 2008 ("Act 63") and Act 1 of Special Session 1 of 2008 ("Act 1"). Combined, these two acts provide the CFA with additional bond issuance authority of up to an additional \$1,300 million. Act 63 of 2008 provides the CFA with authority to issue up to \$800 million in limited obligation revenue bonds in order to fund water or sewer projects, storm water projects, flood control projects and high hazard unsafe dam projects. Act 63 also provides for the use of Pennsylvania Gaming and Economic Development and Tourism Fund revenues to support debt service costs associated with the \$800 million in additional CFA debt authority. Act 1

provides the CFA with authority to issue up to \$500 million in limited obligation revenue bonds to fund the development of alternative sources of energy. As of December 31, 2013, the CFA had issued \$365.0 million in limited obligation revenue bonds authorized by Act 1. Further, the CFA has issued \$757.0 million in limited obligation revenue bonds authorized by Act 63.

As of June 30, 2013, the CFA had \$1,667.8 million in outstanding bond debt. With respect thereto, the Commonwealth's General Fund has appropriation responsibility for \$927.8 million thereof and the Pennsylvania Gaming and Economic Development and Tourism Fund has appropriation responsibility with respect to \$740 million of such outstanding debt. In preparation for the enactment of the fiscal year 2011 Commonwealth budget, DCED and the Office of the Budget, in compliance with the various service agreements, requested an appropriation from the Pennsylvania General Assembly in the full amount of the then estimated debt service for the CFA. In light of available resources of the CFA, the Pennsylvania General Assembly enacted its fiscal year 2011 budget which appropriated \$76.480 million in state funds to the CFA for payment of CFA debt service during fiscal year 2011, which amount was approximately \$3.5 million less than required to meet all of the CFA's debt service obligations in that fiscal year. In order to address this shortfall, the CFA applied approximately \$3.5 million in available interest earnings to its debt service payments. The Commonwealth's fiscal year 2012 enacted budget appropriated \$82.019 million, which amount was sufficient for the CFA to meet all of its debt service obligations. The Commonwealth's fiscal year 2013 enacted budget appropriated \$85.519 million in state funds to the CFA for payment of CFA debt service during fiscal year 2013. CFA debt service for fiscal year 2014 is estimated to be \$82.012 million. With respect to future fiscal year budgets, additional appropriations from the General Fund for future debt service are expected to be requested each year by the Department of Community and Economic Development for inclusion in annual Executive Budget requests to the General Assembly.

Pensions and Retirement Systems

General Information

The Commonwealth maintains contributory benefit pension plans covering all state employees, public school employees and employees of certain state-related organizations. State employees and employees of certain state-related organizations are members of the State Employees' Retirement System ("SERS"). Public school employees are members of the Public School Employees' Retirement System ("PSERS"). With certain exceptions, membership in the applicable retirement system is mandatory for covered employees.

SERS and PSERS are established by state law as independent administrative boards of the Commonwealth, each directed by a governing board that exercises control and management of its system, including the investment of its assets. The board of the SERS consists of eleven members, six appointed by the Governor, two members each from the Senate and House of Representatives and the State Treasurer. The PSERS board has fifteen members, including the Commonwealth's Secretary of Education, the State Treasurer, the executive secretary of the Pennsylvania School Boards Association, two members appointed by the Governor, six elected members (five from among PSERS members and one from among school board members in Pennsylvania) and two members each from the Senate and the House of Representatives.

The retirement plans of SERS and PSERS are contributory defined benefit plans for which the benefit payments to members and contribution rates by employees are specified in state law. Changes in benefit and contribution provisions for each retirement plan must be made by legislation enacted by the General Assembly. Under statutory provisions established in 1981, all legislative bills and amendments proposing to change a public employee pension or retirement plan are to be accompanied with an actuarial note prepared by an enrolled pension actuary providing an estimate of the cost and actuarial effect of the proposed change.

The Commonwealth's retirement programs are funded by contributions from both the employer and employee. The contribution rate for new PSERS members who enrolled in the pension plan on or after January 1, 2002 and before July 1, 2011 is 7.5 percent of compensation. The contribution rate for new PSERS members who enroll on or after July 1, 2011 is 7.5% or 10.3% depending upon elections made by each employee member. The contribution rates for PSERS members who enrolled prior to January 1, 2002 range from 5 percent to 7.5 percent of compensation, depending upon the date of commencement of employment and elections made by each employee member. The SERS' employee

contribution rate is 6.25 percent for a majority of member employees. Interest on each employee's accumulated contributions is credited annually at a 4 percent rate mandated by state statute. Accumulated contributions plus interest credited are refundable to covered employees upon termination of their employment for most members hired before December 31, 2010, for SERS and before June 30, 2011, for PSERS.

Act 120 of 2010 and Commonwealth Contributions

On November 23, 2010, the Governor signed Act 120 of 2010 into law ("Act 120") to implement changes to the actuarial methodologies of both of the PSERS and the SERS pension plans. Act 120 also implemented employer contribution collars, set a minimum employer contribution rate, changed the retirement benefits for new employees and prohibited the use by the Commonwealth of pension obligation bonds, among other changes. In addition the Act proposed to amortize certain PSERS unfunded liability over 24 years and certain SERS unfunded liability over 30 years.

The most significant change to the Commonwealth benefit pension systems from Act 120 is the enactment of employer contribution collars to reduce the previously anticipated major increases in pension contributions which would have been required of the Commonwealth beginning in fiscal year 2013. Contribution collars are limits on the amount of year-over-year increase that are required from the employer, namely the Commonwealth, plus in the case of PSERS, the Commonwealth school districts. Contribution collars are expressed as a percentage of payroll and under Act 120, the contribution collars are 3 percent in fiscal year 2012, 3.5 percent in fiscal year 2013 and 4.5 percent in fiscal year 2014 and all future years beyond 2014 until the actuarial calculated rate is below the collared rate. To the extent the pension funds have large unfunded liabilities, as is presently the case, such capping of required employer contributions to the pension funds is likely to materially extend the period over which such unfunded liability is funded.

For PSERS, the employer's contribution is shared by the Commonwealth and the school districts. The Commonwealth remits its employer contribution portion to the school districts, which then remit the entire employer contributions (both school district and Commonwealth portions) to PSERS. The Commonwealth's contribution is appropriated annually from the General Fund to the Department of Education. In fiscal year 2008, the Commonwealth contributions to SERS and PSERS were \$237.5 million and \$451.2 million respectively, constituting 8.4 and 18 percent increases in the year-over-year contribution to SERS and PSERS. During fiscal year 2009, Commonwealth contributions to SERS and PSERS were \$242.5 million and \$360.6 million, a 2.1 percent increase and a 20.1 percent reduction respectively in year-over-year contributions. During fiscal year 2010, Commonwealth contributions totaled \$262.5 million for SERS, an 8.2 percent increase in year-over-year contributions, and for PSERS \$342.6 million, a 5.0 percent decrease in the year-over-year contributions. For fiscal year 2011, for SERS, the Commonwealth contribution was \$300.4 million, a 14.4 percent increase, and for PSERS, \$408.6 million, a 19.3 percent increase. For fiscal year 2012, the SERS Commonwealth contributions were \$463.7 million, a 54.4 percent increase and for PSERS, \$600.1 million, a 47 percent increase. For fiscal year 2013, PSERS' Commonwealth contributions were \$856.1 million.

Based on the 2009 valuations of the two retirement systems, Commonwealth contributions to both systems were projected to increase significantly in fiscal year 2012 based on pre-Act 120 provisions. Those increases were lowered in the near-term as a result of Act 120, but would continue to significantly rise over the next decade. For fiscal year 2013 the PSERS rate was 12.36% under the provisions of Act 120 compared to a pre-Act 120 rate of 29.65%. For fiscal year 2014 the PSERS rate is 16.93% under Act 120 compared to a pre-Act 120 rate of 32.32%. After 2014, under Act 120 employer rates are expected to rise in fiscal year 2015 and fiscal year 2016 by the 4.5 percentage increase provided by the collars and would reach a maximum rate of 33.27 percent in fiscal year 2035 and then drop below 20 percent and decrease for several years thereafter.

With respect to SERS, Commonwealth contributions were \$660.7 million or 11.59 percent of payroll in fiscal year 2013 compared to anticipated contributions of \$1,559.7 or 26.49 percent of payroll without collar restrictions. For fiscal year 2014, under Act 120 the Commonwealth contribution rate is 16.05 percent as compared to 31.25 percent without collar restrictions. After 2014, the Commonwealth rates are expected to rise every year through fiscal year 2017 by the percentage increases as provided for in the collars. It will reach a maximum rate of 29.61 percent in fiscal year 2018 and then will decline slowly and not drop below 20 percent until fiscal year 2037.

Investment Performance

SERS returns for the calendar years 2010, 2011, 2012, and 2013 were 11.9 percent, 2.7 percent, 12.0 percent and 13.6 percent respectively. PSERS' fiscal years 2010, 2011, 2012 and 2013 investment performance was 14.59 percent, 20.37 percent, 3.43 percent and 7.96 percent respectively.

Plan Assets

Contributions to the PSERS and SERS pension plans by the Commonwealth including medical premium assistance payments, employee contributions, interest earnings and benefit payments are shown in the following tables, which have been prepared by the respective staffs of PSERS and SERS.

Table 21
Public School Employees' Retirement Fund
(In Millions)

| <u>Year Ended June 30</u> | <u>Employer Contributions</u> | <u>Employee Contributions^(a)</u> | <u>Net Investment Income (Loss)</u> | <u>Total Deductions From Plan Net Assets^(b)</u> | <u>Net Assets^(c)</u> |
|-------------------------------|-----------------------------------|---|---|--|-------------------------------------|
| 2006..... | \$ 531 | \$ 828 | \$ 7,943 | \$ 4,164 | \$ 57,417 |
| 2007..... | 746 | 855 | 12,703 | 4,371 | 67,523 |
| 2008..... | 835 | 880 | (1,776) | 4,991 | 62,659 |
| 2009..... | 608 | 911 | (16,198) | 4,983 | 43,207 |
| 2010..... | 638 | 952 | 6,115 | 5,300 | 45,837 |
| 2011..... | 748 | 1,043 | 9,247 | 5,675 | 51,433 |
| 2012..... | 1,086 | 953 | 1,094 | 6,049 | 48,764 |
| 2013..... | 1,555 | 991 | 4,126 | 6,436 | 49,276 |

^(a) PSERS no longer classifies member premiums to its Health Option Plans as Employee Contributions. Numbers have been adjusted for each year to reflect this change.

^(b) Includes PSERS administrative expenses.

^(c) PSERS adopted GASB Statement Nos. 25 and 26 retroactively to fiscal 1994. GASB Statement No. 25 requires the presentation of Plan Net Assets, which combines the cumulative residual effects of all System assets and current liabilities. System long-term actuarial liabilities are not presented on the System's basic financial statements, but instead are presented upon a supplementary schedule of funding progress. The presentations above include the effects of financial activity related to the administration of the PSERS healthcare insurance premium assistance program and Health Options Program. As required with the adoption of GASB Statement No. 26, separate financial presentations for these programs are made in PSERS financial statements. PSERS also adopted GASB Statement No. 34 for the fiscal year beginning July 1, 2001 that requires the presentation of Management's Discussion and Analysis as required supplementary information preceding the financial statement.

Table 22
State Employees' Retirement Fund
(In Millions)

| <u>Year Ended December 31</u> | <u>Employer Contributions</u> | <u>Employee Contributions</u> | <u>Net Investment Income^(a)</u> | <u>Total Deductions From Plan Net Assets^(b)</u> | <u>Plan Net Assets^(c)</u> |
|-----------------------------------|-----------------------------------|-----------------------------------|--|--|--|
| 2006..... | \$ 196 | \$ 318 | \$ 4,730 | \$ 1,943 | \$ 32,053 |
| 2007..... | 244 | 334 | 5,247 | 2,361 | 35,516 |
| 2008..... | 235 | 337 | (11,061) | 2,231 | 22,796 |
| 2009..... | 253 | 349 | 3,561 | 2,297 | 24,662 |
| 2010..... | 273 | 349 | 3,076 | 2,474 | 25,886 |
| 2011..... | 392 | 351 | 480 | 2,732 | 24,377 |
| 2012..... | 566 | 348 | 2,794 | 2,696 | 25,389 |

^(a) Includes net appreciation (depreciation) in fair value of investments.

^(b) Includes SERS administrative costs.

^(c) Market value of investment assets. SERS adopted GASB Statement No. 25 which requires that investments be reported at their fair value. Also includes securities lending collateral pool pursuant to GASB Statement No. 28. In 2002, SERS adopted GASB Statement No. 34, which requires the presentation of Management Discussion and Analysis as required supplementary information preceding the financial statements.

Actuarial Calculations and Unfunded Actuarial Accrued Liability

Annual actuarial valuations are required by state law to determine the employer contribution rates necessary to accumulate sufficient assets and provide for payment of future benefits. Actuarial assessments are “forward-looking” information that reflect the judgment of the fiduciaries of the pension plans, and are based upon a variety of assumptions, one or more of which may prove to be inaccurate or be changed in the future. Actuarial assessments will change with the future experience of the pension plans. The actuary’s recommendations for employer contribution rates represent a funding plan for meeting current and future retirement obligations. The employer’s contribution rate is computed to fully amortize the unfunded actuarial accrued liability of a plan as determined by the actuary. The unfunded accrued liability is a measure of the present value of benefits estimated to be due in the future for current employees under specified assumptions as to mortality, pay levels, retirement experience and employee turnover, less the present value of assets available to pay those benefits, under specified assumptions of normal cost, supplemental annuity amortization, employer contribution levels and employee contributions. The unfunded actuarial accrued liability for recent years with completed valuations is shown in Table 23 below for both SERS and PSERS.

The Boards of PSERS and SERS periodically review their respective system actuarial assumptions with actuaries, investment consultants and staff and determine whether to make any prospective changes to these assumptions. Both Boards have recently adopted changes to their respective system actuarial assumptions. In January 2009, the PSERS Board of Trustees decreased PSERS’ actuarial investment rate of return assumption from 8.5 percent to 8.25 percent, effective for the June 30, 2008 actuarial valuation, and further decreased the rate of return assumption from 8.25 percent to 8.0 percent for the June 30, 2009 valuation. In March 2011, the PSERS Board decreased the actuarial investment rate of return for a third time from 8.0 percent to 7.5 percent for the June 30, 2011 actuarial valuation based on a further reduction in the long term capital market rate of return assumptions of its investment consultant. In April 2009, the State Employees’ Retirement Board decreased SERS’ assumed rate of return on investments from 8.5 percent to 8.0 percent effective for the December 31, 2008 valuation. In May 2012, SERS’ Board decreased the actuarial rate of return from 8.0 percent to 7.5 percent for the December 31, 2011 valuation. These changes to SERS’ investment return assumptions conform to the median assumption used by public pension funds nationally.

Table 23
Unfunded Actuarial Accrued Liability
2005-2013
(In Millions)

| <u>Valuation Year Ended In</u> | <u>SERS^(a)</u> | <u>PSERS^(b)</u> |
|--------------------------------|---------------------------|----------------------------|
| 2005..... | \$ 2,058 | \$ 10,007 |
| 2006..... | 2,216 | 12,163 |
| 2007..... | 914 | 9,438 |
| 2008..... | 3,801 | 9,924 |
| 2009..... | 5,592 | 15,739 |
| 2010..... | 9,736 | 19,699 |
| 2011..... | 14,664 | 26,499 |
| 2012..... | 17,753 | 29,533 |
| 2013..... | | 32,599 |

^(a) The fiscal year for SERS ends on December 31 of each year.

^(b) The fiscal year for PSERS ends on June 30 of each year.

The net increase in the unfunded actuarial accrued liability is attributable to legislative pension plan modification to limit funding increases, to changes to the actuarial assumptions and to recent actual rates of return on pension fund investments being materially below the actuarially assumed rates.

For financial reporting purposes, both SERS and PSERS have adopted the Governmental Accounting Standards Board’s Statement No. 25. Statement No. 25 requires a specific method of accounting and financial reporting

for defined benefit pension plans. Among other things, Statement No. 25 requires a comparison of employer contributions to “annual required contributions” (“ARC”). Independently audited financial statements for both SERS and PSERS, as of June 30, 2013 and December 31, 2012, respectively, provide this comparison for each of the fiscal years then ended as shown in the following tables. The SERS and PSERS audited financial statements and other data regarding the respective pension plan are available electronically at the following respective websites www.sers.state.pa.us and www.psers.state.pa.us.

Table 24
Comparison of Employer Contributions to Annual Required Contributions
(In Thousands)

Public School Employees’ Retirement Fund

| <u>Year Ended</u> <u>June 30</u> | <u>Annual</u> <u>Required Cont</u> <u>ributions</u> | <u>Actual</u> <u>Employer</u> <u>Contributions</u> | <u>Percentages Cont</u> <u>ributed</u> |
|-------------------------------------|---|--|---|
| 2013 | \$ 3,110,429 | \$ 1,434,815* | 46% |
| 2012 | 2,629,244 | 1,001,140* | 38 |
| 2011 | 2,436,602 | 646,560* | 27 |
| 2010 | 1,928,278 | 527,212* | 27 |
| 2009 | 1,761,295 | 503,277* | 29 |
| 2008 | 1,852,238 | 753,532 | 41 |
| 2007 | 1,708,821 | 659,545 | 39 |
| 2006 | 1,328,373 | 456,878 | 34 |
| 2005 | 945,107 | 431,556 | 46 |
| 2004 | 321,091 | 321,091 | 100 |

State Employees’ Retirement Fund

| <u>Year Ended</u> <u>December 31</u> | <u>Annual</u> <u>Required Cont</u> <u>ributions</u> | <u>Actual</u> <u>Employer</u> <u>Contributions</u> | <u>Percentages Cont</u> <u>ributed</u> |
|---|---|--|---|
| 2012 | \$ 1,044,632 | \$ 565,621 | 54% |
| 2011 | 913,778 | 391,749 | 43 |
| 2010 | 866,822 | 273,083 | 31 |
| 2009 | 643,861 | 253,250 | 39 |
| 2008 | 584,248 | 235,288 | 40 |
| 2007 | 617,253 | 243,936 | 39 |
| 2006 | 584,745 | 196,420 | 36 |
| 2005 | 319,190 | 148,375 | 46 |
| 2004 | 105,229 | 106,703 | 100 |

(*) Net of purchase of service contributions

New Accounting Standards

On June 25, 2012, GASB approved Statement 67 (Plans) which replaces requirements of Statement 25 (effective for fiscal years beginning after June 15, 2013) and Statement 68 (Employers) which replaces the requirements of Statement 27 (effective for fiscal years beginning after June 15, 2014). These new standards impact the accounting treatment of pension plans in which state and local governments participate. Major changes are: 1) the inclusion of unfunded pension liabilities on the government’s balance sheet (such unfunded liabilities are currently typically included as notes to the government’s financial statements); 2) full pension costs will be shown as expenses regardless

of actual contribution levels; 3) lower actuarial discount rates may be required to be used for most plans for certain purposes of the financial statements, resulting in increased liabilities and pension expenses; and 4) shorter amortization periods for unfunded liabilities will be required to be used for certain purposes of the financial statements, which generally would increase pension expenses.

Other Post-Employment Benefits

In addition to a defined benefit pension plan for state employees and employees of certain state-related organizations, the Commonwealth also provides health care plans for its eligible retirees and their qualifying dependents. These and similar plans are commonly referred to as “other post-employment benefits” or “OPEBs.” The Commonwealth provides OPEBs under two plans. The Retired Pennsylvania State Police Program (RPSPP) provides collectively bargained benefits to retired state enlisted members and their dependents. The Retired Employee Health Program (REHP) provides Commonwealth-determined benefits to other retired state employees and their dependents.

The General Assembly, based upon the Governor’s request, annually appropriates funds to meet the obligation to pay current retiree health care benefits on a “pay-as-you-go” basis. Retiree health care expenditures are currently funded by the Commonwealth’s General Fund (approximately 46 percent), and by Federal, Other and Special Funds. Commonwealth costs for such benefits totaled \$626 million in fiscal year 2011, \$662 million in fiscal year 2012 and \$629 million in fiscal year 2013. Fiscal year 2014 employer contributions for retiree health care are estimated at \$699 million.

Summary of Commonwealth Actions to Control Retiree Health Care Costs

The following is a summary of key actions taken to date by the Commonwealth to contain the growth of the cost of health care/OPEB obligations for retirees:

1. REHP-eligible employees retiring after July 1, 2005 but prior to July 1, 2007 are required to annually pay 1 percent of their final annual gross salary as a contribution towards the cost of coverage.
2. REHP-eligible employees retiring on or after July 1, 2007 are required to annually pay an escalating percentage of their final annual gross salary as a contribution towards the cost of retiree health care coverage. The current contribution rate is 3 percent. Any future collectively bargained increases in the employee contribution rate for active employees will also automatically cover all retirees who retire on or after July 1, 2007.
3. REHP-eligible employees retiring after July 1, 2004 will have their post employment benefits changed automatically as the benefits for active employees are updated and changed.
4. Effective June 30, 2008, active employees who retire after age 60 must have at least 20 years of service to be REHP-eligible (prior to June 30, 2008, eligibility was attained with 15 years of service).
5. The Commonwealth has received the Medicare Part D drug subsidy for its retiree health care plans since June 2006.
6. The REHP Plan was redesigned for prescription drugs (three-tiered formulary and utilization management) and medical benefits (increased co-payments for specialist and emergency room visits). Changes were effective in February 2008 and May 2008.
7. Effective July 1, 2007, State Police retirees are eligible to enroll in PPO plans.
8. State Police enlisted members who retired on or after April 21, 2005 will have a two-tiered co-payment structure and those retiring on or after July 1, 2007 will have a three-tiered formulary for their prescription drug plan.
9. Effective May 1, 2008, REHP Medicare supplemental coverage was replaced with a Medicare Private Fee-For-Service Plan. Effective January 1, 2010, this plan was eliminated and retirees enrolled in this plan had the option to enroll in a Medicare HMO or Medicare PPO.

Governmental Accounting Standards Board Statement #45

On June 21, 2004, the Governmental Accounting Standards Board (GASB) released its Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (“Statement No. 45”). Statement No. 45 establishes standards for the measurement, recognition and display in the financial reports of state and local governments of obligations to pay OPEBs, when provided separately from a pension plan, expense or expenditures and related liabilities. Under Statement No. 45, governments are required to: (i) measure the costs of benefits, and recognize other post-employment benefits expenses, on the accrual basis of accounting during periods that employees are providing service; (ii) provide information about the actuarial liabilities of promised benefits associated with past service and whether, or to what extent, those benefits have been funded; and (iii) provide information useful in assessing potential demands on the employer’s future cash flows.

In fiscal year 2008, the Commonwealth’s Office of Budget entered into an Interagency Agreement with the independent Pennsylvania Department of Treasury to establish irrevocable trust equivalent arrangements trust accounts for the purpose of providing advance funding to both the REHP and RPSPP programs. The Commonwealth had previously established restricted receipt accounts for the REHP and RPSPP programs in order to accumulate funds to pay retiree health care costs on a “pay-as-you-go” basis while maintaining an adequate reserve balance.

In fiscal year 2008, \$60 million was transferred to the REHP Trust Account and \$50.8 million was transferred to the RPSPP Trust Account from the pre-existing restricted receipt accounts. No additional transfers have been made to the trust accounts. At the end of fiscal year 2012, the combined balance in the trust accounts and restricted receipt accounts was \$377 million.

The Commonwealth has retained the Hay Group, a national employee benefits consulting firm, to provide actuarial services for GASB 45 implementation and reporting. The Hay Group’s 2012 OPEB valuation for the REHP and RPSPP programs is updated to reflect the following:

1. The combined unfunded actuarial accrued liability (“UAAL”) as of June 30, 2013 was \$16,271 million. The UAAL for the REHP was \$13,152 million comprised of an actuarial accrued liability of \$13,234 million less \$82 million of plan assets. The UAAL for the RPSPP was \$3,119 million comprised of an actuarial accrued liability of \$3,188 million less \$69 million of plan assets.
2. The annual required contribution (“ARC”) for the fiscal year ended June 30, 2013 was \$1,168 million. The REHP ARC was \$865 million and the RPSPP ARC was \$207 million.
3. The OPEB liability as of June 30, 2013 was \$1,954 million consisting of \$1,430 million for the REHP and \$524 million for the RPSPP.

Unemployment Compensation

The Commonwealth, as of June 30, 2012, had \$2,592.7 million in outstanding loans from the Federal Unemployment Account to the Pennsylvania Unemployment Compensation Fund (the “UC Fund”).

The Commonwealth was one of 35 states that had exhausted its UC Fund balances during the most recent economic downturn. The federal loans, which began in March 2009, were needed to fund unemployment compensation benefits in excess of UC Fund receipts.

Under current federal law, such loans must be repaid by the states with interest. Under ARRA, a waiver of interest on federal loans was extended through the end of calendar year 2010. Beginning in January 2011, interest started to accrue on outstanding loan amounts. Pursuant to the Unemployment Compensation Law, for each year in which interest is due on federal loans the Department calculates an Interest Factor tax to be paid by Commonwealth employers on the first \$8,000 in wages paid to each employee. The assigned Interest Factor rate was 0.44 percent for calendar year 2011 and 0.20 percent for calendar year 2012. In addition, federal law requires that employers in a state with an outstanding loan balance at the end of two consecutive years must pay additional federal unemployment taxes (“FUTA”) to repay the principal of the loan. Initially this FUTA tax increase is 0.3 percent on the federal wage base of \$7,000 and automatically increases by 0.3 percent each year that the loan remains outstanding.

Based on econometric assumptions and in the absence of legislative action to improve the UC Fund's solvency and address the federal debt, the Commonwealth anticipated that the UC Fund would continue to require federal loans to pay benefits through at least 2018 and projected that its outstanding loan balance would total \$286 million by 2018. Mandatory loan repayments through increased FUTA taxes, which began in 2011, were expected to grow from \$94 million that year to an estimated \$854 million annually by 2018. Additional voluntary loan repayments from the UC Fund would likely decrease from an estimated \$2,560 million in fiscal year 2011 to \$176 million by fiscal year 2018 and the estimated interest on the outstanding UC Fund loans would drop from \$101 million annually in fiscal year 2011 to \$9 million by fiscal year 2018. It is important to note that these UC-related expenditures did not have any impact on the Commonwealth's General Fund. They are funded solely by federal taxes, the UC Fund and the Interest Factor assessment, none of which affect the revenues or expenditures of the General Fund.

To address these circumstances, on June 12, 2012 the Commonwealth amended its unemployment compensation law by enactment of Act 2012-60 (the "Act"), which among other things, authorized the issuance of up to \$4,500 million of unemployment compensation bonds by the Department of Labor and Industry acting through the Pennsylvania Economic Development Financing Authority ("PEDFA"). The proceeds of such bonds, (the "UC Bonds") could be used to repay all outstanding loan advances, including interest, from the Federal Unemployment Account as well as to provide additional funding for the UC Fund. UC Bonds would be issued only if the Department of Labor and Industry determined that such issuance would result in a savings to Pennsylvania employers. A stable funding source, i.e. the Interest Factor tax (with a maximum rate not to exceed 1.1%) would finance the repayment of the UC Bonds.

Also, the Act includes a number of provisions intended to stabilize the UC Fund on an ongoing basis, including enhanced collections authority for the Department of Labor and Industry, a longer statute of limitations for collection of fault overpayments, an increase in the taxable wage base, closing of loopholes in eligibility requirements, and an amnesty program to give employers and claimants an incentive to pay UC debts.

Overall, the key provisions of Act 6 of 2011 and Act 60 of 2012 are estimated to produce average annual savings of \$290 million per year for the UC Fund.

On July 25, 2012, PEDFA closed on a \$3,185.0 million interim financing with Citibank to both fully repay the outstanding loan from the Federal Unemployment Account and to fund the continued payment of benefits for a period through the Fall of 2012. On October 18, 2012 and as permitted under the Act, PEDFA issued its \$2,827.4 million Unemployment Compensation Revenue Bonds which are secured by certain assessments on contributing employers doing business in Pennsylvania. Proceeds of the UC Bonds were used to repay the Citibank interim financing. As a result of the Citibank interim financing and PEDFA's issuance of its UC Bonds, the Commonwealth estimates that it will save employers an estimated \$89 million as compared to repaying the previously existing federal advances through increased FUTA taxes with interest at the federal rate.

GOVERNMENT AUTHORITIES AND OTHER ORGANIZATIONS

Certain state-created organizations have statutory authorization to issue debt for which state appropriations to pay debt service thereon are not required. The debt of these organizations is funded by assets of, or revenues derived from, the various projects financed and is not a statutory or moral obligation of the Commonwealth. However, some of these organizations are indirectly dependent upon Commonwealth operating appropriations. In addition, the Commonwealth may choose to take action to financially assist these organizations. These organizations, their purposes and their outstanding debt, as computed by each organization, (excluding swap obligations) are as follows:

Delaware River Joint Toll Bridge Commission ("DRJTBC"). The DRJTBC, a public corporation of the Commonwealth and New Jersey, owns and operates bridges across the Delaware River. Debt service on bonds is paid from tolls and other revenues of the Commission. The DRJTBC had \$343.5 million in bonds outstanding as of December 31, 2013.

Delaware River Port Authority ("DRPA"). The DRPA, a public corporation of the Commonwealth and New Jersey, operates several toll bridges over the Delaware River, and promotes the use of the Philadelphia-Camden port and promotes economic development in the port district. Debt service on bonds is paid from toll revenues and other

revenues pledged by DRPA to repayment of bonds. The DRPA had \$1,654.2 million in revenue bond debt outstanding as of December 31, 2013.

Pennsylvania Economic Development Financing Authority (“PEDFA”). The PEDFA was created in 1987 to offer pooled bond and other bond issues for both taxable and tax-exempt bonds on behalf of local industrial and commercial development authorities for economic development projects. Bonds may be secured by loan repayments and all other revenues of the PEDFA. The PEDFA had \$6,056.1 million of debt outstanding as of December 31, 2013, including the UC Bonds.

Pennsylvania Energy Development Authority (“PEDA”). The PEDA was created in 1982 to finance energy research projects, demonstration projects promoting the production or conservation of energy and the promotion, utilization and transportation of Pennsylvania energy resources. The authority’s funding is from appropriations and project revenues. Debt service on bonds is paid from project revenues and other revenues pledged by PEDA to repayment of bonds. The PEDA had no bonds outstanding as of December 31, 2013.

Pennsylvania Higher Education Assistance Agency (“PHEAA”). The PHEAA makes or guarantees student loans to students or parents, or to lending institutions or post-secondary institutions. Debt service on the bonds is paid by loan interest and repayments and other agency revenues. The PHEAA had \$7,055.2 million in bonds outstanding as of December 31, 2013.

Pennsylvania Higher Educational Facilities Authority (“PHEFA”). The PHEFA is a public corporation of the Commonwealth established to finance college facilities. As of December 31, 2013, the PHEFA had \$6,442.3 million in revenue bonds and notes outstanding payable from the lease rentals or loan repayments of the projects financed. Some of the lessees or borrowers, although private institutions, receive grants and subsidies from the Commonwealth.

Pennsylvania Industrial Development Authority (“PIDA”). The PIDA is a public corporation of the Commonwealth established for the purpose of financing economic development. The PIDA had \$237.2 million in revenue bond debt outstanding on December 31, 2013, to which all of its revenues are pledged.

Pennsylvania Infrastructure Investment Authority (“Pennvest”). Pennvest was created in 1988 to provide low-interest rate loans and grants for the purpose of constructing new and improving existing water supply and sewage disposal systems to protect the health and safety of the citizens of the Commonwealth and to promote economic development within the Commonwealth. Loans and grants are available to local governments and, in certain circumstances, to private companies. The Pennvest bonds are secured by principal repayments and interest payments on Pennvest loans. Pennvest had \$1.6 million of revenue bonds outstanding as of December 31, 2013.

Pennsylvania Turnpike Commission (“PTC”). The PTC operates the Pennsylvania Turnpike System (“System”). Its outstanding indebtedness, \$8,856.4 million as of December 31, 2013, is payable from the net revenues of the System, primarily toll revenues and rentals from leases and concessions or from certain taxes dedicated to the System.

State Public School Building Authority (“SPSBA”). The SPSBA finances public school projects and community college capital projects. Bonds issued by the SPSBA are supported by the lease rental payments or loan repayments made to the SPSBA by local school districts and the community colleges. A portion of the funds appropriated annually by the Commonwealth as aid to local school districts and community colleges may be used by them to pay a portion of such lease rental payments or loan repayments. The SPSBA had \$3,291.1 million of revenue bonds outstanding as of December 31, 2013.

CITY OF PHILADELPHIA – PICA

The Pennsylvania Intergovernmental Cooperation Authority (“PICA”) was created by Commonwealth legislation in 1991 to assist the City of Philadelphia, the Commonwealth’s largest city, in remedying its fiscal emergencies. PICA is authorized to provide assistance through the issuance of debt and to make factual findings and recommendations to Philadelphia concerning its budgetary and fiscal affairs. This financial assistance has included grants used by the City for defeasance of certain City general obligation bonds, funding of capital projects, and the liquidation of the cumulative general fund deficit of the City of Philadelphia, as of June 30, 1992, of \$224.9 million. At

this time, Philadelphia is operating under a five-year financial plan covering fiscal years 2014 through 2018. This plan was initially approved by PICA on September 17, 2013. Revisions to the plan were approved by the Authority on November 19, 2013 and March 18, 2014.

No further bonds may be issued by PICA for the purpose of financing capital projects or an operating deficit, as the authority for such bond issuance expired December 31, 1994. PICA's authority to issue debt for the purpose of financing a cash flow deficit expired on December 31, 1995. Its ability to refund existing outstanding debt is unrestricted. PICA had \$409.3 million in special tax revenue bonds outstanding as of June 30, 2013. Neither the taxing power nor the credit of the Commonwealth is pledged to pay debt service on PICA's bonds.

LITIGATION

The Commonwealth's Office of Attorney General and Office of General Counsel have reviewed the status of pending litigation against the Commonwealth, its officers and employees, and have provided the following brief descriptions of certain cases affecting the Commonwealth.

In 1978, the General Assembly approved a limited waiver of sovereign immunity with respect to lawsuits against the Commonwealth. This cap does not apply to tax appeals, such as *Northbrook* (now *Allstate*) as detailed below. Damages for any loss are limited to \$250,000 for each person and \$1,000,000 for each accident. The Supreme Court of Pennsylvania has held that this limitation is constitutional. Approximately 3,150 suits against the Commonwealth remain open. Tort claim payments for the departments and agencies, other than the Department of Transportation, are paid from departmental and agency operating and program appropriations. Tort claim payments for the Department of Transportation are paid from an appropriation from the Motor License Fund. The Motor License Fund tort claim appropriation for fiscal year 2013 is \$20.0 million.

The Commonwealth also represents and indemnifies employees who have been sued under Federal civil rights statutes for actions taken in good faith in carrying out their employment responsibilities. There are no caps on damages in civil rights actions. The Commonwealth's self insurance program covers damages in these cases up to \$250,000 per incident. Damages in excess of \$250,000 are paid from departmental and agency operating and program appropriations.

Northbrook Life Insurance Co. v. Commonwealth (now Allstate Life Insurance Co. v. Commonwealth)

The *Northbrook* case was the lead case in litigation with potentially the entire insurance industry that does business in Pennsylvania. On January 26, 2006, the *en banc* Commonwealth Court issued a decision in which the majority partially ruled for both parties. *Northbrook Life Ins. Co. v. Commonwealth*, 890 A.2d 1223 (Pa. Commw. Ct. 2006). Both parties filed exceptions. The Court denied all exceptions and upheld its earlier decision. *Northbrook* filed an appeal to the Pennsylvania Supreme Court. The Supreme Court ruled in *Northbrook's* favor, but only on a technicality. See *Northbrook Life Ins. Co. v. Commonwealth*, 597 Pa. 18, 949 A.2d 333 (2008). The Court did not address the substantive findings of the Commonwealth Court.

Counsel then selected the *Allstate* case to relitigate the issues involved. *Northbrook* (now *Allstate*) and other pending cases challenged the Department of Revenue's application of portions of the Life and Health Guaranty Association Act of 1982 (the "Act"). The Act establishes a funding mechanism to fulfill defaulted obligations of insurance companies under life and health insurance policies and annuities contracts to insured Pennsylvania residents. In accordance with this funding mechanism, other insurance companies are assessed to provide the funds due to Pennsylvania residents insured by insurance companies which have become insolvent or are otherwise in default to their insureds.

Because the assessed insurance companies are paying the insurance obligations of other companies, a provision was placed in the Act that allows assessed insurance companies to claim a credit against their gross premiums tax liability based on such assessments. The assessments on each company are broken into various categories, including life insurance assessments, health insurance assessments, and annuity assessments, based on the type and amount of business each company transacts in Pennsylvania.

Life and health insurance premiums have always been subject to the premiums tax, and there is no dispute that companies may claim credit for life and health assessments. Annuity considerations, however, were taxed for

approximately a three-year period, 1992-1995. Some annuity considerations were subject to tax; others were not. After several changes of direction, the Department of Revenue decided to allow credits for assessments paid on taxable annuity considerations. Credits were not allowed for assessments paid on non-taxable annuities. There is no provision in the insurance law that restricts the credit to only the assessments paid on taxable annuities. Taxpayers claim the credit for assessments paid on all annuities, both during the period that annuities were taxed and going forward.

On March 25, 2010, by a 3-2 vote, an *en banc* panel of the Commonwealth Court ruled that Allstate was entitled to claim a credit for all annuity assessments paid to the Guaranty Fund. *See Allstate Life Ins. Co. v. Commonwealth*, 992 A.2d 910 (Pa. Commw. Ct. 2010). The Commonwealth filed exceptions. Following briefing and oral argument before a seven-judge *en banc* Commonwealth Court panel, a 4-3 majority of the Court on October 15, 2010, issued an unreported decision overruling the Commonwealth's exceptions. *See Allstate Life Ins. Co. v. Commonwealth*, No. 89 F.R. 1997, 2010 Pa. Commw. Unpub. LEXIS 704 (2010).

The Commonwealth appealed to the Pennsylvania Supreme Court. On August 2, 2012, an evenly divided court affirmed the final order of the Commonwealth Court. *See Allstate Life Ins. Co. v. Commonwealth*, 52 A.3d 1077 (Pa. 2012). On August 16, 2012, the Commonwealth filed an Application for Reargument. On October 24, 2012, the Pennsylvania Supreme Court denied the Commonwealth's Application for Reargument. The Commonwealth has asserted the position that the evenly divided holding in this case is final and binding precedent only as to the petitioner Allstate Life Insurance Co. for the tax period involved in the *Allstate* case and has notified counsel for the cases that were held at either of the administrative boards or in Commonwealth Court pending a final decision in the *Allstate* matter ("pending cases") that it wishes to select a new case to re-litigate the issues with the objective of obtaining a final majority decision on the merits. Under docket of the pending cases in Commonwealth Court, petitioners' counsel has filed with the Court an application for special and/or summary relief, and declaratory relief seeking an order and declaratory judgment from the Court among other things to enforce the evenly divided decision as to all petitioners, granting annuity assessments full tax credit against their gross premiums tax. The Commonwealth filed an answer and new matter seeking an order from the Court, among other things, to deny the petitioners' request for declaratory judgment and to direct the parties to proceed with litigation of a new case. The Court issued an order on August 14, 2013, establishing a briefing schedule and scheduling oral argument for October 22, 2013.

The MCARE Case (Pa. Commw. Ct.)

On April 15, 2010, the Commonwealth Court of Pennsylvania in *Hosp. & Healthsystem Ass'n of Pa. v. Commonwealth*, 997 A.2d 392 (Pa. Commw. Ct. 2010) (the "MCARE Case"), held that legislation causing the Commonwealth to transfer \$100 million from the Medical Care Availability and Reduction of Error ("MCARE") Fund to the General Fund was unlawful in that it violated the petitioners' vested rights in that money. On September 26, 2013, the Supreme Court of Pennsylvania reversed and remanded to Commonwealth Court, with instructions to conduct further proceedings. *See Hosp. & Health System Ass'n of Pa v. Commonwealth* 77 A 3d 587 (Pa. 2013). The case remains pending in Commonwealth Court.

The MCARE Fund is a special fund, established within the Treasury pursuant to Act 13 of 2002, that pays claims against health providers for losses or damages awarded in medical professional liability actions in excess of their basic insurance coverage. All health care providers in Pennsylvania are required to pay annual assessments to the MCARE Fund. As part of the fiscal year 2010 budget legislation, the General Assembly transferred \$100 million from the MCARE Fund to the General Fund. The Commonwealth Court held that this transfer was unlawful in that it violated the petitioners' vested rights in that money.

Reversing the Commonwealth Court, on September 26, 2013, remanded the cases for a determination of whether the \$100 million that the General Assembly transferred from the MCARE Fund to the General Fund in 2009 constituted surplus MCARE Fund monies that the General Assembly constitutionally could use for non-MCARE purposes. The Supreme Court also held that the MCARE Fund is protected by the vested rights doctrine and that, if the 2009 legislation that transferred the \$100 million from the MCARE Fund to the General Fund violated the health care providers' vested rights, then the State Treasurer would be required to transfer \$100 million from the General Fund to the MCARE Fund.

Remand proceedings in Commonwealth Court began on April 9, 2014. Though discovery between the parties will proceed, Commonwealth Court by order entered April 10, 2014, indicated that it will not consider the merits of the case until after the Supreme Court has decided a related matter pending on appeal from Commonwealth Court at No. 5 MAP 2014. *See Hosp. & Healthsystem Ass'n of Pa. v. Ins. Comm'r*, No. 681 MAL 2013, 2014 Pa. LEXIS 408 (Pa. Feb. 12, 2014) (allowing the Insurance Commissioner to appeal Commonwealth Court's ruling that the MCARE Act requires the Insurance Commissioner to assume a "spend down" of any balance in the MCARE Fund in calculating annual provider assessments).

Harlee Manor, Inc., et al. v. Dept. of Public Welfare, et al. (Pa Commw. Ct.)

This action, pending at Dkt. No. 264 M.D. 2005, challenges an assessment imposed on nursing homes to generate revenue for the Medicaid budget. The parties have executed a settlement agreement, which requires the Centers for Medicare and Medicaid Services approval to be binding. The parties are still in the process of obtaining that approval. If the Court strikes down the assessment, analysts estimate the Commonwealth would lose \$331 million in state funds and a like amount in federal matching funds.

CG, et al. v. PDE, et al. (U.S. 3rd Cir. Ct. of Appeals)

This is a certified class action commenced in 2006. The representative plaintiffs are parents of students in the Lancaster and Reading School Districts who challenge the Commonwealth of Pennsylvania's method for distributing special education funds. The defendants are the Pennsylvania Department of Education and the Secretary of Education. The Office of Attorney General represents the defendants.

The plaintiffs contend that section 2509.5 of the Public School Code of 1949, 24 P.S. § 25-2509.5 – the Pennsylvania statute that apportions special education funding – violates these federal laws: the Individuals with Disabilities Education Act ("IDEA"); section 504 of the Rehabilitation Act of 1973; the Due Process Clause of the Fourteenth Amendment (this claim was dismissed by Chief Judge Kane on summary judgment entered in January 2011); the Equal Educational Opportunities Act of 1974 ("EEOA"); and Title II of the Americans with Disabilities Act of 1990 ("ADA").

The claims against the Secretary under the ADA and section 504 of the Rehabilitation Act were dismissed on summary judgment because they cannot be made against individuals, only entities such as PDE. The court dismissed the plaintiffs' constitutional claim because the judge discerned a rational basis for Pennsylvania's special education funding formula. *See CG v. Pa. Dep't of Educ.*, No. 1:CV-06-1523, 2011 U.S. Dist. LEXIS 8339 (M.D. Pa. Jan. 28, 2011).

Following a bench trial on the claims that were not dismissed on summary judgment, Chief Judge Kane made findings of fact, rendered conclusions of law, and entered judgment against the plaintiffs and in favor of the defendants as to all claims. *See CG v. Pa. Dep't of Educ.*, 2012 U.S. Dist. LEXIS 119615 (M.D. Pa. Aug. 23, 2012). The plaintiffs have appealed to the U.S. Court of Appeals for Third Circuit, which has docketed the appeal at No. 12-3747. On appeal, the Plaintiffs argued that the District Court erred in its ADA/Rehab Act analysis by failing to consider the disparate impact of the statute on class members.

On November 5, 2013, in a precedential opinion, the Third Circuit affirmed the ruling of the District Court, noting that "[t]he District Court's unchallenged factual findings support the conclusion that there is an absence of evidence that any class member was deprived of a service available to non-class member."

The Plaintiffs have not appealed this ruling to the U.S. Supreme Court. The case is now closed.

Sears, et al. v. Corbett, et al.; and Weisblatt, et al. v. Corbett, et al. (Pa. Commw. Ct.)

Petitioners, former participants in the Pennsylvania adultBasic Insurance Coverage Program ("adultBasic"), filed a pair of class action suits against Commonwealth officials seeking declaratory, mandamus and injunctive relief to remedy claimed violations of the Pennsylvania Tobacco Settlement Act (Act), 35 P.S. § 5701.101 *et. seq.* They are docketed at No. 121 M.D. 2011 and No. 157 M.D. 2011.

Section 303 of the Act, 35 P.S. § 5701.303, establishes a Tobacco Settlement Fund ("Fund") to receive and distribute payments received by the Commonwealth pursuant to the Master Settlement Agreement ("Agreement") of June 22, 2000. The Agreement was entered into on November 23, 1998, by the Commonwealth and leading United

States tobacco manufacturers approved by the Court of Common Pleas of Philadelphia County on January 13, 1999. See 40 Pa. D.&C. 4th 225; 35 P.S. §§ 5671-75. The Agreement requires tobacco product manufactures to provide for home and community based care for tobacco use prevention and cessation efforts. 35 P.S. § 5701.101. The Agreement further mandates the establishment of a Health Endowment Account (“Account”) for long-term hope pursuant to Section 303 of the Act. 35 P.S. § 5701.303. The money placed into the Fund is governed by Section 306 of the Act, 35 P.S. § 5701.306, which sets forth a formula determining the percentage of appropriated money allocated for certain programs.

One of the programs created by Section 1303 of the Act was the adultBasic coverage insurance program. The adultBasic program received appropriations from the Fund pursuant to section 306(b)(1)(vi) of the Act. 35 P.S. § 5701.306(b)(1)(vi). Section 306(b)(1)(vi) of the Act established that the adultBasic program shared its funding stream with the Medical Benefits for Workers With Disabilities Program (“MAWD”), established by Section 1503 of the Act, 35 P.S. § 5701.1503.

The ultimate purpose of the lawsuit is to force the Legislature to restore adultBasic. The gravamen of the petitioners’ legal claims is predicated on their contention that in redirecting money from the Tobacco Settlement Fund through certain 2010 and 2011 amendments to The Fiscal Code, the Legislature “violated” the Act.

As part of their challenge to the Fiscal Code amendments, the petitioners assert that the amendments were enacted in violation of the Pennsylvania Constitution’s “single subject” rule. PA. CONST. art. III, § 3. The petitioners also allege violations of Article III, Sections 6 and 11, of the Pennsylvania Constitution. Petitioners claim that the General Assembly, when enacting the 2010 and 2011 amendments to the Fiscal Code, effectively amended the Tobacco Settlement Act by reference only to its title, in violation of Article III, Section 6, of the Pennsylvania Constitution. They also claim the legislative process occurred in a manner inconsistent with the provisions of the Act in violation of the Article III, Section 11, requirement that the general appropriation bill embrace nothing but appropriations for the executive, legislative and judicial departments of the Commonwealth, for the public debt and for public schools.

The respondents filed preliminary objections to the amended petitions for review in both actions. On June 27, 2012, an *en banc* panel of the Commonwealth Court sustained in part and overruled in part the respondents’ preliminary objection in the *Sears* case and directed the respondents to answer the amended petitions for review within 30 days. *Sears v. Corbett*, 49 A.3d 463 (Pa. Commw. Ct. 2012) (*Sears I*). The court made the same decision in the *Weisblatt* case on June 28, 2012. See *Weisblatt v. Corbett*, 53 A.3d 91 (Pa. Commw. Ct. 2012).

After the pleadings were closed, all parties filed applications for summary relief with the Commonwealth Court. On March 4, 2013, Commonwealth Court (through President Judge Pellegrini, acting for the court as a single judge) granted in part and denied in part the parties’ applications. Relying upon the *en banc* court’s opinion in *Sears I*, the court declared that the acts amending the Fiscal Code in 2010 and 2011 redirecting money from the Fund were unconstitutional in that they contained more than a single subject and amended the Tobacco Settlement Act in a procedurally improper manner. However, based on principles of sovereign immunity as had been summarized in the *en banc* court’s opinion in *Sears I*, the court declined to order the Commonwealth parties to restore to the Tobacco Settlement Fund and the adultBasic program the funds that had been transferred in 2010 and 2011 pursuant to the Fiscal Code amendments; and it did not order the immediate restoration of the adultBasic insurance coverage program. Instead, the court ordered the executive respondents prospectively to adhere to the relevant Tobacco Settlement Act provisions during the 2013-14 fiscal year, unless the General Assembly were properly to enact appropriations or other laws that direct otherwise.

The General Assembly, the Executive, and Weisblatt filed cross-appeals of the Commonwealth Court’s order with the Pennsylvania Supreme Court, *Sears v. Corbett*, 22 MAP 2013 (Pa.); *Sears v. Corbett*, 23 MAP 2013 (Pa.); *Weisblatt v. Corbett*, 24 MAP 2013 (Pa.); and *Weisblatt v. Corbett*, 31 MAP 2013 (Pa.). The General Assembly and Executive challenge the Commonwealth Court’s declaration that Acts 46 and 26 violate the Pennsylvania Constitution and entry of injunctive relief enjoining enforcement of the acts. Weisblatt appealed the Commonwealth Court’s ruling that sovereign immunity precludes recovery of damages. The four appeals have been consolidated into a single briefing schedule. All briefs have been filed and are ripe for disposition by the Supreme Court.

Oral argument has not been scheduled.

RATINGS

Fitch Ratings has assigned its municipal bond rating of “AA” (outlook “Negative”) to the Bonds. On July 16, 2013, Fitch Ratings (“Fitch”) lowered its ratings on Commonwealth General Obligations bonds from AA+ to AA, with a negative outlook. Moody’s has assigned its municipal bond rating of “Aa2” (outlook “Stable”) to the Bonds. Standard and Poor’s Ratings Services, a division of the McGraw-Hill Companies (“S&P”) has assigned its municipal bond rating of “AA” (outlook “Negative”) to the Bonds.

The ratings reflect only the views of the respective rating agencies.

The ratings are based upon current information furnished by the Commonwealth or obtained from other sources considered reliable by the rating agencies, which do not perform any audit in connection with any rating and may, on occasion, rely on unaudited financial information. Reference is made to the rating agencies’ manuals for complete descriptions of their respective rating procedures and other rating categories, and to S&P’s, Moody’s and Fitch’s written analyses of Commonwealth finances expected to be released upon release of their respective ratings.

A security rating is not a recommendation to buy, sell or hold securities. There is no assurance that such ratings will continue for any given period of time or that they will not be revised downward or withdrawn entirely if, in the opinion of the rating agencies, circumstances warrant such revision or withdrawal. Any such downward revision or withdrawal could have an adverse effect on the marketability or market price of the Bonds. The Commonwealth has not undertaken any responsibility after issuance of the Bonds to assure the maintenance of the ratings, to oppose any revision or withdrawal of the ratings by S&P, Moody’s or Fitch or to inform the holders of the Bonds of any such revision or withdrawal, except as set forth under “CONTINUING DISCLOSURE.”

TAX EXEMPTION AND OTHER TAX MATTERS

Tax Exemption-Opinion of Bond Counsel

The Internal Revenue Code of 1986, as amended (the “Code”) contains provisions relating to the tax-exempt status of interest on obligations issued by governmental entities which apply to the Bonds. These provisions include, but are not limited to, requirements relating to the use and investment of the proceeds of the Bonds and the rebate of certain investment earnings derived from such proceeds to the United States Treasury Department on a periodic basis. These and other requirements of the Code must be met by the Commonwealth subsequent to the issuance and delivery of the Bonds in order for interest thereon to be and remain excludable from gross income for purposes of federal income taxation. The Commonwealth has made covenants to comply with such requirements.

In the opinion of Bond Counsel, interest (including accrued original issue discount) on the Bonds is not includable in gross income for purposes of federal income taxation under existing statutes, regulations, rulings and court decisions. The opinion of Bond Counsel is subject to the condition that the Commonwealth comply with all applicable federal income tax law requirements that must be satisfied subsequent to the issuance of the Bonds in order that interest thereon continues to be excluded from gross income. Failure to comply with certain of such requirements could cause the interest on the Bonds to be so includable in gross income retroactive to the date of issuance of the Bonds. The Commonwealth has covenanted to comply with all such requirements. Interest on the Bonds is not treated as an item of tax preference under Section 57 of the Code for purposes of the individual and corporate alternative minimum taxes; however, under the Code, to the extent that interest on the Bonds is a component of a corporate holder's “adjusted current earnings,” a portion of that interest may be subject to the corporate alternative minimum tax. Bond Counsel expresses no opinion regarding other federal tax consequences relating to the Bonds or the receipt of interest thereon. See discussion of “Alternative Minimum Tax”, “Branch Profits Tax”, “S Corporations with Passive Investment Income”, “Social Security and Railroad Retirement Benefits”, “Deduction for Interest Paid by Financial Institutions to Purchase or Carry Tax-Exempt Obligations”, “Property or Casualty Insurance Company” and “Accounting Treatment of Original Issue Discount and Amortizable Bond Premium” below.

Alternative Minimum Tax

The Code includes, for purposes of the corporate alternative minimum tax, a preference item consisting of, generally, seventy-five percent of the excess of a corporation's “adjusted current earnings” over its “alternative minimum taxable income” (computed without regard to this particular preference item and the alternative tax net

operating loss deduction). Thus, to the extent that tax-exempt interest (including interest on the Bonds) is a component of a corporate holder's "adjusted current earnings," a portion of that interest may be subject to the alternative minimum tax.

Branch Profits Tax

Under the Code, foreign corporations engaged in a trade or business in the United States will be subject to a "branch profits tax" equal to thirty percent (30%) of the corporation's "dividend equivalent amount" for the taxable year. The term "dividend equivalent amount" includes interest on tax-exempt obligations.

S Corporations with Passive Investment Income

Section 1375 of the Code imposes a tax on the income of certain small business corporations for which an S Corporation election is in effect, and that have "passive investment income". For purposes of Section 1375 of the Code, the term "passive investment income" includes interest on the Bonds. This tax applies to an S Corporation for a taxable year if the S Corporation has Subchapter C earnings and profits at the close of the taxable year and has gross receipts, more than twenty-five percent (25%) of which are "passive investment income". Thus, interest on the Bonds may be subject to federal income taxation under Section 1375 of the Code if the requirements of that provision are met.

Social Security and Railroad Retirement Benefits

Under Section 86 of the Code, certain Social Security and Railroad Retirement benefits (the "benefits") may be includable in gross income. The Code provides that interest on tax-exempt obligations (including interest on the Bonds) is included in the calculation of "modified adjusted gross income" in determining whether a portion of the benefits received are to be includable in gross income of individuals.

Deduction for Interest Paid by Financial Institutions to Purchase or Carry Tax-Exempt Obligations

The Code, subject to limited exceptions not applicable to the Bonds, denies the interest deduction for indebtedness incurred or continued to purchase or carry tax-exempt obligations, such as the Bonds. With respect to banks, thrift institutions and other financial institutions, the denial to such institutions is one hundred percent (100%) for interest paid on funds allocable to the Bonds and any other tax-exempt obligations acquired after August 7, 1986.

Property or Casualty Insurance Company

The Code also provides that a property or casualty insurance company may also incur a reduction, by a specified portion of its tax-exempt interest income, of its deduction for losses incurred.

Accounting Treatment of Original Issue Discount and Amortizable Bond Premium

The First Series Bonds maturing on June 15, 2028 are herein referred to as the "Discount Bonds." In the opinion of Bond Counsel, the difference between the initial public offering price of the Discount Bonds set forth on the inside cover page and the stated redemption price at maturity of each such Bonds constitutes "original issue discount," all or a portion of which will, on the disposition or payment of such Bonds, be treated as tax-exempt interest for federal income tax purposes. Original issue discount will be apportioned to an owner of the Discount Bonds under a "constant interest method," which utilizes a periodic compounding of accrued interest. If an owner of a Discount Bond who purchases it in the original offering at the initial public offering price owns that Discount Bond to maturity, that Bondholder will not realize taxable gain for federal income tax purposes upon payment of the Discount Bond at maturity. An owner of a Discount Bond who purchases it in the original offering at the initial public offering price and who later disposes of the Discount Bond prior to maturity will be deemed to have accrued tax-exempt income in a manner described above; amounts realized in excess of the sum of the original offering price of such Discount Bond and the amount of accrued original issue discount will be taxable gain.

Purchasers of Discount Bonds should consider possible state and local income, excise or franchise tax consequences arising from original issue discount on the Discount Bonds. Prospective purchasers of the Discount Bonds should consult their tax advisors regarding the Commonwealth tax treatment of original issue discount.

The First Series Bonds maturing on June 15, 2015 through and including June 15, 2027 and June 15, 2029 through and including June 15, 2034 and the First Refunding Series Bonds are hereinafter referred to as the "Premium Bonds". An amount equal to the excess of the initial public offering price of a Premium Bond set forth on the inside

cover page over its stated redemption price at maturity constitutes premium on such Premium Bond. A purchaser of a Premium Bond must amortize any premium over such Premium Bond's term using constant yield principles, based on the purchaser's yield to maturity. As premium is amortized, the purchaser's basis in such Premium Bond is reduced by a corresponding amount, resulting in an increase in the gain (or decrease in the loss) to be recognized for federal income tax purposes upon a sale or disposition of such Premium Bond prior to its maturity. Even though the purchaser's basis is reduced, no federal income tax deduction is allowed.

Purchasers of Premium Bonds, whether at the time of initial issuance or subsequent thereto, should consult their own tax advisors with respect to the determination and treatment of premium for federal income tax purposes and with respect to state and local tax consequences of owning such Premium Bonds.

Pennsylvania Tax Exemption

In the opinion of Bond Counsel, under the existing laws of the Commonwealth, the interest on the Bonds is free from Pennsylvania personal income taxation and Pennsylvania corporate net income taxation, but such exemption does not extend to gift, estate, succession or inheritance taxes or any other taxes not levied or assessed directly on the Bonds or the interest thereon. Profits, gains or income derived from the sale, exchange or other disposition of the Bonds are subject to state and local taxation within the Commonwealth.

This summary is based on laws, regulations, rulings and decisions now in effect, all of which may change. Any change could apply retroactively and could affect the continued validity of this summary. **Prospective purchasers should consult their tax advisors about the consequences of purchasing or holding the Bonds.**

CHANGES IN FEDERAL TAX LAW

From time to time, there are presidential proposals, proposals by various federal committees and legislative proposals in Congress that, if enacted, could alter or amend the tax matters referred to herein or adversely affect the marketability or market value of the Bonds or otherwise prevent holders of the Bonds from realizing the full benefit of the tax exemption of interest on the Bonds. Further, such proposals may impact the marketability or market value of the Bonds simply by being proposed. It cannot be predicted whether or in what form any such proposals may be enacted or whether if enacted such proposals would apply to bonds issued prior to enactment. In addition, regulatory actions are from time to time announced or proposed and litigation is threatened or commenced which, if implemented or concluded in a particular manner, could adversely affect the market value, marketability or tax status of the Bonds. It cannot be predicted whether any such regulatory action will be implemented, how any particular litigation or judicial action will be resolved, or whether the Bonds would be impacted thereby.

Purchasers of the Bonds should consult their tax advisors regarding any pending or proposed legislation, regulatory initiatives or litigation. The opinions expressed by Bond Counsel are based upon existing legislation and regulations as interpreted by relevant judicial and regulatory authorities as of the date of issuance and delivery of the Bonds, and Bond Counsel has expressed no opinion as of any date subsequent thereto or with respect to any proposed or pending legislation.

UNDERWRITING

After competitive bidding on April 29, 2014, the Bonds were awarded to a selling group represented by Bank of America Merrill Lynch (the "Underwriters") for a purchase price of \$947,305,314.20 which is equivalent to the principal amount of such Bonds, less Underwriters' discount of \$2,608,251.15 plus net original issue premium of \$114,968,565.35. The Underwriters have supplied the public offering yields and prices of the Bonds shown on the inside cover hereof. If all of the Bonds are resold to the public at such yields, the underwriters' discount will approximate 0.312386 percent of the aggregate principal amount of the Bonds. The Underwriters may change the public offering yields from time to time.

LEGALITY FOR INVESTMENT

Under the Pennsylvania Probate, Estates and Fiduciaries Code, the Bonds are authorized investments for fiduciaries, as defined in that code, within the Commonwealth of Pennsylvania. The Bonds are legal investments for Pennsylvania savings banks, banks, bank and trust companies, and insurance companies and are acceptable as security

for deposits of funds of the Commonwealth. The Bonds are eligible for purchase, dealing in, underwriting and unlimited holding by national banking associations pursuant to regulations promulgated by the Comptroller of the Currency set forth in the Code of Federal Regulations, Title 12—Banks and Banking, Sections 1.3(c) and 1.4.

FINANCIAL ADVISOR

Public Financial Management Inc., Philadelphia, Pennsylvania, is serving as independent financial advisor to the Commonwealth with respect to the Bonds (the “Financial Advisor”). The Financial Advisor’s fees in connection with the issuance of the Bonds are expected to be paid from Bond proceeds.

LEGAL MATTERS

All legal matters incident to the authorization and issuance of the Bonds are subject to the approval of the Attorney General of the Commonwealth of Pennsylvania, The Honorable Kathleen Kane, and of Saul Ewing LLP, Bond Counsel. A copy of the opinion of Bond Counsel for the Bonds will accompany the Bonds delivered to DTC. Copies of the opinion of the Attorney General, together with additional copies of the opinions of Bond Counsel, will be available at the time of delivery of the Bonds. Proposed forms of these opinions are included as Appendices F and G respectively.

ADDITIONAL INFORMATION

Periodic public reports relating to the financial condition of the Commonwealth are prepared by the Office of the Budget. These reports and additional information may be obtained upon request from the office of the Secretary of the Budget, Mr. Charles Zogby, Attn.: Ms. Mindy Dierich, 18th Floor, Harrisstown 2, 333 Market Street, Harrisburg, Pennsylvania 17101-2210 (Telephone (717) 787-7342). The annual Comprehensive Annual Financial Report (“CAFR”), a summary of the enacted fiscal year 2013 budget and certain other information are available in the Budget and Financial Reports section of the Office of the Budget’s web site, <http://www.budget.state.pa.us>.

CONTINUING DISCLOSURE

The Commonwealth will execute a written agreement (the “Continuing Disclosure Agreement”) for the benefit of the beneficial owners of the Bonds in order to assist the Underwriters in meeting the requirements of Rule 15c2-12 (the “Rule”) promulgated by the Securities and Exchange Commission. The Continuing Disclosure Agreement will require the Commonwealth to:

- (i) File in an electronic format as required by the MSRB on the MSRB’s Electronic Municipal Market Access system (“EMMA”) not later than 240 days following the end of each of the Commonwealth’s fiscal years, Annual Financial Statements and Annual Operating Data, as defined below, with the Municipal Securities Rulemaking Board (the “MSRB”);
- (ii) File in a timely manner to the MSRB notice of certain specified events listed below; and
- (iii) File with the MSRB notice of any failure of the Commonwealth to file the information required by (i) above.

Annual Financial Information. It is expected that the financial statements to be filed annually as provided by (i) above will be audited financial statements. The Continuing Disclosure Agreement, however, permits the filing of unaudited financial statements if audited financial statements are not available by the 240-day deadline, with audited financial statements to be filed as soon as they are available. The Annual Operating Data will be operating data of the type contained in this Official Statement in the following tables:

Tables 5 through 12 under the heading “COMMONWEALTH FINANCIAL PERFORMANCE”;
Tables 15 through 18 under the heading “OUTSTANDING INDEBTEDNESS OF THE COMMONWEALTH”; and
Tables 20 through 24 under the heading “OTHER STATE-RELATED OBLIGATIONS.”

If any of the tables listed above reflect information that is no longer calculated and available or relevant because of changes in operations, the Commonwealth will provide notice of such change in the first annual filing of Annual Operating Data after such changes are undertaken. The format of the tables also may be altered.

Event Disclosure. The Continuing Disclosure Agreement requires the Commonwealth to provide timely notice, but in no event longer than within 10 business days following such a listed occurrence, to the MSRB of the following events with respect to the Bonds:

1. Principal and interest payment delinquencies;
2. Non-payment related defaults, if material;
3. Unscheduled draws on debt service reserves reflecting financial difficulties;
4. Unscheduled draws on credit enhancements reflecting financial difficulties;
5. Substitution of credit or liquidity providers, or their failure to perform;
6. Adverse tax opinions, the issuance by the IRS of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the Bonds, or other material events affecting the tax status of the Bonds;
7. Modifications to rights of Bond holders, if material;
8. Bond calls, if material and tender offers;
9. Defeasances;
10. Release, substitution or sale of property securing repayment of the Bonds, if material;
11. Rating changes;
12. Bankruptcy, insolvency, receivership or similar event of the Commonwealth;
13. The consummation of a merger, consolidation, or acquisition involving the Commonwealth or the sale of all or substantially all of the assets of the Commonwealth, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and
14. Appointment of a successor or additional trustee or the change of name of a trustee, if material.

The fourteen events listed above are specified by the Rule but some of them may not be relevant to the Bonds.

Limitations, Remedy and Amendments. The Continuing Disclosure Agreement requires the Commonwealth to provide only limited information at limited times, and such information may not include all information necessary to determine the value of the Bonds at any time. The Commonwealth may also make other information available on a voluntary basis, but it is not contractually obligated to do so. See “ADDITIONAL INFORMATION” herein for the availability of other information from the Commonwealth’s Office of the Budget.

The sole and exclusive remedy for any breach by the Commonwealth of its obligations under the Continuing Disclosure Agreement is an action to compel specific performance by the Commonwealth of its obligations. No assurance can be provided as to the outcome of any such proceeding. A breach by the Commonwealth of its obligations under the Continuing Disclosure Agreement does not constitute a default under the Bonds.

The Commonwealth reserves the right to amend the Continuing Disclosure Agreement consistent with the provisions of the Rule (or any successor legal requirements) as then in effect.

The Commonwealth has complied in all material respects with its prior continuing disclosure obligations.

The execution of this Official Statement has been authorized in the Resolutions and may be executed in any number or counterparts and by different parties hereto in separate counterparts, each of which when so executed and delivered shall be deemed to be an original and all of which taken together shall constitute but one and the same document.

/s/ Tom Corbett
Tom Corbett, Governor

/s/ Robert M. McCord
Robert M. McCord, State Treasurer

/s/ Eugene A. DePasquale
Eugene A. DePasquale, Auditor General

**CERTIFICATE OF THE AUDITOR GENERAL
Pursuant to
ARTICLE VIII, SECTION 7(a)(4) and (c)
of the
CONSTITUTION OF PENNSYLVANIA
and
Section 304 of the Capital Facilities Debt Enabling Act**

To the Governor and the General Assembly:

I, Eugene A. DePasquale, Auditor General of the Commonwealth of Pennsylvania, pursuant to Article VIII, Section 7(a)(4) of the Pennsylvania Constitution and Section 304 of Capital Facilities Debt Enabling Act (Act 1 of 1999, as amended) certify as follows:

| | |
|--|-------------------|
| The average annual tax revenues deposited in all funds in the five fiscal years ended preceding the date of February 28, 2014 | \$ 34,173,780,183 |
| (i) The amount of outstanding net debt as of the end of the preceding fiscal year | \$ 9,526,883,776 |
| (ii) The amount of such net debt as of February 28, 2014..... | \$ 9,803,558,568 |
| (iii) The difference between the limitation upon all net debt outstanding as provided in Article VIII, Section 7 (a) (4) of the Constitution of Pennsylvania and the amount of such net debt as of the date of February 28, 2014 | \$ 50,000,556,752 |
| (iv) The amount of such debt scheduled to be repaid during the remainder of the current fiscal year | \$ 165,440,000 |
| (v) The amount of debt authorized by law to be issued, but not yet incurred | \$ 97,301,088,968 |
| (vi) The amount of outstanding obligations excluded from outstanding debt as self sustaining pursuant to Article VIII, Section 7(c)(1), (2) and (3) of the Constitution of Pennsylvania | \$ 9,984,852,334 |

IN TESTIMONY WHEREOF, I have set my hand and affixed the seal of the Auditor General, this 1st day of March 2014.

/s/Eugene A. DePasquale
EUGENE A. DEPASQUALE
Auditor General
Commonwealth of Pennsylvania

(Seal)

SELECTED DATA ON THE COMMONWEALTH OF PENNSYLVANIA

General

The Commonwealth of Pennsylvania (the “Commonwealth” or “Pennsylvania”) is one of the most populous states, ranking sixth behind California, Texas, New York, Florida, and Illinois. Pennsylvania is an established state with a diversified economy. Pennsylvania had been historically identified as a heavy industrial state. That reputation has changed over the last thirty years as the coal, steel and railroad industries declined. The Commonwealth’s business environment readjusted with a more diversified economic base. This economic readjustment was a direct result of a long-term shift in jobs, investment, and workers away from the northeast part of the nation. Currently, the major sources of growth in Pennsylvania are in the service sector, including trade, medical, health services, education and financial institutions.

Pennsylvania’s agricultural industries remain an important component of the Commonwealth’s economic structure, accounting for more than \$7.3 billion in crop and livestock products annually. In 2013, agribusiness and food related industries reached export sales surpassing \$1.3 billion in economic activity. Over 59,000 farms form the backbone of the Commonwealth’s agricultural economy. Farmland in Pennsylvania includes over four million acres of harvested cropland and three million acres of pasture and farm woodlands - nearly one-third of the Commonwealth’s total land area. Agricultural diversity in the Commonwealth is demonstrated by the fact that Pennsylvania ranks among the top ten states in the production of a variety of agricultural products.

Pennsylvania’s extensive public and private forests provide a vast source of material for the lumber, furniture, and paper products industries. The forestry and related industries accounts for 1.5% of employment with economic activity of nearly \$5 billion in sales in domestic and international trade. Additionally, the Commonwealth derives a good water supply from underground sources, abundant rainfall, and a large number of rivers, streams, and lakes. Other natural resources include major deposits of coal, petroleum, and natural gas. Annually, about 66 million tons of anthracite and bituminous coal, 1,310 billion cubic feet of natural gas, and about 2.2 million barrels of oil are extracted from Pennsylvania. Pennsylvania is one of the top 10 producing states in the country for aggregate/crushed stone. The value of non-coal mineral production in Pennsylvania is approximately \$1 billion annually.

Pennsylvania is a Mid-Atlantic state within easy reach of the populous eastern seaboard and, as such, is the keystone to the Midwest. A comprehensive transportation grid enhances the Commonwealth’s strategic geographic position. The Commonwealth’s water systems afford the unique feature of triple port coverage, a deep-water port at Philadelphia, a Great Lakes port at Erie and an inland water port at Pittsburgh. Between air, rail, water, and road, Pennsylvania is easily accessible for both inter and intra state trade and commerce.

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Population

The Commonwealth is highly urbanized. Of the Commonwealth's 2013 mid-year population estimate, 79 percent resided in the 15 Metropolitan Statistical Areas ("MSAs") of the Commonwealth. The largest MSAs in the Commonwealth are those that include the cities of Philadelphia and Pittsburgh, which together contain almost 44 percent of the Commonwealth's total population. The population of Pennsylvania, 12.7 million people in 2013, according to the U.S. Bureau of the Census, represents a population growing slower than the nation with a higher portion than the nation or the region comprised of persons 45 or over. The following tables present the population trend from 2004 to 2013 and the age distribution of the population for 2012.

Population Trends Pennsylvania, Middle Atlantic Region and the United States 2004-2013

| As of July 1 | Total Population In Thousands | | | Total Population as a % of 2003 base | | |
|-----------------|----------------------------------|---|---------|---|---|------|
| | PA | Middle Atlantic Region ^(a) | U.S. | PA | Middle Atlantic Region ^(a) | U.S. |
| 2004 | 12,388 | 40,297 | 293,045 | 100% | 100% | 100% |
| 2005 | 12,418 | 40,370 | 295,753 | 100 | 101 | 102 |
| 2006 | 12,471 | 40,451 | 295,593 | 101 | 101 | 103 |
| 2007 | 12,522 | 40,581 | 301,579 | 101 | 101 | 103 |
| 2008 | 12,566 | 40,697 | 304,374 | 102 | 101 | 105 |
| 2009 | 12,604 | 40,854 | 307,006 | 102 | 102 | 106 |
| 2010 | 12,711 | 40,913 | 309,326 | 102 | 102 | 107 |
| 2011 | 12,743 | 40,030 | 311,588 | 103 | 102 | 107 |
| 2012 | 12,763 | 41,198 | 313,914 | 103 | 103 | 108 |
| 2013 | 12,773 | 41,324 | 316,128 | 103 | 103 | 108 |

^(a) Middle Atlantic Region: Pennsylvania, New York, New Jersey
Source: U.S. Department of Commerce, Bureau of the Census

Population by Age Group — 2012 Pennsylvania, Middle Atlantic Region and the United States

| Age | Pennsylvania | Middle Atlantic Region ^(a) | United States |
|------------------------|--------------|---|---------------|
| Under 5 years | 5.6 % | 5.9 % | 6.4 % |
| 5-24 years | 25.7 | 25.9 | 27.1 |
| 25-44 years | 24.5 | 26.1 | 26.3 |
| 45-64 years | 28.2 | 27.5 | 26.4 |
| 65 years and over..... | 16.0 | 14.6 | 13.8 |

^(a) Middle Atlantic Region: Pennsylvania, New York, New Jersey.
Source: U.S. Department of Commerce, Bureau of the Census

Employment

Non-agricultural employment in Pennsylvania over the 10 years ending in 2013 increased at an average annual rate of 0.02 percent compared with an increase 0.03 percent rate for the Middle Atlantic region and 0.04 percent rate for the U.S. The following table shows employment trends from 2004 through 2013.

Non-Agricultural Establishment Employment Trends Pennsylvania, Middle Atlantic Region and the United States 2004-2013

| Calendar Year | Total Establishment Employment In Thousands | | | Total Establishment Employment as a % of 2004 base | | |
|------------------|--|---|---------|---|---|-------|
| | PA | Middle Atlantic Region ^(a) | US | PA | Middle Atlantic Region ^(a) | US |
| 2004 | 5,647 | 18,099 | 131,749 | 100 % | 100 % | 100 % |
| 2005 | 5,705 | 18,270 | 134,005 | 101 | 100 | 102 |
| 2006 | 5,759 | 18,437 | 136,398 | 101 | 101 | 102 |
| 2007 | 5,801 | 18,602 | 137,936 | 101 | 101 | 101 |
| 2008 | 5,802 | 18,633 | 137,170 | 100 | 100 | 101 |
| 2009 | 5,618 | 18,058 | 131,233 | 99 | 99 | 99 |
| 2010 | 5,623 | 18,028 | 130,275 | 99 | 99 | 98 |
| 2011 | 5,686 | 18,212 | 131,842 | 100 | 100 | 100 |
| 2012 | 5,726 | 18,415 | 134,104 | 100 | 100 | 100 |
| 2013 | 5,743 | 18,587 | 136,368 | 100 | 100 | 100 |

^(a) Middle Atlantic Region: Pennsylvania, New York, New Jersey.
Source: U.S. Department of Labor, Bureau of Labor Statistics.

Non-manufacturing employment in Pennsylvania has increased in recent years and reached 90.2 percent of total employment by 2013. Consequently, manufacturing employment constitutes a diminished share of total employment within the Commonwealth. Manufacturing, contributing 9.8 percent of 2013 non-agricultural employment, has fallen behind the services sector, the trade sector and the government sector as the 4th largest single source of employment within the Commonwealth. In 2013, the services sector accounted for 48.4 percent of all non-agricultural employment while the trade sector accounted for 14.9 percent. The following table shows trends in employment by sector for Pennsylvania from 2009 through 2013.

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**Non-Agricultural Establishment Employment by Sector
Pennsylvania
2009-2013**
(In Thousands)

| | CALENDAR YEAR | | | | | | | | | |
|------------------------------------|---------------|-------|-----------|------|-----------|-------|-----------|-------|-----------|-------|
| | 2009 | | 2010 | | 2011 | | 2012 | | 2013 | |
| | Employees | % | Employees | % | Employees | % | Employees | % | Employees | % |
| Manufacturing: | | | | | | | | | | |
| Durable..... | 344.8 | 6.1 | 334.3 | 5.9 | 342.0 | 6.0 | 347.5 | 6.1 | 345.8 | 6.0 |
| Non-Durable..... | 229.3 | 4.1 | 225.7 | 4.0 | 223.0 | 3.9 | 219.7 | 3.8 | 217.5 | 3.8 |
| Total | | | | | | | | | | |
| Manufacturing ^(d) | 574.1 | 10.2 | 560.0 | 10.0 | 565.0 | 9.9 | 567.2 | 9.9 | 563.3 | 9.8 |
| Non-Manufacturing: | | | | | | | | | | |
| Trade ^(a) | 850.3 | 15.1 | 847.7 | 15.1 | 852.9 | 15.0 | 857.8 | 15.0 | 857.5 | 14.9 |
| Finance ^(b) | 318.4 | 5.7 | 311.0 | 5.5 | 308.6 | 5.4 | 309.5 | 5.4 | 312.5 | 5.5 |
| Services..... | 2,630.2 | 46.8 | 2,660.1 | 47.3 | 2,714.0 | 47.7 | 2,755.2 | 48.1 | 2,781.6 | 48.4 |
| Government..... | 768.2 | 13.7 | 770.6 | 13.7 | 751.4 | 13.2 | 732.3 | 12.8 | 721.1 | 12.6 |
| Utilities ^(c) | 230.5 | 4.1 | 231.6 | 4.1 | 238.2 | 4.2 | 241.8 | 4.2 | 245.0 | 4.3 |
| Construction..... | 224.6 | 4.0 | 215.9 | 3.8 | 222.8 | 3.9 | 225.8 | 3.9 | 226.4 | 3.9 |
| Mining..... | 21.7 | 0.4 | 25.9 | 0.5 | 33.2 | 0.6 | 36.3 | 0.6 | 35.1 | 0.6 |
| Total | | | | | | | | | | |
| Non-Manufacturing ^(d) | 5,043.9 | 89.8 | 5,062.8 | 89.8 | 5,121.1 | 90.1 | 5,158.7 | 90.1 | 5,179.2 | 90.2 |
| Total Employees ^{(d)(e)} | 5,618.0 | 100.0 | 5,622.8 | 99.8 | 5,686.1 | 100.0 | 5,725.9 | 100.0 | 5,742.5 | 100.0 |

^(a) Wholesale and retail trade.

^(b) Finance, insurance and real estate.

^(c) Includes transportation, communications, electric, gas and sanitary services.

^(d) Discrepancies occur due to rounding.

^(e) Does not include workers involved in labor-management disputes.

Source: US Bureau of Labor & Statistics

The following table presents the percentages of non-agricultural employment in various sectors in Pennsylvania and the United States in 2013.

**Non-Agricultural Establishment Employment by Sector
Pennsylvania and the United States**

| | 2013 Calendar Year | |
|--------------------------------|--------------------|---------------|
| | Pennsylvania | United States |
| Manufacturing..... | 9.8% | 8.8% |
| Trade ^(a) | 14.9 | 15.3 |
| Finance ^(b) | 5.5 | 5.8 |
| Services..... | 48.4 | 45.6 |
| Government..... | 12.6 | 16.0 |
| Utilities ^(c) | 4.3 | 3.7 |
| Construction..... | 3.9 | 4.2 |
| Mining..... | 0.6 | 0.6 |
| Total ^(d) | 100.0% | 100.0% |

^(a) Wholesale and retail trade.

^(b) Finance and insurance.

^(c) Includes transportation, communications, electric, gas and sanitary services.

^(d) Discrepancies occur due to rounding.

Source: U.S. Department of Labor, Bureau of Labor Statistics.

Within the manufacturing sector of Pennsylvania's economy, which now accounts for less than one-tenth of total non-agricultural employment in Pennsylvania, the fabricated metals industries employed the largest number of workers. Employment in fabricated metals industries was 14.4 percent of Pennsylvania manufacturing employment but only 1.4 percent of total Pennsylvania non-agricultural employment in 2013. The following table shows trends in manufacturing employment by industry for Pennsylvania from 2009 through 2013.

Manufacturing Establishment Employment by Industry
Pennsylvania
2009-2013
 In Thousands)

| | CALENDAR YEAR | | | | | | | | | |
|--|---------------|-------|-----------|-------|-----------|-------|-----------|-------|-----------|-------|
| | 2009 | | 2010 | | 2011 | | 2012 | | 2013 | |
| | Employees | % | Employees | % | Employees | % | Employees | % | Employees | % |
| Durable Goods: | | | | | | | | | | |
| Primary Metals..... | 35.6 | 6.2 | 36.2 | 6.5 | 38.5 | 6.8 | 39.7 | 7.0 | 39.5 | 7.0 |
| Fabricated Metals..... | 79.5 | 12.8 | 77.6 | 13.9 | 80.3 | 14.2 | 81.7 | 14.4 | 80.9 | 14.4 |
| Machinery (excluding electrical).... | 47.4 | 7.9 | 45.2 | 8.1 | 47.0 | 8.3 | 48.8 | 8.6 | 48.5 | 8.6 |
| Electrical Equipment..... | 24.8 | 3.7 | 24.7 | 4.4 | 25.9 | 4.6 | 26.0 | 4.6 | 26.0 | 4.6 |
| Transportation Equipment.... | 38.6 | 6.2 | 36.9 | 6.6 | 37.6 | 6.7 | 39.1 | 6.9 | 38.7 | 6.9 |
| Furniture Related Products..... | 16.1 | 3.5 | 14.9 | 2.7 | 15.1 | 2.7 | 15.1 | 2.7 | 14.9 | 2.6 |
| Other Durable Goods..... | 102.8 | 19.2 | 98.8 | 17.6 | 97.6 | 17.3 | 97.1 | 17.1 | 97.3 | 17.3 |
| Total Durable Goods ^(a) | 344.8 | 59.5 | 334.3 | 59.7 | 342.0 | 60.5 | 347.5 | 61.3 | 345.8 | 61.4 |
| Non-Durable Goods: | | | | | | | | | | |
| Pharmaceutical/Medicine... | 21.7 | 3.3 | 21.3 | 3.8 | 20.2 | 3.6 | 19.0 | 3.3 | 18.0 | 3.2 |
| Food Products..... | 66.8 | 10.5 | 66.5 | 11.9 | 66.7 | 11.8 | 67.1 | 11.8 | 67.3 | 11.9 |
| Chemical Products..... | 43.5 | 7.6 | 43.0 | 7.7 | 42.2 | 7.5 | 41.2 | 7.3 | 40.7 | 7.2 |
| Printing and Publishing..... | 29.9 | 5.5 | 28.2 | 5.0 | 27.0 | 4.8 | 25.5 | 4.5 | 24.4 | 4.3 |
| Plastics/Rubber Products..... | 35.0 | 5.9 | 35.2 | 6.3 | 35.3 | 6.2 | 35.2 | 6.2 | 35.2 | 6.2 |
| Other Non-Durable Goods... | 32.4 | 7.5 | 31.5 | 5.6 | 31.6 | 5.6 | 31.7 | 5.6 | 31.9 | 5.7 |
| Total Non-Durable Goods ^(a) | 229.3 | 40.3 | 225.7 | 40.3 | 223.0 | 39.5 | 219.7 | 38.7 | 217.5 | 38.6 |
| Total Manufacturing | | | | | | | | | | |
| Employees ^(a) | 574.1 | 100.0 | 560.0 | 100.0 | 565.0 | 100.0 | 567.2 | 100.0 | 563.3 | 100.0 |

^(a) Discrepancies occur due to rounding

Source: U.S. Department of Labor, Bureau of Labor Statistics.

Unemployment

Pennsylvania's annual average unemployment rate was equivalent to the national average throughout the 2000's. Slower economic growth caused the unemployment rate in the Commonwealth to rise to 8.5 percent in 2010 compared to 4.4 percent annual unemployment rate in 2007. As of February 2013, the most recent month for which figures are available, Pennsylvania had a seasonally adjusted annual unemployment rate of 6.2 percent. The following table represents the annual non-adjusted unemployment rate in Pennsylvania, the Middle Atlantic Region, and the United States from 2004 through 2013.

**Annual Average Unemployment Rate
Pennsylvania, Middle Atlantic Region and the United States
2004-2013**

| <u>Calendar Year</u> | <u>Pennsylvania</u> | <u>Middle Atlantic Region^(a)</u> | <u>United States</u> |
|----------------------|---------------------|---|----------------------|
| 2004..... | 5.4 | 5.5 | 5.5 |
| 2005..... | 5.0 | 4.9 | 5.1 |
| 2006..... | 4.5 | 4.6 | 4.6 |
| 2007..... | 4.4 | 4.4 | 4.6 |
| 2008..... | 5.3 | 5.4 | 5.8 |
| 2009..... | 7.9 | 8.4 | 9.3 |
| 2010..... | 8.5 | 8.8 | 9.6 |
| 2011..... | 8.0 | 8.4 | 8.9 |
| 2012..... | 7.9 | 8.5 | 8.1 |
| 2013..... | 7.4 | 7.7 | 7.4 |

^(a) Middle Atlantic Region: Pennsylvania, New York, New Jersey.
Source: U.S. Department of Labor, Bureau of Labor Statistics.

The following table presents the thirty (30) largest non-governmental employers in Pennsylvania:

**Commonwealth of Pennsylvania
Thirty Largest
Non-Governmental Employers
June 2013**

| <u>Company</u> | <u>Rank</u> | <u>Company</u> | <u>Rank</u> |
|---|-------------|--|-------------|
| Wal-Mart Associates | 1 | GMRI Inc..... | 16 |
| University of Pennsylvania | 2 | Vanguard Group Inc..... | 17 |
| Pennsylvania State University | 3 | Comcast Cablevision Corp | 18 |
| Giant Food Stores | 4 | Highmark Inc | 19 |
| UPMC Presbyterian | 5 | K-MART Corporation..... | 20 |
| Lowe's Home Centers Inc | 6 | US Airways Inc | 21 |
| University of Pittsburgh | 7 | Milton Hershey Medical Center..... | 22 |
| PNC Bank NA | 8 | Heartland Employment Services | 23 |
| United Parcel Service Inc | 9 | Wawa Inc..... | 24 |
| Giant Eagle Inc | 10 | Thomas Jefferson University Hospital. | 25 |
| The Home Depot USA Inc | 11 | Pennsylvania CVS Pharmacy LLC..... | 26 |
| Weis Markets Inc..... | 12 | Western Penn Allegheny Health..... | 27 |
| Schering Corporation..... | 13 | Sheetz Inc..... | 28 |
| The Children's Hospital of Philadelphia | 14 | Wegmans Food Markets Inc..... | 29 |
| Target Corporation | 15 | Hershey Entertainment & Resorts Co..... | 30 |

Source: Pennsylvania Department of Labor, Office of Employment Security.

Personal Income

Personal income in the Commonwealth for 2012 is \$556.7 billion, an increase of 3.3 percent over the previous year. During the same period, national personal income increased by 4.2 percent. Based on the 2012 personal income estimates, per capita income is at \$43,616 in the Commonwealth compared to per capita income in the United States of \$42,693. The following tables represent annual personal income and per capita income from 2003 through 2012.

Personal Income Pennsylvania, Mideast Region and the United States 2003-2012

| Year | Total Personal Income Dollars in Millions | | | Total Personal Income As a % of 2003 base | | |
|------------|--|----------------------------------|--------------------|--|----------------------------------|-------|
| | PA | Mideast Region ^(a) | US. ^(b) | PA | Mideast Region ^(a) | US |
| 2003 | \$ 399,547 | \$ 1,707,492 | \$ 9,487,600 | 100 % | 100 % | 100 % |
| 2004 | 417,790 | 1,808,113 | 10,049,200 | 105 | 106 | 106 |
| 2005 | 432,247 | 1,898,598 | 10,610,300 | 108 | 111 | 112 |
| 2006 | 462,703 | 2,046,137 | 11,389,800 | 116 | 120 | 120 |
| 2007 | 489,076 | 2,177,747 | 11,900,500 | 122 | 128 | 126 |
| 2008 | 512,992 | 2,271,109 | 12,451,600 | 128 | 133 | 131 |
| 2009 | 496,664 | 2,176,565 | 11,852,700 | 124 | 127 | 125 |
| 2010 | 514,352 | 2,270,628 | 12,308,400 | 129 | 133 | 129 |
| 2011 | 538,909 | 2,375,021 | 12,949,800 | 135 | 139 | 136 |
| 2012 | 556,692 | 2,443,129 | 13,401,800 | 139 | 143 | 141 |

^(a) Mideast Region: Pennsylvania, New York, New Jersey, Maryland, District of Columbia, and Delaware.

^(b) Sum of States.

Source: U.S. Department of Commerce, Bureau of Economic Analysis

Per Capita Income Pennsylvania, Mideast Region and the United States 2003-2012

| Calendar Year | Per Capita Income | | | As % of US | |
|------------------|-------------------|----------------------------------|-----------|------------|----------------------------------|
| | PA | Mideast Region ^(a) | U.S. | PA | Mideast Region ^(a) |
| 2003 | \$ 32,288 | \$ 36,303 | \$ 33,345 | 97 % | 109 % |
| 2004 | 33,664 | 38,338 | 34,224 | 98 | 112 |
| 2005 | 34,719 | 40,191 | 34,428 | 101 | 117 |
| 2006 | 36,984 | 43,227 | 35,461 | 104 | 122 |
| 2007 | 38,927 | 45,873 | 39,506 | 99 | 116 |
| 2008 | 40,674 | 47,627 | 40,947 | 99 | 116 |
| 2009 | 39,210 | 45,398 | 38,637 | 101 | 117 |
| 2010 | 40,444 | 47,106 | 39,791 | 102 | 118 |
| 2011 | 42,291 | 49,088 | 41,560 | 102 | 118 |
| 2012 | 43,616 | 50,237 | 42,693 | 102 | 117 |

^(a) Mideast Region: Pennsylvania, New York, New Jersey, Maryland, District of Columbia, and Delaware.

Source: U.S. Department of Commerce, Bureau of Economic Analysis

The following table presents growth rates in personal income and selected components of personal income for Pennsylvania, the Mideast Region and the United States from 2008 through 2012.

Annual Growth Rates
Personal Income and Selected Components of Personal Income
Pennsylvania, Mideast Region and the United States

| <u>Calendar Year</u> | <u>Pennsylvania</u> | <u>Mideast Region^(a)</u> | <u>United States</u> |
|------------------------------|---------------------|-------------------------------------|----------------------|
| Total Personal Income | | | |
| 2008..... | 4.9% | 4.3% | 4.6% |
| 2009..... | -3.2 | -4.1 | -4.8 |
| 2010..... | 3.6 | 4.3 | 3.8 |
| 2011..... | 4.8 | 4.6 | 5.2 |
| 2012..... | 3.3 | 2.9 | 3.4 |
| Manufacturing | | | |
| 2008..... | 1.0% | 1.1% | 0.2% |
| 2009..... | -11.1 | -10.4 | -11.3 |
| 2010..... | 2.0 | 6.2 | 2.4 |
| 2011..... | 4.2 | 2.1 | 5.3 |
| 2012..... | 3.3 | 1.5 | 4.6 |
| Trade^(b) | | | |
| 2008..... | -1.2% | -1.7% | -1.7% |
| 2009..... | -2.8 | -3.3 | -4.8 |
| 2010..... | 2.3 | 2.8 | 2.3 |
| 2011..... | 4.7 | 4.3 | 4.8 |
| 2012..... | 3.6 | 4.2 | 5.1 |
| Finance^(c) | | | |
| 2008..... | 1.5% | -3.4% | -3.5% |
| 2009..... | -4.0 | -10.0 | -4.2 |
| 2010..... | 2.9 | 12.7 | 7.8 |
| 2011..... | 2.8 | 4.4 | 4.4 |
| 2012..... | -0.9 | 2.9 | -1.3 |
| Services | | | |
| 2008..... | 7.8% | 9.4% | 8.3% |
| 2009..... | -6.2 | -6.4 | -7.3 |
| 2010..... | 1.7 | 2.7 | 3.2 |
| 2011..... | 3.8 | 5.3 | 5.7 |
| 2012..... | 6.5 | 5.4 | 5.5 |
| Utilities | | | |
| 2008..... | 9.3% | 12.2% | 13.3% |
| 2009..... | -8.8 | -10.0 | -6.3 |
| 2010..... | 2.7 | 7.5 | 3.3 |
| 2011..... | 8.4 | 4.0 | 4.2 |
| 2012..... | 6.7 | 8.7 | 8.9 |
| Construction | | | |
| 2008..... | -1.3% | 0.7% | -4.5% |
| 2009..... | -10.9 | -8.9 | -13.1 |
| 2010..... | 2.9 | 1.5 | -1.7 |
| 2011..... | 4.5 | 2.9 | 1.8 |
| 2012..... | 3.7 | 2.4 | 5.4 |
| Mining | | | |
| 2008..... | 49.0% | 22.0% | 44.5% |
| 2009..... | -32.9 | -44.9 | -40.0 |
| 2010..... | 30.9 | 23.1 | 13.5 |
| 2011..... | 28.6 | 34.7 | 17.7 |
| 2012..... | 6.5 | 4.0 | 3.7 |

^(a) Mideast Region: Delaware, District of Columbia, Maryland, Pennsylvania, New York, and New Jersey.

^(b) Wholesale and retail trade.

^(c) Finance and insurance.

Source: U.S. Department of Commerce, Bureau of Economic Analysis

The Commonwealth's average hourly wage rate of \$19.16 for manufacturing and production workers compares below the national average of \$20.13 for 2013. The following table presents the average hourly wage rates for 2009 through 2013.

**Average Hourly Wages
Production Workers on Manufacturing Payrolls
Pennsylvania and the United States
2009-2013**

| <u>Calendar Year</u> | <u>PA</u> | <u>US</u> |
|--------------------------|-----------|-----------|
| 2009..... | \$ 16.28 | \$ 18.61 |
| 2010..... | 16.88 | 19.05 |
| 2011..... | 17.49 | 19.44 |
| 2012..... | 18.26 | 19.74 |
| 2013..... | 19.16 | 20.13 |

Source: U.S. Department of Labor, Bureau of Labor Statistics

Market and Assessed Valuation of Real Property

Annually, the State Tax Equalization Board (the "STEB") determines an aggregate market value of all taxable real property in the Commonwealth. The STEB determines the market value by applying assessment to sales ratio studies to assessment valuations supplied by local assessing officials. The market values certified by the STEB do not include property that is tax exempt but do include an adjustment correcting the data for preferential assessments granted to certain farm and forestlands.

The table below shows the assessed valuation as determined and certified by the counties and the market value and the assessed to market value ratio determined by the STEB for real property over the last ten years. Increases in valuations shown below result from reassessment valuations by the counties, changes in property tax rolls and increases in the real value of existing property. In computing the market values for uneven-numbered years, the STEB is statutorily restricted to certifying only those changes in market value that result from properties added to or removed from the assessment rolls. The STEB is permitted to adjust the market valuation to reflect any change in real estate values or other economic change in value only in even-numbered years. This restriction accounts for the two-year pattern of market value changes apparent in the data below.

**Valuations of Taxable Real Property
2003-2012**

| <u>Year</u> | <u>Market Value^(a)</u> | <u>Assessed Valuation</u> | <u>Ratio of Assessed Valuation to Market Value^(a)</u> |
|-------------|-----------------------------------|---------------------------|--|
| 2003 | \$ 478,362,689,800 | \$ 348,726,965,926 | 72.9 |
| 2004 | 523,595,339,800 | 352,014,550,601 | 67.2 |
| 2005 | 546,222,770,500 | 378,011,903,306 | 69.2 |
| 2006 | 619,788,036,800 | 393,869,708,825 | 63.5 |
| 2007 | 633,886,898,100 | 400,428,104,035 | 63.1 |
| 2008 | 708,521,506,000 | 406,426,527,325 | 57.3 |
| 2009 | 717,475,983,911 | 431,911,595,146 | 60.2 |
| 2010 | 753,847,457,900 | 436,995,393,629 | 57.9 |
| 2011 | 756,045,833,849 | 451,343,272,265 | 59.7 |
| 2012 | 753,344,175,841 | 452,361,346,637 | 60.0 |

^(a) Value adjusted for difference between regular assessment and preferential assessment permitted on certain farm and forestlands.
Source: Annual Certifications by the State Tax Equalization Board July 2013.

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COMMONWEALTH GOVERNMENT AND FISCAL ADMINISTRATION

The government of the Commonwealth (the “Commonwealth” or “Pennsylvania”) is composed of three separate branches. A general organization chart of the Commonwealth’s government is shown on the following page.

Legislative Branch

The legislative branch consists of the General Assembly and its staff. The General Assembly is bicameral, composed of the Senate and the House of Representatives. The 50 members of the Senate serve staggered four-year terms and the 203 Representatives serve identical two-year terms. The General Assembly meets in regular session biannually beginning on the first Tuesday of January following elections. Special sessions may be called by the Governor on petition of a majority of the members of each house or whenever the Governor determines that public interest so requires. Legislative leadership includes majority and minority leaders in each house, a President Pro Tempore of the Senate and a Speaker of the House of Representatives.

Executive Branch

The Executive Branch is headed by five elected officials and encompasses 19 departments and approximately 36 independent commissions, boards, authorities and agencies.

The five elected officials are the Governor, the Lieutenant Governor, the Attorney General, the State Treasurer and the Auditor General. The Governor and the Lieutenant Governor are elected on the same ballot and serve a four-year term. The Governor is eligible to succeed himself for one term. The Auditor General, the Attorney General and the State Treasurer are elected for four-year terms in an even-year election held between gubernatorial elections.

The Governor is the chief executive officer of the Commonwealth. All departments except those of the State Treasurer, the Attorney General and the Auditor General are under the direct jurisdiction of the Governor. The head of each of the remaining departments is a Secretary who is appointed by the Governor and confirmed by a majority vote of the Senate. Each Secretary serves at the Governor’s pleasure and is a member of the Governor’s Cabinet.

The Lieutenant Governor presides over the Senate and serves as Acting Governor during the disability of the Governor and becomes Governor in the case of the death, conviction or impeachment, failure to qualify or resignation of the Governor.

The Attorney General is the chief law enforcement officer of the Commonwealth and is responsible for upholding and defending the constitutionality of all statutes. The Attorney General is also responsible for reviewing the form and legality of all proposed rules and regulations, deeds, leases and contracts to be executed by Commonwealth agencies. The Office of Attorney General is under the Attorney General’s direct jurisdiction.

The State Treasurer is charged with receiving, depositing and investing all Commonwealth funds and is responsible for the pre-audit approval of all requisitions for the disbursements of monies in the State Treasury. The Treasury Department is under the State Treasurer’s direct jurisdiction.

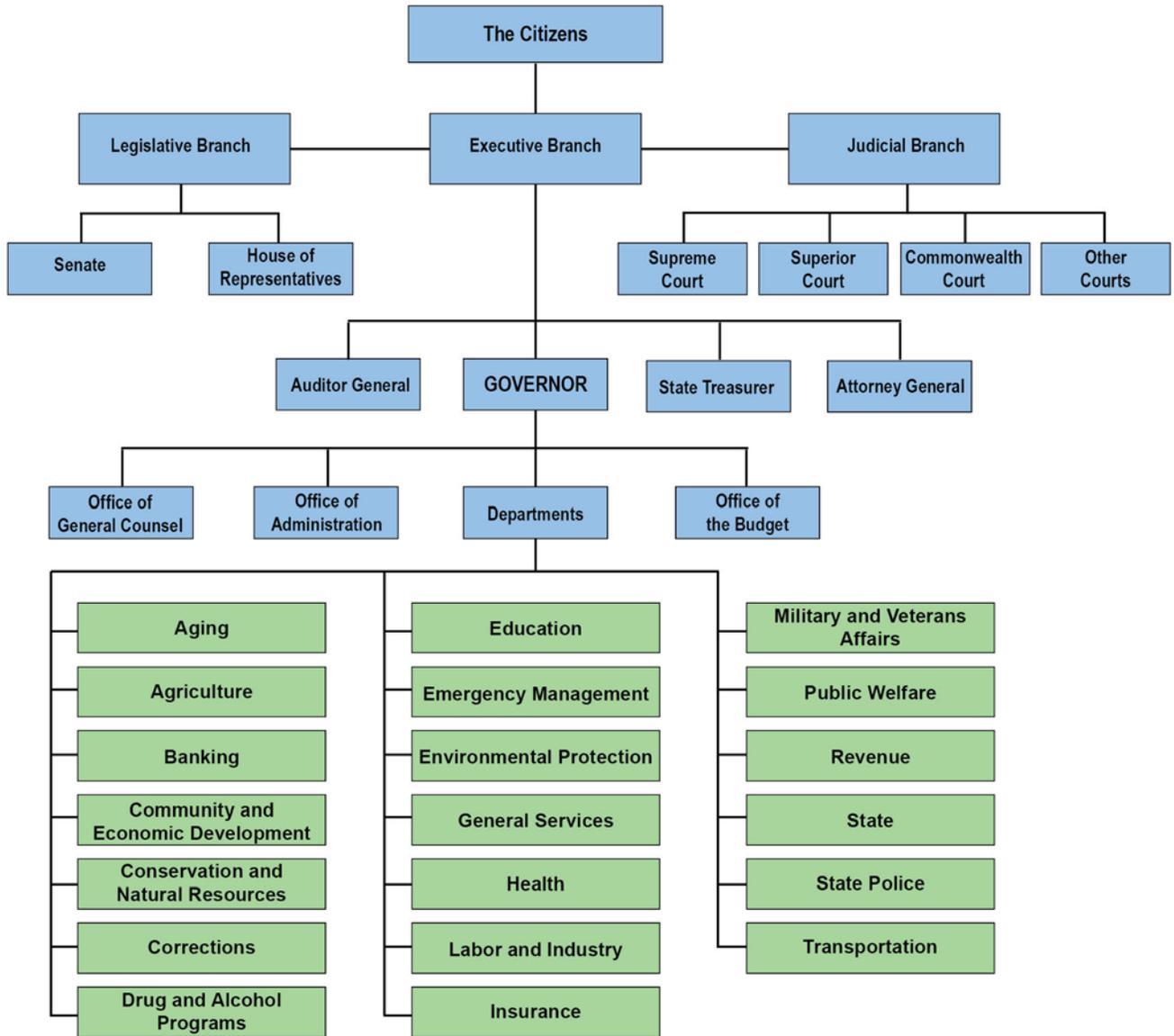
The Auditor General is charged with making audits of completed financial transactions. The Department of the Auditor General is under the Auditor General’s direct jurisdiction.

Activities of state government are also conducted by various independent commissions, boards, authorities and agencies created by statute and not under the direct jurisdiction of the executive and legislative branches.

Judicial Branch

The judicial power of the Commonwealth is vested in a unified judicial system consisting of a Supreme Court and various other courts of original and appellate jurisdiction which are under the supervision and authority of the Supreme Court. All justices, judges and district justices are elected to office.

Commonwealth of Pennsylvania Organization Chart



AGENCIES

Higher Education Assistance
Housing Finance
Interstate Agencies

AUTHORITIES

Commonwealth Financing
Energy Development
Higher Education Facilities
Industrial Development
Infrastructure Investment
Minority Business Development
Public School Building

BOARDS

Claims
Environmental Hearing
Gaming Control
Finance and Revenue
Liquor Control
Milk Marketing
Municipal Retirement
Pardons
Probation and Parole
Public School Employees' Retirement
State Employees' Retirement
Tax Equalization

COMMISSIONS

Civil Service
Crime and Delinquency
Ethics
Fish and Boat
Game
Harness Racing
Historical and Museum
Horse Racing
Human Relations
Juvenile Court Judges
Public Employee Retirement
Public Utility
Securities
Turnpike

Fiscal Organization

Each branch of the Commonwealth's government is responsible for its respective fiscal operations subject to restrictions embodied in the Constitution, the Administrative Code, and the Fiscal Code. Such restrictions are enforced and other central administrative functions are provided by five departments: the Office of the Budget ("OB"), the Office of Administration ("OA"), the Treasury Department, the Department of Revenue and the Department of the Auditor General. OB and OA are administrative offices within the Governor's offices. The Secretary of the Budget and the Secretary of Administration are appointed by the Governor and are responsible for the operations of their respective offices. The Department of Revenue is led by the Secretary of Revenue, who is appointed by the Governor subject to the advice of the Senate. The Treasury Department and the Department of the Auditor General are headed by the respective elected officials.

OB monitors the operation of the Commonwealth's departments, operates a central accounting system, compiles and publishes the Commonwealth's financial reports, assists in the preparation and publication of the budget, coordinates capital improvements and is responsible for the issuance of the Commonwealth's debt. OA is responsible for personnel policy and programs, management policy and organizational structure, data processing service, and electronic data processing policy and planning. The Treasury Department receives, invests and disburses all funds and maintains central cash records. The Department of Revenue administers the collection of most taxes. The Department of the Auditor General oversees the examination of the majority of financial transactions.

Commissions, authorities and agencies that are both independent by statute and financially self-supporting, operate autonomously although their capital projects and financing are reviewed by OB and included in the capital budget.

The Budgetary Process

The Commonwealth operates on a fiscal year beginning July 1 and ending June 30. For example, "fiscal year 2007" refers to the fiscal year ending on June 30, 2007.

The budget process commences in September, nine months prior to the beginning of the fiscal year, as departments formulate their initial budgets in response to Program Policy Guidelines issued by the Governor and hold preliminary hearings with OB and other members of the Governor's staff. By November 1, formal budget requests are submitted to OB by all government departments and other institutions requesting appropriations. OB, under the direction of the Secretary of Budget, reviews the requests through November and December and may hold formal hearings.

The Department of Revenue, in conjunction with OB, prepares revenue estimates. In the preparation of such estimates, internal analysis, information from selected departments and econometric analysis are utilized. The Commonwealth subscribes to economic forecasts prepared by Global Insight for national and Pennsylvania economic data that are used to estimate economically sensitive Commonwealth revenues. Other econometric forecasts are also consulted.

The Constitution requires that the Governor submit annually to the General Assembly a budget consisting of three parts:

- (a) a balanced operating budget for the ensuing fiscal year setting forth proposed expenditures and estimated revenues from all sources and, if estimated revenues and available surplus are less than proposed expenditures, recommending specific additional sources of revenue sufficient to pay the deficiency;
- (b) a capital budget for the ensuing fiscal year setting forth in detail proposed expenditures to be financed from the proceeds of obligations of the Commonwealth or of its agencies or authorities or from operating funds; and
- (c) a financial plan for not less than the succeeding five fiscal years, which includes for each year (i) projected operating expenditures classified by department or agency and by program, and estimated revenues by major categories from existing and additional sources, and (ii) projected expenditures for capital projects specifically itemized by purpose and their proposed sources of financing.

All funds received by the Commonwealth are subject by statute to appropriation in specific amounts by the General Assembly or by executive authorizations by the Governor. The Governor's budget encompasses both annual appropriations and executive authorizations.

The Governor is required to submit the proposed budget as soon as possible after the organization of the General Assembly but not later than the first full week in February except in his first year of office. The Governor's submission begins with the Budget Message delivered in joint session. The budget in the form of a proposed bill is delivered to the appropriations committee of one of the houses. Hearings are held on the bills constituting the budget. In an iterative process, bills are reported from committee to floor and considered in and between houses.

The operating budget is considered in the form of the General Appropriations Bill and its supplements. The Bill is limited to appropriations for debt service, public schools and the executive, legislative and judicial branches. Its supplements cover appropriations from special revenue funds not included in the General Appropriations Bill and for such subjects as capital projects funded from current revenues. The operating budget also includes single subject bills covering appropriations made to any charitable or educational institutions not under the absolute control of the Commonwealth other than certain State-owned schools (“non-preferred appropriations”).

The Constitution mandates that total operating budget appropriations made by the General Assembly may not exceed the sum of (a) the actual and estimated revenues in a given year, and (b) the surplus of the preceding year. The Constitution further specifies that a surplus of operating funds at the end of the fiscal year shall be appropriated. That is, if funds remain from the end of a fiscal year they must be appropriated for the ensuing year. Also, if a deficit occurs at year-end, funds must be provided for such a deficit.

Pursuant to the Administrative Code, the executive branch establishes the revenue estimates used in the budget. In practice, the revenue estimates used to balance the operating budget consist of the appropriate fund’s available surplus and its estimated cash receipts for the fiscal year as well as net accruals. Appropriation lapses estimated to occur during the year or at year-end are not included; lapses are not available for re-appropriation until they occur.

Under this budgetary process a deficit can occur if revenues are less than those estimated in the budget and the shortfall is not offset by any unappropriated surplus or by appropriation lapses during or at the end of the year or by legislative action to increase revenues or reduce appropriation.

The Administrative Code was amended in 1978 to provide for stronger executive control of expenditures. All departments under the Governor’s jurisdiction may be required to submit estimates of expenditures during the ensuing month, quarter or any other such period as requested by the Governor. These estimates are subject to the approval of the Secretary of Budget. The Governor is empowered to request the State Treasurer to withhold funds from any such department not spending within such estimates. The Secretary of Budget is empowered to set personnel levels for departments. Departments are required to provide personnel data monthly so that the Commonwealth’s computerized data file on personnel levels can be maintained and used to monitor the Commonwealth’s largest operating expense.

The proposed capital budget is considered in the form of the Capital Budget Bill and its supplements. The capital budget determines limits for the amount of debt that can be issued in that fiscal year for categories of capital projects, itemizes for funding all capital projects not previously itemized, authorizes the issuance of debt to finance these projects and appropriates the proceeds from the issuance of debt.

All appropriations require the majority vote of all members in each house except for non-preferred appropriations and appropriations from the Budget Stabilization Reserve Fund and from the Health Endowment Account portion of the Tobacco Settlement Fund which require passage by a two-thirds vote. During the legislative process, the General Assembly may add, change or delete any items in the budget proposed by the Governor. Once the bills constituting the budget have passed both houses and are returned to the Governor, he may either veto bills or item veto appropriations within bills. A gubernatorial veto can be overridden only by a two-thirds majority of all members of each house.

In the event that the General Assembly fails to pass or the Governor fails to sign an appropriations act prior to July 1 of any fiscal year for that fiscal year, the Pennsylvania Constitution, the laws of Pennsylvania and certain state and federal court decisions provide that the Commonwealth may continue during such un-budgeted fiscal year to make debt service payments, payments for mandated federal programs such as cash assistance and payments related to the health and safety of the citizens of the Commonwealth such as police and correctional services.

Accounting and Budgetary Controls

Every department of the executive branch that receives appropriations from the Commonwealth, with the exception of the Treasury Department and the Departments of the Auditor General and the Attorney General, has a comptroller appointed by and under the direct jurisdiction of the Governor. These agencies share a centralized encumbrance-based accounting system supervised by OB. Executive departments operating separate additional accounting systems include the Department of Transportation for the Motor License Fund, the Liquor Control Board for the State Stores Fund and the Department of Labor and Industry for the payment of unemployment compensation benefits. Officials within the Treasury Department, the Departments of the Auditor General and the Attorney General and the judicial and legislative branches administer individual operations under the jurisdiction of their respective areas.

Expenditure control occurs at two levels. The first is by appropriations and is enforced by the State Treasurer and individual comptrollers. The second is by allocations and allotments and is enforced by OB for all departments receiving appropriations, except for the legislative branch.

Departments receive authorization to spend and commit funds in the form of appropriations for a specific amount, purpose and time period. Funds appropriated to a single department may be in one or more appropriations as the General Assembly determines. When multiple appropriations to a department are enacted, separate appropriations are made for general operating expenses, special outlays and for specific programs or groupings thereof. The degree to which a department's total appropriations are itemized may vary, but control is exercised over both total and individual appropriations.

The Constitution requires that with the exceptions named, monies may be paid from the Treasury only if appropriated by law. Accordingly, when a voucher is submitted to the State Treasurer, a check will not be issued unless the amount is within the balance of the agency's total appropriation.

Departments are prevented by their comptrollers from incurring obligations in excess of their unexpended individual appropriations by an encumbrance system. Encumbrance control prevents spending beyond remaining individual appropriation balances. When a commitment or obligation is incurred, for example, when a contract or purchase order is signed, the required portion of the corresponding appropriation is reserved. This reserving of funds is called the encumbrance procedure. All obligations anticipating future disbursement of cash in the fiscal year require an encumbrance, with the exception of debt service payments. Since a debt service appropriation is used for no purpose other than debt service, an encumbrance is not necessary.

All individual appropriations are allocated by OB to departments by major object groups. For example, a department's appropriation for operating expenses may be broken down into such major object groups as personnel service, operating expenses and supplies, etc. Additionally, major object groups are subdivided into minor object groups. For example, personnel service would be broken down into salaries, benefits, overtime, etc. Department expenditures are monitored to insure that expenditures within an allocation do not exceed the designated totals. The departments, however, are free to adjust their expenditures between minor object groups as long as they do not exceed the major object group allocation. OB can monitor department expenditures against their allocations on a continuing basis as the records of departments under the Governor's jurisdiction can be accessed from the central system while those of most other departments and branches are provided monthly.

In addition to the preceding controls, another check is provided by the financial reporting process. All department records are reconciled by OB on a monthly basis with the Treasury Department's records of cash transactions and with the Department of Revenue's records of cash collections.

Audits

The Constitution requires that the financial affairs of any entity receiving appropriations and all department boards, commissions, agencies, instrumentalities, authorities and institutions of the Commonwealth be subject to audits made in accordance with generally accepted auditing standards. Any Commonwealth officer whose approval is necessary for any transaction may not be charged with the function of auditing that transaction after its occurrence.

The Department of the Auditor General has the responsibility for auditing all state-related financial transactions except its own, those of the legislative and judicial branches, and boards and commissions on which the Auditor General serves and those of certain funds. At least one audit must be made annually of the fiscal affairs of the executive branch. Audits of the Commonwealth General Purpose Financial Statements since fiscal 1985 have been performed jointly by the Department of the Auditor General and an independent public accounting firm.

The Treasury Department is required to pre-audit all requests for expenditures to insure that they are in accordance with law. In addition, OB conducts, as a matter of administrative policy, periodic audits of comptrollers under the Governor's jurisdiction and performance audits of state and federal programs.

**INFORMATION REGARDING
THE DEPOSITORY TRUST COMPANY
AND ITS BOOK-ENTRY SYSTEM**

The information that follows concerning The Depository Trust Company, New York, New York (“DTC”) and the book-entry only system described below is based solely on information furnished by DTC and is not, and should not be construed as, a representation by the Commonwealth as to its accuracy, completeness or otherwise.

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each maturity of the Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world’s largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.6 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has a Standard & Poor’s rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC’s records. The ownership interest of each actual purchaser of each Bond (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co. or such other name as requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

Beneficial Owners of the Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners, or in the alternative, Beneficial Owners may wish to provide their names and addresses to the Loan and Transfer Agent and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. If less than all of the Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Bonds. Under its usual procedures, DTC will mail an Omnibus Proxy to the Commonwealth as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments of principal or redemption price of and interest on the Bonds will be made to Cede & Co. or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Commonwealth or its agent, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Direct and Indirect Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Direct and Indirect Participants and not of DTC (nor its nominee), the Loan and Transfer Agent, or the Commonwealth, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal or redemption price of and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Commonwealth or the Loan and Transfer Agent, disbursement of such payments to Direct Participants is the responsibility of DTC, and disbursement of such payments to the Beneficial Owners is the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Commonwealth or the Loan and Transfer Agent. Under such circumstances, in the event that a successor securities depository is not obtained, Bond certificates are required to be printed and delivered.

The foregoing information concerning DTC and DTC's book-entry system has been obtained from information furnished by DTC. No representation or warranty is made by the Commonwealth as to the accuracy or completeness of such information.

The Commonwealth may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered.

For so long as the Bonds are registered in the name of DTC, or its nominee Cede & Co., the Commonwealth and the Loan and Transfer Agent will treat Cede & Co. as the registered owner of the Bonds for all purposes, including payments, notices and voting.

Neither the Commonwealth nor the Loan and Transfer Agent shall have any responsibility or obligation to any Direct or Indirect Participant or Beneficial Owner with respect to (a) the accuracy of any records maintained by DTC or any Direct or Indirect Participant with respect to any beneficial ownership interest in any Bonds; (b) the payment by any Direct or Indirect Participant of any amount due to any Beneficial Owner in respect of the principal of, premium, if any, and interest on the Bonds; (c) the delivery or timeliness of delivery by any Direct or Indirect Participant of any notice to any Beneficial Owner of any notice with respect to the Bond, including, without limitation any notice of redemption; or (d) other action taken by DTC or Cede & Co., including the effectiveness of any action taken pursuant to an Omnibus Proxy.

**SELECTED
CONSTITUTIONAL PROVISIONS
RELATING TO THE FINANCES
OF THE COMMONWEALTH**

Article VIII — TAXATION AND FINANCE

Commonwealth Indebtedness

Section 7. (a) No debt shall be incurred by or on behalf of the Commonwealth except by law and in accordance with the provisions of this section.

- (1) Debt may be incurred without limit to suppress insurrection, rehabilitate areas affected by man-made or natural disaster, or to implement unissued authority approved by the electors prior to the adoption of this article.
- (2) The Governor, State Treasurer and Auditor General, acting jointly, may (i) issue tax anticipation notes having a maturity within the fiscal year of issue and payable exclusively from revenues received in the same fiscal year, and (ii) incur debt for the purpose of refunding other debt, if such refunding debt matures within the term of the original debt.
- (3) Debt may be incurred without limit for purposes specifically itemized in the law authorizing such debt, if the question whether the debt shall be incurred has been submitted to the electors and approved by a majority of those voting on the question.
- (4) Debt may be incurred without the approval of the electors for capital projects specifically itemized in a capital budget if such debt will not cause the amount of all net debt outstanding to exceed one and three-quarters times the average of the annual tax revenues deposited in the previous five fiscal years as certified by the Auditor General. For the purposes of this subsection, debt outstanding shall not include debt incurred under clauses (1) and (2) (i), or debt incurred under clause (2) (ii) if the original debt would not be so considered, or debt incurred under subsection (3) unless the General Assembly shall so provide in the law authorizing such debt.

(b) All debt incurred for capital projects shall mature within a period not to exceed the estimated useful life of the projects as stated in the authorizing law, and when so stated shall be conclusive. All debt, except indebtedness permitted by clause (2) (i), shall be amortized in substantial and regular amounts, the first of which shall be due prior to the expiration of a period equal to one-tenth the term of the debt.

(c) As used in this section, debt shall mean the issued and outstanding obligations of the Commonwealth and shall include obligations of its agencies or authorities to the extent they are to be repaid from lease rentals or other charges payable directly or indirectly from revenues of the Commonwealth. Debt shall not include either (1) that portion of obligations to be repaid from charges made to the public for the use of the capital projects financed, as determined by the Auditor General, or (2) obligations to be repaid from lease rentals or other charges payable by a school district or other local taxing authority, or (3) obligations to be repaid by agencies or authorities created for the joint benefit of the Commonwealth and one or more other State governments.

(d) If sufficient funds are not appropriated for the timely payment of the interest upon and installments of principal of all debt, the State Treasurer shall set apart from the first revenues thereafter received applicable to the appropriate fund a sum sufficient to pay such interest and installments of principal, and shall so apply the money so set apart. The State Treasurer may be required to set aside and apply such revenues at the suit of any holder of Commonwealth obligations.

Commonwealth Credit Not to be Pledged

Section 8. The credit of the Commonwealth shall not be pledged or loaned to any individual, company, corporation or association nor shall the Commonwealth become a joint owner or stockholder in any company, corporation or association.

Municipal Debt Not to be Assumed by Commonwealth

Section 9. The Commonwealth shall not assume the debt, or any part thereof, of any county, city, borough, incorporated town, township or any similar general purpose unit of government unless such debt shall have been incurred to enable the Commonwealth to suppress insurrection or to assist the Commonwealth in the discharge of any portion of its present indebtedness.

Audit

Section 10. The financial affairs of any entity funded or financially aided by the Commonwealth, and all departments, boards, commissions, agencies, instrumentalities, authorities and institutions of the Commonwealth, shall be subject to audits made in accordance with generally accepted auditing standards.

Any Commonwealth officer whose approval is necessary for any transaction relative to the financial affairs of the Commonwealth shall not be charged with the function of auditing that transaction after its occurrence.

Gasoline Taxes and Motor License Fees Restricted

Section 11. (a) All proceeds from gasoline and other motor fuel excise taxes, motor vehicle registration fees and license taxes, operators' license fees and other excise taxes imposed on products used in motor transportation after providing therefrom for (a) cost of administration and collection, (b) payment of obligations incurred in the construction and reconstruction of public highways and bridges shall be appropriated by the General Assembly to agencies of the State or political subdivisions thereof; and used solely for construction, reconstruction, maintenance and repair of and safety on public highways and bridges and costs and expenses incident thereto, and for the payment of obligations incurred for such purposes, and shall not be diverted by transfer or otherwise to any other purpose, except that loans may be made by the State from the proceeds of such taxes and fees for a single period not exceeding eight months, but no such loan shall be made within the period of one year from any preceding loan, and every loan made in any fiscal year shall be repayable within one month after the beginning of the next fiscal year.

(b) All proceeds from aviation fuel excise taxes, after providing therefrom for the cost of administration and collection, shall be appropriated by the General Assembly to agencies of the State or political subdivisions thereof and used solely for: the purchase, construction, reconstruction, operation, and maintenance of airports and other air navigation facilities; aircraft accident investigation; the operation, maintenance and other costs of aircraft owned or leased by the Commonwealth; any other purpose reasonably related to air navigation including but not limited to the reimbursement of airport property owners for property tax expenditures; and costs and expenses incident thereto and for the payment of obligations incurred for such purposes, and shall not be diverted by transfer or otherwise to any other purpose.

Governor's Budgets and Financial Plan

Section 12. Annually, at the times set by law, the Governor shall submit to the General Assembly:

(a) A balanced operating budget for the ensuing fiscal year setting forth in detail (i) proposed expenditures classified by department or agency and by program and (ii) estimated revenues from all sources. If estimated revenues and available surplus are less than proposed expenditures, the Governor shall recommend specific additional sources of revenue sufficient to pay the deficiency and the estimated revenue to be derived from each source;

(b) A capital budget for the ensuing fiscal year setting forth in detail proposed expenditures to be financed from the proceeds of obligations of the Commonwealth or of its agencies or authorities or from operating funds; and

(c) A financial plan for not less than the next succeeding five fiscal years, which plan shall include for each such fiscal year:

- (i) Projected operating expenditures classified by department or agency and by program, in reasonable detail, and estimated revenues, by major categories, from existing and additional sources; and
- (ii) Projected expenditures for capital projects specifically itemized by purpose, and the proposed sources of financing each.

Appropriations

Section 13. (a) Operating budget appropriations made by the General Assembly shall not exceed the actual and estimated revenues and surplus available in the same fiscal year.

(b) The General Assembly shall adopt a capital budget for the ensuing fiscal year.

Surplus

Section 14. All surplus of operating funds at the end of the fiscal year shall be appropriated during the ensuing fiscal year by the General Assembly.

Project “70”

Section 15. In addition to the purposes stated in article eight, section seven of this Constitution, the Commonwealth may be authorized by law to create debt and to issue bonds to the amount of seventy million dollars (\$70,000,000) for the acquisition of land for State parks, reservoirs and other conservation and recreation and historical preservation purposes and for participation by the Commonwealth with political subdivisions in the acquisition of land for parks, reservoirs and other conservation and recreation and historical preservation purposes, subject to such conditions and limitations as the General Assembly may prescribe.

Land and Water Conservation and Reclamation Fund

Section 16. In addition to the purposes stated in article eight, section seven of this Constitution, the Commonwealth may be authorized by law to create debt and issue bonds in the amount of five hundred million dollars (\$500,000,000) for a Land and Water Conservation and Reclamation Fund to be used for the conservation and reclamation of land and water resources of the Commonwealth, including the elimination of acid mine drainage, sewage, and other pollution from the streams of the Commonwealth, the provision of State financial assistance to political subdivisions and municipal authorities of the Commonwealth of Pennsylvania for the construction of sewage treatment plants, the restoration of abandoned strip-mined areas, the control and extinguishment of surface and underground mine fires, the alleviation and prevention of subsidence resulting from mining operations, and the acquisition of additional lands and the reclamation and development of park and recreational lands acquired pursuant to the authority of Article VIII, section 15 of this Constitution, subject to such conditions and liabilities as the General Assembly may prescribe.

**PROPOSED FORM OF OPINION OF
THE ATTORNEY GENERAL OF
THE COMMONWEALTH OF PENNSYLVANIA**

May 15, 2014

TO THE GOVERNOR, THE STATE TREASURER AND THE AUDITOR GENERAL AS THE ISSUING OFFICIALS OF THE COMMONWEALTH:

Re: Commonwealth of Pennsylvania General Obligation Bonds, First Series and First Refunding Series of 2014

This opinion is furnished to you in connection with the issuance and sale by the Commonwealth of Pennsylvania (the "Commonwealth") on the date hereof of \$545,000,000 aggregate principal amount of Commonwealth of Pennsylvania General Obligation Bonds, First Series of 2014 (the "First Series Bonds"), and the \$289,945,000 aggregate principal amount of the Commonwealth of Pennsylvania General Obligation Bonds, First Refunding Series of 2014 (the "First Refunding Series Bonds" and together with the First Series Bonds, the "Bonds"). The Bonds are dated the date of issuance and delivery. The Bonds are issued as fully registered bonds without coupons in the denomination of \$5,000 or any integral multiple thereof within a maturity and will bear interest from the date of issuance and delivery, payable semi-annually on June 15 and December 15 of each year commencing December 15, 2014 with respect to the First Series Bonds, and payable semi-annually January 1 and July 1 of each year commencing January 1, 2015 with respect to the First Refunding Series Bonds, until the obligation with respect to the payment of such principal shall have been discharged.

The Bonds are authorized and issued pursuant to and in full compliance with the provisions, restrictions and limitations of Section 7 of Article VIII of the Constitution; the laws of the Commonwealth, including the Capital Facilities Debt Enabling Act, Act No. 1999-1, approved February 9, 1999, as amended, annual capital budget bills and various bond authorization bills enacted by the General Assembly. The Bonds are also authorized and issued pursuant to resolutions adopted by the Governor, the State Treasurer and the Auditor General (the "Issuing Officials") on April 22, 2014, and April 29, 2014 (collectively, the "Resolutions").

The Resolutions, among other things, authorize the issuance and sale of the Bonds, and prescribe the forms thereof, the manner of bidding therefor and the forms of the bidding documents used in connection with the issuance and sale of the Bonds.

Under Section 7(a)(4) of Article VIII of the Constitution, the Commonwealth may incur debt without the approval of the electors to finance such projects, if such debt will not cause the amount of all debt outstanding (as defined for the purposes of that Section) to exceed one and three-quarters times the average of the annual tax revenues deposited in all funds in the previous five fiscal years, as certified by the Auditor General.

I have examined Article VIII, Section 7 of the Constitution and the statutes referred to above, specimens of the Bonds, the Resolutions, and the other certificates delivered today at the Closing and such other matters and documents as I deemed necessary or appropriate.

I am of the opinion that:

1. Section 7 of Article VIII of the Constitution has been duly approved and adopted and has become part of the Constitution of Pennsylvania, and the statutes referred to above have been duly and properly enacted.
2. Pursuant to full and adequate legal power conferred upon them by the Constitution and the statutes referred to above, the Governor, the State Treasurer and the Auditor General have duly adopted the Resolutions and have validly taken all other necessary and proper action to issue and sell the Bonds, and the Bonds have been validly authorized, issued and sold pursuant to proper and appropriate action of such officials.

3. The Bonds are lawful, valid, direct and general obligations of the Commonwealth, and the full faith and credit of the Commonwealth is pledged for the payment of interest thereon as the same shall become due and for the payment of the principal thereof at maturity.

4. Under the provisions of Section 2901 of the Tax Reform Code of 1971, as amended, the Bonds and the interest thereon are exempt from taxation for state and local purposes within the Commonwealth, but this exemption does not extend to (a) gift, estate, succession or inheritance taxes or (b) any other taxes not levied or assessed directly on the Bonds or the interest thereon.

5. The Commonwealth has the power to provide for the payment of the principal of and interest on \$527,000,000.00 aggregate principal amount of the Bonds by levying unlimited ad valorem taxes upon all taxable property within the Commonwealth and excise taxes upon all taxable transactions within the Commonwealth, uniform on the same class of subjects, except gasoline and other motor fuel excise taxes, motor vehicle registration fees and license taxes, and operators' license fees and other excise taxes imposed on products used in motor transportation, and aviation fuel excise taxes, the proceeds of which are limited to certain special purposes by Section 11 of Article VIII of the Constitution.

6. The Commonwealth has the power to provide for the payment of the principal of and interest on \$18,000,000.00 aggregate principal amount of the Bonds being issued for bridge projects by levying unlimited ad valorem taxes upon all taxable property within the Commonwealth and excise taxes upon all taxable transactions within the Commonwealth, uniform on the same class of subjects, excluding aviation fuel excise taxes but including gasoline and other motor fuel excise taxes, and other excise taxes imposed on products used in motor transportation and by applying the motor vehicle registration fees, license taxes and operators' license fees to such payment.

7. If sufficient funds are not appropriated for timely payment of interest on and installments of principal of the Bonds, the Constitution requires the State Treasurer to set apart from the first revenues thereafter received applicable to the appropriate fund, a sum sufficient to pay such interest and installments of principal and to apply said sum to such purposes, and the State Treasurer may be required to set aside and apply such revenues at the suit of the holder of any of the Bonds.

Very truly yours,

Kathleen Kane
Attorney General

BELOW IS THE PROPOSED FORM OF OPINION OF BOND COUNSEL
EXPECTED TO BE DELIVERED IN CONNECTION WITH THE ISSUANCE
OF THE BONDS

May 15, 2014

RE: Commonwealth of Pennsylvania General Obligation Bonds,
\$545,000,000 First Series of 2014 and
\$289,945,000 First Refunding Series of 2014

TO THE PURCHASERS OF THE BONDS:

We have served as Bond Counsel to the Commonwealth of Pennsylvania (the "Commonwealth") in connection with the issuance of its \$545,000,000 General Obligation Bonds, First Series of 2014, and \$289,945,000 First Refunding Series of 2014 (the "Bonds"). The Bonds are issued under and pursuant to (i) Section 7 of Article VIII of the Constitution of the Commonwealth, (ii) the laws of the Commonwealth, including the Capital Facilities Debt Enabling Act, Act No. 1991-1, approved February 9, 1999, as amended (the "Act"), annual capital budget bills and various bond authorization bills enacted by the General Assembly, as amended, and (iii) bond resolutions adopted by the Governor, State Treasurer and Auditor General of the Commonwealth (collectively, the "Issuing Officials") on April 22, 2014 and April 29, 2014 (the "Resolutions"). Capitalized terms used herein but not defined shall have the meanings set forth in the Resolutions.

The Bonds are being issued by the Commonwealth (i) to finance capital projects consisting of public improvement projects for buildings and structures, transportation assistance projects, redevelopment assistance projects, bridge projects and public improvement projects for furniture and equipment, (ii) refunding of all or a portion of the following bonds; Second Series of 2003, First Series of 2004, Fourth Series of 2004, First Series of 2005, Second Series of 2005, First Series of 2006, First Series of 2007 A, First Series of 2007 B, Second Series of 2007 B and (iii) to pay the costs of issuance of the Bonds.

We have examined and relied on the proceedings relating to the authorization and issuance of the Bonds, including, among other things: (a) the Constitution of the Commonwealth, the Act and certain of the annual capital budget bills and bond authorization bills referenced above; (b) certified copies of the Resolutions; (c) an opinion of the Honorable Kathleen G. Kane, Attorney General of the Commonwealth; (d) certificates executed by the Commonwealth and its Loan and Transfer Agent for the Bonds as to the execution and authentication of the Bonds; (e) a certificate of the Auditor General of the Commonwealth regarding the Commonwealth's compliance with the debt limitation contained in Section 7(a)(4) of Article VIII of the Constitution; (f) various other certificates executed by the Commonwealth, including a certificate with regard to Sections 103 and 141 through 150 of the Internal Revenue Code of 1986, as amended (the "Code"); and (g) the Form 8038-G of the Commonwealth with respect to the Bonds. In rendering our opinion, we have assumed the accuracy of and not undertaken to verify the factual matters set forth in such certificates and other documents by independent investigation and have relied on the covenants, warranties and representations made by the Commonwealth in such certificates and in the Resolutions and other financing documents.

In addition, we have assumed the genuineness of all signatures, the authenticity of all documents submitted to us as originals, the conformity with originals of all documents submitted to us as copies and the authenticity of certificates of public officials.

From our examination of the foregoing and such other items as we deem relevant, we are of the opinion that:

1. The principal amount of the Bonds is within all applicable debt and other limitations fixed by the Constitution and the laws of the Commonwealth.

2. The Bonds have been duly authorized, executed and delivered by the Commonwealth pursuant to all necessary action of the Issuing Officials and constitute valid and binding general obligations of the Commonwealth, enforceable against the Commonwealth in accordance with the terms thereof, except as enforcement may be limited by laws relating to bankruptcy, insolvency, reorganization, arrangement, moratorium or similar laws affecting creditors' rights generally and subject to limitations on legal remedies against public entities in the Commonwealth, to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law) and to the exercise of judicial discretion.

3. The full faith and credit of the Commonwealth are pledged for the payment of the interest due on the Bonds and the principal thereof due at maturity. If sufficient funds are not appropriated for the timely payment of interest on and installments of principal of the Bonds, the Constitution requires the State Treasurer to set apart from the first revenues thereafter received applicable to the appropriate fund, a sum sufficient to pay such interest and installments of principal and to apply said sum to such purposes, and the State Treasurer may be required to set aside and apply such revenues at the suit of the holder of any of the Bonds.

4. Under existing laws of the Commonwealth, the interest on the Bonds is free from Pennsylvania personal income taxation and Pennsylvania corporate net income taxation, but such exemption does not extend to gift, estate, succession or inheritance taxes or any other taxes not levied or assessed directly on the Bonds or the interest thereon.

5. Interest (including accrued original issue discount) on the Bonds is not includable in gross income for purposes of federal income taxation under existing statutes, regulations, rulings and court decisions. The opinion set forth in the preceding sentence is subject to the condition that the Commonwealth complies with all applicable federal income tax law requirements that must be satisfied subsequent to the issuance of the Bonds in order that interest thereon continues to be excluded from gross income for purposes of federal income taxation. The Commonwealth has covenanted to comply with all such requirements. Failure to comply with all of such requirements could cause the interest on the Bonds to be includable in gross income retroactive to the date of issuance of the Bonds. Interest on the Bonds is not treated as an item of tax preference under Section 57 of the Code for purposes of the individual and corporate alternative minimum taxes; however, under the Code, to the extent that interest on the Bonds is a component of a corporate holder's "adjusted current earnings," a portion of that interest may be subject to the corporate alternative minimum tax. We express no opinion regarding other federal tax consequences relating to the Bonds or the receipt of interest thereon.

6. The Bonds are exempt from registration under the provisions of the Securities Act of 1933, as amended.

We express no opinion herein on the adequacy, completeness or accuracy of any official statement, placement memorandum or other disclosure document pertaining to the offering of the Bonds.

These opinions are rendered on the basis of federal law and the laws of the Commonwealth as enacted and construed on the date hereof.

This opinion is limited to the matters expressly stated herein. No implied opinions are to be inferred to extend this opinion beyond the matters expressly stated herein. This opinion is expressed as of

the date hereof. We do not assume any obligation to update or supplement this opinion to reflect, or otherwise advise you of, any facts or circumstances which may hereafter come to our attention or any changes in facts, circumstances or law which may hereafter occur. This opinion is rendered and may be relied upon solely in connection with the transactions contemplated hereby and may not be relied upon for any other purpose.

Very truly yours,