

# FRANKLIN NORTH CAROLINA TAX-FREE INCOME FUND

AS OF 12/31/13 TAX-FREE INCOME

#### **FUND DESCRIPTION**

The fund seeks to provide investors with as high a level of income exempt from federal income taxes and North Carolina personal income taxes as is consistent with prudent investment management and the preservation of shareholders' capital.<sup>1</sup>

## **FUND DATA<sup>2</sup>**

Total Net Assets-All Share Classes: \$1.1 billion

Number of Holdings: 170

Inception: 9/1/87

Dividends: Monthly, on or near the last business day

Credit Quality<sup>3</sup>

AAA: 14.36% BBB: 7.20% AA: 52.12% BB: 0.15% A: 19.81% RF: 6.36%

Average Weighted Maturity: 19.9 years

Average Duration<sup>4</sup>: 5.0 years AMT Exposure: 0.00% Symbol by Class:

Α	С	Advisor
FXNCX	FNCIX	FNCZX

#### MAXIMUM SALES CHARGES

Class A: 4.25% initial sales charge

Class C: 1% contingent deferred sales charge

(CDSC) in the first year only

# TOTAL ANNUAL OPERATING EXPENSES

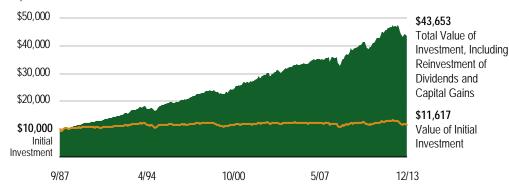
Class A: 0.62%; Class C: 1.17%

Performance data represents past performance, which does not guarantee future results. Current performance may differ from figures shown. The fund's investment return and principal value will change with market conditions, and you may have a gain or a loss when you sell your shares. Please call Franklin Templeton Investments at (800) DIAL BEN/342-5236 or visit franklintempleton.com for the most recent month-end performance.

- 1. For investors subject to the alternative minimum tax, a small portion of fund dividends may be taxable. Distributions of capital gains are generally taxable.
- 2. As of 12/31/13. Holdings are subject to change. For updated information, please call Franklin Templeton Investments at (800) DIAL BEN/342-5236 or visit franklintempleton.com.

#### GROWTH OF A \$10,000 INVESTMENT—CLASS A (Without Sales Charge)

September 1, 1987-December 31, 2013



If the sales charge had been included, the return would have been lower.

# AVERAGE ANNUAL TOTAL RETURNS (As of December 31, 2013)

With Maximum Sales Charges<sup>5</sup>

Class	Inception Date	1 Yr	5 Yrs	10 Yrs	Since Inception
Α	9/1/87	-10.69%	4.64%	3.20%	5.58%
С	5/1/95	-8.16%	4.98%	3.07%	4.23%

YIELDS (As of December 31, 2013)

Class	30-Day Standardized Yield <sup>6</sup>	Taxable Equivalent Yield <sup>7</sup>
Α	3.24%	6.10%
С	2.84%	5.35%

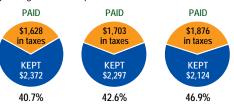
## Without Sales Charges

			Since
1 Yr	5 Yrs	10 Yrs	Inception
-6.75%	5.55%	3.64%	5.76%
-7.26%	4.98%	3.07%	4.23%

### KEEP MORE OF WHAT YOU EARN8

Based on a hypothetical one-year return for a \$100,000 investment, you would have:

Earned \$4,000 annually from a taxable investment yielding 4.00%, but paid taxes as shown below.



Or, earned \$3,750 that would have been yours to keep from a tax-free investment yielding 3.75%.1

Tax-Free Solution



Combined Federal Income, North Carolina State Income and Medicare Tax Rates<sup>9</sup>

There is no quarantee that after-tax returns of municipal bonds will be greater than those of taxable investments.

- 3. Securities, except for those labeled Not Rated ("NR"), are assigned ratings by one or more Nationally Recognized Statistical Rating Organizations ("NRSRO"), such as Standard & Poor's, Moody's and Fitch. The ratings are an indication of an issuer's creditworthiness and typically range from AAA or Aaa (highest) to D (lowest). When ratings from multiple agencies are available, the highest is used. The Refunded ("RF") category consists of refunded bonds with an implied Aaa rating since they are secured by U.S. government securities. The Not Rated category consists of rateable securities that have not been rated by an NRSRO. Cash and equivalents (defined as bonds with stated maturities, or that can be redeemed at intervals, of seven days or less), as well as short-term bonds (defined as bonds maturing in more than seven days but less than one
- year) are excluded from this breakdown. This methodology differs from that used in Fund shareholder reports.
- 4. Calculated according to the modified duration formula. Duration is an indication of a fund's sensitivity to changes in interest rates. Please note, duration numbers will change as market conditions change; therefore duration should not solely be relied upon to indicate a municipal bond fund's potential volatility.
- 5. Class A: On 5/1/94, these shares implemented a Rule 12b-1 plan, which affects subsequent performance. Class C: Prior to 1/1/04, these shares were offered with an initial sales charge; thus actual returns would have differed.

#### **PORTFOLIO MANAGERS**

#### Stella Wong

Since 1987; joined Franklin Templeton in 1986

#### Carrie Higgins

Since 1992; joined Franklin Templeton in 1990

#### MANAGER'S PERSPECTIVE

"We strive to maximize monthly tax-free income and adhere to a conservative, disciplined investment strategy. Consistent with that approach, the fund does not use leverage or invest in derivatives, which can increase volatility in municipal bond portfolios. We conduct stringent credit analysis to identify undervalued municipal securities for the portfolio. Our buy-and-hold strategy helps provide relative price stability and can also help reduce the fund's capital gain distributions."

—Stella Wong, Portfolio Manager

#### WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal. Because municipal bonds are sensitive to interest rate movements, the fund's yield and share price will fluctuate with market conditions. Bond prices generally move in the opposite direction of interest rates. Thus, as prices of bonds in the fund adjust to a rise in interest rates, the fund's share price may decline. Because the fund invests principally in a single state, it is subject to greater risk of adverse economic and regulatory changes in that state than a geographically diversified fund. The fund holds a portion of its assets in Puerto Rico municipal bonds that have been impacted by recent adverse economic and market changes, which may cause the fund's share price to decline. Changes in the credit rating of a bond, or in the credit rating or financial strength of a bond's issuer, insurer or guarantor, may affect the bond's value. The fund may invest a significant part of its assets in municipal securities that finance similar types of projects, such as utilities, hospitals, higher education and transportation. A change that affects one project would likely affect all similar projects, thereby increasing market risk.

Investors should carefully consider a fund's investment goals, risks, charges and expenses before investing. To obtain a summary prospectus and/or prospectus, which contains this and other information, talk to your financial advisor, call us at (800) DIAL BEN/342-5236 or visit franklintempleton.com. Please carefully read a prospectus before you invest or send money.

#### PORTFOLIO BREAKDOWN<sup>10</sup> (As of December 31, 2013)



# CALENDAR YEAR TOTAL RETURNS—CLASS A (Without Sales Charge)

2013	2012	2011	2010	2009	2008	2007	2006	2005	2004
-6.75%	6.98%	11.28%	0.85%	17.01%	-6.64%	2.11%	4.86%	4.05%	4.97%
2003	2002	2001	2000	1999	1998	1997	1996	1995	1994

If the sales charge had been included, the returns would have been lower.

#### **GAIN FROM OUR PERSPECTIVE®**

Franklin Templeton's distinct multi-manager structure combines the specialized expertise of three world-class investment management groups—Franklin, Templeton and Mutual Series.

#### Specialized Expertise

Each of our portfolio management groups operates autonomously, relying on its own research and staying true to the unique investment disciplines that underlie its success.

- Franklin. Founded in 1947, Franklin is a recognized leader in fixed income investing and also brings expertise in growth- and value-style U.S. equity investing.
- Templeton. Founded in 1940, Templeton pioneered international investing and, in 1954, launched what has become the industry's oldest global fund. Today, with offices in over 25 countries, Templeton offers investors a truly global perspective.
- **Mutual Series.** Founded in 1949, Mutual Series is dedicated to a unique style of value investing, searching aggressively for opportunity among what it believes are undervalued stocks, as well as arbitrage situations and distressed securities.
- 6. The 30-Day Standardized Yield reflects an estimated yield to maturity. It should be regarded as an estimate of the fund's rate of investment income, and it may not equal the fund's actual income distribution rate, which reflects the fund's past dividends paid to shareholders.
- 7. Assumes the maximum regular federal income tax rate; the maximum state personal income tax rate; and the Medicare tax in effect on December 2013.
- 8. Hypothetical yields are for illustrative purposes only. Assumes a fixed rate of return and the stated tax rates. Does not reflect fund performance. Fund dividends and share price will vary with market conditions.
- 9. The combined tax rates are based on the 33%, 35% and 39.6% regular federal income tax rates (left to right), the 5.8% state personal income tax rate, and the 3.8% Medicare tax. They give full effect to the deduction of state income taxes and are based on published rates in effect on December 2013.
- 10. Portfolio holdings are subject to change. Due to rounding, the sum of portfolio holdings may not equal 100%. From time to time, the Cash & Cash equivalents/Money Market Funds, as applicable, may reflect a negative position in cash as result of the time required to settle securities transactions, which temporarily affected cash and securities balances. Information is historical and may not reflect current or future portfolio characteristics. All portfolio holdings are subject to change.



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