August 1, 2026

LEGG MASON PARTNERS INCOME TRUST

Fund	Ticker Symbol				
	Class A	Class C	Class FI	Class I	Class IS
WESTERN ASSET INTERMEDIATE-TERM MUNICIPALS FUND ("Intermediate-Term Municipals Fund")	SBLTX	SMLLX	—	SBTYX	SMLSX
WESTERN ASSET NEW JERSEY MUNICIPALS FUND ("New Jersey Municipals Fund")	SHNJX	SNJLX	—	LNJIX	LNISX
WESTERN ASSET NEW YORK MUNICIPALS FUND ("New York Municipals Fund")	SBNYX	SBYLX	—	SNPYX	SNIPX
WESTERN ASSET PENNSYLVANIA MUNICIPALS FUND ("Pennsylvania Municipals Fund")	SBPAX	SPALX	—	LPPIX	LPISX

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New York, New York 10010
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STATEMENT OF ADDITIONAL INFORMATION

This Statement of Additional Information ("SAI") is not a prospectus and is meant to be read in conjunction with the Prospectus of the Fund, dated August 1, 2026, as amended or supplemented from time to time, and is incorporated by reference in its entirety into each Prospectus. This SAI contains additional information about each fund listed above (references to the "Fund" mean each Fund listed on this cover page, unless otherwise noted).

Additional information about the Fund's investments is available in the Fund's annual and semi-annual reports to shareholders and in Form N-CSR. In the Fund's annual report, you will find a discussion of the market conditions and investment strategies that significantly affected the Fund's performance during its last fiscal year. In Form N-CSR, you will find the Fund's annual and semi-annual financial statements. The Fund's audited financial statements and the accompanying independent registered public accounting firm's report for the fiscal year ended March 31, 2026, as filed on Form N-CSR, are incorporated herein by reference (https://www.sec.gov/ix?doc=/Archives/edgar/data/764624/000113322826008375/waitmf-efp24585_ncsr.htm https://www.sec.gov/ix?doc=/Archives/edgar/data/764624/000113322826008371/wanjmf-efp24588_ncsr.htm https://www.sec.gov/ix?doc=/Archives/edgar/data/764624/000113322826008373/wanymf-efp24594_ncsr.htm https://www.sec.gov/ix?doc=/Archives/edgar/data/764624/000113322826008377/wapmf-efp24591_ncsr.htm). The Fund's Prospectus, copies of the annual and semi-annual reports and other information such as Fund financial statements may be obtained free of charge by contacting banks, brokers, dealers, insurance companies, investment advisers, financial consultants or advisers, mutual fund supermarkets and other financial intermediaries that have entered into an agreement with the Fund's distributor to sell shares of the Fund (each called a "Service Agent"), by writing the Fund at Legg Mason Funds, P.O. Box 33030, St. Petersburg, FL 33733-8030, by calling the telephone number set forth above, by sending an e-mail request to prospectus.us.franklintempleton@fisglobal.com or by visiting www.franklintempleton.com/prospectus. Franklin Distributors, LLC ("Franklin Distributors" or the "Distributor"), an indirect, wholly-owned broker/dealer subsidiary of Franklin Resources, Inc., serves as the Fund's sole and exclusive distributor.

THIS SAI IS NOT A PROSPECTUS AND IS AUTHORIZED FOR DISTRIBUTION TO PROSPECTIVE INVESTORS ONLY IF PRECEDED OR ACCOMPANIED BY AN EFFECTIVE PROSPECTUS.

No person has been authorized to give any information or to make any representations not contained in the Prospectus or this SAI in connection with the offering made by the Prospectus and, if given or made, such information or representations must not be relied upon as having been authorized by the Fund or the Distributor. The Prospectus and this SAI do not constitute an offering by the Fund or by the Distributor in any jurisdiction in which such offering may not lawfully be made.

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GLOSSARY OF TERMS

Because the following is a combined glossary of terms, certain terms below may not apply to your fund. Any terms used but not defined herein have the meaning ascribed to them in the applicable Fund's prospectus.

"12b-1 Plans" means the Fund's distribution and shareholder services plan.

"1933 Act" means the Securities Act of 1933, as amended.

"1934 Act" means the Securities Exchange Act of 1934, as amended.

"1940 Act" means the Investment Company Act of 1940, as amended.

"1940 Act Vote" means the vote of the lesser of: (a) more than 50% of the outstanding shares of the Fund; or (b) 67% or more of the shares of the Fund present at a shareholders' meeting if more than 50% of the outstanding shares of that Fund are represented at the meeting in person or by proxy.

"Advisers Act" means the Investment Advisers Act of 1940, as amended.

"Board" means the Board of Trustees or Board of Directors, as applicable.

"CEA" means the Commodity Exchange Act, as amended.

"CFTC" means the U.S. Commodity Futures Trading Commission.

"Code" means the Internal Revenue Code of 1986, as amended.

"Corporation" (if applicable) means the corporation listed on the cover page of this SAI.

"Directors" means the directors of the Corporation.

"Distributor" means the party that is responsible for the distribution or sale of the Fund's shares. Franklin Distributors, LLC ("Franklin Distributors") is the Fund's distributor.

"FINRA" means the Financial Industry Regulatory Authority, Inc.

"Franklin Resources" means Franklin Resources, Inc.

"Fund" means the Fund or Funds listed on the cover of this SAI unless stated otherwise.

"Fundamental Investment Policy" means an investment policy of the Fund that may be changed only by a 1940 Act Vote. Only those policies expressly designated as such are fundamental investment policies. All other policies and restrictions may be changed by the Board without shareholder approval.

"Independent Director" or "Independent Trustee" (as applicable) means a Director of the Corporation or a Trustee of the Trust who is not an "interested person" (as defined in the 1940 Act) of the Corporation or Trust (as applicable).

"IRAs" means Individual Retirement Accounts.

"IRS" means Internal Revenue Service.

"Legg Mason" means Legg Mason, Inc.

"Manager" or "FTFA" means Franklin Templeton Fund Adviser, LLC.

"NAV" means net asset value.

"NRSROs" means nationally recognized (or non-U.S.) statistical rating organizations, including, but not limited to, Moody's Investors Service, Inc. ("Moody's"), Fitch Ratings and S&P Global Ratings, a subsidiary of S&P Global Inc. ("S&P").

"NYSE" means the New York Stock Exchange.

"Prospectus" means the prospectus of a Fund as referenced on the cover page of this SAI.

"SAI" means this Statement of Additional Information.

"SEC" means the U.S. Securities and Exchange Commission.

"Service Agent" means each bank, broker, dealer, insurance company, investment adviser, financial consultant or adviser, mutual fund supermarket and any other financial intermediaries that have entered into an agreement with the Distributor to sell shares of the Fund.

"Subadviser" means Western Asset Management Company, LLC, as referred to in the Fund's Prospectus and this SAI.

"Trust" (if applicable) means the trust listed on the cover page of this SAI.

"Trustees" means the trustees of the Trust.

INVESTMENT POLICIES

Investment Objective and Strategies

The Fund is registered under the 1940 Act as an open-end management investment company. The Fund's Prospectus discusses the Fund's investment objective and strategies. The following is a summary of principal investment strategies and certain additional strategies and investment limitations of the Fund and supplements the description of the Fund's investment strategies in its Prospectus. Additional information regarding investment practices and risk factors with respect to the Fund may also be found below in the section entitled *Investment Practices and Risk Factors*.

Intermediate-Term Municipals Fund

- *Investment objective*. The Fund seeks to provide as high a level of income exempt from regular federal income tax as is consistent with prudent investing.
- Under normal circumstances, the Fund invests at least 80% of its assets in "municipal securities." Municipal securities are securities and other investments with similar economic characteristics, the interest on which is exempt from regular U.S. federal income tax but which may be subject to the U.S. federal alternative minimum tax ("AMT"). The Fund's 80% investment policy may not be changed without a shareholder vote.
- The Fund may invest more than 25% of its assets in municipal securities that derive income from similar types of projects or that are otherwise related in such a way that an economic, business or political development or change affecting one of the securities would also affect the others.
- The Fund focuses on investment grade bonds but may invest up to 20% of its assets in below investment grade bonds (commonly known as "high yield" or "junk" bonds).

New Jersey Municipals Fund

- *Investment objective.* The Fund seeks to provide New Jersey investors with as high a level of income exempt from regular federal income tax and New Jersey state personal income tax as is consistent with prudent investment management and the preservation of capital.
- Under normal circumstances, the Fund invests at least 80% of its assets in "New Jersey municipal securities." New Jersey municipal securities are securities and other investments with similar economic characteristics, the interest on which is exempt from regular U.S. federal income tax and New Jersey state personal income tax but which may be subject to the U.S. federal alternative minimum tax ("AMT"). If the interest income on a municipal security meets these standards, the fund will treat the municipal security as qualifying for purposes of the fund's 80% investment policy even if the issuer is located outside of the State of New Jersey. The Fund's 80% investment policy may not be changed without a shareholder vote.
- The Fund may invest more than 25% of its assets in municipal securities that derive income from similar types of projects or that are otherwise related in such a way that an economic, business or political development or change affecting one of the securities would also affect the others.
- The Fund focuses on investment grade bonds but may invest up to 20% of its assets in below investment grade bonds (commonly known as "high yield" or "junk" bonds).

New York Municipals Fund

- *Investment objective.* The Fund seeks as high a level of income exempt from regular federal income tax and New York state and New York City personal income taxes as is consistent with prudent investing.
- Under normal circumstances, the Fund invests at least 80% of its assets in "New York municipal securities." New York municipal securities are securities and other investments with similar economic characteristics, the interest on which is exempt from regular U.S. federal income tax and New York state and New York City personal income taxes but which may be subject to the U.S. federal alternative minimum tax ("AMT"). If the interest income on a municipal security meets these standards, the fund will treat the municipal security as qualifying for purposes of the fund's 80% investment policy even if the issuer is located outside of the State of New York. The Fund's 80% investment policy may not be changed without a shareholder vote.
- The Fund may invest more than 25% of its assets in municipal securities that derive income from similar types of projects or that are otherwise related in such a way that an economic, business or political development or change affecting one of the securities would also affect the others.

- The Fund focuses on investment grade bonds but may invest up to 20% of its assets in below investment grade bonds (commonly known as "high yield" or "junk" bonds).

Pennsylvania Municipals Fund

- *Investment objective.* The Fund seeks as high a level of income exempt from regular federal income tax and Pennsylvania personal income taxes as is consistent with prudent investing.
- Under normal circumstances, the Fund invests at least 80% of its assets in "Pennsylvania municipal securities." Pennsylvania municipal securities are securities and other investments with similar economic characteristics, the interest on which is exempt from regular U.S. federal income tax and Pennsylvania state personal income taxes but which may be subject to the U.S. federal alternative minimum tax ("AMT"). If the interest income on a municipal security meets these standards, the fund will treat the municipal security as qualifying for purposes of the fund's 80% investment policy even if the issuer is located outside of the Commonwealth of Pennsylvania. The Fund's 80% investment policy may not be changed without a shareholder vote.
- The Fund may invest more than 25% of its assets in municipal securities that derive income from similar types of projects or that are otherwise related in such a way that an economic, business or political development or change affecting one of the securities would also affect the others.
- The Fund focuses on investment grade bonds but may invest up to 20% of its assets in below investment grade bonds (commonly known as "high yield" or "junk" bonds).

Fundamental and Non-Fundamental Investment Policies

General

The Fund has adopted the fundamental and non-fundamental investment policies below for the protection of shareholders. Fundamental investment policies of the Fund may not be changed without a 1940 Act Vote. The Board may change non-fundamental investment policies at any time without shareholder approval and upon notice to shareholders.

If any percentage restriction described below (other than the limitation on borrowing) is complied with at the time of an investment, a later increase or decrease in the percentage resulting from a change in asset values or characteristics will not constitute a violation of such restriction, unless otherwise noted below.

The Fund's investment objective is non-fundamental.

Fundamental Investment Policies

The Fund's fundamental investment policies are as follows:

Borrowing: The Fund may not borrow money except as permitted by (i) the 1940 Act, or interpretations or modifications by the SEC, SEC staff or other authority with appropriate jurisdiction, or (ii) exemptive or other relief or permission from the SEC, SEC staff or other authority.

Underwriting: The Fund may not engage in the business of underwriting the securities of other issuers except as permitted by (i) the 1940 Act, or interpretations or modifications by the SEC, SEC staff or other authority with appropriate jurisdiction, or (ii) exemptive or other relief or permission from the SEC, SEC staff or other authority.

Lending: The Fund may lend money or other assets to the extent permitted by (i) the 1940 Act, or interpretations or modifications by the SEC, SEC staff or other authority with appropriate jurisdiction, or (ii) exemptive or other relief or permission from the SEC, SEC staff or other authority.

Senior Securities: The Fund may not issue senior securities except as permitted by (i) the 1940 Act, or interpretations or modifications by the SEC, SEC staff or other authority with appropriate jurisdiction, or (ii) exemptive or other relief or permission from the SEC, SEC staff or other authority.

Real Estate: The Fund may not purchase or sell real estate except as permitted by (i) the 1940 Act, or interpretations or modifications by the SEC, SEC staff or other authority with appropriate jurisdiction, or (ii) exemptive or other relief or permission from the SEC, SEC staff or other authority.

Commodities: The Fund may purchase or sell commodities or contracts related to commodities to the extent permitted by (i) the 1940 Act, or interpretations or modifications by the SEC, SEC staff or other authority with appropriate jurisdiction, or (ii) exemptive or other relief or permission from the SEC, SEC staff or other authority.

Concentration: Except as permitted by exemptive or other relief or permission from the SEC, SEC staff or other authority with appropriate jurisdiction, the Fund may not make any investment if, as a result, the Fund's investments will be concentrated in any one industry.

Municipal Securities:

Intermediate-Term Municipals Fund: Under normal circumstances, the Fund invests at least 80% of its net assets (plus any borrowings for investment purposes) in "municipal securities."

New Jersey Municipals Fund: Under normal circumstances, the Fund invests at least 80% of its net assets (plus any borrowings for investment purposes) in "New Jersey municipal securities."

New York Municipals Fund: Under normal circumstances, the Fund invests at least 80% of its net assets (plus any borrowings for investment purposes) in "New York municipal securities."

Pennsylvania Municipals Fund: Under normal circumstances, the Fund invests at least 80% of its net assets (plus any borrowings for investment purposes) in "Pennsylvania municipal securities."

For purposes of these policies, the term "municipal securities" includes municipal securities that pay interest subject to the U.S. federal alternative minimum tax.

With respect to the fundamental policy relating to borrowing money set forth above, the 1940 Act permits a fund to borrow money in amounts of up to one-third of the fund's total assets from banks for any purpose, and to borrow up to 5% of the Fund's total assets from banks or other lenders for temporary purposes. (A fund's total assets include the amounts being borrowed.) To limit the risks attendant to borrowing, the 1940 Act requires a fund to maintain an "asset coverage" of at least 300% of the amount of its borrowings, provided that in the event that the fund's asset coverage falls below 300%, the fund is required to reduce the amount of its borrowings so that it meets the 300% asset coverage threshold within three days (not including Sundays and holidays). Asset coverage means the ratio that the value of a fund's total assets (including amounts borrowed), minus liabilities other than borrowings, bears to the aggregate amount of all borrowings. Certain trading practices and investments, such as reverse repurchase agreements, may be considered to be borrowing, and thus subject to the 1940 Act restrictions. Borrowing money to increase portfolio holdings is known as "leveraging." Borrowing, especially when used for leverage, may cause the value of the Fund's shares to be more volatile than if the Fund did not borrow. This is because borrowing tends to magnify the effect of any increase or decrease in the value of the Fund's portfolio holdings. Borrowed money thus creates an opportunity for greater gains, but also greater losses. To repay borrowings, the Fund may have to sell securities at a time and at a price that is unfavorable to the Fund. There also are costs associated with borrowing money, and these costs would offset and could eliminate the Fund's net investment income in any given period. Currently, the Fund does not contemplate borrowing money for leverage, but if the Fund does so, it will not likely do so to a substantial degree. The policy above will be interpreted to permit the Fund to engage in trading practices and investments that may be considered to be borrowing to the extent permitted by the 1940 Act. Short-term credits necessary for the settlement of securities transactions and arrangements with respect to securities lending will not be considered to be borrowings under the policy. Practices and investments that may involve leverage but are not considered to be borrowings are not subject to the policy.

With respect to the fundamental policy relating to underwriting set forth above, the 1940 Act does not prohibit a fund from engaging in the underwriting business or from underwriting the securities of other issuers; in fact, the 1940 Act permits a fund to have underwriting commitments of up to 25% of its assets under certain circumstances. Those circumstances currently are that the amount of the fund's underwriting commitments, when added to the value of the fund's investments in issuers where the fund owns more than 10% of the outstanding voting securities of those issuers, cannot exceed the 25% cap. A fund engaging in transactions involving the acquisition or disposition of portfolio securities may be considered to be an underwriter under the 1933 Act. Under the 1933 Act, an underwriter may be liable for material omissions or misstatements in an issuer's registration statement or prospectus. Securities purchased from an issuer and not registered for sale under the 1933 Act are considered restricted securities. There may be a limited market for these securities. If these securities are registered under the 1933 Act, they may then be eligible for sale but participating in the sale may subject the seller to underwriter liability. These

risks could apply to a fund investing in restricted securities. Although it is not believed that the application of the 1933 Act provisions described above would cause the Fund to be engaged in the business of underwriting, the policy above will be interpreted not to prevent the Fund from engaging in transactions involving the acquisition or disposition of portfolio securities, regardless of whether the Fund may be considered to be an underwriter under the 1933 Act.

With respect to the fundamental policy relating to lending set forth above, the 1940 Act does not prohibit a fund from making loans; however, SEC staff interpretations currently prohibit funds from lending more than one-third of their total assets, except through the purchase of debt obligations or the use of repurchase agreements. (A repurchase agreement is an agreement to purchase a security, coupled with an agreement to sell that security back to the original seller on an agreed-upon date at a price that reflects current interest rates. The SEC frequently treats repurchase agreements as loans.) While lending securities may be a source of income to the Fund, as with other extensions of credit, there are risks of delay in recovery or even loss of rights in the underlying securities should the borrower fail financially. However, loans would be made only when the Fund's Manager or the Subadviser believes the income justifies the attendant risks. The Fund also will be permitted by this policy to make loans of money, including to other funds. The Fund would have to obtain exemptive relief from the SEC to make loans to other funds. The policy above will be interpreted not to prevent a fund from purchasing or investing in debt obligations and loans. In addition, collateral arrangements with respect to options, forward currency and futures transactions and other derivative instruments, as well as delays in the settlement of securities transactions, will not be considered loans.

With respect to the fundamental policy relating to issuing senior securities set forth above, "senior securities" are defined as fund obligations that have a priority over the fund's shares with respect to the payment of dividends or the distribution of fund assets. The 1940 Act prohibits a fund from issuing senior securities, except that the fund may borrow money in amounts of up to one-third of the fund's total assets from banks for any purpose. A fund also may borrow up to 5% of the fund's total assets from banks or other lenders for temporary purposes, and these borrowings are not considered senior securities. The issuance of senior securities by a fund can increase the speculative character of the fund's outstanding shares through leveraging. Leveraging of the Fund's portfolio through the issuance of senior securities magnifies the potential for gain or loss on monies, because even though the Fund's net assets remain the same, the total risk to investors is increased to the extent of the Fund's gross assets. The policy above will be interpreted not to prevent collateral arrangements with respect to swaps, options, forward or futures contracts or other derivatives, or the posting of initial or variation margin.

With respect to the fundamental policy relating to real estate set forth above, the 1940 Act does not prohibit a fund from owning real estate; however, a fund is limited in the amount of illiquid assets it may purchase. Investing in real estate may involve risks, including that real estate is generally considered illiquid and may be difficult to value and sell. Owners of real estate may be subject to various liabilities, including environmental liabilities. To the extent that investments in real estate are considered illiquid, an SEC rule limits a fund's purchases of illiquid securities to 15% of net assets. The policy above will be interpreted not to prevent the Fund from investing in real estate-related companies, companies whose businesses consist in whole or in part of investing in real estate, instruments (like mortgages) that are secured by real estate or interests therein, or real estate investment trust securities.

With respect to the fundamental policy relating to commodities set forth above, the 1940 Act does not prohibit a fund from owning commodities, whether physical commodities and contracts related to physical commodities (such as oil or grains and related futures contracts), or financial commodities and contracts related to financial commodities (such as currencies and, possibly, currency futures). However, a fund is limited in the amount of illiquid assets it may purchase. To the extent that investments in commodities are considered illiquid, an SEC rule limits a fund's purchases of illiquid securities to 15% of net assets. If the Fund were to invest in a physical commodity or a physical commodity-related instrument, the Fund would be subject to the additional risks of the particular physical commodity and its related market. The value of commodities and commodity-related instruments may be extremely volatile and may be affected either directly or indirectly by a variety of factors. There also may be storage charges and risks of loss associated with physical commodities. The policy above will be interpreted to permit investments in exchange traded funds that invest in physical and/or financial commodities.

With respect to the fundamental policy relating to concentration set forth above, the 1940 Act does not define what constitutes "concentration" in an industry. The SEC staff has taken the position that investment of 25% or more of a fund's total assets in one or more issuers conducting their principal activities in the same industry or group of industries constitutes concentration. It is possible that interpretations of concentration could change in the future. A fund that invests a significant percentage of its total assets in a single industry may be particularly susceptible to adverse events affecting that industry and

may be more risky than a fund that does not concentrate in an industry. The policy above will be interpreted to refer to concentration as that term may be interpreted from time to time. In addition, the term industry will be interpreted to include a related group of industries. The policy also will be interpreted to permit investment without limit in the following: securities of the U.S. government and its agencies or instrumentalities; securities of state, territory, possession or municipal governments and their authorities, agencies, instrumentalities or political subdivisions; and repurchase agreements collateralized by any such obligations. Accordingly, issuers of the foregoing securities will not be considered to be members of any industry. There also will be no limit on investment in issuers domiciled in a single jurisdiction or country. The policy also will be interpreted to give broad authority to the Fund as to how to classify issuers within or among industries or groups of industries. The Fund has been advised by the staff of the SEC that the staff currently views securities issued by a foreign government to be in a single industry for purposes of calculating applicable limits on concentration.

The Fund's fundamental policies are written and will be interpreted broadly. For example, the policies will be interpreted to refer to the 1940 Act and the related rules as they are in effect from time to time, and to interpretations and modifications of or relating to the 1940 Act by the SEC and others as they are given from time to time. When a policy provides that an investment practice may be conducted as permitted by the 1940 Act, the policy will be interpreted to mean either that the 1940 Act expressly permits the practice or that the 1940 Act does not prohibit the practice.

Diversification

Intermediate-Term Municipals Fund

The Fund is currently classified as a diversified fund under the 1940 Act. This means that the Fund may not purchase securities of an issuer (other than obligations issued or guaranteed by the U.S. government, its agencies or instrumentalities) if, with respect to 75% of its total assets, (a) more than 5% of the Fund's total assets would be invested in securities of that issuer or (b) the Fund would hold more than 10% of the outstanding voting securities of that issuer. With respect to the remaining 25% of its total assets, the Fund can invest more than 5% of its assets in one issuer. Under the 1940 Act, the Fund cannot change its classification from diversified to non-diversified without shareholder approval.

New Jersey Municipals Fund, New York Municipals Fund and Pennsylvania Municipals Fund

The Fund is currently classified as a non-diversified fund under the 1940 Act. A non-diversified fund can invest a greater portion of its assets in a single issuer or a limited number of issuers than may a diversified fund. In this regard, the Fund is subject to greater risk than a diversified fund. Under the 1940 Act, the Fund may change its classification from non-diversified to diversified without shareholder approval.

The Fund intends to continue to qualify for treatment as a regulated investment company under the Code. Compliance with the diversification requirements of the Code may limit the flexibility of the Fund.

Non-Fundamental Investment Policies

The following are some of the non-fundamental investment limitations that the Fund currently observes:

- If at any time another registered open-end investment company that is part of the same group of investment companies as the Fund invests in the Fund in reliance upon the provisions of subparagraph (G) of Section 12(d)(1) of the 1940 Act, the Fund will not invest in other registered open-end investment companies and registered unit investment trusts in reliance upon the provisions of subparagraphs (G) or (F) of Section 12(d)(1) of the 1940 Act.
- The Fund may not purchase or otherwise acquire any security if, as a result, more than 15% of its net assets would be invested in securities that are illiquid. The Fund monitors the portion of the Fund's total assets that is invested in illiquid securities on an ongoing basis, not only at the time of investment in such securities.

Commodity Exchange Act Regulation — Exclusion from Commodity Pool Operator Definition

The Fund is operated by persons who have claimed an exclusion, granted to operators of registered investment companies like the Fund, from registration as a "commodity pool operator" with respect to the Fund under the CEA and, therefore are not subject to registration or regulation with respect to the Fund under the CEA. As a result, the Fund is limited in its ability to trade instruments subject to the CFTC's jurisdiction, including commodity futures (which include futures on broad-based securities indexes, interest rate futures and currency futures), options on commodity futures, and certain swaps or other investments, either directly or indirectly through investments in other investment vehicles (collectively, "Commodity Interests").

Under this exclusion, the Fund must satisfy one of the following two trading limitations whenever it establishes a new Commodity Interest position: (1) the aggregate initial margin and premiums required to establish the Fund's Commodity Interest positions does not exceed 5% of the liquidation value of the Fund's portfolio (after accounting for unrealized profits and unrealized losses on any such investments); or (2) the aggregate net notional value of the Fund's Commodity Interests, determined at the time the most recent position was established, does not exceed 100% of the liquidation value of the Fund's portfolio (after accounting for unrealized profits and unrealized losses on any such positions). The Fund is not required to consider its exposure to such instruments if they are held for "bona fide hedging" purposes, as such term is defined in the rules of the CFTC. In addition to meeting one of the foregoing trading limitations, the Fund may not be marketed as a commodity pool or otherwise as a vehicle for trading in the markets for Commodity Interests.

If the Fund's operators were to lose their ability to claim this exclusion with respect to the Fund, such persons would be required to comply with certain CFTC rules regarding commodity pools that could impose additional regulatory requirements and compliance obligations.

INVESTMENT PRACTICES AND RISK FACTORS

In addition to the investment strategies and the risks described in the Fund's Prospectus and in this SAI under Investment Objective and Strategies, the Fund may employ other investment practices and may be subject to other risks, which are described below. The Fund may engage in the practices described below to the extent consistent with its investment objectives, strategies, policies and restrictions. However, as with any investment or investment technique, even when the Fund's Prospectus or this discussion indicates that the Fund may engage in an activity, the Fund may not actually do so for a variety of reasons. In addition, new types of instruments and other securities may be developed and marketed from time to time. Consistent with its investment limitations, the Fund expects to invest in those new types of securities and instruments that its portfolio manager believes may assist the Fund in achieving its investment objective.

This discussion is not intended to limit the Fund's investment flexibility, unless such a limitation is expressly stated, and therefore will be construed by the Fund as broadly as possible. Statements concerning what the Fund may do are not intended to limit any other activity.

Alternative Investment Strategies and Temporary Defensive Investments

At times the Fund's portfolio manager may judge that conditions in the securities markets make pursuing the Fund's typical investment strategy inconsistent with the best interest of its shareholders. At such times, the portfolio manager may temporarily use alternative strategies, primarily designed to reduce fluctuations in the value of the Fund's assets. In implementing these defensive strategies, the Fund may invest without limit in securities that the portfolio manager believes present less risk to the Fund, including equity securities, debt and fixed income securities, preferred stocks, U.S. government and agency obligations, cash or money market instruments, certificates of deposit, demand and time deposits, bankers' acceptance or other securities the portfolio manager considers consistent with such defensive strategies, such as, but not limited to, options or futures. During periods in which such strategies are used, the duration of the Fund may diverge from the duration range for the Fund disclosed in its Prospectus (if applicable). It is impossible to predict when, or for how long, the Fund will use these alternative strategies. As a result of using these alternative strategies, the Fund may not achieve its investment objective. Additionally, although the portfolio manager has the ability to take defensive positions, the portfolio manager may choose not to do so for a variety of reasons, even during volatile market conditions.

Artificial Intelligence

Artificial intelligence refers to computer systems that can perform tasks that would otherwise require human intelligence and encompasses various different forms of artificial intelligence, including machine learning models. Artificial intelligence is typically designed to analyze data, learn from patterns and experiences, make decisions, and solve problems. Artificial intelligence can be categorized into two types: narrow artificial intelligence, which is designed for specific tasks, and general artificial intelligence, which has the ability to perform any intellectual task that a human can do and includes generative artificial intelligence ("GAI"). GAI is a type of artificial intelligence technology that produces new text, images, audio, and other content based on training data that includes examples of the desired output.

Typically, users enter questions, queries, or other inputs that prompt the GAI model or tool to produce output. In addition, some software uses GAI to suggest changes, summarize information, or translate text. Artificial intelligence has various applications in many fields such as healthcare, finance, transportation, and law.

The use of artificial intelligence in general may adversely impact markets, the overall performance of the Fund's investments, or the services provided to the Fund by its service providers. The Manager or the Subadviser or a third party service provider may use and/or expand its use of artificial intelligence in connection with its business, operating and investment activities and the Fund's investments may also use such technologies. Actual usage of such artificial intelligence will vary, and while the Manager or the Subadviser expects that it and the third party service providers to the Fund may, from time to time, adopt and adjust usage policies and procedures governing the use of artificial intelligence by its personnel, there is a risk of misuse of artificial intelligence technologies.

Artificial intelligence is highly reliant on the collection and analysis of large amounts of data and complex algorithms, but it is not possible nor practicable to incorporate all data that would be relevant for a task conducted by artificial intelligence. Therefore, it is possible that the information provided through use of artificial intelligence could be insufficient, incomplete, inaccurate or biased leading to adverse effects for the Fund, including, potentially, operational errors and investment losses.

Artificial intelligence and its current and potential future applications, including in the investment and financial sectors, as well as the regulatory frameworks within which they operate, continue to rapidly evolve, and it is impossible to predict the full extent of future applications or regulations. Ongoing and future regulatory actions with respect to artificial intelligence generally or artificial intelligence's use in any industry in particular may alter, perhaps to a materially adverse extent, the ability of the Manager or the Subadviser, a third-party service provider, the Fund or its investments to utilize artificial intelligence in the manner it has to-date, and may have an adverse impact on the ability of any of those entities to continue to operate as intended.

Bank Obligations

The Fund may invest in all types of bank obligations, including certificates of deposit ("CDs"), time deposits and bankers' acceptances. CDs are short-term negotiable obligations of commercial banks. Time deposits are non-negotiable deposits maintained in banking institutions for specified periods of time at stated interest rates. Bankers' acceptances are time drafts drawn on commercial banks by borrowers usually in connection with international transactions.

U.S. commercial banks organized under federal law are supervised and examined by the Comptroller of the Currency and are required to be members of the Federal Reserve System and to be insured by the Federal Deposit Insurance Corporation (the "FDIC"). U.S. banks organized under state law are supervised and examined by state banking authorities, but are members of the Federal Reserve System only if they elect to join. Most state banks are insured by the FDIC (although such insurance may not be of material benefit to the Fund, depending upon the principal amount of CDs of each bank held by the Fund) and are subject to federal examination and to a substantial body of federal law and regulation. As a result of federal and state laws and regulations, U.S. branches of U.S. banks are, among other things, generally required to maintain specified levels of reserves, and are subject to other supervision and regulation designed to promote financial soundness. Banks may be particularly susceptible to certain economic factors, such as interest rate changes and adverse developments in the market for real estate. Fiscal and monetary policy and general economic cycles can affect the availability and cost of funds, loan demand and asset quality and thereby impact the earnings and financial conditions of banks.

Obligations of foreign branches of U.S. banks, such as CDs and time deposits, may be general obligations of the parent bank in addition to the issuing branch, or may be limited by the terms of a specific obligation and governmental regulation. Such obligations are subject to different risks than are those of U.S. banks or U.S. branches of foreign banks. These risks relate to foreign economic and political developments, foreign governmental restrictions that may adversely affect payment of principal and interest on the obligations, foreign exchange controls and foreign withholding and other taxes on interest income. Foreign branches of U.S. banks and foreign branches of foreign banks are not necessarily subject to the same or similar regulatory requirements that apply to U.S. banks, such as mandatory reserve requirements, loan limitations and accounting, auditing and financial recordkeeping requirements. In addition, less information may be publicly available about a foreign branch of a U.S. bank or about a foreign bank than about a U.S. bank.

Obligations of U.S. branches of foreign banks may be general obligations of the parent bank, in addition to the issuing branch, or may be limited by the terms of a specific obligation and by federal and state regulation as well as governmental action in the country in which the foreign bank has its head office. A U.S. branch of a foreign bank with assets in excess of $1 billion

may or may not be subject to reserve requirements imposed by the Federal Reserve System or by the state in which the branch is located if the branch is licensed in that state. In addition, branches licensed by the Comptroller of the Currency and branches licensed by certain states ("State Branches") may or may not be required to: (a) pledge to the regulator, by depositing assets with a designated bank within the state; and (b) maintain assets within the state in an amount equal to a specified percentage of the aggregate amount of liabilities of the foreign bank payable at or through all of its agencies or branches within the state. The deposits of State Branches may not necessarily be insured by the FDIC. In addition, there may be less publicly available information about a U.S. branch of a foreign bank than about a U.S. bank.

Volatility in the banking system may impact the viability of banking and financial services institutions. In the event of failure of any of the financial institutions where the Fund maintains its cash and cash equivalents, there can be no assurance that the Fund would be able to access uninsured funds in a timely manner or at all and the Fund may incur losses. Any such event could adversely affect the business, liquidity, financial position and performance of the Fund.

Benchmark Reference Rates Risk

Many debt securities, derivatives, and other financial instruments utilize benchmark or reference rates for variable interest rate calculations, including the Euro Interbank Offer Rate, Sterling Overnight Index Average Rate, and the Secured Overnight Financing Rate (each a "Reference Rate"). Instruments in which the Fund invests may pay interest at floating rates based on such Reference Rates or may be subject to interest caps or floors based on such Reference Rates. The Fund and issuers of instruments in which the Fund invests may also obtain financing at floating rates based on such Reference Rates. The elimination of a Reference Rate or any other changes to or reforms of the determination or supervision of Reference Rates could have an adverse impact on the market for, or value of, any instruments or payments linked to those Reference Rates.

For example, some Reference Rates, as well as other types of rates and indices, are described as "benchmarks" and have been the subject of ongoing national and international regulatory reform, including under the European Union regulation on indices used as benchmarks in financial instruments and financial contracts (known as the "Benchmarks Regulation"). The Benchmarks Regulation has been enacted into United Kingdom law by virtue of the European Union (Withdrawal) Act 2018 (as amended), subject to amendments made by the Benchmarks (Amendment and Transitional Provision) (EU Exit) Regulations 2019 (SI 2019/657) and other statutory instruments. Following the implementation of these reforms, the manner of administration of benchmarks has changed and may further change in the future, with the result that relevant benchmarks may perform differently than in the past, the use of benchmarks that are not compliant with the new standards by certain supervised entities may be restricted, and certain benchmarks may be eliminated entirely. Such changes could cause increased market volatility and disruptions in liquidity for instruments that rely on or are impacted by such benchmarks. Additionally, there could be other consequences which cannot be predicted.

Borrowings

The Fund may engage in borrowing transactions as a means of raising cash to satisfy redemption requests, for other temporary or emergency purposes or, to the extent permitted by its investment policies, to raise additional cash to be invested by the Fund in other securities or instruments in an effort to increase the Fund's investment returns. Reverse repurchase agreements may be considered to be a type of borrowing.

When the Fund invests borrowing proceeds in other securities, the Fund will be at risk for any fluctuations in the market value of the securities in which the proceeds are invested. Like other leveraging risks, this makes the value of an investment in the Fund more volatile and increases the Fund's overall investment exposure. In addition, if the Fund's return on its investment of the borrowing proceeds does not equal or exceed the interest that the Fund is obligated to pay under the terms of a borrowing, engaging in these transactions will lower the Fund's return.

The Fund may be required to liquidate portfolio securities at a time when it would be disadvantageous to do so in order to make payments with respect to its borrowing obligations. Interest on any borrowings will be an expense to the Fund and will reduce the value of the Fund's shares. The Fund may borrow on a secured or on an unsecured basis. If the Fund enters into a secured borrowing arrangement, a portion of the Fund's assets will be used as collateral. During the term of the borrowing, the Fund will remain at risk for any fluctuations in the market value of these assets in addition to any securities purchased with the proceeds of the loan. In addition, the Fund may be unable to sell the collateral at a time when it would be advantageous to do so, which could result in lower returns. The Fund would also be subject to the risk that the lender may file for bankruptcy, become insolvent, or otherwise default on its obligations to return the collateral to the Fund. In the event of a default by the lender, there

may be delays, costs and risks of loss involved in the Fund's exercising its rights with respect to the collateral or those rights may be limited by other contractual agreements or obligations or by applicable law.

The 1940 Act requires the Fund to maintain an "asset coverage" of at least 300% of the amount of its borrowings, provided that in the event that the Fund's asset coverage falls below 300%, the Fund is required to reduce the amount of its borrowings so that it meets the 300% asset coverage threshold within three days (not including Sundays and holidays). Asset coverage means the ratio that the value of the Fund's total assets, minus liabilities other than borrowings and other senior securities, bears to the aggregate amount of all borrowings. Although complying with this requirement would have the effect of limiting the amount that the Fund may borrow, it does not otherwise mitigate the risks of entering into borrowing transactions.

Collateralized Debt Obligations ("CDOs"), Collateralized Loan Obligations ("CLOs") and Collateralized Bond Obligations ("CBOs")

The Fund may invest in collateralized debt obligations ("CDOs"), which include collateralized bond obligations ("CBOs"), collateralized loan obligations ("CLOs") and other similarly structured securities. CDOs are types of asset-backed securities. A CBO is a trust or other special purpose entity ("SPE") which is typically backed by a diversified pool of fixed income securities (which may include high risk, below investment grade securities). A CLO is a trust or other SPE that is typically collateralized by a pool of loans, which may include, among others, domestic and non-U.S. senior secured loans, senior unsecured loans, and subordinate corporate loans, including loans that may be rated below investment grade or equivalent unrated loans. Although certain CDOs may receive credit enhancement in the form of a senior-subordinate structure, over-collateralization or bond insurance, such enhancement may not always be present, and may fail to protect the Fund against the risk of loss on default of the collateral. Certain CDOs may use derivatives contracts to create "synthetic" exposure to assets rather than holding such assets directly, which entails the risks of derivative instruments described elsewhere in this SAI. CDOs may charge management fees and administrative expenses, which are in addition to those of the Fund.

For both CBOs and CLOs, the cashflows from the SPE are split into two or more portions, called tranches, varying in risk and yield. The riskiest portion is the "equity" tranche, which bears the first loss from defaults from the bonds or loans in the SPE and serves to protect the other, more senior tranches from default (though such protection is not complete). Since it is partially protected from defaults, a senior tranche from a CBO or CLO typically has higher ratings and lower yields than its underlying securities, and may be rated investment grade. Despite the protection from the equity tranche, CBO or CLO tranches can experience substantial losses due to actual defaults, increased sensitivity to defaults due to collateral default and disappearance of protecting tranches, market anticipation of defaults, as well as investor aversion to CBO or CLO securities as a class. Interest on certain tranches of a CDO may be paid in kind (paid in the form of obligations of the same type rather than cash), which involves continued exposure to default risk with respect to such payments.

The risks of an investment in a CDO depend largely on the type of the collateral securities and the class of the CDO in which the Fund invests. Normally, CBOs, CLOs and other CDOs are privately offered and sold, and thus, are not registered under the securities laws. As a result, investments in CDOs may be characterized by the Fund as illiquid securities. However, an active dealer market may exist for CDOs, allowing a CDO to qualify for Rule 144A transactions. In addition to the normal risks associated with fixed income securities discussed elsewhere in this SAI and the Prospectus (e.g., interest rate risk and credit risk), CDOs carry additional risks including, but not limited to: (i) the possibility that distributions from collateral securities will not be adequate to make interest or other payments; (ii) the collateral may decline in value or default or its credit rating may be downgraded, if rated by a nationally recognized statistical rating organization; (iii) the Fund may invest in tranches of CDOs that are subordinate to other tranches; (iv) the complex structure of the security may not be fully understood at the time of investment and may produce disputes with the issuer or unexpected investment results; and (v) the CDO's manager may perform poorly.

Custodial Receipts

The Fund may acquire custodial receipts or certificates underwritten by securities dealers or banks that evidence ownership of future interest payments, principal payments or both on certain municipal obligations. The underwriter of these certificates or receipts typically purchases municipal obligations and deposits the obligations in an irrevocable trust or custodial account with a custodian bank, which then issues receipts or certificates that evidence ownership of the periodic unmatured coupon payments and the final principal payment on the obligations. Although under the terms of a custodial receipt, the Fund would be typically authorized to assert its rights directly against the issuer of the underlying obligation, the Fund could be required to assert through the custodian bank those rights as may exist against the underlying issuer. Thus, in the event the

underlying issuer fails to pay principal and/or interest when due, the Fund may be subject to delays, expenses and risks that are greater than those that would have been involved if the Fund had purchased a direct obligation of the issuer. In addition, in the event that the trust or custodial account in which the underlying security has been deposited is determined to be an association taxable as a corporation for U.S. federal income tax purposes, the yield on the underlying security would be reduced by any entity-level corporate taxes paid by the issuer.

Custodial receipts may also evidence ownership of future interest payments, principal payments or both on certain U.S. government obligations. Such obligations are held in custody by a bank on behalf of the owners. Custodial receipts are generally not considered obligations of the U.S. government for purposes of securities laws.

Cybersecurity Risk

Like other funds and business enterprises, the Fund, the Manager and the Subadviser and their service providers are subject to the risk of cyber incidents occurring from time to time. With the increased use of technologies such as mobile devices and Web-based or "cloud" applications, and the dependence on the Internet and computer systems to conduct business, the Fund, the Manager, the Subadviser, and other service providers are susceptible to operational, information security and related risks. In general, cybersecurity incidents can result from deliberate attacks or unintentional events (arising from external or internal sources) that may cause the Fund, the Manager and the Subadviser and/or their service providers to lose proprietary information, suffer data corruption, physical damage to a computer or network system or lose operational capacity. Cybersecurity attacks include, but are not limited to, infection by malicious software, such as malware or computer viruses or gaining unauthorized access to digital systems, networks or devices that are used to service the Fund's operations (e.g., through "hacking," "phishing" or malicious software coding) or other means for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. Cybersecurity attacks may also be carried out in a manner that does not require gaining unauthorized access, such as causing denial-of-service attacks on the Fund's websites (i.e., efforts to make network services unavailable to intended users). Recently, geopolitical tensions may have increased the scale and sophistication of deliberate cybersecurity attacks, particularly those from nation-states or from entities with nation-state backing. In addition, authorized persons could inadvertently or intentionally release confidential or proprietary information stored on the Fund's systems.

Cybersecurity incidents affecting the Fund's Manager, the Subadviser, and other service providers to the Fund or its shareholders (including, but not limited to, Fund accountants, custodians, sub-custodians, transfer agents and financial intermediaries) have the ability to cause disruptions and impact business operations, potentially resulting in financial losses to both the Fund and its shareholders, interference with the Fund's ability to calculate its net asset value, impediments to trading, the inability of Fund shareholders to transact business and the Fund to process transactions (including fulfillment of Fund share purchases and redemptions), violations of applicable privacy and other laws (including the release of private shareholder information) and attendant breach notification and credit monitoring costs, regulatory fines, penalties, litigation costs, reputational damage, reimbursement or other compensation costs, forensic investigation and remediation costs, and/or additional compliance costs. Similar adverse consequences could result from cybersecurity incidents affecting issuers of securities in which the Fund invests, counterparties with which the Fund engages in transactions, governmental and other regulatory authorities, exchange and other financial market operators, banks, brokers, dealers, insurance companies and other financial institutions (including financial intermediaries and other service providers) and other parties. In addition, substantial costs may be incurred in order to safeguard against and reduce the risk of any cybersecurity incidents in the future. In addition to administrative, technological and procedural safeguards, the Fund's Manager and the Subadviser have established business continuity plans in the event of, and risk management systems to prevent or reduce the impact of, such cybersecurity incidents. However, there are inherent limitations in such plans and systems, including the possibility that certain risks have not been identified, as well as the rapid development of new threats. Furthermore, the Fund cannot control the cybersecurity plans and systems put in place by its service providers or any other third parties whose operations may affect the Fund and its shareholders. The Fund and its shareholders could be negatively impacted as a result.

New ways to carry out cyber attacks continue to develop. There is a chance that some risks have not been identified or prepared for, or that an attack may not be detected, which puts limitations on the Fund's, the Manager's and the Subadviser's and/or their service providers' ability to plan for or respond to a cyber attack.

Debt and Fixed Income Securities

The Fund may invest in a variety of debt and fixed income securities, which may be issued by governmental, corporate or other issuers. Debt securities may pay fixed, floating or variable rates of interest or interest at a rate contingent upon some other factor. Variable rate securities reset at specified intervals, while floating rate securities reset whenever there is a change in a specified index rate. In most cases, these reset provisions reduce the effect of market interest rates on the value of the security. However, some securities do not track the underlying index directly, but reset based on formulas that can produce an effect similar to leveraging; others may provide for interest payments that vary inversely with market rates. The market prices of these securities may fluctuate significantly when interest rates change.

These securities share principal risks. For example, the level of interest income generated by the Fund's fixed income investments may decline due to a decrease in market interest rates. Thus, when fixed income securities mature or are sold, they may be replaced by lower-yielding investments. Also, their values fluctuate with changes in interest rates. A decrease in interest rates will generally result in an increase in the value of the Fund's fixed income investments. Conversely, during periods of rising interest rates, the value of the Fund's fixed income investments will generally decline. However, a change in interest rates will not have the same impact on all fixed rate securities. For example, the magnitude of these fluctuations will generally be greater when the Fund's duration or average maturity is longer. In addition, certain fixed income securities are subject to credit risk, which is the risk that an issuer of securities will be unable to pay principal and interest when due, or that the value of the security will suffer because investors believe the issuer is unable to pay. Recently, there have been inflationary price movements. As such, fixed income securities markets may experience heightened levels of interest rate volatility and liquidity risk.

Changing Interest Rates. In a low or negative interest rate environment, debt securities may trade at, or be issued with, negative yields, which means the purchaser of the security may receive at maturity less than the total amount invested. To the extent the Fund holds a negatively-yielding debt security or has a bank deposit with a negative interest rate, the Fund would generate a negative return on that investment. Cash positions may also subject the Fund to increased counterparty risk to the Fund's bank. Debt market conditions are highly unpredictable and some parts of the market are subject to dislocations. In a low or negative interest rate environment, some investors may seek to reallocate assets to other income-producing assets. This may cause the price of such higher yielding instruments to rise, could further reduce the value of instruments with a negative yield, and may limit the Fund's ability to locate fixed income instruments containing the desired risk/return profile. Changes in monetary or fiscal policy may exacerbate the risks associated with changing interest rates. In the past, the U.S. government and certain foreign central banks have taken steps to stabilize markets by, among other things, reducing interest rates. In recent years, the U.S. government implemented increases to the federal funds interest rate and there may be further rate increases or other actions which may increase market volatility to the extent inconsistent with general market expectations. As interest rates rise, there is risk that rates across the financial system also may rise. To the extent rates increase substantially and/or rapidly, the Fund may be subject to significant losses. Changing interest rates could have unpredictable effects on the markets and may expose fixed income markets to heightened volatility, increased redemptions, and potential illiquidity.

Fixed Income Securities Ratings. Securities rated in the fourth highest ratings category by a NRSRO, such as those rated BBB by S&P, or Baa by Moody's, and unrated securities of comparable quality, are generally regarded as having adequate capacity to pay interest and repay principal but may have some speculative characteristics. Securities rated below the fourth highest ratings category by a NRSRO, including those rated below Baa by Moody's or BBB by S&P, and unrated securities of comparable quality, are generally considered below "investment grade," and may have speculative characteristics, including a greater possibility of default or bankruptcy of the issuers of such securities, market price volatility based upon interest rate sensitivity, questionable creditworthiness and relative liquidity of the secondary trading market. Changes in economic conditions or other circumstances are more likely to lead to a weakened capacity for lower rated securities to make principal and interest payments, including a greater possibility of default or bankruptcy of the issuer, than is the case for high rated securities. Appendix B to this SAI contains further information concerning the rating categories of NRSROs and their significance.

Derivatives — Generally

A derivative is a financial instrument that has a value based on, or derived from, the value of one or more underlying reference instruments or measures of value or interest rates ("underlying instruments"), such as a security, a commodity, a currency, an index, an interest rate or a currency exchange rate. A derivative can also have a value based on the likelihood that an event will or will not occur. Derivatives include futures contracts, forward contracts, options and swaps.

The Fund may use derivatives for any purpose, including but not limited to, to attempt to enhance income, yield or return, as a substitute for investing directly in a security or asset, or as a hedging technique in an attempt to manage risk in the Fund's portfolio. The Fund may choose not to make use of derivatives for a variety of reasons, and no assurance can be given that any derivatives strategy employed will be successful. The Fund's use of derivative instruments may be limited from time to time by applicable law, availability or by policies adopted by the Board, Manager or Subadviser (as applicable).

The Fund may utilize multiple derivative instruments and combinations of derivative instruments to seek to adjust the risk and return characteristics of its overall position. Combined positions will typically contain elements of risk that are present in each of its component transactions. It is possible that the combined position will not achieve its intended goal and will instead increase losses or risk to the Fund. Because combined positions involve multiple trades, they result in higher transaction costs and may be more difficult to open and close out.

The Fund may enter into derivatives with standardized terms that have no or few special or unusual components, which are generally traded on an exchange, as well as derivatives with more complex features, singly or in combination. Non-standardized derivatives are generally traded over the counter ("OTC"). OTC derivatives may be standardized or have customized features and may have limited or no liquidity. The Fund's derivatives contracts may be centrally cleared or settled bilaterally directly with a counterparty. The Fund's derivatives contracts may be cash settled or physically settled.

In addition to the instruments and strategies discussed in this section, additional opportunities in connection with derivatives and other similar or related techniques may become available to the Fund as a result of the development of new techniques, the development of new derivative instruments or a regulatory authority broadening the range of permitted transactions. The Fund may utilize these opportunities and techniques to the extent that they are consistent with the Fund's investment objectives and permitted by its investment limitations and applicable regulatory authorities. These opportunities and techniques may involve risks different from or in addition to those summarized herein.

- *Risks of Derivatives Generally*. The use of derivatives involves special considerations and risks, certain of which are summarized below, and may result in losses to the Fund. In general, derivatives may increase the volatility of the Fund and may involve a small investment of cash relative to the magnitude of the risk or exposure assumed. Even a small investment in derivatives may magnify or otherwise increase investment losses to the Fund.
- *Market risk.* Derivatives can be complex, and their success depends in part upon the portfolio manager's ability to forecast correctly future market or other trends or occurrences or other financial or economic factors or the value of the underlying instrument. Even if the portfolio manager's forecasts are correct, other factors may cause distortions or dislocations in the markets that result in losses or otherwise unsuccessful transactions. Derivatives may behave in unexpected ways, especially in abnormal or volatile market conditions. The market value of the derivative itself or the market value of underlying instruments may change in a way that is adverse to the Fund's interest. There is no assurance that the use of derivatives will be advantageous to the Fund or that the portfolio manager will use derivatives to hedge at an appropriate time.
- *Illiquidity risk*. The Fund's ability to close out or unwind a derivative prior to expiration or maturity depends on the existence of a liquid market or, in the absence of such a market, the ability and willingness of the other party to the transaction (the "counterparty") to enter into a transaction closing out the position. If there is no market or the Fund is not successful in its negotiations, the Fund may not be able to sell or unwind the derivative position at an advantageous or anticipated time or price. This may also be the case if the counterparty becomes insolvent. The Fund may be required to make delivery of portfolio securities or other underlying instruments in order to settle a position or to sell portfolio securities or assets at a disadvantageous time or price in order to obtain cash to settle the position. While a position remains open, the Fund continues to be subject to investment risk on a derivative. The Fund may or may not be able to take other actions or enter into other transactions, including hedging transactions, to limit or reduce its exposure to the derivative. Illiquidity risk may be enhanced if a derivative transaction is particularly large. Certain derivatives, including certain OTC options and swaps, may be considered illiquid and therefore subject to the Fund's limitation on illiquid investments.
- *Leverage risk.* Certain derivative transactions may have a leveraging effect on the Fund, meaning that the Fund can obtain significant investment exposure in return for meeting a relatively small margin or other investment requirement. An adverse change in the value of an underlying instrument can result in losses substantially greater than the amount invested in the derivative itself. When the Fund engages in transactions that have a leveraging effect, the value of the Fund is likely to be more volatile and certain other risks also are likely to be compounded. This is because leverage generally magnifies the

effect of any increase or decrease in the value of an investment. Certain derivatives have the potential for unlimited loss, regardless of the size of the initial investment.

- *Margin risk.* Certain derivatives require the Fund to make initial margin payments, a form of security deposit intended to protect against nonperformance of the derivative contract. The Fund may have to post additional margin (known as "variation margin") if the value of the derivative position changes in a manner adverse to the Fund. Derivatives may be difficult to value, which may result in increased payment requirements to counterparties or a loss of value to the Fund. If the Fund has insufficient cash to meet additional margin requirements, it might need to sell securities at a disadvantageous time.
- *Speculation risk.* Derivatives used for non-hedging purposes may result in losses which are not offset by increases in the value of portfolio holdings or declines in the cost of securities or other assets to be acquired. In the event that the Fund uses a derivative as an alternative to purchasing or selling other investments or in order to obtain desired exposure to an index or market, the Fund will be exposed to the same risks as are incurred in purchasing or selling the other investments directly, as well as the risks of the derivative transaction itself, such as counterparty risk.
- *Counterparty risk.* Derivatives involve the risk of loss resulting from the actual or potential insolvency or bankruptcy of the counterparty or the failure by the counterparty to make required payments or otherwise comply with the terms of the contract. In the event of default by a counterparty (or its affiliates), the Fund may have contractual remedies pursuant to the agreements related to the transaction, which may be limited by applicable law in the case of the counterparty's (or its affiliates') bankruptcy. The Fund may not be able to recover amounts owed to it by an insolvent counterparty.
- *Operational risk.* There may be incomplete or erroneous documentation or inadequate collateral or margin, or transactions may fail to settle. The Fund may have only contractual remedies in the event of a counterparty default, and there may be delays, costs or disagreements as to the meaning of contractual terms and litigation in enforcing those remedies.
- *OTC risk.* Derivative transactions that are traded OTC, such as options, swaps, forward contracts, and options on foreign currencies, are entered into directly with counterparties or financial institutions acting as market makers, rather than being traded on exchanges or centrally cleared. Because OTC derivatives and other transactions are traded between counterparties based on contractual relationships, the Fund is subject to increased risk that its counterparty will not perform its obligations under the related contracts. Although the Fund intends to enter into transactions only with counterparties which the Fund believes to be creditworthy, there can be no assurance that a counterparty will not default and that the Fund will not sustain a loss on a transaction as a result. Information available on counterparty creditworthiness may be incomplete or outdated, thus reducing the ability to anticipate counterparty defaults. The Fund bears the risk of loss of the amount expected to be received under an OTC derivative in the event of the default or bankruptcy of the counterparty to the OTC derivative. When a counterparty's obligations are not fully secured by collateral, then the Fund is essentially an unsecured creditor of the counterparty. If the counterparty defaults, the Fund will have contractual remedies, but there is no assurance that a counterparty will be able to meet its obligations pursuant to such contracts or that, in the event of default, the Fund will succeed in enforcing contractual remedies. Credit/counterparty risk still exists even if a counterparty's obligations are secured by collateral because the Fund's interest in collateral may not be perfected or additional collateral may not be promptly posted as required. Credit/counterparty risk also may be more pronounced if a counterparty's obligations exceed the amount of collateral held by the Fund (if any), the Fund is unable to exercise its interest in collateral upon default by the counterparty, or the termination value of the instrument varies significantly from the marked-to-market value of the instrument.
- *Non-U.S. derivatives risk.* Derivative transactions may be conducted OTC outside of the United States or traded on foreign exchanges. Such transactions may not be regulated as effectively as similar transactions in the United States, may not involve a clearing mechanism and related guarantees and are subject to the risk of governmental actions affecting trading in, or the price of, foreign securities or currencies. The value of such positions also could be adversely affected by (1) other foreign political, legal and economic factors, (2) lesser availability than in the United States of data on which to make trading decisions, (3) delays in the Fund's ability to act upon economic events occurring in foreign markets during non-business hours in the United States, (4) the imposition of different exercise and settlement terms, procedures, margin requirements, fees, taxes or other charges than in the United States and (5) lesser trading volume. Counterparty risk and many of the risks of OTC derivatives transactions are also applicable to derivative transactions conducted outside the United States.
- *Currency derivatives risk.* Currency related transactions may be negatively affected by factors such as government exchange controls, blockages, and manipulations. Exchange rates may be influenced by factors extrinsic to a country's economy. Also,

there is no systematic reporting of last sale information with respect to foreign currencies. As a result, the information on which trading in currency derivatives is based may not be as complete as, and may be delayed beyond, comparable data for other types of transactions.

– *Turnover risk*. Use of derivatives involves transaction costs, which may be significant. The Fund may be required to sell or purchase investments in connection with derivative transactions, potentially increasing the Fund's portfolio turnover rate and transaction costs. Use of derivatives also may increase the amount of taxable income to shareholders, if applicable.

Risks Associated with Hedging with Derivatives. If the portfolio manager uses a hedging strategy at the wrong time or judges market conditions incorrectly, hedging strategies may reduce the Fund's return. Successful use of derivatives to hedge positions depends on the correlation between the price of the derivative and the price of the hedged asset.

The Fund may attempt to protect against declines in the value of the Fund's portfolio assets by entering into a variety of derivatives transactions, including selling futures contracts, entering into swaps or purchasing puts on indices or futures contracts (short hedging). Short hedging involves the risk that the prices of the futures contracts or the value of the swap or the applicable index will correlate imperfectly with price movements in the Fund's assets. If the value of the assets held in the Fund's portfolio declines while the Fund has used derivative instruments in a short hedge, and the prices referenced in the short hedge do not also decline, the value of the Fund's assets would decline, and the short hedge would not hedge or mitigate the loss in the value of the assets. With respect to a derivative transaction based on an index, the risk of imperfect correlation increases as the composition of the Fund's portfolio diverges from the assets included in the applicable index. To compensate for the imperfect correlation of movements in the price of the portfolio securities being hedged and movements in the price of the hedging instruments, the Fund may use derivative instruments in a greater dollar amount than the dollar amount of portfolio assets being hedged. It might do so if the historical volatility of the prices of the portfolio assets being hedged is more than the historical volatility of the applicable index.

If the Fund has used derivatives to hedge or otherwise reduce the Fund's risk exposure to a particular position and then disposes of that position at a time at which it cannot also settle, terminate or close out the corresponding hedge position, this may create short investment exposure. Certain "short" derivative positions involve investment leverage, and the amount of the Fund's potential loss is theoretically unlimited.

The Fund can use derivative instruments to establish a position in the market as a temporary substitute for the purchase of individual securities or other assets (long hedging) by buying futures contracts and/or calls on such futures contracts, indices or on securities or other assets, or entering into swaps. It is possible that when the Fund does so the market might decline. If the Fund then decides not to invest in the assets because of concerns that the market might decline further or for other reasons, the Fund will realize a loss on the hedge position that is not offset by a reduction in the price of the asset the Fund had intended to purchase.

Risk of Government Regulation of Derivatives. The regulation of derivatives transactions and funds that engage in such transactions is an evolving area of law and is subject to modification by government, self-regulatory organization and judicial action. Registered investment companies are subject to regulatory limitations on their use of derivative investments and certain financing transactions (e.g. reverse repurchase agreements). Among other things, a fund that invests in derivative instruments beyond a specified limited amount must apply a value-at-risk based limit to its use of certain derivative instruments and financing transactions and must adopt and implement a derivatives risk management program. A fund that uses derivative instruments in a limited amount, as specified by applicable rules, is not subject to the same restrictions. Regulatory restrictions may restrict the Fund's ability to engage in certain derivatives transactions and/or increase the costs of such derivatives transactions, which could adversely affect the value or performance of the Fund.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") has caused broad changes to the OTC derivatives market and granted significant authority to the SEC and the CFTC to regulate OTC derivatives and market participants. Pursuant to such authority, rules have been enacted that currently require clearing of many OTC derivatives transactions and may require clearing of additional OTC derivatives transactions in the future and that impose minimum margin and capital requirements for uncleared OTC derivatives transactions. Similar regulations have been or are being adopted in other jurisdictions around the world. The implementation of the clearing requirement has increased the costs of derivatives transactions since investors have to pay fees to clearing members and are typically required to post more margin for cleared derivatives than had historically been the case. While the new rules and regulations and central clearing of some derivatives transactions are designed to reduce systemic risk (i.e., the risk that the interdependence of large derivatives dealers could cause

them to suffer liquidity, solvency or other challenges simultaneously), there is no assurance that they will achieve that result, and mandatory clearing of derivatives may expose the Fund to new kinds of costs and risks.

Additionally, new regulations may result in increased uncertainty about credit/counterparty risk and may limit the flexibility of the Fund to protect its interests in the event of an insolvency of a derivatives counterparty. In the event of a counterparty's (or its affiliate's) insolvency, the Fund's ability to exercise remedies, such as the termination of transactions, netting of obligations and realization on collateral, could be stayed or eliminated under the rules of the applicable exchange or clearing corporation or under relatively new special resolution regimes adopted in the United States, the United Kingdom, the European Union and various other jurisdictions. Such regimes provide government authorities with broad authority to intervene when a financial institution is experiencing financial difficulty. In particular, with respect to counterparties who are subject to such proceedings in the United Kingdom and the European Union, the liabilities of such counterparties to the Fund could be reduced, eliminated, or converted to equity in such counterparties (sometimes referred to as a "bail in").

Forward Currency Contracts

The Fund may enter into forward currency contracts to purchase or sell foreign currencies for a fixed amount of U.S. dollars or another currency at a future date and at a price set by the parties to the forward currency contract. Forward currency contracts are traded directly between currency traders (usually large commercial banks) and their customers (such as the Fund).

The Fund may purchase a forward currency contract to lock in the U.S. dollar price of a security denominated in a foreign currency that the Fund intends to acquire (a long hedge). The Fund may sell a forward currency contract to lock in the U.S. dollar equivalent of the proceeds from the anticipated sale of a security, dividend or interest payment denominated in a foreign currency (a short hedge). A "position hedge" is when the Fund owns a security denominated in, for example, euros and to protect against a possible decline in the euro's value, the Fund enters into a forward currency contract to sell euros in return for U.S. dollars. A "position hedge" tends to offset both positive and negative currency fluctuations but would not offset changes in security values caused by other factors. A "proxy hedge" is when the Fund owns a security denominated in, for example, euros and to protect against a possible decline in the euro's value, the Fund enters into a forward currency contract to sell a currency expected to perform similarly to the euro in return for U.S. dollars. A "proxy hedge" could offer advantages in terms of cost, yield or efficiency, but generally would not hedge currency exposure as effectively as a position hedge to the extent the proxy currency does not perform similarly to the targeted currency. The Fund could, in fact, lose money on both legs of the hedge, *i.e.*, between the euro and proxy currency, and between the proxy currency and the dollar. The Fund also may use forward currency contracts to attempt to enhance return or yield. The Fund could use forward currency contracts to increase its exposure to foreign currencies that the portfolio manager believes might rise in value relative to the U.S. dollar, or shift its exposure to foreign currency fluctuations from one currency to another. For example, if the Fund's portfolio manager believes that the U.S. dollar will increase in value relative to the euro, the Fund could write a forward contract to buy U.S. dollars in three months at the current price in order to sell those U.S. dollars for a profit if the U.S. dollar does in fact appreciate in value relative to the euro. The cost to the Fund of engaging in forward currency contracts varies with factors such as the currency involved, the length of the contract period and the market conditions then prevailing. Because forward currency contracts are usually entered into on a principal basis, no fees or commissions are involved. When the Fund enters into a forward currency contract, it relies on the counterparty to make or take delivery of the underlying currency at the maturity of the contract or to otherwise fulfill its obligations in connection with settlement. Failure by the counterparty to do so would result in the loss of any expected benefit of the transaction.

The precise matching of forward currency contract amounts, and the value of the securities involved generally will not be possible because the value of such securities, measured in the foreign currency, will change after the forward currency contract has been established. Thus, the Fund may need to purchase or sell foreign currencies in the spot (*i.e.*, cash) market to the extent such foreign currencies are not covered by forward currency contracts. The projection of short-term currency market movements is extremely difficult, and the successful execution of a short-term hedging strategy is highly uncertain.

Successful use of forward currency contracts depends on the portfolio manager's skill in analyzing and predicting currency values. Forward currency contracts may substantially change the Fund's exposure to changes in currency exchange rates and could result in losses to the Fund if currencies do not perform as the portfolio manager anticipates. There is no assurance that the portfolio manager's use of forward currency contracts will be advantageous to the Fund or that the portfolio manager will hedge at an appropriate time.

Non-deliverable Forwards. The consummation of a deliverable foreign exchange forward requires the actual exchange of the principal amounts of the two currencies in the contract (i.e., settlement on a physical basis). Forward currency contracts in which the Fund may engage also include non-deliverable forwards ("NDFs"). NDFs are cash-settled, forward contracts on foreign currencies (each a "Reference Currency") that are non-convertible and that may be thinly traded or illiquid. NDFs involve an obligation to pay an amount equal to the difference between the prevailing market exchange rate for the Reference Currency and the agreed upon exchange rate, with respect to an agreed notional amount. NDFs are subject to many of the risks associated with derivatives in general and forward currency transactions, including risks associated with fluctuations in foreign currency and the risk that the counterparty will fail to fulfill its obligations.

Under the Dodd-Frank Act, NDFs are classified as "swaps" and are therefore subject to the full panoply of CFTC swap regulations under the Dodd-Frank Act. Although NDFs have historically been traded OTC, in the future, pursuant to the Dodd-Frank Act, they may be subject to mandatory clearing. Non-centrally-cleared NDFs are subject to mandatory minimum margin requirements for uncleared swaps. Deliverable foreign exchange forwards that solely involve the exchange of two different currencies on a specific future date at a fixed rate agreed upon by the parties are not considered "swaps" and accordingly are not subject to many of the regulations that apply to NDFs. However, as mandated by the Dodd-Frank Act and set forth in CFTC regulations adopted thereunder, foreign exchange forwards must be reported to a swap data repository, and swap dealers and major swap participants who are party to such transactions remain subject to the business conduct standards pertaining to swaps in connection with such deliverable foreign exchange forwards.

Futures Contracts and Options on Futures Contracts

Generally, a futures contract is an exchange-traded, standardized agreement that obligates the seller of the contract to sell a specified quantity of an underlying instrument or asset, such as a security, currency or commodity, to the purchaser of the contract, who has the obligation to buy the underlying instrument or asset, at a specified price and date. In the case of futures on indices, the two parties agree to take or make delivery of an amount of cash equal to the difference between the level of the index calculated for purposes of settlement and the price at which the contract originally was written. Options on futures give the purchaser the right to assume a position in a futures contract at the specified exercise price at any time during the period of the option or at the expiration of the option, depending on the terms of the option.

Futures contracts, by their terms, have stated expirations and, at a specified point in time prior to expiration, trading in a futures contract for the current delivery month will cease. As a result, an investor wishing to maintain exposure to a futures contract with the nearest expiration must close out the position in the expiring contract and establish a new position in the contract for the next delivery month, a process referred to as "rolling." The process of rolling a futures contract can be profitable or unprofitable depending in large part on whether the futures price for the subsequent delivery month is less than or more than the price of the expiring contract.

Futures contracts and related options may be used for hedging and non-hedging purposes, such as to simulate full investment in the underlying instrument or asset while retaining a cash balance for portfolio management purposes, as a substitute for direct investment in the underlying instrument or asset, to facilitate trading, to reduce transaction costs, or to seek higher investment returns (e.g., when a futures contract or option is priced more attractively than the underlying instrument). In addition, futures strategies can be used to manage the average duration of the Fund's fixed income portfolio, if applicable. The Fund may sell a debt futures contract or a call option thereon or purchase a put option on that futures contract to attempt to shorten the portfolio's average duration. Alternatively, the Fund may buy a debt futures contract or a call option thereon or sell a put option thereon to attempt to lengthen the portfolio's average duration.

At the inception of a futures contract the Fund is required to deposit "initial margin" with a futures commission merchant ("FCM") in an amount at least equal to the amount designated by the futures exchange. Margin must also be deposited when writing a call or put option on a futures contract, in accordance with applicable exchange rules. Unlike margin in securities transactions, initial margin on futures contracts does not represent a borrowing, but rather is in the nature of a performance bond or good-faith deposit that is required to be returned to the Fund at the termination of the transaction if all contractual obligations have been satisfied. Under certain circumstances, such as periods of high volatility, the Fund may be required by an exchange or by its FCM to increase the level of its initial margin payment, and initial margin requirements might be increased generally in the future by regulatory action.

In addition to initial margin payments, during the life of the transaction "variation margin" payments are made to and from the FCM as the value of the margin and the underlying derivative transaction varies, a process known as "marking-to-market." Variation margin is intended to represent a daily settlement of the Fund's obligations to or from an FCM. When the Fund purchases an option on a futures contract, the premium paid plus transaction costs is all that is at risk. However, there may be circumstances when the purchase of an option on a futures contract would result in a loss to the Fund when the use of a futures contract would not, such as when there is no movement in the value of the securities or currencies being hedged. In that case, the Fund would lose the premium it paid for the option plus transaction costs. In contrast, when the Fund purchases or sells a futures contract or writes a call or put option thereon, it is subject to daily variation margin calls that could be substantial in the event of adverse price movements. If the Fund has insufficient cash to meet daily variation margin requirements, it might need to sell securities at a time when such sales are disadvantageous.

Although some futures and options on futures call for making or taking delivery of the underlying instrument or asset, generally those contracts are closed out prior to delivery by offsetting purchases or sales of matching futures or options (involving the same instrument or asset and delivery month). If an offsetting purchase price is less than the original sale price, the Fund realizes a gain, or if it is more, the Fund realizes a loss. If an offsetting sale price is more than the original purchase price, the Fund realizes a gain, or if it is less, the Fund realizes a loss. The Fund will also bear transaction costs for each contract, which will be included in these calculations. Positions in futures and options on futures may be closed only on an exchange or board of trade that provides a secondary market. However, there can be no assurance that a liquid secondary market will exist for a particular contract at a particular time. In such event, it may not be possible to close a futures contract or options position.

Under certain circumstances, futures exchanges may establish daily limits on the amount that the price of a futures contract or an option on a futures contract can vary from the previous day's settlement price; once that limit is reached, no trades may be made that day at a price beyond the limit. Daily price limits do not limit potential losses because prices could move to the daily limit for several consecutive days with little or no trading, thereby preventing liquidation of unfavorable positions. If the Fund were unable to liquidate a futures contract or an option on a futures position due to the absence of a liquid secondary market, the imposition of price limits or otherwise, it could incur substantial losses. The Fund would continue to be subject to market risk with respect to the position. In addition, except in the case of purchased options, the Fund would continue to be required to make daily variation margin payments.

Risks of Futures Contracts and Options Thereon. In addition to the risks found under "Derivatives – Risks of Derivatives Generally," futures contracts and options on futures contracts are subject to the following risks:

Successful use of futures contracts and related options depends upon the ability of the portfolio manager to assess movements in the direction of prices of securities, commodities, measures of value, or interest or exchange rates, which requires different skills and techniques than assessing the value of individual securities. Moreover, futures contracts relate not to the current price level of the underlying instrument or asset, but to the anticipated price level at some point in the future; accordingly trading of stock index futures may not reflect the trading of the securities that are used to formulate the index or even actual fluctuations in the index itself. There is, in addition, the risk that movements in the price of the futures contract will not correlate with the movements in the prices of the securities or other assets being hedged. Price distortions in the marketplace, resulting from increased participation by speculators in the futures market (among other things), may also impair the correlation between movements in the prices of futures contracts and movements in the prices of the hedged assets. If the price of the futures contract moves less than the price of assets that are the subject of the hedge, the hedge will not be fully effective; but if the price of the assets being hedged has moved in an unfavorable direction, the Fund would be in a better position than if it had not hedged at all. If the price of the assets being hedged has moved in a favorable direction, this advantage may be partially offset by losses on the futures position.

Positions in futures contracts and related options may be closed out only on an exchange or board of trade that provides a market for such contracts. Although the Fund intends to purchase and sell futures and related options only on exchanges or boards of trade where there appears to be a liquid market, there is no assurance that such a market will exist for any particular contract at any particular time. In such event, it may not be possible to close a futures position and, in the event of adverse price movements, the Fund would continue to be required to make variation margin payments, where applicable. Options have a limited life and thus can be disposed of only within a specific time period.

Purchasers of options on futures contracts pay a premium in cash at the time of purchase which, in the event of adverse price movements, could be lost. Sellers of options on futures contracts must post initial margin and are subject to

additional margin calls that could be substantial in the event of adverse price movements. Because of the low margin deposits required, futures trading involves a high degree of leverage; as a result, a relatively small price movement in a futures contract may result in immediate and substantial loss, or gain, to the Fund. In addition, the Fund's activities in the futures markets may result in a higher portfolio turnover rate (see "Portfolio Transactions and Brokerage") and additional transaction costs in the form of added brokerage commissions.

As noted above, exchanges may impose limits on the amount by which the price of a futures contract or related option is permitted to change in a single day. If the price of a contract moves to the limit for several consecutive days, the Fund may be unable during that time to close its position in that contract and may have to continue making payments of variation margin. The CFTC and domestic exchanges have also established (and continue to evaluate and revise) speculative position limits on the maximum speculative position that any person, or group of persons acting in concert, may hold or control in particular contracts. Under current rules and regulations, other accounts managed by the Manager or, if applicable, Subadviser are combined with the positions held by the Fund under the Manager's or, if applicable, Subadviser's management for position limit purposes, unless an exemption applies. This aggregation could preclude additional trading by the Fund in such contracts and may require positions held by the Fund to be liquidated, which may adversely affect the performance of the Fund.

When the Fund engages in futures transactions, it will also be exposed to the credit risk of its FCM. If the Fund's FCM becomes bankrupt or insolvent, or otherwise defaults on its obligations to the Fund, the Fund may not receive all amounts owed to it in respect of its trading, even if the clearinghouse fully discharges all of its obligations. If an FCM were not to appropriately segregate client assets to the full extent required by the CEA, the Fund might not be fully protected in the event of the bankruptcy of an FCM. In the event of an FCM's bankruptcy, the Fund would be limited to recovering only a pro rata share of all available funds segregated on behalf of an FCM's combined customer accounts for the relevant account class, even if certain property held by an FCM is specifically traceable to the Fund (for example, U.S. Treasury bills deposited by the Fund). Such situations could arise due to various factors, or a combination of factors, including inadequate FCM capitalization, inadequate controls on customer trading and inadequate customer capital. In addition, in the event of the bankruptcy or insolvency of a clearinghouse, the Fund might experience a loss of funds deposited through its FCM as margin with the clearinghouse, a loss of unrealized profits on its open positions and the loss of funds owed to it as realized profits on closed positions. Such a bankruptcy or insolvency might also cause a substantial delay before the Fund could obtain the return of funds owed to it by an FCM who is a member of such clearinghouse.

Options

A call option gives the purchaser the right to buy, and obligates the writer to sell, an underlying investment (such as a specified security, commodity, currency, interest rate, currency exchange rate or index) at an agreed-upon price ("strike price"). A put option gives the purchaser the right to sell, and obligates the writer to buy, an underlying investment at an agreed-upon price. An American-style option may be exercised at any time during the term of the option, while a European-style option may be exercised only at the expiration of the option. Purchasers of options pay an amount, known as a premium, to the option writer in exchange for the right granted under the option contract.

The value of an option position will reflect, among other things, the current market value of the underlying instrument, the time remaining until expiration, the relationship of the strike price to the market price of the underlying instrument, the historical price volatility of the underlying instrument and general market conditions. If the purchaser does not exercise the option, it will expire and the purchaser will have only lost the premium paid. If a secondary market exists, a purchaser or the writer may terminate a put option position prior to its exercise by selling it in the secondary market at its current price. The Fund will pay a brokerage commission each time it buys or sells an option. Such commissions may be higher than those that would apply to direct purchases or sales of the underlying instrument.

Exchange-traded options in the United States are issued by a clearing organization affiliated with the exchange on which the option is listed and are standardized with respect to the underlying instrument, expiration date, contract size and strike price. In contrast, OTC options (options not traded on exchanges) are contracts between the Fund and a counterparty (usually a securities dealer or a bank) with no clearing organization guarantee. The terms of OTC options generally are established through negotiation with the other party to the option contract (the counterparty). For a discussion on options on futures see "*Futures Contracts and Options on Futures Contracts*".

Put Options. In return for receipt of the premium, the writer of a put option assumes the obligation to pay the strike price for the option's underlying instrument if the buyer exercises the option. A put writer would generally expect to profit, although its gain would be limited to the amount of the premium it received, if the underlying instrument's price remains greater than or equal to the strike price. If the underlying instrument's price falls below the strike price, the put writer would expect to suffer a loss. The buyer of a put option can expect to realize a gain if the underlying instrument's price falls enough to offset the cost of purchasing the option. Any losses suffered by the buyer would be limited to the amount of the premium plus related transaction costs.

Optional delivery standby commitments are a type of put that gives the buyer of an underlying instrument the right to sell the underlying instrument back to the seller on specified terms to induce a purchase of the underlying instrument.

Call Options. In return for the receipt of the premium, the writer of a call option assumes the obligation to sell the underlying instrument at the strike price to the buyer upon exercise of the option. A call writer would generally expect to profit, although its gain would be limited to the amount of the premium it received, if the option goes unexercised, which typically occurs when the underlying instrument's price remains less than or equal to the strike price. If the underlying instrument's price were to rise above the strike price, the writer of the call option would generally expect to suffer a loss, which is theoretically unlimited. A call buyer's maximum loss is the premium paid for the call option, whereas the buyer's maximum profit is theoretically unlimited.

Straddles. A long straddle is the purchase of a call and a put option with the same expiration date and relating to the same underlying instrument where the strike price of the put is less than or equal to the strike price of the call. The Fund may enter into a long straddle when its portfolio manager believes that the underlying instrument's price will move significantly during the term of the options. A short straddle is a combination of a call and a put written on the same underlying instrument with the same expiration date where the strike price of the put is less than or equal to the strike price of the call. In a covered short straddle, the underlying instrument is considered cover for both the put and the call that the Fund has written. The Fund may enter into a short straddle when the portfolio manager believes that it is unlikely that the underlying instrument's prices will experience volatility during the term of the options.

Options on Indices. Puts and calls on indices are similar to puts and calls on other underlying instruments except that all settlements are in cash and gains or losses depend on changes in the level of the index rather than on price movements of individual underlying instruments. The writer of a call on an index receives a premium and the obligation to pay the purchaser an amount of cash equal to the difference between the closing level of the index and the strike price times a specified multiple ("multiplier"), if the closing level of the index is greater than the strike price of the call. The writer of a put on an index receives a premium and the obligation to deliver to the buyer an amount of cash equal to the difference between the closing level of the index and strike price times the multiplier if the closing level is less than the strike price.

Risks of Options – In addition to the risks described under "*Derivatives – Risks of Derivatives Generally*," options are also subject to the following risks:

Options on Indices Risk. The risks of investment in options on indices may be greater than options on securities and other instruments. Because index options are settled in cash, when the Fund writes a call on an index it generally cannot provide in advance for other underlying instruments because it may not be practical for the call writer to hedge its potential settlement obligations by acquiring and holding the underlying securities. The Fund can offset some of the risk of writing a call index option by holding a diversified portfolio of securities similar to those on which the underlying index is based. However, the Fund cannot, as a practical matter, acquire and hold a portfolio containing exactly the same securities as underlie the index and, as a result, bears a risk that the value of the securities held will vary from the value of the index.

If the Fund exercises an index option before the closing index value for that day is available, there is the risk that the level of the underlying index may subsequently change. If such a change causes the exercised option to fall out-of-the-money, the Fund will be required to pay the difference between the closing index value and the strike price of the option (times the applicable multiplier) to the assigned writer.

Timing Risk. The hours of trading for options may not conform to the hours during which the underlying instrument are traded. To the extent that the options markets close before the markets for the underlying instrument, significant price and rate movements can take place in the underlying markets that cannot be reflected in the options markets. Options are marked to market daily and their value will be affected by changes in the value of the underlying instrument, changes in the dividend rates

of the underlying securities, an increase in interest rates, changes in the actual or perceived volatility of the stock market and the underlying instrument and the remaining time to the options' expiration. Additionally, the exercise price of an option may be adjusted downward before the option's expiration as a result of the occurrence of certain corporate or other events affecting the underlying instrument, such as extraordinary dividends, stock splits, merger or other extraordinary distributions or events. A reduction in the exercise price of an option would reduce the Fund's capital appreciation potential on an underlying instrument.

Swaps

Generally, a swap agreement involves the exchange between two parties of their respective commitments to pay or receive cash flows, *e.g.*, an exchange of floating rate payments for fixed-rate payments. Swaps may be negotiated bilaterally and traded OTC (OTC swaps) or, for certain types of swaps, must be executed through a centralized exchange or regulated facility and be cleared through a regulated clearinghouse (cleared swaps). Swaps include but are not limited to, interest rate swaps, total return swaps, index swaps, inflation indexed swaps, currency swaps, credit default swaps and options on swaps or "swaptions".

OTC swap agreements can be individually negotiated and structured to include exposure to a variety of different types of investments (such as individual securities, baskets of securities and securities indices) or market factors. The swapped returns are generally calculated with respect to a notional amount, that is, the nominal or face amount used to calculate the payments to be made between the parties to the OTC swap.

The Fund may enter into a swap agreement for hedging or non-hedging purposes, including but not limited to, to enhance returns, increase liquidity, protect against currency and security price fluctuations, manage duration and gain exposure to certain markets or securities in a more cost-efficient manner.

Risks of Swaps Generally. In addition to the risks found under "Derivatives – Risks of Derivatives Generally," swaps are subject to the following risks:

Depending on their structure, swap agreements may increase or decrease the overall volatility of the Fund's investments and its share price and yield and may affect the Fund's exposure to long- or short-term interest rates (in the United States or abroad), foreign currency values, mortgage-backed security values, corporate borrowing rates or other market factors such as security prices or inflation rates.

Swap agreements will tend to shift the Fund's investment exposure from one type of investment to another. For example, if the Fund agrees to exchange payments in U.S. dollars for payments in foreign currency, the swap agreement would tend to decrease the Fund's exposure to U.S. interest rates and increase its exposure to foreign currency and interest rates.

The absence of a central exchange or market for OTC swap transactions may lead, in some instances, to difficulties in trading and valuation, especially in the event of market disruptions.

Cleared Swaps. Relatively recent legislation and implementing regulation require certain swaps to be cleared through a regulated clearinghouse. Although this clearing mechanism is generally intended to reduce counterparty credit risk, it may disrupt or limit the swap market and may result in swaps being more difficult to trade or value. As swaps become more standardized, the Fund may not be able to enter into swaps that meet its investment needs. The Fund also may not be able to find a clearing member and clearinghouse willing to accept a swap for clearing. In a cleared swap, a central clearing organization will be the counterparty to the transaction. The Fund will assume the risk that the clearinghouse and the clearing member through which the Fund holds its position may be unable to or may otherwise fail to perform their obligations.

When the Fund enters into a cleared swap transaction, the Fund is subject to the credit and counterparty risk of the clearinghouse and the clearing member through which it holds its cleared position. Credit/counterparty risk of market participants with respect to centrally cleared swaps is concentrated in a few clearinghouses, and it is not clear how an insolvency proceeding of a clearinghouse would be conducted and what impact an insolvency of a clearinghouse would have on the financial system. A clearing member is obligated by contract and by applicable regulation to segregate all funds received from customers with respect to cleared derivatives transactions from the clearing member's proprietary assets. However, all funds and other property received by a clearing broker from its customers generally are held by the clearing broker on a commingled basis in an omnibus account by account class, and the clearing member may invest those funds in certain instruments permitted under the applicable regulations. The assets of the Fund might not be fully protected in the event of the bankruptcy of the Fund's clearing member, because the Fund would be limited to recovering only a pro rata share of all available funds segregated on behalf of the clearing broker's customers for a relevant account class. Also, the clearing member is required

to transfer to the clearing organization the amount of margin required by the clearing organization for cleared derivatives, which amounts generally are held in an omnibus account at the clearing organization for all customers of the clearing member. Regulations promulgated by the CFTC require that the clearing member notify the clearinghouse of the amount of initial margin provided by the clearing member to the clearing organization that is attributable to each cleared swaps customer. However, if the clearing member does not provide accurate reporting, the Fund is subject to the risk that a clearing organization will use the Fund's assets held in an omnibus account at the clearing organization to satisfy payment obligations of a defaulting customer of the clearing member to the clearing organization. In addition, clearing members generally provide to the clearing organization the net amount of variation margin required for cleared swaps for all of its customers in the aggregate, rather than the gross amount of each customer. The Fund is therefore subject to the risk that a clearing organization will not make variation margin payments owed to the Fund if another customer of the clearing member has suffered a loss and is in default, and the risk that the Fund will be required to provide additional variation margin to the clearinghouse before the clearinghouse will move the Fund's cleared derivatives transactions to another clearing member. In addition, if a clearing member does not comply with the applicable regulations or its agreement with the Fund, or in the event of fraud or misappropriation of customer assets by a clearing member, the Fund could have only an unsecured creditor claim in an insolvency of the clearing member with respect to the margin held by the clearing member.

In some ways, centrally cleared swaps arrangements are less favorable to the Fund than OTC swaps arrangements. For example, the Fund may be required to provide greater amounts of margin for cleared swaps than for OTC swaps. Also, in contrast to OTC swaps, following a period of notice to the Fund, a clearing member generally can require termination of existing cleared swaps at any time or increases in margin requirements above the margin that the clearing member required at the beginning of a transaction. Clearinghouses also have broad rights to increase margin requirements for existing transactions or to terminate transactions at any time. Any increase in margin requirements or termination by the clearing member or the clearinghouse could interfere with the ability of the Fund to pursue its investment strategy. Further, any increase in margin requirements by a clearing member could also expose the Fund to greater credit risk of its clearing member, because margin for cleared swaps in excess of clearinghouse margin requirements typically is held by the clearing member. While the documentation in place between the Fund and its clearing members generally provides that the clearing members will accept for clearing all transactions submitted for clearing that are within credit limits (specified in advance) for the Fund, the Fund is still subject to the risk that no clearing member will be willing or able to clear a transaction. In those cases, the transaction might have to be terminated, and the Fund could lose some or all of the benefit of the transaction, including loss of an increase in the value of the transaction and/or loss of hedging protection offered by the transaction. In addition, the documentation governing the relationship between the Fund and its clearing members is developed by the clearing members and generally is less favorable to the Fund than typical OTC swap documentation. For example, this documentation generally includes a one-way indemnity by the Fund in favor of the clearing member, indemnifying the clearing member against losses it incurs in connection with acting as the Fund's clearing member, and the documentation typically does not give the Fund any rights to exercise remedies if the clearing member defaults or becomes insolvent.

Some types of cleared swaps are required to be executed on an exchange or on a swap execution facility ("SEF"). A SEF is a trading platform where multiple market participants can execute swaps by accepting bids and offers made by multiple other participants in the platform. While this execution requirement is designed to increase transparency and liquidity in the cleared swap market, trading on a SEF can create additional costs and risks for the Fund. For example, SEFs typically charge fees, and if the Fund executes swaps on a SEF through a broker intermediary, the intermediary may impose fees as well. Also, the Fund may indemnify a SEF, or a broker intermediary who executes cleared swaps on a SEF on the Fund's behalf, against any losses or costs that may be incurred as a result of the Fund's transactions on the SEF.

The Fund may enter into swap transactions with certain counterparties pursuant to master netting agreements. A master netting agreement provides that all swaps entered into between the Fund and that counterparty shall be regarded as parts of an integral agreement. If amounts are payable on a particular date in the same currency in respect of more than one swap transaction, the amount payable shall be the net amount. In addition, the master netting agreement may provide that if one party (or its affiliates) defaults generally or on any swap, the counterparty can terminate all outstanding swaps with that party. As a result, to the extent the Fund enters into master netting agreements with a counterparty, the Fund may be required to terminate a greater number of swap agreements than if it had not entered into such an agreement, which may result in losses to the Fund.

Interest Rate Swaps, Caps and Floors. Interest rate swaps are agreements between two parties to exchange interest rate payment obligations. Typically, one party's obligation is based on a fixed interest rate while the other party's obligation is based on an interest rate that fluctuates with changes in a designated benchmark. An interest rate cap transaction entitles the purchaser, to the extent that a specified index exceeds a predetermined value, to receive payments on a notional principal amount from the party selling the cap. An interest rate floor transaction entitles the purchaser, to the extent that a specified index falls below a predetermined value, to receive payments on a notional principal amount from the party selling the floor. A collar combines elements of buying a cap and a floor. Caps and floors have an effect similar to buying or writing options. Caps and floors typically have lower liquidity than swaps.

Options on Swaps ("Swaptions"). A swaption is a contract that gives the counterparty the right, but not the obligation to enter into a new swap agreement or to shorten, extend, cancel or otherwise modify an existing swap agreement, at some designated future time on specified terms. The Fund may write (sell) and purchase put and call swaptions. Swaptions are generally subject to the same risks involved in the use of options and swaps. Depending on the terms of the option agreement, the Fund will generally incur a greater degree of risk when it writes a swaption than it will incur when it purchases a swaption. When the Fund purchases a swaption, only the amount of premium the Fund paid is at risk should the option expire unexercised. However, when the Fund writes a swaption, upon exercise of the option the Fund will become obligated according to the terms of the underlying agreement, which may result in losses to the Fund in excess of the premium it received.

Credit Default Swaps and Related Investments. The Fund may enter into credit default swap contracts for investment purposes and to add leverage to its investment portfolio. As the seller in a credit default swap contract, the Fund would be required to pay the par (or other agreed-upon) value of a debt-reference obligation to the counterparty in the event of a default by a third party on the debt obligation. In return, the Fund would receive from the counterparty a periodic stream of payments over the term of the contract provided that no event of default has occurred. If no default occurs, the Fund would keep the stream of payments and would have no payment obligations. As the seller, the Fund would effectively add leverage to its portfolio because, in addition to its net assets, the Fund would be subject to investment exposure on the swap. Credit default swap contracts involve special risks and may result in losses to the Fund. Credit default swaps may in some cases be illiquid, and they increase credit risk since the Fund has exposure to both the issuer of the referenced obligation and the counterparty to the credit default swap. As there is no central exchange or market for certain credit default swap transactions, they may be difficult to trade or value, especially in the event of market disruptions. It is possible that developments in the swap market, including new or modified government regulation, could adversely affect the Fund's ability to terminate existing credit default swap agreements or to realize amounts to be received under such agreements.

The Fund may also purchase credit default swap contracts to attempt to hedge against the risk of default of debt securities held in its portfolio, in which case the Fund would function as the counterparty referenced in the preceding paragraph. This would involve the risk that the investment may expire worthless and would only generate income in the event of an actual default by the issuer of the underlying obligation (or, as applicable, a credit downgrade or other indication of financial instability). It would also involve credit risk—that the seller may fail to satisfy its payment obligations to the Fund in the event of a default.

The Fund may invest in credit default swap index products that provide exposure to obligations of multiple issuers. The Fund can either buy the index (take on credit exposure) or sell the index (pass credit exposure to a counterparty). Such investments are subject to the associated risks with investments in credit default swaps discussed above.

Duration

For the simplest fixed income securities, "duration" indicates the average time at which the security's cash flows are to be received. For simple fixed income securities with interest payments occurring prior to the payment of principal, duration is always less than maturity. For example, a current coupon "bullet" bond with a maturity of 3.5 years (i.e., a bond that pays interest at regular intervals and that will have a single principal payment of the entire principal amount in 3.5 years) might have a duration of approximately three years. In general, the lower the stated or coupon rate of interest of a fixed income security, the closer its duration will be to its final maturity; conversely, the higher the stated or coupon rate of interest of a fixed income security, the shorter its duration will be compared to its final maturity.

Determining duration becomes more complex when fixed income security features like floating or adjustable coupon payments, optionality (for example, the right of the issuer to prepay or call the security), and structuring (for example, the right of the holders of certain securities to receive priority as to the issuer's cash flows) are considered. The calculation of "effective

duration" attempts to take into account optionality and other complex features. Generally, the longer the effective duration of a security, the greater will be the expected change in the percentage price of the security with respect to a change in the security's own yield. By way of illustration, a security with an effective duration of 3.5 years might normally be expected to go down in price by 35 bps if its yield goes up by 10 bps, while another security with an effective duration of 4.0 years might normally be expected to go down in price by 40 bps if its yield goes up by 10 bps. The assumptions that are made about a security's features and options when calculating effective duration may prove to be incorrect. For example, many mortgage pass-through securities may have stated final maturities of 30 years, but current prepayment rates, which can vary widely under different economic conditions, may have a large influence on the pass-through security's response to changes in yield. In these situations, the Fund's portfolio manager may consider other analytical techniques that seek to incorporate the security's additional features into the determination of its response to changes in its yield.

A security may change in price for a variety of reasons. For example, floating rate securities may have final maturities of ten or more years, but their effective durations will tend to be very short. If there is an adverse credit event, or a perceived change in the issuer's creditworthiness, these securities could experience a far greater negative price movement than would be predicted by the change in the security's yield in relation to its effective duration. As a result, investors should be aware that effective duration is not an exact measurement and may not reliably predict a security's price sensitivity to changes in yield or interest rates.

Equity Securities

Equity securities include exchange-traded and over-the-counter common and preferred stocks, warrants and rights, and securities convertible into common stocks. Equity securities fluctuate in price based on changes in a company's financial condition and overall market and economic conditions. The value of a particular security may decline due to factors that affect a particular industry or industries, such as an increase in production costs, competitive conditions or labor shortages; or due to general market conditions, such as real or perceived adverse economic conditions, changes in the general outlook for corporate earnings, changes in interest or currency rates or generally adverse investor sentiment. The value of an equity security can be more volatile than the market as a whole and can perform differently from the value of the market as a whole. The value of a company's equity securities may deteriorate because of a variety of factors, including disappointing earnings reports by the issuer, unsuccessful products or services, loss of major customers, major litigation against the issuer or changes in government regulations affecting the issuer or the competitive environment.

Exchange Traded Funds ("ETFs")

ETFs are ownership interests in investment companies, unit investment trusts, depositary receipts and other pooled investment vehicles that are traded on an exchange and that hold a portfolio of securities or other financial instruments (the "Underlying Assets"). The Underlying Assets are typically selected to correspond to the securities that comprise a particular broad based sector or international index, or to provide exposure to a particular industry sector or asset class, including precious metals or other commodities. "Short ETFs" seek a return similar to the inverse, or a multiple of the inverse, of a reference index. Short ETFs carry additional risks because their Underlying Assets may include a variety of financial instruments, including futures and options on futures, options on securities and securities indexes, swap agreements and forward contracts, and a short ETF may engage in short sales. An ETF's losses on short sales are potentially unlimited; however, the Fund's risk would be limited to the amount it invested in the ETF. Certain ETFs are actively managed by a portfolio manager or management team that makes investment decisions on Underlying Assets without seeking to replicate the performance of a reference index or industry sector or asset class.

Unlike shares of typical open-end management investment companies or unit investment trusts, shares of ETFs are designed to be traded throughout the trading day and bought and sold based on market price rather than net asset value. Shares can trade at either a premium or discount to net asset value. The portfolios held by ETFs are typically publicly disclosed on each trading day and an approximation of actual net asset value is disseminated throughout the trading day. An ETF will generally gain or lose value depending on the performance of the Underlying Assets. In the future, as new products become available, the Fund may invest in ETFs that do not have this same level of transparency and, therefore, may be more likely to trade at a larger discount or premium to actual net asset values.

Gains or losses on the Fund's investment in ETFs will ultimately depend on the purchase and sale price of the ETF. An active trading market for an ETF's shares may not develop or be maintained and trading of an ETF's shares may be halted if the

listing exchange's officials deem such action appropriate, the shares are delisted from the exchange or the activation of market-wide "circuit breakers" (which are tied to large decreases in stock prices) halts stock trading generally. The performance of an ETF will be reduced by transaction and other expenses, including fees paid by the ETF to service providers. Investors in ETFs are eligible to receive their portion of income, if any, accumulated on the securities held in the portfolio, less fees and expenses of the ETF.

An investment in an ETF involves risks similar to investing directly in the Underlying Assets, including the risk that the value of the Underlying Assets may fluctuate in accordance with changes in the financial condition of their issuers, the value of securities and other financial instruments generally, and other market factors.

If an ETF is a registered investment company (as defined in the 1940 Act), the limitations applicable to the Fund's ability to purchase securities issued by other investment companies apply absent certain exemptive rules or other available exemptive relief. However, under Rule 12d1-4, the Fund may invest in other investment companies, including ETFs, in excess of these limits, subject to certain conditions. These restrictions may limit the Fund's ability to invest in ETFs to the extent desired. Some ETFs are not structured as investment companies and thus are not regulated under the 1940 Act.

High Yield ("Junk") Bonds

High yield securities are medium or lower rated securities and unrated securities of comparable quality, sometimes referred to as "high yield" or "junk" bonds. Generally, such securities offer a higher current yield than is offered by higher rated securities, but also are predominantly speculative with respect to the issuer's capacity to pay interest and repay principal in accordance with the terms of the securities. The market values of certain of these securities also tend to be more sensitive to individual corporate developments and changes in economic conditions than higher quality bonds. In addition, medium and lower rated securities and comparable unrated securities generally present a higher degree of credit risk. The risk of loss because of default by issuers of these securities is significantly greater because medium and lower rated securities generally are unsecured and frequently subordinated to senior indebtedness. In addition, the market value of securities in lower rated categories is generally more volatile than that of higher quality securities, and the markets in which medium and lower rated securities are traded are more limited than those in which higher rated securities are traded. The existence of limited markets may make it more difficult for the Fund to obtain accurate market quotations for purposes of valuing its securities and calculating its net asset value. Moreover, the lack of a liquid trading market may restrict the availability of securities for the Fund to purchase and may also limit the ability of the Fund to sell securities at their fair value either to meet redemption requests or to respond to changes in the economy or the financial markets.

Lower rated debt obligations often have redemption features that permit an issuer to repurchase the security from the Fund before it matures. If an issuer exercises that right, the Fund may have to replace the security with a lower yielding security, resulting in a decreased return for investors. If the Fund experiences unexpected net redemptions, it may be forced to sell its higher rated bonds, resulting in a decline in the overall credit quality of the securities held by the Fund and increasing the exposure of the Fund to the risks of lower rated securities. Investments in lower rated zero coupon bonds may be more speculative and subject to greater fluctuations in value because of changes in interest rates than lower rated bonds that pay interest currently.

Subsequent to its purchase by the Fund, an issue of securities may cease to be rated or its rating may be reduced below the minimum required for purchase by the Fund (if applicable). Neither event will require sale of these securities by the Fund, but the portfolio manager will consider the event in determining whether the Fund should continue to hold the security.

Illiquid Investments and Restricted Securities

The Fund may invest up to 15% of its net assets in illiquid investments. An illiquid security is any security which the Fund reasonably expects cannot be sold or disposed of in current market conditions in seven calendar days or less without the sale or disposition significantly changing the market value of the security. To the extent required by applicable law and SEC guidance, the Fund will not acquire an illiquid security if such acquisition would cause the aggregate value of illiquid securities to exceed 15% of the Fund's net assets. If at any time the portfolio manager determines that the value of illiquid securities held by the Fund exceeds 15% of the Fund's net assets, the portfolio manager will take such steps as it considers appropriate to reduce the percentage within a reasonable period of time consistent with applicable regulatory requirements. Because illiquid investments may not be readily marketable, the Fund may not be able to dispose of them in a timely manner. As a result, the

Fund may be forced to hold illiquid investments while their price depreciates. Depreciation in the price of illiquid investments may cause the net asset value of the Fund to decline.

Restricted securities are securities subject to legal or contractual restrictions on their resale, such as private placements. Such restrictions might prevent the sale of restricted securities at a time when the sale would otherwise be desirable. Under SEC regulations, certain restricted securities acquired through private placements can be traded freely among qualified purchasers. While restricted securities are generally presumed to be illiquid, it may be determined that a particular restricted security is liquid. Investing in these restricted securities could have the effect of increasing the Fund's illiquidity if qualified purchasers become, for a time, uninterested in buying these securities.

Restricted securities may be sold only (1) pursuant to SEC Rule 144A or another exemption, (2) in privately negotiated transactions or (3) in public offerings with respect to which a registration statement is in effect under the 1933 Act. Rule 144A securities, although not registered in the U.S., may be sold to qualified institutional buyers in accordance with Rule 144A under the 1933 Act. As noted above, the Fund may determine that some Rule 144A securities are liquid. Where registration is required, the Fund may be obligated to pay all or part of the registration expenses and a considerable period may elapse between the time of the decision to sell and the time the Fund may be permitted to sell a restricted security under an effective registration statement. If, during such a period, adverse market conditions were to develop, the Fund might obtain a less favorable price than prevailed when it decided to sell.

Illiquid securities may be difficult to value, and the Fund may have difficulty disposing of such securities promptly. The Fund does not consider non-U.S. securities to be restricted if they can be freely sold in the principal markets in which they are traded, even if they are not registered for sale in the U.S.

Liquidity Risk Management. Rule 22e-4 under the 1940 Act requires, among other things, that the Fund and other Franklin Templeton ETFs and open-end funds establish a liquidity risk management program ("LRMP") that is reasonably designed to assess and manage liquidity risk. Rule 22e-4 defines "liquidity risk" as the risk that a fund could not meet requests to redeem shares issued by the fund without significant dilution of the remaining investors' interests in the fund. The Fund has implemented a LRMP designed to meet the relevant requirements. Additionally, the Board, including a majority of the Independent Trustees, approved the designation of the Fund's LRMP administrator to administer such program and reviews no less frequently than annually a written report prepared by the LRMP administrator that addresses the operation of the LRMP and assesses its adequacy and effectiveness of implementation. There is no guarantee the LRMP will be effective in its operations, and complying with Rule 22e-4 or any amendment thereto, including bearing related costs, could impact the Fund's performance and its ability to achieve its investment objective.

Investments by Other Funds and by Other Significant Investors

Certain investment companies, including those that are affiliated with the Fund because they are managed by the Manager or an affiliate of the Manager, may invest in the Fund and may at times have substantial investments in one or more funds. Other investors also may at times have substantial investments in one or more funds.

From time to time, the Fund may experience relatively large redemptions or investments due to transactions in Fund shares by a fund or other significant investor. In addition, a large number of shareholders collectively may purchase or redeem Fund shares in large amounts rapidly or unexpectedly (collectively, such transactions are referred to as "large shareholder transactions"). The effects of these transactions could adversely affect the Fund's performance. In the event of such redemptions or investments, the Fund could be required to sell securities or to invest cash at a time when it is not advantageous to do so. Such transactions may increase brokerage and/or other transaction costs of the Fund. A large redemption could cause the Fund's expenses to increase and could result in the Fund becoming too small to be economically viable. Large redemptions of Fund shares may indirectly result in required distributions to non-redeeming shareholders, and those distributions would generally be taxable to shareholders who do not hold their Fund shares in an IRA, 401(k) plan or other tax-advantaged plan. Redemptions may result in the recognition of short-term capital gains by the Fund, and distributions of short-term capital gains will generally be taxed at ordinary income tax rates for shareholders who hold Fund shares in a taxable account. Redemptions may directly or indirectly result from actions taken (or not taken) by the Trust, the Manager, the Subadviser, a fund, or an affiliate. A number of circumstances may cause the Fund to experience large redemptions, such as changes in the eligibility criteria for the Fund or share class of the Fund; liquidations, reorganizations, repositionings, or other announced Fund events; or changes in investment objectives, strategies, policies, risks, or investment personnel.

The Manager and the Subadviser are subject to potential conflicts of interest in connection with investments in the Fund by an affiliated fund due to their affiliation. For example, the Manager or the Subadviser could have the incentive to permit an affiliated fund to become a more significant shareholder (with the potential to cause greater disruption) than would be permitted for an unaffiliated investor. Investments by an affiliated fund may also give rise to conflicts in connection with the voting of fund shares. The Manager, the Subadviser and/or its advisory affiliates intend to seek to address these potential conflicts of interest in the best interests of the Fund's shareholders, although there can be no assurance that such efforts will be successful. The Manager and the Subadviser will consider how to minimize potential adverse impacts of affiliated fund investments, and, may take such actions as each deems appropriate to address potential adverse impacts, including redemption of shares in-kind, rather than in cash.

Investments in Other Investment Companies

Subject to applicable statutory and regulatory limitations described below, the Fund may invest in shares of other investment companies, including shares of open-end and closed-end investment companies affiliated or unaffiliated with the Fund, business development companies, exchange-traded funds and unregistered investment companies.

An investment in an investment company is subject to the risks associated with that investment company's portfolio securities. Investments in closed-end funds may entail the additional risk that the market value of such investments may be substantially less than their net asset value. To the extent the Fund invests in shares of another investment company, the Fund will indirectly bear a proportionate share of that investment company's advisory fees and other operating expenses. These fees are in addition to the advisory fees and other operational expenses incurred directly by the Fund. In addition, the Fund could incur a sales charge in connection with purchasing an investment company security or a redemption fee upon the redemption of such security.

Section 12(d)(1)(A) of the 1940 Act provides that a fund may not purchase or otherwise acquire the securities of other investment companies if, as a result of such purchase or acquisition, it would own: (i) more than 3% of the total outstanding voting stock of the acquired investment company; (ii) securities issued by any one investment company having a value in excess of 5% of the fund's total assets; or (iii) securities issued by all investment companies having an aggregate value in excess of 10% of the fund's total assets. These limitations are subject to certain statutory and regulatory exemptions including Rule 12d1-4, which permits the Fund to invest in other investment companies beyond the statutory limits, subject to certain conditions. Among other conditions, the Rule prohibits a fund from acquiring control of another investment company (other than an investment company in the same group of investment companies), including by acquiring more than 25% of its voting securities. In addition, the Rule imposes certain voting requirements when a fund's ownership of another investment company exceeds particular thresholds. If shares of a fund are acquired by another investment company, the "acquired" fund may not purchase or otherwise acquire the securities of an investment company or private fund if immediately after such purchase or acquisition, the securities of investment companies and private funds owned by that acquired fund have an aggregate value in excess of 10% of the value of the total assets of the acquired fund, subject to certain exceptions. These restrictions may limit the Fund's ability to invest in other investment companies to the extent desired. In addition, other unaffiliated investment companies may impose other investment limitations or redemption restrictions which may also limit the Fund's flexibility with respect to making investments in those unaffiliated investment companies.

Investment in Affiliated Money Market Funds

The Fund may invest, to the extent permitted by applicable law, all or some of its short-term cash investments in a money market fund or similarly-managed pool advised by the Manager, Subadviser or an affiliate of the Manager that may or may not be required to register with the SEC as an investment company. In connection with any such investments, the Fund, to the extent permitted by the 1940 Act, may pay its share of expenses of the fund in which it invests, which may result in additional expenses for the Fund.

Loans

Loans are negotiated and underwritten by a bank or syndicate of banks and other institutional investors. The Fund may acquire an interest in loans through the primary market by acting as one of a group of lenders of a loan. The primary risk in an investment in loans is that the borrower may be unable to meet its interest and/or principal payment obligations. The occurrence of such a default with regard to a loan in which the Fund had invested would have an adverse effect on the Fund's net asset

value. In addition, a sudden and significant increase in market interest rates may cause a decline in the value of these investments and in the Fund's net asset value. Other factors, such as rating downgrades, credit deterioration, or large downward movement in stock prices, a disparity in supply and demand of certain securities or market conditions that reduce liquidity could reduce the value of loans, impairing the Fund's net asset value. Loans may not be considered "securities" for certain purposes and purchasers, such as the Fund, therefore may not be entitled to rely on the anti-fraud protections of the federal securities laws.

Loans in which the Fund may invest may be collateralized or uncollateralized and senior or subordinate. Investments in uncollateralized and/or subordinate loans entail a greater risk of nonpayment than do investments in loans which hold a more senior position in the borrower's capital structure or that are secured with collateral. In the case of collateralized senior loans, however, there is no assurance that sale of the collateral would raise enough cash to satisfy the borrower's payment obligation or that the collateral can or will be liquidated. As a result, the Fund might not receive payments to which it is entitled and thereby may experience a decline in the value of its investment and its net asset value. In the event of bankruptcy, liquidation may not occur and the court may not give lenders the full benefit of their senior positions. If the terms of a senior loan do not require the borrower to pledge additional collateral, the Fund will be exposed to the risk that the value of the collateral will not at all times equal or exceed the amount of the borrower's obligations under the senior loans. To the extent that a senior loan is collateralized by stock in the borrower or its subsidiaries, such stock may lose all of its value in the event of bankruptcy of the borrower.

The Fund may also acquire an interest in loans by purchasing participations ("Participations") in and/or assignments ("Assignments") of portions of loans from third parties. By purchasing a Participation, the Fund acquires some or all of the interest of a bank or other lending institution in a loan to a borrower. Participations typically will result in the Fund's having a contractual relationship only with the lender and not the borrower. The Fund will have the right to receive payments of principal, interest and any fees to which it is entitled only from the lender selling the Participation and only upon receipt by the lender of the payments from the borrower. In connection with purchasing Participations, the Fund generally will have no right to enforce compliance by the borrower with the terms of the loan agreement relating to the loan, nor any rights of set-off against the borrower, and the Fund may not directly benefit from any collateral supporting the loan in which it has purchased the Participation. As a result, the Fund will assume the credit risk of both the borrower and the lender that is selling the Participation.

When the Fund purchases Assignments from lenders, the Fund will acquire direct rights against the borrower on the loan. However, since Assignments are arranged through private negotiations between potential assignees and assignors, the rights and obligations acquired by the Fund as the purchaser of an Assignment may differ from, and be more limited than, those held by the lender from which the Fund is purchasing the Assignments. Certain of the Participations or Assignments acquired by the Fund may involve unfunded commitments of the lenders or revolving credit facilities under which a borrower may from time to time borrow and repay amounts up to the maximum amount of the facility. In such cases, the Fund would have an obligation to advance its portion of such additional borrowings upon the terms specified in the loan documentation.

The Fund may acquire loans of borrowers that are experiencing, or are more likely to experience, financial difficulty, including loans of borrowers that have filed for bankruptcy protection. Although loans in which the Fund will invest generally will be secured by specific collateral, there can be no assurance that liquidation of such collateral would satisfy the borrower's obligation in the event of nonpayment of scheduled interest or principal, or that such collateral could be readily liquidated. In the event of bankruptcy of a borrower, the Fund could experience delays or limitations with respect to its ability to realize the benefits of the collateral securing a senior loan.

In addition, the Fund may have difficulty disposing of its investments in loans. The liquidity of such securities is limited and the Fund anticipates that such securities could be sold only to a limited number of institutional investors. The lack of a liquid secondary market could have an adverse impact on the value of such securities and on the Fund's ability to dispose of particular loans or Assignments or Participations when necessary to meet the Fund's liquidity needs or in response to a specific economic event, such as a deterioration in the creditworthiness of the borrower. The lack of a liquid secondary market for loans may also make it more difficult for the Fund to assign a value to those securities for purposes of valuing the Fund's investments and calculating its net asset value.

The issuer of a loan may offer to provide material, non-public information about the issuer to investors, such as the Fund. The Fund's portfolio manager may avoid receiving this type of information about the issuer of a loan either held by or considered for investment by the Fund, because of prohibitions on trading in securities of issuers while in possession of such

information. The decision not to receive material, non-public information may place the Fund at a disadvantage, relative to other loan investors, in assessing a loan or the loan's issuer.

Mortgage-Backed and Other Asset-Backed Securities – Generally

An asset-backed security is a fixed income security that derives its value primarily from cash flows relating to a pool of assets. There are a number of different types of asset-backed and related securities, including mortgage-backed securities, securities backed by other pools of collateral (such as automobile loans, student loans, sub-prime mortgages, and credit card receivables), collateralized mortgage obligations, and collateralized debt obligations.

Asset-backed and mortgage-backed securities differ from conventional bonds in that principal is paid over the life of the securities rather than at maturity. As a result, payments of principal of and interest on mortgage-backed securities and asset-backed securities are made more frequently than are payments on conventional debt securities. The average life of asset-backed and mortgage-backed securities is likely to be substantially less than the original maturity of the underlying asset pools as a result of prepayments or foreclosures of mortgages, as applicable. In addition, holders of mortgage-backed securities and of certain asset-backed securities (such as asset-backed securities backed by home equity loans) may receive unscheduled payments of principal at any time representing prepayments on the underlying mortgage loans or financial assets. When the holder of the security attempts to reinvest prepayments or even the scheduled payments of principal and interest, it may receive a rate of interest that is higher or lower than the rate on the mortgage-backed security or asset-backed security originally held. To the extent that mortgage-backed securities or asset-backed securities are purchased by the Fund at a premium, mortgage foreclosures and principal prepayments may result in a loss to the extent of the premium paid. To the extent the loans underlying a security representing an interest in a pool of mortgages or other assets are prepaid, the Fund may experience a loss (if the price at which the respective security was acquired by the Fund was at a premium over par, which represents the price at which the security will be redeemed upon prepayment) or a gain (if the price at which the respective security was acquired by the Fund was at a discount from par). In addition, prepayments of such securities held by the Fund will reduce the share price of the Fund to the extent the market value of the securities at the time of prepayment exceeds their par value, and will increase the share price of the Fund to the extent the par value of the securities exceeds their market value at the time of prepayment. Prepayments may occur with greater frequency in periods of declining interest rates because, among other reasons, it may be possible for borrowers to refinance their outstanding obligation at lower interest rates. When market interest rates increase, the market values of asset-backed and mortgage-backed securities decline. At the same time, however, refinancing slows, which lengthens the effective maturities of these securities. As a result, the negative effect of the rate increase on the market value of asset-backed and mortgage-backed securities is usually more pronounced than it is for other types of fixed income securities.

Changes in the market's perception of the mortgages or assets backing the security, the creditworthiness of the servicing agent for the loan pool, the originator of the loans, or the financial institution providing any credit enhancement, will all affect the value of an asset-backed or mortgage-backed security, as will the exhaustion of any credit enhancement.

The risks of investing in asset-backed and mortgage-backed securities ultimately depend upon the payment of the underlying loans by the individual borrowers. In its capacity as purchaser of an asset-backed security or mortgage-backed security, the Fund would generally have no recourse to the entity that originated the loans in the event of default by the borrower. The risk of non-payment is greater for asset-backed and mortgage-backed securities that are backed by pools that contain subprime loans, but a level of risk exists for all loans. Market factors adversely affecting loan repayments may include a general economic turndown and high unemployment. Mortgage-backed securities may be adversely affected by a general slowdown in the real estate market, a drop in the market prices of real estate, or an increase in interest rates resulting in higher mortgage payments by holders of adjustable rate mortgages. Developments following the onset of COVID-19 have adversely impacted the commercial real estate markets, causing the deferral of mortgage payments, renegotiated commercial mortgage loans, commercial real estate vacancies or outright mortgage defaults, and potential acceleration of macro trends such as work from home and online shopping which may negatively impact certain industries, such as brick-and-mortar retail.

Additional information regarding different types of asset-backed and mortgage-backed securities is provided below. Governmental, government-related or private entities may create pools of loan assets offering pass-through investments in addition to those described below. As new types of asset-backed or mortgage-backed securities are developed and offered to investors, the portfolio manager may, consistent with the Fund's investment objective and policies, consider making investments in such new types of securities.

Mortgage-backed securities. Mortgage-backed securities ("MBS") represent interests in pools of mortgage loans made by lenders such as savings and loan institutions, mortgage bankers, commercial banks and others, to finance purchases of homes, commercial buildings or other real estate. The individual mortgage loans are assembled for sale to investors (such as the Fund) by various governmental or government-related agencies and private organizations, such as dealers.

Government-sponsored MBS. Some government sponsored mortgage-related securities are backed by the full faith and credit of the United States. The Government National Mortgage Association ("Ginnie Mae"), the principal guarantor of such securities, is a wholly-owned United States government corporation within the Department of Housing and Urban Development. Other government-sponsored mortgage-related securities are not backed by the full faith and credit of the United States government. Issuers of such securities include Fannie Mae (formally known as the Federal National Mortgage Association) and Freddie Mac (formally known as the Federal Home Loan Mortgage Corporation). Fannie Mae is a government-sponsored corporation which is subject to general regulation by the Secretary of Housing and Urban Development. Pass-through securities issued by Fannie Mae are guaranteed as to timely payment of principal and interest by Fannie Mae. Freddie Mac is a stockholder-owned corporation chartered by Congress and subject to general regulation by the Department of Housing and Urban Development. Participation certificates representing interests in mortgages from Freddie Mac's national portfolio are guaranteed as to the timely payment of interest and ultimate collection of principal by Freddie Mac. The U.S. government has provided financial support to Fannie Mae and Freddie Mac in the past, but there can be no assurances that it will support these or other government-sponsored entities in the future.

Privately issued MBS. Unlike MBS issued or guaranteed by the U.S. government or certain government-sponsored entities, MBS issued by private issuers do not have a government or government-sponsored entity guarantee, but may have credit enhancement provided by external entities such as banks or financial institutions or achieved through the structuring of the transaction itself.

In addition, MBS that are issued by private issuers are not subject to the underwriting requirements for the underlying mortgages that are applicable to those MBS that have a government or government-sponsored entity guarantee. As a result, the mortgage loans underlying private MBS may, and frequently do, have less favorable collateral, credit risk or other underwriting characteristics than government or government-sponsored MBS and have wider variances in a number of terms including interest rate, term, size, purpose and borrower characteristics. Privately issued pools more frequently include second mortgages, high loan-to-value mortgages and manufactured housing loans. The coupon rates and maturities of the underlying mortgage loans in a private-label MBS pool may vary to a greater extent than those included in a government guaranteed pool, and the pool may include subprime mortgage loans. Subprime loans refer to loans made to borrowers with weakened credit histories or with a lower capacity to make timely payments on their loans. For these reasons, the loans underlying these securities have had in many cases higher default rates than those loans that meet government underwriting requirements.

Privately issued mortgage-backed securities are not traded on an exchange and there may be a limited market for the securities, especially when there is a perceived weakness in the mortgage and real estate market sectors. Without an active trading market, mortgage-backed securities held in the Fund's portfolio may be particularly difficult to value because of the complexities involved in assessing the value of the underlying mortgage loans.

Adjustable rate mortgage-backed securities. Adjustable rate mortgage-backed securities ("ARMBS") are pass-through securities collateralized by mortgages with adjustable rather than fixed rates. Adjustable rate mortgages eligible for inclusion in a mortgage pool generally provide for a fixed initial mortgage interest rate for a set number of scheduled monthly payments. After that schedule of payments has been completed, the interest rates of the adjustable rate mortgages are subject to periodic adjustment based on changes to a designated benchmark index.

Mortgages underlying most ARMBS may contain maximum and minimum rates beyond which the mortgage interest rate may not vary over the lifetime of the mortgage. In addition, certain adjustable rate mortgages provide for additional limitations on the maximum amount by which the mortgage interest rate may adjust for any single adjustment period. In the event that market rates of interest rise more rapidly to levels above that of the maximum rate for the adjustable rate mortgages underlying an ARMBS, the ARMBS' coupon may represent a below market rate of interest. In these circumstances, the market value of the ARMBS will likely have fallen. During periods of declining interest rates, income to the Fund derived from adjustable rate mortgages that remain in the mortgage pool underlying the ARMBS may decrease in contrast to the income on fixed rate mortgages, which will remain constant. Adjustable rate mortgages also have less potential for appreciation in value as interest

rates decline than do fixed rate investments. In addition, the current yields on ARMBS may be different than market yields during interim periods between coupon reset dates.

Stripped mortgage-backed securities. Stripped mortgage-backed securities ("SMBS") are structured with two or more classes of securities that receive different proportions of the interest and principal distributions on a pool of mortgage assets. A common type of SMBS will have at least one class receiving only a small portion of the principal. In the most extreme case, one class will receive all of the interest ("IO" or interest-only class), while the other class will receive all of the principal ("PO" or principal-only class). The yield to maturity on IOs, POs and other mortgage-backed securities that are purchased at a substantial premium or discount generally are extremely sensitive not only to changes in prevailing interest rates but also to the rate of principal payments (including prepayments) on the related underlying mortgage assets, and a rapid rate of principal payments may have a material adverse effect on such securities' yield to maturity. If the underlying mortgage assets experience greater than anticipated prepayments of principal, the Fund may fail to fully recoup its initial investment in these securities even if the securities have received the highest rating by a NRSRO.

SMBS have greater volatility than other types of securities. Although SMBS are purchased and sold by institutional investors through several investment banking firms acting as brokers or dealers, the market for such securities has not yet been fully developed. Accordingly, the secondary market for SMBS may be more volatile and have lower liquidity than that for other MBS, potentially limiting the Fund's ability to buy or sell SMBS at any particular time.

Collateralized mortgage obligations. Another type of security representing an interest in a pool of mortgage loans is known as a collateralized mortgage obligation ("CMO"). CMOs represent interests in a short-term, intermediate-term or long-term portion of a mortgage pool. Each portion of the pool receives monthly interest payments, but the principal repayments pass through to the short-term CMO first and to the long-term CMO last. A CMO permits an investor to more accurately predict the rate of principal repayments. CMOs are issued by private issuers, such as broker-dealers, and by government agencies, such as Fannie Mae and Freddie Mac. Investments in CMOs are subject to the same risks as direct investments in the underlying mortgage-backed securities. In addition, in the event of a bankruptcy or other default of a broker that issued the CMO held by the Fund, the Fund could experience delays in liquidating both its position and losses. The Fund may invest in CMOs in any rating category of the recognized rating services and may invest in unrated CMOs. The Fund may also invest in "stripped" CMOs, which represent only the income portion or the principal portion of the CMO. The values of stripped CMOs are very sensitive to interest rate changes; accordingly, these instruments present a greater risk of loss than conventional mortgage-backed securities.

Tiered index bonds. Tiered index bonds are relatively new forms of mortgage-related securities. The interest rate on a tiered index bond is tied to a specified index or market rate. So long as this index or market rate is below a predetermined "strike" rate, the interest rate on the tiered index bond remains fixed. If, however, the specified index or market rate rises above the "strike" rate, the interest rate of the tiered index bond will decrease. Thus, under these circumstances, the interest rate on a tiered index bond, like an inverse floater, will move in the opposite direction of prevailing interest rates, with the result that the price of the tiered index bond would decline and may be considerably more volatile than that of a fixed-rate bond.

Other Asset-Backed Securities – Additional Information

Similar to mortgage-backed securities, other types of asset-backed securities may be issued by agencies or instrumentalities of the U.S. government (including those whose securities are neither guaranteed nor insured by the U.S. government), foreign governments (or their agencies or instrumentalities), or non-governmental issuers. These securities include securities backed by pools of automobile loans, educational loans, home equity loans, and credit card receivables. The underlying pools of assets are securitized through the use of trusts and special purpose entities. These securities may be subject to the risks described above under "Mortgage-Backed and Other Asset-Backed Securities — Generally," including risks associated with changes in interest rates and prepayment of underlying obligations.

Certain types of asset-backed securities present additional risks that are not presented by mortgage-backed securities. In particular, certain types of asset-backed securities may not have the benefit of a security interest in the related assets. For example, many securities backed by credit card receivables are unsecured. Even when security interests are present, the ability of an issuer of certain types of asset-backed securities to enforce those interests may be more limited than that of an issuer of mortgage-backed securities. For instance, automobile receivables generally are secured by automobiles rather than by real property. Most issuers of automobile receivables permit loan servicers to retain possession of the underlying assets. In addition, because of the large number of underlying vehicles involved in a typical issue of asset-backed securities and technical

requirements under state law, the trustee for the holders of the automobile receivables may not have a proper security interest in all of the automobiles. Therefore, recoveries on repossessed automobiles may not be available to support payments on these securities.

In addition, certain types of asset-backed securities may experience losses on the underlying assets as a result of certain rights provided to consumer debtors under federal and state law. In the case of certain consumer debt, such as credit card debt, debtors are entitled to the protection of a number of state and federal consumer credit laws, many of which give such debtors the right to set off certain amounts owed on their credit cards (or other debt), thereby reducing their balances due. For instance, a debtor may be able to offset certain damages for which a court has determined that the creditor is liable to the debtor against amounts owed to the creditor by the debtor on his or her credit card.

Additionally, an asset-backed security is subject to risks associated with the servicing agent's or originator's performance. For example, a servicing agent or originator's mishandling of documentation related to the underlying collateral (e.g., failure to properly document a security interest in the underlying collateral) may affect the rights of the security holders in and to the underlying collateral.

Asset-backed commercial paper. The Fund may purchase commercial paper, including asset-backed commercial paper ("ABCP") that is issued by structured investment vehicles or other conduits. These conduits may be sponsored by mortgage companies, investment banking firms, finance companies, hedge funds, private equity firms and special purpose finance entities. ABCP typically refers to a debt security with an original term to maturity of up to 270 days, the payment of which is supported by cash flows from underlying assets, or one or more liquidity or credit support providers, or both. Assets backing ABCP, which may be included in revolving pools of assets with large numbers of obligors, include credit card, car loan and other consumer receivables and home or commercial mortgages, including subprime mortgages. The repayment of ABCP issued by a conduit depends primarily on the cash collections received from the conduit's underlying asset portfolio and the conduit's ability to issue new ABCP. Therefore, there could be losses to the Fund investing in ABCP in the event of credit or market value deterioration in the conduit's underlying portfolio, mismatches in the timing of the cash flows of the underlying asset interests and the repayment obligations of maturing ABCP, or the conduit's inability to issue new ABCP. To protect investors from these risks, ABCP programs may be structured with various protections, such as credit enhancement, liquidity support, and commercial paper stop-issuance and wind-down triggers. However there can be no guarantee that these protections will be sufficient to prevent losses to investors in ABCP.

Some ABCP programs provide for an extension of the maturity date of the ABCP if, on the related maturity date, the conduit is unable to access sufficient liquidity through the issue of additional ABCP. This may delay the sale of the underlying collateral and the Fund may incur a loss if the value of the collateral deteriorates during the extension period. Alternatively, if collateral for ABCP deteriorates in value, the collateral may be required to be sold at inopportune times or at prices insufficient to repay the principal and interest on the ABCP. ABCP programs may provide for the issuance of subordinated notes as an additional form of credit enhancement. The subordinated notes are typically of a lower credit quality and have a higher risk of default. A fund purchasing these subordinated notes will therefore have a higher likelihood of loss than investors in the senior notes.

Collateralized debt obligations. The Fund may invest in collateralized debt obligations ("CDOs"), which include collateralized bond obligations ("CBOs"), collateralized loan obligations ("CLOs") and other similarly structured securities. CDOs are types of asset-backed securities. A CBO is a trust or other special purpose entity ("SPE") which is typically backed by a diversified pool of fixed income securities (which may include high risk, below investment grade securities). A CLO is a trust or other SPE that is typically collateralized by a pool of loans, which may include, among others, domestic and non-U.S. senior secured loans, senior unsecured loans, and subordinate corporate loans, including loans that may be rated below investment grade or equivalent unrated loans. Although certain CDOs may receive credit enhancement in the form of a senior-subordinate structure, over-collateralization or bond insurance, such enhancement may not always be present, and may fail to protect the Fund against the risk of loss on default of the collateral. Certain CDOs may use derivatives contracts to create "synthetic" exposure to assets rather than holding such assets directly, which entails the risks of derivative instruments described elsewhere in this SAI. CDOs may charge management fees and administrative expenses, which are in addition to those of the Fund.

For both CBOs and CLOs, the cashflows from the SPE are split into two or more portions, called tranches, varying in risk and yield. The riskiest portion is the "equity" tranche, which bears the first loss from defaults from the bonds or loans in the SPE and serves to protect the other, more senior tranches from default (though such protection is not complete). Since it is partially protected from defaults, a senior tranche from a CBO or CLO typically has higher ratings and lower yields than its underlying

securities, and may be rated investment grade. Despite the protection from the equity tranche, CBO or CLO tranches can experience substantial losses due to actual defaults, increased sensitivity to defaults due to collateral default and disappearance of protecting tranches, market anticipation of defaults, as well as investor aversion to CBO or CLO securities as a class. Interest on certain tranches of a CDO may be paid in kind (paid in the form of obligations of the same type rather than cash), which involves continued exposure to default risk with respect to such payments.

The risks of an investment in a CDO depend largely on the type of the collateral securities and the class of the CDO in which the Fund invests. Normally, CBOs, CLOs and other CDOs are privately offered and sold, and thus, are not registered under the securities laws. As a result, investments in CDOs may be characterized by the Fund as illiquid securities. However, an active dealer market may exist for CDOs, allowing a CDO to qualify for Rule 144A transactions. In addition to the normal risks associated with fixed income securities discussed elsewhere in this SAI and the Prospectus (e.g., interest rate risk and credit risk), CDOs carry additional risks including, but not limited to: (i) the possibility that distributions from collateral securities will not be adequate to make interest or other payments; (ii) the collateral may decline in value or default or its credit rating may be downgraded, if rated by a nationally recognized statistical rating organization; (iii) the Fund may invest in tranches of CDOs that are subordinate to other tranches; (iv) the complex structure of the security may not be fully understood at the time of investment and may produce disputes with the issuer or unexpected investment results; and (v) the CDO's manager may perform poorly.

Forward Roll Transactions

In a forward roll transaction, also known as a mortgage dollar roll, the Fund sells MBS for delivery in the current month and simultaneously contracts to repurchase substantially similar (same type, coupon and maturity) MBS on a specified future date. The Fund may enter into a forward roll transaction commitment with the intention of entering into an offsetting transaction whereby, rather than accepting delivery of the security on the specified future date, the Fund sells the security and then agrees to repurchase a similar security at a later time. In this case, the Fund forgoes interest on the security during the roll period and is compensated by the interest earned on the cash proceeds of the initial sale of the security and by the difference between the sale price and the lower repurchase price at the future date.

Forward roll transactions involve the risk that the market value of the securities the Fund is obligated to repurchase under the agreement may decline below the repurchase price. In the event the buyer of securities under a forward roll transaction files for bankruptcy or becomes insolvent, the Fund's use of proceeds of the forward roll transaction may be restricted pending a determination by the other party, or its trustee or receiver, whether to enforce the Fund's obligation to repurchase the securities.

Forward roll transactions may have a leveraging effect on the Fund, making the value of an investment in the Fund more volatile and increasing the Fund's overall investment exposure. Successful use of forward roll transactions may depend on the portfolio manager's ability to correctly predict interest rates and prepayments. There is no assurance that forward roll transactions can be successfully employed.

Municipal Securities

Municipal securities (which are also referred to herein as "municipal obligations" or "municipal bonds") generally include debt obligations (including, but not limited to bonds, notes or commercial paper) issued by or on behalf of the states, territories and possessions of the United States, and the District of Columbia, and their political subdivisions, agencies and public authorities, and other qualifying issuers, participations or other interests in these securities and other related investments. The interest paid on municipal securities is generally excluded from gross income for regular U.S. federal income tax purposes, although it may be subject to a U.S. federal alternative minimum tax ("AMT").

Municipal securities are issued to obtain funds for various public purposes, including the construction of a wide range of public facilities, such as airports, bridges, highways, housing, hospitals, mass transportation, schools, streets, water and sewer works, gas, and electric utilities. They may also be issued to refund outstanding obligations, to obtain funds for general operating expenses, or to obtain funds to loan to other public institutions and facilities and in anticipation of the receipt of revenue or the issuance of other obligations.

The two principal classifications of municipal securities are "general obligation" securities and "limited obligation" or "revenue" securities. General obligation securities are secured by a municipal issuer's pledge of its full faith, credit, and taxing power for the payment of principal and interest. Accordingly, the capacity of the issuer of a general obligation bond to pay

interest and repay principal when due is affected by the issuer's maintenance of its tax base. Revenue securities are payable only from the revenues derived from a particular facility or class of facilities or, in some cases, from the proceeds of a special excise tax or other specific revenue source. Accordingly, the timely payment of interest and the repayment of principal in accordance with the terms of the revenue security is a function of the economic viability of the facility or revenue source. Revenue securities include private activity bonds which are not payable from the unrestricted revenues of the issuer. Consequently, the credit quality of private activity bonds is usually directly related to the credit standing of the corporate user of the facility involved. Municipal securities may also include "moral obligation" bonds, which are normally issued by special purpose public authorities. If the issuer of moral obligation bonds is unable to meet its debt service obligations from current revenues, it may draw on a reserve fund the restoration of which is a moral commitment but not a legal obligation of the state or municipality which created the issuer.

Private Activity Bonds. Private activity bonds are issued by or on behalf of public authorities to provide funds, usually through a loan or lease arrangement, to a private entity for the purpose of financing construction of privately operated industrial facilities, such as warehouse, office, plant and storage facilities and environmental and pollution control facilities. Such bonds are secured primarily by revenues derived from loan repayments or lease payments due from the entity, which may or may not be guaranteed by a parent company or otherwise secured. Private activity bonds generally are not secured by a pledge of the taxing power of the issuer of such bonds. Therefore, repayment of such bonds generally depends on the revenue of a private entity. The continued ability of an entity to generate sufficient revenues for the payment of principal and interest on such bonds will be affected by many factors, including the size of the entity, its capital structure, demand for its products or services, competition, general economic conditions, government regulation and the entity's dependence on revenues for the operation of the particular facility being financed.

Under U.S. federal income tax law, interest on municipal bonds issued after August 7, 1986 which are specified private activity bonds, and the proportionate share of any exempt-interest dividend paid by a regulated investment company that receives interest from such private activity bonds, will be treated as an item of tax preference for purposes of the AMT. For regular U.S. federal income tax purposes such interest is tax-exempt. Bonds issued in 2009 and 2010 generally will not be treated as private activity bonds, and interest earned on such bonds generally will not be treated as a tax preference item.

Industrial Development Bonds. Industrial development bonds ("IDBs") are issued by public authorities to obtain funds to provide financing for privately-operated facilities for business and manufacturing, housing, sports, convention or trade show facilities, airport, mass transit, port and parking facilities, air or water pollution control facilities, and certain facilities for water supply, gas, electricity or sewerage or solid waste disposal. Although IDBs are issued by municipal authorities, the payment of principal and interest on IDBs is dependent solely on the ability of the user of the facilities financed by the bonds to meet its financial obligations and the pledge, if any, of the real and personal property being financed as security for such payments. IDBs are considered municipal securities if the interest paid is exempt from regular U.S. federal income tax. Interest earned on IDBs may be subject to the AMT.

Tender Option Bonds. In a tender option bond ("TOB") transaction, a tender option bond trust ("TOB Trust") issues floating rate certificates ("TOB Floaters") and residual interest certificates ("TOB Residuals" also known as an "inverse floaters") and utilizes the proceeds of such issuance to purchase a bond, typically a fixed-rate municipal bond ("Fixed-Rate Bond"). The Fund may invest in both TOB Floaters and TOB Residuals. The Fund may purchase a TOB Residual in the secondary market or purchase a TOB Residual from a TOB Trust where the Fixed-Rate Bond held by the TOB Trust was either owned or identified by the Fund. The TOB Floaters typically have first priority on the cash flow from the Fixed-Rate Bond held by the trust, and the remaining cash flow, less certain expenses, is paid to holders of the TOB Residuals. Where the Fixed-Rate Bond held by the TOB Trust was either owned or identified by the Fund, the net proceeds of the sale of the TOB Floaters, after expenses, may be received by the Fund and may be invested in additional securities. This would generate economic leverage for the Fund.

TOB Residuals in which the Fund will invest will pay interest or income that, in the opinion of counsel to the applicable TOB Trust, is exempt from regular U.S. federal income tax. Neither the Fund, nor the Manager, nor the Subadviser will conduct its own analysis of the tax status of the interest or income paid by residual interest held by the Fund, but will rely on the opinion of counsel to the applicable TOB Trust. There is a risk that the Fund will not be considered the owner of a TOB for U.S. federal income tax purposes, and in that case it would not be entitled to treat such interest as exempt from U.S. federal income tax.

Typically, a liquidity provider is engaged to purchase the TOB Floaters at their original purchase price plus accrued interest upon the occurrence of certain events, such as the failure to remarket a certain percentage of the floating rate interests

in a timely fashion, the downgrading (but typically not below investment grade or in connection with events indicating that bankruptcy of the issuer may be likely) of the bonds held by the TOB Trust, or certain regulatory or tax events. A Fund participating in a TOB transaction will bear the fees paid to the liquidity provider for providing the put option to the holders of the TOB Floaters. If the liquidity provider acquires the TOB Floaters upon the occurrence of an event described above, the liquidity provider generally will be entitled to an in-kind distribution of the Fixed-Rate Bond held by the TOB Trust or to cause the TOB Trust to sell the securities and distribute the proceeds to the liquidity provider.

The TOB Trust may be collapsed without the consent of the Fund upon the occurrence of tender option termination events ("TOTEs") and mandatory termination events ("MTEs"), as defined in the TOB Trust agreements. TOTEs typically include the bankruptcy or default of the issuer of the Fixed-Rate Bonds held in the TOB Trust, a substantial downgrade in the credit quality of the issuer of the Fixed-Rate Bonds held in the TOB Trust, failure of any scheduled payment of principal or interest on the Fixed-Rate Bonds, and a judgment or ruling that interest on the Fixed-Rate Bonds is subject to U.S. federal income taxation. MTEs may include, among other things, a failed remarketing of the TOB Floaters, the inability of the TOB Trust to obtain renewal of the liquidity support agreement, and a substantial decline in the market value of the Fixed-Rate Bonds held in the TOB Trust. Upon the occurrence of a TOTE or an MTE, a TOB Trust would be liquidated with the proceeds applied first to any accrued fees owed to the trustee of the TOB Trust, the remarketing agent of the TOB Floaters and the liquidity provider. In the case of an MTE, after the payment of fees, the holders of the TOB Floaters would be paid senior to the TOB Residual holders. In contrast, generally in the case of a TOTE, after payment of fees, the holders of TOB Floaters and the TOB Residual holders would be paid pro rata in proportion to the respective face values of their certificates.

The Fund may invest in a TOB Trust on either a non-recourse and recourse basis. TOB Trusts are typically supported by a liquidity facility provided by a third-party bank or other financial institution (the "liquidity provider") that allows the holders of the TOB Floaters to tender their TOB Floaters in exchange for payment of par plus accrued interest on any business day (subject to the non-occurrence of a TOTE described above). Depending on the structure of the TOB Trust, the liquidity provider may purchase the tendered TOB Floaters, or the TOB Trust may draw upon a loan from the liquidity provider to purchase the tendered TOB Floaters.

When the Fund invests in TOB Trusts on a non-recourse basis, and the liquidity provider is required to make a payment under the liquidity facility, the liquidity provider will typically liquidate all or a portion of the fixed-income bonds held in the TOB Trust and then fund the balance, if any, of the amount owed under the liquidity facility over the liquidation proceeds (the "Liquidation Shortfall"). If the Fund invests in a TOB Trust on a recourse basis, it will typically enter into a reimbursement agreement with the liquidity provider pursuant to which the Fund is required to reimburse the liquidity provider the amount of any Liquidation Shortfall. As a result, if the Fund invests in a recourse TOB Trust, the Fund will bear the risk of loss with respect to any Liquidation Shortfall. The net economic effect of this agreement is to treat the Fund as though it had entered into a special type of reverse repurchase agreement pursuant to which the Fund is required to repurchase the municipal bonds or other securities upon the occurrence of certain events. Such an arrangement may expose the Fund to a risk of loss that exceeds its investment in the TOB and the residual interest income received by the Fund.

In a non-recourse transaction, the Fund does not expect to pay the liquidity provider in the event that it suffers a loss. However, the Fund might incur a loss if the liquidity provider liquidates the TOB Trust at an inopportune time. Even if a TOB transaction was entered into on a non-recourse basis, under certain circumstances it might be in the Fund's interest to later agree to a recourse arrangement in order to prevent the liquidity provider from terminating the TOB Trust at that time.

Transactions in the short-term floating rate interests of TOBs are generally facilitated by a remarketing agent for the TOB Trust, which sets an interest rate for the securities periodically, usually every 7-35 days. Holders of the floating rate securities usually have the right to require the TOB Trust or a specified third party acting as agent for the TOB Trust (such as the liquidity provider) to purchase the bonds, usually at par plus accrued interest, at a certain time or times prior to maturity or upon the occurrence of specified events or conditions. The put option or tender option right is typically available to the investor on a periodic (daily, weekly or monthly) basis. Typically, the put option is exercisable on dates on which the interest rate changes. A failure to remarket typically requires the liquidity provider to purchase the floating rate interests and in turn the liquidity provider may have recourse to the TOB Trust and to the Fund, as described above. A Fund participating in a TOB transaction will also bear the fees paid to the remarketing agent and/or tender agent for providing services to the TOB Trust.

If the Fund purchases all or a portion of the short-term floating rate securities sold by the TOB Trust, it is usually permitted to surrender those short-term floating rate securities together with a proportionate amount of residual interests to the trustee of the TOB Trust in exchange for a proportionate amount of the municipal bonds or other securities held by the TOB Trust.

In December 2013, U.S. regulators finalized rules implementing Section 619 (the "Volcker Rule") and Section 941 (the "Risk Retention Rules") of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), both of which place restrictions on TOB Trust sponsors and their participation in TOB transactions. TOB Trusts and related transactions are generally considered to be subject to the limitations of the Volcker Rule and, thus, may not be sponsored by a banking entity absent an applicable exemption. No exemption to the Volcker Rule exists that would allow covered banking entities to sponsor TOB Trusts in the same manner as they did prior to the Volcker Rule's compliance date in 2017.

In response to the Volcker Rule, industry participants developed alternative structures for TOB financings in which service providers are engaged to assist with establishing, structuring and sponsoring TOB Trusts. The service providers, such as administrators, liquidity providers, trustees and remarketing agents act at the direction of, and as agent of, the Fund holding residual interests of the TOB Trust. This new structure and any other strategies that may be developed to address the Volcker Rule may be more or less advantageous to the Fund than obtaining leverage through existing TOB transactions. In addition, the Fund, rather than a bank entity, may be the sponsor of the TOB Trust and undertakes certain responsibilities that previously belonged to the sponsor bank. Although the Fund may use third-party service providers to complete some of these additional responsibilities, being the sponsor of the TOB Trust may give rise to certain additional risks including compliance, securities law and operational risks.

The Risk Retention Rules, which took effect in 2016, require the sponsor of a TOB Trust to retain at least five percent of the credit risk of the underlying assets supporting the TOB Trust's underlying securities. The Risk Retention Rules may adversely affect the Fund's ability to engage in TOB Trust transactions or increase the costs of such transactions in certain circumstances. Other accounts managed by the Subadviser may contribute bonds to a TOB Trust into which the Fund has contributed bonds. If multiple accounts/funds managed by the Subadviser participate in the same TOB Trust, the economic rights and obligations under the TOB Residual will generally be shared among the funds/accounts ratably in proportion to their participation in the TOB Trust.

Separately, the Fund will treat reverse repurchase agreements and similar financing transactions, including TOB Trust transactions, either (i) consistently with Section 18 of the 1940 Act, by maintaining asset coverage of at least 300% of the value of such transactions or (ii) as derivatives transactions for purposes of Rule 18f-4, including, as applicable, the value-at-risk based limit on leverage risk.

Municipal Leases. Municipal leases or installment purchase contracts are issued by a U.S. state or local government to acquire equipment or facilities. Municipal leases frequently have special risks not normally associated with general obligation bonds or revenue bonds. Many leases include "non-appropriation" clauses that provide that the governmental issuer has no obligation to make future payments under the lease or contract unless money is appropriated for such purpose by the appropriate legislative body on a yearly or other periodic basis. Although the obligations are typically secured by the leased equipment or facilities, the disposition of the property in the event of non-appropriation or foreclosure might, in some cases, prove difficult or, if sold, may not fully cover the Fund's exposure.

Participation Interests. Tax-exempt participation interests in municipal obligations (such as private activity bonds and municipal lease obligations) are typically issued by a financial institution. A participation interest gives the Fund an undivided interest in the municipal obligation in the proportion that the Fund's participation interest bears to the total principal amount of the municipal obligation. Participation interests in municipal obligations may be backed by an irrevocable letter of credit or guarantee of, or a right to put to, a bank (which may be the bank issuing the participation interest, a bank issuing a confirming letter of credit to that of the issuing bank, or a bank serving as agent of the issuing bank with respect to the possible repurchase of the participation interest) or insurance policy of an insurance company. The Fund has the right to sell the participation interest back to the institution or draw on the letter of credit or insurance after a specified period of notice, for all or any part of the full principal amount of the Fund's participation in the security, plus accrued interest.

Issuers of participation interests will retain a service and letter of credit fee and a fee for providing the liquidity feature, in an amount equal to the excess of the interest paid on the instruments over the negotiated yield at which the participations were purchased on behalf of the Fund. The issuer of the participation interest may bear the cost of insurance

backing the participation interest, although the Fund may also purchase insurance, in which case the cost of insurance will be an expense of the Fund. Participation interests may be sold prior to maturity. Participation interests may include municipal lease obligations. Purchase of a participation interest may involve the risk that the Fund will not be deemed to be the owner of the underlying municipal obligation for purposes of the ability to claim tax exemption of interest paid on that municipal obligation.

Municipal Notes. There are four major varieties of municipal notes: Tax and Revenue Anticipation Notes ("TRANs"); Tax Anticipation Notes ("TANs"); Revenue Anticipation Notes ("RANs"); and Bond Anticipation Notes ("BANs"). TRANs, TANs and RANs are issued by U.S. states, municipalities and other tax-exempt issuers to finance short-term cash needs or, occasionally, to finance construction. Many TRANs, TANs and RANs are general obligations of the issuing entity payable from taxes or designated revenues, respectively, expected to be received within the related fiscal period. BANs are issued with the expectation that their principal and interest will be paid out of proceeds from renewal notes or bonds to be issued prior to the maturity of the BANs. BANs are issued most frequently by both general obligation and revenue bond issuers usually to finance such items as land acquisition, facility acquisition and/or construction and capital improvement projects.

Tax-Exempt Commercial Paper. Tax-exempt commercial paper is a short-term obligation with a stated maturity of 270 days or less. It is issued by state and local governments or their agencies to finance seasonal working capital needs or as short-term financing in anticipation of longer term financing. Although tax-exempt commercial paper is intended to be repaid from general revenues or refinanced, it frequently is backed by a letter of credit, lending arrangement, note repurchase agreement or other credit facility agreement offered by a bank or financial institution.

Demand Instruments. Municipal bonds may be issued as floating- or variable-rate securities subject to demand features ("demand instruments"). Demand instruments usually have a stated maturity of more than one year but contain a demand feature (or "put") that enables the holder to redeem the investment. Variable-rate demand instruments provide for automatic establishment of a new interest rate on set dates. Floating-rate demand instruments provide for automatic adjustment of interest rates whenever a specified interest rate (e.g., the prime rate) changes.

These floating and variable rate instruments are payable upon a specified period of notice which may range from one day up to one year. The terms of the instruments provide that interest rates are adjustable at intervals ranging from daily to up to one year and the adjustments are based upon the prime rate of a bank or other appropriate interest rate adjustment index as provided in the respective instruments. Variable rate instruments include participation interests in variable- or fixed-rate municipal obligations owned by a bank, insurance company or other financial institution or affiliated organizations. Although the rate of the underlying municipal obligations may be fixed, the terms of the participation interest may result in the Fund receiving a variable rate on its investment.

Because of the variable nature of the instruments when prevailing interest rates decline, the yield on these instruments generally will decline. On the other hand, during periods when prevailing interest rates increase, the yield on these instruments generally will increase and the instruments will have less risk of capital depreciation than instruments bearing a fixed rate of return.

Stand-By Commitments. Under a stand-by commitment a dealer agrees to purchase, at the Fund's option, specified municipal obligations held by the Fund at a specified price and, in this respect, stand-by commitments are comparable to put options. A stand-by commitment entitles the holder to achieve same day settlement and to receive an exercise price equal to the amortized cost of the underlying security plus accrued interest, if any, at the time of exercise. The Fund will be subject to credit risk with respect to an institution providing a stand-by commitment and a decline in the credit quality of the institution could cause losses to the Fund.

The Fund will generally acquire stand-by commitments to facilitate fund liquidity. The cost of entering into stand-by commitments will increase the cost of the underlying municipal obligation and similarly will decrease such security's yield to investors. Gains, if any, realized in connection with stand-by commitments will be taxable.

Taxable Municipal Obligations. The market for U.S. taxable municipal obligations is relatively small, which may result in a lack of liquidity and in price volatility of those securities. Interest on taxable municipal obligations is includable in gross income for regular U.S. federal income tax purposes. While interest on taxable municipal obligations may be exempt from personal taxes imposed by the U.S. state within which the obligation is issued, such interest will nevertheless generally be subject to all other U.S. state and local income and franchise taxes.

Additional Risks Relating to Municipal Securities

Tax Risk. The Code imposes certain continuing requirements on issuers of tax-exempt bonds regarding the use, expenditure and investment of bond proceeds and the payment of rebates to the U.S. government. Failure by the issuer to comply after the issuance of tax-exempt bonds with certain of these requirements could cause interest on the bonds to become includable in gross income retroactive to the date of issuance.

From time to time, proposals have been introduced before the U.S. Congress for the purpose of restricting or eliminating the U.S. federal income tax exemption for interest on municipal obligations. In this regard, for bonds issued after December 31, 2017, the tax-advantaged treatment previously available to "tax credit bonds" and "advance refunding bonds" is no longer available. Further, similar proposals may be introduced in the future. In addition, the U.S. federal income tax exemption has been, and may in the future be, the subject of litigation. If one of these proposals were enacted, or if any such litigation were adversely decided, the availability of tax-exempt obligations for investment by the Fund and the value of the Fund's investments could be affected.

Opinions relating to the validity of municipal obligations and to the exclusion of interest thereon from gross income for regular U.S. federal and/or state income tax purposes are rendered by bond counsel to the respective issuers at the time of issuance. The Fund and its service providers will rely on such opinions and will not review the proceedings relating to the issuance of municipal obligations or the bases for such opinions.

Information Risk. Information about the financial condition of issuers of municipal obligations may be less available than about corporations whose securities are publicly traded.

U.S. State and Federal Law Risk. Municipal obligations are subject to the provisions of bankruptcy, insolvency and other laws affecting the rights and remedies of creditors, such as the U.S. federal Bankruptcy Code, and laws, if any, that may be enacted by the U.S. Congress or state legislatures extending the time for payment of principal or interest, or both, or imposing other constraints upon enforcement of such obligations or upon the ability of municipalities to levy taxes. There is also the possibility that, as a result of litigation or other conditions, the power or ability of any one or more issuers to pay, when due, the principal of and interest on its or their municipal obligations may be materially affected.

Market and Ratings Risk. The yields on municipal obligations are dependent on a variety of factors, including economic and monetary conditions, general market conditions, supply and demand, general conditions of the municipal market, size of a particular offering, the maturity of the obligation and the rating of the issue. Adverse economic, business, legal or political developments might affect all or substantial portions of the Fund's municipal obligations in the same manner.

Unfavorable developments in any economic sector may have far-reaching ramifications for the municipal market overall or any state's municipal market. Although the ratings of tax-exempt securities by ratings agencies are relative and subjective, and are not absolute standards of quality, such ratings reflect the assessment of the ratings agency, at the time of issuance of the rating, of the economic viability of the issuer of a general obligation bond or, with respect to a revenue bond, the special revenue source, with respect to the timely payment of interest and the repayment of principal in accordance with the terms of the obligation, but do not reflect an assessment of the market value of the obligation. See Appendix B for additional information regarding ratings. Consequently, municipal obligations with the same maturity, coupon and rating may have different yields when purchased in the open market, while municipal obligations of the same maturity and coupon with different ratings may have the same yield.

Risks Associated with Sources of Liquidity or Credit Support. Issuers of municipal obligations may employ various forms of credit and liquidity enhancements, including letters of credit, guarantees, swaps, puts and demand features, and insurance, provided by U.S. or non-U.S. entities such as banks and other financial institutions. Changes in the credit quality of the entities providing the enhancement could affect the value of the securities or the Fund's share price. U.S. banks and certain financial institutions are subject to extensive governmental regulation which may limit both the amounts and types of loans and other financial commitments which may be made and interest rates and fees which may be charged. Non-U.S. banks and financial institutions may be less regulated than their U.S. counterparts and may be subject to additional risks, such as those relating to foreign economic and political developments and foreign governmental restrictions. The profitability of the banking industry is largely dependent upon the availability and cost of capital for the purpose of financing lending operations under prevailing money market conditions. Also, general economic conditions play an important part in the operation of the banking

industry, and exposure to credit losses arising from possible financial difficulties of borrowers might affect a bank's ability to meet its obligations under a letter of credit.

Other. Securities may be sold in anticipation of a market decline (a rise in interest rates) or purchased in anticipation of a market rise (a decline in interest rates). In addition, a security may be sold and another purchased at approximately the same time to take advantage of what the portfolio manager believes to be a temporary disparity in the normal yield relationship between the two securities. In general, the secondary market for tax-exempt securities in the Fund's portfolio may have lower liquidity than that for taxable fixed income securities. Accordingly, the ability of the Fund to make purchases and sales of securities in the foregoing manner may be limited. Yield disparities may occur for reasons not directly related to the investment quality of particular issues or the general movement of interest rates, but instead due to such factors as changes in the overall demand for or supply of various types of tax-exempt securities or changes in the investment objectives of investors.

Risks Inherent in an Investment in Different Types of Municipal Securities

General Obligation Bonds. General obligation bonds are backed by the issuer's pledge of its full faith, credit and taxing power for the payment of principal and interest. However, the taxing power of any governmental entity may be limited by provisions of state constitutions or laws and an entity's credit will depend on many factors. Some such factors are the entity's tax base, the extent to which the entity relies on federal or state aid, and other factors which are beyond the entity's control.

Industrial Development Revenue Bonds ("IDRs"). IDRs are tax-exempt securities issued by states, municipalities, public authorities or similar entities to finance the cost of acquiring, constructing or improving various projects. These projects are usually operated by corporate entities. IDRs are not general obligations of governmental entities backed by their taxing power. Issuers are only obligated to pay amounts due on the IDRs to the extent that funds are available from the unexpended proceeds of the IDRs or receipts or revenues of the issuer. Payment of IDRs is solely dependent upon the creditworthiness of the corporate operator of the project or corporate guarantor. Such corporate operators or guarantors that are industrial companies may be affected by many factors, which may have an adverse impact on the credit quality of the particular company or industry.

Hospital and Health Care Facility Bonds. The ability of hospitals and other health care facilities to meet their obligations with respect to revenue bonds issued on their behalf is dependent on various factors. Some such factors are the level of payments received from private third-party payors and government programs and the cost of providing health care services, as well as competition from other health care facilities and providers. There can be no assurance that payments under governmental programs will be sufficient to cover the costs associated with their bonds. It also may be necessary for a hospital or other health care facility to incur substantial capital expenditures or increased operating expenses to effect changes in its facilities, equipment, personnel and services. Hospitals and other health care facilities are additionally subject to claims and legal actions by patients and others in the ordinary course of business. There can be no assurance that a claim will not exceed the insurance coverage of a health care facility or that insurance coverage will be available to a facility.

Single Family and Multi-Family Housing Bonds. Multi-family housing revenue bonds and single family mortgage revenue bonds are state and local housing issues that have been issued to provide financing for various housing projects. Multi-family housing revenue bonds are payable primarily from mortgage loans to housing projects for low to moderate income families. Single-family mortgage revenue bonds are issued for the purpose of acquiring notes secured by mortgages on residences. The ability of housing issuers to make debt service payments on their obligations may be affected by various economic and non-economic factors. Such factors include: occupancy levels, adequate rental income in multi-family projects, the rate of default on mortgage loans underlying single family issues and the ability of mortgage insurers to pay claims. All single-family mortgage revenue bonds and certain multi-family housing revenue bonds are prepayable over the life of the underlying mortgage or mortgage pool. Therefore, the average life of housing obligations cannot be determined. However, the average life of these obligations will ordinarily be less than their stated maturities. Mortgage loans are frequently partially or completely prepaid prior to their final stated maturities.

Power Facility Bonds. The ability of utilities to meet their obligations with respect to bonds they issue is dependent on various factors. These factors include the rates that they may charge their customers, the demand for a utility's services and the cost of providing those services. Utilities are also subject to extensive regulations relating to the rates which they may charge customers. Utilities can experience regulatory, political and consumer resistance to rate increases. Utilities engaged in long-term capital projects are especially sensitive to regulatory lags in granting rate increases. Utilities are additionally subject to increased costs due to governmental environmental regulation and decreased profits due to increasing competition. Any difficulty

in obtaining timely and adequate rate increases could adversely affect a utility's results of operations. The portfolio manager cannot predict with certainty the effect of such factors on the ability of issuers to meet their obligations with respect to bonds.

Water and Sewer Revenue Bonds. Water and sewer bonds are generally payable from user fees. The ability of state and local water and sewer authorities to meet their obligations may be affected by a number of factors. Some such factors are the failure of municipalities to utilize fully the facilities constructed by these authorities, declines in revenue from user charges, rising construction and maintenance costs, impact of environmental requirements, the difficulty of obtaining or discovering new supplies of fresh water, the effect of conservation programs, the impact of "no growth" zoning ordinances and the continued availability of federal and state financial assistance and of municipal bond insurance for future bond issues.

University and College Bonds. The ability of universities and colleges to meet their obligations is dependent upon various factors. Some of these factors of which an investor should be aware are the size and diversity of their sources of revenues, enrollment, reputation, management expertise, the availability and restrictions on the use of endowments and other funds and the quality and maintenance costs of campus facilities. Also, in the case of public institutions, the financial condition of the relevant state or other governmental entity and its policies with respect to education may affect an institution's ability to make payments on its own.

Lease Rental Bonds. Lease rental bonds are predominantly issued by governmental authorities that have no taxing power or other means of directly raising revenues. Rather, the authorities are financing vehicles created solely for the construction of buildings or the purchase of equipment that will be used by a state or local government. Thus, the bonds are subject to the ability and willingness of the lessee government to meet its lease rental payments, which include debt service on the bonds. Lease rental bonds are subject to the risk that the lessee government is not legally obligated to budget and appropriate for the rental payments beyond the current fiscal year. These bonds are also subject to the risk of abatement in many states as rents cease in the event that damage, destruction or condemnation of the project prevents its use by the lessee. Also, in the event of default by the lessee government, there may be significant legal and/or practical difficulties involved in the reletting or sale of the project.

Capital Improvement Facility Bonds. Capital improvement bonds are bonds issued to provide funds to assist political subdivisions or agencies of a state through acquisition of the underlying debt of a state or local political subdivision or agency. The risks of an investment in such bonds include the risk of possible prepayment or failure of payment of proceeds on and default of the underlying debt.

Solid Waste Disposal Bonds. Bonds issued for solid waste disposal facilities are generally payable from tipping fees and from revenues that may be earned by the facility on the sale of electrical energy generated in the combustion of waste products. The ability of solid waste disposal facilities to meet their obligations depends upon the continued use of the facility, the successful and efficient operation of the facility and, in the case of waste-to-energy facilities, the continued ability of the facility to generate electricity on a commercial basis. Also, increasing environmental regulation on the federal, state and local level has a significant impact on waste disposal facilities. While regulation requires more waste producers to use waste disposal facilities, it also imposes significant costs on the facilities.

Moral Obligation Bonds. A moral obligation bond is a type of revenue bond issued by a state or municipality pursuant to legislation authorizing the establishment of a reserve fund to pay principal and interest payments if the issuer is unable to meet its obligations. The establishment of such a reserve fund generally requires appropriation by the state legislature, which is not legally required. Accordingly, the establishment of a reserve fund is generally considered a moral commitment but not a legal obligation of the state or municipality that created the issuer.

Pre-Refunded Bonds. Pre-refunded bonds are typically secured by direct obligations of the U.S. government, or in some cases obligations guaranteed by the U.S. government, placed in an escrow account maintained by an independent trustee until maturity or a predetermined redemption date. These obligations are generally non-callable prior to maturity or the predetermined redemption date. In a few isolated instances to date, however, bonds which were thought to be escrowed to maturity have been called for redemption prior to maturity. For credit ratings purposes, pre-refunded bonds are deemed to be unrated. The Subadviser determines the credit quality of pre-refunded bonds based on the quality of the escrowed collateral and such other factors as the Subadviser deems appropriate.

Airport, Port and Highway Revenue Bonds. Certain facility revenue bonds are payable from and secured by the revenue from the ownership and operation of particular facilities, such as airports, highways and port authorities. Airport operating income may be affected by the ability of airlines to meet their obligations under the agreements with airports. Similarly, payment on bonds related to other facilities is dependent on revenues from the projects, such as use fees from ports, tolls on turnpikes and bridges and rents from buildings. Therefore, payment may be adversely affected by reduction in revenues due to such factors and increased cost of maintenance or decreased use of a facility. The portfolio manager cannot predict what effect conditions may have on revenues which are required for payment on these bonds.

Special Tax Bonds. Special tax bonds are payable from and secured by the revenues derived by a municipality from a particular tax. Examples of such special taxes are a tax on the rental of a hotel room, the purchase of food and beverages, the rental of automobiles or the consumption of liquor. Special tax bonds are not secured by the general tax revenues of the municipality, and they do not represent general obligations of the municipality. Therefore, payment on special tax bonds may be adversely affected by a reduction in revenues realized from the underlying special tax. Also, should spending on the particular goods or services that are subject to the special tax decline, the municipality may be under no obligation to increase the rate of the special tax to ensure that sufficient revenues are raised from the shrinking taxable base.

Tax Allocation Bonds. Tax allocation bonds are typically secured by incremental tax revenues collected on property within the areas where redevelopment projects financed by bond proceeds are located. Such payments are expected to be made from projected increases in tax revenues derived from higher assessed values of property resulting from development in the particular project area and not from an increase in tax rates. Special risk considerations include: reduction of, or a less than anticipated increase in, taxable values of property in the project area; successful appeals by property owners of assessed valuations; substantial delinquencies in the payment of property taxes; or imposition of any constitutional or legislative property tax rate decrease.

Tobacco Settlement Revenue Bonds. Tobacco settlement revenue bonds are secured by a state or local government's proportionate share in the Master Settlement Agreement ("MSA"). The MSA is an agreement, reached out of court in November 1998 between the attorneys general of 46 states (Florida, Minnesota, Mississippi and Texas all settled independently) and six other U.S. jurisdictions (including the District of Columbia, Puerto Rico and Guam), and the four largest U.S. tobacco manufacturers at that time (Philip Morris, RJ Reynolds, Brown & Williamson, and Lorillard). Subsequently, smaller tobacco manufacturers signed on to the MSA. The MSA basically provides for payments annually by the manufacturers to the states and jurisdictions in perpetuity, in exchange for releases of all claims against the manufacturers and a pledge of no further litigation. The MSA established a base payment schedule and a formula for adjusting payments each year. Manufacturers pay into a master escrow trust based on their market share, and each state receives a fixed percentage of the payment as set forth in the MSA. Annual payments are highly dependent on annual U.S. cigarette shipments and inflation, as well as several other factors. As a result, payments made by tobacco manufacturers could be reduced if there is a decrease in tobacco consumption over time. A market share loss by the MSA companies to non-MSA participating manufacturers would also cause a downward adjustment in the payment amounts. A participating manufacturer filing for bankruptcy could cause delays or reductions in bond payments.

Certain tobacco settlement revenue bonds are issued with "turbo" redemption features. Under this turbo structure, all available excess revenues are applied as an early redemption to the designated first turbo maturity until it is completely repaid, and then to the next turbo maturity until paid in full, and so on. The result is that the returned principal creates an average maturity that could be much shorter than the legal final maturity.

Transit Authority Bonds. Mass transit is generally not self-supporting from fare revenues. Therefore, additional financial resources must be made available to ensure operation of mass transit systems as well as the timely payment of debt service. Often such financial resources include federal and state subsidies, lease rentals paid by funds of the state or local government or a pledge of a special tax. If fare revenues or the additional financial resources do not increase appropriately to pay for rising operating expenses, the ability of the issuer to adequately service the debt may be adversely affected.

Convention Facility Bonds. Bonds in the convention facilities category include special limited obligation securities issued to finance convention and sports facilities payable from rental payments and annual governmental appropriations. The governmental agency is not obligated to make payments in any year in which the monies have not been appropriated to make such payments. In addition, these facilities are limited use facilities that may not be used for purposes other than as convention centers or sports facilities.

Correctional Facility Bonds. Bonds in the correctional facilities category include special limited obligation securities issued to construct, rehabilitate and purchase correctional facilities payable from governmental rental payments and/or appropriations. An issuer's ability to pay its lease obligations under these bonds could be adversely affected by a number of factors, including insufficient occupancy rates, unanticipated costs (such as legal claims), or the reduction or discontinuation of legislative appropriations.

Land-Secured or "Dirt" Bonds. Land-secured or "dirt" bonds are issued in connection with special taxing districts that are organized to plan and finance infrastructure development to induce residential, commercial and industrial growth and redevelopment. Obligations under these bonds are generally payable solely from taxes (using methods such as tax assessments, special taxes or tax increment financing) or other revenues attributable to the specific projects financed by the bonds, without recourse to the credit or taxing power of related or overlapping municipalities. The projects to which these bonds relate often are exposed to real estate development-related risks, such as the failure of property development, unavailability of financing, extended vacancies of properties, increased competition, limitations on rents, changes in neighborhood values, lessening demand for properties, and changes in interest rates. These real estate risks may be heightened if a project is subject to foreclosure and, in that event, the Fund, as a holder of the bonds, might be required to pay certain maintenance or operating expenses or taxes relating to the project. In addition, the bonds financing these projects may have more taxpayer concentration risk than general tax-supported bonds. Further, the fees, special taxes, or tax allocations and other revenues that are established to secure such financings generally are limited as to the rate or amount that may be levied or assessed and are not subject to increase pursuant to rate covenants or municipal or corporate guarantees. The bonds could default if a development fails to progress as anticipated or if taxpayers fail to pay the assessments, fees and taxes as provided in the financing plans of the projects.

New Jersey Municipal Obligations

Payment of interest and preservation of principal is dependent upon the continuing ability of New Jersey issuers and/or obligors of state, municipal and public authority debt obligations to meet their obligations thereunder.

There can be no assurance that current or future economic difficulties in the United States or New Jersey and the resulting impact on the state will not adversely affect the market value of New Jersey municipal obligations held by the Fund or the ability of particular issuers to make timely payments of debt service on these obligations. It should also be noted that the fiscal condition and creditworthiness of the state may not have a direct relationship to the fiscal condition or creditworthiness of other issuers or obligors of New Jersey municipal obligations. There is no obligation on the part of the state to make payments on those securities in the event of default.

For further information concerning the economy of New Jersey, see Appendix C to this SAI. The summary set forth above and in Appendix C is included for the purpose of providing a general description of the State of New Jersey's credit and financial conditions, is based on information from statements of issuers of New Jersey municipal obligations, and does not purport to be complete. The Fund is not responsible for the accuracy, completeness or timeliness of this information.

New York Municipal Obligations

Payment of interest and preservation of principal is dependent upon the continuing ability of New York issuers and/or obligors of state, municipal and public authority debt obligations to meet their obligations thereunder.

There can be no assurance that current or future economic difficulties in the United States or New York and the resulting impact on the state will not adversely affect the market value of New York municipal obligations held by the Fund or the ability of particular issuers to make timely payments of debt service on these obligations. It should also be noted that the fiscal condition and creditworthiness of the state may not have a direct relationship to the fiscal condition or creditworthiness of other issuers or obligors of New York municipal obligations. There is no obligation on the part of the state to make payments on those securities in the event of default.

For further information concerning the economy of New York, see Appendix D to this SAI. The summary set forth above and in Appendix D is included for the purpose of providing a general description of the State of New York's credit and financial conditions, is based on information from statements of issuers of New York municipal obligations, and does not purport to be complete. The Fund is not responsible for the accuracy, completeness or timeliness of this information.

Pennsylvania Municipal Obligations

Payment of interest and preservation of principal is dependent upon the continuing ability of Pennsylvania issuers and/or obligors of state, municipal and public authority debt obligations to meet their obligations thereunder.

There can be no assurance that current or future economic difficulties in the United States or Pennsylvania and the resulting impact on the commonwealth will not adversely affect the market value of Pennsylvania municipal obligations held by the Fund or the ability of particular issuers to make timely payments of debt service on these obligations. It should also be noted that the fiscal condition and creditworthiness of the commonwealth may not have a direct relationship to the fiscal condition or creditworthiness of other issuers or obligors of Pennsylvania municipal obligations. There is no obligation on the part of the commonwealth to make payments on those securities in the event of default.

For further information concerning the economy of Pennsylvania, see Appendix E to this SAI. The summary set forth above and in Appendix E is included for the purpose of providing a general description of the Commonwealth of Pennsylvania's credit and financial conditions, is based on information from statements of issuers of Pennsylvania municipal obligations, and does not purport to be complete. The Fund is not responsible for the accuracy, completeness or timeliness of this information.

Municipal Obligations of Other U.S. Territories

Municipal securities include the obligations of the governments of Puerto Rico and other U.S. territories and their political subdivisions (such as the U.S. Virgin Islands and Guam). Payment of interest and preservation of principal is dependent upon the continuing ability of such issuers and/or obligors of territorial, municipal and public authority debt obligations to meet their obligations thereunder. The sources of payment for such obligations and the marketability thereof may be affected by financial and other difficulties experienced by such issuers.

Puerto Rico. Municipal securities of issuers located in the Commonwealth of Puerto Rico may be affected by political, social and economic conditions in Puerto Rico. Puerto Rico's economy has been in a recession since late 2006, which has contributed to a steep increase in unemployment rates, funding shortfalls of state employees' retirement systems, a budget deficit resulting from a structural imbalance, and reduced government revenues. In May 2017, Puerto Rico made a filing in the U.S. District Court in Puerto Rico to commence a debt restructuring process similar to that of a traditional municipal bankruptcy. Puerto Rico had previously defaulted on certain agency debt payments and the Governor had warned of its inability to meet additional pending obligations, including under general obligation bonds.

On March 15, 2022, Puerto Rico's government formally exited bankruptcy, completing the largest public debt restructuring in U.S. history. Puerto Rico's debt restructuring plan was approved by a federal judge in January 2022, and reduced claims against Puerto Rico's general obligation bonds from $33 billion to just over $7.4 billion. The restructuring did not resolve the bankruptcy proceedings for Puerto Rico's Electric Power Authority ("PREPA"), which owed nearly $9 billion, the largest debt of any government agency. Since 2024, multiple amended restructuring proposals for PREPA have been filed, and negotiations have involved ongoing litigation among creditors, the Puerto Rico Oversight Board and other stakeholders. In March 2025, the Oversight Board filed its Fifth Amended Plan of Adjustment, seeking to cut PREPA's debt by nearly 80%, a plan which is heavily disputed by some bondholders. The PREPA restructuring remains unresolved and the timing and outcome remain uncertain. The continued debt restructuring process could adversely affect the value of Puerto Rico municipal securities, including Puerto Rico municipal securities that are not subject to the debt restructuring process. In addition, Puerto Rico municipal securities remain subject to all of the other risks applicable to fixed income securities, including the risk of non-payment. To the extent that the Fund holds any Puerto Rico municipal securities, the Fund may lose some or all of the value of those investments.

In addition, Puerto Rico has faced significant out-migration relating to its economic difficulties, eroding the Commonwealth's economic base and creating additional further uncertainty regarding its ability to meet its future repayment obligations. The Puerto Rican constitution prioritizes general obligation bonds over revenue bonds, so that all tax revenues, even those pledged to revenue bondholders, can be applied first to general obligation bonds and other Commonwealth-guaranteed debt if other revenues are insufficient to satisfy such obligations.

The following is a brief summary of certain factors affecting Puerto Rico's economy and does not purport to be a complete description of such factors.

The dominant sectors of the Puerto Rico economy are manufacturing and services. The manufacturing sector has undergone fundamental changes over the years as a result of increased emphasis on higher wage, high technology industries,

such as pharmaceuticals, biotechnology, computers, microprocessors, professional and scientific instruments, and certain high technology machinery and equipment. The services sector, including finance, insurance, real estate, wholesale and retail trade, transportation, communications and public utilities and other services, also plays a major role in the economy. It ranks second only to manufacturing in contribution to the gross domestic product and leads all sectors in providing employment.

Most external factors that affect the Puerto Rico economy are determined by the policies and performance of the United States. These external factors include exports, direct investment, the amount of federal transfer payments, the level of interest rates, the rate of inflation, and tourist expenditures.

Guam. General obligations and/or revenue bonds of issuers located in Guam may be affected by political, social and economic conditions in Guam. The following is a brief summary of factors affecting the economy of Guam and does not purport to be a complete description of such factors.

Guam, the westernmost territory of the U.S., is located 3,800 miles to the west-southwest of Honolulu, Hawaii and approximately 1,550 miles south-southeast of Tokyo, Japan. The population of Guam was estimated to be 170,185 in July 2026. Guam's unemployment rate was at 3.4% as of March 2026.

Guam's economy depends in large measure on tourism and the U.S. military presence, each of which is subject to uncertainties as a result of global economic, social and political events. Tourism, particularly from Japan, which has been a source of a majority of visitors to Guam, represents the primary source of income for Guam's economy. A weak economy, war, severe weather, epidemic outbreaks or the threat of terrorist activity, among other influences that are beyond Guam's control, can adversely affect its tourism industry. Guam is also exposed to periodic typhoons, tropical storms, super typhoons and earthquakes, such as the Super Typhoon Mawar in May 2023, which caused widespread damage and disruptions across the island. The U.S. military presence also affects economic activity on Guam in various ways and recently has been a positive contributor to the economy. The U.S. Department of Defense recently opened a third U.S. military base in Guam. Nevertheless, economic, geopolitical, and other influences which are beyond Guam's control could cause the U.S. military to reduce its existing presence on Guam or forgo any planned enhancements to its presence on Guam. Any reduction in tourism or the U.S. military presence could adversely affect Guam's economy.

United States Virgin Islands. General obligations and/or revenue bonds of issuers located in the U.S. Virgin Islands may be affected by political, social and economic conditions in the U.S. Virgin Islands. The territory has experienced high levels of debt, increasing pension obligations and a declining population. The credit rating of certain bonds issued by the territory are rated below investment grade due to a perceived increased possibility that the territory may be forced to restructure its debts to address its financial problems.

In September 2017, the territory was hit by two hurricanes within the span of two weeks. Together, the hurricanes caused significant damage to the most populated islands, including to their infrastructure, hospitals, homes and other structures.

The following is a brief summary of factors affecting the economy of the U.S. Virgin Islands and does not purport to be a complete description of such factors.

The U.S. Virgin Islands consists of four main islands: St. Croix, St. Thomas, St. John, and Water Island and approximately 70 smaller islands, islets and cays. The total land area is about twice the size of Washington, D.C.

The U.S. Virgin Islands is located 60 miles east of Puerto Rico and 1,075 miles south of Miami, Florida in the Caribbean Sea and the Atlantic Ocean. The population of the U.S. Virgin Islands was estimated to be 83,400 in July 2026.

Tourism, trade, and other services, including manufacturing (rum distilling, watch assembly, pharmaceuticals, and electronics), are the primary economic activities, accounting for a substantial portion of the Virgin Islands' gross domestic product and civilian employment. The agricultural sector is small, with most of the islands' food being imported. A weak economy, severe weather, war, epidemic outbreaks or the threat of terrorist activity, among other influences that are beyond the control of the territory, can adversely affect its tourism and other industries. The COVID-19 pandemic has also had a significant effect on the tourism industry in the Virgin Islands. The coastal and marine communities of the U.S. Virgin Islands are susceptible to climate change, including warming water temperatures, increasing storm intensity, beach erosion, ocean acidification, increasing hazardous coastal conditions, and loss of life-sustaining marine, coastal and island resources. Climate change is anticipated to add to the stresses of coastal environments by altering temperatures and precipitation patterns, increasing the likelihood of extreme precipitation events, and accelerating rates of sea level rise.

Ratings as Investment Criteria

In general, the ratings of NRSROs represent the opinions of these agencies as to the quality of securities that they rate. Such ratings, however, are relative and subjective, are not absolute standards of quality and do not evaluate the market value risk of the securities. These ratings will be used by the Fund as initial criteria for the selection of portfolio securities, but the Fund also will rely upon the independent advice of the portfolio manager to evaluate potential investments. Among the factors that will be considered are the long-term ability of the issuer to pay principal and interest and general economic trends. Appendix B to this SAI contains further information concerning the rating categories of NRSROs and their significance.

If a security is rated by multiple NRSROs and receives different ratings, the Fund will treat the security as being rated in the highest rating category received from a NRSRO.

If, after purchase, the credit rating on a security is downgraded or the credit quality deteriorates, or if the maturity is extended, the Subadviser will decide whether the security should be held or sold. Upon the occurrence of certain triggering events, such as a corporate transaction affecting a security held by the Fund, or defaults on a security held by the Fund, or if an obligor of such a security has difficulty meeting its obligations, the Fund may elect to participate in an exchange offer, consent solicitation, restructuring or similar transaction and obtain a new or restructured security or underlying assets. In that case, the Fund may become the holder of securities that it could not otherwise purchase at a time when those assets may be difficult to sell or can be sold only at a loss.

Redemption Risk

The Fund may experience periods of heavy redemptions that could cause the Fund to liquidate its assets at inopportune times or at a loss or depressed value, particularly during periods of declining or illiquid markets. Redemption risk is greater to the extent that the Fund has investors with large shareholdings, short investment horizons, or unpredictable cash flow needs. In addition, redemption risk is heightened during periods of overall market turmoil. The redemption by one or more large shareholders of their holdings in the Fund could hurt performance and/or cause the remaining shareholders in the Fund to lose money. The Fund's redemption risk is increased if one decision maker has control of fund shares owned by separate fund shareholders, including clients or affiliates of the Fund's Manager. If the Fund is forced to liquidate its assets under unfavorable conditions or at inopportune times, the value of your investment could decline.

Repurchase Agreements

Under the terms of a typical repurchase agreement, the Fund would acquire one or more underlying debt securities from a counterparty (typically a bank or a broker-dealer), subject to the counterparty's obligation to repurchase, and the Fund to resell, the securities at an agreed-upon time and price. The Fund may enter into repurchase agreements where the underlying collateral consists entirely of cash items and/or securities of the U.S. Government, its agencies, its instrumentalities, or U.S. Government sponsored enterprises. The Fund may also enter into repurchase agreements where the underlying collateral consists of other types of securities, including securities the Fund could not purchase directly. For such repurchase agreements, the underlying securities which serve as collateral may include, but are not limited to, U.S. government securities, municipal securities, corporate debt obligations, asset-backed securities (including collateralized mortgage obligations ("CMOs")), convertible securities and common and preferred stock and may be of below investment grade quality. The repurchase price is typically greater than the purchase price paid by the Fund, thereby determining the Fund's yield. A repurchase agreement is similar to, and may be treated as, a secured loan, where the Fund loans cash to the counterparty and the loan is secured by the underlying securities as collateral. All repurchase agreements entered into by the Fund are required to be collateralized so that at all times during the term of a repurchase agreement, the value of the underlying securities is at least equal to the amount of the repurchase price. Also, the Fund or its custodian is required to have control of the collateral, which the portfolio manager believes will give the Fund a valid, perfected security interest in the collateral.

Repurchase agreements could involve certain risks in the event of default or insolvency of the counterparty, including possible delays or restrictions upon the Fund's ability to dispose of the underlying securities, the risk of a possible decline in the value of the underlying securities during the period in which the Fund seeks to assert its right to them, the risk that there may be a limited market or no market for disposition of such underlying securities, the risk of incurring expenses associated with asserting those rights and the risk of losing all or part of the income from the agreement. The Fund will seek to mitigate these risks but there is no guarantee that such efforts will be successful. If the Fund enters into a repurchase agreement involving securities the Fund could not purchase directly, and the counterparty defaults, the Fund may become the holder of such

securities. Repurchase agreements collateralized by securities other than U.S. government securities may be subject to greater risks and are more likely to have a term to maturity of longer than seven days. Repurchase agreements with a maturity of more than seven days are considered to be illiquid.

Repurchase agreements may be entered into or novated with a financial clearinghouse, which would become the Fund's counterparty. The Fund would then become subject to the rules of the clearinghouse, which may limit the Fund's rights and remedies (including recourse to collateral) or delay or restrict the rights and remedies, and expose the Fund to the risks of the clearinghouses' insolvency.

Pursuant to an exemptive order issued by the SEC, the Fund, along with other affiliated entities managed by the Manager, may transfer uninvested cash balances into one or more joint accounts for the purpose of entering into repurchase agreements secured by cash and U.S. government securities, subject to certain conditions.

Reverse Repurchase Agreements

The Fund may enter into reverse repurchase agreements. A reverse repurchase agreement has the characteristics of a secured borrowing by the Fund and creates leverage in the Fund's portfolio. In a reverse repurchase transaction, the Fund sells a portfolio instrument to another person, such as a financial institution or broker-dealer, in return for cash. At the same time, the Fund agrees to repurchase the instrument at an agreed-upon time and at a price that is greater than the amount of cash that the Fund received when it sold the instrument, representing the equivalent of an interest payment by the Fund for the use of the cash. During the term of the transaction, the Fund will continue to receive any principal and interest payments (or the equivalent thereof) on the underlying instruments.

The Fund may engage in reverse repurchase agreements as a means of raising cash to satisfy redemption requests or for other temporary or emergency purposes. Unless otherwise limited in the Fund's Prospectus or this SAI, the Fund may also engage in reverse repurchase agreements to the extent permitted by its fundamental investment policies in order to raise additional cash to be invested by the Fund's portfolio manager in other securities or instruments in an effort to increase the Fund's investment returns.

During the term of the transaction, the Fund will remain at risk for any fluctuations in the market value of the instruments subject to the reverse repurchase agreement as if it had not entered into the transaction. When the Fund reinvests the proceeds of a reverse repurchase agreement in other securities, the Fund will also be at risk for any fluctuations in the market value of the securities in which the proceeds are invested. Like other forms of leverage, this makes the value of an investment in the Fund more volatile and increases the Fund's overall investment exposure. In addition, if the Fund's return on its investment of the proceeds of the reverse repurchase agreement does not equal or exceed the implied interest that it is obligated to pay under the reverse repurchase agreement, engaging in the transaction will lower the Fund's return.

When the Fund enters into a reverse repurchase agreement, it is subject to the risk that the buyer under the agreement may file for bankruptcy, become insolvent or otherwise default on its obligations to the Fund. In the event of a default by the counterparty, there may be delays, costs and risks of loss involved in the Fund's exercising its rights under the agreement, or those rights may be limited by other contractual agreements or obligations or by applicable law.

In addition, the Fund may be unable to sell the instruments subject to the reverse repurchase agreement at a time when it would be advantageous to do so, or may be required to liquidate portfolio securities at a time when it would be disadvantageous to do so in order to make payments with respect to its obligations under a reverse repurchase agreement. This could adversely affect the Fund's strategy and result in lower fund returns.

The Fund will treat reverse repurchase agreements and similar financing transactions either (i) consistently with Section 18 of the 1940 Act by maintaining asset coverage of at least 300% of the value of such transactions or (ii) as derivatives transactions for purposes of Rule 18f-4, including, as applicable, the value-at-risk based limit on leverage risk.

Securities Lending

The Fund may lend its portfolio securities, provided that cash or equivalent collateral, equal to at least 100% of the market value of such securities, is continuously maintained by the other party with the Fund. During the pendency of the transaction, the other party will pay the Fund an amount equivalent to any dividends or interest paid on such securities, and the Fund may invest the cash collateral and earn additional income, or it may receive an agreed upon amount of interest income from

the other party who has delivered equivalent collateral. These transactions are subject to termination at the option of the Fund or the other party. The Fund may pay administrative and custodial fees in connection with these transactions and may pay a negotiated portion of the interest earned on the cash or equivalent collateral to the other party or placing agent or broker. Although voting rights or rights to consent with respect to the relevant securities generally pass to the other party, the Fund will make arrangements to vote or consent with respect to a material event affecting such securities. The risks in lending portfolio securities include possible delays in recovering or the failure to recover the securities and possible loss of rights in the collateral should the borrower fail financially. The Fund runs the risk that the counterparty to a loan transaction will default on its obligation and that the value of the collateral received may decline before the Fund can dispose of it. If the Fund receives cash as collateral and invests that cash, the Fund is subject to the risk that the collateral will decline in value before the Fund must return it to the counterparty. Subject to the foregoing, loans of fund securities are effectively borrowings by the Fund and have economic characteristics similar to reverse repurchase agreements. The Fund does not currently intend to engage in securities lending, although it may engage in transactions (such as reverse repurchase agreements) which have similar characteristics.

Short-Term Trading

Fund transactions will be undertaken principally to accomplish the Fund's investment objective in relation to anticipated movements in the general level of interest rates, but the Fund may also engage in short-term trading consistent with its investment objective.

Structured Notes and Related Instruments

"Structured" notes and other related instruments, including indexed securities, are derivative debt instruments, the interest rate or principal of which is determined by an unrelated underlying instrument (for example, a currency, security, commodity or index thereof). Structured instruments are generally privately negotiated debt obligations issued by corporations, including banks, as well as by governmental agencies and frequently are assembled in the form of medium-term notes, but a variety of forms are available and may be used in particular circumstances. The terms of such structured instruments normally provide that their principal and/or interest payments are to be adjusted upwards or downwards (but ordinarily not below zero) to reflect changes in the underlying instrument while the instruments are outstanding. As a result, the interest and/or principal payments that may be made on a structured product may vary widely. The rate of return on structured notes may be determined by applying a multiplier to the performance or differential performance of the underlying instrument or other asset(s). Application of a multiplier involves leverage that will serve to magnify the potential for gain and the risk of loss. Investment in indexed securities and structured notes involves certain risks, including the credit risk of the issuer and the normal risks of price changes in response to changes in interest rates. Further, in the case of certain indexed securities or structured notes, a decline in the underlying instrument may cause the interest rate to be reduced to zero, and any further declines in the underlying instrument may then reduce the principal amount payable on maturity. Finally, these securities may have lower liquidity than other types of securities and may be more volatile than their underlying instruments. Subordinated "structured" notes, which are subordinated to the right of payment of another class of the structured note, typically have higher yields and present greater risks than unsubordinated "structured" notes.

Subordinated Securities

Subordinated securities include securities which are subordinated or "junior" to more senior securities of the issuer, or which represent interests in pools of such subordinated or junior securities. Such securities may include so-called "high yield" or "junk" bonds (i.e., bonds that are rated below investment grade by a rating agency or that are determined by the Fund's portfolio manager to be of equivalent quality) and preferred stock. Under the terms of subordinated securities, payments that would otherwise be made to their holders may be required to be made to the holders of more senior securities, and/or the subordinated or junior securities may have junior liens, if they have any rights at all, in any collateral (meaning proceeds of the collateral are required to be paid first to the holders of more senior securities). As a result, subordinated or junior securities will be disproportionately adversely affected by a default or even a perceived decline in creditworthiness of the issuer.

Trade Policy

The U.S. government has indicated its intent to alter its approach to international trade policy and, in some cases, to renegotiate or potentially terminate certain existing bilateral or multilateral trade agreements and treaties with foreign countries and has made proposals and taken actions related thereto. In addition, the U.S. government has recently imposed tariffs on

certain foreign goods and has indicated a willingness to impose tariffs on imports of other products. Some foreign governments have instituted retaliatory tariffs on certain U.S. goods and have indicated a willingness to impose additional tariffs on U.S. products. Other countries have threatened retaliatory tariffs on certain U.S. products.

Global trade disruption, significant introductions of trade barriers, and bilateral trade frictions, together with any future downturns in the global economy resulting therefrom, could adversely affect the financial performance of the Fund and its investments. Trade policy may be an ongoing source of instability, potentially resulting in significant currency fluctuations and/or having other adverse effects on international markets, international trade agreements, and/or other existing cross-border cooperation arrangements (whether economic, tax, fiscal, legal, regulatory, or otherwise). To the extent trade disputes escalate globally, there could be additional significant impacts on the sectors or industries in which the Fund invests and other adverse impacts on the Fund's overall performance.

U.S. Government Securities

U.S. Government securities include (1) U.S. Treasury bills (maturity of one year or less), U.S. Treasury notes (maturity of one to ten years) and U.S. Treasury bonds (maturities generally greater than ten years); (2) obligations issued or guaranteed by U.S. Government agencies or instrumentalities which are supported by any of the following: (a) the full faith and credit of the U.S. Government (such as certificates issued by the Government National Mortgage Association ("Ginnie Mae")); (b) the right of the issuer to borrow an amount limited to a specific line of credit from the U.S. Government (such as obligations of the Federal Home Loan Banks); (c) the discretionary authority of the U.S. Government to purchase certain obligations of agencies or instrumentalities (such as securities issued by the Federal National Mortgage Association); or (d) only the credit of the agency or instrumentality (such as securities issued by the Federal Home Loan Mortgage Corporation); and (3) obligations issued by non-governmental entities (like financial institutions) that carry direct guarantees from U.S. government agencies as part of government initiatives in response to a market crisis or otherwise. Agencies and instrumentalities of the U.S. Government include but are not limited to: Farmers Home Administration, Export-Import Bank of the United States, Federal Housing Administration, Federal Land Banks, Federal Financing Bank, Central Bank for Cooperatives, Federal Intermediate Credit Banks, Farm Credit Bank System, Federal Home Loan Banks, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, General Services Administration, Government National Mortgage Association, Student Loan Marketing Association, United States Postal Service, Maritime Administration, Small Business Administration, Tennessee Valley Authority, Washington D.C. Armory Board and any other instrumentality established or sponsored by the U.S. Government.

In the case of obligations not backed by the full faith and credit of the United States, the Fund must look principally to the agency or instrumentality issuing or guaranteeing the obligation for ultimate repayment and may not be able to assert a claim against the United States itself in the event the agency or instrumentality does not meet its commitments. Neither the U.S. Government nor any of its agencies or instrumentalities guarantees the market value of the securities they issue. Therefore, the market value of such securities will fluctuate in response to changes in interest rates and other factors. In addition, any downgrade of the credit rating of the securities issued by the U.S. Government may result in a downgrade of securities issued by its agencies or instrumentalities, including government-sponsored entities. From time to time, uncertainty regarding the status of negotiations in the U.S. government to increase the statutory debt ceiling could increase the risk that the U.S. government may default on payments on certain U.S. government securities, cause the credit rating of the U.S. government to be downgraded, increase volatility in the stock and bond markets, result in higher interest rates, reduce prices of U.S. Treasury securities, and/or increase the costs of various kinds of debt. If a U.S. Government-sponsored entity is negatively impacted by legislative or regulatory action (or lack thereof), is unable to meet its obligations, or its creditworthiness declines, the performance of a fund that holds securities of the entity will be adversely impacted.

Variable and Floating Rate Securities

Variable and floating rate securities provide for a periodic adjustment in the interest rate paid on the obligations. The terms of such obligations provide that interest rates are adjusted periodically based upon an interest rate adjustment index as provided in the respective obligations. The adjustment intervals may be regular, and range from daily up to annually, or may be event-based, such as based on a change in the prime rate.

The Fund may invest in floating rate debt instruments ("floaters") and engage in credit spread trades. The interest rate on a floater is a variable rate which is tied to another interest rate, such as a corporate bond index or U.S. Treasury bill rate. The interest rate on a floater resets periodically, typically every six months. While, because of the interest rate reset feature, floaters

may provide the Fund with a certain degree of protection against rising interest rates, the Fund will participate in any declines in interest rates as well. A credit spread trade is an investment position relating to a difference in the prices or interest rates of two bonds or other securities or currencies, where the value of the investment position is determined by movements in the difference between the prices or interest rates, as the case may be, of the respective securities or currencies.

The Fund may also invest in inverse floating rate debt instruments ("inverse floaters"). The interest rate on an inverse floater resets in the opposite direction from the market rate of interest to which the inverse floater is indexed. An inverse floating rate security may exhibit greater price volatility than a fixed rate obligation of similar credit quality.

A floater may be considered to be leveraged to the extent that its interest rate varies by a magnitude that exceeds the magnitude of the change in the index rate of interest. The higher degree of leverage inherent in some floaters is associated with greater volatility in their market values.

The Fund may also invest in variable amount master demand notes, which permit the indebtedness thereunder to vary in addition to providing for periodic adjustments in the interest rate. The absence of an active secondary market with respect to particular variable and floating rate instruments could make it difficult for the Fund to dispose of a variable or floating rate note if the issuer were to default on its payment obligation or during periods that the Fund is not entitled to exercise its demand rights, and the Fund could, for these or other reasons, suffer a loss with respect to such instruments. In determining average-weighted portfolio maturity, an instrument will be deemed to have a maturity equal to either the period remaining until the next interest rate adjustment or the time the Fund can recover payment of principal as specified in the instrument, depending on the type of instrument involved.

When-Issued Securities and Forward Commitments

Securities may be purchased on a "when-issued" or "to be announced" or "forward delivery" basis. The payment obligation and the interest rate that will be received on the "when-issued" securities are fixed at the time the buyer enters into the commitment although settlement, i.e., delivery of and payment for the securities, takes place at a later date. In a "to be announced" transaction, the Fund commits to purchase securities for which all specific information is not known at the time of the trade.

Securities purchased on a "when-issued" or "forward delivery" basis are subject to changes in value based upon the market's perception of the creditworthiness of the issuer and changes, real or anticipated, in the level of interest rates. The value of these securities experiences appreciation when interest rates decline and depreciation when interest rates rise. Purchasing securities on a "when-issued" or "forward delivery" basis can involve a risk that the yields available in the market on the settlement date may actually be higher or lower than those obtained in the transaction itself.

An increase in the percentage of the Fund's assets committed to the purchase of securities on a "when-issued" basis may increase the volatility of its net asset value.

Zero Coupon, Pay-In-Kind and Deferred Interest Securities

Zero Coupon Bond. A zero coupon bond is a security that makes no fixed interest payments but instead is sold at a discount from its face value. The bond is redeemed at its face value on the specified maturity date. Zero coupon bonds may be issued as such, or they may be created by a broker who strips the coupons from a bond and separately sells the rights to receive principal and interest. The prices of zero coupon bonds tend to fluctuate more in response to changes in market interest rates than do the prices of interest-paying debt securities with similar maturities. Zero coupon bonds with a fixed maturity date of more than one year from the date of issuance will be treated as debt obligations that are issued originally at a discount for U.S. federal income tax purposes. Generally, the original issue discount ("OID") is treated as interest income and is included in the Fund's income and required to be distributed by the Fund over the term of the bond, even though payment of that amount is not received until a later time, upon partial or full repayment or disposition of the bond. The Fund may thus be required to pay out as an income distribution each year an amount which is greater than the total amount of cash the Fund actually received, and may have to dispose of other securities, including at times when it may be disadvantageous to do so, to generate the cash necessary for the distribution of income attributable to its zero coupon bonds.

Pay-In-Kind Securities. Pay-in-kind securities are bonds which pay interest through the issuance of additional debt or equity securities. Pay-in-kind securities have characteristics similar to those of zero coupon securities, but interest on such securities may be paid in the form of obligations of the same type rather than cash. Similar to zero coupon obligations, pay-in-

kind bonds also carry additional risk as holders of these types of securities realize no cash until the cash payment date unless a portion of such securities is sold and, if the issuer defaults, the Fund may obtain no return at all on its investment. The market price of pay-in-kind bonds is affected by interest rate changes to a greater extent, and therefore tends to be more volatile, than that of securities which pay interest in cash. Similar to zero coupon bonds, current U.S. federal income tax law requires the holder of pay-in-kind bonds to accrue income with respect to these securities prior to the receipt of cash payments. To maintain its qualification as a regulated investment company and avoid liability for U.S. federal income and excise taxes, the Fund may be required to distribute income accrued with respect to these securities and may have to dispose of portfolio securities under disadvantageous circumstances in order to generate cash to satisfy these distribution requirements.

Deferred Interest Bonds. Deferred interest bonds are debt obligations that generally provide for a period of delay before the regular payment of interest begins and that are issued at a significant discount from face value. The original discount approximates the total amount of interest the bonds will accrue and compound over the period until the first interest accrual date at a rate of interest reflecting the market rate of the security at the time of issuance. Although this period of delay is different for each deferred interest bond, a typical period is approximately one-third of the bond's term to maturity. Such investments benefit the issuer by mitigating its initial need for cash to meet debt service, but some also provide a higher rate of return to attract investors who are willing to defer receipt of such cash.

Zero-coupon, pay-in-kind and deferred interest securities may be subject to greater fluctuation in value and lesser liquidity in the event of adverse market conditions than comparably rated securities paying cash interest at regular interest payment periods.

MANAGEMENT

Trustees and Officers

The business and affairs of the Fund are conducted by management under the supervision and subject to the direction of its Board. The business address of each Trustee (including each Independent Trustee) is c/o Jane Trust, Franklin Templeton, 100 International Drive, 11th Floor, Baltimore, Maryland 21202. The tables below provide information about each of the Trustees and officers of the Trust.

Independent Trustees#:

Name and Year of Birth	Position(s) with Trust	Term of Office* and Year Service Began**	Principal Occupation(s) During the Past Five Years	Number of Funds in the Franklin Templeton Fund Complex Overseen by Trustee***	Other Board Memberships Held by Trustee During the Past Five Years
Robert Abeles, Jr. Born 1945	Trustee	Since 2013	Board Member of Excellent Education Development (since 2012); Senior Vice President Emeritus (since 2016) and formerly, Senior Vice President, Finance and Chief Financial Officer (2009 to 2016) at University of Southern California; and formerly, Board Member of Great Public Schools Now (2018 to 2022)	49	None
Jane F. Dasher Born 1949	Trustee	Since 1999	Director (since 2022) and formerly, Chief Financial Officer, Long Light Capital, LLC, formerly known as Korsant Partners, LLC (a family investment company) (since 1997)	49	Formerly, Director, Visual Kinematics, Inc. (2018 to 2022)
Anita L. DeFrantz Born 1952	Trustee	Since 1998	President of Tubman Truth Corp. (since 2015); Vice President (since 2017), Member of the Executive Board (since 2013) and Member of the International Olympic Committee (since 1986); and President Emeritus (since 2015) and formerly, President (1987 to 2015) and Director (1990 to 2015) of LA84 (formerly Amateur Athletic Foundation of Los Angeles)	49	None
Susan B. Kerley Born 1951	Trustee	Since 1992	Investment Consulting Partner, Strategic Management Advisors, LLC (investment consulting) (since 1990)	49	Director and Trustee (since 1990) and Chairman (2017 to 2024 and 2005 to 2012) of various series of New York Life Investments Family of Funds (86 funds), including certain series previously known as the MainStay Family of Funds; formerly, Chairman of the Independent Directors Council (2012 to 2014); ICI Executive Committee (2011 to 2014); and Investment Company Institute (ICI) Board of Governors (2006 to 2014)

Michael Larson Born 1959	Trustee	Since 2004	Chief Investment Officer for William H. Gates III (since 1994)±	49	Ecolab Inc. (since 2012); Fomento Economico Mexicano, SAB (since 2011); and Republic Services, Inc. (since 2009)
Avedick B. Poladian Born 1951	Trustee	Since 2007	Director and Advisor (since 2017) and formerly, Executive Vice President and Chief Operating Officer (2002 to 2016) of Lowe Enterprises, Inc. (privately held real estate and hospitality firm); and formerly, Partner, Arthur Andersen, LLP (1974 to 2002)	49	Public Storage (since 2010); Occidental Petroleum Corporation (since 2008); and formerly, California Resources Corporation (2014 to 2021)
William E.B. Siart Born 1946	Trustee and Chairman of the Board	Since 1997 (Chairman of the Board since 2020)	Chairman of Excellent Education Development (since 2000); formerly, Chairman of Great Public Schools Now (2015 to 2020); Trustee of The Getty Trust (2005 to 2017); and Chairman of Walt Disney Concert Hall, Inc. (1998 to 2006)	49	Trustee, University of Southern California (since 1994); and formerly, Member of Board of United States Golf Association, Executive Committee Member (2017 to 2021)
Jaynie Miller Studenmund Born 1954	Trustee	Since 2004	Corporate Board Member and Advisor (since 2004); formerly, Chief Operating Officer of Overture Services, Inc. (publicly traded internet company that created search engine marketing) (2001 to 2004); President and Chief Operating Officer, PayMyBills (internet innovator in bill presentment/payment space) (1999 to 2001); and Executive Vice President for consumer and business banking for three national financial institutions (1984 to 1997)	49	Director of Columbia Bank (2025 to present, coincident with Columbia Bank's acquisition of Pacific Premier Bank); formerly, Director of Pacific Premier Bancorp Inc. and Pacific Premier Bank (2019 to 2025); Director of EXL (operations management and analytics company) (2018 to 2025); Director of LifeLock, Inc. (identity theft protection company) (2015 to 2017); Director of CoreLogic, Inc. (information, analytics and business services company) (2012 to 2021); and Director of Pinnacle Entertainment, Inc. (gaming and hospitality company) (2012 to 2018)
Peter J. Taylor Born 1958	Trustee	Since 2019	Retired; formerly, President, ECMC Foundation (nonprofit organization) (2014 to 2023); and Executive Vice President and Chief Financial Officer for University of California system (2009 to 2014)	49	Director of Pacific Mutual Holding Company (since 2016);∞ Ralph M. Parson Foundation (since 2015); Edison International (since 2011); formerly, Director of 23andMe, Inc. (genetics and health care services company) (2021 to 2024); Member of the Board of Trustees of California State University system (2015 to 2022); and Kaiser Family Foundation (2012 to 2022)

Interested Trustee and Officer:

Jane Trust, CFA† Born 1962	Trustee, President and Chief Executive Officer	Since 2015	Senior Vice President, Fund Board Management, Franklin Templeton (since 2020); Officer and/or Trustee/Director of 118 funds associated with FTFA or its affiliates (since 2015); President and Chief Executive Officer of FTFA (since 2015); formerly, Senior Managing Director (2018 to 2020) and Managing Director (2016 to 2018) of Legg Mason & Co., LLC ("Legg Mason & Co."); and Senior Vice President of FTFA (2015)	Trustee/Director of Franklin Templeton funds consisting of 118 portfolios; Trustee of Putnam Family of Funds consisting of 99 portfolios	None

Trustees who are not "interested persons" of the Trust within the meaning of Section 2(a)(19) of the 1940 Act.

* Each Trustee serves until his or her respective successor has been duly elected and qualified or until his or her earlier death, resignation, retirement or removal.

** Indicates the earliest year in which the Trustee became a board member for a fund in the Franklin Templeton fund complex.

*** Information is for the calendar year ended December 31, 2025, except as otherwise noted.

± Mr. Larson is the chief investment officer for William H. Gates III and in that capacity oversees the non-Microsoft investments of Mr. Gates and all the investments of the Gates Foundation Trust (such combined investments are referred to as the "Accounts"). Since 1997, Western Asset has provided discretionary investment advice with respect to one or more Accounts. Since December 31, 2023, at no time did the value of those investment portfolios exceed 1.50% of Western Asset's total assets under management. No changes to these arrangements are currently contemplated.

∞ Western Asset and its affiliates provide investment advisory services with respect to registered investment companies sponsored by an affiliate of Pacific Mutual Holding Company ("Pacific Holdings"). Affiliates of Pacific Holdings receive compensation from FTFA or its affiliates for shareholder or distribution services provided with respect to registered investment companies for which Western Asset or its affiliates serve as investment adviser.

† Ms. Trust is an "interested person" of the Trust, as defined in the 1940 Act, because of her position with FTFA and/or certain of its affiliates.

Additional Officers:

Name, Year of Birth and Address	Position(s) with Trust	Term of Office* and Year Service Began**	Principal Occupation(s) During the Past Five Years
Ted P. Becker Born 1951 Franklin Templeton One Madison Avenue New York, NY 10010	Chief Compliance Officer	Since 2007	Vice President, Global Compliance of Franklin Templeton (since 2020); Chief Compliance Officer of FTFA (since 2006); Chief Compliance Officer of certain funds associated with Legg Mason & Co. or its affiliates (since 2006); formerly, Director of Global Compliance at Legg Mason (2006 to 2020); Managing Director of Compliance of Legg Mason & Co. (2005 to 2020)
Christopher Berarducci Born 1974 Franklin Templeton One Madison Avenue New York, NY 10010	Treasurer and Principal Financial Officer	Since 2019	Vice President, Fund Administration and Reporting, Franklin Templeton (since 2020), Treasurer (since 2010) and Principal Financial Officer (since 2019) of certain funds associated with Legg Mason & Co. or its affiliates; formerly, Managing Director (2020), Director (2015 to 2020), and Vice President (2011 to 2015) of Legg Mason & Co.
Marc A. De Oliveira Born 1971 Franklin Templeton 100 First Stamford Place 6th Floor Stamford, CT 06902	Secretary and Chief Legal Officer	Since 2020	Associate General Counsel of Franklin Templeton (since 2020); Secretary and Chief Legal Officer (since 2020) and Assistant Secretary of certain funds in the Franklin Templeton fund complex (since 2006); formerly, Managing Director (2016 to 2020) and Associate General Counsel of Legg Mason & Co. (2005 to 2020)
Jeanne Kelly Born 1951 Franklin Templeton One Madison Avenue New York, NY 10010	Senior Vice President	Since 2007	U.S. Fund Board Team Manager, Franklin Templeton (since 2020); Senior Vice President of certain funds associated with Legg Mason & Co. or its affiliates (since 2007); Senior Vice President of FTFA (since 2006); President and Chief Executive Officer of LM Asset Services, LLC ("LMAS") and Legg Mason Fund Asset Management, Inc. ("LMFAM") (formerly registered investment advisers) (since 2015); formerly, Managing Director of Legg Mason & Co. (2005 to 2020), and Senior Vice President of LMFAM (2013 to 2015)
Susan Kerr Born 1949 Franklin Templeton One Madison Avenue New York, NY 10010	Chief Anti-Money Laundering Compliance Officer	Since 2013	Senior Compliance Analyst, Franklin Templeton (since 2020); Chief Anti-Money Laundering Compliance Officer of certain funds associated with Legg Mason & Co. or its affiliates (since 2013) and Anti-Money Laundering Compliance Officer (since 2012), Senior Compliance Officer (since 2011) and Assistant Vice President (since 2010) of the Distributor; formerly, Assistant Vice President of Legg Mason & Co. (2010 to 2020)
Thomas C. Mandia Born 1962 Franklin Templeton 100 First Stamford Place 6th Floor Stamford, CT 06902	Senior Vice President	Since 2020	Senior Associate General Counsel to Franklin Templeton (since 2020); Senior Vice President (since 2020) and Assistant Secretary of certain funds in the Franklin Templeton fund complex (since 2006); Secretary of FTFA (since 2006); Secretary of LMAS (since 2002) and LMFAM (formerly registered investment advisers) (since 2013); formerly, Managing Director and Deputy General Counsel of Legg Mason & Co. (2005 to 2020)

* Each officer serves until his or her respective successor has been duly elected and qualified or until his or her earlier death, resignation, retirement or removal.

** Indicates the earliest year in which the officer took such office.

Qualifications of Trustees, Board Leadership Structure and Oversight and Standing Committees

The Board believes that each Trustee's experience, qualifications, attributes or skills on an individual basis and in combination with those of its other Trustees lead to the conclusion that the Board possesses the requisite skills and attributes. The Board believes that the Trustees' abilities to review, critically evaluate, question and discuss information provided to them; to interact effectively with the Manager, the Subadviser, other service providers, counsel and independent auditors; and to exercise effective business judgment in the performance of their duties serves to support this conclusion. The Board has considered the following experience, qualifications, attributes and/or skills, among others, of its members in reaching its conclusion: his or her character and integrity; such person's length of service as a board member of certain Funds; such person's willingness to serve and willingness and ability to commit the time necessary to perform the duties of a Trustee; as to each Trustee other than Ms. Trust, his or her status as not being an "interested person" (as defined in the 1940 Act) of the Trust. In addition, the following specific experience, qualifications, attributes and/or skills apply as to each Trustee: Mr. Abeles, business, accounting and finance expertise and experience as a chief financial officer, board member and/or executive officer of various businesses and other organizations; Ms. Dasher, experience as a chief financial officer of a private investment company; Ms. DeFrantz, business expertise and experience as a president, board member and/or executive officer of various businesses and non-profit and other organizations; Ms. Kerley, investment consulting experience and background and mutual fund board experience; Mr. Larson, portfolio management expertise and experience as a board member of various businesses and other organizations; Mr. Poladian, business, finance and accounting expertise and experience as a board member of various businesses and/or as a partner of a multi-national accounting firm; Mr. Siart, business and finance expertise and experience as a president, chairperson, chief executive officer and/or board member of various businesses and non-profit and other organizations; Ms. Studenmund, business and finance expertise and experience as a president, board member and/or chief operating officer of various businesses; Mr. Taylor, business and finance expertise and experience as a chief financial officer, president and/or board member of various businesses and non-profit organizations; and Ms. Trust, investment management and risk oversight experience as an executive and portfolio manager and leadership roles within Franklin Templeton (and before that, Legg Mason) and affiliated entities. References to the qualifications, attributes and skills of Trustees are pursuant to requirements of the SEC, do not constitute holding out of the Board or any Trustee as having any special expertise or experience, and shall not impose any greater responsibility or liability on any such person or the Board by reason thereof.

The Board is responsible for overseeing the management and operations of the Fund. Ms. Trust is an interested person of the Fund. Independent Trustees constitute more than 75% of the Board. Mr. Siart, who is not an interested person of the Fund, serves as Chair of the Board (since 2020).

The Board has four standing committees: the Audit Committee, Governance and Nominating Committee (referred to as the Governance Committee), Executive and Contracts Committee (referred to as the Contracts Committee) and Investment and Performance Committee (referred to as the Performance Committee). Each of the Audit, Governance, Contracts and Performance Committees is chaired by an Independent Trustee and each (other than the Performance Committee) is composed of all the Independent Trustees. Where deemed appropriate, the Board constitutes ad hoc committees.

The Contracts Committee, which consists of Messrs. Abeles, Larson, Poladian, Siart and Taylor and Mses. Dasher, DeFrantz, Kerley and Studenmund, may meet from time to time between Board meetings in order to consider appropriate matters and to review the various contractual arrangements between the Trust and its affiliated persons.

The Audit Committee, which consists of Messrs. Abeles, Larson, Poladian, Siart and Taylor and Mses. Dasher, DeFrantz, Kerley and Studenmund, provides oversight with respect to the accounting and financial reporting and compliance policies and practices of the Fund and, among other things, considers the selection of an independent registered public accounting firm for the Fund and the scope of the audit and approves all services proposed to be performed by the independent registered public accounting firm on behalf of the Fund and, under certain circumstances, the Subadviser and certain affiliates.

The Governance Committee, which consists of Messrs. Abeles, Larson, Poladian, Siart and Taylor and Mses. Dasher, DeFrantz, Kerley and Studenmund, meets to select nominees for election as Trustees of the Trust and consider other matters of Board policy, including to review and make recommendations to the Board with respect to the compensation of the Independent Trustees. It is the policy of the Governance and Nominating Committee to consider nominees recommended by shareholders. Shareholders of the Trust who wish to recommend a nominee to the Governance Committee of a Trust should send recommendations to the Secretary of the Trust that include all information relating to such person that is required to be disclosed in solicitations of proxies for the election of Trustees. Such a recommendation must be accompanied by a written consent of the

individual to stand for election if nominated by the Board and to serve if elected by the shareholders of the Trust. The procedures by which shareholders of the Trust can submit nominee recommendations to the Governance Committee of the Trust are set forth in Appendix F to the SAI.

The Performance Committee, which consists of Messrs. Abeles, Larson, Poladian, Siart and Taylor and Mses. Dasher, DeFrantz, Kerley, Studenmund and Trust, is charged with, among other things, reviewing investment performance.

The Board has determined that its leadership structure is appropriate given the business and nature of the Fund. In connection with its determination, the Board considered that the Chairman of the Board is an Independent Trustee. The Chairman of the Board can play an important role in setting the agenda of the Board and also serves as a key point person for dealings between management and the other Independent Trustees. The Independent Trustees believe that the Chairman's independence facilitates meaningful dialogue between Fund management and the Independent Trustees. The Board also considered that the chairperson of each Board committee is an Independent Trustee, which yields similar benefits with respect to the functions and activities of the various Board committees (e.g., each committee's chairperson works with the Manager and other service providers to set agendas for the meetings of the applicable Board committees). As noted above, through the committees the Independent Trustees consider and address important matters involving the Fund, including those presenting conflicts or potential conflicts of interest for management. The Independent Trustees also regularly meet outside the presence of management and are advised by independent legal counsel. The Board has determined that its committees help ensure that the Fund has effective and independent governance and oversight. The Board also believes that its leadership structure, in which the Chair of the Board is not affiliated with Franklin Templeton, is appropriate. The Board also believes that its leadership structure facilitates the orderly and efficient flow of information to the Independent Trustees from management, including the Subadviser. The Board reviews its structure on an annual basis.

As an integral part of its responsibility for oversight of the Fund in the interests of shareholders, the Board oversees risk management of the Fund's investment programs and business affairs. The function of the Board with respect to risk management is one of oversight not active involvement in, or coordination of, day-to-day risk management activities for the Fund. The Board has emphasized to the Fund's Manager and Subadviser the importance of maintaining vigorous risk management. The Board exercises oversight of the risk management process primarily through the Performance Committee, the Audit Committee and the Contracts Committee, and through oversight by the Board itself.

The Fund faces a number of risks, such as investment risk, counterparty risk, valuation risk, reputational risk, risk of operational failure or lack of business continuity, and legal, compliance and regulatory risk. Risk management seeks to identify and address risks, i.e., events or circumstances that could have material adverse effects on the business, operations, shareholder services, investment performance or reputation of the Fund. Under the overall supervision of the Board or the applicable committee, the Fund, the Manager, the Subadviser, and the affiliates of the Manager and the Subadviser, or other service providers to the Fund employ a variety of processes, procedures and controls to identify various of those possible events or circumstances, to lessen the probability of their occurrence and/or to mitigate the effects of such events or circumstances if they do occur.

Different processes, procedures and controls are employed with respect to different types of risks. Various personnel, including the Fund's and the Manager's CCO and the Manager's chief risk officer, as well as various personnel of the Subadviser and other service providers such as the Fund's independent accountants, also make periodic reports to the Performance Committee, Contracts Committee, Audit Committee and/or to the Board with respect to various aspects of risk management, as well as events and circumstances that have arisen and responses thereto.

These reports and other similar reports received by the Trustees as to risk management matters are typically summaries of the relevant information. The Board recognizes that not all risks that may affect the Fund can be identified, that it may not be practical or cost-effective to eliminate or mitigate certain risks, that it may be necessary to bear certain risks (such as investment-related risks) to achieve the Fund's goals, and that the processes, procedures and controls employed to address certain risks may be limited in their effectiveness.

During the fiscal year ended March 31, 2026, the Board met 5 times. The Committees of the Board met as follows: the Audit Committee met 5 times, the Governance and Nominating Committee met 3 times, the Investment and Performance Committee met 5 times, and the Executive and Contracts Committee met 2 times.

Trustee Ownership of Securities

The following tables show the dollar range of equity securities owned by the Trustees in the Fund and other investment companies in the Franklin Templeton fund complex overseen by the Trustees as of December 31, 2025.

	Dollar Range of Equity Securities in the Fund ($)				
Name of Trustee	**Intermediate-Term Municipals Fund**	**New Jersey Municipals Fund**	**New York Municipals Fund**	**Pennsylvania Municipals Fund**	**Aggregate Dollar Range of Equity Securities in All Registered Investment Companies in Franklin Templeton Fund Complex Overseen by Trustee ($)**
Independent Trustees:					
Robert Abeles, Jr.	None	None	None	None	None
Jane F. Dasher	None	None	None	None	Over 100,000
Anita L. DeFrantz	None	None	None	None	10,001-50,000
Susan B. Kerley	None	None	None	None	Over 100,000
Michael Larson	None	None	None	None	Over 100,000
Avedick B. Poladian	None	None	None	None	None
William E. B. Siart	None	None	None	None	Over 100,000
Jaynie Miller Studenmund	None	None	None	None	Over 100,000
Peter J. Taylor	None	None	None	None	Over 100,000
Interested Trustee:					
Jane Trust	None	None	None	None	Over 100,000

As of December 31, 2025, none of the Independent Trustees or their immediate family members owned beneficially or of record any securities of the Manager, the Subadviser, or the Distributor of the Fund, or of a person (other than a registered investment company) directly or indirectly controlling, controlled by or under common control with the Manager, the Subadviser, or the Distributor of the Fund.

For serving as a Trustee of the Trust, each Independent Trustee receives an annual retainer plus fees for attending each regularly scheduled meeting and special Board meeting they attend in person or by telephone. Each Independent Trustee is also reimbursed for all out-of-pocket expenses relating to attendance at such meetings. Those Independent Trustees who serve in leadership positions of the Board or Board committees receive additional compensation. The Board reviews the level of Trustee compensation periodically and Trustee compensation may change from time to time. Ms. Trust, an "interested person" of the Trust, as defined in the 1940 Act, does not receive compensation from the Fund for her service as Trustee. The Fund pays its pro rata share of the fees and expenses of the Trustees based upon asset size.

Officers of the Trust receive no compensation from the Fund, although they may be reimbursed for reasonable out-of-pocket travel expenses for attending Board meetings.

Trustee Compensation

Information regarding compensation paid to the Trustees is shown below.

	Aggregate Compensation from the Fund*($)					
Name of Trustee	Intermediate-Term Municipals Fund	New Jersey Municipals Fund	New York Municipals Fund	Pennsylvania Municipals Fund	Total Pension or Retirement Benefits Paid as Part of Fund Expenses* ($)	Total Compensation from Franklin Templeton Fund Complex Paid to Trustee** ($)
Independent Trustees:						
Robert Abeles, Jr.	6,272	516	897	276	None	382,000
Jane F. Dasher	5,686	468	814	251	None	347,000
Anita L. DeFrantz	5,636	464	807	248	None	341,000
Susan B. Kerley	6,105	502	874	269	None	372,000
Michael Larson	5,686	468	814	251	None	347,000
Avedick B. Poladian	5,686	468	814	251	None	347,000
William E. B. Siart	7,777	639	1,112	342	None	472,000
Jaynie Miller Studenmund	6,105	502	874	269	None	372,000
Peter J. Taylor	5,686	468	814	251	None	347,000
Interested Trustee:						
Jane Trust †	None	None	None	None	None	None

* Information is for the fiscal year ended March 31, 2026.

** Information is for the calendar year ended December 31, 2025.

† Ms. Trust is not compensated by the Trust for her services as a Trustee because of her affiliations with the Manager.

INVESTMENT MANAGEMENT AND SERVICE PROVIDER INFORMATION

Manager

The Manager, a limited liability company organized under the laws of the State of Delaware, serves as investment manager to the Fund and provides administrative and certain oversight services to the Fund, pursuant to an investment management agreement (the "Management Agreement"). The Manager has offices at One Madison Avenue, New York, New York, 10010 and also serves as the investment manager of other Franklin Templeton funds. The Manager is an indirect, wholly-owned subsidiary of Franklin Resources, a Delaware corporation. Franklin Resources, whose principal executive offices are at One Franklin Parkway, San Mateo, California 94403, is a global investment management organization operating, together with its subsidiaries, as Franklin Templeton.

The Manager has agreed, under the Management Agreement, subject to the supervision of the Board, to provide the Fund with investment research, advice, management and supervision, furnish a continuous investment program for the Fund's

portfolio of securities and other investments consistent with the Fund's investment objectives, policies and restrictions, and place orders pursuant to its investment determinations. The Manager is permitted to enter into contracts with subadvisers or subadministrators, subject to the Board's approval. The Manager has entered into subadvisory agreements, as described below.

As compensation for services performed, facilities furnished and expenses assumed by the Manager, the Fund pays the Manager a fee computed daily at an annual rate of the Fund's average daily net assets as described below. The Manager also performs administrative and management services as reasonably requested by the Fund necessary for the operation of the Fund, such as (i) supervising the overall administration of the Fund, including negotiation of contracts and fees with, and monitoring of performance and billings of, the Fund's transfer agent, shareholder servicing agents, custodian and other independent contractors or agents; (ii) providing certain compliance, fund accounting, regulatory reporting and tax reporting services; (iii) preparing or participating in the preparation of Board materials, registration statements, proxy statements and reports and other communications to shareholders; (iv) maintaining the Fund's existence; and (v) maintaining the registration or qualification of the Fund's shares under federal and state laws.

The Management Agreement will continue in effect for its initial term and thereafter from year to year, provided continuance is specifically approved at least annually (a) by the Board or by a 1940 Act Vote, and (b) in either event, by a majority of the Independent Trustees casting votes in accordance with applicable law.

The Management Agreement provides that the Manager may render services to others. The Management Agreement is terminable without penalty by the Board or by vote of a majority of the outstanding voting securities of the Fund on not more than 60 days' nor less than 30 days' written notice to the Manager, or by the Manager on not less than 90 days' written notice to the Fund as applicable, and will automatically terminate in the event of its assignment (as defined in the 1940 Act) by the Manager. No Management Agreement is assignable by the Trust except with the consent of the Manager.

The Management Agreement provides that the Manager, its affiliates performing services contemplated by the Management Agreement, and the partners, shareholders, directors, officers and employees of the Manager and such affiliates, will not be liable for any error of judgment or mistake of law, for any loss arising out of any investment, or for any act or omission in the execution of securities transactions for the Fund, but the Manager is not protected against any liability to the Fund to which the Manager would be subject by reason of willful misfeasance, bad faith or gross negligence in the performance of its duties or by reason of its reckless disregard of its obligations and duties under the Management Agreement.

For its services under the Fund's Management Agreement, the Manager receives an investment management fee that is calculated daily and payable monthly at an annual rate according to the following schedule:

Fund	Investment Management Fee Rate (% of Average Daily Net Assets)
Intermediate-Term Municipals Fund	0.35
New Jersey Municipals Fund	0.45
New York Municipals Fund	0.45
Pennsylvania Municipals Fund	0.45

The table below sets forth the management fees paid by the Fund to the Manager (waived/reimbursed amounts are in parentheses), with respect to the fiscal periods indicated:

Fund	For the Fiscal Period Ended March 31,	Gross Management Fees ($)	Management Fees Waived/Expenses Reimbursed ($)	Net Management Fees (After Waivers/Expense Reimbursements) ($)
Intermediate-Term Municipals Fund[1]	2026	5,937,944	(506,796)	5,431,148
	2025	7,899,146	(452,090)	7,447,056
	2024	8,785,737	(467,418)	8,318,319
New Jersey Municipals Fund	2026	680,932	(103,228)	577,704
	2025	664,535	(93,077)	571,458
	2024	671,173	(78,655)	592,518
New York Municipals Fund	2026	1,145,867	(29,148)	1,116,719
	2025	1,355,480	(32,974)	1,322,506
	2024	1,522,770	(21,498)	1,501,272
Pennsylvania Municipals Fund	2026	360,053	(109,672)	250,381
	2025	401,366	(104,651)	296,715
	2024	458,850	(86,181)	372,669

[1] For the fiscal year ended March 31, 2026, FTFA recaptured $410 of fees that were previously waived and/or reimbursed.

Any expense limitation arrangements in place during the Fund's past three fiscal periods can be found in the Fund's Prospectus in effect (as amended or supplemented from time to time) for such year.

Subadviser

Western Asset Management Company, LLC, organized under the laws of the State of California, serves as the subadviser to the Fund (the "Subadviser") pursuant to a subadvisory agreement between the Manager and the Subadviser (the "Subadvisory Agreement"). The Subadviser has offices at 385 East Colorado Boulevard, Pasadena, California 91101 and One Madison Avenue, New York, New York 10010. The Subadviser is an indirect, wholly-owned subsidiary of Franklin Resources.

Under the Subadvisory Agreement, subject to the supervision of the Board and the Manager, the Subadviser regularly provides with respect to the portion of the Fund's assets allocated to it by the Manager, investment research, advice, management and supervision; furnishes a continuous investment program for the allocated assets consistent with the Fund's investment objectives, policies and restrictions; and places orders pursuant to its investment determinations. The Subadviser may delegate to companies that the Subadviser controls, is controlled by, or is under common control with, certain of the Subadviser's duties under a Subadvisory Agreement, subject to the Subadviser's supervision, provided the Subadviser will not be relieved of its duties or obligations under the Subadvisory Agreement as a result of any delegation.

The Subadvisory Agreement will continue in effect for its initial term and thereafter from year to year provided such continuance is specifically approved at least annually (a) by the Board or by a majority of the outstanding voting securities of the Fund (as defined in the 1940 Act), and (b) in either event, by a majority of the Independent Trustees casting votes in accordance with applicable law. The Board or a majority of the outstanding voting securities of the Fund (as defined in the 1940 Act) may terminate the Subadvisory Agreement without penalty, in each case on not more than 60 days' nor less than 30 days' written notice to the Subadviser. The Subadviser may terminate the respective Subadvisory Agreement, on 90 days' written notice to the Fund and the Manager. The Subadvisory Agreement may be terminated upon the mutual written consent of the Manager and the

Subadviser. The Subadvisory Agreement will terminate automatically in the event of assignment (as defined in the 1940 Act) by the applicable Subadviser, and shall not be assignable by the Manager without the consent of the Subadviser.

The Subadvisory Agreement provides that the Subadviser, its affiliates performing services contemplated by the Subadvisory Agreement, and the partners, shareholders, directors, officers and employees of the Subadviser and such affiliates will not be liable for any error of judgment or mistake of law, for any loss arising out of any investment, or for any act or omission in the execution of securities transactions for the Fund, but the Subadviser is not protected against any liability to the Fund or the Manager to which the Subadviser would be subject by reason of willful misfeasance, bad faith or gross negligence in the performance of its duties or by reason of its reckless disregard of its obligations and duties under the Subadvisory Agreement.

As compensation for its services, the Manager pays to Western Asset a fee equal to 70% of the management fee paid to the Manager by the Fund, net of any waivers and expense reimbursements.

Expenses

In addition to amounts payable under the Management Agreement and the 12b-1 Plan (as discussed in this SAI), the Fund is responsible for its own expenses, including, among other things: interest; taxes; governmental fees; voluntary assessments and other expenses incurred in connection with membership in investment company organizations; organizational costs of the Fund; costs (including interest, brokerage commissions, transaction fees or charges or acquired fund fees and expenses, if any) in connection with the purchase or sale of the Fund's securities and other investments and any losses in connection therewith; fees and expenses of custodians, transfer agents, registrars, independent pricing vendors or other agents; legal expenses; loan commitment fees; expenses relating to the issuance and redemption or repurchase of the Fund's shares and servicing shareholder accounts; expenses of registering and qualifying the Fund's shares for sale under applicable federal and state law; expenses of preparing, setting in print, printing and distributing prospectuses and statements of additional information and any supplements thereto, reports, proxy statements, notices and dividends to the Fund's shareholders; costs of stationery; website costs; costs of meetings of the Board or any committee thereof, meetings of shareholders and other meetings of the Fund; Board fees; audit fees; travel expenses of officers, Trustees and employees of the Fund, if any; the Fund's pro rata portion of premiums on any fidelity bond and other insurance covering the Fund and its officers, Trustees and employees; and litigation expenses and any non-recurring or extraordinary expenses as may arise, including, without limitation, those relating to actions, suits or proceedings to which the Fund is a party and any legal obligation which the Fund may have to indemnify the Fund's Trustees and officers with respect thereto.

Management may agree to implement an expense cap, waive fees and/or reimburse operating expenses for one or more classes of shares. Any such expense caps, waived fees and/or reimbursed expenses are described in the Fund's Prospectus. The expense caps, waived fees and/or reimbursed expenses do not cover extraordinary expenses, such as (a) any expenses or charges related to litigation, derivative actions, demands related to litigation, regulatory or other government investigations and proceedings, "for cause" regulatory inspections and indemnification or advancement of related expenses or costs, to the extent any such expenses are considered extraordinary expenses for the purposes of fee disclosure in Form N-1A as the same may be amended from time to time; (b) transaction costs (such as brokerage commissions and dealer and underwriter spreads) and taxes; (c) other extraordinary expenses as determined for the purposes of fee disclosure in Form N-1A, as the same may be amended from time to time; and (d) any other exclusions enumerated in the Fund's particular expense cap. Without limiting the foregoing, extraordinary expenses are generally those that are unusual or expected to recur only infrequently, and may include such expenses, by way of illustration, as (i) expenses of the reorganization, restructuring, redomiciling or merger of the Fund or class or the acquisition of all or substantially all of the assets of another fund or class; (ii) expenses of holding, and soliciting proxies for, a meeting of shareholders of the Fund or class (except to the extent relating to routine items such as the election of Trustees or the approval of the independent registered public accounting firm); and (iii) expenses of converting to a new custodian, transfer agent or other service provider, in each case to the extent any such expenses are considered extraordinary expenses for the purposes of fee disclosure in Form N-1A as the same may be amended from time to time. In order to implement an expense limitation, the Manager will, as necessary, waive management fees or reimburse operating expenses. However, the Manager is permitted to recapture amounts waived and/or reimbursed to a class within two years after the fiscal year in which the Manager earned the fee or incurred the expense if the class' total annual fund operating expenses have fallen to a level below the class' expense limitation shown in the Fund's Prospectus. In no case will the Manager recapture any amount that would result, on any particular business day of the Fund, in the class' total annual fund operating expenses exceeding such expense limitation or any other lower limit then in effect. These arrangements may be reduced or terminated under certain circumstances.

Investment Professionals

Other Accounts Managed by the Investment Professionals

The table below identifies the investment professionals, the number of accounts (other than the Fund) for which the investment professionals have day-to-day management responsibilities and the total assets in such accounts, within each of the following categories: registered investment companies, other pooled investment vehicles, and other accounts. For each category, the number of accounts and total assets in the accounts where fees are based on performance are also indicated, as applicable. Unless noted otherwise, all information is provided as of March 31, 2026.

Investment Professionals	Type of Account	Number of Accounts Managed	Total Assets Managed (Billions) ($)	Number of Accounts Managed for which Advisory Fee is Performance-Based	Assets Managed for which Advisory Fee is Performance-Based (Billions) ($)
Intermediate-Term Municipals Fund					
Robert E. Amodeo	Registered Investment Companies	17	6.53	None	None
	Other Pooled Investment Vehicles	2	5.35	None	None
	Other Accounts	27	6.73	None	None
Ryan K. Brist	Registered Investment Companies	27	9.13	None	None
	Other Pooled Investment Vehicles	15	13.02	None	None
	Other Accounts	73	30.84	4	1.51
Michael C. Buchanan	Registered Investment Companies	61	89.72	None	None
	Other Pooled Investment Vehicles	184	48.46	13	2.42
	Other Accounts	265	77.90	11	6.17
David T. Fare	Registered	16	6.41	None	None

	Investment Companies				
	Other Pooled Investment Vehicles	2	5.35	None	None
	Other Accounts	14	3.73	None	None
John Mooney	Registered Investment Companies	17	6.53	None	None
	Other Pooled Investment Vehicles	2	5.35	None	None
	Other Accounts	27	6.73	None	None
New Jersey Municipals Fund					
Robert E. Amodeo	Registered Investment Companies	17	7.54	None	None
	Other Pooled Investment Vehicles	2	5.35	None	None
	Other Accounts	27	6.73	None	None
Ryan K. Brist	Registered Investment Companies	27	10.14	None	None
	Other Pooled Investment Vehicles	15	13.02	None	None
	Other Accounts	73	30.84	4	1.51
Michael C. Buchanan	Registered Investment Companies	61	90.73	None	None
	Other Pooled Investment Vehicles	184	48.46	13	2.42

	Other Accounts	265	77.90	11	6.17
David T. Fare	Registered Investment Companies	16	7.42	None	None
	Other Pooled Investment Vehicles	2	5.35	None	None
	Other Accounts	14	3.73	None	None
John Mooney	Registered Investment Companies	17	7.54	None	None
	Other Pooled Investment Vehicles	2	5.35	None	None
	Other Accounts	27	6.73	None	None
New York Municipals Fund					
Robert E. Amodeo	Registered Investment Companies	17	7.45	None	None
	Other Pooled Investment Vehicles	2	5.35	None	None
	Other Accounts	27	6.73	None	None
Ryan K. Brist	Registered Investment Companies	27	10.05	None	None
	Other Pooled Investment Vehicles	15	13.02	None	None
	Other Accounts	73	30.84	4	1.51
Michael C. Buchanan	Registered Investment	61	90.64	None	None

	Companies				
	Other Pooled Investment Vehicles	184	48.46	13	2.42
	Other Accounts	265	77.90	11	6.17
David T. Fare	Registered Investment Companies	16	7.33	None	None
	Other Pooled Investment Vehicles	2	5.35	None	None
	Other Accounts	14	3.73	None	None
John Mooney	Registered Investment Companies	17	7.45	None	None
	Other Pooled Investment Vehicles	2	5.35	None	None
	Other Accounts	27	6.73	None	None
Pennsylvania Municipals Fund					
Robert E. Amodeo	Registered Investment Companies	17	7.62	None	None
	Other Pooled Investment Vehicles	2	5.35	None	None
	Other Accounts	27	6.73	None	None
Ryan K. Brist	Registered Investment Companies	27	10.22	None	None
	Other Pooled Investment Vehicles	15	13.02	None	None

	Other Accounts	73	30.84	4	1.51
Michael C. Buchanan	Registered Investment Companies	61	90.80	None	None
	Other Pooled Investment Vehicles	184	48.46	13	2.42
	Other Accounts	265	77.90	11	6.17
David T. Fare	Registered Investment Companies	16	7.49	None	None
	Other Pooled Investment Vehicles	2	5.35	None	None
	Other Accounts	14	3.73	None	None
John Mooney	Registered Investment Companies	17	7.62	None	None
	Other Pooled Investment Vehicles	2	5.35	None	None
	Other Accounts	27	6.73	None	None

Investment Professionals Securities Ownership

The table below identifies ownership of equity securities of the Fund by the investment professionals responsible for the day-to-day management of the Fund as of March 31, 2026.

Investment Professionals	Dollar Range of Ownership of Securities ($)
Intermediate-Term Municipals Fund	
Robert E. Amodeo	None
Ryan K. Brist	None
Michael C. Buchanan	None
David T. Fare	None
John Mooney	None
New Jersey Municipals Fund	
Robert E. Amodeo	None
Ryan K. Brist	None
Michael C. Buchanan	None
David T. Fare	None
John Mooney	None
New York Municipals Fund	
Robert E. Amodeo	None
Ryan K. Brist	None
Michael C. Buchanan	None
David T. Fare	None
John Mooney	None
Pennsylvania Municipals Fund	
Robert E. Amodeo	None
Ryan K. Brist	None
Michael C. Buchanan	None
David T. Fare	None
John Mooney	None

Conflicts of Interest

The Subadviser has adopted compliance policies and procedures to address a wide range of potential conflicts of interest that could directly impact client portfolios. For example, potential conflicts of interest may arise in connection with the management of multiple portfolios (including portfolios managed in a personal capacity). These could include potential conflicts of interest related to the knowledge and timing of a portfolio's trades, investment opportunities and broker selection. Portfolio managers are privy to the size, timing, and possible market impact of a portfolio's trades.

It is possible that an investment opportunity may be suitable for both a portfolio and other accounts managed by a portfolio manager, but may not be available in sufficient quantities for both the portfolio and the other accounts to participate fully. Similarly, there may be limited opportunity to sell an investment held by a portfolio and another account. A conflict may arise where the portfolio manager may have an incentive to treat an account preferentially as compared to a portfolio because the account pays a performance-based fee or the portfolio manager, the Subadviser or an affiliate has an interest in the account. The Subadviser has adopted procedures for allocation of portfolio transactions and investment opportunities across multiple

client accounts on a fair and equitable basis over time. Eligible accounts that can participate in a trade generally share the same price on a pro-rata allocation basis, taking into account differences based on factors such as cash availability, investment restrictions and guidelines, and portfolio composition versus strategy.

With respect to securities transactions, the Subadviser determines which broker or dealer to use to execute each order, consistent with their duty to seek best execution of the transaction. However, with respect to certain other accounts (such as pooled investment vehicles that are not registered investment companies and other accounts managed for organizations and individuals), the Subadviser may be limited by the client with respect to the selection of brokers or dealers or may be instructed to direct trades through a particular broker or dealer. In these cases, trades for a portfolio in a particular security may be placed separately from, rather than aggregated with, such other accounts. Having separate transactions with respect to a security may temporarily affect the market price of the security or the execution of the transaction, or both, to the possible detriment of a portfolio or the other account(s) involved. Additionally, the management of multiple portfolios and/or other accounts may result in a portfolio manager devoting unequal time and attention to the management of each portfolio and/or other account. The Subadviser's team approach to portfolio management and block trading approach seeks to limit this potential risk.

The Subadviser also maintains a gift and entertainment policy to address the potential for a business contact to give gifts or host entertainment events that may influence the business judgment of an employee. Employees are permitted to retain gifts of only a nominal value and are required to make reimbursement for entertainment events above a certain value. All gifts (except those of a de minimis value) and entertainment events that are given or sponsored by a business contact are required to be reported in a gift and entertainment log which is reviewed on a regular basis for possible issues.

Employees of the Subadviser have access to transactions and holdings information regarding client accounts and the Subadviser's overall trading activities. This information represents a potential conflict of interest because employees may take advantage of this information as they trade in their personal accounts. Accordingly, the Subadviser maintains a Code of Ethics that is compliant with Rule 17j-1 under the 1940 Act and Rule 204A-1 under the Advisers Act to address personal trading. In addition, the Code of Ethics seeks to establish broader principles of good conduct and fiduciary responsibility in all aspects of the Subadviser's business. The Code of Ethics is administered by the Legal and Compliance Department and monitored through the Subadviser's compliance monitoring program.

The Subadviser may also face other potential conflicts of interest with respect to managing client assets, and the description above is not a complete description of every conflict of interest that could be deemed to exist. The Subadviser also maintains a compliance monitoring program and engages independent auditors to conduct a SOC1/ISAE 3402 audit on an annual basis. These steps help to ensure that potential conflicts of interest have been addressed.

Investment Professional Compensation

With respect to the compensation of the Fund's investment professionals, the Subadviser's compensation system assigns each employee a total compensation range, which is derived from annual market surveys that benchmark each role with its job function and peer universe. This method is designed to reward employees with total compensation reflective of the external market value of their skills, experience and ability to produce desired results. Standard compensation includes competitive base salaries, generous employee benefits and a retirement plan.

In addition, the Subadviser's employees are eligible for bonuses. These are structured to closely align the interests of employees with those of the Subadviser, and are determined by the professional's job function and pre-tax performance as measured by a formal review process. All bonuses are completely discretionary. The principal factor considered is an investment professional's investment performance versus appropriate peer groups and benchmarks (i.e., a securities index and with respect to the Fund, the benchmark set forth in the Fund's Prospectus to which the Fund's average annual total returns are compared or, if none, the benchmark set forth in the Fund's annual report). Performance is reviewed on a 1, 3 and 5 year basis for compensation—with 3 and 5 years having a larger emphasis. The Subadviser may also measure an investment professional's pre-tax investment performance against other benchmarks, as it determines appropriate. Because investment professionals are generally responsible for multiple accounts (including the Fund) with similar investment strategies, they are generally compensated on the performance of the aggregate group of similar accounts, rather than a specific account. Other factors that may be considered when making bonus decisions include client service, business development, length of service to the Subadviser, management or supervisory responsibilities, contributions to developing business strategy and overall contributions to the Subadviser's business.

Finally, in order to attract and retain top talent, all investment professionals are eligible for additional incentives in recognition of outstanding performance. These are determined based upon the factors described above and include long-term incentives that vest over a set period of time past the award date.

Custodian and Transfer Agent

The Fund has entered into an agreement with The Bank of New York Mellon ("BNY Mellon"), 240 Greenwich Street, New York, New York 10286, to serve as custodian of the Fund. BNY Mellon, among other things, maintains a custody account or accounts in the name of the Fund, receives and delivers all assets for the Fund upon purchase and upon sale or maturity, collects and receives all income and other payments and distributions on account of the assets of the Fund and makes disbursements on behalf of the Fund. BNY Mellon neither determines the Fund's investment policies nor decides which securities the Fund will buy or sell. For its services, BNY Mellon receives a monthly fee based upon the daily average market value of securities held in custody and also receives securities transaction charges, including out-of-pocket expenses. The Fund may also periodically enter into arrangements with other qualified custodians with respect to certain types of securities or other transactions such as repurchase agreements or derivatives transactions.

Franklin Templeton Investor Services, LLC ("Investor Services") is the Fund's shareholder servicing agent and acts as the Fund's transfer agent and dividend-paying agent. Investor Services is located at 3344 Quality Drive, Rancho Cordova, CA 95670-7313. Please send all correspondences relating to the Fund to Investor Services at P.O. Box 33030, St. Petersburg, FL 33733-8030.

Investor Services receives a fee for servicing Fund shareholder accounts. The Fund also will reimburse Investor Services for certain out-of-pocket expenses necessarily incurred in servicing the shareholder accounts in accordance with the terms of its servicing contract with the Fund.

In addition, Investor Services may make payments (or cause payments to be made) to financial intermediaries that provide administrative services to defined benefit plans. Investor Services does not seek reimbursement by the Fund for such payments.

For all classes of shares of the Fund, except for Class IS shares, Investor Services may also pay servicing fees, that will be reimbursed by the Fund, in varying amounts to certain financial institutions (to help offset their costs associated with client account maintenance support, statement preparation and transaction processing) that (i) maintain omnibus accounts with the Fund in the institution's name on behalf of numerous beneficial owners of Fund shares who are either direct clients of the institution or are participants in an IRS-recognized tax-advantaged savings plan (including Employer Sponsored Retirement Plans and Section 529 Plans) for which the institution, or its affiliate, provides participant level recordkeeping services (called "Beneficial Owners"); or (ii) provide support for Fund shareholder accounts by sharing account data with Investor Services through the National Securities Clearing Corporation (NSCC) networking system. In addition to servicing fees received from the Fund, these financial institutions also may charge a fee for their services directly to their clients. Investor Services will also receive a fee from the Fund (other than for Class IS shares) for services provided in support of Beneficial Owners and NSCC networking system accounts.

Fund Counsel

Ropes & Gray LLP, 1211 Avenue of the Americas, New York, New York 10036, serves as legal counsel to the Trust and the Fund.

Independent Registered Public Accounting Firm

PricewaterhouseCoopers LLP, 301 Mission Boulevard #1501, Baltimore, Maryland 21230, serves as the Fund's independent registered public accounting firm.

PORTFOLIO TRANSACTIONS AND BROKERAGE

Portfolio Transactions

Pursuant to the Subadvisory Agreement and subject to the general supervision of the Board and in accordance with the Fund's investment objectives and strategies, the Subadviser is responsible for the execution of the Fund's portfolio transactions

with respect to assets allocated to the Subadviser. The Subadviser is authorized to place orders pursuant to its investment determinations for the Fund either directly with the issuer or with any broker or dealer, foreign currency dealer, futures commission merchant or others selected by it.

In certain instances, there may be securities that are suitable as an investment for the Fund as well as for one or more of the other clients of the Subadviser. Investment decisions for the Fund and for the Subadviser's other clients are made with a view to achieving their respective investment objectives. It may develop that a particular security is bought or sold for only one client even though it might be held by, or bought or sold for, other clients. Likewise, a particular security may be bought for one or more clients when one or more clients are selling the same security. Some simultaneous transactions are inevitable when several clients receive investment advice from the same investment adviser, particularly when the same security is suitable for the investment objectives of more than one client. When two or more clients are simultaneously engaged in the purchase or sale of the same security, the securities are allocated among clients in a manner believed to be equitable to each. It is recognized that in some cases this system could adversely affect the price of or the size of the position obtainable in a security for the Fund. When purchases or sales of the same security for the Fund and for other portfolios managed by the Subadviser occur contemporaneously, the purchase or sale orders may be aggregated in order to obtain any price advantages available to large volume purchases or sales.

Transactions on stock exchanges and other agency transactions involve the payment of negotiated brokerage commissions by the Fund. Transactions in foreign securities often involve the payment of brokerage commissions that may be higher than those in the United States. Fixed income securities are generally traded on a net basis (i.e., without a commission) through dealers acting as principal for their own account and not as brokers. This means that a dealer makes a market for securities by offering to buy at one price and selling the security at a slightly higher price. The difference between the prices is known as a "spread." Other portfolio transactions may be executed through brokers acting as agents and the Fund will pay a spread or commission in connection with such transactions. The cost of securities purchased from underwriters includes an underwriting commission, concession or a net price. The Fund may also purchase securities directly from the issuer. The aggregate brokerage commissions paid by the Fund for the three most recent fiscal years or periods, as applicable, are set forth below under "Aggregate Brokerage Commissions Paid."

Brokerage and Research Services

The general policy of the Subadviser in selecting brokers and dealers is to obtain the best results achievable in the context of a number of factors which are considered both in relation to individual trades and broader trading patterns. The Fund may not always pay the lowest commission or spread available. Rather, in placing orders on behalf of the Fund, the Subadviser also takes into account other factors bearing on the overall quality of execution, such as size of the order, difficulty of execution, the reliability of the broker/dealer, the competitiveness of the price and the commission, the research services received and whether the broker/dealer commits its own capital.

In connection with the selection of such brokers or dealers and the placing of such orders, subject to applicable law, brokers or dealers may be selected who also provide brokerage and research services (as those terms are defined in Section 28(e) of the 1934 Act) to the Fund and/or the other accounts over which the Subadviser or its affiliates exercise investment discretion. The Subadviser is authorized to pay a broker or dealer that provides such brokerage and research services a commission for executing a portfolio transaction for the Fund which is in excess of the amount of commission another broker or dealer would have charged for effecting that transaction if the Subadviser determines in good faith that such amount of commission is reasonable in relation to the value of the brokerage and research services provided by such broker or dealer. Investment research services include information and analysis on particular companies and industries as well as market or economic trends and portfolio strategy, market quotations for portfolio evaluations, analytical software and similar products and services. If a research service also assists the Subadviser in a non-research capacity (such as bookkeeping or other administrative functions), then only the percentage or component that provides assistance to the Subadviser in the investment decision making process may be paid in commission dollars. This determination may be viewed in terms of either that particular transaction or the overall responsibilities that the Subadviser and its affiliates have with respect to accounts over which they exercise investment discretion. The Subadviser may also have arrangements with brokers pursuant to which such brokers provide research services to the Subadviser in exchange for a certain volume of brokerage transactions to be executed by such brokers. While the payment of higher commissions increases the Fund's costs, the Subadviser does not believe that the receipt of such brokerage and research services significantly reduces its expenses as Subadviser. Arrangements for the receipt of research

services from brokers (so-called "soft dollar" arrangements) may create conflicts of interest. Although the Subadviser is authorized to use soft dollar arrangements in order to obtain research services, it is not required to do so, and the Subadviser may not be able or may choose not to use soft dollar arrangements because of regulatory restrictions, operational considerations or for other reasons.

Research services furnished to the Subadviser by brokers that effect securities transactions for the Fund may be used by the Subadviser in servicing other investment companies and accounts which the Subadviser manages. Similarly, research services furnished to the Subadviser by brokers that effect securities transactions for other investment companies and accounts which the Subadviser manages may be used by the Subadviser in servicing the Fund. Not all of these research services are used by the Subadviser in managing any particular account, including the Fund.

Firms that provide research and brokerage services to the Subadviser may also promote the sale of the Fund or other pooled investment vehicles advised by the Subadviser, and the Subadviser and/or its affiliates may separately compensate them for doing so. Such brokerage business is placed on the basis of brokerage and research services provided by the firm and is not based on any sales of the Fund or other pooled investment vehicles advised by the Subadviser.

The Fund contemplates that, consistent with the policy of obtaining the best net results, brokerage transactions may be conducted through "affiliated broker/dealers," as defined in the 1940 Act. The Fund's Board has adopted procedures in accordance with Rule 17e-1 under the 1940 Act to ensure that all brokerage commissions paid to such affiliates are reasonable and fair in the context of the market in which such affiliates operate. For the three most recent fiscal periods (as applicable), the Fund did not pay any brokerage commission to its affiliates.

Aggregate Brokerage Commissions Paid

The table below shows the aggregate brokerage commissions paid by the Fund during the periods indicated.

Fund	For the Fiscal Period Ended March 31,	Aggregate Brokerage Commissions Paid ($)
Intermediate-Term Municipals Fund	2026	4,136
	2025	15,376
	2024	10,994
New Jersey Municipals Fund	2026	62
	2025	498
	2024	374
New York Municipals Fund	2026	138
	2025	1,107
	2024	810
Pennsylvania Municipals Fund	2026	40
	2025	318
	2024	247

For the fiscal period ended March 31, 2026, the Fund did not direct any brokerage transactions related to research services and did not pay any brokerage commissions related to research services.

Securities of Regular Broker/Dealers

As of March 31, 2026, the Fund did not hold securities issued by its regular broker/dealers (as defined in Rule 10b-1 under the 1940 Act).

Portfolio Turnover

For reporting purposes, the Fund's portfolio turnover rate is calculated by dividing the lesser of purchases or sales of portfolio securities for the fiscal year by the monthly average of the value of the portfolio securities owned by the Fund during the fiscal year. In determining such portfolio turnover, all securities whose maturities at the time of acquisition were one year or less are excluded. A 100% portfolio turnover rate would occur, for example, if all of the securities in the Fund's investment portfolio (other than short-term money market securities) were replaced once during the fiscal year.

In the event that portfolio turnover increases, this increase necessarily results in correspondingly greater transaction costs which must be paid by the Fund. To the extent the portfolio trading results in recognition of net short-term capital gains, shareholders that hold their shares in a taxable account will generally be taxed on distributions of such gains at ordinary tax rates.

Portfolio turnover will not be a limiting factor should the Subadviser deem it advisable to purchase or sell securities.

Fund	For the Fiscal Period Ended 2026 (%)	For the Fiscal Period Ended 2025 (%)
Intermediate-Term Municipals Fund	6	10
New Jersey Municipals Fund	5	17
New York Municipals Fund	6	9
Pennsylvania Municipals Fund	9	1

SHARE OWNERSHIP

Principal Shareholders

As of June 30, 2026, to the knowledge of the Trust, the following shareholders owned of record or beneficially 5% or more of the outstanding shares of the classes of the Fund as set forth below:

Class	Name and Address	Percent of Class (%)
Intermediate-Term Municipals Fund		
A	EDWARD D JONES & CO FOR THE BENEFIT OF CUSTOMERS 12555 MANCHESTER RD SAINT LOUIS MO 63131-3729	34.80
A	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	20.15
A	BNY MELLON INVESTMENT SERVICING (US) INC FBO PRIMERICA FINANCIAL SERVICES 760 MOORE RD KING OF PRUSSIA PA 19406-1212	16.07
C	AMERICAN ENTERPRISE INVESTMENT SVC 707 2ND AVE S MINNEAPOLIS MN 55402-2405	24.21

Class	Name and Address	Percent of Class (%)
C	WELLS FARGO CLEARING SVCS LLC 2801 MARKET STREET SAINT LOUIS, MO 63103	16.45
C	RAYMOND JAMES OMNIBUS FOR MUTUAL FUNDS 880 CARILLON PKWY ST PETERSBURG FL 33716-1100	13.30
C	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	10.39
C	STIFEL NICOLAUS & CO INC EXCLUSIVE BENEFIT OF CUSTOMERS 501 N BROADWAY ST LOUIS MO 63102-2188	9.03
C	LPL FINANCIAL OMNIBUS CUSTOMER ACCOUNT 4707 EXECUTIVE DRIVE SAN DIEGO CA 92121	6.91
C	PERSHING LLC 1 PERSHING PLZ JERSEY CITY NJ 07399-0001	5.69
I	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	29.91
I	NATIONAL FINANCIAL SERVICES CORP FBO EXCLUSIVE BENEFIT OF OUR CUST ATTN MUTUAL FUNDS DEPT 4TH FLOOR 499 WASHINGTON BLVD JERSEY CITY NJ 07310-2010	14.42
I	AMERICAN ENTERPRISE INVESTMENT SVC 707 2ND AVE S MINNEAPOLIS MN 55402-2405	14.19
I	RAYMOND JAMES OMNIBUS FOR MUTUAL FUNDS 880 CARILLON PKWY ST PETERSBURG FL 33716-1100	9.42

Class	Name and Address	Percent of Class (%)
I	LPL FINANCIAL OMNIBUS CUSTOMER ACCOUNT 4707 EXECUTIVE DRIVE SAN DIEGO CA 92121	6.57
I	RBC CAPITAL MARKETS, LLC MUTUAL FUND OMNIBUS PROCESSING OMNIBUS ATT MUTL FD OPS MANAGER 250 NICOLLET MALL STE 1400 MINNEAPOLIS MN 55401-1931	5.59
I	CHARLES SCHWAB & CO INC SPECIAL CUSTODY ACCT FBO CUSTOMERS ATTN MUTUAL FUNDS 211 MAIN STREET SAN FRANCISCO CA 94105-1905	5.58
IS	EDWARD D JONES & CO FOR THE BENEFIT OF CUSTOMERS 12555 MANCHESTER RD SAINT LOUIS MO 63131-3729	74.83
IS	NATIONAL FINANCIAL SERVICES CORP FBO EXCLUSIVE BENEFIT OF OUR CUST ATTN MUTUAL FUNDS DEPT 4TH FLOOR 499 WASHINGTON BLVD JERSEY CITY NJ 07310-2010	10.21
New Jersey Municipals Fund		
A	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	33.78
A	BNY MELLON INVESTMENT SERVICING (US) INC FBO PRIMERICA FINANCIAL SERVICES 760 MOORE RD KING OF PRUSSIA PA 19406-1212	16.67
A	MLPF&S FOR THE SOLE BENEFIT OF ITS CUSTOMERS ATTN: FUND ADMINISTRATION 4800 DEER LAKE DRIVE EAST 3RD FLOOR JACKSONVILLE FL 32246-6484	15.34

Class	Name and Address	Percent of Class (%)
A	WELLS FARGO CLEARING SVCS LLC 2801 MARKET STREET SAINT LOUIS, MO 63103	11.63
A	PERSHING LLC 1 PERSHING PLZ JERSEY CITY NJ 07399-0001	5.14
C	AMERICAN ENTERPRISE INVESTMENT SVC 707 2ND AVE S MINNEAPOLIS MN 55402-2405	41.81
C	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	29.88
C	LPL FINANCIAL OMNIBUS CUSTOMER ACCOUNT 4707 EXECUTIVE DRIVE SAN DIEGO CA 92121	8.34
C	RAYMOND JAMES OMNIBUS FOR MUTUAL FUNDS 880 CARILLON PKWY ST PETERSBURG FL 33716-1100	5.86
C	WELLS FARGO CLEARING SVCS LLC 2801 MARKET STREET SAINT LOUIS, MO 63103	5.13
I	NATIONAL FINANCIAL SERVICES CORP FBO EXCLUSIVE BENEFIT OF OUR CUST ATTN MUTUAL FUNDS DEPT 4TH FLOOR 499 WASHINGTON BLVD JERSEY CITY NJ 07310-2010	20.12
I	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	20.09
I	AMERICAN ENTERPRISE INVESTMENT SVC 707 2ND AVE S MINNEAPOLIS MN 55402-2405	15.39

Class	Name and Address	Percent of Class (%)
I	WELLS FARGO CLEARING SVCS LLC 2801 MARKET STREET SAINT LOUIS, MO 63103	11.97
I	RAYMOND JAMES OMNIBUS FOR MUTUAL FUNDS 880 CARILLON PKWY ST PETERSBURG FL 33716-1100	8.64
I	MLPF&S FOR THE SOLE BENEFIT OF ITS CUSTOMERS ATTN: FUND ADMINISTRATION 4800 DEER LAKE DRIVE EAST 3RD FLOOR JACKSONVILLE FL 32246-6484	7.48
I	LPL FINANCIAL OMNIBUS CUSTOMER ACCOUNT 4707 EXECUTIVE DRIVE SAN DIEGO CA 92121	5.34
New York Municipals Fund		
A	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	39.94
A	PERSHING LLC 1 PERSHING PLZ JERSEY CITY NJ 07399-0001	25.18
A	BNY MELLON INVESTMENT SERVICING (US) INC FBO PRIMERICA FINANCIAL SERVICES 760 MOORE RD KING OF PRUSSIA PA 19406-1212	6.50
C	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	27.49
C	PERSHING LLC 1 PERSHING PLZ JERSEY CITY NJ 07399-0001	25.41

Class	Name and Address	Percent of Class (%)
C	JP MORGAN SECURITIES LLC OMNIBUS ACCOUNT FOR THE EXCLUSIVE BENEFIT OF CUSTOMERS 3RD FLOOR MUTUAL FUND DEPARTMENT BROOKLYN NY 11245	12.93
C	NATIONAL FINANCIAL SERVICES LLC FOR THE EXCLUSIVE BENEFIT OF OUR CUSTOMERS ATTN MUTUAL FUNDS DEPARTMENT 4TH FL 499 WASHINGTON BLVD JERSEY CITY NJ 07310	10.98
C	WELLS FARGO CLEARING SVCS LLC 2801 MARKET STREET SAINT LOUIS, MO 63103	10.07
I	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	51.55
I	MLPF&S FOR THE SOLE BENEFIT OF ITS CUSTOMERS ATTN: FUND ADMINISTRATION 4800 DEER LAKE DRIVE EAST 3RD FLOOR JACKSONVILLE FL 32246-6484	13.11
I	PERSHING LLC 1 PERSHING PLZ JERSEY CITY NJ 07399-0001	11.65
I	NATIONAL FINANCIAL SERVICES CORP FBO EXCLUSIVE BENEFIT OF OUR CUST ATTN MUTUAL FUNDS DEPT 4TH FLOOR 499 WASHINGTON BLVD JERSEY CITY NJ 07310-2010	5.67
I	WELLS FARGO CLEARING SVCS LLC 2801 MARKET STREET SAINT LOUIS, MO 63103	5.32
Pennsylvania Municipals Fund		
A	BNY MELLON INVESTMENT SERVICING (US) INC FBO PRIMERICA FINANCIAL SERVICES 760 MOORE RD KING OF PRUSSIA PA 19406-1212	24.53

Class	Name and Address	Percent of Class (%)
A	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	18.98
A	WELLS FARGO CLEARING SVCS LLC 2801 MARKET STREET SAINT LOUIS, MO 63103	14.72
A	MLPF&S FOR THE SOLE BENEFIT OF ITS CUSTOMERS ATTN: FUND ADMINISTRATION 4800 DEER LAKE DRIVE EAST 3RD FLOOR JACKSONVILLE FL 32246-6484	8.75
C	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	22.39
C	WELLS FARGO CLEARING SVCS LLC 2801 MARKET STREET SAINT LOUIS, MO 63103	16.67
C	AMERICAN ENTERPRISE INVESTMENT SVC 707 2ND AVE S MINNEAPOLIS MN 55402-2405	11.39
C	RAYMOND JAMES OMNIBUS FOR MUTUAL FUNDS 880 CARILLON PKWY ST PETERSBURG FL 33716-1100	10.41
C	LPL FINANCIAL OMNIBUS CUSTOMER ACCOUNT 4707 EXECUTIVE DRIVE SAN DIEGO CA 92121	9.81
C	STIFEL NICOLAUS & CO INC EXCLUSIVE BENEFIT OF CUSTOMERS 501 N BROADWAY ST LOUIS MO 63102-2188	9.06
C	OPPENHEIMER CO INC FBO HELEN M MICHAELS 3322 ARDMORE ST BURLINGTON NC 27215	6.67

Class	Name and Address	Percent of Class (%)
I	AMERICAN ENTERPRISE INVESTMENT SVC 707 2ND AVE S MINNEAPOLIS MN 55402-2405	37.85
I	UBS WM USA FBO SPEC CDY A/C EXL BEN CUSTOMERS OF UBSFSI 1000 HARBOR BLVD WEEHAWKEN, NJ 07086	11.85
I	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	11.45
I	LPL FINANCIAL OMNIBUS CUSTOMER ACCOUNT 4707 EXECUTIVE DRIVE SAN DIEGO CA 92121	7.28
I	MLPF&S FOR THE SOLE BENEFIT OF ITS CUSTOMERS ATTN: FUND ADMINISTRATION 4800 DEER LAKE DRIVE EAST 3RD FLOOR JACKSONVILLE FL 32246-6484	5.12

As of June 30, 2026, to the knowledge of the Trust, the following shareholders owned of record or beneficially 25% or more of the outstanding shares of the Fund as set forth below. Shareholders who beneficially own 25% or more of the outstanding shares of the Fund or who are otherwise deemed to "control" the Fund may be able to determine or significantly influence the outcome of matters submitted to a vote of the Fund's shareholders.

Fund	Name and Address	Percent of Fund (%)
Intermediate-Term Municipals Fund	EDWARD D JONES & CO FOR THE BENEFIT OF CUSTOMERS 12555 MANCHESTER RD SAINT LOUIS MO 63131-3729	30.97
New Jersey Municipals Fund	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12 NEW YORK NY 10004-1901	28.50
New York Municipals Fund	MORGAN STANLEY SMITH BARNEY LLC FOR THE EXCLUSIVE BENEFIT OF ITS CUSTOMERS 1 NEW YORK PLAZA FL 12	41.41

NEW YORK NY 10004-1901

As of June 30, 2026, the Trustees and officers of the Trust, as a group, owned less than 1% of the outstanding shares of each class of the Fund.

DISTRIBUTOR

Franklin Distributors, LLC, an indirect, wholly-owned broker/dealer subsidiary of Franklin Resources, located at One Franklin Parkway, San Mateo, CA 94403-1906, serves as the sole and exclusive distributor of the Fund pursuant to a written agreement (as amended, the "Distribution Agreement").

Under the Distribution Agreement, the Distributor is appointed as principal underwriter and distributor in connection with the offering and sale of shares of the Fund. The Distributor offers the shares on an agency or "best efforts" basis under which the Fund issues only the number of shares actually sold. Shares of the Fund are continuously offered by the Distributor.

The Distribution Agreement is renewable from year to year with respect to the Fund if approved (a) by the Board or by a vote of a majority of the Fund's outstanding voting securities, and (b) by the affirmative vote of a majority of Trustees who are not parties to such agreement or interested persons of any party by votes cast in person at a meeting called for such purpose.

The Distribution Agreement is terminable with respect to the Fund without penalty by the Board or by vote of a majority of the outstanding voting securities of the Fund, or by the Distributor, on not less than 60 days' written notice to the other party (unless the notice period is waived by mutual consent). The Distribution Agreement will automatically and immediately terminate in the event of its assignment.

The Distributor may be deemed to be an underwriter for purposes of the 1933 Act. Dealer reallowances, if any, are described in the Fund's Prospectus.

The Distributor, the Manager, their affiliates and their personnel have interests in promoting sales of Franklin Templeton funds, including remuneration, fees and profitability relating to services to and sales of the funds. Associated persons of the Manager, the Distributor or their affiliates (including wholesalers registered with the Distributor) may receive additional compensation related to the sale of individual Franklin Templeton funds or categories of Franklin Templeton funds. The Manager, the Subadviser, and their advisory or other personnel may also benefit from increased amounts of assets under management.

Service Agents also may benefit from the sales of shares of funds sold by the Distributor. For example, in connection with such sales, Service Agents may receive compensation from the Fund (with respect to the Fund as a whole or a particular class of shares) and/or from the Manager, the Distributor, and/or their affiliates, as further described below. The structure of these compensation arrangements, as well as the amounts paid under such arrangements, vary and may change from time to time. In addition, new compensation arrangements may be negotiated at any time. The compensation arrangements described in this section are not mutually exclusive, and a single Service Agent may receive multiple types of compensation.

The Distributor has agreements in place with Service Agents defining how much each firm will be paid for the sale of the Fund from sales charges, if any, paid by Fund shareholders and from 12b-1 Plan fees, if any, paid to the Distributor by the Fund. These Service Agents then pay their employees or associated persons who sell such fund shares from the sales charges and/or fees they receive. The Service Agent, and/or its employees or associated persons may receive a payment when a sale is made and will, in most cases, continue to receive ongoing payments while you are invested in the Fund. In other cases, the Distributor may retain all or a portion of such fees and sales charges.

In addition, the Distributor, the Manager and/or certain of their affiliates may make additional payments (which are often referred to as "revenue sharing" payments) to the Service Agents from their past profits and other available sources, including profits from their relationships with the Fund. Revenue sharing payments are a form of compensation paid to a Service Agent in addition to the sales charges paid by Fund shareholders or 12b-1 Plan fees paid by the Fund. The Manager, the Distributor and/or certain of its affiliates may revise the terms of any existing revenue sharing arrangement and may enter into additional revenue sharing arrangements with other Service Agents.

Revenue sharing arrangements are intended, among other things, to foster the sale of Fund shares and/or to compensate financial services firms for assisting in marketing or promotional activities in connection with the sale of Fund

shares. In exchange for revenue sharing payments, the Manager and the Distributor generally expect to receive the opportunity for the Fund to be sold through the Service Agents' sales forces or to have access to third-party platforms or other marketing programs, including but not limited to mutual fund "supermarket" platforms or other sales programs. To the extent that Service Agents receiving revenue sharing payments sell more shares of the Fund, the Manager and the Distributor and/or their affiliates benefit from the increase in Fund assets as a result of the fees they receive from the Fund. The Distributor, FTFA or their affiliates consider revenue sharing arrangements based on a variety of factors and services to be provided.

Revenue sharing payments are usually calculated based on a percentage of Fund sales and/or Fund assets attributable to a particular Service Agent. Payments are at times based on other criteria or factors such as, for example, a fee per each transaction. Specific payment formulas are negotiated based on a number of factors, including, but not limited to, reputation in the industry, ability to attract and retain assets, target markets, customer relationships and scope and quality of services provided. In addition, the Distributor, the Manager and/or certain of their affiliates may pay flat fees on a one-time or irregular basis for the initial set-up of the Fund on a Service Agent's systems, participation or attendance at a Service Agent's meetings, or for other reasons. Furthermore, the Distributor, the Manager and/or certain of their affiliates at times pay certain education and training costs of Service Agents (including, in some cases, travel expenses) to train and educate the personnel of the Service Agents. In addition, the Distributor, the Manager and/or certain of their affiliates at times may provide access to technology and other tools and support services that facilitate the marketing and promotion of investment management portfolios sponsored by Franklin Templeton and/or its affiliates. It is likely that Service Agents that execute portfolio transactions for the Fund will include those firms with which the Manager, the Distributor and/or certain of their affiliates have entered into revenue sharing arrangements.

The Fund generally pays the transfer agent for certain recordkeeping and administrative services. In addition, the Fund may pay Service Agents for certain recordkeeping, administrative, sub-accounting and networking services. These services include maintenance of shareholder accounts by the firms, such as recordkeeping and other activities that otherwise would be performed by the Fund's transfer agent. Administrative fees may be paid to a firm that undertakes, for example, shareholder communications on behalf of the Fund. Networking services are services undertaken to support the electronic transmission of shareholder purchase and redemption orders through the National Securities Clearing Corporation ("NSCC"). These payments are generally based on either (1) a percentage of the average daily net assets of Fund shareholders serviced by a Service Agent or (2) a fixed dollar amount for each account serviced by a Service Agent. The Distributor, the Manager and/or their affiliates may make all or a portion of these payments.

In addition, the Fund reimburses the Distributor for NSCC fees that are invoiced to the Distributor as the party to the agreement with NSCC for the administrative services provided by NSCC to the Fund and its shareholders. These services include transaction processing and settlement through Fund/SERV, electronic networking services to support the transmission of shareholder purchase and redemption orders to and from Service Agents, and related recordkeeping provided by NSCC to the Fund and its shareholders.

If your Fund shares are purchased through a retirement plan, the Distributor, the Manager or certain of their affiliates at times also make similar payments to those described in this section to the plan's recordkeeper or an affiliate.

Revenue sharing payments, as well as the other types of compensation arrangements described in this section, create an incentive for Service Agents and their employees or associated persons to recommend the Fund over other investments or sell shares of the Fund to customers and in doing so may create conflicts of interest between the firms' financial interests and the interests of their customers. The total amount of these payments is substantial, may be substantial to any given recipient and may exceed the costs and expenses incurred by the recipient for any Fund-related marketing or shareholder servicing activities.

As of December 31, 2025, the Distributor, the Manager or their affiliates made revenue sharing payments to the Service Agents listed below (or their affiliates or successors). It is possible that each Service Agent listed is not receiving payments with respect to each fund sold by the Distributor. This list of intermediaries will change over time, and any additions, modifications or deletions thereto that have occurred since December 31, 2025 are not reflected.

ADP Retirement Services
Allianz Life Insurance Company
Allstate Life Insurance Company
American Enterprise Investment Services Inc.
American General Life Insurance Co of DE
American General Life Insurance Co.
American United Life Insurance Company
Ameriprise Financial, Inc

Ameritas Life Insurance Corporation
Ascensus, Inc.
AuguStar Life Insurance Company
Axelus Financial
BlackRock Inc
Brighthouse Life Insurance Company
CAIS LLC
Cetera Financial Group
Citigroup Global Markets Inc.
CMFG Life Insurance Company
Commonwealth Annuity & Life Insurance Company
Connecticut Mutual Life Insurance Company
Delaware Life Insurance Co
Deutsche Bank
Edward D. Jones & Co., L.P.
Empower Annuity Insurance Company of America
Empower Life & Annuity Insurance Company of New York
Equitable Advisors, LLC
Equitable Life Insurance Company
Fidelity Investments
First Allmerica Financial Life Insurance Company
First Security Benefit Life Insurance and Annuity Company of NY
Forethought Life Insurance Company
Genworth Life & Annuity Insurance Company
Genworth Life Insurance Company of NY
Guardian Insurance & Annuity Company
Integrity Life Insurance Company
Janney Montgomery Scott LLC
Kestra Investment Services, LLC
Lincoln Investment Planning, Inc.
Lincoln National Life Insurance Company
LPL Financial LLC
Members Life Insurance Company
MetLife Insurance Company USA
Midland National
Minnesota Life Insurance Company
MONY Life Insurance Company of America (Equitable)
Morgan Stanley Smith Barney LLC
Nassau Life Insurance Company
National Integrity Life Insurance Company
National Security Life & Annuity Company
Nationwide Life Insurance Company
Northwestern Mutual Investment Svcs LLC
Osaic Wealth, Inc.
Pacific Life Insurance Company
PCS Retirement
PHL Variable Insurance Company
Phoenix Life Insurance Company
Primerica
Principal Life Insurance Company
Protective Life and Annuity Insurance Company
Pruco Life Insurance
Annuity Investors Life Insurance Company
Atria Wealth Solutions
Avantax Investment Services, Inc.
Benjamin F. Edwards & Company, Inc.
Brighthouse Financial
Brighthouse Life Insurance Company of NY
Cambridge Investment Research, Inc
Charles Schwab & Co.
Citizens Securities, Inc.
Columbia ThreadNeedle
Commonwealth Financial Network
Corebridge Insurance Company of Bermuda, Ltd
Delaware Life Insurance Co of NY
DWC-The 401(K) Experts
Empire Fidelity Investments Life
Empower Financial Services
Envestnet
Equitable Financial Life Insurance
Everlake Services Company
Fidelity Investments Life Insurance Co
First Command
Forethought Distributors, LLC
FTMF Consulting
Genworth Life Insurance
Goldman Sachs
Hantz Financial Services
J.P. Morgan Securities LLC
John Hancock
Lincoln Benefit Life Company
Lincoln Life & Annuity Company of NY
Lincoln Retirement Services Co
Massachusetts Mutual Life Insurance Company
Merrill Lynch, Pierce, Fenner & Smith, Inc.
Metropolitan Life Insurance Company
Midland National Life Insurance Company
MML Investors Services, LLC
MONY Life Insurance Company of America (Protective Life)
MSCS
National Financial Services LLC
National Life Insurance Company
Nationwide Financial Services, Inc.
New York Life Insurance and Annuity Corporation
Osaic Services, Inc
Pacific Life and Annuity Company
Paychex Securities Corp
Pershing
Phoenix Life & Annuity Company
PNC Investments LLC
Principal Financial Services
Principal National Life Insurance Company
Protective Life Insurance Company
Pruco Life Insurance Company of AZ

Pruco Life Insurance Company of NJ
Raymond James & Associates, Inc.
RBC Capital Markets LLC
ReliaStar Life Insurance Company of NY
Riversource Life Insurance Company of New York
Rockefeller Capital
Sanctuary Wealth
Security Benefit Life Insurance Company
Stifel Financial Corporation
Symetra Life Insurance Company
Talcott Resolution Life Insurance Company
The Guardian Insurance & Annuity Company, Inc.
Thrivent Financial for Lutherans
TIAA-CREF Life Insurance Company
Transamerica Financial Life Insurance Company
Transamerica Premier Life Insurance Company
UBS Financial Services, Inc.
USI Consulting Group
Vanguard Marketing Corporation
Voya Financial Advisors, LLC
Wells Fargo Advisors, LLC
Western National Life Insurance Company
Prudential Insurance Company of America
Raymond James Financial Services, Inc.
ReliaStar Life Insurance Company
Riversource Life Insurance Company
Robert W. Baird & Co., Inc.
Sammons Financial Network
Securian Financial Group, Inc
Standard Insurance Company
SunAmerica Annuity and Life Assurance Company
Talcott Resolution Life and Annuity Insurance Company
TFS Securities, Inc.
The Variable Annuity Life Insurance Company (VALIC)
TIAA-CREF Individual & Institutional Services, LLC
TIFIN Wealth
Transamerica Life Insurance Company
U.S. Bancorp Investments
United States Life Insurance Co in the City of NY
(fka First SunAmerica)
Valor Financial Securities, LLC
Venerable Insurance and Annuity Company
Voya Retirement Insurance and Annuity Company
Wells Fargo Clearing Services, LLC
Wilton Reassurance Life Company of New York

The Distributor, the Manager or their affiliates may also pay fees, from their own assets, to Service Agents for providing other distribution-related services as well as recordkeeping, administrative, subaccounting, and networking services (or portions thereof), and other shareholder or administrative services in connection with investments in the Fund. These payments may be considered revenue sharing payments. The Service Agents receiving such payments may not be listed above.

You should assume that your Service Agent receives revenue sharing payments and/or other compensation described in this SAI. Please contact your Service Agent for details about any payments it (and its employees) may receive from the Fund and/or from the Distributor, the Manager and/or their affiliates. You should review your Service Agent's disclosure and/or talk to your Service Agent to obtain more information on how this compensation may have influenced your Service Agent's recommendation of the Fund.

Dealer Commissions and Concessions

From time to time, the Distributor or the Manager, at its expense, may provide compensation or promotional incentives ("concessions") to dealers that sell or arrange for the sale of shares of the Fund or a managed account strategy of which the Fund is part. Such concessions provided by the Distributor or the Manager may include financial assistance to dealers in connection with preapproved conferences or seminars, sales or training programs for invited registered representatives and other employees, payment for travel expenses, including lodging, incurred by registered representatives and other employees for such seminars or training programs, seminars for the public, advertising and sales campaigns regarding one or more funds, and/or other dealer-sponsored events. From time to time, the Distributor or the Manager may make expense reimbursements for special training of a dealer's registered representatives and other employees in group meetings or to help pay the expenses of sales contests. Other concessions may be offered to the extent not prohibited by applicable laws or any self-regulatory agency, such as the FINRA.

Sales Charges

The following expenses were incurred during the fiscal periods indicated:

Initial Sales Charges

The aggregate dollar amounts of initial sales charges received on Class A shares and the amounts retained by the Distributor were as follows:

Class A Shares

Fund	For the Fiscal Period Ended March 31,	Total Commissions ($)	Amounts Retained by Distributor ($)
Intermediate-Term Municipals Fund	2026	372,013	22,904
	2025	625,268	29,882
	2024	820,020	39,596
New Jersey Municipals Fund	2026	114,505	2,959
	2025	108,072	2,665
	2024	86,408	2,816
New York Municipals Fund	2026	75,624	2,751
	2025	104,133	3,610
	2024	119,854	3,897
Pennsylvania Municipals Fund	2026	36,252	1,656
	2025	49,664	2,103
	2024	41,163	2,531

Contingent Deferred Sales Charges

The aggregate dollar amounts of contingent deferred sales charges on Class A and Class C shares received and retained by the Distributor were as follows:

Class A Shares

Fund	For the Fiscal Period Ended March 31,	Amounts Retained by Distributor ($)
Intermediate-Term Municipals Fund	2026	22,663
	2025	25,151
	2024	6,847
New Jersey Municipals Fund	2026	10,264
	2025	242
	2024	417
New York Municipals Fund	2026	4,796
	2025	6,051
	2024	56

Pennsylvania Municipals Fund	2026	149
	2025	124
	2024	518

Class C Shares

Fund	For the Fiscal Period Ended March 31,	Amounts Retained by Distributor ($)
Intermediate-Term Municipals Fund	2026	0
	2025	0
	2024	0
New Jersey Municipals Fund	2026	6
	2025	24
	2024	0
New York Municipals Fund	2026	298
	2025	0
	2024	0
Pennsylvania Municipals Fund	2026	628
	2025	0
	2024	0

Services and Distribution Plan

The Trust, on behalf of the Fund, has adopted a 12b-1 Plan in accordance with Rule 12b-1 under the 1940 Act. Under the 12b-1 Plan, the Fund may pay monthly fees to the Distributor at up to the annual rates set forth below (as a percentage of the average daily net assets of the Fund attributable to the applicable share class).

Fund/Class	Rate (%)
Intermediate-Term Municipals Fund	
Class A	0.15
Class C	0.75
Class FI	0.25
New Jersey Municipals Fund	
Class A	0.15
Class C	0.70
Class FI	0.25
New York Municipals Fund	
Class A	0.15
Class C	0.70
Class FI	0.25
Pennsylvania Municipals Fund	
Class A	0.15
Class C	0.70

Class FI	0.25

The Fund will provide the Board with periodic reports of amounts expended under the 12b-1 Plan and the purposes for which such expenditures were made. Fees under the 12b-1 Plan may be used to make payments to the Distributor, Service Agents and other parties with respect to the sale of Fund shares for advertising, marketing or other promotional activity, and payments for preparation, printing, and distribution of prospectuses, statements of additional information and reports for recipients other than existing shareholders. The Fund also may make payments to the Distributor, Service Agents and others for providing personal service or the maintenance of shareholder accounts. The amounts paid to each recipient may vary based upon certain factors, including, among other things, the levels of sales of shares and/or shareholder services; provided, however, that the fees paid to a recipient with respect to a particular class that may be used to cover expenses primarily intended to result in the sale of shares of that class, or that may be used to cover expenses primarily intended for personal service and/or maintenance of shareholder accounts, may not exceed the maximum amounts, if any, as may from time to time be permitted for such services under FINRA Conduct Rule 2341 or any successor rule, in each case as amended or interpreted by FINRA.

Since fees paid under the 12b-1 Plan are not tied directly to expenses incurred by the Distributor (or others), the amount of the fees paid by a class of the Fund during any year may be more or less than actual expenses incurred by the Distributor (or others). This type of distribution fee arrangement is characterized by the staff of the SEC as being of the "compensation variety" (in contrast to "reimbursement" arrangements by which a distributor's payments are directly linked to its expenses). Thus, even if the Distributor's expenses exceed the fees provided for by the 12b-1 Plan, the Fund will not be obligated to pay more than those fees and, if expenses incurred by the Distributor (or others) are less than the fees paid to the Distributor and others, they will realize a profit.

The 12b-1 Plan recognizes that various service providers to the Fund, such as the Manager, may make payments for distribution, marketing or sales-related expenses out of their own resources of any kind, including profits or payments received from the Fund for other purposes, such as management fees. The 12b-1 Plan provides that, to the extent that such payments might be deemed to be indirect financing of any activity primarily intended to result in the sale of shares of the Fund, the payments are deemed to be authorized by the 12b-1 Plan.

Under its terms, the 12b-1 Plan continues in effect for successive annual periods, provided continuance is specifically approved at least annually by vote of the Board, including a majority of the Independent Trustees who have no direct or indirect financial interest in the operation of the 12b-1 Plan or in any agreements related to it ("Qualified Trustees"). The 12b-1 Plan may not be amended to increase the amount of the service and distribution fees without shareholder approval, and all amendments of the 12b-1 Plan also must be approved by the Trustees, including the Qualified Trustees, in the manner described above. The 12b-1 Plan may be terminated with respect to a class of the Fund at any time, without penalty, by vote of a majority of the Qualified Trustees or by vote of a majority of the outstanding voting securities of that class (as defined in the 1940 Act).

The following service and distribution fees were incurred by the Fund pursuant to the 12b-1 Plan in effect during the fiscal period ended March 31, 2026:

Fund/Class	Service and Distribution Fees Incurred ($)	Service and Distribution Fees Waived/Reimbursed ($)
Intermediate-Term Municipals Fund		
Class A	1,006,359	0
Class C	213,409	0
New Jersey Municipals Fund		
Class A	142,005	0
Class C	18,517	0

New York Municipals Fund		
Class A	325,660	0
Class C	14,235	0
Pennsylvania Municipals Fund		
Class A	95,695	0
Class C	16,191	0

No information provided for Class FI shares of the Fund, as no shares of that class were outstanding as of March 31, 2026.

For the fiscal period ended March 31, 2026, the Distributor incurred distribution expenses for advertising, printing and mailing prospectuses, support service and overhead expenses and compensation to Service Agents and third parties as expressed in the following table. The Distributor may have made revenue sharing payments in addition to the expenses shown here.

Fund/Class	Third Party Fees ($)	Financial Consultant Compensation (Amortized) ($)	Marketing ($)	Printing ($)	Total Expenses ($)
Intermediate-Term Municipals Fund					
Class A	1,006,359	217,083	232,406	0	1,455,848
Class C	213,409	0	8,721	0	222,130
New Jersey Municipals Fund					
Class A	142,005	72,153	42,013	0	256,171
Class C	18,517	351	806	0	19,674
New York Municipals Fund					
Class A	325,660	38,665	69,819	0	434,144
Class C	14,235	705	614	0	15,555
Pennsylvania Municipals Fund					
Class A	95,695	12,625	20,932	0	129,253
Class C	16,191	2,394	1,332	0	19,917

No information provided for Class FI shares of the Fund, as no shares of that class were outstanding as of March 31, 2026.

PURCHASE OF SHARES

Purchases of Fund shares are discussed under the "Buying shares" and "Exchanging shares" sections of the Fund's Prospectus; this information is incorporated herein by reference. See the Fund's Prospectus for a discussion of which share classes of the Fund are available for purchase, who is eligible to purchase shares of each class, and applicable investment minimums.

Investors may purchase shares from a Service Agent. However, Service Agents may not offer all classes of shares. In addition, certain investors, including retirement plans purchasing through certain Service Agents, may purchase shares directly

from the Fund. When purchasing shares of the Fund, investors must specify the class of shares being purchased. Payment must be made with the purchase order. Service Agents may charge their customers an annual account maintenance fee in connection with a brokerage or other financial account through which an investor purchases or holds shares. Accounts held directly at the transfer agent are not subject to a maintenance fee.

Purchase orders received by the Fund prior to the scheduled close of regular trading on the NYSE on any day the Fund calculates its NAV are priced according to the NAV determined on that day (the "trade date"). Orders received by a Service Agent prior to the scheduled close of regular trading on the NYSE on any day the Fund calculates its NAV are priced according to the NAV determined on that day, provided the order is transmitted by the Service Agent to the Fund's transfer agent in accordance with their agreed-upon procedures. See "Valuation of Shares" below for additional information about the NYSE's holiday schedule. NAV is calculated separately for each share class.

Class A Shares. Class A shares are sold to investors at the public offering price, which is the NAV plus an initial sales charge, as described in the Fund's Prospectus. The sales charge is waived for shareholders purchasing Class A shares through accounts where the Distributor is the broker-dealer of record ("Distributor Accounts"). Shareholders purchasing Class A shares through certain Service Agents or in certain types of accounts may be eligible for a waiver of the initial sales charge. For more information, see the appendix to the Prospectus titled "Appendix: Waivers and Discounts Available from Certain Service Agents."

The Distributor and Service Agents may receive a portion of the sales charge as described in the Fund's Prospectus and may be deemed to be underwriters of the Fund as defined in the 1933 Act. Sales charges are calculated based on the aggregate of purchases of Class A shares of the Fund made at one time by any "person," which includes an individual and his or her spouse and children, or a trustee or other fiduciary of a single trust estate or single fiduciary account. For additional information regarding sales charge reductions, see "Sales Charge Waivers and Reductions for Class A Shares" below.

Class A Shares. Purchases of Class A shares of $250,000 or more will be made at NAV without any initial sales charge on purchases but are subject to a contingent deferred sales charge on redemptions made within 18 months of purchase (except for purchases made through Distributor Accounts). The contingent deferred sales charge is waived in the same circumstances in which the contingent deferred sales charge applicable to Class C shares is waived. See "Contingent Deferred Sales Charge Provisions" and "Waivers of Contingent Deferred Sales Charge" below.

Class C Shares (Intermediate-Term Municipals Fund). Class C shares are not available for purchase through Distributor Accounts. Class C shares are sold at NAV without an initial sales charge on purchases and are not subject to a contingent deferred sales charge payable upon redemptions. See "Contingent Deferred Sales Charge Provisions."

Class C Shares (New Jersey Municipals Fund, New York Municipals Fund and Pennsylvania Municipals Fund). Class C shares are not available for purchase through Distributor Accounts. Class C shares are sold at NAV without an initial sales charge on purchases but are subject to a contingent deferred sales charge payable upon certain redemptions. See "Contingent Deferred Sales Charge Provisions."

Class D Shares. Class D shares are offered to a limited group of investors who invest in the Fund through certain financial intermediary and retirement plan programs. Service Agents selling Class D shares may in the future discontinue offering Class D shares to clients of financial intermediaries. A Service Agent or financial intermediary may impose investment minimums. For more information about these programs, contact a Service Agent.

Class FI, Class R, Class I and Class IS Shares. Class FI shares are not available for purchase through Distributor Accounts. Class FI, Class R, Class I and Class IS shares are sold at NAV with no initial sales charge on purchases and no contingent deferred sales charge upon redemption.

Class I shares may be purchased directly from the Fund by the following persons: (i) current employees of the Manager and its affiliates; (ii) former employees of the Manager and its affiliates with existing accounts; (iii) current and former board members of investment companies managed by affiliates of Franklin Resources; (iv) current and former board members of Franklin Resources; and (v) the "immediate families" of such persons. "Immediate families" are such person's spouse (including the surviving spouse of a deceased board member), parents, grandparents, and children and grandchildren (including step-relationships). For such investors, the minimum initial investment is $1,000 and the minimum for each purchase of additional shares is $50. Current employees may purchase additional Class I shares through a systematic investment plan.

Class IS shares may be purchased only by retirement plans with omnibus accounts held on the books of the Fund, certain rollover IRAs and Institutional Investors, Clients of Eligible Financial Intermediaries and other investors authorized by the Distributor. In order to purchase Class IS shares, an investor must hold its shares in an account that is not subject to payment of fees for recordkeeping services, account servicing, networking, or similar services to Service Agents.

Class 1 Shares. Class 1 shares are closed to all purchases and incoming exchanges. Investors owning Class 1 shares may continue to maintain their then-current Class 1 shares but are no longer permitted to add to their Class 1 share positions, except through reinvestments of dividends.

* * * * *

Under certain circumstances, an investor who purchases Fund shares pursuant to a fee-based advisory account program of an Eligible Financial Intermediary as authorized by the Distributor may be afforded an opportunity to make a conversion between one or more share classes owned by the investor in the same Fund to Class I shares of that Fund. Such a conversion in these particular circumstances does not cause the investor to realize taxable gain or loss.

For additional information regarding applicable investment minimums and eligibility requirements for purchases of Fund shares, please see the Fund's Prospectus.

Systematic Investment Plan

Shareholders may make additions to their accounts at any time by purchasing shares through a service known as the Systematic Investment Plan. Under the Systematic Investment Plan, shareholders may arrange for automatic periodic investments of $25 or more in certain share classes by authorizing the Distributor or the transfer agent to charge the shareholder's account held with a bank or other financial institution, as indicated by the shareholder, to provide for systematic additions to the shareholder's Fund account. Shareholders have the option of selecting the frequency of the investment as long as the investment equals a minimum of $25 per month. Shareholders may terminate participation in the Systematic Investment Plan at any time without charge or penalty. Additional information is available from the Fund or your Service Agent.

Sales Charge Waivers and Reductions for Class A Shares

Initial Sales Charge Waivers. Purchases of Class A shares may be made at NAV without an initial sales charge in the following circumstances:

i. sales to (a) current and retired board members, (b) current employees of Franklin Resources and its subsidiaries, (c) the "immediate families" of such persons, as defined above, and (d) a pension, profit-sharing or other benefit plan for the benefit of such persons;

ii. sales to employees of certain Service Agents having dealer, service or other selling agreements with the Distributor or otherwise having an arrangement with any such Service Agent with respect to sales of Fund shares, and by the immediate families of such persons or by a pension, profit-sharing or other benefit plan for the benefit of such persons (providing the purchase is made for investment purposes and such securities will not be resold except through redemption or repurchase);

iii. offers of Class A shares to any other investment company to effect the combination of such company with the Fund by merger, acquisition of assets or otherwise;

iv. purchases by shareholders who have redeemed Class A shares in the Fund (or Class A shares of another fund sold by the Distributor (excluding Putnam Investments Funds) that is offered with a sales charge) and who wish to reinvest their redemption proceeds in the Fund, provided the reinvestment is made within 90 calendar days of the redemption;

v. purchases by certain separate accounts used to fund unregistered variable annuity contracts;

vi. purchases by investors participating in "wrap fee" or asset allocation programs or other fee-based arrangements sponsored by broker/dealers and other financial institutions that have entered into agreements with the Distributor;

vii. purchases by direct retail investment platforms through mutual fund "supermarkets," where the sponsor links its client's account (including IRA accounts on such platforms) to a master account in the sponsor's name;

viii. sales through Service Agents who have entered into an agreement with the Distributor to offer shares to self-directed investment brokerage accounts that may or may not charge a transaction fee to their customers;

ix. purchases of Class A shares by shareholders investing through Distributor Accounts;

x. investors investing through certain retirement plans;

xi. investors who rollover Fund shares from an employer-sponsored retirement plan into an individual retirement account administered on the same retirement plan platform; and

xii. purchases by or through a Franklin Templeton donor-advised fund (such as the Franklin or Fiduciary Trust Charitable Programs).

In order to obtain such discounts, the purchaser must provide sufficient information at the time of purchase to permit verification that the purchase qualifies for the elimination of the initial sales charge.

All existing retirement plan shareholders who purchased Class A shares at NAV prior to November 20, 2006, are permitted to purchase additional Class A shares at NAV. Certain existing programs for current and prospective retirement plan investors sponsored by Service Agents approved by the Distributor prior to November 20, 2006 will also remain eligible to purchase Class A shares at NAV.

There are several ways you can combine multiple purchases of Class A shares of funds sold by the Distributor (excluding Putnam Investments Funds) or units of a Section 529 college savings plan managed by a Franklin Templeton affiliate (a "Section 529 plan"), to take advantage of the breakpoints in the Class A shares sales charge schedule. In order to take advantage of reductions in sales charges that may be available to you when you purchase Fund shares, you must inform your Service Agent or the Fund if you believe you are eligible for a Letter of Intent or a right of accumulation. Whether you purchased shares of funds and/or units of a Section 529 Plan through one or more Service Agents, directly from the Fund or through a combination of the foregoing, it is your responsibility to inform your Service Agent or the Fund if you own shares of other funds or units of a Section 529 plan that you believe are eligible to be aggregated with your purchases. **If you do not do so, you may not receive all sales charge reductions for which you are eligible.** Account statements may be necessary in order to verify your eligibility for a reduced sales charge.

Accumulation Privilege. The accumulation privilege allows you to combine the dollar amount of your next purchase of Class A shares of the Fund, as applicable, with the current or cost value, whichever is higher, of shares of other funds sold by the Distributor held in Eligible Accounts (as defined below), for purposes of calculating the initial sales charges.

If you hold fund shares or units of a Section 529 plan in accounts at two or more Service Agents, please contact your Service Agents to determine whether your shares or units may be combined.

Shares of certain money market funds sold by the Distributor may be combined for purposes of the accumulation privilege. Please contact your Service Agent or the Fund for additional information.

Certain trustees and other fiduciaries may be entitled to combine accounts in determining their sales charge.

Letter of Intent. A Letter of Intent allows you to combine the current or cost value, whichever is higher, of Eligible Fund Purchases in Eligible Accounts with the value that you intend to purchase within the next 13-months, which would, if bought all at once, qualify you for a reduced Class A sales charge. In addition, current holdings under the accumulation privilege (as described above) may be included in the Letter of Intent. See the Fund's Prospectus for the sales charges and breakpoints applicable to Class A shares of the Fund. Sales charges and breakpoints vary among the funds sold by the Distributor.

Purchases of Class A shares or units of a Section 529 plan may be aggregated for purposes of calculating each breakpoint. You may purchase Class A shares of funds sold by the Distributor (excluding Putnam Investments Funds) or units of a Section 529 plan managed by a Franklin Templeton affiliate over a 13-month period and pay the same sales charge, if any, as if all shares or units had been purchased at once.

At the time you enter into a Letter of Intent, you select your asset goal amount. Each time you make a Class A purchase under a Letter of Intent, you will be entitled to pay the sales charge that is applicable to the amount of your asset goal amount. For example, if your asset goal amount is $100,000, any Class A investments you make under a Letter of Intent would be subject to the sales charge of the specific fund you are investing in for purchases of $100,000.

When you enter into a Letter of Intent, you agree to purchase in Eligible Accounts over a 13-month period Eligible Fund Purchases in an amount equal to the asset goal amount you have selected. You may also credit towards your asset goal amount any Eligible Fund Purchases made in Eligible Accounts at any time prior to entering into the Letter of Intent that have not been sold or redeemed, based on the current value or cost value, whichever is higher, of those shares as of the date of calculation. The current value of shares is determined by multiplying the number of shares as of the day prior to your current purchase by their public offering price. The cost value of shares is determined by aggregating the amount of Eligible Fund Purchases in Eligible Accounts (including reinvested dividends and capital gains, but excluding capital appreciation), less any withdrawals, as of the date prior to your current purchase. The cost value of Eligible Fund Purchases in Eligible Accounts, however, may only be aggregated for share purchases that took place within 18 months of the Letter of Intent start date.

Your commitment will be met if at any time during the 13-month period the value, as so determined, of eligible holdings is at least equal to your asset goal amount. All reinvested dividends and distributions on shares acquired under the Letter of Intent will be credited towards your asset goal amount. You may include any Eligible Fund Purchases toward the asset goal amount, including shares of classes other than Class A shares. However, a Letter of Intent will not entitle you to a reduction in the sales charge payable on any shares other than Class A shares, and if any shares, including Class A shares, are subject to a contingent deferred sales charge, you will still be subject to that contingent deferred sales charge with respect to those shares. You must make reference to the Letter of Intent each time you make a purchase under the Letter of Intent.

Eligible Fund Purchases. Eligible Fund Purchases include: (i) any class of shares of any other Legg Mason or Franklin Templeton fund other than shares of such funds offered through separately managed accounts that are managed by a Franklin Templeton affiliate; and (ii) units of a Section 529 Plan managed by a Franklin Templeton affiliate. Shares of certain money market funds sold by the Distributor may be combined for purposes of the Letter of Intent. Eligible funds may change from time to time, investors should check with their Service Agent to see which funds or Section 529 plans may be eligible.

For purposes of a letter of intent and the accumulation privilege, Legg Mason and Franklin Templeton funds include BrandywineGLOBAL funds, ClearBridge Investments funds, and Western Asset funds. They do not include the funds in the Franklin Templeton Variable Insurance Products Trust, Legg Mason Partners Variable Equity Trust, Legg Mason Partners Variable Income Trust or Legg Mason Partners Money Market Trust (except for shares held in Distributor Accounts). Please contact your Service Agent or the Fund for more information.

Eligible Accounts. Eligible Accounts include shares of Legg Mason or Franklin Templeton funds registered to (or held by a financial intermediary for):

- You, individually;
- Your "family member" defined as your spouse or domestic partner, as recognized by applicable state law, or your children under the age of 21;
- You jointly with one or more family members;
- You jointly with one or more persons who are not family members if that other person has not included the value of the jointly-owned shares for purposes of the accumulation privilege for that person's separate investments in Legg Mason or Franklin Templeton fund shares;
- A Coverdell Education Savings account for which you or a family member is the identified responsible person;
- A trustee/custodian of an IRA (which includes a Roth IRA and an employer sponsored IRA such as a SIMPLE IRA) or your non-ERISA covered 403(b) plan account, if the shares are registered/recorded under your or a family member's Social Security number;
- A 529 college savings plan over which you or a family member has investment discretion and control;
- Any entity over which you or a family member has individual or shared authority, as principal, has investment discretion and control (for example, an UGMA/UTMA account for a child on which you or a family member is the custodian, a trust on which you or a family member is the trustee, a business account (not to include retirement plans) for your solely owned business (or the solely owned business of a family member) on which you or a family member is the authorized signer); or

- A trust established by you or a family member as grantor.

You may need to provide certain records, such as account statements, in order to verify your eligibility for reduced sales charges. Contact your Service Agent to see which accounts may be credited toward your asset goal amount. A Letter of Intent is not available to Distributor Accounts.

Increasing the Amount of the Letter of Intent. You may at any time increase your asset goal amount. You must, however, contact your Service Agent, or if you purchase your shares directly through the transfer agent, contact the transfer agent, prior to making any purchases in an amount in excess of your current asset goal amount. Upon such an increase, you will be credited by way of additional shares at the then-current offering price for the difference between:

i. the aggregate sales charges actually paid for shares already purchased under the Letter of Intent; and

ii. the aggregate applicable sales charges for the increased asset goal amount.

However, you must contact your Service Agent before purchasing shares in excess of the asset goal amount as no retroactive adjustments can be made. The 13-month period during which the asset goal amount must be achieved will remain unchanged.

Sales and Exchanges. Shares acquired pursuant to a Letter of Intent, other than Escrowed Shares as defined below, may be redeemed or exchanged at any time, although any shares that are redeemed prior to meeting your asset goal amount will no longer count towards meeting your asset goal amount. However, complete liquidation of purchases made under a Letter of Intent prior to meeting the asset goal amount will result in the cancellation of the Letter of Intent. See "Failure to Meet Asset Goal Amount" below. Exchanges in accordance with the Fund's Prospectus are permitted, and shares so exchanged will continue to count towards your asset goal amount, as long as the exchange results in an Eligible Fund Purchase.

Cancellation of the Letter of Intent. You may cancel a Letter of Intent by notifying your Service Agent, or if you purchase your shares directly through the transfer agent, by notifying the transfer agent. The Letter of Intent will be automatically cancelled if all shares are sold or redeemed as set forth above. See "Failure to Meet Asset Goal Amount" below.

Escrowed Shares. Shares equal in value to five percent (5%) of your asset goal amount as of the date your Letter of Intent (or the date of any increase in the amount of the Letter of Intent) is accepted will be held in escrow during the term of your Letter of Intent. The Escrowed Shares will be included in the total shares owned as reflected in your account statement and any dividends and capital gains distributions applicable to the Escrowed Shares will be credited to your account and counted towards your asset goal amount or paid in cash upon request. The Escrowed Shares will be released from escrow if all the terms of your Letter of Intent are met.

Failure to Meet Asset Goal Amount. If the total assets under your Letter of Intent within its 13-month term are less than your asset goal amount whether because you made insufficient Eligible Fund Purchases, redeemed all of your holdings or otherwise cancelled the Letter of Intent before reaching your asset goal amount, you will be liable for the difference between: (a) the sales charge actually paid and (b) the sales charge that would have applied if you had not entered into the Letter of Intent. You may, however, be entitled to any breakpoints that would have been available to you under the accumulation privilege. An appropriate number of shares in your account will be redeemed to realize the amount due. For these purposes, by entering into a Letter of Intent, you irrevocably appoint your Service Agent, or if you purchase your shares directly through the transfer agent, the transfer agent, as your attorney-in-fact for the purposes of holding the Escrowed Shares and surrendering shares in your account for redemption. If there are insufficient assets in your account, you will be liable for the difference. Any Escrowed Shares remaining after such redemption will be released to your account.

Contingent Deferred Sales Charge Provisions

Class A Shares.

- *Class A shares that were purchased without an initial sales charge but are subject to a contingent deferred sales charge.* A contingent deferred sales charge may be imposed on certain redemptions of these shares. Class A shares that are contingent deferred sales charge shares are subject to a contingent deferred sales charge if redeemed within 18 months of purchase.

- *Class A shares that are not subject to a contingent deferred sales charge*. If Class A shares of the Fund are exchanged for shares of another fund sold by the Distributor that are subject to a contingent deferred sales charge, you may pay a contingent deferred sales charge if the shares acquired by exchange are redeemed within 18 months of purchase.

Class C Shares.

- *Class C shares that are subject to a contingent deferred sales charge*. A contingent deferred sales charge will be imposed if shares are redeemed within 12 months of purchase.
- *Class C shares that are not subject to a contingent deferred sales charge*. If Class C shares of the Fund are exchanged for shares of another fund sold by the Distributor that are subject to a contingent deferred sales charge, you may pay a contingent deferred sales charge if the shares acquired by exchange are redeemed within 12 months from the date of such exchange.

Class C1 Shares.

- *Class C1 shares that are subject to a contingent deferred sales charge*. A contingent deferred sales charge will be imposed if shares are redeemed within 12 months of purchase. If Class C1 shares of the Fund are exchanged for Class C1 shares (or, if not available, Class C shares) of another fund sold by the Distributor, any contingent deferred sales charge that applies to the Class C1 shares of the other fund will apply to the Class C1 shares (or Class C shares, as applicable) acquired in exchange for the Class C1 shares of the Fund, and that contingent deferred sales charge will be measured from the date the shares exchanged were initially acquired.
- *Class C1 shares that are not subject to a contingent deferred sales charge.* Class C1 shares of the Fund are not subject to a contingent deferred sales charge, but if Class C1 shares of the Fund are exchanged for Class C1 shares (or, if not available, Class C shares) of another fund sold by the Distributor that are subject to a contingent deferred sales charge, any contingent deferred sales charge that applies to the Class C1 shares of the other fund will apply to the Class C1 shares (or Class C shares, as applicable) acquired in exchange for the Class C1 shares of the Fund, and that contingent deferred sales charge will be measured from the date of such exchange.

Any applicable contingent deferred sales charge will be assessed on the NAV at the time of purchase or redemption, whichever is less.

In determining the applicability of any contingent deferred sales charge, it will be assumed that a redemption is made first of shares representing capital appreciation, next of shares representing the reinvestment of dividends and capital gain distributions, next of shares that are not subject to the contingent deferred sales charge and finally of other shares held by the shareholder for the longest period of time. Unless otherwise noted above, the length of time that contingent deferred sales charge shares acquired through an exchange have been held will be calculated from the date the shares exchanged were initially acquired in one of the other funds sold by the Distributor. For U.S. federal income tax purposes, the amount of the contingent deferred sales charge will reduce the gain or increase the loss, as the case may be, on the amount realized on redemption. The Distributor receives contingent deferred sales charges in partial consideration for its expenses in selling shares.

Waivers of Contingent Deferred Sales Charge

The contingent deferred sales charge will be waived on:

i. exchanges (see "Exchange of Shares");
ii. redemptions through a systematic withdrawal plan, up to 1% monthly, 3% quarterly, 6% semiannually or 12% annually of your account's net asset value depending on the frequency of your plan (see "Systematic Withdrawal Plan");
iii. redemptions of shares within 12 months following the death or disability (as defined by the Code) of the shareholder;
iv. mandatory post-retirement distributions from retirement plans or IRAs commencing on or after attainment of a specific age required by law (except that shareholders of certain retirement plans or IRAs established prior to May 23, 2005 will be eligible to obtain a waiver of the contingent deferred sales charge on all funds held in those accounts at age 59 $^{1}/_{2}$ and may be required to demonstrate such eligibility at the time of redemption);
v. involuntary redemptions;
vi. redemptions of shares to effect a combination of the Fund with any investment company by merger, acquisition of assets or otherwise;

vii. effective May 1, 2020, on redemptions with respect to investors where the Distributor did not pay the Service Agent a commission;
viii. tax-free returns of an excess contribution to any retirement plan;
ix. certain redemptions of shares of the Fund in connection with lump-sum or other distributions made by eligible retirement plans or redemption of shares by participants in certain "wrap fee" or asset allocation programs sponsored by broker/dealers and other financial institutions that have entered into agreements with the Distributor or the Manager;
x. Class A shares held through Distributor Accounts; and
xi. redemptions of Class A shares purchased by or through a Franklin Templeton donor-advised fund (such as the Franklin or Fiduciary Trust Charitable Programs).

The contingent deferred sales charge is also waived on Class C and Class C1 shares purchased by retirement plans with omnibus accounts held on the books of the Fund. Different Service Agents may offer different contingent deferred sales charge waivers. For more information, see the appendix to the Prospectus titled "Appendix: Waivers and Discounts Available from Certain Service Agents."

A shareholder who has redeemed shares from another fund sold by the Distributor (excluding Putnam Investments Funds) may, under certain circumstances, reinvest all or part of the redemption proceeds within 90 days in another fund sold by the Distributor (excluding Putnam Investments Funds) and receive pro rata credit for any contingent deferred sales charge imposed on the prior redemption.

To have a contingent deferred sales charge waived, you or your Service Agent must let the Fund know at the time you redeem shares that you qualify for such a waiver. Contingent deferred sales charge waivers will be granted subject to confirmation by the Distributor or the transfer agent of the shareholder's status or holdings, as the case may be.

Grandfathered Retirement Program with Exchange Features

Certain retirement plan programs with exchange features in effect prior to November 20, 2006 (collectively, the "Grandfathered Retirement Program") that are authorized by the Distributor to offer eligible retirement plan investors the opportunity to exchange all of their Class C shares or Class C1 shares, if applicable, for Class A shares of the same fund, are permitted to maintain such share class exchange features for current and prospective retirement plan investors.

Under the Grandfathered Retirement Program, Class C shares and Class C1 shares of the Fund may be purchased by plans investing less than $3,000,000. Class C shares and Class C1 shares are eligible for exchange into Class A shares not later than eight years after the plan joins the program. They are eligible for exchange in the following circumstances: For participating plans established with the Fund or another fund for which FTFA or any predecessor serves or has served as investment manager or administrator (each a "Grandfathered Retirement Program Fund") prior to June 2, 2003, if such plan's total Class C and Class C1 holdings in all Grandfathered Retirement Program Funds (excluding money market funds) equal at least $1,000,000 at the end of the fifth year after the date the participating plan enrolled in the Grandfathered Retirement Program, the participating plan will be permitted to exchange all of its Class C shares and Class C1 shares for Class A shares of the Fund. For participating plans established with the Fund or another Grandfathered Retirement Program Fund on or after June 2, 2003, if such plan's total Class C and Class C1 holdings in all Grandfathered Retirement Program Funds (excluding money market funds) equal at least $3,000,000 at the end of the fifth year after the date the participating plan enrolled in the Grandfathered Retirement Program, the participating plan will be permitted to exchange all of its Class C shares and Class C1 shares for Class A shares of the Fund.

Unless the exchange offer has been rejected in writing, the exchange will automatically occur within approximately 30 days after the fifth anniversary date. If the participating plan does not qualify for the five-year exchange to Class A shares, a review of the participating plan's holdings will be performed each quarter until either the participating plan qualifies or the end of the eighth year.

Any participating plan that has not previously qualified for an exchange into Class A shares will be offered the opportunity to exchange all of its Class C shares and Class C1 shares for Class A shares of the same fund regardless of asset size at the end of the eighth year after the date the participating plan enrolled in the Grandfathered Retirement Program. Unless the exchange has been rejected in writing, the exchange will automatically occur on or about the eighth anniversary date. Once an exchange has occurred, a participating plan will not be eligible to acquire additional Class C shares and Class C1 shares but

instead may acquire Class A shares of the same fund. Any Class C shares and Class C1 shares not converted will continue to be subject to the distribution fee.

For further information regarding the Grandfathered Retirement Program, contact your Service Agent or the transfer agent. Participating plans that enrolled in the Grandfathered Retirement Program prior to June 2, 2003 should contact the transfer agent for information regarding Class C shares and Class C1 shares exchange privileges applicable to their plan.

Determination of Public Offering Price

The Fund offers its shares to the public on a continuous basis. The public offering price for each class of shares of the Fund is equal to the net asset value per share at the time of purchase, plus for Class A shares, an initial sales charge based on the aggregate amount of the investment.

Set forth below is an example of the method of computing the offering price of the Class A shares of the Fund based on the net asset value of a share of the Fund as of March 31, 2026:

Class A

	Intermediate-Term Municipals Fund	New Jersey Municipals Fund	New York Municipals Fund	Pennsylvania Municipals Fund
Net Asset Value Per Share ($)	6.02	11.54	11.81	11.72
Maximum Initial Sales Charge Percentage (%)	2.25	3.75	3.75	3.75
Offering Price ($)	6.16	11.99	12.27	12.18

REDEMPTION OF SHARES

Redemptions of Fund shares are discussed under the "Exchanging shares" and "Redeeming shares" sections of the Fund's Prospectus; this information is incorporated herein by reference.

The right of redemption may be suspended or the date of payment postponed:

i. for any period during which the NYSE is closed (other than for customary weekend and holiday closings);

ii. when trading in the markets the Fund normally utilizes is restricted, or an emergency exists, as determined by the SEC, so that disposal of the Fund's investments or determination of NAV is not reasonably practicable; or

iii. for such other periods as the SEC by order may permit for protection of the Fund's shareholders.

In the case of any such suspension, you may either withdraw your request for redemption or receive payment based upon the NAV next determined after the suspension is lifted.

The Fund's transfer agent, acting on behalf of the Fund, may place a temporary hold for up to 25 business days on the disbursement of redemption proceeds from an account held directly with the Fund if the transfer agent, in consultation with the Fund, reasonably believes that financial exploitation of a Specified Adult (as defined below) has occurred, is occurring, has been attempted, or will be attempted. In order to delay payment of redemption proceeds under these circumstances, the Fund and the transfer agent must adopt certain policies and procedures and otherwise comply with the terms and conditions of no-action relief provided by the SEC staff. Financial exploitation means: (i) the wrongful or unauthorized taking, withholding, appropriation, or use of a Specified Adult's funds or securities; or (ii) any act or omission by a person, including through the use of a power of attorney, guardianship, or any other authority regarding a Specified Adult, to (a) obtain control, through deception, intimidation or undue influence, over the Specified Adult's money, assets or property, or (b) convert the Specified Adult's money, assets or property. The transfer agent and/or the Fund may not be aware of factors suggesting financial exploitation of a Specified Adult and may not be able to identify Specified Adults in all circumstances. Furthermore, the transfer agent is not required to delay the

disbursement of redemption proceeds and does not assume any obligation to do so. For purposes of this paragraph, the term "Specified Adult" refers to an individual who is a natural person (i) age 65 and older, or (ii) age 18 and older and whom the Fund's transfer agent reasonably believes has a mental or physical impairment that renders the individual unable to protect his or her own interests.

Unless otherwise instructed, redemption proceeds will be mailed to an investor's address of record. The transfer agent may require additional supporting documents for redemptions made by corporations, executors, administrators, trustees or guardians. A redemption request will not be deemed properly received until the transfer agent receives all required documents in proper form.

If a shareholder holds shares in more than one class, any request for redemption must specify the class being redeemed. In the event of a failure to specify which class, or if the investor owns fewer shares of the class than specified, the redemption request will be delayed until the transfer agent receives further instructions. Redemption proceeds for shares purchased by check, other than a certified or official bank check, will be remitted upon clearance of the check, which may take up to ten days. Each Service Agent is responsible for transmitting promptly orders for its customers.

The Service Agent may charge you a fee for executing your order. The amount and applicability of such a fee is determined and should be disclosed to its customers by each Service Agent.

The Fund reserves the right to modify or terminate telephonic, electronic or other redemption services described in the Prospectus and this SAI at any time.

Systematic Withdrawal Plan

The Systematic Withdrawal Plan permits you to have a specified dollar amount automatically withdrawn from your account on a regular basis (i.e., on a monthly, quarterly, semi-annual or annual basis). The Systematic Withdrawal Plan is available to those shareholders who own shares directly with the Fund. You should contact your Service Agent to determine if it offers a similar service.

Class A, Class C, Class C1 and Class D Shareholders. Class A, Class C, Class C1 and Class D shareholders having an account with a balance of $5,000 or more may elect to make withdrawals of a minimum of $50 per transaction per month. For retirement plans subject to mandatory distribution requirements, the minimum withdrawal amounts will not apply. There are two ways to receive payment of proceeds of redemptions made through the Systematic Withdrawal Plan: (1) Check mailed by the Fund's transfer agent—Fund shares will be redeemed on the day of the month indicated on your account application, (or if no day is indicated, on the 20th day of the month) or the next business day and a check for the proceeds will be mailed within three business days. Available processing dates currently are the 1st, 5th, 10th, 15th, 20th and 25th days of the month; or (2) electronic transfer (ACH) to checking or savings account—redemptions of Fund shares may occur on any business day of the month and the checking or savings account will be credited with the proceeds in approximately two business days. You may change the amount to be paid to you or terminate the Systematic Withdrawal Plan at any time, without charge or penalty, by contacting the Fund or your Service Agent. The Fund, its transfer agent, and the Distributor also reserve the right to modify or terminate the Systematic Withdrawal Plan at any time. See "Waivers of Contingent Deferred Sales Charge," above, for information about application of the contingent deferred sales charge to withdrawals under the Systematic Withdrawal Plan.

Class FI, Class I and Class IS Shareholders. Certain shareholders of the Fund's Class FI, Class I and Class IS shares with an initial NAV of $1,000,000 or more, or certain other shareholders authorized by the Distributor, may be eligible to participate in the Systematic Withdrawal Plan. Receipt of payment of proceeds of redemptions made through the Systematic Withdrawal Plan will be wired through electronic transfer (ACH) to your checking or savings account—redemptions of Fund shares may occur on any business day of the month and the checking or savings account will be credited with the proceeds in approximately two business days. Requests to change or discontinue the Systematic Withdrawal Plan may be made at the Fund's website, www.franklintempleton.com/prospectus, by calling the Fund at 877-6LM-FUND/656-3863, or by writing to the Fund or your Service Agent. You may change the amount to be paid to you or terminate the Systematic Withdrawal Plan at any time, without charge or penalty, by notifying the Fund or your Service Agent. The Fund, its transfer agent, and the Distributor also reserve the right to modify or terminate the Systematic Withdrawal Plan at any time.

In General. The amounts paid to you each redemption period are obtained by redeeming sufficient shares from your account to provide the withdrawal amount that you have specified.

Redemptions will be made at the NAV per share, determined as of the scheduled close of regular trading on the NYSE (normally 4:00 p.m., Eastern time) on the day corresponding to the redemption option designated by the investor, less any applicable contingent deferred sales charge. If the NYSE is not open for business on that day, the shares will be redeemed at the per share NAV determined as of the scheduled close of regular trading on the NYSE on the next day the NYSE is open, less any applicable contingent deferred sales charge. See "Valuation of Shares" below for additional information about the NYSE's holiday schedule.

Withdrawal payments are treated as a sale of shares rather than as a dividend or other distribution. A payment is taxable to the extent that the total amount of the payment exceeds the tax basis in the shares deemed sold. Other taxes or tax-related consequences may apply, and you should consult your tax professional before establishing a Systematic Withdrawal Plan. If the periodic withdrawals exceed reinvested dividends and other distributions, the amount of your original investment may be correspondingly reduced.

Ordinarily, you should not purchase additional shares of a fund in which you have an account if you maintain a Systematic Withdrawal Plan because there are tax disadvantages associated with such purchases and withdrawals.

Redemptions In Kind

The Fund reserves the right, under certain conditions, to honor any request for a redemption by making payment in whole or in part by delivering securities valued in accordance with the procedures described under "Share price" in the Fund's Prospectus. Because redemption in kind may be used at times of unusual illiquidity in the markets, these valuation methods may include fair value estimations. If payment is made in securities, a shareholder should expect to incur brokerage expenses in converting those securities into cash, and the market price of those securities will be subject to fluctuation until they are sold. In addition, a redemption is generally a taxable event for shareholders, regardless of whether the redemption is satisfied in cash or in kind. The securities delivered may not be representative of the entire Fund portfolio, may represent only one issuer or a limited number of issuers and may be securities that the Fund would otherwise sell. The Fund will not use securities to pay redemptions by the Distributor or other affiliated persons of the Fund, except as permitted by law, SEC rules or orders, or interpretive guidance from the SEC staff or other proper authorities.

Shares Purchased and Redeemed Through Another Service Agent

The Fund has authorized certain Service Agents to receive on its behalf purchase and redemption orders. Such Service Agents are authorized to designate plan administrator intermediaries to receive purchase and redemption orders on the Fund's behalf. The Fund will be deemed to have received a purchase or redemption order when an authorized Service Agent or, if applicable, a Service Agent's authorized designee, receives the order. Orders will be priced at the Fund's NAV next computed after they are received by an authorized Service Agent or the Service Agent's authorized designee and accepted by the Fund.

Transferring Fund Shares to Another Service Agent

You may transfer Fund shares only to a Service Agent that has entered into an agreement with the Distributor or one of its affiliates with respect to the Fund. Some Service Agents may have agreements with the Distributor or one of its affiliates with respect to some funds and not others. Depending on the Service Agent to which you transfer the shares, certain shareholder services may not be available for the transferred shares. After the transfer, you may purchase additional Fund shares. All future trading of Fund shares, including exchanges, is subject to the rules of the Service Agent and its continued agreement with the Distributor that permits such trading.

You should contact your Service Agent or the appropriate fund for further information on transferring Fund shares.

EXCHANGE OF SHARES

Exchanges of Fund shares are discussed under the "Buying shares," "Exchanging shares," and "Redeeming shares" sections of the Fund's Prospectus; this information is incorporated herein by reference. The exchange privilege enables shareholders to acquire shares of the same class in another fund sold by the Distributor (excluding Putnam Investments Funds). If the fund into which you wish to exchange your shares does not offer the class of shares in which you are currently invested, you may be able to exchange for a different share class (see the Fund's Prospectus for more information). This privilege is available to shareholders residing in any state in which the Fund shares being acquired may legally be sold. Prior to any exchange, the

shareholder should obtain and review a copy of the current prospectus of each fund into which an exchange is being considered. The Prospectus describes the requirements for exchanging shares of the Fund and may be obtained as described on the cover page of this SAI.

Upon receipt of proper instructions and all necessary supporting documents, shares submitted for exchange are redeemed at the then-current NAV, and the proceeds, net of any applicable sales charge, are immediately invested in shares of the fund being acquired at that fund's then current NAV. The Distributor reserves the right to reject any exchange request. The exchange privilege may be modified or terminated at any time after written notice to shareholders.

Class A, Class FI, Class R, Class I and Class IS Exchanges. Class A, Class FI, Class R, Class I and Class IS shareholders of the Fund who wish to exchange all or a portion of their shares for shares of the respective class in another fund may do so without imposition of any initial sales charge (if shares being exchanged were subject to an initial sales charge) but subject to a contingent deferred sales charge, if applicable. An exchange of shares that were not subject to any sales charge will be subject to any applicable initial sales charge or contingent deferred sales charge upon exchange.

Class C Exchanges. Class C shares of the Fund may be exchanged for other Class C shares without imposition of any charge but subject to a contingent deferred sales charge, if applicable. Upon an exchange, the new Class C shares will be deemed to have been purchased on the same date as the Class C shares of the Fund that have been exchanged.

Class C1 Exchanges. Investors that hold Class C1 shares may exchange those shares for Class C1 shares of another fund, or if a fund does not offer Class C1, for Class C shares, in each case without imposition of any charge but subject to a contingent deferred sales charge, if applicable. However, once an investor exchanges Class C1 shares for Class C shares, the investor would not be permitted to exchange from Class C shares back to Class C1 shares.

Class D Exchanges. Class D shares of the Fund may not be exchanged.

Class 1 Exchanges. Class 1 shareholders who wish to exchange all or a portion of their shares may exchange Class 1 shares for Class A shares of certain funds available for exchange. Ask your Service Agent about the funds available for exchange.

Certain retirement plan programs with exchange features in effect prior to November 20, 2006, as approved by the Distributor, will remain eligible for exchange from Class C shares or Class C1 shares to Class A shares in accordance with the program terms. See "Grandfathered Retirement Program with Exchange Features" for additional information.

Additional Information Regarding the Exchange Privilege

The Fund is not designed to provide investors with a means of speculation on short-term market movements. A pattern of frequent exchanges by investors can be disruptive to efficient portfolio management and, consequently, can be detrimental to the Fund and its shareholders. See "Frequent trading of fund shares" in the Prospectus.

During times of drastic economic or market conditions, the Fund may suspend the exchange privilege temporarily without notice and treat exchange requests based on their separate components—redemption orders with a simultaneous request to purchase the other fund's shares. In such a case, the redemption request would be processed at the Fund's next determined NAV but the purchase order would be effective only at the NAV next determined after the fund being purchased formally accepts the order, which may result in the purchase being delayed.

Certain shareholders may be able to exchange shares by telephone. See the Fund's Prospectus for additional information. Exchanges will be processed at the NAV next determined. Redemption procedures discussed above are also applicable for exchanging shares, and exchanges will be made upon receipt of all supporting documents in proper form. If the account registration of the shares of the fund being acquired is identical to the registration of the shares of the fund exchanged, no signature guarantee is required.

The exchange privilege may be modified or terminated at any time and is available only in those jurisdictions where such exchanges legally may be made. An exchange is treated as a sale of the shares exchanged and could result in taxable gain or loss to the shareholder making the exchange. Other taxes or tax-related consequences may apply, and you should consult your tax professional before requesting an exchange.

UNCLAIMED SHARE ACCOUNTS

The Fund may be required to close your account after a period of inactivity, as determined by applicable U.S. state or territory abandoned or unclaimed property laws and regulations, and transfer your shares to the appropriate U.S. state or territory. Please be advised that abandoned or unclaimed property laws and regulations for certain U.S. states or territories require financial organizations to transfer (escheat) unclaimed property to the appropriate U.S. state or territory if no activity occurs in an account for a period of time as specified by applicable laws and regulations. These laws and regulations may require the transfer of shares of the Fund, including shares held through a traditional or Roth IRA account. For traditional IRA accounts escheated to a U.S. state or territory under these abandoned or unclaimed property laws and regulations, the escheatment will generally be treated as a taxable distribution from your IRA to you; U.S. federal and any applicable state income tax may be withheld. This may apply to Roth IRA accounts in addition to traditional IRA accounts. For more information on unclaimed property and how to maintain an active account, please contact your Service Agent or the Fund's transfer agent.

VALUATION OF SHARES

The NAV per share of each class of the Fund is generally calculated as of the close of regular trading (normally 4:00 p.m., Eastern time) on each day on which the NYSE is open. As of the date of this SAI, the NYSE is normally open for trading every weekday except in the event of an emergency or for the following holidays (or the days on which they are observed): New Year's Day, Martin Luther King, Jr. Day, Presidents' Day, Good Friday, Memorial Day, Juneteenth National Independence Day, Independence Day, Labor Day, Thanksgiving Day and Christmas Day. Because of the differences in distribution fees and class specific expenses, the per share NAV of each class of the Fund will differ. Please see the Fund's Prospectus for a description of the procedures used by the Fund in valuing its assets.

PROXY VOTING GUIDELINES AND PROCEDURES

The Manager delegates to the Subadviser the responsibility for voting proxies for the Fund through its contracts with the Subadviser. The Subadviser may use its own proxy voting policies and procedures to vote proxies of the Fund if the Fund's Board reviews and approves the use of those policies and procedures. Accordingly, the Manager does not expect to have proxy-voting responsibility for the Fund.

Should the Manager become responsible for voting proxies for any reason, such as the inability of the Subadviser to provide investment advisory services, the Manager shall utilize the proxy voting guidelines established by the most recent Subadviser to vote proxies until a new subadviser is retained and the use of its proxy voting policies and procedures is authorized by the Board. In the case of a material conflict between the interests of the Manager (or its affiliates if such conflict is known to persons responsible for voting at the Manager) and any fund, the Board of Directors of the Manager shall consider how to address the conflict and/or how to vote the proxies. The Manager shall maintain records of all proxy votes in accordance with applicable securities laws and regulations.

The Manager shall be responsible for gathering relevant documents and records related to proxy voting from the Subadviser and providing them to the Fund as required for the Fund to comply with applicable rules under the 1940 Act. The Manager shall also be responsible for coordinating the provision of information to the Board with regard to the proxy voting policies and procedures of the Subadviser, including the actual proxy voting policies and procedures of the Subadviser, changes to such policies and procedures, and reports on the administration of such policies and procedures.

The Subadviser's proxy voting policies and procedures govern in determining how proxies relating to the Fund's portfolio securities are voted. A copy of the proxy voting policies and procedures is attached as Appendix A to this SAI. Information regarding how the Fund voted proxies (if any) relating to portfolio securities during the most recent twelve month period ended June 30 is available without charge (1) by calling 877-6LM-FUND/656-3863, (2) on www.franklintempleton.com/prospectus (click on the name of the Fund), and (3) on the SEC's website at http://www.sec.gov.

DISCLOSURE OF PORTFOLIO HOLDINGS

The Fund's Board has adopted policies and procedures (the "policy") developed by the Manager with respect to the disclosure of the Fund's portfolio securities and any ongoing arrangements to make available information about the Fund's portfolio securities. The Manager believes the policy is in the best interests of the Fund and its shareholders and that it strikes an appropriate balance between the desire of investors for information about fund portfolio holdings and the need to protect the Fund from potentially harmful disclosures.

General Rules/Website Disclosure

The policy provides that information regarding the Fund's portfolio holdings may be shared at any time with employees of the Manager, the Fund's Subadviser and other affiliated parties involved in the management, administration or operations of the Fund (referred to as fund-affiliated personnel). With respect to non-money market funds, the Fund's complete list of holdings (including the size of each position) may be made available to investors, potential investors, third parties and Franklin Templeton personnel that are not fund-affiliated personnel (i) upon the filing of portfolio holdings reports in accordance with SEC rules, provided that such filings are not made until 15 calendar days following the end of the period covered by the applicable holdings report or (ii) no sooner than 8 business days after month end, provided that such information has been made available through public disclosure. Typically, public disclosure is achieved by required filings with the SEC and/or posting the information to the Fund's Internet site that is accessible by the public, or through public release by a third party vendor.

The Fund currently discloses its complete portfolio holdings 8 business days after month-end. The Fund discloses this information on the Fund's website: www.franklintempleton.com/prospectus (click on the name of the Fund).

Ongoing Arrangements

Under the policy, the Fund may release portfolio holdings information on a regular basis to a custodian, sub-custodian, fund accounting agent, proxy voting provider, rating agency or other vendor or service provider for a legitimate business purpose, where the party receiving the information is under a duty of confidentiality, including a duty to prohibit the sharing of non-public information with unauthorized sources and trading upon non-public information. The Fund may enter into other ongoing arrangements for the release of portfolio holdings information, but only if such arrangements serve a legitimate business purpose and are with a party who is subject to a confidentiality agreement and restrictions on trading upon non-public information. None of the Fund, Franklin Templeton or any other affiliated party may receive compensation or any other consideration in connection with such arrangements. Ongoing arrangements to make available information about the Fund's portfolio securities will be reviewed at least annually by the Fund's Board.

Set forth below is a list, as of December 1, 2025, of those parties with whom the Manager, on behalf of the Fund, has authorized ongoing arrangements that include the release of portfolio holdings information in accordance with the policy, as well as the maximum frequency of the release under such arrangements, and the minimum length of the lag, if any, between the date of the information and the date on which the information is disclosed. The ongoing arrangements may vary for each party, and it is possible that not every party will receive information for the Fund. The parties identified below as recipients are service providers, fund rating agencies, consultants and analysts.

Recipient	Frequency	Delay Before Dissemination
Barclays Bank PLC	Daily	None
Bloomberg AIM	Daily	None
Bloomberg L.P.	Daily	None
Bloomberg Portfolio Analysis	Daily	None
Brown Brothers Harriman	Daily	None
Charles River	Daily	None

Citco	Daily	None
Eagle Investment Systems Corp	Daily	None
Emerging Portfolio Fund Research, Inc. (EPFR), an Informa Company	Monthly	None
Enfusion Systems	Daily	None
ENSO LP	Daily	None
eVestment Alliance	Quarterly	8-10 Days
FactSet	Daily	None
HSBC Global Asset Management	Daily	None
Institutional Shareholder Services	Daily	None
ITG	Daily	None
Kailash Concepts	Monthly	None
Middle Office Solutions, LLC	Daily	None
Morgan Stanley Capital Inc.	Daily	None
Morningstar	Daily	None
NaviSite, Inc.	Daily	None
StarCompliance	Daily	None
State Street Bank and Trust Company	Daily	None
STP Investments	Daily	None
SunGard/Protegent (formerly Dataware)	Daily	None
The Bank of New York Mellon	Daily	None
The Northern Trust Company	Daily	None
The Northern Trust Melbourne	Daily	None
Thomson	Semi-annually	None
Thomson Reuters	Daily	None
VPD Financial Software Consulting	Daily	None
Wilshire Analytics (Axiom and Compass)	Daily	None

Portfolio holdings information for the Fund may also be released from time to time pursuant to ongoing arrangements with the following parties:

Recipient	Frequency	Delay Before Dissemination
Broadridge	Daily	None
Deutsche Bank	Monthly	6-8 Business Days
DST International plc (DSTi)	Daily	None
Electra Information Systems	Daily	None

Fidelity	Quarterly	5 Business Days
Fitch	Monthly	6-8 Business Days
Frank Russell	Monthly	1 Day
Glass Lewis & Co.	Daily	None
Informa Investment Solutions	Quarterly	8-10 Days
Interactive Data Corp	Daily	None
Liberty Hampshire	Weekly and Month End	None
RBC Investor and Treasury Services	Daily	None
S&P (Rating Agency)	Weekly Tuesday Night	1 Business Day
SunTrust	Weekly and Month End	None

Excluded from the lists of ongoing arrangements set forth above are ongoing arrangements where either (i) the disclosure of portfolio holdings information occurs concurrently with or after the time at which the portfolio holdings information is included in a public filing with the SEC that is required to include the information, or (ii) the Fund's portfolio holdings information is made available no earlier than the day next following the day on which the Fund makes the information available on its website, as disclosed in the Fund's Prospectus. The approval of the Fund's Chief Compliance Officer, or designee, must be obtained before entering into any new ongoing arrangement or altering any existing ongoing arrangement to make available portfolio holdings information, or with respect to any exceptions from the policy.

Release of Limited Portfolio Holdings Information

In addition to the ongoing arrangements described above, the Fund's complete or partial list of holdings (including size of positions) may be released to another party on a one-time basis, provided the party receiving the information has executed a non-disclosure and confidentiality agreement and provided that the specific release of information has been approved by the Fund's Chief Compliance Officer or designee as consistent with the policy. By way of illustration and not of limitation, release of non-public information about the Fund's portfolio holdings may be made (i) to a proposed or potential adviser or Subadviser(s) or other investment manager asked to provide investment management services to the Fund, or (ii) to a third party in connection with a program or similar trade.

In addition, the policy permits the release to investors, potential investors, third parties and Franklin Templeton personnel that are not fund-affiliated personnel of limited portfolio holdings information in other circumstances, including:

- The Fund's top ten securities, current as of month-end, and the individual size of each such security position may be released at any time following month-end with simultaneous public disclosure.
- The Fund's top ten securities positions (including the aggregate but not individual size of such positions) may be released at any time with simultaneous public disclosure.
- A list of securities (that may include fund holdings together with other securities) followed by an investment professional (without position sizes or identification of particular funds) may be disclosed to sell-side brokers at any time for the purpose of obtaining research and/or market information from such brokers.
- A trade in process may be discussed only with counterparties, potential counterparties and others involved in the transaction (i.e., brokers and custodians).
- The Fund's sector weightings, yield and duration (for fixed income and money market funds), performance attribution (e.g., analysis of the Fund's out-performance or underperformance of its benchmark based on its portfolio holdings) and other summary and statistical information that does not include identification of specific portfolio holdings may be released, even if non-public, if such release is otherwise in accordance with the policy's general principles.

- A small number of the Fund's portfolio holdings (including information that the Fund no longer holds a particular holding) may be released, but only if the release of the information could not reasonably be seen to interfere with current or future purchase or sales activities of the Fund and is not contrary to law.
- The Fund's portfolio holdings may be released on an as-needed basis to its legal counsel, counsel to its Independent Trustees and its independent public accounting firm, in required regulatory filings or otherwise to governmental agencies and authorities.

Exceptions to the Policy

The Fund's Chief Compliance Officer, or designee, may, as is deemed appropriate, approve exceptions from the policy. Exceptions are granted only after a thorough examination and consultation with the Manager's legal department, as necessary. Exceptions from the policy are reported annually to the Fund's Board.

Limitations of Policy

The Fund's portfolio holdings policy is designed to prevent sharing of portfolio information with third parties that have no legitimate business purpose for accessing the information. The policy may not be effective to limit access to portfolio holdings information in all circumstances, however. For example, the Manager or the Subadviser may manage accounts other than the Fund that have investment objectives and strategies similar to those of the Fund. Because these accounts, including the Fund, may be similarly managed, portfolio holdings may be similar across the accounts. In that case, an investor in another account managed by the Manager or the Subadviser may be able to infer the portfolio holdings of the Fund from the portfolio holdings in that investor's account.

THE TRUST

The certificate of trust to establish the Trust was filed with the State Department of Assessments and Taxation of Maryland on October 4, 2006. The Fund is a series of the Trust. As of April 16, 2007, the Fund was redomiciled as a series of the Trust. Prior to that, the Fund was a series of Legg Mason Partners Income Funds, a Massachusetts business trust. From October 5, 2009 to August 1, 2012, Intermediate-Term Municipals Fund, New Jersey Municipals Fund, New York Municipals Fund and Pennsylvania Municipals Fund were known as Legg Mason Western Asset Intermediate-Term Municipals Fund, Legg Mason Western Asset New Jersey Municipals Fund, Legg Mason Western Asset New York Municipals Fund and Legg Mason Western Asset Pennsylvania Municipals Fund, respectively.

The Trust is a Maryland statutory trust. A Maryland statutory trust is an unincorporated business association that is established under, and governed by, Maryland law. Maryland law provides a statutory framework for the powers, duties, rights and obligations of the trustees and shareholders of a statutory trust, while the more specific powers, duties, rights and obligations of the trustees and the shareholders are determined by the trustees as set forth in a trust's declaration of trust. The Trust's Declaration of Trust (the "Declaration") provides that by becoming a shareholder of the Fund, each shareholder shall be expressly held to have agreed to be bound by the provisions of the Declaration and any other governing instrument of the Trust, such as the by-laws of the Trust, which contain additional rules governing the conduct of the business of the Trust.

Some of the more significant provisions of the Declaration are summarized below. The following summary is qualified in its entirety by reference to the applicable provisions of the Declaration.

Shareholder Voting

Under the Declaration, the Trustees have broad authority to direct the business and affairs of the Trust. The Declaration provides for shareholder voting as required by the 1940 Act or other applicable laws but otherwise permits, consistent with Maryland law, actions by the Trustees without seeking the consent of shareholders. For example, the Trustees are empowered to amend the Declaration or authorize the merger or consolidation of the Trust into another trust or entity, reorganize the Trust or any series or class into another trust or entity or a series or class of another entity, sell all or substantially all of the assets of the Trust or any series or class to another entity, or a series or class of another entity, terminate the Trust or any series or class, or adopt or amend the by-laws of the Trust, in each case without shareholder approval if the 1940 Act would not require such approval.

The Fund is not required to hold an annual meeting of shareholders, but the Fund will call special meetings of shareholders whenever required by the 1940 Act or by the terms of the Declaration. The Declaration provides for "dollar-weighted voting" which means that a shareholder's voting power is determined, not by the number of shares he or she owns, but by the dollar value of those shares determined on the record date. All shareholders of record of all series and classes of the Trust vote together, except where required by the 1940 Act to vote separately by series or by class, or when the Trustees have determined that a matter affects only the interests of one or more series or classes of shares. There is no cumulative voting on any matter submitted to a vote of the shareholders.

Election and Removal of Trustees

The Declaration provides that the Trustees may establish the number of Trustees and that vacancies on the Board may be filled by the remaining Trustees, except when election of Trustees by the shareholders is required under the 1940 Act. When a vote of shareholders is required to elect Trustees, the Declaration provides that such Trustees shall be elected by a plurality of votes cast by shareholders at a meeting at which a quorum is present. The Declaration also provides that a mandatory retirement age may be set by action of two-thirds of the Trustees and that Trustees may be removed, with or without cause, by a vote of shareholders holding two-thirds of the voting power of the Trust, or by a vote of two-thirds of the remaining Trustees. The provisions of the Declaration relating to the election and removal of Trustees may not be amended without the approval of two-thirds of the Trustees.

Amendments to the Declaration

The Trustees are authorized to amend the Declaration without the vote of shareholders, but no amendment may be made that impairs the exemption from personal liability granted in the Declaration to persons who are or have been shareholders, Trustees, officers or, employees of the Trust or that limits the rights to indemnification, advancement of expenses or insurance provided in the Declaration with respect to actions or omissions of persons entitled to indemnification, advancement of expenses or insurance under the Declaration prior to the amendment.

Issuance and Redemption of Shares

The Fund may issue an unlimited number of shares for such consideration and on such terms as the Trustees may determine. All shares offered pursuant to the Prospectus of the Fund, when issued, will be fully paid and non-assessable. Shareholders are not entitled to any appraisal rights with respect to their shares and, except as the Trustees may determine, shall have no preemptive, conversion, exchange or similar rights. The Fund may involuntarily redeem a shareholder's shares upon certain conditions as may be determined by the Trustees, including, for example, if the shareholder fails to provide the Fund with identification required by law, or if the Fund is unable to verify the information received from the shareholder. Additionally, as discussed below, shares may be redeemed in connection with the closing of small accounts.

Disclosure of Shareholder Holdings

The Declaration specifically requires shareholders, upon demand, to disclose to the Fund such information with respect to their ownership of shares of the Fund, whether direct or indirect, as the Trustees may deem necessary in order to comply with various laws or regulations or for such other purpose as the Trustees may decide. The Fund may disclose such ownership information if required by law or regulation, or as the Trustees otherwise decide.

Small Accounts

The Declaration provides that the Fund may close out a shareholder's account by redeeming all of the shares in the account if the account falls below a minimum account size (which may vary by class) that may be set by the Trustees from time to time. Alternately, the Declaration permits the Fund to assess a fee for small accounts (which may vary by class) and redeem shares in the account to cover such fees, or convert the shares into another share class that is geared to smaller accounts.

Series and Classes

The Declaration provides that the Trustees may establish series and classes in addition to those currently established and that the Trustees may determine the rights and preferences, limitations and restrictions, including qualifications for ownership, conversion and exchange features, minimum purchase and account size, expenses and charges, and other features of the series and classes. The Trustees may change any of those features, terminate any series or class, combine series with other

series in the Trust, combine one or more classes of a series with another class in that series or convert the shares of one class into shares of another class.

Each share of the Fund, as a series of the Trust, represents an interest in the Fund only and not in the assets of any other series of the Trust.

Shareholder, Trustee and Officer Liability

The Declaration provides that shareholders are not personally liable for the obligations of the Fund and requires the Fund to indemnify a shareholder against any loss or expense claimed solely because of the shareholder's being or having been a shareholder. The Fund will assume the defense of any claim against a shareholder for personal liability at the request of the shareholder. The Declaration further provides that a Trustee acting in his or her capacity as a Trustee is not personally liable to any person, other than the Trust or its shareholders, in connection with the affairs of the Trust. Each Trustee is required to perform his or her duties in good faith and in a manner he or she believes to be in the best interests of the Trust. All actions and omissions of Trustees are presumed to be in accordance with the foregoing standard of performance, and any person alleging the contrary has the burden of proving that allegation.

The Declaration limits a Trustee's liability to the Trust or any shareholder to the fullest extent permitted under current Maryland law by providing that a Trustee is liable to the Trust or its shareholders for monetary damages only (a) to the extent that it is proved that he or she actually received an improper benefit or profit in money, property, or services or (b) to the extent that a judgment or other final adjudication adverse to the Trustee is entered in a proceeding based on a finding in the proceeding that the Trustee's action, or failure to act, was the result of active and deliberate dishonesty and was material to the cause of action adjudicated in the proceeding. The Declaration requires the Trust to indemnify any persons who are or who have been Trustees, officers or employees of the Trust to the fullest extent permitted by law against liability and expenses in connection with any claim or proceeding in which he or she is involved by virtue of having been a Trustee, officer or employee. Subject to applicable federal law, expenses related to the defense against any claim to which indemnification may apply shall be advanced by the Trust upon receipt of an undertaking by or on behalf of the recipient of those expenses to repay the advanced amount if it is ultimately found that he or she is not entitled to indemnification. In making any determination as to whether a person has engaged in conduct for which indemnification is not available, or as to whether there is reason to believe that such person ultimately will be found entitled to indemnification, such person shall be afforded a rebuttable presumption that he or she did not engage in conduct for which indemnification is not available.

The Declaration provides that any Trustee who serves as chair of the Board, a member or chair of a committee of the Board, lead independent Trustee, audit committee financial expert, or in any other similar capacity will not be subject to any greater standard of care or liability because of such position.

Derivative Actions

The Declaration provides a detailed process for the bringing of derivative actions by shareholders in order to permit legitimate inquiries and claims while avoiding the time, expense, distraction, and other harm that can be caused to the Fund or its shareholders as a result of spurious shareholder demands and derivative actions. Prior to bringing a derivative action, a demand by no fewer than three unrelated shareholders must be made on the Trustees. The Declaration details information, certifications, undertakings and acknowledgements that must be included in the demand. The Trustees are not required to consider a demand that is not submitted in accordance with the requirements contained in the Declaration. The Declaration also requires that, in order to bring a derivative action, the complaining shareholders must be joined in the action by shareholders owning, at the time of the alleged wrongdoing, at the time of demand, and at the time the action is commenced, shares representing at least 5% of the voting power of the affected funds. The Trustees have a period of 90 days, which may be extended for an additional period not to exceed 60 days, to consider the demand. If a majority of the Trustees who are considered independent for the purposes of considering the demand determine that a suit should be maintained, then the Trust will commence the suit and the suit will proceed directly and not derivatively. If a majority of the independent Trustees determines that maintaining the suit would not be in the best interests of the Fund, the Trustees are required to reject the demand and the complaining shareholders may not proceed with the derivative action unless the shareholders are able to sustain the burden of proof to a court that the decision of the Trustees not to pursue the requested action was not consistent with the standard of performance required of the Trustees in performing their duties. If a demand is rejected, the complaining shareholders will be responsible for the costs and expenses (including attorneys' fees) incurred by the Trust in connection with

the consideration of the demand, if, in the judgment of the independent Trustees, the demand was made without reasonable cause or for an improper purpose. If a derivative action is brought in violation of the Declaration, the shareholders bringing the action may be responsible for the Fund's costs, including attorneys' fees.

The Declaration further provides that the Fund shall be responsible for payment of attorneys' fees and legal expenses incurred by a complaining shareholder only if required by law, and any attorneys' fees that the Fund is obligated to pay shall be calculated using reasonable hourly rates. The Declaration also requires that actions by shareholders against the Trust or the Fund be brought only in the U.S. District Court for the District of Maryland (Baltimore Division), or if such action may not be brought in that court, then such action shall be brought in the Circuit Court for Baltimore City and that the right to jury trial be waived to the fullest extent permitted by law.

The Declaration further provides that no provision of the Declaration will be effective to require a waiver of compliance with any provision of the 1933 Act, the 1934 Act or the 1940 Act, or of any valid rule, regulation or order of the Commission thereunder.

TAXES

The following is a summary of certain material U.S. federal (and, where noted, state and local) income tax considerations affecting the Fund and its shareholders. This discussion is very general and does not address all the potential U.S. federal income tax consequences that may be applicable to the Fund or to all categories of investors, some of which may be subject to special tax rules. This summary is based upon the Code, its legislative history, Treasury regulations (including temporary and proposed regulations), published rulings, and court decisions, each as of the date of this SAI and all of which are subject to change, possibly with retroactive effect, which could affect the continuing accuracy of this discussion. This discussion assumes that each shareholder holds its shares of the Fund as capital assets for U.S. federal income tax purposes. Current and prospective shareholders are urged to consult their own tax professionals with respect to the specific U.S. federal, state, local, and non-U.S. tax consequences of investing in the Fund.

Tax Treatment of the Fund

The Fund has elected to be treated, and intends to qualify each year, as a "regulated investment company" under Subchapter M of the Code. To qualify as such, the Fund must, among other things: (a) derive at least 90% of its gross income in each taxable year from dividends, interest, payments with respect to certain securities loans, gains from the sale or other disposition of stock, securities or foreign currencies, other income (including, but not limited to, gains from options, futures, or forward contracts) derived with respect to its business of investing in such stock, securities or currencies, and net income derived from interests in "qualified publicly traded partnerships" (*i.e.*, partnerships (x) the interests in which are traded on an established securities market or are readily tradable on a secondary market or the substantial equivalent thereof, and (y) that derive less than 90% of their income from sources described in this subparagraph (a) other than qualified publicly traded partnerships); and (b) diversify its holdings so that, at the end of each quarter of the Fund's taxable year, (i) at least 50% of the market value of the Fund's assets consists of cash and cash items (including receivables), securities of other regulated investment companies, U.S. government securities, and other securities, with such other securities limited, in respect of any one issuer, to an amount not greater than 5% of the value of the Fund's assets and not more than 10% of the outstanding voting securities of such issuer and (ii) not more than 25% of the value of the Fund's assets is invested, including through corporations in which the Fund owns a 20% or larger voting stock interest, (x) in the securities (other than U.S. government securities or securities of other regulated investment companies) of any one issuer, (y) in the securities (other than the securities of other regulated investment companies) of any two or more issuers that the Fund controls and that are treated as engaged in the same, similar, or related trades or businesses, or (z) in the securities of one or more "qualified publicly traded partnerships," which generally include master limited partnerships.

In general, for purposes of the 90% gross income test described above, income derived from a partnership will be treated as qualifying income only to the extent such income is attributable to items of income of the partnership which would be qualifying income if realized directly by the Fund. However, 100% of the net income derived from an interest in a qualified publicly traded partnership will be treated as qualifying income. In general, qualified publicly traded partnerships will be treated as partnerships for U.S. federal income tax purposes because they meet a passive income requirement under the Code. In addition, although in general the passive loss rules of the Code do not apply to regulated investment companies, such rules do apply to a regulated investment company with respect to items attributable to interests in qualified publicly traded partnerships.

The Fund's investments in partnerships, if any, including in qualified publicly traded partnerships, may result in the Fund being subject to U.S. federal, state, local, or non-U.S. income, franchise, or withholding tax liabilities.

For purposes of the diversification test described above, the term "outstanding voting securities of such issuer" will include the equity securities of a qualified publicly traded partnership. Also, for purposes of the diversification test, the identification of the issuer (or, in some cases, issuers) of a particular Fund investment can depend on the terms and conditions of that investment. In some cases, identification of the issuer (or issuers) is uncertain under current law, and an adverse determination or future guidance by the IRS with respect to issuer identification for a particular type of investment may adversely affect the Fund's ability to meet the diversification test.

As a regulated investment company, the Fund will not be subject to U.S. federal income tax on the portion of its taxable investment income and capital gains that it distributes, provided that it satisfies a minimum distribution requirement. To satisfy the minimum distribution requirement, the Fund must distribute at least the sum of (i) 90% of its "investment company taxable income" (*i.e.*, generally, its taxable income other than the excess of its net long-term capital gain over its net short-term capital loss, plus or minus certain other adjustments, and calculated without regard to the deduction for dividends paid), and (ii) 90% of its net tax-exempt income for the taxable year. The Fund will be subject to income tax at the regular corporate tax rate on any taxable income or gains that it does not distribute.

If, for any taxable year, the Fund were to fail to qualify as a regulated investment company under the Code or were to fail to meet the distribution requirement, it would be taxed in the same manner as an ordinary corporation, and distributions would not be deductible by the Fund in computing its taxable income. In addition, in the event of a failure to qualify, the Fund's distributions, including any distributions of net tax-exempt income and net long-term capital gains, would be taxable to shareholders as ordinary dividend income for U.S. federal income tax purposes to the extent of the Fund's current and accumulated earnings and profits. However, such dividends would be eligible, subject to any generally applicable limitations, (i) to be treated as qualified dividend income in the case of shareholders taxed as individuals and (ii) for the dividends-received deduction in the case of corporate shareholders. Moreover, if the Fund were to fail to qualify as a regulated investment company in any year, it would be required to pay out its earnings and profits accumulated in that year in order to qualify again as a regulated investment company. If the Fund were to fail to meet the income, diversification, or distribution test described above, the Fund could in some cases cure such failure, including by paying a Fund-level tax, paying interest, making additional distributions, or disposing of certain assets. In particular, if in the first instance, the Fund does not satisfy the diversification test as of a particular quarter end, it will have up to 30 days after that quarter end to adjust its holdings in order to comply with the test retroactively. Portfolio transactions executed by the Fund in order to comply with the diversification test will increase the Fund's portfolio turnover and trading costs and may increase the amount of taxes payable by shareholders to the extent any capital gains are realized as a result of such transactions. If the Fund were to fail to qualify as a regulated investment company for a period greater than two taxable years, the Fund would generally be required to recognize any net built-in gains with respect to certain of its assets upon a disposition of such assets within five years of qualifying as a regulated investment company in a subsequent year.

If the Fund were to fail to distribute in a calendar year at least the sum of (i) 98% of its ordinary income for that year and (ii) 98.2% of its capital gain net income (*i.e.*, the excess of all gains from sales or exchanges of capital assets over the losses from such sales or exchanges) for the one-year period ending October 31 of that year (or November 30 or December 31 of that year if the Fund is permitted to elect and so elects), it would be subject to a 4% nondeductible excise tax. For this purpose, however, any ordinary income or capital gain net income that is retained by the Fund and subject to corporate income tax will be considered to have been distributed by year end. In addition, the minimum amounts that must be distributed in any year to avoid the excise tax will be increased or decreased to reflect any under-distribution or overdistribution, as the case may be, from the previous year. For purposes of the required excise tax distribution, a regulated investment company's ordinary gains and losses from the sale, exchange or other taxable disposition of property that would otherwise be taken into account after October 31 of a calendar year (or November 30 of that year if the regulated investment company makes the election described above) generally are treated as arising on January 1 of the following calendar year; in the case of a fund with a December 31 year end that makes the election described above, no such gains or losses will be so treated. The Fund anticipates that it will pay such dividends and will make such distributions as are necessary to avoid the application of this excise tax, but there can be no assurance that it will be able to do so. In determining its net capital gain (*i.e.*, net realized long-term capital gains in excess of net realized short-term capital losses, including any capital loss carryforwards), its taxable income, and its earnings and profits, a regulated investment company generally is permitted to elect to treat part or all of any post-October capital loss (defined as any net capital loss

attributable to the portion of the taxable year after October 31, or if there is no such loss, the net long-term capital loss or net short-term capital loss attributable to such portion of the taxable year), or late-year ordinary loss (generally, the sum of its (i) net ordinary loss from the sale, exchange or other taxable disposition of property, attributable to the portion of the taxable year after October 31 and its (ii) other net ordinary loss attributable to the portion of the taxable year after December 31) as if incurred in the succeeding taxable year.

Tax Treatment of the Fund's Investments

The Fund's transactions in zero coupon securities, foreign currencies, forward contracts, options, and futures contracts (including options and futures contracts on foreign currencies), if any, will be subject to special provisions of the Code (including provisions relating to "hedging transactions" and "straddles") that, among other things, may affect the character of gains and losses realized by the Fund (*i.e.*, may affect whether gains or losses are ordinary or capital), accelerate recognition of income to the Fund, and defer Fund losses. These rules could therefore affect the character, amount, and timing of distributions to shareholders. These provisions also (a) will require the Fund to "mark to market" certain types of the positions in its portfolio (*i.e.*, require the Fund to treat all unrealized gains and losses with respect to those positions as though they were realized at the end of each year) and (b) may cause the Fund to recognize income prior to or without receiving cash with which to pay dividends or make distributions in amounts necessary to satisfy the distribution requirements for avoiding income and excise taxes. In order to distribute this income and avoid a tax at the Fund level, the Fund might be required to sell portfolio securities that it might otherwise have continued to hold, potentially resulting in additional taxable gain or loss.

As a result of entering into swap contracts, if any, the Fund may make or receive periodic net payments. The Fund may also make or receive a payment when a swap is terminated prior to maturity through an assignment of the swap or other closing transaction. Periodic net payments will generally constitute ordinary income or deductions, while termination of a swap will generally result in capital gain or loss (which will be a long-term capital gain or loss if the Fund has been a party to the swap for more than one year). With respect to certain types of swaps, the Fund may be required to recognize currently income or loss with respect to future payments on such swaps or may elect under certain circumstances to mark such swaps to market annually for tax purposes as ordinary income or loss.

Any investments by the Fund in so-called "section 1256 contracts," such as regulated futures contracts, most foreign currency forward contracts traded in the interbank market, and non-equity options written or purchased by the Fund on U.S. exchanges (including options on broad-based equity indices and debt securities), are subject to special tax rules. Any section 1256 contracts held by the Fund at the end of its taxable year (and, for purposes of the 4% excise tax, on certain later dates as prescribed under the Code) are required to be marked to their market value, and any unrealized gain or loss on those positions will be included in the Fund's income as if each position had been sold for its fair market value at the end of the taxable year. The resulting gain or loss will be combined with any gain or loss realized by the Fund from positions in section 1256 contracts closed during the taxable year. Provided such positions were held as capital assets and were neither part of a "hedging transaction" nor part of a "straddle," 60% of the resulting net gain or loss will be treated as long-term capital gain or loss, and 40% of such net gain or loss will be treated as short-term capital gain or loss, regardless of the period of time the positions were actually held by the Fund. Section 1256 contracts do not include any interest rate swap, currency swap, basis swap, interest rate cap, interest rate floor, commodity swap, equity swap, equity index swap, credit default swap, or similar agreement.

In general, option premiums received by the Fund are not immediately included in the income of the Fund. Instead, the premiums are recognized when the option contract expires, the option is exercised by the holder, or the Fund transfers or otherwise terminates the option (e.g., through a closing transaction). If a call option written by the Fund is exercised and the Fund sells or delivers the underlying security, the Fund generally will recognize capital gain or loss equal to (a) the sum of the strike price and the option premium received by the Fund minus (b) the Fund's basis in the security. Such gain or loss generally will be short-term or long-term depending upon the holding period of the underlying security. If securities are purchased by the Fund pursuant to the exercise of a put option written by it, the Fund generally will subtract the premium received for purposes of computing its cost basis in the securities purchased. Gain or loss arising in respect of a termination of the Fund's obligation under an option other than through the exercise of the option will be short-term gain or loss depending on whether the premium income received by the Fund is greater or less than the amount paid by the Fund (if any) in terminating the transaction. Thus, for example, if an option written by the Fund expires unexercised, the Fund generally will recognize short-term gain equal to the premium received.

In general, gain or loss on a short sale is recognized when the Fund closes the sale by delivering the borrowed property to the lender, not when the borrowed property is sold. Gain or loss from a short sale is generally considered as capital gain or loss to the extent that the property used to close the short sale constitutes a capital asset in the Fund's hands. Except with respect to certain situations where the property used by the Fund to close a short sale has a long-term holding period on the date of the short sale, special rules generally treat the gains on short sales as short-term capital gains. These rules may also terminate the running of the holding period of "substantially identical property" held by the Fund. Moreover, a loss on a short sale will be treated as a long-term capital loss if, on the date of the short sale, "substantially identical property" has been held by the Fund for more than one year.

The Fund may purchase debt obligations with original issue discount ("OID"), market discount, or acquisition discount. Some debt obligations with a fixed maturity date of more than one year from the date of issuance (and all zero-coupon debt obligations with a fixed maturity date of more than one year from the date of issuance) will be treated as debt obligations that are issued with OID. Generally, the amount of the OID is treated as interest income and is included in taxable income (and is accordingly required to be distributed by the Fund) over the term of the debt security, even though payment of that amount is not received until a later time, usually when the debt security matures. Periodic adjustments for inflation in the principal value of inflation-indexed bonds also may be treated as OID that is includible in the Fund's gross income on a current basis.

Some debt obligations with a fixed maturity date of more than one year from the date of issuance that are acquired in the secondary market may be treated as having "market discount." Very generally, market discount is the excess of the stated redemption price of a debt obligation (or in the case of an obligation issued with OID, its "revised issue price") over the purchase price of such obligation. Under the Code, generally, any gain recognized on the disposition of, and any partial payment of principal on, a debt security having market discount is treated as ordinary income to the extent the gain, or principal payment, does not exceed the "accrued market discount" on such debt security. Alternatively, the Fund may elect to accrue market discount currently, in which case the Fund will be required to include the accrued market discount in the Fund's income (as ordinary income) and thus distribute it over the term of the debt security, even though payment of that amount is not received until a later time, upon partial or full repayment or disposition of the debt security. If the Fund elects to accrue market discount currently, the rate at which the market discount accrues, and thus is included in the Fund's income, will depend upon which of the permitted accrual methods the Fund elects.

Some debt obligations with a fixed maturity date of one year or less from the date of issuance that are acquired by the Fund may be treated as having OID or, in certain cases, "acquisition discount" (very generally, the excess of the stated redemption price over the purchase price). The Fund will be required to include the OID or acquisition discount in income (as ordinary income) and thus distribute it over the term of the debt security, even though payment of that amount is not received until a later time, upon partial or full repayment or disposition of the debt security. The rate at which OID or acquisition discount accrues, and thus is included in the Fund's income, will depend upon which of the permitted accrual methods the Fund elects.

Because the OID, market discount, or acquisition discount earned by the Fund in a taxable year may exceed the total amount of cash interest the Fund receives from the relevant debt obligations, the Fund may have to dispose of one or more of its investments, including at a time when it is not advantageous to do so, and use the proceeds thereof to make distributions in amounts necessary to satisfy the distribution requirements. The Fund may realize capital gains or losses from such dispositions, which would increase or decrease the Fund's investment company taxable income and/or net capital gain.

In addition, payment-in-kind securities held by the Fund, if any, will give rise to income which is required to be distributed and is taxable even though the Fund receives no interest payment in cash on the security during the year.

Very generally, where the Fund purchases a bond at a price that exceeds the redemption price at maturity (*i.e.*, a premium), the premium is amortizable over the remaining term of the bond. In the case of a taxable bond, if the Fund makes an election applicable to all such bonds it purchases, which election is irrevocable without consent of the IRS, the Fund reduces the current taxable income from the bond by the amortized premium and reduces its tax basis in the bond by the amount of such offset; upon the disposition or maturity of such bonds acquired on or after January 4, 2013, the Fund is permitted to deduct any remaining premium allocable to a prior period. In the case of a tax-exempt bond, tax rules require the Fund to reduce its tax basis by the amount of amortized premium.

The Fund may invest in debt obligations that are in the lowest rating categories or are unrated, including debt obligations of issuers not currently paying interest or that are in default. Investments in debt obligations that are at risk of or in

default present special tax issues for the Fund. Tax rules are not entirely clear about issues such as when the Fund may cease to accrue interest, OID or market discount, when and to what extent deductions may be taken for bad debts or worthless securities, and how payments received on obligations in default should be allocated between principal and income. These and other related issues will be addressed by the Fund when, as, and if it invests in such securities, in order to seek to ensure that it distributes sufficient income to preserve its eligibility for treatment as a regulated investment company and does not become subject to U.S. federal income or excise tax.

A portion of the interest paid or accrued on high yield obligations may not (and interest paid on debt obligations, if any, that are considered for tax purposes to be payable in the equity of the issuer or a related party will not) be deductible to the issuer. If a portion of the interest paid or accrued on certain high yield discount obligations is not deductible by the issuer, that portion will be treated as a dividend for purposes of the corporate dividends-received deduction. In such cases, if the issuer of the high yield discount obligations is a domestic corporation, dividend payments by the Fund may be eligible for the dividends-received deduction to the extent of the deemed dividend portion of such accrued interest.

The Fund may be required to treat amounts as taxable income or gain, subject to the distribution requirements referred to above, even though no corresponding amounts of cash are received concurrently, as a result of (1) mark-to-market rules, constructive sale rules or rules applicable to passive foreign investment companies ("PFICs"), to partnerships or trusts in which the Fund invests or to certain options, futures, or forward contracts, or "appreciated financial positions," (2) the inability to obtain cash distributions or other amounts due to currency controls or restrictions on repatriation imposed by a non-U.S. country with respect to the Fund's investments (including through depositary receipts) in issuers in such country, or (3) tax rules applicable to debt obligations acquired with OID, including zero-coupon or deferred payment bonds and pay-in-kind debt obligations, or to market discount if the Fund elects to accrue such market discount currently. In order to distribute this income and avoid a tax on the Fund, the Fund might be required to liquidate portfolio securities that it might otherwise have continued to hold, potentially resulting in additional taxable gain or loss. The Fund might also meet the distribution requirements by borrowing the necessary cash, thereby incurring interest expenses.

Investments in Municipal or Other Tax-Exempt Funds

The Fund intends to satisfy conditions that will enable it to pay "exempt-interest dividends" to its shareholders. The Fund is eligible to pay exempt-interest dividends for taxable years in which, at the end of each quarter, at least 50% of the value of its total assets consists of securities generating interest that is exempt from U.S. federal income tax under Section 103(a) of the Code. Exempt-interest dividends are distributions attributable to interest income received from municipal obligations and are generally not subject to regular U.S. federal income taxes, although they may be considered taxable for certain state and local income tax purposes and may be subject to the U.S. federal alternative minimum tax. Repurchase agreements on municipal obligations generally give rise to taxable interest income, which will not be included in exempt-interest dividends when distributed by the Fund.

Interest on indebtedness incurred by shareholders, directly or indirectly, to purchase or carry Fund shares is not deductible for U.S. federal income tax purposes in proportion to the percentage that the Fund's distributions of exempt-interest dividends bears to all of the Fund's distributions, excluding Capital Gain Dividends (defined below). Investors receiving social security or railroad retirement benefits should be aware that exempt-interest dividends received from the Fund may, under certain circumstances, cause a portion of such benefits to be subject to U.S. federal income tax. Furthermore, a portion of any exempt-interest dividend paid by the Fund that represents income derived from certain revenue or "private activity bonds" held by the Fund may not retain its U.S. federal tax-exempt status in the hands of a shareholder who is a "substantial user" of a facility financed by such bonds or a "related person" thereof. Moreover, some or all of the exempt-interest dividends distributed by the Fund may be a specific preference item, or a component of an adjustment item, for purposes of the U.S. federal alternative minimum tax. Shareholders should consult their own tax professionals to determine whether they are (a) "substantial users" with respect to a facility or "related" to such users within the meaning of the Code or (b) subject to the U.S. federal alternative minimum tax or the U.S. federal "excess net passive income" tax.

The treatment under state and local tax law of Fund dividends may differ from the U.S. federal income tax treatment of such dividends under the Code.

Capital Loss Carryforwards

As of March 31, 2026, as set forth below, the listed capital losses may be carried forward indefinitely to offset future taxable capital gains. These capital losses have been deferred as either short-term or long-term losses and will be deemed to occur on the first day of the next taxable year in the same character as they were originally deferred.

Fund	Amount of Capital Loss Carryforward ($)
Intermediate-Term Municipals Fund	157,779,765
New Jersey Municipals Fund	10,249,458
New York Municipals Fund	40,719,915
Pennsylvania Municipals Fund	10,607,584

Taxation of U.S. Shareholders

Dividends and Distributions. Dividends and other distributions by the Fund are generally treated under the Code as received by the shareholders at the time the dividend or distribution is made. However, if any dividend or distribution is declared by the Fund in October, November, or December of any calendar year and payable to shareholders of record on a specified date in such a month but is actually paid during the following January, such dividend or distribution will be deemed to have been received by each shareholder on December 31 of the year in which the dividend was declared.

The Fund intends to distribute annually substantially all of its investment company taxable income (determined without regard to the dividends-paid deduction), and any net capital gain. However, if the Fund retains for investment an amount equal to all or a portion of its net capital gain, it will be subject to a corporate tax on the amount retained. In that event, the Fund may designate such retained amounts as undistributed capital gains in a notice to its shareholders who, in turn, (a) will be required to include in income for U.S. federal income tax purposes, as long-term capital gains, their proportionate shares of the undistributed amount, (b) will be entitled to credit their proportionate shares of the income tax paid by the Fund on the undistributed amount against their U.S. federal income tax liabilities, if any, and to claim refunds on a properly filed U.S. tax return to the extent their credits exceed their liabilities, if any, and (c) will be entitled to increase their tax basis, for U.S. federal income tax purposes, in their shares by an amount equal to their share of the excess of the amount of undistributed net capital gain included in their income over the income tax paid by the Fund on the undistributed amount. Organizations or persons not subject to U.S. federal income tax on such capital gains will be entitled to a refund of their pro rata share of such taxes paid by the Fund upon timely filing appropriate returns or claims for refund with the IRS.

Exempt-interest dividends paid by the Fund are exempt from regular U.S. federal income taxes. Other distributions from the Fund's net investment income and of net realized short-term capital gains, whether paid in cash or in shares, are taxable to a U.S. shareholder as ordinary income or, if certain conditions are met, as "qualified dividend income," taxable to individual and certain other non-corporate shareholders at the rates applicable to long-term capital gain. Distributions of net capital gain, if any, that the Fund reports as capital gain dividends ("Capital Gain Dividends") are taxable as long-term capital gains, whether paid in cash or in shares, and regardless of how long a shareholder has held shares of the Fund. The IRS and the Department of the Treasury have issued regulations that impose special reporting of Capital Gain Dividends by the Fund in order to allow Capital Gain Dividends to be taxable at reduced rates in the hands of certain non-corporate taxpayers who hold shares of the Fund through entities treated as partnerships.

In general, dividends may be reported by the Fund as qualified dividend income if they are attributable to qualified dividend income received by the Fund. Qualified dividend income generally means dividend income received from the Fund's investments in common and preferred stock of U.S. corporations and stock of certain qualified foreign corporations, provided that certain holding period and other requirements are met by both the Fund and the shareholders. If 95% or more of the Fund's gross income (calculated without taking into account net capital gain derived from sales or other dispositions of stock or securities) consists of qualified dividend income, the Fund may report all distributions of such income as qualified dividend income.

A non-U.S. corporation is treated as a qualified foreign corporation for this purpose if it is incorporated in a possession of the United States or it is eligible for the benefits of certain income tax treaties with the United States and meets certain additional requirements. Certain non-U.S. corporations that are not otherwise qualified foreign corporations will be treated as qualified foreign corporations with respect to dividends paid by them if the stock with respect to which the dividends are paid is readily tradable on an established securities market in the United States. PFICs are not qualified foreign corporations for this purpose.

A dividend that is attributable to qualified dividend income of the Fund that is paid by the Fund to a shareholder will not be taxable as qualified dividend income to such shareholder (1) if the dividend is received with respect to any share of the Fund held for fewer than 61 days during the 121-day period beginning on the date that is 60 days before the date on which such share became ex-dividend with respect to such dividend, (2) to the extent that the shareholder is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property, or (3) if the shareholder elects to have the dividend treated as investment income for purposes of the limitation on deductibility of investment interest. The "ex-dividend" date is the date on which the owner of the share at the commencement of such date is entitled to receive the next issued dividend payment for such share even if the share is sold by the owner on that date or thereafter.

Certain dividends received by the Fund from U.S. corporations (generally, dividends received by the Fund in respect of any share of stock (1) with a tax holding period of at least 46 days during the 91-day period beginning on the date that is 45 days before the date on which the stock becomes ex-dividend as to that dividend and (2) that is held in an unleveraged position) and distributed and appropriately so reported by the Fund may be eligible for the dividends-received deduction generally available to corporations under the Code. Certain preferred stock must have a holding period of at least 91 days during the 181-day period beginning on the date that is 90 days before the date on which the stock becomes ex-dividend as to that dividend in order to be eligible. In order to qualify for the deduction, corporate shareholders must meet the minimum holding period requirement stated above with respect to their Fund shares, taking into account any holding period reductions from certain hedging or other transactions or positions that diminish their risk of loss with respect to their Fund shares, and, if they borrow to acquire or otherwise incur debt attributable to Fund shares, they may be denied a portion of the dividends-received deduction with respect to those shares. Any corporate shareholder should consult its tax professional regarding the possibility that its tax basis in its shares may be reduced, for U.S. federal income tax purposes, by reason of "extraordinary dividends" received with respect to the shares and, to the extent such basis would be reduced below zero, current recognition of income may be required.

The Fund does not anticipate that any of its dividends paid will qualify for the dividends-received deduction or be treated as qualified dividend income.

Under Section 163(j) of the Code, a taxpayer's business interest expense is generally deductible to the extent of the taxpayer's business interest income plus certain other amounts. If the Fund earns business interest income, it may report a portion of its dividends as "Section 163(j) interest dividends," which its shareholders may be able to treat as business interest income for purposes of Section 163(j) of the Code. The Fund's "Section 163(j) interest dividend" for a tax year will be limited to the excess of its business interest income over the sum of its business interest expense and other deductions properly allocable to its business interest income. In general, the Fund's shareholders may treat a distribution reported as a Section 163(j) interest dividend as interest income only to the extent the distribution exceeds the sum of the portions of the distribution reported as other types of tax-favored income. To be eligible to treat a Section 163(j) interest dividend as interest income, a shareholder may need to meet certain holding period requirements in respect of the Fund shares and must not have hedged its position in the Fund shares in certain ways.

The Code generally imposes a 3.8% Medicare contribution tax on the net investment income of U.S. individuals to the extent their income exceeds certain threshold amounts. The 3.8% tax also applies to all or a portion of the undistributed net investment income of certain shareholders that are estates and trusts. For these purposes, "net investment income" generally includes, among other things, (i) distributions paid by the Fund of net investment income (excluding exempt-interest dividends) and capital gains as described above, and (ii) any net gain from the sale, redemption, exchange or other taxable disposition of Fund shares.

Certain tax-exempt educational institutions will be subject to an excise tax on net investment income. For these purposes, certain dividends (excluding exempt-interest dividends) and capital gain distributions, and certain gains from the

disposition of Fund shares (among other categories of income), are generally taken into account in computing a shareholder's net investment income.

Distributions in excess of the Fund's current and accumulated earnings and profits will, as to each shareholder, be treated as a tax-free return of capital to the extent of the shareholder's basis in shares of the Fund, and as a capital gain thereafter (assuming the shareholder holds shares of the Fund as capital assets). One or more of the Fund's distributions during the year may include such a return of capital distribution. Shareholders who receive taxable distributions in the form of additional shares will be treated for U.S. federal income tax purposes as if receiving distributions of cash in amounts equal to the amounts they would have received if they had instead elected to receive cash distributions. Those shareholders' aggregate tax basis in shares of the Fund will be increased by those amounts.

Investors considering buying shares just prior to a dividend or capital gain distribution should be aware that, although the price of shares purchased at that time may reflect the amount of the forthcoming distribution, such dividend or distribution may nevertheless be taxable to them.

If Fund shares are held through a qualified retirement plan entitled to tax-advantaged treatment for U.S. federal income tax purposes, distributions will generally not be taxable currently but may be subject to U.S. federal income taxes upon a later withdrawal of monies from the plan. Special tax rules apply to such retirement plans. You should consult your tax professional regarding the tax treatment of distributions (which may include amounts attributable to Fund distributions) which may be taxable when distributed from the retirement plan.

Sale, Exchange or Other Taxable Disposition of Shares. Upon the sale or exchange of a shareholder's shares, the shareholder will generally recognize a taxable gain or loss equal to the difference between the amount realized and the shareholder's basis in the shares. A redemption of shares by the Fund will be treated as a sale for this purpose. Such gain or loss will be treated as capital gain or loss if the shares are capital assets in the shareholder's hands, and will be long-term capital gain or loss if the shareholder held such shares for more than one year and short-term capital gain or loss if the shareholder held such shares for one year or less. Any loss realized on a sale, exchange or other taxable disposition will be disallowed to the extent the shares disposed of are replaced, including by reinvesting dividends or capital gains distributions in the Fund, within a 61-day period beginning 30 days before and ending 30 days after the disposition of the shares. In such a case, the basis of the shares acquired will be increased to reflect the disallowed loss. Any loss realized by a shareholder on the sale of Fund shares held by the shareholder for six months or less will be disallowed to the extent of exempt-interest dividends received by the shareholder with respect to the shares and, to the extent not disallowed will be treated for U.S. federal income tax purposes as a long-term capital loss to the extent of any distributions or deemed distributions of long-term capital gains received by the shareholder (including amounts credited to the shareholder as undistributed capital gains) with respect to such shares during that six-month period.

If a shareholder incurs a sales charge in acquiring shares of the Fund, disposes of those shares within 90 days and then by January 31 of the calendar year following the year of disposition acquires shares in a mutual fund for which the otherwise applicable sales charge is reduced by reason of a reinvestment right (*e.g.*, an exchange privilege), the original sales charge will not be taken into account in computing gain or loss on the original shares to the extent the subsequent sales charge is reduced. Instead, the disregarded portion of the original sales charge will be added to the tax basis of the newly acquired shares. Furthermore, the same rule also applies to a disposition of the newly acquired shares made within 90 days of the second acquisition. This provision prevents a shareholder from immediately deducting the sales charge by shifting his or her investment within a family of mutual funds.

If a shareholder recognizes a loss with respect to the Fund's shares of at least $2 million in any single taxable year or $4 million in any combination of taxable years for an individual shareholder or at least $10 million in any taxable year or $20 million in any combination of taxable years for a corporate shareholder, the shareholder must file with the IRS a disclosure statement on IRS Form 8886. Direct shareholders of portfolio securities are in many cases excepted from this reporting requirement, but under current guidance, shareholders of a regulated investment company are not excepted. The fact that a loss is so reportable does not affect the legal determination of whether the taxpayer's treatment of the loss is proper.

If a shareholder's shares are redeemed to pay a fee because the shareholder's account balance is less than a certain threshold, the redemption will be treated as a taxable sale or exchange of shares, as described above. Such a fee generally will not be deductible by a shareholder that is an individual.

Basis Reporting. The Fund, or, in the case of a shareholder holding shares through a Service Agent, the Service Agent, will report to the IRS the amount of proceeds that a shareholder receives from a redemption or exchange of Fund shares. For redemptions or exchanges of shares acquired on or after January 1, 2012, the Fund will also report the shareholder's cost basis in those shares and the character of any gain or loss (i.e., short-term or long-term) that the shareholder realizes on the redemption or exchange, and certain related tax information. If a shareholder has a different cost basis for different shares of the Fund in the same account (e.g., if a shareholder purchased Fund shares held in the same account when the shares were at different prices), the Fund will by default report the cost basis of the shares redeemed or exchanged using the average basis method, under which the cost basis per share is the average of the cost bases of all the shareholder's Fund shares in the account. For these purposes, shares acquired prior to January 1, 2012 and shares acquired on or after January 1, 2012 will generally be treated as held in separate accounts.

A shareholder may instruct the Fund to use a method other than average basis for an account. If redemptions, including in connection with payment of an account fee, or exchanges have occurred in an account to which the average basis method applied, the basis of the Fund shares remaining in the account will continue to reflect the average basis notwithstanding the shareholder's subsequent election of a different method. For further assistance, shareholders who hold their shares directly with the Fund may call the Fund at 877-6LM-FUND/656-3863. Shareholders who hold shares through a Service Agent should contact the Service Agent for further assistance or for information regarding the Service Agent's default method for calculating basis and procedures for electing to use an alternative method. Shareholders should consult their tax professionals concerning the tax consequences of applying the average basis method or electing another method of basis calculation and should consider electing such other method prior to making redemptions or exchanges in their accounts.

Backup Withholding. The Fund may be required in certain circumstances to apply backup withholding on dividends (including exempt-interest dividends), distributions and redemption proceeds payable to non-corporate shareholders who fail to provide the Fund with their correct taxpayer identification numbers or to make required certifications, or who have been notified by the IRS that they are subject to backup withholding. Certain shareholders are exempt from backup withholding. Backup withholding is not an additional tax and any amount withheld may be credited against a shareholder's U.S. federal income tax liability, provided the appropriate information is furnished to the IRS.

Notices. Shareholders will receive, if appropriate, various written notices after the close of the Fund's taxable year regarding the U.S. federal income tax status of certain dividends, distributions and redemption proceeds that were paid (or that are treated as having been paid) by the Fund during the preceding taxable year. In certain cases, the Fund may be required to amend the tax information reported to you with respect to a particular year. In this event, you may be required to file amended U.S. federal income or other tax returns with respect to such amended information and, if applicable, to pay additional taxes (including potentially interest and penalties) or to seek a tax refund and may incur other related costs.

Other Taxes

Dividends, distributions and redemption proceeds may also be subject to additional state, local and non-U.S. taxes depending on each shareholder's particular situation. Generally, shareholders will have to pay state or local taxes on Fund dividends and other distributions, although distributions derived from interest on U.S. government obligations (but not distributions of gain from the sale of such obligations) may be exempt from certain state and local taxes.

Taxation of Non-U.S. Shareholders

Distributions by the Fund to shareholders that are not "U.S. persons" within the meaning of the Code ("non-U.S. shareholders") properly reported by the Fund as (1) capital gain dividends, (2) short-term capital gain dividends, (3) interest-related dividends, each as defined and subject to certain conditions described below, and (4) exempt interest dividends, generally are not subject to withholding of U.S. federal income tax.

In general, the Code defines (1) "short-term capital gain dividends" as distributions of net short-term capital gains in excess of net long-term capital losses and (2) "interest-related dividends" as distributions derived from U.S.-source interest income of types similar to those not subject to U.S. federal income tax if earned directly by an individual non-U.S. shareholder, in each case to the extent such distributions are properly reported as such by the Fund in a written notice to shareholders. The exceptions to withholding for capital gain dividends and short-term capital gain dividends do not apply to (A) distributions to an individual non-U.S. shareholder who is present in the United States for a period or periods aggregating 183 days or more during the year of the distribution and (B) distributions attributable to gain that is treated as effectively connected with the conduct by

the non-U.S. shareholder of a trade or business within the United States, under special rules regarding the disposition of "United States real property interests" ("USRPIs") as described below. The exception to withholding for interest-related dividends does not apply to distributions to a non-U.S. shareholder (A) that has not provided a satisfactory statement that the beneficial owner is not a U.S. person, (B) to the extent that the dividend is attributable to certain interest on an obligation if the non-U.S. shareholder is the issuer or is a 10% shareholder of the issuer, (C) that is within certain non-U.S. countries that have inadequate information exchange with the United States, or (D) to the extent the dividend is attributable to interest paid by a person that is a related person of the non-U.S. shareholder and the non-U.S. shareholder is a controlled foreign corporation. Although the Fund may be eligible to report interest-related and/or short-term capital gain dividends, the Fund is not required to do so. In the case of shares held through an intermediary, the intermediary may withhold even if the Fund reports all or a portion of a payment as an interest-related or short-term capital gain dividend to shareholders. Non-U.S. shareholders should contact their intermediaries regarding the application of these rules to their accounts.

Distributions by the Fund to non-U.S. shareholders other than (1) capital gain dividends, (2) short-term capital gain dividends, (3) interest-related dividends and (4) exempt interest dividends, (e.g., dividends attributable to dividend and foreign-source interest income or to short-term capital gains or U.S. source interest income to which the exception from withholding described above does not apply) are generally subject to withholding of U.S. federal income tax at a rate of 30% (or lower applicable treaty rate).

If income from the Fund is treated as effectively connected with a trade or business conducted by a non-U.S. shareholder within the United States, the income will in general be subject to U.S. federal income tax at the rates applicable to U.S. citizens, residents or domestic corporations, as applicable, whether such income is received in cash or reinvested in shares of the Fund, and, in the case of a non-U.S. corporation, may also be subject to a branch profits tax. If a non-U.S. shareholder is eligible for the benefits of a tax treaty, the shareholder's effectively connected income or gain will generally be subject to U.S. federal income tax on a net basis only if it is also attributable to a permanent establishment maintained by the shareholder in the United States. More generally, non-U.S. shareholders who are residents in a country with an income tax treaty with the United States may obtain different tax results than those described herein, and are urged to consult their tax professionals.

A non-U.S. shareholder is not, in general, subject to U.S. federal income tax on gains (and is not allowed a deduction for losses) realized on the sale of shares of the Fund unless (i) such gain is effectively connected with the conduct of a trade or business carried on by the non-U.S. shareholder within the United States, (ii) in the case of a non-U.S. shareholder that is an individual, the holder is present in the United States for a period or periods aggregating 183 days or more during the year of the sale and certain other conditions are met or (iii) the special rules relating to gain attributable to the sale, exchange or other taxable disposition of USRPIs apply to the non-U.S. shareholder's sale of shares of the Fund.

Special rules would apply if the Fund were a qualified investment entity ("QIE") because it is either a "United States real property holding corporation" ("USRPHC") or would be a USRPHC but for the operation of certain exceptions to the definition of USRPIs described below. Very generally, a USRPHC is a domestic corporation that holds USRPIs the fair market value of which equals or exceeds 50% of the sum of the fair market values of the corporation's USRPIs, interests in real property located outside the United States, and other trade or business assets. USRPIs are generally defined as any interest in U.S. real property and any interest (other than solely as a creditor) in a USRPHC or, very generally, an entity that has been a USRPHC in the last five years. A regulated investment company that holds, directly or indirectly, significant interests in real estate investment trusts ("REITs") may be a USRPHC. Interests in domestically controlled QIEs, including REITs and regulated investment companies that are QIEs, not-greater-than-10% interests in publicly traded classes of stock in REITs and not-greater-than-5% interests in publicly traded classes of stock in regulated investment companies generally are not USRPIs, but these exceptions do not apply for purposes of determining whether the Fund is a QIE. If an interest in the Fund were a USRPI, the Fund would be required to withhold U.S. tax on the proceeds of a share redemption by a greater-than-5% non-U.S. shareholder, in which case such non-U.S. shareholder generally would also be required to file U.S. federal income tax returns and pay any additional taxes due in connection with the redemption.

If the Fund were a QIE, under a special "look through" rule, any distributions by the Fund to a non-U.S. shareholder (including, in certain cases, distributions made by the Fund in redemption of its shares) attributable directly or indirectly to (i) distributions received by the Fund from a lower-tier regulated investment company or REIT that the Fund is required to treat as USRPI gain in its hands and (ii) gains realized on the disposition of USRPIs by the Fund would retain their character as gains realized from USRPIs in the hands of the non-U.S. shareholder and would be subject to U.S. tax withholding. In addition, such

distributions could result in the non-U.S. shareholder being required to file a U.S. federal income tax return and pay tax on the distributions at regular U.S. federal income tax rates. The consequences to a non-U.S. shareholder, including the rate of such withholding and character of such distributions (*e.g.*, as ordinary income or USRPI gain), would vary depending upon the extent of the non-U.S. shareholder's current and past ownership of the Fund.

In order to qualify for any exemptions from withholding described above or for lower withholding tax rates under income tax treaties, or to establish an exemption from backup withholding, a non-U.S. shareholder must comply with special certification and filing requirements relating to its non-U.S. status (including, in general, furnishing an IRS Form W-8BEN, W-8BEN-E or substitute form). Non-U.S. shareholders should consult their tax advisers in this regard. Special rules (including withholding and reporting requirements) apply to non-U.S. partnerships and those holding Fund shares through non-U.S. partnerships. Additional considerations may apply to non-U.S. trusts and estates. Investors holding Fund shares through non-U.S. entities should consult their tax advisers about their particular situation.

A non-U.S. shareholder may be subject to state and local tax and to the U.S. federal estate tax in addition to the U.S. federal income tax referred to above.

Under legislation commonly known as "FATCA," the Fund is required to withhold 30% of certain ordinary dividends it pays to shareholders that fail to meet prescribed information reporting or certification requirements. In general, no such withholding will be required with respect to a U.S. person or non-U.S. individual that timely provides the certifications required by the Fund or its agent on a valid IRS Form W-9 or applicable IRS Form W-8, respectively. Shareholders potentially subject to withholding include foreign financial institutions ("FFIs"), such as non-U.S. investment funds, and non-financial foreign entities ("NFFEs"). To avoid withholding under FATCA, an FFI generally must enter into an information sharing agreement with the IRS in which it agrees to report certain identifying information (including name, address, and taxpayer identification number) with respect to its U.S. account holders (which, in the case of an entity shareholder, may include its direct and indirect U.S. owners), and an NFFE generally must identify and provide other required information to the Fund or other withholding agent regarding its U.S. owners, if any. Such non-U.S. shareholders also may fall into certain exempt, excepted or deemed compliant categories as established by regulations and other guidance. A non-U.S. shareholder in a country that has entered into an intergovernmental agreement with the U.S. to implement FATCA will be exempt from FATCA withholding provided that the shareholder and the applicable foreign government comply with the terms of such agreement.

A non-U.S. entity that invests in the Fund will need to provide the Fund with documentation properly certifying the entity's status under FATCA in order to avoid FATCA withholding.

Non-U.S. investors should consult their own tax professionals regarding the impact of these requirements on their investment in the Fund.

State Tax Information

Generally, dividends received from a fund that are attributable to interest on U.S. government securities are not subject to state and local income taxes.

New Jersey Taxation. So long as the New Jersey Municipals Fund holds New Jersey municipal obligations that constitute not less than 80% of the aggregate principal amount of the Fund's investments, distributions by the Fund that are derived from interest on New Jersey municipal securities or from gain on the sale of municipal securities issued by New Jersey issuers will be exempt from New Jersey personal income tax. Distributions attributable to interest earned by the Fund on U.S. government securities will also be exempt from New Jersey personal income tax. Interest on indebtedness incurred or continued to purchase or carry shares of the New Jersey Municipals Fund generally is not deductible for New Jersey income tax purposes. All distributions by the Fund to a corporate shareholder will generally be subject to New Jersey Corporation Business Tax. The foregoing is only a brief summary of the New Jersey tax considerations generally affecting the New Jersey Municipals Fund and its shareholders who are New Jersey residents. Investors are urged to consult their tax advisors with specific reference to their own tax situations.

New York State and City Taxation. New York resident shareholders of the New York Municipals Fund will not be subject to New York state or New York City personal income tax on exempt-interest dividends from the Fund attributable to interest on New York municipal securities. The New York Municipals Fund is required to report annually the source, tax status and recipient information related to its exempt-interest dividends distributed within the State of New York. Exempt-interest

dividends are not excluded in determining New York state franchise or New York City business taxes on corporations and financial institutions. The foregoing is only a brief summary of some of the tax considerations generally affecting the New York Municipals Fund and its shareholders who are New York residents. Investors are urged to consult their tax advisors with specific reference to their own tax situation.

Pennsylvania Taxation. Exempt-interest dividends distributed by the Pennsylvania Municipals Fund will not be subject to the Pennsylvania personal income tax, the corporate net income tax or to the Philadelphia school district investment income tax to the extent that the dividends are attributable to interest received by the Fund from its investments in Pennsylvania municipal obligations and U.S. Government obligations, including obligations issued by U.S. possessions. For Pennsylvania personal income tax purposes, capital gain distributions are treated as ordinary dividends and are taxed at ordinary income tax rates. For purposes of the Philadelphia school district investment income tax distributions that are designated as capital gain distributions for U.S. federal income tax purposes will be excluded from the tax base. The foregoing is only a brief summary of the Pennsylvania tax considerations generally affecting the Pennsylvania Municipals Fund and its shareholders that are subject to Pennsylvania taxation. Investors are urged to consult their tax advisors with specific reference to their own tax situations.

CODES OF ETHICS

Pursuant to Rule 17j-1 under the 1940 Act, the Fund, the Manager, the Subadviser and the Distributor each has adopted a code of ethics that permits its personnel to invest in securities for their own accounts, including securities that may be purchased or held by the Fund. All personal securities transactions by employees must adhere to the requirements of the codes of ethics. Copies of the codes of ethics applicable to personnel of the Fund, the Manager, the Subadviser, the Distributor and the Independent Trustees are on file with the SEC.

FINANCIAL STATEMENTS

The Fund's audited annual financial statements for the fiscal period ended March 31, 2026, including the accompanying notes and the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, as filed on Form N-CSR, are incorporated by reference into this SAI
(https://www.sec.gov/ix?doc=/Archives/edgar/data/764624/000113322826008375/waitmf-efp24585_ncsr.htm
https://www.sec.gov/ix?doc=/Archives/edgar/data/764624/000113322826008371/wanjmf-efp24588_ncsr.htm
https://www.sec.gov/ix?doc=/Archives/edgar/data/764624/000113322826008373/wanymf-efp24594_ncsr.htm
https://www.sec.gov/ix?doc=/Archives/edgar/data/764624/000113322826008377/wapmf-efp24591_ncsr.htm). These audited financial statements are available free of charge upon request by calling the Fund at 877-6LM-FUND/656-3863.

Appendix A

Proxy Voting Policies

Western Asset Management Company, LLC
Proxy Voting Policies and Procedures

BACKGROUND

An investment adviser is required to adopt and implement policies and procedures that we believe are reasonably designed to ensure that proxies are voted in the best interest of clients, in accordance with fiduciary duties and Rule 206(4)-6 under the Investment Advisers Act of 1940 ("Advisers Act"). The authority to vote the proxies of our clients is established through investment management agreements or comparable documents. In addition to SEC requirements governing advisers, long-standing fiduciary standards and responsibilities have been established for ERISA accounts. Unless a manager of ERISA assets has been expressly precluded from voting proxies, the Department of Labor has determined that the responsibility for these votes lies with the investment manager.

POLICY

As a fixed income only manager, the occasion to vote proxies is very rare, for instance, in particular when fixed income securities are converted into equity by its terms or in connection with a bankruptcy or corporate workout. However, the Firm has adopted and implemented policies and procedures that we believe are reasonably designed to ensure that proxies are voted in the best interest of clients, in accordance with our fiduciary duties and Rule 206(4)-6 under the Advisers Act. In addition to SEC requirements governing advisers, our proxy voting policies reflect the long-standing fiduciary standards and responsibilities for ERISA accounts. Unless a manager of ERISA assets has been expressly precluded from voting proxies, the Department of Labor has determined that the responsibility for these votes lies with the investment manager.

While the guidelines included in the procedures are intended to provide a benchmark for voting standards, each vote is ultimately cast on a case-by-case basis, taking into consideration the Firm's contractual obligations to our clients and all other relevant facts and circumstances at the time of the vote (such that these guidelines may be overridden to the extent the Firm deems appropriate).

In exercising its voting authority, Western Asset will not consult or enter into agreements with officers, directors or employees of Franklin Resources (Franklin Resources includes Franklin Resources, Inc. and organizations operating as Franklin Resources) or any of its affiliates (other than Western Asset affiliated companies) regarding the voting of any securities owned by its clients.

PROCEDURES

Responsibility and Oversight

The Legal and Compliance Group is responsible for administering and overseeing the proxy voting process. The gathering of proxies is coordinated through the Corporate Actions team of the Investment Operations Group ("Corporate Actions"). Research analysts and portfolio managers are responsible for determining appropriate voting positions on each proxy utilizing any applicable guidelines contained in these procedures.

Client Authority

The Investment Management Agreement for each client is reviewed at account start-up for proxy voting instructions. If an agreement is silent on proxy voting but contains an overall delegation of discretionary authority or if the account represents assets of an ERISA plan, Western Asset will assume responsibility for proxy voting. The Portfolio Compliance Group maintains a matrix of proxy voting authority.

Proxy Gathering

Registered owners of record, client custodians, client banks and trustees ("Proxy Recipients") that receive proxy materials on behalf of clients should forward them to Corporate Actions. Proxy Recipients for new clients (or, if Western Asset becomes aware that the applicable Proxy Recipient for an existing client has changed, the Proxy Recipient for the existing client) are notified at start-up of appropriate routing to Corporate Actions of proxy materials received and reminded of their responsibility to forward all proxy materials on a timely basis. If Western Asset personnel other than Corporate Actions receive proxy materials, they should promptly forward the materials to Corporate Actions.

Proxy Voting

Once proxy materials are received by Corporate Actions, they are forwarded to the Portfolio Compliance Group for coordination and the following actions:

a. Proxies are reviewed to determine accounts impacted.

b. Impacted accounts are checked to confirm Western Asset voting authority.

c. Where appropriate, the Regulatory Affairs Group reviews the issues presented to determine any material conflicts of interest. (see Conflicts of Interest section of these procedures for further information on determining material conflicts of interest.)

d. If a material conflict of interest exists, (i) to the extent reasonably practicable and permitted by applicable law, the client is promptly notified, the conflict is disclosed and Western Asset obtains the client's proxy voting instructions, and (ii) to the extent that it is not reasonably practicable or permitted by applicable law to notify the client and obtain such instructions (e.g., the client is a mutual fund or other commingled vehicle or is an ERISA plan client), Western Asset seeks voting instructions from an independent third party

e. The Portfolio Compliance Group provides proxy material to the appropriate research analyst or portfolio manager to obtain their recommended vote. Research analysts and portfolio managers determine votes on a case-by-case basis taking into account the voting guidelines contained in these procedures. For avoidance of doubt, depending on the best interest of each individual client, Western Asset may vote the same proxy differently for different clients. The analyst's or portfolio manager's basis for their decision is documented and maintained by the Portfolio Compliance Group.

f. Portfolio Compliance Group votes the proxy pursuant to the instructions received in (d) or (e) and returns the voted proxy as indicated in the proxy materials.

Timing

Western Asset's Legal and Compliance Department personnel act in such a manner to ensure that, absent special circumstances, the proxy gathering and proxy voting steps noted above can be completed before the applicable deadline for returning proxy votes.

Recordkeeping

Western Asset maintains records of proxies voted pursuant to Rule 204-2 of the Advisers Act and ERISA DOL Bulletin 94-2. These records include:

a. A copy of Western Asset's proxy voting policies and procedures.

b. Copies of proxy statements received with respect to securities in client accounts.

c. A copy of any document created by Western Asset that was material to making a decision how to vote proxies.

d. Each written client request for proxy voting records and Western Asset's written response to both verbal and written client requests.

e. A proxy log including:

1. Issuer name;
2. Exchange ticker symbol of the issuer's shares to be voted;
3. Committee on Uniform Securities Identification Procedures ("CUSIP") number for the shares to be voted;
4. A brief identification of the matter voted on;
5. Whether the matter was proposed by the issuer or by a shareholder of the issuer;
6. Whether a vote was cast on the matter;
7. A record of how the vote was cast;
8. Whether the vote was cast for or against the recommendation of the issuer's management team;
9. Funds are required to categorize their votes so that investors can focus on the topics they find important. Categories include, for example, votes related to director elections, audit-related, extraordinary transactions, say-on-pay, shareholder rights and defenses, compensation, and the environment or climate, among others; and
10. Funds are required to disclose the number of shares voted or instructed to be cast, as well as how securities lending activities impacted their voting i.e. the number of shares loaned but not recalled and, therefore, not voted by the fund.

Records are maintained in an easily accessible place for a period of not less than five (5) years with the first two (2) years in Western Asset's offices.

Disclosure

Western Asset's proxy policies and procedures are described in the Firm's Form ADV Part 2A. Clients are provided with a copy of these policies and procedures upon request. In addition, clients may receive reports on how their proxies have been voted, upon request.

Conflicts of Interest

All proxies that potentially present conflicts of interest are reviewed by the Regulatory Affairs Group for a materiality assessment. Issues to be reviewed include, but are not limited to:

a. Whether Western Asset (or, to the extent required to be considered by applicable law, its affiliates) manages assets for the company or an employee group of the company or otherwise has an interest in the company;

b. Whether Western Asset or an officer or director of Western Asset or the applicable portfolio manager or analyst responsible for recommending the proxy vote (together, "Voting Persons") is a close relative of or has a personal or business relationship with an executive, director or person who is a candidate for director of the company or is a participant in a proxy contest; and

c. Whether there is any other business or personal relationship where a Voting Person has a personal interest in the outcome of the matter before shareholders.

Voting Guidelines

Western Asset's substantive voting decisions are based on the particular facts and circumstances of each proxy vote and are evaluated by the designated research analyst or portfolio manager. The examples outlined below are meant as guidelines to aid in the decision-making process.

Situations can arise in which more than one Western Asset client invests in instruments of the same issuer or in which a single client may invest in instruments of the same issuer but in multiple accounts or strategies. Multiple clients or the same client in multiple accounts or strategies may have different investment objectives, investment styles, or investment professionals involved in making decisions. While there may be differences, votes are always cast in the best interests of the client and the investment objectives agreed with Western Asset. As a result, there may be circumstances where Western Asset casts different votes on behalf of different clients or on behalf of the same client with multiple accounts or strategies.

Guidelines are grouped according to the types of proposals generally presented to shareholders. Part I deals with proposals which have been approved and are recommended by a company's board of directors; Part II deals with proposals submitted by shareholders for inclusion in proxy statements; Part III addresses issues relating to voting shares of investment companies; and Part IV addresses unique considerations pertaining to foreign issuers.

I. Board Approved Proposals

The vast majority of matters presented to shareholders for a vote involve proposals made by a company itself that have been approved and recommended by its board of directors. In view of the enhanced corporate governance practices currently being implemented in public companies, Western Asset generally votes in support of decisions reached by independent boards of directors. More specific guidelines related to certain board-approved proposals are as follows:

1. Matters relating to the Board of Directors

Western Asset votes proxies for the election of the company's nominees for directors and for board-approved proposals on other matters relating to the board of directors with the following exceptions:

a. Votes are withheld for the entire board of directors if the board does not have a majority of independent directors or the board does not have nominating, audit and compensation committees composed solely of independent directors.

b. Votes are withheld for any nominee for director who is considered an independent director by the company and who has received compensation from the company other than for service as a director.

c. Votes are withheld for any nominee for director who attends less than 75% of board and committee meetings without valid reasons for absences.

d. Votes are cast on a case-by-case basis in contested elections of directors.

2. Matters relating to Executive Compensation

Western Asset generally favors compensation programs that relate executive compensation to a company's long-term performance. Votes are cast on a case-by-case basis on board-approved proposals relating to executive compensation, except as follows:

a. Except where the firm is otherwise withholding votes for the entire board of directors, Western Asset votes for stock option plans that will result in a minimal annual dilution.

b. Western Asset votes against stock option plans or proposals that permit replacing or repricing of underwater options.

c. Western Asset votes against stock option plans that permit issuance of options with an exercise price below the stock's current market price.

d. Except where the firm is otherwise withholding votes for the entire board of directors, Western Asset votes for employee stock purchase plans that limit the discount for shares purchased under the plan to no more than 15% of their market value, have an offering period of 27 months or less and result in dilution of 10% or less.

3. Matters relating to Capitalization

The Management of a company's capital structure involves a number of important issues, including cash flows, financing needs and market conditions that are unique to the circumstances of each company. As a result, Western Asset votes on a case-by-case basis on board-approved proposals involving changes to a company's capitalization except where Western Asset is otherwise withholding votes for the entire board of directors.

a. Western Asset votes for proposals relating to the authorization of additional common stock.

b. Western Asset votes for proposals to effect stock splits (excluding reverse stock splits).

c. Western Asset votes for proposals authorizing share repurchase programs.

4. Matters relating to Acquisitions, Mergers, Reorganizations and Other Transactions

Western Asset votes these issues on a case-by-case basis on board-approved transactions.

5. Matters relating to Anti-Takeover Measures

Western Asset votes against board-approved proposals to adopt anti-takeover measures except as follows:

a. Western Asset votes on a case-by-case basis on proposals to ratify or approve shareholder rights plans.

b. Western Asset votes on a case-by-case basis on proposals to adopt fair price provisions.

6. Other Business Matters

Western Asset votes for board-approved proposals approving such routine business matters such as changing the company's name, ratifying the appointment of auditors and procedural matters relating to the shareholder meeting.

a. Western Asset votes on a case-by-case basis on proposals to amend a company's charter or bylaws.

b. Western Asset votes against authorization to transact other unidentified, substantive business at the meeting.

7. Reporting of Financially Material Information

Western Asset generally believes issuers should disclose information that is material to their business. What qualifies as "material" can vary, so votes are cast on a case-by-case basis but consistent with the overarching principle.

II. Shareholder Proposals

SEC regulations permit shareholders to submit proposals for inclusion in a company's proxy statement. These proposals generally seek to change some aspect of a company's corporate governance structure or to change some aspect of its business operations. Western Asset votes in accordance with the recommendation of the company's board of directors on all shareholder proposals, except as follows:

1. Western Asset votes for shareholder proposals to require shareholder approval of shareholder rights plans.

2. Western Asset votes for shareholder proposals that are consistent with Western Asset's proxy voting guidelines for board-approved proposals.

3. Western Asset votes on a case-by-case basis on other shareholder proposals where the firm is otherwise withholding votes for the entire board of directors.

Environmental or social issues that are the subject of a proxy vote will be considered on a case-by-case basis. Constructive proposals that seek to advance the health of the issuer and the prospect for risk-adjusted returns to Western Asset's clients are viewed more favorably than proposals that advance a single issue or limit the ability of management to meet its operating objectives.

III. Voting Shares of Investment Companies

Western Asset may utilize shares of open or closed-end investment companies to implement its investment strategies. Shareholder votes for investment companies that fall within the categories listed in Parts I and II above are voted in accordance with those guidelines.

1. Western Asset votes on a case-by-case basis on proposals relating to changes in the investment objectives of an investment company taking into account the original intent of the fund and the role the fund plays in the clients' portfolios.

2. Western Asset votes on a case-by-case basis all proposals that would result in increases in expenses (e.g., proposals to adopt 12b-1 plans, alter investment advisory arrangements or approve fund mergers) taking into account comparable expenses for similar funds and the services to be provided.

IV. Voting Shares of Foreign Issuers

In the event Western Asset is required to vote on securities held in non-U.S. issuers – i.e. issuers that are incorporated under the laws of a foreign jurisdiction and that are not listed on a U.S. securities exchange or the NASDAQ stock market, the following guidelines are used, which are premised on the existence of a sound corporate governance and disclosure framework. These guidelines, however, may not be appropriate under some circumstances for foreign issuers and therefore apply only where applicable.

1. Western Asset votes for shareholder proposals calling for a majority of the directors to be independent of management.

2. Western Asset votes for shareholder proposals seeking to increase the independence of board nominating, audit and compensation committees.

3. Western Asset votes for shareholder proposals that implement corporate governance standards similar to those established under U.S. federal law and the listing requirements of U.S. stock exchanges, and that do not otherwise violate the laws of the jurisdiction under which the company is incorporated.

4. Western Asset votes on a case-by-case basis on proposals relating to (1) the issuance of common stock in excess of 20% of a company's outstanding common stock where shareholders do not have preemptive rights, or (2) the issuance of common stock in excess of 100% of a company's outstanding common stock where shareholders have preemptive rights.

V. Sustainable Investing Matters

Western Asset incorporates sustainable investing considerations, among other relevant risks, as part of the overall investment process. Environmental, Social and Governance (ESG) research is integrated with the Firm's general research process and led by its sector specialists, who analyze ESG facts in conjunction with traditional metrics. The Firm seeks to identify and consider material risks to the investment thesis, including material risks presented by ESG factors. While Western Asset is primarily a fixed income manager, opportunities to vote proxies are considered on the investment merits of the instruments and strategies involved.

As a general proposition, Western Asset votes to encourage disclosure of information material to their business. This principle extends to ESG matters. What qualifies as "material" can vary, so votes are cast on a case-by-case basis but consistent with the overarching principle. Western Asset recognizes that objective standards and criteria may not be available or universally agreed and that there may be different views and subjective analysis regarding factors and their significance.

Targeted environmental or social issues that are the subject of a proxy vote will be considered on a case-by-case basis. Constructive proposals that seek to advance the health of the issuer and the prospect for risk-adjusted returns to Western Asset's clients are viewed more favorably than proposals that advance a single issue or limit the ability of management to meet its operating objectives.

Retirement Accounts

For accounts subject to ERISA, as well as other retirement accounts, Western Asset is presumed to have the responsibility to vote proxies for the client. The Department of Labor has issued a bulletin that states that investment managers have the responsibility to vote proxies on behalf of Retirement Accounts unless the authority to vote proxies has been specifically reserved to another named fiduciary. Furthermore, unless Western Asset is expressly precluded from voting the proxies, the Department of Labor has determined that the responsibility remains with the investment manager.

In order to comply with the Department of Labor's position, Western Asset will be presumed to have the obligation to vote proxies for its retirement accounts unless Western Asset has obtained a specific written instruction indicating that: (a) the right to vote proxies has been reserved to a named fiduciary of the client, and (b) Western Asset is precluded from voting proxies on behalf of the client. If Western Asset does not receive such an instruction, Western Asset will be responsible for voting proxies in the best interests of the retirement account client and in accordance with any proxy voting guidelines provided by the client.

Disclosure

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Appendix B

Credit Ratings

DESCRIPTION OF RATINGS

The ratings of Moody's Investors Service, Inc., S&P Global Ratings and Fitch Ratings represent their opinions as to the quality of various debt obligations. It should be emphasized, however, that ratings are not absolute standards of quality. Consequently, debt obligations with the same maturity, coupon and rating may have different yields while debt obligations of the same maturity and coupon with different ratings may have the same yield. As described by the rating agencies, ratings are generally given to securities at the time of issuances. While the rating agencies may from time to time revise such ratings, they undertake no obligation to do so.

Moody's Investors Service, Inc. Global Rating Scales

Credit ratings are assigned on Moody's global long-term and short-term rating scales and are forward-looking opinions of the relative credit risks of financial obligations issued by non-financial corporates, financial institutions, structured finance vehicles, project finance vehicles, and public sector entities. Moody's defines credit risk as the risk that an entity may not meet its contractual financial obligations as they come due and any estimated financial loss in the event of default or impairment. The contractual financial obligations[1] addressed by Moody's ratings are those that call for, without regard to enforceability, the payment of an ascertainable amount, which may vary based upon standard sources of variation (e.g., floating interest rates), by an ascertainable date. Moody's rating addresses the issuer's ability to obtain cash sufficient to service the obligation, and its willingness to pay.[2] Moody's ratings do not address non-standard sources of variation in the amount of the principal obligation (e.g., equity indexed), absent an express statement to the contrary in a press release accompanying an initial rating.[3] Long-term ratings are assigned to issuers or obligations with an original maturity of eleven months or more and reflect both on the likelihood of a default or impairment on contractual financial obligations and the expected financial loss suffered in the event of default or impairment. Short-term ratings are assigned to obligations with an original maturity of thirteen months or less and reflect both on the likelihood of a default or impairment on contractual financial obligations and the expected financial loss suffered in the event of default or impairment.[4, 5, 6] Moody's issues ratings at the issuer level and instrument level on both the long-term scale and the short-term scale. Typically, ratings are made publicly available although private and unpublished ratings may also be assigned.[7]

Moody's differentiates structured finance ratings from fundamental ratings (i.e., ratings on nonfinancial corporate, financial institution, and public sector entities) on the global long-term scale by adding (sf) to all structured finance ratings.[8] The addition of (sf) to structured finance ratings should eliminate any presumption that such ratings and fundamental ratings at the same letter grade level will behave the same.

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1 In the case of impairments, there can be a financial loss even when contractual obligations are met.

2 In some cases the relevant credit risk relates to a third party, in addition to, or instead of the issuer. Examples include credit-linked notes and guaranteed obligations.

3 Because the number of possible features or structures is limited only by the creativity of issuers, Moody's cannot comprehensively catalogue all the types of non-standard variation affecting financial obligations, but examples include equity indexed principal values and cash flows, prepayment penalties, and an obligation to pay an amount that is not ascertainable at the inception of the transaction.

4 For certain preferred stock and hybrid securities in which payment default events are either not defined or do not match investors' expectations for timely payment, long-term and short-term ratings reflect the likelihood of impairment and financial loss in the event of impairment.

5 Debts held on the balance sheets of official sector institutions – which include supranational institutions, central banks and certain government-owned or controlled banks – may not always be treated the same as debts held by private investors and lenders. When it is known that an obligation is held by official sector institutions as well as other investors, a rating (short-term or long-term) assigned to that obligation reflects only the credit risks faced by non-official sector investors.

6 Where grace periods are disproportionately long relative to the stated maturity, Moody's may choose not to rate the Instrument. This is particularly relevant in the commercial paper market where maturities may be 30 days or less with strong investor expectation of prompt payment.

7 For information on how to obtain a Moody's credit rating, including private and unpublished credit ratings, please see Moody's Investors Service Products. Please note that Moody's always reserves the right to choose not to assign or maintain a credit rating for its own business reasons.

8 Like other global scale ratings, (sf) ratings reflect both the likelihood of a default and the expected loss suffered in the event of default. Ratings are assigned based on a rating committee's assessment of a security's expected loss rate (default probability multiplied by expected loss severity), and may be subject to the constraint that the final expected loss rating assigned would not be more than a certain number of notches, typically three to five notches, above the rating that would be assigned based on an assessment of default probability alone. The magnitude of this constraint may vary with the level of the rating, the seasoning of the transaction, and the uncertainty around the assessments of expected loss and probability of default.

The (sf) indicator for structured finance security ratings indicates that otherwise similarly rated structured finance and fundamental securities may have different risk characteristics. Through its current methodologies, however, Moody's aspires to achieve broad expected equivalence in structured finance and fundamental rating performance when measured over a long period of time.

Description of Moody's Investors Service, Inc.'s Global Long-Term Ratings:

Aaa—Obligations rated Aaa are judged to be of the highest quality, subject to the lowest level of credit risk.

Aa—Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.

A—Obligations rated A are judged to be upper-medium grade and are subject to low credit risk.

Baa—Obligations rated Baa are judged to be medium-grade and subject to moderate credit risk and as such may possess certain speculative characteristics.

Ba—Obligations rated Ba are judged to be speculative and are subject to substantial credit risk.

B—Obligations rated B are considered speculative and are subject to high credit risk.

Caa—Obligations rated Caa are judged to be speculative of poor standing and are subject to very high credit risk.

Ca—Obligations rated Ca are highly speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest.

C—Obligations rated C are the lowest rated and are typically in default, with little prospect for recovery of principal or interest.

Note: *Moody's appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that generic rating category. Additionally, a "(hyb)" indicator is appended to all ratings of hybrid securities issued by banks, insurers, finance companies, and securities firms.**

** By their terms, hybrid securities allow for the omission of scheduled dividends, interest, or principal payments, which can potentially result in impairment if such an omission occurs. Hybrid securities may also be subject to contractually allowable write-downs of principal that could result in impairment. Together with the hybrid indicator, the long-term obligation rating assigned to a hybrid security is an expression of the relative credit risk associated with that security.*

Description of Moody's Investors Service, Inc.'s Global Short-Term Ratings:

P-1—Ratings of Prime-1 reflect a superior ability to repay short-term debt obligations.

P-2—Ratings of Prime-2 reflect a strong ability to repay short-term debt obligations.

P-3—Ratings of Prime-3 reflect an acceptable ability to repay short-term debt obligations.

NP—Issuers (or supporting institutions) rated Not Prime do not fall within any of the Prime rating categories.

Description of Moody's Investors Service, Inc.'s US Municipal Ratings:

US Municipal Short-Term Debt and Demand Obligation Ratings:

Moody's uses the global short-term Prime rating scale for commercial paper issued by US municipalities and nonprofits. These commercial paper programs may be backed by external letters of credit or liquidity facilities, or by an issuer's self-liquidity.

For other short-term municipal obligations, Moody's uses one of two other short-term rating scales, the Municipal Investment Grade (MIG) and Variable Municipal Investment Grade (VMIG) scales discussed below.

MIG Ratings:

Moody's uses the MIG scale for US municipal cash flow notes, bond anticipation notes and certain other short-term obligations, which typically mature in three years or less.

MIG 1—This designation denotes superior credit quality. Excellent protection is afforded by established cash flows, highly reliable liquidity support, or demonstrated broad-based access to the market for refinancing.

MIG 2—This designation denotes strong credit quality. Margins of protection are ample, although not as large as in the preceding group.

MIG 3—This designation denotes acceptable credit quality. Liquidity and cash-flow protection may be narrow, and market access for refinancing is likely to be less well-established.

SG—This designation denotes speculative grade credit quality. Debt instruments in this category may lack sufficient margins of protection.

VMIG Ratings:

For variable rate demand obligations (VRDOs), Moody's assigns both a long-term rating and a short-term payment obligation rating. The long-term rating addresses the issuer's ability to meet scheduled principal and interest payments. The short-term payment obligation rating addresses the ability of the issuer or the liquidity provider to meet any purchase price payment obligation resulting from optional tenders ("on demand") and/or mandatory tenders of the VRDO. The short-term payment obligation rating uses the VMIG scale. Transitions of VMIG ratings with conditional liquidity support differ from transitions of Prime ratings reflecting the risk that external liquidity support will terminate if the issuer's long-term rating drops below investment grade.

For VRDOs, Moody's typically assigns a VMIG rating if the frequency of the payment obligation is less than every three years. If the frequency of the payment obligation is less than three years, but the obligation is payable only with remarketing proceeds, the VMIG short-term rating is not assigned and it is denoted as "NR". Industrial development bonds in the US where the obligor is a corporate may carry a VMIG rating that reflects Moody's view of the relative likelihood of default and loss. In these cases, liquidity assessment is based on the liquidity of the corporate obligor.

VMIG 1—This designation denotes superior credit quality. Excellent protection is afforded by the superior short-term credit strength of the liquidity provider and structural and legal protections.

VMIG 2—This designation denotes strong credit quality. Good protection is afforded by the strong short-term credit strength of the liquidity provider and structural and legal protections.

VMIG 3—This designation denotes acceptable credit quality. Adequate protection is afforded by the satisfactory short-term credit strength of the liquidity provider and structural and legal protections.

SG—This designation denotes speculative-grade credit quality. Demand features rated in this category may be supported by a liquidity provider that does not have a sufficiently strong short-term rating or may lack the structural or legal protections.

Description of Moody's Investors Service, Inc.'s National Scale Long-Term Ratings:

Moody's long-term National Scale Ratings (NSRs) are opinions of the relative creditworthiness of issuers and financial obligations within a particular country. NSRs are not designed to be compared among countries; rather, they address relative credit risk within a given country. Moody's assigns national scale ratings in certain local capital markets in which investors have found the global rating scale provides inadequate differentiation among credits or is inconsistent with a rating scale already in common use in the country.

In each specific country, the last two characters of the rating indicate the country in which the issuer is located or the financial obligation was issued (e.g., Aaa.ke for Kenya).

Long-Term NSR Scale

Aaa.n Issuers or issues rated Aaa.n demonstrate the strongest creditworthiness relative to other domestic issuers and issuances.

Aa.n Issuers or issues rated Aa.n demonstrate very strong creditworthiness relative to other domestic issuers and issuances.

A.n Issuers or issues rated A.n demonstrate above-average creditworthiness relative to other domestic issuers and issuances.

Baa.n Issuers or issues rated Baa.n demonstrate average creditworthiness relative to other domestic issuers and issuances.

Ba.n Issuers or issues rated Ba.n demonstrate below-average creditworthiness relative to other domestic issuers and issuances.

B.n Issuers or issues rated B.n demonstrate weak creditworthiness relative to other domestic issuers and issuances.

Caa.n Issuers or issues rated Caa.n demonstrate very weak creditworthiness relative to other domestic issuers and issuances.

Ca.n Issuers or issues rated Ca.n demonstrate extremely weak creditworthiness relative to other domestic issuers and issuances.

C.n Issuers or issues rated C.n demonstrate the weakest creditworthiness relative to other domestic issuers and issuances.

Note: Moody's appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that generic rating category.

Description of S&P Global Ratings' Long-Term Issue Credit Ratings:

Issue credit ratings are based, in varying degrees, on S&P Global Ratings' analysis of the following considerations:

- The likelihood of payment—the capacity and willingness of the obligor to meet its financial commitments on an obligation in accordance with the terms of the obligation;
- The nature and provisions of the financial obligation, and the promise S&P Global Ratings imputes; and
- The protection afforded by, and relative position of, the financial obligation in the event of a bankruptcy, reorganization, or other arrangement under the laws of bankruptcy and other laws affecting creditors' rights.

An issue rating is an assessment of default risk but may incorporate an assessment of relative seniority or ultimate recovery in the event of default. Junior obligations are typically rated lower than senior obligations, to reflect lower priority in bankruptcy, as noted above. (Such differentiation may apply when an entity has both senior and subordinated obligations, secured and unsecured obligations, or operating company and holding company obligations.)

AAA—An obligation rated "AAA" has the highest rating assigned by S&P Global Ratings. The obligor's capacity to meet its financial commitments on the obligation is extremely strong.

AA—An obligation rated "AA" differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitments on the obligation is very strong.

A—An obligation rated "A" is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitments on the obligation is still strong.

BBB—An obligation rated "BBB" exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to weaken the obligor's capacity to meet its financial commitments on the obligation.

BB, B, CCC, CC, and C—Obligations rated "BB", "B", "CCC", "CC", and "C" are regarded as having significant speculative characteristics. "BB" indicates the least degree of speculation and "C" the highest. While such obligations will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposure to adverse conditions.

BB—An obligation rated "BB" is less vulnerable to nonpayment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions that could lead to the obligor's inadequate capacity to meet its financial commitments on the obligation.

B—An obligation rated "B" is more vulnerable to nonpayment than obligations rated "BB", but the obligor currently has the capacity to meet its financial commitments on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitments on the obligation.

CCC—An obligation rated "CCC" is currently vulnerable to nonpayment and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitments on the obligation. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its financial commitments on the obligation.

CC—An obligation rated "CC" is currently highly vulnerable to nonpayment.

The "CC" rating is used when a default has not yet occurred but S&P Global Ratings expects default to be a virtual certainty, regardless of the anticipated time to default.

C—An obligation rated "C" is currently highly vulnerable to nonpayment, and the obligation is expected to have lower relative seniority or lower ultimate recovery compared with obligations that are rated higher.

D—An obligation rated "D" is in default or in breach of an imputed promise. For non-hybrid capital instruments, the "D" rating category is used when payments on an obligation are not made on the date due, unless S&P Global Ratings believes that such payments will be made within the next five business days in the absence of a stated grace period or within the earlier of the stated grace period or the next 30 calendar days. The "D" rating also will be used upon the filing of a bankruptcy petition or the taking of similar action and where default on an obligation is a virtual certainty, for example due to automatic stay provisions. A rating on an obligation is lowered to "D" if it is subject to a distressed debt restructuring.

Note: The ratings from "AA" to "CCC" may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the rating categories.

Description of S&P Global Ratings' Short-Term Issue Credit Ratings:

A-1—A short-term obligation rated "A-1" is rated in the highest category by S&P Global Ratings. The obligor's capacity to meet its financial commitments on the obligation is strong. Within this category, certain obligations are designated with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitments on these obligations is extremely strong.

A-2—A short-term obligation rated "A-2" is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rating categories. However, the obligor's capacity to meet its financial commitments on the obligation is satisfactory.

A-3—A short-term obligation rated "A-3" exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to weaken an obligor's capacity to meet its financial commitments on the obligation.

B—A short-term obligation rated "B" is regarded as vulnerable and has significant speculative characteristics. The obligor currently has the capacity to meet its financial commitments; however, it faces major ongoing uncertainties that could lead to the obligor's inadequate capacity to meet its financial commitments.

C—A short-term obligation rated "C" is currently vulnerable to nonpayment and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitments on the obligation.

D—A short-term obligation rated "D" is in default or in breach of an imputed promise. For non-hybrid capital instruments, the "D" rating category is used when payments on an obligation are not made on the date due, unless S&P Global Ratings believes that such payments will be made within any stated grace period. However, any stated grace period longer than five business days will be treated as five business days. The "D" rating also will be used upon the filing of a bankruptcy petition or the taking of a similar action and where default on an obligation is a virtual

certainty, for example due to automatic stay provisions. A rating on an obligation is lowered to "D" if it is subject to a distressed debt restructuring.

Description of S&P Global Ratings' Municipal Short-Term Note Ratings:

An S&P Global Ratings U.S. municipal note rating reflects S&P Global Ratings' opinion about the liquidity factors and market access risks unique to the notes. Notes due in three years or less will likely receive a note rating. Notes with an original maturity of more than three years will most likely receive a long-term debt rating. In determining which type of rating, if any, to assign, S&P Global Ratings' analysis will review the following considerations:

- Amortization schedule—the larger the final maturity relative to other maturities, the more likely it will be treated as a note; and
- Source of payment—the more dependent the issue is on the market for its refinancing, the more likely it will be treated as a note.

SP-1—Strong capacity to pay principal and interest. An issue determined to possess a very strong capacity to pay debt service is given a plus (+) designation.

SP-2—Satisfactory capacity to pay principal and interest, with some vulnerability to adverse financial and economic changes over the term of the notes.

SP-3—Speculative capacity to pay principal and interest.

D—"D" is assigned upon failure to pay the note when due, completion of a distressed debt restructuring, or the filing of a bankruptcy petition or the taking of similar action and where default on an obligation is a virtual certainty, for example due to automatic stay provisions.

Description of S&P Global Ratings' Long-Term Issuer Credit Ratings

AAA An obligor rated "AAA" has extremely strong capacity to meet its financial commitments. "AAA" is the highest issuer credit rating assigned by S&P Global Ratings.

AA An obligor rated "AA" has very strong capacity to meet its financial commitments. It differs from the highest-rated obligors only to a small degree.

A An obligor rated "A" has strong capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.

BBB An obligor rated "BBB" has adequate capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to weaken the obligor's capacity to meet its financial commitments.

BB, B, CCC, and CC Obligors rated "BB", "B", "CCC", and "CC" are regarded as having significant speculative characteristics. "BB" indicates the least degree of speculation and "CC" the highest. While such obligors will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposure to adverse conditions.

BB An obligor rated "BB" is less vulnerable in the near term than other lower-rated obligors. However, it faces major ongoing uncertainties and exposure to adverse business, financial, or economic conditions that could lead to the obligor's inadequate capacity to meet its financial commitments.

B An obligor rated "B" is more vulnerable than the obligors rated "BB", but the obligor currently has the capacity to meet its financial commitments. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitments.

CCC An obligor rated "CCC" is currently vulnerable and is dependent upon favorable business, financial, and economic conditions to meet its financial commitments.

CC An obligor rated "CC" is currently highly vulnerable. The "CC" rating is used when a default has not yet occurred but S&P Global Ratings expects default to be a virtual certainty, regardless of the anticipated time to default.

SD and D An obligor is rated "SD" (selective default) or "D" if S&P Global Ratings considers there to be a default on one or more of its financial obligations, whether long- or short-term, including rated and unrated obligations but excluding hybrid instruments classified as regulatory capital or in nonpayment according to terms. A "D" rating is assigned when S&P Global Ratings believes that the default will be a general default and that the obligor will fail to pay all or substantially all of its obligations as they come due. An "SD" rating is assigned when S&P Global Ratings believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner. A rating on an obligor is lowered to "D" or "SD" if it is conducting a distressed debt restructuring.

Ratings from "AA" to "CCC" may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the rating categories.

Description of S&P Global Ratings' Short-Term Issuer Credit Ratings

A-1 An obligor rated "A-1" has strong capacity to meet its financial commitments. It is rated in the highest category by S&P Global Ratings. Within this category, certain obligors are designated with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitments is extremely strong.

A-2 An obligor rated "A-2" has satisfactory capacity to meet its financial commitments. However, it is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in the highest rating category.

A-3 An obligor rated "A-3" has adequate capacity to meet its financial obligations. However, adverse economic conditions or changing circumstances are more likely to weaken the obligor's capacity to meet its financial commitments.

B An obligor rated "B" is regarded as vulnerable and has significant speculative characteristics. The obligor currently has the capacity to meet its financial commitments; however, it faces major ongoing uncertainties that could lead to the obligor's inadequate capacity to meet its financial commitments.

C An obligor rated "C" is currently vulnerable to nonpayment that would result in an "SD" or "D" issuer rating and is dependent upon favorable business, financial, and economic conditions to meet its financial commitments.

SD and D An obligor is rated "SD" (selective default) or "D" if S&P Global Ratings considers there to be a default on one or more of its financial obligations, whether long- or short-term, including rated and unrated obligations but excluding hybrid instruments classified as regulatory capital or in nonpayment according to terms. A "D" rating is assigned when S&P Global Ratings believes that the default will be a general default and that the obligor will fail to pay all or substantially all of its obligations as they come due. An "SD" rating is assigned when S&P Global Ratings believes that the obligor has selectively defaulted on a specific issue or class of obligations but it will continue to meet its payment obligations on other issues or classes of obligations in a timely manner. A rating on an obligor is lowered to "D" or "SD" if it is conducting a distressed debt restructuring.

Description of S&P Global Ratings' Dual Ratings:

Dual ratings may be assigned to debt issues that have a put option or demand feature. The first component of the rating addresses the likelihood of repayment of principal and interest as due, and the second component of the rating addresses only the demand feature. The first component of the rating can relate to either a short-term or long-term transaction and accordingly use either short-term or long-term rating symbols. The second component of the rating relates to the put option and is assigned a short-term rating symbol (for example, "AAA/A-1+" or "A-1+/A-1"). With U.S. municipal short-term demand debt, the U.S. municipal short-term note rating symbols are used for the first component of the rating (for example, "SP-1+/A-1+").

Description of S&P Global Ratings' Active Qualifiers:

S&P Global Ratings uses the following qualifiers that limit the scope of a rating. The structure of the transaction can require the use of a qualifier such as a "p" qualifier, which indicates the rating addresses the principal portion of the obligation only. A qualifier appears as a suffix and is part of the rating.

Federal deposit insurance limit: "L" qualifier. Ratings qualified with "L" apply only to amounts invested up to federal deposit insurance limits.

Principal: "p" qualifier. This suffix is used for issues in which the credit factors, the terms, or both that determine the likelihood of receipt of payment of principal are different from the credit factors, terms, or both that determine the likelihood of receipt of interest on the obligation. The "p" suffix indicates that the rating addresses the principal portion of the obligation only and that the interest is not rated.

Preliminary ratings: "prelim" qualifier. Preliminary ratings, with the "prelim" suffix, may be assigned to obligors or obligations, including financial programs, in the circumstances described below. Assignment of a final rating is conditional on the receipt by S&P Global Ratings of appropriate documentation. S&P Global Ratings reserves the right not to issue a final rating. Moreover, if a final rating is issued, it may differ from the preliminary rating.

- Preliminary ratings may be assigned to obligations, most commonly structured and project finance issues, pending receipt of final documentation and legal opinions.
- Preliminary ratings may be assigned to obligations that will likely be issued upon the obligor's emergence from bankruptcy or similar reorganization, based on late-stage reorganization plans, documentation, and discussions with the obligor. Preliminary ratings may also be assigned to the obligors. These ratings consider the anticipated general credit quality of the reorganized or post-bankruptcy issuer as well as attributes of the anticipated obligation(s).
- Preliminary ratings may be assigned to entities that are being formed or that are in the process of being independently established when, in S&P Global Ratings' opinion, documentation is close to final. Preliminary ratings may also be assigned to the obligations of these entities.
- Preliminary ratings may be assigned when a previously unrated entity is undergoing a well-formulated restructuring, recapitalization, significant financing, or other transformative event, generally at the point that investor or lender commitments are invited. The preliminary rating may be assigned to the entity and to its proposed obligation(s). These preliminary ratings consider the anticipated general credit quality of the obligor, as well as attributes of the anticipated obligation(s), assuming successful completion of the transformative event. Should the transformative event not occur, S&P Global Ratings would likely withdraw these preliminary ratings.
- A preliminary recovery rating may be assigned to an obligation that has a preliminary issue credit rating.

Termination structures: "t" qualifier. This symbol indicates termination structures that are designed to honor their contracts to full maturity or, should certain events occur, to terminate and cash settle all their contracts before their final maturity date.

Counterparty instrument rating: "cir" qualifier. This symbol indicates a counterparty instrument rating (CIR), which is a forward-looking opinion about the creditworthiness of an issuer in a securitization structure with respect to a specific financial obligation to a counterparty (including interest rate swaps, currency swaps, and liquidity facilities). The CIR is determined on an ultimate payment basis; these opinions do not take into account timeliness of payment.

Description of Fitch Ratings' Corporate Finance Obligations:

Ratings of individual securities or financial obligations of a corporate issuer address relative vulnerability to default on an ordinal scale. In addition, for financial obligations in corporate finance, a measure of recovery given default on that liability is also included in the rating assessment. This notably applies to covered bonds ratings, which incorporate both an indication of the probability of default and of the recovery given a default of this debt instrument. On the contrary, ratings of debtor-in-possession (DIP) obligations incorporate the expectation of full repayment.

The relationship between the issuer scale and obligation scale assumes a generic historical average recovery. Individual obligations can be assigned ratings higher, lower, or the same as that entity's issuer rating or Issuer Default Rating (IDR), based on their relative ranking, relative vulnerability to default or based on explicit Recovery Ratings.

As a result, individual obligations of entities, such as corporations, are assigned ratings higher, lower, or the same as that entity's issuer rating or IDR, except DIP obligation ratings that are not based off an IDR and senior tranches of Enhanced Equipment Trust Certificates, for which IDRs are secondary dependencies, as Fitch focuses primarily on structure, collateral and legal protection.

At the lower end of the ratings scale, Fitch publishes explicit Recovery Ratings in many cases to complement issuer and obligation ratings.

AAA: Highest Credit Quality. "AAA" ratings denote the lowest expectation of credit risk. They are assigned only in cases of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA: Very High Credit Quality. "AA" ratings denote expectations of very low credit risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

A: High Credit Quality. "A" ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.

BBB: Good Credit Quality. "BBB" ratings indicate that expectations of credit risk are currently low. The capacity for payment of financial commitments is considered adequate, but adverse business or economic conditions are more likely to impair this capacity.

BB: Speculative. "BB" ratings indicate an elevated vulnerability to credit risk, particularly in the event of adverse changes in business or economic conditions over time; however, business or financial alternatives may be available to allow financial commitments to be met.

B: Highly Speculative. "B" ratings indicate that material credit risk is present.

CCC: Substantial Credit Risk. "CCC" ratings indicate that substantial credit risk is present.

CC: Very High Levels of Credit Risk. "CC" ratings indicate very high levels of credit risk.

C: Exceptionally High Levels of Credit Risk. "C" indicates exceptionally high levels of credit risk.

The ratings of corporate finance obligations are linked to IDRs (or sometimes Viability Ratings for banks and non-bank financial institutions) by i) recovery expectations, including as often indicated by Recovery Ratings assigned in the case of low speculative grade issuers and ii) for banks and non-bank financial institutions an assessment of nonperformance risk relative to the risk captured in the IDR or Viability Ratings (e.g. in respect of certain hybrid securities).

For performing obligations, the obligation rating represents the risk of default including the effect of expected recoveries on the credit risk should a default occur.

If the obligation rating is higher than the rating of the issuer, this indicates above average recovery expectations in the event of default. If the obligations rating is lower than the rating of the issuer, this indicates low expected recoveries should default occur.

Ratings in the categories of "CCC", "CC" and "C" can also relate to obligations or issuers that are in default. In this case, the rating does not opine on default risk but reflects the recovery expectation only.

Description of Fitch Ratings' Issuer Default Ratings:

Rated entities in several sectors, including financial and non-financial corporations, sovereigns, insurance companies and some sectors within public finance, are generally assigned IDRs. IDRs are also assigned to certain entities or enterprises in global infrastructure, project finance and public finance. IDRs opine on an entity's relative vulnerability to default – including by way of a distressed debt exchange (DDE) – on financial obligations. The threshold default risk addressed by the IDR is generally that of the financial obligations whose non-payment would best reflect the uncured failure of that entity. As such, IDRs also address relative vulnerability to bankruptcy, administrative receivership or similar concepts.

In aggregate, IDRs provide an ordinal ranking of issuers based on the agency's view of their relative vulnerability to default, rather than a prediction of a specific percentage likelihood of default.

AAA: Highest Credit Quality. "AAA" ratings denote the lowest expectation of default risk. They are assigned only in cases of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA: Very High Credit Quality. "AA" ratings denote expectations of very low default risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

A: High Credit Quality. "A" ratings denote expectations of low default risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.

BBB: Good Credit Quality. "BBB" ratings indicate that expectations of default risk are currently low. The capacity for payment of financial commitments is considered adequate, but adverse business or economic conditions are more likely to impair this capacity.

BB: Speculative. "BB" ratings indicate an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time; however, business or financial flexibility exists that supports the servicing of financial commitments.

B: Highly Speculative. "B" ratings indicate that material default risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is vulnerable to deterioration in the business and economic environment.

CCC: Substantial Credit Risk. Default is a real possibility.

CC: Very High Levels of Credit Risk. Very low margin for safety. Default of some kind appears probable.

C: Near Default. A default or default-like process has begun, or for a closed funding vehicle, payment capacity is irrevocably impaired. Conditions that are indicative of a "C" category rating for an issuer include:

- The issuer has entered into a grace or cure period following non-payment of a material financial obligation;
- The formal announcement by the issuer or their agent of a distressed debt exchange ("DDE");
- A closed financing vehicle where payment capacity is irrevocably impaired such that it is not expected to pay interest and/or principal in full during the life of the transaction, but where no payment default is imminent

RD: Restricted Default. "RD" ratings indicate an issuer that in Fitch's opinion has experienced:

- An uncured payment default or DDE on a bond, loan or other material financial obligations, but has not entered into bankruptcy filing, administration, receivership, liquidation, or other formal winding-up procedure, and
- Has not otherwise ceased operating.

  This would include:
  - The selective payment default on a specific class or currency of debt;
  - The uncured expiry of any applicable original grace period, cure period or default forbearance period following a payment default on a bank loan, capital markets security or other material financial obligation;

D: Default. "D" ratings indicate an issuer that in Fitch's opinion has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure or which has otherwise ceased business.

Default ratings are not assigned prospectively to entities or their obligations; within this context, non-payment on an instrument that contains a deferral feature or grace period will generally not be considered a default until after the expiration of the deferral or grace period, unless a default is otherwise driven by bankruptcy or other similar circumstance, or by a distressed debt exchange.

In all cases, the assignment of a default rating reflects the agency's opinion as to the most appropriate rating category consistent with the rest of its universe of ratings and may differ from the definition of default under the terms of an issuer's financial obligations or local commercial practice.

Description of Fitch Ratings' Structured Finance Long-Term Obligation Ratings:

Ratings of structured finance obligations on the long-term scale consider the obligations' relative vulnerability to default. These ratings are typically assigned to an individual security or tranche in a transaction and not to an issuer.

AAA: Highest Credit Quality.

"AAA" ratings denote the lowest expectation of default risk. They are assigned only in cases of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA: Very High Credit Quality.

"AA" ratings denote expectations of very low default risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

A: High Credit Quality.

"A" ratings denote expectations of low default risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.

BBB: Good Credit Quality.

"BBB" ratings indicate that expectations of default risk are currently low. The capacity for payment of financial commitments is considered adequate, but adverse business or economic conditions are more likely to impair this capacity.

BB: Speculative.

"BB" ratings indicate an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.

B: Highly Speculative.

"B" ratings indicate that material default risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is vulnerable to deterioration in the business and economic environment.

CCC: Substantial Credit Risk.

Very low margin for safety. Default is a real possibility.

CC: Very High Levels of Credit Risk.

Default of some kind appears probable.

C: Exceptionally High Levels of Credit Risk.

Default appears imminent or inevitable.

D: Default.

Indicates a default. Default generally is defined as one of the following:

- Failure to make payment of principal and/or interest under the contractual terms of the rated obligation;
- Bankruptcy filings, administration, receivership, liquidation or other winding-up or cessation of the business of an issuer/obligor; or
- Distressed exchange of an obligation, where creditors were offered securities with diminished structural or economic terms compared with the existing obligation to avoid a probable payment default.

Description of Fitch Ratings' Country Ceilings Ratings:

Country Ceilings are expressed using the symbols of the long-term issuer primary credit rating scale and relate to sovereign jurisdictions also rated by Fitch on the IDR scale. They reflect the agency's judgment regarding the risk of capital and exchange controls being imposed by the sovereign authorities that would prevent or materially impede the private sector's ability

to convert local currency into foreign currency and transfer to non-resident creditors — transfer and convertibility (T&C) risk. They are not ratings but expressions of a cap for the foreign currency issuer ratings of most, but not all, issuers in a given country. Intervention through capital or currency controls where an issuer is prevented comprehensively by its own government from paying out on cross-border bonds, held by investors both inside and outside its borders, would typically lead to a T&C default.

Description of Fitch Ratings' Sovereigns, Public Finance and Global Infrastructure Obligations:

Ratings of public finance obligations, infrastructure and project finance obligations on the long-term scale, structured finance and fund finance obligations only consider the obligations' relative vulnerability to default.

In limited cases in U.S. public finance, where Chapter 9 of the Bankruptcy Code provides reliably superior prospects for ultimate recovery to local government obligations that benefit from a statutory lien on revenues, Fitch reflects this in a security rating with limited notching above the IDR. Recovery expectations can also be reflected in a security rating in the U.S. during the pendency of a bankruptcy proceeding under the Code if there is sufficient visibility on potential recovery prospects.

Recovery Ratings are only assigned to infrastructure and project finance obligations, to indicate likely recovery prospects upon request. They are assessed in parallel to instrument ratings and typically do not influence the obligation rating, which remains premised on vulnerability to default.

AAA: Highest Credit Quality. "AAA" ratings denote the lowest expectation of default risk. They are assigned only in cases of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA: Very High Credit Quality. "AA" ratings denote expectations of very low default risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

A: High Credit Quality. "A" ratings denote expectations of low default risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.

BBB: Good Credit Quality. "BBB" ratings indicate that expectations of default risk are currently low. The capacity for payment of financial commitments is considered adequate, but adverse business or economic conditions are more likely to impair this capacity.

BB: Speculative. "BB" ratings indicate an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.

B: Highly Speculative. "B" ratings indicate that material default risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is vulnerable to deterioration in the business and economic environment.

CCC: Substantial Credit Risk. Very low margin for safety. Default is a real possibility.

CC: Very High Levels of Credit Risk. Default of some kind appears probable.

C: Exceptionally High Levels of Credit Risk. Default appears imminent or inevitable.

D: Default. Indicates a default. Default generally is defined as one of the following:

- Failure to make payment of principal and/or interest under the contractual terms of the rated obligation;
- Bankruptcy filings, administration, receivership, liquidation or other winding-up or cessation of the business of an issuer/obligor where payment default on an obligation is a virtual certainty; or
- Distressed exchange of an obligation, where creditors were offered securities with diminished structural or economic terms compared with the existing obligation to avoid a probable payment default.

Notes: In U.S. public finance, obligations may be pre-refunded, where funds sufficient to meet the requirements of the respective obligations are placed in an escrow account. When obligation ratings are maintained based on the escrowed funds and their structural elements, the ratings carry the suffix "pre" (e.g. "AAApre", "AA+pre").

Structured Finance Defaults

Imminent default, categorized under "C", typically refers to the occasion where a payment default has been intimated by the issuer and is all but inevitable. This may, for example, be where an issuer has missed a scheduled payment but (as is typical) has a grace period during which it may cure the payment default. Another alternative would be where an issuer has formally announced a distressed debt exchange, but the date of the exchange still lies several days or weeks in the immediate future.

Additionally, in structured finance transactions, where analysis indicates that an instrument is irrevocably impaired such that it is not expected to pay interest and/or principal in full in accordance with the terms of the obligation's documentation during the life of the transaction, but where no payment default in accordance with the terms of the documentation is imminent, the obligation will typically be rated in the "C" category.

Structured Finance Write-downs

Where an instrument has experienced an involuntary and, in the agency's opinion, irreversible write-down of principal (i.e. other than through amortization, and resulting in a loss to the investor), a credit rating of "D" will be assigned to the instrument. Where the agency believes the write-down may prove to be temporary (and the loss may be written up again in future if and when performance improves), then a credit rating of "C" will typically be assigned. Should the write-down then later be reversed, the credit rating will be raised to an appropriate level for that instrument. Should the write-down later be deemed as irreversible, the credit rating will be lowered to "D".

Notes:

In the case of structured finance, while the ratings do not address the loss severity given default of the rated liability, loss severity assumptions on the underlying assets are nonetheless typically included as part of the analysis. Loss severity assumptions are used to derive pool cash flows available to service the rated liability.

The suffix "sf" denotes an issue that is a structured finance transaction.

Description of Fitch Ratings' Short-Term Ratings Assigned to Issuers and Obligations:

A short-term issuer or obligation rating is based in all cases on the short-term vulnerability to default of the rated entity and relates to the capacity to meet financial obligations in accordance with the documentation governing the relevant obligation. Short-term deposit ratings may be adjusted for loss severity. Short-Term Ratings are assigned to obligations whose initial maturity is viewed as "short term" based on market convention (a long-term rating can also be used to rate an issue with short maturity). Typically, this means a timeframe of up to 13 months for corporate, sovereign, and structured obligations, and up to 36 months for obligations in U.S. public finance markets.

F1: Highest Short-Term Credit Quality. Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.

F2: Good Short-Term Credit Quality. Good intrinsic capacity for timely payment of financial commitments.

F3: Fair Short-Term Credit Quality. The intrinsic capacity for timely payment of financial commitments is adequate.

B: Speculative Short-Term Credit Quality. Minimal capacity for timely payment of financial commitments, plus heightened vulnerability to near term adverse changes in financial and economic conditions.

C: High Short-Term Default Risk. Default is a real possibility.

RD: Restricted Default. Indicates an entity that has defaulted on one or more of its financial commitments, although it continues to meet other financial obligations. Typically applicable to entity ratings only.

D: Default. Indicates a broad-based default event for an entity, or the default of a short-term obligation.

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ADDITIONAL INFORMATION CONCERNING

NEW JERSEY MUNICIPAL OBLIGATIONS

The following information is a summary of certain factors affecting the credit and financial condition of the state of New Jersey ("New Jersey" or the "State"). The sources of payment for New Jersey municipal obligations and the marketability thereof may be affected by financial or other difficulties experienced by the State and certain of its municipalities and public authorities. This summary does not purport to be a complete description and, with the exception of the last paragraph hereof, is derived from (i) information provided by the State in an official statement relating to an offering of New Jersey bonds, dated April 22, 2021, and Appendix I, dated April 9, 2021, thereto (the "Official Statement"), and (ii) with respect to the section titled "Fiscal Year 2024 Report," information contained in the State's Office of Management and Budget's analysis of New Jersey's Comprehensive Annual Financial Report ("CAFR") for the Fiscal Year Ended June 30, 2024, dated March 28, 2025. The funds have not independently verified the accuracy, completeness or timeliness of the information contained in the Official Statement or the CAFR. Any characterizations of fact, assessments of conditions, estimates of future results and other projections are statements of opinion made by the State in, and as of the date of, such Official Statement or Supplement, as applicable, and are subject to risks and uncertainties that may cause actual results to differ materially.

GENERAL INFORMATION

New Jersey is the most densely populated state in the nation, with an average density of 1,208 persons per square mile as of 2019. The State is a part of a megalopolis that extends from Washington D.C. in the south to Boston, Massachusetts in the north and includes over one-fifth of the nation's population. Thus, New Jersey is an attractive location for businesses due to its central location and ability to access both regional and world markets.

The following core industry clusters are the center of the State's diverse economy: technology, transportation and logistics, health care, financial services, biopharmaceuticals, and advanced manufacturing. There is also a strong commercial agriculture sector in the rural areas. The "Jersey Shore", along the Atlantic Seaboard, is the focus of the State's tourism sector and includes casino gambling in Atlantic City. The State attracted over 110.8 million visitors in 2018 and 116.2 million visitors in 2019.

There were just under 8.9 million persons residing in New Jersey according to the latest population estimates from the U.S. Census Bureau as of July 1, 2019. New Jersey's population grew an average of 0.1% per year from 2010 to 2019. This was above the average annual growth rate of 0.03% and 0.08% for New York and Pennsylvania, respectively. It was below the national growth rate of 0.7%. 30.3% of New Jersey's population was under the age of 25, lower than the national average of 31.4%. In addition, 16.6% of the State's population is 65 years or older, similar to the national share of 16.4%.

41.2% of New Jersey residents 25 years of age or older had a bachelor's degree or higher in 2019. This is the third highest rate in the nation and above the national average of 33.1%. New Jersey is also a diverse state. At 23.4%, New Jersey has the second highest share of foreign-born residents, behind only California, and above the national average of 13.7%. New Jersey also has the fourth highest percentage of residents that speak a language other than English at home at 32.2%. The State ranks behind only California, Texas, and New Mexico and is above the national percentage of 22%.

New Jersey's total population grew by 0.9% from 2010 to 2019. However, New Jersey also experienced net domestic out-migration during this period. Net domestic out-migration was greatest for residents aged 18-24, followed by residents aged 60 and over, according to data from the U.S. Census's American Community Survey. New Jersey's overall population still grew despite net domestic out-migration because natural population growth and foreign in-migration offset the losses from net domestic out-migration during this period.

New Jersey state income tax return data also indicates that the higher-income population grew faster than the overall population from 2009 to 2019 (the most recent year for which data is available). The total number of resident returns grew 8.2% during this time. Growth in the higher-income population was greatest with returns reporting income between $500,000 and $1.0 million growing by 112.9% and returns with income greater than $1.0 million growing by 95.1%.

ECONOMIC OUTLOOK

The COVID-19 pandemic upended the economic outlook for New Jersey and the nation. Calendar Year 2020 started off well with the New Jersey labor market adding 23,000 jobs in the first two months, continuing the growth trend of 2019 when 31,100 jobs were added. Economic growth in New Jersey strengthened in both 2018 and 2019, with real gross domestic production ("GDP") expanding by an average of 1.5% per year, which was expected to continue into 2020.

The positive outlook changed quickly. The U.S. Department of Health and Human Services declared a public health emergency on January 31, 2020, which was followed by a declaration of a national emergency by the President of the United States on March 13, 2020. The Governor issued Executive Order No. 103 on March 9, 2020, whereby the Governor declared a public health emergency and a state of emergency. However, the rapid spread of COVID-19 across the country forced many states to strengthen restrictions by issuing "stay-at-home" orders. The Governor issued a "stay-at-home" order, Executive Order No. 107, on March 21, 2020. The Governors of New York and Pennsylvania issued similar "stay-at-home" orders shortly thereafter.

Payroll employment in New Jersey declined by a total of 717,200 jobs, or 17.0%, during March and April 2020 as a result of the COVID-19 pandemic restrictions. Other states suffered similar declines with employment falling by 20.2% in New York and 18.5% in Pennsylvania. New Jersey's real GDP deteriorated at a seasonally adjusted annual rate of 35.6% in the second quarter of 2020, in line with New York's 36.3% decline and Pennsylvania's 34.0% decline.

Job growth rebounded when states began to re-open their economies in May 2020. Payroll employment grew by an average of 69,600 jobs per month in New Jersey from May to September 2020. However, growth subsequently plateaued because health considerations required that the COVID-19 pandemic-related restrictions remain in place. The State added 5,300 jobs in total from October 2020 to January 2021. The State's unemployment rate, which peaked at 16.6% in April 2020, improved to 7.9% by January 2021.

Through January 2021, the New Jersey labor market recovered 49.3% of the total jobs lost from this past spring, which is below the 59.8% share of Pennsylvania, but above the 46.1% share for New York. The brunt of the economic impact of the COVID-19 pandemic has been borne by workers in low-wage sectors. The leisure & hospitality services sector (hotels, restaurants, & bars); trade, transportation & utilities sector (retail trade); and other services sector accounted for 57.4% of job losses in March and April 2020. As of January 2021, both the leisure & hospitality services sector (47.0%) and the other services sector (46.9%) have recovered just under half of the jobs lost during Spring 2020.

Real GDP recovered in the third quarter with economic activity in New Jersey growing at a seasonally adjusted annual rate of 37.2%, which was faster than the 35.5% rate of Pennsylvania and 30.3% rate of New York. As of April 9, 2021, the housing market had been a bright spot during the recovery. While, according to the estimates of New Jersey Realtors Association, single-family home sales in New Jersey were 19.1% lower year-over-year from March to June 2020, they rebounded in July and August 2020, up 6.0% over the same period during the prior year. Sales then rapidly accelerated beginning in September 2020, higher by 34.0% on average over the last four months of 2020. Transaction prices have also risen sharply, with the average price of a single-family home sale in 2020 reaching nearly $475,000, which is 16.3% higher than in 2019.

The substantial federal stimulus provided to businesses and households in Spring 2020 provided necessary support to the economic recovery. New Jersey residents received $6.7 billion in Economic Impact Payments last spring, while businesses received $17.4 billion in Paycheck Protection Program loans through August 2020. Unemployed workers in New Jersey received $14.1 billion in unemployment insurance ("UI") benefits through newly established federal programs, including this past fall's Lost Wage Assistance Program that was funded by the Federal Emergency Management Agency ("FEMA").

New Jersey's personal income grew at a 40.8% annual rate in the second quarter of 2020 due to the significant federal stimulus, even though wage and salary income declined by 31.3%. Wages and salaries rebounded in the third quarter, increasing at a 26.6% annual rate because of the strong job growth. However, personal income declined at an 8.7% annual rate in the third quarter of 2020 due to the phase-out of federal aid.

As of April 9, 2021, the economic outlook had improved for both New Jersey and the United States, though COVID-19 continued to determine the path of the economic recovery. Members of the Federal Open Market Committee ("FOMC") estimated real GDP in the U.S. to grow 4.2% in 2021 according to the FOMC's December 2020 projection. Economists surveyed by the Wall Street Journal were forecasting real GDP growth of 6.0% for the U.S. in 2021 according to the March survey, which is more than

two full percentage points over the December 2020 average forecast of 3.7%. The improved outlook is based on the additional federal stimulus this spring as well as continued success in the rollout of COVID-19 vaccines.

FISCAL YEAR 2024 REPORT

Financial Highlights

Government-wide

The primary government's assets and deferred outflows of resources totaled $119.5 billion, a decrease of $5.7 billion from the prior fiscal year after restatements; however, net position increased by $9.0 billion. Restatements were made to increase net position over various accounts. As of June 30, 2024, liabilities and deferred inflows of resources exceeded assets and deferred outflows of resources by $158.7 billion. The State's unrestricted net position, which represents net position that has no statutory commitments and is available for discretionary use, totaled a negative $183.1 billion. The negative balance was primarily a result of the State implementing, in Fiscal Year 2015, GASB Statement No. 68, Accounting and Financial Reporting for Pensions and the State implementing in Fiscal Year 2018, GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions. Financing activities that have contributed to the State's negative unrestricted net position included liabilities from pension obligation bonds, the funding of a portion of local elementary and high school construction, and the securitization of all annual tobacco master settlement agreement receipts with no corresponding assets.

As of June 30, 2024, component unit assets and deferred outflows of resources exceeded component unit liabilities and deferred inflows of resources by $23.7 billion after restatements. Total component unit assets and deferred outflows of resources totaled $67.9 billion, an increase of $2.8 billion from the prior year, after restatements.

Fund Level

The State's governmental funds reported, as of June 30, 2024, combined ending fund balances of $33.1 billion, a decrease of $76.5 million after restatements when compared to the prior fiscal year. Fund balances are segregated into the following categories: non-spendable, restricted, committed, and unassigned. The non-spendable fund balance classification ($20.4 million) includes amounts that are legally required to remain intact. The restricted fund balance classification ($9.7 billion) is used when constraints have been placed upon the use of resources through enabling legislation initiated by voter referendum, constitutional provisions, debt covenants, or other external parties such as the federal government. The committed fund balance classification ($14.2 billion) includes amounts that can only be used for purposes specified in enabling legislation with the consent of both the legislative and executive branches. In contrast to the restricted fund balance classification, amounts in this category may be redeployed for other purposes with appropriate due process. Finally, the unassigned fund balance ($9.1 billion) represents the fund balance amount that has not been restricted or committed to a specific purpose within the General Fund.

During Fiscal Year 2024, the proprietary funds' net position increased by $946.4 million from the prior fiscal year after restatements, resulting in net position of $3.0 billion as of June 30, 2024.

Long-term Obligations

During Fiscal Year 2024, the State's governmental long-term obligations increased 0.02%to $201.0 billion, after restatements, which included a net decrease in bonded obligations of $1.7 billion. During Fiscal Year 2024, the State issued $2.0 billion in bonds. New money issuances represented $1.5 billion, issued primarily for transportation program improvements. The State also issued $446 million of refunding bonds that provided the State with $19.2 million in net present value savings. During Fiscal Year 2024, the State made principal and interest payments totaling $4.7 billion on its long-term obligations; an additional $0.5 billion was expended from the New Jersey Debt Defeasance and Prevention Fund to defease certain outstanding long-term obligations.

As of June 30, 2024, non-bonded portions of the State's governmental long-term obligations totaled $161.3 billion. This amount represented a $1.8 billion increase from Fiscal Year 2023, after restatements, and was mainly attributable to an increase in the Other Postemployment Benefits ("OPEB") Liability of $2.0 billion, resulting from changes in actuarial assumptions relating to the pensions and OPEB plans, offset by a decrease in the Net Pension Liability of $0.3 billion.

Government-Wide Financial Analysis

Net Position

The State ended Fiscal Year 2024 with combined net position for the primary government totaling a negative $158.7 billion. This amount represents an increase of net position of $9.0 billion from the prior fiscal year after restatements. Restricted net position includes funds used to pay unemployment claims and open space preservation. Capital assets, net of depreciation, are used by the State to provide services to citizens; consequently, these assets are not available for future spending. Net investment in capital assets includes land, land easements, land improvements, buildings and improvements, equipment and software, infrastructure (roads, bridges, and other immovable assets), and construction in progress. The deficit in unrestricted governmental net position arose primarily as a result of the cost of the State's bonded obligations, depreciation expense related to capital assets, and certain liabilities, including, but not limited to, the Net Pension Liability and the OPEB Liability, that are required to be included in the government-wide financial statements.

Changes in Net Position

The State's Fiscal Year 2024 net position increased by $9.0 billion after restatements. Approximately 50.1% of the State's total revenues came from general taxes, while 32.6% was derived from operating grants. Charges for services amounted to 14.9% of total revenues, while other items such as capital grants, miscellaneous revenues and interest earnings accounted for the remainder. State expenses cover a range of services. The largest expense, at 32.3%, was for educational cultural, and intellectual development, which included approximately $8.4 billion in state aid to school districts and $241.1 million disbursed by the New Jersey Schools Development Authority (a blended component unit) ("NJSDA") to help finance school facilities construction; physical and mental health amounted to 26.8%; and economic planning, development, and security amounted to 11.8%. Other major expenditures focused on government direction, management, and control; public safety and criminal justice; the State Lottery Fund; the Unemployment Compensation Fund; community development and environmental management, and transportation programs. During Fiscal Year 2024, governmental activities expenses exceeded program revenues. This imbalance was mainly funded through $50.1 billion of general revenues (mostly taxes). The remaining $8.1 billion resulted in an increase in net position. Additionally, business-type activities reflected a net position increase of $0.9 billion primarily because the Unemployment Compensation Fund's claims were less than available resources.

Primary Government – Fiscal Year 2024 Revenues and Expenses

During Fiscal Year 2024, State revenues totaled $95.6 billion or a decrease of $0.5 billion when compared to the prior fiscal year after restatements. This increase is primarily attributable to higher charges for services and interest earnings. General taxes totaled $47.9 billion and operating grants totaled $31.2 billion, accounting for 50.1% and 32.6%, respectively, of total State revenues for Fiscal Year 2024. The State's Gross Income Tax totaled $18.9 billion, the Sales and Use Tax totaled $13.5 billion, and the Corporation Business Tax ("CBT") totaled $4.7 billion. The State's three major taxes comprised 77.4% of the total general taxes that were collected during Fiscal Year 2024. General taxes decreased by $0.5 billion when compared to Fiscal Year 2023.

Fiscal Year 2024 expenses totaled $86.6 billion, an increase of $4.0 billion after restatements in comparison to the prior fiscal year. State spending increased in education, cultural, and intellectual development ($1.8 billion); physical and mental health ($1.2 billion); transportation programs ($1.1 billion); and the Unemployment Compensation Fund ($0.6 billion).. The aforementioned increases were partially offset by a spending decrease in public safety and criminal justice ($0.4 billion).

Component Units

Combined operating revenues and expenses for the State's component units for Fiscal Year 2024 amounted to $19.5 billion and $19.0 billion, respectively. Total operations along with other revenue and expenses contributed to total combined net position at fiscal year-end of $23.7 billion. The component units received $1.5 billion in State appropriations during Fiscal Year 2024.

Major Governmental Funds

The focus of the State's governmental funds reported in the fund financial statements is on near term inflows, outflows, and balance of expendable resources, which are essential elements in assessing the State's financing needs and serve as useful measures of the government's net resources available for future spending. The State's governmental funds reported June 30, 2024 fund balances of $33.1 billion, a $0.1 billion decrease after restatements from the prior fiscal year.

General Fund

The General Fund is the State's chief operating fund and is the fund into which all State revenues, not otherwise restricted by statute, are deposited. The General Fund's ending fund balance for Fiscal Year 2024 totaled $23.5 billion of which $9.1 billion represented unassigned fund balance. During Fiscal Year 2024, unassigned fund balance decreased by $1.4 billion. A primary reason for the decrease in fund balance was due to a $869.8 million decrease in federal and other grants. The Surplus Revenue Fund is an account within the State's General Fund that is used as a "Rainy Day Fund." Surplus revenue is defined as an amount equivalent to 50.0% of the excess between the General Fund revenues certified by the Governor at the time of the approval of the annual appropriations act (the "Appropriations Act") and the amount of revenue reported from the annual financial report of the General Fund for the fiscal year. Any General Fund excess is then subtracted by the amount of revenue reported from the annual financial report of the Property Tax Relief Fund that is less than revenue amounts certified by the Governor at the time of the approval of the annual Appropriations Act. As of June 30, 2024, the fund has a balance of $322.2 million.

On a budgetary basis, the General Fund collected general revenues of $61.0 billion. These general revenues were $0.2 billion higher than final budget and were $0.1 billion lower than originally anticipated, primarily due to decreases in federal and other grants.

Total expenditures and transfers were $0.4 billion lower than final budgeted expenditures. From a Fiscal Year 2024 program perspective, under-spending transpired in physical and mental health ($1.2 billion); economic planning, development, and security ($856.9 million); community development and environmental management ($611.8 million); transportation programs ($505.7 million); and special government services ($390.4 million); while over spending transpired in: educational, cultural, and intellectual development ($421.7 million). Additionally, transfers to other funds were $2.8 billion higher than original plus supplemental appropriations.

Property Tax Relief Fund

The Property Tax Relief Fund accounts for revenues from the Gross Income Tax and one-half percent of the Sales and Use Tax that is constitutionally dedicated for property tax relief. Appropriations from this fund must be used exclusively for the constitutional purpose of reducing or offsetting property taxes. During Fiscal Year 2024, $19.3 billion of property tax relief expenditures were made. The Property Tax Relief Fund's Fiscal Year 2024 ending fund balance was $799.5 billion. Gross Income Tax collections increased $95.7 million from Fiscal Year 2023.

Proprietary Funds

State Lottery Fund (Common Pension Fund L)

Contribution monies derived from the sale of State lottery tickets are deposited into Common Pension Fund L pursuant to the Lottery Enterprise Contribution Act ("LECA"). Disbursements are authorized for the payment of prizes to holders of winning lottery tickets, vendor fees in the production and distribution of lottery tickets, and for the administrative expenses of the Division of the State Lottery. In accordance with the LECA, remaining balances are contributed to Teachers' Pension and Annuity Fund ("TPAF") (77.78%), Public Employees' Retirement System ("PERS") (21.02%), and Police and Firemen's Retirement System ("PFRS") (1.20%) for a 30-year term effective as of June 30, 2017. The present value of obligations for future installment payments of lottery prizes, which are funded by the purchase of deposit fund contracts and United States Government Treasury securities, are accounted for in this fund.

For Fiscal Year 2024, gross revenues totaled $3.7 billion of which $2.2 billion was returned in prizes; $1.2 billion was transferred to pension funds; $279.7 million was paid to sales agents and ticket vendors; and $63.8 million covered Lottery operational and promotional expenses. As of June 30, 2024, the State Lottery, since its inception, has generated over $95.6 billion in gross revenues, $53.5 billion in prizes, contributed $26.0 billion to the State, and $7.7 billion in pension contributions.

Unemployment Compensation Fund

The Unemployment Compensation Fund accounts for monies deposited from employers' and employees' contributions for unemployment compensation, amounts credited or advances made by the federal government, and amounts received from any other source. After consideration is given to any claim for refund of overpayment of contributions, the Division of Employment Security transfers the remainder to the Treasurer of the United States for credit to the State of New Jersey Unemployment Compensation Fund. Total unemployment claims paid increased by $579 million in Fiscal Year 2024, due to increases in the State unemployment rate and weekly benefit maximum rates compared to Fiscal Year 2023.

Capital Assets

The New Jersey Department of the Treasury is responsible for ensuring all departments record their capital assets in the State's capital asset system. In addition to New Jersey's Department of Transportation ("NJDOT") identifying significant requirements for bridge repair and maintenance, the New Jersey Commission on Capital Budgeting and Planning (the "Commission") has identified a significant amount of capital investment requirements for State facilities. The State's annual budget and planning process prioritizes these requirements and recommends funding, as can be accommodated within available resources.

The Fiscal Year 2024 capital appropriation included $4.5 billion of State and matching federal funds for both NJDOT and the New Jersey Transit Corporation ("NJTC"). The State's share, funded through the TTFA, produced $810.0 million for State highway infrastructure, $430.0 million for local highways, and $760.0 million for mass transit. During Fiscal Year 2024, the New Jersey Economic Development Authority issued $281.7 million of School Facilities Construction Refunding Bonds, to help fund the New Jersey Schools Development Authority's program. As of June 30, 2024, a total of $11.9 billion of the $12.5 billion school facilities construction bond program had been issued. The constitutional dedication of 6.0% of the CBT was appropriated and/or reserved to fund hazardous discharge cleanup, underground storage tank improvements, and surface water quality projects.

The State's investment in capital assets, net of accumulated depreciation, totaled $32.8 billion as of June 30, 2024. Depreciation expense charges for Fiscal Year 2024 totaled $1.3 billion.

Debt Administration

As of June 30, 2024, New Jersey's outstanding long-term obligations for governmental activities totaled $201.0 billion, a $35.9 million increase, or 0.02% after restatements, relative to the prior fiscal year. The relatively flat change in outstanding obligations is primarily attributable to an increase in OPEB Liability of $2.0 billion, offset by a $1.7 billion decrease in bonded debt. Long-term bonded obligations totaled $39.7 billion, while other long-term non-bonded obligations totaled $161.3 billion. In addition, the State had $10.4 billion of legislatively authorized bonding capacity that had not yet been issued as of June 30, 2024. As of June 30, 2024, the legislatively authorized but unissued debt increased by $2.0 billion from the prior fiscal year.

Pension and Other Postemployment Benefits Obligations

In Fiscal Year 2024 the State funded the various defined benefit pension systems at 104% of the full actuarially determined contributions. Employer contributions to the pension plans are calculated per the requirements of the governing State statutes using generally accepted actuarial procedures and practices. The actuarial funding method used to determine the State's contribution is a matter of State law. Any change to the funding method requires the approval of the State Legislature and the Governor. The amount the State actually contributes to the pension plans may differ from the actuarially determined contributions of the pension plans because the State's contribution to the pension plans is subject to the appropriation of the State Legislature and actions by the Governor. GASB Statement No. 68, Accounting and Financial Reporting for Pensions, requires participating employers to recognize their proportionate share of the collective net pension liability. Under the new statement, the calculation of the pension liability was changed to a more conservative methodology and each employer was allocated a proportional share of the pension plans' net pension liability. The State's share of the net pension liability, based on a measurement date of June 30, 2024, which is required to be recorded on the financial statements, is $79.4 billion.

The Fiscal Year 2025 projected aggregate State contribution to the pension plans of $7.2 billion represents 104% of the actuarially determined contribution.

The State provides post-retirement medical ("PRM") benefits for certain State and other retired employees meeting the service credit eligibility requirements. In Fiscal Year 2024, the State paid PRM benefits for 161,268 State and local retirees.

The State funds PRM benefits on a "pay-as-you-go" basis, which means that the State does not pre-fund, or otherwise establish a reserve or other pool of assets against the PRM expenses that the State may incur in future years. For Fiscal Year 2024, the State contributed $2.3 billion to pay for "pay-as-you-go" PRM benefit costs incurred by covered populations, a slight increase from $2.1 billion in Fiscal Year 2023. The State has appropriated $2.4 billion in Fiscal Year 2025 as the State's contribution to fund increases in prescription drugs and medical claims costs.

In accordance with the provisions of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, the State is required to quantify and disclose its obligations to pay OPEB to retired plan members.

This new standard supersedes the previously issued guidance, GASB Statement No. 45, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, effective for Fiscal Year 2018. The State is now required to accrue a liability in all instances where statutory language names the State as the legal obligor for benefit payments. The Fiscal Year 2024 State OPEB liability to provide these benefits was $76.9 billion, an increase of $2.0 billion, or 2.6% from the $74.9 billion liability recorded in Fiscal Year 2023.

STATE FINANCES AND CONSTITUTIONAL LIMITATIONS

Budget Limitations

The State Constitution provides, in part, that no money shall be drawn from the State Treasury but for appropriations made by law and that no law appropriating money for any State purpose shall be enacted if the appropriations contained therein, together with all prior appropriations made for the same fiscal period, shall exceed the total amount of the revenue on hand and anticipated to be available to meet such appropriations during such fiscal period, as certified by the Governor (Article VIII, Sec. 2, para. 2) (the "Appropriations Clause"). In addition to line-item appropriations for the payment of debt service on bonds, notes or other obligations which are subject to appropriation, beginning in Fiscal Year 2005, the annual Appropriations Act contains a general language provision which appropriates such additional amounts necessary to pay such debt service obligations subject to the approval of the Budget Director (defined below). For bonds which must be paid for from constitutionally-dedicated sources, such supplemental appropriations would need to be from constitutionally-dedicated revenues.

Debt Limitations

The State Constitution further provides, in part, that the State Legislature shall not, in any manner, create in any fiscal year a debt or liability of the State, which, together with any previous debts or liabilities, shall exceed at any time one percent of the total appropriations for such year, unless the same shall be authorized by a law for some single object or work distinctly specified therein. No such law shall take effect until it shall have been submitted to the people at a general election and approved by a majority of the legally qualified voters voting thereon; provided, however, no such voter approval is required for any such law authorizing the creation of a debt for a refinancing of all or any portion of the outstanding debts or liabilities of the State, so long as such refinancing shall produce a debt service savings. Furthermore, any funds raised under these authorizations must be applied only to the specific object stated therein. The State Constitution provides as to any law authorizing such debt: "Regardless of any limitation relating to taxation in this Constitution, such law shall provide the ways and means, exclusive of loans, to pay the interest of such debt or liability as it falls due, and also to pay and discharge the principal thereof within thirty-five years from the time it is contracted; and the law shall not be repealed until such debt or liability and the interest thereon are fully paid and discharged." This constitutional requirement for voter approval does not apply to the creation of debts or liabilities for purposes of war, or to repel invasion, or to suppress insurrection or to meet emergencies caused by disaster or act of God (Article VIII, Sec. 2, para. 3) (the "Debt Limitation Clause").

The Debt Limitation Clause was amended by the voters on November 4, 2008 (the "Lance Amendment"). The Lance Amendment provides that, beginning after the effective date of the amendment, the State Legislature is prohibited from enacting any law that creates or authorizes the creation of a debt or liability of an autonomous State corporate entity, which debt or liability has a pledge of an annual appropriation as the means to pay the principal of and interest on such debt or liability, unless a law authorizing the creation of that debt or liability for some single object or work distinctly specified therein shall have been submitted to the people and approved by a majority of the legally qualified voters of the State voting thereon at a general election. The Lance Amendment does not require voter approval for any such law providing the means to pay the principal of and interest on such debt or liability subject to appropriations of an independent non-State source of revenue paid by third persons for the use of the single object or work thereof, or from a source of State revenue otherwise required to be appropriated pursuant to another provision of the State Constitution. Furthermore, voter approval is not needed for any law providing for the refinancing of all or a portion of any outstanding debts or liabilities of the State or of an autonomous State corporate entity provided that such law requires that the refinancing produces debt service savings, or for any law authorizing the issuance of General Obligation Bonds to meet an emergency caused by a disaster.

New Jersey's Budget and Appropriation System Process

The State operates on a fiscal year beginning July 1 and ending June 30, with the exception of Fiscal Years 2020 and 2021. In accordance with Chapter 19, Fiscal Year 2020 was extended by three months to end on September 30, 2020, and the date of the

beginning of Fiscal Year 2021 was delayed to October 1, 2020. Fiscal Year 2022 begins July 1, 2021 and ends on June 30, 2022. New Jersey's budget process is comprehensive and inclusive, involving every department and agency in the Executive Branch, the State Legislature, the Judicial Branch, and through a series of public hearings, the citizens of the State.

Pursuant to the Appropriations Clause, no money may be drawn from the State Treasury except for appropriations made by law. In addition, all monies for the support of State government and all other State purposes, as far as can be ascertained or reasonably foreseen, must be provided for in one general appropriations law covering one and the same fiscal year. The State Legislature enacts the Appropriations Act on an annual basis which provides the basic framework for the operation of governmental funds, including the General Fund. No general appropriations law or other law appropriating money for any State purpose shall be enacted if the amount of money appropriated therein, together with all other prior appropriations made for the same fiscal year, exceeds the total amount of revenue on hand and anticipated to be available for such fiscal year. The Appropriations Clause requires that at the time of enactment of the annual Appropriations Act, the Governor certify that there are sufficient resources available to support the line item appropriations in the Appropriations Act.

Budget Requests and Preliminary Projections

The budget process begins in the summer prior to the following fiscal year with preliminary projections of revenues and expenditures, which are the basis for development of budget targets for each branch, department and agency. Individual departments and agencies are required to prepare a funding plan or strategy for operating within the established target in the following fiscal year, which funding plan or strategy includes an analysis of the costs, benefits and priorities of every program.

Budget Director Review

On or before October 1 in each year, each Department, Board, Commission, Office or other Agency of the State must file with the Director of the Division of the Budget and Accounting in the New Jersey Department of the Treasury (the "Budget Director") a request for appropriation or permission to spend specifying all expenditures proposed to be made by such spending agency during the following fiscal year. The Budget Director then examines each request and determines the necessity or advisability of the appropriation request. On or before December 31 of each year or such other time as the Governor may request, after review and examination, the Budget Director submits the requests, together with his or her findings, comments and recommendations, to the Governor.

Governor's Budget Message

The Governor's budget message (the "Governor's Budget Message") is presented by the Governor during an appearance before a joint session of the State Legislature which, by law, is convened on a date on or before the fourth Tuesday in February in each year, except if such date is changed as provided by law which generally occurs during the first year when a new governor is elected. The Governor's Budget Message must include the proposed complete financial program of the State government for the next ensuing fiscal year and must set forth in detail each source of anticipated revenue and the purposes of recommended expenditures for each spending agency (*N.J.S.A.* 52:27B-20).

Legislative Review

The financial program included in the Governor's Budget Message is then subject to a process of legislative committee review. As part of such review, testimony is given by a number of parties. The Office of Legislative Services, which is an agency of the State Legislature, generally provides its own estimates of anticipated revenues which may be higher or lower than those included in the Governor's Budget Message, and the State Treasurer generally provides an updated statement of anticipated revenues in May of each year which may increase or decrease the amounts included in the Governor's Budget Message. In addition, various parties may release their own estimates of anticipated revenues and recommended expenditures to the media. After completion of the legislative committee review process, the budget, in the form of an appropriations bill, must be approved by the Senate and Assembly and must be submitted to the Governor for review. The Appropriations Act includes the General Fund, and the Casino Control, Casino Revenue, Gubernatorial Elections, and Property Tax Relief Funds. In addition to anticipated revenues, the Appropriations Act also provides for the appropriation of non-budgeted revenue, including primarily federal funds and other dedicated funds.

Governor's Line-Item Veto Power

Upon enactment by the Legislature of the Appropriations Act, the Governor may approve the bill, revise the estimate of anticipated revenues contained therein, delete or reduce appropriation items contained in the bill through the exercise of his or her line-item veto power, or veto the bill in its entirety. As with any gubernatorial veto, such action may be reversed by a two-thirds vote of each House of the State Legislature.

Fiscal Controls

The departments maintain legal control at the appropriation line item level and exercise budgetary control by individual appropriations and allocations within annual appropriations to various programs and major expenditure objects. Revisions to the Appropriations Act, reflecting program changes or interdepartmental transfers of an administrative nature, may be effected during the fiscal year with certain Executive and Legislative Branch approvals. Management may amend a department's budget with approval by the Budget Director; provided that under specific conditions, additional approval by the Office of Legislative Services is required. Transfers of appropriations between departments or between line items within a department are authorized pursuant to general provisions of the Appropriations Act.

During the course of the fiscal year, the Governor may take steps to reduce State expenditures if it appears that revenues have fallen below those originally anticipated. Pursuant to various statutes, the Governor may order the Budget Director to set aside a reserve out of each appropriation, and if sufficient revenues are not available by the end of the fiscal year to fund such reserve, the amount reserved lapses back into the General Fund. In addition, the Governor is authorized to prohibit and enjoin and place conditions upon the expenditure of monies in the case of extravagance, waste or mismanagement.

Furthermore, under the State Constitution, no supplemental appropriation may be enacted after adoption of the Appropriations Act except where there are sufficient revenues on hand or anticipated, as certified by the Governor, to meet such appropriation and all prior appropriations for such fiscal year.

State Budget Shutdown

If the Appropriations Act is not enacted prior to the first day of the next fiscal year, under the Appropriations Clause, no moneys can be withdrawn from the State treasury. Accordingly, all non-essential operations of State government must be shut down until such time as the Appropriations Act is passed and approved by the Governor. If a shutdown occurs in a future fiscal year, no moneys, other than general obligation bond debt service and available amounts already held under bond financing documents will be available to make payment on obligations paid from State revenue subject to annual appropriation.

INDEBTEDNESS AND OTHER STATE RELATED OBLIGATIONS

General Obligation Bonds

The State finances certain capital projects through the sale of General Obligation Bonds of the State. These bonds are backed by the faith and credit of the State. Certain State tax revenues and certain other fees are pledged to meet the principal payments, interest payments, and redemption premium payments, if any, required to fully pay the bonds.

General Obligation Bonds of the State are authorized from time to time by Acts of the State Legislature. Each such "Bond Act" sets forth the authorized amounts and purposes of the bonds as well as certain parameters for issuing bonds, such as maximum term. Purposes under the Bond Acts have included open space and farmland preservation, water supply protection, transportation, higher education, port development, economic development, hazardous waste remediation, and many other public purposes. The Bond Acts provide that the bonds issued represent a debt of the State, and the faith and credit of the State are pledged to their repayment. Generally, each Bond Act requires voter approval. However, the Emergency Exception provides that no voter approval is required for bonds issued to meet an emergency caused by a disaster. To address the financial consequences of the COVID-19 pandemic, the Emergency Bond Act was passed pursuant to which the State intends to issue General Obligation Bonds in Fiscal Year 2021 to provide additional resources to the State. On November 24, 2020, pursuant to the Emergency Bond Act, the State issued its $3,672,360,000 New Jersey COVID-19 General Obligation Emergency Bonds, 2020 Series A. As of April 9, 2021, the State did not intend to issue any additional bonds under the Emergency Bond Act.

Certain decisions relating to a general obligation bond sale, including the setting of interest rates and amortization of the bonds, are delegated to the "Issuing Officials" of the State, comprising the Governor, State Treasurer and Budget Director. The State Treasurer is directed to hold and invest the proceeds of the bond sale pending their expenditure in separate funds as

established by the Bond Act. The Refunding Bond Act of 1985 sets forth the procedures and parameters for issuing bonds for the purpose of refunding outstanding bonds issued under any other Bond Act.

Tax and Revenue Anticipation Notes

The State issues short-term tax and revenue anticipation notes ("TRANs") in advance of income tax and corporation business tax collections, depositing the proceeds in the General Fund. These notes are used to provide effective cash management to fund the imbalances that occur between the collection of revenues and the disbursement of appropriations of the General Fund and Property Tax Relief Fund. No TRANs were authorized for fiscal year 2024.

State Appropriation Obligations

As of April 9, 2021, the State had entered into a number of leases and contracts (collectively, the "Agreements") with several governmental authorities to secure the financing of various projects and programs in the State. Under the terms of the Agreements, the State agreed to make payments equal to the debt service on, and other costs related to, the obligations sold to finance the projects, including payments, if any, on interest rate exchange agreements ("swap agreements"). The State Legislature has no legal obligation to enact appropriations to fund such payments, but, as of April 9, 2021, had done so for all such obligations. The amounts appropriated to make such payments are included in the appropriation for the department, authority or other entity administering the program or in other line item appropriations. The principal amount of bonds which may be issued and the notional amount of swap agreements which may be entered into by such governmental authorities is, in certain cases, subject to specific statutory dollar ceilings or programmatic restrictions which effectively limit such amounts. In other cases, as of April 9, 2021, there were no such ceilings or limitations. In addition, the State Legislature may at any time impose, remove, increase or decrease applicable existing ceilings or limitations and impose, modify or remove programmatic restrictions. The State Legislature may also authorize new swap agreements with the governmental authorities to secure the financing of projects and programs in the future. Certain of these changes may require voter approval.

As of April 9, 2021, the State expected that additional State Appropriation Obligations would be issued during Fiscal Years 2021 and 2022 and future fiscal years. The Lance Amendment prohibits the State Legislature from enacting legislation authorizing State Appropriation Obligations payable from sources other than constitutionally dedicated sources unless such legislation is submitted and approved by a majority of legally qualified voters of the State voting thereon at a general election. The State Legislature is not legally obligated to appropriate amounts for the payment of such State Appropriation Obligations debt service in any year, and there can be no assurance that the State Legislature will make any such appropriations.

Variable Rate Obligations

As of June 30, 2020, NJEDA and the TTFA had outstanding $528,015,000 of floating rate notes, which bear interest at rates that reset weekly and are based on the Securities Industry and Financial Markets Association rate plus a fixed spread. There are no letters of credit in support of these notes.

Bank Loan Bonds

As of April 9, 2021, the NJEDA and New Jersey Educational Facilities Authority had issued certain series of bonds to finance school facilities construction projects and higher education capital improvement projects pursuant to term loan agreements with several banks. A bank's rights under such term loan agreements are essentially the same as bondholders' rights except for a few differences. The bank may require the mandatory term out of the bonds for a shortened amortization period if certain events occur under the loan agreement, including, without limitation, the failure to pay, or cause to be paid, when due, principal of or interest on the bonds, a debt moratorium, a ratings downgrade, a material failure to perform under a contract among the TTFA, the State Treasurer and the Commissioner of Transportation (the "State Contract"), an action that material adversely affects the rights, remedies or security of the trustee under the bond resolution or the bank under the term loan agreement or a material amendment or modification to the State Contract without the prior written consent of the bank. For tax-exempt bonds, the term loan agreements provide that if an event of taxability occurs, the interest rate on the bonds will increase. The aggregate amount of such bank loan bonds outstanding as of June 30, 2020 was $1,681,522,000.

Swap Agreements

The various independent State authorities authorized to issue State Appropriation Obligations in certain cases are also authorized to enter into swap agreements. As of June 30, 2020, the notional amount of interest rate swap agreements supported by State appropriations was zero.

"Moral Obligation" Financing

The authorizing legislation for certain State entities provides for specific budgetary procedures with respect to certain obligations issued by these entities. Pursuant to such legislation, a designated official is required to certify any deficiency in a debt service reserve fund maintained to meet payments of principal of and interest on the obligations, and a State appropriation in the amount of the deficiency is to be made. However, the State Legislature is not legally bound to make such an appropriation. Bonds issued pursuant to authorizing legislation of this type are sometimes referred to as moral obligation bonds. There is no statutory limitation on the amount of moral obligation bonds which may be issued by eligible State entities. Currently, bonds issued by the South Jersey Port Corporation, the New Jersey Housing and Mortgage Finance Agency and the Higher Education Student Assistance Authority have not had a deficiency in their respective debt service funds which required the State to appropriate funds.

South Jersey Port Corporation

The State, under its moral obligation, has provided the South Jersey Port Corporation (the "Port Corporation") with funds to replenish its debt service reserve fund to the extent drawn upon by the Port Corporation when Port Corporation revenues are insufficient to pay debt service on its outstanding bonds. Such payments to the Port Corporation are subject to appropriation by the State Legislature. On December 1, 2023, the Corporation certified that it would be unable to provide sufficient funds from operations for debt service, and therefore, required a State appropriation for Fiscal Year 2024 in the amount of $31.5 million.

Higher Education Student Assistance Authority

The Higher Education Student Assistance Authority ("HESAA") has not had a revenue deficiency which required the State to appropriate funds to meet its moral obligation. It is anticipated that the HESAA's revenues would continue to be sufficient to pay debt service on its bonds.

Pension Plans for State Employees

Almost all of the public employees of the State and its counties, municipalities and political subdivisions are members of pension plans administered by the State. From June 30, 2015 to June 30, 2020, the total number of active members of all of the State-administered plans decreased by 7,208 or 1.6%, and the total number of retired members increased by 30,406 or 9.7%.

The State sponsors and operates seven defined benefit pension plans (the "Pension Plans"), which fund retirement benefits for almost all of the public employees of the State. The Pension Plans will fund those retirement benefits from their assets, earnings on their assets, contributions by the State and contributions from Pension Plan members. Local governments within the State participate as employers sponsoring two of the Pension Plans. In both of these Pension Plans, the assets that the State and the local governments contribute are invested together and generate one investment rate of return. However, both of these Pension Plans segregate the active and retired members and the related actuarial liabilities between the State and the local governments.

The State makes contributions to the Pension Plans under the State statutes and such contributions are subject to the appropriation of the State Legislature and actions by the Governor. Under the Pension Contribution Act, the State, beginning in Fiscal Year 2018, is required to make its contributions to the Pension Plans in quarterly installments on September 30, December 31, March 31 and June 30. The State has contributed to the State's lottery and related assets, including intellectual property (the "Lottery Enterprise") to three of the Pension Plans under the LECA, pursuant to which the net proceeds of the Lottery Enterprise are available to pay retirement benefits of the applicable Pension Plans without further action by the State Legislature or the Governor.

As a result of lower-than-recommended contributions by the State to the Pension Plans for an extended period, lower than assumed investment returns on an actuarial basis, benefit enhancements enacted during the late 1990s and early 2000s, and reductions in member contributions, the Pension Plans experienced a deterioration in their financial condition. As a result, the State believes that, in addition to the existing assets of the Pension Plans, the expected earnings on those assets, and

contributions from members of the Pension Plans, the State will need to make significantly larger contributions to the Pension Plans in the future to ensure that the Pension Plans will have a sufficient amount of assets to fund expected retirement benefits.

The State has followed a funding policy for the Pension Plans since 2016, which was to increase its contribution to the Pension Plans by 10% of the actuarially recommended contribution each Fiscal Year until the State contributes 100% of the actuarially recommended contribution, which, as of April 9, 2021, was expected to occur in the Fiscal Year ending June 30, 2023, and then to contribute the full actuarially recommended contribution for each Fiscal Year thereafter. As of April 9, 2021, the State expected that it would contribute 78% of the actuarially recommended contribution to the Pension Plans for Fiscal Year 2021. The Governor's Fiscal Year 2022 Budget Message recommends a full contribution to the Pension Plans in Fiscal Year 2022. If approved by the State Legislature, the State will resume making full contributions one year sooner than anticipated under the funding policy followed by the State since 2016.

The State contributed its Lottery Enterprise to the Pension Plans as of June 30, 2017 and the State's contributions to the Pension Plans are offset each fiscal year by a statutorily fixed amount until the fiscal year ending June 30, 2023, when the amount of the State's contributions will be offset by a lower amount designed to increase the funded ratio of the Pension Plans.

Pension Plan Assets

As of June 30, 2020, the State's portion of the market value of assets in the Pension Plans was $35.3 billion, which amount does not include the value of the Lottery Contribution (defined below). The Division of Investment of the New Jersey Department of the Treasury invests the cash and investments of the Pension Plans. State law and State Investment Council regulations regulate the types of investments which are permitted. The State Investment Council is responsible for formulating the policies that govern the methods, practices and procedures for investments, reinvestments, sale or exchange transactions to be followed by the Director of the Division of Investment. However, pursuant to *L. 2018, c. 55*, responsibility for formulating investment policies of the assets of the PFRS will be transferred from the State Investment Council to the twelve-member PFRS Board of Trustees.

Lottery Enterprise Contribution Act

In accordance with the LECA and a Memorandum of Lottery Contribution dated July 5, 2017 and effective as of June 30, 2017 (the "MOLC"), executed by the State Treasurer and acknowledged by the Director of the Division of Investment, New Jersey Department of the Treasury, the Lottery Enterprise was contributed to TPAF, PERS, and PFRS for a 30-year term (the "Lottery Contribution"). Under LECA, the Department of the Treasury, Division of the State Lottery ("State Lottery Division") will continue to operate the Lottery Enterprise with a goal of maximizing net proceeds for the benefit of the applicable Pension Plans. Starting on October 1, 2013, Northstar New Jersey Lottery Group, LLC ("Northstar NJ") officially began a 15-year contract to provide growth management services to the State Lottery Division. The Northstar NJ contract, which will remain in effect through the end of Fiscal Year 2029, contains incentives for the vendor to maximize net proceeds while reducing downside risk through minimum payment requirements imposed on the vendor.

Neither LECA nor the MOLC contain a provision permitting the termination of the contribution prior to the end of the 30-year term of the contribution. However, a future Legislature could pass legislation to reverse the contribution prior to the expiration of its term. Any termination of the Lottery Contribution could implicate the exclusive benefit rule of the Internal Revenue Code, which requires the assets of the Pension Plans to exist for the exclusive benefit of their members in order for the Pension Plans to qualify for the favorable tax treatment under the Internal Revenue Code. Based on a 1996 settlement with the Internal Revenue Service, the State's Pension Plan statutes include the exclusive benefit provisions required by the Internal Revenue Code. The term of the contribution of the Lottery Enterprise will expire at the start of Fiscal Year 2048, and the Lottery Enterprise will revert back to the State at that time.

Benefits

Almost all State employees participate in one of the Pension Plans, with eight to ten years of employment required before retirement benefits become vested. The level of retirement benefits varies among the different Pension Plans and is calculated based on a member's years of service, compensation and age of retirement. State law provides that the retirement benefits of the Pension Plans are not subject to negotiations between the State and other public employers and the employee members of the Pension Plans. The State Legislature has in the past adopted laws that increased the retirement benefits payable by the Pension Plans and may do so in the future.

Historical Funding Policy

The level of the State's annual contributions has significantly varied since the 1990's. In some years, the State's contribution to the Pension Plans have been minimal or none. In other years, the State has contributed a percentage of the actuarially recommended contribution.

Post-Retirement Medical Benefits for State Employees

In addition to the pension benefits, the State provides PRM benefits for certain State and other retired employees meeting the service credit eligibility requirements. This includes retired State employees of PERS, TPAF, PFRS, State Police Retirement System, Judicial Retirement System, and Alternate Benefit Program; local retired TPAF and other school board employees; and some local PFRS retirees.

To become eligible for this State-paid benefit, a member of these Pension Plans must retire with 25 or more years of pension service credit or on a disability pension. These benefits are provided through the State Health Benefits Program ("SHBP") and the School Employees' Health Benefits Program ("SEHBP"). The SHBP and the SEHBP are administered by the Division of Pensions and Benefits. The benefits provided include medical, prescription drug, and Medicare Part B and Part D reimbursement for covered retirees, spouses and dependents. In Fiscal Year 2024, the State paid PRM benefits for 161,268 State and local retirees.

The State funds PRM benefits on a "pay-as-you-go" basis, which means that the State does not pre-fund, or otherwise establish a reserve or other pool of assets against the PRM expenses that the State may incur in future years. For Fiscal Year 2024, the State contributed $2.3 billion to pay for "pay-as-you-go" PRM benefit costs incurred by covered populations, a slight increase from $2.1 billion in Fiscal Year 2023. The State has appropriated $2.4 billion in Fiscal Year 2025 as the State's contribution to fund increases in prescription drugs and medical claims costs.

Debt Service on General Obligation Bonds and State Appropriation Obligations

The total Fiscal Year 2022 recommended appropriation for debt service on General Obligation Bonds and State Appropriation Obligations is $4,352 million. Of this amount, $395.2 million represents principal and interest payments for General Obligation Bonds.

The Governor's Fiscal Year 2022 Budget Message recommends appropriations for debt service on State Appropriation Obligations in the aggregate amount of $3,957 million. Such recommended appropriations are contained within the multiple functional categories, including State Aid, Grants-in-Aid, Direct State Services and Capital Construction.

Risk Factors That May Affect Fiscal Year 2021 Appropriations and Fiscal Year 2022 Recommended Appropriations

Fiscal Year 2022 recommended appropriations are based on an estimate of various costs. There are various risk factors that could result in expenditures being significantly higher or lower than current forecasts such as increased COVID-19 pandemic-related expenditures associated with federal aid, as well as future COVID-19 pandemic mitigation and response expenditures, including testing, treatment, and vaccination delivery.

Cybersecurity

The New Jersey Office of Information Technology, as the State's centralized infrastructure technology provider, has put in place multiple measures to minimize cyber threats, which include working in conjunction with the New Jersey Office of Homeland Security and Preparedness' cybersecurity division. These measures are recognized as industry-leading modern cyber protection mechanisms and serve to reduce the risk of successful cyber-attacks upon the State's information technology assets. However, despite these measures, it is recognized in the cybersecurity industry that no amount of preventative countermeasures and security features can successfully prevent 100% of all cyber-attacks. In addition, the State has purchased cyber breach insurance that covers professional services necessary to respond to a cybersecurity breach.

As the majority of the State's workforce has shifted to remote work, the State has experienced COVID-19 pandemic-themed email threats. In addition to its multi-stage mail filtering solution, the State worked to mitigate email risks by increasing security awareness training, communications, and phishing simulation exercises. The State recognizes that having employees work from home utilizing their home networks rather than at their State offices location and through the State network that has

defense-in-depth protections, introduces additional risks. As of April 9, 2021, the State had not identified any increase in malware infections or compromises of endpoints that were being operated from home networks. Employees were continuously being provided with threat identification and risk mitigation communications, and the State security operations center had increased monitoring for all threats.

Health Benefits

Fiscal Year 2022 recommended appropriations for employee health benefits and PRM benefits assume $51 million in savings from new planned reforms, including setting pre-determined pricing for certain medical services and requiring that an entire course of medical treatment for certain procedures be conducted at facilities that offer sustained quality performance in a particular area of medicine. The Fiscal Year 2022 recommendation also includes $37.3 million of savings from changes implemented in January 2021, including new health plans for educator early retirees with out-of-network reforms, new Medicare Advantage rates and a closed formulary for Medicare-eligible educators. As of April 9, 2021, there had been $146 million of Coronavirus Relief Fund ("CRF") monies allocated to State Health Benefits for COVID-19 related medical claims.

Other Factors

In recent years, the need for the Tort Claims Liability Fund and the Medical Malpractice Self-Insurance Fund for Rutgers, The State University of New Jersey ("Rutgers"), Rowan University ("Rowan") and University Hospital in Newark, New Jersey ("University Hospital") has exceeded originally appropriated levels.

In Fiscal Year 2022, medical costs for NJ FamilyCare and for State employee health care costs could fluctuate based on actual utilization rates and varying prescription drug prices and rebates. The State contracts with managed care organizations to provide services to most NJ FamilyCare clients, which includes the cost of the home and community-based services portion of managed long-term services and supports. In addition, NJ FamilyCare resources assume recoveries from fraud, national settlements, pharmaceutical rebates, and other sources that have been historically difficult to predict. Projected costs in these areas are closely monitored and constantly updated.

The Governor's Fiscal Year 2022 Budget Message also includes enhanced federal Medicaid matching funds of 6.2% through December 31, 2021, under the Families First Coronavirus Response Act ("FFCRA"). Should there be a change in the federal Public Health Emergency period, and a reduction in this matching rate, State supplemental appropriations may be required to support the costs.

The cost of community-based services for clients with intellectual and developmental disabilities could fluctuate and may require supplemental funding in Fiscal Year 2022. This cost depends on the amount of services clients need during the year, including emergency residential placements. Projected costs in this area are closely monitored and constantly updated.

Contracts for various Executive Branch employees and Judicial Branch employees are in various stages of negotiations.

A base allocation of $10 million for winter operations is included in the Governor's Fiscal Year 2022 Budget Message. The Budget Director is authorized to provide supplemental appropriations for costs in excess of the base. Between Fiscal Years 2018 and 2021, these annual supplemental appropriations have averaged approximately $68.7 million.

In order to partially accommodate the increase in formula aid provided to school districts that were identified as underfunded per the modified school funding formula, $197.0 million was reduced from the appropriation to school districts considered overfunded. The reduction in funding may lead to fiscal distress in these school districts which could require Emergency Aid funding in order to fully support Fiscal Year 2022 needs. However, the Fiscal Year 2022 budget includes $50 million of Stabilization Aid to help assist districts transition to the reduction schedule of the modified school funding formula.

The Coronavirus Response and Relief Supplemental Appropriations Act, 2021 ("CRRSA") appropriated additional federal support under the Elementary and Secondary School Emergency Relief Fund (the original round of authorized funds referred to herein as "ESSER" and the second round of authorized funds referred to herein as "ESSER II"), and the Governor's Emergency Education Relief Fund ("GEERF II"), to supplement funds provided under the CARES Act to address the impact of COVID-19 on elementary, secondary and higher education. CRRSA requires states that receive these funds to maintain support for elementary and secondary education and higher education in Fiscal Year 2022 based on the proportional share of the State's support for those same categories averaged over Fiscal Years 2017 through 2019. The U.S. Department of Education has provided limited guidance on this maintenance of effort ("MOE") requirement. However, based on that limited guidance, New Jersey does

not meet the MOE as it relates to higher education. Although New Jersey may request a waiver, it is uncertain if New Jersey will qualify for a waiver. It is uncertain how New Jersey will need to rectify the MOE issue. It is possible New Jersey may have to pay some portion of funding back to the federal government.

The American Rescue Plan Act ("ARP") also provides funding under ESSER ("ARP ESSER"), and contains a similar MOE provision, which the State currently meets for elementary and secondary education, but does not meet for higher education, as previously noted. However, like the CRRSA, ARP does allow the State to apply for a waiver. As of April 9, 2021, it was unknown how funds would be repaid by the State if the waiver is not approved. In addition, the ARP ESSER also contains a maintenance of equity provision that does not allow the State to reduce per pupil funding for the highest need districts in either Fiscal Year 2022 or 2023 by more than any per pupil reduction across all districts, and requires that the State maintain the per pupil funding for the highest need districts at least at the Fiscal Year 2019 amount. Local school districts must also meet a maintenance of equity requirement. The State may not meet the maintenance of equity provision in Fiscal Year 2022, and there is no waiver provision for maintenance of equity. As of April 9, 2021, it was unknown how the federal government would respond to States and or districts that cannot meet this requirement.

Following enactment of the Appropriations Act, the State closely monitors revenues and expenditures, comparing actual results to projections. Such monitoring has identified where actual expenditures and commitments in various items of appropriation have been less than originally anticipated. Though the factors above could require certain supplemental appropriations in Fiscal Years 2021 and 2022, identified budget savings have offset fully or substantially the need for supplemental appropriations in prior fiscal years. In the past, factors resulting in such budget savings have included, but have not been limited to: attrition of the State workforce; trend changes in the marketplace; and shifts in demographics and service beneficiaries' utilization rates. Consistent with past experience, it is likely that certain appropriations will exceed actual expenditures and commitments by the close of Fiscal Year 2022, allowing for flexibility to either fully or substantially address the need for other appropriations that arise through the course of the fiscal year, or to add to the undesignated fund balance.

REVENUE SOURCES AND STATE FUNDS

Governmental Funds

Governmental funds finance most Direct State Services, which support the normal operations of State government. The governmental funds' financial statements focus on current inflows and outflows of expendable resources and the unexpended balances at the end of a fiscal year that are available for future spending. Governmental fund information helps determine whether or not there was an addition or a reduction in financial resources that can be spent in the near future to finance State programs.

The State's governmental funds are the General Fund, which receives revenues from taxes that are unrestricted by statute, most federal revenue and certain miscellaneous revenue items; the Property Tax Relief Fund, which receives revenues from the New Jersey Gross Income Tax and revenues derived from a tax rate of 0.5% imposed under the Sales and Use Tax both of which are constitutionally dedicated toward property tax relief and reform; the Special Revenue Funds, which are used to account for resources legally restricted to expenditure for specified purposes; and the Capital Projects Funds, which are used to account for financial resources to be used for the acquisition or construction of major State capital facilities. The Capital Projects Funds includes the Special Transportation Fund which is used to account for financial resources for State transportation projects. These funds are reported using the modified accrual basis of accounting, which measures cash and all other financial assets that can readily be converted to cash.

Property Tax Relief Fund

The Property Tax Relief Fund is used to account for revenues from the New Jersey Gross Income Tax and for revenues derived from a tax rate of 0.5% imposed under the Sales and Use Tax that is constitutionally dedicated toward property tax reform. Revenues realized from the Gross Income Tax and derived from a tax rate of 0.5% imposed under the Sales and Use Tax are dedicated by the State Constitution. All receipts from taxes levied pursuant to the New Jersey Gross Income Tax on personal income of individuals, estates, and trusts must be appropriated exclusively for the purpose of reducing or offsetting property taxes. Annual appropriations are made from the Fund, pursuant to formulas established by the State Legislature, to counties, municipalities and school districts. The Property Tax Relief Fund was established by the New Jersey Gross Income Tax Act, *N.J.S.A.* 54A:9-25, approved July 8, 1976.

Proprietary Funds

Proprietary Funds are used to account for State business-type activities. Since these funds charge fees to external users, they are known as enterprise funds.

Fiduciary Funds

Fiduciary Funds, which include the State's Pension Plans, are used to account for resources held by the State for the benefit of parties outside of State government. Unlike other government funds, fiduciary funds are reported using the accrual basis of accounting.

Component Units

Component Units-Authorities account for operations where the intent of the State is that the cost of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges, or where periodic measurement of the results of operations is appropriate for capital maintenance, public policy, management control or accountability. Component Units-Colleges and Universities account for the operations of the eleven State colleges and universities including their foundations and associations.

Federal Aid

Federal Aid Receipts

In general, federal aid receipts in the General Fund and Special Transportation Fund of the State do not have a material impact on the financial condition of the General Fund of the State because federal aid receipts are required to be applied to specific designated expenditures, and the amount of federal aid receipts matches the amount of such expenditures. In some circumstances, federal aid receipts do impact the General Fund because they offset expenditures that the State would otherwise be required to make. In addition, with respect to many of the programs pursuant to which the State receives federal aid, the State is subject to audits of the expenditures to ensure that the State complied with the program requirements. In instances in which the State makes expenditures in violation of program requirements, the State may be obligated to repay the federal government the amounts of such expenditures and other associated amounts.

Actual federal aid receipts in the General Fund and Special Transportation Fund for Fiscal Years 2018 through 2020, which are non-budgeted revenues, amounted to $14,408.3 million, $14,951.7 million and $16,414.2 million, respectively. As of April 9, 2021, federal receipts in the General Fund and the Special Transportation Fund for Fiscal Year 2021 and for Fiscal Year 2022 were estimated to be $17,851.9 million and $19,210.4 million respectively. Such federal aid receipts for Fiscal Year 2022 are composed of $12,564.4 million for health related family programs under Titles XIX and XXI, $1,236.9 million for other human services, $966.7 million for Title I and other education, $541.9 million for labor, $1,147.8 million for transportation, and the remainder for all other federal aid programs.

Any changes by the federal government in how census data is collected and utilized may impact certain census data-based future federal awards made to New Jersey.

Federal Coronavirus Relief Aid

The CARES Act established a $150 billion CRF. The State received approximately $2.4 billion in CRF funds. These funds are subject to the CARES Act and guidance from the U.S. Department of the Treasury on eligible uses of these funds. The CARES Act required that the payments from the CRF only be used to support unbudgeted, COVID-19 expenses that were incurred between March 1 and December 30, 2020. On December 27, 2020, CRRSA was enacted, which amended and supplemented the CARES Act. One of the changes in CRRSA was to extend the CRF deadline from December 30, 2020 to December 31, 2021. Following these guidelines, as of April 9, 2021, the State had plans to expend the funds in the following categories: Payroll, Health Benefits and State Capacity; Child Care, K-12 and Higher Education; Social Services and Health Care Supports; COVID-Related Emergency Spending; and Local Government, Economic Development, and Housing Assistance. Any CRF funding that is not expended on costs incurred between March 1, 2020 and December 31, 2021 must be returned to the U.S. Department of the Treasury.

In addition to the CRF, other federal funds are available to help mitigate the financial pressures of COVID-19. Under the Robert T. Stafford Relief and Emergency Assistance Act, the President declared a nationwide emergency for COVID-19, which

allows New Jersey to apply for public assistance reimbursements from FEMA. As of April 9, 2021, New Jersey had at least $750 million in funding available to support 100% of qualifying expenditures. The FFCRA provides a temporary 6.2 percentage point increase to qualifying Federal Medical Assistance Percentage ("FMAP") effective beginning January 1, 2020 and extending through the last day of the calendar quarter in which the public health emergency terminates. New Jersey had been awarded approximately $1,090 million as of March 24, 2021 but, as of April 9, 2021, was expecting to continue to receive the enhanced FMAP through December 31, 2021. In order to qualify for the enhanced FMAP, states must maintain eligibility standards that are no more restrictive than those in place as of January 1, 2020; not charge premiums that exceed those in places as of January 1, 2020; cover, without cost sharing, testing, services and treatment related to COVID-19; and not terminate individuals from Medicaid if they were enrolled at the beginning of the emergency period. The federal government by means of the Paycheck Protection Program and Health Care Enhancement Act of 2020 is awarding a total of $10.25 billion nationally to support a broad range of COVID-19 testing and epidemiologic surveillance related activities. New Jersey has received approximately $614 million of these funds. CRRSA has provided an Emergency Rental Assistance ("ERA") program to assist households that are unable to pay rent and utilities due to the COVID-19 pandemic. New Jersey has been awarded $344 million to support the ERA program. The CARES Act also authorized an Elementary and Secondary School Emergency Relief Fund, with funds allocated to State educational agencies to provide funding to local educational agencies to address the impact of COVID-19. New Jersey was awarded $310 million in ESSER funds. CRRSA authorized ESSER II, and, as of April 9, 2021, New Jersey had received $1.231 billion in funds with a period of performance through September of 2023. There are numerous other federal aid grants that have been allocated to various State departments and agencies. Taking into account all available federal relief aid, as of March 24, 2021, New Jersey had received almost $23.5 billion in federal aid grant awards including awards that went directly to the New Jersey Department of Labor and Workforce Development ("DOLWD").

As with all federal aid grants, the expenditure and use of these funds will be subject to federal audit. As of April 9, 2021, the State was utilizing a host of internal controls and documentation to ensure, to the greatest extent possible, that the expenditure of funds complied with the federal regulations and guidance.

State Unemployment Insurance Trust Fund

In Fiscal Year 2018, the Unemployment Insurance Trust Fund (the "Trust Fund"), which provides funding for unemployment benefits in the State, received approximately $2.1 billion in contributions from employers and workers while paying out approximately $2.0 billion in regular, annual State unemployment benefits (excluding benefits paid entirely by the federal government) on a cash basis. In Fiscal Year 2019, contributions from employers and workers were approximately $2.0 billion, while regular State unemployment benefits were $1.9 billion. In Fiscal Year 2020, contributions from employers and workers were approximately $2.0 billion, while regular State unemployment benefits were $4.3 billion. As of June 30, 2020, the State's Trust Fund balance, on a cash basis, was approximately $0.9 billion.

Under State law, the State unemployment tax rate charged to employers during a fiscal year is determined by State statutory formula based on the status of the Trust Fund in relation to total taxable wages as of March 31st of the preceding fiscal year. For Fiscal Year 2021, the statutorily calculated employer tax rate remains the same as Fiscal Year 2020. The minimal base Federal Unemployment Tax Act rate did not change and remains at 0.6%. The employee State unemployment rate did not change and remains at 0.38%.

Pursuant to Article VIII, section 2, paragraph 8 of the State Constitution, all contributions collected by the State from any employer or employee for the Trust Fund are dedicated solely to the purpose of providing and administering unemployment benefits.

As a result of the COVID-19 pandemic, from March 15, 2020 to March 11, 2021, there have been approximately 2.0 million initial UI claims filed. Unemployed State residents are benefiting from multiple UI benefit enhancements as provided for in the CARES Act, which are 100% federally funded. Due to the large increase in claims activity, the State borrowed $704 million in Calendar Year 2020 and an additional $182 million in January and February 2021, bringing the loan balance to $886 million as of February 28, 2021. These advances will be interest free through September 6, 2021.

Due to the tremendous influx of UI data and the related output of UI benefits, there has been an increase in the number of suspected fraudulent claims for UI benefits in the State. The State understands that suspected fraudulent UI claims have become a national problem. As of April 9, 2021, the DOLWD was working to develop preventative safeguards to limit fraudulent payments and the State Treasurer was monitoring these developments.

Programs Funded Under Recommended Appropriations in Fiscal Year 2022

$44,832 million is recommended for Fiscal Year 2022 from the General Fund, the Property Tax Relief Fund, the Casino Control Fund, the Casino Revenue Fund and the Gubernatorial Elections Fund. $19,986 million (45%) is recommended for State Aid, which consists of payments to, or on behalf of, local government entities including counties, municipalities and school districts, to assist them in carrying out their local responsibilities. $13,067 million (29%) is recommended for Grants-in-Aid, which represents payments to individuals or public or private agencies for benefits to which a recipient is entitled by law or for the provision of services on behalf of the State. $9,450 million (21%) is recommended for Direct State Services, which supports the operation of the State government's departments, the Governor's Office, several commissions, the State Legislature and the Judiciary. $1,934 million (4%) is recommended for Capital Construction, which supports capital construction pay-as-you-go and debt service on bonds issued to fund capital construction. $395 million (1%) is recommended for Debt Service on State General Obligation Bonds.

In Fiscal Year 2022, $5,292 million is recommended to the Pension Plans from State funds. This recommendation does not include the impact of the Lottery Enterprise contribution.

Capital Construction

All recommended appropriations for capital projects were subject to the review of the Commission which voted to recommend such funding at its meeting on February 18, 2021. The Commission is charged with the preparation of the State's seven-year Capital Improvement Plan. The Capital Improvement Plan is a detailed account of capital construction projects requested by State departments, agencies and institutions of higher education for the next three fiscal years and forecasts as to the requirements for capital projects for the four fiscal years following. The Capital Improvement Plan includes the Commission's recommendations as to the priority of such capital projects and the means of funding them. The Capital Improvement Plan is also required to include a report on the State's overall debt. This debt report includes information on the outstanding general obligation debt and debt service costs for the prior fiscal year, the current fiscal year, and the estimated amount for the subsequent five fiscal years. The report also provides similar information on capital leases and installment obligations. *L.* 2009, *c.* 304, enacted in January 2010, requires that the debt report also include data on other State liabilities as reported in the CAFR, as well as the unfunded actuarial accrued liability for pension plans and the actuarial accrued liability for other post-employment medical benefits. The debt report is not an audited report.

For Fiscal Year 2022, requests for Capital Construction funding were substantially higher than the amount recommended by the Commission. The recommended appropriations for Capital Construction contained in Fiscal Year 2022 are largely based on the recommendations of the Commission. There can be no assurance that the amounts ultimately appropriated are sufficient to maintain or improve the State's capital facilities and infrastructure assets, or that such capital funding requests will not be substantially greater in future years.

Transportation Capital Program

L. 2016, *c.* 56, provides for an eight (8) year, $16 billion Transportation Capital Program between Fiscal Year 2017 and Fiscal Year 2024. The Governor's Fiscal Year 2022 Budget Message includes a $2 billion Transportation Capital Program for NJDOT, NJTC and local governments.

Debt Service on General Obligation Bonds and State Appropriation Obligations

The total Fiscal Year 2022 recommended appropriation for debt service on General Obligation Bonds and State Appropriation Obligations is $4,352 million. Of this amount $395.2 million represents principal and interest payments for General Obligation Bonds.

The Governor's Fiscal Year 2022 Budget Message recommends appropriations for debt service on State Appropriation Obligations in the aggregate amount of $3,957 million.

LITIGATION

The following are cases pending or threatened, as of April 9, 2021, in which the State has the potential for either a significant loss of revenue or a significant unanticipated expenditure.

Abbott v. Burke (Motion in Aid of Litigants' Rights). On January 28, 2021, the State Defendants (consisting of the Commissioner of Education and the Schools Development Authority ("SDA")) received a motion in aid of litigants' rights filed by

the Education Law Center (the "ELC") seeking an order from the New Jersey Supreme Court to compel the State Defendants to seek and secure by June 30, 2021, from the Legislature school construction funding as is needed and required to manage, undertake, and complete the school facilities projects in the SDA 2019 Statewide Strategic Plan. The motion also seeks for the State Defendants to seek and secure funds from the Legislature by June 30, 2021, for health and safety projects, including those necessary to ensure the safe reopening and operation of school buildings in SDA Districts during the ongoing COVID-19 health crisis. The ELC is seeking to enforce the school facilities construction funding mandate set forth in *Abbott v. Burke*, 153 N.J. 480 (1998) and *Abbott v. Burke*, 164 N.J. 84 (2000). State Defendants filed its opposition to the motion on March 22, 2021. As of April 9, 2021, the State was vigorously defending this matter.

East Cape May Associates v. New Jersey Department of Environmental Protection. This matter is a regulatory taking case in which the Plaintiff claims that it is entitled to in excess of $30 million in damages for a taking of its property without just compensation. The property is approximately 96 acres of freshwater wetlands in the City of Cape May. Plaintiff filed its complaint in Superior Court, Law Division, on December 8, 1992, after the New Jersey Department of Environmental Protection ("DEP") denied an application for 366 single family homes. On motion for summary judgment, the trial court ruled that the State was liable for a regulatory taking as of December 1992. Thereafter, the New Jersey Appellate Division held that DEP could avoid liability by approving development on the property under Section 22(b) of the Freshwater Wetlands Protection Act. In addition, the Appellate Division remanded the case for a determination of whether the "property" also included a 100-acre parcel previously developed by the Plaintiff's principals. On remand from the Appellate Division, the trial court ruled on October 8, 1999 that the "property" did not include the 100 acre-parcel previously developed, and that the DEP could not approve development of the 80 remaining acres without first adopting rules. Since the DEP had not adopted rules, the trial court held that DEP's development offer of 64 homes on the 80 acres was ineffective and DEP was liable for a taking of the property. DEP filed an appeal of the trial court's decision and East Cape May Associates filed a cross-appeal. On July 25, 2001, the Appellate Division affirmed the trial court's decision, and found that before DEP could approve limited development to avoid a taking, it was required to adopt rules. The Appellate Division remanded the case for such rule-making, the making of a development offer under the rules, and a determination by the trial court as to whether the new offer complies with the rules and avoids a taking. Upon remand from the Appellate Division, DEP promulgated regulations to implement Section 22(b), which took effect on January 22, 2002. On July 1, 2009, the parties reached a settlement of the case, and submitted a consent order and stipulation of dismissal to the trial court contingent upon federal approval from the United States Army Corps of Engineers. The relevant federal agencies expressed opposition to the proposed settlement. On May 25, 2012, East Cape May Associates served notice asserting its rights to terminate the settlement, demanding that within 60 days DEP initiate the reconsideration process. DEP initiated the reconsideration process pursuant to the regulations.

On June 4, 2014, DEP issued an amelioration authorization which approved development of between 80 to 90 dwelling units clustered on approximately 25 acres of land on the 100-acre parcel. The authorization was consistent with municipal residential zoning, requiring conservation of the remaining 75 acres. DEP also required mitigation of 25 acres of barren land to serve the migratory bird species that uses the subject property. Plaintiff reinstated its longstanding complaint in the trial court, claiming that DEP's amelioration authorization was excessive for this type of environmentally sensitive property and therefore did not follow DEP's rules, and was also inadequate to avoid a taking.

Trial was scheduled to begin November 12, 2019, but the new trial court judge *sua sponte* requested emergent briefing on the issue of burden of proof, reversed the decision of the previous judge who had ruled that DEP had the burden of proof, and declared a mistrial. With the burden rightfully placed on Plaintiff, the Plaintiff requested an adjournment of the trial and additional discovery. A new trial date has not been set by the trial court. Surrounding neighbors also formed a nonprofit entity and intervened to challenge the DEP's amelioration authorization. On March 10, 2021, the parties entered into a settlement to resolve this matter.

NL Industries, Inc. v. State of New Jersey. The Raritan Bay Slag Superfund Site (the "Site") is approximately 47 acres of real property located in the Laurence Harbor section of Old Bridge Township and Sayreville. Portions of the Site are located on State riparian lands. In 2012, the United States Environmental Protection Agency ("EPA") informed NL Industries, Inc. ("NL") that EPA believed that slag was generated, in part or in whole, by NL's (then National Lead Industries) lead-smelting facility in Perth Amboy. EPA selected a remediation remedy and named NL as the potentially responsible party subject to enforcement. On March 19, 2014, NL filed an initial complaint for contribution against the State in the Superior Court, Law Division for the costs to remediate the Site. On August 16, 2017, NL filed an amended complaint alleging that in the 1980s the State dredged areas that were impacted by hazardous substances, transported the contaminated sediments and discharged the hazardous substances on

areas of the Site, and that the State had caused, or contributed to, the discharge by virtue of the State's failure, as owner of a portion of the Site, to remove the slag after the enactment of the Spill Compensation and Control Act ("Spill Act"), *N.J.S.A.* 58:10 23.11 *et seq.,* in 1977. In the amended complaint, NL sought declaratory relief as to the State's liability for cleanup and removal costs, including future costs or damages. The State filed its answer denying liability and asserting defenses under the New Jersey Tort Claims Act, *N.J.S.A.* 59:1-1 *et seq*. The State also filed a counterclaim asserting claims under the Spill Act seeking the State's past and future remediation costs, and natural resource damages. Mediation of this matter began in 2018 and, as a result, NL withdrew its complaint and the State withdrew its counterclaim, both without prejudice. As of April 9, 2021, the State continued to mediate this matter with all involved parties. As of April 9, 2021, the State was vigorously defending this matter.

Chapter 7 Trustee for Richard Bernardi, Marilyn Bernardi & Strategic Environmental Partners v. New Jersey Department of Environmental Protection. Richard Bernardi, Marilyn Bernardi, and Strategic Environmental Partners (collectively, "Debtors") are Chapter 7 Debtors in Federal Bankruptcy Court, Trenton. Debtors are the owners/operators of the former "Fenimore Landfill" in Roxbury Township, Morris County. In February 2011, Debtors purchased the landfill property with the stated purpose of closing the landfill and redeveloping it as a solar farm. In conjunction with closure of the landfill, Debtors were authorized to import certain solid waste material. Between November 2012 and June 26, 2013, the DEP investigated over 2500 complaints of noxious hydrogen sulfide gas ("H2S") odors emitting from the landfill. On June 26, 2013, following enactment of the "Legacy Landfill Law," *N.J.S.A.* 13:1 E-125.1 *et seq.,* DEP issued an emergency order authorizing DEP to enter the landfill property to take measures to abate the H2S odors, which the Debtors had failed to control. DEP entered the property and eventually installed a gas collection system, thermal oxidizer and scrubber to capture and destroy the H2S. DEP continues to occupy a portion of the property in order to operate the H2S treatment systems.

In June 2016, the Debtors filed separate bankruptcy petitions under Chapter 11 of the Bankruptcy Code and a trustee was appointed (the "Chapter 7 Trustee"). In July 2017 the matters were consolidated and converted to Chapter 7 bankruptcy. In December 2017, the Chapter 7 Trustee's counsel advised DEP that they were preparing an adversary complaint in Bankruptcy Court against the DEP seeking damages for DEP's take-over. After brief settlement discussions, on June 14, 2018, the Chapter 7 Trustee filed the adversary complaint for unspecified damages, alleging, inter alia, a taking of Debtors' property without just compensation. DEP filed counter-claims seeking costs incurred to date by DEP abating the H2S emissions. As of April 9, 2021, discovery was ongoing and the trial was tentatively scheduled to begin in August 2021. As of April 9, 2021, the State was vigorously defending this matter.

PDX North, Inc., and SLS Delivery Services, Inc. v. Robert Asaro-Angelo (in his capacity as Commissioner of the Department of Labor and Workforce Development). PDX North, Inc. ("PDX") facilitates, brokers and provides distribution and transportation services of wholesale auto parts to auto dealers in the northeast. DOLWD issued three (3) assessments to PDX for unpaid contributions under New Jersey's unemployment compensation law from 2006 to 2015. PDX has challenged those assessments in the New Jersey Office of Administrative Law ("NJOAL").

PDX filed a federal complaint and sought to declare void and permanently enjoin the enforcement of the unemployment compensation tax exemptions set forth in *N.J.S.A.* 43:21-19(i)(6) and -19(i)(7)(X), claiming those statutes are preempted by the Federal Aviation Administration Authorization Act of 1994 ("FAAAA"), 49 *U.S.C.* § 1450l(c). The complaint specifically alleged that PDX was damaged by the imposition of three (3) audit assessments lodged by the DOLWD for unpaid unemployment compensation taxes. PDX also claimed that it would have to substantially change its business model because of its inability to satisfy the exemptions promulgated in *N.J.S.A.* 43:21-19(i)(6) and -19(i)(7)(X).

SLS Delivery Services, Inc. ("SLS") facilitates and provides distribution and transportation services of packages and parcels to national and international carriers. SLS was permitted to intervene in the PDX federal complaint as a plaintiff and SLS sought the same relief as PDX. On July 29, 2019, the U.S. District Court entered judgment in favor of the DOLWD with respect to both the PDX complaint and the SLS complaint. Both PDX and SLS appealed the District Court's decision to the Third Circuit. The appeal was fully briefed and oral argument took place on April 15, 2020. The Third Circuit issued a published decision on October 22, 2020, affirming the District Court's decision in favor of DOLWD with respect to PDX and remanded back to the U.S. District Court as to SLS. PDX filed a petition for certiorari with the U.S. Supreme Court on March 19, 2021. On January 8, 2021, the DOLWD filed a motion for judgement on the pleadings, seeking to dismiss SLS's complaint in its entirety.

With respect to the SLS matter, the parties have agreed to a settlement in principle. As of April 9, 2021, the PDX matter was stayed in the OAL pending the federal matter. As of April 9, 2021, the State was vigorously defending this matter.

Verizon Americas Inc. (fka Vodafone Americas Inc.) v. Director, Division of Taxation. On July 28, 2016, Verizon Americas Inc. ("Verizon") filed a series of Complaints in the Tax Court of New Jersey, contesting the New Jersey Department of the Treasury, Division of Taxation's ("Division") CBT Act, *N.J.S.A.* 54:10A-1 *et seq.*, refund denials. The Division concluded that Verizon was a general partner in a partnership doing business in New Jersey and subject to CBT. In addition, the Division concluded that Verizon is "unitary" with the partnership and, thus, subject to CBT. In the Complaints, Verizon asserts that it is not subject to tax and entitled to a refund for tax years ending December 2002 through March 2014. As of April 9, 2021, the parties were in the discovery stage. As of April 9, 2021, the State was vigorously defending this matter.

Johnson & Johnson v. Director, Division of Taxation and Commissioner, Banking & Insurance. On November 2, 2015, Johnson & Johnson submitted a request to the New Jersey Department of Banking & Insurance and the Division seeking a refund of self-procured insurance premium taxes paid pursuant to *N.J.S.A.* 17:22-6.64 for the period November 1, 2011 through March 31, 2015. Johnson & Johnson obtained its insurance through Middlesex Assurance Company Limited, its captive insurance company domiciled in Vermont. Middlesex Assurance is a nonadmitted insurer, that is, it is not authorized to conduct insurance business in New Jersey. The basis for Johnson & Johnson's refund request is the assertion that the Nonadmitted and Reinsurance Reform Act and, by extension, N.J.S.A. 17:22-6.64, were never intended to apply to captive insurance companies. On August 9, 2016, the Division denied Johnson & Johnson's refund claim. Johnson & Johnson filed a complaint in the Tax Court on October 24, 2016 challenging the Division's denial of the refund claim. The State's answer was filed on February 21, 2017. Both parties moved for summary judgment. The motions were argued in the Tax Court on February 26, 2018. The Tax Court issued a published opinion and order on June 15, 2018, granting summary judgment to the State and dismissing Johnson & Johnson's complaint. Johnson & Johnson filed a notice of appeal with the Appellate Division on July 27, 2018. On September 25, 2019, the Appellate Division reversed the Tax Court decision and remanded the case to the Tax Court for determination of the refund amount due. The State filed a petition for certification with the New Jersey Supreme Court. The Supreme Court granted the petition for certification on February 19, 2020. The New Jersey Supreme Court issued a per curiam opinion on December 7, 2020, affirming the Appellate Division's opinion.

Public Service Electric & Gas Company, Inc. v. Director, Division of Taxation. For tax years 2006 through 2014, Public Service Electric & Gas Company, Inc. ("PSE&G") filed CBT returns and included its transitional energy facility assessment ("TEFA") in its CBT base, in accordance with *N.J.S.A.* 54:10A-4.1. Thereafter, PSE&G recalculated its CBT liability, removed the TEFA from the tax base and sought a CBT refund. Notably, the Appellate Division recently concluded that TEFA payments are included in the CBT base and denied a similar refund claim. *Rockland Elec. Co. v. Director, Div. of Taxation*, 30 N.J. Tax 448 (Tax 2018), aff'd., A-4522-l7T2 (App. Div. June 24, 2019), cert. denied. *Rockland Elec. Co.* is now final and binding upon the Tax Court. The Division denied PSE&G's refund claim. On or about May 28, 2019, PSE&G filed a Complaint in the Tax Court of New Jersey, contesting the CBT refund denial. The Division filed its answer to the complaint. As of April 9, 2021, the State was vigorously defending this matter.

Stanislaus Food Products Co. v. Director, Division of Taxation. On or about July 31, 2017, Stanislaus Foods filed a complaint in the Tax Court contesting the constitutionality of the CBT's Alternative Minimum Assessment ("AMA") component. For periods after June 30, 2006, the AMA is $0, except for foreign corporations protected from income tax by the Interstate Income Act of 1959, *P.L.* 86-272. Stanislaus Foods alleges the AMA discriminates against foreign corporations in violation of the federal constitution's Dormant Commerce Clause and Supremacy Clause. The parties filed partial cross-motions for summary judgment. On June 28, 2019, the Tax Court concluded that the AMA, for periods after June 30, 2016, conflicts with the mandates of *P.L.* 86-272, and thus, violates the federal Supremacy Clause. The remainder of the case continues to proceed in Tax Court to address remaining non-constitutional issues. The Division filed a motion for reconsideration on March 2, 2020, and the Tax Court heard oral argument on June 19, 2020. As of April 9, 2021, the Tax Court had not yet issued its decision. As of April 9, 2021 the State was vigorously defending this matter.

Cargill Meat Solutions Corporation. v. Director, Division of Taxation. Plaintiff, based out of Kansas, sells meat products and services throughout the United States. Plaintiff does not engage in meat processing or packaging in New Jersey. Rather, its operations in New Jersey are limited to storage and distribution, as it arranges for delivery of its products to a 180-mile radius market covering portions of Pennsylvania, New Jersey, New York and Maryland. In calculating its New Jersey Litter Control Fee

liabilities, Plaintiff took a $465 million deduction in 2014 and $509 million deduction in 2015, claiming its sales to wholesalers are not subject to the Litter Control Fee under *N.J.S.A.* 13:1E-216(a), the wholesaler-to-wholesaler exception. The Division disallowed these deductions, finding that the Plaintiff was not entitled to the wholesaler-to-wholesaler exception because even though Plaintiff's sales were all to wholesalers, the Plaintiff is a manufacturer and, thus, not entitled to a wholesaler exemption. The Division imposed additional Litter Control Fee to comport with the disallowance of the deductions. Plaintiff filed a complaint with the Tax Court contesting the denial of the deduction and, to invalidate the additional Litter Control Fee assessment by challenging the facial constitutionality of the Litter Control Fee statute. The Division filed an answer on July 16, 2018, and on June 14, 2019, filed a motion to dismiss the facial constitutional challenge to the Litter Control Fee. On March 12, 2020, the court granted the Division's motion. As of April 9, 2021, oral argument was scheduled for April 16, 2021. As of April 9, 2021, discovery was ongoing and the State was vigorously defending this matter.

Gomez v. DCPP et al. On March 12, 2012, the Plaintiff child was allegedly assaulted by her biological father, suffering severe injuries. Plaintiff alleged that the New Jersey Department of Children Protection and Permanency ("DCPP") knew that the Plaintiff's parents had a history of drug and alcohol abuse, psychiatric problems and were unemployed. The biological mother had two other children removed from her care and was in a methadone program when the Plaintiff was born. The biological father also had an extensive criminal history of domestic violence. Plaintiff claims DCPP failed to comply with its own policy and procedure, failed to remove the Plaintiff from the home, negligent training, violation of the New Jersey Child Placement Bill of Rights, and Section 1983 claims. The complaint was filed in State court on February 12, 2015. On March 11, 2015, DCPP removed the case to the U.S. District Court for the District of New Jersey and filed a motion to dismiss the complaint. The State's motion to dismiss the complaint was denied without prejudice on May 8, 2015. The Plaintiff agreed to withdraw the federal claims and the matter was remanded to State court. As of April 9, 2021, discovery was ongoing and the State was vigorously defending this matter.

J.A. v. Monroe Township Board of Education. On May 23, 2018, Plaintiffs filed a complaint in the U.S. District Court for the District of New Jersey naming the New Jersey Department of Education ("NJDOE"), NJOAL, Commissioner of Education, and Administrative Law Judge Jeffrey R. Wilson (collectively, the "State Defendants") as well as the Monroe Township Board of Education, as defendants. Plaintiffs purport to bring class action claims against State Defendants under the Individuals with Disabilities Education Act ("IDEA") *P.L.* 101-476 and 42 *U.S.C.* § 1983 alleging two (2) separate systemic violations of the IDEA. Plaintiffs also sought to bring a class action declaratory judgment claim against State Defendants and to appeal three (3) separate interlocutory orders of the Administrative Law Judge. Among other things, Plaintiffs seek the following relief: (1) a trust fund to provide educational services to all class members for the denial of a Free and Appropriate Public Education ("FAPE") as such term is defined in IDEA; (2) a trust fund to reimburse class members for the denial of a FAPE; (3) punitive damages; and (4) attorneys' fees and costs.

State Defendants filed a motion to dismiss. Plaintiffs opposed that motion and subsequently filed a motion to amend the complaint, seeking to add additional plaintiffs and a claim for "Federal Preemption". The proposed amended complaint sought the same relief as the original complaint. As of April 9, 2021, the U.S. District Court has yet to issue a decision on the State Defendants' motion to dismiss and the Plaintiffs' motion to amend the complaint.

The State Defendants renewed the motion to dismiss the amended complaint. With that motion pending, Plaintiffs filed a motion on May 30, 2020, seeking to supplement the record with the opinion and transcript of the motion to dismiss decision filed in *C.P., et al. v. NJDOE, et al*., 1:19-cv-12807 (NLH/KMW) ("C.P."). (C.P. is a related matter with similar claims, but only seeks injunctive and declaratory relief). On June 28, 2020, the U.S. District Court denied the State Defendants motion to dismiss without prejudice and ordered the parties to show cause as to why this matter should not instead be consolidated with the C.P. matter. Both parties opposed consolidation and Plaintiffs instead proposed to stay this matter until the C.P. matter has been fully litigated and appealed. However, as April 9, 2021, Plaintiffs had not yet filed a motion for a stay. As of April 9, 2021, the U.S. District Court had not issued a formal order or decision on this State Defendants' motion to dismiss the amended complaint, and the State Defendants' time to answer the amended complaint had been extended until such time as the U.S. District Court does so. As of April 9, 2021, the State was vigorously defending this matter.

J.A. v. Monroe Township Board of Education, et al. United State District Court for the District of New Jersey, (NLH/KMW). On July 28, 2020, Plaintiff J.A., individually and on behalf of her minor child J.A., filed a complaint in the New Jersey District Court naming the NJDOE, NJOAL, Kevin Dehmer, Interim Commissioner of Education, Administrative Law Judge MaryAnn Bogan, Administrative Law Judge Joseph A. Ascione and NJDOEs 1-250 Similarly Situated Administrative Law Judges,

as well as the Monroe Township Board of Education (collectively, "Defendants"). Plaintiff's Complaint alleges various systemic violations of the IDEA and 42 *U.S.C.* § 1983; a claim of discrimination under the Americans with Disabilities Act of 1990, 42 *U.S.C.* §12101 et seq.; and a claim of retaliation pursuant to Section 504 of the Rehabilitation Act of 1973, 29 *U.S.C.* §701 et seq. Plaintiff also seeks to appeal a final decision and order of ALJ Ascione's ruling in *Monroe Twp. Bd. of Ed. v. J.A. et al.*, OAL Dkt. No. EDS 04281-2020S (the subject of this litigation). Plaintiff seeks declaratory and injunctive relief and monetary relief as follows: (1) damages in the amount of $400,000,000; (2) punitive damages in excess of $4,500,000,000; (3) compensatory education; and (4) attorneys' fees and costs. The Defendants' filed a motion to dismiss in lieu of an answer on November 19, 2020. As of April 9, 2021, the State was vigorously defend this matter.

J.A. v. New Jersey Department of Education et al. On March 23, 2021, Plaintiff J.A., individually and on behalf of her minor child J.A., filed a complaint in the New Jersey District Court naming the NJDOE, NJOAL, Kevin Dehmer, Interim Commissioner of Education, Administrative Law Judge Ellen Bass, Administrative Law Judge Jeffrey Wilson, Administrative Law Judge John S. Kennedy, and Administrative Law Judge Catherine Tuohy, and NJDOEs 1-250 Similarly Situated Administrative Law Judges, as well as the Monroe Township Board of Education (collectively, the "State Defendants"). Plaintiff's complaint alleges various systemic violations of the IDEA and 42 *U.S.C.* § 1983; a claim of discrimination under the Americans with Disabilities Act of 1990, 42 *U.S.C.* §12101 et seq.; a systemic "malicious abuse of process" claim; a "federal preemption" claim; and a claim of retaliation pursuant to Section 504 of the Rehabilitation Act of 1973, 29 *U.S.C.* §701 et seq. Plaintiff also seeks to appeal a final decision and order of ALJ Tuohy ruling in *Monroe Twp. Bd. of Ed. v. J.A. et al*. Plaintiff seeks declaratory and injunctive relief; monetary relief; compensatory education and services; and attorneys' fees and costs. As of April 9, 2021, the State was vigorously defending this matter.

Jersey City Board of Education and E.H., a minor, by his guardian ad litem, Shanna C. Givens v. State of New Jersey. On April 29, 2019, the Jersey City Board of Education ("JCBOE") and E.H., a minor, by his guardian ad litem, Shanna C. Givens ("Plaintiffs") filed a complaint against the State and various State officials (collectively, the "State Defendants") alleging that the recent amendments to the School Funding Reform Act, *N.J.S.A.* 18A:7F-43 to -63 (the "Amendments"), violate the State's constitutional requirement to "provide for the maintenance and support of a thorough and efficient system of free public schools..." *N.J. Const.* art. VIII, § 4. The Amendments at issue slowly phase out certain additional State aid previously granted to "SDA Districts". The phase out of this additional State aid is to occur over a six-year period beginning in the 2019-2020 school year. Plaintiffs allege that the reduction in State aid to JCBOE will jeopardize JCBOE's ability to provide the level of funding necessary to meet the legal standard of a "thorough and efficient" education.

The Plaintiffs seek, among other things, a preliminary and permanent injunction enjoining the State Defendants from reducing funding to JCBOE. On July 23, 2019, Plaintiffs filed a first amended complaint, which continues to allege that the reduction in State aid to JCBOE as a result of the School Refunding Reform Act Amendments will jeopardize JCBOE's ability to provide a thorough and efficient education to its students. The State Defendants filed a motion to dismiss the first amended complaint, which was denied by the trial court on January 17, 2020. The State Defendants filed an answer to the first amended complaint on March 4, 2020. On September 1, 2020, the Plaintiffs filed a second amended complaint, which made factual and substantive allegations identical to the first amended complaint and merely made changes to the identity of a participating minor-plaintiff. The State Defendants' filed an answer to the second amended complaint. As of April 9, 2021, discovery was ongoing and the State was vigorously defending this matter.

Lorillard Tobacco Co. v. Director, Division of Taxation. This case involves constitutional challenges to the Division's regulation, *N.J.A.C.* 18:7-5.18(b), the Division's interpretation of the unreasonableness exception to the State's corporate royalty addback statute, *N.J.S.A.* 54:10A-4.4(c)(1)(b), and Division's Schedule G-2, which implements the calculation of the unreasonable exception based on Taxation's interpretation of its regulation. In 2006, the Division assessed CBT on a subsidiary of Lorillard Tobacco Co. ("Lorillard") for tax years 1999-2004 based on royalty payments the subsidiary had received from Lorillard. The subsidiary was a non-filer in New Jersey and contested the assessment in the New Jersey Tax Court claiming, among other things, that it did not have physical presence in the State so it lacked substantial nexus to permit it to be subject to CBT. While the subsidiary's case was pending in the Tax Court, Lorillard filed refund claims for 2002-2005 by filing amended CBT returns, claiming it would be improper, unreasonable, and unconstitutional to deny it a deduction for the royalty payments if, at the same time, the Division subjected its subsidiary to tax on such amounts. Taxation denied the claims as "protective" and Lorillard filed a complaint with the Tax Court in 2007. The subsidiary ultimately conceded nexus, filed CBT returns and paid taxes under the State's 2009 Tax Amnesty program, after the U.S. Supreme Court denied certiorari regarding the New Jersey Supreme Court decision in *Lanco v. Dir., Div. of Taxation*, 188 N.J. 380 (2006). In Lanco, the Court held that the State could subject a taxpayer to

CBT even though it lacked physical presence in the State. Thereafter, Lorillard sought an expedited payment of the CBT refund based on the Division's Schedule G-2 calculation, which limited Lorillard's deduction due to its subsidiary's lower allocation factor. Lorillard reserved its challenge to the remainder of the exemption. In 2012, Lorillard filed another complaint with the Tax Court challenging the Division's partial refund denial for tax years 2008-2010 on the same basis as the 2007 complaint.

Lorillard claims that the Division improperly and unconstitutionally granted only a partial deduction of royalty payments that Lorillard made to its subsidiary. In February 2019, the Tax Court issued a decision granting Lorillard summary judgment, and holding that the Division's denial of a deduction for the full amount of royalties Lorillard paid was not a reasonable exercise of the Division's discretion. The Tax Court found it unnecessary to address Lorillard's constitutional attacks.

The Division appealed to the Appellate Division, and Lorillard filed a cross-appeal, re-asserting its constitutional challenges. The Tax Court issued a final judgment on Lorillard's 2012 complaint based on its reasoning regarding the 2007 complaint. Both parties again appealed and the matters were consolidated by the Appellate Division. Oral argument was held on December 14, 2020. The State is vigorously defending this matter.

Medicaid, Tort, Contract, Workers' Compensation and Other Claims. The Office of the Inspector General of the U.S. Department of Health & Human Services ("OIG") has conducted and continues to conduct various audits of Medicaid claims for different programs administered by the State's Department of Human Services ("DHS"). The OIG audits, which have primarily focused on claim documentation and cost allocation methodologies, recommend that certain claims submitted by DHS be disallowed. OIG submits its recommendations on disallowances to the Centers for Medicare and Medicaid Services ("CMS") which may, in whole or in part, accept or disagree with the OIG's recommendations. If the OIG's recommendations are not challenged by the State or are upheld by CMS, DHS will be required to refund the amount of any disallowances. As of April 9, 2021, twenty-two audits, which in the aggregate total nearly $1 billion, were in draft or final form but, due to possible revisions or appeals, the final amounts were uncertain. Approximately one-third of the amount above relates to an audit of the State's School-based Medicaid claiming. However, DHS is disputing the OIG's audit findings. Given that, as of April 9, 2021, the State was disputing and appealing the OIG audit findings, it cannot estimate any final refund amounts or the timing of any refund payments that may be due to CMS. These current audits and any future audits of Medicaid claims submitted by DHS may result in claim disallowances which may be significant. As of April 9, 2021, the State was unable to estimate its exposure for these claim disallowances.

The federal Disaster Relief Appropriations Act of 2013 (the "Disaster Relief Act") appropriated approximately $50.38 billion (later reduced by sequestration to $47.9 billion) to various federal agencies to assist states and local communities with the impacts of Superstorm Sandy, including funding provided directly to private homeowners and businesses. The Disaster Relief Act allocated funding to the various federal OIGs to conduct audits and investigations related to the expenditure of disaster relief aid. As of April 9, 2021, audits were ongoing or had already been undertaken by the OIG from the U.S. Department of Homeland Security, the U.S. Department of Housing and Urban Development, the U.S. Department of Transportation, and the U.S. Department of Health and Human Services. The State anticipates that there will be continued audit activity throughout the duration of the federally-funded Sandy programs. As with any federal OIG audit or investigation, there is the potential for an OIG recommendation that the federal agency de-obligate funding in the event of non-compliance with federal statutes or regulations.

At any given time, there are various numbers of claims and cases pending against the State, State agencies and employees, seeking recovery of monetary damages that are primarily paid out of the fund created pursuant to the New Jersey Tort Claims Act (*N.J.S.A.* 59:1-1 *et seq.*). The State does not formally estimate its reserve representing potential exposure for these claims and cases. As of April 9, 2021, the State had indicated that it was unable to estimate its exposure for these claims and cases.

The State routinely receives notices of claim seeking substantial sums of money. The majority of those claims have historically proven to be of substantially less value than the amount originally claimed. Under the New Jersey Tort Claims Act, any tort litigation against the State must be preceded by a notice of claim, which affords the State the opportunity for a six-month investigation prior to the filing of any suit against it.

In addition, at any given time, there are various numbers of contract and other claims against the State and State agencies, including environmental claims asserted against the State, among other parties, arising from the alleged disposal of hazardous waste. Claimants in such matters are seeking recovery of monetary damages or other relief which, if granted, would

require the expenditure of funds. As of April 9, 2021, the State had indicated that it was unable to estimate its exposure for these claims.

At any given time, there are various numbers of claims by employees against the State and State agencies seeking recovery for workers' compensation claims that are primarily paid out of the fund created pursuant to the New Jersey Workers' Compensation Law (*N.J.S.A.* 35:15-1 *et seq.*). Claimants in such matters are seeking recovery for personal injuries suffered by a claimant by accident arising out of and in the course of the claimant's employment due to the employer's negligence. As of April 9, 2021, the State had indicated that it was unable to estimate its exposure for these claims.

Prior to July 1, 2013, there were various numbers of claims and cases pending against the University of Medicine and Dentistry of New Jersey ("UMDNJ") and its employees, seeking recovery of monetary damages that were primarily paid out of the UMDNJ Self Insurance Reserve Fund created pursuant to the New Jersey Tort Claims Act (*N.J.S.A.* 59:1-1 *et seq.*). As a result of the enactment of the New Jersey Medical and Health Sciences Education Restructuring Act, *L.* 2012, *c.* 45 (the "Restructuring Act"), all of UMDNJ has been transferred to Rutgers, with the exception of the School of Osteopathic Medicine which has been transferred to Rowan, and University Hospital, which now exists as a separate instrumentality of the State. All claims and liabilities of UMDNJ associated with the transferred facilities have been transferred to Rutgers, Rowan and University Hospital, as applicable. Pursuant to the Restructuring Act, Rutgers and Rowan each entered into a memorandum of understanding with the State Treasurer pursuant to which the State shall pay from a self-insurance reserve fund established for each entity medical malpractice claims occurring prior to and post the effective date of the transfers, which was July 1, 2013. The Restructuring Act also provides for University Hospital's medical malpractice claims to be covered by a self-insurance reserve fund established by the State Treasurer. University Hospital entered into a memorandum of understanding with the State Treasurer for such claims. All claims, other than medical malpractice claims, incurred by UMDNJ with respect to the UMDNJ facilities transferred to Rutgers will be paid for by Rutgers out of its own funds. All claims, other than medical malpractice claims, incurred by Rowan will be paid from the Tort Claims Fund. As of April 9, 2021, the State was unable to estimate its exposure for these claims.

Approximately two dozen hospitals have challenged in the Office of Administrative Law and the Appellate Division the Medicaid reimbursement rates paid to these hospitals alleging that there were calculation errors or that the methodology used to calculate the rates is incorrect. Additionally, a group of hospitals have challenged the constitutionality of the charity care statute and the inpatient Medicaid rate reimbursement framework. This group of hospitals alleges the losses incurred in treatment of the charity care and Medicaid patients are an unconstitutional taking of the hospitals' property. These challenges date back to 2002. As of April 9, 2021, the State was vigorously defending this matter and there had been no findings against the State. In the event the hospitals are successful, DHS has advised that they may possibly need to refund millions of dollars to the hospitals over the various relevant years. As of April 9, 2021, the State had indicated that it was unable to estimate its exposure for these claims.

Affirmative Litigation. From time to time, the State initiates litigation against various entities to enforce State laws, contractual and other rights, pursue cost recoveries and natural resource damages in the environmental arena and prosecute entities who have engaged in alleged fraudulent, negligent or other wrongful conduct. As of April 9, 2021, the State has indicated that it is unable to estimate the amount of any monetary recoveries from such affirmative litigation. In addition, depending on which State department, division or agency is the plaintiff, any monetary recoveries may already be included in such State department, division or agency's revenue estimates for the current fiscal year.

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ADDITIONAL CONSIDERATIONS

New Jersey municipal obligations may also include obligations of the governments of Puerto Rico and other U.S. territories and their political subdivisions to the extent that these obligations are exempt from New Jersey state personal income taxes. Accordingly, the fund's investments in such securities may be adversely affected by local political and economic conditions and developments within Puerto Rico and certain other U.S. territories affecting the issuers of such obligations.

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Appendix D

ADDITIONAL INFORMATION CONCERNING

NEW YORK MUNICIPAL OBLIGATIONS

The following information is a summary of certain factors affecting the credit and financial condition of the State of New York ("New York" or the "State"). The sources of payment for New York municipal obligations and the marketability thereof may be affected by financial or other difficulties experienced by the State and certain of its municipalities and public authorities. This summary does not purport to be a complete description and, with the exception of the last paragraph hereof, is derived solely from information provided by the State in its Annual Information Statement ("AIS"), dated June 12, 2025, as updated on October 30, 2025. The Funds have not verified the accuracy, completeness or timeliness of the information contained in the AIS. Any characterizations of fact, assessments of conditions, estimates of future results and other projections are statements of opinion made by the State in, and as of the date of, such AIS and are subject to risks and uncertainties that may cause actual results to differ materially.

ECONOMY

New York is the fourth most populous state in the nation, after California, Texas and Florida, and had a relatively high level of personal wealth. The State's economy is diverse, with a large share of the nation's financial activities, information, education, and health services employment, and a small share of the nation's farming and mining activity. The State's location, air transport facilities and natural harbors have made it an important hub for international commerce. Travel and tourism constitute an important part of the economy. Like the rest of the nation, New York has a declining proportion of its workforce engaged in manufacturing and an increasing proportion engaged in service industries.

The U.S. Economy

As the State entered the new fiscal year, the U.S. economy appeared to be heading into stagflation conditions – a period during which inflation remains elevated while economic growth slows to a pace below its long-run trend. This represents a shift from recent U.S. economic performance. After robust growth during the second half of 2024, U.S. real GDP contracted by 0.2 percent in the first quarter of 2025. This contraction was driven by a surge of imports in response to anticipated tariff hikes which, without a corresponding increase in exports, increases the trade deficit. It is not indicative of an imminent decline in economic activity. Healthy growth in domestic final sales, which is the sum of personal consumption expenditures and gross private fixed investment, suggests economic output remained resilient. National employment growth remained strong, and the unemployment rate was relatively low at 4.2 percent in May 2025. Price inflation continued moderating towards the Federal Reserve's 2.0 percent target with a slight uptick in May 2025.

U.S. Economic Forecast

Looking ahead, concerns about Federal economic policy related to tariffs and Federal spending have led to downgraded economic scenarios for 2025 and 2026. Forward-looking indicators related to consumer and business sentiments suggest a growing pessimism about the economy, alongside rising inflation expectations. Economic data published by Federal statistical agencies on output, employment, income, and prices are lagged in providing insights into the economic situation in the current quarter. As of May 2025, Federal economic data have yet to show significant deterioration in the economy.

Once domestic final sales pay back earlier gains made in the first quarter due to purchases prompted by the coming tariffs, economic growth is poised to slow in the remainder of 2025. Meanwhile, trade policy is still evolving, so the size and timing of the policy changes and their ultimate economic implications remain unknown. The New York Division of the Budget's ("DOB") baseline economic outlook expects tariff hikes and corresponding retaliation by trading partners will push up the prices of goods and weigh on consumer spending, business investment, imports, and exports; however, the U.S. economy is not expected to fall into a recession. The baseline forecast also assumes an extension of the Tax Cuts and Jobs Act of 2017 ("TCJA") beyond 2025 and a more restrictive immigration policy that will reduce national labor supply growth. Meanwhile, business investment, particularly productivity-enhancing tech investment, may be buoyed under the corporate tax cuts that were already a part of the TCJA, partially offsetting the negative impact from tariffs on investment.

On balance, U.S. real GDP growth is forecast to slow from an average pace of 2.8 percent in 2024 to 1.2 percent in 2025 and 1.3 percent in 2026, below its long-term potential growth. Meanwhile, price inflation will rise and remain above the Federal Reserve's target inflation rate following the expected tariff hikes and tax cuts. The Federal Reserve is expected to resume its rate cuts in the second half of 2025 to support potential weakening in consumer spending, residential and business investment, as well as employment and income gains.

In line with broader national trends of slowing economic momentum, a cooling labor market, and heightened uncertainty due to Federal tariffs and immigration policies, New York State's employment growth is expected to decelerate to 0.6 percent in 2025 from a robust 1.6 percent rate in 2024. Job growth is projected to slow down further to just 0.3 percent in 2026 due to the softening national economy and ongoing labor shortages. This suggests employment growth will be at its weakest pace since 2011, excluding the pandemic-led decline in 2020.

The slowdown in job growth is expected to suppress personal income growth. State personal income is forecast to grow by 3.5 percent in FY 2026, down from an estimated 5.4 percent in FY 2025. This deceleration is attributed to the slower wage growth during the economic slowdown. As bonus growth declines and the labor market weakens, State wage growth is projected to slow to 2.4 percent in FY 2026. Looking ahead, a modest recovery in the national economy is anticipated to provide tailwinds to New York State's personal income outlook after FY 2026. In FY 2027, State personal income and wage growth rates are expected to return to average rates seen before the pandemic recession and grow by 3.7 percent and 3.6 percent, respectively, supported by improved financial conditions and a stabilized growth rate of bonus payouts despite relatively low employment growth.

The New York Economy

Consistent with the broader trend of a cooling national labor market, New York State's labor market has continued to lose momentum. The State added an average of just 6,900 jobs per month in the first four months of 2025, less than half the monthly average of 14,400 job gains for the same period in 2024. The State's labor market growth might be further constrained by subdued growth in the working age population driven by tightening immigration restrictions and the State's aging population. New York's foreign-born population (23.1 percent of the State population) is substantially larger than the Nation's (14.3 percent of the total population). As a result, New York's labor force could be more susceptible to changes in Federal immigration policy. Furthermore, the State's population is older, with 18.6 percent of the State population at or over 65 years old compared to 17.7 percent of the nation.

Growing uncertainties stemming from international trade policy are likely to contribute to a slowdown in hiring. While New York State is less reliant on exports compared to the rest of the nation, it might still be negatively impacted. On average, the City of New York's labor force grew by approximately 6,500 individuals per month in 2024 but lost a total of 1,200 people over the first four months of 2025. New York's total employment is projected to grow by 0.6 percent in 2025, followed by even weaker growth of 0.3 percent in 2026 due to weak economic growth and constraints in the labor force.

New York's unemployment rate is projected to be 4.4 percent in 2025, aligning with the national rate. The State's unemployment rate was stable in 2024, hovering around 4.3 percent. The gap between the State rate and the national rate has been steadily narrowing since the State's rate peaked at 16.7 percent during the pandemic. In March and April 2025, the State's unemployment rate has matched the national rate after years of remaining above the national rate. The parity between these rates has been largely driven by a steadily declining unemployment rate in the City of New York (from 5.6 percent in December 2024 to 5.0 percent in April 2025). In 2025, employers in the City of New York continued adding jobs while the labor force contracted. The City's labor force is expected to continue its contraction due to the expected slowdown in immigrant inflow and challenges of attracting and retaining workers due to high living costs. While the State's unemployment rate is projected to rise to 4.6 percent in 2026, the unemployment rate will remain 0.1 percentage point below the national rate as State employment growth as well as labor shortages continue.

FINANCIAL PLAN OVERVIEW

FY 2026 Enacted Budget Agreement

The Governor submitted the FY 2026 Executive Budget to the Legislature on January 21, 2025, the day after the U.S. Presidential Inauguration, and the 30-Day amendments to the Executive Budget on February 20, 2025.

On March 27, 2025, the Legislature enacted the annual debt service appropriations, without amendment, in advance of the new fiscal year that began on April 1. On May 8, 2025 the Legislature completed final action on the budget bills and delivered the bills to the Governor. The Governor completed her review of the budget bills on May 20, 2025. The legislative session concluded on June 12, 2025 for the Senate and is expected to conclude on June 17, 2025 for the Assembly. DOB does not anticipate any legislation with significant fiscal impacts will be approved.

The final budget agreement continues support for investments and increases to nearly all program areas made over the past three years and includes key elements of the Governor's affordability proposals advanced in her Executive Budget. The Enacted Budget delivers $2 billion back to New Yorkers through Inflation Refund payments to qualified tax filers from surplus resources available in FY 2025, lowers the rates for five of the nine income tax brackets to reduce the tax burden, and significantly enhances the child tax credit for children under 4 years old in FY 2027 and for children 4 through 16 in FY 2028 and FY 2029. The Budget also increases or extends several other tax credits. To support the long-term cost of these tax cuts, the Enacted Budget extends the top tax rates for tax filers with taxable incomes above $2.1 million.

The Enacted Budget also includes increased funding to address public safety, mental health care, housing affordability and access, transportation, health care delivery, abortion access, and child care. In addition, it updates the Foundation Aid formula, increasing aid by 5.7 percent in School Year (SY) 2026. Additional spending is included to support a 2.6 percent targeted inflationary increase for certain eligible programs; free school meals for all students regardless of income; the remaining costs of tuition, fees, and books for community college students ages 25 to 55 pursuing select first-time associates degrees in high-demand occupations, including nursing, teaching in shortage areas, technology, and engineering; distressed hospital assistance; hunger prevention and nutrition assistance; operating aid for the State University of New York (SUNY) and City University of New York (CUNY) campuses and the SUNY Downstate Hospital; Medication-Assisted Treatment (MAT) for substance abuse disorders; mental health services for justice-involved individuals; law enforcement activities; City of New York (NYC) subway safety initiatives; and the authorized repayment of the outstanding Federal Unemployment Account loan that would otherwise be borne by businesses.

New capital funding commitments will support transportation, affordable and supportive housing, economic and community development, environmental and clean energy initiatives, increased access to care and housing opportunities for individuals facing mental health challenges, health care transformation, public safety, and investments in higher education. The new capital commitments enacted in the budget are funded not only with bonds but also with cash resources, to ensure the State's debt burden remains affordable.

In addition, the Enacted Budget includes a multi-year spending plan supported by the Federal government's approval of an assessment on managed care organizations (MCO) which took effect on January 1, 2025. The assessment is expected to provide up to $3.7 billion of new resources over two years, which will be deposited to the Healthcare Stability Fund (HSF). The resources are expected to be used to offset existing Global Cap Medicaid spending and provide additional funding for the Healthcare Safety Net Transformation Program, as well as increased funding for hospitals, nursing homes, outpatient clinics, maternal health services, and other health care providers. These resources and investments are dependent on the successful execution of the assessment, for which the Federal government's current approval may be revisited or amended via regulation changes to prevent the State from receiving the planned two years of resources. Given the uncertainty of continued Federal approval, the Financial Plan does not include support for these investments in future years.

The Enacted Budget projects total spending in FY 2026 of $254.4 billion in All Governmental Funds and $146.1 billion in State Operating Funds. Compared to FY 2025 results, spending is projected to increase by $12.9 billion or 5.3 percent for All Governmental Funds and $12.4 billion or 9.3 percent for State Operating Funds. General Fund spending, which includes transfers to other funds, is projected to total $125.5 billion in FY 2026 inclusive of an estimated $7.2 billion transfer to the Unemployment Insurance Fund4 to support the planned payoff of a Federal Unemployment Account loan. Excluding this transfer, General Fund spending is projected to total $118.3 billion, an increase of $9.6 billion or 8.9 percent from FY 2025 results.

Roughly $6 billion, or almost half, of the projected State Operating Funds spending increase in FY 2026 supports the State's two largest assistance and grants programs – Medicaid and School Aid. Another $3 billion in spending growth in FY 2026 is attributable to projected operational costs, including fringe benefits, for all branches of State government.

FY 2026 Budget Outlook

The projected General Fund budget gap in FY 2026 of $8.8 billion results from estimated spending growth exceeding the forecasted increase in resources available to support such growth.

In FY 2026, All Funds tax receipts are estimated to increase by $2.6 billion over the current year estimate. State Operating Funds spending is currently projected to outpace tax receipts and is projected to increase by $13.8 billion (10.4 percent) in FY 2026 compared to the estimated FY 2025 level. The State's two largest programs, School Aid and Medicaid, continue to drive a large share (nearly half) of the spending growth in FY 2026. All other assistance and grants spending growth includes projected increases of $2.7 billion for all other areas including social services, mental hygiene, public safety, transportation, and higher education, as well as $2.3 billion in Other State Agency (OSA) local Medicaid spending that has been moved from the Department of Health (DOH) Medicaid Global Cap. Beginning in FY 2026, these costs that were previously reported in the DOH budget will now be reported in the respective agency budgets to more appropriately align program activities and costs to agencies responsible for managing such spending.

FY 2026 Financial Plan

Receipts

General Fund receipts, including transfers from other funds, are estimated to total nearly $115 billion in FY 2026, an increase of $383 million (0.3 percent) from FY 2025. As noted earlier, receipt levels in the General Fund may be significantly impacted by the deposit of dedicated taxes in other funds for debt service and PTET. Excluding the impact of debt prepayments and PTET, total General Fund tax receipts, including transfers after the payment of debt service, are estimated to total $103.9 billion in FY 2026, an increase of $4.3 billion (4.3 percent) from FY 2025. The following discussion of annual changes in tax receipts exclude the impact of PTET and debt prepayments.

PIT receipts are estimated to total $72.6 billion in FY 2026, an increase of $3.7 billion from the prior year. The increase reflects expected growth in all gross receipt components partially offset by an increase in total refunds.

Consumption/use tax receipts are estimated to total $18.7 billion in FY 2026, an increase of $389 million (2.1 percent) from FY 2025. This increase reflects the estimated growth of taxable consumption in the sales tax base.

Business tax receipts are estimated to remain virtually unchanged, primarily reflecting a projected increase in Corporate Franchise Tax (CFT) refunds and a projected decrease in bank audits, offset by increases in CFT gross receipts, audits, and gross insurance receipts.

Other tax receipts are estimated to total $2.5 billion in FY 2026, an increase of $163 million from FY 2025. This is primarily due to estimated increases in both estate tax and real estate transfer tax receipts. These increases reflect an expected decrease in estate tax refunds, as well as estimated growth in household net worth, housing starts, and the average housing price, partially offset by estimated declines in the S&P 500 and finance and insurance sector bonuses.

The reduction in non-tax receipts reflects the final planned use of State and Local Fiscal Recovery Fund (SLFRF) resources in FY 2025 consistent with Federal treasury rules and the continued practice of budgeting for a $2 billion transaction risk reserve that partially offsets total projected transfers from other funds and provides a hedge against risks to receipts that may materialize later in the fiscal year. Other year-to-year reductions include lower FY 2026 estimates for abandoned property receipts and investment income commensurate with projected fund balance declines. These decreases are partly offset by available resources in other funds, including interest earned on monies awarded under the SLFRF program which will be transferred to the General Fund over several years.

Disbursements

General Fund disbursements, including transfers to other funds, are expected to grow by $16.8 billion (15.5 percent), totaling $125.5 billion in FY 2026, mostly driven by increased funding for Foundation Aid, Medicaid and extraordinary transfers to the Federal Unemployment Account; excluding these transfers, General Fund spending grows by 8.9 percent.

Assistance and grants spending supported by the General Fund is estimated to total $84 billion in FY 2026, an increase of $9.2 billion (12.3 percent) from FY 2025. General Fund spending for education, health care, and continued time-limited support to the City of New York for asylum seeker assistance represents nearly all of the assistance and grants spending growth. General

Fund support for these programs is also affected by the level of financing sources (i.e., HCRA and lottery/gaming receipts) available in other funds.

General Fund support for School Aid is estimated to increase by $1.4 billion (4.8 percent) on a State fiscal year basis. This growth reflects enacted reforms to the Foundation Aid formula, including updates to the formula's two measures of the percentage of low-income-students in a district, an increase in aid for English Language Learners, additional aid to low-wealth school districts, modifications to the Regional Cost index and a minimum 2 percent annual increase in aid to districts. In addition, the annual increase in School Aid spending reflects enhancements to Special Services Aid and BOCES Aid and provides additional aid to school districts with large portions of their enrollment attending charter schools.

Medicaid spending is projected to grow by $1.5 billion, primarily due to the additional Global Cap spending allowance that supports enrollment and escalating MLTC growth offset by $500 million in expected MCO assessment resources to support existing Global cap investments. Beginning in FY 2026, costs reported under the DOH Medicaid budget exclude OSA local Medicaid expenses which were included under the Global Cap. These costs, previously reported in the DOH budget, will now be reported in the respective agencies, including OPWDD and OMH.

Other assistance and grants growth is primarily the result of continued State support of an expanded level and eligibility of child care subsidies, hunger prevention and nutrition assistance, programs for older adults, City of New York subway safety initiatives, funding to offset county costs related to the assigned counsel rate for attorneys providing services to low-income individuals, CUNY operational support, asylum seeker assistance, and new initiatives to provide universal free school meals and free community college for high-demand fields.

Agency operations and fringe benefits growth is impacted by the Federal Emergency Management Agency (FEMA) reimbursements for prior year COVID-19 pandemic related eligible spending. Excluding these reimbursements, the largest drivers of growth include rising health insurance costs for State employees, Judicial staffing and operational increases, general salary increases consistent with existing collective bargaining agreements, investments in cybersecurity and information technology, and continued staffing increases across various agencies. In addition, spending has been increased for the MAT Program which provides treatment for incarcerated individuals in State correctional facilities with substance use disorder, enhanced security measures for correctional facilities, and an increase in the National Guard members assigned to the Joint Task Force Empire Shield Mission, which provides support to deter and prevent terrorist activity in the City of New York area, including transit and commuter hubs. In response to the CO strike, spending has been increased to support the deployment of the National Guard members to staff prisons, enhanced overtime rates, and expanded recruitment efforts.

The Judiciary spending plan includes a substantial increase in FY 2026 to support general salary increases and other non-judicial staffing initiatives, including new court clerks and attorneys, costs associated with four court officer academy classes, and increased staffing levels to address case backlogs. The Judiciary's budget also includes funding for: ten City of New York Family Court Support Magistrates, ten City of New York Civil Court judges, and five Court of Claims judges; increases for various technology initiatives; cost of living adjustment for contractual providers of the Attorney for Child program; expansion of various programs including Alternative Dispute Resolution and Alternatives to Incarceration; and providing for health insurance and pension cost increases.

The increase in General Fund transfers is attributable to $7.2 billion of extraordinary one-time transfers to the Federal Unemployment Account planned in FY 2026, which is partly offset by a decline in transfers to support capital projects due to timing of bond proceed reimbursements and one-time funding for HSF in FY 2025. Other transfer changes include additional State general operating aid for SUNY four-year campuses and Downstate Hospital, funding to support targeted engineering pay increases and revised projections across various programs and funds.

General Fund Closing Balance

The General Fund closing balance is comprised of Principal Reserves to protect essential services in the event of a significant economic downturn and other reserves that are programmed for the timing of payments and to reduce outyear gaps, manage risks, and support future costs that include tax refunds and liabilities, capital projects, and operational needs.

DOB expects the General Fund to end FY 2026 with a balance of $44.9 billion, nearly $12 billion below the FY 2025 closing balance. The decrease is comprised of the expected use of resources to support extraordinary transfers to the Federal

Unemployment Account, one-time costs related to the CO strike and staffing shortage, PTET related credits and offsets, debt management, existing capital commitments and projects, and the timing of payments delayed from prior years.

Cash Flow

DOB expects that the General Fund will maintain sufficient liquidity in FY 2026 to make all planned payments as they become due. The State continues to reserve money on a quarterly basis for debt service payments financed with General Fund resources. Money to pay debt service on bonds secured by dedicated receipts, including PIT bonds and Sales Tax Revenue bonds, continues to be set aside as required by law and bond covenants.

The Enacted Budget continues to authorize short-term financing for liquidity purposes during the fiscal year, and, in doing so, retains a cashflow management tool to manage unanticipated financial disruptions. Specifically, the authorization allows for the issuance of up to $3 billion of PIT revenue anticipation notes which mature no later than March 31, 2026. Borrowed amounts cannot be extended or refinanced beyond the initial maturity. The Financial Plan does not assume the use of short-term financing for liquidity purposes. DOB evaluates operating results and liquidity levels regularly and may adjust the use of notes based on liquidity needs, market considerations, and other factors.

APRIL – SEPTEMBER 2025 OPERATING RESULTS

Summary of General Fund Operating Results

The General Fund ended September 2025 with a positive variance driven in large part to routine timing related spending variances, FEMA reimbursement of previously incurred COVID-19 costs, and higher receipts inclusive of $525 million in PTET collections, which are Financial Plan neutral at year end via the reserve set aside to fund credits and refunds in subsequent years. DOB has revised the Updated Financial Plan projections for receipts and spending across several program and functional areas considering the operating results through the first half of the FY 2026.

Through September 2025, General Fund Receipts, including transfers from other funds, totaled $60.9 billion, $2.1 billion (3.7 percent) above the initial estimate.

FYE 2025 Personal Income Tax (PIT) receipts are estimated to increase from FY 2025, reflecting increases in all major gross receipt components, partially offset by modest growth in total refunds.

General Fund Spending

Receipts, including transfers from other funds and excluding PTET receipts, exceeded the initial estimate by $1.7 billion (3.2 percent). Higher PIT collections were driven by stronger than anticipated withholding, current estimated payments and assessments, partially offset by lower business tax collections, primarily gross CFT and Insurance tax receipts.

PTET collections exceeded the initial estimate driven by higher than projected estimated payments, slightly offset by increased State-City distribution offsets.

Higher miscellaneous receipts are comprised of greater than projected earnings from investment income and refunds and reimbursements. Transfers from Other Funds include FEMA reimbursement of previously incurred COVID-19 costs.

Spending, including transfers to other funds, was $1.9 billion (3.1 percent) below the initial estimate, primarily due to routine timing-related delays across all categories. The largest assistance and grants variances were observed in the following areas:

- Children and Family Services ($655 million) primarily for Day Care and Child Welfare Services.
- School Aid ($606 million) mainly due to lower than projected spending for Excess Cost Aid, categorical programs, General Aid and Statewide Universal Full-Day Prekindergarten (SUFPK).
- Temporary and Disability Assistance ($425 million lower) reflecting the timing of payments for Asylum Seeker Assistance to the City of New York, the ERAP and the ESSHI.
- Medicaid ($444 million higher) due to pending General Fund reconciliation of MCO assessment revenues in the HSF, delays in Federal approval of Indigent Care payments that offset general fund expenses, and the timing of Global Hospital Budget Initiative payments.
- All Other Education ($374 million higher) driven by the timing of preschool and summer special education claims and payments.

- Mental Hygiene ($256 million higher) mainly driven by the OMH Adult Residential and Non-Residential programs.

Medicaid spending was $250 million above the plan due to delays in expected reimbursements from the City of New York and increased costs in the Nursing Home Transition & Diversion/Traumatic Brain Injury waiver programs that are partly offset by lower Managed Care claims due to revised enrollment cost estimates.

Agency operations spending, including fringe benefits, varied marginally in aggregate. Transfers to Other Funds were lower than projected due mainly to slower spending for capital transportation projects.

Summary of All Governmental Funds Operating Results

All Governmental Funds ended September 2025 with a balance of $75 billion, $4.5 billion above the initial estimate driven by higher than projected receipts ($3.2 billion) and lower spending ($1.3 billion).

Receipts

All Funds receipts totaled $127.5 billion, exceeding initial estimates by $3.2 billion due to a combination of the timing of Federal operating aid spending and reimbursements, including earlier than planned Federal ARP education grants spending, higher tax collections, and miscellaneous receipts. In addition to the General Fund tax collections and miscellaneous receipts described above, collections exceeded planned amounts most significantly in the areas of HCRA and mobile sports wagering receipts.

Spending

Higher All Funds receipts were driven by Federal receipts and tax collections, partly offset by lower than planned miscellaneous receipts. The timing of Federal operating aid spending that is principally reimbursement-based drives Federal receipts variances and the tax variance is consistent with the General Fund variances described above. Lower than projected miscellaneous receipts were comprised of the timing of MCO collections into the HSF, partially offset by higher investment income and refunds and reimbursements.

All Funds disbursements were below the initial estimate mainly due to timing-related spending delays for assistance and grants, consistent with the variances described in the General Fund section above, as well as delays in transportation and environmental construction projects. Variances in Federal operating aid spending occurred in the following areas:

- Medicaid (including administration) ($991 million lower) due to timing of claims disbursements that were processed to align with the disbursement of State claims, as well as earlier timing of Mainstream and MLTC withhold payments, and increased offsets for CHP claims resulting from higher than anticipated utilization.
- Homeland Security and Emergency Services ($751 million higher) for FEMA funding that flows through the Updated Financial Plan to reimburse local entities for COVID-19 expenses.
- Children and Family Services ($519 million higher) for prioritizing the use of Federal funds for Child Care, Title XX Equity grants and Child Welfare programs.
- Public Health ($415 million higher) related to the timing of Federal CHP payments and credits.
- Essential Plan ($353 million higher) due to program expansion and increased utilization.
- Temporary and Disability Assistance ($348 million higher) related to Child Care, the Flexible Fund for Family Services and Public Assistance Benefit Payments.
- School Aid ($385 million lower) due primarily to lower-than-expected spending on COVID-19 related grants and Elementary and Secondary Education Title Act grants.

All Governmental Funds Results Compared to Prior Year

The FY 2026 September All Funds balance, totaling $75 billion, was $1.1 billion higher than the prior year due to an increase in receipts ($7 billion), offset partially by an increase in annual disbursements ($7.5 billion).

Receipts

Compared to FY 2025 results through September, receipts and disbursements were higher in FY 2026 by $7.0 billion and $7.5 billion, respectively.

Excluding PTET collections, tax receipts grew by $4.6 billion (9.6 percent) reflective of anticipated growth across all tax categories, including substantial growth in PIT receipts experienced in the April 2025 settlement. Growth in Federal receipts typically mirrors the timing of Federal grant spending.

Spending

State Operating Funds spending through September increased 8.7 percent compared to the prior year and is consistent with the estimated annual growth. This spending growth reflects planned funding increases for nearly all areas, particularly for Mental Hygiene, Medicaid, School Aid (inclusive of increased General Aid spending), and Higher Education. Medicaid growth is largely attributable to increased Managed Care claims and non-recurring credits for HCBS. Other notable growth includes planned increases in support for CUNY Senior Colleges, and Tuition Assistance Program awards.

Executive agency operations spending growth is also in line with expectations and largely driven by staffing shortages at prisons throughout the State due to the correctional officer strike, resulting in assignment of National Guard members to correctional facilities and the temporary enhanced overtime rate for correctional staff. In addition, retroactive salary payments to State Police for Fiscal Years 2024 and 2025 were made in July 2025.

University systems' operations growth is largely due to salary increases pursuant to existing labor contracts, continued hiring, and expanded spending on campus and hospital operations. Elected Officials spending growth is primarily attributable to the Judiciary.

Increased hiring, which includes the additional 3,000 DMNA members to address prison staffing shortages and overtime use drives the growth in employer payroll tax and other salary sensitive fringe benefits.

Spending for capital projects increased by $1.1 billion through September largely driven by increased support for social welfare and health projects.

Increased Federal operating spending is largely due to enrollment growth in the EP associated with the 1332 Waiver, increased managed care, other long-term care spending, and pharmacy benefits. In addition, FEMA reimbursements for costs incurred for COVID-19 pandemic response and recovery efforts passed through to local entities and spending for COVID-19 related education and Elementary and Secondary Education Title Act grants are declining from prior year levels.

Impact of Federal Tax Law Changes

The Tax Cuts and Jobs Act of 2017 ("TCJA") made extensive changes to the Federal individual income tax, corporate income taxes, and estate taxes, most of which were effective in tax year 2018. Many provisions of the TCJA were scheduled to expire at the end of 2025, including the $10,000 limit on the deductibility of SALT payments. H.R. 1 included extensions and modifications to many provisions of the TCJA, including increasing the SALT cap from $10,000 to $40,000. The increased cap is phased out for taxpayers with income levels above $500,000 and remains at $10,000 for taxpayers with income greater than $600,000. The increased cap is set to expire after tax year 2029 for all income levels. It should be noted that PTET and the Employer Compensation Expense Program are independent of the TCJA, both of which are not scheduled to sunset, and taxpayer utilization of these programs is expected to continue. However, the Federal government could elect to bar or curtail utilization of these programs in the future, which could impact taxpayer migration and future State tax receipts.

State Response to Federal Tax Law Changes

Pass-Through Entity Tax. The U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") have determined that State and local income taxes imposed on and paid by a partnership or an S corporation on its income, such as the PTET, are allowable as a deduction to Federal taxable income. Legislation enacted in FY 2022 allows an optional PTET on the New York-sourced income of partnerships and S corporations. Qualifying entities that elect to participate can pay a PTET payment of up to 10.9 percent on their taxable income at the partnership or corporation level, and their individual partners, members and shareholders receive a refundable PIT credit equal to the proportionate or pro rata share of taxes paid by the electing entity. Additionally, the program includes a resident tax credit that allows for reciprocity with other states that have implemented similar taxes, which currently include Connecticut and New Jersey.

The Updated Financial Plan estimates include PTET collections within business taxes and a corresponding decrease in PIT receipts and is expected to be cost neutral to the State on a multiyear basis. However, because the PTET credits are not

necessarily realized by taxpayers within the same fiscal year that PTET revenue is received by the State, the PTET will not be revenue-neutral to the State within each fiscal year. The reserve balance established at the inception of the program has and is expected to continue to cover the difference between PTET collections and related PIT credits in each fiscal year making it General Fund balance neutral, as shown in the table below.

STATE GOVERNMENT EMPLOYMENT

As of March 31, 2025, the State had approximately 172,944 Full-Time Equivalent ("FTE") annual salaried employees within agencies subject to direct Executive control (101,574 FTEs), the University Systems (50,958 FTEs) and the Independently Elected Agencies (20,412 FTEs). These figures do not include non-annual salaried employees or employees of the Legislature and Judiciary.

OTHER MATTERS AFFECTING THE STATE FINANCIAL PLAN

The Financial Plan is subject to a myriad of risks, including, but not limited to, economic, social, financial, political, public health, and environmental risks and uncertainties. The projections of receipts and disbursements in the Financial Plan are based on reasonable assumptions at the time they were prepared. DOB is unable to provide any assurance that actual results will not differ materially and adversely from these projections.

Receipts. State tax collections are economically sensitive and are affected by the condition of the State and national economies, as well as State and Federal tax law changes, and related taxpayer behavior and migration. Uncertainties and risks that may affect the economic and receipts forecasts include, but are not limited to: national and international events; inflation; consumer confidence; commodity prices; supply chain disruptions; major terrorist events; hostilities or war; climate change and extreme weather events; severe epidemic or pandemic events; cybersecurity events; Federal laws and regulations; financial sector compensation; capital gains; and monetary policy affecting interest rates and the financial markets.

The largest component of State tax revenue comes from PIT. Beginning in Tax Year 2021, the State created three new top PIT rates for taxpayers earning over $2.1 million annually, which resulted in a more progressive state income tax system. The top PIT rate is currently 10.9 percent and includes less than 0.1 percent of taxpayers. These rates are scheduled to expire at the end of tax year 2032 and revert to a single bracket with a rate of 8.82 percent.

Disbursements. Annual spending projections and timing of disbursements are subject to many of the same risks listed above for receipts, as well as variations from assumptions, policy changes, and future labor agreements which may increase spending, including, but not limited to: the level of wage and benefit increases for State employees; changes in the size of the State's workforce; factors affecting the State's required pension fund contributions; the receipt of Federal approvals necessary to implement the Medicaid savings actions; continued Federal participation in cost sharing for health care and human services programs; unanticipated growth in in public assistance programs, including the assumed level of utilization of newly expanded benefits; State payments and assistance to health care facilities and providers beyond the typical rate reimbursement system; enrollment, utilization and availability of funding for certain public health programs; adherence to statutorily limited growth caps; and the ability of the State and its public authorities to issue securities successfully in public credit markets.

The State utilizes spending growth caps intended to limit the year-to-year growth in the State's two largest assistance and grants programs, School Aid and Medicaid. Both caps, as well as the scope of the cap for Medicaid, have been modified since initial implementation and have been impacted by administrative and other actions over the past several years.

The School Aid growth cap limits annual spending growth to increases in State Personal Income, as calculated in the Personal Income Growth Index (PIGI). The statutory PIGI for School Aid is based on the average annual income growth over a ten-year period. However, the authorized School Aid increases have exceeded the indexed levels in most years since its inception. In SY 2022 through SY 2024, School Aid substantially exceeded the PIGI, due to the State's phase in of full funding of the Foundation Aid formula completed in SY 2024, driving an annual increase of 9.7 percent compared to the indexed PIGI rate of 4.2 percent. The increase in State funded School Aid for SY 2025 of 4.1 percent was slightly above the indexed PIGI rate of 3.7 percent. The Updated Financial Plan includes an estimated School Aid increase for SY 2026 of 4.9 percent, compared to the indexed PIGI rate of 4.5 percent.

The Updated Financial Plan projections for SY 2027 and beyond assume that School Aid growth will be based on estimated growth in Foundation Aid and expense-based aids and that growth will be below the PIGI rate.

Nearly three-quarters of DOH State Funds Medicaid spending growth is subject to the Global Cap that is intended to establish a limit for Medicaid growth. The amount of State-share Medicaid spending excluded from the Global Cap continues to increase and includes supplemental hospital payments, costs for the takeover of Medicaid growth from local governments, reimbursement to providers for increased minimum wage costs, and investments made from HSF. Prior to FY 2023, the Global Cap was calculated using the ten-year rolling average of the medical component of the Consumer Price Index (CPI) for all urban consumers and thus allowed for growth attributable to increasing costs, though not increasing utilization. To accommodate growth in utilization, the Global Cap was amended to be calculated using the five-year rolling average of health care spending, using projections from the CMS Actuary. The CMS Actuary updates the projections annually and DOB incorporates the revisions into the multi-year forecast with the Executive Budget, as applicable. The new Global Cap index added a substantial amount of allowable Medicaid growth – over $23 billion covering the six-year period from FY 2023 through FY 2029.

The statutory provisions of the Global Cap grant the Commissioner of Health (the Commissioner) certain powers to limit Medicaid disbursements to the level authorized by the Global Cap and allow for flexibility in adjusting Medicaid projections to meet unanticipated costs resulting from a disaster. The Commissioner's powers are intended to limit the annual growth rate to the levels set by the Global Cap for the then-current fiscal year through actions that may include reducing reimbursement rates to providers. These actions may be dependent upon timely Federal approvals and other elements of the program that govern implementation.

Since the enactment of the Global Cap, the portion of actual State Funds Medicaid spending subject to the Global Cap has remained at or below indexed levels. However, the scope of spending subject to the Global Cap has been modified, and in certain fiscal years, the General Fund has provided relief to the Global Cap and DOH has taken management actions, including adjustments to the timing of Medicaid payments consistent with contractual terms, to ensure compliance with the Global Cap. Similarly, in response to initial delays in the Federal approval of planned FY 2022 through FY 2024 Managed Care Directed Payment Template (DPT), the State advanced payments of over $2.2 billion in State-only payments to certain providers to help them cover their immediate cash flow needs. These advanced payments were expected to be remitted to the State by the providers upon their receipt of federally approved DPT funds. While all prior year Federal approvals have been granted with respect to these DPT funds, approximately $1.2 billion in provider reimbursements to the State are in various phases of the administrative remittance process. The Updated Financial Plan assumes these advances will be reimbursed over a multi-year period due to an inability by certain distressed hospitals to repay advances in the near term.

Escalating health care costs and industry pressures present fiscal challenges for the State that will need to be addressed to ensure long-term fiscal sustainability of these programs. A summary of these programs and pertinent issues are described in more detail below.

Public Health Insurance Programs. Recent Medicaid spending growth is largely driven by the expanded utilization of the State's MLTC program and other programs serving seniors and individuals enrolled in both Medicaid and Medicare. These programs currently comprise roughly 60 percent of total Medicaid spending, which is expected to rise to nearly 70 percent by 2028 as the baby boomer population ages. By 2030, 23 percent of the State's population is expected to be over age 65, up from 9 percent in 2000. This is expected to place a substantial amount of pressure on health care funding needs, and as such there can be no assurance that costs will not exceed projections in the later years of the Updated Financial Plan absent savings actions and/or rate reductions.

CHP. Since its inception in 1990, the State's CHP program has provided free or subsidized health insurance coverage to children in New York State under the age of 19 in families with incomes too high to qualify for Medicaid and is partly funded by the Federal government. In addition, the CHP program covers undocumented children at a 100 percent State cost. CHP currently covers over 565,000 enrollees, an increase of almost 175,000 from the level recorded two years ago.

Hospital Assistance. The State provides a substantial amount of supplemental funding to private and not-for-profit hospitals beyond traditional Medicaid reimbursement rates, which include payments through various programs and grants, including the Vital Access Provider Assurance Program, Vital Access Provider Program, Graduate Medical Education Incentive Program, and various other programs. Currently, 75 of 261 New York hospitals (29 percent) are deemed financially distressed – a 200 percent increase from FY 2017 through FY 2025 that has driven a concomitant 504 percent increase in Federal/State fiscal assistance to these entities. Many hospitals responsible for supporting medical needs in underserved communities across the State, including those with higher rates of uninsured individuals and government payor mix, were further stressed financially due

to the pandemic. Despite hospitals in the State receiving roughly $11 billion in COVID-19 pandemic related assistance from the Federal government, many hospitals continue to rely on and expect ongoing supplemental State assistance.

The State has provided substantial targeted funding to certain facilities above the longstanding baseline annual hospital assistance of $984 million provided in aggregate to all hospitals statewide. Since FY 2023, the State has provided $1.8 billion in supplemental State support to hospitals: $800 million in FY 2023, of which $100 million was added to the recurring base support; and $500 million in both FY 2024 and FY 2025. Another $500 million in new support in FY 2026 and over $800 million in additional funding is planned through FY 2028 associated with the Safety Net Transformation program to fund projects and partnerships to promote financial sustainability of provider systems, subject to approval and the availability of MCO assessments.

The importance of the hospital industry to local communities for purposes of accessing critical health care services, as well as other social and economic benefits, including employment opportunities and sustainability, creates the potential for increased cost pressure within the Updated Financial Plan should the State continue to provide supplemental payments to hospitals. There can be no assurance that the State will continue to provide additional funding at or above current commitment levels, as many facilities, including those which are not currently fiscally distressed, continue to seek State financial support.

CDPAP. New York's CDPAP allows Medicaid enrollees that are determined eligible for personal care services to select their own caregiver, which can include friends or family members. Utilization of CDPAP grew by 1,200 percent since 2016, and State costs were expected to continue to escalate at unsustainable levels. In response to this expansion, hundreds of for-profit private businesses, known as FIs, emerged to provide payroll functions and administrative support for an administrative fee that is paid by the Medicaid program. Nearly all other states with CDPAP programs utilize one or only a few FIs to limit administrative costs and prudently use taxpayer funds. The State has transitioned to a single FI administrator, consolidating the administrative and payroll functions from hundreds of existing FIs to administer the program in a more cost-effective manner. This action has resulted in savings that has surpassed previous estimates and did not result in a change to care or services authorized and available through the CDPAP.

Medical Indemnity Fund (MIF). The MIF was created in 2011 and is administered by DOH to provide for the future health care costs of individuals who suffered birth-related neurological injuries because of medical malpractice during delivery. The purpose of the MIF is to ensure qualified plaintiffs have their health care needs met throughout their lifetime and to protect hospitals by limiting their liabilities for medical malpractice expenses. The costs are supported partially through an assessment on hospitals with the balance funded by the State. To date, the State has provided $928 million in funding for the MIF. In 2017, rates were increased, and eligibility expanded to births occurring at non-hospital facilities. Services covered by the MIF are expansive and can include medical, dental, surgical, hospital, nursing, custodial, and rehabilitative care.

Pursuant to law, if the MIF's total estimated liabilities reach or surpass 80 percent of its total assets, then the MIF will be closed to new enrollment to maintain solvency. The FY 2026 Enacted Budget included funding to maintain MIF solvency and allow the program to remain open to new enrollees through FY 2026. However, due to increased enrollment, escalating average medical costs per enrollee, and legislatively mandated average commercial reimbursement requirements (which are in place until June 1, 2026), the MIF is expected to reach the threshold for closure to new enrollees sometime in FY 2027. Absent policy changes to require hospitals and providers to provide additional funding to the MIF and/or implement program reforms, additional State funding would be needed to prevent the potential closure of the MIF to new enrollees. If closed to new enrollees, those who would have been considered qualified plaintiffs and automatically enrolled in the MIF will instead be able to seek legal recourse against hospitals and physicians for medical costs.

Litigation Risk. The Financial Plan forecast is subject to litigation risk. Litigation against the State may challenge the constitutionality of various actions with fiscal implications. In the aggregate, these litigation matters could negatively affect the forecasts and projections contained in the Updated Financial Plan.

Financial Plan Risk Management. In developing the Financial Plan, DOB attempts to manage financial risks, with an emphasis on the General Fund. It does this by, among other things, exercising caution when calculating total General Fund disbursements and managing the accumulation of financial resources, subject to availability, and including a $2 billion transaction risk reserve in each year, to maintain budget flexibility. Such resources include but are not limited to: fund balances that are not needed each year; management of the timing of reimbursement for capital advances; and prepayment of expenses. DOB routinely executes cash management actions to manage the State's large and complex budget. These actions are intended

to improve the State's cash flow, manage resources within and across State fiscal years, adhere to spending targets, and better position the State to address unanticipated costs, including economic downturns, revenue deterioration, and unplanned expenses. There is no guarantee that such financial resources or cash management actions will be sufficient to address risks that may materialize in a given fiscal year.

In some cases, the ability of the State to implement cash management actions requires the approval of the Legislature and cannot be implemented solely by the Governor. The FY 2026 Enacted Budget includes provisions designed to maintain a balanced budget that authorize the Budget Director to reduce payments subject to a plan submitted to the Legislature for review, in the event a General Fund imbalance exceeding $2 billion is expected.

There can be no assurance that the State's financial position will not change materially and adversely from current projections. If this were to occur, the State may be required to take gap-closing actions to preserve General Fund balance. Such actions may include but are not limited to: reductions in State agency operations; delays or reductions in payments to local governments or other recipients of State aid; delays in or suspension of capital maintenance and construction; extraordinary financing of operating expenses; and use of non-recurring resources.

Federal Impacts to the Financial Plan

Overview

The Federal government influences the economy and budget of New York State through various policies, mainly Federal tax policy, cost sharing for many State run programs, and various grants, as well as direct spending on its own programs such as Medicare and Social Security. The State's income tax system interacts closely with the Federal system and changes to the Federal tax code have significant flow-through effects on State tax burdens and concomitantly on State tax receipts. Federal resources support vital services such as health care, education, and transportation, as well as severe weather and emergency response and recovery, and climate resiliency and clean energy programs. Federal policymakers may place conditions on grants, mandate certain state actions, preempt state laws, alter taxpayer behavior through tax policies, such as placing limits on SALT deductions, and influence industries through regulatory action. Any changes to Federal policy or reductions in funding levels could have a materially adverse impact on the Financial Plan.

Routine Federal aid supports programs for vulnerable populations and those living at or near the poverty level. Such programs include Medicaid, Temporary Assistance for Needy Families ("TANF"), ESEA Title I grants, and IDEA grants. Other Federal resources are directed at infrastructure and public safety.

Over the past few years, Federal Funds spending has included COVID-19 pandemic response and recovery assistance provided to state and local governments, schools, hospitals, transit systems, businesses, families and individuals. More recently, the Federal government has also passed significant legislation dealing with transportation infrastructure, climate and energy policy, and advanced manufacturing. The State continues to monitor these Federal investments for opportunities to meet its policy goals amid changing Federal government priorities.

- **Medicaid/Health.** Funding shared by the Federal government helps support health care costs for over nine million New Yorkers, including more than two and a half million children. Medicaid is the single largest category of Federal funding. The Federal government also provides support for several health programs administered by DOH, including the EP.
- **Social Welfare.** Federal funding helps with several programs managed by OTDA, including TANF-funded public assistance benefits and the Flexible Fund for Family Services, Home Energy Assistance Program ("HEAP"), Supplemental Nutrition Assistance ("SNAP"), and Child Support. Funding from the Federal government also supports programs managed by OCFS, including Child Care, Child Welfare Services, Adult Protective & Domestic Violence Services, Foster Care, and Adoption Subsidies.
- **Education.** Federal funding supports K-12 education, special education and Higher Education. Like Medicaid and the social services programs, significant portions of Federal education funding are directed toward vulnerable New Yorkers, such as students in schools with high poverty levels, students with disabilities, and higher education students who qualify for programs such as Pell grants and Work-Study.
- **Public Protection.** Federal funding supports various programs and operations of the State Police, Department of Corrections and Community Supervision ("DOCCS"), the Office of Victim Services, the Division of Homeland Security and Emergency

Services ("DHSES"), and the Division of Military and Naval Affairs ("DMNA"). Federal funds are also distributed by the State to municipalities to support a variety of public safety programs.

- **Transportation.** Federal resources support infrastructure investments in highway and transit systems throughout the State, including funding participation in ongoing transportation capital plans. The Infrastructure Investment and Jobs Act ("IIJA") (P.L. 117-58) increased the amount of Federal resources available to the State to fund capital costs associated with transportation projects.
- **All Other.** Other programs supported by Federal resources include housing, economic development, mental hygiene, parks and environmental conservation and general government uses.

Federal Funds Spending – Pandemic Assistance

The Federal government enacted six major laws between March 2020 and March 2021 in response to the COVID-19 pandemic and issued major disaster declarations for all states. These one-time funds to aid states in their response to and recovery from COVID-19 continue to wind down.

New York State was awarded $12.75 billion under the SLFRF program included in the ARP, of which the State utilized the remaining $3.65 billion program balance in FY 2025. A small number of programs are expected to continue in the current State Fiscal Year, specifically:

- **Education ARP Funds**. The ARP granted additional education funding for Elementary and Secondary School Emergency Relief ("ESSER") Fund and Emergency Assistance for Nonpublic Schools ("EANS") programs, as well as funding for homeless education, IDEA, library services and the arts. The State expects to expend nearly $144 million in FY 2026.
- **FEMA Local Pass-Through Funding**. Funding from this program is assumed to flow through the Updated Financial Plan to reimburse local entities for their Federal share of COVID-19 claims submitted to FEMA.
- **Coronavirus Capital Projects Fund**. The ARP created the Coronavirus Capital Projects Fund to provide funding to carry out critical capital projects that directly enable work, education, and health monitoring, including remote options, in response to the COVID-19 PHE. The State has been allocated $345 million for the program.
- **State Small Business Credit Initiative**. This program provides funding to empower small businesses to access capital needed to invest in job-creating opportunities.
- **Federal Highway Administration Surface Transportation Block Grant**. This emergency funding was provided under the CRRSAA to address COVID-19 impacts related to Highway Infrastructure Programs and is expected to continue to disburse through FY 2026.

Federal Government Funding Risks

The amount and composition of Federal funding received by the State fluctuates over time, as legislative and regulatory actions at the Federal level often change. Specific Federal government authority and rules that pose an ongoing risk to the Updated Financial Plan include audits, disallowances, changes to Federal participation rates or other Medicaid rules, discretionary spending reductions, and the expected need for Congress to increase or suspend the debt limit to avoid delaying payments and/or defaulting on debt obligations.

On July 4, 2025, the President signed H.R. 1, that substantially alters Federal funding for health care and food security programs and services provided to New Yorkers and amends the Federal tax liability of New York's residents and businesses. The bill modifies tax rates, deductions, and credits; adjusts eligibility requirements for several Federal benefit programs, including adding and expanding work and community engagement requirements; and makes reductions and amendments to Medicaid and nutrition assistance funding. The Updated Financial Plan includes estimates of the impact beginning in the current fiscal year.

On October 1, 2025, the Federal government shut down due to a failure to pass new appropriations for the 2026 fiscal year and repeated failure to pass any short-term continuing resolutions to reopen the Federal Government. The shutdown halted the flow of new Federal funding for most discretionary grant programs and many mandatory programs that require annual appropriations, as well as Federal employee paychecks. However, specific benefit payments like Social Security, Medicare, and Medicaid are not impacted. The length of the shutdown will determine the severity of the impact to New York as Federal funding is depleted or halted for benefit programs such as Women, Infants, and Children (WIC) (Special Supplemental Nutrition Program

for WIC), SNAP, and Low Income Heating Assistance Program. In addition, the shutdown may delay Federal action on Medicaid waivers or other pending Federal requests.

Debt Limit. Periodically, the Federal government has increased or suspended its debt limit. Failure to increase or suspend the debt limit when needed could result in the Federal government delaying or defaulting on payments. If Federal payments are not made, particularly for a prolonged period, it could have a materially adverse effect on national and state economies, financial markets, and intergovernmental aid payments. Specific effects on the Updated Financial Plan resulting from a potential Federal government delay in payments or default are unknown and impossible to predict. However, data from past economic downturns suggests that the State's revenue loss could be substantial if a delay in Federal payments or default triggered an economic downturn.

Federal Aid Reductions. The Federal government participates in funding a significant portion of programs that provide health care and human services to New Yorkers. Any significant reductions in Federal aid or participation levels could have a materially adverse impact on the Updated Financial Plan.

Health Care. Changes in Federal funding levels or eligibility criteria for public health care programs, including Medicaid, EP, and CHP, could result in a reduction in public health coverage and could negatively impact the Updated Financial Plan. A majority of the State's Medicaid program is operated under a Federal demonstration waiver, which is subject to review by CMS every five years and is currently extended through March 31, 2027. This authorization includes funding for Medicaid Managed Care Programs, MLTC programs, and Home and Community Based Services (HCBS).

Federal Medicaid funding also supports a variety of services, including CDPAP, that permit enrollees to manage and self-direct providers of personal care services. In addition, the State operates the EP under a Federal waiver, which receives Federal subsidies authorized through the ACA. EP currently provides coverage for lawfully present immigrants not eligible for Federal financial participation in Medicaid due to their immigration status, which H.R. 1, disqualifies from receiving Federal funding for their EP benefits resulting in over half of the EP's funding being eliminated. Income eligible lawfully present immigrants may otherwise qualify for the Medicaid program. To alleviate new State costs and maintain coverage for as many individuals as possible, DOH has submitted a request to CMS to terminate its 1332 Waiver and EP expansion and reactivate its (currently suspended) Basic Health Program (authorized under Section 1331 of the ACA). If approved by CMS, this action would shift an estimated 1.3 million current EP 1332 enrollees with incomes below 200 percent of the FPL into the EP 1331 allowing them to maintain comparable health coverage. If denied by CMS, roughly 535,000 current EP enrollees would be eligible to access coverage under Medicaid, and subsequently the remaining roughly 795,000 would lose coverage under EP and would need to obtain employer-based insurance, enroll in a Quality Health Plan on the ACA Marketplace or become uninsured. The Updated Financial Plan estimates of receipts and disbursements assume the Medicaid eligible EP enrollees will transfer to Medicaid in July 2026. Additional revisions to the EP's enrollment and spending projections will be reflected in future updates to account for the status of CMS' approval.

The State is also utilizing a CMS approved three-year, $5.8 billion demonstration waiver through March 31, 2027, to respond to the State's request to address health disparities exacerbated by the COVID-19 pandemic. This funding helps support social, physical, and behavioral health care services throughout the State and requires a total of $1.7 billion in additional State resources, which have been assumed in the Updated Financial Plan over the same period. Given the time limit on the Federal funding, these services are expected to be discontinued at the end of the term absent an extension by the Federal government. Accordingly, there is no State or Federal funding included in the Updated Financial Plan projections beyond the term period.

Human Services. Federal funding supports SNAP and the Home Energy Assistance Program (HEAP), which is administered and supported by Local Departments of Social Services (LDSS). H.R. 1 increases the state's administrative cost-sharing for SNAP from 50 percent to 75 percent effective October 1, 2026, which has been reflected in the Updated Financial Plan. In addition, H.R. 1 introduces a new non-Federal share of benefits in the SNAP program, ranging from zero percent to 15 percent of program costs, effective as early as October 1, 2027. The implementation of this new non-Federal share may be delayed by up to two years depending on the State's error rate in Federal Fiscal Years 2025 or 2026. Currently, Federal resources flow directly to recipients to fund the benefits of the SNAP program. Costs for this provision of H.R. 1 have not been reflected in the Updated Financial Plan, as factors such as error rate and local cost sharing have yet to be determined, nor does the State currently make payments of this nature.

Other Federal funding through the Office of Refugee Resettlement contributes to the State's response to the migrant crisis, and reductions would threaten the health, well-being, and stability of refugees. The Commission for the Blind uses Federal funds to support mobility training, academic instruction, case management, and vocational training, and a reduction in Federal funds would result in a reduction or elimination of services.

Likewise, a reduction in Federal funding from the Child Care Development Funds (CCDF) would reduce the size of the State's annual child care block grant allocations to New York LDSS and result in waitlists for services. The Federal government has approved a State waiver to effectuate a delay of certain provisions of new CCDF rules for two years through August 1, 2026. However, the waiver could be revoked at the discretion of the Federal government.

Reductions in Federal funding through Title IV-E and IV-B would threaten foster care placements, adoption subsidies, and kinship caregiver supports. Changes to Title XX funding would impact child welfare and domestic violence services. The Office of Children and Family Services (OCFS) also receives a variety of Federal grants for child preventive services programs, domestic violence services, adoption incentive programs, and the Chafee Independent Living program that would potentially be reduced or eliminated if Federal support was modified.

Climate Change

Overview. Climate change poses significant threats to physical, biological, and economic systems in New York and around the world. The immediate and long-term effects of climate change could adversely impact the Updated Financial Plan in the current year or in future years. Climate change risks also increasingly fall within the maximum maturity term of current outstanding bonds of the State, which may generally be issued with a term of up to 30 years under State statute, as well as bonds issued by public authorities and municipalities. Hazards and risks related to climate change for the State include, among other things, rising sea levels, increased coastal flooding and related erosion hazards, intensifying storms, wildfires, and more extreme heat.

Consequences of Climate Change. Powerful storms affecting the State, including Hurricane Ida (September 2021), Superstorm Sandy (October 2012), Tropical Storm Lee (September 2011), and Hurricane Irene (August 2011), and more recently flooding in 2024 due to the remnants of Hurricane Beryl and Tropical Storm Debby have demonstrated vulnerabilities in the State's infrastructure (including mass transit systems, power transmission and distribution systems, and other critical lifelines) to extreme weather driven events, including coastal flooding caused by storm surges and flash floods from rainfall.

To mitigate and manage the impacts of climate change, all levels of government, including municipalities and public utilities, continue to undertake a variety of actions to reduce greenhouse gas emissions and adapt existing infrastructure to the changing environment. However, given the size and scope of potential disruptions, there can be no assurance that such efforts will be adequate or timely enough to mitigate the most damaging effects of climate change.

State Response to Climate Change. In 2019, the State enacted the Climate Leadership and Community Protection Act ("CLCPA"). The CLCPA set the State on a path toward reducing statewide greenhouse gas emissions by 85 percent below the 1990 level by 2050; and a plan to fully transition its electricity sector to zero emissions by 2040. Several factors may impact the ability to achieve these goals and directives, and, therefore, no assurances can be made that such objectives will be met.

The CLCPA created the Climate Action Council ("CAC"), which was tasked with developing a Scoping Plan with recommendations to reduce greenhouse gas emissions, increase renewable energy usage, and promote climate justice. The CAC approved and adopted the final Scoping Plan in December 2022. In response, New York is working to develop an affordable and effective cap-and-invest program that will drive emissions reductions across all regions of the State, while maintaining the competitiveness of New York businesses and industries. Pursuant to the CLCPA, the Department of Environmental Conservation is required to promulgate rules and regulations to ensure the State meets the CLCPA's statewide greenhouse gas emission limits. DEC has already adopted a variety of regulations to help meet this objective, which will play a key role in New York's overall policies aimed at reducing greenhouse gas emissions across the State.

New York's electricity system is already part of a regional cap-and-invest program: the Regional Greenhouse Gas Initiative ("RGGI"). Since RGGI began operation in 2008, the program has helped reduce greenhouse gases from power plants by more than half and raised over $2.7 billion to support cleaner energy solutions in New York and over $9.0 billion collectively among participating states.

Concurrently, the State has been taking regulatory and legislative actions that are intended to limit greenhouse gas emissions, electrify transportation, and generate more electricity from renewable sources. Realization of these actions and their intended outcomes is contingent upon successful implementation, and, therefore, no assurances can be made that such actions will be realized as planned. Major actions include:

- Making a $1 billion capital investment in the FY 2026 Enacted Budget to lower building emissions, advance clean transportation and build renewable energy projects.
- Authorizing the New York Power Authority to plan, design, develop, finance, construct, own, operate, maintain, and improve renewable energy generating projects.
- Prohibiting building systems and/or equipment that burn fossil fuels in new construction starting December 31, 2025, for any new building seven stories or lower, except large commercial and industrial buildings, and December 31, 2028 for other new buildings.
- Requiring new off-road vehicles and equipment sold in New York to be zero-emissions by 2035 and new medium-duty and heavy-duty vehicles to be zero-emissions by 2045.
- Providing direct financial investment to school districts and private transportation contractors for the purchase or lease of zero-emission school buses – to facilitate compliance with the State's 2027 deadline, with full fleet conversion and operation of zero-emission school buses required by July 1, 2035.
- Signing the Climate Change Superfund Act in December 2024, which will require companies that have contributed significantly to the buildup of climate-warming greenhouse gases in the atmosphere to pay for critical infrastructure investments to adapt to climate change.

During the November 2022 general election, New York State voters approved the Clean Water, Clean Air, and Green Jobs Bond Act. The $4.2 billion bond act is actively being implemented and is supporting substantial capital improvements and enhancements in the following areas: flood risk reduction/restorations; open space, working lands conservation, and recreation; climate change mitigation; and water quality improvement and resilient infrastructure.

Labor Negotiations and Agreements

All State labor unions are covered by a ratified contract through the end of FY 2026. The State expects to continue to engage with unions to discuss future agreements. The Updated Financial Plan includes amounts informally reserved for future operational needs that could be available to fund costs of future labor contracts; however, there can be no assurance that those amounts will be available or sufficient to fund costs related to future agreements in their entirety.

Pension Contributions

The State makes annual contributions to the New York State and Local Retirement System (NYSLRS) for employees in the New York State and Local Employees' Retirement System (ERS) and Police and Fire Retirement System (PFRS). This section discusses contributions to the NYSLRS, which account for most of the State's pension expenses. All projections are based on estimated market returns and numerous actuarial assumptions which, if unrealized, could have a materially adverse effect on these projections.

New York State Retirement and Social Security Law (RSSL) Section 11 directs NYSLRS to provide regular reports on the System's experience and to propose assumptions and methods for the actuarial valuations. Employer contribution rates for NYSLRS are determined based on investment performance in the Common Retirement Fund and actuarial assumptions recommended by the Retirement System's Actuary and approved by the State Comptroller. Pension estimates are based on the actuarial report issued in September each year. The current year report included the statutorily required quinquennial study that reviews the experience over the previous five years in relation to the current assumption made by the retirement system, and adopts new assumptions, if necessary, which are used to measure experience on a prospective basis. The Comptroller does not provide a multi-year forecast of pension liability estimates requiring DOB to forecast costs for the outyears of the State's Updated Financial Plan. DOB's forecast assumes growth in the salary base consistent with collective bargaining agreements and a conservative rate of return that is generally comparable to the current 5.9 percent rate of return assumed by NYSLRS.

On September 4, 2025, the Comptroller announced an increase in employer contribution rates for both ERS and PFRS which will impact State and local government expenses beginning in FY 2027. The average employer contribution rate for ERS

increased from 16.5 percent to 17.6 percent of payroll, its highest level since FY 2016. Likewise, the average employer contribution rate for PFRS increased from 33.7 percent to 36.5 percent of payroll, its highest level in over 55 years.

The ERS rate increase is mainly due to the continued growth in the State workforce. In addition, the PFRS rate increase was primarily driven by changes to the System's Actuary Disability assumption as numerous bills have been enacted over the last few years to expand or improve the disability benefit, increasing the probability a disability retirement will be awarded in the future. Lastly, the service retirement assumption was changed due to the increase in the number of retirements being filed upon a member's initial eligibility for a service retirement.

Pension costs have escalated over the past several years due to a variety of factors including growth in the State workforce; a higher-than-expected number of service retirements; fluctuating investment performance, including prior year market losses in the CRF; and recent enhancements to the retirement benefits for Tier 6 members11 and certain groups of first responders and officers. The enhancements include a retirement benefit for firefighters employed by DMNA equal to 50 percent of Final Average Salary (FAS) after twenty-five years of service and a new 20-year and 25-year retirement plan for members of PBANYS which includes State Park Police, Department of Environmental Conversation (DEC) Police, DEC Forest Rangers, and SUNY Police. In addition, several bills are pending action by the Governor that would further enhance pension benefits for certain groups. If approved, these bills would collectively require approximately $40 million in short-term costs to the State.

Contribution Stabilization Program

State and local governments are authorized to amortize (defer paying) a portion of their annual pension costs that exceed a statutorily defined fixed increase. Amortization temporarily reduces the pension costs that must be paid by public employers in a given fiscal year but results in financing costs that increase total costs overall inclusive of interest liability. The full amount of each amortization must be repaid within ten years at a fixed interest rate determined by the Office of the State Comptroller ("OSC"). The State and local governments are required to begin repayment on new amortizations in the fiscal year immediately following the year in which the amortization was initiated. The State currently has no outstanding pension amortization liability and no plans to withdraw from the program.

Other Post-Employment Benefits ("OPEB")

State employees become eligible for post-employment benefits (e.g., health insurance) if they reach retirement while working for the State; are enrolled in either the New York State Health Insurance Program (NYSHIP) or the NYSHIP opt-out program at the time they reach retirement; and have the required years of eligible service. The cost of providing post-retirement health insurance is shared between the State and the retired employee. Contributions are established by law and may be amended by the Legislature. The State is not required to provide funding above the PAYGO amount necessary to provide current benefits to retirees. The State continues to fund these costs, along with all other employee health care expenses, on a PAYGO basis, meaning the State pays these costs as they become due.

The State has deposited over $1.7 billion to the Retiree Health Benefit Trust Fund (RHBTF) created in FY 2018 as a qualified trust under Governmental Accounting Standards Board Statements (GASBS) No. 74 to reserve money for the payment of health benefits of retired employees and their dependents. The RHBTF is a Fiduciary Fund and is excluded from All Governmental Funds. Under current law, the State may annually deposit up to 1.5 percent of the total then-current unfunded actuarial accrued OPEB liability ($58.3 billion on March 31, 2025). The Updated Financial Plan includes $250 million deposits to the RHBTF in each year, that will be dependent on fiscal conditions.

Cybersecurity

The New York State government, like many other large public and private entities, relies on a large and complex technology environment to conduct its operations. As a recipient and provider of personal, private, or sensitive information, the State and its authorities, agencies and public benefit corporations, as well as its political subdivisions (including counties, cities, towns, villages and school districts) face multiple cyber threats involving, but not limited to, hacking, viruses, ransomware, malware and other attacks on computers and other networks and systems. Entities or individuals may attempt to gain unauthorized access to the State's technology environment for the purposes of misappropriating assets or information or causing operational disruption and damage. In addition, the tactics used in malicious attacks to obtain unauthorized access to networks and systems change frequently and are often not recognized until launched against a target. Accordingly, the State may be unable to fully anticipate these techniques or implement adequate preventative measures.

To mitigate the risk of business operations impact and/or damage from cyber incidents or cyber-attacks, the State invests in multiple forms of cybersecurity and operational controls. The State's Chief Information Security Office ("CISO") within the State's Office of Information Technology Services maintains policies, standards, programs, and services relating to the security of State government networks. The CISO is responsible for annually assessing the effectiveness of certain State agencies' cybersecurity defenses through the Nationwide Cybersecurity Review. In addition, the CISO maintains the New York State Cyber Command Center team, which possesses digital forensics capabilities, and manages cyber incident reporting and response. The CISO also distributes real-time advisories and alerts, provides managed security services, and implements statewide information security awareness training. The State has also developed partnerships with local governments to better address cybersecurity threats.

In February 2022, the Governor announced the creation of an information-sharing partnership, the Joint Security Operations Center ("JSOC"). The JSOC is a partnership between the State and the cities of Albany, Buffalo, the City of New York, Rochester, Syracuse, and Yonkers. The JSOC combines local, state, and Federal cyber threat information in order to increase collaboration on threat intelligence, reduce response times, and yield faster and more effective remediation in the event of a major cyber incident. The FY 2026 Enacted Budget continued to invest in New York's Shared Services Program, which helps county and local governments and other regional partners acquire and deploy high quality cybersecurity services to bolster their cyber defenses.

Occasionally, intrusions into State digital systems have been detected, but they have generally been contained. While cybersecurity procedures and controls are routinely reviewed and tested, there can be no assurance that such security and operational control measures will be successful at preventing future cyber threats and attacks. Successful attacks could adversely impact the State, including disrupting business operations, harming State networks and systems, and damaging State and local infrastructure; and the costs of remediation and recovery could be substantial.

The State has also adopted regulations designed to protect the financial services industry from cyberattacks. Banks, insurance companies and other covered entities regulated by DFS are, unless eligible for limited exemptions, required to: (a) maintain a cybersecurity program, (b) create written cybersecurity policies and perform risk assessments, (c) designate someone with responsibility to oversee the cybersecurity program, (d) annually certify compliance with the cybersecurity regulations, and (e) report to DFS cybersecurity events that have a reasonable likelihood of materially harming any substantial part of the entity's normal operation(s) or for which notice is required to any government body, self-regulatory agency, or supervisory body.

Financial Condition of New York State Localities

The State's localities and certain public authorities rely in part on State financial assistance to meet their commitments and expenses. Unanticipated financial needs among localities and the MTA can create pressure for the State to assist and may adversely affect the State's Updated Financial Plan projections.

The largest driver of costs for most counties is Medicaid; however, the State has taken over all the growth in the program since FY 2007 and funds the entire cost of minimum wage and homecare wage increases. In addition, certain localities outside the City of New York, including cities and counties, have experienced financial problems, and have been allocated additional State assistance during the last several State fiscal years. The Financial Restructuring Board for Local Governments (the "Restructuring Board") aids distressed local governments by performing comprehensive reviews and providing grants and loans on the condition of implementing recommended efficiency initiatives. For additional details on the Restructuring Board, please visit frb.ny.gov.

Metropolitan Transportation Authority

The MTA operates public transportation in the City Of New York metropolitan area, including subways, buses, commuter rail, and tolled vehicle crossings. The services provided by the MTA and its operating agencies are integral to the economy of the City of New York and the surrounding metropolitan region, as well as to the economy of the State. MTA operations are funded mainly from fare and toll revenue, dedicated taxes, and subsidies from the State and the City of New York. MTA Capital Plans also rely on significant direct contributions from the State and the City of New York.

MTA Capital Plans. The FY 2026 Enacted Budget provided funding for the MTA's 2025-2029 Capital Plan. The Budget included $4.2 billion in direct State contributions, of which $3 billion is from a new appropriation and $1.2 billion is from

repurposing an existing Penn Station appropriation. Additionally, the Budget included adjustments to the Metropolitan Commuter Transportation Mobility Tax (MCTMT) that are anticipated to generate an estimated $31.5 billion for the 2025-2029 Capital Plan.

The State is also directly contributing $9.1 billion to the MTA's 2015-2019 Capital Plan and $3.1 billion to the MTA's 2020-2024 Capital Plan. These State commitment levels represent substantial increases from the funding levels for prior MTA Capital Plans (2010-2014: $770 million; 2005-2009: $1.45 billion). In addition, a substantial amount of new funding to the MTA was authorized in the FY 2020 Enacted Budget as part of a comprehensive reform plan expected to generate an estimated $25 billion in financing for the MTA's 2020-2024 Capital Plan, including $15 billion from congestion pricing revenues.

New York's Central Business District Tolling Program (CBDTP) was implemented in Manhattan on January 5, 2025, following the entry of an agreement, dated November 21, 2024, by and among the Federal Highway Administration (FHWA), NYS Department of Transportation, NYC Department of Transportation, and the Triborough Bridge and Tunnel Authority (TBTA), approving the CBDTP under the Federal Value Pricing Pilot Program (the VPPP Agreement). On February 19, 2025, the U.S. Department of Transportation (US DOT) delivered a letter to Governor Kathy Hochul asserting its intent to terminate the VPPP Agreement and rescind FHWA's approval of the CBDTP. In response, the TBTA and MTA filed a complaint in the U.S. District Court for the Southern District of New York seeking, among other legal remedies, an order vacating US DOT's purported termination which was undertaken in violation of the terms of that agreement, and in excess of the Department's authority. The TBTA and MTA have stated they will continue operation of the CBDTP absent a valid court order.

Additionally, in October 2025, the Federal government announced that it would withhold $18 billion in funding for the MTA's Second Avenue Subway project and the Gateway Development Commission's Hudson Tunnel Project pending an administrative review of project contracting processes. Given the scale and importance of these major infrastructure initiatives, a prolonged withholding of Federal funding could negatively impact project schedules and the regional economy more generally.

Other State Actions. MTA ridership has yet to return to pre-pandemic levels. In the FY 2024 Enacted Budget, the State took substantial action to provide the MTA with additional operating revenues dedicated to help solve the MTA's fiscal crisis. This included an increase in the metropolitan commuter transportation mobility tax in the City of New York, a one-time State subsidy of $300 million, an increase in the City of New York's contribution to the MTA for the costs of paratransit services and directing a portion of future casino revenues, the timing of which is uncertain, to the MTA.

Risks to the MTA include, but are not limited to, the level and pace at which ridership will return, the economic conditions of the MTA region, the ability to implement cost controls and savings actions, and the ability to implement biennial fare and toll increases.

Bond Market and Credit Ratings

Successful execution of the Updated Financial Plan is dependent on the State's ability to market bonds. The State pays for much of its capital spending, in the first instance, from the General Fund or STIP and then reimburses itself with proceeds from the sale of bonds. An inability of the State to sell bonds or notes at the level or on the timetable it expects could have a material and adverse impact on the State's financial position and the implementation of its Capital Plan. The success of projected public sales of municipal bonds is subject to prevailing market conditions and related ratings issued by national credit rating agencies, among other factors. Future developments in the financial markets, including possible changes to the Internal Revenue Code relating to the taxation of interest on municipal bonds, may affect the market for outstanding State-supported and State-related debt.

The major rating agencies - Fitch, KBRA, Moody's, and S&P - have assigned the State general credit ratings of AA+, AA+, Aa1, and AA+, respectively. The State's rating has a stable outlook from all four rating agencies. These ratings reflect the State's large and diverse economy, commitment to strong reserve levels, and strong budget management.

Debt Reform Act of 2000 ("Debt Reform Act") Limit

The Debt Reform Act restricts the issuance of State-supported debt funding to capital purposes only and, with certain limited exceptions for long-lived MTA projects, generally limits the maximum term of bonds to 30 years. The Debt Reform Act limits the amount of new State-supported debt to 4 percent of State personal income, and new State-supported debt service costs to 5 percent of All Funds receipts. The restrictions apply to State-supported debt issued after April 1, 2000. DOB, as administrator of the Debt Reform Act, determined that the State complied with the statutory caps in the most recent calculation period (FY 2025).

The statute requires that limitations on the amount of State-supported debt and debt service costs be calculated by October 31 of each year and reported in the Mid-Year Update to the Financial Plan. If the actual amount of new State-supported debt outstanding and debt service costs for the prior fiscal year is below the caps at that time, State-supported debt may continue to be issued. However, if either the debt outstanding or debt service caps are met or exceeded, the State would be precluded from issuing new State-supported debt until the next annual cap calculation is made and the debt is found to be within the applicable limitations.

Actual levels of debt outstanding and debt service costs are in compliance with the statutory caps. From April 1, 2000 through March 31, 2025, the State has issued new debt resulting in $42.0 billion of debt outstanding subject to the debt limit. This is approximately $26.0 billion below the statutory debt limitation. In addition, the debt service costs on this new debt totaled $2.4 billion in FY 2025, or roughly $10.1 billion below the debt service limit.

The State enacted legislation that suspended certain provisions of the Debt Reform Act for FY 2021 and FY 2022 bond issuances as part of the State's response to the COVID-19 pandemic. Accordingly, a total of $14 billion of State-supported debt issued in FY 2021 and FY 2022 and outstanding as of March 31, 2025, is not counted towards the statutory caps on debt outstanding and debt service.

Current projections anticipate that State-supported debt outstanding and State-supported debt service will continue to remain below the limits imposed by the Debt Reform Act. Based on the most recent personal income and debt outstanding forecasts, the available debt capacity under the debt outstanding cap is expected to decline from $26.0 billion in FY 2025 to a low point of $268 million in FY 2030. This calculation includes the estimated impact of funding capital commitments with State bonds. The debt service on State-supported debt subject to the statutory cap is projected at $3.0 billion in FY 2026 inclusive of prior year prepayments, or roughly $9.9 billion below the statutory debt service limit.

The State uses personal income estimates published by the Federal government, specifically the Bureau of Economic Analysis (BEA), to calculate the cap on debt outstanding, as required by statute. The BEA revises these estimates on a quarterly basis and such revisions can be significant. For Federal reporting purposes, BEA reassigns income from the state where it was earned to the state in which a person resides, for situations where a person lives and earns income in different states (the "residency adjustment"). The BEA residency adjustment has the effect of reducing reported New York State personal income because income earned in New York by non-residents regularly exceeds income earned in other states by New York residents. The State taxes all personal income earned in New York, regardless of place of residency.

Executive Budget - Debt Cap Changes

Changes in the State's available debt capacity reflect factors such as personal income forecast adjustments, defeasances, and bond sale results. The decrease in debt capacity in the Mid-Year Update to the Financial Plan reflects lower personal income estimates. The State may adjust capital spending priorities and debt financing practices from time to time to preserve available debt capacity and stay within the statutory limits, as events warrant.

STATE FINANCIAL PLAN PROJECTIONS

Introduction

This section presents multi-year projections for receipts and disbursements, with an emphasis on FY 2026 projections.

The budget development and quarterly updates process includes a comprehensive evaluation of the State's multi-year operating forecast; however, estimates and projections in the later years of the Updated Financial Plan are typically subject to more substantial revision than those in the current year and first "outyear." Accordingly, in terms of outyear projections, the first "outyear," FY 2027, is the most relevant from a planning perspective.

The State budgets on a cash basis, using a complex fund structure that earmarks certain tax receipts for specific purposes, which often complicates the reporting and discussion of the State's receipts and disbursements projections. To reduce potential distortions caused by these factors and to highlight relevant aspects of the projections, DOB adopts certain approaches in summarizing projections.

Receipts: Financial Plan receipts include a variety of taxes, fees and assessments, charges for State-provided services, Federal receipts, and other miscellaneous receipts. Multi-year receipts estimates are prepared by DOB with the

assistance of the Department of Taxation and Finance and other agencies, which collect State receipts and are premised on economic analysis and forecasts.

Overall base growth (i.e., growth not due to law changes) in tax receipts is dependent on many factors. In general, base tax receipts growth rates are determined by economic changes including, but not limited to, changes in interest rates, prices, wages, employment, nonwage income, capital gains realizations, taxable consumption, corporate profits, household net worth, real estate prices and gasoline prices. Federal law changes can influence taxpayer behavior, which often alters base tax receipts.

General Fund tax receipts are affected by the deposit of dedicated taxes in other funds for debt service and the STAR program. Changes in debt service on State-supported revenue bonds also affect General Fund tax receipts. The State utilizes bonding programs, where tax receipts are deposited into dedicated Debt Service Funds (outside the General Fund) and used to make debt service payments. After satisfying debt service requirements for these bonding programs, the balance is transferred to the General Fund. Accordingly, amounts transferred to the General Fund which are in excess of amounts needed for certain debt service obligations (e.g., PIT receipts in excess of the amount transferred to debt service on revenue bonds) may be excluded from some tables displaying General Fund tax receipts.

Projections of Federal receipts generally correspond to the anticipated spending levels of a variety of programs supported by Federal aid, including Medicaid, public assistance, mental hygiene, education, public health, and other activities.

State and All Funds receipts reflect estimated tax receipts before distribution to various funds and accounts, including tax receipts dedicated to Capital Projects Funds (which fall outside the General Fund and State Operating Funds accounting perspectives) to provide a clearer picture of projected receipts, trends, and forecast assumptions, and avoid the distortions created by earmarking tax receipts for specific purposes.

Disbursements: To provide a clear representation of spending commitments, the multi-year spending projections, growth rates, and summary of annual changes are presented on a State Operating Funds basis to include spending that is accounted for in dedicated Special Revenue Funds, primarily for School Aid, health, higher education, and transportation. Roughly a quarter of projected State-financed spending for operating purposes (excluding transfers) is reported outside the General Fund.

The multi-year disbursements projections consider various factors, including statutorily indexed rates intended to limit spending in certain programs, agency staffing levels, program caseloads, inflation, and funding formulas contained in State and Federal law. Factors that affect spending estimates vary by program. For example, public assistance spending is based primarily on anticipated caseloads that are estimated by analyzing historical trends and projected economic conditions. Projections also account for the timing of payments, since not all the amounts appropriated are disbursed in the same fiscal year. Consistent with past practice, the aggregate receipts and spending projections (i.e., the sum of all projected receipts and spending by individual agencies) in State Special Revenue Funds are centrally adjusted downward to reflect aggregate spending trends and patterns observed between estimated and actual results over time.

Overview of the Receipts Forecast

All Funds receipts are projected to total $258.7 billion in FY 2026, a 5.6 percent ($13.7 billion) increase from FY 2025 results. FY 2026 State tax receipts, excluding one-time tax refund payments, are projected to increase $8.4 billion (7.4 percent) from FY 2025 results. FY 2027 State tax receipts are projected to total $123.4 billion, a 1.3 percent increase from FY 2026.

Personal Income Tax

FY 2026 PIT receipts are estimated to increase moderately from FY 2025, reflecting increases in all major gross receipts components, partially offset by an increase in total refunds.

FY 2026 withholding is estimated to increase compared to the prior year despite weaker bonus wage growth and the cost of the Middle-Class Tax Cut beginning in tax year 2026. Current estimated payments for tax year 2025 and extension payments (i.e., prior year estimated) for tax year 2024 are both expected to increase. The projected growth in current estimated payments reflects moderate growth in non-wage income. Delinquent collections and final return payments are projected to increase as well.

Total refunds in FY 2026 are projected to increase significantly, driven primarily by Inflation Refund checks, an advanced credit payment effectuated by FY 2026 Enacted Budget legislation. The increase in prior year refunds for tax year 2024,

which impact FY 2026 refunds, is driven by more PTET-related refunds compared to tax year 2023. State/City offsets and refunds for tax years previous to 2024 are also expected to increase.

FY 2027 PIT receipts are expected to increase from FY 2026 due to growth in all gross receipts components. Withholding is projected to grow modestly and will be suppressed by the influence of the aforementioned Middle-Class Tax Cut. Total estimated payments are expected to increase, driven by growth in both current estimated payments for tax year 2026 and extension payments for tax year 2025. Final returns and delinquent collections are also expected to increase. The nearly flat growth in refunds is driven by a sharp decline in advanced credit payments after the one-time Inflation Refund payments in the prior fiscal year, offset by an increase in PTET-related refunds coupled with the first effect of the temporarily enhanced Empire State Child Credit effectuated by FY 2026 Enacted Budget legislation.

FY 2028 PIT receipts are projected to increase from FY 2027 due to growth in all gross receipts components partially offset by increases in total refunds. The increase in refunds is driven by increases in advanced credit payments, State/City offsets, prior refunds for tax year 2026, and refunds for years previous to tax year 2026. Receipts also include elevated refunds from the expansion of the enhanced Empire State Child Credit to children over three years old.

FY 2029 PIT receipts are projected to increase due to increases in withholding, estimated tax payments, final returns and delinquencies partially offset by an increase in total refunds.

Consumption/Use Taxes

All Funds consumption/use tax receipts for FY 2026 are estimated to increase from FY 2025 results. Sales tax receipts are estimated to increase due to moderate growth in taxable consumption. Cigarette and tobacco tax receipts are estimated to decrease, reflecting a continuing trend of declining taxable consumption. Opioid and medical cannabis excise tax receipts are both expected to marginally decline; the estimated decline in opioids receipts reflects the continued long-term trend of declining opioid consumption, while the medical cannabis decline is largely attributable to the full year impact of the reduced excise tax rate (from 7 percent to 3.15 percent) that went into effect June 1, 2024. Peer-to-peer car sharing receipts are estimated to decline as consumer demand appears to wane while the industry works toward stabilizing and increasing utilization in this market. Adult-use cannabis taxes are projected to significantly increase as the State's cannabis market expands during the third full year of receipts. Auto rental tax receipts are estimated to increase, continuing the underlying long-term growth trend. General Fund consumption/use tax receipts for FY 2026 are projected to increase largely due to the previously noted All Funds sales tax receipts trend.

FY 2027 consumption/use tax receipts are projected to increase, largely driven by a projected increase in sales tax receipts. Several consumption/use taxes are projected to experience flat or nearly flat year-over-year growth, including opioid excise tax, medical cannabis excise tax, peer-to-peer tax, car-sharing tax, and the vapor excise tax; or moderate/marginal growth, as is the case with auto rental and highway use tax receipts. Adult-use cannabis taxes are projected to significantly increase as the cannabis market continues to evolve and mature. However, the increases above are partially offset by a continued decline in taxable cigarette consumption and a moderate decline in motor fuel tax receipts due to a projected decline in overall fuel consumption.

Consumption/use tax receipts for FY 2028 and FY 2029 are projected to increase, largely reflecting a projected increase in sales tax receipts and the continued maturation of the adult-use cannabis market, partially offset by a continued decline in taxable cigarette consumption.

Business Taxes

The H.R. 1 bill enacted July 4, 2025, created and modified several corporate tax provisions that the State remains coupled to. While the fiscal impact at the time of enactment remained unclear, the changes to corporate tax provisions at the Federal level, notably the provisions regarding immediate expensing of research costs and first-year expensing of qualified properties, are anticipated to have a negative impact on State corporate tax receipts.

CFT receipts are estimated to decrease in FY 2026, reflecting increases in refunds and decreases in gross receipts due in large part to the Federal tax law changes.

Corporation and Utilities Tax (CUT) receipts are estimated to marginally decrease in FY 2026 due to a combination of decreased gross receipts from the telecommunications sector and an increase in refunds. This decrease is partially offset by a

projected increase in audits coupled with an increase in gross receipts for utilities. Special revenue fund receipts are projected to increase slightly due to audits.

Insurance tax receipts are estimated to decrease in FY 2026 due to an increase in refunds and a decline in gross receipts. This is partially offset by a projected increase in audits.

PTET collections are estimated to slightly decrease in FY 2026 due to an estimated increase in refunds and distribution offset, partially offset by increased estimated payments. As noted, DOB expects PTET will be revenue-neutral for the State; however, PTET will not be revenue-neutral within each fiscal year as PTET payments are generally received in the fiscal year prior to PIT credit claims.

Receipts from the repealed bank tax (all from prior liability periods) are estimated to significantly decreased in FY 2026 due to an expectation of lower audit receipts. Petroleum Business Tax (PBT) receipts are estimated to decrease from FY 2025 results, primarily due to two successive rate index declines, as the net impact of a 5 percent decline in the PBT rate index effective January 1, 2025 is coupled with another 5 percent decline effective January 1, 2026.

Business tax receipts for FY 2027 are projected to decrease due to CFT receipts, largely on account of the Federal tax law changes, and PBT receipts. Increases in PTET, insurance, and CUT tax receipts partially offset the overall business tax receipts decrease. These increases are driven by PTET estimated payments for tax year 2026 and gross receipts for both CUT and insurance, coupled with a slight decline in insurance tax refunds. Bank tax receipts are projected to fall to zero in FY 2027.

Business tax receipts for FY 2028 are projected to decline, due to PBT and CFT, offset by increases in PTET, insurance tax, and CUT. PTET is projected to show the largest increase, driven by increased estimated payments for tax year 2027. The decrease in CFT receipts is driven by a combination of the expiration of the temporary tax rates after tax year 2026 and Federal tax law changes.

Business tax receipts for FY 2029 are projected to increase in the PTET, CUT, and insurance tax, while CFT and PBT are projected to decline.

Other Taxes

FY 2026 other tax receipts are estimated to increase from FY 2025 results, primarily due to increases in both estate tax and real estate transfer tax receipts. Estimated estate tax receipts reflect estimated growth in household net worth, as well as an expected decrease in refunds. Estimated real estate transfer tax receipts largely reflect estimated growth in the average housing price, bonuses, and the S&P 500, partially offset by a minor decline in housing starts.

Other tax receipts in FY 2027 and the outyears are projected to increase, largely due to increases in both estate tax and real estate transfer tax receipts, reflecting projected annual growth in household net worth, housing starts, the average housing price, the S&P 500, and bonuses.

Miscellaneous Receipts

All Funds miscellaneous receipts in FY 2026 are projected to increase from FY 2025, driven by projected growth of bond proceeds receipts, primarily due to the increase in bond-eligible capital spending, partly offset by a projected decline in investment income and abandoned property receipts.

In the later years of the Updated Financial Plan, All Funds miscellaneous receipts reflect the timing of capital reimbursements and bond issuances and a continued decline in investment income attributable to lower forecasted interest rates and available balances.

Federal Receipts

Aid from the Federal government helps to pay for a variety of programs including Medicaid, public assistance, mental hygiene, School Aid, public health, transportation, and other activities. Annual changes to Federal receipts generally correspond to changes in federally- reimbursed spending. Accordingly, DOB typically projects Federal reimbursements will be received in the State FY in which spending occurs, but due to the variable timing of Federal receipts, actual results often differ from projections.

The changes in Federal receipts projections correspond with expected changes in Federal spending across the Financial Plan period, which include increases to Medicaid, Public Health, and Transportation, partially offset by the wind-down of

pandemic assistance to aid states in their response to and recovery from COVID-19. In addition, Federal receipts in the General Fund reflect the final use of Federal ARP funds in FY 2025, consistent with Treasury rules.

Many of the policies that drive Federal aid may be subject to change. If Federal funding to the State were reduced, this could have a materially adverse impact on the Updated Financial Plan.

Disbursements

The multi-year disbursements projections considered various factors including statutorily-indexed rates intended to limit spending in certain programs, agency staffing levels, program caseloads, inflation, and funding formulas contained in State and Federal law. Factors that affected spending estimates vary by program. For example, public assistance spending was based primarily on anticipated caseloads that were estimated by analyzing historical trends and projected economic conditions. Projections also accounted for the timing of payments, since not all the amounts appropriated are disbursed in the same FY. Consistent with past practice, the aggregate receipts and spending projections (i.e., the sum of all projected receipts and spending by individual agencies) in State Special Revenue Funds were centrally adjusted downward to reflect aggregate spending trends and patterns observed between estimated and actual results over time.

Assistance and Grants

Assistance and grants spending represents approximately two-thirds of total State Operating Funds spending, and includes payments to local governments, school districts, health care providers and associations, hospitals, nursing homes, and other entities, as well as financial, and other entities, as well as financial assistance to, or on behalf of, individuals, families and not-for-profit organizations who provide services to individuals. School Aid and health care spending account for most of the State Operating Funds assistance and grants spending.

Education

School Aid

School Aid supports elementary and secondary education for roughly 2.4 million public school pupils in the State's 673 major school districts. State aid is provided to districts based on statutory aid formulas and through reimbursement of categorical expenses, such as prekindergarten programs, education of homeless children, and bilingual education. State funding for schools assists districts in meeting locally defined needs, such as the construction of school facilities and the education of students with disabilities.

School Year (July 1 - June 30)

The FY 2026 Enacted Budget provides $37.6 billion in total School Aid for SY 2026, representing an annual increase of $1.7 billion (4.9 percent). This includes a $1.4 billion (5.7 percent) increase in Foundation Aid. The FY 2026 Enacted Budget reformed the Foundation Aid formula by updating the formula's two measures of the percentage of low-income students in a school district, increasing aid for English language learners, providing additional aid to low-wealth school districts, modifying the Regional Cost Index, and ensuring that each district receives at least a 2 percent annual increase in aid. The Enacted Budget also provided enhancements to Special Services Aid and BOCES Aid to better support career and technical education. The Enacted Budget further provided additional aid to school districts with large portions of their enrollment attending charter schools.

In SY 2027 and beyond, growth in School Aid reflects estimated growth in Foundation Aid and expense-based aids, which incorporates DOB's inflation forecast and recent annual expense-based aid growth, respectively.

State FY School Aid

State School Aid is funded from the General Fund, commercial gaming receipts, Cannabis sales, Mobile Sports Wagering receipts, and Lottery Fund receipts, including revenues from VLTs. Commercial gaming, Lottery, and Mobile Sports Wagering receipts are accounted for and disbursed from dedicated accounts. Revenue from the fantasy sports education and the cannabis education accounts are transferred to the Lottery Fund for disbursement. The amount of School Aid spending financed by mobile sports wagering receipts is expected to increase in FY 2026 due to an increase in anticipated revenue collections. Additionally, the amount of School Aid spending financed by lottery receipts is expected to decrease in FY 2026 due to higher than anticipated revenue collections in FY 2024 that rolled into FY 2025.

Because the State FY begins annually on April 1 and the SY begins annually on July 1, the State typically pays approximately 70 percent of the annual SY commitment during the initial State FY and the remaining 30 percent in the first quarter of the following State FY.

Other Education Funding

The State provides funding and support for various other education-related programs. These include special education services; programs administered by the Office of Prekindergarten through Grade 12 education; cultural education; higher and professional education programs; and adult career and continuing education services.

The State helps fund special education services for approximately 500,000 students with disabilities, from ages 3 to 21. Major programs under the Office of Prekindergarten through Grade 12 Education address specialized student needs or reimburse school districts for education-related services, including assisted meal programs, after-school programs, and other educational grant programs. Cultural education includes aid for operating expenses of the major cultural institutions, State Archives, State Library, and State Museum, as well as support for the Office of Educational Television and Public Broadcasting. Higher and professional education programs monitor the quality and availability of post-secondary education programs, and license and regulate over 50 professions. Adult career and continuing education services focus on the education and employment needs of the State's adult citizens, ensuring that such individuals have access to a one-stop source for all their employment needs, and are made aware of the full range of services available in other agencies.

Special Education costs in FY 2026 are currently projected to decline slightly from the prior fiscal year, due to increased claims in FY 2025 as a result of recent reforms that have accelerated the issuance of tuition rates with the cost of living adjustment growth and reduced overpayment recoveries, as well as increased enrollment. These costs are paid in the first instance by school districts and counties and partially reimbursed by the State starting in the following year. Outyear spending increases are attributable to projected enrollment and cost growth. Spending for All Other Education programs in FY 2026 is projected to increase by 15.9 percent. This increase is driven largely by the adoption of a universal free school meals program under which all school districts, charter schools, and nonpublic schools that participate in the national school lunch and breakfast program will be required to provide free meals to all students regardless of their families' income, with the State paying the student's share of costs for all meals served to students not already receiving free meals. The projected increase in spending is also partly attributable to reimbursement to nonpublic schools for State-mandated activities; reimbursement to nonpublic schools for Science, Technology, Engineering, and Math instruction; reimbursement of school districts' supplemental charter school tuition payments; and payments to the City of New York for charter school facilities aid. Outyear spending growth is largely attributable to increased reimbursement for school meals, nonpublic schools, and charter schools.

STAR Program

The STAR program provides school tax relief to taxpayers by exempting the first $30,000 of every eligible homeowner's property value from the local school tax levy. As of Senior citizens with incomes below $107,300 will receive an $86,100 exemption in FY 2026.

Spending on STAR property tax exemptions reflects reimbursements made to school districts to offset the reduction in the amount of property tax revenue collected from homeowners. Since FY 2017, the STAR exemption program has been gradually transitioning from a spending program to an advance refundable PIT credit program. As a result, first-time homebuyers and homeowners who move receive a refundable PIT credit instead of a property tax exemption. This transition did not change the value of the STAR benefit received by homeowners.

The STAR program also includes a credit for income-eligible taxpayers who are residents of the City of New York. The City of New York PIT rate reduction was converted into a State PIT tax credit starting with TY 2017 and, as of FY 2019, is no longer a component of State Operating Funds spending. This change has no impact on the value of the STAR benefit received by taxpayers.

All homeowners with incomes above $250,000 were transitioned from the basic exemption benefit program to the advance credit program in FY 2020. Additionally, a zero percent growth cap on the STAR exemption benefit remains in effect. The decline in reported disbursements on STAR exemptions in FY 2026 through FY 2029 can be attributed to these actions. By moving taxpayers to the credit program, the State can more efficiently administer the program while strengthening its ability to prevent

abuse. The move from the basic exemption to the credit program does not reduce the value of the benefit received by homeowners.

The Enacted Budget included legislation that simplified the STAR income and age eligibility rules to make it easier for taxpayers to qualify for and receive benefits. Notably, the age eligibility is updated so that: only one resident owner needs to be 65 or older to qualify for the Enhanced STAR benefit (instead of the current requirement that all owners be 65 or older unless the owners are married or are siblings); only the income of primary owners will be used to determine eligibility; and taxpayers who do not file annual tax returns can retain eligibility using prior returns.

Higher Education

Assistance and Grants spending for higher education includes funding for CUNY, SUNY, and Higher Education Services Corporation ("HESC").

As of Fall 2024 enrollment data, SUNY and CUNY operate 47 four-year colleges and graduate schools with a total enrollment of roughly 372,000 full- and part-time students. SUNY and CUNY also operate 37 community colleges, serving approximately 242,000 students. State funds support a significant portion of SUNY and CUNY operations. In addition to the spending reflected in the above table, the State provides nearly $2.0 billion in annual support for the fringe benefit costs of all employees at SUNY state-operated campuses and approximately $1.5 billion for SUNY four-year campus operations via an annual General Fund transfer, and an estimated $947 million for debt service payments on bond-financed capital projects at SUNY and CUNY in FY 2026. Additionally, an estimated $330 million in student financial aid support will continue to be transferred from HESC to SUNY in FY 2026. This is the result of an accounting change first implemented in FY 2020 to reflect certain financial aid payments made from HESC to SUNY as transfers instead of disbursements.

HESC is New York State's student financial aid agency. HESC oversees State-funded financial aid programs, including the Excelsior Scholarship, the Tuition Assistance Program ("TAP"), and various other scholarship and loan forgiveness programs. Together, these programs provide financial aid to approximately 300,000 students. HESC also partners with OSC in administering the College Choice Tuition Savings program.

Higher education assistance and grants spending is projected to increase by $318 million, or 9.7 percent, from FY 2025 to FY 2026. This spending includes an increase in General Fund operating assistance to CUNY senior colleges for campus operating support, increased fringe benefits, investments in artificial intelligence, and programs to support academic and career advisement, tuition grants, textbooks, and transportation costs. In addition, increased spending at SUNY and CUNY community colleges is driven by additional operating aid and legislation included in the Enacted Budget to provide for the remaining cost of tuition, fees, books, and supplies for students aged 25 to 55 who pursue associate's degrees in high-demand fields. Student financial aid spending is expected to increase due to the expansion of Veteran's Tuition Awards to include non-combat veterans.

Health Care

DOH works with local health departments and social services departments, including the City of New York, to coordinate and administer statewide health insurance programs and activities, including operating the Medicaid program. The combined benefit of the State's health insurance program is to provide health care coverage to over 9 million low-income individuals and long-term care services for the elderly and disabled. Most government-financed health care programs are included under DOH; however, several programs are also supported through multi-agency efforts. In addition to Medicaid and Statewide public health programs, assistance and grants spending for health care includes a variety of mental hygiene programs.

DOH also engages in Federally supported initiatives, including Medicaid redesign and public health response efforts.

Medicaid

Medicaid is a means-tested program that finances health care services for low-income individuals and long-term care services for the elderly and disabled, primarily through monthly premium payments to managed care plans that enroll Medicaid eligible individuals and direct payments to health care providers for services rendered to Medicaid enrollees. According to the most recent Center for Medicaid and Medicaid Services Data, New York is the second largest program in terms of spending, behind California, which spends roughly 37 percent more in gross expenditures and covers more than 13 million people. Medicaid services include inpatient hospital care, outpatient hospital services, clinics, nursing homes, managed care, prescription drugs, home care, and services provided in a variety of community-based settings (including personal care, mental

health, substance use disorder treatment, developmental disabilities services, school-based services, and foster care services). The Medicaid program is financed by the Federal government, the State, and counties, including the City of New York. DOB estimates that spending from all sources, including spending by local governments that is not part of the State's All Funds activity, will total over $126 billion in FY 2026.

The DOH Medicaid State-share of spending is financed by a combination of the General Fund, HCRA resources, indigent care support, provider assessment revenue, and tobacco settlement proceeds. In any year, Medicaid costs financed by the General Fund may be affected by several factors, including the statutory Medicaid Global Cap that limits annual growth for a subset of State-share Medicaid spending, financial resources available in HCRA and, to a lesser extent, other State Special Revenue Funds, and temporary changes to the Federal share of Medicaid (e.g., eFMAP).

The Essential Plan

The State established the EP, a health insurance program which receives Federal subsidies authorized through the ACA. The EP includes health insurance coverage for New York State residents who are lawfully present in the United States, including lawfully present immigrants not eligible for Medicaid, CHP, or employer-sponsored coverage. Individuals who meet the EP eligibility standards are enrolled through the New York State of Health (NYSOH) insurance exchange, with the cost of insurance premiums subsidized by the State and Federal governments. The Exchange – NYSOH – serves as a centralized marketplace to shop for, compare, and enroll in a health plan. Over 1.7 million New Yorkers are currently enrolled in the EP, in H.R. 1, a provision was included that disqualifies the lawfully present immigrant population from receiving Federal funding for their EP benefits. When effective, this provision would result in over half of the program's funding being eliminated. These lawfully present immigrants may otherwise qualify for the Medicaid program, which would generate additional State costs. To alleviate new State costs and maintain coverage for as many individuals as possible, DOH is seeking to terminate its 1332 State Waiver and EP expansion and reactivate its (currently suspended) Basic Health Program (BHP), which is authorized under Section 1331 of the ACA. This transition is subject to CMS approval. If approved, this action would allow enrollees with incomes below 200 percent of the FPL to maintain the same level of health coverage as under the 1332 Waiver. This transition would be anticipated to take effect by July 2026.

Federal EP spending over the Financial Plan period reflects H.R. 1 as executed. Projections do not assume the transition to the BHP under Section 1331 of the ACA that is pending CMS approval. Additional revisions to the Federal EP spending will be reflected in future updates reflecting the status of CMS approval.

Under the original EP, Federal funding was received in advance pursuant to a formula that calculated what EP enrollees would have received had they enrolled in a qualified health plan and deposited 95 percent of that value into the EP Trust Fund. These funds were earmarked exclusively for eligible expenses under the Section 1331 Waiver, which was limited to reducing premiums and cost sharing, as well as providing additional benefits for eligible EP enrollees. Due to restrictions on eligible expenses, advances had exceeded disbursements, resulting in a fund balance of $8.8 billion as of March 31, 2025. With approval of the 1332 Waiver, effective April 1, 2024, this accumulated balance was suspended for the life of the Waiver, previously expected through December 31, 2029. Pending CMS approval, these funds will be utilized once the EP has transitioned back to the original BHP.

Public Health/Aging Programs

The State administers more than 150 separate programs to promote public health and wellbeing and provide access to quality health services for New Yorkers. CHP, the single largest program in this category, provides health insurance coverage for children of low-income families up to the age of 19. The General Public Health Work ("GPHW") program reimburses local health departments for the cost of providing certain public health services. The Elderly Pharmaceutical Insurance Coverage ("EPIC") program provides prescription drug insurance to seniors. The Early Intervention ("EI") program pays for services provided to infants and toddlers with disabilities or developmental delays who are under the age of three. Many public health programs, such as the EI and GPHW programs, are run by county health departments that are reimbursed by the State for a share of the program costs. State spending projections do not include the county share of these programs. In addition, a significant portion of HCRA spending is included under the Public Health budget.

The State Office for the Aging ("SOFA") promotes and administers programs and services for New Yorkers 60 years of age and older. SOFA primarily oversees community-based services (including in-home services and nutrition assistance) provided through a network of county Area Agencies on Aging and local providers.

Public Health spending is projected to increase by 12 percent in FY 2026 and grow by less than 2 percent annually over the remaining years of the Financial Plan period. The growth in FY 2026 reflects one time increases for MIF and the Healthcare Facility Restructuring Program Pool. The leveling off of spending growth in the outyears primarily reflects anticipated declines in CHP enrollment, partially offset by increased State spending on reproductive health and abortion access, and higher reimbursement rates under the EI program.

Over the multi-year period, the Updated Financial Plan supports programs to address the needs of individuals living in underserved communities by ensuring surplus agricultural products are rerouted through the State's network of food banks; monitoring and providing support for unforeseen public health emergencies; reducing infant, child, and maternal mortality; improving maternal mental health; and maintaining on-going workforce investments to safeguard access to health care.

The Updated Financial Plan supports SOFA programs to address locally identified capacity needs, including retention of the elderly in their communities; support for family and friends in their caregiving roles; establishment of quality reporting and accreditation for assisted living residences; and implementation of quality improvement initiatives in nursing homes to promote transparency.

Health Care Reform Act Financial Plan

HCRA was established in 1996 to help fund a portion of State health care activities and is currently authorized through FY 2026. HCRA resources include surcharges and assessments on hospital revenues, a "covered lives" assessment paid by insurance carriers, and a portion of cigarette tax revenues. These resources are used to fund roughly 15 percent of State share Medicaid costs, and other programs and health care industry investments, including: CHP; EPIC; Physician Excess Medical Malpractice Insurance; Indigent Care payments to hospitals serving a disproportionate share of individuals without health insurance; Worker Recruitment and Retention; Doctors Across New York; Nurses Across New York; and the Statewide Health Information Network for New York/All-Payer Claims Databases.

Total HCRA receipts are anticipated to grow at a steady rate over the course of the multi-year plan while cigarette tax revenues will moderately decline, concurrent with the anticipated decline in taxable cigarette consumption. These declines are offset by $150 million in annual revenues set aside to support distressed providers through Medicaid program payments.

HCRA spending over the same plan period reflects approximately $5 billion in continued support for Medicaid spending, including the $150 million set aside for distressed providers and approximately $1.5 billion for the CHP program. Additionally, the FY 2026 Enacted Budget included $211 million in funding to maintain MIF solvency and allow the program to remain open to new enrollees through FY 2026. However, due to increased enrollment, escalating average medical costs per enrollee, and legislatively mandated average commercial reimbursement requirements, which are in place until June 1, 2026, the MIF is expected to reach the threshold for closure to new enrollees sometime in FY 2027. If closed to new enrollees, those who would have been considered qualified plaintiffs and automatically enrolled in the MIF will instead be able to seek legal recourse against hospitals and physicians for medical costs.

HCRA is expected to remain in balance over the Financial Plan period. Under the current HCRA appropriation structure, spending reductions will occur if resources are insufficient to maintain a balanced fund. Any such spending reductions could affect General Fund Medicaid funding or HCRA programs. Conversely, any unanticipated balances or excess resources in HCRA are expected to fund Medicaid costs that would have otherwise been paid from the General Fund.

Mental Hygiene

The Mental Hygiene agencies consist of the OPWDD, the OMH, the OASAS, the Council on Developmental Disabilities, and the Justice Center for the Protection of People with Special Needs (Justice Center). OPWDD, OMH, and OASAS provide services directly to their clients through State-operated facilities and indirectly through community-based providers. Services are provided for adults with mental illness, children with emotional disturbance, individuals with intellectual and developmental disabilities and their families, people with substance use disorder, and individuals with problem gambling. The service costs are reimbursed by Medicaid, Medicare, third-party insurance, and State funding.

The Updated Financial Plan includes continued support for individuals with developmental disabilities to ensure appropriate access to care, including funding to expand independent living opportunities, provide choice in service options, and support increased utilization levels.

Funding continues support for OMH community services and the transition of individuals from inpatient to community settings. The Updated Financial Plan includes funding to support the launch of an Aging in Place pilot program to enhance residential services for people with mental illness who need additional assistance to continue living independently as they age, the creation of new Intensive and Sustained Engagement Teams and Hospital-Based Peer Bridger services and expanding the teen Mental Health First Aid program.

Funding for OASAS programs will continue support to not-for-profit providers for addiction prevention, treatment, harm reduction, and recovery programs. Additional investments include expanding access to opioid treatment medications in underserved areas. Similarly, the multi-year Updated Financial Plan includes approximately $400 million in resources from the Opioid Stewardship Tax and litigation settlements with pharmaceutical manufacturers and distributors that will be targeted at the overdose epidemic through investments in substance use disorder programs.

The Updated Financial Plan also continues funding for provider reimbursements associated with scheduled increases to the minimum wage index and to establish and operate 3,500 new residential units for New Yorkers with mental illness; significantly expand outpatient mental health services; enhance mental health services in schools; and increase funding for Safe Options Support (SOS) teams and specialized programs for children. The FY 2026 Enacted Budget also provided a 2.6 percent targeted inflationary increase for eligible programs run by voluntary operated providers.

Since the beginning of FY 2026, costs reported under the DOH Medicaid budget exclude OSA local Medicaid expenses which had been included under the Global Cap. These costs, previously reported in the DOH budget, are now reported in the respective agencies, including OPWDD and OMH. The reclassification of this spending is cost neutral to the overall Updated Financial Plan and more appropriately aligns program activities and costs to agencies responsible for managing such services. The level of Mental Hygiene spending reported under the DOH Medicaid Global Cap and/or the OPWDD related local share expenses funded with additional financial plan resources have no impact on mental hygiene service delivery or operations and may fluctuate depending on the availability of resources and other cost pressures within the Medicaid program.

Social Services

Office of Temporary and Disability Assistance

OTDA assistance and grants programs provide cash benefits and supportive services to low-income families. The State's three main programs are Family Assistance, Safety Net Assistance and SSI. The Family Assistance program, financed by the Federal government, provides time-limited cash assistance to eligible families. The Safety Net Assistance program, financed by the State and local districts, provides cash assistance to single adults, childless couples, and families that have exhausted their five-year limit on Family Assistance imposed by Federal law. The State SSI Supplementation program provides a supplement to the Federal SSI benefit for the elderly, the visually handicapped, and disabled persons.

DOB's caseload models project a total of 713,509 public assistance recipients in FY 2026. Approximately 208,640 families are expected to receive benefits through the Family Assistance program and 142,955 through the Safety Net Assistance program in FY 2026, an increase in both programs from FY 2025. The caseload for single adults and childless couples supported through the Safety Net Assistance program is projected to be 361,914 in FY 2026, an increase of 10 percent from FY 2025.

FY 2026 growth in Public Assistance Initiatives is attributed to expanding Welcome Centers in the City of New York to combat homelessness, and one-time rental arrears payments. Growth in Public Assistance Benefits is attributable to increases in Safety Net Assistance spending driven by an increase in caseload, particularly in the City of New York, as well as the implementation of the Birth Allowance for Beginning Year program, which will provide an enhanced benefit to eligible families after the birth of a child. Asylum seeker assistance year-over-year spending increases are due to the estimated timing of claiming and disbursements for one-time funding provided to the City of New York.

Homeless Housing and Services reflects the continued transition from State settlement funds to the General Fund for the ESSHI. ESSHI funds supportive housing constructed for vulnerable homeless populations under the Governor's Affordable Housing and Homelessness Plan and reflects the full estimated costs that are shared by multiple agencies. Costs are expected to experience a timing-related decline in FY 2026 and recover beginning in FY 2027.

Office of Children and Family Services

OCFS provides funding for foster care, adoption, child protective services, preventive services, delinquency prevention, and child care. It oversees the State's system of family support and child welfare services administered by local social services districts and community-based organizations. Specifically, child welfare services, financed jointly by the Federal government, the State, and local districts, are structured to encourage local governments to invest in preventive services for reducing out-of-home placement of children. Also financed by a combination of Federal, State and local sources, the Child Care Block Grant supports child care subsidies for public assistance, as well as low and middle-income families.

The Updated Financial Plan continues State support for child care subsidies for eligible families up to 85 percent of the State income threshold and projects that funding for residential school placements of children with special needs will resume beginning in FY 2027. In addition, spending growth reflects the State's investment in youth programs through Get Offline Get Outside 2.0, additional funding for homeless youth, and a 2.6 percent targeted inflationary increase for eligible programs. OCFS's Medicaid budget increase reflects shifting program funding from DOH to OCFS.

Transportation

The Department of Transportation ("DOT") maintains approximately 44,475 State highway lane miles and 7,700 State highway bridges. The DOT also partially funds regional and local transit systems, including the MTA; local government highway and bridge construction; and rail, airport, and port programs.

In FY 2026, the State plans to provide $9.0 billion in operating aid to mass transit systems. The MTA, the nation's largest transit and commuter rail system, is scheduled to receive $8 billion (approximately 90 percent) of the State's mass transit aid, including $3.8 billion from the direct remittance of various dedicated taxes and fees that do not flow through the State's Updated Financial Plan and are thus excluded from the table below.

Increased projected spending in FY 2026 includes an additional $138 million to the MTA, $37 million for other downstate transit systems, $16 million for upstate systems, and funding for an Orange County Transit Study. These increases are partially offset by lower operating support, commensurate with need, to the Gateway Development Commission and the Ogdensburg Bridge and Port Authority.

State Operations

State operations spending consists of PS and NPS. PS includes salaries of State employees of the Executive, Legislative, and Judicial branches consistent with current negotiated collective bargaining agreements, as well as temporary/seasonal employees. NPS includes real estate rentals, utilities, contractual payments (e.g., consultants, IT, and professional business services), supplies and materials, equipment, and telephone service. Certain state operations costs of DOT and the Department of Motor Vehicles ("DMV") are included in Capital Projects Funds and were not reflected in State Operating Funds.

Over 90 percent of the State workforce is unionized. The largest unions include: Public Employees Federation (PEF), which represents professional and technical personnel (attorneys, nurses, accountants, engineers, social workers, and institution teachers); Civil Service Employees Association (CSEA), which represents office support staff, administrative personnel, machine operators, skilled trade workers, and therapeutic and custodial care staff; United University Professionals (UUP), which represents faculty and nonteaching professional staff within the SUNY system; and New York State Correctional Officers and Police Benevolent Association ("NYSCOPBA"), which represents security personnel (correctional, safety and security officers).

State operations spending for executive agencies is affected by the timing of Federal reimbursement of State incurred COVID-19 pandemic response and recovery efforts, contractual general salary increases, inflation, and new investments. Excluding general salary increases and inflation, agency spending changes include:

- **Department of Corrections and Community Supervision (DOCCS)**. funding increases support the need to stabilize the correctional system because of the illegal strike, and significant investments to ensure the safety and security of correctional staff and incarcerated individuals, expansion of the body worn camera program, acceleration and continued installation of fixed cameras in all facilities, and expansion and restructure of the Office of Special Investigations.
- **OMH**. spending increases support expansion of various mental health programs, including enhancing SOS teams to provide psychiatric and medical care to individuals experiencing street homelessness and those in temporary shelter settings; and enhanced staffing at forensic psychiatric centers to improve patient outcomes.

- **OPWDD** additional funding reflects the alignment of PS funding to support the Full-Time Equivalent (FTE) forecast and to expand Intensive Treatment Opportunity capacity to develop inpatient treatment settings for individuals that require intensive behavior supports in the Finger Lakes region.
- **DOH**. spending growth is reflective of H.R. 1 impacts associated with the elimination of Federal funding for the State's 1332 EP Waiver and the Federal government requirement for states to establish Medicaid community engagement requirements for certain non-exempted populations that will be required to document at least 80 hours per month of work, education, and/or community service to be eligible for Medicaid benefits.

  In addition to H.R. 1, the Enacted Budget included funding for staffing and contractual services requirements for programs created and strengthened by legislative bills, including the opioid antagonist distribution program which will begin providing fentanyl test strips and informational packets to individuals receiving opioid antagonists. Funding has also been provided for conducting a study of the delivery of services to individuals with Traumatic Brain Injuries (TBIs). These and other investments will ensure that the programs are well-equipped to achieve their objectives to improve public health across the State.
- **State Police**. Funding is increased to support the deployment of additional State Police and counterterrorism investigators to strengthen criminal border enforcement efforts and the payment of retroactive costs for the labor agreement between the State of New York and the PBANYS in FY 2026..
- **Information Technology Services**. Spending growth reflects continued investments in resources dedicated to cybersecurity and the IT workforce as well as system modernization and demographic data collection efforts.
- **Children and Family Services**. Spending in FY 2026 and beyond reflects Statewide costs associated with implementing and supporting Raise the Age reforms, such as comprehensive diversion, probation, and programming services for 16- and 17-year-old youth in the juvenile justice system. Costs will be shifted to other agencies where costs are incurred in a later Financial Plan update.
- **All Other Executive Agencies**. Spending increases in FY 2026 are largely due to lower spending in FY 2025 as the Federal reimbursement of previously incurred State costs related to COVID-19 pandemic response and recovery expenses offset spending. In addition, costs related to the deployment of National Guard members assigned to correctional facilities to supplement existing staffing levels and the Joint Task Force Empire Shield Mission, expenses for public service announcements, and public service recruitment efforts, drive higher spending.
- **State University**. Spending growth reflects escalating staffing levels and additional operating support at four-year campuses and for SUNY Downstate Hospital.
- **Judiciary**. Growth supports non-judicial staffing initiatives including new court clerks and attorneys, costs associated with four court officer academy classes, and increased staffing levels to address case backlogs and provide operational support to various courts. Higher funding also supports new judgeships, including: ten additional City of New York Civil Court Judges and five additional Court of Claims judges; ten additional City of New York Family Court Support Magistrates, including non-judicial staff supporting these new judges; civil legal services; various technology initiatives; and expansion of various programs including Alternative Dispute Resolution and Alternatives to Incarceration.

Workforce

In FY 2026, over $18 billion of the State Operating Funds budget is dedicated to supporting FTE employees under direct Executive control; individuals employed by SUNY and Independent Agencies; employees paid on a non-annual salaried basis; and overtime pay. Roughly 60 percent of the Executive agency workforce is in the mental hygiene agencies and DOCCS.

General State Charges

GSC spending includes employee related expenses for fringe benefits the State provides to current and former employees, as well as certain statewide fixed costs. Fringe benefits include health insurance, pensions, workers' compensation coverage, unemployment insurance, survivors' benefits, and dental and vision benefits (some of which are provided through union-specific Employee Benefit Funds). The GSCs budget also pays the Social Security payroll tax, taxes on State-owned lands, Payments in Lieu of Taxes, and judgments awarded in the Court of Claims. Many of these payments are mandated by law or collective bargaining agreements. Employee fringe benefits are paid centrally through the General Fund. Some agencies with

dedicated revenue sources outside of the General Fund partially reimburse the General Fund via the agency fringe benefit assessments process.

GSC spending over the Financial Plan period is primarily driven by the increased costs of health care services, with NYSHIP projections correlating with continued growth rates in the hospital, medical and pharmaceutical industries, as well as the changes in the healthcare industry as a result of new technology and medicines, such as GLP-1 drugs, that drive up costs and healthcare utilization. Pension growth in the outyears reflects projected costs associated with conservative pension fund investment returns and the continued growth in the State workforce.

Programmatically, the State has and continues to fund employee and retiree health care expenses as they become due, on a PAYGO basis. To help limit the State's liability exposure to postemployment health benefits of retired employees and their dependents, the State has made

aggregate deposits to the RHBTF totaling $1.74 billion through FY 2025. The Updated Financial Plan assumes $250 million in annual deposits will continue if fiscal conditions permit. Under current law, the State may deposit into the RHBTF, in any given fiscal year, up to 1.5 percent of the total then-current unfunded actuarial accrued OPEB liability.

Social Security spending reflects the continued growth in the State workforce and other salary increases. Workers' compensation growth reflects current utilization. Other fringe benefits and fixed costs reflect wage and property tax increases, as well as the forecasted spending trends.

Debt Service

The State pays debt service on all outstanding State-supported bonds. These include General Obligation Bonds for which the State is constitutionally obligated to pay debt service, as well as certain bonds issued by State public authorities, such as Empire State Development ("ESD"), Dormitory Authority of the State of New York ("DASNY"), and New York State Thruway Authority ("NYSTA"), for which debt service is subject to annual appropriation by the State Legislature. Depending on the credit structure, debt service is financed by transfers from the General Fund and dedicated taxes and fees.

State Operating Funds debt service is projected to be $2.3 billion in FY 2026, of which $301 million is paid from the General Fund and $2.0 billion is paid from other State funds supported by dedicated tax receipts. The General Fund finances debt service payments on General Obligation Bonds and service contract bonds, including expected service contract payments to the Gateway Development Commission relating to the Hudson Tunnel Project. Debt service for other State-supported bonds is paid directly from other dedicated State funds, subject to appropriation, including PIT and Sales Tax Revenue bonds.

Debt service spending levels are impacted by prepayments. The Updated Financial Plan reflects prepayments that totaled $2.8 billion in FY 2025 and a new prepayment of $750 million in FY 2026. As shown in the table below, the net impact of these prepayments and prior year prepayments decreases debt service costs in FY 2026 through FY 2029.

The FY 2026 Enacted Budget authorized liquidity financing in the form of up to $3.0 billion of PIT notes as a tool to manage unanticipated financial disruptions. The Updated Financial Plan does not assume any PIT note issuances. DOB evaluates cash results regularly and may adjust the use of notes based on liquidity needs, market considerations, and other factors.

The Updated Financial Plan estimates for debt service spending reflect bond sale results, including refundings, projections of future refunding savings, and the adjustment of debt issuances to align with projected bond-financed capital spending. Debt service projections were reduced to reflect the contribution of $13.6 billion of PAYGO capital resources that were added since FY 2023.

PRIOR FISCAL YEARS

Cash-Basis Results for Prior Fiscal Years

General Fund Fiscal Years 2023 through 2025

The General Fund is the principal operating fund of the State and is used to account for all financial transactions, except those required by law to be accounted for in another fund. It is the State's largest single fund and receives most State taxes and other resources not dedicated to particular purposes. Transfers from the General Fund to other funds primarily support

capital projects, university operations, and certain State share Medicaid expenses, paid from other fund types. In some cases, the fiscal year results provided below may exclude certain timing-related transactions which have no net impact on operations.

In the cash basis of accounting, the State defines a balanced budget in the General Fund in any given fiscal year as (a) the ability to make all planned payments anticipated in the Financial Plan, including tax refunds, without the issuance of deficit bonds or notes or extraordinary cash management actions, (b) the restoration of the balances in the Rainy Day Reserves to a level equal to or greater than the level at the start of the fiscal year, and (c) maintenance of other designated balances, as required by law.

The General Fund balance has increased by $13.5 billion from FY 2023 to FY 2025, driven by extraordinary tax collections that allowed significant increases in reserves, as well as the establishment of a reserve for payment of PTET/PIT tax credits15 in FY 2022 which totaled $18.2 billion at the end of FY 2025. In addition, over $17 billion has been added to principal reserve balances since FY 2021, which is complemented by additional reserves for future operating costs and timing of resource management.

FY 2025

The State ended FY 2025 in balance on a cash basis in the General Fund, based on preliminary unaudited results. General fund receipts, including transfers from other funds, totaled $119.3 billion. General Fund disbursements, including transfers from other funds, totaled $108.7 billion. The State ended FY 2025 with a General Fund balance of $56.9 billion, an increase of $10.6 billion from FY 2024 results. The higher balance reflects a deposit to the Rainy Day Fund; an increase in the reserves for future operations and PTET/PIT credits; and additional resources available at year-end that are carried forward to offset delayed payments, operational costs, and capital projects spending, as well as to reduce the budget gaps in subsequent years.

FY 2024

The State ended FY 2024 in balance on a cash basis in the General Fund. General fund receipts, including transfers from other funds, totaled $103.0 billion. General Fund disbursements, including transfers from other funds, totaled $100.1 billion. The State ended FY 2024 with a General Fund balance of $46.3 billion, an increase of $2.9 billion from FY 2023 results. The higher balance reflects a set aside for asylum seeker assistance, an increase for the reserves for labor settlements/agency operations, and additional net resources available at year-end that were carried forward to reduce the budget gaps in subsequent years.

FY 2023

The State ended FY 2023 in balance on a cash basis in the General Fund. General Fund receipts, including transfers from other funds, totaled $103.2 billion. General Fund disbursements, including transfers from other funds, totaled $92.8 billion. The State ended FY 2023 with a General Fund balance of $43.5 billion, an increase of $10.4 billion from FY 2022 results. The higher balance reflects the deposit of $10.6 billion to the State's principal reserves, partially offset by use of prior year resources as planned to fund certain commitments and operations in FY 2023.

State Operating Funds Fiscal Years 2023 through 2025

The All Funds Financial Plan records the operations of the four governmental fund types: the General Fund, special revenue funds, capital projects funds, and debt service funds. It is the broadest measure of State governmental activity and includes spending from Federal funds and capital projects funds.

FY 2025

The FY 2025 All Funds closing balance totaled $73.7 billion, $7.8 billion above FY 2024. The increase reflected higher receipts ($14.5 billion), which more than offset growth in disbursements ($6.6 billion) compared to the prior year.

Tax collections grew by $11.1 billion inclusive of anticipated growth in PIT receipts, coupled with a decline in current and prior year refunds and advanced credit payments; PTET participation and extensions; modest growth in sales tax collections and significant growth in adult-use cannabis receipts resulting from the continued maturation of the market; CFT gross receipts; and the resolution of two significant bank audit cases. The growth was partly offset by increased CFT refunds and a decrease in

super large estate tax collections. Miscellaneous receipts increased due primarily to collections from the Mental Hygiene Services Debt Service fund, HCRA, the DFS, and Licenses & Fees.

Higher spending was mainly due to assistance and grants spending reflecting planned increases for School Aid, inclusive of increased Excess Cost Aid and BOCES Aid spending, and Medicaid. Substantial growth in Medicaid is largely attributable to the expiration of the COVID eFMAP benefit in FY 2024, higher FFS claims, and increased Managed Long Term Care claims due to enrollment growth. Other spending increases include enrollment growth and the inclusion of undocumented pregnant individuals under CHP, retroactive to April 2022, as well as spending on Day Care and Child Welfare services.

Executive agency operations spending increased from the prior year due largely to FEMA reimbursements received in FY 2024 for State costs incurred for COVID pandemic response and recovery efforts, as well as general salary increases pursuant to existing labor contracts, workforce growth, and inflationary increases for energy, medical expenses, and other commodities.

University systems' agency operations spending increased from the prior year largely due to salary increases pursuant to existing labor contracts and increased funding for campus and hospital operations. Spending growth for Elected Officials was due primarily to higher Judiciary spending.

Lower annual spending for pensions and debt service is the result of prepaying expenses prior to the fiscal year in which they come due. Excluding these prepayments, debt service would have increased by $188 million (3.1 percent) and pensions would have increased by $448 million (21 percent). Other fringe benefit spending increases are associated with rising health benefits and Social Security costs.

Federal operating spending decreased in FY 2025 in large part due to COVID related spending impacts, including: the discontinuation of the Medicaid enhanced Federal match; FEMA reimbursements for State costs incurred for COVID-19 pandemic response and recovery efforts and reimbursements of costs that were passed through to local entities; decreased spending for the Emergency Rental Assistance Program and Public Assistance benefit payments; and a decrease in COVID-19-related School Aid grants and U.S. Department of Agriculture School Lunch Act spending. These declines are partially offset by higher spending for the EP due to expansion of program eligibility associated with the 1332 waiver and increased hospital investments ($3.1 billion higher); timing of Federal CHP and Health and Human Services payments; Elementary and Secondary Education Title Act grants; Child Care subsidies, the Summer Electronic Benefits Transfer program, and the Flexible Fund for Family Services.

FY 2024

The FY 2024 All Funds closing balance totaled $65.9 billion, $44 million below FY 2023. This stable closing balance was due to a higher opening fund balance ($12.4 billion) and net growth in receipts ($1.4 billion), which supported higher disbursements ($14.4 billion). More than half of the increase in disbursements compared to FY 2023 was attributable to Federal operating aid ($9 billion).

Total tax collections in FY 2024 were $5.2 billion or 4.7 percent lower than FY 2023, mostly driven by a decrease in PIT receipts ($4.9 billion). FY 2024 PIT collections reflected lower estimated payments and final return payments, coupled with increased current and prior year refunds. Declines in PIT payments were partly offset by increased withholding and decreases in advanced credit payments attributable to the expiration of the Homeowner Tax Rebate Credit and the State/City offset. PTET collections also decreased ($989 million), due to lower estimated payments and higher refunds.

All other tax receipts increased by $716 million in FY 2024, primarily due to growth in consumption/use taxes ($1.3 billion). The growth reflected higher sales tax receipts and increased motor fuel tax receipts related to the expiration of the temporary fuel tax holiday in December 2022.

The decline in total FY 2024 tax collections was offset by increases in Federal operating aid and miscellaneous receipts. Federal receipts increased by $4.7 billion, reflecting the timing of spending and reimbursements from Federal aid. Miscellaneous receipts were also $1.9 billion higher than in FY 2023, primarily due to higher investment income ($2.4 billion).

The increase in disbursements in FY 2024 primarily reflects increased spending on assistance and grants ($7.3 billion) from State Operating Funds, as well as higher Federal operating spending ($9.0 billion) compared to FY 2023. Within the State Operating Funds category, the higher spending on assistance and grants was partially offset by a decrease in debt service payments ($3.5 billion) due to the timing of prepayments.

State Operating Funds spending totaled $128.5 billion in FY 2024, an increase of $4.7 billion (3.8 percent) compared to FY 2023. Within this category, assistance and grants spending was $7.3 billion higher than in the prior year. The largest changes within assistance and grants were as follows:

- School Aid ($3.1 billion higher) due primarily to the final year of the three-year phase-in of Foundation Aid.
- Medicaid ($2.3 billion higher) attributable primarily to continued claims growth ($3.4 billion), offset partially by increases in the Local Cap Contribution ($663 million) and increased pharmacy rebate offsets ($621 million).
- Mental Hygiene ($2 billion higher) due to a $1.9 billion increase in mental hygiene spending moved out of the Global Cap through the Local Share Adjustment and Mental Hygiene Stabilization Fund.
- Children and Family Services ($841 million lower) due primarily to non-recurring spending for Child Welfare Services ($1.2 billion) for settled and advanced claims.

In addition, spending on State operations from State Operating Funds increased by $882 million in FY 2024, reflecting underlying growth in salary costs. Within the executive agency operations category, pandemic-related FEMA reimbursements received in FY 2024 (roughly $960 million) more than offset cost growth. For fringe benefits, increased spending ($493 million) reflected the prepayment of future pension obligations in FY 2024 ($1.6 billion), partially offset by a smaller deposit to the Retiree Health Benefit Trust Fund compared to FY 2023.

Debt Service spending from State Operating Funds was $3.5 billion lower due to the net impact of debt service prepayments executed in FY 2024 and prior years ($3.9 billion).

Federal operating spending increased by $9 billion over the prior year due primarily to the following:

- EP ($3.5 billion higher) attributable to increased rates and higher program participation due to an expansion of program eligibility.
- Medicaid ($3.3 billion higher) primarily attributable to growth in claims.
- Children and Family Services ($1.2 billion higher) driven by increased spending on Child Care ($749 million) and Child Welfare Services ($399 million).
- Temporary & Disability Assistance ($1.1 billion lower) driven primarily by decreased spending on the Emergency Rental Assistance Program ($449 million), the Home Energy Assistance Program ($208 million), Child Care ($187 million), and Pandemic Emergency Assistance ($124 million).
- All Other Federal spending ($1.5 billion higher) increased due to Federal reimbursements of pandemic-related costs passed through to local entities ($1.2 billion).

FY 2023

The FY 2023 All Funds closing balance totaled $66.0 billion, $12.4 billion above FY 2022. The growth was attributable to a larger opening balance ($34.8 billion), offset by lower receipts ($11.3 billion) and higher disbursements ($11.1 billion) compared to the prior year.

The decline in receipts primarily reflects lower tax collections ($9.5 billion). PIT receipts decreased by $12 billion in FY 2023, largely due to the PTET program and the timing of PTET credit realization during FY 2022 and FY 2023. In FY 2022, taxpayers were statutorily prohibited from adjusting tax year 2021 current estimated PIT payments based on anticipated PTET credits. This restriction did not apply for tax year 2022, and FY 2023 PIT collections reflect the realization of a high concentration of PTET credits from both tax years 2021 and 2022. PTET collections also decreased by $1.5 billion in FY 2023, primarily because five quarters of PTET collections were reflected in FY 2022 and FY 2023 was the first year in which PTET refunds were issued.

The decline in PIT and PTET receipts in FY 2023 was offset by growth in other tax categories compared to FY 2022. Higher business tax collections ($2.4 billion) were driven by increased Corporate Franchise Tax receipts, insurance gross receipts, and audits. Consumption/use tax collections grew by $964 million mostly due to stronger-than-expected sales tax collections, partially offset by the temporary suspension of the sales and motor fuel excise taxes (on gasoline and diesel motor fuel) from June 2022 through December 2022.

Non-tax miscellaneous receipts increased by $3.9 billion in FY 2023, primarily due to the timing of reimbursements for various capital programs ($1.4 billion) and higher investment income ($1.1 billion). Federal grants decreased by $5.7 billion, largely due to the receipt of $12.75 billion in ARP aid in FY 2022.

The increase in disbursements in FY 2023 primarily reflects increased spending on assistance and grants ($6.9 billion) from State Operating Funds, as well as higher spending from Federal grants ($5.5 billion) compared to FY 2022.

State Operating Funds spending totaled $123.8 billion in FY 2023, an increase of $6.3 billion (5.4 percent) compared to FY 2022. Within this category, assistance and grants spending through March was $6.9 billion higher than in the prior year. The largest spending changes within assistance and grants were as follows:

- Medicaid ($3.5 billion higher) primarily attributable to enrollment growth in Managed Care associated with the Public Health Emergency and Federal requirement prohibiting the disenrollment of recipients ($1.8 billion); increased Fee for Service Spending related to higher utilization and prices ($689 million); and increased spending in the Vital Access Provider Assurance Program related to advancement of the Federal share of directed payment template payments for distressed hospitals ($2 billion). The higher spending is partially offset by increased COVID eFMAP collections in FY 2023 ($812 million) and Federal Family Planning credits ($108 million) that were not claimed in FY 2022.
- School Aid ($2 billion higher) due to planned General Aid payment increases ($675 million) related to the second year of the three-year phase-in of full funding of Foundation Aid, education payments supported by higher Mobile Sports Wagering receipts ($517 million), increased disbursements supported by Lottery and VLT receipts ($630 million), and higher Teacher Retirement System payments ($141 million).
- Office of Children and Family Services ($1.1 billion higher) primarily attributable to higher spending for Child Welfare Services ($1.2 billion) and Day Care ($49 million), partially offset by reduced spending on Foster Care Block Grant payments ($55 million) and Adult Protective Services ($52 million).

Executive agency operations spending from State Operating Funds increased by $1.4 billion in FY 2023, largely because eligible State costs were offset by the Federal CRF in FY 2022. Debt Service decreased by $2.1 billion in FY 2023, due to prior prepayments of FY 2023 debt service.

Federal operating aid increased by $5.5 billion over the prior year due predominantly to the following:

- Medicaid ($5.1 billion higher) primarily attributable to significantly higher claims-based spending ($3.4 billion) caused by Federal Maintenance of Effort (MOE) restrictions on disenrollment during the Public Health Emergency and increased rates ($1.3 billion), higher Fee-for-Service expenditures resulting from increased utilization and price increases ($1.2 billion) and increased Managed Long-Term Care spending ($879 million). Additional increased year-to-year spending is attributable to higher COVID eFMAP collections ($860 million), the claiming of Federal Community First Choice Option credits ($761 million), and Family Planning credits ($108 million) that were not claimed by the State in FY 2022.
- School Aid ($2.3 billion higher) primarily due to increased spending from COVID-19 related grants ($2.1 billion).

All Funds Fiscal Years 2023 through 2025

The All Funds Financial Plan records the operations of the four governmental fund types: the General Fund, special revenue funds, capital projects funds, and debt service funds. It is the broadest measure of State governmental activity and includes spending from Federal funds and capital projects funds.

FY 2025

The FY 2025 All Funds closing balance totaled $73.7 billion, $7.8 billion above FY 2024. The increase reflected higher receipts ($14.5 billion), which more than offset growth in disbursements ($6.6 billion) compared to the prior year.

Tax collections grew by $11.1 billion inclusive of anticipated growth in PIT receipts, coupled with a decline in current and prior year refunds and advanced credit payments; PTET participation and extensions; modest growth in sales tax collections and significant growth in adult-use cannabis receipts resulting from the continued maturation of the market; CFT gross receipts; and the resolution of two significant bank audit cases. The growth was partly offset by increased CFT refunds and a decrease in super large estate tax collections. Miscellaneous receipts increased due primarily to collections from the Mental Hygiene Services Debt Service fund, HCRA, the DFS, and Licenses & Fees.

Higher spending was mainly due to assistance and grants spending reflecting planned increases for School Aid, inclusive of increased Excess Cost Aid and BOCES Aid spending, and Medicaid. Substantial growth in Medicaid is largely attributable to the expiration of the COVID eFMAP benefit in FY 2024, higher FFS claims, and increased Managed Long Term Care

claims due to enrollment growth. Other spending increases include enrollment growth and the inclusion of undocumented pregnant individuals under CHP, retroactive to April 2022, as well as spending on Day Care and Child Welfare services.

Executive agency operations spending increased from the prior year due largely to FEMA reimbursements received in FY 2024 for State costs incurred for COVID pandemic response and recovery efforts, as well as general salary increases pursuant to existing labor contracts, workforce growth, and inflationary increases for energy, medical expenses, and other commodities.

University systems' agency operations spending increased from the prior year largely due to salary increases pursuant to existing labor contracts and increased funding for campus and hospital operations. Spending growth for Elected Officials was due primarily to higher Judiciary spending.

Lower annual spending for pensions and debt service is the result of prepaying expenses prior to the fiscal year in which they come due. Excluding these prepayments, debt service would have increased by $188 million (3.1 percent) and pensions would have increased by $448 million (21 percent). Other fringe benefit spending increases are associated with rising health benefits and Social Security costs.

Federal operating spending decreased in FY 2025 in large part due to COVID related spending impacts, including: the discontinuation of the Medicaid enhanced Federal match; FEMA reimbursements for State costs incurred for COVID-19 pandemic response and recovery efforts and reimbursements of costs that were passed through to local entities; decreased spending for the Emergency Rental Assistance Program and Public Assistance benefit payments; and a decrease in COVID-19-related School Aid grants and U.S. Department of Agriculture School Lunch Act spending. These declines are partially offset by higher spending for the EP due to expansion of program eligibility associated with the 1332 waiver and increased hospital investments ($3.1 billion higher); timing of Federal CHP and Health and Human Services payments; Elementary and Secondary Education Title Act grants; Child Care subsidies, the Summer Electronic Benefits Transfer program, and the Flexible Fund for Family Services.

FY 2024

The FY 2024 All Funds closing balance totaled $65.9 billion, $44 million below FY 2023. This stable closing balance was due to a higher opening fund balance ($12.4 billion) and net growth in receipts ($1.4 billion), which supported higher disbursements ($14.4 billion). More than half of the increase in disbursements compared to FY 2023 was attributable to Federal operating aid ($9 billion).

Total tax collections in FY 2024 were $5.2 billion or 4.7 percent lower than FY 2023, mostly driven by a decrease in PIT receipts ($4.9 billion). FY 2024 PIT collections reflected lower estimated payments and final return payments, coupled with increased current and prior year refunds. Declines in PIT payments were partly offset by increased withholding and decreases in advanced credit payments attributable to the expiration of the Homeowner Tax Rebate Credit and the State/City offset. PTET collections also decreased ($989 million), due to lower estimated payments and higher refunds.

All other tax receipts increased by $716 million in FY 2024, primarily due to growth in consumption/use taxes ($1.3 billion). The growth reflected higher sales tax receipts and increased motor fuel tax receipts related to the expiration of the temporary fuel tax holiday in December 2022.

The decline in total FY 2024 tax collections was offset by increases in Federal operating aid and miscellaneous receipts. Federal receipts increased by $4.7 billion, reflecting the timing of spending and reimbursements from Federal aid. Miscellaneous receipts were also $1.9 billion higher than in FY 2023, primarily due to higher investment income ($2.4 billion).

The increase in disbursements in FY 2024 primarily reflects increased spending on assistance and grants ($7.3 billion) from State Operating Funds, as well as higher Federal operating spending ($9.0 billion) compared to FY 2023. Within the State Operating Funds category, the higher spending on assistance and grants was partially offset by a decrease in debt service payments ($3.5 billion) due to the timing of prepayments.

State Operating Funds spending totaled $128.5 billion in FY 2024, an increase of $4.7 billion (3.8 percent) compared to FY 2023. Within this category, assistance and grants spending was $7.3 billion higher than in the prior year. The largest changes within assistance and grants were as follows:

- School Aid ($3.1 billion higher) due primarily to the final year of the three-year phase-in of Foundation Aid.
- Medicaid ($2.3 billion higher) attributable primarily to continued claims growth ($3.4 billion), offset partially by increases in the Local Cap Contribution ($663 million) and increased pharmacy rebate offsets ($621 million).

- Mental Hygiene ($2 billion higher) due to a $1.9 billion increase in mental hygiene spending moved out of the Global Cap through the Local Share Adjustment and Mental Hygiene Stabilization Fund.
- Children and Family Services ($841 million lower) due primarily to non-recurring spending for Child Welfare Services ($1.2 billion) for settled and advanced claims.

In addition, spending on State operations from State Operating Funds increased by $882 million in FY 2024, reflecting underlying growth in salary costs. Within the executive agency operations category, pandemic-related FEMA reimbursements received in FY 2024 (roughly $960 million) more than offset cost growth. For fringe benefits, increased spending ($493 million) reflected the prepayment of future pension obligations in FY 2024 ($1.6 billion), partially offset by a smaller deposit to the Retiree Health Benefit Trust Fund compared to FY 2023.

Debt Service spending from State Operating Funds was $3.5 billion lower due to the net impact of debt service prepayments executed in FY 2024 and prior years ($3.9 billion).

Federal operating spending increased by $9 billion over the prior year due primarily to the following:

- EP ($3.5 billion higher) attributable to increased rates and higher program participation due to an expansion of program eligibility.
- Medicaid ($3.3 billion higher) primarily attributable to growth in claims.
- Children and Family Services ($1.2 billion higher) driven by increased spending on Child Care ($749 million) and Child Welfare Services ($399 million).
- Temporary & Disability Assistance ($1.1 billion lower) driven primarily by decreased spending on the Emergency Rental Assistance Program ($449 million), the Home Energy Assistance Program ($208 million), Child Care ($187 million), and Pandemic Emergency Assistance ($124 million).
- All Other Federal spending ($1.5 billion higher) increased due to Federal reimbursements of pandemic-related costs passed through to local entities ($1.2 billion).

FY 2023

The FY 2023 All Funds closing balance totaled $66.0 billion, $12.4 billion above FY 2022. The growth was attributable to a larger opening balance ($34.8 billion), offset by lower receipts ($11.3 billion) and higher disbursements ($11.1 billion) compared to the prior year.

The decline in receipts primarily reflects lower tax collections ($9.5 billion). PIT receipts decreased by $12 billion in FY 2023, largely due to the PTET program and the timing of PTET credit realization during FY 2022 and FY 2023. In FY 2022, taxpayers were statutorily prohibited from adjusting tax year 2021 current estimated PIT payments based on anticipated PTET credits. This restriction did not apply for tax year 2022, and FY 2023 PIT collections reflect the realization of a high concentration of PTET credits from both tax years 2021 and 2022. PTET collections also decreased by $1.5 billion in FY 2023, primarily because five quarters of PTET collections were reflected in FY 2022 and FY 2023 was the first year in which PTET refunds were issued.

The decline in PIT and PTET receipts in FY 2023 was offset by growth in other tax categories compared to FY 2022. Higher business tax collections ($2.4 billion) were driven by increased Corporate Franchise Tax receipts, insurance gross receipts, and audits. Consumption/use tax collections grew by $964 million mostly due to stronger-than-expected sales tax collections, partially offset by the temporary suspension of the sales and motor fuel excise taxes (on gasoline and diesel motor fuel) from June 2022 through December 2022.

Non-tax miscellaneous receipts increased by $3.9 billion in FY 2023, primarily due to the timing of reimbursements for various capital programs ($1.4 billion) and higher investment income ($1.1 billion). Federal grants decreased by $5.7 billion, largely due to the receipt of $12.75 billion in ARP aid in FY 2022.

The increase in disbursements in FY 2023 primarily reflects increased spending on assistance and grants ($6.9 billion) from State Operating Funds, as well as higher spending from Federal grants ($5.5 billion) compared to FY 2022.

State Operating Funds spending totaled $123.8 billion in FY 2023, an increase of $6.3 billion (5.4 percent) compared to FY 2022. Within this category, assistance and grants spending through March was $6.9 billion higher than in the prior year. The largest spending changes within assistance and grants were as follows:

- Medicaid ($3.5 billion higher) primarily attributable to enrollment growth in Managed Care associated with the Public Health Emergency and Federal requirement prohibiting the disenrollment of recipients ($1.8 billion); increased Fee for Service Spending related to higher utilization and prices ($689 million); and increased spending in the Vital Access Provider Assurance Program related to advancement of the Federal share of directed payment template payments for distressed hospitals ($2 billion). The higher spending is partially offset by increased COVID eFMAP collections in FY 2023 ($812 million) and Federal Family Planning credits ($108 million) that were not claimed in FY 2022.
- School Aid ($2 billion higher) due to planned General Aid payment increases ($675 million) related to the second year of the three-year phase-in of full funding of Foundation Aid, education payments supported by higher Mobile Sports Wagering receipts ($517 million), increased disbursements supported by Lottery and VLT receipts ($630 million), and higher Teacher Retirement System payments ($141 million).
- Office of Children and Family Services ($1.1 billion higher) primarily attributable to higher spending for Child Welfare Services ($1.2 billion) and Day Care ($49 million), partially offset by reduced spending on Foster Care Block Grant payments ($55 million) and Adult Protective Services ($52 million).

Executive agency operations spending from State Operating Funds increased by $1.4 billion in FY 2023, largely because eligible State costs were offset by the Federal CRF in FY 2022. Debt Service decreased by $2.1 billion in FY 2023, due to prior prepayments of FY 2023 debt service. Federal operating aid increased by $5.5 billion over the prior year due predominantly to the following:

- Medicaid ($5.1 billion higher) primarily attributable to significantly higher claims-based spending ($3.4 billion) caused by Federal MOE restrictions on disenrollment during the Public Health Emergency and increased rates ($1.3 billion), higher Fee-for-Service expenditures resulting from increased utilization and price increases ($1.2 billion) and increased Managed Long-Term Care spending ($879 million). Additional increased year-to-year spending is attributable to higher COVID eFMAP collections ($860 million), the claiming of Federal Community First Choice Option credits ($761 million), and Family Planning credits ($108 million) that were not claimed by the State in FY 2022.
- School Aid ($2.3 billion higher) primarily due to increased spending from COVID-19 related grants ($2.1 billion).

CAPITAL PROGRAM AND FINANCING PLAN

Capital Plan

The total commitment and disbursement levels in the Capital Plan reflect, among other things, projected capacity under the State's statutory debt limit, anticipated levels of Federal aid, and the timing of capital activity based on known needs and historical patterns. The following capital projects information relates to FY 2026.

FY 2026 Capital Projects Spending

Spending on capital projects was projected to total $19.4 billion in FY 2026. Overall, capital spending in FY 2026 was projected to increase by $2.4 billion or 14 percent from FY 2025.

In FY 2026, transportation and transit spending is projected to total $8.5 billion, which represents 44 percent of total capital spending. Education and higher education spending accounts of 13 percent, spending related to parks, environment, and clean energy represents 13 percent, and economic development spending accounts for 11 percent. The remaining 19 percent comprises spending for health care, mental hygiene, social welfare, public protection, general government, and all other (discussed later).

Transportation and transit spending is projected to increase by $1.2 billion (17 percent) from FY 2025 to FY 2026. The growth is attributable to projected increases in spending by DOT for the State road and bridge projects and local transportation programs. State spending on the MTA is expected to total $1.3 billion in FY 2026, an increase of $610 million, which is attributable to the continued State support for the MTA's 2020-2024 Capital Plan and initial funding for the 2025-2029 Capital Plan.

Parks and environment spending is estimated to increase by $671 million (37 percent) in FY 2026, primarily reflecting spending from the clean water drinking grants program, which the FY 2026 Enacted Budget increased by $500 million to $6 billion; increased capital support for State parks, including NY SWIMS; and spending from the $4.2 billion Clean Water, Clean

Air, and Green Jobs Bond Act. Additionally, the Plan reflects spending in FY 2026 from new initiatives, including: the Sustainable Future Program, NY PLAYS, and NY BRICKS.

Economic development spending is projected to increase by $404 million (24 percent) in FY 2026. The increase is primarily attributable to regional economic development programs administered by ESD, including the DRI and NY Forward, RESTORE, and REDC's. FY 2026 spending also includes continued investment in offshore wind port infrastructure and supply chains, ConnectALL broadband expansion, and upgrades at Olympic Regional Development Authority facilities.

Spending for health care is projected to increase by $351 million (77 percent) in FY 2026. The increase is due to spending from Health Care Restructuring Program grant awards and spending related to five rounds of the Health Care Facility Transformation Program.

Spending for social welfare is projected to increase by $303 million (18 percent) in FY 2026, primarily reflecting ongoing spending from the prior housing plan and the phase-in of funding from the $25 billion housing plan, of which the State is providing $5.7 billion in direct capital assistance.

Education spending is projected to increase by $273 million (128 percent) in FY 2026. The increase is largely due to the implementation of additional programs included in the FY 2025 and FY 2026 Enacted Budgets, and continued spending from prior year initiatives.

Higher education spending is projected to increase by $452 million (28 percent) in FY 2026, which is primarily related to maintaining SUNY and CUNY campus facilities in a state of good repair and making strategic investments in new facilities.

Spending for public protection is projected to increase by $11 million (1 percent) in FY 2026. Public protection capital funding supports maintaining DOCCS, DHSES, DMNA, and DSP infrastructure. In addition, FY 2026 projections assume continued spending for capital investments in communities with high gun violence and another round of the SCAHC grant program.

Mental hygiene capital spending is anticipated to increase by $250 million (41 percent) in FY 2026, reflecting continued investment in both inpatient and outpatient facilities.

General governmental capital spending is projected to increase by $342 million (81 percent) in FY 2026, which includes the maintenance of State facilities and State information technology projects.

Spending in the All Other category is projected to increase by $85 million (20 percent). Total planned capital disbursements are reduced by $2 billion, or approximately 10 percent, in each year of the Capital Plan, consistent with spending trends for the past ten years.

Financing Fiscal Year 2026 Capital Projects Spending

In FY 2026, the State plans to finance 46 percent of capital projects spending with long-term bonds and 54 percent with cash and Federal grants. Most of the long-term bonds (95 percent) will be issued on behalf of the State through public authorities. All authority debt issued on behalf of the State is approved by the State Legislature, acting on behalf of the people, and the issuing authority's board of directors, and in most instances, is subject to approval by the Public Authorities Control Board (PACB). Authority Bonds, as defined in the Capital Plan, do not include debt issued by authorities that are backed by non-State resources. State cash resources will finance 37 percent of capital spending. Federal aid is expected to fund 17 percent of the State's FY 2026 capital spending, primarily for transportation. Year-to-year, total PAYGO support is projected to increase from FY 2025 to FY 2026 by $1.3 billion, with State PAYGO increasing by $741 million and Federal PAYGO support increasing by $558 million. Bond-financed spending is projected to increase by $1.1 billion, with Authority Bond spending increasing by $842 million and General Obligation Bond spending increasing by $246 million.

Financing Plan

New York State, including its public authorities, is one of the largest issuers of municipal debt in the United States, ranking second among the states, behind California, in the aggregate amount of debt outstanding. As of March 31, 2025, State-related debt outstanding totaled $55.9 billion excluding installation and mortgage loan commitments, equal to approximately 3.3 percent of New York personal income. The State's debt levels are typically measured by DOB using two categories: *State-supported debt and State-related debt*.

State-supported debt represents obligations of the State that are paid from traditional State resources (i.e., tax revenue) and have a budgetary impact. It includes General Obligation debt, to which the full faith and credit of the State has been pledged, and lease purchase and contractual obligations of public authorities and municipalities, where the State's legal obligation to make payments to those public authorities and municipalities is subject to and paid from annual appropriations made by the Legislature. These include the State PIT Revenue Bond program and the State Sales Tax Revenue Bond program. The State's debt reform caps on debt outstanding and debt service apply to State-supported debt.

State-related debt is a broader measure of State debt which includes all debt that is reported in the State's GAAP-basis financial statements, except for unamortized premiums and accumulated accretion on capital appreciation bonds. These financial statements are audited by external independent auditors and published by OSC on an annual basis. The debt reported in the GAAP basis financial statements includes General Obligation debt, other State-supported debt as defined in the State Finance Law, and installation commitments and mortgage loan commitments. This category also includes inter-governmental loans, where no bonds are issued but the State has agreed to pay annual loan payments to another governmental entity. Inter-governmental loans include annual payments to the Gateway Development Commission ("GDC") to fund the State's commitment for the Gateway Hudson Tunnel Project. In addition, State-related debt reported by DOB includes State-guaranteed debt, moral obligation financings and certain contingent-contractual obligation financings, where debt service is paid from non-State sources in the first instance, but State appropriations are available to make payments if necessary. These financings are not reported as debt in the State's GAAP-basis financial statements.

The State's debt does not include debt that is issued by, or on behalf of, local governments and secured (in whole or in part) by State local assistance aid payments. For example, certain State aid to public schools paid to school districts or New York City has been pledged by those local entities to help finance debt service for locally-sponsored and locally-determined financings. Additionally, certain of the State's public authorities issue debt supported by non-State resources (e.g., NYSTA revenue bonds, Triborough Bridge and Tunnel Authority revenue bonds, MTA revenue bonds and DASNY dormitory facilities revenue bonds) or issue debt on behalf of private clients (e.g., DASNY's bonds issued for not-for-profit colleges, universities, and hospitals). This debt, however, is not treated by DOB as either State-supported debt or State-related debt because it (i) is not issued by the State (nor on behalf of the State), and (ii) does not result in a State obligation to pay debt service. Instead, this debt is accounted for in the respective financial statements of the local governments or other entity responsible for the issuance of such debt and is similarly treated.

The issuance of General Obligation debt is undertaken by OSC. All other State-supported and State-related debt is issued by the State's financing authorities (known as "Authorized Issuers" in connection with the issuance of PIT and Sales Tax Revenue Bonds) acting under the direction of DOB, which coordinates the structuring of bonds, the timing of bond sales, and decides which programs are to be funded in each transaction. The Authorized Issuers for PIT Revenue Bonds are DASNY, ESD, NYSTA, the Environmental Facilities Corporation, and the New York State Housing Finance Agency and the Authorized Issuers for Sales Tax Revenue Bonds are DASNY, ESD, and NYSTA. Prior to any issuance of new State-supported debt and State-related debt, approval is required by the State Legislature, DOB, the issuer's board, and in certain instances, PACB and the State Comptroller.

The State uses three primary bond programs, Personal Income Tax Revenue Bonds, Sales Tax Revenue Bonds, and to a lesser extent General Obligation Bonds to finance capital spending.

State-Supported Debt Outstanding

State-supported debt includes General Obligation Bonds, State PIT Revenue Bonds, Sales Tax Revenue Bonds, and lease purchase and service contract obligations of public authorities and municipalities. Payment of all obligations, except for General Obligation Bonds, cannot be made without annual appropriation by the State Legislature, but the State's credits have different security features, as described in this section. The Debt Reform Act of 2000 limits the amount of new State-supported debt issued since April 1, 2000. Legislation included in the FY 2021 and FY 2022 Enacted Budgets authorized the exclusion of all State-supported debt issued in FY 2021 and FY 2022 from the calculation of the debt caps.

Legislation included in the FY 2026 Enacted Budget authorizes short-term financing for liquidity purposes during FY 2026. In doing so, it maintained a tool to help the State manage cashflow if unanticipated financial disruptions arise. Specifically, the authorization allows for the issuance of up to $3 billion of PIT revenue anticipation notes that mature no later than March 31, 2026. Borrowed amounts cannot be extended or refinanced beyond the initial maturity. The Financial Plan does

not currently assume the use of short-term financing for liquidity purposes. DOB evaluates cash results regularly and may adjust the use of notes based on liquidity needs, market considerations, and other factors.

State PIT Revenue Bond Program

Since 2002, the PIT Revenue Bond Program has been the primary financing vehicle used to fund the State's capital program. Legislation enacted in 2001 provided for the issuance of State PIT Revenue Bonds by the State's Authorized Issuers. The legislation originally required 25 percent of State PIT receipts (excluding refunds owed to taxpayers) to be deposited into the RBTF for purposes of making debt service payments on these bonds, with the excess amounts returned to the General Fund. Over time, additional State revenue sources have been dedicated to the RBTF in order to address the anticipated impact that certain legislative changes could have on the level of State PIT receipts, namely, the enactment of (i) the ECEP and the Charitable Gifts Trust Fund in 2018, and (ii) the PTET in 2021. The legislative changes were implemented to mitigate the effect of the TCJA that, among other things, limited the SALT deduction. In order to preserve coverage in the PIT Revenue Bond program, State legislation was enacted that dedicated 50 percent of ECEP receipts and 50 percent of PTET receipts for deposit to the RBTF for the payment of PIT bonds. In addition, in 2018 legislation was enacted that increased the percentage of PIT receipts dedicated to the payment of PIT bonds from 25 to 50 percent. As a result, 50 percent of PIT receipts, 50 percent of ECEP receipts and 50 percent of PTET receipts (collectively, the "RBTF Receipts") now secure the timely payment of debt service on all PIT bonds.

Debt service on State PIT Revenue Bonds is subject to legislative appropriation, as part of the annual debt service bill. In the event that (a) the State Legislature fails to appropriate amounts required to make all debt service payments on the State PIT Revenue Bonds or (b) having been appropriated and set aside pursuant to a certificate of the Director of the Budget, financing agreement payments have not been made when due on the State PIT Revenue Bonds, the legislation requires that RBTF Receipts continue to be deposited to the RBTF until amounts on deposit in the RBTF equal the greater of 40 percent of the aggregate of annual State PIT receipts, ECEP receipts, and PTET receipts or $12 billion.

DOB expects that the ECEP and PTET will be revenue neutral on a multi-year basis for PIT bondholders, although PIT receipts would decrease and ECEP and PTET receipts would increase to the extent that employers elect to participate in the ECEP and qualifying entities elect to pay PTET. However, because the PTET credits are not necessarily realized by taxpayers within the same fiscal year that PTET revenue is received by the State, the PTET will not be revenue-neutral to the State within each fiscal year.

The Charitable Gifts Trust Fund, when created in 2018, had the potential to materially impact the PIT Revenue Bond Program, as deposits to the Charitable Gifts Trust Fund could reduce State PIT receipts by nearly one dollar for every dollar donated. In 2019, the IRS issued final regulations (Treasury Decision 9864) that effectively curtailed further donations to the Charitable Gifts Trust Fund. If Treasury Decision 9864 is upheld in Federal court, taxpayer participation in the Charitable Gifts Trust Fund and the impact on New York State PIT receipts is expected to remain negligible.

As of March 31, 2025, approximately $38.8 billion of State PIT Revenue Bonds were outstanding. The projected PIT Revenue Bond coverage ratios, noted below, are based upon estimates of RBTF Receipts and include projected debt issuances. PIT Revenue Bonds are expected to comprise 75 percent of bond issuances annually, excluding GO Bonds, but can be used interchangeably with the Sales Tax Revenue Bond Program as needed.

While DOB routinely monitors the State's debt portfolio across all State-supported credits for refunding opportunities, no future refunding transactions are reflected in the following projected coverage ratios.

Sales Tax Revenue Bond Program

Legislation enacted in 2013 created the Sales Tax Revenue Bond program. This bonding program replicates certain credit features of PIT Revenue Bonds and is expected to continue to provide the State with increased efficiencies and a lower cost of borrowing.

The legislation created the Sales Tax Revenue Bond Tax Fund, a sub-fund within the General Debt Service Fund that will provide for the payment of these bonds. The Sales Tax Revenue Bonds are secured by dedicated revenues consisting of two cents of the State's four cent sales and use tax. Such sales tax receipts in excess of debt service requirements are transferred to the State's General Fund.

The Sales Tax Revenue Bond Fund has appropriation-incentive and General Fund "reach back" features comparable to PIT bonds. A "lock box" feature restricts transfers back to the General Fund in the event of non-appropriation or non-payment. In addition, in the event that sales tax revenues are insufficient to pay debt service, a "reach back" mechanism requires the State Comptroller to transfer moneys from the General Fund to meet debt service requirements.

The legislation also authorized the use of State Sales Tax Revenue Bonds and PIT Revenue Bonds to finance any capital purpose, including projects that were previously financed through the State's Mental Health Facilities Improvement Revenue Bond program and the DHBTF program. This allowed the State to transition to the use of three primary credits - PIT Revenue Bonds, Sales Tax Revenue Bonds and General Obligation Bonds to finance the State's capital needs. Sales Tax Revenue Bonds are used interchangeably with PIT Revenue Bonds to finance State capital needs. As of March 31, 2025, $14.5 billion of Sales Tax Revenue Bonds were outstanding.

Debt service coverage for the Sales Tax Revenue Bond program reflects estimates of sales and use tax receipts and includes projected debt issuances. Sales Tax Revenue Bonds are expected to comprise 25 percent of bond issuances annually, excluding GO Bonds, but can be used interchangeably with the PIT Revenue Bond Program as needed. While DOB routinely monitors the State's debt portfolio across all State-supported credits for refunding opportunities, no future refunding transactions are reflected in the following projected coverage ratios.

General Obligation Financings

With limited exceptions for emergencies, the State Constitution prohibits the State from undertaking a long-term General Obligation borrowing (i.e., borrowing for more than one year) unless it is authorized in a specific amount for a single work or purpose by the Legislature and approved by voter referendum. There is no constitutional limitation on the amount of long-term General Obligation debt that may be so authorized and subsequently incurred by the State. The State Constitution provides that General Obligation Bonds, which can be paid without an appropriation, must be paid in equal annual principal installments or installments that result in substantially level or declining debt service payments, mature within 40 years after issuance, and begin to amortize not more than one year after the issuance of such bonds. However, general obligation housing bonds must mature within 50 years after issuance, with principal amortization commencing no more than three years after issuance.

General Obligation debt is currently authorized for transportation, environment, housing and education purposes. Transportation-related bonds are issued for State and local highway and bridge improvements, mass transportation, rail, aviation, canal, port and waterway programs and projects. Environmental bonds are issued to fund environmentally sensitive land acquisitions, air and water quality improvements, municipal non-hazardous waste landfill closures and hazardous waste site cleanup projects. Education-related bonds are issued to fund enhanced education technology in schools, with eligible projects including infrastructure improvements to bring high-speed broadband to schools and communities in their school districts and the purchase of classroom technology for use by students. Additionally, these bonds will enable long-term investments in full-day pre-kindergarten through the construction of new pre-kindergarten classroom space.

General Obligation Bonds must be approved directly by the voters at a general election. Only one General Obligation offering, limited to a single work or purpose, may be voted on in a general election. General Obligation bond-financed spending accounts for approximately 2 percent of total spending over the Capital Plan. The Capital Plan assumes the continued implementation of ten previously authorized bond acts (five for transportation, four for environmental and recreational programs, and one for education), as well as spending for the $4.2 billion Clean Water, Clean Air, and Green Jobs Bond Act that was approved by voters in November 2022.

As of March 31, 2025, approximately $2.3 billion of General Obligation Bonds were outstanding.

The State Constitution permits the State to undertake short-term General Obligation borrowings without voter approval in anticipation of the receipt of (i) taxes and revenues, by issuing general obligation tax and revenue anticipation notes ("TRANs"), and (ii) proceeds from the sale of duly authorized but unissued General Obligation Bonds, by issuing bond anticipation notes ("BANs"). General Obligation TRANs must mature within one year from their date of issuance and cannot be refunded or refinanced beyond such period. However, since 1990, the State's ability to issue general obligation TRANs that mature in the same State FY in which they were issued has been limited due to the enactment of the fiscal reforms.

General Obligation BANs may only be issued for the purposes and within the amounts for which bonds may be issued pursuant to General Obligation authorizations, and must be paid from the proceeds of the sale of bonds in anticipation of which they were issued or from other sources within two years of the date of issuance or, in the case of BANs for housing purposes, within five years of the date of issuance. In order to provide flexibility within these maximum term limits, the State has previously used the BANs authorization to conduct a commercial paper program to fund disbursements eligible for General Obligation Bond financing.

State-Supported Lease-Purchase and Other Contractual-Obligation Financings

Prior to the 2002 commencement of the State's PIT Revenue Bond program, public authorities or municipalities issued other lease purchase and contractual-obligation debt. These types of debt, where debt service is payable from moneys received from the State and is subject to annual State appropriation, are not general obligations of the State.

Debt service payable to certain public authorities from State appropriations for such lease-purchase and contractual obligation financings are paid from general resources of the State. Although these financing arrangements involve a contractual agreement by the State to make payments to a public authority, municipality or other entity, the State's obligation to make such payments is expressly made subject to appropriation by the Legislature and the actual availability of money to the State for making the payments. As of March 31, 2025, approximately $242 million of State-supported lease- purchase and other contractual obligation financings were outstanding.

Legislation first enacted in FY 2011, and extended through June 30, 2026, authorizes the State to set aside moneys in reserve for debt service on general obligation, lease-purchase, and service contract bonds. Pursuant to a certificate filed by the Director of the Budget with the State Comptroller, the Comptroller is required to transfer from the General Fund such reserved amounts on a quarterly basis in advance of required debt service payment dates. The State currently has no plans to issue additional lease-purchase or other contractual-obligation financings.

Dedicated Highway and Bridge Trust Fund Bonds

DHBTF bonds were issued for State transportation purposes and are backed by dedicated motor fuel, gas and other transportation related taxes and fees, subject to appropriation. As of March 31, 2025, approximately $34 million of DHBTF bonds were outstanding which were fully retired on April 1, 2025. The State currently has no plans to issue additional DHBTF bonds but could in the future if market conditions warrant.

State-Related Obligations Outstanding

State-related debt is a broader measure of debt that includes State-supported debt and contingent-contractual obligations, moral obligations, State-guaranteed debt, intergovernmental loans, and other debt.

Contingent-Contractual Obligation Financing

Contingent-contractual debt, included in State-related debt, is debt where the State enters into a statutorily authorized contingent-contractual obligation via a service contract to pay debt service in the event there are shortfalls in revenues from other non-State resources pledged or otherwise available to pay the debt service. As with State-supported debt, except for General Obligation Bonds, all payments are subject to annual appropriation. There is no State contingent-contractual debt outstanding.

State-Guaranteed Financings

Pursuant to specific constitutional authorization, the State may also directly guarantee certain public authority obligations. Payments of debt service on State guaranteed bonds and notes are legally enforceable obligations of the State. The only current authorization provides for the State guarantee of the repayment of certain borrowings for designated projects of the New York State Job Development Authority ("JDA"). However, all JDA bonds guaranteed by the State have been paid off, and the State does not anticipate any future JDA indebtedness to be guaranteed by the State. The State has never been called upon to make any direct payments pursuant to any such guarantees.

Other State Financings

Other State financings relate to the issuance of debt by a public authority, including capital leases and mortgage loan commitments.

Intergovernmental Loans

Intergovernmental loans represent loans where no bonds are issued but the State has agreed to pay annual loan payments, subject to appropriation, to another governmental entity. Accordingly, intergovernmental loans are classified as State-related debt and are not subject to the State's debt cap. Legislation authorizes the Budget Director to enter into a financing agreement with GDC to make payments to GDC in an amount sufficient to allow GDC to make payments on a New York Railroad Rehabilitation and Improvement Financing (RRIF) loan, subject to annual appropriation by the State Legislature, to support the State's capital commitment to the Gateway Hudson Tunnel Project. Pursuant to the legislative authorization, the State Budget Director entered into a contractual obligation with GDC that obligates the State to seek appropriations annually in future budgets and, if appropriated, to provide to GDC an amount each year sufficient to make all payments on the RRIF loan. Such payments are expected to be funded from the State's General Fund. The legislation also includes the authorization to set aside funds quarterly in advance of payments due to GDC for the Hudson Tunnel Project.

The State's share of the Gateway Hudson Tunnel Project is currently estimated at $1.3 billion, inclusive of financing costs, based on the July 2024 financial plan for the project. As of March 31, 2025 there was $14 million outstanding under the RRIF loan.

Borrowing Plan

Debt issuances totaling $9.1 billion are planned to finance capital project spending in FY 2026, an increase of $3.9 billion (73 percent) from FY 2025. The year-over-year growth is largely attributable to the increase in capital spending projected in FY 2026. Bond issuances in FY 2026 will finance capital commitments for economic development and housing ($1.7 billion), education ($1.4 billion), the environment ($993 million), health and mental hygiene ($871 million), State facilities and equipment ($881 million), and transportation ($3.3 billion).

Over the five-year Capital Plan, new debt issuances are projected to total $50.6 billion. This reflects the application of $13.6 billion of PAYGO to supplant bond issuances. New issuances are expected for economic development and housing ($9.3 billion), education facilities ($7.7 billion), the environment ($5.5 billion), mental hygiene and health care facilities ($4.8 billion), State facilities and equipment ($4.9 billion), and transportation infrastructure ($18.4 billion).

State-Related Debt Service Requirements

State-related debt service is projected at $1.5 billion in FY 2026, a decrease of $2.2 billion (59 percent) from FY 2025, which is affected by the prepayment of $2.8 billion in FY 2025 of future debt service costs and additional prepayments in previous fiscal years. The State is contractually required to make debt service payments prior to bondholder payment dates in most instances and may also elect to make payments earlier than contractually required. The State expects to use three principal bonding programs -- Personal Income Tax Revenue Bonds, Sales Tax Revenue Bonds, and General Obligation Bonds -- to fund all bond-financed capital spending.

Adjusting for prepayments, State-related debt service is projected at $6.7 billion in FY 2026, an increase 8.2 percent from FY 2025. Over the five-year Capital Plan, adjusted debt service costs are expected to grow to $8.6 billion in FY 2030, an average annual increase of 6.8 percent from FY 2025.

AUTHORITIES AND LOCALITIES

Public Authorities

For the purposes of this section, "authorities" refer to public benefit corporations or public authorities, created pursuant to State law, which are reported in the State's Annual Comprehensive Financial Report. Authorities are not subject to the constitutional restrictions on the incurrence of debt that apply to the State itself and they may issue bonds and notes within the amounts and restrictions set forth in legislative authorization. Certain of these authorities issue bonds under two of the three primary State credits—PIT Revenue Bonds and Sales Tax Revenue Bonds. The State's access to the public credit markets through bond issuances constituting State-supported or State-related debt issuances by certain of its authorities could be impaired and the market price of the outstanding debt issued on its behalf may be materially and adversely affected if any of these authorities were to default on their respective State-supported or State-related debt issuances.

The State has numerous public authorities with various responsibilities, including those which finance, construct and/or operate revenue-producing public facilities. These entities generally pay their own operating expenses and debt service costs on their notes, bonds or other legislatively authorized financing structures from revenues generated by the projects they finance or operate, such as tolls charged for the use of highways, bridges or tunnels; charges for public power, electric and gas utility services; tuition and fees; rentals charged for housing units; and charges for occupancy at medical care facilities. Since the State has no actual or contingent liability for the payment of this type of public authority indebtedness, it is not classified as either State-supported debt or State-related debt. Some public authorities, however, receive monies from State appropriations to pay for the operating costs of certain programs.

There are statutory arrangements that, under certain circumstances, authorize State local assistance payments that have been appropriated in a given year and are otherwise payable to localities to be made instead to the issuing public authorities in order to secure the payment of debt service on their revenue bonds and notes. However, in honoring such statutory arrangements for the redirection of local assistance payments, the State has no constitutional or statutory obligation to provide assistance to localities beyond amounts that have been appropriated therefor in any given year.

As of December 31, 2024 (with respect to JDA as of March 31, 2024), each of the 15 authorities had outstanding debt of $100 million or more, and the aggregate outstanding debt, including refunding bonds, was approximately $219 billion, only a portion of which constitutes State-supported or State-related debt.

Localities

There have been severe financial and other adverse impacts on localities throughout the State, but particularly on the City and the surrounding counties as the initial epicenter of the COVID-19 pandemic. No attempt is made in this AIS to assess, at this time, the financial and healthcare impacts on the State's localities.

While the fiscal condition of New York City and other local governments in the State is reliant, in part, on State aid to balance their annual budgets and meet their cash requirements, the State is not legally responsible for their financial condition and viability. Indeed, the provision of State aid to localities, while one of the largest disbursement categories in the State budget, is not constitutionally obligated to be maintained at current levels or to be continued in future FYs and the State Legislature may amend or repeal statutes relating to the formulas for and the apportionment of State aid to localities.

The City of New York

The fiscal demands on the State may be affected by the fiscal condition of the City, which relies in part on State aid to balance its budget and meet its cash requirements. It is also possible that the State's finances may be affected by the ability of the City, and its related issuers, to market securities successfully in the public credit markets.

The staffs of the Financial Control Board for the City, the Office of the State Deputy Comptroller, the City Comptroller and the Independent Budget Office issue periodic reports on the City's financial plans.

Other Localities

Certain localities other than the City have experienced financial problems and have requested and received additional State assistance during the last several State FYs. While a relatively infrequent practice, deficit financing by local governments has become more common in recent years. State legislation enacted from 2004 to date includes 32 special acts authorizing bond issuances to finance local government operating deficits. Included in this figure are special acts that extended the period of time related to prior authorizations and modifications to issuance amounts previously authorized. When a local government is authorized to issue bonds to finance operating deficits, the local government is subject to certain additional fiscal oversight during the time the bonds are outstanding as required by the State's Local Finance Law, including an annual budget review by OSC.

In addition to deficit financing authorizations, the State has periodically enacted legislation to create oversight boards in order to address deteriorating fiscal conditions within particular localities. The City of Buffalo and the Counties of Erie and Nassau are subject to varying levels of review and oversight by entities created by such legislation. The Cities of Dunkirk and Newburgh operate under special State legislation that provides for fiscal oversight by the State Comptroller and the City of Yonkers must adhere to a Special Local Finance and Budget Act. The impact on the State of any possible requests in the future

for additional oversight or financial assistance cannot be determined at this time and therefore is not included in the Financial Plan projections.

Legislation enacted in 2013 created the Financial Restructuring Board for Local Governments (the "Restructuring Board"). The Restructuring Board consists of ten members, including the State Director of the Budget, who is the Chair, the AG, the State Comptroller, the Secretary of State and six members appointed by the Governor. The Restructuring Board, upon the request of a "fiscally eligible municipality", is authorized to perform a number of functions including reviewing the municipality's operations and finances, making recommendations on reforming and restructuring the municipality's operations, proposing that the municipality agree to fiscal accountability measures, and making available certain grants and loans. To date, the Restructuring Board is currently reviewing or has completed reviews for twenty-six municipalities. The Restructuring Board is also authorized, upon the joint request of a fiscally eligible municipality and a public employee organization, to resolve labor impasses between municipal employers and employee organizations for police, fire and certain other employees in lieu of binding arbitration before a public arbitration panel.

OSC implemented its Fiscal Stress Monitoring System (the "Monitoring System") in 2013. The Monitoring System utilizes a number of fiscal and environmental indicators with the goal of providing an early warning to local communities about stress conditions in the State's local governments and school districts. Fiscal indicators consider measures of budgetary solvency while environmental indicators consider measures such as population, poverty, and tax base trends. Individual entities are then scored according to their performance on these indicators. An entity's score on the fiscal components will determine whether or not it is classified in one of three levels of stress: significant, moderate or susceptible. Entities that do not meet established scoring thresholds are classified as "No Designation".

Based on financial data filed with OSC for the local fiscal years ending in 2024, a total of 9 non-calendar fiscal year end local governments (all villages) and 22 school districts have been placed in a stress category by OSC. Additionally, of the local governments with a December 31, 2023 fiscal year end, 8 — including 3 cities and 5 towns — were placed in a fiscal stress category by OSC. The vast majority of local governments (98.7 percent) and school districts (96.7 percent) are not classified in a fiscal stress category.

The Monitoring System relies on data submitted to OSC by local governments in their Annual Financial Report ("AFR"). The AFR captures a local government's annual revenue, expenditures, cash reserves, fund balance and outstanding debt for the period. From 2018 to 2023, the number of municipalities that failed to file their AFRs increased from 10 to 18 percent. Additional information on local governments that have failed to file an AFR is available on the OSC website at the following address: https://web.osc.state.ny.us/localgov/afr-non-filers/.

Like the State, local governments must respond to changing political, economic and financial influences over which they have little or no control, but which can adversely affect their financial condition. For example, the State or Federal government may reduce (or, in some cases, eliminate) funding of local programs, thus requiring local governments to pay these expenditures using their own resources. Similarly, past cash flow problems for the State have resulted in delays in State aid payments to localities. In some cases, these delays have necessitated short-term borrowing at the local level.

Other factors that have had, or could have, an impact on the fiscal condition of local governments and school districts include: the end of temporary Federal stimulus funding; the pause or termination of Federal assistance programs; recent State aid trends; constitutional and statutory limitations on the imposition by local governments and school districts of property, sales and other taxes; the economic ramifications of a pandemic; and for some communities, the significant upfront costs for rebuilding and clean-up in the wake of a natural disaster. Localities may also face unanticipated problems resulting from certain pending litigation, judicial decisions and long-range economic trends. Other large-scale potential problems, such as declining urban populations, declines in the real property tax base, increasing pension, health care and other fixed costs, or the loss of skilled manufacturing jobs, may also adversely affect localities and necessitate requests for State assistance.

Ultimately, localities as well as local public authorities may suffer serious financial difficulties that could jeopardize local access to public credit markets, which may adversely affect the marketability of notes and bonds issued by localities within the State.

LITIGATION

General

The legal proceedings listed below involve State finances and programs and other claims in which the State is a defendant and the potential monetary claims against the State are deemed to be material, meaning in excess of $300 million or involving significant challenges to or impacts on the State's financial policies or practices. As explained below, these proceedings could adversely affect the State's finances in FY 2026 or thereafter. The State intends to describe newly initiated proceedings that the State deems to be material and existing proceedings that the State has subsequently deemed to be material, as well as any material and adverse developments in the listed proceedings, in quarterly updates and/or supplements to the AIS.

For the purpose of the "Litigation" section, the State defines "material and adverse developments" as rulings or decisions on or directly affecting the merits of a proceeding that have a significant adverse impact upon the State's ultimate legal position, and reversals of rulings or decisions on or directly affecting the merits of a proceeding in a significant manner, whether in favor of or adverse to the State's ultimate legal position. The State intends to discontinue disclosure with respect to any individual case after a final determination on the merits or upon a determination by the State that the case does not meet the materiality threshold described above.

The State is party to other claims and litigation, with respect to which its legal counsel has advised that it is not probable that the State will suffer adverse court decisions, or which the State has determined do not, considered on a case-by-case basis, meet the materiality threshold described in the first paragraph of this section. Although the amounts of potential losses, if any, resulting from these litigation matters are not presently determinable, it is the State's position that any potential liability in these litigation matters is not expected to have a material and adverse effect on the State's financial position in FY 2026 or thereafter. The Basic Financial Statements for FY 2025, which OSC issued on July 28, 2025, reported possible and probable awards and anticipated unfavorable judgments against the State.

Adverse developments in the proceedings described below; other proceedings for which there are unanticipated, unfavorable and material judgments; or the initiation of new proceedings could affect the ability of the State to maintain a balanced Financial Plan during FY 2026. The State believes that the Updated Financial Plan includes sufficient reserves to offset the costs associated with the payment of judgments that may be required during FY 2026. These reserves include (but are not limited to) amounts appropriated for Court of Claims payments and projected fund balances in the General Fund. In addition, any amounts ultimately required to be paid by the State may be subject to settlement or may be paid over a multi-year period. There can be no assurance, however, that adverse decisions in legal proceedings against the State would not exceed the amount of all potential Enacted Budget resources available for the payment of judgments, and could therefore adversely affect the ability of the State to maintain a balanced Financial Plan.

Real Property Claims

Canadian St. Regis Band of Mohawk Indians, et al. v. State of New York, et al., 82 CV 783 (NDNY) (consolidated with 82 CV 1114, and 89 CV 829), is a consolidated action first instituted in 1982 under the federal Non-Intercourse Act. The tribe plaintiffs seek ejectment and monetary damages for their claim that approximately 2,000 acres over the area known as the Hogansburg Triangle in Franklin and St. Lawrence Counties were illegally transferred from their predecessors-in-interest. The United States is an intervenor plaintiff due to the underlying claim that New York violated the Non-Intercourse Act when acquiring Mohawk lands.

In March 2022, the Court concluded that plaintiffs had established a prima facie case under the Non-Intercourse Act. The parties executed a final settlement agreement, which is currently awaiting Congressional approval. At this time, it is unknown what future financial impact this claim may have on the State's Financial Plan.

School Aid

In *Maisto v. State of New York (*formerly identified *as Hussein v. State of New York)*, 8997-08 (Sup. Ct. Albany Cty.), plaintiffs seek a judgment declaring that the State's system of financing public education violates section 1 of article 11 of the State Constitution, on the ground that it fails to provide a sound basic education. In 2021, after trial and appeals, the Appellate Division, Third Department, held that plaintiffs demonstrated a violation of Article 11, § 1 in each of the subject school districts

with respect to the at-risk student population. The Appellate Division remitted the matter to the Supreme Court for the State to determine the appropriate remedy. The Supreme Court subsequently determined that the State's remedy was reasonable and terminated the case. Plaintiffs appealed and the matter awaits briefing and argument. At the time, it is unknown what future financial impact this claim may have on the State's Financial Plan.

Compensation of Assigned Counsel

New York County Lawyers Ass'n, et al. v. State of New York, et al., 156916/2021 (Sup Ct. N.Y. Cty.), is a plenary action in which plaintiffs challenge the compensation rates paid pursuant to County Law Article 18-B, Section 245 of the Family Court Act, and Section 35 of the Judiciary Law for private counsel assigned to represent children and indigent adults. Plaintiffs asserted that the low rates prevent children and indigent adults from receiving their constitutional right to effective and meaningful legal representation and they sought declaratory and injunctive relief preventing the continued violation and setting new rates. In July 2022, the Court granted the plaintiffs' requested preliminary injunction and ordered payment of an increased rate by the State and the City of New York of $158 per hour, retroactive to February 2, 2022. The preliminary injunction was silent on the funding structure for payment of the increased rates. Accordingly, the structure remained as established by statute, with the State responsible for increased costs to the Judiciary as applicable to the representation of children pursuant to Judiciary Law Section 35, while the City will be responsible for the increased costs to represent indigent adults in Family Court, Criminal Court, and other court proceedings in New York City as required by County Law Article 18-B. In May 2023, Governor Hochul signed a new budget bill that increased the hourly rate of compensation paid to all assigned counsel statewide to $158 per hour, with a cap of $10,000 per case, with changes retroactive to April 1, 2023. See Part GG of Chapter 56 of the Laws of 2023, FY 2024 Budget, Article VII, Education, Labor and Family Assistance. While plaintiffs received much of the relief requested, the matter remains open and plaintiffs have advised that they may seek further intervention. At this time, it is unknown what future financial impact this claim may have on the State's Financial Plan.

New York State Bar Association v. State of New York, 16091/2022 (Sup. Ct. N.Y. Cty.), is a plenary action against the State as sole defendant, seeking the same relief as in the New York County Lawyers Association ("NYCLA") litigation, but applicable to all 57 non-New York City counties. In January 2023, Plaintiffs moved for a preliminary injunction seeking a rate increase to $164 per hour, consistent with the current federal rate. In May 2023, Governor Hochul signed a new budget bill that increased the hourly rate of compensation paid to all assigned counsel statewide to $158 per hour, with a cap of $10,000 per case, with changes retroactive to April 1, 2023. See Part GG of Chapter 56 of the Laws of 2023, FY 2024 Budget, Article VII, Education, Labor and Family Assistance. Plaintiffs subsequently withdrew the preliminary injunction motion without prejudice. While plaintiffs received much of the relief requested, the matter remains open and plaintiffs have advised that they may seek further intervention. At this time, it is unknown what future financial impact this claim may have on the State's Financial Plan.

Adult Survivors Act Claims

Under New York's Adult Survivors Act (ASA), survivors of sexual assault that occurred when they were 18 or older were given one year to sue their abusers, regardless of when the abuse occurred. The one-year "lookback" window ran from November 24, 2022, through November 23, 2023. While the window was open, more than 1600 claims were filed against the State. Allegations include abuse from at least as early as the 1980's and seek damages, in some cases, of up to $25 million. The State is evaluating the individual claims and anticipates beginning to settle ASA claims in 2025. Discovery is ongoing. At this time, it is unknown what future financial impact the remaining claims may have on the State's Financial Plan.

Medicaid Services to Minors

In *C.K., et al. v. McDonald, et al.*, 22 CV 1791 (EDNY), plaintiffs are four Medicaid-eligible children who suffer from various mental health issues and who claim that they are not provided legally required services. Plaintiffs assert violations of (1) the Medicaid Act's "Reasonable Promptness" and "Early Periodic Screening, Diagnostic and Treatment" provisions; (2) the Americans with Disabilities Act's integration mandate and prohibition on discrimination based on disability; and (3) the Rehabilitation Act's similar requirements. After filing the complaint in 2022, plaintiffs filed a motion seeking class certification of two statewide classes. The Court certified the classes in February 2024. The Court stayed litigation deadlines while the parties negotiated settlement. The Court now has given preliminary approval to the parties' settlement agreement, which is subject to final approval. At this time, it is unknown what future financial impact this claim may have on the State's Financial Plan.

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ADDITIONAL CONSIDERATIONS

New York municipal obligations may also include obligations of the governments of Puerto Rico and other U.S. territories and their political subdivisions to the extent that these obligations are exempt from New York State PITs. Accordingly, investments in such securities may be adversely affected by local political and economic conditions and developments within Puerto Rico and certain other U.S. territories affecting the issuers of such obligations.

ADDITIONAL INFORMATION CONCERNING

PENNSYLVANIA MUNICIPAL OBLIGATIONS

The following information is a summary of certain factors affecting the credit and financial condition of the Commonwealth of Pennsylvania ("Pennsylvania," the "Commonwealth" or the "State"). The sources of payment for Pennsylvania municipal obligations and the marketability thereof may be affected by financial or other difficulties experienced by the State and certain of its municipalities and public authorities. This summary does not purport to be a complete description and, with the exception of the last paragraph hereof, is derived solely from information provided by the State in an official statement relating to an offering of Pennsylvania bonds dated October 16, 2024 (the "Official Statement"). More current information regarding the State's financial condition may be found in the Annual Comprehensive Financial Report for the Fiscal Year Ended June 30, 2024, dated December 20, 2024 (the "ACFR"). The funds have not independently verified the accuracy, completeness or timeliness of the information contained in the Official Statement or the ACFR. Any characterizations of fact, assessments of conditions, estimates of future results and other projections are statements of opinion made by the State in, and as of the date of, the Official Statement and the ACFR, as applicable, and are subject to risks and uncertainties that may cause actual results to differ materially.

ECONOMY GENERALLY

The Commonwealth is one of the nation's most populous states, ranking fifth behind California, Texas, Florida and New York. Boasting a diverse economy, Pennsylvania has been a key player in various industries throughout its history, including shipbuilding, iron, chemicals, lumber, oil, textiles, glass, coal, and steel. Historically recognized as a heavy industrial state, this identity has evolved in recent decades with the decline of coal, steel, and railroad industries. Consequently, Pennsylvania's business landscape has adapted, fostering a more diversified economic base. Presently, the state experiences significant growth in the service sector, particularly in health care and leisure-hospitality.

The "eds and meds" sector, combining education and health care, is integral to Pennsylvania's economy. Education institutions contribute to job creation and the cultivation of new businesses. The Pittsburgh region has witnessed rapid growth in high-tech fields like software development and robotics, while Philadelphia's universities support regional health systems and foster startups in the life sciences – a major economic driver in the region.

Although the manufacturing sector has shifted from its peak during Pittsburgh's steel dominance and Philadelphia's claim as the "workshop of the world," Pennsylvania still maintains a manufacturing employment share above the national average. The production of pharmaceuticals remains a significant growth engine and the state's increased production of natural gas liquids forms the basis for growth in chemicals and plastics. While employment in the manufacturing sector has grown in the last three years, employment is expected to remain below pre-pandemic levels and gradually fall for the next several years.

Professional, scientific, and technical services will stand out as a bright spot for the State in terms of job growth and economic output gains. High-tech fields such as artificial intelligence, industrial automation, and bio-sciences are anticipated to experience the most growth, with more traditional fields like legal services seeing more moderate gains. The State's healthcare and social service sector will continue to be a reliable source of job gains, albeit with slower overall growth compared to previous years. Burnout among health care workers is often cited as a factor in hospital staffing shortages, while nursing homes and day care centers have faced challenges competing for workers.

Lastly, the State's geographic location positions it as a prime corridor for the transportation of goods. With extensive rail service, ports, and a grid of interstate highways, Pennsylvania remains an integral part of the northeast region's economic activity.

Population

The Commonwealth is highly urbanized. Its largest Metropolitan Statistical Areas include the cities of Philadelphia and Pittsburgh, which together contain most of the State's total population. According to the U.S. Bureau of the Census, the population of Pennsylvania, was just under 13.0 million people in 2022. Unlike the nation as a whole, Pennsylvania's population is declining, and it has a higher percentage of individuals aged 45 or over compared to the nation or the Middle Atlantic Region.

Employment

Preliminary figures for 2024 show that non-agricultural employment experienced growth over the prior year not only in Pennsylvania but also across the Middle Atlantic Region and the entire United States.

Non-manufacturing employment in Pennsylvania increased in 2024 to 90.8 percent of total non-agricultural employment from 90.7 percent during the previous year. Manufacturing, contributing 9.2 percent of 2024 non-agricultural employment, has fallen behind the services sector, the trade sector, and the government sector as the 4th largest single source of employment within the Commonwealth. In 2024, the service sector accounted for 50.8 percent of all non-agricultural employment while the trade sector accounted for 13.1 percent.

Fabricated metals industries are the largest employer within Pennsylvania's manufacturing sector. In 2024, employment in the fabricated metals industries makes up 14 percent of Pennsylvania manufacturing employment while accounting for just 1.3 percent of total non-agricultural employment in the state.

Unemployment

In 2023, Pennsylvania had an annual unemployment rate of 3.4 percent, which was lower than the United States unemployment rate of 3.6 percent. Pennsylvania maintains an unemployment rate of 3.4 percent through the first half of 2024.

Personal Income

In 2022, total personal income in the Commonwealth reached $836.8 billion, a 0.4 percent increase over the previous year. Meanwhile, national personal income saw a higher growth of 2.0 percent during the same period. Per capita income in the Commonwealth stood at $64,506, slightly below the national figure of $65,470. The Commonwealth's average hourly wage rate of $32.99 for manufacturing and production workers is below the national average of $33.72 for 2024.

Market and Assessed Valuation of Real Property

Annually, the State Tax Equalization Board, Tax Equalization Division (the "STEB") calculates an aggregate market value of all taxable real property in the Commonwealth. This determination involves applying assessment to sales ratio studies to assessment valuations provided by local assessing officials. The market values certified by the STEB include taxable properties, exclude tax-exempt ones, and include adjustments for preferential assessments granted to specific farm and forestlands.

SUMMARY OF COMMONWEALTH FINANCIAL PERFORMANCE

The Pennsylvania legislature approved, and the Governor signed, a budget for fiscal year 2025 on July 11, 2024. The enacted budget appropriates $47,559.0 million from the Commonwealth's General Fund. The budget includes increases in basic education funding and preserves funding for core State government functions and services.

Net position is one way of monitoring the health of the Commonwealth's finances. Total net position is the difference between total assets and total deferred outflows of resources less total liabilities and total deferred inflows of resources as reported on the statement of net position. Total net position is reported in three distinct components: Net investment in capital assets; restricted net position; and unrestricted net position.

Net investment in capital assets represents total capital assets less accumulated depreciation and the outstanding liability (excluding unspent proceeds) for debt specifically related to the construction and acquisition of the capital assets. As of June 30, 2023, governmental and business-type activities, respectively, reported net investment in capital assets of $37,541 million and $898 million.

Restricted net position is reported based on constraints imposed by either: 1) creditors, grantors, contributors, or laws or regulations of the Federal or other governments; or 2) Commonwealth enabling legislation. As of June 30, 2023, governmental and business-type activities, respectively, reported $6,004 million and $3,038 million of restricted net position.

Unrestricted net position represents total net position less the amounts of net investment in capital assets and restricted net position. As of June 30, 2023, governmental and business-type activities, respectively, reported unrestricted net position deficits of $15,936 million and $3,754 million.

Financial Data for Governmental Fund Types (GAAP Basis)

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

The governmental funds balance sheet reports total fund balances for all governmental funds. Assets of the Commonwealth's governmental funds (the General Fund and the Motor License Fund are major governmental funds) as of June 30, 2023, were $46,265.2 million. Liabilities for the same date totaled $13,309.1 million and deferred inflows of resources totaled $4,060.2 million resulting in a fund balance of $28,895.9 million, an increase of $6,499.1 million from the fund balance at June 30, 2022. On a fund specific basis, in comparison to fiscal year 2022, the ending fund balance for the General Fund increased by $4,803.1 million, the fund balance for the Motor License Fund increased by $308.2 million and the fund balance for aggregated non-major funds increased by $1,387.7 million.

DEBT LIMITS

The Pennsylvania Constitution (the "State Constitution") (Article VIII, Section 7(a)) permits debt to be incurred (i) for purposes itemized in law and approved by voter referendum, (ii) without approval of the electorate for the rehabilitation of areas affected by man-made or natural disasters, and (iii) without approval of the electorate for capital facilities projects specifically itemized in a capital budget if such debt does not cause the amount of all net debt outstanding (as defined for purposes of that Section) to exceed one and three quarters times (1.75x) the average of the annual tax revenues of the Commonwealth deposited in all funds in the previous five fiscal years, as certified by the Auditor General (the "Constitutional Debt Limit"). As of August 31, 2024, the semi-annual computation of the Constitutional Debt Limit and the amount of net debt outstanding subject to such limit were $79,057.62 million and $9,662.21 million, respectively.

COMMONWEALTH GOVERNMENT

The Commonwealth is organized into three separate branches of government — executive, legislative and judicial — as defined in the State Constitution.

Commonwealth Employees

Employees are permitted to organize and bargain collectively. As of June 30, 2023, 79.0 percent of full-time salaried employees, under the Governor's jurisdiction, were covered by collective bargaining agreements or memoranda of understanding, with approximately 37.5 percent of State employees represented by the American Federation of State, County and Municipal Employees ("AFSCME"). In September 2023, the Commonwealth signed a new agreement with AFSCME for a four-year pact effective July 1, 2023 through June 30, 2027. As AFSCME is the union representing the most employees, they generally set the economic pattern that other union contracts follow. The contract agreed upon with AFSCME provides a general pay increase in each contract year, which totals 11.25 percent, as well as a service increment each contract year. This results in a maximum total of 20.25 percent over the contract term. As of August 2024, the Commonwealth has reached agreement with all the unions who had expiring contracts in 2023. These agreements follow the AFSCME economic pattern. Collectively, these unions represent approximately 59 percent of the workforce.

Interest arbitration awards typically dictate the employee salary increases and employee/employer health care contributions to be provided to, or on behalf of, employees covered by six public safety unions who possess the statutory right under Act 111(1968) or Act 195 (1970) to have a neutral arbitrator decide the terms of a contract when parties reach impasse.

Most of these public safety unions had contracts that expired on June 30, 2024, except for the Fraternal Order of Police (FOP) Lodge 85, who represent the Capitol Police. All these unions are currently working under the terms of their expired contract. The FOP Lodge 85 has declared impasse to proceed to interest arbitration, so the AFSCME economic pattern cannot be guaranteed. Tentative agreement has been reached with the Pennsylvania State Corrections Officers Association representing corrections officers and forensic security employees. Their tentative agreement follows the AFSCME economic pattern. Negotiations continue with the remaining four unions (Pennsylvania State Troopers Association, Pennsylvania State Rangers Association, FOP Lodge #114 (Game), and FOP Lodge #114 (Fish and Boat) with the goal of reaching agreement that follows the

AFSCME economic pattern; however, as they have the right to proceed to interest arbitration, following the AFSCME economic pattern cannot be guaranteed at this time.

FINANCIAL STRUCTURE AND PROCEDURES

The State Constitution and the laws of the Commonwealth require all payments from the State Treasury except for refunds of taxes, licenses, fees and other charges to be made only by duly enacted appropriations. Amounts appropriated from a fund may not exceed the fund's 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, if not spent or encumbered by the end of the fiscal year, are returned to the unappropriated surplus of the fund categorized as a lapse The Commonwealth's fiscal year begins July 1 and ends June 30. For example, fiscal year 2024 refers to the fiscal year ended June 30, 2024.

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. Most 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. All revenues relating to motor fuels and vehicles are required by the State 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 ("PSP"), are also paid from the Motor License Fund. Debt service on certain 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. Some receive funding, in addition to their specified revenues, through appropriations.

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 deposited to the Tobacco Settlement Fund are subject to annual appropriation by the General Assembly and approval by the Governor.

The Budget Stabilization Reserve Fund is a special revenue fund designated to receive a statutorily determined portion of the budgetary basis fiscal year-end surplus of the General Fund. The Budget Stabilization Reserve Fund (previously designated the "Tax Stabilization Reserve Fund") is used for emergencies threatening the health, safety or welfare of citizens and is used during downturns in the economy that result in significant unanticipated revenue shortfalls not able to be addressed through the normal budget process. Assets of the Budget Stabilization Reserve Fund may be used upon recommendation by the Governor and an approving vote by two-thirds of the members of each chamber of the General Assembly. For purposes of reporting in

accordance with generally accepted accounting principles ("GAAP"), the Budget 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.

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

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

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

OUTSTANDING INDEBTEDNESS OF THE COMMONWEALTH

General Obligation Debt Outstanding

Article VIII, Section 7(a) of 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 the Constitutional Debt Limit, and (iv) tax anticipation notes payable in the fiscal year of issuance. All debt, except debt incurred through the issuance of tax anticipation notes, must be amortized in substantial and regular amounts.

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.

Net outstanding general obligation debt totaled $10,505.6 million at June 30, 2024, an increase of $299.0 million over June 30, 2023. Over the 10-year period ending June 30, 2024, total net outstanding general obligation debt decreased at an annual rate of 1.4 percent. Over the 5-year period ending June 30, 2024, total net outstanding general obligation debt has decreased at an annual rate of 0.5 percent.

General obligation debt for non-highway purposes of $9,742.1 million was outstanding on June 30, 2024. Outstanding debt for these purposes increased by a net $373.3 million since June 30, 2023. For the period ending June 30, 2024, the 10- year and 5-year average annual compound growth rate for total outstanding debt for non-highway purposes has been -0.9 percent and -1.5 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 $763.5 million on June 30, 2024, a decrease of $74.3 million from June 30, 2023. Highway outstanding general obligation debt grew over the 10-year and decreased over the 5-year period ending June 30, 2024, at the annual average rates of 0.4 percent and -6.2 percent, respectively. A previous decline in outstanding highway debt was due to the policy that began in 1980 of funding highway capital projects with current revenues, except for very limited exceptions. However, beginning with fiscal year 2009, the Commonwealth initiated a multi-year plan to issue an average of $200 million in general obligation bonds annually to accelerate the rehabilitation of a portion of the Commonwealth's 6,000 structurally deficient bridges. Funding to support such debt issuance was initially provided from an existing restricted account rather than from general revenues of the Motor License Fund or the General Fund. During the 2010 fiscal year, the Commonwealth issued $200 million in general obligation bonds to jumpstart its bridge rehabilitation program. During fiscal years 2011, 2012, 2013 and 2014 the Commonwealth issued $130 million, $120 million, $85 million and $40 million, respectively, in general obligation debt for the bridge rehabilitation program.

Nature of Commonwealth Debt

Capital Projects Debt. The Commonwealth may incur debt to fund capital projects for community colleges, highways, bridge projects, public improvements, transportation assistance, flood control, and redevelopment assistance. Before a project may be funded, it must be itemized in a capital budget bill adopted by the General Assembly. An annual capital budget bill states

the maximum amount of debt for capital projects that may be incurred during the current fiscal year for projects authorized in the current or previous years' capital budget bills. Capital projects debt is subject to the Constitutional Debt Limit.

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

Electorate-Approved Debt. The issuance of electorate-approved debt is subject to the enactment of legislation that places on the ballot the question of whether debt shall be incurred. The legislation authorizing the referendum must state the purposes for which the debt is to be authorized and, as a matter of practice, includes a maximum amount of funds to be borrowed. Upon electorate approval and enactment of legislation implementing the proposed debt-funded program, bonds may be issued. As of October 16, 2024, all such authorizing legislation had given issuance authority to at least two of the Issuing Officials, one of whom must be the Governor.

Other Bonded Debt. Debt issued to rehabilitate areas affected by disasters is authorized by specific legislation. Authorizing legislation has given issuance authority to at least two of the three 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, however, are distributed more evenly throughout the fiscal year. As a result, operating cash shortages can occur during certain months of the fiscal year. When necessary, the Commonwealth engages in short-term borrowing to fund expenses within the fiscal year through the sale of tax anticipation notes. The authority to issue such notes rests with the Issuing Officials.

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

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

Line of Credit (General Fund). The Commonwealth has entered into an investment agreement with the Pennsylvania Treasury Department which allows the Commonwealth to use governmental monies on deposit with the Treasury Department on a short-term basis to fund General Fund expenses within the fiscal year (the "STIP Facility"). Under the STIP Facility, the Treasury Department invested and the Commonwealth repaid $650 million in fiscal year 2019 and $1,700 million in fiscal year 2020. The Treasury Department did not make a STIP Facility investment in fiscal years 2021, 2022, 2023 and 2024. All amounts due and owing under the STIP Facility are repaid with interest within the same fiscal year in which they are invested. As of the date of this Official Statement, there is no STIP Facility in place or expected to be needed in fiscal year 2025.

Line of Credit (Capital Facilities Fund). The Commonwealth has entered into an investment agreement with the Pennsylvania Treasury Department which allows the Commonwealth to use governmental monies on deposit with the Treasury Department on a short-term basis to fund capital expenses within the fiscal year. On November 13, 2023, the Commonwealth used $200 million of the line of credit to fund projects within several capital facilities categories. The $200 million was repaid with interest on December 20, 2023 at settlement of the Commonwealth's First Series of 2023 Bonds.

Bond Anticipation Notes. Pending the issuance of general obligation bonds, the Commonwealth may issue bond anticipation notes subject to the same statutory and constitutional limitations generally imposed on general obligation bonds. The term of such borrowings may not exceed three years. Issuing authority rests with the Issuing Officials. As of October 16, 2024, no bond anticipation notes were outstanding.

OTHER STATE-RELATED OBLIGATIONS

Pennsylvania Housing Finance Agency ("PHFA")

The PHFA is a State-created agency that provides financing for housing for low and moderate-income families, and people with special housing needs 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 minimum capital reserve fund required for such fund. 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 directs the Governor, upon notification from PHFA, to include in the proposed executive budget of the Commonwealth for the next succeeding year an amount sufficient to fund such deficiency to avoid such default. The budget as passed by the General Assembly may or may not include the amount so requested by the Governor. PHFA is not permitted to borrow additional funds so long as any deficiency exists in the Capital Reserve Fund. As of October 16, 2024, no deficiency existed.

According to PHFA, as of June 30, 2024, PHFA had $5,442.2 million of revenue bonds outstanding.

Lease Financing

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

In 2010, the Commonwealth executed an installment purchase agreement with Noresco, LLC, a Massachusetts limited liability company ("Noresco"). The purpose of the installment purchase agreement is to assist the Commonwealth, acting through its Department of Human Services ("DHS"), to acquire certain energy-savings improvements at Ebensburg State Center, an intermediate care facility. Certificates of participation in the amount of $15.6 million were issued in March 2010 and are payable from lease payments made by the Commonwealth from, and subject to, annual appropriation to DHS. The Commonwealth has also entered into additional installment purchase agreements with Noresco and Johnson Controls. Certificates of participation in the amount of $86.9 million were issued in October 2010 and are payable by the Commonwealth from, and subject to, annual appropriations to its Departments of General Services, Corrections and Human Services. Certificates of participation in the amount of $12.4 million were issued in December 2010 and are payable by the Commonwealth from, and subject to, annual appropriations to its Departments of General Services and Human Services. The purpose of the additional installment purchase agreements was to assist the Commonwealth, acting through various departments, to acquire certain energy-saving improvements.

On March 1, 2009, the Commonwealth entered into a 25-year master lease agreement for certain office space within the Forum Place complex in the City of Harrisburg. The master lease covered 375,000 square feet of office space and had a term through February 28, 2034. In January 2012, the Pennsylvania Economic Development Financing Authority ("PEDFA") issued lease revenue bonds in the principal amount of $107.4 million to acquire the Forum Place complex from the then-controlling majority holder of the defaulted 1998 Dauphin County General Authority bonds. Contemporaneous with the issuance of the PEDFA bonds to acquire the Forum Place, the Capital Region Economic Development Corporation ("CREDC") entered into an agreement with both the Commonwealth and PEDFA pursuant to which the Commonwealth leases approximately 375,000 square feet of office space and 500,000 square feet of parking space in the Forum Place complex from CREDC. The PEDFA Bonds are payable from lease payments made by the Commonwealth to CREDC from and subject to annual appropriations authorizing payments to various Commonwealth agencies occupying the leased space.

Lease for Pittsburgh Penguins Arena

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

While the special revenues were projected to be adequate to pay all debt service on the Arena Bonds, as of October 16, 2024, the revenues had not been able to fully cover the debt service. To the extent such revenues are in any year inadequate to cover debt service, the Commonwealth is obligated under the Arena Lease to fund such deficiency, subject in all cases to appropriation by the General Assembly. The maximum annual amount payable by the Commonwealth under the Arena Lease is $18.6 million. In December 2009, the Commonwealth was notified by the SEA that an additional $2.8 million would be required in fiscal year 2010 to support debt service. In compliance with its obligations under the Arena Lease, the Commonwealth included an appropriation request for $2.8 million from the Pennsylvania Gaming and Economic Development Tourism Fund in its fiscal year 2010 budget. Subsequent to the fiscal year 2010 budget, the Commonwealth has been annually notified by the SEA that additional funds are required to support debt service. In each subsequent year, the Commonwealth included the appropriation request in the appropriate fiscal year budget. In fiscal year 2019 it was $754,059.60; in fiscal year 2020 the debt service was $695,000.00; in fiscal year 2021 the debt service was $783,144.78; in fiscal year 2022 the debt service was $262,764.24; in fiscal year 2023 the debt service was $243,753.68 and in fiscal year 2024 the debt service was $191,346.38.

During April 2010, the SEA issued $17.4 million in additional Commonwealth Lease Revenue Bonds (the "Supplemental Arena Bonds") to complete the Arena. The Supplemental Arena Bonds do not constitute debt of the Commonwealth but are limited obligations of the SEA payable solely from the special revenues pledged therefor. As with the Arena Bonds, the Commonwealth is obligated under the Arena Lease, as amended, to fund any deficiency in special revenues necessary to pay debt service on the Supplemental Arena Bonds, subject in all cases to appropriation by the General Assembly.

Pennsylvania Convention Center

In April 2010, the Commonwealth acquired (through ownership and a long-term leasehold interest) the Pennsylvania Convention Center located in Philadelphia, Pennsylvania (the "City" or "Philadelphia") and the expansion thereto in 2011. Such acquisition was financed through the issuance by PEDFA of $281.1 million of revenue bonds (the "Convention Center Bonds"). The Commonwealth, the City and the Pennsylvania Convention Center Authority (the "Convention Center Authority") entered into an Operating Agreement (the "Operating Agreement") in connection with the issuance of the Convention Center Bonds and the acquisition of the Pennsylvania Convention Center which provides for the operation of the Pennsylvania Convention Center by the Convention Center Authority (which also leases the facility), for the City to make an annual payment of $15 million plus a percentage of its Hotel Room Rental Tax and Hospitality Promotion Tax revenues to support operations of the Pennsylvania Convention Center and for the Commonwealth to make payments to finance operating deficits and operating and capital reserve deposits of the Pennsylvania Convention Center and to pay debt service on the Convention Center Bonds. The Commonwealth also entered into a Grant Agreement (the "Grant Agreement") with PEDFA and U.S. Bank National Association, as trustee for the Convention Center Bonds, with respect to the obligations of the Commonwealth to make the payments required under the Operating Agreement and related amounts due with respect to the Pennsylvania Convention Center and the Convention Center Bonds.

The obligations of the Commonwealth under the Operating Agreement and the Grant Agreement do not create indebtedness of the Commonwealth but are payable from (1) funds available in the Gaming Economic Development and Tourism Fund and (2) other funds of the Commonwealth, subject to annual appropriation by the State legislature. Payments from the Gaming Economic Development and Tourism Fund of up to $64 million per year for up to 30 years (but not exceeding $880 million in the aggregate) have been appropriated by the General Assembly (by Act 53 of 2007, ("Act 53")) for the payment of debt issued with regard to the Pennsylvania Convention Center and for operating expenses of the Pennsylvania Convention Center; however, there is no requirement in Act 53 or otherwise that funds in the Gaming Economic Development and Tourism Fund be so applied. Moneys in the Gaming Economic Development and Tourism Fund have also been appropriated by the General Assembly to several other projects and could be appropriated to additional projects in the future. The Gaming Economic Development and Tourism Fund is funded with an assessment of five percent of the gross terminal revenue of all total wagers received by all slot machines in the Commonwealth less cash payments. While, as of October 16, 2024, the Gaming Economic Development and Tourism Fund was projected to continue to have sufficient revenues to pay its appropriated obligations, there can be no absolute assurance that the Gaming Economic Development and Tourism Fund in any future fiscal year will receive sufficient receipts to pay its appropriated obligations.

Any payments due from the Commonwealth under the Operating Agreement and the Grant Agreement and which are not paid from the Gaming Economic Development and Tourism Fund are subject to annual appropriation by the General Assembly. As of October 16, 2024, the Commonwealth projected that payments materially in excess of the aggregate $880

million appropriated from the Gaming Economic Development and Tourism Fund would be required to be paid by it to satisfy the Commonwealth's obligations under the Operating Agreement and the Grant Agreement over the terms of such agreements.

Commonwealth Financing Authority

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

In Act 85 of 2016, the General Assembly enacted a new Section 1753.1-E of the Fiscal Code that obligates the State Treasurer, in consultation with the Commonwealth's Secretary of the Budget, to transfer the monies necessary for payment of CFA's debt service each fiscal year, beginning July 1, 2016 from sales tax receipts deposited in the General Fund to a restricted revenue account within the General Fund which may only be used to pay that debt service.

As of October 16, 2024, debt service for Authority debt (other than the Tobacco Master Settlement Payment Revenue Bonds (the "Tobacco Bonds")) was payable from continuing appropriations pursuant to Section 1753.1-E of the Fiscal Code while debt service for Tobacco Bonds was payable from continuing appropriations pursuant to Sections 2805 and 2809 of the Tax Reform Code.

Since November 2005, the CFA has completed multiple bond issues to fund programs established by its original economic stimulus mission of April 2004, the ("Original Programs.") As of October 16, 2024, there were no plans to issue additional debt for the Original Programs.

As part of the enactment process for the fiscal year 2009 budget, the General Assembly enacted and on July 9, 2008, the Governor signed into law Act 63 of 2008 ("Act 63") and Act 1 of Special Session 1 of 2008 ("Act 1"). Combined, these two acts provided the CFA with additional bond issuance authority of up to an additional $1,300 million. Act 63 provides the CFA with authority to issue up to $800 million in limited obligation revenue bonds in order to fund water or sewer projects, storm water projects, flood control projects and high hazard unsafe dam projects. Act 63 also provides for the use of Pennsylvania Gaming and Economic Development and Tourism Fund revenues to support debt service costs associated with the $800 million in additional CFA debt authority. Act 1 provides the CFA with authority to issue up to $500 million in limited obligation revenue bonds to fund the development of alternative sources of energy. As of 2021, the CFA has issued $473 million in limited obligation revenue bonds authorized by Act 1 and $757 million in limited obligation revenue bonds authorized by Act 63 of 2008. Other than bonds for refunding purposes, there were no plans, as of October 16, 2024 to issue additional debt for these programs.

As of June 30, 2024, the CFA had $4,063.1 million in outstanding bond debt (including Tobacco Bonds). With respect thereto, a restricted revenue account is funded annually through a Sales and Use Tax Transfer as the source used to service approximately $3,513.0 million of outstanding debt and the Pennsylvania Gaming and Economic Development and Tourism Fund has been the source used to service approximately $550.1 million of such outstanding debt.

Pursuant to Act 25 of 2016 ("Act 25"), the CFA is authorized to issue debt related to the Commonwealth's share of school district construction costs referred to as the PlanCon process. Act 25 established a new funding mechanism to pay school districts for construction reimbursements due to them and to fund capital grants to school districts as part of the PlanCon process. The CFA is authorized to issue up to $2,500 million in appropriation backed debt in connection with the Commonwealth's share of school construction costs; debt in excess of $2,500 million may be incurred by CFA for this purpose if CFA and the Department of Education determine that $2,500 million is insufficient to carry out the purposes of Act 25 and if the Secretary of the Budget approves such determination. The expectation is that the borrowings (other than refunding bonds) will occur from time to time through fiscal year 2025 based on statute as authorized by Act 25. As of June 30, 2024, the CFA has issued $1,903.1 million for construction reimbursement purposes under Act 25.

In addition, the CFA pursuant to Article XXVIII of the Tax Reform Code, added by the Act 43 of 2017, issued Tobacco Bonds on February 13, 2018, in a principal amount necessary to fund a deposit of $1,500 million in the General Fund of the

Commonwealth to provide General Fund budgetary relief. As of October 16, 2024, there were no plans to issue additional Tobacco Bonds (other than for refunding purposes).

Pensions and Retirement

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 Pennsylvania State Employees' Retirement System ("SERS"). Public school employees are members of the Public School Employees' Retirement System ("PSERS"). With certain exceptions, membership in the applicable retirement system is mandatory for covered employees.

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

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

The Commonwealth's retirement programs are funded by contributions from both the employer and employee. Act 120 of 2010 introduced a shared risk program that can affect member contribution rates for state employees enrolled on or after January 2011 and school members enrolled on or after July 1, 2011 depending on the investments results of the respective retirement system. Act 5 of 2017 enhanced the shared risk program. Under the shared risk program, eligible members benefit when the investments results of the retirement systems are doing well and share some of the risk when the investment underperform benchmarks defined in the retirement codes of each System. The investment performance for the shared risk program is measured every three years and contributions for members eligible for the shared risk program can fluctuate every three years based on how the Systems' actual investment performance compares to the shared risk investment return target defined in the retirement code.

The contribution rate for PSERS members who enrolled in the pension plan on or after January 1, 2002 and before July 1, 2011 is 7.5 percent of compensation. Effective July 1, 2021 the contribution rates for PSERS members who enrolled on or after July 1, 2011 and before June 30, 2019 were increased by 0.5 percent to 8.0 percent or 10.8 percent, depending upon elections made by each member, in accordance with member shared risk provisions of the retirement code. The new rates will remain in effect through June 30, 2024 when they may be adjusted based on the results of the next shared risk measurement period. For PSERS members enrolled on July 1, 2019 or thereafter member contribution rates are set forth in Act 5 of 2017 ("Act 5"). The contribution rates for PSERS members who enrolled prior to January 1, 2002 range from 5.25 percent to 7.5 percent of compensation, depending upon the date of commencement of employment and elections made by each employee member. The SERS' employee contribution rate is 6.25 percent for most member employees. Interest on each employee's accumulated contributions is credited annually at a 4 percent rate mandated by State statute. Accumulated contributions plus interest credited are refundable to covered employees upon termination of their employment for most members.

Act 5 established three pension plan design options for most State employees hired on or after January 1, 2019 and for most school employees hired on or after July 1, 2019.

Act 5 of 2017. On June 12, 2017, the Governor signed Act 5 of 2017 into law which established three new pension plan design options for most State employees hired on or after January 1, 2019 and for most school employees hired on or after July 1, 2019.

Investment Performance. SERS returns for the calendar years 2019, 2020, 2021, 2022, and 2023 were 18.8 percent, 11.1 percent, 17.2 percent, -12.2 percent, and 12.2 percent respectively. PSERS' returns for fiscal years 2019, 2020, 2021, 2022, and 2023 were 6.68 percent, 1.12 percent, 24.58 percent, 2.23 percent, and 3.54 percent, respectively.

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

The Boards of PSERS and SERS hire their actuarial firms through a competitive Request for Proposal process generally for a five-year term. As of October 16, 2024, PSERS' actuary was Buck Global, LLC, and SERS' actuary was Korn Ferry Hay Group ("Korn Ferry"). The Boards of PSERS and SERS periodically review their respective system actuarial assumptions with actuaries, investment consultants and staff and determine whether to make any prospective changes to these assumptions. Both Boards have adopted changes to their respective system actuarial assumptions recently and in past years. As discussed below, PSERS Board decreased the actuarial rate of return assumption from 7.25 percent to 7.0 percent for the June 30, 2021 valuation and for subsequent valuations. The SERS Board maintained the actuarial rate of return at 6.875 percent for the December 31, 2023 valuation. These changes to SERS' and PSERS' investment return assumptions bring both Fund's return assumptions below the median assumption used by public pension funds nationally.

During fiscal year 2021, PSERS Actuary, Buck Global, LLC, presented to the PSERS Board recommendations from the Five-Year Actuarial Study which is a periodic review of actual versus expected actuarial experience of the retirement system to ensure that the system is financed on a sound basis. This is an investigation of actuarial experience that has been performed based upon economic and demographic experience from July 1, 2015 through June 30, 2020. The study reviewed the experience and developed recommended assumptions for use in the June 30, 2021 valuation and subsequent valuations. The PSERS Board approved several recommended actuarial assumption changes which included, but was not limited to, lowering the actuarial rate of return from 7.25 percent to 7.0 percent, lowering the annual inflation assumption from 2.75 percent to 2.50 percent, reducing salary growth from 5.0 percent to 4.5 percent and the payroll growth assumption from 3.50 percent to 3.25 percent. The aggregate impact of all assumption changes increased PSERS unfunded actuarial liability by approximately $2.8 billion.

As of June 30, 2019, PSERS funded ratios were 58.1 percent and 55.7 percent on an actuarial and market value basis, respectively. As of June 30, 2020, PSERS funded ratios were 59.2 percent and 54.4 percent on an actuarial and market value basis, respectively. As of June 30, 2021, PSERS funded ratios were 59.6 percent and 63.7 percent on an actuarial and market value basis, respectively. As of June 30, 2022, PSERS funded ratios were 61.6 percent and 61.3 percent on an actuarial and market value basis, respectively. As of June 30, 2023, PSERS funded ratios were 63.6 percent and 61.9 percent on an actuarial and market value basis, respectively.

Changes in the PSERS unfunded actuarial liability and unfunded liability on a market value basis are attributable to several factors that include investment returns as well as differences between actual and expected demographic results. Additionally, 2021 valuations, subsequent valuations, unfunded actuarial liability and unfunded liability on a market value basis were impacted by the change in actuarial assumptions resulting from the most recent five-year experience study.

For SERS, its funded ratios as of December 31, 2019 were 56.5 percent and 58.7 percent on an actuarial and market value basis, respectively. As of December 31, 2020, SERS funded ratios were 59.4 percent and 63.6 percent on an actuarial and market value basis, respectively. As of December 31, 2021, SERS funded ratios were 69.6 percent and 76.0 percent on an actuarial and market value basis, respectively. As of December 31, 2022, SERS funded ratios were 68.0 percent and 61.5 percent on an actuarial and market value basis, respectively. As of December 31, 2023, SERS funded ratios were 69.6 percent and 65.3 percent on an actuarial and market value basis, respectively.

Changes in the SERS unfunded actuarial liability are attributable to several factors that include actual investment returns, the reduction in the actuarial assumed rate of return from 7.0% to 6.875%, as well as differences between actual and expected results.

Changes in the unfunded actuarial accrued liability are attributable to investment returns as well as differences between expected and actual experience.

Previously for financial reporting purposes, both PSERS and SERS adopted the Governmental Accounting Standards Board's ("GASB") Statement No. 25 ("GASB 25").

GASB 25 required a specific method of accounting and financial reporting for DB pension plans. Among other things, GASB 25 required a comparison of employer contributions to "annual required contributions". GASB 25 is superseded by GASB's Statement No. 67 ("GASB 67") and is only provided for informational purposes. Currently for financial reporting purposes starting with December 31, 2014 for SERS and June 30, 2014 for PSERS, both systems adopted GASB 67, which is discussed in the following section under "New Accounting Standards."

For PSERS as of June 30, 2023, the employer net pension liability was $44.5 billion while plan fiduciary net position as a percentage of the total pension liability was 61.85 percent. For PSERS as of June 30, 2022 and 2021, the employer net pension liability was $44.5 billion and $41.1 billion, respectively, while plan fiduciary net position as a percentage of the total pension liability was 61.34 percent and 63.67 percent, respectively.

Over the past 7 years the longer-term trend of the employer net pension liability has decreased from $49.6 billion to $44.5 billion and the plan fiduciary net position as a percentage of total pension liability has increased from 50.14 percent to 61.85 percent over the same time period. For PSERS as of June 30, 2023 and 2022, actuarially determined contribution and contributions in relation to the ADC were both $5,237 million and $4,986 million, respectively.

SERS is the administrator of a cost-sharing multiple-employer DB pension plan and reports required items per GASB 67 in Notes to Financial Statements as well as in Required Supplementary Information starting with its 2014 Annual Comprehensive Financial Report. SERS implemented GASB 67 as of December 31, 2014, but also retroactively reported as of December 31, 2013. For SERS as of December 31, 2023 and 2022, net pension liability was $19.4 billion and $21.0 billion, respectively, while plan fiduciary net position as a percentage of the total pension liability was 65.3 percent and 61.5 percent, respectively. For SERS as of December 31, 2023 and 2022, actuarially determined contributions (ADC) and contributions in relation to the ADC were both $2.2 billion and $2.1 billion, respectively. For SERS as of December 31, 2021, ADCs are $2.1 billion and contributions in relation to ADC are $2.9 billion.

Other Post-Employment Benefits

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

The General Assembly, based upon the Governor's request, annually appropriates funds to meet the obligation to pay current retiree health care benefits on a "pay-as-you-go" basis. As of October 16, 2024, retiree health care expenditures were funded by the Commonwealth's General Fund (approximately 41 percent), and by Federal, Other and Special Funds. Commonwealth costs for such benefits totaled $579 million in fiscal year 2020, $410 million in fiscal year 2021, $372 million in fiscal year 2022, $448 million in fiscal year 2023, and $682 million in fiscal year 2024.

Governmental Accounting Standards Board Statements #74/75. In June 2015, the GASB released Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* and GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* ("Statements No. 74/75"). Statements No. 74/75 establish standards for the measurement, recognition and display in the financial reports of state and local governments of OPEBs liabilities, when provided separately from a pension plan, and related expense or expenditures. Under Statements No. 74/75, governments are required to: (i) recognize the actuarial liabilities of promised benefits associated with past service net of any assets held in trust for the payment of those benefits (the net OPEB liability)|("NOL") and the related expense on the accrual basis

of accounting; (ii) provide plan information on the membership, benefits, trusted assets, actuarial assumptions, and changes to the NOL from the previous valuation; and (iii) provide information useful in assessing trends and potential demands on the employer's future cash flows.

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

In fiscal year 2024, $50 million was transferred to the REHP Trust Account and $1 million was transferred to the RPSPP Trust Account from the pre-existing restricted receipt accounts. No additional transfers have been made to the trust accounts. At June 30, 2024, the combined balance in the trust accounts and restricted receipt accounts was $1.103 billion.

The Commonwealth has retained Deloitte Consulting, LLP, a multinational professional services firm, to provide actuarial services for GASB 75 implementation and reporting. The Deloitte Consulting's fiscal year 2022 OPEB valuation for the REHP and RPSPP programs is updated to reflect the following:

The combined NOL reported as of June 30, 2023 was $13,925 million. The NOL for the REHP was $7,776 million comprised of an actuarial accrued liability of $8,528 million less $752 million of plan assets. The NOL for the RPSPP was $6,149 million comprised of an actuarial accrued liability of $6,284 million less $135 million of plan assets.

GOVERNMENT AUTHORITIES AND OTHER ORGANIZATIONS

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

Delaware River Joint Toll Bridge Commission ("DRJTBC")

The DRJTBC, a public corporation of the Commonwealth and New Jersey, owns and operates toll and non-toll bridges across the Delaware River north of the toll bridges operated by the Delaware River Port Authority ("DRPA"). Debt service on bonds is paid from tolls and other revenues of DRJTBC. DRJTBC had $634.1 million in bonds outstanding as of December 31, 2024.

Delaware River Port Authority

The DRPA, a public corporation of the Commonwealth and New Jersey, operates several toll bridges over the Delaware River within and near Philadelphia, 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. As of June 30, 2024, the DRPA had $906.3 million in revenue bond debt outstanding and $42.1 million in other bond debt outstanding that is paid from general funds.

Pennsylvania Economic Development Financing Authority

PEDFA was created in 1987 to offer pooled bonds and other issues of both taxable and tax-exempt bonds on behalf of local industrial development authorities and industrial development corporations for economic development projects. Bonds are payable from and secured by loan repayments and other revenues which may be received by PEDFA. The PEDFA had $8,746.5 million of debt outstanding as of June 30, 2024.

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 $1,553.1 million in bonds outstanding as of June 30, 2024.

Pennsylvania Higher Educational Facilities Authority ("PHEFA")

The PHEFA is a public corporation of the Commonwealth established to finance college facilities. As of June 30, 2024, the PHEFA had $5,039.8 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 $13.78 million in revenue bond debt outstanding on June 30, 2024, to which all 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 $65.8 million of revenue bonds outstanding as of June 30, 2024.

Pennsylvania Turnpike Commission ("PTC"*)*

The PTC operates the Pennsylvania Turnpike System ("System"). Its outstanding indebtedness, $15,930.7 million as of June 30, 2024, is payable from the net revenues of the System, primarily toll revenues, or from certain taxes dedicated to the System.

State Public School Building Authority ("SPSBA")

The SPSBA finances public school projects and community college capital projects. Bonds issued by the SPSBA are supported by the lease rental payments or loan repayments made to the SPSBA by local school districts and the community colleges. A portion of the funds appropriated annually by the Commonwealth as aid to local school districts and community colleges may be used by them to pay a portion of such lease rental payments or loan repayments. The SPSBA had $2,152.2 million of revenue bonds outstanding as of June 30, 2024.

City of Philadelphia—PICA

The Pennsylvania Intergovernmental Cooperation Authority ("PICA") was created by Commonwealth Act No. 1991-6, approved June 6, 1991 to assist the City, the Commonwealth's largest city, in remedying its fiscal emergencies. PICA is authorized to provide financial assistance to the City through the issuance of debt, and to make factual findings and recommendations to the City concerning its budgetary and fiscal affairs. This financial assistance has included grants used by the City for defeasance of certain City general obligation bonds, funding of capital projects, and the liquidation of the cumulative general fund deficit of the City, as of June 30, 1992, of $224.9 million. Under the PICA act, the City is required to submit to PICA: (i) a five-year financial plan on an annual basis; and (ii) quarterly financial reports. As of October 16, 2024, the City was operating under a five-year financial plan that covers fiscal years 2025 through 2029, which was approved by PICA.

Over the years, the City has expressed a desire to retain the financial oversight and reporting requirements of the PICA act beyond the expiration of the PICA Bonds. Act 36 of 2022 amended the PICA act to, among other things, (i) extend the term of PICA's existence until the later of (A) January 2, 2047 or (B) one year after all its liabilities are met or, in the case of PICA Bonds, one year after provision for such payment shall have been made or provided for in the applicable bond indenture; (ii) continue all of the financial oversight and reporting requirements of the PICA act for the life of PICA (regardless of whether PICA Bonds are outstanding); (iii) permit on a limited basis, at the request of the City, the issuance of PICA Bonds for capital projects of the City; and (iv) continue the authorization and dedication of the PICA Tax for so long as PICA remains in existence (regardless of whether any PICA Bonds are outstanding).

Neither the taxing power nor the credit of the Commonwealth is pledged to pay debt service on the PICA bonds. All PICA bonds were retired on June 30, 2023 and presently, there are no PICA bonds outstanding as of June 30, 2024.

Tax Revenues (Unaudited Budgetary Basis)

General Fund. Tax revenues constituted approximately 96.5 percent of Commonwealth revenues in the General Fund for the fiscal year ended June 30, 2024 (hereafter, fiscal year 2024). The major tax sources for the General Fund of the Commonwealth are the personal income tax, the sales and use tax, the corporate net income tax, the gross receipts tax, and the inheritance tax. Together these five taxes produced 92.9 percent of General Fund tax revenues for the fiscal year 2024.

Motor License Fund. The major tax source for the Motor License Fund is the Oil Company Franchise Tax ("OCFT") including fuels and liquid fuels, which produced 50.9 percent of non-restricted Motor License Fund revenues in fiscal year 2024. 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 discussions of the tax revenues of the Motor License Fund.

General Fund Revenue Detail

The major revenue sources (those representing more than 1 percent of total revenues) for the General Fund are described briefly below. The receipt amounts in the descriptions are on a budgetary basis.

Corporate Net Income Tax. Total corporate net income taxes of $5,651.5 million were collected in fiscal year 2024 (12.4 percent of total General Fund revenues).

This tax is paid by all domestic and foreign business corporations for the privilege of doing business, carrying on activities, or employing or owning capital or property in Pennsylvania and is levied on Federal taxable income with Pennsylvania modifications. When the entire business of any corporation is not transacted within Pennsylvania, taxable income is usually determined by a single sales factor apportionment formula for tax years 2013 and beyond.

The tax rate for 2024 is 8.99 percent for the tax year that began January 1, 2023 and then decreased to 8.49 percent for the tax year beginning January 1, 2024. The rate will decrease by 0.5 percent each tax year thereafter until the rate is 4.99 percent for tax year 2031 and after.

Gross Receipts Tax. Total gross receipts taxes of $1,389.2 million were collected in fiscal year 2024 (3.1 percent of total General Fund revenues).

This tax is levied on the gross receipts from business transacted within Pennsylvania by specified companies owned, operated or leased by corporations, associations, or individuals. Various gross receipts taxes are imposed upon private bankers; pipeline, conduit, steamboat, canal, slack water navigation and transportation companies; telephone, telegraph and mobile telecommunications companies; electric light, water power and hydroelectric companies; express companies; palace car and sleeping car companies; and freight and oil transportation companies.

The current tax rate on gross receipts from sales of electric energy within Pennsylvania is 59 mills and has been in effect since 2003. The current tax rate on other gross receipts is 50 mills and has been in effect since 1991.

Insurance Premiums Tax. Total insurance premium taxes of $546.8 million were collected in fiscal year 2024 (1.2 percent of total General Fund revenues).

This tax is levied on the gross premiums from all business transacted within the Commonwealth during each calendar year by domestic and foreign insurance companies.

Prior to the passage of Act 53 of 2022, premiums from foreign casualty companies and foreign fire companies were deposited in the Municipal Pension Aid Fund (MPAF) and the Fire Insurance Tax Fund (FITF), respectively. Act 53 of 2022 provides that all insurance premiums tax payments are deposited in the General Fund. At the close of the fiscal year, the greater of 38 percent of insurance premiums tax revenues or $345 million is to be transferred to the MPAF, and the greater of 8.5 percent of insurance premiums tax revenues or $85 million is to be transferred to the FITF. The change is effective beginning with fiscal year 2022-23. Amounts transferred in fiscal year 2024 (figures shown above are net of these transfers):

- Municipal Pension Aid Fund - $382.0 million
- Fire Insurance Tax Fund - $85.9 million

The current tax rate is 2 percent of gross premiums plus a retaliatory fee where applicable.

Sales & Use Tax. Total sales and use taxes of $14,255.9 million were collected in fiscal year 2024 (31.3 percent of total General Fund revenues).

This tax is levied on the sale at retail, including rental, of tangible personal property and certain services, or upon the use with Pennsylvania of tangible personal property, or taxable services purchased at retail if the tax was not paid at time of purchase. A tax on the occupancy of hotel rooms is imposed as part of the sales and use tax law.

Listed below are the transfers made from Sales and Use Tax in fiscal year 2024 (figures shown above are net of these transfers):

- CFA - $162.1 million
- Public Transportation Assistance Fund - $149.3 million (0.947 percent of gross collections)
- Public Transportation Trust Fund - $693.9 million (4.4 percent of gross collections)
- Transit Revitalization Investment District Fund - $0.7 million
- Beginning in fiscal year 2023 an additional monthly transfer is made to the Public Transportation Trust Fund. The transfer is made from Motor Vehicle Sales and Use Tax only, but is calculated on total collections (3.28 percent of gross collections) - $517.7 million.

The current tax rate uses a bracket system based on 6 percent of purchase price. This rate has been in effect since 1968.

Cigarette Tax. Total cigarette taxes of $668.0 million were collected in fiscal year 2024 (1.5 percent of total General Fund revenues).

This tax is imposed and assessed on the sale or possession of cigarettes and little cigars weighing less than 4 pounds per 1,000 sticks within Pennsylvania.

Listed below are the transfers made from Cigarette Tax in fiscal year 2024 (figures shown above are net of these transfers):

- Agricultural Conservation Easement Purchase Fund - $25.5 million
- Children's Health Insurance Program - $30.7 million
- Tobacco Debt Service - $115.3 million
- Local Cigarette Tax Fund – $36.5 million. If collections from the additional Philadelphia Cigarette Tax ($0.10 per cigarette) fall below $58.0 million in a fiscal year, a transfer is made from the General Fund to the Local Cigarette Tax Fund to make up the difference.

The current tax rate of $0.13 per cigarette has been in effect since August 2016.

Personal Income Tax. Total personal income taxes of $17,856.8 million were collected in fiscal year 2024 (39.3 percent of total General Fund revenues).

This tax is paid by all residents, resident trusts and estates on eight separate classes of income:

- Compensation
- Net profits
- Interest
- Dividends
- Income from the disposition of property
- Rents and royalties
- Gambling and lottery winnings, including cash prizes of the Pennsylvania Lottery
- Income from estates and trusts.

The tax is also paid by non-resident individuals, estates and trusts on the following income from sources within the Commonwealth:

- Compensation for personal services performed in Pennsylvania unless the taxpayer is a resident of a state with which there is a reciprocal agreement

- Net profits from activity conducted in Pennsylvania
- Income from the rental, ownership or disposition of any real or personal property
- Income from gambling activity in Pennsylvania including cash prizes of the Pennsylvania Lottery.

A loss in one class of income may not be offset against income in another class, nor may gains or losses be carried back or forward from year to year. A credit is available to those individuals receiving tax forgiveness under the special provisions for poverty.

The following transfers were made from Personal Income Tax in fiscal year 2023:

- Environmental Stewardship Fund - $12.3 million
- Farm Show Complex restricted account - $13.3 million
- Election Integrity Restricted Account - $45.0 million.

The current tax rate of 3.07 percent has been in effect since 2004.

Realty Transfer Tax. Total realty transfer taxes of $530.8 million were collected in fiscal year 2024 (1.2 percent of total General Fund revenues).

This tax is levied on the value of real estate transferred by a deed, instrument, or other writing. Other taxable transfers include long-term leases greater than 30 years, transfers of real estate from industrial development authorities that will not be used primarily for industrial purposes, and "deemed" transfers of real estate because of the acquisition of companies which are not in the business of holding or selling real estate.

The following transfers were made from Realty Transfer Tax in fiscal year 2024:

- Keystone Recreation, Park, and Conservation Fund – $106.4 million (15 percent of gross collections)
- Pennsylvania Housing Affordability and Rehabilitation Enhancement Fund - $60.0 million in 2024, increasing $10 million per year until reaching $100.0 million per fiscal year. The transfer will increase to $70.0 million in 2025; $80 million in 2026; $90.0 million in 2027; and $100.0 million in 2028 and each year thereafter.

The current tax rate for the Pennsylvania share of the Realty Transfer Tax is 1 percent of the actual consideration or price of the property represented in the deed. Pennsylvania realty transfer tax is collected, often along with an additional local realty transfer tax, by county Recorders of Deeds. The Recorders of Deeds remit the Commonwealth's 1 percent to the Department of Revenue, and locals have the option to share their realty transfer tax among school districts and municipalities.

Inheritance Tax. Total inheritance taxes of $1,636.0 million were collected in fiscal year 2024 (3.6 percent of total General Fund revenues).

This tax is imposed on the value of property transferred to beneficiaries of a deceased person and certain transfers made during the decedent's lifetime. The value of the transfer is established on the date of the decedent's death.

Rates are based on the relationship of the decedent and the beneficiary. Transfers of non-jointly held property to spouses are untaxed. Transfers to parents from decedents 21 years of age or younger are untaxed. Transfers to beneficiaries 21 years of age or younger from their decedent parents are also untaxed. Transfers to other lineal beneficiaries are taxed at 4.5 percent. Transfers to siblings of the decedents are subject to a 12 percent tax rate. Transfers to all other beneficiaries are taxed at 15 percent.

Liquor Tax. Total liquor taxes of $448.8 million were collected in fiscal year 2024 (1.0 percent of total General Fund revenues)

This tax is a consumption tax on the sale of liquor by the Commonwealth. The distribution of liquor is a state enterprise under the auspices of the Pennsylvania Liquor Control Board ("LCB"). The Commonwealth assumed the liquor control responsibility following the repeal of Prohibition in 1933.

All liquors sold by the LCB are subject to this tax at a rate of 18 percent, which is computed on the actual price paid by the consumer including mark-up, handling charge, and federal tax. The first sale of liquor is also subject to the Sales and Use Tax at the time of purchase. Retail licensees, such as restaurants and bars, purchase liquor from the LCB at a discounted price and

pay Liquor and Sales Taxes on these purchases. These taxes are not charged on subsequent purchases of liquor by restaurant customers.

Non-Tax Revenues. Total non-tax revenues of $1,608.7 million were collected in fiscal year 2024 (3.5 percent of total General Fund revenues).

This category is made up of the following major components:

- Liquor Store Profits
- Licenses and Fees
- Miscellaneous Non-Tax Revenues
- Fines, Penalties, and Interest

Motor License Fund Revenue Detail

The major tax sources (those representing more than 1 percent of total non-restricted revenues) for the Motor License Fund are described briefly below. The tax receipt amounts in the descriptions are on a budgetary basis.

Motor Carriers Road Tax/International Fuel Tax Agreement ("IFTA"). Total motor carriers road tax/IFTA of $146.0 million was collected in fiscal year 2024 (4.6 percent of total non-restricted Motor License Fund revenues).

The motor carriers road tax/IFTA is imposed on fuel consumed by qualified motor vehicles operated within Pennsylvania. Qualified motor vehicles operated exclusively in Pennsylvania are subject to fuel taxation under the Motor Carriers Road Tax. Credit is granted for tax paid on fuel purchases.

The tax rate is equivalent to the rate per gallon currently in effect on liquid fuels, fuels, or alternative fuels.

Annual decal fees indicating vehicle registration in Pennsylvania are also included in these taxes. The cost is $12 per vehicle per calendar year. The decals must be displayed on both sides of each qualified vehicle operated in Pennsylvania.

Oil Company Franchise Tax. Total oil company franchise taxes, which includes fuels and liquid fuels taxes, of $1,613.8 million were collected in fiscal year 2024 (50.9 percent of total non-restricted Motor License Fund revenues).

The oil company franchise tax is imposed on all taxable liquid fuels and fuels on a cents-per-gallon equivalent basis, and it is remitted by distributors of liquid fuels and fuels.

Fuels sold and delivered to the following are exempt from the tax:

- U.S. government, the Commonwealth, and any of its political subdivisions; volunteer fire companies;
- volunteer ambulance services and volunteer rescue squads;
- second class county port authorities; and
- nonpublic, nonprofit schools (K-12).

In addition to these exemptions, reimbursements are made for certain agricultural purposes and for fuel consumed in truck-mounted refrigerator units.

Licenses and Fees. Total licenses and fees revenues of $1,283.1 million were collected in fiscal year 2024 (40.5 percent of total non-restricted Motor License Fund revenues).

This category is made up of the following major components:

- Special Hauling Permits
- Pennsylvania's share of registration fees from other states
- Operator's Licenses
- Vehicle Registration and Titling

Federal Revenues

Receipts by the Commonwealth in its General Fund, Motor License Fund and Tobacco Settlement Fund from the federal government during fiscal year 2023 totaled $46,892 million and during fiscal year 2024 totaled $46,229 million. Anticipated receipts from the federal government included in the fiscal year 2025 enacted budget is $50,120 million. Approximately $36,478

million, or 77.8 percent, of total federal revenue to the Commonwealth for fiscal year 2023 was attributed 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 2024, $34,534 million, or 74.7 percent, of federal revenues were attributed to these types of programs. In the fiscal year 2025 enacted budget, approximately $35,993 million or 71.8 percent of federal revenues are expected to be attributable to public health and welfare programs.

MAJOR COMMONWEALTH EXPENDITURES

The Commonwealth's major operating funds—the General Fund, the Motor License Fund and the State Lottery Fund—provide financial resources to operate programs and fund grants. Trends in expenditures from those funds for various program areas are discussed below based on budgetary basis financial statements for fiscal year 2023 and fiscal year 2024 and based on the enacted budget for fiscal year 2025.

Education

In fiscal year 2023, expenditures from Commonwealth revenues for education purposes were more than $17,127 million. In fiscal year 2024, expenditures from Commonwealth revenues for education purposes were more than $18,021 million. The enacted budget for fiscal year 2025 includes more than $19,442 million in education funding, an increase of approximately 7.89 percent over fiscal year 2024.

Elementary and Secondary Education. The financing of public elementary and secondary education in Pennsylvania is shared by the Commonwealth and local school districts. There are 500 local school districts in the State. With certain exceptions, each is governed by a locally elected school board responsible for the administration of the public schools in the school district with the authority to levy taxes within the limits prescribed by the Public School Code of 1949, as amended. Funds supplied by the Commonwealth supplement the funds raised locally. Local school districts receive various subsidy payments for basic instruction, career and technical education, debt service, pupil transportation, employee retirement programs including Social Security and various special education programs. The largest such subsidy is the Basic Education subsidy. The enacted budget for fiscal year 2025 increases the State Basic Education subsidy by $285 million to $8,157.4 million. A portion of the education funding is distributed to school districts, based on local wealth, existing tax burden, district size and certain student characteristics.

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

Total Commonwealth expenditures for basic education programs in fiscal year 2023 were more than $15,001 million, representing 87.59 percent of all Commonwealth expenditures for education in fiscal year 2023. Total Commonwealth expenditures for basic education programs in fiscal year 2024 were more than $15,842 million, representing approximately 87.91 percent of all Commonwealth expenditures for education in fiscal year 2024. The enacted budget for fiscal year 2025 includes more than $17,108 million for basic education programs.

Higher Education. Higher education in Pennsylvania is provided through degree-granting institutions, which include the universities of the State System of Higher Education ("PASSHE"), four State-related universities, community colleges, independent colleges and universities and specialized degree-granting institutions. PASSHE, established by statute in 1983 from the fourteen State-owned colleges, is administered by a 20-member Board of Governors of which 11 members are appointed by the Governor and confirmed by the Senate. Over $2,007 million was expended by the Commonwealth in fiscal year 2023 for these institutions and student financial assistance. Over $2,056 million was expended by the Commonwealth in the 2024 fiscal year for these institutions and student financial assistance. The enacted budget for fiscal year 2025 includes over $2,208 million for higher education.

Public Health and Human Services

Fiscal year 2024 public health and human services expenditures were $58,371 million (budgetary basis) and are projected to be $61,600 million in fiscal year 2025. Regarding fiscal year 2024 expenditures, nearly $18,346 million was funded from the General Fund, while $19,261 million was estimated, as of October 16, 2024, to be provided from the General Fund for

fiscal year 2025. As of October 16, 2024, federal funds were expected to increase by $1,472 million and augmentations were expected to increase by $801 million for fiscal year 2025. Public health and human service programs are the largest single component of combined State and federal spending in the Commonwealth's operating budget. The overall budget increase reflects the impact of caseload increases, federal mandates, litigation and continued support of county operated programs for child welfare, mental health and intellectual disabilities.

The fiscal year 2025 budget includes $333 million of receipts from the Tobacco Settlement Fund to be expended for health care related programs. For fiscal year 2025, the Governor has proposed to transfer $115.3 million of cigarette tax revenue to the Tobacco Settlement Fund to replace monies deducted from the Tobacco MSA for deposit in the Tobacco Revenue Bond Debt Service Account. Federal funds matching the State Tobacco MSA funds were also expected to be provided. However, under the terms of the 1998 settlement that created the Tobacco Settlement Fund, payments by the tobacco companies may, in certain circumstances be reduced, reflecting a decline in cigarette sales and such payments also may be limited, delayed or terminated as a result of bankruptcy or insolvency of tobacco companies or legal challenges to the settlement or to amounts due thereunder. In June 2018, a settlement was reached with various tobacco companies resolving 20 years of disputes and future disputes related to the non-participating manufacturer adjustment. The settlement resulted in a payment of which $352 million was used to offset health care related costs in fiscal year 2024.

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 $14,198 million in fiscal year 2024, while $14,869 million is budgeted from the General Fund for fiscal year 2025. In addition, a nursing home assessment fee provided a General Fund offset (meaning a reduction in required General Fund appropriations) of $170 million in fiscal year 2024 and was expected, as of October 16, 2024, to provide a $174 million offset in fiscal year 2025. A Managed Care Organization assessment provided a General Fund offset of $1,330 million in fiscal year 2024 and in fiscal year 2025 the offset was projected, as of October 16, 2024, at $1,485 million. Also, a Statewide Quality Care assessment provided a $368 million offset in fiscal year 2024 and was expected, as of October 16, 2024, to provide a $452 million offset in fiscal year 2025. In fiscal year 2025, approximately 31.27 percent of the total cost of assistance to the economically needy was proposed to be supported by Commonwealth funds appropriated from the General Fund. The balance was expected, as of October 16, 2024, to be provided from reimbursements by the federal government and through various program collection activities conducted by the Commonwealth.

As of October 16, 2024, medical assistance, including long-term living home and community-living programs and the intellectual disability waiver program, continued to be a growing component of public health and human services expenditures. Despite implementation of Commonwealth initiatives to restrain costs, the program continued to grow due to expanding caseloads, technology improvements and general medical cost inflation. Expenditures for medical assistance increased during the period from fiscal years 2014 through 2024 by an average annual rate of 8.02 percent. Fiscal year 2024 expenditures from Commonwealth funds were $13,961 million (budgetary basis) and were projected, as of October 16, 2024, to be $14,597 million in fiscal year 2025, an increase of 4.56 percent from the prior fiscal year. Income maintenance cash assistance payments to families in transition to independence were $1,028 million for fiscal year 2024, of which $139 million was from the General Fund. The enacted budget for fiscal year 2025 includes a total of $925 million, for such purpose with $143 million provided from the General Fund.

Transportation

The Commonwealth is responsible for the construction, restoration and maintenance of the highways and bridges in its 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 financial aid grants. Highway maintenance costs, construction costs, and assistance grants are paid from the Motor License Fund. Other special funds, including the Public Transportation Assistance Fund, the Public Transportation Trust Fund, the Multimodal Transportation Fund and the State Lottery Fund provide funding for mass transit and other modes of transportation.

Act 89 of 2013 provided dedicated additional funding for highways and bridges through the incremental uncapping of the OCFT and the indexing of vehicle and driver services fees. Act 89 also restructured Act 44 of 2007 PTC payment distributions.

In addition to its unrestricted State funds, the Motor License Fund includes five restricted revenue accounts funded by State revenues legislatively dedicated to these specific purposes. Some of the restricted purposes, funded from these accounts,

also receive funding by annual appropriations of unrestricted Motor License Fund revenues. Programs receiving funds from a restricted account include highway bridges, highway construction and maintenance, grants to municipalities for highways and bridges and airport development.

Total funding for the Commonwealth's highway and bridge program for fiscal year 2023 was $3,136 million (budgetary basis). The funding was increased to $3,428 million (budgetary basis) in fiscal year 2024. The fiscal year 2025 budget reflects an increase to $3,493 million (budgetary basis). Support of highway and bridge expenditures by local governments through grants paid from the Motor License Fund and restricted revenues was $677 million in fiscal year 2023 and $647 million in fiscal year 2024. For fiscal year 2025, grants to local governments decreased to $634 million.

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

For fiscal year 2008, the funding mechanisms for mass transit in the Commonwealth were changed with the enactment of Act 44. Mass transit funding was shifted from the General Fund to a combination of sources of revenue primarily going into a Public Transportation Trust Fund established by Act 44. The Public Transportation Trust Fund was created to provide a long-term, predictable and growing source of revenues for public transportation systems. Act 89 increased funding and revenue sources for the Public Transportation Trust Fund. Revenues are provided by scheduled payments by the PTC, a portion of the Sales and Use Tax, certain motor vehicle fees, vehicle code fines and surcharges, and transfers from the Public Transportation Assistance Fund and the Lottery Fund. This funding supports mass transit programs Statewide, providing financial assistance for operating costs, capital costs, and certain administrative costs for the Department of Transportation. For fiscal year 2023, Commonwealth funding available for mass transit was $2,514 million (budgetary basis). Funding for mass transit was increased in fiscal year 2024 to $2,702 million (budgetary basis). The fiscal year 2025 budget for mass transit was increased to $2,721 million.

Act 89 created the Multimodal Transportation Fund to provide additional funding for freight and passenger rail, ports, aviation, bicycle and pedestrian facilities, and other modes of transportation. Revenues deposited into the Multimodal Transportation Fund include payments from the PTC, a portion of certain motor vehicle fees and a portion of the OCFT. For fiscal year 2023, Commonwealth funding available for multimodal transportation was $167 million (budgetary basis). The fiscal year 2024 funding was $183 million (budgetary basis), and the budget for fiscal year 2025 is $183 million.

The Commonwealth's current aviation program funds the development of public airport facilities through grants providing for airport development, runway rehabilitation, and real estate tax rebates for public use airports. Taxes levied on aviation and jet fuel provide revenues for a restricted account for aviation programs in the Motor License Fund. In fiscal year 2023, $9 million was expended from aviation restricted accounts. For fiscal year 2024 funding was $10 million and the budget for fiscal year 2025 is $11 million.

Taxes on motor fuels provide approximately 57 percent of total non-restricted Motor License Fund revenues annually. COVID-19 significantly impacted both non-restricted and restricted Motor License Fund revenues. This resulted in fiscal year 2021 revenues well below previous levels for Pennsylvania's highway and bridge infrastructure system. These revenue shortfalls primarily impacted the construction program. Federal transportation relief funding of $407 million along with higher fund revenues and the enactment of $279 million from federal American Rescue Plan Act State Fiscal Relief funds, allowed calendar year 2021 and 2022 to rebound. The passage of the federal Infrastructure Investment and Jobs Act (IIJA) will afford the opportunity to further increase construction spending by an additional $748 million in 2023, $792 million in 2024, and $838 million in 2025. However, while Motor License Fund revenues are projected to surpass pre-pandemic levels for the current budget and future and planning years, additional state funds for construction will be necessary to meet the overall infrastructure needs of the Commonwealth. Act 85 of 2024 imposes an annual fee on Electric Vehicles (EV) and Plug-in Hybrid Electric Vehicles (PHEV). The EV Fee shall be allocated in the same manner as the Oil Company Franchise Tax and be utilized for the construction, reconstruction, maintenance, repair of, and safety on public highways and bridges.

The Commonwealth is not responsible for toll roads and bridges in Pennsylvania. These are under the jurisdiction of various authorities and commissions.

INVESTMENT OF COMMONWEALTH FUNDS

The Treasury Department is responsible for the deposit and investment of most funds belonging to the Commonwealth, including the proceeds of the Commonwealth's bonds and the funds held for the payment of interest on and maturing principal of

the Commonwealth's bonds. The Commonwealth's Fiscal Code contains statutory limitations on the investment of funds by the Treasury Department. The Board of Finance and Revenue, a three-member board of State officials chaired by the State Treasurer, is authorized to establish the aggregate amount of funds that may be invested in some of the various categories of permitted investments. The State Treasurer ultimately determines the asset allocation and selects the investments within the parameters of the law.

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

The State Treasurer has been legislatively authorized to invest Commonwealth moneys in securities under the "prudent investor" standard since June 1999. The common investment pool operated by the State Treasurer for the investment of operating funds of the Commonwealth maintains a portion of its investments in securities subject to this test. Act 54 of 2024 extends this authority to December 31, 2034.

Budget Stabilization Reserve Fund

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 chambers of the General Assembly. Any funds appropriated from the Budget Stabilization Reserve Fund that are not spent are returned to the Budget Stabilization Reserve Fund. As of June 30, 2024, the Budget Stabilization Reserve Fund had a balance of approximately $6,250.2 million. In September 2024, the Commonwealth made a deposit to the Budget Stabilization Reserve Fund in the amount of $736.9 million. [As of the date of this Official Statement, the amount on deposit in the Budget Stabilization Reserve Fund, which includes earnings on the amounts on deposit therein, is $6,268.4 million.]

COMMONWEALTH FINANCIAL PERFORMANCE

Fiscal Year 2025 Budget

The Pennsylvania legislature approved, and the Governor signed, a budget for fiscal year 2025 on July 11, 2024. The enacted budget appropriates $47,599.0 million from the State General Fund. The budget includes increases in basic education funding and preserves funding for core State government functions and services.

Financial Statements Introduction

The most recent Commonwealth audited financial statements are available in the ACFR of the Commonwealth for the fiscal year ended June 30, 2023, which was issued on December 13, 2023.

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 on a fund-by-fund basis; rather, they reveal information for all governmental activities and all business-type activities in separate columns. In government-wide statements, for both governmental and business-type activities, the economic resources measurement focus, and accrual basis of accounting are used, with revenues and expenses recognized when they occur, rather than when cash is received or paid. This treatment results in including in assets an estimate of the total amount of receivables due at fiscal year-end that are expected to be collected in the future. Capital assets are reported with acquisition or construction costs being reported when the assets are placed in service less accumulated depreciation. Reported liabilities include all liabilities,

regardless of when payment is due, including bond principal, employee disability claims liability, and employee compensated absence liabilities.

GENERAL FUND FINANCIAL PERFORMANCE

Financial Results for Fiscal Years 2019-2024

GAAP Basis. During the five-year period from fiscal year 2019 through fiscal year 2023, total revenues and other sources increased by an average annual rate of 9.7 percent. Tax revenues during this same period increased by an annual average rate of 7.0 percent. Expenditures and other uses during fiscal years 2019 through 2023 rose at an average annual rate of 8.1 percent. Expenditures for the protection of persons and property during this period increased at an average annual rate of 6.9 percent; public education expenditures during this period increased at an average annual rate of 7.2 percent; health and human services expenditures increased at an average annual rate of 8.3 percent; and capital outlays increased at an average annual rate of 43.5 percent. Commonwealth expenditures for direction and support services (State employees and government administration) increased at an average annual rate of 9.0 percent during fiscal years 2019 through 2023.

The fund balance at June 30, 2023 of the General Fund was $18,174.4 million, a $4,803.1 million increase from the June 30, 2022 fund balance. Total revenues and other sources decreased by $3,021.3 million and tax revenues increased $466.6 million. The overall increase in the fund balance is primarily due to a decrease in total liabilities in the fiscal year ended June 30, 2023.

Fiscal Year 2019 Financial Results

GAAP Basis. At June 30, 2019, the General Fund reported a fund balance of $835.4 million, an increase of $21.7 million from the $813.7 million fund balance at June 30, 2018, as expenditures and other uses increased by $4,130.6 million and revenues and other sources increased by $2,641 million.

Budgetary Basis. General Fund revenues of the Commonwealth were above the certified estimate by $883 million or 2.6 percent during fiscal year 2019. Final Commonwealth General Fund revenues for the above fiscal year totaled $34,857.9 million. Total expenditures, net of appropriation lapses and including public health and human services assessments and expenditures from additional sources, were $$33,401.5 million.

General Fund revenues increased $290.9 million or 0.8 percent during fiscal year 2019 when measured on a year-over-year basis as compared to fiscal year 2018. Tax revenue collections increased $2,052.9 million or 6.4 percent on a year-over-year basis from fiscal year 2018 to fiscal year 2019 while non-tax revenue collections decreased $1,761.9 million or negative 68.7 percent from fiscal year 2018 to fiscal year 2019. Corporate tax receipts were $622.1 million higher than fiscal year 2018 levels. The year-over-year increase in corporate taxes was 12.7 percent during fiscal year 2019 as corporate net income tax collections increased 17.9 percent. Personal income taxes were $696.6 million above fiscal year 2018 actual collection and the year-over-year growth in personal income tax receipts was 5.2 percent. Personal income tax collections attributable to withholding increased by 4.1 percent or $407.4 million during fiscal year 2019 and tax collections from the non-withholding portion of the personal income tax increased 8.6 percent or $289.2 million on a year-over-year basis. Sales and use taxes receipts were $718.3 million greater during fiscal year 2019 than during fiscal year 2018, a growth rate of 6.9 percent. Sales tax collections increased during fiscal year 2019 as non-motor vehicle sales tax collections grew 7 percent and motor vehicle sales tax receipts increased 6.5 percent during fiscal year 2019. Cigarette tax collections decreased 6.6 percent during fiscal year 2019 and inheritance tax collections increased 3.4 percent. Realty transfer tax revenues increased 3.8 percent during fiscal year 2019.

Commonwealth General Fund appropriations for fiscal year 2019 totaled $33,401.5 million, an increase of $1,453.4 million or 4.5 percent from fiscal year 2018. The Commonwealth transferred its fiscal year 2019 ending balance of $316.9 million to the Budget Stabilization Reserve Fund.

Fiscal Year 2020 Financial Results

GAAP Basis. At June 30, 2020, the General Fund reported a negative fund balance of $1,525.2 million, a decrease of $2,360.6 million from the $835.4 million fund balance at June 30, 2019. The majority of this decrease was due to delays of tax filing dates for personal and corporate taxes because of the COVID-19 pandemic.

Budgetary Basis. General Fund revenues of the Commonwealth were below the certified estimate by $3,221 million or 9.1 percent during fiscal year 2020. The majority of this difference was due to the Commonwealth delaying the filing date for personal and corporate income tax by 90 days. Final Commonwealth General Fund revenues for this fiscal year totaled $32,275.8 million. Total expenditures, net of appropriation lapses and including public health and human services assessments and expenditures from additional sources, were $34,090.2 million. After accounting for a positive fiscal year 2020 beginning balance of $30.3 million, the Commonwealth ended fiscal year 2020 with an unappropriated negative balance of $2,734.1 million.

General Fund revenues decreased $2,582.0 million or 7.4 percent during fiscal year 2020 when measured on a year-over-year basis as compared to fiscal year 2019. Tax revenue collections decreased $2,445.4 million or 7.2 percent on a year-over-year basis from fiscal year 2019 to fiscal year 2020 while non-tax revenue collections decreased $136.6 million or 17.0 percent from fiscal year 2019 to fiscal year 2020. Corporate tax receipts were $671.8 million lower than fiscal year 2019 levels. The year-over-year decrease in corporate taxes was 12.2 percent during fiscal year 2020 as corporate net income tax collections decreased 16.9 percent and financial institutions tax increased 3.4 percent. Personal income taxes were $1,260.5 million below fiscal year 2019 actual collection and the year-over-year decrease in personal income tax receipts was 8.9 percent. Personal income tax collections attributable to withholding increased by 0.9 percent or $98.9 million during fiscal year 2020 and tax collections from the non-withholding portion of the personal income tax decreased 37.2 percent or $1,359.4 million on a year-over-year basis. Sales and use taxes receipts were $281.8 million less during fiscal year 2020 than during the prior fiscal year, a decrease of 2.5 percent. Cigarette tax collections declined 17.4 percent during fiscal year 2020 and inheritance tax collections increased 2.7 percent. Realty transfer tax revenues decreased by 6.8 percent during fiscal year 2020.

Commonwealth General Fund appropriations for fiscal year 2020 totaled $34,090.2 million, an increase of $688.7 million or 2.1 percent from fiscal year 2019 levels. The ending unappropriated negative balance was $2,734.1 million for fiscal year 2020.

Fiscal Year 2021 Financial Results

GAAP Basis. At June 30, 2021, the General Fund reported a fund balance of $3,073 million, an increase of $4,598.5 million from the $1,525.4 million negative fund balance, as restated at June 30, 2020.

Budgetary Basis. General Fund revenues of the Commonwealth were above the certified estimate by $3,437.3 million or 9.3 percent during fiscal year 2021. Final Commonwealth General Fund revenues for the above fiscal year totaled $40,392.0 million. Total expenditures, net of appropriation lapses and including public health and human services assessments and expenditures from additional sources, were $34,013.2 million in fiscal year 2021. After accounting for a negative fiscal year 2021 beginning balance of $2,734.1 million, the Commonwealth ended fiscal year 2021 with a surplus of $2,621.5 million which was transferred to the Budget Stabilization Reserve Fund.

General Fund revenues increased $8,116.1 million or 25.1 percent during fiscal year 2021 when measured on a year-over-year basis as compared to fiscal year 2020. Tax revenue collections increased $7,568.7 million or 23.9 percent on a year-over-year basis from fiscal year 2020 to fiscal year 2021 while non-tax revenue collections increased $547.4 million or 82.3 percent from fiscal year 2020 to fiscal year 2021. Corporate tax receipts were $1,494.5 million higher than fiscal year 2020 levels. The year-over-year increase in corporate taxes was 30.9 percent during fiscal year 2021 as corporate net income tax collections increased 56.5 percent and financial institutions tax increased 7.7 percent. Personal income taxes were $3,448.4 million above fiscal year 2020 actual collection and the year-over-year decrease in personal income tax receipts was 26.9 percent. Personal income tax collections attributable to withholding increased by 2.8 percent or $295.2 million during fiscal year 2021 and tax collections from the non-withholding portion of the personal income tax increased 137.6 percent or $3,153.2 million on a year-over-year basis. Sales and use taxes receipts were $2,017.1 million more during fiscal year 2021 than during the prior fiscal year , an increase of 18.6 percent. Cigarette tax collections increased 4.3 percent during fiscal year 2021 and inheritance tax collections increased 24.3 percent. Realty transfer tax revenues increased by 28.6 percent during fiscal year 2021.

Commonwealth General Fund appropriations for fiscal year 2021 totaled $34,013.2 million, a decrease of $77.0 million or -0.2 percent from fiscal year 2020 levels. The Commonwealth transferred its fiscal year 2021 ending balance of $2,621.5 million to the Budget Stabilization Reserve Fund.

Fiscal Year 2022 Financial Results

GAAP Basis. At June 30, 2022, the General Fund reported a fund balance of $13,371.2 million, an increase of $10,298.2 million from the $3,073.0 fund balance at June 30, 2021, as revenues and other sources increased by $15,929.7 million.

Budgetary Basis. General Fund revenues of the Commonwealth were above the certified estimate by $5,598.0 million or 13.2 percent during fiscal year 2022. Final Commonwealth General Fund revenues for the fiscal year totaled $48,134.2 million. Total expenditures, net of appropriation lapses and including public health and human services assessments and expenditures from additional sources, were $39,351.3 million. After accounting for a fiscal year 2022 beginning balance of $4.4 million, and a transfer to the Budget Stabilization Reserve Fund, the Commonwealth ended fiscal year 2022 with a surplus of $5,537.4 million.

General Fund revenues increased $7,742.2 million or 19.2 percent during fiscal year 2022 when measured on a year-over-year basis as compared to fiscal year 2021. Tax revenue collections increased $4,309.0 million or 11.0 percent on a year-over-year basis from fiscal year 2021 to fiscal year 2022 while non-tax revenue collections increased $3,433.2 million or 283.2 percent from fiscal year 2021 to fiscal year 2022, due primarily to the one-time transfer of federal ARPA funds to the General Fund as revenue replacement. The year-over-year increase in corporate taxes was 15.5 percent during fiscal year 2022. Corporate net income tax collections increased 20.2 percent or by $895.4 million from 2021 levels. Personal income taxes were $1,842.3 million above fiscal year 2021 actual collections and the year-over-year increase in personal income tax receipts was 11.3 percent. Personal income tax collections attributable to withholding increased by 11.0 percent or $1,188.3 million during fiscal year 2022. Sales and use taxes receipts were $1,079.4 million more during fiscal year 2022 than during the prior fiscal year, an increase of 8.4 percent. Cigarette tax collections decreased 9.3 percent during fiscal year 2022 and inheritance tax collections increased 15.2 percent. Realty transfer tax revenues increased by 32.3 percent and gaming tax collections increased by 27.3 percent during fiscal year 2022.

Commonwealth General Fund appropriations for fiscal year 2022 totaled $39,351.3 million, an increase of $5,338.0 million or 15.6 percent from fiscal year 2021 levels. The Commonwealth transferred $2,100.0 million of its fiscal year 2022 ending balance to the Budget Stabilization Reserve Fund.

Fiscal Year 2023 Financial Results

GAAP Basis. At June 30, 2023, the General Fund reported a fund balance of $18,174.3 million, an increase of $4,803.1 million from the $13,371.2 million fund balance at June 30, 2022, as revenues and other sources decreased by $3,021.3 million.Budgetary Basis. General Fund revenues of the Commonwealth were above the certified estimate by $1,337.5 million or 3.1 percent during fiscal year 2023. Final Commonwealth General Fund revenues for the fiscal year totaled $44,917.1 million. Total expenditures, net of appropriation lapses and including public health and human services assessments and expenditures from additional sources were $40,801.0 million. After accounting for a fiscal year 2023 beginning balance of $5,546.4 million, and a transfer to the Budget Stabilization Reserve Fund, the Commonwealth ended fiscal year 2023 with a surplus of $8,084.9 million

General Fund revenues decreased $3,217.1 million or 6.7 percent during fiscal year 2023 when measured on a year-over-year basis as compared to fiscal year 2022. Tax revenue collections increased $287.8 million or 0.7 percent on a year-over-year basis from fiscal year 2022 to fiscal year 2023 while non-tax revenue collections decreased $3,504.8 million or 75.4 percent from fiscal year 2022 to fiscal year 2023. The year-over-year increase in corporate taxes was 12.8 percent during fiscal year 2023. Corporate net income tax collections increased 15.3 percent or by $815.5 million from 2022 levels. Personal income taxes declined $497.6 million in fiscal year 2023, a decline of 2.7 percent. Personal income tax collections attributable to withholding increased by 5.1 percent or $617.5 million during fiscal year 2023. Non-withheld personal income tax collections declined by $1,115.1 million , or 18.3 percent from 2022. Sales and use taxes receipts were $110.2 million more during fiscal year 2023 than during the prior fiscal year, an increase of 0.8 percent. Cigarette tax collections decreased 11.6 percent during fiscal year 2023 and inheritance tax collections decreased 1.7 percent. Realty transfer tax revenues decreased by 24.0 percent and gaming tax collections increased by 18.6 percent during fiscal year 2023.

Commonwealth General Fund appropriations for fiscal year 2023 totaled $40,801.0 million, an increase of $1,449.7 million or 3.7 percent from fiscal year 2022 levels. In November 2023, the Commonwealth transferred $898.3 million, or 10 percent of its fiscal year 2023 ending General Fund balance to the Budget Stabilization Reserve Fund.

Fiscal Year 2024 Financial Results – *preliminary, unaudited*

Budgetary Basis. General Fund revenues of the Commonwealth were above the certified estimate by $862.9 million or 1.9 percent during fiscal year 2024. Final Commonwealth General Fund revenues for the fiscal year totaled $45,473.5 million. Total expenditures, net of appropriation lapses and including public health and human services assessments and expenditures from additional sources were $45,440.8 million. After accounting for a fiscal year 2024 beginning balance of $8,084.9 million, and a transfer to the Budget Stabilization Reserve Fund, the Commonwealth ended fiscal year 2024 with a surplus of $6,632.1 million.

General Fund revenues increased $556.3 million or 1.2 percent during fiscal year 2024 when measured on a year-over-year basis as compared to fiscal year 2023. Tax revenue collections increased $88.4 million or 0.2 percent on a year-over-year basis from fiscal year 2023 to fiscal year 2024 while non-tax revenue collections increase $468.0 million or 41.0 percent from fiscal year 2023 to fiscal year 2024. The year-over-year decrease in corporate taxes was 2.7 percent during fiscal year 2024. Corporate net income tax collections decreased 8.0 percent or by $491.5 million from 2023 levels. Personal income taxes increased $228.7 million in fiscal year 2024, an increase of 1.3 percent. Personal income tax collections attributable to withholding increased by 4.4 percent or $558.0 million during fiscal year 2024. Non-withheld personal income tax collections declined by $329.3 million, or 6.6 percent from 2023. Sales and use taxes receipts were $231.5 million more during fiscal year 2024 than during the prior fiscal year, an increase of 1.7 percent. Cigarette tax collections decreased 13.6 percent during fiscal year 2024 and inheritance tax collections increased 7.3 percent. Realty transfer tax revenues decreased by 17.6 percent and gaming tax collections decreased by 1.3 percent during fiscal year 2024.

Fiscal Year 2025 Enacted Budget

The enacted fiscal year 2025 budget appropriates $47,599.0 million in state general funds. The General Fund is the primary funding source for most State agencies and institutions supported by the Commonwealth. The majority of every dollar is returned to individuals, local governments, institutions, school districts, and others in the form of grants and subsidies. The remainder pays operating expenses and debt service. Major program expenditures occur in the areas of education, public health and human services, and the State correctional institutions.

MOTOR LICENSE FUND PERFORMANCE

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

Financial Results for Fiscal Years 2019-2024

GAAP Basis. The fund balance at June 30, 2023, of the Motor License Fund was $2,325.8 million, a $308.2 million increase from the June 30, 2022 fund balance. Over five fiscal years, 2019 through 2023, revenues and other sources averaged an annual 1.8 percent increase. Expenditures and other uses during the same period averaged a 0.1 percent annual decrease.

Overall, total revenues and other sources increased by $251.0 million during the fiscal year that ended June 30, 2023. Tax revenues increased $65.8 million primarily due to the increase in the liquid fuels tax. Licenses and fees increased $11.3 million due to increased vehicle registrations and driver licenses. During the prior fiscal year, extensions were granted for the expirations of vehicle registrations, drivers' licenses, and learner's permits, including commercial driver's licenses. These extensions expired during fiscal year 2021.

Total expenditures and other uses increased by $652.9 million during fiscal year ended June 30, 2023. Transportation expenditures increased by $324.6 million and Capital outlay increased by $332.5 million. The increase in transportation expenditures were attributable to an increase in operational costs, specifically fuels and bituminous material usage, as highway projects and construction activity continued to increase following the pandemic.

Fiscal Year 2019 Financial Results

Budgetary Basis. Commonwealth revenues to the Motor License Fund totaled $2,849.3 million, a decrease of $99.2 million or 3.4 percent over fiscal year 2018 revenues. Receipts from liquid fuels taxes decreased by 0.5 percent while license and fee revenues decreased by 5.1 percent from the previous year. Other revenue receipts decreased by 65.2 percent from the previous fiscal year. Fiscal year 2019 Motor License Fund appropriations and executive authorizations totaled $3,066.2 million, an increase of 5.9 percent over fiscal year 2018. The Motor License Fund concluded fiscal year 2019 with an unappropriated surplus of $29.0 million, a net decrease of $187.4 million from the 2018 unappropriated surplus of $216.4 million.

Fiscal Year 2020 Financial Results

Budgetary Basis. Commonwealth revenues to the Motor License Fund totaled $2,663.5 million, a decrease of $185.8 million or 6.5 percent from fiscal year 2019 revenues. Receipts from liquid fuels taxes decreased by 7 percent while license and fee revenues decreased by 3.9 percent from the previous year. Fiscal year 2020 Motor License Fund appropriations and executive authorizations totaled $2,767.0 million, a decrease of 9.8 percent from fiscal year 2019. The Motor License Fund concluded fiscal year 2020 with a negative unappropriated balance of $51.2 million, a net decrease of $80.2 million from the fiscal year 2019 unappropriated surplus of $29.0 million.

Fiscal Year 2021 Financial Results

Budgetary Basis. Commonwealth revenues to the Motor License Fund totaled $2,825.6 million, an increase of $162 million or 6.1 percent from fiscal year 2020 revenues. Receipts from liquid fuels taxes decreased by 3 percent while license and fee revenues increased by 20.7 percent over the previous year. Fiscal year 2021 Motor License Fund appropriations and executive authorizations totaled $2,722.9 million, a decrease of 1.5 percent over fiscal year 2020. The Motor License Fund concluded fiscal year 2021 with an unappropriated surplus of $115.4 million, a net increase of $166.5 million above the fiscal year 2020 negative unappropriated surplus of $51.1 million.

Fiscal Year 2022 Financial Results

Budgetary Basis. Commonwealth revenues to the Motor License Fund totaled $2,883.4 million, an increase of $57.8 million or 2 percent over fiscal year 2021 revenues. Receipts from liquid fuels taxes increased by 5.5 percent while license and fee revenues decreased by 2.2 percent as compared to the previous year. Fiscal year 2022 Motor License Fund appropriations and executive authorizations totaled $2,691.9 million, a decrease of 0.6 percent from fiscal year 2021. The Motor License Fund concluded fiscal year 2022 with an unappropriated surplus of $347.3 million, a net increase of $231.9 million above the fiscal year 2021 unappropriated surplus of $115.4 million.

Fiscal Year 2023 Financial Results

Budgetary Basis. Commonwealth revenues to the Motor License Fund totaled $2,958.3 million, an increase of $75 million or 2.6 percent over fiscal year 2022 revenues. Receipts from liquid fuels taxes increased by 1.6 percent while license and fee revenues decreased by 0.8 percent as compared to the previous year. Fiscal year 2023 Motor License Fund appropriations and executive authorizations totaled $3,151.1 million, an increase of 17 percent from fiscal year 2022. The Motor License Fund concluded fiscal year 2023 with an unappropriated surplus of $255.4 million, a net decrease of $91.9 million below the fiscal year 2022 unappropriated surplus of $347.3 million.

Fiscal Year 2024 Financial Results – *preliminary, unaudited*

Budgetary Basis. Commonwealth revenues to the Motor License Fund totaled $3,169.9 million, an increase of $211.6 million or 7.2 percent over fiscal year 2023 revenues. Receipts from liquid fuels taxes increased by 0.2 percent while license and fee revenues increased by 14.8 percent as compared to the previous year. Fiscal year 2024 Motor License Fund appropriations and executive authorizations totaled $3,233.5 million, an increase of 2.6 percent from fiscal year 2023. The Motor License Fund concluded fiscal year 2024 with an unappropriated surplus of $313.0 million, a net increase of $57.6 million over the fiscal year 2023 unappropriated surplus of $255.4 million.

Fiscal Year 2025 Enacted Budget

Budgetary Basis. Commonwealth revenues to the Motor License Fund are budgeted to be $3,016.2 million, a decrease of $153.7 million or 4.9 percent from fiscal year 2024 revenues. Receipts from the liquid fuels tax are budgeted to decrease 3.2 percent from the prior year, while license and fee revenues are budgeted to decrease by 4.0 percent. Additionally, other revenue receipts are budgeted to be $63.9 million. Fiscal year 2025 Motor License Fund appropriations and executive authorizations are

budgeted to equal $3,253.7 million, an increase of 0.6 percent over fiscal year 2024 appropriations. The Motor License Fund is budgeted to conclude fiscal year 2025 with an unappropriated balance of $75.5 million, a decrease of $237.5 million from the fiscal year 2024 unappropriated fund balance of $313.0 million.

STATE LOTTERY FUND FINANCIAL RESULTS

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

State Lottery Fund receipts support programs to assist elderly and handicapped individuals, primarily through property tax and rent rebate assistance and a pharmaceutical assistance program to recipients who meet specified income limits, and the provision of free mass transit rides during off-peak hours.

Financial Results for Fiscal Years 2019-2024

GAAP Basis. During the fiscal year ended June 30, 2023, the net year-over-year increase in total revenues and other sources was $695.4 million. Total operating revenues increased $556.7 million. Total operating expenses increased $563.0 million. Operating expenses have a strong correlation to operating revenues as the amount of prize payouts are directly related to lottery sales.

Fiscal Year 2019 Financial Results

Budgetary Basis. Fiscal year 2019 net revenues from lottery sources, including instant ticket sales and the state's participation in the multi-state Powerball game, increased by 8.8 percent. Total funds available, including prior year lapses and net revenues received by the Lottery Fund during fiscal year 2019, were $1,956.3 million. Total appropriations, net of current-year lapses, were $1,952.1 million. The fiscal year-end unappropriated balance and reserve had a surplus of $4.2 million.

Fiscal Year 2020 Financial Results

Budgetary Basis. Fiscal year 2020 net revenues from lottery sources, including instant ticket sales and the State's participation in the multi-state Powerball game, decreased by 6.1 percent. Total funds available, including prior year lapses and net revenues received by the Lottery Fund during fiscal year 2020, were $1,959.1 million. Total appropriations, net of current-year lapses, were $2,078.9 million. The fiscal year-end unappropriated balance and reserve had a negative balance of $119.8 million.

Fiscal Year 2021 Financial Results

Budgetary Basis. Fiscal year 2021 net revenues from lottery sources, including instant ticket sales and the State's participation in the multi-State Powerball game, increased by 19.3 percent. Total funds available, including prior year lapses and net revenues received by the Lottery Fund during fiscal year 2021, were $1,999.8 million. Total appropriations, net of current-year lapses, were $1,876.5 million. The fiscal year-end unappropriated balance and reserve had a balance of $48.3 million.

Fiscal Year 2022 Financial Results

Budgetary Basis. Fiscal year 2022 net revenues from lottery sources, including instant ticket sales and the state's participation in the multi-state Powerball game, decreased by 6.9 percent. Total funds available, including prior year lapses and net revenues received by the Lottery Fund during fiscal year 2022 were $2,193.3 million. Total appropriations, net of current-year lapses, were $1,968.5 million. The fiscal year-end unappropriated balance and reserve had a balance of $149.8 million, an increase of 209.9 percent.

Fiscal Year 2023 Financial Results

Budgetary Basis. Fiscal year 2023 net revenues from lottery sources, including instant ticket sales and the state's participation in the multi-state Powerball game, increased by 2.1 percent. Total funds available, including prior year lapses and net revenues received by the Lottery Fund during fiscal year 2023, were $2,450.2 million. Total appropriations, net of current-year lapses, were $2,212.6 million. The fiscal year-end unappropriated balance and reserve had a balance of $162.6 million, an increase of 8.6 percent.

Fiscal Year 2024 Financial Results – ***preliminary, unaudited***

Budgetary Basis. Fiscal year 2024 net revenues from lottery sources, including instant ticket sales and the state's participation in the multi-state Powerball game, decreased by 3.1 percent. Total funds available, including prior year lapses and net revenues received by the Lottery Fund during fiscal year 2024, were $2,467.4 million. Total appropriations, net of current-year lapses, were $2,074.3 million. The fiscal year-end unappropriated balance and reserve had a balance of $318.1 million, an increase of 95.6 percent.

Fiscal Year 2025 Enacted Budget

The enacted fiscal year 2025 budget anticipates a 4.3 percent decrease in net revenues from all lottery sources, including instant-ticket sales and the State's participation in the multi-state Powerball game. State Lottery Funds available, including lapses, are estimated to be $2,473.2 million in fiscal year 2025, an increase of 0.2 percent. Budgeted appropriations and executive authorizations total $2,194.8 million, which represents an increase of $120.5 million or a 5.8 percent increase from fiscal year 2024. The fiscal year-end balance reflects a projected surplus of $203.4 million, a decrease of $114.7 million from the fiscal year 2024 ending balance.

LITIGATION

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

In 1978, the General Assembly approved a limited waiver of sovereign immunity with respect to lawsuits against the Commonwealth. This cap does not apply to tax appeals. 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. 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 Commonwealth also represents and indemnifies employees who have been sued under Federal civil rights statutes for actions taken in good faith in carrying out their employment responsibilities. There are no caps on damages in civil rights actions. The Commonwealth's self-insurance program covers damages in these civil cases up to $250,000 per incident. Damages in excess of $250,000 are paid from departmental and agency operating and program appropriations.

Pennsylvania Professional Liability Joint Underwriting Association v. Wolf, Nos. 18-2297, 18-2323, 19-1057, 19-1058, 21-1099, 21-1112, & 21-1155 (Third Cir. Ct. of Appeals); 19-cv-01121 (U.S.D.C., M.D. Pa.)

The Pennsylvania Professional Liability Joint Underwriting Association ("JUA") first initiated an action against Governor Wolf on May 18, 2017, case no. 1:17-cv-00886-CCC (M.D. Pa.). The JUA challenged, on various federal constitutional grounds, a provision of Act 85 of 2016 that directed (1) the transfer of $200 million from the JUA to the General Fund and (2) repayment of the transferred sum over a five-year period commencing July 1, 2018. The contemplated transfer did not take place. During the pendency of case no. 1:17-cv-00886-CCC, Act 44 of 2017 became law. Act 44 of 2017 again mandated the transfer of $200,000,000 from the JUA to the General Fund and, if such transfer was not made by December 1, 2017, mandated the abolishment of the JUA. The JUA challenged Act 44 of 2017 at case no. 1:17-cv-02041-CCC (M.D. Pa.). As of October 16, 2024, no transfer of funds from the JUA to the General Fund had taken place. On November 30, 2017, the Court stayed case no. 1:17-cv-00886-CCC pending the outcome of 1:17-cv-02041-CCC. On May 17, 2018, the Court held that the sections of Act 44 of 2017 pertaining to the JUA are an unconstitutional taking of private property under the 5th and 14th Amendments to the U.S. Constitution. Act 41 of 2018 folded the JUA into the Department of Insurance and shifted control of the JUA and its assets to that Department. The JUA challenged Act 41 of 2018 at case no. 1:18-cv-01308-CCC (M.D. Pa.). On December 18, 2018, the Court held that Act 41 of 2018 also violated the 5th and 14th Amendments to the U.S. Constitution. Governor Wolf and the other defendants have appealed the trial court orders to the Third Circuit Court of Appeals, which has consolidated the cases for appeal. The appellate briefing is finished and the Third Circuit scheduled argument. During the pendency of the appeal, the General Assembly enacted Act 15 of 2019 ("Act 15"). This act, among other things, places the JUA under the purview of the Right-To-Know Law, the Commonwealth Attorneys Act, the Pennsylvania Web Accountability and Transparency Act, and the Commonwealth Procurement Code. Act 15 also newly requires the JUA to submit annual budget requests to the Secretary of the Budget and to be funded via appropriations from the General Assembly. Aside from these requirements, Act 15 does not implicate any transfer of funds to or from the JUA or the General Fund. The JUA brought a new action challenging the

constitutionality of the law, case no. 1:19-cv-1121 (U.S.D.C., M.D. Pa), seeking, in part, a preliminary injunction. On July 17, 2019, the district court denied the request for injunctive relief, finding that the JUA had failed to establish irreparable harm. Because of the enactment of Act 15 and initiation of case no. 1:19-cv-1121, the Third Circuit canceled oral argument and placed the appeal on its curia advisor vult (CAV) list, requiring the parties to inform the Court every 120 days of the status of case no. 1:19-cv-1121, and any additional legislative enactments. The appeal is stayed pending adjudication of the challenge to Act 15 in the district court. A scheduling order has been issued for the case filed at No. 1:19-cv-1121. Discovery has ended and dispositive motions were filed on April 15, 2020. The Court issued a ruling on December 22, 2020, holding Act 15 unconstitutional in part. Particularly, the Court ruled that Act 15 is unconstitutional insofar as it resources the entity, and requires it to comply with the budgetary process, because it restricts the use of its private funds. It ruled that it is unconstitutional as a violation of the First Amendment and procedural due process insofar as it applies the Commonwealth Attorneys Act, because it restricts JUA's choice of counsel. The Court did grant summary judgment with respect to JUA's claims against the application of the Sunshine Act, and Right-to-Know Law, holding that these provisions are constitutional as rational.

All parties appealed the District Court's order on Act 15 to the Third Circuit, which consolidated the three appeals. Briefing concluded in July 2021. As of October 16, 2024, the Third Circuit heard oral arguments on November 9, 2022. On January 19, 2023, the Third Circuit issued a petition for Certification of Question of State Law to the Pennsylvania Supreme Court asking the following question: Under Pennsylvania law, is the Commonwealth's Joint Underwriting Association a public or private entity? The Pennsylvania Supreme Court granted the petition and certified the question. Briefing has completed. Oral argument was held on November 29, 2023. On February 21, 2024, the Pennsylvania Supreme Court concluded that it had "improvidently granted the petition for certification" and returned the case to the Third Circuit without answering the question posed. These matters remain pending with the Third Circuit.

Level 3 Communications, LLC v. Commonwealth of Pennsylvania Nos. 121-122 FR 2018 (Pa. Commonwealth Ct.)

Level 3 (also known as L3) filed a petition with the Pennsylvania Commonwealth Court seeking a refund of $23 million in gross receipts tax claiming that its sales of private line services are not subject to this tax. L3 contends that its communications technology falls outside the scope of the taxable telephone and telegraph messages component of the gross receipts tax statute because its private lines are largely sold in connection with non-voice services that are not subject to tax (such as colocation and Internet access) or are sold on a stand-alone basis. L3 contends that its services are therefore distinguishable from the private line services that the Pennsylvania Supreme Court held are subject to gross receipts tax in Verizon Pennsylvania, Inc. v. Commonwealth, 127 A.3d 745 (Pa. 2015). In February 2024, the Office of Attorney General delegated this matter to the Department of Revenue. After L3 filed this appeal, numerous other entities that sell similar services filed legal challenges to the gross receipts tax on the same grounds as L3. On September 12, 2024, the court consolidated a number of gross receipts tax appeals based on the same legal arguments pending resolution of L3's appeal. The Department of Revenue estimates that more than $100 million of gross receipts tax collected by the Department could be at issue if the courts rule against the Commonwealth on all of these appeals. Briefing concluded in May 2024. The Commonwealth Court has not yet formally set an oral argument date, but argument is expected to take place in December 2024.

Facebook, Inc. v. Commonwealth of Pennsylvania, Nos. 432-34 FR 2021 (Pa. Commonwealth Ct.) and Meta Platforms, Inc. v. Commonwealth of Pennsylvania, Nos. 51-52 FR 2024 (Pa. Commonwealth Ct.)

These are corporate net income tax appeals concerning the sourcing of advertising receipts originally based on location of target audience but later sourced based on location of customers paying for advertising services. This is contrary to existing Department of Revenue policy. The taxpayer is seeking to reopen closed tax periods to revalue its net operating losses. This lawsuit could result in a potential refund to the taxpayer in excess of $67 million. Briefing and argument has not yet been scheduled by the court. A settlement proposal has been submitted by the taxpayer for the earlier dockets. This proposal is under review.

Apple, Inc. v. Commonwealth of Pennsylvania, Nos. 92, 93, and 276-287 FR 2022 (Pa. Commonwealth Ct.)

These corporate net income tax and franchise tax reassessment appeals involve over $25 million. They concern the apportionment fraction and sourcing of receipts from the sale of digital goods and advertising revenue. The taxpayer treated both types of receipts as income from the sale of intangibles and sourced the according to costs of performance rules. The Department of Revenue treated each as the sale of service income and sourced the receipts under those rules. The taxpayer

maintains that they should both be treated as sales of intangibles and sourced accordingly. The taxpayer has not yet submitted a settlement proposal or stipulation of facts.

Mastercard International, Inc. v. Commonwealth, Nos. 665-672 FR 2018; 819-823 FR 2019; and 227-228 FR 2023 (Pa. Commonwealth Ct.)

These corporate net income tax appeals concern the sourcing of sales receipts based on location of where the benefit of the services was received versus location of where the services are delivered. The taxpayer claims that its services are not delivered to cardholders or merchants but are instead delivered to banks and other third parties that participate in the Mastercard network. The parties are currently in settlement negotiations. The Department of Revenue estimates that these appeals involve at least $34 million.

Nestle Purina PetCare Co. v. Commonwealth of Pennsylvania, Nos. 363-365 FR 2020 (Pa. Commonwealth Ct.)

These corporate net income tax appeals involve almost $13 million. The taxpayer argues that its sales for purposes of determining the sales factor numerator were overstated because the computation was done based on initial shipping destination rather than on the location of the sale to the customer. The taxpayer requests a refund based on reduction of the sales factor numerator because the reported numerator allegedly included receipts from sales with an ultimate destination outside Pennsylvania.

UPS Worldwide Forwarding v. Commonwealth of Pennsylvania, Nos. 199, 203, and 205 FR 2021 (Pa. Commonwealth Ct.)

In these corporate net income tax appeals, the taxpayer claims the right to use the transportation company apportionment for its logistics company. The taxpayer contends that the airline apportionment is appropriate methodology for its computations, and that the taxpayer has only nominal apportionment in Pennsylvania. The parties are involved in settlement negotiations. The Commonwealth addressed this issue as to other open tax years via legislation, and these appeals covers the remaining years that were not addressed through legislation. The Department of Revenue estimates that $18 million is at issue.

Visa USA v. Commonwealth of Pennsylvania, Nos. 330-332 FR 2022; 844-845 FR 2018; 608-609 FR 2019; and 198 FR 2023 (Pa. Commonwealth Ct.)

This corporate net income tax appeal has substantially similar facts and legal argument as set forth in Mastercard matter discussed above. The Department of Revenue estimates that the amount at issue exceeds $19 million.

Verizon Wireless, et al. v. Commonwealth of Pennsylvania, Nos. 600-603 FR 2019; 137-166 FR 2022; 628- 637 FR 2022; 61-63 FR 2023 (Pa. Commonwealth Ct.)

These 41 gross receipts tax refund and reassessment appeals involve nearly $250 million. The appeals primarily deal with receipts from the sale of roaming (Internet), roaming (voice/text), prepaid phone charges (non-Internet access), which accounts for over 97% of the tax at issue. The parties are in active settlement discussions.

XXVI Holdings Inc. (Google) v. Commonwealth of Pennsylvania, Nos. 108-110 FR 2024 (Pa. Commonwealth Ct.)

In these corporate net income tax appeals, the taxpayer contends that taxes regarding its sourcing of advertising revenue receipts should be sourced to Pennsylvania solely based on Pennsylvania population figures. A collateral Department of Revenue audit of Google suggests most of the revenue in question should be sourced to Pennsylvania. The taxpayer filed petitions for review with the Commonwealth Court in March 2024, but the litigation has not yet been scheduled for status conference. The Department of Revenue estimates that over $39 million is at issue in this matter.

Alcatel-Lucent USA, Inc. v. Commonwealth of Pennsylvania, No. 8 MAP 2023 (Pa. Supreme Ct.)

Following the decision in Nextel Communications of the Mid-Atlantic, Inc. v. Commonwealth, the Department of Revenue issued Corporation Tax Bulletins 2017-10 and 2018-02 (the "Bulletins") to announce that the flat-dollar cap on the NOL deduction would no longer be available for tax years beginning in 2017 and thereafter. Alcatel-Lucent challenges those Bulletins and argues that the Department of Revenue has violated the uniformity, equal protection, due process, and remedies clauses in its failure to retroactively apply Nextel and assess taxpayers who took the flat-dollar net loss deduction beginning with the 2014 tax year. On September 13, 2021, a unanimous Commonwealth Court panel held that Nextel applied prospectively and denied the request for a retroactive refund. On June 22, 2022, the matter was argued on exceptions before the Commonwealth Court sitting

en banc. On April 6, 2023, the Commonwealth Court granted taxpayer's exceptions to allow for retroactive relief in accordance with the decision in General Motors Corporation v. Commonwealth. The matter was appealed to the Pennsylvania Supreme Court. Applying Nextel retroactively could result in tax refunds of approximately $150 million for the 2014 – 2016 tax years and tax refunds of approximately $208 million for the 2007 – 2013 tax years. The parties argued this matter before the Pennsylvania Supreme Court in March 2024 and are awaiting a decision from the Court.

Pennsylvania Environmental Defense Foundation (PEDF) v. Commonwealth of Pennsylvania, No. 235 MD 2024 (Pa. Commonwealth Ct.)

The petition for review seeks, among other things, an accounting of all monies derived from public natural resources under the DCNR's management and a repayment of all such monies into the DCNR that are found to have been spent inconsistent with Pa. Const. Art. I, Sec. 27 trust purposes. The petition specifically seeks review of monies derived from oil and gas, timber harvesting, licenses for right-of-way, camp leases. The petition notes the $383 million found by the Supreme Court to be spent inconsistent with trust purposes and needing to be paid back in the PEDF II and IV decisions. The petition specifically requests a finding that $1.7 billion was spent inconsistent with Section 27 and needs to be paid back, in addition to any other amounts found through an accounting. The Commonwealth has filed preliminary objections in the nature of a demurrer in July 2024. In response, Petitioner has filed a request for a preliminary injunction ordering the Trustee to refrain from spending any appropriations from the Oil and Gas Lease Fund pending the Court's review of the past spending.

Pennsylvania Environmental Defense Foundation (PEDF) v. Commonwealth of Pennsylvania, No. 253 MD 2021 (Pa. Commonwealth Ct.)

In its fourth related petition concerning the use of the Oil and Gas Lease Funds, PEDF seeks to compel the State Treasurer to provide an accounting of all Oil and Gas Lease money from 2009-10 through present; pay approximately $383 million into the Oil and Gas Lease Fund to correct for prior transfers to the General Fund; pay approximately $800 million, without appropriation, into the Oil and Gas Lease Fund to redress amounts taken for DCNR's general budgetary needs; and pay approximately $200 million, without appropriation, into the Oil and Gas Fund money to redress appropriations made to the Marcellus Legacy Fund. On September 8, 2021, the Court granted the parties' joint application to stay the case pending the Supreme Court's disposition of 65 MAP 2020. Although 65 MAP 2020 has been resolved, the parties have not yet moved to lift the stay and the case remains active.

Amir Mohammadi v. Slippery Rock University, et al., No. 22-cv-01684 (U.S.D.C., W.D. Pa.)

Former University Vice President claims a violation of the Pennsylvania Whistleblower Law based upon his termination from service at Slippery Rock University in April 2022. Plaintiff alleges that his termination was directly related to good faith reports of alleged waste and wrongdoing regarding the University's engineering program and financial reports. Plaintiff also asserts that his termination is a breach of the terms of a prior settlement agreement with the University, and that then-University President took steps to prevent implementation of the terms of the settlement agreement. If successful, total damages may exceed $1 million based upon Plaintiff's salary at the time of his termination and attorneys' fees.

Abbey Zink v. Pennsylvania State System of Higher Education, et al., No. 22-cv-01170 (U.S.D.C., W.D. Pa.)

Plaintiff, a former Vice President at Slippery Rock University (SRU), filed a Complaint asserting retaliation, discrimination, and substantive and procedural due process violations as a result of her termination from SRU in April 2022. Plaintiff alleges her termination was motivated by retaliatory and discriminatory animus and was directly related to actions she took in reporting alleged improper actions by the University President in managing the implementation of several programs at the University and in reporting the University's financial status. Plaintiff's third Amended Complaint also includes an associational discrimination claim based on her working relationship with Amir Mohammadi, another University Vice President who was also terminated in April 2022. The State System of Higher Education has retained outside counsel to represent the System and the university. If successful, total damages may exceed $1 million based upon Plaintiff's salary at the time of her termination and attorneys' fees.

Borough of West Chester v. State System of Higher Educ. and West Chester University, No. 9 MAP 2023 (Pa. Supreme Ct.)

This litigation concerns the stream protection fee imposed by the Borough of West Chester (Borough) on West Chester University of Pennsylvania (WCU) several years ago. When the University refused to pay the fee in 2018, the Borough brought

this action in Commonwealth Court seeking a declaration that the fee was lawful. In January 2023, the Court, sitting en banc, issued a unanimous decision granting WCU's Application for Summary Relief, holding that the Borough had no legal authority to impose its stormwater management fee on WCU because legally that fee constitutes a tax. Notably, the Court held that "…the Stormwater Charge constitutes a general tax, as opposed to a special assessment, because the work funded thereby does not benefit individual properties, but rather, yields a common benefit shared by residents of the Borough generally." And because "[t]ax immunity extends to every 'arm, agency, subdivision, or municipality of the Commonwealth'…Respondents are immune from payment." The Borough appealed this decision to the Pennsylvania State Supreme Court. The appeal has been fully briefed and oral argument was held on September 11, 2024. This case has the potential to impact the stormwater "fees" imposed on many different Commonwealth agencies by numerous municipalities across Pennsylvania.

West Chester University v. Boro Construction, No. 4259 (Pa. Board of Claims)

West Chester University (WCU) had numerous ongoing issues with timeliness and quality of work by Boro Construction, the general contractor on the Science and Engineering Center and the Commons (SECC) building project, which has become a hub for student and academic activity on the campus. Three years ago, the Pennsylvania State System of Higher Education engaged outside counsel to support the university. The project is now complete, including a full assessment of all the claims by outside counsel, our scheduling expert, and a design professional. WCU's dispute with Boro Construction is now pending in two forums: (1) WCU's claims (seeking more than $5 million in liquidated damages from Boro) are pending in the Commonwealth's Board of Claims (BOC), and Boro's claims for delay damages (over $2 million) are pending in the Board of Claims as well; and (2) WCU's claims against Boro for amounts paid directly to subcontractors (over $1 million) is pending in arbitration (because the BOC did not allow them to be adjudicated at the Board). The BOC matters are now in discovery. Outside construction counsel continues to manage all these matters for the University, with University Legal Counsel providing support and coordination with university officials.

Anglemeyer, et al. v. Ammons, et al., No. 19-cv-03714 (U.S.D.C., E.D. Pa.)

This is a section 1983 excessive force lawsuit brought by four of nine residents of a home that was searched by the Pennsylvania State Police's ("PSP") Special Emergency Response Team pursuant to a search warrant. The plaintiffs assert that they were subjected to excessive force resulting in injury. There were 19 PSP defendants as of October 16, 2024. The Commonwealth's motion for summary judgment was granted and the ruling has been appealed. The parties argued this case to the U.S. Third Circuit Court of Appeals in September 2023, and the Court of Appeals thereafter remanded this lawsuit back to the federal district court. A trial is scheduled for January 13, 2025. The Commonwealth estimates that the Commonwealth's exposure could exceed $1 million if a decision is delivered in favor of the plaintiffs.

Greenwood Gaming and Entertainment, Inc., et al. v. Department of Revenue, et al., No. 76 MAP 2021 (Pa. Commonwealth Ct.)

A group of Pennsylvania casinos challenge the Pennsylvania Lottery's internet instant games alleging they simulate interactive casino-style games in violation of Act 42 of 2017, which amended the Pennsylvania Race Horse Development and Gaming Act. Petitioners seek to either shut down the entire iLottery system or strip the games of certain features. If the Court grants the relief sought it could potentially result in the loss of significant revenue to the Lottery, which over time could be in the millions of dollars. Following a bench trial in October 2020, judgment was entered in favor of the Department of Revenue. On appeal, Commonwealth Court determined iLottery program was not in violation of the Gaming Act. A motion for Post-Trial Relief was denied and the matter was appealed to the Supreme Court. Oral argument was held in April 2023, and the Commonwealth awaits a decision. On December 19, 2023, the Pennsylvania Supreme Court issued a decision establishing a new subjective test under which iLottery games were to be analyzed and remanded the matter to the Commonwealth Court for further review. The matter was re-briefed and re-argued based on the existing Commonwealth Court record. We are still awaiting a final decision based upon the additional briefs filed in May 2024.

Lee v. Lamas, No. 19-cv-00241 (U.S.D.C., E.D. Pa.)

Plaintiff brings a putative collective action under the Fair Labor Standards Act and class action under the Pennsylvania Minimum Wage Law alleging that Corrections Officer Trainees and Corrections Officer 1s at SCI-Chester prison were not paid for post-shift work. Specifically, Plaintiff avers that he was forced to wait at his post at the end of a shift change for the next shift's officer to arrive, and he was not paid for this time. The Court recently granted the Commonwealth's motion for summary

judgment, and plaintiff has filed a notice of appeal, which is now docketed with the Third Circuit, No. 24-2414. A brief for the appellant (plaintiff) is due September 23, 2024.

Brown v. Wilson, No. 20-cv-00985 (U.S.D.C., W.D.Pa.)

After investigation by Pennsylvania State Police, Plaintiff was arrested, charged and adjudicated delinquent in the murder of his stepmother when he was eleven years old. On appeal, the Superior Court affirmed the adjudication, but the Supreme Court concluded there was insufficient evidence to support his adjudication of delinquency beyond a reasonable doubt for the offenses charged. Consequently, Plaintiff was released after spending nearly 10 years in custody. Trial is currently scheduled for December 2024. Settlement negotiations are currently in progress. Given the nature of the litigation, the Commonwealth's estimated exposure could exceed $1 million.

Roberts, et al., v. State Employees' Retirement Board, No. 339 MD 2022 (Pa. Commonwealth Ct.)

This is an original jurisdiction Commonwealth Court action filed by eight judges. Respondents are the State Employees' Retirement Board as an entity, and each of the individual Board members. Petitioners took office on or after January 1, 2019, and are subject to the benefit and contribution provisions of the Act of June 12, 2017, P.L. 11, No. 5 ("Act-5"). Act 5 established the new retirement benefit tiers for most new State employees, including judges. These new tiers are the Class A-5 and Class A-6 hybrid defined benefit/defined contribution plans and the straight defined contribution plan option. Petitioners allege that the new benefit tiers produce lower benefits than the old benefit tiers in violation of constitutional requirements for judicial pension benefits as interpreted and applied by prior Pennsylvania Supreme Court decisions. Petitioners filed an Application for Summary Relief, which was denied. They sought an immediate appeal to the Supreme Court of Pennsylvania. If the Petitioners are ultimately successful, it could have a significant effect on the Commonwealth's budgeting and may require reallocation of funds, of an amount well over $1 million, towards the state employee retirement system. The Pennsylvania Supreme Court, on April 9, 2024, denied Petitioners' request for an interlocutory appeal. The case remains pending before Commonwealth Court.

Hall v. Phelps, et al., No. 22-cv-00480 (U.S.D.C., M.D. Pa.)

This is a section 1983 excessive force and First Amendment retaliation lawsuit brought by the Estate of Christian Hall. PSP responded to several calls of a suicidal male who was standing at the edge of an overpass. The troopers worked for over two hours to deescalate the situation, but Mr. Hall drew his handgun, pointed it in the direction of troopers, and was shot by two of the troopers on scene. There are also First Amendment claims against the former Commissioner related to statements made by PSP following the shooting. Discovery was completed on July 31, 2024. PSP estimates that the Commonwealth's exposure from this lawsuit may exceed $1 million.

Medical Marijuana Access & Patient Safety, Inc. v. Klinepeter, et al., No. 58 MD 2022 (Pa. Commonwealth Ct.)

Petitioners, a collection of medical marijuana organizations and patients, initiated an action seeking declaratory judgment, a temporary injunction, and other relief following the Department of Health's request that medical marijuana grower-processors recall certain medical marijuana vaporization products. Pursuant to the Medical Marijuana Act ("Act"), the Department of Health (the "Department") is required to approve or deny medical marijuana products. These products include a wide range of different devices that aid delivery of medical marijuana. One of the more popular medical marijuana delivery devices are vaporizers. Many grower-processors sell medical marijuana in a form designed to be inhaled using vaporization devices. In some cases, medical marijuana includes additives. Prior to approving vaporization products, the Department takes steps to ensure the products are safe for inhalation. To that end, the Department has relied on the Food and Drug Administration's ("FDA") list of approved additives to evaluate whether an additive in a vaporization product is safe for inhalation. Petitioners have challenged the Department's "safe for inhalation" standard as an unpromulgated regulation. Additionally, Petitioners have argued that the Act only permits the Department to deny an additive if the product does not satisfy one of two listed "considerations" in the Act. In February 2022, the Department instructed grower/processors to recall vaporization products with unapproved additives. Petitioners sought a temporary injunction which was granted in June 2022 and which permitted some of the products to remain on the market. Following briefing and oral argument, on May 30, 2024, the Commonwealth Court granted a permanent injunction against the Department. The injunction permitted only those vaporization devices which were subject to the June 2022 temporary injunction back on the market. The court tacitly approved the Department's authority generally by specifically stating the permanent injunction was issued solely for the "current" recalled products. The court concluded that "Petitioner is entitled to permanent injunctive relief, but only as to DOH's current [recall]" because the recall itself was "unlawful because it is an unpromulgated de facto regulation." The court could have expressly

rejected the Department's authority to approve or deny products but did not, and this is important because the lawsuit occurred prior to approval of the final form regulations which were amended to include new language. The final form regulations include additional language which would arguably permit the "approved for inhalation" standard. (See 28 Pa. Code § 1151a27(f)(iv)). This decision had a significant impact on policy and agency operations. The case is now closed.

Green Analytics N., LLC, et al. v. Pennsylvania Department of Health, No. 104 MD 2023 (Pa Commonwealth Ct.) and 76 MAP 2023 (Pa. Supreme Court)

Petitioners, a licensed medical marijuana laboratory and six medical marijuana grower/processors, initiated this case through the filing of a petition for review with Commonwealth Court on March 4, 2023. That petition challenged one provision of a broader regulation that regulates medical marijuana issued by the Department of Health earlier that day. That provision, known as the "two-lab requirement," required medical marijuana grower-processors to contract with two separate laboratories to have their medical marijuana tested at two different stages of production. Simultaneous with the petition, petitioners filed a motion for an ex parte temporary restraining order preventing the Department from enforcing the two-lab requirement, which Commonwealth Court granted. The Department then agreed to refrain from enforcing the two-lab requirement during the pendency of this litigation. The parties then moved for summary relief, and argument was held before the en banc court on May 10, 2023. On June 29, 2023, a divided Commonwealth Court granted Petitioners' application for summary judgment as to Count I of their petition, which alleged that the two-lab requirement exceeded the Department's statutory authority under the Medical Marijuana Act ("the Act"). It simultaneously denied Respondent's application for summary judgment. The court declared the two-lab requirement invalid and unenforceable, and entered judgment in Petitioners' favor. The majority opinion, found that the two-lab requirement exceeded the Department's authority because it conflicted with Section 704 of the Act, which states, in relevant part: "A grower/processor shall contract with one or more independent laboratories to test the medical marijuana produced by the grower/processor." The matter is pending before the Pennsylvania Supreme Court. If a permanent injunction is issued, or if the Court determines the regulations are not supported by the Act, then the Department will be unable to ensure that two independent labs test all medical marijuana products. The parties argued the case to the Pennsylvania Supreme Court on September 10, 2024, and the Supreme Court took the case under advisement. This decision could have a significant impact on policy and agency operations.

Allegheny Reproductive Health Center v. Pennsylvania Department of Human Services, No. 26 MD 2019 (Pa. Commonwealth Ct.)

This case concerns an equal protection challenge by numerous providers of reproductive health care services throughout Pennsylvania to the prohibition of Medical Assistance coverage for abortion services under 18 Pa. Cons. Stat. §§ 3215(c), (j). Petitioners request that the Court declare the statute and regulations unconstitutional, that abortion is a fundamental right under the Pennsylvania Constitution, and that the Court enjoin enforcement of the Pennsylvania abortion coverage ban statute and implementing regulations. The Commonwealth filed preliminary objections and challenged the Petitioners' standing. Separate applications to intervene were filed by members of the Pennsylvania Senate and the Pennsylvania House of Representatives and were ultimately granted. The Senate and House Intervenors also filed preliminary objections. On March 26, 2021, the Commonwealth Court issued an opinion sustaining the Preliminary Objections filed by the Department of Human Services ("DHS"), as well as Intervenors from the Senate and House of Representatives, and dismissing the Petition for Review. Petitioners appeal the Pennsylvania Supreme Court the Commonwealth Court's order allowing intervention and the order that sustained preliminary objections. On January 29, 2024, the Supreme Court reversed the Commonwealth Court. The Supreme Court (1) held that the Petitioners had standing; (2) held that the Senate and House Intervenors did not have a right to intervene; (3) overruled the interpretation of the Equal Rights Amendment articulated in Fischer v. Department of Public Welfare, 502 A.2d 114 (Pa. 1985); (3) provided guidance on how courts should interpret the Equal Rights Amendment and the Equal Protection Clause; and, (4) remanded the matter to Commonwealth Court. On July 16, 2024, the DHS informed the Commonwealth Court that in light of the Supreme Court's decision, DHS did not intend to defend the statute. Briefing on Petitioners' application for summary relief is ongoing. This decision could have significant impact on policy and agency operations as well as a financial impact on the Commonwealth of at least $1 million.

R., et al. v. Pennsylvania Department of Human Services, No. 17-cv-02332 (U.S.D.C., M.D. Pa.)

This case concerns a class action filed by Disability Rights Pennsylvania, challenging the alleged failure to provide a full array of mental health services for dependent children with mental health needs. The Plaintiffs, on behalf of themselves and all children under the age of 21 who now or in the future are adjudicated dependent and have a diagnosed mental health

disability, allege violations of Title XIX, the ADA, and Section 504 of the Rehabilitation Act, for failure to provide medically necessary Medical Assistance ("MA")-funded behavioral health services with reasonable promptness; failure to provide child welfare services equal to those provided to children without mental health disabilities; and failure to provide services in-state in the most integrated setting appropriate to the needs of the Plaintiffs. The parties have been engaged in settlement discussions for a significant period of time. In view of the amount of discovery involved in this matter and the breadth of the settlement negotiations, costs could be significant. The parties are working to finalize the settlement terms.

Derrick v. Glen Mills School, Miller, Dallas, Utz, et al., No. 19-CV-01541 (U.S.D.C., E.D. Pa.)

This case concerns a putative class action filed by the Juvenile Law Center and the Education Law Center on behalf of former students at Glen Mills against three former Department of Human Services ("DHS") and Pennsylvania Department of Education ("PDE") Secretaries and a DHS Deputy Secretary in their individual capacities only, and Glen Mills executives. Plaintiffs allege DHS defendants violated their rights to be free from excessive and unreasonable use of force, to be protected from harm, and to receive adequate medical treatment. Plaintiffs claim the DHS defendants had an affirmative duty to protect them from harm and knew or should have known Glen Mills staff routinely used physical violence and excessive force against students. Plaintiffs' settlement demand that DHS pay $16.6 million was not accepted. DHS and PDE successfully engaged in global settlement discussions with Plaintiffs, and the settlement agreement was executed by all parties.

Hamilton, et al. v. Pennsylvania Department of Human Services, No. 2024-CV-3681 (Dauphin County Court of Common Pleas)

Sixteen plaintiffs claim to be former minors in the care of the Department of Human Services (DHS) at DHS-operated Youth Development Centers (YDC). The plaintiffs allege that they were physically and sexually abused by YDC staff members from 2003 through 2018, that DHS was negligent in allowing a culture of sexual abuse to flourish, and that DHS failed to protect them despite DHS' alleged knowledge of the abuse. To date, DHS has filed an answer to the plaintiffs' complaint. On July 31, 2024, DHS was apprised of another, separate complaint (captioned L.R. et al. v. DHS; Dauphin Co.) filed by 20 new plaintiffs who also allege abuse at DHS facilities. The Commonwealth does not yet have an estimate of its potential liability, but given the allegations and the number of plaintiffs, it is possible that the Commonwealth's exposure could equal or exceed $1 million if a final judgment or settlement is entered in favor of the plaintiffs.

Turton, Deceased, by U'Ren v. Southwestern Veterans' Center (SWVC), No. GD-21-009829 (Allegheny County Court of Common Pleas)

In this negligence action, Plaintiff alleges the Southwestern Veteran's Center (the "SWVC") breached its duty to resident Turton by leaving drain cleaner accessible to Turton, who ingested the drain cleaner and died. Plaintiff demands $500,000 in damages. The plaintiff has stated an intention to challenge the constitutionality of the Commonwealth's $250,000 statutory cap on damages in 42 Pa. C.S. § 8528. This matter is still in discovery.

Ronnie Johnson, et al., v. Little, et al., No. 22-1516 (U.S.D.C., W.D. Pa.)

Plaintiffs are a class of inmates who are or were incarcerated at SCI Fayette in the Security Threat Group Management Unit ("STGMU"). They are alleging that they suffer from serious mental illness and were confined in long-term segregation despite that diagnosis. They alleged they were living under horrific/harsh conditions, denied adequate mental health care, were mistreated and retaliated against. In May 2024, the parties engaged in an Early Neutral Evaluation (ENE), but the ENE did not progress into a mediation. The parties are now engaging in pre-class discovery.

Anthony Reid, et al. v. Wetzel, et al., No. 18-00176 (U.S.D.C., M.D. Pa.)

Plaintiffs make up a class action of current capital case inmates at Department of Corrections' facilities. The department settled these cases settled and paid attorneys' fees in the amount of $507,500, which exceeds the $250,000 cap set by the Commonwealth's Employee Liability Self-Insurance Program. The settlement agreement led to an additional $240,000 in attorneys' fees that were paid at the conclusion of the settlement in 2020. The department will continue to incur additional attorneys' fees, monitoring fees, and mental health evaluation fees arising from the matter in excess of $1 million.

Fernando Nunez v. Wolf, et al., No. 15-1573 (U.S.D.C., M.D. Pa.) and No. 22-3076 (Third Cir. Ct. of Appeals)

Plaintiff sought three religious accommodations from the Department of Corrections (DOC): (1) conjugal visits; (2) private prayer with his family; and (3) circumcision. The Commonwealth prevailed before the United States District Court and the

plaintiff appealed to the US Court of Appeals for the Third Circuit. The case has been fully briefed and oral argument occurred on November 1, 2023. Although the appellant will not receive significant financial compensation if he prevails, a decision against DOC could require DOC to spend significant funds to create a space for conjugal visits.

Estate of Dominic Ingle v. Wetzel, et al., No. 21-2019 (U.S.D.C., M.D. Pa.)

After arriving from a mental health commitment, Dominic Ingle committed suicide at SCI Camp Hill in December of 2019. Plaintiff's counsel has demanded approximately $5 million in compensation and damages. Discovery is scheduled to conclude on October 17, 2024, with expert discovery is to be completed in February 2025.

Hammond, et al. v. DOC, et al., No. 24-922 (U.S.D.C., E.D. Pa.)

Plaintiffs seek to bring a class action lawsuit on behalf inmates with mental illness in the Department of Corrections' Restricted Housing Unit (RHU) and Intensive Management Unit (IMU). The Court granted a request for a stay and the Court will consider a venue transfer. Based on the current definitions, this class action could exceed 15,000 plaintiffs and this case has the potential to substantially affect state government operations and policies. See also, Henderson and Walker.

Henderson, et al. v. Harry, et al., No. 24-2290 (U.S.D.C., E.D. Pa.)

Plaintiffs brought a purported class action lawsuit on behalf of inmates that have spent three years consecutively or cumulatively in the Department of Corrections' Restricted Housing Unit (RHU) and Intensive Management Unit (IMU). The lawsuit seeks injunctive relief and monetary relief. The Court granted a request for a stay and the Court will consider a venue transfer. Based on the current definitions, this class action could exceed 800 plaintiffs and this case has the potential to substantially affect state government operations and policies. See also, Hammond and Walker.

Walker, et al. v. Harry, et al., No. 24-2295 (U.S.D.C., E.D. Pa.)

Plaintiffs brought a purported class action lawsuit on behalf of inmates that are on the RRL or IMU. This is a due process case that seeks both injunctive and compensatory damages. The Court granted a request for a stay and the Court will consider a venue transfer. Based on the current definitions, this class action could exceed 150 Plaintiffs and this case has the potential to substantially affect state government operations and policies. See also, Henderson and Hammond.

Williams v. Little, et al., No. 23-0037 (U.S.D.C., W.D. Pa.)

Plaintiff filed a preliminary injunction challenging the DOC's new ceremonial meals policy, a policy commonly known as "the Little Policy" that affects religious meals. The Court granted Williams's preliminary injunction and required the DOC to revert to the ceremonial meals policy that pre-dated the Little Policy. The DOC submitted a new policy pertaining to religious meals. Both parties filed for summary judgment. The Court granted, in part, and denied, in part, both motions. Notably, the Court granted a permanent injunction regarding the "Little Policy" as it applies to SCI Albion. As to the new policy, the remaining question to be resolved at a bench trial, are whether Williams has a sincerely held religious belief that halal meat consumed at the Eid feasts must be fresh and if so, whether the Shelf Stable Policy burdens such a belief and is the least restrictive means in addressing a compelling DOC interest. DOC will already need to pay attorneys' fees relating to Williams prevailing on the former policy. The larger cost is if the Court finds that the DOC must provide freshly slaughtered halal meat that is prepared in a Halal kitchen. The DOC does not have a halal or kosher kitchen. It will cost the DOC millions of dollars to construct kitchens that are kosher and/or halal appropriate.

Keefer, et al. v. Joseph R. Biden, et al., No. 24-cv-1716 (Third Cir. Ct. of Appeals)

On January 25, 2024, a group of Pennsylvania legislators sued President Biden, Governor Shapiro, Pennsylvania Secretary of State Schmidt, and Deputy Secretary Marks claiming violations of the Electors Clause and Elections Clause of the U.S. Constitution, as well as the Pennsylvania Constitution, by excluding Plaintiffs from the law-making process regulating federal elections for President and Congress. Plaintiffs assert that Defendants repeatedly violate both clauses by "usurping the rights of the state legislators by changing Pennsylvania election laws, through inter alia, Executive Order 14019, which requires federal agencies to develop plans to increase voter registration (against President Biden only); the implementation of an opt-out process (instead of opt-in) for voter registration at PennDOT; and, the Department's 2018 Directive Concerning Help America Vote Act-Matching directive. The State Executive Branch Defendants filed a response to the preliminary injunction motion and a Motion to Dismiss the Complaint. On March 26, 2024, the District Court granted the motions to dismiss, denied Plaintiffs' motion for a preliminary injunction, and dismissed the case. The Court ruled that Plaintiffs lacked standing, both as individual legislators

and candidates and in any other capacity to pursue their claims. Plaintiffs filed a Notice of Appeal with the Third Circuit on April 18, 2024, and also filed a Petition for Writ of Certiorari Before Judgement with the U.S. Supreme Court. The appeal has been fully briefed.

Pennsylvania State Conference of the NAACP, et al. v. Schmidt, et al., No. 22-cv-339 (U.S.D.C., W.D. Pa.)

On November 4, 2022, the American Civil Liberties Union, on behalf of various public interest groups including the NAACP and the League of Women Voters filed suit in federal court for the Western District of Pennsylvania, No. 1:22-cv-339, against the Secretary of the Commonwealth and all 67 County Board of Elections claiming that the refusal to count ballots enclosed in outer envelopes that are undated or wrongly dated mail-in and absentee ballots violates the materiality provision of the Civil Rights Act. The suit outlines the history of litigation in Pennsylvania state and federal courts on this issue. Plaintiffs assert one count that such refusal is a violation of the materiality provision of the Civil Rights Act and seek a declaration and injunctive relief. On November 21, 2023, the District Court held that excluding undated ballots violates the materiality provisions of the Civil Rights Act. A notice of appeal was filed with the Third Circuit and a three-judge panel of Circuit judges reversed the District Court decision concluding that the materiality provision applies only with respect to the voter qualification process during registration. The Third Circuit rejected the argument that the right to vote encompasses the right to have an undated or wrongly dated ballot count. Judge Shwartz issued a dissent arguing against this narrow reading of the materiality provision. The case was remanded back to District Court for the remaining claims. Plaintiffs then obtained leave to file an amended complaint adding a claim that the refusal to count timely-received ballots violates the First Amendment by imposing an undue burden on the right to vote. The RNC and York, Lancaster and Berks counties filed motions for summary judgment. While briefing is now complete, the parties have asked for a stay in the proceeding pending the outcome of Black Political Empowerment Project v. Schmidt, No. 283 MD 2024 (Pa. Commonwealth Ct.).

Voter Reference Foundation, LLC v. Schmidt, No. 24-cv-00294 (U.S.D.C., M.D. Pa)

On February 19, 2024, Voter Reference sued Pennsylvania Secretary of State Schmidt under the National Voter Registration Act (NVRA) in connection with the Secretary's enforcement of a regulation that conditions the provision of the full voter export to a requestor on the requirement that the requester will not publish the list (containing personal information of every registered PA voter) on the internet. Voter Reference has asserted a six-count Complaint claiming: (1) the internet ban is preempted by the NVRA; (2) violation of the NVRA based on March 2022 denial; (3) violation of the NVRA based on November 2023 denial, (4) violation of Section 1983 claiming the Secretary's action results in a ban on core political speech; (5) violation of Section 1983 claiming the ban is overbroad; and (6) action for declaratory judgment. The Secretary filed a motion to dismiss which is pending before the federal district court. Although the motion is pending, the parties are continuing with discovery.

United Sovereign Americans, Inc., et al. v. Commonwealth of Pennsylvania, et al., No. 24-cv-1003 (U.S.D.C., M.D. Pa.)

On June 18, 2024, United Sovereign Americans and three individuals filed a petition for relief in the form of a writ of mandamus against Pennsylvania Secretary of State Schmidt, the Pennsylvania Department of State, the Pennsylvania Office of Attorney General, and the U.S. Attorney General. The petition alleges that Commonwealth officials failed to ensure that safeguards were in place to ensure election integrity in 2022, citing error rates that exceeded the maximum error rate allowed by § 21083 of the Help America Vote Act (HAVA) and the voting system standards issued by the Federal Election Commission (FEC). Petitioners request the court issue a writ of mandamus requiring compliance with state and federal election law, ensuring reliable results within the margin of error allowed for subsequent elections. The Secretary filed a motion to dismiss which is pending with the federal district court.

Omar Almusa, M.D. v. State Board of Medicine, No. 25 MAP 2024 (Pa. Supreme Ct.)

On April 3, 2024, the Pennsylvania Supreme Court granted the petition for allowance of appeal filed by Dr. Omar Almusa of the order of the Commonwealth Court issued on July 13, 2023 that affirmed an order of the State Board of Medicine which denied reinstatement of Dr. Almusa's license to practice medicine and surgery. Dr. Almusa's license was automatically suspended in 2019 for 10 years following his felony conviction under the Pennsylvania Drug Act. The Commonwealth Court held that the plain language of sections 40(b) and 43(b) of the Medical Practice Act required the Board to impose a 10-year automatic suspension of his license in 2019, and that the enactment of Act 53 in 2020 does not change the Court's interpretation of the relationship between sections 40(b) and 43(b) of the Act. The Court also held that Section 3113(f) of Act 53 may not be applied retroactively to Dr. Almusa's suspension in the absence of the Legislature's expression of its clear and manifest intent to do so. This matter has been briefed and oral argument is scheduled for October 2024.

Clymer v. Schmidt, No. 376 M.D. 2024 (Pa. Commonwealth Ct.) and No. 67 MAP 2024 (Pa. Supreme Ct.)

This case arises because the Constitution Party submitted nomination papers for the 2024 general election that purported to nominate candidates for President, Vice President, and presidential electors, but failed to submit an affidavit from each presidential elector being nominated. The Department of State therefore rejected the Constitution Party's nominations as to the offices of President, Vice President, and presidential elector. The Constitution Party filed a mandamus action against Pennsylvania Secretary of State Schmidt in Commonwealth Court. The parties filed cross-applications for summary relief. Commonwealth Court granted Respondent's application and Petitioner filed a notice of appeal to the Supreme Court of Pennsylvania. The matter has been submitted on briefs.

Williams v. Pennsylvania Department of State, No. 394 M.D. 2024 (Pa. Commonwealth Ct.) and No. 25 WAP 2024 (Pa. Supreme Ct.)

This case arises because a political body known as Justice for All submitted nomination papers for the 2024 general election that purported to nominate candidates for President, Vice President, and presidential electors, but failed to submit an affidavit from each presidential elector being nominated. The Department of State therefore rejected Justice for All's nomination papers. Petitioners — one of the individuals identified as a presidential elector in Justice for All's paperwork, along with two others who wish to serve as replacement electors — filed an action in Commonwealth Court seeking to compel the Department to accept Justice for All's nomination papers. The parties filed cross-applications for summary relief. Commonwealth Court granted Respondent's application and Petitioner filed a notice of appeal to the Supreme Court of Pennsylvania. The matter has been submitted on briefs.

Black Political Empowerment Project, et al. v. Schmidt, et al., No. 283 MD 2024 (Pa. Commonwealth Ct.) and No. 68 MAP 2024 (Pa. Supreme Ct.)

On May 28, 2024, a group of voting rights organizations, including the Black Political Empowerment Project, POWER Interfaith, and the League of Women Voters of Pennsylvania filed suit in the Commonwealth Court of Pennsylvania against the Secretary of the Commonwealth and the Philadelphia and Allegheny County Board of Elections claiming the refusal to count mail-in or absentee ballots with an incorrect or missing date on the return envelope violates the Free and Equal Elections Clause of the Pennsylvania Constitution. The suit refers to previous litigation demonstrating that the handwritten date on the return envelope does not serve a purpose in determining whether a ballot was received in a timely manner. Petitioners assert two claims that the refusal to count these ballots violates the Free and Equal Elections Clause by disenfranchising eligible voters and seek a declaration and injunctive relief. Cross-applications for summary relief were filed on July 8, 2024, and oral argument took place on August 1, 2024. Commonwealth Court granted Petitioners' application and the Intervener (RNC) filed a notice of appeal to the Supreme Court of Pennsylvania. The matter has been submitted on briefs.

Astou Diop, Tanyita Henry and Awa Gaye v. State Board of Cosmetology, No. 363 MD 2020 (Pa. Commonwealth Ct.)

Petitioners challenge licensure requirements for natural hair braiders as a violation of their right to pursue their chosen occupation under Article 1, Section 1 of the Pennsylvania Constitution. They also claim a violation of equal protection as cosmetologists are authorized to perform natural hair braiding but are not required to undergo natural hair braiding training. They seek a declaratory judgment that the regulatory scheme for natural hair braiding licensure violates substantive due process. They also seek an order enjoining the Board from enforcing the hair braiding licensure provisions against the petitioners or anyone else. On March 3, 2022, the Commonwealth Court ruled that the requirement in the Cosmetology Law requiring a natural hair braider license is not facially unconstitutional and does not violate the Equal Protection clause because licensed cosmetologists and unlicensed natural hair braiders are not similarly situated. However, the court determined that the "as applied" substantive due process claims of Diop and Gaye as experienced natural hair braiders operating their businesses for profit would go forward. On June 7, 2024, the Court issued an order denying the Motion for Summary Judgment and the Cross-Application for Summary Relief, holding that there are disputed material facts precluding such relief. Trial is scheduled for November 2024 but the matter may be moot if the General Assembly passes House Bill 1820 which would eliminate the natural hair braider license.

Heath Gray v. Pennsylvania Dept. of State, No. 442 MD 2023 (Pa. Commonwealth Ct.)

On September 25, 2023, Petitioner filed a Petition for Review claiming that he, as an incarcerated felon, is being unconstitutionally deprived of his right to vote. He requested a voter registration form from prison staff at SCI-Greene and prison staff denied that request based on DOS guidance regarding prisoners with felony convictions. Petitioner seeks an order that DOS

be required to facilitate the right of suffrage for confined felons. The Department filed preliminary objections on October 27, 2023, which are pending before the Court.

County of Fulton, et al. v. Secretary of the Commonwealth, Nos. 277 MD 2021 (Pa. Commonwealth Ct.) and 56 MAP 2024 (Pa. Supreme Ct.)

On August 18, 2021, Fulton County sued the Secretary of the Commonwealth over the decision to decertify certain of Fulton County's voting system components which were turned over to third parties as part of an "audit." Both parties filed applications for summary relief which are currently pending before Commonwealth Court. There was also an interlocutory appeal of an order before the Pennsylvania Supreme Court, No. 3 MAP 2022, on the Secretary's emergency application related to spoilation of evidence. The Pennsylvania Supreme Court issued an opinion holding Fulton County in contempt and granting nearly all relief sought in the sanctions application. The Pennsylvania Supreme Court ordered Fulton County to pay all of the Secretary's costs and fees from December 17, 2021, and ordered the voting systems to be impounded and kept by a third party at the county's expense. On June 11, 2024, the Commonwealth Court granted Intervenor Dominion Voting Systems, Inc.'s Application for Renewal of the Special Master's Injunction Order and enjoined the Petitioners and their counsel from disseminating or allowing third parties to access certain evidence and information. On July 19, 2024, Petitioners filed an appeal with the Pennsylvania Supreme Court, which remains pending.

P.G.S. v. Hendricks, et al., No. 390 M.D. 2024 (Pa. Commonwealth Ct.)

On March 18, 2019, three members of the State Board of Nursing's Probable Cause Screening Committee, Suzanne Hendricks, Linda Kerns, and Sherri Luchs, were served with a Praecipe for Writ of Summons. On June 28, 2021, the complaint was finally filed, alleging a violation of procedural due process under the United States Constitution and under the Pennsylvania Constitution, a violation of substantive due process under the United States Constitution and under the Pennsylvania Constitution, a violation of Pamela Stauffer's right to privacy under the Pennsylvania Constitution and a violation of Pamela Stauffer's right to privacy under the United States Constitution. Stauffer is challenging the Mental/Physical Evaluation process of the State Board of Nursing arguing that the process violates the Court's holding in a decision known as Lencovich, because she was compelled to attend the mental/physical examination without an opportunity to challenge the order compelling prior to attending, and she was not provided adequate notice that she would be afforded a hearing prior to suspending her license. On March 1, 2024, the Dauphin County Court of Common Pleas (Judge Andrew H. Dowling Jr.) issued a memorandum opinion granting PGS's motion for summary judgment and denied the Defendants' cross motion for summary judgment. The Court held that the board failed to provide PGS with due process before requiring her to submit to a mental and physical examination. The Court also held that the members of the Probable Cause Screening Committee are not entitled to quasi-judicial immunity because of the lack of procedural safeguards before the Order to Compel was entered. The Court also held that they are not entitled to qualified immunity because they are presumed to know the dictates of the statute under which they derived their authority to issue orders compelling licensees to undergo mental and physical examinations, and they violated PGS' rights under that statute. The Office of Attorney General filed a notice of appeal with Commonwealth Court on behalf of the members of the Probable Cause Screening Committee arguing that an order denying qualified immunity or quasi-judicial immunity is immediately appealable under the collateral order doctrine. The opening brief is due October 30, 2024.

Zimmerman, et al. v. Schmidt, et al, No. 33 M.D. 2024 (Pa. Commonwealth Ct.) and No. 63 MAP 2024 (Pa. Supreme Ct.)

On January 30, 2024, Petitioners David Zimmerman and Kathy Rapp, members of the Pennsylvania House of Representatives, filed a Petition for Review in the Commonwealth Court against the Pennsylvania Secretary of State and all 67 county boards of election claiming that the statutory revision within Act 77 of 2019 that requires absentee ballots to be delivered and canvassed centrally at county boards of elections (previously they were distributed to local election districts) violates Article VII, Section 14 of the Pa. Constitution which requires the General Assembly to provide a means by which voters can cast absentee ballots and for the "return and canvass of their votes in the election district in which they respectively reside." Cross-applications for summary relief have been filed. Commonwealth Court granted Respondent's application and Petitioner filed a notice of appeal to the Supreme Court of Pennsylvania. The matter has been submitted on briefs.

PNAP v. Pennsylvania Department of State, No. 1450 CD 2023 (Pa. Commonwealth Ct.)

On December 12, 2023, PNAP filed a petition for review of a final order issued by the Pennsylvania Secretary of State on November 28, 2023that denied the bid protest filed by PNAP on October 26, 2023. PNAP is the former vendor for peer

assistance monitoring for the State Board of Nursing, and it challenged the award of the new contract for these services to the Foundation of the PA Medical Society (PHP) after completion of the RFP process. The matter has been fully briefed to the Court.

Batuhan Dogrusoz v. PA Department of Labor and Industry, Unemployment Compensation Board of Review, No. 230 MD 2023 (Pa. Commonwealth Ct.)

Dogrusoz filed a complaint in mandamus to the Commonwealth Court requesting, among other things, an award for Pandemic Unemployment Assistance (PUA) benefits for a period of time not previously requested and an award of those benefits without an offset for any earnings. Though Commonwealth Court lacks original jurisdiction in this matter, and it is unlikely Dogrusoz will be successful, if the Court entertains petitioner's arguments, it would significantly alter the method by which individuals submit claims for unemployment benefits. The Department of Labor and Industry filed preliminary objections on October 3, 2023 and filed its brief in April 2024. The parties are awaiting the court's ruling. On September 9, 2024, Commonwealth Court held that Dogrusoz didn't exhaust his administrative remedies and, thus, dismissed the action.

Ursinus College v. International Brotherhood of Electrical Workers, Local Union No. 98, 18 MAP 2023 (Pa. Supreme Court)

The primary issue in this matter is whether the Pennsylvania Prevailing Wage Act, 43 P.S. §§ 165-1- 165-17 (PWA), applies to a construction project at Ursinus College funded by issuance of municipal bonds to a private trustee. The Commonwealth Court held that because the project funding never touched "public coffers" the PWA did not apply. This decision could have significant implications on the application of the PWA as it could narrow the interpretation of "public work." The Department of Labor & Industry intervened in the Commonwealth Court proceeding but did not file a brief in the Supreme Court proceeding. The briefing was completed on May 22, 2023, and the case was subsequently argued on September 14, 2023. On February 21, 2024, our Supreme Court affirmed Commonwealth Court and held that the PWA doesn't apply to this project because the "economic realities" of the transaction revealed that the project was paid for out of private funds, which were generated by the Authority's exercise of its statutory ability to issue bonds. The Authority didn't hold or disburse those funds or the bond debt service payments at any point nor did the Authority bear any risk or liability with respect to repayment of the bonds. This case is now closed.

PSP NE, LLC v. Prevailing Wage Appeal Board, 38 MAP 2024 (Pa. Supreme Court)

The primary issue in this matter is whether the Pennsylvania Prevailing Wage Act, 43 P.S. §§ 165- 1-165-17 (PWA), applies to the construction of a new Pennsylvania State Police barracks in which a public entity bears the financial risk of construction pursuant to a long-term pre-development lease. The Commonwealth Court held that, because the construction costs were not provided by a public body, the risk of repayment was not borne by a public body, and the developer retained a reversionary interest in the property, a bona fide lease existed, rather than construction contract. Accordingly, the PWA did not apply. This decision could also have significant implications on the application of the PWA. On October 30, 2023, the Supreme Court issued an Order holding the Petition for Review filed by Bureau of Labor Law Compliance pending the outcome the Ursinus College case described above. On May 22, 2024, our Supreme Court granted the Department of Labor and Industry's (L&I) 'petition for allowance of appeal as to the following issues: (1) is risk allocation the only consideration in determining whether a pre-construction lease is covered by the PWA; (2) how much risk must a developer bear to ensure that public funds to not in part pay for construction under Pennsylvania State Supreme Court (SCOPA) precedent such that a pre-construction lease does not 'implicate the PWA; and (3) under SCOPA precedent, what is the distinction between a grievant's burden to prove a "facially legitimate lease" and the Bureau's burden to prove "that the economic reality of the transaction is different from its appearance." L&I filed its initial brief on July 31, 2024 and is awaiting the briefing from the appellee.

Federated Insurance Company v. Summit Pharmacy (Bureau of Workers' Compensation Fee Review Hearing Office), No. 61 MAL 2024 (Pa. Commonwealth Ct.)

Section 306(f.1)(3)(vi)(A) of the Pennsylvania Workers' Compensation Act, 77 P.S. § 531(3)(vi)(A), provides: "The reimbursement for drugs and professional pharmaceutical services shall be limited to one hundred ten per centum of the average wholesale price (AWP) of the product, calculated on a per unit basis, as of the date of dispensing." Further, the Medical Cost Containment Regulations at 34 Pa. Code § 127.131 provide: "Pharmacists and insurers may reach agreements on which Nationally recognized schedule shall be used to define the AWP of prescription drugs. The Bureau [of Workers' Compensation] in resolving payment disputes, may use any of the Nationally recognized schedules to determine the AWP of prescription drugs. The Bureau will provide information by an annual notice in the Pennsylvania Bulletin as to which of the Nationally recognized

schedules it is using to determine the AWP of prescription drugs." To this end, the Bureau's Fee Review Section had been utilizing the "Red Book," a privately published, electronic compendium of pharmaceutical and over-the-counter drug AWPs. However, in analyzing an appeal from a decision of a fee review hearing officer in which competing AWP schedules were presented for consideration, the Commonwealth Court determined that use of the Red Book was legally inconsistent with Section 306(f.1)(3)(vi)(A). The Court indicated that (1) AWP must be based on a schedule that reflects actual acquisition costs and (2) Red Book pricing is based on inflated manufacturer suggested retail pricing and therefore cannot be used to determine AWP. The Court directed the Bureau to designate another Nationally recognized schedule promptly that is based on actual acquisition costs. A Petition for Allowance of Appeal was filed by the pharmacy with the PA Supreme Court. The Commonwealth Court's Order may have significant impact on the calculation of prescription drug reimbursement under the Workers' Compensation Act. On August 27, 2024, the PA Supreme Court granted the Petition for Allowance of Appeal; however, it denied the request for a stay of Commonwealth Court's order. Briefing will be scheduled and the matter decided by the Supreme Court.

Schmidt v. Schmidt, Kirifides and Rassias, PC, 32 MAP 2024 (Pa. Supreme Court)

Section 306(f.1) of the Pennsylvania Workers' Compensation Act, 77 P.S. § 531, requires an employer "provide payment in accordance with this section for reasonable surgical and medical services… medicines and supplies." In addition, Section 306(f.1) requires a "provider" to file periodic reports with an employer as a prerequisite for payment of medical expenses. The claimant in this case filed a Penalty Petition alleging that his employer failed to reimburse him for cannabinoid oil (CBD oil) he had purchased out-of-pocket from a specialty foods store. Following a WCJ's granting of reimbursement and the Workers' Compensation Appeal Board's reversal, the Commonwealth Court determined, inter alia, that CBD oil is both a "medicine[]" and a "suppl[y]" under Section 306(f.1), and that the claimant is not a "provider" under Section 306(f.1) and is not subject to reporting requirements in seeking reimbursement for out-of-pocket payments for CBD oil. The case has been accepted for review by the Supreme Court on a threefold issue: (1) whether the terms "medical services" and "medicines and supplies" as used in Section 306(f.1) include CBD oil, specifically, as well as dietary supplements, generally, and products that may be purchased without a prescription from a healthcare provider; (2) do the Medical Cost Containment Regulations of the Act apply to CBD oil; and (3) does Section 306(f.1) require employers to reimburse claimants for out-of-pocket expenses for "medical services" and "medicines and supplies," and if so, are claimants obligated to submit supporting documentation before they may receive such reimbursement? Expanding the definition of "medicines" and "supplies" under the Workers' Compensation Act to encompass unprescribed dietary supplements and excluding claimants from reporting requirements for reimbursement of those purchases may have significant cost implications.

Reading Anthracite Company v. State Workers' Insurance Fund, Board of Claims, No. 4247 (Pa. Department of Labor & Industry Workers' Compensation Appeal Board)

On August 30, 2022, Reading Anthracite Company (RAC), a State Workers' Insurance Fund (SWIF) insured, filed a Statement of Claim with the Board of Claims (BOC) seeking damages from SWIF totaling $1,379,244.60 plus attorney's fees and interest based upon its assertion that SWIF is obligated under the terms of the policy of insurance that SWIF issued to RAC to reimburse it for the costs of defending and settling a civil suit filed in which it had been named as a defendant. SWIF refused to assume the defense or indemnification of RAC since SWIF's Employers Liability Insurance only applies to injuries that arise out of and in the course of employment, and the Complaint in the third-party suit arising out of a fatal accident was devoid of any allegation that RAC employed the decedent. The issue of whether decedent was RAC's employee when he was killed was separately litigated, and in June of 2024 Commonwealth Court affirmed the determination of the Workers' Compensation Judge who held that decedent was not a RAC employee. The BOC litigation had been stayed pending that final determination, and the Commonwealth now expects the stay to be lifted.

Warren, et al v. Commonwealth, et al, No. 309 MD 2024 (Pa. Commonwealth Ct.)

In this original jurisdiction action, individuals who have been criminally charged and who rely on public defenders to provide them with legal representation have brought a putative class action against the Commonwealth, Governor Shapiro, Speaker of the Pennsylvania General Assembly McClinton, and Pennsylvania Senate President Pro Tempore Ward. The petitioners assert various state and federal constitutional claims based on the theory that Pennsylvania is not appropriating sufficient monies for indigent defense. The petitioners seek to compel Pennsylvania to spend as much as $100 million more on indigent defense. The Office of General Counsel is defending Governor Shapiro and filed his response to the petition for review on August 30, 2024. The Office of Attorney General is separately representing the Commonwealth and filed its response to the petition on July 15, 2024.

Allegrini v. Sobeck, et al., No. 24-cv-1139 (U.S.D.C. E.D. Pa.)

The Pennsylvania State Police responded to a report that civilian vehicles were blocking highway I-95 and racing on the highway. State troopers arrived at the scene and found more than 50 vehicles blocking the highway and racing. One of the troopers stopped Allegrini's vehicle and removed three individuals from the vehicle. Allegrini was able to re-enter his vehicle. He drove it towards the state troopers and struck one of the troopers with the vehicle. Trooper Sobeck then fired his weapon, striking and killing Allegrini. The Commonwealth's total exposure to this civil rights lawsuit could exceed $1 million.

Peoples v. Hooven, No. 23-cv-297, (U.S.D.C. W.D. Pa.)

This case was brought by the Estate of Matthew Chelgren who died after he crashed his vehicle into a tree while being pursued by two Pennsylvania State Police troopers. The parties reached a settlement agreement for $750,000 on September 9, 2024.

Phillips v. Powell, et al., No. 23-cv-00103, (U.S.D.C. W.D. Pa.)

The Pennsylvania State Police's Special Emergency Response Team (SERT) responded to a mental health warrant issued in connection with a reportedly suicidal individual. SERT attempted to contact the individual to have him exit the residence. When the individual refused to leave the residence, SERT used a Rook vehicle to remove the residence's main door. The individual then approached the open doorway and pointed a weapon at the operator of the Rook. Another trooper at the scene discharged his weapon, striking and killing the individual. The Commonwealth's total exposure to this lawsuit could exceed $1 million.

Oleksandr Washington, Admin. of the Estate of Max Burakho v. Brown, et al., No. 23-cv-01632, (U.S.D.C. M.D. Pa.)

The Pennsylvania State Police were asked by a family member of an individual who had stopped taking his mental health medications to perform a welfare check on the individual. The individual was alleged to have been sending threatening or suicidal text messages. The family member advised the State Police that the individual had firearms in his residence. When the state troopers arrived at the individual's residence to perform the welfare check, the individual exited the rear door of the residence carrying a firearm. Two state troopers discharged their weapons which resulted in the death of the individual. The Commonwealth's exposure to this lawsuit could exceed $1 million.

Nathan Whisler, as Admin. of the Estate of Alicia Whisler v. Timothy O'Connor, et al. No. 24-cv-1368 (U.S.D.C., E.D. Pa.)

Alicia Whisler was killed when her vehicle was struck by another vehicle being pursued by PSP. Ms. Whisler's 5-year old daughter was also in the vehicle when the incident occurred. The original complaint was filed in April 2024 and following an initial review it was determined that the risk of liability could exceed $1 million so attempts at early settlement were made. The parties came to an agreement in July 2024 to resolve these claims for $2.5 million. Because the settlement involves a minor the court has scheduled a hearing for September 24, 2024 to review and approve the final terms of the settlement.

Louis Gallo, as Admin. of the Estate of Anthony Gallo v. Weaver, et al., No. 19-cv-1260 (U.S.D.C., W.D. Pa.)

Trooper Weaver responded to a 911 call of an individual running around a trailer park threatening to stab people. After failing to respond to verbal commands to drop a knife, Anthony Gallo was fatally shot. A jury trial was held the week of May 20, 2024 resulting in a Plaintiff's verdict. The jury awarded $3 million in damages to the decedent; $7 million in damages to the survivor; and $11 million in punitive damages against Weaver – for a total of $21 million. An award for attorney's fees and costs is still pending. A post-trial motion is currently pending before the district court with the potential for an appeal to be filed following the disposition of the post-trial motion.

Jeffrey Krug v. Bloomsburg University, et al., No. 18-cv-1669 (U.S.D.C., M.D. Pa.)

Jeffrey Krug was a former professor at Bloomsburg University who claimed he was terminated in retaliation for, among other things, assisting the former President's assistant with the filing of a discrimination complaint. A jury trial was held the week of August 12, 2024 resulting in a Plaintiff's verdict. The jury awarded $1,008,549 in back pay; $775,589 in front pay, $1.5 million in compensatory damages, and $650,000 in punitive damages – for a total of $3,934,138. An award for attorney's fees and costs is still pending. Post-trial motions are being drafted with the potential for an appeal to be filed following the disposition of the post-trial motion.

Citizens of Lehigh County, et al. v. Commonwealth of Pa., (Pa. Board of Claims No. 4267)

Lehigh County has presented a claim before the Board of Claims concerning its potential award of over $5.5 million dollars from the opioid settlement fund, claiming that a verbal agreement was reached between Governor Shapiro and the Lehigh County District Attorney to provide the county additional funds (i.e., $5.7 million) without the constraints of the settlement fund (meaning the monetary award can only be utilized to fund opioid-related matters and not go to legal fees as now demanded by Lehigh County). Preliminary objections have been filed by the Commonwealth and are currently pending.

Appendix F

Procedures for Shareholders to Submit Nominee Candidates

A Fund shareholder must follow the following procedures in order to properly submit a nominee recommendation for the Governance and Nominating Committee's consideration.

1. The shareholder must submit any such recommendation (a "Shareholder Recommendation") in writing to the Fund, to the attention of the Secretary, at the address of the principal executive offices of the Fund.

2. The Shareholder Recommendation must be delivered to or mailed and received at the principal executive offices of the Fund not less than one hundred and twenty (120) calendar days nor more than one hundred and thirty-five (135) calendar days prior to the date of the Board or shareholder meeting at which the nominee would be elected.

3. The Shareholder Recommendation must include: (i) a statement in writing setting forth (A) the name, age, date of birth, business address, residence address and nationality of the person recommended by the shareholder (the "candidate"); (B) the class or series and number of all shares of the Fund owned of record or beneficially by the candidate, as reported to such shareholder by the candidate; (C) any other information regarding the candidate called for with respect to director nominees by paragraphs (a), (d), (e) and (f) of Item 401 of Regulation S-K or paragraph (b) of Item 22 of Rule 14a-101 (Schedule 14A) under the 1934 Act, adopted by the SEC (or the corresponding provisions of any regulation or rule subsequently adopted by the SEC or any successor agency applicable to the Fund); (D) any other information regarding the candidate that would be required to be disclosed if the candidate were a nominee in a proxy statement or other filing required to be made in connection with solicitation of proxies for election of Trustees or directors pursuant to Section 14 of the 1934 Act and the rules and regulations promulgated thereunder; and (E) whether the recommending shareholder believes that the candidate is or will be an "interested person" of the Fund (as defined in the 1940 Act) and, if not an "interested person," information regarding the candidate that will be sufficient for the Fund to make such determination; (ii) the written and signed consent of the candidate to be named as a nominee and to serve as a Trustee if elected; (iii) the recommending shareholder's name as it appears on the Fund's books; (iv) the class or series and number of all shares of the Fund owned beneficially and of record by the recommending shareholder; and (v) a description of all arrangements or understandings between the recommending shareholder and the candidate and any other person or persons (including their names) pursuant to which the recommendation is being made by the recommending shareholder. In addition, the Governance and Nominating Committee may require the candidate to furnish such other information as it may reasonably require or deem necessary to determine the eligibility of such candidate to serve on the Board.