NEW ISSUE - BOOK-ENTRY ONLY

Ratings: Moody's: Aa2
Standard & Poor's: AA
Fitch: AA

In the opinion of Bond Counsel, under existing law and assuming continuing compliance by the Commonwealth with the requirements of the Internal Revenue Code of 1986, as amended, and the regulations thereunder, that relate to the Bonds, the interest on the Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. However, for the purpose of computing the alternative minimum tax imposed on certain corporations (as defined for federal income tax purposes), interest on the Bonds is taken into account in determining adjusted current earnings. Bond Counsel is also of the opinion that, under existing law, interest on the Bonds is exempt from Pennsylvania personal income tax and from Pennsylvania corporate net income tax, and the Bonds are exempt from personal property taxes in Pennsylvania. See "TAX MATTERS" herein.

$373,000,000
Commonwealth of Pennsylvania
General Obligation Bonds
First Series A and B of 2007

Dated: Date of Issuance and Delivery **Due: November 1, as shown on inside cover**

The Bonds 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 May 1 and November 1, commencing May 1, 2008. U.S. Bank, National Association, Pittsburgh, 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 Bonds are subject to redemption as set forth herein. See "THE BONDS – Optional Redemption" And "THE BONDS – Extraordinary Redemption" herein.

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.

CIFG
TRIPLE-A FINANCIAL GUARANTY

The scheduled payment of principal of and interest on the Series B of 2007 Bonds maturing on November 1 of the years 2008-2027 (the "Insured Bonds" as indicated by an "*" in the table on the following page), when due, will be guaranteed under an insurance policy to be issued concurrently with the delivery of the Insured Bonds by CIFG Assurance North America, Inc.. See Appendix I herein titled "THE CIFG ASSURANCE NORTH AMERICA INSURANCE POLICY."

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.

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 Reed Smith LLP, Philadelphia, Pennsylvania, Bond Counsel. The Commonwealth expects that the Bonds will be available in definitive form for delivery in New York, New York, on or about June 7, 2007

Dated: May 22, 2007

$373,000,000
Commonwealth of Pennsylvania
General Obligation Bonds
First Series A and B of 2007
$346,000,000 Series A
$27,000,000 Series B

MATURITY SCHEDULE
(Base CUSIP Number: 70914P)

Due November 1	Series A Principal Amount	Interest Rate	Yield or Price	CUSIP Number	Due November 1	Series B Principal Amount	Interest Rate	Yield or Price	CUSIP Number
2008	$10,625,000	5.000%	3.700%	AA0	2008	$805,000*	3.500%	3.720%	AW2
2009	11,170,000	5.000	3.720	AB8	2009	845,000*	3.500	3.740	AX0
2010	11,745,000	5.000	3.730	AC6	2010	890,000*	3.750	3.750	AY8
2011	12,345,000	5.000	3.740	AD4	2011	935,000*	3.750	3.760	AZ5
2012	12,975,000	5.000	3.780	AE2	2012	985,000*	3.750	3.780	BA9
2013	13,645,000	5.000	3.810	AF9	2013	1,035,000*	3.750	3.810	BB7
2014	14,345,000	5.000	3.830	AG7	2014	1,085,000*	3.750	3.830	BC5
2015	15,080,000	5.000	3.860	AH5	2015	1,145,000*	3.750	3.860	BD3
2016	15,850,000	5.000	3.890	AJ1	2016	1,200,000*	3.750	3.890	BE1
2017	15,960,000	5.000	3.930	AK8	2017	1,265,000*	3.750	3.927	BF8
2018	16,775,000	5.000	3.980	AL6	2018	1,330,000*	4.000	4.000	BG6
2019	17,635,000	5.000	4.020	AM4	2019	1,395,000*	4.000	4.100	BH4
2020	18,540,000	5.000	4.060	AN2	2020	1,470,000*	4.000	4.147	BJ0
2021	19,490,000	4.500	4.330	AP7	2021	1,545,000*	4.125	4.265	BK7
2022	20,490,000	4.500	4.380	AQ5	2022	1,620,000*	4.125	4.258	BL5
2023	21,540,000	5.000	4.160	AR3	2023	1,705,000*	4.250	4.379	BM3
2024	22,645,000	5.000	4.180	AS1	2024	1,795,000*	4.250	4.374	BN1
2025	23,805,000	5.000	4.200	AT9	2025	1,885,000*	4.250	4.369	BP6
2026	25,030,000	4.500	4.480	AU6	2026	1,980,000*	4.375	4.470	BQ4
2027	26,310,000	4.750	4.390	AV4	2027	2,085,000*	4.375	4.480	BR2

The interest rates shown above are the interest rates per annum payable by the Commonwealth on the Bonds of each maturity date as indicated. The yields shown above for each maturity were furnished to the Commonwealth by the group of banks and investment banking firms who purchased the Bonds from the Commonwealth on May 22, 2007, and may not reflect the current market prices of the Bonds. All information concerning the re-offering of the Bonds should be obtained from the underwriters and not from the Commonwealth.

"*" indicates Insured Bonds (See Appendix I)

THE ISSUING OFFICIALS

Governor .... *EDWARD G. RENDELL*
State Treasurer .... *ROBIN L. WIESSMANN*
Auditor General .... *JACK WAGNER*

OFFICE OF THE BUDGET

Secretary .... *MICHAEL J. MASCH*

Attorney General of the Commonwealth of Pennsylvania:

Tom Corbett

Bond Counsel:

Reed Smith LLP
Philadelphia, Pennsylvania

Special Disclosure Counsel:

Hunton & Williams LLP
Richmond, Virginia

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 .... $373,000,000 Commonwealth of Pennsylvania, General Obligation Bonds, First Series A and B of 2007 (the "Bonds"), consisting of $346,000,000 First Series A of 2007 (the "Series A Bonds") and $27,000,000 First Series B of 2007 (the "Series B 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:

Purpose	**Principal Amount**
Series A	
Capital Facilities Projects	$290,000,000
Pennworks Projects (Grants)	56,000,000
Series B	
Pennvest Projects (Loans)	$15,000,000
Pennworks Projects (Loans)	12,000,000

Optional Redemption .... The Bonds maturing on or after November 1, 2018 are subject to optional redemption in whole or in part at any time on and after November 1, 2017 at a redemption price equal to the principal amount thereof, plus accrued interest to the date fixed for redemption.

Extraordinary Redemption ... The Series B Bonds are subject to extraordinary redemption at the direction of the Commonwealth, at the respective redemption prices hereinafter specified, (a) in part, in an aggregate principal amount not in excess of $8,500,000, on September 1, 2008, and (b) in whole or in part, on September 1, 2010, but in any such case only if and to the extent the Commonwealth determines that such redemption is required under Section 149(f) of the Internal Revenue Code of 1986, as amended (the "Code"), in order to maintain the status of the Bonds as obligations the interest on which is excludable from the gross income of the owners thereof for federal income tax purposes. The redemption price for Bonds to be redeemed under this provision on September 1, 2008 shall be 106% of the principal amount of the Bonds to be redeemed, plus accrued interest to the redemption date. The redemption price for Bonds to be redeemed under this provision on September 1, 2010 shall be 104% of the principal amount of the Bonds to be redeemed, plus accrued interest to the redemption date.

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 .... U.S. Bank, National Association, Pittsburgh, Pennsylvania.

Legal Opinions .... Reed Smith LLP, Bond Counsel.
Tom Corbett, Attorney General of the Commonwealth of Pennsylvania.

Bond Ratings .... Moody's Investors Service Aa2
Standard & Poor's Rating Services, a division of the McGraw-Hill Companies....................AA
Fitch Ratings..AA

Official Statement

$373,000,000
Commonwealth of Pennsylvania
General Obligation Bonds

First Series A and B of 2007

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 $373,000,000 aggregate principal amount of the Commonwealth's General Obligation Bonds, First Series A and B of 2007 (the "Bonds"). The Bonds are being issued to finance various Commonwealth capital projects and environmental improvement programs. See "USE OF PROCEEDS." A summary of the purposes for which the Bonds are to be issued with their principal amounts and maturities is:

<u>**Purpose**</u>	<u>**Amount**</u>
Series A	
Capital Facilities Projects	$290,000,000
Pennworks Projects (Grants)	56,000,000
Series B	
Pennvest Projects (Loans)	$15,000,000
Pennworks Projects (Loans)	12,000,000

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 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 provisions of such documents and to any judicial interpretations thereof.

THE BONDS

Description of the Bonds

The 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 cover page hereof, will be payable semi-annually on each May 1 and

November 1, commencing May 1, 2008, 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 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 Bond. Copies of the Resolutions, including the full text of the form of the Bonds, are on file at the designated office of U.S. Bank, National Association, as Loan and Transfer Agent ("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 the fifteenth day (whether or not a business day) of the calendar month next preceding each interest payment date (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 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 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 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 (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

Series A Bonds maturing in the years 2008 to 2017, inclusive, are not subject to redemption. The Series A Bonds, or portions thereof in integral multiples of $5,000, maturing on and after November 1, 2018, are subject to redemption at the option of the Commonwealth prior to scheduled maturity on or after November 1, 2017, as a whole or in part 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.

The Series B Bonds, or portions thereof, in integral multiples of $5,000 maturing on and after November 1, 2018, are subject to redemption at the option of the Commonwealth prior to scheduled maturity on and after November 1, 2017, as a whole or in part at any time and from time to time, in any order of maturity and by lot within a maturity in such a manner as the Commonwealth in its discretion may determine, on notice of at least 30 days (but not more than 60 days), at a redemption price equal to par (100%) plus accrued interest thereon to the date fixed for redemption.

Extraordinary Redemption

The Series B Bonds are subject to extraordinary redemption at the direction of the Commonwealth, at the respective redemption prices hereinafter specified, (a) in part, in an aggregate principal amount not in excess of $8,500,000.00, on September 1, 2008, and (b) in whole or in part, on September 1, 2010, but in any such case only if and to the extent the Commonwealth determines that such redemption is required under Section 149(f) of the Internal Revenue Code of 1986, as amended (the "Code"), in order to maintain the status of the Series B Bonds as obligations the interest on which is excludable from the gross income of the owners thereof for federal income tax purposes. Any such redemption in part shall be in integral multiples of $5,000, and the Series B Bonds or portions thereof to be redeemed shall be selected on a pro rata basis from among each maturity of the Series B Bonds and from within a maturity as selected by lot, unless the Commonwealth determines that another method of selection of Series B Bonds for redemption is required in order to achieve compliance with such section of the Code, in which event the Commonwealth reserves the right to select Series B Bonds for redemption from among such maturities and in such principal amounts per maturity as it may determine in its discretion, and from within a maturity as selected by lot. Any such extraordinary redemption shall be upon notice of at least 30 days, and not more than 60 days, prior notice. The redemption price for Series B Bonds to be redeemed under this provision on September 1, 2008 shall be 106% of the principal amount of the Series B Bonds to be redeemed, plus accrued interest to the redemption date. The redemption price for Series B Bonds to be redeemed under this provision on September 1, 2010 shall be 104% of the principal amount of the Series B Bonds to be redeemed, plus accrued interest to the redemption date.

Notice of Redemption

As long as the 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 Bonds. So long as Cede & Co. is the registered owner of the 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 Bonds to be redeemed are registered at the close of business on the fifth (5^{th}) 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 Bonds, or portions thereof, called for redemption shall accrue after the date fixed for redemption, and the registered holders of the 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 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 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 in Appendix F and the proposed form of the opinion of Bond Counsel is in Appendix G.

Authorization

The Bonds are authorized and issued pursuant to and in full compliance with the provisions, restrictions and limitations of Sections 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, including but not limited to: the Pennsylvania Infrastructure Investment Authority Act, Act No. 1988-16, approved March 1, 1988 (the “1988 Pennvest Act”); the Small Water Systems Assistance Act, Act No.1992-5, approved March 16, 1992 (the “1992 Pennvest Act” and collectively with the 1988 Pennvest Act, the “Pennvest Acts”); constitutional referendum questions approved by the voters of the Commonwealth on April 26, 1988 (the “1988 Referendum”) and April 28, 1992 (the “1992 Referendum” and collectively with the 1988 Referendum, the “Pennvest Referenda”); Act No. 2004-218, approved November 30, 2004 (the “Pennworks Act”); the Water and Wastewater Treatment Project Bond Act, Act No. 2004-10, approved February 12, 2004 (the “Water and Wastewater Treatment Project Bond Act” and collectively with the Pennworks Act, the “Pennworks Acts”); and a constitutional referendum question approved by the voters of the Commonwealth on April 27, 2004 (the “Pennworks Referendum”); as well as additional bond authorization bills referenced in the Resolutions; defined hereafter. 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 May 11, 2007, and May 22, 2007 (collectively, the “Resolutions”).

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) 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 on the following page:

Table 1
Constitutional Debt Limit[(a)]
February 28, 2007
(In Millions)

Average Annual Tax Revenues Fiscal 2001-2006	$ 27,536.5
Times 1.75	48,188.9
Less: Net Debt Outstanding[(b)]	6,708.2
Debt Issuable Within Limit	$ 41,480.7

[(a)] As certified by the Auditor General on February 28, 2007 (Appendix A).
[(b)] After credit for refunded debt.

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

Table 2
Aggregate Capital Debt Authorization
(In Millions)

Capital Facilities Projects Category	Debt Authorized	Issued[(a)]	Authorized But Unissued	Pro Forma Remaining Debt Authorized After Issuance Of the Bonds
Buildings and Structures	$ 21,607.3	$ 7,231.5	$ 14,375.8	$ 14,257.9
Furniture and Equipment	875.8	381.5	494.3	489.3
Transportation Assistance	8,575.1	2,572.8	6,002.3	6,002.3
Redevelopment Assistance	21,489.4	2,032.0	19,457.4	19,290.4
Community Colleges	35.8	28.0	7.8	7.8
Highway and Highway Bridge	17,931.0	2,012.5	15,918.5	15,918.5
Advance Construction Interstate	450.0	450.0	0	0
Flood Control	379.9	53.8	326.2	326.2
Site Development	150.0	150.0	0	0
Total	$ $71,494.5	$ 14,912.1	$ 56,582.4	$ 56,292.3

[(a)] Not all are 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 fiscal year 2007 capital budget provides that such budget will be in effect until the fiscal year 2008 capital budget is enacted. The maximum amount of debt currently authorized by the fiscal year 2007 capital budget is as shown in Table 3 on the following page.

Table 3
Fiscal Year 2007 Capital Budget Debt Limits[a]
(In Millions)

Capital Facilities Projects Category	Limits	Issued to Date	Remaining Issuable Within Limit	Pro Forma Remaining After Issuance Of the Bonds
Buildings and Structures	$ 445.0	$ 300.0	$ 145.0	$ 27.0
Furniture and Equipment	5.0	0.0	5.0	0.0
Transportation Assistance	155.0	75.0	80.0	80.0
Redevelopment Assistance	400.0	233.0	167.0	0.0
Flood Control	10.0	0.0	10.0	10.0
Total	$ 1,015.0	$ 608.0	$ 407.0	$ 117.0

[a] The fiscal year 2007 capital budget debt limits became effective on November 22, 2006, and will remain in force until the fiscal year 2008 capital budget debt limit becomes effective.

Upon issuance of $290.0 million aggregate principal amount of the Bonds under the Capital Budget, $117.0 million principal amount of debt will remain authorized and unissued thereunder.

The 1988 Referendum and the 1988 Pennvest Act authorized the issuance of $300.0 million aggregate principal amount of debt, all of which has heretofore been issued, for the purpose of making loans for water supply, storm water control and sewage treatment systems. See “USE OF PROCEEDS - Pennvest Loans.” The 1992 Referendum and the 1992 Pennvest Act authorized the issuance of $350.0 million aggregate principal amount of debt for the purpose of making loans for water supply, storm water control and sewage treatment systems. See “USE OF PROCEEDS - Pennvest Loans.” To date, $183.0 million principal amount of bonds has been issued pursuant to the authority of the 1992 Referendum and the 1992 Pennvest Act. Upon the issuance of $15.0 million of the Bonds pursuant to the 1992 Referendum and the 1992 Pennvest Act, $152.0 million principal amount of debt will remain authorized and unissued thereunder.

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, $65.0 million principal amount of bonds have been issued pursuant to the authority of the Pennworks Acts. Upon the issuance of $68.0 million of the Bonds pursuant to the Pennworks Act, $117.0 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) $290,000,000 of the Series A Bonds will be used to provide for the construction, acquisition and major rehabilitation of capital facilities projects as described below under “Capital Facilities.”;

(ii) $56,000,000 of the Series A Bonds will be used to provide for Pennworks Acts grants described below under “Pennworks Acts.”

(iii) $15,000,000 of the Series B Bonds will be used to provide for Pennvest loans as described below under “Pennvest Loans.”;

(iii) $12,000,000 of the Series B Bonds will be used to provide for Pennworks Acts loans described below under “Pennworks Acts.”

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

Capital Facilities

Of the $346,000,000 aggregate principal amount of the Series A Bonds issued, $290.0 million will be deposited into the Capital Facilities Fund and applied to defray the costs of issuance of the Series A Bonds and the financial costs of various capital facilities projects of the Commonwealth. Of the $290,000,000 aggregate principal amount of the Series A Bonds issued for capital facilities: (i) $118,000,000 aggregate principal amount of the Series A Bonds is to 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) $167,000,000 aggregate principal amount of the Series A Bonds is to be allocated to the Department of Community and Economic Development to fund redevelopment assistance projects; and (iii) $5,000,000 aggregate principal amount of the Series A Bonds is to be allocated to the Department of General Service to purchase furniture and equipment for Commonwealth buildings. Pending application to the above purposes, the proceeds of the Series A 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 Series A Bonds is dedicated to the purposes of the Pennworks Act and to pay the costs of issuance of the Series A Bonds allocated to such purposes. The proceeds from $56.0 million aggregate principal amount of the Series A Bonds to be issued for the Pennworks Act will be deposited into the Water Supply and Wastewater Treatment Fund 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 Series A 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.

Pennvest Projects (Loans)

A portion of the proceeds of the Series B Bonds is dedicated to the purposes of the Pennvest Acts for loans to local governments and authorities to acquire, repair, construct, reconstruct, rehabilitate, extend and improve water supply, storm water control and sewage treatment systems and to pay the costs of issuance of the Series B Bonds allocated to such purposes. The proceeds of $15.0 million aggregate principal amount of the Series B Bonds issued under the authority of the Pennvest Acts shall be paid into the special funds established in the State Treasury for the purposes of the Pennvest Acts in such amounts as may be specified by the Board of the Pennsylvania Infrastructure Investment Authority (the “Pennvest Authority”). The Pennvest Acts provide a program for financing drinking water and sewage treatment facilities in Pennsylvania to protect public health, to maintain environmental quality and to promote economic development. The Pennvest Authority also administers the Commonwealth’s water pollution control revolving fund for the purpose of the federal Water Quality Act of 1987. Initial capital for the Pennvest Authority was provided from $650 million of general obligation debt authorized by the Commonwealth’s voters through the Pennvest Referenda, $150 million of capital budget authorization, and the remaining $166 million of debt authorization from the Water Facilities Restoration Act, Act No. 1981-88, approved July 12, 1981 and a 1981 referendum that was reallocated to the Pennvest Authority in March 1988. Pending application to the above purposes, the proceeds of the Series B Bonds allocated to these purposes will be held by the State Treasurer in the Pennvest Bond Fund and invested in accordance with applicable state and federal laws.

Pennworks Projects (Loans)

A portion of the proceeds of the Series B Bonds is dedicated to the purposes of the Pennworks Act and to pay the costs of issuance of the Series B Bonds allocated to such purposes. The proceeds from $12.0 million aggregate principal amount of the Series B Bonds to be issued for the Pennworks Act will be deposited into the Water Supply and Wastewater Treatment Fund and applied to defray the financial costs to making loans to local governments and authorities and certain private organizations 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 Series B 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.

COMMONWEALTH GOVERNMENT

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

Name	Office	Term Expires
Edward G. Rendell	Governor	January 18, 2011
Catherine Baker Knoll	Lieutenant Governor	January 18, 2011
Tom Corbett	Attorney General	January 20, 2009
Robin L. Wiessmann*	State Treasurer	January 20, 2009
Jack Wagner	Auditor General	January 20, 2009

* Replacement appointed by the Governor and confirmed by the Pennsylvania Senate on April 30, 2007.

Commonwealth Employees

Employees are permitted to organize and bargain collectively. As of July 2007, 82 percent of the full-time salaried employees under the Governor's jurisdiction were covered by collective bargaining agreements or memoranda of understanding. Approximately 45 percent of state employees are represented by the American Federation of State, County and Municipal Employees ("AFSCME"). Approximately 72.5 percent of state employees, represented by the AFSCME, Pennsylvania Social Services Union and other unions, are covered by contracts effective July 1, 2007 and expiring on June 30, 2011. These contracts provide for a $1,250.00 one-time cash bonus payment, which is equivalent to approximately 2.8 percent in the first year of the contract, and ten percent salary increases over the last three-year life of the contracts. Interest arbitration awards cover five other unions. Three of the awards expire June 30, 2007. The other two awards expire June 30, 2008 and provide, respectively, a 14 percent increase over their four year life, and a 10 percent increase over a three year term. Table 4 presents the number of approved and filled positions under the Governor's jurisdiction for the period 2002 through 2006.

Negotiations have begun for the collective bargaining agreements which are set to expire on June 30, 2007.

Table 4
Filled Salaried Positions and Employees
Under the Governor's Jurisdiction[(a)]
2002-2006

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
2002	80,146	79,665	56,296	70.2
2003	78,691	78,691	54,817	69.7
2004	76,410	76,087	52,869	69.5
2005	77,041	76,726	53,163	69.0
2006	78,733	78,366	54,428	69.1

[(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, *Governor's Annual Work Force Reports*.

COMMONWEALTH FINANCIAL STRUCTURE AND PROCEDURES

The 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 2007 refers to the fiscal year ended June 30, 2007.) 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 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 Tax Stabilization Reserve Fund and the Budget Stabilization Reserve Fund that replaced the Tax Stabilization Reserve Fund following its abolishment in 2002 are special revenue funds designated to receive a statutorily determined portion of the budgetary basis fiscal year-end surplus of the General 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 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 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 lottery ticket sales and lottery licenses and fees. Its revenues, after payment of prizes, 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 revenue unrealized; 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 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, 2006, have been filed with each Nationally Recognized Municipal Information Repository (a "NRMSIR") currently recognized by the Securities and Exchange Commission and are available from any NRMSIR 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. In February 2004, the Commonwealth restated its GAAP basis financial statements for the fiscal year ended June 30, 2002, for reasons discussed in "COMMONWEALTH FINANCIAL PERFORMANCE – Restatement of Financial Statements." The Commonwealth has filed both the restated financials and restated CAFR with each NRMSIR and has posted them at the Office of the Budget's web site. **Beginning with the CAFR for the fiscal year ended June 30, 2002 and continuing in subsequent CAFRs, the Commonwealth has incorporated several new accounting and reporting standards that affect the comparability of financial information for those fiscal years to GAAP basis financial information reported for fiscal years prior to the adoption of the new standards. See "New Governmental Accounting and Reporting Standards" below.**

New Governmental Accounting and Reporting Standards

Beginning with its GAAP basis financial statements for the fiscal year ended June 30, 2002, the Commonwealth adopted several new accounting and reporting standards established by the Governmental Accounting Standards Board in its Statements 33, 34, 35, 36, 37 and 38 (collectively, the "New Standards"). Among other things, these New Standards require presentation of government-wide and fund financial statements that constitute basic financial statements and replace general-purpose financial statements reported under former standards. Government-wide financial statements are intended to portray the government "as a whole" while fund financial statements provide fund-specific information. Government-wide financial statements are intended to describe the total cost of providing governmental services and disclose whether the Commonwealth's financial condition improved or weakened during the fiscal year. Other features of the new government-wide financial statements are the reporting of infrastructure assets and related depreciation. Previously, the Commonwealth did not report infrastructure values or accumulated depreciation related to general fixed assets. As part of implementing the New Standards, effective July 1, 2001, the Commonwealth reclassified and/or restated numerous fund balance amounts previously reported at June 30, 2001 and reported governmental activities net assets at June 30, 2001. Note B to the financial statements in the June 30, 2002 CAFR provides a detailed explanation of the nature and amount of such restatements. The New Standards also require providing supplementary information, including a Management's Discussion and Analysis of the financial statements. Beginning with fiscal year 2002 the Commonwealth also changed how functional expenditure categories are defined. All of these changes may hamper the comparability of GAAP basis financial information for fiscal years ended June 30, 2002 and later to financial reports for years prior to the implementation of the New Standards.

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 periodic 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 six-person 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 with obligations described under (i); (v) banker's acceptances written by domestic commercial banks with a rating of "Aa" or better, or its equivalent; and (vi) other non-equity investments subject to a "prudent investor" test not to exceed ten percent of assets. 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.

Additionally, in June 1999, legislation authorized the State Treasurer to invest Commonwealth moneys in equity securities under a prudent person standard. 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 equity securities. The legislative authorization to invest in equity securities has been extended until December 2008.

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 billion 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 for deposit to the 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.

Balances in the Budget Stabilization Reserve Fund, the successor to the Tax Stabilization Reserve Fund, may be used to alleviate emergencies threatening the health, safety or welfare of the Commonwealth's citizens or to offset unanticipated revenue shortfalls due to economic downturns. Income to the fund is provided by the transfer of a legislatively determined portion of the General Fund budgetary basis unappropriated surplus at the close of a fiscal year, by investment income to the fund, and by specific appropriation from other available funds by the General Assembly. The Budget Stabilization Reserve Fund is intended to accumulate a balance equal to 6 percent of General Fund revenues. Beginning with fiscal year 2003, 25 percent of any fiscal year-end surplus is to be deposited into the Budget Stabilization Reserve Fund. When the Budget Stabilization Reserve Fund balance reaches or exceeds a level equal to 6 percent of General Fund revenues, the proportion of the General Fund's fiscal year-end balance to be transferred to the Budget Stabilization Reserve Fund is to be lowered from 25 percent to 10 percent. The General Assembly may appropriate additional amounts to this fund at any time. At the end of the 2005 fiscal year, the Commonwealth's unappropriated surplus balance was $429.2 million and a one-time reduction in the transfer rate from 25 percent to 15 percent resulted in a statutorily required transfer of nearly $64.4 million to the Budget Stabilization Reserve Fund. For fiscal year 2006, $171.4 million has been transferred to the Fund, which represents the required statutory transfer of 25 percent of the $685.4 million unappropriated surplus balance. At present, the Commonwealth maintains a balance of approximately $531.8 million in the Budget Stabilization Reserve Fund. Further, as of April 2007, the Commonwealth maintains balances in various funds and accounts, including the Budget Stabilization Reserve Fund, totaling approximately 6.0 percent of the Commonwealth's annual operating costs. See data contained in Table 8 for additional information. These additional funds may become available through either executive or legislative action to address unforeseen budgetary stresses that could occur. 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. However, Act 66 of 2006, provided the Secretary of the Budget with the option to transfer up to $290 million from the Budget Stabilization Reserve Fund to the operating budget to cover certain state appropriations related to health care costs within the Department of Public Welfare. Such a transfer could be authorized by the Secretary of the Budget if sufficient funds to cover said health care costs were not sufficiently appropriated as part of the fiscal year 2007 budget. The Budget Secretary has not authorized a transfer from the Budget Stabilization Reserve Fund under the provisions of Act 66 of 2006 nor is he compelled to do so. 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 6, 2007, the Governor submitted to the General Assembly his proposed fiscal year 2008 budget. See "Fiscal Year 2008 Proposed Budget."

The CAFR for the fiscal year ended June 30, 2006 was issued on December 22, 2006. The CAFR, beginning with the one issued for the fiscal year ended June 30, 2002, incorporates several new accounting and reporting standards that affect the comparability of financial information for that fiscal year and subsequent fiscal years to GAAP basis financial information reported for fiscal years prior to the adoption of the new standards. Also beginning with the fiscal year ended June 30, 2002, the CAFR provides a new presentation of government-wide financial statements that are intended to provide an all-encompassing view of a government's financial condition and activities. See the discussion in "COMMONWEALTH FINANCIAL STRUCTURE AND PROCEDURES – New Governmental Accounting and Reporting Standards" and below in "Government-Wide Financial Data (GAAP Basis)."

The current economic expansion has been moderating significantly at both the national and state levels over the past year. Growth, however, continues to increase the revenue receipts to the Commonwealth. General Fund revenue estimates incorporated in the enacted budget for fiscal year 2007 included a projected growth in receipts of 3.7

percent, while actual receipts through April 2007 have grown by 5.5 percent on a year-over-year basis. In February 2007, the Governor's proposed budget for fiscal year 2008 included a slight upward revision of $66 million or 0.2 percent to the fiscal year 2007 General Fund revenue estimate to reflect the moderating national and state economies. Actual revenues through April 2007 are $207.8 million or 0.9 percent above the estimate enacted in July 2006, as part of the fiscal year 2007 budget. Based on projections of revenues, as incorporated in the Governor's proposed fiscal year 2008 budget released in February, the General Fund is currently projected to have a preliminary ending balance of nearly $50.0 million. See "Fiscal Year 2007 Budget."

Introduction

The most recent audited financial statements for a fiscal year are available in the CAFR issued by the Commonwealth for the fiscal period ended June 30, 2006 ("fiscal year 2006"), which was filed with each NRMSIR in February 2007. Beginning with the CAFR for fiscal year 2002, the Commonwealth incorporated New Standards that affect the comparability of financial information for that fiscal year to GAAP basis financial information reported for fiscal years prior to the adoption of the New Standards. See "COMMONWEALTH FINANCIAL STRUCTURE AND PROCEDURES - New Governmental Accounting And Reporting Standards." Information contained in the fund financial statements for fiscal years 2002 through 2006 continue to report what was formerly reported for governmental funds in the General Purpose Financial Statements in CAFRs for prior fiscal years, although fund reclassifications and changed definitions for categories of expenditures for fiscal year 2002 and beyond will hamper comparability to data for prior fiscal years.

Copies of CAFRs recently issued by the Commonwealth are available from (i) any NRMSIR listed in the section "CONTINUING DISCLOSURE", (ii) the Secretary of the Budget, Mr. Michael Masch, Attn: Mr. Mike Higgins, 6th Floor, Strawberry Square Bell Tower, Harrisburg, Pennsylvania 17101 (Telephone (717) 787-5312), and (iii) the Budget & 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 2006 are incorporated herein by the above reference as to their availability by other than in this Official Statement. 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 results in assets including 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, on the following page, presents condensed financial statement information derived from the Commonwealth's government-wide June 30, 2006 Statement of Net Assets and includes amounts for the "primary government" only.

Table 5
Condensed Statement of Net Assets
Primary Government
Fiscal Year Ended June 30, 2006
(In Billions)

	Governmental Activities	Business-Type Activities	Total
Assets:			
Cash and investments	$ 11.1	$ 6.2	$ 17.3
Capital assets (net)	22.8	-	22.8
All other assets	6.1	1.4	7.5
Total Assets	$ 40.0	$ 7.6	$ 47.6
Liabilities:			
Accounts payable	$ 4.1	$ 0.5	$ 4.6
All other current liabilities	4.0	1.4	5.4
Total Current Liabilities	8.1	1.9	10.0
Bonds payable	7.1	-	7.1
All other long-term liabilities	2.2	2.4	4.6
Total long-term liabilities	9.3	2.4	11.7
Total liabilities	$ 17.4	$ 4.3	$ 21.7
Net assets:			
Invested in capital assets, net of related debt	$ 19.1	-	$ 19.1
Restricted	3.9	$ 3.3	7.2
Unrestricted	(0.4)	-	(0.4)
Total Net Assets	$ 22.6	$ 3.3	$ 25.9

Source: Comprehensive Annual Financial Report, fiscal year ended June 30, 2006.

During the fiscal year ended June 30, 2006, the overall financial position (net assets) of the Commonwealth, including both governmental and business-type activities, increased by $2.5 billion or nearly 10.7 percent of total beginning net assets of $23.4 billion. For governmental activities, the net increase in net assets was $1.8 billion or 8.6 percent of beginning net assets of $20.8 billion. Total investments, excluding the State Employees' Retirement Fund and all other fiduciary funds, totaled over $15.6 billion and total cash balances were over $1.6 billion. These amounts represent considerable liquidity for the current and future fiscal years. The increase in governmental activities net assets ($1.8 billion) significantly exceeded the prior year change, where revenues, transfers and special items exceeded expenses by $1.1 billion. These increases represent year-over-year improvements in the Commonwealth's overall financial position, during the two fiscal years ended June 30, 2006 and 2005. The $0.7 billion increase in total net assets for business-type activities follows a $0.5 billion increase during the prior fiscal year. This $0.2 billion improvement is primarily attributable to a net assets increase of $0.5 billion in the unemployment compensation program, where the prior year net assets increase was $0.3 billion. During the current fiscal year, unemployment compensation revenues and expenses increased; in the prior year revenues increased and expenses decreased by a large amount. Statutory contribution increases occurred during each of the fiscal years. Such increases are intended to eliminate or avoid net assets decreases in the unemployment compensation program. During the fiscal year ended June 30, 2006, aggregate increases in net assets of the State Workers' Insurance Fund, the State Lottery Fund and the Tuition Payment Fund amounted to over $190 million, after net transfers to other Funds.

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, the Motor License Fund and the Tobacco Settlement Fund are major governmental funds) as of June 30, 2006 were $17,150.93 million. Liabilities for the same date totaled $9,501.05 million, leaving a fund balance of $7,649.9 million, an increase of $667.89 million from the fund balance at June 30, 2005. On a fund specific basis, the fund balance for the General Fund increased by $537.14 million, the fund balance for the Motor License Fund increased by $255.88 million, the fund balance for the Tobacco Settlement Fund increased by $168.85 million and the fund balance for aggregated non-major funds increased by $204.97 million. See "General Fund – Fiscal Year 2006 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
Govermental Funds (Fund Perspective) to
the Statement of Net Assets - Governmental Activities
June 30, 2006
(In Thousands)

Fund Balances - Governmental Funds		
General Fund	$	2,969.5
Motor License Fund		1,549.1
Tobacco Settlement Fund		1,095.3
Nonmajor Funds		2,036.0
Total Fund Balance - Governmental Funds	$	7,649.9
Plus: Capital Assets, including infrastructure		34,390.2
Less: Accumulated depreciation		(11,659.8)
Plus: Deferred revenue		2,064.6
Plus: Additional accrued receivables		212.2
Plus: Net assets of internal service funds		108.7
Plus: Inventories		88.0
Less: Long-term liabilities		(10,261.8)
Total Net Assets - Governmental Activities	$	22,592.0

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 estimates for fiscal year 2007 and the proposed budget for fiscal year 2008 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 2002 through fiscal year 2006, total revenues and other sources increased by an average of 6.3 percent annually. Tax revenues during this same period increased by an annual average of 7.4 percent with a portion of the average annual growth rate attributable to various tax rate and base changes enacted over the same period. 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 2002 through 2006 rose at an average annual rate of 4.9 percent. Comparison of expenditures by individual category in fiscal years 2002 through 2006 to prior fiscal years is not reliable due to a change to the definitions for these expenditure categories in fiscal year 2002.

The fund balance at June 30, 2006 totaled $2,969.5 million, an increase of $100.4 million from the balance at June 30, 2005. The fiscal year 2006 year-end unreserved-undesignated portion of the fund balance was $789.9 million, $137.3 million below the amount recorded for fiscal year 2005 at years end.

Table 7 on the next page presents a summary of revenues and expenditures (GAAP basis for the General Fund, including the Budget Stabilization Reserve Fund that replaced the Tax Stabilization Reserve Fund) for the fiscal years 2002 through 2006.

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

	Fiscal Year Ended June 30				
	2002(a)	**2003**	**2004**	**2005**	**2006**
Fund Balance — Beginning of Period	$ 4,484,995	$ 3,022,842	$ 2,357,713	$ 3,006,514	$ 2,869,109
Restatements	159,919	-	-	-	-
Fund Balance — Beginning of Period, as Restated	$ 4,644,914	$ 3,022,842	$ 2,357,713	$ 3,006,514	$ 2,869,109
Revenues:					
Taxes	$ 18,649,928	$ 19,553,998	$ 21,190,494	$ 22,841,136	$ 24,783,040
Licenses and fees	201,388	250,264	275,898	300,450	294,728
Intergovernmental	11,652,199	12,943,624	14,790,701	15,102,454	14,662,940
Other revenues	2,539,271	2,313,183	2,423,649	4,053,837	2,970,801
Other Financing Sources:					
Operating transfers in	213,419	425,875	133,670	62,912	88,930
Transfer from component unit	256,206	-	-	-	-
Other additions	4,428	3,851	1,535	640	568
TOTAL REVENUES AND OTHER SOURCES	$ 33,516,839	$ 35,490,795	$ 38,815,947	$ 42,361,429	$ 42,801,007
Expenditures: (b)					
Direction and supportive services	$ 910,399	$ 854,434	$ 1,412,250	$ 2,047,999	$ 2,062,113
Protection of persons and property	3,104,079	2,941,339	2,958,160	3,013,875	3,278,962
Health and human services	18,221,987	19,549,141	20,816,721	23,361,454	23,135,166
Public education	8,813,198	10,174,386	10,520,428	11,382,118	11,666,929
Recreation and cultural enrichment	326,361	324,186	225,367	292,981	297,854
Economic development	824,830	984,334	963,926	987,325	956,411
Transportation	315,591	407,328	351,911	449,228	443,270
Capital outlay	50,818	17,698	142,651	27,305	27,758
Debt service	-	-	-	-	5,064
Other Uses:					
Operating transfers out	1,528,451	903,078	775,732	936,549	827,040
Transfers to component units	1,043,197	-	-	-	-
TOTAL EXPENDITURES AND OTHER USES	$ 35,138,911	$ 36,155,924	$ 38,167,146	$ 42,498,834	$ 42,700,567
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURE AND OTHER USES	(1,622,072)	(665,129)	648,801	(137,405)	100,440
Residual Equity Transfer In (Out)	-	-	-	-	-
Fund Balance — End of Period	$ 3,022,842	$ 2,357,713	$ 3,006,514	$ 2,869,109	$ 2,969,549
Components of Fund Balance					
Reserved for encumbrances	$ 479,314	$ 341,881	$ 259,178	$ 617,861	$ 709,115
Reserved for advances and other	315,822	431,552	622,292	809,911	751,062
Unreserved — designated	623,884	269,775	491,718	514,174	719,414
Unreserved — undesignated	1,603,822	1,314,505	1,633,326	927,163	789,958
TOTAL FUND BALANCE	$ 3,022,842	$ 2,357,713	$ 3,006,514	$ 2,869,109	$ 2,969,549

(a) Restated. For the fiscal year ended June 30, 2002 and subsequent fiscal years, the Commonwealth has adopted several new accounting and reporting standards described earlier in "COMMONWEALTH FINANCIAL STRUCTURE AND PROCEDURES – New Governmental Accounting and Reporting Standards." The new standards require numerous changes to how fund financial statements are presented. Certain funds have been reclassified and fund balances restated. See Note B to the Comprehensive Annual Financial Report for the fiscal year ended June 30, 2002 for a more detailed explanation. These changes may limit the comparability of that year's data and subsequent data to data for prior fiscal years.

(b) Beginning with the fiscal year ended June 30, 2002, the number and the definition of the functional categories of expenditures have been revised. These changes limit the comparability of fiscal years' 2002 through 2006 data to data shown for prior fiscal years.

Source: Compiled from Office of the Budget, Comprehensive Annual Financial Report for fiscal years ended June 30, 2002 through 2006.

Fiscal Year 2005 Financial Results

GAAP Basis. At June 30, 2005, the General Fund reported a fund balance of $2,869.1 million, a decrease of $137.4 million from the reported $3,006.5 million fund balance at June 30, 2004. On a net basis, total assets decreased by $601 million to $9,863 million. Liabilities decreased by $463 million to $6,994 million largely because of a smaller securities lending program ($369 million) and a lower accounts payable ($156 million).

General Fund tax revenues increased by 8 percent due to overall economic growth, including nearly identical percentage increase in personal income tax revenue during the fiscal year ended June 30, 2005. Intergovernmental revenues increased by only $311 million, almost solely due to increases in federally-funded medical and other assistance, where expenditures increased significantly over the prior year. Charges for sales and services increased by nearly $2 billion, more than doubling prior year revenues of $1,751 million because of specific program funding changes, including nursing home assessments associated with an increase in health and human services expenditures. Total General Fund revenues increased by 9 percent during the fiscal year. The overall decrease in fund balance, $137.4 million, during the fiscal year was $787 million less than the prior fiscal year increase in fund balance of $649 million. Total General Fund expenditures increased by 11 percent during the fiscal year ended June 30, 2005, on a GAAP-reported basis, largely because of a $2.5 billion increase in expenditures for medical and other assistance (reported as part of health and human services). This increase was caused by significant increases in utilization (participation) and per-unit health care cost increases. Expenditures for direction and support services increased due to significantly higher reported employer costs for active and retired employee healthcare benefits. Higher public education appropriations resulted in an $861 million expenditure increase. Actual, final General Fund expenditures (budgetary basis) increased by 9 percent over the prior fiscal year, while revenues (budgetary basis) increased by 10 percent.

Budgetary Basis. Total fiscal year 2005 revenues, net of reserves for tax refunds and including intergovernmental transfers and additional resources, totaled $24,405.6 million. Total expenditures net of appropriation lapses and including intergovernmental transfers and expenditures from additional resources were $24,053.9 million. As result of Commonwealth financial operations during the fiscal year, the preliminary unappropriated surplus balance, prior to the statutorily required 25 percent transfer to the Budget Stabilization Reserve Fund, was $429.2 million, an increase of $162.5 million from the fiscal year 2004 preliminary ending balance. Following the statutorily required 25 percent transfer to the Budget Stabilization Reserve Fund ($64.4 million) the fiscal year 2005 final unappropriated surplus balance was $364.8 million as of June 30, 2005.

The fiscal year 2005 budget was based initially on an estimated 4.5 percent increase for Commonwealth General Fund revenues prior to accounting for any changes in tax and revenue provisions enacted in the second half of fiscal year 2004. After adjustments for various tax rate and tax base changes enacted for the fiscal year 2004 budget, total Commonwealth General Fund revenues were projected to increase 3.8 percent over fiscal year 2004 actual receipts and total $23,866.5 million prior to reserves for tax refunds. Total fiscal year 2005 Commonwealth revenues net of reserves for tax refunds, exceeded $24,308.5 million, a 6.5 percent increase over fiscal year 2004 receipts. The tax revenue component of Commonwealth receipts, including the effects of the tax rate and tax base changes enacted in fiscal year 2004, rose $1,666.4 million or 7.6 percent over fiscal year 2004 actual receipts. An estimated two-thirds of the increase in tax revenues is associated with the various tax rate and tax base changes. Major components of the tax revisions were: (i) an increase in the personal income tax from 2.8 percent to 3.07 percent; (ii) a restructuring of taxation of telecommunications to include the imposition of the gross receipts tax on cellular and interstate telecommunication as well as certain sales and use tax exemptions for particular telecommunications activities; (iii) an increase to the cigarette tax from $1.00 per pack to $1.35 per pack, a portion of which was transferred to the new Health Care Provider Retention Account to be used to provide financial assistance for malpractice premiums for certain physicians practicing in particular high-risk medical specializations under the medical malpractice abatement program. This program was enacted for calendar years 2003 and 2004, and the General Assembly approved an extension for an additional year in 2005; (iv) a modification of the scheduled phase-out of the capital stock and franchise tax for tax years 2003 and 2004; and (v) various other tax rate and tax base revisions, including some tax cuts. Total revenues to the Commonwealth exceeded the budget estimate by $442.0 million or 1.9 percent. Personal income tax receipts grew by $1,013 million or 13.1 percent over fiscal year 2004 revenues. Revisions to the personal income tax rate in December 2003 contributed to the large year-over-year increase in these receipts. During fiscal year 2005, corporate tax receipts grew $285.1 million or 10.7 percent, which generally reflected improvements in the overall state and national economy. Sales and use tax revenues to the Commonwealth grew $271.4 million or 3.5 percent over fiscal year 2004 receipts. Receipts of Commonwealth non-tax revenues continued to exceed the estimate as total revenue from this source exceeded $596.0 million. Earnings from investments and revisions to the Commonwealth's escheats program continued to provide revenues well in excess of the estimate for fiscal year 2005. Various revisions to the Commonwealth's escheat program were enacted as part of the fiscal year 2003 and 2004 budgets. These revisions to the escheat program have produced substantial non-recurring revenues during each of the two most recent fiscal years. Additionally, significant non-recurring capital gains earnings on the investment of available General Fund cash balances (See "General Fund Fiscal Year 2004 Financial Results") and increased contributions from the Commonwealth's liquor store profits contributed to enhanced non-tax revenues during the prior two fiscal years. Reserves for tax refunds in fiscal year 2005 were $1,000.0 million, a decrease of $14.7 million or 1.4 percent from fiscal year 2004 levels.

Fiscal year 2005 state-level expenditures, including supplemental appropriations and net of appropriation lapses, totaled $22,956.8 million, an increase of 5.6 percent from fiscal year 2004 appropriations. A total of $148.1 million in appropriations were lapsed in fiscal year 2005 and the fiscal year 2005 budget continued to utilize an enhanced level of intergovernmental transfers for a portion of medical assistance costs, albeit at a reduced rate from fiscal year 2004. Intergovernmental transfers replaced $697.9 million of General Fund medical assistance costs in fiscal year 2005, compared to $738.7 million in fiscal year 2004. In addition, approximately $399 million in additional funds, primarily $377.6 million of remaining federal fiscal relief, was appropriated in fiscal year 2005 to fund expenditures normally funded from Commonwealth revenues. The ending unappropriated balance was $364.8 million for fiscal year 2005.

Fiscal Year 2006 Financial Results

GAAP Basis. At June 30, 2006, the General Fund reported a fund balance of $2,969.5 million, an increase of $100.4 million from the reported $2,869.1 million fund balance at June 30, 2005. On a net basis, total assets increased by $537.1 million to $10,400.2 million. Liabilities increased by $436.8 million to $7,430.7 million largely because of an increase in unearned revenue ($348 million) and an increase in accounts payable ($235 million).

General Fund tax revenues increased by 9 percent due to significant economic growth; both corporation and personal income tax collections rose an average of 9 percent during the fiscal year ended June 30, 2006. Sales and use tax collections increased by 4.2 percent. Intergovernmental revenues decreased by $439 million, resulting from lower amounts appropriated for Federal participation in medical and other assistance. Charges for sales and services decreased by $981 million due to specific program funding changes, including nursing home assessments. Total General Fund revenues increased by $414 million (0.98 percent) during the fiscal year. The overall increase in fund balance, $101 million, during the fiscal year was $239 million more than the prior fiscal year decrease in fund balance $138 million. Total General Fund expenditures increased by less than 1 percent during the fiscal year ended June 30, 2006, by $311 million. Expenditures for Protection of persons and property increased by $265 million due primarily to increases in amounts appropriated/expended for state police activities. Public education expenditures increased by $285 million due primarily to increases in basic and other subsidies to school districts; net changes in higher education subsidies were not significant. Health and human services expenditures decreased by $227 million, caused by lower aggregate demand and utilization of medical and other assistance during the fiscal year. Actual, final General Fund expenditures (budgetary basis) increased by 3.1 percent over the prior fiscal year, while revenues (budgetary basis) increased 2.8 percent.

Budgetary Basis. During fiscal year 2006, revenues to the Commonwealth exceeded the certified estimate by $864.6 million or nearly 3.5 percent. Final Commonwealth General Fund revenues for the fiscal year totaled $25,854.1 million. Total fiscal year 2006 revenues, net of reserves for tax refunds and including intergovernmental transfers and additional resources, totaled $25,700.9 million. Total expenditures, net of appropriation lapses and including intergovernmental transfers and expenditures from additional sources, was $25,380.3 million. As result of Commonwealth financial operations during the fiscal year, the preliminary unappropriated surplus balance, prior to the statutorily required 25 percent transfer to the Budget Stabilization Reserve Fund, increased to $685.4 million, including the beginning balance from the prior year of operations. Accordingly, 25 percent of this preliminary balance or $171.4

million was transferred to the Budget Stabilization Reserve Fund. The final fiscal year 2006 unappropriated surplus balance was $514.1 million as of June 30, 2006.

Revenues available to the Commonwealth, including intergovernmental transfers and additional sources, increased 5.3 percent. Fiscal year 2006 revenues (all sources) totaled $25,700.9 million, an increase of $1,295.3 million over fiscal year 2005. Intergovernmental transfer proceeds increased $3819 million or 5.5 percent, while funding from additional sources decreased $253.3 million or 63 percent, primarily due to the expiration of the previously available one-time federal fiscal relief that had been made available to the various states. General Fund revenues grew $1,563 million or 6.3 percent during fiscal year 2006 when measured on a year-over-year basis. Corporate tax receipts grew $425.8 million over estimate, an 8.9 percent surplus to the year-to-date estimate. Personal income taxes were $342.6 million over the estimate, a surplus of 3.7 percent versus the year-to-date estimate. Sales and use taxes were essentially at estimate as actual receipts were $65.2 million above estimate, a difference of 0.8 percent from the fiscal year estimate. Realty transfer tax revenues also exceeded the estimate by $61.4 million or 12.5 percent based in part on continuation of a strong housing market within the Commonwealth. Non-tax revenues of the Commonwealth were below estimate for fiscal year 2006 by $61.4 million or 11.3 percent, due primarily to lower than projected earnings from the Commonwealth's escheats program. Reserves for tax refunds in fiscal year 2006 were $1,035 million, an increase of 3.5 percent from the fiscal year 2005 reserves. At the end of fiscal year 2006, approximately $103 million of reserves were available for making tax refunds in the following fiscal year.

In July 2005, the General Assembly approved and the Governor signed into law Act 45 of 2005, which authorized the issuance of up to $625 million in debt of the Commonwealth to support programs commonly referred to as "Growing Greener II." The enactment of Act 45 implements the Governor's major environmental initiative in the fiscal year 2006 budget. The Growing Greener II program will provide bond funding for the maintenance and protection of the environment, open space and farmland preservation, watershed protection, abandoned mine reclamation, acid mine drainage remediation and other environmental initiatives. Additionally, Act 45 of 2005 authorizes the Governor to direct up to $60 million in existing Growing Greener fees, that are otherwise directed into the Commonwealth's Environmental Stewardship Fund, to support General Fund debt service for the authorized Growing Greener II bond issuances.

Fiscal year 2006 appropriations from Commonwealth revenues, including supplemental appropriations and net of appropriation lapses, totaled $24,664.6, an increase of 7.4 percent from fiscal year 2005 expenditures. A total of $181.8 million in appropriations were lapsed in fiscal year 2006, and the fiscal year 2006 budget continued to utilize an enhanced level of intergovernmental transfers for a portion of medical assistance costs. Intergovernmental transfers replaced $735.7 million of General Fund medical assistance costs in fiscal year 2006, compared to $697.9 million in fiscal year 2005. In addition, approximately $145.9 million in additional funds were appropriated in fiscal year 2006 to fund expenditures normally funded from Commonwealth revenues, a decrease from $399 million in fiscal year 2005. The ending unappropriated balance was $514.1 million for fiscal year 2006.

Fiscal Year 2007 Budget

The adopted fiscal year 2007 budget and proposed supplemental appropriations provide appropriations totaling $26,326.8 million of Commonwealth funds against estimated revenues, net of tax refunds and proposed tax reductions, of $25,766.2 million. The $560.61 million difference between estimated revenues and budgeted appropriations is funded by a draw down of the $514 million beginning balance as well as from the utilization of $95 million in prior and current year lapses. Additionally, the enacted fiscal year 2007 budget allocates additional state funds to replace significant amounts of formerly available intergovernmental transfer transaction-derived federal funds.

The fiscal year 2007 revenue estimate for the Commonwealth is based upon an economic forecast of 3.0 percent growth in gross domestic product from the start of the third quarter of 2006 to the end of the second quarter of 2007. Trends in the Commonwealth's economy are expected to maintain their close association with national economic trends. Personal income growth in Pennsylvania is projected to remain slightly below that of the United States, while the Pennsylvania unemployment rate is anticipated to be close to the national rate. The tax revenue component of Commonwealth General Fund receipts is expected to increase by $804.7 million or approximately 3.2 percent prior to reserves for refunds. Fiscal year 2007 Commonwealth revenues from the personal income tax are forecast to increase by 4.6 percent, while receipts from the sales and use tax are estimated to rise 3.3 percent over fiscal year 2006 receipts.

Corporate receipts are expected to grow in fiscal year 2007, at a rate of 6.4 percent and revenues from non-tax sources such as liquor store profits and earnings on investments forecast to increase by 29.0 percent. A majority of the projected increase in non-tax revenues is attributable to additional profit transfers from the state liquor stores.

The current economic expansion has been moderating significantly at both the national and state levels over the past year. Growth, however, continues to increase revenue receipts to the Commonwealth. General Fund revenue estimates incorporated in the enacted budget for fiscal year 2007 included a projected growth in receipts of 3.7 percent, while actual receipts through April 2007 have grown by 5.5 percent on a year-over-year basis. In February 2007, the Governor's proposed budget for fiscal year 2008 included a slight upward revision of $66 million or 0.2 percent to the fiscal year 2007 General Fund revenue estimate to reflect the moderating national and state economies. Actual revenues through April 2007 are $207.8 million or 0.9 percent above the estimate enacted in July 2006, as part of the fiscal year 2007 budget.

The Commonwealth's fiscal year 2007 enacted budget includes significant increases in funding for local school districts and higher education within the Commonwealth as the Basic Education appropriation is increased $267 million or 5.9 percent, the largest increase since fiscal year 1992. Additionally, the Commonwealth's contribution to the Public School Employees Retirement System is increased $114 million in fiscal year 2007, and the Pennsylvania Accountability Block Grant to local school districts is increased by $50 million to $250 million annually. The enacted budget also includes a new children's health insurance program called "Cover All Kids" which is intended to gradually expand available health insurance to all Pennsylvania children not currently covered by insurance. The Commonwealth's prescription drug coverage program is expanded to cover an additional 120,000 seniors within the next 18 months by building upon the federal Medicare Part D program. The enacted fiscal year 2007 budget reflects initiatives to increase the efficiency of government operations within the Commonwealth and includes estimates to save over $1 billion annually in fiscal year 2007. The enacted budget for fiscal year 2007 also includes $543.4 million in funding for various medical assistance expenditures through intergovernmental transfer proceeds, certain nursing home assessments and a tax on managed care organizations. This amount is an increase of 3.3 percent from the $856.8 million in such proceeds utilized during fiscal year 2006. Under the intergovernmental transfer transactions, certain county governments contribute funds to the Commonwealth to help pay Medicaid expenses. The Commonwealth receives the contributions as augmentations to appropriations of Commonwealth revenues for the medical assistance program. These augmentations have the effect of supplementing the amount of Commonwealth revenues available for the medical assistance program and are available to match federal Medicaid funds. Federal authority for Pennsylvania to use the county contributions to pool transactions to match additional federal funds is currently scheduled to expire in 2010. Included in the Governor's proposed fiscal year 2008 budget is a request for supplemental appropriations for fiscal year 2007 totaling $211.6 million. Additional funding via requested supplemental appropriations includes $201 million in additional medical and other assistance funds. The preliminary fiscal year ending unappropriated balance, net of lapses and supplemental appropriations is currently estimated to be nearly $49.9 million for fiscal year 2007. Following a statutorily-required transfer of 25 percent of this preliminary ending balance totaling $12 million, the 2007 fiscal year ending unappropriated balance is currently estimated to be nearly $37.5 million. The year ending unappropriated balance is currently estimated to be $3.6 million for fiscal year 2007. A more detailed description of fiscal year 2007 expenditures among major program areas is provided in the section titled "COMMONWEALTH REVENUES AND EXPENDITURES."

As part of his fiscal year 2007 budget proposal, the Governor proposed a major program revision to the Commonwealth's Health Investment Plan, a series of health-related programs funded entirely from Tobacco MSA revenues. Currently, 100 percent of Tobacco MSA payments received are utilized for health care related expenditures and revenues received are statutorily distributed based upon enacted funding formula. The Commonwealth's health research component currently receives 19 percent of annual Tobacco MSA funds and these funds are annually expended on health-related research projects undertaken by Pennsylvania-based researchers. The Governor's fiscal year 2007 budget proposed to create the Jonas Salk Legacy Fund, which would utilize half of the 19 percent (9.5 percent) of Tobacco MSA payments, currently dedicated to health research activities, to accelerate funding for bioscience research in Pennsylvania. Under this proposal, 9.5 percent of Tobacco MSA payments would be securitized through the issuance of approximately $500 million in bonds, the proceeds of which would be used to accelerate the construction of bioscience facilities, including laboratories, incubators and research parks. The proposed debt would be issued over a two-year period following approval by the General Assembly and programs funded with this debt from the Jonas Salk Legacy Fund would require a dollar-for-dollar private match, thereby increasing total investment in biosciences research and facility construction to over $1 billion. The proposed debt would be secured and paid solely from a pledge of 9.5 percent of the revenue from the Tobacco MSA. The General Assembly and the Governor continue to deliberate the proposal.

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.

Table 8
Sources, Uses and Changes in Unappropriated Balance
General Fund and Other Funding Sources — Unaudited Budgetary Basis
Commonwealth Revenues Only
(In Millions)

	Actual Fiscal Year 2006	Estimate Fiscal Year 2007	Proposed Fiscal Year 2008
Sources:			
Cash revenues	$ 25,854.3	$ 26,866.2	$ 28,392.4
Tax refunds	(1,035.0)	(1,100.0)	(1,150.0)
Additional resources available	145.9	257.7	142.5
Intergovernmental transfer transactions[(a)]	735.7	543.4	490.4
TOTAL SOURCES	$ 25,700.9	$ 26,567.3	$ 27,875.3
Uses:			
General fund appropriations	$ 24,664.6	$ 26,326.8	$ 27,274.7
Expenditures from additional resources	145.9	257.7	142.5
Lapses and other reductions[(b)]	(165.9)	(95.0)	…...
Intergovernmental transfer transactions[(a)]	735.7	543.4	490.4
TOTAL USES	$ 25,380.3	$ 27,032.9	$ 27,907.6
OPERATING BALANCE	$ 320.6	$ (465.6)	$ (32.3)
BEGINNING UNAPPROPRIATED BALANCE	364.8	514.1	37.5
ADJUSTMENT TO UNAPPROPRIATED BALANCE[(c)]	…...	1.5	…...
TRANSFER (TO)/FROM BUDGET STABILIZATION RESERVE FUND	(171.4)	(12.5)	(1.2)
ENDING UNAPPROPRIATED BALANCE	$ 514.1	$ 37.5	$ 3.8

Totals may not add due to rounding.
(a) Only includes funds replacing Commonwealth funds. Fiscal year 2006 included $212.8 million, fiscal year 2007 includes $145 million and fiscal year 2008 includes $137.5 million from a nursing home tax used to augment appropriated funds for long-term care. Additionally, fiscal year 2006 included $194.5 million, fiscal year 2007 includes $204.1 million and fiscal year 2008 includes $183.8 million from a tax imposed on managed care organizations.
(b) Includes prior year appropriation lapses from fiscal year 2005 of $165.9 million and $85 million from fiscal year 2006.
(c) The fiscal year 2007 adjustments generally reflect the appropriation of prior year funds.

Fiscal Year 2008 Proposed Budget

A proposed fiscal year 2008 budget was submitted by the Governor to the General Assembly on February 6, 2007. The proposed budget recommends appropriations totaling $27,274.7 million of Commonwealth funds against estimated revenues, net of tax refunds and proposed tax reductions, of $27,242.4 million. The $32.3 million difference between estimated revenues and recommended appropriations is to be funded by a draw down of the anticipated $37.5 million beginning balance. Additionally, the proposed fiscal year 2008 budget allocates additional state funds of approximately $720 million to replace significant amounts of formerly available intergovernmental transfer transaction-derived federal funds (See "MAJOR COMMONWEALTH EXPENDITURES – Public Health and Human Services") and other formerly available federal funds. The fiscal year 2008 proposed budget represents a 3.6 percent ($948 million) increase over the fiscal year 2007 budget. More than half of the year-over-year increase in appropriations ($544 million) would be dedicated to increased education funding. The proposed budget reduces spending by 3.6 percent in all areas other than education, welfare, corrections and probation and parole and administrative spending is proposed to grow by less than 2 percent in fiscal year 2008.

The Governor's proposed fiscal year 2008 budget includes proposals for significant additional reductions in local property taxes, an expansion of health care coverage within the Commonwealth, a proposal to achieve greater energy independence, and an effort to increase funding for transportation needs. The budget again proposes to securitize a portion of the Commonwealth's Tobacco Settlement funds to fund biomedical research. The proposed budget includes an increase in the state Sales and Use tax rate from 6 percent to 7 percent while maintaining the current tax base. Proceeds of the proposed tax increase would be split to both further reduce local property taxes and to provide additional funding to the General Fund. The proposed Sales Tax increase would generate approximately $1,246 million in the first year with $826 million utilized to support the General Fund and $420 million to further reduce local property taxes. By the second year, the Sales tax increase would generate $1,400 million and the proceeds would be shared 50-50 between local property tax reduction and support for the General Fund.

A major component of the proposed fiscal year 2008 budget is the "Prescription for Pennsylvania" initiative, which would implement a plan designed to increase access to affordable health care coverage for all Pennsylvanians, improve the quality of care delivered throughout the Commonwealth and help bring health care costs under control for employers and employees. The Cover All Pennsylvanians program would offer affordable basic health insurance to small businesses and uninsured individuals. A total of $302 million in state and federal funds is proposed to support the Cover All Pennsylvanians program. The program would also include enrollee and small employer cost-sharing and a new 3 percent Fair Share Assessment levied on payrolls of businesses that do not offer health care coverage to their employees.

A new Energy Independence Initiative is proposed that would provide $850 million in additional investment in new, clean and alternative energy projects. The Energy Independence Fund would support early stage financing and project financing, along with new incentives for energy conservation and solar energy. A new Systems Benefit Charge of 1/20th cent per kilowatt-hour of electricity consumption would be imposed to support the Energy Independence Fund. Through this charge, approximately $75 million would be generated annually, which would support the issuance of $850 million of debt to be issued by the Pennsylvania Energy Development Authority. Programs which are proposed to be funded from the Energy Independence Fund include: Clean Energy Greenhouse ($56 million), which would assist in converting clean energy research and development into commercial products; the Clean Energy Venture Capital program ($50 million), which will make early stage investments in clean energy concepts of emerging companies; the Clean Energy Loans and Grants program ($300 million) would provide loans and grants to stimulate the development of innovative clean energy projects and companies; the Energy Site Preparation program ($150 million) would stimulate the development of highly efficient advanced energy business sites for clean energy companies by offering grants and low-interest financing to prepare sites and infrastructure; the Energy Capital Assistance program ($50 million) would provide grant funding for the acquisition, construction and improvement of regional energy projects; the Air Conditioner/Refrigerator Swap program ($44 million) would provide rebates to Pennsylvania retailers so that residential and small business consumers can replace inefficient air conditioners and refrigerators with high efficiency units; and the Sunshine program ($200 million) which would jump start investment in solar energy within Pennsylvania.

A recently released study performed by the Pennsylvania Transportation Reform Commission determined that an additional $1,600 million in annual investments is required to stabilize public transportation systems and to improve roads and bridges in the Commonwealth. The fiscal year 2008 budget proposes two new initiatives to implement the recommendations of the Transportation Reform Commission. First, a Public-Private-Partnership to lease the Pennsylvania Turnpike to a private operator is proposed. All funding generated from the potential lease of the Pennsylvania Turnpike ($965 million) would be dedicated to the Commonwealth's Motor License Fund and would be utilized to repair additional existing structurally deficient bridges and to expand the miles of state roads repaired and resurfaced. Second, a new state tax would be imposed on all oil company gross profits and the proceeds ($760 million) would be utilized to improve mass transportation across the Commonwealth. The tax rate would be set at 6.17 percent and oil companies would be exempt from the existing Corporate Net Income tax.

As part of his fiscal year 2008 budget proposal, the Governor has again proposed a major program revision to the Commonwealth's Health Investment Plan, a series of health-related programs funded entirely from Tobacco MSA revenues. Currently, 100 percent of Tobacco MSA payments received are utilized for health care related expenditures and revenues received are statutorily distributed based upon enacted funding formula. The Commonwealth's health research component currently receives 19 percent of annual Tobacco MSA funds and these funds are annually expended on health-related research projects undertaken by Pennsylvania-based researchers. The Governor's fiscal year 2007 budget proposes to create the Jonas Salk Legacy Fund, which would utilize half of the 19 percent (9.5 percent) of Tobacco MSA payments currently dedicated to health research activities to accelerate funding for bioscience research in Pennsylvania. Under this proposal, 9.5 percent of Tobacco MSA payments would be securitized through the issuance of approximately $500 million in bonds, the proceeds of which would be used to accelerate the construction of bioscience facilities, including laboratories, incubators and research parks. The proposed debt would be issued over a two-year period following approval by the General Assembly. Programs funded with this debt from the Jonas Salk Legacy Fund would require a dollar-for-dollar private match, thereby increasing total investment in biosciences research and facility construction to over $1 billion. The proposed debt would be secured by and paid solely from a pledge of 9.5 percent of the revenue from the Tobacco MSA.

In February 2007, the Pennsylvania General Assembly began appropriations committee hearings for the fiscal year 2008 budget. Further legislative debate is anticipated before both houses adopt the General Appropriation Bill.

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. The GAAP basis presentations include restricted account revenues and expenditures.

Financial Results for Recent Fiscal Periods (GAAP Basis)

The fund balance at June 30, 2006, was $1,549.1 million, a $272.6 million increase from the June 30, 2005 fund balance, which represents a 21.4 percent increase. Over the five fiscal years of 2002 through 2006, revenues and other sources have averaged an annual 2.9 percent increase. Expenditures and other uses during the period from fiscal years 2002 through 2006 have averaged a 1.1 percent annual increase. Revenues grew $411 million from fiscal 2005 to fiscal 2006. During fiscal year 2006, the fund reported total tax revenues of $2,033 million and license and fee revenues of $899 million, which represented growth of 10.2 percent and 1.1 percent respectively from fiscal year 2005 to fiscal year 2006. Reported federal revenues, received principally from the Federal Highway Administration, totaled $1,413 million, an increase of 16.5 percent. Other revenues to the fund, principally earnings on investments, totaled $185 million, an increase of 8 percent from the prior fiscal year. Expenditures from the fund were $4,211 million during fiscal year 2006, an increase of $347 million over fiscal year 2005 expenditure levels. The increase in capital outlay during the 2006 fiscal year was responsible for the majority of the increase in reported transportation expenditures. 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 2002 through 2006.

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

	Fiscal Year Ended June 30				
	2002[(a)]	**2003**	**2004**	**2005**	**2006**
Fund Balance — Beginning of Period	$ 751,961	$ 712,427	$ 893,133	$ 1,079,617	$ 1,276,525
Revenues:					
Taxes	$ 1,694,421	$ 1,705,082	$ 1,742,332	$ 1,844,670	$ 2,033,227
Licenses and fees	838,525	842,466	866,552	889,984	899,690
Intergovernmental	1,402,468	1,379,786	1,323,005	1,213,487	1,413,434
Other revenues	94,273	124,866	176,910	171,839	185,611
Other Financing Sources:					
Operating transfers in	3,937	-	-	-	-
Other additions	1,339	805	-	562	-
TOTAL REVENUES AND OTHER SOURCES	$ 4,034,963	$ 4,053,005	$ 4,108,799	$ 4,120,542	$ 4,531,962
Expenditures: (b)					
Direction and supportive services	$ 48,579	$ 48,400	$ 49,693	$ 50,338	$ 51,738
Protection of persons and property	492,504	514,100	496,105	509,999	553,679
Public education	1,075	1,068	1,023	1,058	1,024
Recreation and cultural enrichment	1,927	3,504	4,199	3,437	-
Transportation	3,369,240	3,205,830	1,641,755	1,826,539	1,679,517
Capital outlay	46,416	39,154	1,668,261	1,472,434	1,924,821
Other Uses:					
Operating transfers out	86,756	60,243	61,279	59,829	48,630
Transfers to component units	28,000	-	-	-	-
TOTAL EXPENDITURES AND OTHER USES	$ 4,074,497	$ 3,872,299	$ 3,922,315	$ 3,923,634	$ 4,259,409
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURE AND OTHER USES	(39,534)	180,706	186,484	196,908	272,553
Residual Equity Transfers In (Out)	-	-	-	-	-
Fund Balance — End of Period	$ 712,427	$ 893,133	$ 1,079,617	$ 1,276,525	$ 1,549,078
Components of Fund Balance					
Reserved for encumbrances	$ 389,942	$ 456,015	$ 591,598	$ 601,809	$ 464,511
Reserved for advances and other	-	-	220,662	110,000	1,635
Unreserved - designated - highways	175,249	215,946	209,647	218,885	203,118
Unreserved - undesignated	147,236	221,172	57,710	345,831	879,814
TOTAL FUND BALANCE	$ 712,427	$ 893,133	$ 1,079,617	$ 1,276,525	$ 1,549,078

(a) For the fiscal year ended June 30, 2002 and subsequent fiscal years, the Commonwealth has adopted several new accounting and reporting standards described earlier in "COMMONWEALTH FINANCIAL STRUCTURE AND PROCEDURES – New Governmental Accounting and Reporting Standards." The new standards require numerous changes to how fund financial statements are presented. Certain funds have been reclassified and fund balances restated. See Note B to the Comprehensive Annual Financial Report for the fiscal year ended June 30, 2002 for a more detailed explanation. These changes limit the comparability of that year's data and subsequent data to data for prior fiscal years.

(b) Beginning with the fiscal year ended June 30, 2002, the functional categories of expenditures have been revised. Additionally, beginning with the fiscal year ended June 30, 2004, a portion of the functional categories within expenditures (transportation and capital outlay) have been further revised. These changes limit the comparability of fiscal years' 2002 through 2006 data to data for prior fiscal years.

Source: Compiled from Office of the Budget, Comprehensive Annual Financial Report for fiscal years ended June 30, 2002 through 2006.

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

Fiscal Year 2005 Financial Results

The Motor License Fund ended the fiscal year with an unappropriated surplus of $212.4 million, a net increase of $98.8 million or 87 percent from fiscal year 2004. Motor License Fund revenues totaled $2,156.8 million, an increase of 3.4 percent over actual fiscal year 2004 receipts. Revenues from other revenue receipts, primarily earnings on investments, grew 86.7 percent during fiscal year 2004, while receipts from license and fees increased by 4.0 percent over fiscal year 2004 receipts. Revenues to the Motor License Fund from liquid fuels taxes increased by 4.2 percent during fiscal year 2005. Expenditures of Commonwealth Motor License Fund revenues totaled $2,071.2 million for fiscal year 2005, an increase of 2.4 percent from actual fiscal year 2004 expenditures net of lapses.

Fiscal Year 2006 Financial Results

During fiscal year 2006, revenues excluding prior year lapses, of the Motor License Fund were $2,265.8 million, an increase of 5.1 percent over actual fiscal year 2005 receipts. Liquid fuels tax receipts increased by 5.7 percent while license and fee revenues grew minimally (0.1% growth). Other revenue receipts, including earnings on investments, increased by 34.9%. Appropriations and executive authorizations from Commonwealth funds for fiscal year 2006 totaled $2,340.6 million, an increase of 13 percent. The Motor License Fund ended the fiscal year with an unappropriated surplus of $283.7 million, a net increase of $71.3 million.

Fiscal Year 2007 Budget

The fiscal year 2007 budget for the Motor License Fund estimates revenues of $2,293.9 million, an increase of 1.2 percent over actual fiscal year 2006 receipts. The fiscal year 2007 Motor License Fund budget provides $2,564.5 million of appropriations and executive authorizations from Commonwealth funds for fiscal year 2007. The budgeted appropriations and authorizations represents an increase of 9.6 percent above the amount expended during fiscal year 2006. The enacted budget anticipates a draw down of approximately $212.6 million from the fiscal year 2007 beginning balance.

Through April 2007, Commonwealth revenues in the Motor License Fund are slightly below estimate by 1.2 percent versus the certified revenue estimate for the same year-to-date period.

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 or adverse developments in the price and availability of motor vehicle fuels.

Fiscal Year 2008 Proposed Budget

A budget proposing $2,352.1 million of appropriations from Commonwealth Motor License Fund revenues for fiscal year 2008 has been submitted to the General Assembly. The requested amount of appropriations represents a decrease of 8.3 percent below the appropriated level for fiscal year 2007 and approximates the draw down of a portion of the fiscal year 2007 beginning balance. The budget proposed for fiscal year 2008 includes $965.0 million in additional proposed revenues to the Motor License Fund, which would be generated from a proposed Public-Private-Partnership to lease the Pennsylvania Turnpike to a private operator. All funding generated from the potential lease of the Pennsylvania Turnpike would be utilized to repair additional existing structurally deficient bridges and to expand the miles of state roads repaired and resurfaced. The proposed budget for fiscal year 2008 projects a further draw down of approximately $49.1 million from the estimated fiscal year beginning balance.

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 proposed 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 financially 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 being paid by the General Fund, beginning in fiscal year 2000.

Financial Results for Recent Fiscal Periods (GAAP Basis)

State Lottery Fund cash and investments increased by $93 million or 17 percent during the fiscal year ended June 30, 2006, due to an increase in gross ticket sales. Total revenue increased $410 million or 15 percent, primarily due to an increase in Powerball/Powerplay sales, an increase in instant ticket sales and the introduction of a new Raffle game during the fiscal year. Expenditures and other uses from the State Lottery Fund increased $401 million or 15 percent during the fiscal year, partly due to increased field paid prizes from instant ticket sales, advertising and special services. The fiscal year 2006 statutory transfer from the State Lottery Fund for the payment of benefits to the elderly that the fund subsidizes amounted to $380 million, an increase of $80 million over fiscal year 2005. Table 10, on the following page, sets forth a condensed summary of revenues and expenditures (presented on a GAAP basis) for the State Lottery Fund for fiscal years 2002 through 2006.

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

Fiscal Year 2005 Financial Results

Revenues from tickets sales of the Lottery and other miscellaneous revenue sources rose 3.5 percent during fiscal year 2005, totaling $1,211.9 million. Expenditures net of lapses, totaled $1,139 million, an amount equal to the expenditure levels experienced in fiscal year 2004. Revenues, including prior year lapses, in excess of expenditures for fiscal year 2005 contributed to an unappropriated fund balance and reserve of $381.0 million (including $100 million of reserves), an increase of 27 percent from fiscal year 2004.

Fiscal Year 2006 Financial Results

During fiscal year 2006, ticket sales less field prizes and commissions were $1,459.5 million, a 20.4 percent increase in revenues from lottery sources, including instant ticket sales and the state's participation in the multi-state Powerball game. Expenditures, net of projected lapses totaled $1,437.7.1 million, were 26.2 percent above fiscal year 2005 expenditures. The fiscal year-end unappropriated balance and reserve totaled $439.0 million (including $100 million of reserves), an increase of 15.2 percent.

Fiscal Year 2007 Budget

The fiscal year 2007 budget anticipates an 11.9 percent increase in revenues from lottery sources, including instant ticket sales and the state's participation in the multi-state Powerball game. Total revenues estimated to be received by the Lottery fund during fiscal year 2007 are $1,633. 4 million while total appropriations of $1,433.7 million are budgeted. The expansion of the federal Medicare program to cover prescription drugs is expected to save the Commonwealth's Lottery Fund approximately $185 million annually. The Commonwealth's prescription drug coverage program is also expanded to cover an additional 120,000 seniors within the next 18 months by building upon the federal Medicare Part D program. Additionally, the fiscal year 2007 budget includes a transfer of approximately $248.8 million in long-term care costs from the Commonwealth's General Fund to the State Lottery Fund. The anticipated fiscal year-end balance and reserve is projected to total $720.7 million, (including $100 million of reserves), an increase of 64.2 percent.

The achievement of the budgeted results may be adversely affected by a number of factors, including failure of the marketing and game strategies to achieve the projected rise in revenues and increased competition from other forms of gaming that may be available to Pennsylvania lottery players.

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

	Fiscal Year Ended June 30				
	2002(a)	**2003**	**2004**	**2005**	**2006**
Net Assets -					
Beginning of Period	$ 201,215	$ 180,921	$ 142,372	$ 158,426	$ 291,416
Restatements	173	-	-	-	-
Net Assets -					
Beginning of Period, as Restated	$ 201,388	$ 180,921	$ 142,372	$ 158,426	$ 291,416
Revenues:					
Lottery revenues	1,932,692	2,100,096	2,350,892	2,645,713	3,046,854
Investment income	23,042	15,139	13,127	17,282	25,360
Other revenues	65,474	68,522	73,681	68,412	78,331
TOTAL REVENUES AND OTHER SOURCES	$ 2,021,208	$ 2,183,757	$ 2,437,700	$ 2,731,407	$ 3,150,545
Expenditures:					
Operating expenses (b)	$ 1,682,675	$ 1,827,306	$ 2,051,646	$ 2,298,417	$ 2,704,265
Other Uses:					
Operating transfers out	359,000	395,000	370,000	300,000	380,000
TOTAL EXPENDITURES AND OTHER USES	$ 2,041,675	$ 2,222,306	$ 2,421,646	$ 2,598,417	$ 3,084,265
REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURE AND OTHER USES	(20,467)	(38,549)	16,054	132,990	66,280
Net Assets - End of Period	$ 180,921	$ 142,372	$ 158,426	$ 291,416	$ 357,696
Components of Net Assets					
Invested in capital assets, net of debt	$ 107	$ 88	$ 83	$ 87	$ 31,771
Restricted for elderly programs	180,814	142,284	158,343	291,329	325,925
TOTAL NET ASSETS	$ 180,921	$ 142,372	$ 158,426	$ 291,416	$ 357,696

(a) For the fiscal year ended June 30, 2002 and subsequent fiscal years, the Commonwealth has adopted several new accounting and reporting standards described earlier in "COMMONWEALTH FINANCIAL STRUCTURE AND PROCEDURES – New Governmental Accounting and Reporting Standards." The new standards require numerous changes to how fund financial statements are presented. The State Lottery Fund has been reclassified from the governmental fund category to the proprietary fund category. The change in fund category also produced a change in basis of accounting and required a restatement of beginning fund balance/net assets for the fund at June 30, 2001. See Note B to the Comprehensive Annual Financial Report for the fiscal year ended June 30, 2002 for a more detailed explanation. These changes limit comparability of fiscal year 2002 through 2006 data to data reported for prior fiscal years.

(b) The reclassification of the State Lottery Fund to the proprietary fund category caused a change in reporting of all expenditures as operating expenses.

Source: Compiled from Office of the Budget, Comprehensive Annual Financial Report for fiscal years ended June 30, 2002 through 2006.

Fiscal Year 2008 Proposed Budget

The Governor's proposed fiscal year 2008 budget anticipates a 2.4 percent increase in revenues from lottery sources, including instant ticket sales and the state's participation in the multi-state Powerball game. Appropriations totaling $1,821.1 million are recommended, which represents an increase of $387.4 million or 27.0 percent over fiscal year 2007. The existing Property Tax and Rent Rebate program has been expanded to include an additional 422,000 senior citizens and appropriations for this program are proposed to rise from $130.0 million in fiscal year 2007 to $324.9 million in fiscal year 2008. The fiscal year 2007 budget also expanded the Commonwealth's prescription drug coverage program to cover an additional 120,000 seniors and an additional $74.4 million is proposed as part of the fiscal year 2008 budget for this expansion and to cover the increasing cost of prescription drugs. Additionally, the Governor's proposed fiscal year 2008 budget includes a transfer of approximately $248.8 million in long-term care costs from the

Commonwealth's General Fund to the State Lottery Fund. The proposed fiscal year-end balance and reserve is projected to total $572.7 million, a decrease of 20.5 percent.

Trend projections for fiscal years beyond fiscal year 2008 show estimated program and administrative costs above estimated net revenues as the forecasted rate of increase in program expenditures, namely the pharmaceutical assistance program, is expected to outpace revenues. The estimated expenditures in excess of estimated revenues will be 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 balance operations within a fiscal year.

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 proposed 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 following, 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 2001 through 2006 and as re-estimated for the fiscal year 2007 budget.

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Table 11
Commonwealth Revenues [a]
General Fund, Motor License Fund and State Lottery Fund - Unaudited
Fiscal Year 2001 – Fiscal Year 2006 and Fiscal Year 2007 Budget

(In Millions)

Fiscal Year Ended June 30

	2001	2002	2003	2004	2005	2006	Estimate 2007
General Fund							
Tax Revenues:							
Sales and use	$ 7,203.8	$ 7,292.5	$ 7,519.6	$ 7,728.5	$ 8,000.0	$ 8,334.2	$ 8,545.7
Personal income	7,491.5	7,138.7	7,105.9	7,733.8	8,746.8	9,524.1	10,030.0
Corporate (b)	2,666.4	2,331.9	2,292.9	2,661.7	2,947.3	3,382.8	3,400.5
Public utility (c)	705.8	739.4	897.6	1,062.7	1,167.1	1,191.2	1,259.5
Inheritance	799.8	779.6	693.8	747.6	716.1	745.2	738.2
Financial and insurance (d)	481.3	516.9	545.0	608.3	619.6	595.0	607.7
Cigarette	269.3	266.8	826.7	856.4	784.4	792.1	778.0
Realty transfer	268.8	290.5	362.6	400.6	472.5	552.5	571.7
Alcoholic beverages (e)	187.6	197.4	219.9	221.4	237.4	249.2	267.0
Other	16.6	19.9	33.2	25.0	21.3	3.7	25.0
TOTAL TAX REVENUES	$ 20,090.9	$ 19,573.6	$ 20,497.2	$ 22,046.0	$ 23,712.5	$ 25,370.0	$ 26,223.3
Non-Tax Revenues:							
Liquor store profits	$ 50.0	$ 120.0	$ 155.0	$ 50.0	$ 54.9	$ 80.0	$ 150.0
Licenses, fees and miscellaneous	387.7	333.4	627.4	696.9	509.1	368.6	453.7
Fines, penalties and interest	33.1	32.6	34.9	35.1	32.0	35.5	39.2
TOTAL NON-TAX REVENUES	$ 470.8	$ 486.0	$ 817.3	$ 782.0	$ 596.0	$ 484.1	$ 642.9
TOTAL GENERAL FUND	$ 20,561.7	$ 20,059.6	$ 21,314.5	$ 22,828.0	$ 24,308.5	$ 25,854.1	$ 26,866.2
Motor License Fund							
Tax Revenues:							
Liquid fuels	$ 567.8	$ 578.5	$ 579.4	$ 587.1	$ 588.4	$ 581.8	$ 590.8
Fuels use	146.2	148.4	148.8	155.0	157.4	162.4	165.2
Oil company franchise	324.5	337.3	343.1	342.4	381.3	445.2	472.5
Motorbus & alt fuels	31.7	26.4	34.2	28.6	32.7	36.6	37.9
TOTAL TAX REVENUES	$ 1,070.2	$ 1,090.6	$ 1,105.5	$ 1,113.1	$ 1,159.8	$ 1,226.0	$ 1,266.4
Non-Tax Revenues:							
Licenses and fees	$ 795.4	$ 814.4	$ 828.8	$ 843.2	$ 876.9	$ 877.8	$ 882.7
Other and miscellaneous	86.3	50.2	64.5	129.4	120.1	162.0	144.8
TOTAL NON-TAX REVENUES	$ 881.7	$ 864.6	$ 893.3	$ 972.6	$ 997.0	$ 1,039.8	$ 1,027.5
TOTAL MOTOR LICENSE FUND	$ 1,951.9	$ 1,955.2	$ 1,998.8	$ 2,085.7	$ 2,156.8	$ 2,265.8	$ 2,293.9
State Lottery Fund							
Non-Tax Revenues:							
Lottery revenues	$ 916.1	$ 989.6	$ 1,057.0	$ 1,152.2	$ 1,194.0	$ 1,430.1	$ 1,493.9
Other and miscellaneous	11.7	12.9	9.8	18.3	17.9	29.5	139.1
TOTAL NON-TAX REVENUES	$ 927.8	$ 1,002.5	$ 1,066.8	$ 1,170.5	$ 1,211.9	$ 1,459.6	$ 1,633.0
TOTAL STATE LOTTERY FUND	$ 927.8	$ 1,002.5	$ 1,066.8	$ 1,170.5	$ 1,211.9	$ 1,459.6	$ 1,633.0

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.

Table 12, on the following page, 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 2002 through 2006.

Table 12
Commonwealth Revenues — Official Estimate vs. Actual[(a)]
General Fund and Motor License Fund – Unaudited
Fiscal Year 2002 — Fiscal Year 2006
(In Millions)

	General Fund			Motor License Fund		
Fiscal Year Ended June 30	Official Estimate[(b)]	Actual	Variance	Official Estimate [(b)]	Actual	Variance
2002	21,328.3	20,059.6	-1,268.7	1,955.8	1,955.2	-0.6
2003	21,812.1	21,314.5	-497.6	2,029.3	1,998.8	-30.5
2004	22,191.3	22,828.0	636.7	2,026.3	2,085.7	59.3
2005	23,866.5	24,308.5	442.0	2,101.9	2,156.9	55.0
2006	24,989.9	25,854.3	864.4	2,229.2	2,265.9	36.7

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 percent of Commonwealth revenues in the General Fund. The major tax sources for the General Fund of the Commonwealth are the personal income tax, the sales tax, the corporate net income tax, and the capital stock and franchise tax. Together these four taxes produce over 81 percent of General Fund tax revenues.

The major tax sources for the Motor License Fund are the liquid fuels taxes and the oil company franchise tax. Together these taxes produce nearly 54 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 $9,524.1 million or 36.8 percent of fiscal year 2006 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 is 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 $8,334.2 million or 32.2 percent of fiscal year 2006 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 1998, 1.22 percent of collections, up to an annual limit of $75 million, are transferred to a special fund for mass transit assistance. Beginning in fiscal year 2004, an additional 0.417 percent of receipts are transferred for transit assistance purposes.

Vendors collecting $600 or more of sales tax in the previous year's third quarter are required to remit collections monthly within 20 days of the last day of the collection month.

Corporate Net Income Tax. The Commonwealth received $2,301.9 million, or 8.9 percent of fiscal year 2006 General Fund Commonwealth revenues, from this tax. The tax is paid by all domestic and foreign corporations for the privilege of doing business, carrying on activities, or employing capital or property in Pennsylvania and is levied on federal net taxable income with Pennsylvania modifications. Building and loan associations, banks, savings institutions, trust companies, insurance and surety companies, Pennsylvania S corporations and non-profit 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.

Utility Gross Receipts Tax. This tax accounted for $1,150.9 million, or 4.5 percent of fiscal year 2006 General Fund Commonwealth revenues. The tax is levied on the gross receipts from business transacted within Pennsylvania by specified public utilities owned, operated or leased by corporations, associations or individuals. Public utilities owned or operated by a municipality or a municipal authority furnishing public utility services within the limits of the municipality are exempt from paying tax on the receipts arising from business done within 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 44 mills. The tax rate for electric utilities is adjusted annually under provisions of a formula enacted with the deregulation of electric generation in Pennsylvania. Beginning with fiscal year 1999, 0.18 percent of receipts are transferred to a special fund for mass transit purposes. Revenue from 0.2 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 and motor transportation companies, are required to file estimated revenue reports annually, together with the tentative payment of the current year's tax calculated by applying the current tax rate to 90 percent of the tax base for the preceding year. Effective for tax years after January 1, 2000, natural gas companies became exempt from the tax. The tax report and tentative 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 $1,080.9 million for the Commonwealth in fiscal year 2006, or 4.2 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 tentative payments are payable quarterly based on 90 percent of the tax liability of the year preceding the immediate prior year. Under current law, the General Fund tax rate for tax years that began in 2006 is 4.89 mills, having been reduced from 5.99 mills effective January 1, 2006. This tax is scheduled to be phased out by annual rate reductions through 2010 under legislation enacted in 2002 and amended in 2003 and 2006.

Cigarette Tax. Collections of this tax totaled $792.1 million in fiscal year 2006, or 3.1 percent of General Fund Commonwealth revenues. The tax is imposed and assessed on the sale or possession of cigarettes 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 $1.35 per package of 20 cigarettes, which was increased by 31 cents in 2002 and further increased by 35 cents effective in 2004. The 6 percent sales tax is also imposed on the retail sale of cigarettes. 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. Additionally, an amount approximately equal to 25 cents per pack is transferred to the Healthcare Provider Retention Account.

Inheritance and Estate Taxes. Collections of these taxes were $745.2 million in fiscal year 2006, or 2.9 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 descendents was lowered to 4.5 percent and a new tax rate of 12 percent on transfers to siblings was established. The estate tax is a "pick-up" tax in the amount of the maximum federal tax credit less State death taxes paid. 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.

A 90 percent tentative payment is required for insurance companies, except foreign fire and casualty companies, calculated on the tax base of the preceding tax year. As an alternative, the taxpayer may elect to make a tentative payment in an amount not less than 90 percent of the tax as finally reported. Payments must be submitted by March 15 of each year, while the remaining amount due must be paid by April 15 of the following 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. From July 1994 through December 2001, fifteen percent of the revenues from this tax was transferred to the Keystone Recreation, Park and Conservation Fund, and the remaining portion was deposited in the General Fund. For the period from January 2002 through June 2002, the transfer amount was reduced to 10 percent; from July 2002 to June 2003, the transfer was reduced to seven and one-half percent. Effective July 2003, the transfer is fifteen percent. The fiscal year 2007 enacted budget includes a one-year suspension of the fifteen percent transfer to the Keystone Recreation, Park and Conservation Fund.

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 1.25 percent of the value of shares of state and national banks and title insurance companies. Each institution computes the tax base by averaging the share value, adjusted to exclude the value of United States obligations, for each quarter of the previous calendar year. A payment of the tax for the current tax year is due by March 15 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. Annually, the mutual thrift institutions are required to transmit tentative reports together with a tentative payment of the current year's tax computed by applying the current tax rate to 90 percent of the tax base for the second preceding tax year. The taxpayer may elect to make a tentative payment at an amount not less than 90 percent of the tax as finally reported. Tentative reports and prepayments are due by March 15 of the current calendar year, with the remaining amount payable by April 15 of the next year.

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. Revenues from an additional 7.6 mill tax are deposited into a special revenue 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.

Malt Beverage Tax. This tax is levied on all malt or brewed beverages sold in Pennsylvania. The tax rate is $^2/_3$ 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 $581.8 million, or 25.7 percent of Motor License Fund Commonwealth revenues in fiscal year 2006. It is an excise tax imposed upon all liquid fuels 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. This tax accounted for $445.2 million, or 19.6 percent of fiscal year 2006 Motor License Fund Commonwealth revenues. The tax is levied on the privilege of selling petroleum products subject to liquid fuels taxes (primarily gasoline) for transportation purposes at the rate of 153.5 mills upon each dollar of such revenues. The tax rate was increased by 38.5 mills in May 1997 to its current rate. 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 $162.4 million, or 7.2 percent of fiscal year 2006 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 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.

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 2006 totaled $115.8 million, representing 0.4 percent of Commonwealth revenues to the General Fund. A general increase in various General Fund fees was enacted in December 2003 and effective beginning in January 2004. Revenues from motor vehicle licenses and fees in fiscal 2004 were $877.89 million, representing 38.7 percent of total fiscal year 2006 Motor License Fund Commonwealth revenues. A general increase in various fees and licenses was enacted in April 1997 and effective beginning with the 1998 fiscal year.

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 2006 totaled $252.8 million or 0.9% of the Commonwealth revenues to the General Fund. Receipts from miscellaneous motor vehicle revenues in fiscal 2006 were $162.0 million, representing 7.1 percent of total fiscal year 2006 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 2006 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 tax regulations. The amount deposited to the General Fund for fiscal year 2006 was $35.5 million. The largest portion is from corporation tax penalties.

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 FINANCAL STRUCTURE AND PROCEDURES – Description of Funds."

Federal Revenues

Receipts by the Commonwealth in its General Fund, Motor License Fund, Tobacco and State Lottery Fund from the federal government during fiscal year 2006 totaled $17.5 billion, while such federal receipts are expected to total $17.8 billion in fiscal year 2007. Approximately $11.4 billion, or 65.4 percent of total federal revenue to the Commonwealth for fiscal year 2006, 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 2007 $11.8 billion, or 66.1 percent of federal revenues, will be attributable to these types of programs.

For fiscal year 2008, funds expected to be received from the federal government in the General Fund, the Motor License Fund, the Tobacco Fund and the State Lottery Fund are estimated to be $17.5 billion.

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 2006 and the enacted budget for fiscal year 2007.

Education

In fiscal year 2006, expenditures from Commonwealth revenues for education purposes were over $10.1 billion. The enacted budget for fiscal year 2007 includes over $10.8 billion in education funding, an increase of 7.6 percent over fiscal year 2006. The proposed budget for fiscal year 2008 includes over $11.4 billion in education funding.

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 501 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 from the Commonwealth. The largest such subsidy is the Basic Education Funding subsidy. The enacted budget for fiscal year 2007 increases Basic Education Funding by over $267 million, or 5.9 percent, to over $4.78 billion. The increase includes a base supplement based on school district enrollment and relative wealth, a small district assistance component, an enrollment growth supplement and a supplement based upon school district personal income and relative wealth and a supplement based upon enrollment and relative local taxing effort. For fiscal year 2007, every school district is guaranteed a 3.5 percent increase over its fiscal year 2006 total allocation. The recommended budget for fiscal year 2008 includes $4.95 billion, or a $166.67 million or 3.48 percent increase over fiscal year 2007.

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 annual General Fund appropriations and 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 2006 were over $8.1 billion, representing 80.1 percent of all Commonwealth expenditures for education in fiscal year 2006. The enacted budget for fiscal year 2007 includes over $8.7 billion for basic education programs and the recommended budget for fiscal year 2008 includes over $9.2 billion for basic education programs.

Table 13
Fall Enrollment in Pennsylvania Public and
Non-Public Elementary Schools and Secondary Schools
School Years 2002-2006
(In Thousands)

	School Year Ended June				
	2002	**2003**	**2004**	**2005**	**2006**
Elementary Schools					
Public	960	942	933	935	931
Nonpublic	236	229	220	210	203
Secondary Schools					
Public	862	875	888	893	900
Nonpublic	85	84	83	81	78
Total					
Public	1,822	1,817	1,821	1,828	1,831
Nonpublic	321	313	303	291	281
Total	2,143	2,130	2,124	2,119	2,112

Source: Pennsylvania Department of Education.

Philadelphia School District. The Secretary of Education of the Commonwealth, under the provisions of the Commonwealth's Public School Code (the "School Code"), declared the Philadelphia School District as distressed effective December 22, 2001. During the period of distress covered by that declaration, all powers and duties of the Philadelphia School District Board of Education granted under the School Code or any other law are suspended and all such powers and duties are vested in a school reform commission. Currently, the school reform commission statutorily consists of five members, four appointed by the Governor and one appointed by the Mayor of the City of Philadelphia. The school reform commission's objectives are to improve the levels of academic achievement and achieve financial stability within the school district. Termination of the declaration of distress by the Secretary of Education of the Commonwealth may be made only upon the recommendation of a majority of the members of the school reform commission. Upon termination of the declaration of distress, the Philadelphia School District Board of Education will resume the exercise of its powers. The fiscal year 2006 budget included a $25 million appropriation for the Philadelphia School District. Funding for the Philadelphia School District was formerly shown under its own appropriation. That funding is now included as part of the Basic Education Funding appropriation in the fiscal year 2007 enacted budget and the fiscal year 2008 proposed budget.

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 ("SSHE"), four State-related universities, community colleges, independent colleges/universities and specialized degree-granting institutions. SSHE, 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. Over $1.90 billion was expended by the Commonwealth in the 2006 fiscal year for these institutions and for student financial assistance. The enacted budget for fiscal year 2007 includes over $2.016 billion for higher education while the fiscal year 2008 budget proposes over $2.03 billion for higher education.

Table 14
Full-Time Equivalent Enrollment at State-Supported Institutions of Higher Education
School Years 2002-2006
(In Thousands)

	School Year Ended June				
	2002	**2003**	**2004**	**2005**	**2006**
State System of Higher Education.	94	96	95	99	100
State-Related Universities	137	140	141	141	141
Community Colleges	75	81	87	88	91
State-Aided Institutions	39	40	42	43	44
Total	345	357	365	371	376

Source: Governor's Executive Budget, various years.

Public Health and Human Services

The Commonwealth provides temporary support for its residents who are seeking to achieve and sustain independence. It also provides care, treatment and rehabilitation to persons with mental and physical disabilities and supports programs to prevent or reduce social, mental and physical disease and disabilities. In addition, it plans for and coordinates all the health resources within Pennsylvania. Services are provided directly through administration of programs and services, and indirectly through programs of standard setting, regulation, supervision, licensing, grants, subsidies and purchases of services.

Fiscal year 2006 public health and human services expenditures were $23.8 billion and are projected to be $24.2 billion for fiscal year 2007. For fiscal year 2008, $24.6 billion is proposed for these purposes. Of the fiscal year 2007 expenditures, $9.6 billion will be funded from the General Fund, while $10.0 billion is estimated to be provided from the General Fund for fiscal year 2008. Federal funds are expected to increase by $249.1 million, and augmentations are expected to decrease by $125.5 million for fiscal year 2008. 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 as well as higher costs to provide support for former welfare clients obtaining work, federal mandates, litigation and continued support of county operated programs for child welfare, mental health and mental retardation.

The fiscal year 2008 proposed budget includes $361.0 million of receipts from the Tobacco Settlement Fund that will be expended for health care. Federal funds matching the additional state Tobacco MSA funds are included in the increase noted above. In addition, 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. For fiscal year 2007, receipts from the Tobacco MSA have been reduced by $42.8 million as certain tobacco companies decided to withhold or to place into escrow over $1 billion in payments from their April 2006 payments to the various states and localities under provisions of the Tobacco MSA. The Commonwealth's share of withheld Tobacco MSA funds totals $42.8 million and the Commonwealth has filed suit to recover the funding withheld by tobacco companies. For fiscal year 2008, estimated receipts from the April 2007 payment have been reduced by $43.2 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 $5.4 billion in fiscal year 2006, while $5.7 billion is budgeted from the General Fund for fiscal year 2007 and $6.1 billion is proposed for fiscal year 2008. The fiscal year 2006 budget included the use of $80.0 million in additional intergovernmental transfer funds to offset General Fund requirements and $40.0 million is estimated for fiscal year 2008. A nursing home assessment fee provided a General Fund offset of $213.3 million in fiscal year 2006 and is expected to provide $145.0 million offset in fiscal year 2007. In fiscal year 2008, the nursing home assessment offset is projected at $137.5 million. In addition, a managed care organization assessment provided a General Fund offset of $193.0 million in fiscal year 2006 and is expected to provide a $204.1 million offset in fiscal year 2007. The managed care organization offset is projected to provide $187.5 million in General Fund offset in fiscal year 2008. Approximately 41 percent of the total cost of assistance to the economically needy is 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 rapidly 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 1996 through 2006 by an average annual rate of 10.7 percent. Fiscal year 2007 expenditures from Commonwealth funds are projected to be $5.35 billion and the proposed budget for fiscal year 2008 provides $5.4 billion for medical assistance, an increase of 1.0 percent over the previous fiscal year. The increase reflects normal inflationary increases and is deflated by proposed cost containment initiatives and cash flow strategies anticipated to reduce General Fund expenditures by $462.2 million in fiscal year 2008. The Commonwealth has experienced the rise in medical and pharmaceutical costs that has been occurring nationwide. This increase is particularly evident in the rates requested by managed care providers and in services for children. Income maintenance cash assistance payments to families in transition to independence were $1,082.0 million for fiscal year 2007, of which $488.8 million is from the General Fund. The proposed budget for fiscal year 2008 includes a total of $1,117.9 million, with $538.9 million provided from the General Fund. Cash assistance is time-limited and requires participation in work activities to maintain eligibility. To support a client’s finding and retaining employment, small grants are available to clients to overcome employment obstacles such as child care, transportation, vision and hearing difficulties, and other such barriers. In fiscal year 2007 and the future, increased costs are expected to be incurred in training and support for the most hard to place clients in order to meet the 50 percent work participation requirements included in the Temporary Assistance to Needy Families Reauthorization. These increased costs will include some state-only payments for clients who are working the required amount but still require assistance to complete training.

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. The General Fund, the State Lottery Fund and other special funds, including the Public Transportation Assistance Fund, the Liquid Fuels Tax Fund, the Highway Beautification Fund and the Motor Vehicle Transaction Recovery Fund provide the remainder of funding for transportation programs.

In addition to its unrestricted state funds, the Motor License Fund includes five restricted revenue accounts funded by specific 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.

In addition to its support of the highway system, the Commonwealth provides subsidies for mass transit systems including passenger rail and bus service. The Commonwealth assists local mass transit systems through grants and payment for free rides by senior citizens during non-peak hours. In addition, transit operators receive payments for providing senior citizen transportation service on a shared-ride basis generally in areas where fixed route service is not available. A total of $444.8 million in Commonwealth revenues was expended from the General Fund and the State Lottery Fund for such purposes in fiscal year 2006, and $463.7 million is available for fiscal year 2007. In fiscal year 2008, an estimated $465.1 million is proposed. In addition, new funding is being proposed as part of the fiscal year 2008 budget that would add an estimated $760 million to this program. Beginning with fiscal year 1998, 1.22 percent of sales and use tax collections in the General Fund, up to an annual limit of $75 million, is transferred to a separate account and used to pay mass transportation operating grants to local mass transit systems.

In 1991, the Public Transportation Assistance Fund was created with dedicated sources of funding for mass transit systems. Funds totaling $174.4 million were expended from this fund in fiscal year 2006 and $175.6 million is available for fiscal year 2007. A total of $180.1 million is the proposed budget for fiscal year 2008.

Liquid fuels tax and license and fee revenues provide resources for expenditures for highway construction and maintenance. Motor License Fund restricted revenues budgeted for highway construction purposes totaled $594.2 million in fiscal year 2006. In fiscal year 2007, $625.8 million is available. In fiscal year 2008, an estimated $595.2 million is proposed. Combined Motor License Fund and restricted revenues expended for highway maintenance in fiscal year 2006 totaled $1,445.2 million. A total of $1,558.5 million is budgeted for fiscal year 2007 while an estimated $1,375.5 million is proposed for fiscal year 2008. In addition, new funding is being proposed as part of the fiscal year 2008 budget that would add an estimated $960 million for highway construction and maintenance. Support of highway and bridge expenditures by local governments through grants paid from Motor License Fund and restricted revenues were $325.5 million in fiscal year 2006. A total of $333.9 million is available for fiscal year 2007. In fiscal year 2008, an estimated $331.3 million is proposed.

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 2006, $8.3 million was expended from the aviation restricted account for such purposes. A total of $8.3 million is available for fiscal year 2007. For fiscal year 2008, $9.3 million is proposed.

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."

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 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.

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Table 15
General Obligation Debt Outstanding[(a)]
Fiscal Years 1997-2006
(In Millions)

June 30	General Obligation Debt Outstanding
1997	$4,795.1
1998	4,724.5
1999	4,921.5
2000	5,014.9
2001	5,416.2
2002	6,059.3
2003	6,767.2
2004	6,892.6
2005	6,747.4
2006	7,287.0

(a) Net of sinking fund balances for all debt.

Net outstanding general obligation debt totaled $7,287.0 million at June 30, 2006, a net increase of $539.6 million from June 30, 2005. Over the 10-year period ended June 30, 2006, total net outstanding general obligation debt increased at an annual rate of 3.7 percent. Within the most recent 5-year period, outstanding general obligation debt has increased at an annual rate of 6.1 percent.

General obligation debt for non-highway purposes of $7,149.9 million was outstanding on June 30, 2006. Outstanding debt for these purposes increased by a net $567.4 million since June 30, 2005. For the period ended June 30, 2006, the 10-year and 5-year average annual compound growth rate for total outstanding debt for non-highway purposes has been 5.4 percent and 7.1 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 $137.2 million on June 30, 2006, a decrease of $27.7 million from June 30, 2005. Highway outstanding debt has declined over the most recent 10-year and 5-year periods ended June 30, 2006, by the annual average rates of 16.7 percent and 17.0 percent respectively. The decline in outstanding highway debt is due to the policy begun in 1980 of funding highway capital projects with current revenues except for very limited exceptions. No debt issuance for highway capital projects is currently planned.

Table 16, on the following page, shows selected debt ratios for the Commonwealth for fiscal year 1996 and for fiscal years 2002 through 2006. 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).

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Table 16
Selected Debt Ratios
Fiscal Years 1996 and 2002 to 2006

	1996	2002	2003	2004	2005	2006
		Fiscal Year Ended June 30				
Net Outstanding Debt (Millions)						
General Obligation Debt(a)............................	$ 5,056	$ 6,059	$ 6,767	$ 6,893	$ 6,747	$ 7,287
Lease Payment Obligations(b).......................	942	687	648	114	108	476
Total...	$ 5,998	$ 6,746	$ 7,415	$ 7,007	$ 6,855	$ 7,763
% Increase (Decrease) over prior year..........	-9.0%	11.2%	9.9%	-5.5%	-2.2%	13.2%
Population (Thousands)	12,038	12,324	12,365	12,394	12,430	12,430
Per Capita Debt..	$ 498	$ 547	$ 600	$ 565	$ 551	$ 625
Personal Income (Millions)............................	$ 297,493	$ 382,251	$ 392,791	$ 412,890	$ 433,752	$ 433,752
Debt as a % of Personal Income..................	2.0%	1.8%	1.9%	1.7%	1.6%	1.8%
Debt Service (Millions)(c)						
Highway Bonds(d).......................................	$ 183	$ 84	$ 62	$ 50	$ 33	$ 36
All Other Bonds(e).......................................	530	676	701	718	766	800
Lease Payments..	113	70	73	12	12	125
Total...	$ 826	$ 830	$ 836	$ 780	$ 811	$ 961
Increase (Decrease) Over Prior Year	-4.2%	(0.1%)	0.7%	(6.7%)	4.0%	18.5%
Cash Revenues (Million)[f]						
Motor License Fund.....................................	$ 1,566	$ 1,955	$ 1,999	$ 2,086	$ 2,157	$ 2,266
General Fund...	16,339	20,059	21,315	22,828	24,309	25,854
Total...	$ 17,905	$ 22,014	$ 23,314	$ 24,914	$ 26,465	$ 28,120
% Increase (Decrease) over prior year.........	0.7%	(2.2%)	5.9%	6.9%	6.2%	6.3%
Highway Bond Debt Service as a % of Motor Fund Revenues..	11.7%	4.3%	3.1%	2.4%	1.5%	1.6%
All Other Bond Debt Service and Lease % of General Fund Revenues............................	3.9%	3.7%	3.6%	3.2%	3.2%	3.6%
Total Debt Service and Lease Payments as a % License and General Fund Revenues.................	4.6%	3.8%	3.6%	3.1%	3.1%	3.4%

(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) Fiscal year 2002 decline due to use of available balance in lieu of appropriations.
(f) Commonwealth revenues only.

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General Obligation Debt Outstanding

As of June 30, 2006, the Commonwealth had the following amount of general obligation debt outstanding:

Table 17
General Obligation Debt Outstanding as of June 30, 2006
(In Thousands)

	Debt Outstanding[b]	Less: Refunding Escrow[c]	Less: Sinking Fund[d]	Net Debt Outstanding
Capital Projects Debt:				
Capital Facilities Bonds	$ 5,361,580	$ (1,500,075)	$ (7,748)	$ 3,853,757
Highway Bonds	-	-	-	-
Refunding Bonds	2,633,862	-	-	2,633,862
Total Capital Projects Debt Outstanding	$ 7,995,442	$ (1,500,075)	$ (7,748)	$ 6,487,619
Electorate Approved Debt:				
PA Economic Revitalization Bonds	$ 2,880	. . . .	-	$ 2,880
Land & Water Development Bonds	1,440	-	(189)	1,251
Nursing Home Loan Development Bonds	-	-	-	-
Volunteer Companies' Loan Bonds	6,740	(5,325)	-	1,415
Vietnam Veterans Compensation Bonds	-	-	-	-
Water Facilities Restoration-1981 Referendum	13,210	(2,475)	-	10,735
Pennvest—1988 Referendum Bonds	53,775	(7,600)	-	46,175
Pennvest—1992 Referendum Bonds	26,700	(5,550)	-	21,150
Agricultural Conservation Easement Bonds	16,185	(6,050)	-	10,135
Local Criminal Justice Bonds	10,670	(4,200)	-	6,470
Keystone Recreation, Parks & Conservation Bonds	8,400	(6,750)	-	1,650
Growing Greener Bonds	183,000	-	-	183,000
Water Supply and Wastewater Treatment Bonds	50,000	-	-	50,000
Total Electorate Approved Debt Outstanding	$ 373,000	$ (37,950)	$ (189)	$ 334,861
Other Bonded Debt:				
Disaster Relief Bonds	$ 17,095	(9,025)	(2)	$ 8,068
Refunding Bonds	456,483	-	-	456,483
Total Other Bonded Debt Outstanding	$ 473,578	$ (9,025)	(2)	$ 464,551
Total General Obligation Debt Outstanding	$ 8,842,020	$ (1,547,050)	$ (7,939)	$ 7,287,031

[a] Subsequent to June 30, 2006, the Commonwealth has issued $950,670,000 million of bonds, which included $250,670,000 of refunding bonds.
[b] Accreted value of capital appreciation bonds included.
[c] Principal amount of bonds refunded to be paid from State Treasurer escrow account.
[d] Balance in sinking fund.

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Debt service payable during each fiscal year on outstanding general obligation debt, net of refunding escrow amounts, as of June 30, 2006, for the years shown is as follows:

Table 18
Bond Debt Service
(In Thousands)

Fiscal Year Ending June 30	Principal	Interest	Total
2007	$521,774	$361,874	$883,648
2008	540,397	336,911	877,308
2009	541,620	309,283	850,903
2010	537,245	277,681	814,926
2011	544,005	249,337	793,342
2012	541,065	221,296	762,361
2013	516,695	193,722	710,417
2014	465,885	167,510	633,395
2015	404,520	143,968	548,488
2016	365,225	124,664	489,889
2017	334,385	107,426	441,811
2018	324,875	90,895	415,770
2019	312,725	74,227	386,952
2020	279,540	59,496	339,036
2021	259,035	47,959	306,994
2022	239,120	35,533	274,653
2023	183,945	24,913	208,858
2024	156,125	16,131	172,256
2025	99,650	9,179	108,829
2026	88,065	4,697	92,762
2027	28,085	702	28,787
Grand Total	$ 7,283,980	$ 2,857,406	$ 10,141,386

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, 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 two of the 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 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 that outstanding, may not exceed in the aggregate 20 percent of the revenues estimated to accrue to the appropriate fund or both funds in the fiscal year.

Tax anticipation notes must mature within the fiscal year in which they were 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 within the succeeding fiscal year's budget.

Currently, the Commonwealth has no tax anticipation notes outstanding. The fiscal year 2008 budget does not anticipate issuing tax anticipation notes.

In the last nine fiscal years, the Commonwealth has not issued any tax anticipation notes.

Bond Anticipation Notes. Pending the issuance of bonds, the Commonwealth may issue bond anticipation notes subject to the applicable 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 long-term bonds or bond anticipation notes through fiscal year 2011 as currently estimated based on current authorizations. Included in Table 19 are bonds expected to be issued under two bond referendums proposed by the Governor and enacted by the General Assembly in 2004 and 2005. 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 this projection.

Table 19
Projected Bond Issuance and Principal Retirements
Fiscal Years 2007-2011[(a)]
(In Millions)

	Fiscal Year Ending June 30				
	2007	**2008**	**2009**	**2010**	**2011**
Capital Facilities[(b)]					
Buildings and Structures	$ 400	$ 320	$ 780	$ 835	$ 735
Furniture and Equipment	0	25	80	11	1
Transportation Assistance	95	150	150	150	150
Redevelopment Assistance	353	250	315	375	230
Flood Control	0	7	5	2	3
Special Purpose:					
Pennvest — 1988 & 1992 Referenda	70	40	10	0	0
Local Criminal Justice	0	0	0	0	0
Disaster Relief	0	0	0	0	0
Water Facilities Loan—1981 Referendum	0	0	0	0	0
Water and Wastewater Referendum[(a)]	64	81	40	0	0
Growing Greener II Referendum[(a)]	27	105	105	105	1000
Total Projected Issuance	$ 1,009	$ 981	$ 1,490	$ 1,485	$ 1,224
Principal Retirement[(c)]	$ 521.8	$ 587.3	$ 641.1	$ 685.6	$ 737.4

Totals may not add due to rounding.
(a) As proposed in fiscal year 2008 budget.
(b) Includes issuance for new projects and for projects previously authorized.
(c) On bonded debt outstanding and pro forma for projected.

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, 2006, PHFA had $3,787.5 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 their respective lease payments 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 obligations of significant amounts secured by lease payments from leases with Commonwealth departments and agencies payable from the General Fund or other budgeted special funds.

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

Lessor	Purpose	Maximum Annual Lease Payment	Principal Amount Outstanding as of 12/31/2006	Final Maturity
Harristown Development Corporation	Office Space	$ 6,306	$ 53,360	May 1, 2016
Philadelphia Regional Port Authority	Port Facilities	4,601	43,900	Sept. 1, 2020

The Harristown Development Corporation leases office space to the Commonwealth in the city of Harrisburg. Certificates of participation in the principal amount of $71,135,000 were issued in October 2001, 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. These bonds are payable from lease payments made by the Commonwealth from an annual appropriation authorizing payments to PRPA.

These lease obligations and agreements to lease various other facilities and equipment entered into by the Commonwealth are included in Note K to the Fund Financial Statements for the fiscal year ended June 30, 2006.

Commonwealth Financing Authority

The Commonwealth Financing Authority (the "CFA"), a major component of the Governor's Economic Stimulus Proposals for the Commonwealth, 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 its 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 will not be a debt or liability of the Commonwealth but it is expected that the CFA may issue debt that may be payable from appropriations of the Commonwealth.

In November 2005, the CFA issued its first bonds and since that time, the CFA has completed two additional bond issues. As of December 31, 2006, the CFA had $562.5 million in outstanding bond debt. The Commonwealth's fiscal year 2007 enacted budget appropriated $36.939 million in state funds to the CFA for payment of all or a portion of CFA debt service during fiscal year 2007. In addition, the Governor's Proposed Budget for fiscal year 2008 included a request for appropriation of $61.617 million in state funds. Additional appropriations from Commonwealth General Funds for future debt service beyond those mentioned in this section are expected to be requested by the Department of Community and Economic Development for inclusion in future Governor's 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, which 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. 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 enroll in the pension plan on or after January 1, 2002 is 7.5 percent of compensation. The contribution rates for PSERS members who enrolled prior to such date range from 5 percent to 7.5 percent of compensation depending upon their date of employment and elections made by the member. The SERS' employee contribution rate is 6.25% for a majority of its members. Interest on each employee's accumulated contributions is credited annually at a 4 percent rate mandated by state statute. Accumulated contributions plus interest credited is refundable to covered employees upon termination of their employment.

Act 40 of 2003 ("Act 40"), passed by the General Assembly on December 10, 2003, amended the PSERS' actuarial cost method. Under Act 40, both the outstanding balance of the unfunded accrued liability as of June 30, 2001 and the decrease in the unfunded accrued liability due to the actuarial asset method change provided by Act 38 of 2002 ("Act 38"), passed by the General Assembly on April 23, 2002, continue to be amortized over a 10-year period, with level dollar funding, beginning July 1, 2002 [Under Act 38, they were amortized over 30 years.]. The increases in the unfunded accrued liability due to the July 1, 2002 and July 1, 2003 cost-of-living adjustments provided by Act 38 continue to be amortized over a 10-year period, with level dollar funding, starting on July 1, 2003 and July 1, 2004, respectively. All other changes in the unfunded accrued liability at June 30, 2001, June 30, 2002, and June 30, 2003, are amortized over a 30-year period, with level dollar funding, starting on July 1, 2002, July 1, 2003, and July 1, 2004, respectively. Future benefit improvements for active members and retirees will be amortized over a 10-year period with level dollar funding. Future gains and losses will be amortized over a 30-year period with level dollar funding. Act 40 requires a minimum employer contribution of 4.00 percent for PSERS.

With respect to SERS, Act 40 set the amortization period for the accrued liabilities at 10 and 30 year schedules with level payments. Additionally, Act 40 increased minimum contributions for SERS to 2%, 3%, and 4% effective July 1, 2004, 2005, and 2006, respectively; these minimum contribution provision for SERS will expire on July 1, 2007 unless extended. Supplemental annuity contributions are funded over 10 years with level dollar payments. SERS employer rates vary by class/category of service. For fiscal year 2006, the SERS composite employer rate was 3.02 percent and for fiscal year 2007, it is 4.02 percent.

For PSERS, the employer's contribution is shared by the Commonwealth and the school districts. For school entities, the Commonwealth remits its employer contribution portion to those school entities, which then remit the entire employer contributions (both school entity and Commonwealth portions) to PSERS. The Commonwealth's contribution is appropriated annually from the General Fund to the Department of Education. The PSERS employer rate for fiscal year 2006 is 4.69 percent, for fiscal year 2007 it is 6.46 percent, and for fiscal year 2008 it is 7.13 percent.

Commonwealth contributions to both pension systems are projected to increase significantly in fiscal year 2007, based on current assumptions. Commonwealth contributions to SERS and PSERS were $172.6 million and $254.50 million respectively in fiscal year 2006. The fiscal year 2007 enacted budget includes Commonwealth contributions for both SERS and PSERS of $204.0 million and $368.8 million respectively, an 18 and 45 percent increase respectively in the year-over-year contribution to each system. The proposed fiscal year 2008 budget includes $216 million and $452.2 million for SERS and PSERS respectively, with the SERS contribution reflecting the proposed change in the SERS employer contribution rate described below. Additionally, based on the most recent valuations of the two systems, after several years of projected moderate increases, Commonwealth contributions to both systems are projected to increase significantly in fiscal year 2013. Current projections forecast that Commonwealth contributions to SERS will be zero in fiscal year 2012, due mainly to the expiration of the minimum contribution provisions for SERS as provided in Act 40, as well as the continued effect of the change in the amortization period from 30 years to 10 years in Act 40. However, the Commonwealth contributions to SERS are projected to rise to $711.0 in fiscal year 2013. For PSERS, the number is $349.0 million for fiscal year 2012 and $1,203.0 million for fiscal year 2013. On April 25, 2007, the SERS Board certified an employer contribution rate of 1.91 percent, but the Governor's Executive Budget for fiscal year 2008 proposes maintaining the rate at the significantly higher 4.0 percent level for agencies under the Governor's jurisdiction. If the Governor's proposal is not enacted into law through amendments to the Retirement Code, the forecast employer contribution of SERS in fiscal year 2012 is estimated to be $729.5 million.

The projected Commonwealth contribution levels for fiscal years 2012 and 2013 listed above are materially higher than those projected in the Commonwealth's last Official Statement dated December 5, 2006.

The projected increases reflect a variety of factors. These include a significant increase in benefits enacted in 2001, a cost of living adjustment implemented in 2002 and actuarial method changes enacted in 2002 and 2003.

Both SERS and PSERS have recently announced strong investment returns – 16.4 percent for SERS and 15.3 percent for PSERS in fiscal year 2006. Three years of top-decile investment returns have reduced the forecast fiscal year 2013 contribution rate for both systems. The projected fiscal year 2013 contribution rate for SERS has been reduced from 24.9 percent of payroll, based on the 2003 valuation, to 10.2 percent of payroll, based on the 2006 valuation. With respect to PSERS, the projected fiscal year 2013 employer contribution has been reduced from 27.7 percent of payroll, based on the 2003 valuation, to 18.7 percent of payroll, based on the 2006 valuation. Under current law and using such assumptions, employer contributions for SERS could now be virtually eliminated between fiscal year 2009 and fiscal year 2012 and Commonwealth contributions to PSERS could decrease from $445 million in fiscal year 2008 to less that $350 million by fiscal year 2012. The systems' most recent valuations, however, still project at least a single-year increase of approximately 700 percent from zero to at least $700 million for SERS in fiscal year 2013 and a 240 percent increase, from approximately $500.0 million to at least $1,200.0 million in the Commonwealth employer contribution rate for PSERS in fiscal year 2013. Such forecasts and their accuracy in terms of the amount of funding actually required in future years may also be affected by the actuarial procedures required under state law. Required contributions in forecasts for the period ending in 2012 are, under current procedures, positively affected, i.e., the are lower than they otherwise would be, because of the unusually high investment returns in recent years and their assumed continuance in forecasted future returns. Forecasts assuming annual 15 to 16 percent investment returns should be appropriately discounted to reflect more conservative investment assumptions.

Reflecting the above numbers and factors, the Commonwealth currently is actively evaluating ways both to moderate and to finance the substantial contribution increases now projected to begin in fiscal year 2012.

Contributions to the pension plans by the employer (including normal costs and payments to amortize prior service costs and medical premium assistance payments), employee contributions, interest earnings on the plans and benefit payments are shown in the tables on the following page, which have been prepared by the staffs of SERS and PSERS.

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

Year Ended June 30	Employer Contributions	Employee Contributions	Net Investment Income	Total Deductions From Plan Net Assets[(a)]	Net Assets[(b)]
2002	$109	$806	$(2,523)	$2,948	$43,597
2003	116	897	1,022	3,144	42,488
2004	407	944	8,245	3,547	48,537
2005	458	955	6,081	3,920	52,111
2006	531	983	7,943	4,164	57,417

(a) Includes the PSERS administrative expenses.
(b) 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 presentation for these programs are made on 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)

Year Ended December 31	Employer Contributions	Employee Contributions	Net Investment Income[(a)]	Total Deductions From Plan Net Assets[(b)]	Plan Net Assets[(c)]
2001	$77	$241	$(2,226)	$1,266	$24,706
2002	51	304	(2,731)	1,450	20,880
2003	69	308	4,936	1,656	24,536
2004	107	310	3,569	1,881	26,641
2005	148	306	3,623	1,966	28,752
2006	196	318	4,730	1,943	32,053

(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. GASB Statement No. 25 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. The 2006 year data is unaudited.

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. The actuary's recommendations for employer contribution rates represent a funding plan for meeting current and future retirement obligations and are included in the enacted budget for the current fiscal year. The employer's contribution rate is computed to fully amortize the unfunded actuarial accrued liability of the respective plan as determined by its actuary. The unfunded accrued liability is a measure of the present value of benefits estimated to be due in the future for current employees given assumptions as to mortality, pay levels, retirement experience and employee turnover, less the present value of assets available to pay those benefits given assumptions of normal cost, supplemental annuity amortization, employer contribution levels and member contributions. The unfunded actuarial accrued liability for the most recent years with completed valuations based on the projected benefit method utilizing level percentage entry age and normal cost is shown in Table 23 on the following page. Both SERS and PSERS currently use an investment rate of return assumption of 8.5 percent.

Table 23
Unfunded Actuarial Accrued Liability
2001-2005
(In Millions)

Valuation Year Ended	SERS[(a)]	PSERS[(b)]
2001	(3,846)	(6,913)
2002	(1,848)	(2,500)
2003	(1,286)	(1,543)
2004	1,099	5,028
2005	2,058	10,007
2006	NA	12,163

(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 from 2001 to 2005 is attributable to pension plan modification under Act 9 of 2001 and Act 38 of 2002 and actual rates of return below the actuarially assumed rate.

For financial reporting purposes, both SERS and PSERS have adopted the Governmental Accounting Standards Board's Statement No. 25. This Statement requires a specific method of accounting and financial reporting for defined benefit pension plans. Among other things, the Statement requires a comparison of employer contributions to "annual required contributions" (the "ARC'). Independently audited financial statements for both SERS and PSERS, as of December 31, 2005 and June 30, 2006, respectively, provide this comparison for each of the five fiscal years then ended.

Other Post-Employment Benefits

In addition to a defined benefit retirement plan for State employees and employees of certain state-related organizations, the Commonwealth also provides certain health care benefits for Commonwealth retirees and retired State Police enlisted members. These and similar benefits are commonly referred to as "other post-employment benefits" or "OPEB." The State Police retiree benefits are determined through collective bargaining, while the Commonwealth's other retiree health care benefits are determined by the Commonwealth.

The General Assembly, based upon the Governor's request, annually appropriates funds to meet its obligation to pay such benefits on a "pay-as-you-go" basis. The Commonwealth has not established any fund or irrevocable trust for the accumulation of assets with which to pay such benefits in future years. Such expenditures are currently funded by the Commonwealth's General Fund (approximately 48 percent), Federal, Other and Special Funds. In fiscal year 2005 costs for such benefits totaled approximately $469 million, and in fiscal year 2006 approximately $499 million. The enacted budget for fiscal year 2007 estimates costs for retiree health care at $556 million from all funding sources, including the General Fund, while fiscal year 2008 costs are currently estimated to be $625 million. The Commonwealth has established a restricted receipts account for the purpose of accumulating the funds from which OPEB costs are paid. This restricted receipts account accumulated an ending balance of $144 million in fiscal year 2006, which is expected to grow to $277 million by the end of fiscal year 2007.

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 will be required to: (i) measure the costs of benefits, and recognize other post-employment benefits expenses, on the accrual basis of accounting in periods that approximate employees' years of service; (ii) provide information about the actuarial liabilities of promised benefits associated with past services 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. Statement No. 45 reporting requirements are effective for the Commonwealth in fiscal year 2008, and therefore the Commonwealth's financial statements to date do not reflect these requirements.

To date, the Commonwealth has not received a completed actuarial valuation of its potential liability to pay retiree health care benefits.

In 2006, the Commonwealth retained the Hay Group, a national employee benefits consulting firm, to provide actuarial services for the Commonwealth in preparation for GASB 45 implementation. Through March 2007, the Hay Group has collected substantial demographic, utilization and cost data and provided to the Commonwealth various preliminary draft actuarial valuations addressing the requirements of Statement No. 45. The Hay Group has developed a preliminary actuarial valuation of the Commonwealth's OPEB liability but the Commonwealth has subsequently supplied additional information and has requested a revised valuation. In particular, the Hay Group has provided the Commonwealth the following preliminary draft valuations:

1. Estimated unfunded actuarial accrued liability ("UAAL") as of July 1, 2007 -- $13.778 billion.
2. Estimated potential annual required contribution ("ARC") -- $1.125 billion. Note that this estimate should be reduced to reflect the amount of cash the Commonwealth currently contributes annually for such benefits. The currently estimated cash contribution ("pay-as-you-go) from all funds for such benefits for fiscal year 2008 is $625 million, thereby resulting in an estimated net reportable OPEB liability of $500 million as of June 30, 2008.

Assuming that the contributions from the General Fund for such benefits continue at 48 percent as described above, the projected impact of the estimated UAAL, ARC and net OPEB liability on the Commonwealth's General Fund would be approximately one half of the estimated valuations cited herein.

As noted above, after reviewing the various actuarial assumptions and cost methods, including discount rates, utilized by the Hay Group, the Commonwealth has (1) provided updated demographic, census and utilization data and (2) requested that the Hay Group revise its valuation accordingly. The Commonwealth has also requested that the Hay

Group further refine its estimates based on recently bargained changes to the benefit plans. Recently completed collective bargaining agreements, covering approximately 72.5 percent of the Commonwealth's employees and extending through June 30, 2011, provide for significant increases in employee share contributions to the Commonwealth's Retired Employee Health Program ("REHP"), the Commonwealth's main OPEB program. In particular, contributions by retired employees will increase over time from one percent of final gross salary to three percent in fiscal year 2011. Any future changes in active employee contribution rates will cause a corresponding change in annuitant contribution rates. Before the new collective bargaining agreements take effect on July 1, 2007, an increase in the number of retirements could increase the number of eligible participants under the existing annuitant contribution rates for REHP. **Accordingly, all of the above numbers must be considered preliminary and are subject to material change.** The actuarial measures to be used for the financial statements beginning as of June 30, 2008, will reflect further revisions and refinements and will be determined using a December 31, 2005 valuation date.

The Commonwealth expects the Hay Group to complete its actuarial services by the Fall of 2007. The Commonwealth may provide additional information on OPEBs when further analysis and refinement have been completed.

Future Obligations

The Commonwealth has already taken several steps to manage its OPEB obligations over time. These include, but are not limited to:

1. Establishing a restricted receipt account for the accumulation of assets to fund a portion of its OPEB liability. While it is recognized that this account is not yet an irrevocable trust, balances continue to accumulate in this Commonwealth account. The fiscal year 2007 ending balance in this account is estimated to be $277 million,
2. As discussed above, employees retiring after July 1, 2007 are required to pay an escalating percentage of their final salary as a contribution towards the cost of retiree health care coverage. The current contribution rate is 1 percent and it will rise to 3 percent by June 30, 2011. Any future collectively bargained increases in the employee contribution rate for active employees will also automatically cover all retirees who retire after July 1, 2007,
3. State Police new hires are required to enroll in Medicare upon age 65,
4. Employees retiring after July 1, 2005 but prior to July 1, 2007 are required to pay 1 percent of their final salary as a contribution towards the cost of coverage,
5. Service requirement eligibility has been lengthened from 15 years to 20 years, starting after June 30, 2008,
6. The Commonwealth has applied for Medicare Part D drug subsidy for its retirees as of September 2005,
7. The Commonwealth has rebid health care and pharmacy coverages periodically to obtain lower costs,
8. Employees retiring after July 1, 2004 will have their post employment benefits changed automatically as the benefits for active employees are updated and changed,
9. State Police retirees are eligible to enroll in preferred provider organization (PPO) plans and State Police retirees will have three tier drug formularies.

Beyond these steps and others contemplated but not yet implemented or negotiated, the General Assembly has not, to date, adopted or considered any program for funding OPEB payments other than from annual appropriations on a "pay-as-you-go" basis. As indicated above, the Commonwealth has received draft valuations for both its UAAL and ARC estimates, and its audited financial statements currently do not reflect any obligation to make such payments. Based on existing collective bargaining agreements and related assumptions, the Commonwealth believes that the amount of such payments necessary to continue to fund OPEBs on a "pay-as-you-go" basis will increase modestly in future years. Conversely, based on the same collective bargaining agreements and related assumptions, the Commonwealth believes that the amount of contributions required to fund SERS and PSERS will increase substantially beginning in fiscal year 2013 as described above under "General Information." The Commonwealth is actively evaluating additional ways to address these significant increases and expects to take into account OPEB obligations as it addresses issues related to employee benefits.

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, 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 $181.4 million in bonds outstanding as of December 31, 2006.

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 $1,216.9 million in revenue bond debt outstanding as of December 31, 2006.

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 $1,433.3 million of debt outstanding as of December 31, 2006.

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 $52.9 million in bonds outstanding as of December 31, 2006.

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 $9,649.9 million in bonds outstanding as of December 31, 2006.

Pennsylvania Higher Educational Facilities Authority ("PHEFA"). The PHEFA is a public corporation of the Commonwealth established to finance college facilities. As of December 31, 2006, the PHEFA had $5,296.9 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 $435.9 million in revenue bond debt outstanding on December 31, 2006, 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 $61.0 million of revenue bonds outstanding as of December 31, 2006.

Pennsylvania Turnpike Commission ("PTC"). The PTC operates the Pennsylvania Turnpike System ("System"). Its outstanding indebtedness, $2,715.8 million as of December 31, 2006, 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 colleges. 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 $1,700.5 million of revenue bonds outstanding as of December 31, 2006.

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 funding 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 balance 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 fiscal plan approved by PICA on July 5, 2006.

No further bonds may be issued by PICA for the purpose of either financing capital projects or a 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 $674.3 million in special tax revenue bonds outstanding as of June 30, 2006. 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. 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 2006 is $20.0 million.

County of Allegheny v. Commonwealth of Pennsylvania

In December 1987, the Supreme Court of Pennsylvania held in *County of Allegheny v. Commonwealth of Pennsylvania* that the statutory scheme for county funding of the judicial system is in conflict with the Pennsylvania Constitution. However, the Supreme Court of Pennsylvania stayed its judgment to afford the General Assembly an opportunity to enact appropriate funding legislation consistent with its opinion and ordered that the prior system of county funding shall remain in place until this is done.

The Court appointed retired Justice Frank J. Montemuro, Jr. as special master to devise and submit a plan for implementation. The *Interim Report of the Master* recommended a four-phase transition to state funding of a unified judicial system, during each of which specified court employees would transfer into the state payroll system. Phase I recommended that the General Assembly provide for an administrative structure of local court administrators to be employed by the Administrative Office of Pennsylvania Courts, a state agency. Numbering approximately 165 people statewide, local court administrators are employees of the counties in which they work. On June 22, 1999, the Governor approved Act No. 1999-12, under which approximately 165 county-level court administrators became employees of the Commonwealth. Act 12 also triggered the release of appropriations that had been made for this purpose in 1998 and 1999.

The remainder of Justice Montemuro's recommendation for later phases remains pending before the Supreme Court of Pennsylvania.

Unisys Corporation v. Commonwealth

Unisys challenged the statutory three-factor apportionment formula used for the apportionment of capital stock value in the franchise tax on constitutional and statutory (fairness) grounds. Unisys's argument is that, because the valuation formula requires the use of consolidated net worth, instead of separate company net worth, and the inclusion of dividends paid by subsidiary corporations, the apportionment factors should also include the property, payroll and sales of the subsidiary corporations, not just those of the taxpayer.

The case was argued before the Commonwealth Court *en banc*, which issued its decision on March 8, 1999. The court sustained the statute from the constitutional challenge in favor of the Commonwealth. However, it ruled in favor of the taxpayer's fairness argument, which was based on 72 P.S. §7401(3) 2. (a)(18). There were two dissents.

The Commonwealth appealed this decision to the Pennsylvania Supreme Court and Unisys cross-appealed. The Court held oral argument in December 2000. On October 25, 2002, the Court issued a decision reversing the holding of the Commonwealth Court and upholding the Commonwealth's statutory apportionment formula. Unisys filed an application for re-argument, which was denied. Unisys filed a petition for certiorari to the U.S. Supreme Court, which was denied. The decision in this matter denied relief to the taxpayer because it failed to carry its burden of proof and did not resolve the underlying issue. Thus, the decision has very limited applicability to the numerous cases pending which raise the identical issue and which collectively involve undetermined but significant dollars.

Northbrook Life Insurance Co. v. Commonwealth

This case is the lead case in potential litigation with the entire insurance industry that does business in Pennsylvania. Currently, the Commonwealth Court has docketed in excess of 40 cases representing 20 or more insurance companies. Dozens of additional cases are being held pending this litigation at the administrative boards.

The cases challenge the Department of Revenue's application of portions of the Life and Health Guarantee 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 which 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 want the credit for assessments paid on all annuities, both during the period that annuities were taxed and going forward.

On January 26, 2006, the *en banc* Court issued a conflicted decision in which the majority ruled for both parties. Both parties file exceptions. The Court denied all exceptions and upheld its earlier decision. Northbrook filed an appeal to the Pennsylvania Supreme Court. Currently, all briefs have been filed, and the Commonwealth is awaiting a decision of the Court as to whether it will entertain oral arguments. It is impossible to predict the outcome. If taxpayers prevail on all issues, estimated refunds would total about $150 million.

RATINGS

Moody's Investors Service ("Moody's") has assigned its municipal bond rating of "Aa2" 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" to the Bonds, and Fitch Ratings ("Fitch") has assigned its municipal bond rating of "AA" to the Bonds. The ratings reflect only the views of the 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 discussions of the Commonwealth expected to be released in connection with their 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 MATTERS

In the opinion of Bond Counsel, under existing law, interest on the Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. It should be noted, however, that with respect to corporations (as corporations are defined for federal income tax purposes), such interest is taken into account in determining adjusted current earnings for the purpose of computing the alternative minimum tax imposed on corporations by the Internal Revenue Code of 1986, as amended (the "Code").

Bond Counsel is also of the opinion that, under existing law, interest on the Bonds is exempt from Pennsylvania personal income tax and from Pennsylvania corporate net income tax, and the Bonds are exempt from personal property taxes in Pennsylvania.

Except as expressly stated above, Bond Counsel will not express any opinion as to any other federal or state tax consequences of acquiring, carrying, owning or disposing of the Bonds, and prospective purchasers of the Bonds should consult with their own tax advisors as to the applicability of these and any other collateral tax consequences of ownership of the Bonds.

The opinion of Bond Counsel on federal tax matters will be based upon and will assume the accuracy of certain representations and certifications, and compliance with certain covenants, of the Commonwealth to be contained in the transcript of proceedings and that are intended to evidence and assure that the Bonds are and will remain obligations the interest on which is excluded from gross income for federal income tax purposes. Bond Counsel will not independently verify the accuracy of those certifications and representations.

The Code prescribes a number of qualifications and conditions for the interest on state and local obligations to be and to remain excluded from gross income for federal income tax purposes, some of which require future or continued compliance after issuance of the obligations in order for the interest to be and to continue to be so excluded from the date of issuance. Noncompliance with these requirements by the Commonwealth may cause the interest on the Bonds to be included in gross income for federal income tax purposes and thus to be subject to federal income tax retroactively to their date of issuance. The Commonwealth has covenanted to take the actions required of it for the interest on the Bonds to be and to remain excluded from gross income for federal income tax purposes, and not to take any actions that would adversely affect that exclusion.

Ownership of the Bonds may result in collateral federal income tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, individual recipients of Social Security or Railroad Retirement benefits, S corporations with “excess net passive income” and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry the Bonds. Bond Counsel expresses no opinion as to such collateral federal income tax consequences.

The difference between the principal amount payable at maturity of certain of the Bonds (the “OID Bonds”) and the initial offering price to the public (excluding bond houses and brokers) at which price a substantial number of the such OID Bonds are sold (“Original Issue Discount”) also represents interest that is exempt from federal income taxation to the extent and as described above with respect to interest on the Bonds. Original Issue Discount is apportioned on a daily basis among the original purchasers of the OID Bonds and subsequent holders thereof during their respective periods of ownership. Section 1288 of the Code is applicable to the OID Bonds and requires holders of the OID Bonds to accrue Original Issue Discount as tax-exempt interest income on the basis of an economic constant interest rate method over the life of the OID Bonds, taking into account the semiannual compounding of the accrued interest. Under these provisions, upon the sale, exchange or maturity of any OID Bonds, a holder of such OID Bonds would be entitled to increase the adjusted basis with respect to the OID Bonds by the amount of Original Issue Discount which shall have thus accrued as tax-exempt interest income during the period such OID Bonds were held by such holder. Any amounts received by the holder upon such disposition in excess of such adjusted basis would be treated as gain and any amounts so received less than such adjusted basis would be treated as a loss.

Certain of the Bonds were sold with original issue premium (the “Premium Bonds”). The difference between the first price at which a substantial amount of the Premium Bonds is sold to the public and the stated redemption price at maturity constitutes to an initial purchaser amortizable bond premium which is not deductible from gross income for regular federal income tax purposes. The amount of amortizable bond premium for the taxable year is determined actuarially on a constant interest rate basis over the term of a Premium Bond. For purposes of determining gain or loss on the sale or other disposition of a Premium Bond, an initial purchaser who acquires such obligation in the initial offering to the public at the initial offering price is required to decrease such person’s adjusted basis in such Premium Bond by the amount of amortizable bond premium for the taxable year. Owners of Premium Bonds should consult their own tax advisors with respect to the proper treatment of amortizable bond premium in their particular circumstances.

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THE FOREGOING IS NOT INTENDED AS AN EXHAUSTIVE DISCUSSION OF THE PROVISIONS OF FEDERAL OR STATE TAX LAW WHICH MAY HAVE AN EFFECT ON INDIVIDUALS AND CORPORATIONS HOLDING THE BONDS OR RECEIVING INTEREST THEREON. PROSPECTIVE PURCHASERS OF THE BONDS SHOULD CONSULT WITH THEIR TAX ADVISORS REGARDING THE EFFECT ON THEIR AFFAIRS OF HOLDING THE BONDS OR RECEIVING INTEREST THEREON, INCLUDING, BUT NOT LIMITED TO, THE EFFECT OF STATE AND LOCAL TAX LAWS.

UNDERWRITING

After competitive bidding on May 22, 2007, the Bonds were awarded to a selling group represented by Merrill Lynch & Co. (the “Underwriters”) for a purchase price of $391,448,782.10 which is equivalent to the principal amount of the Bonds, less underwriters’ discount of $752,505.08 plus net original issue premium, of $18,448,782.10. The Underwriters have supplied the public offering yields and prices of the Bonds shown on the front cover hereof. If all of the Bonds are resold to the public at such yields, the underwriters’ discount will approximate 2.017440 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, 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 Tom Corbett, and of Reed Smith LLP, Philadelphia, Pennsylvania, Bond Counsel. A copy of the opinion of Bond Counsel will accompany the Bonds delivered to DTC. Copies of the opinion of the Attorney General, together with additional copies of the opinion 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.

Hunton & Williams LLP, Richmond, Virginia, serves as a special disclosure counsel to the Commonwealth in connection with its general obligation bonds.

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. Michael Masch, Attn.: Mr. Richard Dreher, 7th Floor, Bell Tower, 303 Walnut Street, Harrisburg, Pennsylvania 17101-1808 (Telephone (717) 783-3086). The annual Comprehensive Annual Financial Report ("CAFR"), a summary of the enacted fiscal year 2007 budget, the proposed fiscal year 2008 budget and certain other information are available in the Budget and Financial Reports section of the Office of the Budget's web site on the World Wide Web, 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 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 each then-existing NRMSIR, or to DisclosureUSA or a similar central repository approved by the Securities and Exchange Commission (a "Central Repository"), and if one is established and then in operation, with any State Information Depository ("SID") for the Commonwealth of Pennsylvania;

(ii) File in a timely manner to each NRMSIR or a Central Repository (and any SID then existing) notice of certain specified events listed below; and

(iii) File with either each NRMSIR, a Central Repository, or the Municipal Securities Rulemaking Board (and with any SID then existing) 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:

(i) Tables 5 through 12 under the heading "COMMONWEALTH FINANCIAL PERFORMANCE";
(ii) Tables 15 and 17 through 18 under the heading "OUTSTANDING INDEBTEDNESS OF THE COMMONWEALTH"; and
(iii) Tables 20 through 23 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 to each NRMSIR or a Central Repository (and any SID then existing) of the following events if such events are material with respect to the Bonds:

* principal and interest payment delinquencies;
* nonpayment related defaults;
* unscheduled draws on debt service reserves reflecting financial difficulties;
* unscheduled draws on credit enhancements reflecting financial difficulties;
* substitution of credit or liquidity providers, or their failure to perform;
* adverse tax opinions or events affecting the tax-exempt status of the Bonds;
* modifications to the rights of holders of the Bonds;
* Bond calls;
* defeasances;
* release, substitution, or sale of property securing repayment of the Bonds; and
* rating changes.

The eleven 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 as then in effect.

The Commonwealth has never failed to comply in all material respects with any previous continuing disclosure undertaking.

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NRMSIRs. As of the date of this Official Statement, the Securities and Exchange Commission has recognized the following NRMSIRs:

Bloomberg Municipal Repository
100 Business Park Drive
Skillman, NJ 08558
Phone: (609) 279-3225
Fax: (609) 279-5962
E-mail: munis@bloomberg.com

Standard & Poor's Securities Evaluations, Inc.
55 Water Street
45th Floor
New York, NY 10041
Phone: (212) 438-4595
Fax: (212) 438-3975
E-mail: nrmsir_repository@sandp.com

DPC Data Inc
One Executive Drive
Fort Lee, NJ 07024
Phone: (201) 346-0701
Fax: (201) 947-0107
E-mail: nrmsir@dpcdata.com

FT Interactive Data
Attn: NRMSIR
100 William Street
New York, NY 10038
Phone (212) 771-6999
Fax: (212) 771-7390
E-mail: nrmsir@interactivedata.com

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A current list of all NRMSIRs can be obtained at any time from the Securities and Exchange Commission. The Commonwealth makes no representation as to the scope of services provided to the secondary market by any NRMSIR or as to the costs of any such services.

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The execution of this Official Statement has been authorized in the Resolutions.

Edward G. Rendell

EDWARD G. RENDELL, Governor

Robin L. Wiessmann

ROBIN L. WIESSMANN, State Treasurer

Jack Wagner

JACK WAGNER, Auditor General

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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, Jack Wagner, Auditor General of the Commonwealth of Pennsylvania, pursuant to the Pennsylvania Constitution Article VIII, (Section 7(a)(4) and Section 304 of Capital Facilities Debt Enabling Act (Act 1 of 1999) certify as follows:

	The average annual tax revenues deposited in all funds in the five fiscal years ended preceding the date of February 28, 2007	$ 27,536,515,720
(i)	The amount of outstanding net debt as of the end of the preceding fiscal year	$ 6,487,618,757
(ii)	The amount of such net debt as of February 28, 2007....................	$ 6,708,226,780
(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, 2007	$ 41,480,675,730
(iv)	The amount of such debt scheduled to be repaid during the remainder of the current fiscal year	$ 59,770,000
(v)	The amount of debt authorized by law to be issued, but not yet incurred	$ 56,582,355,468
(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	$ 2,349,813,348

IN TESTIMONY WHEREOF, I have set my hand and affixed the seal of the Auditor General, this 28th day of February 2007.

/s/Jack Wagner
JACK WAGNER
Auditor General
Commonwealth of Pennsylvania

(Seal)

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SELECTED DATA ON THE COMMONWEALTH OF PENNSYLVANIA

General

The Commonwealth of 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 $4.9 billion in crop and livestock products annually. In 2006, agribusiness and food related industries reached record export sales surpassing $1.5 billion in economic activity. Over 58,000 farms form the backbone of the State'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. Agriculture exports have grown by more than 4% since 2003.

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 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 80 million tons of anthracite and bituminous coal, 175 billion cubic feet of natural gas, and about 1.4 million barrels of oil are extracted from Pennsylvania.

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.

Population

The Commonwealth is highly urbanized. Of the Commonwealth's 2006 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 State's total population. The population of Pennsylvania, 12.4 million people in 2006, 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 1997 to 2006 and the age distribution of the population for 2005.

Population Trends
Pennsylvania, Middle Atlantic Region and the United States
1997-2006

	Total Population In Thousands			Total Population as a % of 1997 base		
As of July 1	PA	Middle Atlantic Region[a]	U.S.	PA	Middle Atlantic Region[a]	U.S.
1997	12,015	38,213	267,783	100%	100%	100%
1998	12,002	38,257	270,248	99	100	101
1999	11,994	38,334	272,690	99	100	102
2000	12,286	38,718	282,193	102	101	105
2001	12,295	39,892	285,108	102	104	108
2002	12,321	40,066	287,985	102	105	109
2003	12,351	40,222	290,850	102	105	110
2004	12,377	40,344	293,657	102	105	111
2005	12,405	40,424	296,410	103	105	112
2006	12,440	40,471	299,398	103	105	112

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

Population by Age Group — 2005
Pennsylvania, Middle Atlantic Region and the United States

Age	Pennsylvania	Middle Atlantic Region[a]	United States
Under 5 years	5.8 %	6.3 %	6.8 %
5-24 years	26.3	26.5	27.8
25-44 years	26.4	28.1	28.5
45-64 years	26.3	25.4	24.5
65 years and over	15.2	13.7	12.4

[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 2006 increased at an average annual rate of 0.7 percent compared with a 0.8 percent rate for the Middle Atlantic region and 1.2 percent rate for the U.S. The following table shows employment trends from 1997 through 2006.

Non-Agricultural Establishment Employment Trends
Pennsylvania, Middle Atlantic Region and the United States
1997-2006

	Total Establishment Employment In Thousands			Total Establishment Employment as a % of 1997 base		
Calendar Year	PA	Middle Atlantic Region[a]	U.S.	PA	Middle Atlantic Region[a]	U.S.
1997	5,406	17,198	122,776	100 %	100 %	100 %
1998	5,495	17,532	125,930	102	102	103
1999	5,586	17,943	128,993	103	104	105
2000	5,691	18,321	131,785	105	107	107
2001	5,682	18,271	131,826	105	106	107
2002	5,640	18,083	130,341	104	105	106
2003	5,611	17,997	129,999	104	115	106
2004	5,644	18,105	131,435	104	105	107
2005	5,702	18,275	133,703	105	106	109
2006	5,753	18,440	136,174	106	107	111

[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 88.3 percent of total employment by 2006. Consequently, manufacturing employment constitutes a diminished share of total employment within the Commonwealth. Manufacturing, contributing 11.7 percent of 2006 non-agricultural employment, has fallen behind both the services sector and the trade sector as the largest single source of employment within the Commonwealth. In 2006, the services sector accounted for 40.6 percent of all non-agricultural employment while the trade sector accounted for 19.6 percent. The following table shows trends in employment by sector for Pennsylvania from 2002 through 2006.

Non-Agricultural Establishment Employment by Sector
Pennsylvania
2002-2006
(In Thousands)

	CALENDAR YEAR									
	2002		2003		2004		2005		2006	
	Employees	%	Employees	%	Employees	%	Employees	%	Employees	%
Manufacturing:										
Durable………………	449.2	8.0	418.6	7.5	412.2	7.3	412.9	7.2	415.5	7.2
Non-Durable…………	310.6	5.5	293.8	5.2	278.5	4.9	266.5	4.7	256.4	4.5
Total Manufacturing[d]……	759.8	13.5	712.4	12.7	690.7	12.2	679.4	11.9	671.9	11.7
Non-Manufacturing:										
Trade[a]………………	1,112.9	19.7	1,108.2	19.7	1,113.6	19.7	1,120.3	19.6	1,126.3	19.6
Finance[b]……………	336.8	6.0	338.5	6.0	336.2	6.0	335.7	5.9	335.5	5.8
Services……………..	2,181.1	38.7	2,201.8	39.2	2,248.7	39.8	2,300.8	40.3	2,338.5	40.6
Government…………	738.9	13.1	745.6	13.3	744.4	13.2	745.1	13.1	746.4	13.0
Utilities[c]…………….	244.8	4.3	241.6	4.3	242.4	4.3	246.2	4.3	253.0	4.4
Construction…………	248.5	4.4	246.0	4.4	250.2	4.4	255.7	4.5	261.8	4.6
Mining……………….	18.0	0.3	17.2	0.3	18.0	0.3	19.0	0.3	19.8	0.3
Total Non-Manufacturing[d]	4,881.0	86.5	4,898.9	87.1	4,953.5	87.8	5,022.8	88.1	5,081.3	88.3
Total Employees[d][e]	5,640.8	100.0	5,611.3	99.8	5,644.2	100.0	5,702.2	100.0	5,753.2	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: PA Bureau of Labor & Industry

The following table presents the percentages of non-agricultural employment in various sectors in Pennsylvania and the United States in 2006.

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

	2006 Calendar Year	
	Pennsylvania	United States
Manufacturing.......................................	11.7%	10.8%
Trade[a]...	19.6	16.0
Finance[b]	5.8	5.4
Services...	40.6	41.6
Government...	13.0	15.9
Utilities[c]	4.4	3.5
Construction...	4.6	5.5
Mining...	0.3	1.3
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-eighth of total non-agricultural employment in Pennsylvania, the fabricated metals industries employed the largest number of workers. Employment in fabricated metals industries was 13.5 percent of Pennsylvania manufacturing employment but only 0.1 percent of total Pennsylvania non-agricultural employment in 2006. The following table shows trends in manufacturing employment by industry for Pennsylvania from 2002 through 2006.

Manufacturing Establishment Employment by Industry
Pennsylvania
2002-2006
(In Thousands)

	CALENDAR YEAR									
	2002		2003		2004		2005		2006	
	Employees	%	Employees	%	Employees	%	Employees	%	Employees	%
Durable Goods:										
Primary Metals……………..	48.3	6.4	44.6	6.3	43.1	6.2	43.0	6.3	43.3	6.4
Fabricated Metals…………..	95.1	12.5	89.1	12.5	88.7	12.8	90.1	13.3	90.9	13.5
Machinery (excluding electrical)….	60.6	8.0	56.1	7.9	54.8	7.9	55.6	8.2	57.0	8.5
Electrical Equipment……….	26.6	3.5	25.4	3.6	25.6	3.7	25.8	3.8	26.7	4.0
Transportation Equipment….	44.4	5.9	41.5	5.8	42.7	6.2	43.7	6.4	44.3	6.6
Furniture Related Products…..	25.5	3.4	24.4	3.4	24.4	3.5	24.0	3.5	23.8	3.5
Other Durable Goods………	148.7	19.6	137.5	19.3	132.9	19.2	130.7	19.2	129.5	19.3
Total Durable Goods[(a)]…...	449.2	57.7	418.6	58.8	412.2	59.7	412.9	60.8	415.5	61.8
Non-Durable Goods:										
Pharmaceutical/Medicine…	27.2	3.7	25.6	3.6	22.6	3.3	21.9	3.2	22.3	3.3
Food Products……………..	75.1	10.3	74.5	10.5	72.6	10.5	70.9	10.4	68.8	10.2
Chemical Products………..	61.4	8.4	57.8	8.1	52.7	7.6	49.2	7.2	47.1	7.0
Printing and Publishing……	41.1	5.6	39.3	5.5	37.7	5.5	37.1	5.5	36.3	5.4
Plastics/Rubber Products…….	44.5	6.1	42.0	5.9	40.9	5.9	40.2	5.9	40.2	6.0
Paper Products……………..	30.5	4.2	28.8	4.0	27.5	4.0	26.9	4.0	26.3	3.9
Other Non-Durable Goods…	30.8	4.2	25.8	3.6	24.5	3.5	20.3	3.0	15.4	2.3
Total Non-Durable Goods[(a)]	310.6	42.5	293.8	41.2	278.5	40.3	266.5	39.2	256.4	38.2
Total Manufacturing Employees[(a)]……………	759.8	100.0	712.4	100.0	690.7	100.0	679.4	100.0	671.9	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 5.7 percent in 2003. The resumption of faster economic growth resulted in a decrease in the Commonwealth's annual unemployment rate to 4.7 percent in 2006. From 2002 through 2005 Pennsylvania's annual average has been at or below the national average. As of March 2007, the most recent month for which figures are available, Pennsylvania had a seasonally adjusted annual unemployment rate of 3.8 percent. The following table represents the annual non-adjusted unemployment rate in Pennsylvania, the Middle Atlantic Region, and the United States from 1997 through 2006.

Annual Average Unemployment Rate
Pennsylvania, Middle Atlantic Region and the United States
1997-2006

Calendar Year	Pennsylvania	Middle Atlantic Region[(a)]	United States
1997	5.1	5.8	4.9
1998	4.6	5.1	4.5
1999	4.4	4.8	4.2
2000	4.2	4.2	4.0
2001	4.8	4.7	4.7
2002	5.6	5.9	5.8
2003	5.7	6.1	6.0
2004	5.4	5.5	5.5
2005	5.0	4.9	5.1
2006	4.7	4.6	4.6

[(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 largest non-governmental employers in Pennsylvania:

Commonwealth of Pennsylvania
Thirty Largest
Non-Governmental Employers
June 2006

Company	Rank	Company	Rank
Wal-Mart Associates	1	Vanguard Group Inc.	16
University of Pennsylvania	2	Pennsylvania Blue Shield	17
Pennsylvania State University	3	Sears Roebuck & Co	18
Giant Food Stores	4	GMR Restaurants of Pennsylvania Inc	19
United Parcel Service Inc	5	US Airways Inc	20
University of Pittsburgh	6	Verizon Pennsylvania Inc.	21
UPMC Presbyterian	7	Temple University	22
Weis Markets Inc	8	The Children Hospital of Philadelphia	23
Merck & Co Inc	9	May Department Stores Co	24
The Home Depot USA INC	10	Wachovia Bank	25
Lowe's Home Centers Inc.	11	Target Div of Target Corp	26
Giant Eagle Inc	12	Eat'n Park Restaurants Inc	27
PNC Bank NA	13	Acme Markets Inc.	28
KMART of Pennsylvania LP	14	Thomas Jefferson Hospital	29
Heartland Employment	15	Hershey Foods Corporation	30

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

Personal Income

Personal income in the Commonwealth for 2006 is $456.3 billion, an increase of 5.2 percent over the previous year. During the same period, national personal income increased at a rate of 6.2 percent. Based on the 2006 personal income estimates, per capita income for 2006 is at $36,680 in the Commonwealth compared to per capita income in the United States of $36,276. The following tables represent annual personal income and per capita income from 1997 through 2006.

Personal Income
Pennsylvania, Mideast Region and the United States
1997-2006

	Total Personal Income Dollars in Millions			Total Personal Income As a % of 1997 base		
Year	**PA**	**Mideast Region[(a)]**	**U.S.[(b)]**	**PA**	**Mideast Region[(a)]**	**U.S.**
1997	$ 311,508	$1,319,270	$ 6,907,332	100 %	100 %	100 %
1998	330,160	1,404,640	7,415,709	105	106	106
1999	342,610	1,467,261	7,796,137	109	111	112
2000	364,837	1,580,733	8,422,074	117	119	119
2001	372,339	1,627,895	8,716,992	119	123	121
2002	382,251	1,648,004	8,872,871	122	124	128
2003	393,908	1,690,345	9,150,320	126	128	132
2004	413,589	1,797,984	9,716,351	132	136	140
2005	433,400	1,883,422	10,220,942	139	142	147
2006	456,315	1,992,326	10,860,916	146	151	157

[(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
1997-2006

	Per Capita Income			As a % of U.S.	
Calendar Year	**PA**	**Mideast Region[(a)]**	**U.S.**	**PA**	**Mideast Region[(a)]**
1997	$ 25,475	$ 28,944	$ 25,334	101 %	114 %
1998	26,961	30,654	26,883	100	114
1999	27,937	31,824	27,939	100	114
2000	29,693	34,074	29,843	99	114
2001	30,281	34,895	30,562	99	114
2002	31,023	35,144	30,795	100	114
2003	31,892	35,871	31,466	101	114
2004	33,415	38,007	33,090	101	114
2005	34,937	39,703	34,471	101	115
2006	36,680	41,924	36,276	101	115

[(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 2002 through 2006.

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

Calendar Year	Pennsylvania	Mideast Region[a]	United States
Total Personal Income			
2002	2.6%	1.2 %	1.7%
2003	3.0	2.5	3.1
2004	4.9	6.3	6.1
2005	4.7	4.7	5.1
2006	5.2	5.8	6.2
Manufacturing			
2002	0.3%	-0.7%	-0.3%
2003	-2.6	0.1	1.8
2004	4.5	3.9	3.3
2005	3.4	2.5	3.7
2006	3.2	2.8	4.6
Trade[b]			
2002	1.9%	1.8%	1.7%
2003	4.5	3.5	2.7
2004	4.7	4.3	5.1
2005	4.3	3.9	5.0
2006	4.6	4.9	6.3
Finance[c]			
2002	3.3%	-4.0%	0.1%
2003	5.7	0.8	4.5
2004	5.8	9.0	7.9
2005	4.6	6.7	7.1
2006	5.0	8.2	5.8
Services			
2002	0.1%	-1.6%	-1.7%
2003	1.7	2.0	0.8
2004	9.6	8.6	8.9
2005	7.8	7.9	8.4
2006	7.6	7.9	9.0
Utilities[d]			
2002	8.5%	10.0%	1.6%
2003	-2.8	3.4	4.2
2004	0.8	0.5	2.1
2005	-0.4	1.3	2.1
2006	-8.8	-0.9	2.1
Construction			
2002	2.4%	3.0%	1.8%
2003	4.8	2.9	3.2
2004	5.2	6.5	8.4
2005	8.8	7.1	9.8
2006	7.8	7.0	8.9
Mining			
2002	-10.9%	0.1%	-5.8%
2003	9.1	-4.6	14.2
2004	14.3	22.6	19.7
2005	14.5	16.9	18.5
2006	11.4	13.3	18.3

[a] Mideast Region: Delaware, District of Columbia, Maryland, Pennsylvania, New York, and New Jersey.
[b] Wholesale and retail trade.
[c] Finance, insurance and real estate.
[d] Includes transportation, communications, electric, gas and sanitary services.
Source: U.S. Department of Commerce, Bureau of Economic Analysis

The Commonwealth's average hourly wage rate of $15.37 for manufacturing and production workers compares to the national average of $16.80 for 2006. The following table presents the average hourly wage rates for 2002 through 2006.

Average Hourly Wages
Production Workers on Manufacturing Payrolls
Pennsylvania and the United States
2002-2006

Calendar Year	PA	U.S.
2002	$ 14.75	$ 15.29
2003	14.99	15.74
2004	15.16	16.15
2005	15.26	16.56
2006	15.37	16.80

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
1996-2005

Year	Market Value[(a)]	Assessed Valuation	Ratio of Assessed Valuation to Market Value[(a)]
1996	$ 359,993,651,000	$ 102,107,687,304	28.4%
1997	366,096,581,900	123,734,109,457	37.2
1998	388,146,465,800	204,581,152,222	52.7
1999	390,136,860,900	208,896,190,899	53.5
2000	420,041,123,600	241,060,798,812	57.4
2001	430,102,389,400	310,111,943,560	72.1
2002	467,311,009,700	325,451,064,697	69.6
2003	478,362,689,800	348,726,965,926	72.9
2004	523,595,339,800	352,014,550,601	67.2
2005	533,700,991,300	378,014,057,174	70.8

[(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 2006.

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COMMONWEALTH GOVERNMENT AND FISCAL ADMINISTRATION

The government of the Commonwealth 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. He 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.

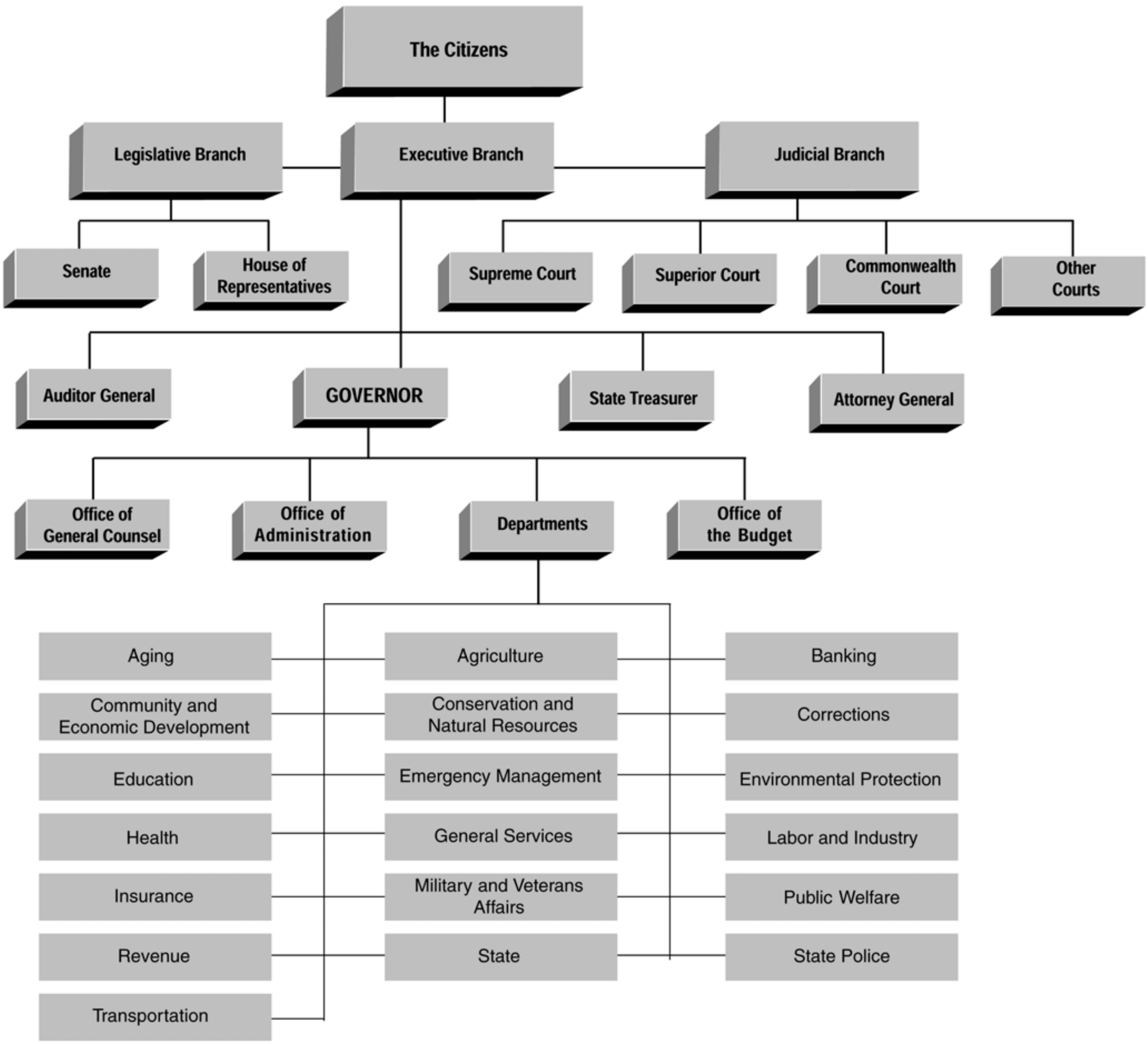
The Auditor General is charged with making audits of completed financial transactions. The Department of the Auditor General is under the Auditor General's direct jurisdiction.

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 Television Network
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.

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APPENDIX D

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 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 securities that its participants ("Direct Participants") deposit with DTC. DTC also facilitates the settlement among Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Direct Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks, and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). The rules applicable to DTC and its Direct Participants are on file with the Securities and Exchange Commission.

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 an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue 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).

Principal and interest payments 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 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 there from 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.

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APPENDIX F

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

June 7, 2007

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

Re: Commonwealth of Pennsylvania General Obligation Bonds, First Series A and B of 2007

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 $373,000,000 aggregate principal amount of Commonwealth of Pennsylvania General Obligation Bonds, First Series A and B of 2007 (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 May 1 and November 1 of each year commencing May 1, 2008, 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 Pennsylvania Infrastructure Investment Authority Act, Act No. 1988-16, approved March 1, 1988 (the "1988 Pennvest Act"); the Small Water Systems Assistance Act, Act No.1992-5, approved March 16, 1992 (the "1992 Act" and collectively with the 1988 Pennvest Act, the "Pennvest Acts"); constitutional referendum questions approved by the voters of the Commonwealth on April 26, 1988 (the "1988 Referendum") and April 28, 1992 the "1992 Referendum," and collectively with the 1988 Referendum, the "Pennvest Referenda"); the Act No. 2004-218, approved November 30, 2004 (the Pennworks Act"); the Water and Wastewater Treatment Project Bond Act, Act No. 2004-10, approved February 12, 2004 (the "Water and Wastewater Treatment Project Bond Act " and collectively with the Pennworks Act, the "Pennworks Acts"); a constitutional referendum question approved by the voters of the Commonwealth on April 27, 2004 (the "Pennworks Referendum"). 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 May 11, 2007, and May 22, 2007 (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. Sections 7 of Article VIII of the Constitution have been duly approved and adopted and have 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 Auditor General and the State Treasurer 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 $373,000,000 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. 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,

Tom Corbett
Attorney General

APPENDIX G

Proposed Form of Opinion of Bond Counsel

[Date of Issuance and Deliver of Bonds]

To: The Governor, the Auditor General and the State Treasurer, as the Issuing Officials of the Commonwealth of Pennsylvania

Re: Commonwealth of Pennsylvania
General Obligation Bonds, First Series A and B of 2007

We have acted as Bond Counsel to the Commonwealth of Pennsylvania (the "Commonwealth") in connection with the issuance and sale by the Commonwealth of $346,000,000 aggregate principal amount of its General Obligation Bonds, First Series A of 2007 (the "First Series A Bonds") and $27,000,000 aggregate principal amount of its General Obligation Bonds, First Series B of 2007 (together with the First Series A Bonds, the "Bonds"). The Bonds are authorized and issued pursuant to and in full compliance with the provisions, restrictions and limitations of the Constitution and laws of the Commonwealth, including Article VIII, Section 7 of the Constitution of the Commonwealth; the Capital Facilities Debt Enabling Act (Act No. 1991-1, approved February 9, 1999, as amended); the Capital Budget Act of 2006-2007, Act No. 2006-152, approved November 22, 2006, and certain other capital budget acts and debt authorization acts relating to capital projects as enumerated in the Resolutions (defined below); the Water and Wastewater Treatment Project Bond Act, Act No. 2004-10, approved February 12, 2004; Act No. 2004-218, approved November 30, 2004; the Pennsylvania Infrastructure Investment Authority Act, Act No. 1988-16, approved March 1, 1988; the Small Water Systems Assistance Act, Act No.1992-5, approved March 16, 1992; constitutional referendum questions approved by the voters of the Commonwealth on April 26, 1988, April 28, 1992 and April 27, 2004; and certain resolutions adopted by the Governor, the Auditor General and the State Treasurer (collectively, the "Issuing Officials") on May 11, 2007 and May 22, 2007, respectively (together, the "Resolutions"). The Resolutions, among other things, authorize the issuance and sale of the Bonds and prescribe the form thereof, the manner of bidding therefor and the forms of the bidding documents used in connection with the issuance and sale of the Bonds.

In our capacity as Bond Counsel to the Commonwealth, we have examined the proceedings relating to the authorization and issuance of the Bonds, including, among other things, (a) the Resolutions; (b) a certificate of the Auditor General as to tax revenues and outstanding debt; (c) an opinion of The Honorable Tom Corbett, Attorney General of the Commonwealth; and (d) certificates of the Commonwealth as to certain material factual matters, including a certificate of the Commonwealth intended to satisfy certain provisions of the Internal Revenue Code of 1986, as amended (the "Code"), and applicable Treasury Regulations, and certificates of the Commonwealth and U.S. Bank, National Association, as Loan and Transfer Agent, with respect to the execution and authentication of the Bonds and certain other matters.

In rendering the opinions set forth below, we have assumed the genuineness, authenticity, truthfulness and completeness of all documents, records and other instruments we have examined and the genuineness of all signatures thereon. We have not undertaken to verify by independent investigation the factual matters set forth therein. Except as set forth in paragraphs 6 and 8 below, our opinions are given only with respect to the laws of the Commonwealth as enacted and construed on the date hereof.

On the basis of the foregoing and subject to the limitations and qualifications hereinafter stated, we are of the opinion that, under existing law:

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

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

3. The Bonds have been validly authorized, issued and sold pursuant to all necessary action of the Issuing Officials.

4. The Commonwealth has the power to provide for the payment of principal of and interest on 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 Article VIII, Section 11 of the Constitution of the Commonwealth.

5. If sufficient funds are not appropriated for the timely payment of interest upon and installments of principal of the Bonds, the Constitution of the Commonwealth 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.

6. Interest on the Bonds is excluded from gross income for federal income tax purposes and is not an item of tax preference for purposes of the federal alternative minimum tax imposed on individuals and corporations. It should be noted, however, that with respect to certain corporations (as defined for federal income tax purposes), such interest is taken into account in determining adjusted current earnings for the purpose of computing the alternative minimum tax imposed on such corporations. The opinion set forth in this paragraph is subject to the condition that the Commonwealth comply with all requirements of the Code that must be satisfied subsequent to the issuance of the Bonds in order that interest thereon be (or continue to be) excluded from gross income for federal income tax purposes. Failure to comply with certain of such requirements could cause the interest on the Bonds to be included in gross income retroactive to the date of issuance of the Bonds. The Commonwealth has covenanted to comply with all such requirements.

7. Under the laws of the Commonwealth, the interest on the Bonds is exempt from Pennsylvania personal income tax and from Pennsylvania corporate net income tax and the Bonds are exempt from personal property taxes in the Commonwealth.

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

With respect to the foregoing, it is to be understood that the rights of the owners of the Bonds and the enforceability of the Bonds may be limited by bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights generally and by equitable principles, whether considered in a proceeding at law or in equity.

We express no opinion as to any matter not set forth herein, including federal and state tax consequences arising with respect to the Bonds other than as expressed in paragraphs 6 and 7 above, or as to the accuracy, adequacy or completeness of the Official Statement prepared with respect to the Bonds, and we make no representation that we have independently verified the contents of such Official Statement.

This opinion is given as of the date hereof, and we assume no obligation to update or supplement this opinion to reflect any facts or circumstances which may hereafter come to our attention or any changes in laws which may hereafter occur.

Very truly yours,

APPENDIX H

NOTICE OF SALE
$373,000,000
Commonwealth of Pennsylvania
General Obligation Bonds
First Series A and B of 2007

Electronic bids and only electronic bids (as explained below) will be received by the Commonwealth of Pennsylvania (the "Commonwealth"), via the Grant Street Group's ***MuniAuction*** ("MuniAuction") web site at either www.GrantStreet.com or at www.MuniAuction.com in the manner described below, beginning at 11:00 A.M., Eastern Daylight Time, on

Tuesday, May 22, 2007

or such other subsequent date ("Amended Bid Date") to be announced in an Amended Notice of Sale (as hereinafter defined) to be distributed not later than 4:00 P.M. on the last business day prior to the Amended Bid Date, for the purchase of all, but not less than all, of $373,000,000 aggregate principal amount of Commonwealth of Pennsylvania General Obligation Bonds, First Series A and B of 2007 (the "Bonds") consisting of $346,000,000 aggregate principal amount of Commonwealth of Pennsylvania General Obligation Bonds, First Series A of 2007 (the "Series A Bonds") and $27,000,000 aggregate principal amount of Commonwealth of Pennsylvania General Obligation Bonds, First Series B of 2007 (the "Series B Bonds").

Bids must be submitted in accordance with this Notice of Sale. All bids must be submitted in their entirety on the Grant Street Group's MuniAuction web site. No telephone, facsimile, telegraph or personal delivery bids will be accepted. The auction will begin at 11:00 A.M. and all bids must be submitted prior to the deadline of 11:15 A.M. Eastern Daylight Time unless extended by the Two Minute Rule (see Electronic Bidding Procedure). No bid will be accepted after the bid deadline, unless the auction is extended by the Two Minute Rule (see Electronic Bidding Procedure).

Right to Amend

The Commonwealth reserves the right, in its sole discretion, to change the date it will receive and open electronic bids to purchase the Bonds and to increase or decrease the principal amount of Bonds being offered. Changes to the Bonds being offered, if made, will be contained in an Amended Notice of Sale (the "Amended Notice") to be transmitted via the Bond Buyer Wire not later than 4:00 P.M. on the last business day prior to the Amended Bid Date. The Amended Notice shall (i) state the Amended Bid Date (a date not before May 22, 2007) and the time by which bids to purchase the Bonds must be received by the Commonwealth; (ii) state the revised principal amounts; (iii) state the proposed closing date; and (iv) supplement and update the information contained herein to the extent deemed necessary by the Commonwealth.

Security

The Bonds will be direct and general obligations of the Commonwealth, issued pursuant to and within the applicable debt limits prescribed by Section 7 of Article VIII of the Constitution of Pennsylvania and various implementing acts of the General Assembly.

Bond Details

The Bonds will be dated the date of issuance and delivery, and will bear such rate or rates of interest, payable semiannually on May 1 and November 1, commencing May 1, 2008, as shall be fixed by the purchaser in its proposal for the purchase of the Bonds (See "Interest Rate and Bidding Details" herein). The Bonds shall mature serially on November 1 in the respective years and in the respective amounts set forth in the following table:

First Series A Bonds

Due November 1	Principal Amount	Due November 1	Principal Amount
2008	$10,625,000	2018	$16,775,000
2009	11,170,000	2019	17,635,000
2010	11,745,000	2020	18,540,000
2011	12,345,000	2021	19,490,000
2012	12,975,000	2022	20,490,000
2013	13,645,000	2023	21,540,000
2014	14,345,000	2024	22,645,000
2015	15,080,000	2025	23,805,000
2016	15,850,000	2026	25,030,000
2017	15,960,000	2027	26,310,000

First Series B Bonds

Due November 1	Principal Amount	Due November 1	Principal Amount
2008	$805,000	2018	$1,330,000
2009	845,000	2019	1,395,000
2010	890,000	2020	1,470,000
2011	935,000	2021	1,545,000
2012	985,000	2022	1,620,000
2013	1,035,000	2023	1,705,000
2014	1,085,000	2024	1,795,000
2015	1,145,000	2025	1,885,000
2016	1,200,000	2026	1,980,000
2017	1,265,000	2027	2,085,000

Delivery of the Bonds is proposed to occur on June 7, 2007, unless another date is set forth in any Amended Notice (the “Closing Date”).

The Bonds will be issued and sold by means of a book-entry only system with no distribution of Bond certificates made to the public. Bond certificates representing the aggregate principal amount of the Bonds of each separate maturity within a separate series will be issued and fully registered as to principal and interest in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"), a depository registered with the Securities and Exchange Commission. Individual ownership of the Bonds will be made in principal amounts of $5,000 or integral multiples thereof within a maturity pursuant to the rules and procedures established between DTC and its participants. Transfers of beneficial ownership will be effected through records maintained by DTC and its participants pursuant to rules and procedures established by DTC. The responsibility for maintaining, reviewing and supervising such records rests collectively with DTC and its participants. The winning bidder, as a condition to the delivery of the Bonds, shall be required to deposit the Bond certificates in its account at DTC, registered in the name of Cede & Co. Interest on the Bonds will be payable on each semi-annual interest payment date and principal of the Bonds will be paid annually as set forth in the foregoing maturity schedule, in same-day funds to DTC or its nominee as registered owner of the Bonds. Transfer of principal and interest payments to the beneficial owners by participants of DTC will be the responsibility of such DTC participants and other nominees of beneficial owners. The Commonwealth will not be responsible or liable for maintaining, supervising or reviewing the records maintained by DTC, its participants or persons acting through such participants.

Optional Redemption

First Series A Bonds maturing in the years 2008 to 2017, inclusive, are not subject to redemption. The First Series A Bonds, or portions thereof in integral multiples of $5,000, maturing on and after November 1, 2018, are subject to redemption at the option of the Commonwealth prior to scheduled maturity on or after November 1, 2017, as a whole or in part 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.

In the event the extraordinary redemptions are not exercised by the Commonwealth (See Extraordinary Redemption), the First Series B Bonds, or portions thereof, in integral multiples of $5,000, maturing on and after November 1, 2018, are subject to redemption at the option of the Commonwealth prior to scheduled maturity on and after November 1, 2017, as a whole or in part at any time and from time to time, in any order of maturity and by lot within a maturity in such a 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%) plus accrued interest thereon to the date fixed for redemption.

Extraordinary Redemption

The First Series B Bonds are subject to extraordinary redemption at the direction of the Commonwealth, at the respective redemption prices hereinafter specified, (a) in part, in an aggregate principal amount not in excess of $8,500,000.00, on September 1, 2008, and (b) in whole or in part, on September 1, 2010, but in any such case only if and to the extent the Commonwealth determines that such redemption is required under Section 149(f) of the Internal Revenue Code of 1986, as amended (the "Code"), in order to maintain the status of the First Series B Bonds as obligations the interest on which is excludable from the gross income of the owners thereof for federal income tax purposes. Any such redemption in part shall be in integral multiples of $5,000, and the First Series B Bonds or portions thereof to be redeemed shall be selected on a pro rata basis from among each maturity of the First Series B Bonds and from within a maturity as selected by lot, unless the Commonwealth determines that another method of selection of First Series B Bonds for redemption is required in order to achieve compliance with such section of the Code, in which event the Commonwealth reserves the right to select First Series B Bonds for redemption from among such maturities and in such principal amounts per maturity as it may determine in its discretion, and from within a maturity as selected by lot. Any such extraordinary redemption shall be upon at least 30 days, and not more than 60 days, prior notice. The redemption price for First Series B Bonds to be redeemed under this provision on September 1, 2008 shall be 106% of the principal amount of the First Series B Bonds to be redeemed, plus accrued interest to the redemption date. The redemption price for First Series B Bonds to be redeemed under this provision on September 1, 2010 shall be 104% of the principal amount of the First Series B Bonds to be redeemed, plus accrued interest to the redemption date.

Interest Rate and Bidding Details

First Series A Bonds

Each bidder shall designate a rate of interest per annum to be paid on the First Series A Bonds of each maturity, subject to the following limitations:

(i) all First Series A Bonds of the same maturity date must bear the same rate of interest and no one First Series A Bond shall bear more than one rate of interest;

(ii) no interest rate shall be other than a whole multiple of one-twentieth (1/20) or one-eighth (1/8) of one percent (1%) and a zero rate of interest may not be named; and

(iii) the reoffering price for First Series A Bonds of any maturity must be greater than 98½% and less than 119% of that maturity's par value.

First Series B Bonds

Each bidder shall designate a rate of interest per annum to be paid on the First Series B Bonds of each maturity, subject to the following limitations:

(i) all First Series B Bonds of the same maturity date must bear the same rate of interest and no one First Series B Bond shall bear more than one rate of interest;

(ii) no interest rate shall be other than a whole multiple of one-twentieth (1/20) or one-eighth (1/8) of one percent (1%) and a zero rate of interest may not be named; and

(iii) the reoffering price for First Series B Bonds of any maturity must be greater than 98½% and less than 119% of that maturity's par value.

No bid for the Bonds at a price less than 98½% of their par value, exclusive of accrued interest, will be considered. Bids may specify any number of interest rates subject to the above limitations for First Series A Bonds and First Series B Bonds. No bid will be considered which does not offer to purchase all of the Bonds.

Electronic Bidding Procedure

The Commonwealth will receive bids electronically through an auction process conducted by MuniAuction. Further information about MuniAuction, including any fee charged and applicable requirements, may be obtained from either www.GrantStreet.com or at www.MuniAuction.com or by calling the Grant Street Group at (412) 391-5555.

Bidder access to the auction and to the MuniAuction web site is via the auction link located at www.GrantStreet.com To bid via the MuniAuction web site, bidders must have both: (1) completed the Registration form on the MuniAuction web site; and (2) requested and received admission to the auction, as described herein. In order to register for the auction and participate as a bidder, all potential bidders must first visit the MuniAuction web site where, if they have never registered with Grant Street Group, they can register and then request admission to bid on the Bonds. Bidders will be notified prior to the scheduled bidding time of their eligibility to bid. All bidders must also review the Preliminary Official Statement and certify that they have done so prior to participating in the bidding auction.

The bidding for the Bonds will be conducted as an auction in which the following will apply:

1. Bidders may change and submit bids as many times as they like during the bidding time period; provided, however, each and any bid submitted subsequent to a Bidder's initial bid must result in a lower True Interest Cost ("TIC") with respect to the bid. In the event that the revised bid does not produce a lower TIC with respect to the bid, the prior bid will remain valid.

2. The last bid submitted by a bidder before the end of the bidding time period will be compared to all other final bids submitted by others to determine the winning bidder.

3. During the bidding, no bidder will see any other bidder's bid, but all bidders will be able to see the ranking of their bid relative to the ranking of other bids, i.e., "Leader," "Cover," "3rd," etc.

4. If any bid becomes the leading bid two (2) minutes prior to the end of the auction, the auction will be automatically extended by two (2) minutes from the time such a new leading bid is received by MuniAuction ("Two Minute Rule"). The auction end time will continue to be extended, indefinitely, until a single leading bid remains the leading bid for at least two (2) minutes.

All electronic bids must be delivered via MuniAuction. The rules of the Grant Street Group can be viewed on the Grant Street Group web site and are incorporated herein by reference. Bidders must comply with the "Rules of Grant Street Group" in addition to the requirements of this Notice of Sale. If any provision of this Notice of Sale conflicts with information provided by MuniAuction, this Notice of Sale shall control. Each bidder submitting an electronic bid agrees by doing so that it is solely responsible for all arrangements with (including any charges by) MuniAuction and that MuniAuction is not acting as an agent of the Commonwealth. Instructions for submitting electronic bids must be obtained from MuniAuction, and the Commonwealth does not assume any responsibility for ensuring or verifying bidder compliance with the procedures of MuniAuction. The Commonwealth shall be entitled to assume that any bid received via MuniAuction has been made by a duly authorized agent of the bidder. Acceptance of electronic bids shall be subject to the limitations set forth in **"Warnings Regarding Electronic Bids"** below.

Warnings Regarding Electronic Bids

The Commonwealth and Bond Counsel assume no responsibility for any error contained in any bid, or for failure of any bid to be transmitted or received at the official time for receipt of bids. The Commonwealth assumes no responsibility for informing any bidders prior to the deadline for receiving bids that its bid is incomplete or not received.

The Commonwealth will accept bids in electronic form only through MuniAuction on the official bid form created for such purpose by MuniAuction. Each bidder submitting an electronic bid understands and agrees by doing so that it is solely responsible for all arrangements with MuniAuction and that MuniAuction is not acting as agent of the Commonwealth. Instructions and forms for submitting electronic bids must be obtained from MuniAuction, and the Commonwealth assumes no responsibility for ensuring or verifying bidder compliance with the procedures of MuniAuction. The Commonwealth shall assume that any bid received though MuniAuction has been made by a duly authorized agent of the bidder.

Reoffering and Sale of Bonds to Public

Within thirty minutes after notification of award of the Bonds the successful bidder (the "Underwriter") shall provide to the Commonwealth the initial offering price to the public (excluding bond houses and brokers or similar persons or organizations acting in the capacity as wholesalers or underwriters) for each maturity of the Bonds (the "Initial Reoffering Prices") and certain other information to enable the Commonwealth to compute the yield on the Bonds for federal tax law purposes. The successful bidder will be required to provide a certificate regarding the issue price of the Bonds prior to settlement for the Bonds in form satisfactory to the Commonwealth and Bond Counsel establishing that the successful bidder has made a bona fide public offering of the Bonds at the Initial Reoffering Prices and that, as of the date of the award of the Bonds, the Underwriter reasonably expected that a substantial amount (at least 10 percent) of each maturity of the Bonds would be sold to the public at the Initial Reoffering Prices.

Each bidder, by the submission of a bid, agrees that if it is the successful bidder, it will make a *bona fide* public offering of the Bonds at prices not greater than the Initial Reoffering Prices, offer the Bonds only pursuant to the Official Statement and only in jurisdictions where the offer is legal, and deliver a copy of the Official Statement to each person or entity that purchases the Bonds from the Underwriter as required by Securities and Exchange Commission Rule 15c2-12. The Underwriter shall abide by all rules of the Municipal Securities Rulemaking Board ("MSRB") in connection with the issuance and sale of the Bonds, including the delivery to the MSRB of the Official Statement and any advance refunding documents.

Basis of Awards

Award of the Bonds will be made on or before 4:00 P.M. Eastern Daylight Time, on May 22, 2007 or, in the event of the announcement of an Amended Bid Date, the date specified in the Amended Notice. The Bonds will be sold to the bidder making a bid conforming to the terms of the offering which, on the basis of the lowest net effective interest rate for the Bonds, determined in the manner hereinafter stated, is the best bid, subject to the right of the undersigned in their sole discretion to reject any and all bids. The net effective interest rate for the Bonds shall be the interest rate determined on a true interest cost ("TIC") basis by doubling the semi-annual interest rate, compounded semi-annually, necessary to discount the debt service payments to the date of delivery of the Bonds, June 7, 2007, to the price bid, including interest accrued to the date of delivery, if any. In the event of more than one bid specifying such lowest rate, the Bonds will be awarded to the bidder whose bid is selected by lot from among all such lowest bids.

The Commonwealth reserves the right in its sole discretion to waive any minor errors or irregularities in form or content of any bid. No sealed, telephone, facsimile, telegraph or personal delivery bids will be accepted. All bids must be submitted electronically through the MuniAuction web site.

Good Faith Check or Surety Bond

A certified or bank cashier's or treasurer's check drawn on an incorporated bank or trust company, must be provided or a financial surety bond (the "Surety Bond") submitted, payable to the order of the Commonwealth of

Pennsylvania in the amount of $1,000,000 (the "Deposit"). If a Surety Bond is submitted, it must be from an insurance company acceptable to the Commonwealth and licensed to issue such a bond in the Commonwealth of Pennsylvania, such Surety Bond must be submitted to the Commonwealth prior to the opening of bids and must be in form and substance acceptable to the Commonwealth. The Surety Bond must identify each bidder whose Deposit is guaranteed by such Surety Bond. Checks accompanying bids not accepted will be returned to the bidders within 24 hours from the time of opening the bids. If the Bonds are awarded to a bidder utilizing a Surety Bond, then that successful bidder is required to submit its Deposit in the form of a federal funds wire transfer as instructed by the Commonwealth by not later than 11:00 a.m. Eastern Daylight Time on the next business day following the award. If such deposit is not received by that time, the Surety Bond may be drawn upon by the Commonwealth to satisfy the Deposit requirement.

The Commonwealth reserves the right, in its sole discretion, to present the good faith check of the successful bidder for payment and to deposit the proceeds of such check or the draw on the Surety Bond and to invest the Deposit to the date of settlement on the Bonds. The Deposit, but not any earnings from any investment thereof, will be applied to the purchase price of the Bonds, or, if such bid is not performed, such proceeds will be retained by the Commonwealth as liquidated damages, unless the failure of performance shall be caused by an act or omission of the Commonwealth.

Official Statement and Continuing Disclosure - SEC Rule 15c2-12

The Preliminary Official Statement dated May 11, 2007, issued with respect to the Bonds (the "Preliminary Official Statement"), has been deemed final by the Commonwealth as of its date for purposes of SEC Rule 15c2-12 (the “Rule”), except for the omission of information as permitted by the Rule, but is subject to revision, amendment, and completion in the final Official Statement (hereinafter the "Official Statement") to be prepared with respect to the Bonds. A reasonable number of copies (not to exceed 1,000) of the Official Statement, to be dated as of a date prior to settlement, will be furnished to the purchaser within seven business days after the sale date. Copies of the Official Statement in excess of 1,000 will be furnished at the request of the successful bidder at its own expense. The successful bidder will be required to provide pricing information necessary for the Commonwealth to complete the Official Statement.

In order to assist bidders in complying with the Rule, the Commonwealth will execute a written Continuing Disclosure Agreement to provide or cause to be provided, in accordance with the Rule, certain annual financial information and timely notices of the occurrence of certain events, if material, with respect to the Bonds. A description of this Continuing Disclosure Agreement is set forth in the Preliminary Official Statement and will also be set forth in the Official Statement.

CUSIP Numbers

CUSIP numbers will be assigned at the purchaser’s expense. The CUSIP numbers will be printed on the Bonds, provided, however, that incorrect numbers shall not constitute grounds for a purchaser of the Bonds to refuse delivery thereof.

Delivery of Bonds

Bond certificates will be delivered through the Loan and Transfer Agent to DTC using DTC’s Fast Automated Security Transfer (FAST) System. Payment for the Bonds must be made by wire in immediately available funds for credit at U.S. Bank, National Association, Loan and Transfer Agent, in Pittsburgh, Pennsylvania, at 10:00 A.M., Eastern Daylight Time, on the Closing Date, or at such other place and time as may be agreed upon with the successful bidder.

The successful bidder shall have the right, at its option, to cancel its obligation to purchase the Bonds if the Commonwealth shall fail to tender the Bonds for delivery within 60 days from the date herein fixed for the receipt of the bids, and in such event, the successful bidder shall only be entitled to the return of its Deposit, without interest, and shall have no right of action against the Commonwealth.

Legal Opinions

The Commonwealth will deliver to the purchaser without charge: (i) the opinion of the Attorney General of the Commonwealth and (ii) the opinion of Reed Smith, LLP, Philadelphia, Pennsylvania, appointed by the Commonwealth as Bond Counsel, both substantially in the forms of their opinions set forth as appendices to the Preliminary Official Statement.

Closing Documents

The Bonds are offered subject to the delivery at settlement by the Commonwealth of (i) a certificate stating that there is no litigation pending affecting the validity of the Bonds or their issuance and sale to the purchaser; (ii) a certification by the Secretary of the Budget that the financial statements contained in the Official Statement accurately reflect the conditions and facts they purport to reflect, that the estimates contained therein, in light of the information available, are believed to be reliable and that there have been no material adverse changes in the financial position of the Commonwealth since the dates of such financial statements not disclosed in the Official Statement; (iii) a certification by the Governor, the Auditor General and the State Treasurer that the Official Statement, except as to the financial statements contained therein, contains no untrue statement of a material fact and does not omit to state a material fact necessary in order to make the statements made therein, in light of the circumstances under which they were made, not misleading; and (iv) a Continuing Disclosure Agreement to provide or cause to be provided certain annual financial information and timely notices of the occurrence of certain events, if material, with respect to the Bonds.

Prior to settlement the purchasers will be required to deliver the certificate referred to under the caption "Reoffering and Sale of Bonds to Public" above.

Copies of Documents

Additional information and copies of the Preliminary Official Statement may be obtained from the Loan and Transfer Agent, U.S. Bank, National Association, Pittsburgh, Pennsylvania (Telephone 412-552-2140) or from the Office of the Budget, Seventh Floor, Bell Tower, Harrisburg, Pennsylvania 17101 (Telephone 717-783-3086). The Preliminary Official Statement may also be downloaded from the Office of the Budget area on the Commonwealth's site on the world wide web, www.budget.state.pa.us or from www.MuniAuction.com

EDWARD G. RENDELL
Governor

ROBIN WIESSMANN
State Treasurer

JACK WAGNER
Auditor General

Dated: May 11, 2007

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APPENDIX I

CIFG ASSURANCE NORTH AMERICA, INC.
OFFICIAL STATEMENT DISCLOSURE

THE BOND INSURER

CIFG Assurance North America, Inc.

The information set forth in the following paragraphs has been provided by CIFG Assurance North America, Inc. ("CIFG" or the "Insurer") for inclusion in this Official Statement. CIFG does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding CIFG set forth under the heading "The Bond Insurer." CIFG makes no representation regarding the Bonds or the advisability of investing in the Bonds.

General

CIFG is a monoline financial guaranty insurance company incorporated under the laws of the State of New York. The address of the principal executive offices of the Insurer is 825 Third Avenue, Sixth Floor, New York, New York 10022; its toll-free telephone number is (866) CIFG-212 and its general telephone number is (212) 909-3939; and its website is located at www.cifg.com.

The Insurer is a member of the CIFG Group of financial guaranty companies, which also includes CIFG Europe, a French insurance company licensed to do business in the European Union, and CIFG Guaranty, a dedicated French reinsurance corporation. In addition to its capital and surplus as set forth below, the Insurer is supported by a net worth maintenance agreement from CIFG Guaranty, which provides that CIFG Guaranty will maintain the Insurer's New York statutory capital and surplus at no less than $80 million. The Insurer also may cede a substantial portion (not to exceed 90%) of its exposure on each transaction to CIFG Guaranty through a facultative reinsurance agreement.

Each of the Insurer, CIFG Europe and CIFG Guaranty has received an insurer financial strength rating of "AAA" from Fitch, an insurer financial strength rating of "Aaa" from Moody's, and an insurer financial enhancement rating of "AAA" from Standard and Poor's, the highest rating assigned by each rating agency. Each such rating should be evaluated independently. The ratings reflect the respective rating agency's current assessment of each company's capacity to pay claims on a timely basis and are not recommendations to buy, sell or hold the Bonds. Such ratings may be subject to revision or withdrawal at any time.

The Insurer is licensed and subject to regulation as a financial guaranty insurance corporation under the laws of the State of New York, its state of domicile, and is licensed to do business in 48 jurisdictions. The Insurer is subject to Article 69 of the New York Insurance Law which, among other things, limits the business of such insurers to financial guaranty insurance and related lines, requires that such insurers maintain a minimum surplus to policyholders, establishes contingency, loss and unearned premium reserve requirements for such insurers, and limits the size of individual transactions and the volume of transactions that may be underwritten by such insurers. Other provisions of the New York Insurance Law applicable to non-life insurance companies such as the Insurer regulate, among other things, permitted investments, payment of dividends, transactions with affiliates, mergers, consolidations, acquisitions or sales of assets and incurrence of liabilities for borrowings.

Capitalization. The following tables set forth the capitalization of the Insurer on the basis of accounting principles generally accepted in the United States ("US GAAP") and statutory accounting practices prescribed or permitted by the New York State Insurance Department, respectively.

	US GAAP March 31, 2007 (in thousands of US dollars)	**US GAAP December 31, 2006 (in thousands of US dollars)**
Total Assets	$ 389,904	$ 385,057
Total Liabilities	$ 267,974	$ 263,160
Shareholder's Equity	$ 121,930	$ 121,897
	Statutory Accounting Practices March 31, 2007 (in thousands of US dollars)	**Statutory Accounting Practices December 31, 2006 (in thousands of US dollars)**
Admitted Assets..............	$ 190,873	$ 191,381
Liabilities........................	$ 89,190	$ 87,561
Capital and Surplus.........	$ 101,683	$ 103,820

For further information concerning the Insurer, see the audited financial statements of the Insurer, including the notes thereto, prepared in accordance with US GAAP as of December 31, 2006 and 2005 and for each of the three years in the period ended December 31, 2006, and the unaudited interim financial statements of the Insurer as of March 31, 2007 and for the three-month period ended March 31, 2007, which are available on the CIFG Group's website at www.cifg.com. Copies of the most recent audited annual and unaudited interim financial statements of the Insurer prepared in accordance with accounting principles prescribed or permitted by the New York State Insurance Department, are also available on the website and may be obtained, without charge, upon request to the Insurer at its address above, Attention: Finance Department.

TRIPLE-A FINANCIAL GUARANTY

CIFG Assurance North America, Inc.
825 Third Avenue, Sixth Floor
New York, NY 10022
For information, contact (212) 909-3939
Toll-free (866) 243-4212

FINANCIAL GUARANTY INSURANCE POLICY

ISSUER: ____________________ Policy No.: CIFG NA-##

CUSIP: _____________________ Effective Date: _______, 200_

OBLIGATIONS: ____

CIFG ASSURANCE NORTH AMERICA, INC. ("CIFG NA"), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY GUARANTEES to each Policyholder, subject only to the terms and conditions of this Policy (which includes each endorsement hereto), the full and complete payment by or on behalf of the Issuer of Regular Payments of principal of and interest on the Obligations.

For the further protection of each Policyholder, CIFG NA irrevocably and unconditionally guarantees:

(1) payment of any amount required to be paid under this Policy by CIFG NA following CIFG NA's receipt of notice and instruments of assignment as described in Endorsement No. 1 hereto and

(2) payment of the amount of any distribution of principal of and interest on the Obligations made during the Term of this Policy to such Policyholder that is subsequently avoided in whole or in part as a preference payment under applicable law, all as described in Endorsement No. 1 hereto.

CIFG NA shall be subrogated to the rights of each Policyholder to receive payments under the Obligations to the extent of any payment by CIFG NA hereunder. Upon disbursement in respect of an Obligation, CIFG NA shall become the owner of the Obligation, appurtenant coupon, if any, and all rights to payment of principal thereof or interest thereon.

The following terms shall have the meanings specified below, subject to and including any modifications set forth in any endorsement hereto, for all purposes of this Policy. "Effective Date," "Issuer" and "Obligations" mean, respectively, the Effective Date, Issuer and Obligations referenced above. "Policyholder" means, if the Obligations are in book-entry form, the registered owner of any Obligation as indicated on the registration books maintained by or on behalf of the Issuer for such purpose or, if the Obligations are in bearer form, the holder of any Obligation; *provided, however, that* any trustee acting on behalf of and for the benefit of such registered owner or holder shall be deemed to be the Policyholder to the extent of such trustee's authority. "Regular Payments" means payments of interest and principal which are agreed to be made during the Term of this Policy in accordance with the original terms of the Obligations when issued and without regard to any amendment or modification of such Obligations thereafter; payments which become due on an accelerated basis as a result of (a) a default by the Issuer or any other person, (b) an election by the Issuer to pay principal or other amounts on an accelerated basis or (c) any other cause, shall not constitute "Regular Payments" unless CIFG NA shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration. "Term of this Policy" has the meaning set forth in Endorsement No. 1 hereto.

This Policy sets forth in full the undertaking of CIFG NA, and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto or to the Obligations (except a contemporaneous or subsequent agreement or instrument given by CIFG NA or to which CIFG NA has given its written consent) or by the merger, consolidation or dissolution of the Issuer. The premiums paid in respect of this Policy are nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Obligations prior to maturity. This Policy may not be cancelled or revoked during the Term of this Policy, including for nonpayment of premium due to CIFG NA. Payments under this Policy may not be accelerated except at the sole option of CIFG NA.

In witness whereof, CIFG ASSURANCE NORTH AMERICA, INC. has caused this Policy to be executed on its behalf by its Authorized Officer.

CIFG ASSURANCE NORTH AMERICA, INC.

By ____
Authorized Officer

SPECIMEN