

# SECURITIES AND EXCHANGE COMMISSION

## FORM 497

Definitive materials filed under paragraph (a), (b), (c), (d), (e) or (f) of Securities Act Rule 497

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### FILER

#### **DEFINED ASSET FUNDS MUNICIPAL INVT TR FD NEW YORK SER 28**

CIK: **315347** | State of Incorpor.: **NY** | Fiscal Year End: **1231**  
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Business Address  
450 LEXINGTON AVE  
C/O DAVIS POLK &  
WARDWELL  
NEW YORK NY 10017  
000000000

DEFINED  
ASSET FUNDSSM

MUNICIPAL INVESTMENT  
TRUST FUND

-----  
NEW YORK SERIES--28  
(A UNIT INVESTMENT TRUST)

PROSPECTUS, PART A  
DATED JULY 29, 1994

SPONSORS:  
Merrill Lynch,  
Pierce, Fenner & Smith Inc.  
Smith Barney Inc.  
Prudential Securities Incorporated  
Dean Witter Reynolds Inc.

MONTHLY INCOME - TAX-FREE

This Defined Fund's objective is to provide interest income that in the opinion of counsel is, with certain exceptions, exempt from regular Federal income taxes and New York State and City personal income taxes under existing law through investment in a fixed portfolio consisting primarily of long-term Debt Obligations issued by or on behalf of the State of New York and counties, municipalities, public authorities and similar entities thereof, or by certain United States territories or possessions, and on the initial Date of Deposit rated investment grade by at least one national rating agency (or having, in the opinion of Defined Asset Funds research analysts, comparable credit characteristics). (See Part C for discussions of New York risk factors and State and local taxes.) There is no assurance that this objective will be met because it is subject to the continuing ability of issuers of the Debt Obligations to meet their principal and interest requirements. Furthermore, the market value of the underlying Debt Obligations, and therefore the value of the Units, will fluctuate with changes in interest rates and other factors.

Minimum Purchase: One Unit

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THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.  
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NOTE: PART A OF THIS PROSPECTUS MAY NOT BE DISTRIBUTED  
UNLESS ACCOMPANIED BY DEFINED ASSET FUNDS--MUNICIPAL INVESTMENT TRUST FUND  
PROSPECTUS, PARTS B AND C.

This Prospectus consists of three parts. The first includes an Investment Summary and certified financial statements of the Fund, including the related securities portfolio; the second contains a general summary of the Fund; the third contains a discussion of New York risk factors and taxes.

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Read and retain the three parts of this Prospectus for future reference.

DEFINED ASSET FUNDSSM is America's oldest and largest family of unit investment trusts with over \$90 billion sponsored since 1970. Each Defined Fund is a portfolio of preselected securities. The portfolio is divided into 'units' representing equal shares of the underlying assets. Each unit receives an equal share of income and principal distributions.

With Defined Asset Funds you know in advance what you are investing in and that changes in the portfolio are limited. Most defined bond funds pay interest monthly and repay principal as bonds are called, redeemed, sold or as they mature. Defined equity funds offer preselected stock portfolios with defined termination dates.

Your financial advisor can help you select a Defined Fund to meet your personal investment objectives. Our size and market presence enable us to offer a wide variety of investments. Defined Funds are available in the following types of securities: municipal bonds, corporate bonds, government bonds, utility stocks, growth stocks, even international securities denominated in foreign currencies.

Termination dates are as short as one year or as long as 30 years. Special funds are available for investors seeking extra features: insured funds, double and triple tax-free funds, and funds with 'laddered maturities' to help protect against rising interest rates. Defined Funds are offered by prospectus only.

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DEFINED ASSET FUNDS--MUNICIPAL INVESTMENT TRUST FUND, NEW YORK SERIES--28  
 INVESTMENT SUMMARY  
 AS OF APRIL 30, 1994, THE EVALUATION DATE

FACE AMOUNT OF SECURITIES	\$	5,140,000+
NUMBER OF UNITS.....		14,266
FACE AMOUNT OF SECURITIES PER UNIT.....	\$	360.29
FRACTIONAL UNDIVIDED INTEREST IN FUND REPRESENTED BY EACH UNIT.....		1/14,266th
PUBLIC OFFERING PRICE		
Aggregate bid side evaluation of underlying Securities.....	\$	5,399,051
Divided by Number of Units.....	\$	378.46
Plus sales charge of 3.979% of Public Offering Price (4.144% of net amount invested)*.....		15.68
Public Offering Price per Unit.....	\$	394.14
		(plus cash adjustments and accrued interest)**
SPONSOR'S REPURCHASE PRICE AND REDEMPTION PRICE PER UNIT.....		
(aggregate bid side evaluation of Securities) (\$15.68 less than Public Offering Price per Unit)	\$	378.46
		(plus cash adjustments and accrued interest)**
CALCULATION OF ESTIMATED NET ANNUAL INTEREST RATE PER UNIT (based on face amount per Unit)		
Annual interest rate per Unit.....		7.643%
Less estimated annual expenses per Unit (\$0.89) expressed as a percentage.....		.247%
Estimated net annual interest rate per Unit.....		7.396%

DAILY RATE AT WHICH ESTIMATED NET INTEREST ACCRUES PER UNIT.....		.0205%
MONTHLY INCOME DISTRIBUTIONS		
Estimated net annual interest rate per Unit times the Face Amount per Unit.....	\$	26.65
Divided by 12.....	\$	2.22
RECORD DAY		
The 1st day of each month.		
DISTRIBUTION DAY		
The 15th day of each month.		

MINIMUM CAPITAL DISTRIBUTION

No distribution need be made from Capital Account if balance in Account is less than \$5.00 per Unit.

TRUSTEE'S ANNUAL FEE AND EXPENSES++

\$0.89 per Unit (see Expenses and Charges in Part B).

EVALUATOR'S FEE FOR EACH EVALUATION

Maximum of \$13 (see Expenses and Charges in Part B).

EVALUATION TIME

3:30 P.M. New York Time

PREMIUM AND DISCOUNT ISSUES IN PORTFOLIO

Face amount of Debt Obligations with bid side evaluation:

Over par.....	88%
At a discount from par.....	12%

MINIMUM VALUE OF FUND

Trust may be terminated if value of Fund is less than 40% of the Face Amount of Securities on the date of their deposit. As of the Evaluation Date, the value of the Fund was 33% of the Face Amount of Securities on the date of their deposit.

\*This is the maximum Effective Sales Charge on the date stated. The sales charge will vary depending on the maturities of the underlying Securities and will be reduced on a graduated scale for purchases of 250 or more Units (see Public Sale of Units--Public Offering Price in Part B). Any resulting reduction in the Public Offering Price will increase the effective current and long term returns on a Unit.

\*\*For Units purchased or redeemed on the Evaluation Date, accrued interest is approximately equal to the undistributed net investment income of the Fund (see Statement of Condition on p. D-2) divided by the number of outstanding Units, plus accrued interest per Unit to the expected date of settlement (5 business days after purchase or redemption). The amount of the cash adjustment which is added is equal to the cash per Unit held in the Capital Account (see Public Sale of Units-- Public Offering Price and Redemption in Part B).

+On the Initial Date of Deposit (July 2, 1980) the Face Amount of Securities was \$16,000,000. Cost of Securities is set forth under Portfolio.

++Of this figure, the Trustee receives annually for its service as Trustee, \$0.72 per \$1,000 face amount of Debt Obligations. The Trustee's Annual Fee and Expenses also includes the Evaluator's Fee and reimbursement of bookkeeping and other administrative expenses of the Sponsors, not exceeding their cost, currently at a maximum annual rate of \$0.10 per Unit.

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DEFINED ASSET FUNDS--MUNICIPAL INVESTMENT TRUST FUND, NEW YORK SERIES--28  
INVESTMENT SUMMARY AS OF THE EVALUATION DATE (CONTINUED)

NUMBER OF ISSUES IN PORTFOLIO.....	8
NUMBER OF ISSUES RATED BY:*	
Standard & Poor's Corporation/ rating .....	AAA-- 5
	A-- 1
	BBB-- 1
NUMBER OF ISSUES NOT RATED**.....	1
RANGE OF MATURITIES.....	2001-2023
NUMBER OF ISSUERS BY SOURCE OF REVENUE:	
Hospital/Health Care Facility.....	2
Housing.....	1
Refunded Bonds.....	5
CONCENTRATIONS+ EXPRESSED AS PERCENTAGE OF AGGREGATE FACE AMOUNT OF PORTFOLIO:	
Obligations of issuers located in the State of New York.....	78%
Refunded Bonds.....	75%
Moral Obligation.....	61%
PERCENTAGE OF AGGREGATE FACE AMOUNT OF PORTFOLIO COMPRISED OF:	
Obligations of issuers located in the Commonwealth of Puerto Rico.....	22%

RISK FACTORS--

Investors should consult Part B for a general summary of the Fund and of certain investment risks related to the Fund; Part C should be consulted for discussions of New York risk factors and New York state and local taxes.

The following supplements the information on p. 11 of Part B.

PUERTO RICO

The Puerto Rican economy is affected by a number of Commonwealth and Federal investment incentive programs. For example, Section 936 of the Internal Revenue Code (the 'Code') provides for a credit against Federal income taxes for U.S. companies operating on the island if certain requirements are met. The

Omnibus Budget Reconciliation Act of 1993 imposes limits on such credit, effective for tax years beginning after 1993. In addition, from time to time proposals are introduced in Congress which, if enacted into law, would eliminate some or all of the benefits of Section 936. Although no assessment can be made at this time of the precise effect of such limitation, it is expected that the limitation of Section 936 credits would have a negative impact on Puerto Rico's economy.

In a plebiscite held in November, 1993, the Puerto Rican electorate chose to continue Puerto Rico's Commonwealth status. Previously proposed legislation, which was not enacted, would have preserved the Federal tax exempt status of the outstanding debts of Puerto Rico and its public corporations regardless of the outcome of the referendum, to the extent that similar obligations issued by the states are so treated and subject to the provisions of the Code currently in effect. There can be no assurance that any pending or future legislation finally enacted will include the same or similar protection against loss or tax exemption. The November 1993 plebiscite can be expected to have both direct and indirect consequences on such matters as the basic characteristics of future Puerto Rico debt obligations, the markets for these obligations, and the types, levels and quality of revenue sources pledged for the payment of existing and future debt obligations. Such possible consequences include, without limitation, legislative proposals seeking restoration of the status of Section 936 benefits otherwise subject to the limitations discussed above. However, no assessment can be made at this time of the economic and other effects of a change in federal laws affecting Puerto Rico as a result of the November 1993 plebiscite.

#### PUBLIC SALE OF UNITS--

The quantity discount to sales charges applies to all purchases of Municipal Investment Trust Fund units in the secondary market on the same day, irrespective of any differences in their rates of Effective Sales Charge. The limitation to a range of 0.5%, described under Public Sale of Units--Volume Purchase Discounts, has been eliminated.

- - - - -

\* The ratings assigned by the bond rating agencies may change from time to time. Certain of the ratings may be provisional or conditional. See Description of Ratings in Part B.

\*\* Issue currently unrated by both Standard & Poor's and Moody's. See Description of Ratings in Part B.

+ A Fund is considered to be 'concentrated' in a category when the Securities in that category constitute 25% or more of the aggregate face amount of the Portfolio. See Risk Factors in Parts B and C for a description of certain investment risks relating to these types of obligations.

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DEFINED ASSET FUNDS - MUNICIPAL INVESTMENT TRUST FUND,  
NEW YORK SERIES - 28

#### REPORT OF INDEPENDENT ACCOUNTANTS

The Sponsors, Trustee and Holders  
of Defined Asset Funds - Municipal Investment Trust Fund,  
New York Series - 28:

We have audited the accompanying statement of condition of Defined Asset Funds - Municipal Investment Trust Fund, New York Series - 28, including the portfolio, as of April 30, 1994 and the related statements of operations and of changes in net assets for the years ended April 30, 1994, 1993 and 1992. These financial statements are the responsibility of the Trustee. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Securities owned at April 30, 1994, as shown in such portfolio, were confirmed to us by The Bank of New York, the Trustee. An audit also includes assessing the accounting principles used and significant estimates made by the Trustee, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Defined Asset Funds - Municipal Investment Trust Fund, New York Series - 28 at April 30, 1994 and the results of its operations and changes in its net assets for the above-stated years in conformity with generally accepted accounting principles.

New York, N.Y.  
June 16, 1994

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DEFINED ASSET FUNDS - MUNICIPAL INVESTMENT TRUST FUND,  
NEW YORK SERIES - 28

STATEMENT OF CONDITION  
AS OF APRIL 30, 1994

<S>	<C>	<C>
TRUST PROPERTY:		
Investment in marketable securities - at value (cost \$4,494,582) (Note 1).....		\$5,399,051
Securities called for redemption (cost \$39,038) (Note 5).....		46,350
Accrued interest receivable.....		168,961
Cash.....		71,875
		<hr/>
Total trust property.....		\$5,686,237 =====
NET ASSETS, REPRESENTED BY:		
14,266 units of fractional undivided interest outstanding (Note 3).....	\$5,451,776	
Undistributed net investment income.....	234,461	
	<hr/>	\$5,686,237 =====
UNIT VALUE ( \$5,686,237/14,266 units).....		\$398.59 =====

&lt;/TABLE&gt;

See Notes to Financial Statements.

DEFINED ASSET FUNDS - MUNICIPAL INVESTMENT TRUST FUND,  
NEW YORK SERIES - 28

<TABLE>  
<CAPTION>  
STATEMENTS OF OPERATIONS

	.....Years Ended April 30,.....			
	1994	1993	1992	
<S>	<C>	<C>	<C>	<C>
INVESTMENT INCOME:				
Interest income.....	\$488,843	\$ 664,794	\$785,482	
Trustee's fees and expenses.....	(13,716)	(15,404)	(17,152)	
Net investment income.....	475,127	649,390	768,330	
REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS:				
Realized gain on securities sold or redeemed.....	75,697	175,764	53,147	
Unrealized appreciation (depreciation) of investments.....	(604,633)	175,045	76,641	
Net realized and unrealized gain (loss) on investments.....	(528,936)	350,809	129,788	
NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS.....	\$ (53,809)	\$1,000,199	\$898,118	

</TABLE>

See Notes to Financial Statements.

DEFINED ASSET FUNDS - MUNICIPAL INVESTMENT TRUST FUND,  
NEW YORK SERIES - 28

<TABLE>  
<CAPTION>  
STATEMENTS OF CHANGES IN NET ASSETS

<S>	.....Years Ended April 30,.....			
	1994	1993	1992	<C>
OPERATIONS:				
Net investment income.....	\$ 475,127	\$ 649,390	\$ 768,330	
Realized gain on securities sold or redeemed.....	75,697	175,764	53,147	
Unrealized appreciation (depreciation) of investments.....	(604,633)	175,045	76,641	
Net increase (decrease) in net assets resulting from operations.....	(53,809)	1,000,199	898,118	
DISTRIBUTIONS TO HOLDERS (Note 2):				
Income.....	(548,159)	(665,744)	(887,258)	
Principal.....	(1,765,521)	(2,452,832)	(149,149)	
Total distributions.....	(2,313,680)	(3,118,576)	(1,036,407)	
CAPITAL SHARE TRANSACTIONS-Redemptions of 206, 250 and 466 units, respectively.....	(100,487)	(139,703)	(330,067)	
NET DECREASE IN NET ASSETS.....	(2,467,976)	(2,258,080)	(468,356)	
NET ASSETS AT BEGINNING OF YEAR.....	8,154,213	10,412,293	10,880,649	
NET ASSETS AT END OF YEAR.....	\$5,686,237	\$8,154,213	\$10,412,293	
PER UNIT:				
Income distributions during year.....	\$38.12	\$45.27	\$59.16	
Principal distributions during year.....	\$122.93	\$166.61	\$10.01	
Net asset value at end of year.....	\$398.59	\$563.45	\$707.26	
TRUST UNITS OUTSTANDING AT END OF YEAR.....	14,266	14,472	14,722	

See Notes to Financial Statements.

DEFINED ASSET FUNDS - MUNICIPAL INVESTMENT TRUST FUND,  
NEW YORK SERIES - 28

NOTES TO FINANCIAL STATEMENTS



1. SIGNIFICANT ACCOUNTING POLICIES

The Fund is registered under the Investment Company Act of 1940 as a Unit Investment Trust. The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements. The policies are in conformity with generally accepted accounting principles.

- (a) Securities are stated at value as determined by the Evaluator based on bid side evaluations for the securities. See "Redemption - Computation of Redemption Price Per Unit" in this Prospectus, Part B.
- (b) The Fund is not subject to income taxes. Accordingly, no provision for such taxes is required.
- (c) Interest income is recorded as earned.

2. DISTRIBUTIONS

A distribution of net investment income is made to Holders each month. Receipts other than interest, after deductions for redemptions and applicable expenses, are distributed as explained in "Administration of the Fund - Accounts and Distributions" in this Prospectus, Part B.

3. NET CAPITAL

<TABLE>	
<S>	<C>
Cost of 14,266 units at Date of Deposit.....	\$13,953,432
Less sales charge.....	544,105
Net amount applicable to Holders.....	13,409,327
Redemptions of units - net cost of 1,734 units redeemed less redemption amounts.....	425,590
Realized gain on securities sold or redeemed.....	548,789
Principal distributions.....	(9,843,711)
Unrealized appreciation of investments.....	911,781
Net capital applicable to Holders.....	\$ 5,451,776
</TABLE>	

4. INCOME TAXES

As of April 30, 1994, unrealized appreciation of investments (including securities called for redemption), based on cost for Federal income tax purposes, aggregated \$11,781, all of which related to appreciated securities. The cost of investment securities for Federal income tax purposes was \$4,533,620 at April 30, 1994.

NOTES TO FINANCIAL STATEMENTS

5. SECURITIES CALLED FOR REDEMPTION

\$45,000 face amount of New York State Medical Care Facilities Finance Agency, Hospital and Nursing Home Project Bonds, were called for redemption on May 2, 1994. Such securities are valued at the amount of the proceeds subsequently received.

DEFINED ASSET FUNDS - MUNICIPAL INVESTMENT TRUST FUND,  
 NEW YORK SERIES - 28

PORTFOLIO  
 AS OF APRIL 30, 1994

<TABLE>  
 <CAPTION>

Portfolio No. and Title of Securities	Rating of Issues (1)	Face Amount	Coupon	Maturities (3)	Optional Redemption Provisions (3)	Cost	Value (2)
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>

1	Dormitory Authority of the State of New York, GNMA Collateralized Hospital Bonds, Series A (St. Vincent's Hospital and Medical Center)	AAA	\$ 195,000	8.125%	2013	Currently	\$ 195,975	\$ 196,862
2	New York State Housing Finance Agency, Health Facilities Bonds, 1979 Series A	AAA	475,000	7.600	2004	None	424,531	503,196
3	New York State Housing Finance Agency, Mental Hygiene Improvement Bonds	AAA	1,600,000	6.400	2007	None	1,238,000	1,607,152
4	New York State Housing Finance Agency, Urban Rental Project Bonds	A	600,000	6.000	2010	Currently	414,000	598,752
5	New York State Medical Care Facilities Finance Agency, Hospital and Nursing Home Project Bonds, 1979 Series A	BBB	475,000	7.400	2016	Currently	412,064	490,257
6	New York State Power Authority, Gen. Purpose Rev. Bnds., Series C	AAA	495,000	9.500	2001	None	538,312	554,390
7	Battery Park City Authority, New York, POD - III Housing Revenue Bonds (FHA-Insured Mortgage)	NR	190,000	8.625	2023 (4)	06/01/05 @ 100.000	186,675	228,918
8	Commonwealth of Puerto Rico, Pub. Imp. Bnds. of 1980 (G.O. Bonds)	AAA	1,110,000	9.375	2005 (4)	07/01/95 @ 104.000	1,085,025	1,219,524
TOTAL			<u>\$5,140,000</u>				<u>\$4,494,582</u>	<u>\$5,399,051</u>

See Notes to Portfolio.

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</TABLE>

DEFINED ASSET FUNDS - MUNICIPAL INVESTMENT TRUST FUND,

NEW YORK SERIES - 28

NOTES TO PORTFOLIO  
AS OF APRIL 30, 1994

(1) A description of the rating symbols and their meanings appears under "Description of Ratings" in this Prospectus, Part B. Ratings, which have been provided by the Evaluator, are by Standard & Poor's (when available) or by Moody's Investors Service (as indicated by "m") when Standard & Poor's ratings are not available. "NR", if applicable, indicates that this security is not currently rated by either rating service.

(2) See Notes to Financial Statements.

(3) Optional redemption provisions, which may be exercised in whole or in part, are initially at prices of par plus a premium, then subsequently at prices declining to par. Certain securities may provide for redemption at par prior or in addition to any optional or mandatory redemption dates or maturity, for example, through the operation of a maintenance and replacement fund, if proceeds are not able to be used as contemplated, the

project is condemned or sold or the project is destroyed and insurance proceeds are used to redeem the securities. Many of the securities are also subject to mandatory sinking fund redemption commencing on dates which may be prior to the date on which securities may be optionally redeemed. Sinking fund redemptions are at par and redeem only part of the issue. Some of the securities have mandatory sinking funds which contain optional provisions permitting the issuer to increase the principal amount of securities called on a mandatory redemption date. The sinking fund redemptions with optional provisions may, and optional refunding redemptions generally will, occur at times when the redeemed securities have an offering side evaluation which represents a premium over par. To the extent that the securities were acquired at a price higher than the redemption price, this will represent a loss of capital when compared with Public Offering Price of the Units when acquired. Distributions will generally be reduced by the amount of the income which would otherwise have been paid with respect to redeemed securities and there will be distributed to Holders any principal amount and premium received on such redemption after satisfying any redemption requests for Units received by the Fund. The estimated current return may be affected by redemptions. The tax effect on Holders of redemptions and related distributions is described under "Taxes" in this Prospectus, Part B.

(4) Bonds with an aggregate face amount of \$1,300,000 have been pre-refunded and are expected to be called for redemption on the optional redemption provision dates shown.

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DEFINED ASSET FUNDS--  
MUNICIPAL INVESTMENT TRUST FUND  
NEW YORK SERIES

I want to learn more about automatic reinvestment in the Investment Accumulation Program. Please send me information about participation in the Municipal Fund Accumulation Program, Inc. and a current Prospectus.

My name (please print) \_\_\_\_\_

My address (please print):  
Street and Apt. \_\_\_\_\_

No. \_\_\_\_\_  
City, State, Zip \_\_\_\_\_

Code \_\_\_\_\_

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NEW YORK, N.Y. 10268-0974

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(Fold along this line.)  
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DEFINED ASSET FUNDS  
MUNICIPAL INVESTMENT TRUST FUND

AMT MONTHLY PAYMENT SERIES	MONTHLY PAYMENT SERIES
CALIFORNIA SERIES	MULTISTATE SERIES
CALIFORNIA INSURED SERIES	NEW YORK SERIES
FLORIDA INSURED SERIES	NEW YORK INSURED SERIES
FLOATING RATE SERIES	NEW YORK PUT SERIES
MBIA SERIES	NEW JERSEY SERIES
INSURED SERIES	OHIO SERIES
INTERMEDIATE TERM SERIES	PENNSYLVANIA SERIES
MASSACHUSETTS SERIES	PUT SERIES
MICHIGAN SERIES	TEXAS INSURED SERIES
MINNESOTA SERIES	

PROSPECTUS, PART B

NOTE: PART B OF THIS PROSPECTUS MAY NOT BE DISTRIBUTED UNLESS ACCOMPANIED BY  
PART A.  
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FUND SUMMARY

RISK FACTORS. Certain Debt Obligations may be redeemed or prepaid from time to time pursuant to optional refunding or sinking fund redemption provisions or may mature according to their terms or be sold under certain circumstances described herein; accordingly, no assurance can be given that the Fund will retain for any length of time its present size and composition (see Payment of the Debt Obligations and Life of the Fund; Redemption; Administration of the Fund--Portfolio Supervision). Units offered hereby may reflect redemptions, prepayments, defaults or dispositions of Securities originally deposited in the Fund. A reduction in the value of a Unit resulting from these events does not mean that a Unit is valued at a market discount; market discounts, as well as market premiums, on Units are determined solely by a comparison of a Unit's outstanding face amount and its evaluated price. As they approach maturity, discount securities tend to increase in market value while premium securities tend to decrease in market value. If currently prevailing interest rates for newly issued and otherwise comparable

securities decline, the market discount of previously issued securities will be reduced and the market premium of previously issued securities will increase. Conversely, if currently prevailing interest rates increase, the market discount of previously issued securities will become deeper and the market premium of previously issued securities will decline. (See Special Considerations.) The Investment Summary in Part A sets forth the percentages of the aggregate face amount of the Portfolio valued at a discount from the par (maturity) value and at a premium over par and sets forth the face amount of Securities underlying each Unit and the value of the Unit as of the evaluation date.

THE PUBLIC OFFERING PRICE of the Units is generally based on the Evaluator's determination of the aggregate bid side evaluation of the underlying Securities divided by the number of Units outstanding. A sales charge (set forth under Investment Summary in Part A) is added. The sales charge will vary

depending on the maturities of the underlying Securities and is reduced on a graduated scale for purchases of 250 or more Units. Units are offered at the Public Offering Price, computed as of the Evaluation Time for all sales made subsequent to the previous evaluation, plus cash adjustments and accrued interest. The Public Offering Price on the date of this Prospectus or on any subsequent date will vary from the Public Offering Price set forth under Investment Summary in Part A. (See Public Sale of Units--Public Offering Price.) Units offered hereby are issued and outstanding Units which have been purchased by the Sponsors in the secondary market or from the Trustee following tender for redemption. Units purchased by the Sponsors in the secondary market or from the Trustee upon tender may be reoffered at the Public Offering Price, deposited in a new series or tendered to the Trustee for redemption. The profit or loss resulting from the sale of Units will accrue to the Sponsors. No proceeds from the sale will be received by the Fund.

**MARKET FOR UNITS.** The Sponsors, though not obligated to do so, intend to maintain a secondary market for Units at prices based for most Series on the Evaluator's determination of the aggregate bid side evaluation of the underlying Securities (see Market for Units). So long as the Sponsors are maintaining a secondary market at prices not less than the Redemption Price per Unit, they will repurchase any Units tendered for redemption. If this market is not maintained, a Holder will be able to dispose of his Units through redemption at prices also based on the aggregate bid side evaluation of the underlying Securities. Market conditions may cause the prices available in the market maintained by the Sponsors or available upon exercise of redemption rights to be more or less than the amount paid for Units (see Redemption).

**ESTIMATED CURRENT RETURN; ESTIMATED LONG-TERM RETURN.** Estimated Current Return on a Unit represents annual cash receipts from coupon-bearing debt obligations (after estimated annual expenses) divided by the maximum Public Offering Price (including the sales charge). 'Current return' provides different information than 'yield' or 'long-term return', which involves a computation of yield to maturity (or earlier call date) and takes into account not only the interest payable on the bonds but also the amortization or accretion to a specified date of any premium over or discount from the par (maturity) value in the bond's purchase price. Long-term return on Units in the secondary market will generally be lower, sometimes significantly, than current return. Estimated Long-Term Return on a Unit shows a net annual long-term return to investors holding to maturity based on the individual Debt Obligations in the Portfolio weighted to reflect the time to maturity (or in certain cases to an earlier call date) and market value of each Debt Obligation in the Portfolio, adjusted to reflect the Public Offering Price (including the maximum applicable sales charge) and estimated expenses. The net annual interest rate per Unit and the net annual long-term return to investors will vary with changes in the fees and expenses of the Trustee and Sponsors and the fees of the Evaluator which are paid by the Fund, and with the exchange, redemption, sale, prepayment or maturity of the underlying Securities; the Public Offering Price will vary with

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any reduction in sales charges paid in the case of quantity purchases of Units, as well as with fluctuations in the offering side evaluation of the underlying Securities. Therefore, it can be expected that the Estimated Current Return and Estimated Long-Term Return will fluctuate in the future. Both current return and long-term return to an investor may be substantially lower than originally estimated (see Description of the Fund--Income; Estimated Current Return; Estimated Long-Term Return).

**DISTRIBUTIONS** of interest and any principal or premium received by the Fund WILL BE PAID IN CASH unless the Holder elects to reinvest in The Municipal Fund Accumulation Program, Inc. Holders will be taxed in the manner described under Taxes regardless of whether distributions from the Fund are actually received by the Holders or are automatically reinvested. For more complete information about the Program, including charges and expenses, return the enclosed card for a prospectus. Read it carefully before you decide to participate. Also, see Administration of the Fund--Investment Accumulation Program.

**TAXATION.** In the opinion of special counsel to the Sponsors, each Holder will be considered to have received the interest on his pro rata portion of each Debt Obligation (including debt obligations in any Other Funds) when interest on the Debt Obligation is received by the Fund or an Other Fund, as the case may be. In the opinion of bond counsel rendered on the date of issuance of the Debt Obligation, that interest is excludable from gross income for regular Federal income tax purposes under existing law (except in certain circumstances depending on the Holder) but may be subject to state and local taxes; for State and Multistate Series, that interest is also exempt from certain state and local personal income taxes of the state for which the Trust is named (except in certain circumstances depending on the Holder) but may be subject to other state and local taxes. Capital gains, if any, are subject to tax. (See Taxes.)

#### FUND STRUCTURE

The Fund (including for all purposes hereunder each Trust of a series such as a Multistate Series), a series of Municipal Investment Trust Fund, is a 'unit investment trust' created under New York law by a Trust Indenture (the

'Indenture') among the Sponsors, the Trustee and the Evaluator. To the extent that references in this Prospectus are to articles and sections of the Indenture, which are hereby incorporated by reference, the statements made herein are qualified in their entirety by this reference. The Fund may be an appropriate investment vehicle for investors who desire to participate in a portfolio of tax-exempt securities with greater diversification than they might be able to acquire individually. In addition, bonds of the type deposited in the Fund often are not available in small amounts.

The holders ('Holders') of units of interest ('Units') will have the right to have their Units redeemed (see Redemption) at a price based on the aggregate bid side evaluation of the Securities ('Redemption Price per Unit') if the Units cannot be sold in the over-the-counter market which the Sponsors propose to maintain at prices determined in the same manner (see Market for Units). The Fund will not continuously offer Units for sale to the public. On the Evaluation Date, each Unit represented the fractional undivided interest in the Securities and net income of the Fund set forth under Investment Summary in Part A. Thereafter, if any Units are redeemed, the face amount of Securities in the Fund will be reduced and the fractional undivided interest represented by each remaining Unit in the balance will be increased. Units will remain outstanding until redeemed upon tender to the Trustee by any Holder (which may include the Sponsors) or until termination of the Indenture (see Redemption; Administration of the Fund--Amendment and Termination).

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The Units being offered by this Prospectus are issued and outstanding Units which have been reacquired by the Sponsors either by purchase in the open market or by purchase of Units tendered to the Trustee for redemption. No offering is being made on behalf of the Fund and any profit or loss realized on the sale of Units will accrue to the Sponsors.

#### RISK FACTORS

An investment in Units of the Fund (except Floating Rate and Put Series) should be made with an understanding of the risks which an investment in fixed-rate debt obligations may entail, including the risk that the value of the Portfolio and hence of the Units will decline with increases in interest rates. Investors in Floating Rate Series should understand the nature of floating-rate obligations as described below. In recent years there have been wide fluctuations in interest rates and thus in the value of fixedrate debt obligations generally. The Sponsors cannot predict future economic policies or their consequences or, therefore, the course or extent of any similar fluctuations in the future. Furthermore, since the issuers of the Debt Obligations are state and local governmental entities, political restrictions on the ability to tax and budgetary constraints affecting the state government, particularly in the current recessionary climate, may result in reductions of or delays in the payment of state aid to cities, counties, school districts and other local units of government, which in turn, may strain the financial operations and have an adverse impact on the creditworthiness of these entities. State agencies, colleges and universities and healthcare organizations, with municipal debt outstanding, may also be negatively impacted by reductions in state appropriations. To the extent that payment of amounts due on Debt Obligations depends on revenue from publicly held corporations, an investor should understand that these Debt Obligations, in many cases, do not have the benefit of covenants which would prevent the corporations from engaging in capital restructurings or borrowing transactions in connection with corporate acquisitions, leveraged buyouts or restructurings, which could have the effect of reducing the ability of the corporation to meet its obligations and may in the future result in the ratings of the Debt Obligations and the value of the underlying Portfolio being reduced.

Units offered in the secondary market may reflect redemptions or prepayments, in whole or in part, or defaults on, certain of the Securities originally deposited in the Fund or the disposition of certain Securities originally deposited in the Fund to satisfy redemptions of Units or pursuant to the exercise by the Sponsors of their supervisory role over the Fund (see Risk Factors--Payment of the Debt Obligations and Life of the Fund and Administration of the Fund--Portfolio Supervision). Accordingly, the face amount of Units may be less than their original face amount at the time of the creation of the Fund. A reduced value per Unit does not therefore mean that a Unit is necessarily valued at a market discount; market discounts, as well as market premiums, on Units are determined solely by a comparison of a Unit's outstanding face amount and its evaluated price.

Certain of the Securities in the Fund may be valued at a market discount. Securities trade at less than par value because the interest rates on the Securities are lower than interest on comparable debt securities being issued at currently prevailing interest rates. The current returns of securities trading at a market discount are lower than the current returns of comparably rated debt securities of a similar type issued at currently prevailing interest rates because discount securities tend to increase in market value as they approach maturity and the full principal amount becomes payable. If currently prevailing interest rates for newly issued and otherwise comparable securities increase, the market discount of previously issued securities will become deeper and if

currently prevailing interest rates for newly issued comparable securities decline, the market discount of

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previously issued securities will be reduced, other things being equal. Market discount attributable to interest rate changes does not indicate a lack of market confidence in the issue.

Certain of the Securities in the Fund may be valued at a market premium. Securities trade at a premium because the interest rates on the Securities are higher than interest rates on comparable debt securities being issued at currently prevailing interest rates. The current returns of securities trading at a market premium are higher than the current returns of comparably rated debt securities of a similar type issued at currently prevailing interest rates because premium securities tend to decrease in market value as they approach maturity when the face amount becomes payable. Because part of the purchase price is thus returned not at maturity but through current income payments, an early redemption of a premium security at par will result in a reduction in yield. If currently prevailing interest rates for newly issued and otherwise comparable securities increase, the market premium of previously issued securities will decline and if currently prevailing interest rates for newly issued comparable securities decline, the market premium of previously issued securities will increase, other things being equal. Market premium attributable to interest rate changes does not indicate market confidence in the issue.

The Securities are generally not listed on a national securities exchange. Whether or not the Securities are listed, the principal trading market for the Securities will generally be in the over-the-counter market. As a result, the existence of a liquid trading market for the Securities may depend on whether dealers will make a market in the Securities. There can be no assurance that a market will be made for any of the Securities, that any market for the Securities will be maintained or of the liquidity of the Securities in any markets made. In addition, the Fund may be restricted under the Investment Company Act of 1940 from selling Securities to any Sponsor. The price at which the Securities may be sold to meet redemptions and the value of the Fund will be adversely affected if trading markets for the Securities are limited or absent.

FLOATING RATE SERIES. The interest rate on most floating-rate obligations is tied to one or more 'prime rates,' which is generally the rate charged by a bank to its most creditworthy customers for short term loans. The prime rate of a particular bank may differ from other banks and will be the rate announced by each bank on a particular day. Changes in the prime rate may occur with great frequency and generally become effective on the date announced. In the past there have been wide fluctuations in prime rates, although the Sponsors cannot predict whether these fluctuations will continue. While the value of the underlying Debt Obligations may change with changes in interest rates generally, the floating rate nature of the underlying Debt Obligations in Floating Rate Series should decrease changes in value. Accordingly, as interest rates decrease or increase the potential for capital appreciation and the risk of potential capital depreciation is less than would be the case with a portfolio of fixed income securities. The portfolio of any Floating Rate Series may contain Debt Obligations on which stated minimum and maximum rates limit the degree to which interest on the Debt Obligations may fluctuate (see Portfolio in Part A); to the extent they do, increases or decreases in value may be somewhat greater than would be the case without such limits. Because the adjustment of interest rates on the floating-rate debt obligations is made in relation to movements of the applicable banks' prime rates, the Debt Obligations are not comparable to long-term fixed-rate securities. Accordingly, interest rates on floating-rate debt obligations may be higher or lower than current market rates for fixed-rate debt obligations of comparable quality with similar maturities.

INTEREST RATE SWAP (OR EXCHANGE) AGREEMENTS. The indentures governing the Debt Obligations may permit an issuer of Debt Obligations to enter into interest rate swap (or exchange) agreements ('Swap Agreements') with another party (each such counterparty a 'Swap Counterparty'). Under a Swap Agreement, the Swap Counterparty will agree to pay the trustee of any affected Debt Obligation on each interest payment date a fixed

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interest rate on the notional amount outstanding and the issuer will agree to pay on each interest payment date, by causing the trustee to pay, the Swap Counterparty a variable interest rate. The payment obligations of the issuer and the Swap Counterparty to each other will be netted on each interest payment date and only one payment will be made by one party to the other. At such times that the fixed interest rate being paid by the Swap Counterparty is greater than the variable interest rate, the ability of the trustee of any affected Debt Obligation to make interest payments on the Debt Obligation will be affected by the Swap Counterparty's ability to meet its net payment obligation to the trustee. Typically, there is a provision for minimum rating of long-term obligations of the Swap Counterparty. Any interest rate swap or exchange agreement is subject to a determination by the relevant rating agency or agencies that there is no adverse impact on rating of the Debt Obligations. However, the issuer must have received written confirmation from the relevant



rating agency or agencies that the execution and delivery of such agreement will not result in the lowering or withdrawal of any rating assigned to any of the Debt Obligations. The Swap Counterparty to the Swap Agreement will be selected by the issuer prior to the issuance of the Debt Obligations from a list of potential counterparties approved by the issuer.

As set forth under Investment Summary in Part A, the Fund may contain or be concentrated in one or more of the classifications of Debt Obligations referred to below. An investment in Units of the Fund should be made with an understanding of the risks which these investments may entail, certain of which are described below.

#### GENERAL OBLIGATION BONDS

Certain of the Debt Obligations in the Portfolio may be general obligations of a governmental entity that are secured by the taxing power of the entity. 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, including an erosion of the tax base due to population declines, natural disasters, declines in the state's industrial base or inability to attract new industries, economic limits on the ability to tax without eroding the tax base and the extent to which the entity relies on Federal or state aid, access to capital markets or other factors beyond the entity's control.

As a result of the recent recession's adverse impact upon both their revenues and expenditures, as well as other factors, many state and local governments are confronting deficits and potential deficits which are the most severe in recent years. Many issuers are facing highly difficult choices about significant tax increases and/or spending reductions in order to restore budgetary balance. Failure to implement these actions on a timely basis could force the issuers to depend upon market access to finance deficits and/or cash flow needs.

In addition, certain of the Debt Obligations in the Fund may be obligations of issuers (including California issuers) who rely in whole or in part on ad valorem real property taxes as a source of revenue. Certain proposals, in the form of state legislative proposals or voter initiatives, to limit ad valorem real property taxes have been introduced in various states and an amendment to the constitution of the state of California, commonly referred to as 'Proposition 13', provided for strict limitations on ad valorem real property taxes and has had a significant impact on the taxing powers of local governments and on the financial conditions of school districts and local governments in California. It is not possible at this time to predict the final impact of Proposition 13, or of similar future legislative or constitutional measures, on school districts and local governments or on their abilities to make future payments on their outstanding debt obligations.

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#### MORAL OBLIGATION BONDS

The Fund may also include 'moral obligation' bonds. If an issuer of moral obligation bonds is unable to meet its obligations, the repayment of the bonds becomes a moral commitment but not a legal obligation of the state or municipality in question. Even though the state may be called on to restore any deficits in capital reserve funds of the agencies or authorities which issued the bonds, any restoration generally requires appropriation by the state legislature and accordingly does not constitute a legally enforceable obligation or debt of the state. The agencies or authorities generally have no taxing power.

#### REFUNDED DEBT OBLIGATIONS

Refunded Debt Obligations 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 noncallable 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.

#### INDUSTRIAL DEVELOPMENT REVENUE BONDS ('IDRS')

IDRs, including pollution control revenue bonds, are tax-exempt securities issued by states, municipalities, public authorities or similar entities ('issuers') to finance the cost of acquiring, constructing or improving various projects, including pollution control facilities and certain industrial development facilities. 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 under arrangements between the issuer and the corporate operator of a project. These arrangements may be in the form of a

lease, installment sale agreement, conditional sale agreement or loan agreement, but in each case the payments to the issuer are designed to be sufficient to meet the payments of amounts due on the IDRs.

IDRs are generally issued under bond resolutions, agreements or trust indentures pursuant to which the revenues and receipts payable under the issuer's arrangements with the corporate operator of a particular project have been assigned and pledged to the holders of the IDRs or a trustee for the benefit of the holders of the IDRs. In certain cases, a mortgage on the underlying project has been assigned to the holders of the IDRs or a trustee as additional security for the IDRs. In addition, IDRs are frequently directly guaranteed by the corporate operator of the project or by another affiliated company. Regardless of the structure, payment of IDRs is solely dependent upon the creditworthiness of the corporate operator of the project or corporate guarantor. 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. These include cyclicality of revenues and earnings, regulatory and environmental restrictions, litigation resulting from accidents or environmentally-caused illnesses, extensive competition (including that of low-cost foreign companies), unfunded pension fund liabilities or off-balance sheet items, and financial deterioration resulting from leveraged buy-outs or takeovers. In certain cases, the different industry groups on behalf of which the IDRs in the Portfolio are issued may be set forth under the Investment Summary. In addition, as discussed below, certain of the IDRs in the Portfolio may be additionally insured or secured by letters of credit issued by banks or otherwise guaranteed or secured to cover amounts due on the IDRs in the event of default in payment by an issuer.

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#### STATE AND LOCAL MUNICIPAL UTILITY OBLIGATIONS

The electric utility industry in general is subject to various external factors including (a) the effects of inflation upon the costs of operation and construction, (b) substantially increased capital outlays and longer construction periods for larger and more complex new generating units, (c) uncertainties in predicting future load requirements, (d) increased financing requirements coupled with limited availability of capital, (e) exposure to cancellation and penalty charges on new generating units under construction, (f) problems of cost and availability of fuel, (g) compliance with rapidly changing and complex environmental, safety and licensing requirements, (h) litigation and proposed legislation designed to delay or prevent construction of generating and other facilities, (i) the uncertain effects of conservation on the use of electric energy, (j) uncertainties associated with the development of a national energy policy, (k) regulatory, political and consumer resistance to rate increases and (l) increased competition as a result of the availability of other energy sources. These factors may delay the construction and increase the cost of new facilities, limit the use of, or necessitate costly modifications to, existing facilities, impair the access of electric utilities to credit markets, or substantially increase the cost of credit for electric generating facilities. In addition, there are various proposals for a new energy tax before Congress. The Sponsors cannot predict at this time the ultimate effect of such factors on the ability of any issuers to meet their obligations with respect to Debt Obligations.

The National Energy Policy Act ('NEPA'), which became law in October, 1992, makes it mandatory for a utility to permit non-utility generators of electricity access to its transmission system for wholesale customers, thereby increasing competition for electric utilities. NEPA also mandated demand-side management policies to be considered by utilities. NEPA prohibits the Federal Energy Regulatory Commission from mandating electric utilities to engage in retail wheeling, which is competition among suppliers of electric generation to provide electricity to retail customers (particularly industrial retail customers) of a utility. However, under NEPA, a state can mandate retail wheeling under certain conditions.

There is concern by the public, the scientific community, and the U.S. Congress regarding environmental damage resulting from the use of fossil fuels. Congressional support for the increased regulation of air, water, and soil contaminants is building and there are a number of pending or recently enacted legislative proposals which may affect the electric utility industry. In particular, on November 15, 1990, legislation was signed into law that substantially revises the Clean Air Act (the '1990 Amendments'). The 1990 Amendments seek to improve the ambient air quality throughout the United States by the year 2000. A main feature of the 1990 Amendments is the reduction of sulphur dioxide and nitrogen oxide emissions caused by electric utility power plants, particularly those fueled by coal. Under the 1990 Amendments the U.S. Environmental Protection Agency ('EPA') must develop limits for nitrogen oxide emissions by 1993. The sulphur dioxide reduction will be achieved in two phases. Phase I addresses specific generating units named in the 1990 Amendments. In Phase II the total U.S. emissions will be capped at 8.9 million tons by the year 2000. The 1990 Amendments contain provisions for allocating allowances to power plants based on historical or calculated levels. An allowance is defined as the authorization to emit one ton of sulphur dioxide.

The 1990 Amendments also provide for possible further regulation of toxic air emissions from electric generating units pending the results of several federal government studies to be conducted over the next three to four years with respect to anticipated hazards to public health, available corrective technologies, and mercury toxicity.

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Electric utilities which own or operate nuclear power plants are exposed to risks inherent in the nuclear industry. These risks include exposure to new requirements resulting from extensive federal and state regulatory oversight, public controversy, decommissioning costs, and spent fuel and radioactive waste disposal issues. While nuclear power construction risks are no longer of paramount concern, the emerging issue is radioactive waste disposal. In addition, nuclear plants typically require substantial capital additions and modifications throughout their operating lives to meet safety, environmental, operational and regulatory requirements and to replace and upgrade various plant systems. The high degree of regulatory monitoring and controls imposed on nuclear plants could cause a plant to be out of service or on limited service for long periods. When a nuclear facility owned by an investor-owned utility or a state or local municipality is out of service or operating on a limited service basis, the utility operator or its owners may be liable for the recovery of replacement power costs. Risks of substantial liability also arise from the operation of nuclear facilities and from the use, handling, and possible radioactive emissions associated with nuclear fuel. Insurance may not cover all types or amounts of loss which may be experienced in connection with the ownership and operation of a nuclear plant and severe financial consequences could result from a significant accident or occurrence. The Nuclear Regulatory Commission (the 'NRC') has promulgated regulations mandating the establishment of funded reserves to assure financial capability for the eventual decommissioning of licensed nuclear facilities. These funds are to be accrued from revenues in amounts currently estimated to be sufficient to pay for decommissioning costs.

Certain of the problems related to electric utilities particularly affect the bonds of Washington Public Power Supply System ('WPPSS'). The percentage of any WPPSS obligations in the Portfolio is set forth under Investment Summary in Part A. These Debt Obligations were issued to help finance construction of WPPSS nuclear plant Project Nos. 4 and 5. On July 22, 1983, WPPSS declared that it was unable to pay principal and interest on bonds issued to finance nuclear Project Nos. 4 and 5. As a result of the default, interest on any Project Nos. 4 and 5 bonds in the Portfolio has not been accrued since 1983 in computing the sale, redemption and repurchase prices of the Units, and the semiannual interest payments due January 1, 1984 and thereafter on Project Nos. 4 and 5 bonds were not made to bondholders (including the Fund). The following information is based on official statements, annual reports to bondholders by Chemical Bank, the bond trustee, and certain subsequent news reports as well as pleadings and decisions in various court cases.

Following rapidly escalating construction costs and forecasts of a reduction in the need for additional power production, WPPSS terminated construction of Project Nos. 4 and 5 in January 1982. Debt service on the \$2.25 billion face amount of WPPSS bonds outstanding for these projects was payable through revenues received by WPPSS pursuant to agreements (the 'Participants' Agreements') with 88 municipal corporations and cooperatives (the 'Participants'). Under such Participants' Agreements, the Participants were obligated to pay their respective shares of the debt service on the bonds, whether or not the projects were ever completed or put into operation ('take or pay' obligations). On June 15, 1983, the Supreme Court of Washington determined that certain of the Participants located in Washington (holding shares representing approximately one-half of the projects) lacked the authority to enter into the Participants' Agreements and therefore could not be bound by the take or pay obligations contained in such Agreements. On August 9, 1983, a Washington Superior Court Judge ruled that the Participants' Agreements were unenforceable as to the remaining Participants which were not covered by the June 15 decision.

On August 3, 1983, Chemical Bank, the bond trustee, filed suit in Federal court in Seattle, Washington, charging WPPSS, the Participants, the 23 utilities which originally formed WPPSS and various individuals

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including former members of WPPSS' board of directors, with fraud and negligence in connection with the issuance of the bonds for Project Nos. 4 and 5.

A number of class action lawsuits were filed by and on behalf of purchasers of WPPSS Project Nos. 4 and 5 bonds. The suits alleged various Federal securities law violations and sought recovery for damages caused by such violations. Defendants named in the various lawsuits included WPPSS, the Participants, certain engineering firms and consultants for WPPSS, several law firms and securities rating services as well as underwriting firms including Merrill Lynch, Pierce, Fenner & Smith Incorporated and Prudential-Bache Securities Inc.

The class actions were consolidated as In re Washington Public Power Supply System Securities Litigation, MDL 551 ('MDL 551'). The Chemical Bank action and MDL 551 were consolidated for discovery purposes and for trial. Settlement agreements providing for the payment of more than \$686,000,000 were reached with the defendants and approved by the district court. On February 4, 1992 the court of appeals affirmed the district court's approval of the settlement agreements in all respects and also affirmed the district courts' September 16, 1990 approval of a plan for allocation of the settlement proceeds.

On November 3, 1992, the court authorized a partial distribution of the settlement funds to the eligible claimants (including the Trustee). In mid-November 1992, the Trustee received checks equal to substantially all of its portion of the partial distribution. Distributions of the remaining settlement funds and any interest are expected to occur upon the resolution of any disputed claims, a determination of what taxes are payable to the Internal Revenue Service and the amount of the fee award to class plaintiffs' counsel and other entities and a completion of all procedural tasks regarding the court's dismissal of the remaining appeals. Therefore, the Trustee cannot predict when it will receive the distribution of the remaining settlement funds.

Because it is unclear whether certain former or current unitholders are entitled to the recovery, the Trustee cannot at this time make any distribution of the settlement proceeds. The Trustee has brought an action in Federal court in New York to obtain a judicial determination of which class of unitholders should receive the settlement proceeds. The court has been asked to determine if the settlement proceeds should be distributed (a) to some or all of those persons who purchased units prior to June 15, 1983 when the contracts that provided for payment of the Bonds were declared invalid or (b) to those persons who held units when the settlement proceeds were received by the Trustee. It is difficult to estimate how long the court process will take, but during this judicial proceeding the settlement proceeds are being held and invested by the Trustee as agent of the court.

The settlement proceeds received by the Trustee were not deposited in the Trust and therefore the net asset value of the Trust's units does not include any amount reflecting any part of the settlement proceeds. If the settlement proceeds are ultimately distributed by the court to unitholders of record as of a date following the sale or redemption by a unitholder of his or her units, this former unitholder will probably have given up his or her right to a share of the settlement proceeds, regardless of when the units were purchased. In contrast, if the settlement proceeds are allocated by the court to unitholders who purchased or held units during an earlier period, a unitholder's subsequent sale of units will not affect any right to share in the settlement proceeds so long as the unitholder purchased or held units during the appropriate period.

On March 9, 1993, the Trustee received a distribution in partial payment of principal and interest on the WPPSS bonds from Chemical Bank, the bond trustee, to the extent that Bonds were still held in the Trust. The Trustee distributed such partial payment to unitholders of record on March 9, 1993. This distribution was not related to or dependent upon the judicial proceeding regarding the settlement proceeds from the class action

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lawsuits discussed above and reflected amounts in the WPPSS bond fund held by Chemical Bank for the benefit of current WPPSS bond holders under the WPPSS bond indenture. It is not known when Chemical Bank will make any further distributions from the bond fund.

Assuming the market value of the Bonds in the portfolio accurately reflects the value of any future distributions from Chemical Bank, a unitholder should receive substantially the same amount if a unitholder sells his or her units prior to the record date for any future Chemical Bank distribution. However, there can be no assurance that the market value of these Bonds will accurately reflect these distributions because of the uncertainty of the amount that will be distributed and when it will be distributed.

Standard & Poor's Corporation ('Standard & Poor's') downgraded its ratings of bonds for Project Nos. 4 and 5 to 'D' on August 24, 1983, and Moody's Investors Service ('Moody's') has withdrawn its ratings of these bonds.

#### LEASE RENTAL OBLIGATIONS

Lease rental obligations are issued for the most part 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 (administrative offices, convention centers and prisons, for example) or the purchase of equipment (police cars and computer systems, for example) that will be used by a state or local government (the 'lessee'). Thus, the obligations are subject to the ability and willingness of the lessee government to meet its lease rental payments which include debt service on the obligations. Willingness to pay may be subject to changes in the government officials' or citizens' views as to the essential nature of the finance project. Lease rental obligations are subject, in almost all cases, to the annual appropriation risk, i.e., the lessee government is not legally

obligated to budget and appropriate for the rental payments beyond the current fiscal year. These obligations are also subject to the risk of abatement in many states--rental obligations cease in the event that damage, destruction or condemnation of the project prevents its use by the lessee. (In these cases, insurance provisions and reserve funds designed to alleviate this risk become important credit factors). In the event of default by the lessee government, there may be significant legal and/or practical difficulties involved in the re-letting or sale of the project. Some of these issues, particularly those for equipment purchase, contain the so-called 'substitution safeguard', which bars the lessee government, in the event it defaults on its rental payments, from the purchase or use of similar equipment for a certain period of time. This safeguard is designed to insure that the lessee government will appropriate the necessary funds even though it is not legally obligated to do so, but its legality remains untested in most, if not all, states.

#### SINGLE FAMILY AND MULTI-FAMILY HOUSING OBLIGATIONS

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 the revenues derived from mortgage loans to housing projects for low to moderate income families. Single-family mortgage revenue bonds are issued for the purpose of acquiring from originating financial institutions notes secured by mortgages on residences.

Housing obligations are not general obligations of the issuer although certain obligations may be supported to some degree by Federal, state or local housing subsidy programs. Budgetary constraints experienced by these programs as well as the failure by a state or local housing issuer to satisfy the qualifications required for coverage

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under these programs or any legal or administrative determinations that the coverage of these programs is not available to a housing issuer, probably will result in a decrease or elimination of subsidies available for payment of amounts due on the issuer's obligations. The ability of housing issuers to make debt service payments on their obligations will also be affected by various economic and non-economic developments including, among other things, the achievement and maintenance of sufficient occupancy levels and 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, employment and income conditions prevailing in local markets, increases in construction costs, taxes, utility costs and other operating expenses, the managerial ability of project managers, changes in laws and governmental regulations and economic trends generally in the localities in which the projects are situated. Occupancy of multi-family housing projects may also be adversely affected by high rent levels and income limitations imposed under Federal, state or local programs.

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, and 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. Single-family issues are subject to mandatory redemption in whole or in part from prepayments on underlying mortgage loans; mortgage loans are frequently partially or completely prepaid prior to their final stated maturities as a result of events such as declining interest rates, sale of the mortgaged premises, default, condemnation or casualty loss. Multi-family issues are characterized by mandatory redemption at par upon the occurrence of monetary defaults or breaches of covenants by the project operator. Additionally, housing obligations are generally subject to mandatory partial redemption at par to the extent that proceeds from the sale of the obligations are not allocated within a stated period (which may be within a year of the date of issue). To the extent that these obligations were valued at a premium when a Holder purchased Units, any prepayment at par would result in a loss of capital to the Holder and, in any event, reduce the amount of income that would otherwise have been paid to Holders.

The tax exemption for certain housing revenue bonds depends on qualification under Section 143 of the Internal Revenue Code of 1986, as amended (the 'Code'), in the case of single family mortgage revenue bonds or Section 142(a)(7) of the Code or other provisions of Federal law in the case of certain multi-family housing revenue bonds (including Section 8 assisted bonds). These sections of the Code or other provisions of Federal law contain certain ongoing requirements, including requirements relating to the cost and location of the residences financed with the proceeds of the single family mortgage revenue bonds and the income levels of tenants of the rental projects financed with the proceeds of the multi-family housing revenue bonds. While the issuers of the bonds and other parties, including the originators and servicers of the single-family mortgages and the owners of the rental projects financed with the multi-family housing revenue bonds, generally covenant to meet these ongoing requirements and generally agree to institute procedures designed to ensure that these requirements are met, there can be no assurance that these ongoing requirements will be consistently met. The failure to meet these requirements

could cause the interest on the bonds to become taxable, possibly retroactively from the date of issuance, thereby reducing the value of the bonds, subjecting the Holders to unanticipated tax liabilities and possibly requiring the Trustee to sell the bonds at reduced values. Furthermore, any failure to meet these ongoing requirements might not constitute an event of default under the applicable mortgage or permit the holder to accelerate payment of the bond or require the issuer to redeem the bond. In any event, where the mortgage is insured by the Federal Housing Administration, its consent may be required before insurance proceeds would become payable to redeem the mortgage bonds.

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#### HOSPITAL AND HEALTH CARE FACILITY OBLIGATIONS

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, including the level of payments received from private third-party payors and government programs and the cost of providing health care services.

A significant portion of the revenues of hospitals and other health care facilities is derived from private third-party payors and government programs, including the Medicare and Medicaid programs. Both private third-party payors and government programs have undertaken cost containment measures designed to limit payments made to health care facilities. Furthermore, government programs are subject to statutory and regulatory changes, retroactive rate adjustments, administrative rulings and government funding restrictions, all of which may materially decrease the rate of program payments for health care facilities. There can be no assurance that payments under governmental programs will remain at levels comparable to present levels or will, in the future, be sufficient to cover the costs allocable to patients participating in such programs. In addition, there can be no assurance that a particular hospital or other health care facility will continue to meet the requirements for participation in such programs.

The costs of providing health care services are subject to increase as a result of, among other factors, changes in medical technology and increased labor costs. In addition, health care facility construction and operation is subject to federal, state and local regulation relating to the adequacy of medical care, equipment, personnel, operating policies and procedures, rate-setting, and compliance with building codes and environmental laws. Facilities are subject to periodic inspection by governmental and other authorities to assure continued compliance with the various standards necessary for licensing and accreditation. These regulatory requirements are subject to change and, to comply, it 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 subject to claims and legal actions by patients and others in the ordinary course of business. Although these claims are generally covered by insurance, 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. In addition, a substantial increase in the cost of insurance could adversely affect the results of operations of a hospital or other health care facility. The Clinton Administration may impose regulations which could limit price increases for hospitals, the level of reimbursements for third-party payors or other measures to reduce health care costs and make health care available to more individuals, which would reduce profits for hospitals. Some states, such as New Jersey, have significantly changed their reimbursement systems. If a hospital cannot adjust to the new system by reducing expenses or raising rates, financial difficulties may arise. Also, Blue Cross has denied reimbursement for some hospitals for services other than emergency room services. The lost volume would reduce revenue unless replacement patients were found.

Certain hospital bonds may provide for redemption at par at any time upon the sale by the issuer of the hospital facilities to a non-affiliated entity, if the hospital becomes subject to ad valorem taxation, or in various other circumstances. For example, certain hospitals may have the right to call bonds at par if the hospital may be legally required because of the bonds to perform procedures against specified religious principles or to disclose information that it considers confidential or privileged. Certain FHA-insured bonds may provide that all or a portion of those bonds, otherwise callable at a premium, can be called at par in certain circumstances. If a hospital defaults upon a bond obligation, the realization of Medicare and Medicaid receivables may be uncertain and, if the bond obligation is secured by the hospital facilities, legal restrictions on the ability to foreclose upon

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the facilities and the limited alternative uses to which a hospital can be put may severely reduce its collateral value.

The Internal Revenue service is currently engaged in a program of intensive audits of certain tax-exempt hospital and health care facility organizations.

Although these audits have not yet been completed, it has been reported that the tax-exempt status of some of these organizations will be revoked. At this time, it is uncertain whether any of the hospital and health care facility obligations held by the Fund will be affected by such audit proceedings.

#### AIRPORT, PORT AND HIGHWAY REVENUE OBLIGATIONS

Certain facility revenue bonds are payable from and secured by the revenues from the ownership and operation of particular facilities, such as airports (including airport terminals and maintenance facilities), bridges, marine terminals, turnpikes and port authorities. For example, the major portion of gross airport operating income is generally derived from fees received from signatory airlines pursuant to use agreements which consist of annual payments for airport use, occupancy of certain terminal space, facilities, service fees, concessions and leases. Airport operating income may therefore be affected by the ability of the airlines to meet their obligations under the use agreements. The air transport industry is experiencing significant variations in earnings and traffic, due to increased competition, excess capacity, increased aviation fuel and other costs, deregulation, traffic constraints, the current recession and other factors. As a result, several airlines are experiencing severe financial difficulties. Several airlines including Trans World Airlines, Inc. and America West Airlines have sought protection from their creditors under Chapter 11 of the Bankruptcy Code. In addition, other airlines such as Eastern Airlines, Inc., Midway Airlines, Inc. and Pan American Corporation have been liquidated. The Sponsors cannot predict what effect these industry conditions may have on airport revenues which are dependent for payment on the financial condition of the airlines and their usage of the particular airport facility.

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, lower cost of alternative modes of transportation or scarcity of fuel and reduction or loss of rents.

#### 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. All of these factors may be affected by a failure of municipalities to fully utilize the facilities, an insufficient supply of waste for disposal due to economic or population decline, rising construction and maintenance costs, any delays in construction of facilities, lower-cost alternative modes of waste processing and changes in environmental regulations. Because of the relatively short history of this type of financing, there may be technological risks involved in the satisfactory construction or operation of the projects exceeding those associated with most municipal enterprise projects. 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. These costs include compliance with frequently changing and complex regulatory requirements, the

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cost of obtaining construction and operating permits, the cost of conforming to prescribed and changing equipment standards and required methods of operation and, for incinerators or waste-to-energy facilities, the cost of disposing of the waste residue that remains after the disposal process in an environmentally safe manner. In addition, waste disposal facilities frequently face substantial opposition by environmental groups and officials to their location and operation, to the possible adverse effects upon the public health and the environment that may be caused by wastes disposed of at the facilities and to alleged improper operating procedures. Waste disposal facilities benefit from laws which require waste to be disposed of in a certain manner but any relaxation of these laws could cause a decline in demand for the facilities' services. Finally, waste-to-energy facilities are concerned with many of the same issues facing utilities insofar as they derive revenues from the sale of energy to local power utilities (see State and Local Municipal Utility Obligations above).

#### SPECIAL TAX BONDS

Special tax bonds are payable from and secured by the revenues derived by a municipality from a particular tax such as a tax on the rental of a hotel room, on the purchase of food and beverages, on the rental of automobiles or on 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 due

to a general decline in the local economy or population or due to a decline in the consumption, use or cost of the goods and services that are subject to taxation. 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.

#### TRANSIT AUTHORITY OBLIGATIONS

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 such as a sales tax or a property 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.

#### MUNICIPAL 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 failure of municipalities to utilize fully the facilities constructed by these authorities, economic or population decline and resulting decline in revenue from user charges, rising construction and maintenance costs and delays in construction of facilities, impact of environmental requirements, failure or inability to raise user charges in response to increased costs, the difficulty of obtaining or discovering new supplies of fresh water, the effect of conservation programs and the impact of 'no growth' zoning ordinances. In some cases this ability may be affected by the continued availability of Federal and state financial assistance and of municipal bond insurance for future bond issues.

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#### UNIVERSITY AND COLLEGE OBLIGATIONS

The ability of universities and colleges to meet their obligations is dependent upon various factors, including 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, the quality and maintenance costs of campus facilities, and, in the case of public institutions, the financial condition of the relevant state or other governmental entity and its policies with respect to education. The institution's ability to maintain enrollment levels will depend on such factors as tuition costs, demographic trends, geographic location, geographic diversity and quality of the student body, quality of the faculty and the diversity of program offerings.

Legislative or regulatory action in the future at the Federal, state or local level may directly or indirectly affect eligibility standards or reduce or eliminate the availability of funds for certain types of student loans or grant programs, including student aid, research grants and work-study programs, and may affect indirect assistance for education.

#### PUERTO RICO

The Portfolio may contain Debt Obligations of issuers which will be affected by general economic conditions in Puerto Rico. Puerto Rico's unemployment rate remains significantly higher than the U.S. unemployment rate. Furthermore, the economy is largely dependent for its development upon U.S. policies and programs that are being reviewed and may be eliminated.

The Puerto Rican economy is affected by a number of Commonwealth and Federal investment incentive programs. For example, Section 936 of the Internal Revenue Code (the 'Code') provides for a credit against Federal income taxes for U.S. companies operating on the island if certain requirements are met. From time to time proposals are introduced in Congress which, if enacted into law, would eliminate some or all of the benefits of Section 936. Although no assessment can be made at this time of the precise effect of the elimination or limitation of any of these programs, it is expected that the elimination of Section 936 would have a strongly negative impact on Puerto Rico's economy.

Aid for Puerto Rico's economy has traditionally depended heavily on Federal programs, and current Federal budgetary policies suggest that an expansion of aid to Puerto Rico is unlikely. An adverse effect on the Puerto Rican economy could result from other U.S. policies, including a reduction of tax benefits for distilled products, further reduction in transfer payment programs such as food stamps, curtailment of military spending and policies which could lead to a stronger dollar.

Congress is currently considering legislation which provides for a referendum in which the Puerto Rican electorate would decide whether Puerto Rico continues in its current Commonwealth status, becomes a state or gains



independence from the United States. Previously proposed legislation, which was not enacted, would have preserved the federal tax exempt status of the outstanding debts of Puerto Rico and its public corporations regardless of the outcome of the referendum, to the extent that similar obligations issued by states are so treated and subject to the provisions of the Code currently in effect. There can be no assurance that any pending or future legislation finally enacted will include the same or similar protection against loss of tax exemption. Depending on its result, such a referendum can be expected to have both direct and indirect consequences on such matters as the basic characteristics of future Puerto Rico debt obligations, the markets for these obligations, and the types, levels and quality of revenue sources pledged for the payment of existing and future debt obligations, including, without

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limitation, the status of Section 936 benefits that Puerto Rico enjoys under the existing Code. However, no assessment can be made at this time of the economic and other effects of a change in federal laws affecting Puerto Rico as a result of a change in status.

#### INSURED OBLIGATIONS

Certain Debt Obligations (the 'Insured Debt Obligations') may be insured or guaranteed by Asset Guaranty Reinsurance Company ('Asset Guaranty') AMBAC Indemnity Corporation ('AMBAC'), Bond Investors Guaranty Insurance Company ('BIG'), Capital Markets Assurance Corp. ('CAPMAC'), Capital Guaranty Insurance Company ('CGIC'), Connie Lee Insurance Company ('Connie Lee'), Continental Casualty Company ('Continental'), Financial Guaranty Insurance Company ('Financial Guaranty'), Financial Security Assurance Inc. ('FSA'), Firemen's Insurance Company of Newark, New Jersey ('Firemen's'), Industrial Indemnity Insurance Company ('IIC') (which operates the Health Industry Bond Insurance ('HIBI') Program), Municipal Bond Investors Assurance Corporation ('MBIA Corp.') or National Union Fire Insurance Company of Pittsburgh, Pa. ('National Union') (collectively the 'Insurance Companies').

The Portfolios of certain Insured Series contain Portfolios consisting entirely of insured Debt Obligations that are rated AAA by Standard & Poor's because the Insurance Companies have insured the Debt Obligations. The assignment of such AAA ratings is due to Standard & Poor's assessment of the creditworthiness of the Insurance Companies and of their ability to pay claims on their policies of insurance. In the event that Standard & Poor's reassesses the creditworthiness of any Insurance Company which would result in the Fund's rating being reduced, the Sponsors are authorized to direct the Trustee to obtain other insurance. The claims-paying ability of each of the Insurance Companies, unless otherwise indicated, is rated AAA by Standard & Poor's or another acceptable national rating service. The ratings are subject to change at any time at the discretion of the rating agencies. In determining whether to insure bonds, the Insurance Companies severally apply their own standards. The cost of this insurance (except the portfolio insurance referred to below) is borne by either the issuers or previous owners of the bonds or by the Sponsors. The insurance policies are non-cancellable and, except in the case of any portfolio insurance, will continue in force so long as the insured Debt Obligations are outstanding and the insurers remain in business. The insurance policies guarantee the timely payment of principal and interest on but do not guarantee the market value of the insured Debt Obligations or the value of the Units. The insurance policies generally do not provide for accelerated payments of principal or, except in the case of any portfolio insurance policies, cover redemptions resulting from events of taxability. If the issuer of any Insured Debt Obligation should fail to make an interest or principal payment, the insurance policies generally provide that the Trustee or its agent shall give notice of nonpayment to the Insurance Company or its agent and provide evidence of the Trustee's right to receive payment. The Insurance Company is then required to disburse the amount of the failed payment to the Trustee or its agent and is thereafter subrogated to the Trustee's right to receive payment from the issuer.

Certain Debt Obligations may be entitled to portfolio insurance ('Portfolio Insurance') that guarantees the scheduled payment of the principal of and interest on those Debt Obligations ('Portfolio-Insured Debt Obligations') while they are retained in the Fund. Since the Portfolio Insurance applies to Debt Obligations only while they are retained in the Fund, the value of Portfolio-Insured Debt Obligations (and hence the value of the Units) may decline if the credit quality of any Portfolio-Insured Debt Obligation is reduced. Premiums for Portfolio Insurance are payable monthly in advance by the Trustee on behalf of the Fund.

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As Portfolio-Insured Debt Obligations are redeemed by their respective issuers or are sold by the Trustee, the amount of the premium payable for the Portfolio Insurance will be correspondingly reduced. Nonpayment of premiums on any policy obtained by the Fund will not result in the cancellation of insurance but will permit the portfolio insurer to take action against the Trustee to recover premium payments due it. Upon the sale of a Portfolio-Insured Debt Obligation from the Fund, the Trustee has the right, pursuant to an irrevocable

commitment obtained from the portfolio insurer, to obtain insurance to maturity ('Permanent Insurance') on the Debt Obligation upon the payment of a single predetermined insurance premium from the proceeds of the sale. It is expected that the Trustee will exercise the right to obtain Permanent Insurance only if the Fund would receive net proceeds from the sale of the Debt Obligation (sale proceeds less the insurance premium attributable to the Permanent Insurance) in excess of the sale proceeds that would be received if the Debt Obligations were sold on an uninsured basis. The premiums for Permanent Insurance for each Portfolio-Insured Debt Obligation will decline over the life of the Debt Obligation.

The Public Offering Price does not reflect any element of value for Portfolio Insurance. The Evaluator will attribute a value to the Portfolio Insurance (including the right to obtain Permanent Insurance) for the purpose of computing the price or redemption value of Units only if the Portfolio-Insured Debt Obligations are in default in payment of principal or interest or, in the opinion of the Agent for the Sponsors, in significant risk of default. In making this determination the Agent for the Sponsors has established as a general standard that a Portfolio-Insured Debt Obligation which is rated less than BB by Standard & Poor's or Ba by Moody's will be deemed in significant risk of default although the Agent for the Sponsors retains the discretion to conclude that a Portfolio-Insured Debt Obligation is in significant risk of default even though at the time it has a higher rating, or not to reach that conclusion even if it has a lower rating (see Description of Ratings). The value of the insurance will be equal to the difference between (i) the market value of the Portfolio-Insured Debt Obligation assuming the exercise of the right to obtain Permanent Insurance (less the insurance premium attributable to the purchase of Permanent Insurance) and (ii) the market value of the Portfolio-Insured Debt Obligation not covered by Permanent Insurance.

In addition, certain Funds may contain Debt Obligations that are insured to maturity as well as being Portfolio-Insured Debt Obligations. The following are brief descriptions of certain of the insurance companies that may insure or guarantee certain Debt Obligations. The financial information presented for each company has been determined on a statutory basis and is unaudited.

AMBAC is a Wisconsin-domiciled stock insurance company, regulated by the Insurance Department of the State of Wisconsin, and licensed to do business in various states, with admitted assets of approximately \$1,598,000,000 and policyholders' surplus of approximately \$604,000,000 as of December 31, 1992. AMBAC is a wholly-owned subsidiary of AMBAC Inc., a financial holding company which is publicly owned following a complete divestiture by Citibank during the first quarter of 1992.

Asset Guaranty is a New York State insurance company licensed to write financial guaranty, credit, residual value and surety insurance. Asset Guaranty commenced operations in mid-1988 by providing reinsurance to several major monoline insurers. The parent holding company of Asset Guaranty, Asset Guaranty Inc. (AGI), merged with Enhance Financial Services (EFS) in June, 1990 to form Enhance Financial Services Group Inc. (EFSG). The two main, 100%-owned subsidiaries of EFSG, Asset Guaranty and Enhance Reinsurance Company, share common management and physical resources. EFSG is 14% owned by Merrill Lynch & Co., Inc. and its affiliates. Both EFSG and Asset Guaranty are rated 'AAA' for claims paying ability by Duff & Phelps but are not

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rated by Standard & Poor's. As of December 31, 1992 Asset Guaranty had admitted assets of \$126,000,000 and policyholders' surplus of \$71,000,000.

CAPMAC commenced operations in December 1987, as the second mono-line financial guaranty insurance company (after FSA) organized solely to insure non-municipal obligations. CAPMAC, a New York corporation, is a wholly-owned subsidiary of CAPMAC Holdings, Inc. (CHI), which was sold in 1992 by Citibank (New York State) to a group of 12 investors led by the following: Dillon Read's Saratoga Partners II; L.P. (Saratoga), an acquisition fund; Caprock Management, Inc., representing Rockefeller family interests; Citigrowth Fund, a Citicorp venture capital group; and CAPMAC senior management and staff. These groups control approximately 70% of the stock of CHI. CAPMAC had traditionally specialized in guaranteeing consumer loan and trade receivable asset-backed securities. Under the new ownership group CAPMAC intends to become involved in the municipal bond insurance business, as well as their traditional non-municipal business. As of December 31, 1992 CAPMAC's admitted assets were approximately \$173,000,000 and its policyholders' surplus was approximately \$148,000,000.

CGIC, a monoline bond insurer headquartered in San Francisco, California, was established in November 1986 to assume the financial guaranty business of United States Fidelity and Guaranty Company ('USF&G'). It is a wholly-owned subsidiary of Capital Guaranty Corporation ('CGC') whose stock is owned by: Constellation Investments, Inc., an affiliate of Baltimore Gas & Electric, Fleet/Norstar Financial Group, Inc., Safeco Corporation, Sibag Finance Corporation, an affiliate of Siemens AG, and USF&G, the 8th largest property/casualty company in the U.S. as measured by net premiums written. In addition to initial paid-in capital of \$100 million the ownership group, under a

binding agreement through October 1, 1993, is committed to provide another \$100 million to CGC, if and when needed. As of December 31, 1992, CGIC had total admitted assets of approximately \$227,000,000 and policyholders' surplus of approximately \$116,000,000.

Connie Lee is a wholly owned subsidiary of College Construction Loan Insurance Association ('CCLIA'), a government-sponsored enterprise established by Congress to provide American academic institutions with greater access to low-cost capital through enhancement. Connie Lee, the operating insurance company, was incorporated in 1987 and began business as a reinsurer of tax-exempt bonds of colleges, universities, and teaching hospitals with a concentration on the hospital sector. During the fourth quarter of 1991 Connie Lee began underwriting primary bond insurance which will focus largely on the college and university sector. CCLIA's founding shareholders are the U.S. Department of Education, which owns 36% of CCLIA, and the Student Loan Marketing Association ('Sallie Mae'), which owns 14%. The other principal owners are: Pennsylvania Public School Employees' Retirement System, Metropolitan Life Insurance Company, Kemper Financial Services, Johnson family funds and trusts, Northwestern University, Rockefeller & Co., Inc. administered trusts and funds, and Stanford University. Connie Lee is domiciled in the state of Wisconsin and has licenses to do business in 47 states and the District of Columbia. As of December 31, 1992, its total admitted assets were approximately \$161,000,000 and policyholders' surplus was approximately \$101,000,000.

Continental is a wholly-owned subsidiary of CNA Financial Corp. and was incorporated under the laws of Illinois in 1948. As of December 31, 1992, Continental had policyholders' surplus of approximately \$3,136,000,000 and admitted assets of approximately \$22,171,000,000. Continental is the lead property-casualty company of a fleet of carriers nationally known as 'CNA Insurance Companies'. CNA is rated AAI by Standard & Poor's.

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Financial Guaranty, a New York stock insurance company, is a wholly-owned subsidiary of FGIC Corporation which is wholly-owned by General Electric Capital Corporation. The investors in the FGIC Corporation are not obligated to pay the debts of or the claims against Financial Guaranty. Financial Guaranty commenced its business of providing insurance and financial guarantees for a variety of investment instruments in January 1984 and is currently authorized to provide insurance in 49 states and the District of Columbia. It files reports with state regulatory agencies and is subject to audit and review by those authorities. As of December 31, 1992, its total admitted assets were approximately \$1,594,000,000 and its policyholders' surplus was approximately \$621,000,000.

FSA is a monoline property and casualty insurance company incorporated in New York in 1984. It is a wholly-owned subsidiary of Financial Security Assurance Holdings Ltd., which was acquired in December 1989 by US West, Inc., the regional Bell Telephone Company serving the Rocky Mountain and Pacific Northwestern states. U.S. West is currently seeking to sell FSA. FSA is licensed to engage in the surety business in 42 states and the District of Columbia. FSA is engaged exclusively in the business of writing financial guaranty insurance, on both tax-exempt and non-municipal securities. As of December 31, 1992, FSA had policyholders' surplus of approximately \$379,000,000 and total admitted assets of approximately \$739,000,000.

Firemen's, which was incorporated in New Jersey in 1855, is a wholly-owned subsidiary of The Continental Corporation and a member of The Continental Insurance Companies, a group of property and casualty insurance companies the claims paying ability of which is rated AA-by Standard & Poor's. It provides unconditional and non-cancellable insurance on industrial development revenue bonds. As of December 31, 1992, the total admitted assets of Firemen's were approximately \$2,211,000,000 and its policyholders' surplus was approximately \$450,000,000.

MBIA is the principal operating subsidiary of MBIA Inc. The principal shareholders of MBIA Inc. were originally Aetna Casualty and Surety Company, The Fund American Companies Inc., subsidiaries of CIGNA Corporation and Credit Local de France, CAECL, S.A. These principal shareholders now own approximately 13% of the outstanding common stock of MBIA Inc., following a series of four public equity offerings over a five-year period. As of December 31, 1992, MBIA had admitted assets of approximately \$2,594,000,000 and policyholders' surplus of approximately \$896,000,000.

BIG, a stock insurance company incorporated in Illinois and now known as 'MBIA Insurance Corp. of Illinois', is a wholly-owned subsidiary of Bond Investors Group, Inc., a Delaware insurance holding company. Effective December 31, 1989, MBIA Inc. acquired Bond Investors Group, Inc. On January 5, 1990, MBIA acquired all of the outstanding stock of Bond Investors Group, Inc. Through a reinsurance agreement, BIG has ceded all of its net insured risks, as well as its unearned premium and contingency reserves to MBIA Corp. and MBIA Corp. has reinsured BIG's net outstanding exposure. Neither MBIA Inc., nor Bond Investors Group, Inc. or any of their shareholders are obligated to pay the debts of or claims against MBIA Corp. or BIG.

IIC, which was incorporated in California in 1920, is a wholly-owned

subsidiary of Crum and Forster, Inc., a New Jersey holding company and a wholly-owned subsidiary of Xerox Corporation. IIC is a property and casualty insurer which, together with certain other wholly-owned insurance subsidiaries of Crum and Forster, Inc., operates under a Reinsurance Participation Agreement whereby all insurance written by these companies is pooled among them. As of December 31, 1992 the total admitted assets and policyholders' surplus of IIC on a consolidated-statutory basis were \$1,733,000,000 and \$215,000,000 respectively. Standard & Poor's has rated IIC's claims-paying ability A. Any IIC/HIBI - rated Debt Obligations in an Insured Series are additionally insured

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for as long as they remain in the Fund and as long as IIC/HIBI's rating is below AAA, in order to maintain the AAA-rating of Fund Units. The cost of any additional insurance is paid by the Fund and such insurance would expire on the sale or maturity of the Debt Obligation.

National Union is a stock insurance company incorporated in Pennsylvania and a wholly-owned subsidiary of American International Group, Inc. National Union was organized in 1901 and is currently licensed to provide insurance in 50 states and the District of Columbia. It files reports with state insurance regulatory agencies and is subject to regulation, audit and review by those authorities including the State of New York Insurance Department. As of December 31, 1992, the total admitted assets and policyholders' surplus of National Union were approximately \$7,593,000,000 and approximately \$1,401,000,000, respectively.

Insurance companies are subject to regulation and supervision in the jurisdictions in which they do business under statutes which delegate regulatory, supervisory and administrative powers to state insurance commissioners. This regulation, supervision and administration relate, among other things, to: the standards of solvency which must be met and maintained; the licensing of insurers and their agents; the nature of and limitations on investments; deposits of securities for the benefit of policyholders; approval of policy forms and premium rates; periodic examinations of the affairs of insurance companies; annual and other reports required to be filed on the financial condition of insurers or for other purposes; and requirements regarding reserves for unearned premiums, losses and other matters. Regulatory agencies require that premium rates not be excessive, inadequate or unfairly discriminatory. Insurance regulation in many states also includes 'assigned risk' plans, reinsurance facilities, and joint underwriting associations, under which all insurers writing particular lines of insurance within the jurisdiction must accept, for one or more of those lines, risks unable to secure coverage in voluntary markets. A significant portion of the assets of insurance companies is required by law to be held in reserve against potential claims on policies and is not available to general creditors.

Although the Federal government does not regulate the business of insurance, Federal initiatives can significantly impact the insurance business. Current and proposed Federal measures which may significantly affect the insurance business include pension regulation (ERISA), controls on medical care costs, minimum standards for no-fault automobile insurance, national health insurance, personal privacy protection, tax law changes affecting life insurance companies or the relative desirability of various personal investment vehicles and repeal of the current antitrust exemption for the insurance business. (If this exemption is eliminated, it will substantially affect the way premium rates are set by all property-liability insurers.) In addition, the Federal government operates in some cases as a co-insurer with the private sector insurance companies.

Insurance companies are also affected by a variety of state and Federal regulatory measures and judicial decisions that define and extend the risks and benefits for which insurance is sought and provided. These include judicial redefinitions of risk exposure in areas such as products liability and state and Federal extension and protection of employee benefits, including pension, workers' compensation, and disability benefits. These developments may result in short-term adverse effects on the profitability of various lines of insurance. Longer-term adverse effects can often be minimized through prompt repricing of coverages and revision of policy terms. In some instances these developments may create new opportunities for business growth. All insurance companies write policies and set premiums based on actuarial assumptions about mortality, injury, the occurrence of accidents and other insured events. These assumptions, while well supported by past experience, necessarily do not take account of future events. The occurrence in the future of unforeseen circumstances could affect the financial condition of one or more insurance companies. The insurance business is highly competitive

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and with the deregulation of financial service businesses, it should become more competitive. In addition, insurance companies may expand into non-traditional lines of business which may involve different types of risks.

The above financial information relating to the Insurance Companies has been obtained from publicly available information. No representation is made as

to the accuracy or adequacy of the information or as to the absence of material adverse changes since the information was made available to the public.

#### OBLIGATIONS BACKED BY LETTERS OF CREDIT, GUARANTEES OR REPURCHASE COMMITMENTS

Certain Debt Obligations may be secured by letters of credit or guarantees issued by commercial banks, by collateralized letters of credit or guarantees issued by savings banks, savings and loan associations and similar institutions ('thrifts'), or by direct obligations of banks or thrifts pursuant to 'loans-to-lenders' programs. Letters of credit and guarantees are irrevocable obligations of the issuing institutions; they may be called upon, and the related Debt Obligation consequently redeemed, should the issuer of the Debt Obligation fail to make payments of amounts due, or default under its reimbursement agreement with the issuer of the letter of credit or guarantee or, in certain cases, in the event the interest on the Debt Obligation should be deemed to be taxable and full payment of amounts due is not made by the issuer. Certain of these letters of credit and guarantees may be secured by a security interest in collateral (see Collateralized Obligations below).

Certain Intermediate Term and Put Series and certain other Series contain Debt Obligations purchased from one or more commercial banks or thrifts or other institutions ('Sellers') which have committed under certain circumstances specified below to repurchase the Debt Obligations from the Fund ('Repurchase Commitments'). The Debt Obligations in these Funds may be secured by one or more Repurchase Commitments (see Investment Summary in Part A) which, in turn may be backed by a letter of credit or secured by a security interest in collateral (see Collateralized Obligations below.) A Seller may have committed to repurchase from the Fund any Debt Obligations sold by it, within a specified period after receiving notice from the Trustee, to the extent necessary to satisfy redemptions of Units despite the market-making activity of the Sponsors (a 'Liquidity Repurchase'). The required notice period may be 14 days (a '14 Day Repurchase') or, if a repurchase date is set forth under Investment Summary in Part A, the Trustee may at any time not later than two hours after the Evaluation Time on the repurchase date (or if a repurchase date is not a business day, on the first business day thereafter), deliver this notice to the Seller. Additionally, if the Sponsors elect to remarket Units which have been received at or before the Evaluation Time on any repurchase date (the 'Tendered Units'), a Seller may have committed to repurchase from the Fund on the date 15 business days after that repurchase date, any Debt Obligations sold by the Seller to the Fund in order to satisfy any tenders for redemption by the Sponsors made within 10 business days after the Evaluation Time. A Seller may also have made any of the following commitments: (i) to repurchase at any time on 14 calendar days' notice any Debt Obligations if the issuer thereof shall fail to make any payments of principal thereof and premium and interest thereon (a 'Default Repurchase'); (ii) to repurchase any Debt Obligation on a fixed disposition date (a 'Disposition Date') if the Trustee elects not to sell the Debt Obligation in the open market (because a price in excess of its Put Price (as defined under Investment Summary in Part A) cannot be obtained) on this date (a 'Disposition Repurchase'); (iii) to repurchase at any time on 14 calendar days' notice any Debt Obligation in the event that the interest thereon should be deemed to be taxable (a 'Tax Repurchase'); and (iv) to repurchase immediately all Debt Obligations if the Seller becomes or is deemed to be bankrupt or insolvent (an 'Insolvency Repurchase'). (See Investment Summary in Part A.) Any repurchase of a Debt Obligation will be at a price no lower than its original purchase

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price to the Fund, plus accrued interest to the date of repurchase, plus any further adjustments as described under Investment Summary in Part A.

Upon the sale of a Debt Obligation by the Fund to a third party prior to its Disposition Date, any related Liquidity and Disposition Repurchase commitments will be transferable, together with an interest in any collateral or letter of credit backing the repurchase commitments and the Liquidity Repurchase commitments will be exercisable by the buyer free from the restriction that the annual repurchase right may only be exercised to meet redemptions of Units. Any Default Repurchase, Tax Repurchase and Insolvency Repurchase commitments also will not terminate upon disposition of the Debt Obligation by the Fund but will be transferable, together with an interest in the collateral or letter of credit backing the Repurchase Commitments or both, as the case may be.

A Seller's Repurchase Commitments apply only to Debt Obligations which it has sold to the Fund; consequently, if a particular Seller fails to meet its commitments, no recourse is available against any other Seller nor against the collateral or letters of credit of any other Seller. Each Seller's Repurchase Commitments relating to any Debt Obligation terminate (i) upon repurchase by the Seller of the Debt Obligation, (ii) on the Disposition Date of the Debt Obligation if its holder does not elect to have the Seller repurchase the Debt Obligation on that date and (iii) in the event notice of redemption shall have been given on or prior to the Disposition Date for the entire outstanding principal amount of the Debt Obligation and that redemption or maturity of the Debt Obligation occurs on or prior to the Disposition Date. On the scheduled Disposition Date of a Debt Obligation, the Trustee will sell that Debt Obligation in the open market if a price in excess of the Put Price as of the

Disposition Date can be obtained.

An investment in Units of a Fund containing any of these types of credit supported Debt Obligations should be made with an understanding of the characteristics of the commercial banking and thrift industries and of the risks which an investment in Units may entail. Banks and thrifts are subject to extensive governmental regulations 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. The profitability of these industries is largely dependent upon the availability and cost of funds for the purpose of financing lending operations under prevailing money market conditions. Also, general economic conditions play an important part in the operations of this industry and exposure to credit losses arising from possible financial difficulties of borrowers might affect an institution's ability to meet its obligations. Since the late 1980's the ratings of U.S. and foreign banks and holding companies have been subject to extensive downgrades due primarily to deterioration in asset quality and the attendant impact on earnings and capital adequacy. Major U.S. banks, in particular, have suffered from a decline in asset quality in the areas of loans to Lesser Developed Countries (LDC's), construction and commercial real estate loans and lending to support Highly Leveraged Transactions (HLT's). LDC loan problems have been addressed to some extent, although construction and commercial real estate loans and HLT exposure remain areas of concern. The Federal Deposit Insurance Corporation indicates that in 1990 168 federally insured banks with an aggregate total of \$15.7 billion in assets failed, and that in 1991 124 federally insured banks with an aggregate total of \$64.3 billion in assets failed. These factors also affect bank holding companies and other financial institutions, which may not be as highly regulated as banks, and may be more able to expand into other non-financial and non-traditional businesses.

In December 1991 Congress passed and the President signed into law the Federal Deposit Insurance Corporation Improvement Act of 1991 ('FDICIA') and the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991. Those laws imposed many new limitations on the way in which

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banks, savings banks, and thrifts may conduct their business and mandated early and aggressive regulatory intervention for unhealthy institutions. Periodic efforts to introduce legislation broadening the ability of banks and thrifts to compete with new products have not been successful, but if enacted could lead to more failures as a result of increased competition and added risks. Failure to enact such legislation, on the other hand, may lead to declining earnings and an inability to compete with unregulated financial institutions. Efforts to expand the ability of federal thrifts to branch on an interstate basis have been initially successful through promulgation of regulations, but legislation to liberalize interstate branching for banks has stalled in the Congress. Consolidation is likely to continue in both cases. The Securities and Exchange Commission ('SEC') is attempting to require the expanded use of market value accounting by banks and thrifts, and adoption of such rules may result in increased volatility in the reported health of the industry, and mandated regulatory intervention to correct such problems.

In addition, historically, thrifts primarily financed residential and commercial real estate by making fixed-rate mortgage loans and funded those loans from various types of deposits. Thrifts were restricted as to the types of accounts which could be offered and the rates that could be paid on those accounts. During periods of high interest rates, large amounts of deposits were withdrawn as depositors invested in Treasury bills and notes and in money market funds which provided liquidity and high yields not subject to regulation. As a result the cost of thrifts' funds exceeded income from mortgage loan portfolios and other investments, and their financial positions were adversely affected. Laws and regulations eliminating interest rate ceilings and restrictions on types of accounts that may be offered by thrifts are designed to permit thrifts to compete for deposits on the basis of current market rates and to improve their financial positions. However, with respect to any Debt Obligations included in the Fund that are secured by collateralized letters of credit, guarantees or Repurchase Commitments of thrifts, the Sponsors believe that investors in the Units should rely solely on the collateral securing the performance of the thrifts' obligations with respect to those Debt Obligations and not on the financial positions of the thrifts.

In certain cases, the Sponsors have agreed that the sole recourse in connection with any default, including insolvency, by thrifts whose collateralized letter of credit, guarantee or Repurchase Commitments may back any of the Debt Obligations will be to exercise available remedies with respect to the collateral pledged by the thrift; should the collateral be insufficient, the Fund will, therefore, be unable to pursue any default judgment against that thrift. Certain of these collateralized letters of credit, guarantees or Repurchase Commitments may provide that they are to be called upon in the event the thrift becomes or is deemed to be insolvent. Accordingly, investors should recognize that they are subject to having the principal amount of their investment represented by a Debt Obligation secured by a collateralized letter of credit, guarantee or Repurchase Commitment returned prior to the termination date of the Fund or the maturity or disposition dates of the Debt Obligations if

the thrift becomes or is deemed to be insolvent, as well as in any of the situations outlined under Repurchase Commitments below.

The thrift industry has experienced severe strains as demonstrated by the failure of numerous savings banks and savings and loan associations. One consequence of this was the insolvency of the deposit insurance fund of the Federal Savings and Loan Insurance Corporation ('FSLIC'). As a result, in 1989 Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act ('FIRREA') which significantly altered the legal rules and regulations governing banks and thrifts. Among other things, FIRREA abolished the FSLIC and created a new agency, the Resolution Trust Corporation ('RTC'), investing it with certain of the FSLIC's powers. The balance of the FSLIC's powers were transferred to the Federal Deposit Insurance Corporation ('FDIC'). Under FIRREA, as subsequently amended in 1990, the RTC was normally to be appointed as receiver or conservator of thrifts that failed between January 1, 1989 and October 1, 1993 if their deposits, prior to FIRREA, were insured

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by the FSLIC. The FDIC is normally to be appointed as receiver or conservator for all thrifts the deposits of which, before FIRREA, were insured by the FDIC, and those thrifts the deposits of which, prior to FIRREA, were insured by the FSLIC that fail on or after October 1, 1993.

FIRREA generally permits the FDIC or the RTC, as the case may be, to prevent the exercise of a Seller's Insolvency Repurchase commitment and empowers that agency to repudiate a Seller's contracts, including a Seller's other Repurchase Commitments. FIRREA also creates a risk that damages against the FDIC or RTC would be limited and that investors could be left without the full protections afforded by the Repurchase Commitments and the Collateral.

Policy statements adopted by the FDIC and the RTC concerning collateralized repurchase commitments have partially ameliorated these risks for the Funds. According to these policy statements, the FDIC or the RTC, as conservator or receiver, will not assert the position that it can repudiate the repurchase commitments without the payment of damages from the collateral, and will instead either (i) accelerate the collateralized repurchase commitments, in which event payment will be made under the repurchase commitments to the extent of available collateral, or (ii) enforce the repurchase commitments, except that any insolvency clause would not be enforceable against the FDIC and the RTC. Should the FDIC choose to accelerate, however, there is some question whether the payment made would include interest on the defaulted Debt Obligations for the period after the appointment of the receiver or conservator through the payment date.

The RTC has also given similar comfort with respect to collateralized letters of credit, but the FDIC has not done so at this time. Consequently, there can be no assurance that collateralized letters of credit issued by thrifts for which the FDIC would be the receiver or conservator appointed, as described two paragraphs earlier, will be available in the event of the failure of any such thrift. Absent legislation, the FDIC will serve as conservator or receiver for all thrifts for which a conservator or receiver is appointed after September 30, 1993.

Investors should realize that should the FDIC or the RTC make payment under a letter of credit or Repurchase Commitment prior to the scheduled maturity or disposition dates of the related Debt Obligation their investment will be returned sooner than originally anticipated.

The possibility of such early payment has been increased significantly by the enactment in December 1991 of FDICIA. FDICIA requires federal regulators of insured banks, savings banks, and thrifts to act more quickly to address the problems of undercapitalized institutions than previously, and specifies in more detail the actions they must take. One such requirement virtually compels the appointment of a receiver or conservator for any institution when its ratio of tangible equity to total assets declines to two percent. Others force aggressive intervention in the business of an institution at even earlier stages of deterioration.

Certain letters of credit or guarantees backing Debt Obligations may have been issued by a foreign bank or corporation or similar entity (a 'Foreign Guarantee'). On the basis of information available to the Sponsors at the present time no Foreign Guarantee is subject to exchange control restrictions under existing law which would materially interfere with payments to the Fund under the Foreign Guarantee. However, there can be no assurance that exchange control regulations might not be adopted in the future which might affect adversely the payments to the Fund. Nor are there any withholding taxes under existing law applicable to payments made on any Foreign Guarantee. While there can be no assurance that withholding taxes might not be imposed in the future, provision is made in the instruments governing any Foreign Guarantee that, in substance, to the extent permitted by applicable law, additional payments will be made by the guarantor so that the total amount paid, after deduction

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of any applicable tax, will not be less than the amount then due and payable on the Foreign Guarantee. The adoption of exchange control regulations and other legal restrictions could have an adverse impact on the marketability of any Debt Obligations backed by a Foreign Guarantee and on the ability of the Fund to satisfy its obligation to redeem Units tendered to the Trustee for redemption (see Redemption).

#### COLLATERALIZED OBLIGATIONS

Funds providing collateralized letters of credit, guarantees or Repurchase Commitments have been structured so that, notwithstanding interest rate fluctuations and any consequent changes in the financial positions of the issuers thereof, investors in Units should in any event rely solely on the collateral for their performance. The Sponsors have provided the collateralization provisions to afford to Holders security which, in the opinion of the Sponsors, is reasonably adequate to support the letters of credit, guarantees or Repurchase Commitments without regard to the ability of the issuers thereof to meet their obligations or to provide additional collateral if called for. The types of 'Eligible Collateral' that initially may be pledged are set forth below. Eligible Collateral may consist of mortgage-backed securities issued by private parties and guaranteed as to full and timely payment of interest and principal by the Government National Mortgage Association ('GNMA') ('GNMA Pass-Throughs') or by the Federal National Mortgage Association ('FNMA') ('FNMA Pass-Throughs'), mortgage-backed securities issued by the Federal Home Loan Mortgage Corporation ('FHLMC') and guaranteed as to full and timely payment of interest and full collection of principal by FHLMC ('FHLMC PCs'), conventional, FHA insured, VA guaranteed and privately insured mortgages ('Mortgages'), debt obligations of states and their political subdivisions and public authorities ('Municipal Obligations'), debt obligations of public nongovernmental corporations rated at least A by Standard & Poor's (or another acceptable rating agency at the time rating the Fund) ('Corporate Obligations'), U.S. Government Securities and cash. In addition, Eligible Collateral may also consist of other securities specified by the Sponsors, and may also be deemed to include the Portfolio Securities, provided that Standard & Poor's (or another acceptable rating agency) confirms that the pledging of the other securities will not result in the reduction of its rating then assigned to Units. Standard & Poor's (or another acceptable rating agency) has no obligation to review or approve any proposed additions to the types of Eligible Collateral and may, at any time, change or withdraw any rating on Units. Additions to types of Eligible Collateral and changes in collateral levels are permitted without the consent of Holders of Units.

**GNMA Pass-Throughs.** GNMA is a wholly-owned U.S. government corporation within the Department of Housing and Urban Development. GNMA is authorized by Section 306(g) of Title III of the National Housing Act to guarantee the timely payment of the principal of, and interest on, certificates which are based on and backed by pools of residential mortgage loans insured or guaranteed by the Federal Housing Administration ('FHA'), the Farmers' Home Administration ('FMHA') or the Department of Veteran's Affairs ('VA'). The GNMA Pass-Throughs will be of the 'modified pass-through' type, the terms of which provide for timely monthly payments by the issuers to the registered holders of their pro rata shares of the scheduled principal payments, whether or not collected by the issuers, on account of the mortgages backing such GNMA Pass-Throughs, plus any prepayment of principal of such mortgages received, and interest (net of the servicing and other charges) on the aggregate unpaid principal balance of such GNMA Pass-Throughs, whether or not interest on account of these mortgages has been collected by the issuers. The GNMA Pass-Throughs will be guaranteed as to timely payment of principal and interest by GNMA. The full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under the guarantee.

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**FNMA Pass-Throughs.** FNMA Pass-Throughs are certificates of beneficial interest evidencing pro rata undivided ownership interests in pools of residential mortgages either previously owned by FNMA or purchased by it in connection with the formation of a pool. FNMA guarantees the full and timely payment of principal and interest (adjusted to the pass-through rate) on the mortgage loans in the pool, whether or not received by FNMA or recovered by it in foreclosure. If FNMA were unable to fulfill its guarantee, distributions to holders of FNMA Pass-Throughs would consist solely of payments and other recoveries upon the underlying mortgages, and, accordingly, delinquencies and defaults would diminish distributions to the holders. The obligations of FNMA under its guarantee are solely those of FNMA and are not backed by the full faith and credit of the United States. Moreover, neither the United States nor any of its agencies is obligated to finance the operations of FNMA or to assist it.

**FHLMC PCs.** FHLMC PCs are certificates issued by FHLMC which represent undivided interests in identified pools of residential mortgage loans purchased by FHLMC. FHLMC guarantees the full and timely payment of interest (adjusted to the certificate rate) on the unpaid principal balance of mortgage loans in the pool as determined or estimated by FHLMC and the collection of principal without any offset or deduction. Payment of principal is subject to delay due to federal and state laws. FHLMC is a corporate instrumentality of the United States



created pursuant to the Emergency Home Finance Act of 1970. The principal activity of FHLMC consists of the purchase of first lien, fixed rate conventional mortgage loans and participations therein, which FHLMC repackages and sells as guaranteed mortgage securities, primarily FHLMC Certificates. These loans must be considered by FHLMC of a quality, type and class to meet generally the purchase standards imposed by private institutional mortgage investors. To minimize interest rate risk FHLMC generally matches its purchases of mortgages and sales of guaranteed mortgage related securities. Mortgage loans retained by FHLMC are financed by debt and equity capital. The obligations of FHLMC under its guarantee are solely those of FHLMC and are not backed by the full faith and credit of the United States nor are they an obligation of any Federal Home Loan Bank.

Mortgages. In order to be eligible as Collateral a Mortgage must either be insured by FHA or guaranteed by VA or must (i) secure a loan not in excess of 80% of the lesser of the purchase price or appraised value, (ii) be secured by a first lien on a single-family (one unit) detached structure that at the time of origination was owner-occupied and designed and intended for use as a primary residence, (iii) not have had any payment of principal or interest or escrow payment in arrears for 60 or more days at any time during the twelve months preceding its pledge date and, as of its pledge date, have no payments more than 30 days due and unpaid, (iv) provide for level monthly payments of principal and interest for an original term to maturity not in excess of 30 years, (v) bear interest at a fixed annual rate and (vi) if originated subsequent to January 1, 1977, be written on then-applicable FHLMC/FNMA documentation.

The regulations governing the FHA single family programs under which a Mortgage may be insured provide that a mortgage will be considered to be in default if the mortgagor fails to make any payment or perform any other obligation under the mortgage and such failure continues for a period of thirty days. Insurance benefits are payable to the mortgagee either upon foreclosure or other acquisition of the property (which, in either case, may be subject to certain delays) or upon assignment of the defaulted Mortgage to the United States Department of Housing and Urban Development ('HUD'). Under most FHA insurance programs for single family residences the Federal Housing Commissioner has the option of paying insurance claims in cash or in debentures, although current FHA policy is to pay insurance claims in cash.

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Claims for the payment of a VA guarantee may be submitted when any default of the mortgagor continues for a period of three months. A guarantee may be paid without the mortgagee instituting foreclosure proceedings or otherwise acquiring title. The maximum amount of guarantee that may be paid is limited to the lesser of (1) sixty percent (60%) of the original principal balance of the mortgage loan or (2) \$27,500 for mortgage loans made on or after October 7, 1980. The liability on the guarantee is reduced or increased pro rata with any reduction or increase in the amount of the indebtedness.

Private mortgage insurance policies currently being issued by private mortgage insurers approved by FHLMC contain provisions substantially as follows: (a) the private mortgage insurer must pay a claim, including unpaid principal, accrued interest and certain expenses, within 60 days of presentment of the claim by the insured; (b) in order for the insured to present a claim, the insured must have acquired, and tendered to the insurer, title to the property free and clear of all liens and encumbrances including any right of redemption by the mortgagor; (c) when a claim is presented, the insurer will have the option of paying the claim in full and taking title to the property and arranging for its sale or of paying the insured percentage of the claim (the insured percentages vary but are customarily 20-25% of the claim) and allowing the insured to retain title to the property; and (d) claims may also be settled by the insurer at the option of the insured for actual losses where such losses are less than the insured percentage of the claim.

Mortgages insured by FHA or guaranteed by VA are subject to current Federal regulations which provide that a mortgagee may not initiate foreclosure proceedings on an FHA insured or VA guaranteed loan unless at least three full monthly installments are due and unpaid. An administrative appeal prior to foreclosure is available to a mortgagor, and, if the mortgagor utilizes this procedure, the foreclosure may be delayed an additional three months. No delay in the foreclosure action is required if the property is encumbered by an FHA/VA mortgage and is abandoned by the Mortgagor.

U.S. Government Securities. Direct obligations of the United States that mature within 30 years at the time of being pledged under the Collateral Agreement.

Municipal Obligations. Debt Obligations issued by or on behalf of states or their political subdivisions or public authorities, bearing interest at a fixed or variable rate and rated at least BBB by Standard & Poor's (or another acceptable rating agency).

Corporate Obligations. Marketable direct obligations of public, nongovernmental corporations payable in U.S. dollars, bearing dividends or interest at a fixed or variable rate and rated at least A by Standard & Poor's

(or another acceptable rating agency at the time rating the Fund), or which have, in the opinion of the Agent for the Sponsors, credit characteristics comparable to obligations rated at least A by Standard & Poor's.

With respect to each Debt Obligation as to which Eligible Collateral has been pledged, the Sponsors have established minimum percentage levels ('Collateral Requirements') of the aggregate market value of each type of Eligible Collateral to the unpaid principal amount of the Debt Obligations. Eligible Collateral is to be valued no less often than quarterly. If on any valuation date it is determined that the aggregate market value of the Eligible Collateral does not satisfy the applicable Collateral Requirements, additional Eligible Collateral must be delivered. Eligible Collateral may be withdrawn or substituted at any time, provided that the remaining or substituted Eligible Collateral meets the applicable Collateral Requirements. Although the Sponsors believe that the Collateral Requirements are sufficient to provide a high degree of protection against loss on the Debt Obligations backed by collateralized letters of credit or guarantees, investors in the Units should be aware that if

liquidation of the collateral is required and proves insufficient to provide for payment in full of the principal and accrued interest on such Debt Obligations, then the full principal amount of their investment could not be returned.

Valuation and Maintenance of Collateral

The Market Value of each Mortgage is determined by using a discount rate determined on the basis of prevailing mortgage market yields. The Market Value of all other Collateral (other than cash) is determined by the Evaluator or by quotations provided by certain securities dealers. Whenever the Collateral Agent notifies a Seller that the aggregate Market Value of the Collateral does not satisfy the aggregate applicable Collateral Requirements, the Seller is required to deposit additional Collateral within a maximum of 10 business days. Failure to do so requires the Collateral Agent to liquidate the Seller's Collateral and reinvest the proceeds in short-term U.S. Government obligations and may lead to a repurchase of Debt Obligations. Collateral may be withdrawn or substituted at any time, provided that the remaining or substituted Eligible Collateral meets the applicable Collateral Requirements and the Seller is not in default. Mortgages are permitted to be withdrawn for servicing purposes, subject to a trust receipt. If the Collateral of a Seller should prove insufficient to cover its repurchase commitments upon a default, the Securities sold by that Seller may be liquidated and the proceeds used to help fulfill the repurchase commitments. For this reason, in determining Collateral levels, the Securities in the Portfolio are deemed to be Collateral so long as they meet the Eligible Collateral requirements.

Collateral Requirements--The Collateral Requirements currently in effect are as follows on weekly, monthly, or quarterly regular valuation basis (at the election of each Seller):

<TABLE>  
<CAPTION>

	QUARTERLY VALUATION	MONTHLY VALUATION
<S>	<C>	<C>
Cash.....	105%	105%
Direct Obligations of the United States with a maturity of:		
1 year or less.....	117	115
5 years or less.....	145	135
10 years or less.....	155	145
15 years or less.....	160	150
30 years or less.....	170	160
GNMA Pass-Throughs.....	160	150
FNMA Pass-Throughs.....	170	160
FHLMC PCs.....	170	160
Mortgages--Fixed Rate.....	180	170
Mortgages--Adjustable-Rate.....	200	190
Municipal Obligations.....	360	175
Corporate Obligations--Bonds.....	190	165
Corporate Obligations--Preferred Stocks.....	205	180

</TABLE>

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	WEEKLY VALUATION
<S>	<C>
Cash.....	105%
Direct Obligations of the United States with a maturity of:	
1 year or less.....	113
5 years or less.....	133
10 years or less.....	140
15 years or less.....	145

30 years or less.....	155
GNMA Pass-Throughs.....	145
FNMA Pass-Throughs.....	155
FHLMC PCs.....	155
Mortgages--Fixed Rate.....	N/A
Mortgages--Adjustable-Rate.....	N/A
Municipal Obligations.....	150
Corporate Obligations--Bonds.....	155
Corporate Obligations--Preferred Stocks.....	160

</TABLE>

(The foregoing valuation figures are based upon a period of 10 business days in the case of quarterly and monthly valuations, and 5 business days in the case of weekly valuations, in which any failure to meet a given collateral requirement may be cured.)

Percentages shown are minimum coverage levels and may be subject to increase by Standard & Poor's upon completion of its review of the mortgage underwriting procedures of the particular Seller. Standard & Poor's may also specify a maximum amount of mortgages that may be pledged in order to ensure the availability of more readily marketable Collateral for payment of quarterly dividend requirements with respect to the underlying Securities.

Fees of the Collateral Agent--Under the Collateral Agreement, the Sellers pay the Collateral Agent's fees set forth in the Collateral Agreement and reimburse the Collateral Agent for its expenses. If payments are not made, the Collateral Agent has a lien against the Collateral for the amounts due and may seek payment from the Fund to the extent not otherwise paid (see Expenses and Charges).

Servicing Arrangement

Each Seller will act as Servicing Agent with respect to its Debt Obligations and, as such, will collect from the underlying obligors the payments of principal, premium, if any, and interest on the Debt Obligations and shall transfer the payments to the Trustee. As Servicing Agent each Seller shall make all decisions regarding amendments to or defaults on its Debt Obligations but prior to taking any material action with respect to a Debt Obligation, it shall secure from the Sponsors approval of any action proposed to be taken by it.

LIQUIDITY

Certain of the Debt Obligations may have been purchased by the Sponsors from various banks and thrifts in large denominations and may not have been issued under bond resolutions or trust indentures providing for issuance of bonds in small denominations. These Debt Obligations were generally directly placed with the banks or thrifts and held in their portfolios prior to sale to the Sponsors. There is no established secondary market for those Debt Obligations. The Sponsors believe that there should be a readily available market among institutional investors for the Debt Obligations which were purchased from these portfolios in the event it is necessary to sell Debt Obligations to meet redemptions of Units (should redemptions be made despite the market making activity of the Sponsors) in light of the following considerations: (i) the credit characteristics of the companies obligated to make payments on the Debt Obligations; (ii) the fact that these Debt Obligations may be backed by irrevocable letters of credit or guarantees of banks or thrifts; and (iii) the fact that banks or thrifts selling these Debt Obligations to the Sponsors for deposit in the Fund or the placement agent acting in connection with their sale generally have stated their intentions, although they are not legally obligated to do so, to remarket or to repurchase, at the then-current bid side evaluation, any of these Debt Obligations proposed to be sold by the Trustee. The interest on these Debt Obligations received by the Fund is net of the fee for the related letter of credit or guarantee charged by the bank or thrift issuing the letter of credit or guarantee.

Any Debt Obligations which were purchased from these portfolios are exempt from the registration provisions of the Federal securities laws, and, therefore, can be sold free of the registration requirements of the securities laws. Because there is no established secondary market for these Debt Obligations, however, there is no assurance that the price realized on sale of these Debt Obligations will not be adversely affected. Consequently it is more likely that the sale of these Debt Obligations may cause a decline in the value of Units than a sale of debt obligations for which an established secondary market exists. In addition, in certain Intermediate Term and Put Series and certain other Series, liquidity of the Fund is additionally augmented by the Sellers' collateralized or letter of credit-backed Liquidity Repurchase commitment in the event it is necessary to sell any Debt Obligations to meet redemptions of Units. If, upon the scheduled Disposition Date for any Debt Obligation, the Trustee elects

not to sell the Debt Obligation scheduled for disposition on this date in the open market (because, for example, a price in excess of its Put Price cannot be obtained), the Seller of the Debt Obligation is obligated to repurchase the Debt Obligation pursuant to its collateralized or letter of credit-backed Disposition Repurchase commitment. There can be no assurance that the prices that can be obtained for the Debt Obligations at any time in the open market will exceed the Put Price of the Debt Obligations. In addition, if any Seller should become unable to honor its repurchase commitments and the Trustee is consequently forced to sell the Debt Obligations in the open market, there is no assurance that the price realized on this sale of the Debt Obligations would not be adversely affected by the absence of an established secondary market for certain of the Debt Obligations.

In some cases, the Sponsors have entered into an arrangement with the Trustee whereby certain of the Debt Obligations may be transferred to a trust (a 'Participation Trust') in exchange for certificates of participation in the Participation Trust which could be sold in order to meet redemptions of Units. The certificates of participation would be issued in readily marketable denominations of \$5,000 each or any greater multiple thereof and the holder thereof would be fully entitled to the repayment protections afforded by the Collateral arrangements to any holder of the underlying Debt Obligations. These certificates would be exempt from registration under the Securities Act of 1933 pursuant to Section 3(a)(2) thereof.

Certain of the Debt Obligations may have been guaranteed or similarly secured by insurance companies or other corporations or entities. The guarantee or similar commitment may constitute a security (a 'Restricted Security') that cannot, in the opinion of counsel, be sold publicly by the Trustee without registration under the Securities Act of 1933, as amended, or similar provisions of law subsequently enacted. The Sponsors nevertheless believe that, should a sale of these Debt Obligations be necessary in order to meet redemptions, the Trustee should be able to consummate a sale with institutional investors. Up to 40% of the Portfolio may initially have consisted of Debt Obligations purchased from various banks and thrifts and other Debt Obligations with guarantees which may constitute Restricted Securities.

The Fund may contain certain Debt Obligations purchased directly from issuers. These Debt Obligations are generally issued under bond resolutions or trust indentures providing for the issuance of bonds in publicly saleable denominations (usually \$5,000), may be sold free of the registration requirements of the Securities Act of 1933 and are otherwise structured in contemplation of ready marketability. In addition, the Sponsors generally have obtained letters of intention to repurchase or to use best efforts to remarket these Debt Obligations from the issuers, the placement agents acting in connection with their sale or the entities providing the additional credit support, if any. These letters do not express legal obligations; however, in the opinion of the Sponsors, these Debt Obligations should be readily marketable.

#### LITIGATION AND LEGISLATION

To the best knowledge of the Sponsors, there is no litigation pending as of the Initial Date of Deposit in respect of any Debt Obligations which might reasonably be expected to have a material adverse effect upon the Fund. At any time after the Initial Date of Deposit, litigation may be initiated on a variety of grounds with respect to Debt Obligations in the Fund. Litigation, for example, challenging the issuance of pollution control revenue bonds under environmental protection statutes may affect the validity of Debt Obligations or the tax-free nature of their interest. While the outcome of litigation of this nature can never be entirely predicted, opinions of bond counsel are delivered on the date of issuance of each Debt Obligation to the effect that the Debt Obligation has been validly issued and that the interest thereon is exempt from Federal income tax. In addition, other factors

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may arise from time to time which potentially may impair the ability of issuers to make payments due on Debt Obligations.

Under the Federal Bankruptcy Act a political subdivision or public agency or instrumentality of any state, including municipalities, may proceed to restructure or otherwise alter the terms of its obligations, including those of the type comprising the Fund's Portfolio. The Sponsors are unable to predict what effect, if any, this legislation will have on the Fund.

From time to time Congress considers proposals to tax the interest on state and local obligations, such as the Debt Obligations. The Supreme Court clarified in *South Carolina v. Baker* (decided April 20, 1988) that the U.S. Constitution does not prohibit Congress from passing a nondiscriminatory tax on interest on state and local obligations. This type of legislation, if enacted into law, could adversely affect an investment in Units. Holders are urged to consult their own tax advisers.

#### PAYMENT OF THE DEBT OBLIGATIONS AND LIFE OF THE FUND

Because certain of the Debt Obligations from time to time may be redeemed

or prepaid or will mature in accordance with their terms or may be sold under certain circumstances described herein, no assurance can be given that the Fund will retain for any length of time its present size and composition (see Redemption). Many of the Debt Obligations may be subject to redemption prior to their stated maturity dates pursuant to optional refunding or sinking fund redemption provisions or otherwise. In general, optional refunding redemption provisions are more likely to be exercised when the offering side evaluation is at a premium over par than when it is at a discount from par. Generally, the offering side evaluation of Debt Obligations will be at a premium over par when market interest rates fall below the coupon rate on the Debt Obligations. The percentage of the face amount of Debt Obligations in the Portfolio which had a bid side evaluation on the Evaluation Date in excess of par is set forth under the Investment Summary. Certain Debt Obligations in the Portfolio may be subject to sinking fund provisions early in the life of the Fund. These provisions are designed to redeem a significant portion of an issue gradually over the life of the issue; obligations to be redeemed are generally chosen by lot. The Portfolio contains a listing of the sinking fund and optional redemption provisions with respect to the Debt Obligations. Additionally, the size and composition of the Fund will be affected by the level of redemptions of Units that may occur from time to time and the consequent sale of Debt Obligations (see Redemption). Principally, this will depend upon the number of Holders seeking to sell or redeem their Units and whether or not the Sponsors continue to reoffer Units acquired by them in the secondary market. Factors that the Sponsors will consider in the future in determining to cease offering Units acquired in the secondary market include, among other things, the diversity of the portfolio remaining at that time, the size of the Fund relative to its original size, the ratio of Fund expenses to income, the Fund's current and long-term returns and the degree to which Units may be selling at a premium over par relative to other funds sponsored by the Sponsors, and the cost of maintaining a current prospectus for the Fund. These factors may also lead the Sponsors to seek to terminate the Fund earlier than would otherwise be the case (see Administration of the Fund--Amendment and Termination).

#### TAX EXEMPTION

In the opinion of bond counsel rendered on the date of issuance of each Debt Obligation, the interest on each Debt Obligation is excludable from gross income under existing law for regular Federal income tax purposes (except in certain circumstances depending on the Holder) but may be subject to state and local taxes. As discussed under Taxes below, interest on some or all of the Debt Obligations may become subject to regular

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Federal income tax, perhaps retroactively to their date of issuance, as a result of changes in Federal law or as a result of the failure of issuers (or other users of the proceeds of the Debt Obligations) to comply with certain ongoing requirements.

Moreover, the Internal Revenue Service announced on June 14, 1993 that it will be expanding its examination program with respect to tax-exempt bonds. The expanded examination program will consist of, among other measures, increased enforcement against abusive transactions, broader audit coverage (including the expected issuance of audit guidelines) and expanded compliance achieved by means of expected revisions to the tax-exempt bond information return forms. At this time, it is uncertain whether the tax exempt status of any of the Debt Obligations would be affected by such proceedings, or whether such effect, if any, would be retroactive.

In certain cases, a Debt Obligation may provide that if the interest on the Debt Obligation should ultimately be determined to be taxable, the Debt Obligation would become due and payable by its issuer, and, in addition, may provide that any related letter of credit or other security could be called upon if the issuer failed to satisfy all or part of its obligation. In other cases, however, a Debt Obligation may not provide for the acceleration or redemption of the Debt Obligation or a call upon the related letter of credit or other security upon a determination of taxability. In those cases in which a Debt Obligation does not provide for acceleration or redemption or in which both the issuer and the bank or other entity issuing the letter of credit or other security are unable to meet their obligations to pay the amounts due on the Debt Obligation as a result of a determination of taxability, the Trustee would be obligated to sell the Debt Obligation and, since it would be sold as a taxable security, it is expected that it would have to be sold at a substantial discount from current market price. In addition, as mentioned above, under certain circumstances Holders could be required to pay income tax on interest received prior to the date on which the interest is determined to be taxable.

#### DESCRIPTION OF THE FUND

##### THE PORTFOLIO

The Portfolio contains different issues of debt obligations with fixed final maturity or disposition dates. In addition up to 10% of the initial value of the Portfolio may have consisted of units ('Other Fund Units') of previously-issued Series of Municipal Investment Trust Fund ('Other Funds')

sponsored and underwritten by certain of the Sponsors and acquired by the Sponsors in the secondary market. The Other Fund Units are not debt obligations as such but represent interests in the securities, primarily state, municipal and public authority debt obligations, in the portfolios of the Other Funds. As used herein, the term 'Debt Obligations' means the debt obligations deposited in the Fund and described under Portfolio in Part A and the term 'Securities' means the Debt Obligations and any Other Fund Units. See Investment Summary in Part A for a summary of particular matters relating to the Portfolio.

In selecting Debt Obligations for deposit in the Fund, the Unit Investment Trusts division of Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Agent for the Sponsors, considered the following factors, among others: (i) whether the Debt Obligations were rated in the category BBB or better by Standard & Poor's or Baa or better by Moody's (A or better for the 51st Monthly Payment, certain Intermediate Term, 7th New York, 11th Pennsylvania and all subsequent Series and all other State and Multistate Series and, as insured, AAA by Standard & Poor's for Insured Series) or had, in the opinion of the Agent for the Sponsors, comparable credit characteristics (see Description of Ratings); (ii) the yield and price of the Debt Obligations relative to comparable debt securities and (iii) the diversification of the Portfolio as to purpose and location of issuer, taking into account

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the availability in the market of issues that met the Fund's criteria. In selecting Debt Obligations to be deposited in Floating Rate Series and certain Intermediate Term Series, in place of the rating standard set forth under (i) above, the Agent for the Sponsors considered whether the Debt Obligations on the Date of Deposit (a) were issued or guaranteed by, or otherwise obligate, issuers or corporate obligors which have outstanding debt obligations rated in the category A or better by either Standard & Poor's or Moody's, or (b) were themselves rated in such category, or (c) if not rated, had in the opinion of the Agent for the Sponsors comparable credit characteristics, or (d) were additionally secured by a letter of credit issued by a bank whose debt obligations, or those of a parent bank holding company (if the debt obligations of that bank are not actually rated), had, in the opinion of the Agent for the Sponsors, credit characteristics comparable to those of banks with outstanding debt obligations which have been rated in the category A or better by Standard & Poor's or Moody's, or (e) were additionally secured by insurance or guarantees issued by insurance companies or other corporations or entities, and therefore had, in the opinion of the Agent for the Sponsors, credit characteristics comparable to obligations rated in the category A or better by either Standard & Poor's or Moody's.

The Portfolio may contain debt obligations rated BBB by Standard & Poor's and Baa by Moody's, which are the lowest 'investment grade' ratings assigned by the two rating agencies or debt obligations rated below investment grade. The Portfolio may also contain debt obligations that have received investment grade ratings from one agency but 'junk bond' ratings from the other agency. In addition, the Portfolio may contain debt obligations which are not rated by either agency but have in the opinion of Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Agent for the Sponsors, comparable credit characteristics to debt obligations rated near or below investment grade. Investors should therefore be aware that these debt obligations may have speculative characteristics and that changes in economic conditions or other circumstances are more likely to lead to a weakened capacity to make principal and interest payments on these debt obligations than is the case with higher rated bonds. Moreover, conditions may develop with respect to any of the issuers of debt obligations in the Portfolio which may cause the rating agencies to lower their ratings below investment grade on a given security or cause the Agent for the Sponsors to determine that the credit characteristics of a given security are comparable to debt obligations rated below investment grade. As a result of timing lags or a lack of current information, there can be no assurance that the rating currently assigned to a given debt obligation by either agency or the credit assessment of the Agent for the Sponsors actually reflects all current information about the issuer of that debt obligation.

Subsequent to the Date of Deposit, a Debt Obligation or other obligations of the issuer or guarantor or bank or other entity issuing a letter of credit related thereto may cease to be rated, its rating may be reduced or the credit assessment of the Agent for the Sponsors may change. Because of the fixed nature of the Portfolio, none of these events require an elimination of that Debt Obligation from the Portfolio, but the lowered rating or changed credit assessment may be considered in the Sponsors' determination to direct the disposal of the Debt Obligation (see Administration of the Fund--Portfolio Supervision).

Because ratings may be lowered or the credit assessment of the Agent for the Sponsors may change, an investment in Units of the Trust should be made with an understanding of the risks of investing in 'junk bonds' (bonds rated below investment grade or unrated bonds having similar credit characteristics), including increased risk of loss of principal and interest on the underlying debt obligations and the risk that the value of the Units may decline with increases in interest rates. In recent years there have been wide fluctuations in interest rates and thus in the value of fixed-rate debt obligations

generally. Debt obligations which are rated below investment grade or unrated debt obligations having similar credit characteristics are often subject to greater market fluctuations

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and risk of loss of income and principal than securities rated investment grade, and their value may decline precipitously in response to rising interest rates. This effect is so not only because increased interest rates generally lead to decreased values for fixed-rate instruments, but also because increased interest rates may indicate a slowdown in the economy generally, which could result in defaults by less creditworthy issuers. Because investors generally perceive that there are greater risks associated with lower-rated securities, the yields and prices of these securities tend to fluctuate more than higher-rated securities with changes in the perceived credit quality of their issuers, whether these changes are short-term or structural, and during periods of economic uncertainty. Moreover, issuers whose obligations have been recently downgraded may be subject to claims by debtholders and suppliers which, if sustained, would make it more difficult for these issuers to meet payment obligations.

Debt rated below investment grade or having similar credit characteristics also tends to be more thinly traded than investment-grade debt and held primarily by institutions, and this lack of liquidity can negatively affect the value of the debt. Debt which is not rated investment grade or having similar credit characteristics may be subordinated to other obligations of the issuer. Senior debtholders would be entitled to receive payment in full before subordinated debtholders receive any payment at all in the event of a bankruptcy or reorganization. Lower rated debt obligations and debt obligations having similar credit characteristics may also present payment-expectation risks. For example, these bonds may contain call or redemption provisions that would make it attractive for the issuers to redeem them in periods of declining interest rates, and investors would therefore not be able to take advantage of the higher yield offered.

The value of Units reflects the value of the underlying debt obligations, including the value (if any) of any issues which are in default. In the event of a default in payment of principal or interest, the Trust may incur additional expenses in seeking payment under the defaulted debt obligations. Because amounts recovered (if any) in respect of a defaulted debt obligation may not be reflected in the value of Units until actually received by the Trust, it is possible that a Holder who sells Units would bear a portion of the expenses without receiving a portion of the payments received. It is possible that new laws could be enacted which could hurt the market for bonds which are not rated investment grade. For example, federally regulated financial institutions could be required to divest their holdings of these bonds, or proposals could be enacted which might limit the use, or tax or other advantages, of these bonds.

The yields on debt obligations of the type deposited in the Fund are dependent on a variety of factors, including general money market conditions, general conditions of the municipal bond market, size of a particular offering, the maturity of the obligation and rating or other credit assessment of the issue. Accordingly, the yields of debt obligations deposited in the Fund will vary with changes in these factors, including changes in ratings or other credit assessments. The ratings represent the opinions of the rating organizations as to the quality of the debt obligations that they undertake to rate. Similarly, the credit assessments of the Agent for the Sponsors represent the opinion of the Agent for the Sponsors as to the credit quality of the debt obligations that it assesses. It should be emphasized, however, that ratings and other credit assessments are general and 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.

The portfolios underlying any Other Fund Units (the units of no one Other Fund represented more than 5%, and all Other Fund Units represented less than 10%, of the aggregate offering side evaluation of the Portfolio on the Date of Deposit) are substantially similar to that of the Fund. The percentage of the Portfolio, if any,

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represented by Other Fund Units on the Evaluation Date is set forth under Investment Summary in Part A. On their respective dates of deposit, the underlying debt obligations in any Other Funds were rated BBB or better by Standard & Poor's or Baa or better by Moody's. While certain of those debt obligations may not currently meet these criteria, they did not represent more than 0.5% of the face amount of the Portfolio on the Date of Deposit. Debt obligations in each Other Fund which do not mature according to their terms within 10 years after the Date of Deposit had an aggregate bid side evaluation of at least 40% of the initial face amount of the Other Fund. The investment objectives of the Other Funds are similar to the investment objective of the Fund, and the Sponsors, Trustee and Evaluator of the Other Funds have responsibilities and authority paralleling in most important respects those described in this Prospectus and receive similar fees. The names of any Other Funds represented in the Portfolio and the number of units of each Other Fund in

the Fund may be obtained without charge by writing to the Trustee.

The Fund consists of the Securities listed under Portfolio in Part A (including certain securities deposited in the Fund in exchange or substitution for Debt Obligations upon certain refundings) as long as they may continue to be held in the Fund, together with accrued and undistributed interest thereon and undistributed and uninvested cash realized from the disposition or redemption of Securities (see Administration of the Fund-- Portfolio Supervision). Neither the Sponsors nor the Trustee shall be liable in any way for any default, failure or defect in any Security.

#### INCOME; ESTIMATED CURRENT RETURN; ESTIMATED LONG-TERM RETURN

Generally. The estimated net annual interest rate per Unit on the Evaluation Date is set forth under Investment Summary in Part A. This rate shows the percentage return based on the face amount per Unit after deducting estimated annual fees and expenses expressed as a percentage. Interest on the Securities in the Fund, less estimated fees of the Trustee and (if applicable) Sponsors and certain other expenses, is expected to accrue (except on Floating Rate Series) at the daily rate (based on a 360-day year) shown under Investment Summary in Part A. These rates will vary as Securities are exchanged, redeemed, paid or sold, or as the expenses of the Fund change.

Estimated Current Return on a Unit represents annual cash receipts from coupon-bearing debt obligations in the Portfolio (after estimated annual expenses) divided by the maximum Public Offering Price (including the sales charge). For investors interested primarily in cash flow, current return is a readily ascertainable measure.

'Current return' provides different information than 'yield' or 'long-term return'. Under accepted bond practice, tax-exempt bonds are customarily offered to investors on a 'yield' basis, which involves a computation of yield to maturity (or earlier call date), and which takes into account not only the interest payable on the bonds but also the amortization or accretion to a specified date of any premium over or discount from the par (maturity) value in the bond's purchase price. The Estimated Long-Term Return represents an average of the yields to maturity (or earliest call date for obligations trading at prices above the particular call price) of the Debt Obligations in the Portfolio, calculated in accordance with accepted bond practice and adjusted to reflect expenses and sales charges. In calculating Estimated Long-Term Return, the average yield for the Portfolio is derived by weighting each Debt Obligation's yield by the market value of the Debt Obligation and by the amount of time remaining to the date to which the Debt Obligation is priced. Once the average Portfolio yield is computed, this figure is then adjusted for estimated expenses and the effect of the maximum sales charge paid by investors. The Estimated Long-Term Return calculation does not take into account certain delays in distributions of income and

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the timing of other receipts and distributions on Units and may, depending on maturities, over or understate the impact of sales charges. Both of these factors may result in a lower figure.

Both Estimated Current Return and Estimated Long-Term Return are subject to fluctuation with changes in Portfolio composition (including changes in the ratings or other credit assessments of as well as the redemption, sale or other disposition of Debt Obligations in the Portfolio), changes in market value of the underlying Debt Obligations and changes in fees and expenses, including sales charges. The size of any difference between Estimated Current Return and Estimated Long-Term Return can also be expected to fluctuate at least as frequently. In addition, both return figures may not be directly comparable to yield figures used to measure other investments, and since the return figures are based on certain assumptions and variables the actual returns received by a Holder may be higher or lower.

Floating Rate Series. The yield on Units will vary from time to time. The Current Yield Quotation is calculated by multiplying net current interest rate per Unit, based on the interest rates applicable to the underlying Debt Obligations as of the day of calculation, times \$1,000 face amount per Unit and dividing the result by the Public Offering Price (which does not include accrued interest). The Public Offering will vary with fluctuations in the offering side evaluation of the underlying Debt Obligations. The net current interest income per Unit will change as the interest rates on the Debt Obligations (which are determined as often as daily) fluctuate with the movement of the applicable prime rates and as Debt Obligations are redeemed, paid or sold or as the fees and expense of the Trustee, Sponsors and Evaluator vary. Any change in either net current interest income per Unit or the Public Offering Price will result in a change in the Current Yield Quotation. There is no assurance that the current yield on Units will be realized in the future.

Accrued Interest. In addition to the Public Offering Price, the price of a Unit includes accrued interest on the Securities. At the time of the original offering of the Fund, and to avoid having Holders pay accrued interest to the initial Date of Deposit, the Trustee was responsible for the payment of accrued



interest on the Debt Obligations to the original Date of Deposit and then recovered this amount from the earliest interest payments received by the Fund. Additionally, interest on the Debt Obligations in the Fund is paid on a semi-annual (or less frequently, annual) basis. Because interest on the Securities is not received by the Fund at a constant rate throughout the year, Monthly Income Distribution may be more or less than the interest actually received by the Fund. In order to eliminate fluctuations in Series making Monthly Income Distributions (except Floating Rate Series), the Trustee is required to advance the amounts necessary to provide approximately equal Monthly Income Distributions. The Trustee will be reimbursed, without interest, for these advances from interest received on the Securities. Therefore, to account for these factors, accrued interest is always added to the value of the Units. And because of the varying interest payment dates of the Securities, accrued interest at any time will be greater than the amount of interest actually received by the Fund and distributed to Holders. If a Holder sells all or a portion of his Units, he will receive his proportionate share of the accrued interest from the purchaser of his Units. Similarly, if a Holder redeems all or a portion of his Units, the Redemption Price per Unit will include accrued interest on the Securities. And if a Security is sold, redeemed or otherwise disposed of, accrued interest will be received by the Fund and will be distributed periodically to Holders.

Certain of the Debt Obligations may have been purchased on a when, as and if issued basis or had a delayed delivery. Since interest on these Debt Obligations did not begin accruing to the benefit of Holders until they were delivered, in order to provide tax-exempt income to the Holders for this non-accrual period, the Trustee's Annual Fee and Expenses (set forth under Investment Summary in Part A) may be reduced in an amount equal to the

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amount of interest that would have accrued on these Debt Obligations between the initial settlement date for Units and the dates of delivery. The reduction of the Trustee's Annual Fee and Expenses eliminates the necessity of reducing Monthly Income Distributions.

#### TAXES

The following discussion addresses only the tax consequences to those holding Units as capital assets and does not address the tax consequences of holding Units to dealers, financial institutions or insurance companies.

In the opinion of Davis Polk & Wardwell, special counsel for the Sponsors, under existing law:

The Fund\* is not an association taxable as a corporation for Federal income tax purposes, and income received by the Fund will be treated as the income of the Holders in the manner set forth below.

Each Holder will be considered the owner of a pro rata portion of each Debt Obligation in the Fund and of each debt obligation in any Other Fund under the grantor trust rules of Sections 671-679 of the Internal Revenue Code of 1986, as amended (the 'Code'). The total cost to a Holder of his Units, including sales charges, is allocated among his pro rata portion of each Security (in proportion to the fair market values thereof on the date the Holder purchases his Units) in order to determine his tax cost for his pro rata portion of each Security. A Holder's tax cost for his pro rata portion of any Other Fund Unit as determined above is further allocated among his pro rata portion of each of the debt obligations in the Other Fund in order to determine the Holder's tax cost for his pro rata portion of each such debt obligation. The term 'Debt Obligations' as used hereinafter under Taxes shall include the debt obligations in any Other Fund.

Each Holder will be considered to have received the interest on his pro rata portion of each Debt Obligation when interest on the Debt Obligation is received by the Fund or an Other Fund, as the case may be. In the opinion of bond counsel (delivered on the date of issuance of the Debt Obligation), such interest will be excludable from gross income for regular Federal income tax purposes (except in certain limited circumstances referred to below). Amounts received by the Fund or an Other Fund, as the case may be, pursuant to a bank letter of credit, guarantee or insurance policy with respect to payments of principal, premium or interest on a Debt Obligation will be treated for Federal income tax purposes in the same manner as if such amounts were paid by the issuer of the Debt Obligation.

The Fund or any Other Fund may contain Debt Obligations which were originally issued at a discount ('original issue discount'). In general, original issue discount is defined as the difference between the price at which a debt obligation was issued and its stated redemption price at maturity. Original issue discount on a tax-exempt obligation issued after September 3, 1982 is deemed to accrue as tax-exempt interest over the life of the obligation under a formula based on the compounding of interest. Original issue discount on a tax-exempt obligation issued before July 2, 1982 is deemed to accrue as tax-exempt interest ratably over the life of

the obligation. Original issue discount on any tax-exempt obligation issued during the period beginning July 2, 1982 and ending September 3, 1982 is also deemed to accrue as tax-exempt interest over the life of the obligation, although it is not clear whether such accrual is ratable or is determined under a formula based on the compounding of interest. If a Holder's tax cost for his pro rata portion of a Debt Obligation issued with original issue discount is greater than the 'adjusted issue price' thereof but less than its stated

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\*For purposes of any Series including multiple Trusts, the term 'Fund' shall refer to each Trust separately.

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redemption price at maturity (as may be adjusted for certain payments), the Holder will be considered to have purchased his pro rata portion of the Debt Obligation at an 'acquisition premium'. Increases to the Holder's tax basis in his pro rata portion of the Debt Obligation resulting from the accrual of original issue discount will be reduced by the amount of such acquisition premium.

If a Holder's tax cost for his pro rata portion of a Debt Obligation exceeds the redemption price at maturity thereof, subject to certain adjustments, the Holder will be considered to have purchased his pro rata portion of the Debt Obligation at a 'premium'. The Holder is required to amortize the premium prior to the maturity of the Debt Obligation. Such amortization is only an adjustment to basis (i.e., a reduction of the Holder's tax cost) for his pro rata portion of the Debt Obligation and does not result in any deduction against the Holder's income. Therefore, under some circumstances, a Holder may recognize taxable gain when his pro rata portion of a Debt Obligation is disposed of for an amount equal to or less than his original tax cost therefor.

A Holder will recognize taxable gain or loss, when all or part of his pro rata portion of a Debt Obligation is disposed of for an amount greater or less than his original tax cost therefor plus any accrued original issue discount (net of any acquisition premium) or minus any amortized bond premium. Under current law, any such taxable gain or loss will be capital gain or loss, except that any gain from the disposition of a Holder's pro rata portion of a Debt Obligation acquired by the Holder at a 'market discount' (i.e., where the Holder's original cost for his pro rata portion of the Debt Obligation (plus any original issue discount which will accrue thereon) is less than its stated redemption price at maturity) would be treated as ordinary income to the extent the gain does not exceed the accrued market discount. Capital gains are generally taxed at the same rate as ordinary income. However, the excess of net long-term capital gains over short-term capital losses may be taxed at a lower rate than ordinary income for certain noncorporate taxpayers. A capital gain or loss is long-term if the asset is held for more than one year and short-term if held for one year or less. The deduction of capital losses is subject to limitations. A Holder will be considered to have disposed of all or part of his pro rata portion of each Debt Obligation when he sells or redeems all or some of his Units. A Holder will be considered to have disposed of all or part of his pro rata portion of each Debt Obligation in any Other Fund when the Fund sells or redeems all or some of the Units in the Other Fund. A Holder will also be considered to have disposed of all or part of his pro rata portion of a Debt Obligation when all or part of the Debt Obligation is sold by the Fund or an Other Fund, as the case may be, or is redeemed or paid at maturity.

Under Section 265 of the Code, a Holder (except a corporate Holder) is not entitled to a deduction for his pro rata share of fees and expenses of the Fund because the fees and expenses are incurred in connection with the production of tax-exempt income. Further, if borrowed funds are used by a Holder to purchase or carry Units of the Fund, interest on this indebtedness will not be deductible for Federal income tax purposes. In addition, under rules used by the Internal Revenue Service, the purchase of Units may be considered to have been made with borrowed funds even though the borrowed funds are not directly traceable to the purchase of Units.

Under the income tax laws of the State and City of New York, the Fund is not an association taxable as a corporation and income received by the Fund will be treated as the income of the Holders in the same manner as for Federal income tax purposes, but will not necessarily be tax-exempt.

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Interest on certain tax-exempt bonds issued after August 7, 1986 (identified under Investment Summary and Portfolio in Part A) is a preference item for purposes of the alternative minimum tax ('AMT'). Interest on other Debt Obligations should not be subject to the AMT for individuals or corporations under this rule. In addition, a corporate Holder should be aware that the

receipt of tax-exempt interest not subject to the AMT may give rise to an alternative minimum tax liability (or increase an existing liability) because the interest income will be included in the corporation's 'adjusted current earnings' for purposes of the adjustment to alternative minimum taxable income required by Section 56(g) of the Code. In addition, interest on Debt Obligations must be taken into consideration in computing the portion, if any, of social security benefits that will be included in an individual's gross income and subject to Federal income tax. Holders are urged to consult their own tax advisers concerning an investment in Units.

At the time of issuance of each Debt Obligation, an opinion relating to the validity of the Debt Obligation and to the exemption of interest thereon from regular Federal income taxes was rendered by bond counsel. Neither the Sponsors, Davis Polk & Wardwell nor any of the special counsel for state tax matters have made any review of the proceedings relating to the issuance of the Debt Obligations or the basis for these opinions. The tax exemption is dependent upon the issuer's (and other users') compliance with certain ongoing requirements, and the opinion of bond counsel assumes that the requirements will be complied with. However, there can be no assurance that the issuer (and other users) will comply with these requirements, in which event the interest on the Debt Obligation could be determined to be taxable retroactively from the date of its issuance.

In the case of certain of the Debt Obligations, the opinions of bond counsel indicate that interest on these Debt Obligations received by a 'substantial user' of the facilities being financed with the proceeds of these Debt Obligations, or persons related thereto, for periods while these Debt Obligations are held by such a user or related person, will not be exempt from regular Federal income taxes, although interest on these Debt Obligations received by others would be exempt from regular Federal income taxes. 'Substantial user' is defined under U.S. Treasury Regulations to include only a person whose gross revenue derived with respect to the facilities financed by the issuance of bonds is more than 5% of the total revenue derived by all users of these facilities, or who occupies more than 5% of the usable area of these facilities or for whom these facilities or a part thereof were specifically constructed, reconstructed or acquired. 'Related persons' are defined to include certain related natural persons, affiliated corporations, partners and partnerships.

After the end of each calendar year, the Trustee will furnish to each Holder an annual statement containing information relating to the interest received by the Fund on the Debt Obligations, the gross proceeds received by the Fund from the disposition of any Debt Obligation (resulting from redemption or payment at maturity of any Debt Obligation or the sale by the Fund of any Debt Obligation or Other Fund Unit), and the fees and expenses paid by the Fund. The Trustee will also furnish annual information returns to each Holder and to the Internal Revenue Service. Holders are required to report to the Internal Revenue Service the amount of tax-exempt interest received during the year.

Holders will be taxed in the manner described above regardless of whether distributions from the Fund are actually received by the Holders or are automatically reinvested in the Municipal Fund Accumulation Program, Inc.

From time to time proposals are introduced in Congress and state legislatures which, if enacted into law, could have an adverse impact on the tax-exempt status of the Debt Obligations. It is impossible to predict whether any legislation in respect of the tax status of interest on such obligations may be proposed and eventually enacted at the Federal or state level. The foregoing discussion relates only to Federal and New York State and City income taxes. Holders may be subject to state and local taxation depending on their state of residence and should consult their own tax advisers in this regard. Holders of State Trusts should also consult Part C of the Municipal Investment Trust Fund Prospectus.

#### PUBLIC SALE OF UNITS

#### PUBLIC OFFERING PRICE

Except for Funds specified in the tables below, the Public Offering Price in the secondary market reflects sales charges which may be at different rates depending on the maturities of the various bonds in the Portfolio. The Public Offering Price per Unit will be computed by adding to the Evaluator's determination of the bid side evaluation of each Security, a sales charge at a rate based on the time to maturity of that Security as described below, and dividing the sum of these calculations for all Securities in the Portfolio by the number of Units outstanding. For this purpose, a Security will be considered to mature on its stated maturity date unless: (a) the Security has been called for redemption or funds or securities have been placed in escrow to redeem it on an earlier call date, in which case the call date will be used; or (b) the Security is subject to a mandatory tender, in which case the mandatory tender date will be used.

TIME TO MATURITY	SALES CHARGE	
	(AS PERCENT OF BID SIDE EVALUATION)	(AS PERCENT OF PUBLIC OFFERING PRICE)
Less than six months	0%	0%
six months to 1 year	0.756%	0.75%
over 1 year to 2 years	1.523%	1.50%
over 2 years to 4 years	2.564%	2.50%
over 4 years to 8 years	3.627%	3.50%
over 8 years to 15 years	4.712%	4.50%
over 15 years	5.820%	5.50%

The total sales charge per Unit, as a percent of the Public Offering Price, is referred to below as the 'Effective Sales Charge'. For example, a Fund consisting entirely of Securities maturing in more than 8 but no more than 15 years would have an Effective Sales Charge of 4.50% of the Public Offering Price (4.712% of the net amount invested) while a Fund consisting entirely of Securities maturing in more than 15 years would have an Effective Sales Charge of 5.50% of the Public Offering Price (5.820% of the net amount invested) and so forth. A Fund consisting of Securities in each of these maturity ranges would have an Effective Sales Charge between these rates. The Public Offering Price of the Units will vary from day to day in accordance with fluctuations in the evaluations of the underlying Securities and any difference in the applicable percentage of sales charge.

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#### VOLUME PURCHASE DISCOUNTS

The sales charge per Unit determined as described above will be reduced on a graduated scale for sales to any single purchaser on a single day of specified numbers of Units set forth below. Units held in the name of the spouse of the purchaser or in the name of a child of the purchaser under 21 years of age are deemed to be registered in the name of the purchaser. The graduated sales charges are also applicable to a trustee or other fiduciary purchasing securities for a single trust estate or single fiduciary account. The number of units of other series sponsored by the Sponsors (or an equivalent number in case of units originally offered at about \$1, \$10 or \$100 each) purchased in the secondary market on the same day will be added in determining eligibility for this reduction, provided that only units of series with Effective Sales Charges within a range of 0.5% of their public offering prices will be eligible. For example, if an investor purchases units of three series of Municipal Investment Trust Fund in the secondary market on the same day--200 units with an Effective Sales Charge of 3.4%, 200 units with an Effective Sales Charge of 3.6% and 100 units with an Effective Sales Charge of 3.9%, he would be entitled to a 40% reduction on each sales charge (an actual sales charge of 60% of each Effective Sales Charge based on purchase of 500 units). If the lowest sales charge were 3.3%, the purchaser would only be entitled to a 20% reduction on two of those purchases (actual sales charge of 80% of Effective Sales Charge based on purchase of more than 249 units). The reduction will be applied on whichever basis is more favorable for the purchaser.

NUMBER OF UNITS	ACTUAL SALES CHARGE AS % OF EFFECTIVE SALES CHARGE DETERMINED ABOVE	DEALER CONCESSION AS % OF EFFECTIVE SALES CHARGE DETERMINED ABOVE
	1-249	100%
250-499	80%	52%
500-749	60%	39%
750-999	45%	29.25%
1,000 or more	35%	22.75%

To qualify for the reduced sales charge and concession applicable to quantity purchases, the selling dealer must confirm that the sale is to a single purchaser, as described in the Prospectus or is purchased for its own account and not for distribution.

Unless otherwise specified below, the Public Offering Price of Units for the Funds listed below is computed by adding to the aggregate bid side evaluation of the Securities (as determined by the Evaluator), divided by the number of Units outstanding, the sales charge at the applicable percentage of the evaluation per Unit (the net amount invested).

The following tables set forth the applicable percentage of sales charge and the concession to dealers for the Funds specified. These amounts are reduced on a graduated scale for quantity purchases and will be applied on whichever basis is more favorable to the purchaser. Sales charges and dealer concessions are as follows:

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<TABLE>  
<CAPTION>

	NUMBER OF UNITS	SALES CHARGE (GROSS UNDERWRITING PROFIT)		DEALER CONCESSION
		AS PERCENT OF PUBLIC OFFERING PRICE	AS PERCENT OF NET AMOUNT INVESTED	AS PERCENT OF PUBLIC OFFERING PRICE
<S>	<C>	<C>	<C>	<C>
Municipal Investment Trust Fund, Floating Rate Series 3, 4, 5, 13, 20, 21, 22 and 23:	Less than 1,000 1,000 or more	1.00% 0.30%	1.010% 0.301%	0.650% 0.195%

</TABLE>

The number of Units includes all Units of this and any other Fund sponsored by the Sponsors with the same rates of sales charge purchased on one day by a single purchaser as described above.

For the Funds listed below, there is no reduction for quantity purchases, and the sales charge and dealer concession are as follows:

<TABLE>  
<CAPTION>

	SALES CHARGE (GROSS UNDERWRITING PROFIT)		DEALER CONCESSION
	AS PERCENT OF PUBLIC OFFERING PRICE	AS PERCENT OF NET AMOUNT INVESTED	AS PERCENT OF PUBLIC OFFERING PRICE
<S>	<C>	<C>	<C>
Municipal Investment Trust Fund, New York Series A, B and Put Series 1-3 and Pennsylvania Put Series A	1.00%	1.010%	0.650%

</TABLE>

For the Funds listed below, the Public Offering Price of Units is computed on the basis of the Evaluator's determination of the aggregate offering side evaluation of the underlying Securities, as follows:

Municipal Investment Trust Fund, Put Series 4-9, New York Put Series 1-4:	no sales charge
Municipal Investment Trust Fund, Put Series 10:	.203% per annum of outstanding principal amount--deferred sales charge

#### PRICE PAID BY PURCHASERS

A proportionate share of any cash held by the Fund in the Capital Account not allocated to the purchase of specific Securities and net accrued and undistributed interest on the Securities to the date of delivery of the Units to the purchaser is added to the Public Offering Price.

Employees of certain of the Sponsors and their affiliates may purchase Units of the Fund at prices based on a reduced sales charge of not less than \$5.00 per Unit.

Evaluations of the Securities are determined by the Evaluator, taking into account the same factors referred to under Redemption--Computation of Redemption Price per Unit. The determination is made each business day as of the Evaluation Time set forth under Investment Summary in Part A (the 'Evaluation Time'), effective for all sales made since the last of these evaluations (Section 4.01). The term 'business day', as used herein and under 'Redemption', shall exclude Saturdays, Sundays and the following holidays as observed by the New York

Stock Exchange: New Year's Day, Washington's Birthday, Good Friday, Memorial Day, Independence Day, Labor Day, Thanksgiving and Christmas.

#### COMPARISON OF PUBLIC OFFERING PRICE, SPONSORS' REPURCHASE PRICE AND REDEMPTION PRICE

On the Evaluation Date the Public Offering Price per Unit (which includes the sales charge) exceeded the Sponsors' Repurchase Price per Unit and the Redemption Price per Unit (each based on the bid side evaluation of the Securities in the Fund--see Redemption) by the amount set forth under Investment Summary in Part A. For various reasons (including fluctuations in the market

prices of the Securities and the fact that the Public Offering Price includes the sales charge), the amount realized by a Holder upon any sale or redemption of Units may be less than the price paid by him for the Units.

#### PUBLIC DISTRIBUTION

The Sponsors intend to continue to qualify Units for sale in certain states in the U.S. in which qualification is deemed necessary by the Sponsors and by dealers who are members of the National Association of Securities Dealers, Inc. The Sponsors do not intend to qualify Units for sale in any foreign countries, and this Prospectus does not constitute an offer to sell Units in any state or country where Units cannot lawfully be sold. Sales to dealers are currently made at prices which represent a concession of the applicable rate specified above, but the Agent for the Sponsors reserves the right to change the amount of the concession to dealers from time to time. Any dealer may reallocate a concession not in excess of the concession to dealers.

#### UNDERWRITERS' AND SPONSORS' PROFITS

In maintaining a market for Units (see Market for Units) the Sponsors will realize profits or sustain losses in the amount of any difference between the prices at which they buy Units and the prices at which they resell these Units (which include the sales charge) or the prices at which they redeem these Units, as the case may be. Cash, if any, made available by buyers of Units to the Sponsors prior to the settlement date for the purchase of Units may be used in the Sponsors' businesses subject to the limitations of Rule 15c3-3 under the Securities Exchange Act of 1934 and may be of benefit to the Sponsors.

#### MARKET FOR UNITS

While the Sponsors are not obligated to do so, it is their intention to maintain a secondary market for Units of this Series and continuously to offer to purchase Units of this Series at prices, subject to change at any time, which will be computed based on the bid side of the market, taking into account the same factors referred to in determining the bid side evaluation of Securities for purposes of redemption (see Redemption). The Sponsors may discontinue purchases of these Units at prices based on the bid side evaluation of the Securities should the supply of Units exceed demand or for other business reasons. In this event the Sponsors may nonetheless under certain circumstances purchase Units, as a service to Holders, at prices based on current redemption prices for those Units (see Redemption). The Sponsors, of course, do not in any way guarantee the enforceability, marketability or price of any Securities in the Portfolio or of the Units. Prospectuses relating to certain other unit trusts indicate an intention, subject to change on the part of the respective sponsors of such trusts, to purchase units of those trusts on the basis of a price higher than the bid prices of the bonds in the trusts. Consequently, depending upon the prices actually paid, the repurchase price of other sponsors for units of their trusts may be computed on a somewhat more favorable basis than the repurchase price offered by the Sponsors for Units of this

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Series in secondary market transactions. As in this Series, the purchase price per unit of such unit trusts will depend primarily on the value of the bonds in the portfolio of the trust.

The Sponsors may redeem any Units they have purchased in the secondary market or through the Trustee in accordance with the procedures described below if they determine it is undesirable to continue to hold these Units in their inventories. Factors which the Sponsors will consider in making this determination will include the number of units of all series of all funds which they hold in their inventories, the saleability of the units and their estimate of the time required to sell the units and general market conditions. For a description of certain consequences of any redemption for remaining Holders, see Redemption.

A Holder who wishes to dispose of his Units should inquire of his bank or broker as to current market prices in order to determine if there exist over-the-counter prices in excess of the repurchase price.

#### REDEMPTION

While it is anticipated that Units in most cases can be sold in the over-the-counter market for an amount equal to the Redemption Price per Unit (see Market for Units), Units may be redeemed at the office of the Trustee upon tender on any business day, as defined under Public Sale of Units--Public Offering Price, of Certificates or, in the case of uncertificated Units, delivery of a request for redemption, and payment of any relevant tax, without any other fee (Section 5.02). Certificates to be redeemed must be properly endorsed or accompanied by a written instrument or instruments of transfer. Holders must sign exactly as their names appear on the face of the Certificate with the signatures guaranteed by an eligible guarantor institution or in some other manner acceptable to the Trustee. In certain instances the Trustee may require additional documents including, but not limited to, trust instruments, certificates of death, appointments as executor or administrator or certificates

of corporate authority.

On the seventh calendar day following the tender (or if the seventh calendar day is not a business day on the first business day prior thereto), the Holder will be entitled to receive the proceeds of the redemption in an amount per Unit equal to the Redemption Price per Unit (see below) as determined as of the Evaluation Time next following the tender. So long as the Sponsors are maintaining a market at prices not less than the Redemption Price per Unit, the Sponsors will repurchase any Units tendered for redemption no later than the close of business on the second business day following the tender (see Market for Units). The Trustee is authorized in its discretion, if the Sponsors do not elect to repurchase any Units tendered for redemption or if a Sponsor tenders Units for redemption, to sell the Units in the over-the-counter market at prices which will return to the Holder a net amount in cash equal to or in excess of the Redemption Price per Unit for the Units (Section 5.02).

The Trustee is empowered to sell Securities in order to make funds available for redemption (Section 5.02) if funds are not otherwise available in the Capital and Income Accounts (see Administration of the Fund-- Accounts and Distributions). The Securities to be sold will be selected from a list supplied by the Sponsors. Securities will be chosen for this list by the Sponsors on the basis of those market and credit factors as they may determine are in the best interests of the Fund. Provision is made under the Indenture for the Sponsors to specify minimum face amounts in which blocks of Securities are to be sold in order to obtain the best price for the Fund. While these minimum amounts may vary from time to time in accordance with market conditions, the Sponsors believe that the minimum face amounts which would be specified would range from \$25,000 for readily marketable Securities to \$250,000 for certain Restricted Securities which can be distributed on short notice only

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by private sale, usually to institutional investors. Provision is also made that sales of Securities may not be made so as to (i) result in the Fund owning less than \$250,000 of any Restricted Security or (ii) result in more than 50% of the Fund consisting of Restricted Securities. In addition, the Sponsors will use their best efforts to see that these sales of Securities are carried out in such a way that no more than 40% in face amount of the Fund is invested in Restricted Securities, provided that sales of unrestricted Securities may be made if the Sponsors' best efforts with regard to timely sales of Restricted Securities at prices they deem reasonable are unsuccessful and if as a result of these sales more than 50% of the Fund does not consist of Restricted Securities. Thus the redemption of Units may require the sale of larger amounts of Restricted Securities than of unrestricted Securities.

To the extent that Securities are sold, the size and diversity of the Fund will be reduced. Sales will usually be required at a time when Securities would not otherwise be sold and may result in lower prices than might otherwise be realized. The price received upon redemption may be more or less than the amount paid by the Holder depending on the value of the Securities in the Portfolio at the time of redemption.

The right of redemption may be suspended and payment postponed (1) for any period during which the New York Stock Exchange, Inc. is closed other than for customary weekend and holiday closings, or (2) for any period during which, as determined by the SEC, (i) trading on that Exchange is restricted or (ii) an emergency exists as a result of which disposal or evaluation of the Securities is not reasonably practicable, or (3) for any other periods which the SEC may by order permit (Section 5.02).

#### COMPUTATION OF REDEMPTION PRICE PER UNIT

Redemption Price per Unit is computed by the Trustee, as of the Evaluation Time, on each June 30 and December 31 (or the last business day prior thereto), on any business day as of the Evaluation Time next following the tender of any Unit for redemption, and on any other business day desired by the Trustee or the Sponsors, by adding (a) the aggregate bid side evaluation of the Securities, (b) cash on hand in the Fund (other than cash covering contracts to purchase Securities), (c) accrued and unpaid interest on the Securities up to but not including the date of redemption and (d) all other assets of the Fund; deducting therefrom the sum of (x) taxes or other governmental charges against the Fund not previously deducted, (y) accrued fees and expenses of the Trustee (including legal and auditing expenses), the Sponsors, the Evaluator and counsel, and certain other expenses and (z) cash held for distribution to Holders of record as of a date prior to the evaluation; and dividing the result by the number of Units outstanding as of the date of computation (Section 5.01).

The aggregate current bid or offering side evaluation of the Securities is determined by the Evaluator in the following manner: if the Securities are traded on the over-the-counter market, this evaluation is generally based on the closing sale prices on the over-the-counter market (unless the Evaluator deems these prices inappropriate as a basis for evaluation). If closing sale prices are unavailable, the evaluation is generally determined (a) on the basis of current bid or offering prices for the Securities, (b) if bid or offering prices are not available for any Securities, on the basis of current bid or offering

prices for comparable securities, (c) by appraising the value of the Securities on the bid or offering side of the market or (d) by any combination of the above (Section 4.01).

The value of any insurance, other than any Portfolio Insurance, is reflected in the market value of any Insured Debt Obligations. The Evaluator will consider the value of any Portfolio Insurance (including the right to obtain Permanent Insurance) in its evaluation of Portfolio-Insured Debt Obligations only when they are in default in payment of principal or interest or in significant risk of default. It is the position of the Sponsors that this is a

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fair method of valuing the Insured Debt Obligations and the insurance and reflects a proper valuation method in accordance with the provisions of the Investment Company Act of 1940.

#### EXPENSES AND CHARGES

##### FEES

An estimate of the total annual expenses of the Fund is set forth under Investment Summary in Part A. The Trustee receives for its services as Trustee and for reimbursement of expenses incurred on behalf of the Fund, payable in monthly installments, the amount set forth under Investment Summary as Trustee's Annual Fee and Expenses, which includes the Evaluator's Fee, the estimated Sponsors' Portfolio Supervision Fee, estimated reimbursable bookkeeping or other administrative expenses paid to the Sponsors and certain mailing and printing expenses. The Trustee also receives benefits to the extent that it holds funds on deposit in the various non-interest bearing accounts created under the Indenture.

The Sponsors' Portfolio Supervision Fee is based on the average of the largest face amount of Debt Obligations in the Fund during each month of a calendar year in which any additional Debt Obligations are deposited, and thereafter on the largest face amount of Debt Obligations in the Fund at any time during the year. This fee, which is not to exceed the maximum amount set forth under Investment Summary in Part A, may exceed the actual costs of providing portfolio supervisory services for this Fund, but at no time will the total amount the Sponsors receive for portfolio supervisory services rendered to all series of Municipal Investment Trust Fund in any calendar year exceed the aggregate cost to them of supplying these services in that year. In addition, the Sponsors may also be reimbursed for bookkeeping and other administrative services provided to the Fund in amounts not exceeding their costs of providing these services (Section 3.04, 7.05 or 7.06).

The foregoing fees may be adjusted for inflation in accordance with the terms of the Indenture without approval of Holders (Sections 4.03, 7.06 and 8.05).

##### OTHER CHARGES

Other charges that may be incurred by the Fund include: (a) fees of the Trustee for extraordinary services (Section 8.05), (b) certain extraordinary expenses of the Trustee (including legal and auditing expenses) and of counsel designated by the Sponsors (Sections 3.04, 3.08 or 3.09, 7.05(b), 8.01, 8.03 and 8.05), (c) various governmental charges (Sections 3.03 and 8.01(h)), (d) expenses and costs of action taken to protect the Fund (Section 8.01(d)), (e) indemnification of the Trustee for any losses, liabilities and expenses incurred without gross negligence, bad faith or wilful misconduct on its part (Section 8.05), (f) indemnification of the Sponsors for any losses, liabilities and expenses incurred without gross negligence, bad faith, wilful misconduct or reckless disregard of their duties (Section 7.05(b)), (g) expenditures incurred in contacting Holders upon termination of the Fund (Section 9.02) and (h) any premiums for additional insurance necessary to retain the rating of any Insured Fund that is rated (see Description of the Fund--Insurance). The amounts of these charges and fees are secured by a lien on the Fund and, if the balances in the Income and Capital Accounts (see below) are insufficient, the Trustee has the power to sell Securities to pay these amounts (Section 8.05).

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#### ADMINISTRATION OF THE FUND

##### RECORDS

The Trustee keeps a register of the names, addresses and holdings of all Holders. The Trustee also keeps records of the transactions of the Fund, including a current list of the Securities and a copy of the Indenture, which are available to Holders for inspection at the office of the Trustee at reasonable times during business hours (Sections 6.01, 8.02 and 8.04).

#### ACCOUNTS AND DISTRIBUTIONS



Interest received is credited to an Income Account and other receipts to a Capital Account (Sections 3.01 and 3.02). For Funds making Monthly Income Distributions these will be made to each Holder as of each Record Day on the following Distribution Day or shortly thereafter. For Funds making Monthly Income Distributions (except Floating Rate Series, on which the amount changes monthly) each distribution shall consist of an amount substantially equal to one-twelfth of the Holder's pro rata share of the estimated annual income to the Income Account, after deducting estimated expenses, plus the Holder's pro rata share of the distributable cash balance of the Capital Account computed as of the close of business on the preceding Record Day. An estimate of the Monthly Income Distribution is set forth under Investment Summary in Part A. This amount will change as Securities are redeemed, paid or sold. Proceeds received from the disposition, payment or prepayment of any of the Securities subsequent to a Record Day and prior to the succeeding Distribution Day will be held in the Capital Account to be distributed on the second succeeding Distribution Day. The first distribution for persons who purchase Units between a Record Day and a Distribution Day will be made on the second Distribution Day following their purchase of Units. No distribution need be made from the Capital Account if the balance therein is less than the amount set forth under Investment Summary in Part A (Section 3.04). A Reserve Account may be created by the Trustee by withdrawing from the Income or Capital Accounts, from time to time, those amounts deemed requisite to establish a reserve for any taxes or other governmental charges that may be payable out of the Fund (Section 3.03). Funds held by the Trustee in the various accounts created under the Indenture do not bear interest (Section 8.01).

For Funds making Semi-Annual Distributions, the pro rata share of the Income Account represented by each Unit will be computed by the Trustee semi-annually on Computation Days (see Investment Summary in Part A), and the pro rata share of the cash in the Capital Account represented by each Unit will be computed semi-annually each year as of the Record Days. The distribution to Holders as of each Record Day will be made on the fifth day following each respective Computation Day or shortly thereafter.

#### INVESTMENT ACCUMULATION PROGRAM

Distributions of interest and any principal or premium received by the Fund will be paid in cash. However, except for Floating Rate Series, a Holder may elect to have these distributions reinvested without sales charge in The Municipal Fund Accumulation Program, Inc. (the 'Program'). The Program is an open-end management investment company whose primary investment objective is to obtain income that is exempt from regular Federal income tax through investment in a diversified portfolio consisting primarily of state, municipal and public authority debt obligations with credit characteristics comparable to those of securities in Monthly Payment Series of Municipal Investment Trust Fund. Investors should note that obligations in the Program are not insured or backed by other third-party obligations and that distributions from the Program probably will not be exempt

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from the personal income taxes of any state. Holders participating in the Program will be taxed on their reinvested distributions in the manner described under Taxes even though distributions are reinvested in the Program. For more complete information about the Program, including charges and expenses, return the enclosed form for a prospectus. Read it carefully before you decide to participate. Notice of election to participate must be received by the Trustee in writing at least ten days before the Record Day for the first distribution to which the notice is to apply.

#### PORTFOLIO SUPERVISION

The Fund is a unit investment trust and is not an actively managed fund. Traditional methods of investment management for a managed fund typically involve frequent changes in a portfolio of securities on the basis of economic, financial and market analyses. The Portfolio of the Fund, however, will not be managed and therefore the adverse financial condition of an issuer will not necessarily require the sale of its securities from the Portfolio. However, Merrill Lynch, Pierce, Fenner & Smith Incorporated, as Agent for the Sponsors, may direct the disposition of Securities upon default in payment of amounts due on any of the Securities, institution of certain legal proceedings, default under certain documents adversely affecting debt service, default in payment of amounts due on other securities of the same issuer or guarantor, decline in projected income pledged for debt service on revenue bond issues, or decline in price or the occurrence of other market or credit factors, including advance refunding (i.e., the issuance of refunding bonds and the deposit of the proceeds thereof in trust or escrow to retire the refunded Securities on their respective redemption dates), that in the opinion of the Sponsors would make the retention of these Securities detrimental to the interest of the Holders. If a default in the payment of amounts due on any Security occurs and if the Sponsors fail to give instructions to sell or to hold the Security, the Indenture provides that the Trustee, within 30 days of that failure by the Sponsors, may sell the Security (Sections 3.06 or 3.07 and 3.09 or 3.10). In addition, the Agent for the Sponsors may occasionally, at the expense of the Fund, seek to supplement existing credit support arrangements for the Securities with letters of credit

or guarantees issued by banks or thrifts if the support can be obtained at a reasonable cost (Section 3.15).

The Sponsors are required to instruct the Trustee to reject any offer made by an issuer of any of the Debt Obligations to issue new Debt Obligations in exchange or substitution for any Debt Obligations pursuant to a refunding or refinancing plan, except that the Sponsors may instruct the Trustee to accept or reject any offer or to take any other action with respect thereto as the Sponsors may deem proper if (a) the issuer is in default with respect to these Debt Obligations or (b) in the written opinion of the Sponsors the issuer will probably default with respect to these Debt Obligations in the reasonably foreseeable future. Any Debt Obligations so received in exchange or substitution will be held by the Trustee subject to the terms and conditions of the Indenture to the same extent as Debt Obligations originally deposited thereunder. Within five days after the elimination of a Debt Obligation and the acquisition of a replacement Debt Obligation in exchange or substitution therefor, the Trustee is required to give notice thereof to each Holder, identifying the Debt Obligations eliminated and the Debt Obligations substituted therefor (Section 3.07 or 3.08). Except as stated herein, the acquisition by the Fund of any securities other than the Securities initially deposited and certain substitute Debt Obligations is prohibited.

#### REPORTS TO HOLDERS

With each distribution, the Trustee furnishes Holders with a statement of the amounts of interest and other receipts, if any, which are being distributed, expressed in each case as a dollar amount per Unit. After the end of each calendar year, the Trustee will furnish to each person who at any time during the calendar year was a Holder

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of record a statement (i) summarizing transactions for the year in the Income and Capital Accounts, (ii) listing the Securities held and the number of Units outstanding at the end of that calendar year, (iii) stating the Redemption Price per Unit based upon the computation thereof made at the end of that calendar year and (iv) specifying the amounts distributed during that calendar year from the Income and Capital Accounts (Section 3.05 or 3.06). The accounts of the Fund are audited at least annually by independent certified public accountants designated by the Sponsors and the report of the accountants shall be furnished by the Trustee to Holders upon request (Section 8.01(e)).

In order to enable them to comply with Federal and state tax reporting requirements, Holders will be furnished upon request to the Trustee with evaluations of Securities furnished to it by the Evaluator (Section 4.02) and evaluations of the debt obligations in any Other Funds.

#### CERTIFICATES

Each purchaser is entitled to receive, on request, a registered Certificate for his Units. Certain of the Sponsors may collect charges for registering and shipping Certificates to purchasers. These Certificates are transferable or interchangeable upon presentation at the office of the Trustee with a payment of \$2.00 if required by the Trustee (or other amounts specified by the Trustee and approved by the Sponsors) for each new Certificate and any sums payable for taxes or other governmental charges imposed upon the transaction (Section 6.01) and compliance with the formalities necessary to redeem Certificates (see Redemption). Mutilated, destroyed, stolen or lost Certificates will be replaced upon delivery of satisfactory indemnity and payment of expenses incurred (Section 6.02).

#### AMENDMENT AND TERMINATION

The Sponsors and Trustee may amend the Indenture, without the consent of the Holders, (a) to cure any ambiguity or to correct or supplement any provision thereof which may be defective or inconsistent, (b) to change any provision thereof as may be required by the SEC or any successor governmental agency or (c) to make any other provisions which do not adversely affect the interest of the Holders (as determined in good faith by the Sponsors). The Indenture may also be amended in any respect by the Sponsors and the Trustee, or any of the provisions thereof may be waived, with the consent of the Holders of 66% of the Units in the case of the 1st California Series, the 1st through 26th Intermediate Term Series, the 1st and 2nd Minnesota Series, the 7th through 37th New York Series, the 9th through 16th Pennsylvania Series, or the 9th through 185th Monthly Payment Series, and of Holders of 51% of the Units in the 186th and subsequent Monthly Payment Series, the 2nd and subsequent California Series, the 27th and subsequent Intermediate Term Series, the 3rd and subsequent Minnesota Series, the 38th and subsequent New York Series, the 17th and subsequent Pennsylvania Series, all Floating Rate Series, Multistate Series, Insured Series, Put Series, and all other State Series, provided that none of these amendments or waivers will reduce the interest in the Fund of any Holder without the consent of the Holder or reduce the percentage of Units required to consent to any of these amendments or waivers without the consent of all Holders (Section 10.01).

The Indenture will terminate upon the maturity, sale, redemption or other disposition of the last Security held thereunder but in no event is it to continue beyond the mandatory termination date set forth under Investment Summary in Part A. Any Fund with a Date of Deposit after June 16, 1987 will in no event continue beyond the expiration of 20 years after the death of the last survivor of eight persons named in the Indenture, the oldest of whom was born in 1985 and the youngest of whom was born in 1987. The Indenture may be terminated

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by the Sponsors if the value of the Fund is less than the minimum value set forth under Investment Summary in Part A, and may be terminated at any time by written instruments executed by the Sponsors and consented to by Holders of the same percentage of the Units as stated in the preceding paragraph (Sections 8.01(g) and 9.01). The Trustee will deliver written notice of any termination to each Holder within a reasonable time prior to the termination, specifying the approximate final payment date. Within a reasonable time after the termination, the Trustee must sell all of the Securities then held and distribute to each Holder, upon surrender for cancellation of his Certificates and after deductions for accrued and unpaid fees, taxes and governmental and other charges, that Holder's interest in the Income and Capital Accounts (Section 9.01). This distribution will normally be made by mailing a check in the amount of each Holder's interest in these accounts to the address of the Holder appearing on the record books of the Trustee.

#### RESIGNATION, REMOVAL AND LIMITATIONS ON LIABILITY

##### SPONSORS

Any Sponsor may resign if one remaining Sponsor maintains a net worth of \$2,000,000 and is agreeable to the resignation (Section 7.04). A new Sponsor may be appointed by the remaining Sponsors and the Trustee to assume the duties of the resigning Sponsor. If there is only one Sponsor and it fails to perform its duties or becomes incapable of acting or becomes bankrupt or its affairs are taken over by public authorities, then the Trustee may (a) appoint a successor Sponsor at rates of compensation deemed by the Trustee to be reasonable and as may not exceed amounts prescribed by the SEC, or (b) terminate the Indenture and liquidate the Fund or (c) continue to act as Trustee without terminating the Indenture (Section 8.01(f)). Merrill Lynch has been appointed by the other Sponsors as agent for purposes of taking action under the Indenture (Section 7.01). If the Sponsors are unable to agree with respect to action to be taken jointly by them under the Indenture and they cannot agree as to which Sponsor shall continue to act as sole Sponsor, then Merrill Lynch shall continue to act as sole Sponsor (Section 7.02(b)). If one of the Sponsors fails to perform its duties or becomes incapable of acting or becomes bankrupt or its affairs are taken over by public authorities, then that Sponsor is automatically discharged and the other Sponsors shall act as sole Sponsors (Section 7.02(a)). The Sponsors shall be under no liability to the Fund or to the Holders for taking any action or for refraining from taking any action in good faith or for errors in judgment and shall not be liable or responsible in any way for depreciation or loss incurred by reason of the sale of any Security. This provision, however, shall not protect the Sponsors in cases of wilful misfeasance, bad faith, gross negligence or reckless disregard of their obligations and duties (Section 7.05). The Sponsors and their successors are jointly and severally liable under the Indenture. A Sponsor may transfer all or substantially all of its assets to a corporation or partnership which carries on its business and duly assumes all of its obligations under the Indenture and in that event it shall be relieved of all further liability under the Indenture (Section 7.03).

##### TRUSTEE

The Trustee or any successor may resign upon notice to the Sponsors. The Trustee may be removed at any time upon the direction of the Holders of the same percentage of the Units as required to amend the Indenture (see Amendment and Termination above) or by the Sponsors without the consent of any of the Holders if the Trustee becomes incapable of acting or becomes bankrupt or its affairs are taken over by public authorities. The resignation or removal shall become effective upon the acceptance of appointment by the successor which may, in the case of a resigning or removed Co-Trustee, be one or more of the remaining Co-Trustees. In the case of resignation or removal, the Sponsors are to use their best efforts to appoint a successor promptly and if upon

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resignation of the Trustee no successor has accepted appointment within thirty days after notification, the Trustee may apply to a court of competent jurisdiction for the appointment of a successor (Section 8.06). The Trustee shall be under no liability for any action taken in good faith in reliance on prima facie properly executed documents or for the disposition of monies or Securities, nor shall it be liable or responsible in any way for depreciation or loss incurred by reason of the sale of any Security. This provision, however, shall not protect the Trustee in cases of wilful misfeasance, bad faith, gross negligence or reckless disregard of its obligations and duties. In the event of the failure of the Sponsors to act, the Trustee may act under the Indenture and shall not be liable for any of these actions taken in good faith. The Trustee

shall not be personally liable for any taxes or other governmental charges imposed upon or in respect of the Securities or upon the interest thereon. In addition, the Indenture contains other customary provisions limiting the liability of the Trustee (Sections 3.06 or 3.07, 3.09 or 3.10, 8.01 and 8.05).

#### EVALUATOR

The Evaluator may resign or may be removed, effective upon the acceptance of appointment by its successor, by the Sponsors, who are to use their best efforts to appoint a successor promptly. If upon resignation of the Evaluator no successor has accepted appointment within thirty days after notification, the Evaluator may apply to a court of competent jurisdiction for the appointment of a successor (Section 4.05). Determinations by the Evaluator under the Indenture shall be made in good faith upon the basis of the best information available to it; provided, however, that the Evaluator shall be under no liability to the Trustee, the Sponsors or the Holders for errors in judgment. This provision, however, shall not protect the Evaluator in cases of wilful misfeasance, bad faith, gross negligence or reckless disregard of its obligations and duties (Section 4.04). The Trustee, the Sponsors and the Holders may rely on any evaluation furnished by the Evaluator and shall have no responsibility for the accuracy thereof.

#### MISCELLANEOUS

##### TRUSTEE

The Trustee of the Fund is named on the back cover page of this Prospectus and is either The Bank of New York, a New York banking corporation with its Unit Investment Trust Department at 101 Barclay Street, New York, New York 10286 (which is subject to supervision by the New York Superintendent of Banks, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System); Bankers Trust Company, a New York banking corporation with its corporate trust office at 4 Albany Street, 7th Floor, New York, New York 10015 (which is subject to supervision by the New York Superintendent of Banks, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System); The Chase Manhattan Bank, N.A., a national banking association with its Unit Trust Department at 1 Chase Manhattan Plaza--3B, New York, New York 10081 (which is subject to supervision by the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System); or (acting as Co-Trustees) Investors Bank & Trust Company, a Massachusetts trust company with its unit investment servicing group at One Lincoln Plaza, Boston, Massachusetts 02111 (which is subject to supervision by the Massachusetts Commissioner of Banks, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System) and The First National Bank of Chicago, a national banking association with its corporate trust office at One First National Plaza, Suite 0126, Chicago, Illinois 60670-0126 (which is subject to supervision by

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the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System).

#### LEGAL OPINION

The legality of the Units originally offered has been passed upon by Davis Polk & Wardwell, 450 Lexington Avenue, New York, New York 10017, as special counsel for the Sponsors. Emmet, Marvin & Martin, 48 Wall Street, New York, New York 10005, act as counsel for The Bank of New York, as Trustee. Hawkins, Delafield & Wood, 67 Wall Street, New York, New York 10005, act as counsel for Bankers Trust Company, as Trustee. Carter, Ledyard & Milburn, 2 Wall Street, New York, New York 10005, act as counsel for United States Trust Company of New York, as Trustee. Bingham, Dana & Gould, 150 Federal Street, Boston, Massachusetts 02110, act as counsel for The First National Bank of Chicago and Investors Bank & Trust Company, as Co-Trustees.

#### AUDITORS

The financial statements of the Fund included in Part A have been examined by Deloitte & Touche, independent accountants, as stated in their opinion appearing therein and have been so included in reliance upon that opinion given on the authority of that firm as experts in accounting and auditing.

#### SPONSORS

The Sponsors of this Fund are listed on the cover of Part A. Each Sponsor is a Delaware corporation and is engaged in the underwriting, securities and commodities brokerage business, and is a member of the New York Stock Exchange, Inc., other major securities exchanges and commodity exchanges, and the National Association of Securities Dealers, Inc. Merrill Lynch, Pierce, Fenner and Smith Incorporated and Merrill Lynch Asset Management, a Delaware corporation and subsidiary of Merrill Lynch & Co., Inc., the parent of Merrill Lynch, Pierce, Fenner & Smith Incorporated, are engaged in the investment advisory business. Smith Barney Shearson Inc., an investment banking and securities broker-dealer firm, is an indirect wholly-owned subsidiary of Primerica Corporation

('Primerica'). In July 1993 Primerica and Smith Barney, Harris Upham & Co. Incorporated ('Smith Barney') acquired the assets of the domestic retail brokerage and asset management businesses of Shearson Lehman Brothers Inc. ('Shearson'), previously a co-Sponsor of various Defined Asset Funds. Prudential Securities Incorporated, a wholly-owned subsidiary of Prudential Securities Group Inc. and an indirect wholly-owned subsidiary of the Prudential Insurance Company of America, is engaged in the investment advisory business. PaineWebber Incorporated is engaged in the investment advisory business and is a wholly-owned subsidiary of PaineWebber Group Inc. Dean Witter Reynolds Inc., a principal operating subsidiary of Dean Witter, Discover & Co., is engaged in the investment advisory business. Sears, Roebuck and Co. indirectly has held a controlling interest in Dean Witter Reynolds Inc. but has sold a portion of that interest and is expected to sell its remaining interest in Dean Witter Reynolds Inc. Each Sponsor has acted as principal underwriter and managing underwriter of other investment companies. The Sponsors, in addition to participating as members of various selling groups or as agents of other investment companies, execute orders on behalf of investment companies for the purchase and sale of securities of these companies and sell securities to these companies in their capacities as brokers or dealers in securities.

Each Sponsor (or a predecessor) has acted as Sponsor of various series of Defined Asset Funds. A subsidiary of Merrill Lynch, Pierce, Fenner & Smith Incorporated succeeded in 1970 to the business of Goodbody & Co., which had been a co-Sponsor of Defined Asset Funds since 1964. That subsidiary resigned as Sponsor of each of

the Goodbody series in 1971. Merrill Lynch, Pierce, Fenner & Smith Incorporated has been co-Sponsor and the Agent for the Sponsors of each series of Defined Asset Funds created since 1971. Shearson Lehman Brothers Inc. and certain of its predecessors were underwriters beginning in 1962 and co-Sponsors from 1965 to 1967 and from 1980 to 1993 of various Defined Asset Funds. As a result of the acquisition of certain of Shearson's assets by Smith Barney and Primerica, as described above, Smith Barney Shearson Inc. now serves as a co-Sponsor of various Defined Asset Funds. Prudential Securities Incorporated and its predecessors have been underwriters of Defined Asset Funds since 1961 and co-Sponsors since 1964, in which year its predecessor became successor co-Sponsor to the original Sponsor. Dean Witter Reynolds Inc. and its predecessors have been underwriters of various Defined Asset Funds since 1964 and co-Sponsors since 1974. PaineWebber Incorporated and its predecessor have co-Sponsored certain Defined Asset Funds since 1983.

The Sponsors have maintained secondary markets in these funds for over 20 years. For decades informed investors have purchased unit investment trusts for dependability and professional selection of investments. Different Defined Asset Funds offer an array of investment choices, suited to fit a wide variety of personal financial goals--a buy and hold strategy for capital accumulation, such as for children's education or a nest egg for retirement, or attractive, regular current income consistent with relative protection of capital. There are Defined Asset Funds to meet the needs of just about any investor. Unit investment trusts are particularly suited for the many investors who prefer to seek long-term profits by purchasing sound investments and holding them, rather than through active trading. Few individuals have the knowledge, resources or capital to buy and hold a diversified portfolio on their own; it would generally take a considerable sum of money to obtain comparable breadth and diversity. Sometimes it takes a combination of Defined Asset Funds to plan for your objectives.

One of your most important investment decisions may be how you divide your money among asset classes. Spreading your money among different kinds of investments can balance the risks and rewards of each one. Most investment experts recommend stocks for long-term capital growth. For attractive income consider long-term corporate bonds. By combining both stock and bond funds, investors can receive attractive current income and growth potential, offering some protection against inflation.

This chart shows the average annual compounded rate of return of selected asset classes over the 10-year and 20-year periods ending December 31, 1992, compared to the rate of inflation over the same periods. Of course,

this chart represents past performance of these investments and is no guarantee of future results of the Funds. Funds also have sales charges and expenses.

Stocks (S&P 500)		
20 yr	11.33%	
10 yr		16.19%
Small-company stocks		
20 yr		15.54%
10 yr	11.55%	
Long-term corporate bonds		
20 yr	9.54%	
10 yr		13.14%

U.S. Treasury bills (short-term)					
20 yr					7.70%
10 yr					6.95%
Consumer Price Index					
20 yr					6.21%
10 yr	3.81%				
0	2	4	6	8	10
12	14	16	18%		

Source: Ibbotson Associates (Chicago)  
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By purchasing Defined Asset Funds, investors not only avoid the responsibility of selecting individual securities by themselves, but also gain the advantage of a higher degree of safety by holding interests in securities of several different issuers. Spreading your investment among different securities and issuers reduces your risk, but does not eliminate it. Defined Municipal Bond Funds offer a simple and convenient means for investors to earn monthly income free from regular Federal income tax. When individual bonds are called or mature, investors might consider reinvesting their proceeds in Defined Municipal Bond Funds. The securities in managed funds continually change. In Defined Asset Funds, the portfolio is defined, so that generally the securities, maturities, call dates and ratings are known before you buy. Of course, the portfolio will change somewhat over time as additional securities are deposited, as securities mature or are called or redeemed or as they are sold to meet redemptions and limited other circumstances. The defined portfolio of securities listed in the prospectus and regular income distributions make Defined Bond Funds a dependable investment. Investors know when they buy what their estimated income, current and long-term returns will be, subject to credit and market risks on the bonds or if the fund portfolio or expenses change.

Investors buy bonds for dependability--they know what they can expect to earn and that principal is distributed as the bonds mature. Defined Bond Funds can offer most of these benefits, with steady income and a yield and maturity similar to owning bonds directly. The tax exemption of municipal securities, which makes

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them attractive to high-bracket taxpayers, is offered by Defined Municipal Investment Trusts. Defined Corporate Income Funds, with higher current returns than municipal or government funds, are suitable for IRAs and other tax-advantaged accounts and offer investors a simple and convenient way to earn monthly income. Defined Government Securities Income Funds offer investors a simple and convenient way to participate in markets for Government securities while earning an attractive current return. Defined International Bond Funds, invested in bonds payable in foreign currencies, offer a potential to profit from changes in currency values and possibly from interest rates higher than paid on comparable US bonds, but investors incur a higher risk for these potentially greater returns. Historically, stocks have offered a potential for growth of capital, and thus some protection against inflation, over the long term. Defined Equity Income Funds offer a smart, sensible way to participate in the stock market. The S&P Index Trusts offer a convenient and inexpensive way to participate in broad market movements. Concept Series seek to capitalize on selected anticipated economic, political or business trends. Utility Series, consisting of issuers with established reputations for regular cash dividends, seek to benefit from dividend increases.

DESCRIPTION OF RATINGS (as described by the rating companies themselves.)

#### STANDARD & POOR'S CORPORATION

A Standard & Poor's rating on the units of an investment trust (hereinafter referred to collectively as 'units' and 'funds') is a current assessment of creditworthiness with respect to the investments held by the fund. This assessment takes into consideration the financial capacity of the issuers and of any guarantors, insurers, lessees, or mortgagors with respect to such investments. The assessment, however, does not take into account the extent to which fund expenses will reduce payment to the unit holder of the interest and principal required to be paid on portfolio assets. In addition, the rating is not a recommendation to purchase, sell, or hold units, as the rating does not comment as to market price of the units or suitability for a particular investor.

AAA--Units rated AAA represent interests in funds composed exclusively of securities that, together with their credit support, are rated AAA by Standard & Poor's and/or certain short-term investments. This AAA rating is the highest rating assigned by Standard & Poor's to a security. Capacity to pay interest and repay principal is extremely strong.

AA--Debt rated AA has a very strong capacity to pay interest and repay principal and differs from the highest rated issues only in small degree.

A--Debt rated A has a strong capacity to pay interest and repay principal

although it is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than debt in higher rated categories.

BBB--Debt rated BBB is regarded as having an adequate capacity to pay interest and repay principal. Whereas it normally exhibits adequate protection parameters, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity to pay interest and repay principal for debt in this category than in higher rated categories.

BB--Debt rated BB has less near-term vulnerability to default than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial or economic conditions which could lead to inadequate capacity to meet timely interest and principal payments. The BB rating category is also used for debt subordinated to senior debt that is assigned an actual or implied BBB-rating

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B--Debt rated B has a greater vulnerability to default but currently has the capacity to meet interest payments and principal repayments. Adverse business, financial, or economic conditions will likely impair capacity or willingness to pay interest and repay principal. The B Rating category is also used for debt subordinated to senior debt that is assigned an actual or implied BB or BB-rating.

CCC--Debt rated CCC has a currently identifiable vulnerability to default, and is dependent upon favorable business, financial, and economic conditions to meet timely payment of interest and repayment of principal. In the event of adverse business, financial, or economic conditions, it is not likely to have the capacity to pay interest and repay principal. The CCC rating category is also used for debt subordinated to senior debt that is assigned an actual or implied B or B-rating.

CC--The rating CC is typically applied to debt subordinated to senior debt that is assigned an actual or implied CCC rating.

C--The rating C is typically applied to debt subordinated to senior debt which is assigned an actual or implied CCC-debt rating. The C rating may be used to cover a situation where a bankruptcy petition has been filed, but debt service payments are continued.

C1--The rating C1 is reserved for income bonds on which no interest is being paid.

D--Debt rated D is in payment default. The D rating category is used when interest payments or principal payments are not made on the date due even if the applicable grace period has not expired, unless S&P believes that such payments will be made during such grace period. The D rating also will be used upon the filing of a bankruptcy petition if debt service payments are jeopardized.

Ratings may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

A provisional rating, indicated by 'p' following a rating, assumes the successful completion of the project being financed by the issuance of the debt being rated and indicates that payment of debt service requirements is largely or entirely dependent upon the successful and timely completion of the project. This rating, however, while addressing credit quality subsequent to completion of the project, makes no comment on the likelihood of, or the risk of default upon failure of, such completion.

NR--Indicates that no rating has been requested, that there is insufficient information on which to base a rating or that Standard & Poor's does not rate a particular type of obligation as a matter of policy.

#### MOODY'S INVESTORS SERVICE

Aaa--Bonds which are rated Aaa are judged to be the best quality. They carry the smallest degree of investment risk and are generally referred to as 'gilt edge'. Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues.

Aa--Bonds which are rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in Aaa securities or fluctuation of protective elements may be of greater amplitude or there may be other elements present which make the long-term risks appear somewhat larger than in Aaa securities.

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A--Bonds which are rated A possess many favorable investment attributes and are to be considered as upper medium grade obligations. Factors giving security

to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment sometime in the future.

Baa--Bonds which are rated Baa are considered as medium grade obligations; i.e., they are neither highly protected nor poorly secured. Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.

Ba--Bonds which are rated Ba are judged to have speculative elements; their future cannot be considered as well assured. Often the protection of interest and principal payments may be very moderate and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class.

B--Bonds which are rated B generally lack characteristics of the desirable investment. Assurance of interest and principal payments or of maintenance of other terms of the contract over any long period of time may be small.

Caa--Bonds which are rated Caa are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest.

Ca--Bonds which are rated Ca represent obligations which are speculative in a high degree. Such issues are often in default or have other marked shortcomings.

C--Bonds which are rated C are the lowest class of bonds and issues so rated can be regarded as having extremely poor prospects of ever attaining any real investment standing.

Rating symbols may include numerical modifiers 1, 2 or 3. The numerical modifier 1 indicates that the security ranks at the high end, 2 in the mid-range, and 3 nearer the low end, of the generic category. These modifiers of rating symbols give investors a more precise indication of relative debt quality in each of the historically defined categories.

Conditional ratings, indicated by 'Con.', are sometimes given when the security for the bond depends upon the completion of some act or the fulfillment of some condition. Such bonds are given a conditional rating that denotes their probable credit stature upon completion of that act or fulfillment of that condition.

NR--Should no rating be assigned, the reason may be one of the following: (a) an application for rating was not received or accepted; (b) the issue or issuer belongs to a group of securities that are not rated as a matter of policy; (c) there is a lack of essential data pertaining to the issue or issuer or (d) the issue was privately placed, in which case the rating is not published in Moody's publications.

DUFF & PHELPS CREDIT RATING CO.

AAA--Highest credit quality. The risk factors are negligible, being only slightly more than for risk-free U.S. Treasury debt.

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EXCHANGE OPTION

ELECTION

Holders may elect to exchange any or all of their Units of this Series for units of one or more of the series of Funds listed in the table set forth below (the 'Exchange Funds'), which normally are sold in the secondary market at prices which include the sales charge indicated in the table. Certain series of the Funds listed have lower maximum applicable sales charges than those stated in the table; also the rates of sales charges may be changed from time to time. No series with a maximum applicable sales charge of less than 3.50% of the public offering price is eligible to be acquired under the Exchange Option, with the following exceptions: (1) Freddie Mac Series may be acquired by exchange during the initial offering period from any of the Exchange Funds listed in the table. (2) Units of any Select Ten Portfolio, if available, may be acquired during their initial offering period or thereafter by exchange from any Exchange Fund; units of Investment Philosophy Series or Select Ten Portfolios may be exchanged only for units of another Select Ten Series, if available. Units of the Exchange Funds may be acquired at prices which include the reduced sales charge for Exchange Fund units listed in the table, subject, however, to these important limitations:

First, there must be a secondary market maintained by the Sponsors in units of the series being exchanged and a primary or secondary market in units of the series being acquired and there must be units of the applicable Exchange Fund lawfully available for sale in the state in which the Holder is resident. There is no legal obligation on the part of the



Sponsors to maintain a market for any units or to maintain the legal qualification for sale of any of these units in any state or states. Therefore, there is no assurance that a market for units will in fact exist or that any units will be lawfully available for sale on any given date at which a Holder wishes to sell his Units of this Series and thus there is no assurance that the Exchange Option will be available to any Holder.

Second, when units held for less than five months are exchanged for units with a higher regular sales charge, the sales charge will be the greater of (a) the reduced sales charge set forth in the table below or (b) the difference between the sales charge paid in acquiring the units being exchanged and the regular sales charge for the quantity of units being acquired, determined as of the date of the exchange.

Third, exchanges will be effected in whole units only. If the proceeds from the Units being surrendered are less than the cost of a whole number of units being acquired, the exchanging Holder will be permitted to add cash in an amount to round up to the next highest number of whole units.

Fourth, the Sponsors reserve the right to modify, suspend or terminate the Exchange Option at any time without further notice to Holders. In the event the Exchange Option is not available to a Holder at the time he wishes to exercise it, the Holder will be immediately notified and no action will be taken with respect to his Units without further instruction from the Holder.

#### PROCEDURES

To exercise the Exchange Option, a Holder should notify one of the Sponsors of his desire to use the proceeds from the sale of his Units of this Series to purchase units of one or more of the Exchange Funds. If units of the applicable outstanding series of the Exchange Fund are at that time available for sale, the Holder may select the series or group of series for which he desires his Units to be exchanged. Of course, the Holder will be provided with a current prospectus or prospectuses relating to each series in which he indicates interest. The exchange

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transaction will generally operate in a manner essentially identical to any secondary market transaction, i.e., Units will be repurchased at a price equal to the aggregate bid side evaluation per Unit of the Securities in the Portfolio plus accrued interest. Units of the Exchange Fund will be sold to the Holder at a price equal to the bid side evaluation per unit of the underlying securities in the Portfolio plus interest plus the applicable sales charge listed in the table below. (Units of Defined Asset Funds--Equity Income Fund are sold, and will be repurchased, at a price normally based on the closing sale prices on the New York Stock Exchange, Inc. of the underlying securities in the Portfolio.) The maximum applicable sales charges for units of the Exchange Funds are also listed in the table. Excess proceeds not used to acquire whole Exchange Fund units will be paid to the exchanging Holder.

#### CONVERSION OPTION

Owners of units of any registered unit investment trust sponsored by others which was initially offered at a maximum applicable sales charge of at least 3.0% ('Conversion Trust') may elect to apply the cash proceeds of sale or redemption of those units directly to acquire available units of any Exchange Fund at the reduced sales charge, subject to the terms and conditions applicable to the Exchange Option (except that no secondary market is required in Conversion Trust units). To exercise this option, the owner should notify his retail broker. He will be given a prospectus of each series in which he indicates interest of which units are available. The broker must sell or redeem the units of the Conversion Trust. Any broker other than a Sponsor must specify to the Sponsors that the purchase of units of the Exchange Fund is being made pursuant to and is eligible for this conversion option. The broker will be entitled to two thirds of the applicable reduced sales charge. The Sponsors reserve the right to modify, suspend or terminate the conversion option at any time without further notice, including the right to increase the reduced sales charge applicable to this option (but not in excess of \$5 more per unit than the corresponding fee then charged for the Exchange Option).

#### THE EXCHANGE FUNDS

The current return from taxable fixed income securities is normally higher than that available from tax exempt fixed income securities. Certain of the Exchange Funds do not provide for periodic payments of interest and are best suited for purchase by IRA's, Keogh plans, pension funds or other tax-deferred retirement plans. Consequently, some of the Exchange Funds may be inappropriate investments for some Holders and therefore may be inappropriate exchanges for Units of this Series. The table below indicates certain characteristics of each of the Exchange Funds which a Holder should consider in determining whether each Exchange Fund would be an appropriate investment vehicle and an appropriate exchange for Units of this Series.

TAX CONSEQUENCES

An exchange of Units pursuant to the Exchange or Conversion Option for units of a series of another Fund should constitute a 'taxable event' under the Code, requiring a Holder to recognize a tax gain or loss, subject to the limitation discussed below. The Internal Revenue Service may seek to disallow a loss (or a pro rata portion thereof) on an exchange of units if the units received by a Holder in connection with such an exchange represent securities that are not materially different from the securities that his previous units represented (e.g., both Funds contain securities issued by the same obligor that have the same material terms). Holders are urged to consult their own tax advisers as to the tax consequences to them of exchanging units in particular cases.

EXAMPLE

Assume that a Holder, who has three units of a fund with a 5.50% sales charge in the secondary market and a current price (based on the bid side evaluation plus accrued interest) of \$1,100 per unit, sells his units and

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exchanges the proceeds for units of a series of an Exchange Fund with a current price of \$950 per unit and the same sales charge. The proceeds from the Holder's units will aggregate \$3,300. Since only whole units of an Exchange Fund may be purchased, the Holder would be able to acquire four units in the Exchange Fund for a total cost of \$3,860 (\$3,800 for units and \$60 for the \$15 per unit sales charge) by adding an extra \$560 in cash. Were the Holder to acquire the same number of units at the same time in the regular secondary market maintained by the Sponsors, the price would be \$4,021.16 (\$3,800 for the units and \$221.16 for the 5.50% sales charge).

<TABLE>  
<CAPTION>

NAME OF EXCHANGE FUND	MAXIMUM APPLICABLE SALES CHARGE*	REDUCED SALES CHARGE FOR SECONDARY MARKET**
<hr/>		
<S>	<C>	<C>
DEFINED ASSET FUNDS--GOVERNMENT SECURITIES INCOME FUND		
GNMA Series (other than those below)	4.25%	\$15 per unit
GNMA Series E or other GNMA Series having units with an initial face value of \$1.00	4.25%	\$15 per 1,000 units
Freddie Mac Series	3.75%	\$15 per 1,000 units
DEFINED ASSET FUNDS-- INTERNATIONAL BOND FUND		
Multi-Currency Series	3.75%	\$15 per unit
Australian and New Zealand Dollar Bonds Series	3.75%	\$15 per unit
Australian Dollar Bonds Series	3.75%	\$15 per unit
Canadian Dollar Bonds Series	3.75%	\$15 per unit
DEFINED ASSET FUNDS--EQUITY INCOME FUND		
Utility Common Stock Series	4.50%	\$15 per 1,000 units+
Concept Series	4.00%	\$15 per 100 units
Investment Philosophy Series, Select 10 Portfolios	2.75%	\$17.50 per 1,000 units
DEFINED ASSET FUNDS--MUNICIPAL INVESTMENT TRUST FUND		
Monthly Payment, State and Multistate Series	5.50%+	\$15 per unit
Intermediate Term Series	4.50%+	\$15 per unit
Insured Series	5.50%+	\$15 per unit
AMT Monthly Payment Series	5.50%+	\$15 per unit

</TABLE>

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<CAPTION>

NAME OF EXCHANGE FUND	INVESTMENT CHARACTERISTICS
<hr/>	
<S>	<C>
DEFINED ASSET FUNDS--GOVERNMENT SECURITIES INCOME FUND	
GNMA Series (other than those below)	long-term, fixed rate, taxable income, underlying securities backed by the full faith and credit of the United States
GNMA Series E or other GNMA Series having units with an initial face value of \$1.00	long-term, fixed rate, taxable income, underlying securities backed by the full faith and credit of the United States, appropriate for IRA's or tax-deferred retirement plans
Freddie Mac Series	intermediate term, fixed rate, taxable income, underlying securities are backed by Federal Home Loan Mortgage Corporation but not by U.S.

Government

DEFINED ASSET FUNDS-- INTERNATIONAL BOND FUND

Multi-Currency Series	intermediate-term, fixed rate, payable in foreign currencies, taxable income
Australian and New Zealand Dollar Bonds Series	intermediate-term, fixed rate, payable in Australian and New Zealand dollars, taxable income
Australian Dollar Bonds Series	intermediate-term, fixed rate, payable in Australian dollars, taxable income
Canadian Dollar Bonds Series	short intermediate term, fixed rate, payable in Canadian dollars, taxable income

DEFINED ASSET FUNDS--EQUITY INCOME FUND

Utility Common Stock Series	dividends, taxable income, underlying securities are common stocks of public utilities
Concept Series	underlying securities constitute a professionally selected portfolio of common stocks consistent with an investment idea or concept
Investment Philosophy Series, Select 10 Portfolios	10 highest dividend yielding stocks in a designated stock index; seeks higher total return than that stock index; terminates after one year

DEFINED ASSET FUNDS--MUNICIPAL INVESTMENT TRUST FUND

Monthly Payment, State and Multistate Series	long-term, fixed-rate, tax-exempt income
Intermediate Term Series	intermediate-term, fixed rate, tax-exempt income
Insured Series	long-term, fixed-rate, tax-exempt income, underlying securities insured by insurance companies
AMT Monthly Payment Series	long-term, fixed rate, income exempt from regular income tax but partially subject to Alternative Minimum Tax

</TABLE>

- \* As described in the prospectuses relating to certain Exchange Funds, this sales charge for secondary market sales may be reduced on a graduated scale in the case of quantity purchases.
- \*\* The reduced sales charge for Units acquired during their initial offering period is: \$20 per unit for Series for which the Reduced Sales Charge for Secondary Market (above) is \$15 per unit; \$20 per 100 units for Series for which the Reduced Sales Charge for Secondary Market is \$15 per 100 Units and \$20 per 1,000 units for Series for which the Reduced Sales Charge for Secondary Market is \$15 per 1,000 units.

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NAME OF EXCHANGE FUND	MAXIMUM APPLICABLE SALES CHARGE*	REDUCED SALES CHARGE FOR SECONDARY MARKET**
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<S>	<C>	<C>
DEFINED ASSET FUNDS--MUNICIPAL INCOME FUND		
Insured Discount Series	5.50%++	\$15 per unit
DEFINED ASSET FUNDS--CORPORATE INCOME FUND		
Monthly Payment Series	5.50%	\$15 per unit
Intermediate Term Series	4.75%	\$15 per unit
Cash or Accretion Bond Series and SELECT Series	3.50%	\$15 per 1,000 units
Insured Series	5.50%	\$15 per unit

</TABLE>

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<CAPTION>

NAME OF EXCHANGE FUND	INVESTMENT CHARACTERISTICS
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<S>	<C>
DEFINED ASSET FUNDS--MUNICIPAL INCOME FUND	
Insured Discount Series	long-term, fixed rate, insured, tax-exempt income, taxable capital gains
DEFINED ASSET FUNDS--CORPORATE INCOME FUND	
Monthly Payment Series	long-term, fixed rate, taxable income
Intermediate Term Series	intermediate-term, fixed rate, taxable income
Cash or Accretion Bond Series and SELECT Series	intermediate-term, fixed rate, underlying securities are collateralized compound interest obligations, taxable income, appropriate for IRA's or tax-deferred retirement plans
Insured Series	long-term, fixed rate, taxable income, underlying securities are insured

</TABLE>

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- \* As described in the prospectuses relating to certain Exchange Funds, this sales charge for secondary market sales may be reduced on a graduated scale in the case of quantity purchases.
- \*\* The reduced sales charge for Units acquired during their initial offering period is: \$20 per unit for Series for which the Reduced Sales Charge for Secondary Market (above) is \$15 per unit; \$20 per 100 units for Series for which the Reduced Sales Charge for Secondary Market is \$15 per 100 Units and \$20 per 1,000 units for Series for which the Reduced Sales Charge for Secondary Market is \$15 per 1,000 units.
- + The reduced sales charge for the Sixth Utility Common Stock Series of The Equity Income Fund is \$15 per 2,000 units and for prior Utility Common Stock Series is \$7.50 per unit.
- ++ Subject to reduction depending on the maturities of the underlying Securities.

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DEFINED ASSET FUNDS--  
MUNICIPAL INVESTMENT TRUST FUND  
PROSPECTUS, PART C  
AS OF FEBRUARY, 1994

NOTE: PART C OF THIS PROSPECTUS MAY NOT BE DISTRIBUTED UNLESS ACCOMPANIED BY PARTS A AND B.

THE TRUSTS

The Portfolio of each State Trust or Fund (the 'Trust') contains different issues of long-term Debt Obligations issued by or on behalf of the State for which the Trust is named and counties, municipalities and other political subdivisions and public authorities thereof or by the Government of Puerto Rico or the Government of Guam or by their respective authorities (see Investment Summary in Part A). Investment in a Trust should be made with an understanding that the value of the underlying Portfolio may decline with increases in interest rates.

Following are brief summaries of some of the factors which may affect the financial condition of the States represented in various series of Defined Asset Funds--Municipal Investment Trust Fund, together with summaries of tax considerations relating to those States. This is not a complete or comprehensive description of these factors or an analysis of their respective financial conditions and may not be indicative of the financial condition of issuers of obligations contained in the portfolios of the Trusts or of any particular projects financed by those obligations. Many factors not included herein, such as the national economy, social and environmental policies and conditions, and the national and international markets for various products, could have an adverse impact on the financial condition of any State and its political subdivisions, including the issuers of obligations contained in the portfolios. It is not possible to predict whether and to what extent those factors may affect the financial condition of a State or other issuers of obligations contained in a portfolio, including the impact thereof of the issuers to meet payment obligations. None of the information presented herein is relevant to Puerto Rico or Guam Debt Obligations which may be included in a Trust. Prospective investors should study with care the issues contained in the portfolio of a Trust, review carefully the information set out in part B of this Prospectus under the caption 'Risk Factors,' and consult with their investment advisors as to the merits of particular issues in the portfolio. For a discussion of the particular risks associated with each of the Debt Obligations, and other factors to be considered in connection therewith, reference should be made to the Official Statements and other offering materials relating to each of the Debt Obligations. The Sponsors believe that the information summarized below describes some of the more significant matters relating to the Trusts. This information has not been independently verified by the Sponsors or their legal counsel. It is based primarily on material presented in various government documents, official statements, offering circulars, prospectuses, and statements of public officials and representatives of certain of the issuers of the Debt Obligations. While the Sponsors have not independently verified this information, they have no reason to believe that it is not correct in all material respects.

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THE ALABAMA TRUST

RISK FACTORS--During recent years the economy of Alabama has grown at a slower rate than that of the U.S. The State of Alabama, other governmental units and agencies, school systems and entities dependent on government appropriations or economic conditions have, in varying degrees, suffered budgetary difficulties. These conditions and other factors described below could adversely affect the Debt Obligations that the Trust acquires and the value of Units in the Trust. The following information constitutes only a brief summary, does not purport to be a complete description of potential adverse economic effects and is based primarily on material presented in various government documents, official statements, offering circulars and prospectuses. While the Sponsors have not independently verified such information, they have no reason to believe that such information is not correct in all material respects.

Limitations on State Indebtedness. Section 213 of the Constitution of Alabama, as amended, requires that annual financial operations of Alabama must be on a balanced budget and prohibits the State from incurring general obligation debt unless authorized by an amendment to the Constitution. Although conventions proposed by the Legislature and approved by the electorate may be called for the purpose of amending the Alabama Constitution, amendments to the Constitution have generally been adopted through a procedure that requires each amendment to be proposed by a favorable vote of three-fifths of all the members of each house of the Legislature and thereafter approved by a majority of the voters of the State voting in a statewide election.

Currently, the State has statutory budget provisions which create a proration procedure in the event estimated budget resources in a fiscal year are insufficient to pay in full all appropriations for such fiscal year. However, this proration procedure has been challenged as unconstitutional because it may violate the separation of powers doctrine by allowing the Governor to prorate budgets with across-the-board cuts. If such challenges are upheld, the legislature would be forced to enact new proration or budget procedures. The effect of such new procedures could have a materially adverse effect on the State. Proration has a materially adverse effect on public entities, such as boards of education, that are substantially dependent on state funds.

Court decisions have indicated that certain State expenses necessary for essential functions of government are not subject to proration under applicable law. The Supreme Court of Alabama has held that the debt prohibition contained in the constitutional amendment does not apply to obligations incurred for current operating expenses payable during the current fiscal year, debts incurred by separate public corporations, or state debt incurred to repel invasion or suppress insurrection. The State may also make temporary loans not exceeding \$300,000 to cover deficits in the state treasury. Limited obligation debt may be authorized by the legislature without amendment to the Constitution. The State has followed the practice of financing certain capital improvement programs--principally for highways, education and improvements to the State Docks--through the issuance of limited obligation bonds payable solely out of certain taxes and other revenues specifically pledged for their payment and not from the general revenues of the State.

Medicaid. Because of Alabama's relatively high incidence of poverty, health care providers in Alabama are more heavily dependent on Medicaid than are health care providers in other states. Contributions to Medicaid by the State of Alabama are financed through the General Fund of the State of Alabama. As discussed above, because deficit spending is prohibited by the Constitution of Alabama, allocations from the General Fund, including Medicaid payments, may be subject to proration. In recent years the General Fund has been subject to proration by virtue of insufficient tax revenues and excessive expenditures, and there can be no assurance that proration of the General Fund budget will not continue and that, if continued, such proration will not have a materially adverse effect on Alabama Medicaid payments.

The State of Alabama Medicaid Agency currently obtains funding through a Federal matching program in which each dollar contributed to the Alabama Medicaid budget by the State is matched by the Federal government on the basis of a formula, provided that the State program meets federally imposed standards. In recent years the State of Alabama has relied in part upon revenues raised through a tax on health care providers to fund its share of the Alabama Medicaid budget. This

provider tax was recently repealed as part of a restructuring of the funding of Alabama's Medicaid program.

In February 1993, the Alabama Medicaid Agency announced that it was expecting a shortfall of approximately \$21 million in the remainder of fiscal year 1993 and that payments to health care providers might be reduced by as much as 15% for the remainder of the fiscal year. The shortfall was attributed to increases in health care costs and eligible recipients. That crisis was averted through a plan developed by the Alabama Medicaid Agency, health care providers, and the State Legislature. Under this plan, the provider tax was repealed, and funds previously appropriated by the Alabama Legislature to State-supported teaching hospitals are transferred to the Alabama Medicaid budget.

The intergovernmental transfers resulted in additional matching funds from the federal government. There can be no assurance that such transfers will continue or that the State funding will be sufficient to meet current or future program needs. In addition, a reduction by the Federal government in matching contributions could also reduce the funds available for Medicaid reimbursement.

Factors such as the increasing pressure on sources of Medicaid funding, at both the State and the Federal level, and the expanding number of people covered by this program, are likely to cause future concern over the Alabama Medicaid budget. Further, there can be no assurance that the current State plan is or will remain in compliance with federal guidelines and regulations, that federal or State allocations to Medicaid will continue at their present level or that Medicaid payments will be adequate to meet the costs of providing care.

According to reports in the news media, a study by a private consumer group indicates that the level of benefits available are materially lower and the eligibility standards significantly more stringent under the Alabama Medicaid program than in most other states. Although, as stated above, Alabama health care facilities are dependent on Medicaid payments, it should be expected that health care facilities in Alabama will receive substantially less in Medicaid payments than would health care facilities in most other states.

Health Care Reform. Reform of the health care system is a primary initiative for the Clinton administration. President Clinton has recently presented to Congress his proposal to reform the health care system of the U.S. The President's proposals, if enacted, would substantially alter the methods by which health care is delivered and financed and would assure some type of insurance coverage for all citizens. No legislation has been enacted to date to implement these reforms, and it is not possible to predict the provisions of any legislation that may be passed or the date on which it will become effective. In addition, the Governor of Alabama has recently formed a task force to study the availability and delivery of health care in the State. No legislation has yet been introduced as a result of that study. There are many possible financial effects that could result from enactment of any federal or state legislation proposing to regulate or reform the health care industry, and it is not possible at this time to predict with assurance the effect of any health care reform proposals that might be enacted.

Dependence on Federal Education Funds. Alabama is disproportionately dependent on federal funds for secondary and higher education, predominantly because of insufficient state and local support. Recent federal cutbacks on expenditures for education have had, and if continued will have, an adverse impact on educational institutions in Alabama.

On December 30, 1991, the District Court for the Northern District of Alabama issued an opinion holding Alabama's institutions of higher learning liable for operating a racially discriminatory dual university system. The Court ordered several remedies and has maintained jurisdiction for ten years to insure compliance. If the State and the universities fail to comply with the Court's orders, the Court may rule that Federal funds for higher education be withheld. A ruling depriving the State of Federal funds for higher education would have a materially adverse effect on certain Alabama colleges and universities.

Alabama Industrial Characteristics. Alabama industrial capacity has traditionally been concentrated in those areas sensitive to cyclical economic trends, such as textiles and iron and steel production. To the extent that American iron and steel and textile production continues to suffer from foreign competition and other factors, the general economy of the State and the ability of particular issuers, especially pollution-control and certain IDB issuers, would be materially adversely affected.

General Obligation Warrants. Municipalities and counties in Alabama traditionally have issued general obligation warrants to finance various public improvements. Alabama statutes authorizing the issuance of such interest-bearing warrants do not require an election prior to issuance. On the other hand, the Constitution of Alabama (Section 222) provides that general obligation bonds may not be issued without an election.

On December 31, 1987, in the case of O'Grady v. City of Hoover, Alabama, 519 So.2d. 1292, the Supreme Court of Alabama validated certain general obligation warrants issued by the City of Hoover, reaffirming that such obligations did not require an election under Section 222 of the Constitution of Alabama. In so holding, the Court found that warrants are not 'bonds' within the meaning of Section 222. According to the Court, warrants are not negotiable instruments and transferees of warrants cannot be holders in due course. Therefore, a transferee of warrants is subject to all defenses that the issuer of such warrants may have against the transferor. The plaintiff-appellant in the case filed an application for rehearing with the Supreme Court, which was denied on February 12, 1988.

Allocation of County-Wide Taxes for Public Education. Under Alabama law, a city with a population in excess of 5,000 is entitled to establish a separate public school system within its jurisdiction with its own board of education, members of which are elected by the governing body of such city. If a city school system is established within a county, the county-wide taxes for general educational purposes will, absent specific law to the contrary, be apportioned among the county board of education and each city board of education within the county according to a statutory formula based on the state's uniform minimum educational program for public school systems. This formula has many factors, but is based largely on the relative number of students within the boundaries of each school system.

County boards of education may borrow money by issuing interest-bearing warrants payable solely out of such board's allocated or apportioned share of a specified tax. The county board's apportioned share of such tax may be diminished upon the establishment of a city school system, which could jeopardize the payment of the county board's warrants.

Limited Taxing Authority. Political subdivisions of the State have limited taxing authority. Ad valorem taxes may be levied only as authorized by the Alabama Constitution. In order to increase the rate at which any ad valorem tax is levied above the limit otherwise provided in the Constitution, the proposed increase must be proposed by the governing body of the taxing authority after a public hearing, approved by an act of the Alabama Legislature and approved at an election within the taxing authority's jurisdiction. In addition, the Alabama Constitution limits the total amount of state, county, municipal and other ad valorem taxes that may be imposed on any class of property in any one tax year. This limitation is expressed in terms of a specified percentage of the market value of such property. In some jurisdictions in the State this limit has already been exceeded for one or more classes of property.

Specific authorizing legislation is required for the levy of taxes by local governments. In addition, the rate at which such taxes are levied may be limited by the authorizing legislation or judicial precedent. For example, the Alabama Supreme Court has held that sales and use taxes, which usually comprise a significant portion of the revenues for local governments, may not be levied at rates that are confiscatory or unreasonable. The total sales tax (state and local) in some jurisdictions is 9%.

Dependence on Certain Taxes. State and local governments in Alabama are more dependent on general and special sales taxes and user fees than are state and local governments in many states, and less dependent on property taxes. Because sales taxes and user fees are less stable sources of revenue than are property taxes, state and local governments in Alabama may be subject to shortfalls in revenue due to economic cycles. Such revenue shortfalls could have a materially adverse effect on Alabama debt obligations in the Alabama Trust.

Priority for Essential Governmental Functions. Numerous decisions of the Alabama Supreme Court hold that a governmental unit may first use its taxes and other revenues to pay the expenses of providing necessary governmental services before paying debt service on its bonds, warrants or other indebtedness.

Challenge to State Budgets. On April 1, 1993, a Montgomery Circuit Court Judge ruled that an unconstitutional disparity exists among Alabama's school districts because of inequitable distribution

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of tax funds. The judge in that case has ordered the plaintiffs to present a new design for the distribution of funds for educational purposes as well as a new system for funding public education. As a result of this ruling, competing education reform proposals are being considered by the Alabama legislature. If a reduction in state tax revenues to certain school districts results from new legislation, the ability of those school districts to service debt may be materially, adversely affected.

#### ALABAMA TAXES

In the opinion of Maynard, Cooper & Gale, P.C., Birmingham, Alabama, special counsel on Alabama tax matters, relying upon the opinion of Messrs. Davis Polk & Wardwell as to the federal income tax consequences to the Alabama Trust and the Holders, and assuming that the Alabama Trust is not an association

taxable as a corporation for federal income tax purposes, under existing Alabama law:

1. The Alabama Trust and the Holders will be treated for purposes of the Alabama income tax laws in substantially the same manner as they are for purposes of federal income tax law, as currently enacted.
2. The Alabama Trust will not be treated as an association taxable as a corporation for Alabama income tax purposes.
3. The income of the Alabama Trust will be treated as the income of the Holders when distributed or deemed distributed to the Holders.
4. Interest on any Alabama Obligation which is excluded from gross income for Alabama income tax purposes when received by the Alabama Trust will be excluded from gross income of the Holders for Alabama income tax purposes when distributed or deemed distributed to the Holders.
5. Generally, gain on sale or disposition of an Alabama Obligation will be subject to Alabama income tax. There may be exceptions to the general rule of limited application.
6. Distribution to the Holders consisting of gain realized upon the sale or distribution of an Alabama Obligation by the Alabama Trust will be subject to Alabama income tax in the same manner as if such Alabama Obligation was held and sold or otherwise disposed of directly by the Holders.
7. Gain on the disposition of Units will be subject to Alabama income tax.
8. Interest on Puerto Rico Obligations will be excluded from gross income for Alabama income tax purposes and such Puerto Rico Obligations held by the Alabama Trust will be treated in the same manner as an Alabama Obligation.

The opinion of Maynard, Cooper & Gale, P.C. does not address the consequences to foreign or domestic corporations of investment in Alabama Obligations under the Alabama franchise tax and ad valorem tax laws.

#### THE ARIZONA TRUST

RISK FACTORS--The State Economy. The Arizona economy during the last few years has been described as one of subdued growth, with a recession in the construction industry that appears to be softening in some sectors. Certain sectors of Arizona's economy, particularly those related to real estate, have experienced sharp downturns. This has resulted from several factors, including previous overbuilding and the collapse of several prominent Arizona savings and loan institutions. However, sales of new, single-family homes reached a several-year high for the third quarter of 1993, and permits for new home construction increased by 23% from 1992 to 1993, suggesting at least a minor rebound in the real estate and construction industries.

The savings and loan crisis hit Arizona hard. In 1988, eleven savings and loans were operating in Arizona. By the end of 1991, only one savings and loan remained. Most of the savings and loans were closed by federal regulators and some were subsequently packaged and sold to other financial institutions by the Resolution Trust Corporation (the 'RTC'). Many of the problems of the Arizona savings and loans were caused by real estate loans made in the mid-1980's, when real estate values were at a peak and tax incentives existed to invest in income-producing real property. The amendments to the tax laws in 1986 and the previous overbuilding led to a significant decline in the

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value of Arizona real estate over the last few years of the 1980's and into the 1990's. In fact, for the first time in 46 years, the total value of real property in Arizona, as assessed for real property tax purposes, declined for the tax year 1991.

The RTC has sold at least \$15.5 billion in assets of defunct Arizona savings and loans since its Phoenix office opened in 1989, and has a considerable amount of assets still to be sold. Most of the assets remaining to be sold are real-estate secured loans and real property. The RTC's Phoenix office closed on January 29, 1993, with management of the remaining assets shifting to the RTC's Denver office.

The decline in value of real property in Arizona has affected other financial institutions as well. The trend in the Arizona banking community continues to be one of consolidation. The RTC is currently seeking bidders for the Great American Federal Savings Association, a San Diego-based thrift that operates 58 branches in Arizona. On August 2, 1993, Federal regulators approved the sale of Citibank Arizona's 59 banking locations to Norwest Corp. Banc One, the Ohio-based bank, acquired Valley National Bank of Arizona in March of 1993. Bank of America, which purchased the assets of MeraBank, Western Savings and



Pima Savings, all former savings and loans under the control of the RTC, merged with Security Pacific, which had already purchased the assets of Security Savings, another defunct savings and loan. In a separate transaction, Bank of America purchased Caliber Bank. Under an agreement with the United States Justice Department which allowed the Bank of America-Security Pacific merger, Bank of America had to sell 49 of its branches to keep from tying up the Arizona market. As a result, Bank of America transferred approximately thirty branches to Caliber Bank, which it held as a subsidiary, and then sold Caliber Bank to Independent Bankcorp of Arizona, an independent bank holding company, in early 1993. As financial institutions within the state consolidate, some branch offices are being closed, displacing workers. Through November 1992, for example, Bank of America had closed 21 branches in Arizona and eliminated 500 banking jobs.

On June 27, 1991, America West Airlines, a Phoenix-based carrier, filed a Chapter 11 reorganization petition in bankruptcy. At that time, America West was the sixth largest employer in Maricopa County, employing approximately 10,000 of its 15,000 employees within the county. Since the filing, approximately 4,500 employees have been laid off, leaving the number of those employed in Maricopa County at approximately 6,800. Before it filed for Bankruptcy Court protection, the carrier served more than 60 cities with 115 planes; America West now serves approximately 55 cities with 85 aircraft. The Bankruptcy Court recently granted America West its eighth extension to file a plan of reorganization under Chapter 11.

Management changes continue at the airline. One co-founder of the airline, Ed Beaurais, resigned as chairman of the board of directors on July 17, 1992. In December of 1993, the other co-founder of the airline, Mike Conway, was forced to resign as president and chief executive officer of the airline. A. Maurice Meyers, formally with Aloha Airlines, replaced Conway as president of America West.

After a turbulent 1992, America West's financial picture improved in 1993. The airline lost approximately \$131.8 million in 1992. In 1993, however, the airline posted a record profit of \$37.2 million; it is believed that America West is one of only two major carriers to post a profit in 1993. In September, 1992, America West reached a loan agreement with airplane lessors and a group of Arizona businesses for \$53 million. This is in addition to approximately \$75 million in loans obtained in 1991. The company has announced that it is seeking to raise \$150 million to \$200 million in new equity as part of its plan to emerge from Bankruptcy Court protection. The effect of the America West bankruptcy on the state economy and, more particularly, the Phoenix economy, is uncertain.

Jobs were lost by the closing of Williams Air Force Base in Chandler, Arizona, on September 30, 1993. Williams Air Force Base was selected as one of the military installations to be closed as a cost-cutting measure by the Defense Base Closure and Realignment Commission, whose recommendations were subsequently approved by the President and the United States House of Representatives. Williams Air Force Base injected an estimated \$300 million in the local economy annually, and employed approximately 3,800 military and civilian personnel. The base has been renamed the Williams Gateway Airport, and efforts are underway to remake the site into a regional civilian airport, including an aviation, educational and business complex.

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Job growth in Arizona was consistently in the range of 2.1% to 2.5% for the years 1988 through 1990. Job growth in 1991 declined to 0.4%, with net job losses in manufacturing, construction, transportation, communication and public utilities, and finance, insurance and real estate. The two sectors that have consistently had positive job growth in the last several years are services and government. Job growth increased in 1992 to 1.9% with an increase of 5.4% in construction. Job growth is projected to be approximately 2.7% in 1993, and is predicted to increase to approximately 3.2% in 1994.

In 1988 the unemployment rate in Arizona, 6.3%, was significantly higher than the national average of 5.5%. The unemployment rate in Arizona decreased in 1989 to 5.2% and 5.3% in 1990, which was similar to the national rates of 5.3% and 5.4%, respectively. Arizona's unemployment rate in 1991 was 5.6%, compared to a national rate of 6.7%. Arizona's unemployment rate in 1992 increased to 7.4%, matching the national rate. The Arizona unemployment rate is expected to decrease in 1993, to approximately 6.3%. Arizona's unemployment rate for December 1993 was 5.7%, compared with the national figure of 6.4%.

Despite the current economic downturn in Arizona, personal income has continued to rise, but at slower rates than in the early to mid-1980's. Personal income grew at a rate of 7.1% in 1988, 6.5% in 1989, 5.8% in 1990 and dropped to 4.5% in 1991. Personal income increased to 5.2% in 1992. It is expected to increase again in 1993 to approximately 6.3%.

Bankruptcy filings in the District of Arizona increased dramatically in the mid-1980's, but percentage increases have decreased over the last several years, with 1993 resulting in the first drop in bankruptcy filings since 1984. Bankruptcy filings totalled 17,381 in 1993, compared to 19,883 in 1992, 19,686

in 1991, 18,258 in 1990, 16,278 in 1989, and 13,726 in 1988. The great majority of filings from 1991 to 1993 were personal liquidations under Chapter 7 of the United States Bankruptcy Code.

The inflation rate, as measured by the consumer price index in the Phoenix, Arizona area, including all of Maricopa County, has hovered around the national average for the last several years, increasing from 4.1% in 1988 to 5.6% in 1990. The inflation rate decreased to 2.8% in 1991, compared to 4.2% on a national level, and decreased slightly to 2.7% in 1992, compared to a national rate of 3.0%. The inflation rate is estimated to be approximately 4.5% in 1993, and as predicted to increase to approximately 5.0% in 1994.

The population of Arizona has grown consistently at a rate between 2.2% and 2.4% annually during the years 1988 through 1992. Population growth is expected to remain at approximately 2.3% in 1993. Although significantly greater than the national average population growth, it is lower than Arizona's population growth in the mid-1980's. The 1990 census results indicate that the population of Arizona rose 35% between 1980 and 1990, a rate exceeded only in Nevada and Alaska. Nearly 950,000 residents were added during this period.

The State Budget, Revenues and Expenditures. The state operates on a fiscal year beginning July 1 and ending June 30. Fiscal year 1994 refers to the year ending June 30, 1994.

Total General Fund revenues of \$3.854 billion are expected during fiscal year 1994. Approximately 45% of this expected revenue comes from sales and use taxes, 37% from income taxes (both individual and corporate) and 5% from property taxes. All taxes total approximately \$3.66 billion, or 95% of the General Fund revenues. Non-tax revenue includes items such as income from the state lottery, licenses, fees and permits, and interest. Lottery income totals approximately 26% of non-tax revenue.

For fiscal year 1994, General Fund expenditures of \$3.793 billion are expected. Major General Fund appropriations include \$1.444 billion to the Department of Education (primarily for K-12), \$477.2 million for the administration of the AHCCCS program (the State's alternative to Medicaid), \$356.7 million to the Department of Economic Security, and \$283.3 million to the Department of Corrections. The estimated expenditures for fiscal year 1993 totalled approximately \$3.717 billion. The budget for fiscal years 1991 and 1992 totalled approximately \$3.5 billion each.

Most or all of the Debt Obligations of the Arizona Trust are not obligations of the State of Arizona, and are not supported by the State's taxing powers. The particular source of payment and security for each of the Debt Obligations is detailed in the instruments themselves and in related

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offering materials. There can be no assurances, however, with respect to whether the market value or marketability of any of the Debt Obligations issued by an entity other than the State of Arizona will be affected by the financial or other condition of the State or of any entity located within the State. In addition, it should be noted that the State of Arizona, as well as counties, municipalities, political subdivisions and other public authorities of the state, are subject to limitations imposed by Arizona's constitution with respect to ad valorem taxation, bonded indebtedness and other matters. For example, the state legislature cannot appropriate revenues in excess of 7% of the total personal income of the state in any fiscal year. These limitations may effect the ability of the issuers to generate revenues to satisfy their debt obligations.

School Finance. The State of Arizona was recently sued by four school districts within the state, claiming that the state's funding system for school buildings, equipment and other capital expenses is unconstitutional. The lawsuit was filed by the Arizona Center for Law in the Public Interest and Southern Arizona Legal Aid Inc., but fifty other school districts helped finance the lawsuit. A state judge rejected the lawsuit in September of 1992, and the school districts appealed. A petition to move the appeal to the Supreme Court of Arizona was granted and arguments were held in November of 1993, although the Arizona Supreme Court has not yet issued its ruling. The lawsuit does not seek damages, but requests that the court order the state to create a new financing system that sets minimum standards for buildings and furnishings that apply on a statewide basis. It is unclear, at this time, what effect any judgment would have on state finances or school district budgets.

Health Care Facilities. Arizona does not participate in the federally administered Medicaid program. Instead, the state administers an alternative program, the Arizona Health Care Cost Containment System ('AHCCCS'), which provides health care to indigent persons meeting certain financial eligibility requirements, through managed care programs. In fiscal year 1994, AHCCCS will be financed approximately 60% by federal funds, 29% by state funds, and 11% by county funds.

Under state law, hospitals retain the authority to raise rates with notification and review by, but not approval from, the Department of Health

Services. Hospitals in Arizona have experienced profitability problems along with those in other states. At least two Phoenix based hospitals have defaulted on or reported difficulties in meeting their bond obligations during the past three years.

Utilities. Arizona's utilities are subject to regulation by the Arizona Corporation Commission. This regulation extends to, among other things, the issuance of certain debt obligations by regulated utilities and periodic rate increases needed by utilities to cover operating costs and debt service. The inability of any regulated public utility to secure necessary rate increases could adversely affect the utility's ability to pay debt service.

Arizona's largest regulated utility, Arizona Public Service Company ('APS'), serves all or part of 11 of Arizona's 15 counties. APS serves approximately 1,736,000 people, or 45% of Arizona's population. APS is a significant part owner of Arizona's nuclear generator, the Palo Verde Nuclear Generating Station. APS is owned by Pinnacle West Capital Corporation ('Pinnacle West'). APS and PacifiCorp, an Oregon utility, entered into a standstill agreement under which PacifiCorp agreed not to attempt a takeover of APS or Pinnacle West through early 1995. Earlier offers by PacifiCorp to purchase Pinnacle West had been rejected. The agreement also provides for a seasonal swap of power, allowing PacifiCorp to purchase electricity from APS during the winter in exchange for selling electricity to APS in the summer. Rate increases for APS of 5.2% were finalized in late 1991, and included a two year moratorium on future rate increases; APS will be able to petition the Arizona Corporation Commission for an additional rate increase in December of 1993, but any such increase would be limited to no more than 6.4%. In October of 1993, APS announced that it would not seek a rate increase in December of 1993, when it again became eligible to seek such an increase. APS employs approximately 7,000 people; since 1988, APS has laid off approximately 2,100 employees.

The Salt River Project Agricultural Improvement and Power District ('SRP') is an agricultural improvement district organized under state law. For this reason, SRP is not subject to regulation by the Arizona Corporation Commission. SRP provides electric service to approximately 570,000 customers (consumer, commercial and industrial) within a 2,900 square mile area in parts of Maricopa, Gila and Pinal Counties in Arizona.

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Under Arizona law, SRP's board of directors has the exclusive authority to establish rates for electricity. SRP must follow certain procedures, including certain public notice requirements and holding a special board of directors meeting, before implementing any changes in standard electric rates. SRP instituted an average rate increase of 2.9% in January of 1992 (the actual increases ranged from 2.4% to 3.4%, depending on the class of customer).

SRP reported a 36% increase in its net income for the fiscal year ended April 30, 1993, representing its highest net income in six years. The previous fiscal year, which was also profitable, followed two consecutive years of losses. In July, 1993, SRP renegotiated two key coal contracts, announcing that it expected the new contracts to cut its production costs by \$40 million over the next five years. Although SRP disclosed plans in late 1991 to increase its rates by as much as 4% in early 1994 and again in early 1996, it has indicated that increased earnings and savings expected from the new contracts could postpone the 1994 rate increase. SRP, along with APS, has laid off a significant number of employees over the last few years. SRP does not expect any growth in its work force through 1996.

The Sponsors believe that the information summarized above describes some of the more significant matters relating to the Arizona Trust. For a discussion of the particular risks with each of the Debt Obligations, and other factors to be considered in connection therewith, reference should be made to the Official Statements and other offering materials relating to each of the Debt Obligations included within the Portfolio of the Arizona Trust. The sources of the information set forth herein are official statements, other publicly available documents, and statements of public officials and representatives of the issuers of certain of the Debt Obligations. While the Sponsors have not independently verified this information, they have no reason to believe that such information is incorrect in any material respect.

#### ARIZONA TAXES

In the opinion of Meyer, Hendricks, Victor, Osborn & Maledon, Phoenix, Arizona, special counsel on Arizona tax matters, under existing Arizona law:

Under the income tax laws of the State of Arizona, the Arizona Trust is not an association taxable as a corporation; the income of the Arizona Trust will be treated as the income of Holders of Units of the Arizona Trust and be deemed to be received by them when received by the Arizona Trust. Interest on the Debt Obligations in the Arizona Trust which is exempt from Arizona income tax when received by the Arizona Trust will retain its status as tax exempt interest for Arizona income tax purposes to the Holders of Units of the Arizona Trust.

For purposes of the Arizona income tax laws, each Holder of Units of the Arizona Trust will be considered to have received his pro rata share of interest on each Debt Obligation in the Arizona Trust when it is received by the Arizona Trust, and each Holder will have a taxable event when the Arizona Trust disposes of a Debt Obligation (whether by sale, exchange, redemption or payment at maturity) or when the Holder redeems or sells his Unit to the extent the transaction constitutes a taxable event for Federal income tax purposes. A Holder's tax cost (or basis) for his pro rata portion of a Debt Obligation will be established and allocated for purposes of the Arizona income tax laws in the same manner as such cost is established and allocated for Federal income tax purposes, except if the Debt Obligation carries bond premium or original issue discount, in which case it is unclear whether the Federal and Arizona tax costs are equivalent.

Because Arizona income tax is based upon Federal income tax law, the foregoing opinions concerning Arizona income tax are based upon the opinion of Davis Polk & Wardwell concerning Federal income tax aspects of the Arizona Trust.

With respect to obligations of issuers located in Guam or Puerto Rico, bond counsel for the issuers has opined that interest on these obligations is exempt pursuant to Federal law from taxation by any state. However, special Arizona counsel has advised that, because of a conflict that exists between Arizona statutes and Federal law, Arizona taxing authorities might take the position that interest on Guam or Puerto Rico obligations is subject to tax by Arizona. Special counsel cannot predict whether this position would be upheld by the courts. Accordingly, Holders are advised to consult their own tax advisers in this regard.

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#### THE CALIFORNIA TRUST

Economic Factors. The Governor's 1993-1994 Budget, introduced on January 8, 1993, proposed general fund expenditures of \$37.3 billion, with projected revenues of \$39.9 billion. It also proposed special fund expenditures of \$12.4 billion and special fund revenues of \$12.1 billion. To balance the budget in the face of declining revenues, the Governor proposed a series of revenue shifts from local government, reliance on increased federal aid, and reductions in state spending.

The Department of Finance of the State of California's May Revision of General Fund Revenues and Expenditures (the 'May Revision'), released on May 20, 1993, indicated that the revenue projections of the January budget proposal were tracking well, with the full year 1992-1993 about \$80 million higher than the January projection. Personal income tax revenue was higher than projected, sales tax was close to target, and bank and corporation taxes were lagging behind projections. The May Revision projected the State would have an accumulated deficit of about \$2.75 billion by June 30, 1993. The Governor proposed to eliminate this deficit over an 18-month period. He also agreed to retain the 0.5% sales tax scheduled to expire June 30 for a six-month period, dedicated to local public safety purposes, with a November election to determine a permanent extension. Unlike previous years, the Governor's Budget and May Revision did not calculate a 'gap' to be closed, but rather set forth revenue and expenditure forecasts and proposals designed to produce a balanced budget.

The 1993-1994 budget act (the '1993-94 Budget Act') was signed by the Governor on June 30, 1993, along with implementing legislation. The Governor vetoed about \$71 million in spending.

The 1993-94 Budget Act is predicated on general fund revenues and transfers estimated at \$40.6 billion, \$400 million below 1992-93 (and the second consecutive year of actual decline). The principal reasons for declining revenue are the continued weak economy and the expiration (or repeal) of three fiscal steps taken in 1991--a half cent temporary sales tax, a deferral of operating loss carryforwards, and repeal by initiative of a sales tax on candy and snack foods.

The 1993-94 Budget Act also assumes special fund revenues of \$11.9 billion, an increase of 2.9 percent over 1992-93.

The 1993-94 Budget Act includes general fund expenditures of \$38.5 billion (a 6.3 percent reduction from projected 1992-93 expenditures of \$41.1 billion), in order to keep a balanced budget within the available revenues. The 1993-94 Budget Act also includes special fund expenditures of \$12.1 billion, a 4.2 percent increase. The 1993-94 Budget Act reflects the following major adjustments:

1. Changes in local government financing to shift about \$2.6 billion in property taxes from cities, counties, special districts and redevelopment agencies to school and community college districts, thereby reducing general fund support by an equal amount. About \$2.5 billion would be permanent, reflecting termination of the State's 'bailout' of local governments following the property tax cuts of Proposition 13 in 1978 (See 'Constitutional, Legislative and Other Factors' below).

The property tax revenue losses for cities and counties are offset in part by additional sales tax revenues and mandate relief. The temporary 0.5 percent sales tax has been extended through December 31, 1993, for allocation to counties for public safety programs. The voters approved Proposition 172 in November 1993 and the 0.5 percent sales tax was extended permanently for public safety purposes.

Legislation also has been enacted to eliminate state mandates in order to provide local governments flexibility in making their programs responsive to local needs. Legislation provides mandate relief for local justice systems which affect county audit requirements, court reporter fees, and court consolidation; health and welfare relief involving advisory boards, family planning, state audits and realignment maintenance efforts; and relief in areas such as county welfare department self-evaluations, noise guidelines and recycling requirements.

Lawsuits have been filed by several local governmental entities challenging the shift of property taxes. The court in one case, County of Los Angeles v. Sasaki, has already ruled in favor of the State. An appeal by the County has been submitted to the Court of Appeal with a decision expected before the end of March. The State's petition to coordinate the other lawsuits into a

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single proceeding has been granted and those matters are proceeding to resolution under the coordination order.

2. The 1993-94 Budget Act keeps K-12 Proposition 98 funding on a cash basis at the same per-pupil level as 1992-93 by providing schools a \$609 million loan payable from future years' Proposition 98 funds.

3. The 1993-94 Budget Act assumed receipt of about \$692 million of aid to the State from the federal government to offset health and welfare costs associated with foreign immigrants living in the State, which would reduce a like amount of General Fund expenditures. About \$411 million of this amount was one-time funding. Congress ultimately appropriated only \$450 million.

4. Reductions of \$600 million in health and welfare programs.

5. Reductions of \$400 million in support for higher education. These reductions will be partly offset by fee increases at all three units of higher education.

6. A 2-year suspension of the renters' tax credit (\$390 million expenditure reduction in 1993-94). A constitutional amendment will be placed on the June 1994 ballot to restore the renter's tax credit after 1994-95.

7. Various miscellaneous cuts (totalling approximately \$150 million) in State government services in many agencies, up to 15 percent.

8. Miscellaneous one-time items, including deferral of payment to the Public Employees Retirement Fund (\$339 million) and a change in accounting for debt service from accrual to cash basis, saving \$107 million.

The 1993-94 Budget Act contains no general fund tax/revenue increases other than a two year suspension of the renters' tax credit.

The 1994-95 Governor's Budget released January 7, 1994 indicates that the continued sluggish performance of the State's economy will have an adverse effect on results for the 1993-94 Fiscal Year. Revenues are now projected to be \$39.7 billion, about \$900 million less than the 1993-94 Budget Act, even though revenues in the first half of the fiscal year have been very close to original projections.

Expenditures for the 1993-94 Fiscal Year are now projected in the 1994-95 Governor's Budget to be \$39.3 billion, about \$800 million above the original 1993-94 Budget Act. The main reasons for this change are increased health and welfare caseloads, lower local property taxes (which require State support for K-14 education to make up the shortfall), and lower than expected federal government payments for immigration-related costs. The 1994-95 Governor's Budget does not reflect possible additional General Fund costs in the 1993-94 Fiscal Year for earthquake relief.

The February 1994 Bulletin of the Department of Finance indicates that revenues in January 1994 (and for year-to-date) were very slightly lower than the projections in the 1994-95 Governor's Budget, but it is thought that these variances are primarily due to cash flow factors, including delays in receipt of some revenues because of the earthquake in Los Angeles.

On January 17, 1994, a major earthquake measuring an estimated 6.8 on the Richter Scale struck Los Angeles. Significant property damage to private and

public facilities occurred in a four-county area including northern Los Angeles County, Ventura County, and parts of Orange and San Bernardino Counties, which were declared as State and federal disaster areas by January 18. Preliminary estimates of total property damage (private and public) are in the range of \$15 billion or more. However, precise estimates of the damage are being developed and may change.

Despite such damage, on the whole, the vast majority of structures in the areas, including large manufacturing and commercial buildings and all modern high-rise offices, survived the earthquake with minimal or no damage, validating the cumulative effect of strict building codes and thorough preparation for such an emergency by the State and local agencies.

Damage to State-owned facilities included transportation corridors and facilities such as Interstate Highways 5 and 10 and State Highways 14, 118 and 210, and certain other State facilities, including the campus at California State University--Northridge (which was heavily damaged and is only partly open), the Van Nuys State Office Building and some damage to University of California at Los

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Angeles. Aside from the road and bridge closures, it is not expected that this damage will interfere significantly with ongoing State government operations.

The State in conjunction with the federal government is committed to providing assistance to local governments, individuals and businesses suffering damage as a result of the earthquake, as well as to provide for the repair and replacement of State-owned facilities. The federal government will provide substantial earthquake assistance.

The President immediately allocated some available disaster funds, and Congress has approved additional funds for a total of at least \$9.5 billion of federal funds for earthquake relief, including assistance to homeowners and small businesses, and costs for repair of damaged public facilities. The Governor has announced that the State will have to pay about \$1.9 billion for earthquake relief costs, including a 10 percent match to some of the federal funds, and costs for some programs not covered by the federal aid. The Governor has proposed to cover \$1.05 billion of these costs from a general obligation bond issue to be placed on the June, 1994 ballot. Under the Governor's plan, some of the additional costs would be paid by the General Fund, and some borrowed from the federal government in a manner similar to that used by the State of Florida after Hurricane Andrew.

The 1994-95 Fiscal Year will represent the fourth consecutive year the Governor and Legislature will be faced with a very difficult budget environment to produce a balanced budget. Many program cuts and budgetary adjustments have already been made in the last three years. The Governor's Budget once again does not calculate a 'gap' which must be 'closed'; rather it sets forth revenue and expenditure forecasts and revenue and expenditure proposals which result in a balanced budget, including elimination of the accumulated 1992-93 budget deficit of \$2.8 billion.

The Governor's Budget projects General Fund revenues and transfers in 1994-95 of \$41.3 billion, about \$1.4 billion above 1993-94. Included in these projections are receipt of \$2.0 billion in new federal aid to reimburse the State for the cost of educating and incarcerating undocumented foreign immigrants, the transfer of 0.5 percent of the State sales tax to counties, and tax relief of about \$95 million proposed by the Governor for low and moderate income taxpayers. The Governor's Budget also includes receipt of \$600 million assuming the State will prevail in the Barclays Bank case now before the U.S. Supreme Court.

The Governor's Budget projects Special Fund revenues of \$13.7 billion, an increase of 9.6 percent over 1993-94 (in part reflecting the tax shift to counties).

The Governor's Budget projects General Fund expenditures of \$38.8 billion (a 1.3 percent reduction from projected 1993-94 expenditures of \$39.3 billion), in order to keep a balanced budget which pays off the accumulated deficit, within the available revenues. The Governor's Budget also proposes Special Fund expenditures of \$13.7 billion, a 5.4 percent increase.

The Governor proposes to achieve the General Fund reductions and balance the 1994-95 Budget with the following major adjustments:

1. Receipt in 1994-95 of about \$1.1 billion in additional federal funds for health and welfare costs which would reduce a like amount of General Fund expenditures. This is based on a possible change in the federal formula for dividing such aid among the states (\$600 million), a request for additional aid for undocumented immigrants (\$300 million) and various other health and welfare proposals (\$200 million).

2. Reductions of approximately \$800 million in health and welfare programs. In addition, the Governor proposes to transfer approximately \$3.3

billion of health and welfare programs to counties, as described below.

3. The Governor's Budget provides continued support for the base level of funding for the University of California and the California State University, but does not include additional funding for enrollment growth. The Governor's Budget does not propose student fee increases for either the UC or CSU systems, but will entertain fee increase proposals from them. To mitigate any potential student fee increases, the Governor's Budget proposes an increase of \$113 million in student financial aid and \$20 million for the Cal-Grant program. The Governor's Budget includes \$90 million in new funds to expand financial aid for community colleges, to be partially offset with an increase in student fees from \$13 per unit to \$20 per unit.

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4. The Governor's Budget proposes an increase of about \$2.0 billion in Proposition 98 General Fund support for K-14 education, exceeding the Proposition 98 guarantee, reflecting an increase for enrollment growth and a small decrease for inflation. See 'State Finances Proposition 98' above. Per student funding is proposed to remain the same as the prior year. The proposal also reflects retransfer back to counties from school districts of \$1.1 billion of property taxes, with the General Fund to make up the shift.

5. Various miscellaneous cuts (totalling approximately \$75 million). The Governor did not propose across-the-board cuts, and would suspend the 4 percent automatic budget reduction 'trigger,' as was done in 1993-94, so cuts can be focused.

The Governor's Budget proposes the largest restructuring of the State-county relationship since Proposition 13. The proposal's objectives are to (1) promote economic development, (2) promote local control and accountability, (3) establish fiscal incentives for program performance, and (4) reduce bureaucracy. In total, the proposal is a \$5.4 billion transaction constructed with existing revenue sources. However, the proposal is fiscally neutral and primarily affects counties with a minor benefit for cities. Special districts and redevelopment agencies are not included in the proposal.

The proposal calls for expanding the realignment program from \$2.1 billion to \$5.4 billion by increasing the counties' share of the State sales tax from 12 cents to 1 cent (\$1.4 billion), transferring some property tax revenue from schools to counties (\$1.1 billion), and increasing other county revenues (\$0.3 billion). In addition, the State would assume responsibility for a greater share of trial court costs (\$0.4 billion). With these additional county resources, the counties will assume a greater share of costs for AFDC (\$1.1 billion), and Medi-Cal (\$1.3 billion) as well as assume full responsibility for Foster Care, In-Home Supportive Services, Alcohol and Drug programs and functions previously funded from the County Services Block Grant (\$0.8 billion).

The Governor's Budget proposes no tax/revenue increases. Therefore, if the health and welfare proposals are not adopted or if the federal aid will not be forthcoming as proposed, additional program cuts or budget adjustments will have to be made in the 1994-95 Fiscal Year to keep the budget in balance. The Governor's Budget projects the June 30, 1995 ending balance of the budget reserve, the Special Fund for Economic Uncertainties to be about \$260 million, or less than 0.5 percent of General Fund revenues.

President Clinton's 1995 Fiscal Year Budget does not contain any additional funds to the State for immigrant-related costs or for revising the formula for paying health and welfare costs. The Governor and other officials intend to vigorously pursue these additional funds through the Congressional budget process.

The Governor's Budget assumes the State's regular cash flow borrowing program in 1994-95, and assumes the budget will be adopted on time. Cash resources at the start of the 1994-95 fiscal year are projected to be insufficient to meet all obligations without external borrowing, such as revenue anticipation notes, reimbursement or refunding warrants or registered warrants as occurred in 1992.

The Governor's Budget continues to predict that population growth in the 1990s will keep upward pressure on major state programs, such as K-14 education, health, welfare, and corrections, outstripping projected revenue growth in an economy only very slowly emerging from a deep recession. The Governor's health, welfare and local government realignment continue his efforts to keep expenditures in line with resources in the long term. The Governor's Budget also proposes significant restructuring of State government, with elimination and consolidation of several agencies and numerous smaller boards, and a change to 'performance budgeting' which would be more efficient and cost-effective.

Constitutional, Legislative and Other Factors. Certain California constitutional amendments, legislative measures, executive orders, administrative regulations and voter initiatives could result in the adverse effects described below. The following information constitutes only a brief summary, does not purport to be a complete description, and is based on

California, available as of the date of this Prospectus. While the Sponsors have not independently verified such information, they have no reason to believe that such information is not correct in all material respects.

Certain Debt Obligations in the Portfolio may be obligations of issuers which rely in whole or in part on California State revenues for payment of these obligations. Property tax revenues and a portion of the State's general fund surplus are distributed to counties, cities and their various taxing entities and the State assumes certain obligations theretofore paid out of local funds. Whether and to what extent a portion of the State's general fund will be distributed in the future to counties, cities and their various entities, is unclear.

On November 1, 1993 the United States Supreme Court agreed to review the California court decisions in *Barclays Bank International, Ltd. v. Franchise Tax Board* and *Colgate-Palmolive Company, Inc. v. Franchise Tax Board* which upheld California's worldwide combined reporting ('WWCR') method of taxing corporations engaged in a unitary business operation against challenges under the foreign commerce and due process clauses. In 1983, in *Container Corporation v. Franchise Tax Board*, the Supreme Court held that the WWCR method did not violate the foreign commerce clause in the case of a domestic-based unitary business group with foreign-domiciled subsidiaries, but specifically left open the question of whether a different result would obtain for a foreign-based multinational unitary business. *Barclays* concerns a foreign-based multinational and *Colgate-Palmolive* concerns a domestic-based multinational in light of federal foreign policy developments since 1983. In a brief filed at the Supreme Court's request, the Clinton Administration had argued that the Court should not hear the *Barclays* case, even though there are 'serious questions' about the California Supreme Court's analysis and holdings, because the recent changes in the law noted below means the issue in *Barclays* 'lacks substantial recurring importance.' The Clinton Administration had previously decided not to become involved in the *Barclays* petition. The United States Government under the Bush Administration, along with various foreign Governments, had appeared as amicus on behalf of *Barclays* before the California Courts. The Clinton Administration has filed an amicus brief on the merits supporting the California Franchise Tax Board, arguing that the Court should judge WWCR by looking at federal policies in effect at the time the taxes were collected and stating that the federal government had not indicated to the States during the 1970s and 1980s that it objected to WWCR.

Oral argument is scheduled for March 28, 1994. California has ceded 10 minutes of its oral argument time to the United States. The fiscal impact on the State of California has been reported as follows: the State would have to refund \$1.730 billion to taxpayers (\$530 million due to *Barclays*; \$1.2 billion due to *Colgate-Palmolive*), and cancel another \$2.35 billion of pending assessments (\$350 million due to *Barclays*; \$1.9 billion due to *Colgate-Palmolive*), if the Supreme Court ultimately strikes down the WWCR method and rules its decision has retrospective effect. Court observers expect a final decision by June 30, 1994.

In 1988, California enacted legislation providing for a water's-edge combined reporting method if an election fee was paid and other conditions met. On October 6, 1993, California Governor Pete Wilson signed Senate Bill 671 (Alquist) which modifies the unitary tax law by deleting the requirements that a taxpayer electing to determine its income on a water's-edge basis pay a fee and file a domestic disclosure spreadsheet and instead requiring an annual information return. Significantly, the Franchise Tax Board can no longer disregard a taxpayer's election. The Franchise Tax Board is reported to have estimated state revenue losses from the Legislation as growing from \$27 million in 1993-94 to \$616 million in 1999-2000, but others, including Assembly Speaker Willie Brown, disagree with that estimate and assert that more revenue will be generated for California, rather than less, because of an anticipated increase in economic activity and additional revenue generated by the incentives in the Legislation. The United Kingdom has been encouraged by the legislative developments in California and threatened retaliatory taxation by the United Kingdom is on hold.

Certain of the Debt Obligations may be obligations of issuers who rely in whole or in part on ad valorem real property taxes as a source of revenue. On June 6, 1978, California voters approved an amendment to the California Constitution known as Proposition 13, which added Article XIII A to the California Constitution. The effect of Article XIII A is to limit ad valorem taxes on real property and to

restrict the ability of taxing entities to increase real property tax revenues. On November 7, 1978, California voters approved Proposition 8, and on June 3, 1986, California voters approved Proposition 46, both of which amended Article XIII A.



Section 1 of Article XIII A limits the maximum ad valorem tax on real property to 1% of full cash value (as defined in Section 2), to be collected by the counties and apportioned according to law; provided that the 1% limitation does not apply to ad valorem taxes or special assessments to pay the interest and redemption charges on (i) any indebtedness approved by the voters prior to July 1, 1978, or (ii) any bonded indebtedness for the acquisition or improvement of real property approved on or after July 1, 1978, by two-thirds of the votes cast by the voters voting on the proposition. Section 2 of Article XIII A defines 'full cash value' to mean 'the County Assessor's valuation of real property as shown on the 1975/76 tax bill under 'full cash value' or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment.' The full cash value may be adjusted annually to reflect inflation at a rate not to exceed 2% per year, or reduction in the consumer price index or comparable local data, or reduced in the event of declining property value caused by damage, destruction or other factors. The California State Board of Equalization has adopted regulations, binding on county assessors, interpreting the meaning of 'change in ownership' and 'new construction' for purposes of determining full cash value of property under Article XIII A.

Legislation enacted by the California Legislature to implement Article XIII A (Statutes of 1978, Chapter 292, as amended) provides that notwithstanding any other law, local agencies may not levy any ad valorem property tax except to pay debt service on indebtedness approved by the voters prior to July 1, 1978, and that each county will levy the maximum tax permitted by Article XIII A of \$4.00 per \$100 assessed valuation (based on the former practice of using 25%, instead of 100%, of full cash value as the assessed value for tax purposes). The legislation further provided that, for the 1978/79 fiscal year only, the tax levied by each county was to be apportioned among all taxing agencies within the county in proportion to their average share of taxes levied in certain previous years. The apportionment of property taxes for fiscal years after 1978/79 has been revised pursuant to Statutes of 1979, Chapter 282 which provides relief funds from State moneys beginning in fiscal year 1979/80 and is designed to provide a permanent system for sharing State taxes and budget funds with local agencies. Under Chapter 282, cities and counties receive more of the remaining property tax revenues collected under Proposition 13 instead of direct State aid. School districts receive a correspondingly reduced amount of property taxes, but receive compensation directly from the State and are given additional relief. Chapter 282 does not affect the derivation of the base levy (\$4.00 per \$100 assessed valuation) and the bonded debt tax rate.

On November 6, 1979, an initiative known as 'Proposition 4' or the 'Gann Initiative' was approved by the California voters, which added Article XIII B to the California Constitution. Under Article XIII B, State and local governmental entities have an annual 'appropriations limit' and are not allowed to spend certain moneys called 'appropriations subject to limitation' in an amount higher than the 'appropriations limit.' Article XIII B does not affect the appropriation of moneys which are excluded from the definition of 'appropriations subject to limitation,' including debt service on indebtedness existing or authorized as of January 1, 1979, or bonded indebtedness subsequently approved by the voters. In general terms, the 'appropriations limit' is required to be based on certain 1978/79 expenditures, and is to be adjusted annually to reflect changes in consumer prices, population, and certain services provided by these entities. Article XIII B also provides that if these entities' revenues in any year exceed the amounts permitted to be spent, the excess is to be returned by revising tax rates or fee schedules over the subsequent two years.

At the November 8, 1988 general election, California voters approved an initiative known as Proposition 98. This initiative amends Article XIII B to require that (i) the California Legislature establish a prudent state reserve fund in an amount as it shall deem reasonable and necessary and (ii) revenues in excess of amounts permitted to be spent and which would otherwise be returned pursuant to Article XIII B by revision of tax rates or fee schedules, be transferred and allocated (up to a maximum of 4%) to the State School Fund and be expended solely for purposes of instructional improvement and accountability. No such transfer or allocation of funds will be required if certain designated state officials determine that annual student expenditures and class size meet certain criteria

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as set forth in Proposition 98. Any funds allocated to the State School Fund shall cause the appropriation limits established in Article XIII B to be annually increased for any such allocation made in the prior year.

Proposition 98 also amends Article XVI to require that the State of California provide a minimum level of funding for public schools and community colleges. Commencing with the 1988-89 fiscal year, state monies to support school districts and community college districts shall equal or exceed the lesser of (i) an amount equalling the percentage of state general revenue bonds for school and community college districts in fiscal year 1986-87, or (ii) an amount equal to the prior year's state general fund proceeds of taxes appropriated under Article XIII B plus allocated proceeds of local taxes, after adjustment under Article XIII B. The initiative permits the enactment of legislation, by a two-thirds vote, to suspend the minimum funding requirement

for one year.

On June 30, 1989, the California Legislature enacted Senate Constitutional Amendment 1, a proposed modification of the California Constitution to alter the spending limit and the education funding provisions of Proposition 98. Senate Constitutional Amendment 1, on the June 5, 1990 ballot as Proposition 111, was approved by the voters and took effect on July 1, 1990. Among a number of important provisions, Proposition 111 recalculates spending limits for the State and for local governments, allows greater annual increases in the limits, allows the averaging of two years' tax revenues before requiring action regarding excess tax revenues, reduces the amount of the funding guarantee in recession years for school districts and community college districts (but with a floor of 40.9 percent of State general fund tax revenues), removes the provision of Proposition 98 which included excess moneys transferred to school districts and community college districts in the base calculation for the next year, limits the amount of State tax revenue over the limit which would be transferred to school districts and community college districts, and exempts increased gasoline taxes and truck weight fees from the State appropriations limit. Additionally, Proposition 111 exempts from the State appropriations limit funding for capital outlays.

Article XIII B, like Article XIII A, may require further interpretation by both the Legislature and the courts to determine its applicability to specific situations involving the State and local taxing authorities. Depending upon the interpretation, Article XIII B may limit significantly a governmental entity's ability to budget sufficient funds to meet debt service on bonds and other obligations.

On November 4, 1986, California voters approved an initiative statute known as Proposition 62. This initiative (i) requires that any tax for general governmental purposes imposed by local governments be approved by resolution or ordinance adopted by a two-thirds vote of the governmental entity's legislative body and by a majority vote of the electorate of the governmental entity, (ii) requires that any special tax (defined as taxes levied for other than general governmental purposes) imposed by a local governmental entity be approved by a two-thirds vote of the voters within that jurisdiction, (iii) restricts the use of revenues from a special tax to the purposes or for the service for which the special tax was imposed, (iv) prohibits the imposition of ad valorem taxes on real property by local governmental entities except as permitted by Article XIII A, (v) prohibits the imposition of transaction taxes and sales taxes on the sale of real property by local governments, (vi) requires that any tax imposed by a local government on or after August 1, 1985 be ratified by a majority vote of the electorate within two years of the adoption of the initiative or be terminated by November 15, 1988, (vii) requires that, in the event a local government fails to comply with the provisions of this measure, a reduction in the amount of property tax revenue allocated to such local government occurs in an amount equal to the revenues received by such entity attributable to the tax levied in violation of the initiative, and (viii) permits these provisions to be amended exclusively by the voters of the State of California.

In September 1988, the California Court of Appeal in *City of Westminster v. County of Orange*, 204 Cal. App. 3d 623, 215 Cal. Rptr. 511 (Cal. Ct. App. 1988), held that Proposition 62 is unconstitutional to the extent that it requires a general tax by a general law city, enacted on or after August 1, 1985 and prior to the effective date of Proposition 62, to be subject to approval by a majority of voters. The Court held that the California Constitution prohibits the imposition of a requirement that local tax measures be submitted to the electorate by either referendum or initiative. It is not

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possible to predict the impact of this decision on charter cities, on special taxes or on new taxes imposed after the effective date of Proposition 62.

On November 8, 1988, California voters approved Proposition 87. Proposition 87 amended Article XVI, Section 16, of the California Constitution by authorizing the California Legislature to prohibit redevelopment agencies from receiving any of the property tax revenue raised by increased property tax rates levied to repay bonded indebtedness of local governments which is approved by voters on or after January 1, 1989. It is not possible to predict whether the California Legislature will enact such a prohibition nor is it possible to predict the impact of Proposition 87 on redevelopment agencies and their ability to make payments on outstanding debt obligations.

Certain Debt Obligations in the Portfolio may be obligations which are payable solely from the revenues of health care institutions. Certain provisions under California law may adversely affect these revenues and, consequently, payment on those Debt Obligations.

The Federally sponsored Medicaid program for health care services to eligible welfare beneficiaries in California is known as the Medi-Cal program. Historically, the Medi-Cal Program has provided for a cost-based system of reimbursement for inpatient care furnished to Medi-Cal beneficiaries by any hospital wanting to participate in the Medi-Cal program, provided such hospital met applicable requirements for participation. California law now provides that

the State of California shall selectively contract with hospitals to provide acute inpatient services to Medi-Cal patients. Medi-Cal contracts currently apply only to acute inpatient services. Generally, such selective contracting is made on a flat per diem payment basis for all services to Medi-Cal beneficiaries, and generally such payment has not increased in relation to inflation, costs or other factors. Other reductions or limitations may be imposed on payment for services rendered to Medi-Cal beneficiaries in the future.

Under this approach, in most geographical areas of California, only those hospitals which enter into a Medi-Cal contract with the State of California will be paid for non-emergency acute inpatient services rendered to Medi-Cal beneficiaries. The State may also terminate these contracts without notice under certain circumstances and is obligated to make contractual payments only to the extent the California legislature appropriates adequate funding therefor.

In February 1987, the Governor of the State of California announced that payments to Medi-Cal providers for certain services (not including hospital acute inpatient services) would be decreased by ten percent through June 1987. However, a federal district court issued a preliminary injunction preventing application of any cuts until a trial on the merits can be held. If the injunction is deemed to have been granted improperly, the State of California would be entitled to recapture the payment differential for the intended reduction period. It is not possible to predict at this time whether any decreases will ultimately be implemented.

California enacted legislation in 1982 that authorizes private health plans and insurers to contract directly with hospitals for services to beneficiaries on negotiated terms. Some insurers have introduced plans known as 'preferred provider organizations' ('PPOs'), which offer financial incentives for subscribers who use only the hospitals which contract with the plan. Under an exclusive provider plan, which includes most health maintenance organizations ('HMOs'), private payors limit coverage to those services provided by selected hospitals. Discounts offered to HMOs and PPOs may result in payment to the contracting hospital of less than actual cost and the volume of patients directed to a hospital under an HMO or PPO contract may vary significantly from projections. Often, HMO or PPO contracts are enforceable for a stated term, regardless of provider losses or of bankruptcy of the respective HMO or PPO. It is expected that failure to execute and maintain such PPO and HMO contracts would reduce a hospital's patient base or gross revenues. Conversely, participation may maintain or increase the patient base, but may result in reduced payment and lower net income to the contracting hospitals.

These Debt Obligations may also be insured by the State of California pursuant to an insurance program implemented by the Office of Statewide Health Planning and Development for health facility construction loans. If a default occurs on insured Debt Obligations, the State Treasurer will issue debentures payable out of a reserve fund established under the insurance program or will pay principal and interest on an unaccelerated basis from unappropriated State funds. At the request of the Office of Statewide Health Planning and Development, Arthur D. Little, Inc. prepared a study in December,

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1983, to evaluate the adequacy of the reserve fund established under the insurance program and based on certain formulations and assumptions found the reserve fund substantially underfunded. In September of 1986, Arthur D. Little, Inc. prepared an update of the study and concluded that an additional 10% reserve be established for 'multi-level' facilities. For the balance of the reserve fund, the update recommended maintaining the current reserve calculation method. In March of 1990, Arthur D. Little, Inc. prepared a further review of the study and recommended that separate reserves continue to be established for 'multi-level' facilities at a reserve level consistent with those that would be required by an insurance company.

Certain Debt Obligations in the Portfolio may be obligations which are secured in whole or in part by a mortgage or deed of trust on real property. California has five principal statutory provisions which limit the remedies of a creditor secured by a mortgage or deed of trust. Two limit the creditor's right to obtain a deficiency judgment, one limitation being based on the method of foreclosure and the other on the type of debt secured. Under the former, a deficiency judgment is barred when the foreclosure is accomplished by means of a nonjudicial trustee's sale. Under the latter, a deficiency judgment is barred when the foreclosed mortgage or deed of trust secures certain purchase money obligations. Another California statute, commonly known as the 'one form of action' rule, requires creditors secured by real property to exhaust their real property security by foreclosure before bringing a personal action against the debtor. The fourth statutory provision limits any deficiency judgment obtained by a creditor secured by real property following a judicial sale of such property to the excess of the outstanding debt over the fair value of the property at the time of the sale, thus preventing the creditor from obtaining a large deficiency judgment against the debtor as the result of low bids at a judicial sale. The fifth statutory provision gives the debtor the right to redeem the real property from any judicial foreclosure sale as to which a deficiency judgment may be ordered against the debtor.

Upon the default of a mortgage or deed of trust with respect to California real property, the creditor's nonjudicial foreclosure rights under the power of sale contained in the mortgage or deed of trust are subject to the constraints imposed by California law upon transfers of title to real property by private power of sale. During the three-month period beginning with the filing of a formal notice of default, the debtor is entitled to reinstate the mortgage by making any overdue payments. Under standard loan servicing procedures, the filing of the formal notice of default does not occur unless at least three full monthly payments have become due and remain unpaid. The power of sale is exercised by posting and publishing a notice of sale for at least 20 days after expiration of the three-month reinstatement period. Therefore, the effective minimum period for foreclosing on a mortgage could be in excess of seven months after the initial default. Such time delays in collections could disrupt the flow of revenues available to an issuer for the payment of debt service on the outstanding obligations if such defaults occur with respect to a substantial number of mortgages or deeds of trust securing an issuer's obligations.

In addition, a court could find that there is sufficient involvement of the issuer in the nonjudicial sale of property securing a mortgage for such private sale to constitute 'state action,' and could hold that the private-right-of-sale proceedings violate the due process requirements of the Federal or State Constitutions, consequently preventing an issuer from using the nonjudicial foreclosure remedy described above.

Certain Debt Obligations in the Portfolio may be obligations which finance the acquisition of single family home mortgages for low and moderate income mortgagors. These obligations may be payable solely from revenues derived from the home mortgages, and are subject to California's statutory limitations described above applicable to obligations secured by real property. Under California antideficiency legislation, there is no personal recourse against a mortgagor of a single family residence purchased with the loan secured by the mortgage, regardless of whether the creditor chooses judicial or nonjudicial foreclosure.

Under California law, mortgage loans secured by single-family owner-occupied dwellings may be prepaid at any time. Prepayment charges on such mortgage loans may be imposed only with respect to voluntary prepayments made during the first five years during the term of the mortgage loan, and cannot in any event exceed six months' advance interest on the amount prepaid in excess of 20% of the original principal amount of the mortgage loan. This limitation could affect the flow of revenues

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available to an issuer for debt service on the outstanding debt obligations which financed such home mortgages.

#### CALIFORNIA TAXES

In the opinion of O'Melveny & Myers, Los Angeles, California, special counsel on California tax matters, under existing California law:

The Trust Fund is not an association taxable as a corporation for California tax purposes. Each Holder will be considered the owner of a pro rata portion of the Trust Fund and will be deemed to receive his pro rata portion of the income therefrom. To the extent interest on the Debt Obligations is exempt from California personal income taxes, said interest is similarly exempt from California personal income taxes in the hands of the Holders, except to the extent such Holders are banks or corporations subject to the California franchise tax. Holders will be subject to California income tax on any gain on the disposition of all or part of his pro rata portion of a Debt Obligation in the Trust Fund. A Holder will be considered to have disposed of all or part of his pro rata portion of each Debt Obligation when he sells or redeems all or some of his Units. A Holder will also be considered to have disposed of all or part of his pro rata portion of a Debt Obligation when all or part of the Debt Obligation is sold by the Trust Fund or is redeemed or paid at maturity. The Debt Obligations and the Units are not taxable under the California personal property tax law.

#### THE CONNECTICUT TRUST

RISK FACTORS--The State Economy. Manufacturing has historically been of prime economic importance to Connecticut. The manufacturing industry is diversified, with transportation equipment (primarily aircraft engines, helicopters and submarines) the dominant industry, followed by non-electrical machinery, fabricated metal products, and electrical machinery. From 1970 to 1992, however, there was a rise in employment in service-related industries. During this period, manufacturing employment declined 30.8%, while the number of persons employed in other non-agricultural establishments (including government) increased 60.8%, particularly in the service, trade and finance categories. In 1992, manufacturing accounted for only 20.1% of total non-agricultural employment in Connecticut. Defense-related business represents a relatively high proportion of the manufacturing sector. On a per capita basis, defense awards to

Connecticut have traditionally been among the highest in the nation, and reductions in defense spending have had a substantial adverse impact on Connecticut's economy. Moreover, the State's largest defense contractors have announced substantial planned labor force reductions scheduled to occur over the next four years.

The annual average unemployment rate (seasonally adjusted) in Connecticut decreased from 6.9% in 1982 a low of 3.0% in 1988 but rose to 7.2% in 1992. While these rates were lower than those recorded for the U.S. as a whole for the same periods, as of May, 1993, the estimated rate of unemployment in Connecticut on a seasonally adjusted basis reached 7.4%, compared to 6.9% for the nation as a whole, and pockets of significant unemployment and poverty exist in some of Connecticut's cities and towns. Moreover, Connecticut is now in a recession, the depth and duration of which are uncertain.

State Revenues and Expenditures. The State derives over seventy percent of its revenues from taxes imposed by the State. The two major taxes have been the sales and use taxes and the corporation business tax, each of which is sensitive to changes in the level of economic activity in the State, but the Connecticut income tax on individuals, trusts, and estates enacted in 1991 is expected to supersede each of them in importance.

The State's General Fund budget for the 1986-87 fiscal year anticipated appropriations and revenues of approximately \$4,300,000,000. The General Fund ended the 1986-87 fiscal year with an operating surplus of \$365,200,000. The General Fund budget for the 1987-88 fiscal year anticipated appropriations and revenues of approximately \$4,915,800,000. However, the General Fund ended the 1987-88 fiscal year with an operating deficit of \$115,600,000. The General Fund budget for the 1988-89 fiscal year anticipated that General Fund expenditures of \$5,551,000,000 and certain educational expenses of \$206,700,000 not previously paid through the General Fund would be financed in part from surpluses of prior years and in part from higher tax revenues projected to result

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from tax laws in effect for the 1987-88 fiscal year and stricter enforcement thereof; a substantial deficit was projected during the third quarter of the 1988-89 fiscal year, but, largely because of tax law changes that took effect before the end of the fiscal year, the operating deficit was kept to \$28,000,000. The General Fund budget for the 1989-90 fiscal year anticipated appropriations of approximately \$6,224,500,000 and, by virtue of tax increases enacted to take effect generally at the beginning of the fiscal year, revenues slightly exceeding such amount. However, largely because of tax revenue shortfalls, the General Fund ended the 1989-90 fiscal year with an operating deficit for the year of \$259,000,000, wiping out reserves for such events built up in prior years. The General Fund budget for the 1990-91 fiscal year anticipated expenditures of \$6,433,000,000, but no significant new or increased taxes were enacted. Primarily because of significant declines in tax revenues and unanticipated expenditures reflective of economic adversity, the General Fund ended the 1990-91 fiscal year alone with a further deficit of \$809,000,000. A General Fund budget was not enacted for the 1991-92 fiscal year until August 22, 1991. This budget anticipated General Fund expenditures of \$7,007,861,328 and revenues of \$7,426,390,000. Anticipated decreases in revenues resulting from a 25% reduction in the sales tax rate effective October 1, 1991, the repeal of the taxes on the capital gains and interest and dividend income of resident individuals for years starting after 1991, and the phase-out of the corporation business tax surcharge over two years commencing with years starting after 1991 were expected to be more than offset by a new general personal income tax imposed at effective rates not to exceed 4.5% on the Connecticut taxable income of resident and non-resident individuals, trusts, and estates. The General Fund ended the 1991-92 fiscal year with an operating surplus of \$110,000,000. The General Fund budget for the 1992-93 fiscal year anticipated General Fund expenditures of \$7,372,062,859 and revenues of \$7,372,210,000, and the General Fund ended the 1992-93 fiscal year with an operating surplus of \$113,500,000. Balanced General Fund budgets for the biennium ending June 30, 1995, have been adopted appropriating expenditures of \$7,829,000,000 for the 1993-94 fiscal year and \$8,266,000,000 for the 1994-95 fiscal year.

State Debt. The primary method for financing capital projects by the State is through the sale of the general obligation bonds of the State. These bonds are backed by the full faith and credit of the State. As of January 1, 1994, there was a total legislatively authorized bond indebtedness of \$9,392,375,363, of which \$7,545,471,616 had been approved for issuance by the State Bond Commission and \$6,477,041,771 had been issued.

To fund operating cash requirements, prior to the 1991-92 fiscal year the State borrowed up to \$750,000,000 pursuant to authorization to issue commercial paper and on July 29, 1991, it issued \$200,000,000 General Obligation Temporary Notes, none of which temporary borrowings were outstanding as of January 14, 1994. To fund the cumulative General Fund deficit for the 1989-90 and 1990-91 fiscal years, the legislation enacted August 22, 1991, authorized the State Treasurer to issue Economic Recovery Notes up to the aggregate amount of such deficit, which must be payable no later than June 30, 1996; at least \$50,000,000 of such Notes, but not more than a cap amount, is to be retired each fiscal year commencing with the 1991-92 fiscal year, and any unappropriated surplus up to

\$205,000,000 in the General Fund at the end of each of the three fiscal years commencing with the 1991-92 fiscal year must be applied to retire such Notes as may remain outstanding at those times. On September 25, 1991 and October 24, 1991, the State issued \$640,710,000 and \$325,000,000 respectively, of such Economic Recovery Notes, of which \$630,610,000 were outstanding as of January 1, 1994.

To meet the need for reconstructing, repairing, rehabilitating and improving the State transportation system (except Bradley International Airport), the State adopted legislation which provides for, among other things, the issuance of special tax obligation ('STO') bonds the proceeds of which will be used to pay for improvements to the State's transportation system. The STO bonds are special tax obligations of the State payable solely from specified motor fuel taxes, motor vehicle receipts, and license, permit and fee revenues pledged therefor and deposited in the special transportation fund. The twelve-year cost of the infrastructure program which began in 1984, to be met from federal, state, and local funds, is currently estimated at \$9.5 billion. To finance a portion of the State's \$4.1 billion share of such cost, the State expects to issue \$3.7 billion of STO bonds over the twelve-year period.

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As of January 1, 1994, the General Assembly has authorized STO bonds for the program in the aggregate amount of \$3,604,363,104, of which \$2,794,650,752 had been issued. It is anticipated that additional STO bonds will be authorized by the General Assembly annually in an amount necessary to finance and to complete the infrastructure program. Such additional bonds may have equal rank with the outstanding bonds provided certain pledged revenue coverage requirements of the STO indenture controlling the issuance of such bonds are met. The State expects to continue to offer bonds for this program.

The State's budget problems led to the ratings of its general obligation bonds being reduced by Standard & Poors from AA+ to AA on March 29, 1990, and by Moody's from Aa1 to Aa on April 9, 1990. Because of concerns over Connecticut's lack of a plan to deal during the current fiscal year with the accumulated projected deficits in its General Fund, on September 13, 1991, Standard & Poors further reduced its ratings of the State's general obligation bonds and certain other obligations that depend in part on the creditworthiness of the State to AA-. On March 7, 1991, Moody's downgraded its ratings of the revenue bonds of four Connecticut hospitals because of the effects of the State's restrictive controlled reimbursement environment under which they have been operating.

Litigation. The State, its officers and employees are defendants in numerous lawsuits. According to the Attorney General's Office, an adverse decision in any of the cases summarized herein could materially affect the State's financial position: (i) an action by taxpayer groups seeking to enjoin expenditures by the State alleged to exceed the expenditure cap provided in the State's constitution; (ii) litigation on behalf of black and Hispanic school children in the City of Hartford seeking 'integrated education' and a declaratory judgment that the public schools within the greater Hartford metropolitan area are segregated and inherently unequal; (iii) litigation involving claims by Indian tribes to monetary recovery and ownership of less than 1/10 of 1% of the State's land area; (iv) litigation challenging the State's method of financing elementary and secondary public schools on the ground that it denies equal access to education; (v) an action in which two retarded persons seek placement outside a State hospital, new programs and damages on behalf of themselves and all mentally retarded patients at the hospital; (vi) litigation involving claims for refunds of taxes by several cable television companies; (vii) an action on behalf of all persons with retardation or traumatic brain injury, claiming that their constitutional rights are violated by placement in State hospitals alleged not to provide adequate treatment and training, and seeking placement in community residential settings with appropriate support services; (viii) an action by the Connecticut Hospital Association and 33 hospitals seeking to require the State to reimburse hospitals for in-patient medical services on a basis more favorable to them; (ix) a class action by the Connecticut Criminal Defense Lawyers Association claiming a campaign of illegal surveillance activity over a period of years and seeking damages and injunctive relief; (x) two actions for monetary damages brought by a former patient at a State mental hospital stemming from an attempted suicide that left her brain-damaged; and (xi) an action challenging the validity of the State's imposition of surcharges on hospital charges to finance certain uncompensated care costs incurred by hospitals.

Municipal Debt Obligations. General obligation bonds issued by municipalities are usually payable from ad valorem taxes on property subject to taxation by the municipality. Certain Connecticut municipalities have experienced severe fiscal difficulties and have reported operating and accumulated deficits in recent years. The most notable of these is the City of Bridgeport, which filed a bankruptcy petition on June 7, 1991. The State opposed the petition. The United States Bankruptcy Court for the District of Connecticut has held that Bridgeport has authority to file such a petition but that its petition should be dismissed on the grounds that Bridgeport was not insolvent when the petition was filed.

In addition to general obligation bonds backed by the full faith and credit

of the municipality, certain municipal authorities may issue bonds that are not considered to be debts of the municipality. Such bonds may only be repaid from the revenues of projects financed by the municipal authority, which revenues may be insufficient to service the authority's debt obligations.

Regional economic difficulties, reductions in revenues, and increased expenses could lead to further fiscal problems for the State and its political subdivisions, authorities, and agencies. This could

result in declines in the value of their outstanding obligations, increases in their future borrowing costs, and impairment of their ability to pay debt service on their obligations.

CONNECTICUT TAXES

In the Opinion of Day, Berry & Howard, special counsel on Connecticut tax matters, which is based explicitly on the Opinion of Davis Polk & Wardwell regarding Federal income tax matters, under existing Connecticut law:

1. The Connecticut Trust is not liable for any tax on or measured by net income imposed by the State of Connecticut.
2. Interest income of the Connecticut Trust from Debt Obligations issued by or on behalf of the State of Connecticut, any political subdivision thereof, or public instrumentality, state or local authority, district, or similar public entity created under the laws of the State of Connecticut ('Connecticut Debt Obligations'), or from Debt Obligations issued by United States territories or possessions the interest on which Federal law would prohibit Connecticut from taxing if received directly by a Holder, is not taxable under the Connecticut tax on the Connecticut taxable income of individuals, trusts, and estates (the 'Connecticut Income Tax'), when any such interest is received by the Connecticut Trust or distributed by it to such a Holder.
3. Gains and losses recognized by a Holder for Federal income tax purposes upon the maturity, redemption, sale, or other disposition by the Connecticut Trust of a Debt Obligation held by the Connecticut Trust or upon the redemption, sale, or other disposition of a Unit of the Connecticut Trust held by a Holder are taken into account as gains or losses, respectively, for purposes of the Connecticut Income Tax, except that, in the case of a Holder holding a Unit of the Connecticut Trust as a capital asset, such gains and losses recognized upon the sale or exchange of a Connecticut Debt Obligation held by the Connecticut Trust are excluded from gains and losses taken into account for purposes of such tax and no opinion is expressed as to the treatment for purposes of such tax of gains and losses recognized upon the maturity or redemption of a Connecticut Debt Obligation held by the Connecticut Trust or, to the extent attributable to Connecticut Debt Obligations, of gains and losses recognized upon the redemption, sale, or other disposition by a Holder of a Unit of the Connecticut Trust held by him.
4. The portion of any interest income or capital gain of the Connecticut Trust that is allocable to a Holder that is subject to the Connecticut corporation business tax is includable in the gross income of such Holder for purposes of such tax.
5. An interest in a Unit of the Connecticut Trust that is owned by or attributable to a Connecticut resident at the time of his death is includable in his gross estate for purposes of the Connecticut succession tax and the Connecticut estate tax.

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The Connecticut Income Tax was enacted in August, 1991. Generally a Holder recognizes gain or loss for purposes of this tax to the same extent as he recognizes gain or loss for Federal income tax purposes. Ordinarily this would mean that gain or loss would be recognized by a Holder upon the maturity, redemption, sale, or other disposition by the Connecticut Trust of a Debt Obligation held by it, or upon the redemption, sale, or other disposition of a Unit of the Connecticut Trust held by the Holder.

However, on June 19, 1992, Connecticut legislation was adopted that provides that gains and losses from the sale or exchange of Connecticut Debt Obligations held as capital assets will not be taken into account for purposes of the Connecticut Income Tax for taxable years starting on or after January 1, 1992. It is not clear whether this provision would apply to gain or loss recognized by a Holder upon the maturity or redemption of a Connecticut Debt Obligation held by the Connecticut Trust or, to the extent attributable to Connecticut Debt Obligations held by the Connecticut Trust, to

gain or loss recognized by a Holder upon the redemption, sale, or other disposition of a Unit of the Connecticut Trust held by the Holder.

By legislation adopted May 19, 1993, as amended by legislation adopted June 25, 1993, Connecticut enacted the net Connecticut minimum tax, retroactive to taxable years beginning on or after January 1, 1993, which is applicable to individuals, trusts, and estates that are subject to the Connecticut Income Tax and also to the Federal alternative minimum tax. Income of the Connecticut Trust that is subject to the Federal alternative minimum tax in the case of such Holders may also be subject to the net Connecticut minimum tax.

Holders are urged to consult their own tax advisors concerning these matters.

#### THE FLORIDA TRUST

RISK FACTORS--The State Economy. In 1980 Florida ranked seventh among the fifty states with a population of 9.7 million people. The State has grown dramatically since then and, as of April 1, 1992, ranked fourth with an estimated population of 13.4 million, an increase of approximately 41.5% since 1980. Since 1982 migration has been fairly steady with an average of 252,000 new residents each year. Since 1982 the prime working age population (18-44) has grown at an average annual rate of 3.3%. The share of Florida's total working age population (18-59) to total state population is approximately 54%. Non-farm employment has grown by approximately 57.9% since 1980. The service sector is Florida's largest employment sector, presently accounting for 31.7% of total non-farm employment. Manufacturing jobs in Florida are concentrated in the area of high-tech and value added sectors, such as electrical and electronic equipment as well as printing and publishing. Job gains in Florida's manufacturing sector have exceeded national averages increasing by 8.4% between 1980 and 1992. Foreign Trade has contributed significantly to Florida's employment growth. Florida's dependence on highly cyclical construction and construction related manufacturing has declined. Total contract construction employment as a share of total non-farm employment has fallen from 10% in 1973, to 7% in 1980 to 5% in 1992. Although the job creation rate for the State of Florida since 1980 is over two times the rate for the nation as a whole, since 1989 the unemployment rate for the State has risen faster than the national average. The average rate of unemployment for Florida since 1980 is 6.5%, while the national average is 7.1%. Because Florida has a proportionately greater retirement age population, property income (dividends, interest and rent) and transfer payments (social security and pension benefits) are a relatively more important source of income. In 1992, Florida employment income represented 61% of total personal income while nationally, employment income represented 72% of total personal income.

On August 24, 1992, Hurricane Andrew passed through South Florida. Property damage is estimated to be between \$20 and \$30 billion, of which \$15 billion is estimated to be insured losses. The office of the Governor has estimated that the costs to State and local governments for emergency services and damage to public facilities and infrastructure are approximately \$1 billion. The Governor's office has estimated lost State revenue to be between \$21.5 million and \$38.5 million including utilities taxes, lottery revenues, tolls and State Park fees. For the local governments in Dade County and the Dade County School Board lost revenues are estimated to be between \$155.9 million and \$258.6 million as a result of reduction in property values.

The U.S. Congress has passed a disaster aid package which will provide \$10.6 billion in aid to South Florida. This includes Federal Emergency Management Agency ('FEMA') payments to State and local governments for repair to facilities owned by local governments, schools and universities, additional costs for debris removal and public safety services related to the hurricane and grants to State and local governments to make up for lost revenue. Also included is funding for grants and loans to individuals for small business assistance, economic development, housing allowance and repairs. The State will be required to match the FEMA funding for those grants and loans with \$32.5 million of State and local money. FEMA also has an Individual and Family Grants Program which is available to uninsured and under-insured households through which up to \$11,500 per household is available to help cover losses. The State will be required to match this program 25% to the FEMA's 75%. At this time, the State estimates its matching requirement will not exceed \$100 million.

The Florida Revenue Estimating Conference has estimated additional non-recurring General Revenues totalling \$645.8 million during fiscal year 1992-93, 1993-94 and 1994-95 from increased

economic activity following the hurricane. In a special session of the Legislature held December 9 to December 11, 1992, the Legislature enacted a law that sets aside an estimated \$630.4 million of the \$645.8 million to be used by State and local government agencies to defray a wide array of expenditures related to Hurricane Andrew.

The ability of the State and its local units of government to satisfy the Debt Obligations may be affected by numerous factors which impact on the economic vitality of the State in general and the particular region of the State in which the issuer of the Debt Obligation is located. South Florida is particularly susceptible to international trade and currency imbalances and to



economic dislocations in Central and South America, due to its geographical location and its involvement with foreign trade, tourism and investment capital. The central and northern portions of the State are impacted by problems in the agricultural sector, particularly with regard to the citrus and sugar industries. Short-term adverse economic conditions may be created in these areas, and in the State as a whole, due to crop failures, severe weather conditions or other agriculture-related problems. The State economy also has historically been somewhat dependent on the tourism and construction industries and is sensitive to trends in those sectors.

The State Budget. The State operates under a biennial budget which is formulated in even numbered years and presented for approval to the Legislature in odd numbered years. A supplemental budget request process is utilized in the even numbered years for refining and modifying the primary budget. Under the State Constitution and applicable statutes, the State budget as a whole, and each separate fund within the State budget, must be kept in balance from currently available revenues during each State fiscal year. (The State's fiscal year runs from July 1 through June 30). The Governor and the Comptroller of the State are charged with the responsibility of ensuring that sufficient revenues are collected to meet appropriations and that no deficit occurs in any State fund.

The financial operations of the State covering all receipts and expenditures are maintained through the use of three types of funds: the General Revenue Fund, Trust Funds and Working Capital Fund. The majority of the State's tax revenues are deposited in the General Revenue Fund and moneys in the General Revenue Fund are expended pursuant to appropriations acts. In fiscal year 1992-93, expenditures for education, health and welfare and public safety represented approximately 49%, 30% and 11% respectively, of expenditures from the General Revenue Fund. The Trust Funds consist of moneys received by the State which under law or trust agreement are segregated for a purpose authorized by law. Revenues in the General Revenue Fund which are in excess of the amount needed to meet appropriations may be transferred to the Working Capital Fund.

State Revenues. Estimated General Revenue and Working Capital Fund revenues of \$12,959.2 million for 1993-94 (excluding Hurricane Andrew related revenues and expenses) represent an increase of 7.5% over revenues for 1992-93. Estimated Revenue for 1994-95 of \$13,944 million (excluding Hurricane Andrew impacts) represent an increase of 7.6% over 1993-1994.

In fiscal year 1992-1993, the State derived approximately 62% of its total direct revenues for deposit in the General Revenue Fund, Trust Funds and Working Capital Fund from State taxes. Federal grants and other special revenues accounted for the remaining revenues. The greatest single source of tax receipts in the State is the 6% sales and use tax. For the fiscal year ended June 30, 1993, receipts from the sales and use tax totaled \$9,426 million, an increase of approximately 12.5% over fiscal year 1991-92. This amount includes non-recurring increases attributable to the rebuilding and reconstruction following the hurricane. The second largest source of State tax receipts is the tax on motor fuels including the tax receipts distributed to local governments. Receipts from the taxes on motor fuels are almost entirely dedicated to trust funds for specific purposes or transferred to local governments and are not included in the General Revenue Fund. For the fiscal year ended June 30, 1992, collections of this tax totaled \$1,475.5 million.

The State currently does not impose a personal income tax. However, the State does impose a corporate income tax on the net income of corporations, organizations, associations and other artificial entities for the privilege of conducting business, deriving income or existing within the State. For the fiscal year ended June 30, 1993, receipts from the corporate income tax totaled \$846.6 million, an increase of approximately 5.6% from fiscal year 1991-92. The Documentary Stamp Tax collections totalled \$639 million during fiscal year 1992-93, or approximately 27% over fiscal year 1991-92. The

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Alcoholic Beverage Tax, an excise tax on beer, wine and liquor totaled \$442.2 million in 1992-93, an increase of 1.6% from fiscal year 1991-92. The Florida lottery produced sales of \$2.13 billion of which \$810.4 million was used for education in fiscal year 1991-92.

While the State does not levy ad valorem taxes on real property or tangible personal property, counties, municipalities and school districts are authorized by law, and special districts may be authorized by law, to levy ad valorem taxes. Under the State Constitution, ad valorem taxes may not be levied by counties, municipalities, school districts and water management districts in excess of the following respective millages upon the assessed value of real estate and tangible personal property: for all county purposes, ten mills; for all municipal purposes, ten mills; for all school purposes, ten mills; and for water management purposes, either 0.05 mill or 1.0 mill, depending upon geographic location. These millage limitations do not apply to taxes levied for payment of bonds and taxes levied for periods not longer than two years when authorized by a vote of the electors. (Note: one mill equals one-tenth of one cent).

The State Constitution and statutes provide for the exemption of homesteads from certain taxes. The homestead exemption is an exemption from all taxation, except for assessments for special benefits, up to a specific amount of the assessed valuation of the homestead. This exemption is available to every person who has the legal or equitable title to real estate and maintains thereon his or her permanent home. All permanent residents of the State are currently entitled to a \$25,000 homestead exemption from levies by all taxing authorities, however, such exemption is subject to change upon voter approval.

On November 3, 1992, the voters of the State of Florida passed an amendment to the Florida Constitution establishing a limitation on the annual increase in assessed valuation of homestead property commencing January 1, 1994, of the lesser of 3% or the increase in the Consumer Price Index during the relevant year, except in the event of a sale thereof during such year, and except as to improvements thereto during such year. The amendment did not alter any of the millage rates described above.

Since municipalities, counties, school districts and other special purpose units of local governments with power to issue general obligation bonds have authority to increase the millage levy for voter approved general obligation debt to the amount necessary to satisfy the related debt service requirements, the amendment is not expected to adversely affect the ability of these entities to pay the principal of or interest on such general obligation bonds. However, in periods of high inflation, those local government units whose operating millage levies are approaching the constitutional cap and whose tax base consists largely of residential real estate, may, as a result of the above-described amendment, need to place greater reliance on non-ad valorem revenue sources to meet their operating budget needs.

State General Obligation Bonds and State Revenue Bonds. The State Constitution does not permit the State to issue debt obligations to fund governmental operations. Generally, the State Constitution authorizes State bonds pledging the full faith and credit of the State only to finance or refinance the cost of State fixed capital outlay projects, upon approval by a vote of the electors, and provided that the total outstanding principal amount of such bonds does not exceed 50% of the total tax revenues of the State for the two preceding fiscal years. Revenue bonds may be issued by the State or its agencies without a vote of the electors only to finance or refinance the cost of State fixed capital outlay projects which are payable solely from funds derived directly from sources other than State tax revenues.

Exceptions to the general provisions regarding the full faith and credit pledge of the State are contained in specific provisions of the State Constitution which authorize the pledge of the full faith and credit of the State, without electorate approval, but subject to specific coverage requirements, for: certain road projects, county education projects, State higher education projects, State system of Public Education and construction of air and water pollution control and abatement facilities, solid waste disposal facilities and certain other water facilities.

Local Bonds. The State Constitution provides that counties, school districts, municipalities, special districts and local governmental bodies with taxing powers may issue debt obligations payable from ad valorem taxation and maturing more than 12 months after issuance, only (i) to finance or

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refinance capital projects authorized by law, provided that electorate approval is obtained; or (ii) to refund outstanding debt obligations and interest and redemption premium thereon at a lower net average interest cost rate.

Counties, municipalities and special districts are authorized to issue revenue bonds to finance a variety of self-liquidating projects pursuant to the laws of the State, such revenue bonds to be secured by and payable from the rates, fees, tolls, rentals and other charges for the services and facilities furnished by the financed projects. Under State law, counties and municipalities are permitted to issue bonds payable from special tax sources for a variety of purposes, and municipalities and special districts may issue special assessment bonds.

Bond Ratings. General obligation bonds of the State are currently rated Aa by Moody's Investors Service and AA by Standard & Poor's Corporation.

Litigation. Due to its size and its broad range of activities, the State (and its officers and employees) are involved in numerous routine lawsuits. The managers of the departments of the State involved in such routine lawsuits believed that the results of such pending litigation would not materially affect the State's financial position. In addition to the routine litigation pending against the State, its officers and employees, the following lawsuits and claims are also pending:

A. In a suit, plaintiff has sought title to Hugh Taylor Birch State Recreation Area by virtue of a reverter clause in the deed from Hugh Taylor Birch to the State. A final judgment at trial was entered in favor of the State. The case has been appealed to the Fourth District Court of Appeal.

The Department of Natural Resources anticipates the area will remain in State lands; however, in the event the court should rule in favor of the plaintiff, the State is subject to a loss of real property valued at approximately \$400 million.

B. In a suit, the Florida Supreme Court prospectively invalidated a tax preference methodology under former Sections 554.06 and 565.12 of the Florida Statutes (1985). This ruling was appealed to the United States Supreme Court which reversed the State Supreme Court and remanded the matter back to the State court. The Supreme Court's opinion suggested that one of the State's options for correcting the constitutional problems would be to assess and collect back taxes at the higher rates applicable to those who were ineligible for the tax preference from all taxpayers who had benefitted from the tax preference during the contested tax period. The State chose to seek a recovery of taxes from those who benefitted from the tax preference by requiring them to pay taxes at the higher rate that applied to out-of-state manufacturers and distributors. The Florida Supreme Court remanded the matter to the Circuit Court for the 2nd Judicial Circuit to hear arguments on the method chosen by the State to provide a clear and certain remedy. The trial court's decision against the State is on appeal at the First District Court of Appeal. With the exception of two parties, all parties have settled their claims with the State. Should an unfavorable outcome result in this case, approximately \$33 million may be refunded.

C. A class action suit brought against the Department of Corrections, alleging race discrimination in hiring and employment practices, originally went to trial in 1982 with the Department prevailing on all claims except a partial summary judgment to a plaintiff sub-class claiming a discriminatory impact on hiring caused by an examination requirement. Jurisdictional aspects of the testing issue were appealed to the Eleventh Circuit Court of Appeals which vacated the trial court's order and was upheld by the United States Supreme Court. The district court consolidated three successor lawsuits with this case and entered a final judgment in favor of the State. The judgment, however, has been appealed to the Eleventh Circuit Court of Appeals. Should the department fail in future appeals, the liability of the State for back pay and other monetary relief could exceed \$40 million.

D. Complaints were filed in the Second Judicial Circuit seeking a declaration that Sections 624.509, 624.512 and 624.514, F.S. (1988) violate various U.S. and Florida Constitutional provisions. Relief was sought in the form of a tax refund. The Florida Supreme Court reversed the trial court in favor of the State. Plaintiffs have petitioned for certiorari with the United States Supreme Court. The State has settled all outstanding litigation in this area. Similar issues had been raised in the following cases which were part of the settlement: Ford Motor Company v. Bill Gunter, Case No. 86-3714, 2nd Judicial Circuit, and General Motors Corporation v. Tom

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Gallagher, Case Nos. 90-2045 and 88-2925, 2nd Judicial Circuit, where the plaintiff are challenging Section 634.131, F.S., which imposes taxes on the premiums received for certain motor vehicle service agreements. Current estimates indicate that the State's potential refund exposure under the remaining refund applications yet to be denied is approximately \$150 million. However, the State hopes that refund exposure will be reduced as these refund requests begin to be denied based upon the Florida Supreme Court decision in the instant case.

E. In two cases, plaintiffs have sought approximately \$25 million in intangible tax refunds based partly upon claims that Florida's intangible tax statutes are unconstitutional.

F. A lawsuit was filed against the Department of Health and Rehabilitative Services (DHRS) and the Comptroller of the State of Florida involving a number of issues arising out of the implementation of a DHRS computer system and seeking declaratory relief and money damages. The estimated potential liability to the State is in excess of \$40 million.

G. Plaintiffs in a case have sought a declaration that statutory assessments on certain hospital net revenues are invalid, unconstitutional, and unenforceable and request temporary and permanent injunctive relief be granted prohibiting the enforcement or collection of the assessment and that all monies paid to the State by the plaintiffs and the class members within the four years preceding the filing of the action be reimbursed by the defendants with interest. An unfavorable outcome to this case could result in the possibility of refunds exceeding \$50 million.

H. In an inverse condemnation suit claiming that the actions of the State constitute a taking of certain leases for which compensation is due, the Circuit Judge granted the State's motion for summary judgment finding that the State had not deprived plaintiff of any royalty rights they might have. Plaintiff has appealed. Additionally, plaintiff's request for a drilling permit was rejected after administrative proceedings before the Department of Environmental Protection. Plaintiff is expected to challenge

the decision.

I. In an inverse condemnation suit alleging the regulatory taking of property without compensation in the Green Swamp Area of Critical State Concern, discovery is concluding and a motion for a summary judgment will likely be made. If the judgment should be for the plaintiff, condemnation procedures would be instituted with costs of \$30 million, plus interest from 1975.

J. In two cases, plaintiffs have challenged the constitutionality of the \$295 fee imposed on the issuance of certificates of title for vehicles previously titled outside the State. The circuit court granted summary judgment to the plaintiff, finding that the fee violated the Commerce Clause of the U.S. Constitution. The Court enjoined further collection of the fee and has ordered refunds to all those who have paid since the statute came into existence in mid-1991. The State has noticed an appeal and is entitled to a stay of the lower court ruling's effectiveness, thus the fee continues to be collected during the appeal. The potential refund exposure may be in excess of \$100 million.

K. Santa Rosa County has filed a complaint for declaratory relief against the State requesting the Circuit Court to: (1) find that Section 206.60(2) (a), F.S., does not allow the Department to deduct administrative expenses unrelated to the collection, administration, and distribution of the county gas tax; and (2) order the department to pay Santa Rosa County all moneys shown to have been unlawfully deducted from the motor fuel tax revenues plus interest. All hearings in the case have been postponed until early 1994. This case seeks refunds of approximately \$45 million.

L. Lee Memorial Hospital has contested the calculation of its disproportionate share payment for the 1992-93 State fiscal year. An unfavorable outcome to this case could result in a possible settlement of \$20 to \$30 million.

M. A lawsuit has challenged the freezing of nursing home reimbursement rates for the period January 1, 1990 through July 1, 1990. The First District Court of Appeal ruled against the Agency for Health Care Administration (AHCA). The AHCA has petitioned the Florida Supreme Court for review of this declaration. An unfavorable outcome to this case could result in a potential liability of \$40 million.

Summary. Many factors including national, economic, social and environmental policies and conditions, most of which are not within the control of the State or its local units of government, could affect or could have an adverse impact on the financial condition of the State. Additionally, the

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limitations placed by the State Constitution on the State and its local units of government with respect to income taxation, ad valorem taxation, bond indebtedness and other matters discussed above, as well as other applicable statutory limitations, may constrain the revenue-generating capacity of the State and its local units of government and, therefore, the ability of the issuers of the Debt Obligations to satisfy their obligations thereunder.

The Sponsors believe that the information summarized above describes some of the more significant matters relating to the Florida Trust. For a discussion of the particular risks with each of the Debt Obligations, and other factors to be considered in connection therewith, reference should be made to the Official Statement and other offering materials relating to each of the Debt Obligations included in the portfolio of the Florida Trust. The foregoing information regarding the State, its political subdivisions and its agencies and authorities constitutes only a brief summary, does not purport to be a complete description of the matters covered and is based solely upon information drawn from official statements relating to offerings of certain bonds of the State. The Sponsors and their counsel have not independently verified this information and the Sponsors have no reason to believe that such information is incorrect in any material respect. None of the information presented in this summary is relevant to Puerto Rico or Guam Debt Obligations which may be included in the Florida Trust.

For a general description of the risks associated with the various types of Debt Obligations comprising the Florida Trust, see the discussion under 'Risk Factors', above.

#### FLORIDA TAXES

In the opinion of Greenberg, Traurig, Hoffman, Lipoff, Rosen & Quentel, P.A., Miami, Florida, special counsel on Florida tax matters, under existing Florida law:

1. The Florida Trust will not be subject to income, franchise or other taxes of a similar nature imposed by the State of Florida or its subdivisions, agencies or instrumentalities.

2. Because Florida does not impose a personal income tax, non-corporate

Holders of Units of the Florida Trust will not be subject to any Florida income taxes with respect to (i) amounts received by the Florida Trust on the Debt Obligations it holds; (ii) amounts which are distributed by the Florida Trust to non-corporate Holders of Units of the Florida Trust; or (iii) any gain realized on the sale or redemption of Debt Obligations by the Florida Trust or of a Unit of the Florida Trust by a non-corporate Holder. However, corporations as defined in Chapter 220, Florida Statutes (1991), which are otherwise subject to Florida income taxation will be subject to tax on their respective share of any income and gain realized by the Florida Trust and on any gain realized by a corporate Holder on the sale or redemption of Units of the Florida Trust by the corporate Holder.

3. The Units will be subject to Florida estate taxes only if held by Florida residents, or if held by non-residents deemed to have business situs in Florida. The Florida estate tax is limited to the amount of the credit for state death taxes provided for in Section 2011 of the Internal Revenue Code of 1986, as amended.

4. Bonds issued by the State of Florida or its political subdivisions are exempt from Florida intangible personal property taxation under Chapter 199, Florida Statutes (1991), as amended. Bonds issued by the Government of Puerto Rico or by the Government of Guam, or by their authority, are exempt by Federal statute from taxes such as the Florida intangible personal property tax. Thus, the Florida Trust will not be subject to Florida intangible personal property tax on any Debt Obligations in the Florida Trust issued by the State of Florida or its political subdivisions, by the Government of Puerto Rico or by its authority or by the Government of Guam or by its authority. In addition, the Units of the Florida Trust will not be subject to the Florida intangible personal property tax if the Florida Trust invests solely in such Florida, Puerto Rico or Guam debt obligations.

#### THE GEORGIA TRUST

RISK FACTORS--Since 1973 the State's long-term debt obligations have been issued in the form of general obligation debt or guaranteed revenue debt. Prior to 1973 all of the State's long-term debt obligations were issued by ten separate State authorities and secured by lease rental agreements

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between such authorities and various State departments and agencies. Currently, Moody's Investors Service, Inc. and Fitch Investors Service, Inc. rate Georgia general obligation bonds AAA and Standard & Poor's Corporation rates such bonds AA+. There can be no assurance that the economic and political conditions on which these ratings are based will continue or that particular bond issues may not be adversely affected by changes in economic, political or other conditions that do not affect the above ratings.

In addition to general obligation debt, the Georgia Constitution permits the issuance by the State of certain guaranteed revenue debt. The State may incur guaranteed revenue debt by guaranteeing the payment of certain revenue obligations issued by an instrumentality of the State. The Georgia Constitution prohibits the incurring of any proposed general obligation debt or guaranteed revenue debt if the highest aggregate annual debt service requirement for the then current year or any subsequent fiscal year for outstanding authority debt, guaranteed revenue debt, and general obligation debt, including the proposed debt, exceed 10% of the total revenue receipts, less refunds, of the State treasury in the fiscal year immediately preceding the year in which any proposed debt is to be incurred. As of September, 1993, the total indebtedness of the State of Georgia consisting of general obligation debt, guaranteed revenue debt and remaining authority debt totalled \$3,803,425,000 and the highest aggregate annual payment for such debt equalled 5.22% of fiscal year 1994 State estimated treasury receipts.

The Georgia Constitution also permits the State to incur public debt to supply a temporary deficit in the State treasury in any fiscal year created by a delay in collecting the taxes of that year. Such debt must not exceed, in the aggregate, 5% of the total revenue receipts, less refunds, of the State treasury in the fiscal year immediately preceding the year in which such debt is incurred. The debt incurred must be repaid on or before the last day of the fiscal year in which it is to be incurred out of the taxes levied for that fiscal year. No such debt may be incurred in any fiscal year if there is then outstanding unpaid debt from any previous fiscal year which was incurred to supply a temporary deficit in the State treasury. No such short-term debt has been incurred under this provision since the inception of the constitutional authority referred to in this paragraph.

The State operates on a fiscal year beginning July 1 and ending June 30. For example, 'fiscal 1993' refers to the year ended June 30, 1993. Revenue collections of \$8,346,376,907 for the fiscal 1993 showed an increase of 11.99% over collections for the previous fiscal year. In November, 1993, the State estimated that fiscal 1994 revenue collections would be \$8,792,192,764 with an estimated increase of 7.50% over collections for the previous fiscal year.

Virtually all of the issues of long-term debt obligations issued by or on

behalf of the State of Georgia and counties, municipalities and other political subdivisions and public authorities thereof are required by law to be validated and confirmed in a judicial proceeding prior to issuance. The legal effect of an approved validation in Georgia is to render incontestable the validity of the pertinent bond issue and the security therefor.

Based on data of the Georgia Department of Revenue for fiscal 1993, income tax receipts and sales tax receipts of the State for fiscal 1993 comprised approximately 46.4% and 37%, respectively, of the total State tax revenues.

The unemployment rate of the civilian labor force in the State as of June 1993 was 5.6% according to data provided by the Georgia Department of Labor. The Metropolitan Atlanta area, which is the largest employment center in the area comprised of Georgia and its five bordering states and which accounts for approximately 42% of the State's population, has for some time enjoyed a lower rate of unemployment than the State considered as a whole. In descending order, wholesale and retail trade, services, manufacturing, government and transportation comprise the largest sources of employment within the State.

Davis v. Michigan. Several lawsuits have been filed against the State of Georgia asserting that the decision in Davis v. Michigan Department of Treasury, 489 U.S. 803 (1989), invalidates Georgia's tax treatment of Federal Retirement Benefits for years prior to 1989. Under the three year statute of limitation set out in Georgia's refund statute, the maximum potential liability under these suits calculated to December 15, 1992, would appear to be no greater than \$104 million. The plaintiffs in these suits originally requested refunds for tax years beginning with 1980. The State's maximum

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exposure to all taxpayers with a Davis claim for the years 1980-1988 would appear to be approximately \$591 million. Any such liability would be predicated on a holding by the State of Georgia court or the United States Supreme Court that a refund remedy is required. The Georgia Supreme Court has held in Georgia's 'test case', Reich v. Collins, that the plaintiff is not entitled to a refund, a decision which the United States Supreme Court vacated and remanded to the Georgia Supreme Court for reconsideration in light of Harper v. Virginia Department of Taxation, 509 U.S. \_\_\_\_ (1993). In December of 1993 the Georgia Supreme Court again ruled that the plaintiff is not entitled to a refund. The plaintiff applied to the United States Supreme Court for a writ of certiorari and, on February 22, 1994, the Court agreed to consider the matter.

James B. Beam Distilling Co. v. Collins. Three suits have been filed against the State of Georgia seeking refunds of liquor taxes in light of Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) under Georgia's pre-Bacchus statute. In the Beam case, 501 U.S. \_\_\_\_ (decided June 20, 1991) the United States Supreme Court indicated that Bacchus was retroactive, but only within the bounds of State statutes of limitations and procedural bars, and left State courts to determine any remedy in light of reliance interests, equitable considerations and other defenses. Georgia's statute of limitations has run on all pre-Bacchus claims for refund except five pending claims seeking 31 million dollars in tax plus interest. On remand, the Fulton County Superior Court has ruled that procedural bars and other defenses bar any recovery by taxpayers on Beam's claims for refund. Beam appealed to the Georgia Supreme Court and received an adverse ruling. Beam has applied to the United States Supreme Court for a writ of certiorari.

Age International, Inc. v. State and Age International, Inc. v. Miller are suits (one for refund and one for declaratory and injunctive relief) which have been filed against the State of Georgia by foreign producers of alcoholic beverages seeking \$96,000,000 in refunds of alcohol import taxes imposed under Georgia's post-Bacchus (see previous note) statute. These claims constitute 99% of all such taxes paid during the preceding three years. In addition, the claimants have filed administrative claims for an additional \$23,000,000 for apparently later time periods. The Age refund case is still pending in the trial court. The Age declaratory/injunctive relief case was dismissed by the District Court and is on appeal to the Eleventh Circuit Court of Appeals.

Board of Public Education for Savannah/Chatham County v. State of Georgia is based on the local school board's claim that the State finance the major portion of the costs of its desegregation program. The Savannah Board originally requested restitution in the amount of \$30,000,000, but the Federal District Court set forth a formula which would require a State payment in the amount of approximately \$6,000,000. Plaintiffs, dissatisfied with the apportionment of desegregation costs between state and county, and an adverse ruling on the state funding formula for transportation costs, have appealed to the Eleventh Circuit Court of Appeals. The State has filed a responsive cross-appeal on the ground that there is no basis for any liability.

A similar complaint has been filed by DeKalb County and there are approximately five other school districts which potentially might attempt to file similar claims. In the DeKalb County case alone, the plaintiffs appear to be seeking approximately \$67,500,000 of restitution. The DeKalb case has been tried and is awaiting final argument and decision by the Court.

The Sponsors believe that the information summarized above describes some of the more significant matters relating to the Georgia Trust. The sources of the information are the official statements of issuers located in Georgia, other publicly available documents and oral statements from various federal and State agencies. The Sponsors and their counsel have not independently verified any of the information contained in the official statements, other publicly available documents or oral statements from various State agencies and counsel have not expressed any opinion regarding the completeness or materiality of any matters contained in this Prospectus other than the tax opinions set forth below relating to the status of certain tax matters in Georgia.

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#### GEORGIA TAXES

In the opinion of King & Spalding, Atlanta, Georgia, special counsel on Georgia tax matters, under existing Georgia law:

1. The Georgia Trust will not be an association taxable as a corporation for Georgia income tax purposes.
2. The income received by the Georgia Trust will be treated for Georgia income tax purposes as the income of the Holders of Units of the Georgia Trust. Each Holder of Units of the Georgia Trust will be considered as receiving the interest on his pro rata portion of each Debt Obligation when interest is received by the Georgia Trust. Interest on a Debt Obligation which would be exempt from Georgia income tax if paid directly to a Holder will be exempt from Georgia income tax when received by the Georgia Trust and distributed to the Holders.
3. A Holder of Units of the Georgia Trust will recognize taxable gain or loss for Georgia income tax purposes to the extent he recognizes gain or loss for Federal income tax purposes if he sells or redeems all or part of his Units or if the Georgia Trust sells or redeems a Debt Obligation.
4. Obligations of the State of Georgia and its political subdivisions and public institutions are exempt from the Georgia intangible personal property tax. Obligations issued by the Government of Puerto Rico or the Government of Guam or by their respective authorities are exempt by Federal statute from taxes such as the Georgia intangible personal property tax. Accordingly, such obligations held by the Georgia Trust will not be subject to the Georgia intangible personal property tax. The Georgia Department of Revenue, however, has taken the position that interests in unit investment trusts similar to the Georgia Trust are fully subject to the Georgia intangibles tax (at the rate of 10 cents per \$1,000 in value) even though some or all of the securities held by the trust are exempt from the tax. Notwithstanding the Georgia Department of Revenue's position, a strong argument can be made that the Units of the Georgia Trust should be exempt from the Georgia intangibles tax to the extent the Securities held by the Georgia Trust are exempt from such tax. At present, it is impossible to predict how this issue will be resolved.
5. Units of the Georgia Trust will be subject to Georgia estate tax if held by an individual who is a Georgia resident at his death or if held by a nonresident decedent and deemed to have a business situs in Georgia. The Georgia estate tax is limited to the amount allowable as a credit against Federal estate tax under Section 2011 of the Internal Revenue Code or, in the case of a nonresident decedent, a portion of such amount equal to the portion of the decedent's property taxable in Georgia.
6. There is no exemption or exclusion for Units of the Georgia Trust for purposes of the Georgia corporate net worth tax.

The opinions expressed herein are based upon existing statutory, regulatory, and judicial authority, any of which may be changed at any time with retroactive effect. In addition, such opinions are based solely on the documents that we have examined, the additional information that we have obtained and the representations that have been made to us (including, in particular, the opinion of Davis Polk & Wardwell on the Federal income tax treatment of the Georgia Trust and the Holders of its Units). Our opinions cannot be relied upon if any of the facts contained in such documents or in such additional information is, or later becomes, inaccurate or if any of the representations made to us is or later becomes inaccurate. Finally, our opinions are limited to the tax matters specifically covered thereby, and we have not been asked to address, nor have we addressed, any other tax consequences relating to the Georgia Trust or the Units thereof.

#### THE LOUISIANA TRUST

Certain Considerations. The following discussion regarding the financial condition of the State government may not be relevant to general obligation or revenue bonds issued by political subdivisions of and other issuers in the State of Louisiana ('the State'). Such financial information is based upon information about general financial conditions that may or may not affect issuers of the Louisiana obligations. The Sponsor has not independently verified any of the

information contained in such publicly available documents, but is not aware of any facts which would render such information inaccurate.

On December 19, 1990 the State received a rating upgrade on its general obligation bonds to the current Standard & Poor's rating of A from BBB+. Standard & Poor's cited improvements in the State's cash flow and fiscal reforms approved by voters in the fall of 1990. The current Moody's rating on the State's general obligation bonds was not upgraded and remains unchanged at Baal. There can be no assurance that the economic conditions on which these ratings were based will continue or that particular bond issues may not be adversely affected by changes in economic or political conditions.

The Revenue Estimating Conference (the 'Conference') was established by Act No. 814 of the 1987 Regular Session of the State Legislature. The Conference was established by the Legislature to provide an official estimate of anticipated State revenues upon which the executive budget shall be based, to provide for a more stable and accurate method of financial planning and budgeting and to facilitate the adoption of a balanced budget as is required by Article VII, Section 10(B) of the State Constitution. Act No. 814 provides that the Governor shall cause to be prepared an executive budget presenting a complete financial and programmatic plan for the ensuing fiscal year based only upon the official estimate of anticipated State revenues as determined by the Revenue Estimating Conference. Act No. 814 further provides that at no time shall appropriations or expenditures for any fiscal year exceed the official estimate of anticipated State revenues for that fiscal year. An amendment to the Louisiana Constitution was approved by the Louisiana Legislature in 1990 and enacted by the electorate which granted constitutional status to the existence of the Revenue Estimating Conference.

**State General Fund:** The State General Fund is the principal operating fund of the State and was established administratively to provide for the distribution of funds appropriated by the Louisiana Legislature for the ordinary expenses of the State government. Revenue is provided from the direct deposit of federal grants and the transfer of State revenues from the Bond Security and Redemption Fund after general obligation debt requirements are met. The beginning accumulated State General Fund deficit for fiscal year 1992-1993 was \$83 million.

The Revenue Estimating Conference's official forecast of recurring State General Fund revenues for the fiscal year ending June 30, 1993 (Revenue Estimating Conference October 1992 as revised through January 1993) is \$4.209 billion. Based upon that estimate the State Office of Planning and Budget estimated a \$618 million budget short-fall to maintain State Operations at a level of those for Fiscal Year 1992-1993.

**Transportation Trust Fund:** The Transportation Trust Fund was established pursuant to (i) Section 27 of Article VII of the State Constitution and (ii) Act No. 16 of the First Extraordinary Session of the Louisiana Legislature for the year 1989 (collectively the 'Act') for the purpose of funding construction and maintenance of state and federal roads and bridges, the statewide flood-control program, ports, airports, transit and state police traffic control projects and to fund the Parish Transportation Fund. The Transportation Trust Fund is funded by a levy of \$0.20 per gallon on gasoline and motor fuels and on special fuels (diesel, propane, butane and compressed natural gas) used, sold or consumed in the state (the 'Gasoline and Motor Fuels Taxes and Special Fuels Taxes'). This levy was increased from \$0.16 per gallon (the 'Existing Taxes') to the current \$0.20 per gallon pursuant to Act No. 16 of the First Extraordinary Session of the Louisiana Legislature for the year 1989, as amended. The additional tax of \$0.04 per gallon (the 'Act 16 Taxes') became effective January 1, 1990 and will expire on the earlier of January 1, 2005 or the date on which obligations secured by the Act No. 16 taxes are no longer outstanding. The Transportation Infrastructure Model for Economic Development Account (the 'TIME Account') was established in the Transportation Trust Fund. Moneys in the TIME account will be expended for certain projects identified in the Act aggregating \$1.4 billion and to fund not exceeding \$160 million of additional capital transportation projects. The State issued \$263,902,639.95 of Gasoline and Fuels Tax Revenue Bonds, 1990 Series A, dated April 15, 1990 payable from the (i) Act No. 16 Taxes, (ii) any Act No. 16 Taxes and Existing Taxes deposited in the Transportation Trust Fund, and (iii) any additional taxes on gasoline and motor fuels and special fuels pledged for the payment of said Bonds.

**Louisiana Recovery District:** The Louisiana Recovery District (the 'Recovery District') was created pursuant to Act No. 15 of the First Extraordinary Session of the Legislature of Louisiana of 1988 to assist the State in the reduction and elimination of a deficit existing at that time and the delivery of essential services to its citizens and to assist parishes, cities and other units of local

government experiencing cash flow difficulties. The Recovery District is a special taxing district the boundaries of which are coterminous with the State and is a body politic and corporate and a political subdivision of the State.



The Recovery District issued \$979,125,000 of Louisiana Recovery District Sales Tax Bonds, Series 1988, dated July 1, 1988 ('Series 1988 Bonds'), secured by (i) the revenues derived from the District's 1% statewide sales and use tax remaining after the costs of collection and (ii) all funds and accounts held under the Recovery District's General Bond Resolution and all investment earnings on such funds and accounts. The Recovery District issued 80,920,000 of Sales Tax Refunding Bonds, Series 1992 dated June 1, 1992 and 86,130,000 of Sales Tax Junior Lien Refunding Bonds, Series 1992, dated June 1, 1992 to refund a portion of the Recovery District's Series 1988 Bonds for the purpose of increasing cash flow available to the Recovery District and creating debt service savings. After the refunding is completed the Series 1988 Bonds will remain outstanding in the principal amount of \$537,255,000.

**Ad Valorem Taxation:** Only local governmental units presently levy ad valorem taxes. Under the 1921 State Constitution a \$5.75 mills ad valorem tax was being levied by the State until January 1, 1973 at which time a constitutional amendment to the 1921 Constitution abolished the ad valorem tax. Under the 1974 State Constitution a State ad valorem tax of up to \$5.75 mills was provided for but is not presently being levied. The property tax is underutilized at the parish level due to a constitutional homestead exemption from the property tax applicable to the first \$75,000 of the full market value of single family residences. Homestead exemptions do not apply to ad valorem property taxes levied by municipalities, with the exception of the City of New Orleans. Because local governments also are prohibited from levying an individual income tax by the constitution, their reliance on State government is increased under the existing tax structure.

**Litigation:** In 1988 the Louisiana legislature created a Self-Insurance Fund within the Department of Treasury. That Fund consists of all premiums paid by State agencies under the State's Risk Management program, the investment earnings on those premiums and commissions retained. The Self-Insurance Fund may only be used for payment of losses incurred by State agencies under the Self-Insurance program, together with insurance premiums, legal expenses and administration costs. For fiscal year 1991-1992, the sum of \$79,744,126.00 was paid from the Self-Insurance Fund as of December 31, 1991 to satisfy claims and judgments. Because of deletion of agency premium allocations from the State General Appropriations Bill for Fiscal Year 1991-1992 and 1992-1993 the Self-Insurance Fund did not receive full funding in those years and the State Division of Administration advised that the Fund might be depleted by June 30, 1993 as a result of payment of covered judgments and settlements. It is the opinion of the Attorney General for the State of Louisiana that only a small portion of the dollar amount of potential liability of the State resulting from litigation which is pending against the State and is not being handled through the Office of Risk Management ultimately will be recovered by plaintiffs. It is the opinion of the Attorney General that the estimated future liability for existing claims is in excess of \$81 million. However, there are other claims with future possible liabilities for which the Attorney General cannot make a reasonable estimate.

The foregoing information constitutes only a brief summary of some of the financial difficulties which may impact certain issuers of Bonds and does not purport to be a complete or exhaustive description of all adverse conditions to which the issuers of the Louisiana Trust are subject. Additionally, many factors including national economic, social and environmental policies and conditions, which are not within the control of the issuers of Bonds, could affect or could have an adverse impact on the financial condition of the State and various agencies and political subdivisions located in the State. The Sponsor is unable to predict whether or to what extent such factors may affect the issuers of Bonds, the market value or marketability of the Bonds or the ability of the respective issuers of the Bonds acquired by the Louisiana Trust to pay interest on or principal of the Bonds.

Prospective investors should study with care the Portfolio of Bonds in the Louisiana Trust and should consult with their investment advisors as to the merits of particular issues in that Trust's Portfolio.

#### LOUISIANA TAXES

In the opinion of Wiener, Weiss, Madison & Howell, A Professional Corporation, Shreveport, Louisiana, special counsel on Louisiana tax matters, under existing Louisiana law:

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1. The Louisiana Trust will be treated as a trust for Louisiana tax purposes and not as an 'association' taxable as a corporation; the income of the Louisiana Trust which is required to be distributed or which is actually distributed to the Holders shall not be taxed to the Louisiana Trust.

2. The Louisiana income tax on resident individuals is imposed upon the 'tax table income' of resident individuals. The 'tax table income' of a resident individual is the individual's federal adjusted gross income with certain additions and exclusions provided under Louisiana law. No provision under Louisiana law requires the addition of interest on obligations of the

state of Louisiana and its political subdivisions, public corporations created by them and constituted authorities thereof authorized to issue obligations on their behalf ('Louisiana Obligations') or interest on obligations of the Government of Puerto Rico or Guam. Accordingly, resident individual Holders will not be subject to Louisiana income tax with respect to amounts received by the Louisiana Trust representing interest on such obligations that is excludable from gross income for federal income tax purposes.

3. With certain exceptions, the State of Louisiana imposes a tax on the 'Louisiana taxable income' of resident corporations. 'Louisiana taxable income' of a resident corporation (other than an insurance company) is the corporation's federal taxable income with certain modifications to federal gross income and to the deductions from federal gross income. No provision under Louisiana law requires the addition of interest on Louisiana Obligations or interest on obligations of the Governments of Puerto Rico or Guam to the federal gross income of such resident corporations. Accordingly, resident corporate Holders (other than insurance companies) will not be subject to Louisiana income tax with respect to amounts received by the Louisiana Trust representing interest on such obligations that is excludable from gross income for federal income tax purposes.

4. To the extent that gain (or loss) from the sale, exchange or other disposition of obligations held by the Louisiana Trust (whether as a result of a sale or exchange of such obligations by the Louisiana Trust or as a result of a sale or exchange of a Unit by a Holder) is includible in (or deductible in the calculation of) federal adjusted gross income of a resident individual or the federal taxable income of a resident corporation, such gain will be included in (or loss deducted from) the calculation of the resident individual Holder's Louisiana tax table income or the resident corporate Holder's Louisiana taxable income.

5. Gain or loss on the Unit or as to the underlying obligations for Louisiana income tax purposes would be determined by taking into account the basis adjustments for federal income tax purposes described in the Prospectus.

6. The State of Louisiana does not impose an intangibles tax on investments, and therefore, Holders will not be subject to Louisiana intangibles tax on their Units of the Louisiana Trust.

No opinion is rendered as to the Louisiana tax consequences of Holders other than as expressed above with regard to Louisiana resident individuals and corporations and, therefore, tax counsel should be consulted by other prospective Holders. In rendering the opinions expressed above, counsel has relied upon the opinion of Davis Polk and Wardwell that, for federal income tax purposes, the Louisiana Trust is not an association taxable as a corporation, each Holder of the Louisiana Trust will be treated as the owner of a pro rata portion of the securities held by such Louisiana Trust and the income of the Louisiana Trust will be treated as income of the Holders.

Tax counsel should be consulted as to the other Louisiana tax consequences not specifically considered herein and as to the Louisiana tax status of taxpayers other than as expressed above with regard to Louisiana resident individuals and corporations who are Holders in the Louisiana Trust. In addition, no opinion is being rendered as to Louisiana tax consequences resulting from any proposed or future federal or state tax legislation.

#### THE MAINE TRUST

RISK FACTORS--Prospective investors should consider the financial condition of the State of Maine and the public authorities and municipal subdivisions issuing the obligations to be purchased with the proceeds of the sale of units. Certain of the debt obligations to be purchased by and held in the Maine

Trust are not obligations of the State of Maine and are not supported by its full faith and credit or taxing power. The type of debt obligation, source of payment and security for such obligations are detailed in the official statements produced by the issuers thereof in connection with the offering of such obligations. Reference should be made to such official statements for detailed information regarding each of the obligations and the specific risks associated with such obligations. This summary of risk factors relates to factors generally applicable to Maine obligations and does not address the specific risks involved in each of the obligations acquired by the Maine Trust.

The Maine Economy. The State's economy continues to be based on natural resources, manufacturing related to natural resources, and tourism. Gradually the economy has begun to diversify with growth in relatively new industries such as health and business services and electronics manufacturing.

Although some of the State's industries are independent from the regional economy, Maine's economy is, in large part, dependent upon overall improvements in both the regional and national economy. The northeast continues to be one of

the nation's weakest economic regions.

As is the case throughout the northeast, Maine's economy has weakened significantly since 1989. During 1992, however, most measures of the Maine economy showed improvement. The Maine Economic Growth Index (the 'EGI') was up 1.8 % in 1992. The EGI, a seasonally adjusted composite of resident employment, real consumer retail sales, production hours worked in manufacturing, and services employment shows an economy that was essentially stagnant from the middle of 1988 through the fall of 1990. From the fall of 1990 through June 1991, the economy worsened and while it improved from spring 1992 through the fall of 1993, the rate of growth (approximately 1% during the first three quarters of 1993) has been well below normal for the beginning of an economic expansion. It also compares poorly with the 2.2% growth experienced during the first three quarters of 1992. The EGI reached 103.8 at the end of the third quarter of 1993, the product of nine straight quarters of increase. Yet this represents an increase of only 0.8% over the average of the first three quarters of 1992, and brings the EGI only two-thirds of the way back to its pre-recession high of 105.7 (November 1988).

During late 1991 and the first half of 1992, the State continued to experience heavy job losses. The average jobless rate for this period was approximately 7.55%. There has been some modest growth in jobs during 1993, primarily in the services, retail trade and construction areas. The State Planning Office predicts an increase of approximately 0.3% in payroll employment over 1992 levels, which will bring to approximately 520,000 the total of payroll jobs in the State by the end of 1993.

Despite the continued weakness in the labor market, Maine taxable retail sales have continued to increase after hitting bottom in the first quarter of 1991. Taxable retail sales for the first three quarters of 1993 were 4.8% greater than during the same period in 1992. The rate of retail inflation during this period was only 1%, indicating a real increase in sales rather than merely price increases. The State Planning office notes that over 50% of this increase was attributable to the automobile transportation sector (up 10.6% over the first three quarters of 1992).

The real estate sector saw significant improvement, but construction was quite weak. According to the Institute for Real Estate Research and Education, the number of housing units sold during the first three quarters of 1993 increased 9.4% over the same period in 1992, although the average sales price was down 1.3%. After noting some growth in 1992 over 1991 levels, the Maine Advancement Program reported \$706,000,000 in total construction awards during the first three quarters of 1993, a 22.7% decrease from the same period of 1992.

An important unresolved question concerning the State's economy is how the restructuring of the United States military will affect defense related industries in Maine. Loring Air Force Base is scheduled to close in the fall of 1994. The base closing, coupled with the shutdown of the Backscatter radar system in Bangor, will mean the loss of several military and civilian jobs in the region. Recent news has been more favorable. Although it will continue to downsize through 1995, Bath Iron Works, the State's largest employer, landed a major ship building contract for the construction of three Aegis Class Destroyers by 1998, bringing the yard's construction backlog to 2.4 billion dollars. Another major employer, the Portsmouth Naval Shipyard in Kittery, Maine, has managed to remain off the list of bases to be closed as part of the military's downsizing efforts.

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There can be no assurances that the economic conditions discussed above will not have an adverse effect upon the market value or marketability of any of the debt obligations acquired by the Maine Trust or the financial or other condition of any of the issuers of such obligations.

State Finances and Budget. The State operates under a biennial budget which is formulated in even-numbered years and presented for approval to the Legislature in odd-numbered years. The economic strength evidenced during the 1980's enabled the State to accumulate high levels of general fund unappropriated surpluses. These surpluses, however, have been exhausted during the current downturn. Economic conditions continue to place financial strain upon the State's budget.

The State closed its fiscal year 1989-90 with a \$3,000,000 ending surplus and an ending budgetary balance for the General Fund of \$61,000,000 due to spending cuts. The continuing decline in the economy during fiscal 1990-91 caused two separate downward revisions to revenue projections totalling \$182,200,000. Through a combination of recurring and one-time actions, including deappropriations, furloughs, fund transfers, accelerated tax collections and governmental shutdowns, an ending budgetary balance of \$1,800,000 was achieved for fiscal 1990-91.

Maine closed out fiscal year 1991-92 with a \$12.4 million surplus, and fiscal 1992-93 with a \$42.8 million surplus. The budget passed during the summer of 1993 for the 1994-95 biennium included additional budget balancing measures, including making permanent the previously temporary 6% sales tax, deferring

\$102,000,000 in payments to the Maine State Retirement System, and assorted program cutting and cost shifting. With little growth projected for the Maine economy in the next few years, additional measures may become necessary to maintain a balanced budget.

The financial condition of the State is, in large measure, a function of the state's and the region's economy and no assurances can be given regarding the future economy or financial condition of the State.

The State of Maine's outstanding general obligations continue to be rated AA+ by Standard & Poor's. Moody's, however, has dropped Maine's rating from Aa1 to Aa2. Moody's cited the weak status of the State's economy and the continued reliance on one time cost cutting measures to deal with budget problems as the reasons for the decision. As of June 30, 1994, there is expected to be outstanding approximately \$522,000,000 general obligation bonds of the State. The State has issued \$170,000,000 of tax anticipation notes which will mature June 30, 1994. As of June 30, 1994, there is expected to be authorized by the voters of the State for certain purposes, but unissued, bonds in the aggregate principal amount of approximately \$50,000,000. As of June 30, 1994, the aggregate principal amount of bonds of the State authorized by the Constitution and implementing legislation for certain purposes, but unissued, is expected to be \$34,295,600. Although increasing, the major rating agencies still consider debt to be at manageable levels.

Maine Municipal Bond Bank. The Portfolio may contain obligations of the Maine Municipal Bond Bank. All Bond Bank debt is secured by loan repayments of borrowing municipalities and the State's moral obligation pledge. The state of the economy in Maine could impact the ability of municipalities to pay debt service on their obligations. Maine Bond Bank debt is rated A+ by Standard & Poor's and Aa by Moody's.

Solid Waste Disposal Facilities. The Portfolio may contain obligations issued by Regional Waste Systems, Inc., a quasi-municipal corporation organized pursuant to an interlocal agreement among approximately 20 Southern Maine communities ('RWS') or other quasi-municipal solid waste disposal facilities. RWS and other similar solid waste disposal projects operate regional solid waste disposal facilities and process the solid waste of the participating municipalities as well as the solid waste of other non-municipal users. The continued viability of such facilities is dependent, in part, upon the approach taken by the State of Maine with respect to solid waste disposal generally. Pursuant to a Public Law 1989 Chapter 585, the Maine Waste Management Agency is charged with preparation and adoption by rule of an analysis and a plan for the management, reduction and recycling of solid waste for the State of Maine. The plan developed by the Maine Waste Management Agency is based on the waste management priorities and recycling goals established by State law. Pursuant to State law, Maine has established minimum goals for recycling and composting requiring that a minimum of 50% of the municipal solid waste stream be recycled or composted by 1994. Although RWS may participate in the mandated recycling activities, its principal existing facility consists of a mass burn 250 ton per

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day furnace boiler with associated equipment for production of electric energy. Thus, the source material for RWS' primary facility could be substantially reduced as a result of implementation of the State's recycling goals. Other mass burn solid waste disposal facilities in the State have experienced seasonal shortages in waste fuel.

Health Care Facilities. Revenue bonds are issued by the Maine Health and Higher Education Facilities Authority to finance hospitals and other health care facilities. The revenues of such facilities consists, in varying but typically material amounts, of payment from insurers and third-party reimbursement programs, including Medicaid, Medicare and Blue Cross. The health care industry in Maine is becoming increasingly competitive. The utilization of new programs and modified benefits by third-party reimbursement programs and the advent of alternative health care delivery systems such as health maintenance organizations contribute to the increasingly competitive nature of the health care industry. This increase in competition could adversely impact the ability of health care facilities in Maine to satisfy their financial obligations.

Further, health care providers are subject to regulatory actions, changes in law and policy changes by agencies that administer third-party reimbursement programs and regulate the health care industry. Any such changes could adversely impact the financial condition of such facilities.

#### MAINE TAXES

In the opinion of Pierce, Atwood, Scribner, Allen, Smith & Lancaster, Portland, Maine, special counsel on Maine tax matters, under existing Maine law:

1. Maine resident trusts and Maine resident individuals are each subject to individual income tax by the State of Maine imposed as a percentage of the individual's or trust's entire taxable income. The taxable income of an individual or trust is its federal adjusted gross income as defined under the laws of the United States, with the modifications and less the

deductions and personal exemptions provided in Part 8 of Title 36 of the Maine Revised Statutes. Thus, to the extent the Trust is not an association taxable as a corporation for purposes of federal income taxation, and to the extent each Holder will be essentially treated as the owner of a pro rated portion of the Trust and the income of such portion of the Trust will be treated as the income of the Holder for purposes of federal income taxation, the Trust will not constitute an association taxable as a corporation for purposes of Maine income tax and each Holder of the Trust will be essentially treated as the owner of a pro rated portion of the Trust and income of such portion of the Trust will be treated as the income of the Holder for Maine income tax purposes.

2. Interest on all Bonds which are exempt from Maine income tax when received by the Trust, and which would be exempt from Maine income tax and the Maine minimum tax if received directly by a Holder, will retain its status as exempt from Maine income tax and the Maine minimum tax when received by the Trust and distributed to the Holder.

3. Each Holder of Units of the Trust will recognize gain or loss for Maine income tax purposes if the Trustee disposes of a Bond (whether by redemption, sale or otherwise) or if the Holder redeems or sells Units of the Trust to the extent that such a transaction results in a recognized gain or loss to such Holder for federal income tax purposes.

4. The Maine income tax does not permit a deduction of interest paid or incurred on indebtedness incurred to purchase or carry Units in the Trust, the interest on which is exempt from Maine income tax.

5. Prospective Holders of Units of the Trust should be advised that interest paid on certain Bonds and distributed to Holders may be taken into account in computing the Maine minimum tax for tax preferences. Prospective Holders should consult their tax advisors regarding applicability of the Maine minimum tax. In addition, any Holders of Units of the Trust which are subject to Maine Franchise Tax should be advised that for purposes of the Maine Franchise Tax, interest on the Bonds received by the Trust and distributed to a Holder subject to such tax will be added to the Holder's federal taxable income and therefore will be taxable.

Special Maine counsel expresses no opinion as regards the acquisition or carrying of interest-bearing obligations of the Commonwealth of Puerto Rico or the Territory of Guam by the Trust or the tax effect of such investments.

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#### THE MARYLAND TRUST

RISK FACTORS--State Debt. The Public indebtedness of the State of Maryland and its instrumentalities is divided into three general types. The State issues general obligation bonds for capital improvements and for various State projects to the payment of which the State ad valorem property tax is exclusively pledged. In addition, the Maryland Department of Transportation issues for transportation purposes its limited, special obligation bonds payable primarily from specific, fixed-rate excise taxes and other revenues related mainly to highway use. Certain authorities issue obligations payable solely from specific non-tax, enterprise fund revenues and for which the State has no liability and has given no moral obligation assurance.

General obligation bonds of the State are authorized and issued primarily to provide funds for State-owned capital improvements, including institutions of higher learning, and the construction of locally owned public schools. Bonds have also been issued for local government improvements, including grants and loans for water quality improvement projects and correctional facilities, to provide funds for repayable loans or outright grants to private, non-profit cultural or educational institutions, and to fund certain loan and grant programs.

The Maryland Constitution prohibits the contracting of State debt unless it is authorized by a law levying an annual tax or taxes sufficient to pay the debt service within 15 years and prohibiting the repeal of the tax or taxes or their use for another purpose until the debt is paid. As a uniform practice, each separate enabling act which authorizes the issuance of general obligation bonds for a given object or purpose has specifically levied and directed the collection of an ad valorem property tax on all taxable property in the State. The Board of Public Works is directed by law to fix by May 1 of each year the precise rate of such tax necessary to produce revenue sufficient for debt service requirements of the next fiscal year, which begins July 1. However, the taxes levied need not be collected if or to the extent that funds sufficient for debt service requirements in the next fiscal year have been appropriated in the annual State budget. Accordingly, the Board, in annually fixing the rate of property tax after the end of the regular legislative session in April, takes account of appropriations of general funds for debt service.

In the opinion of counsel, the courts of Maryland have jurisdiction to entertain proceedings and power to grant mandatory injunctive relief to (i) require the Governor to include in the annual budget a sufficient appropriation

to pay all general obligation bond debt service for the ensuing fiscal year; (ii) prohibit the General Assembly from taking action to reduce any such appropriation below the level required for that debt service; (iii) require the Board of Public Works to fix and collect a tax on all property in the State subject to assessment for State tax purposes at a rate and in an amount sufficient to make such payments to the extent that adequate funds are not provided in the annual budget; and (iv) provide such other relief as might be necessary to enforce the collection of such taxes and payment of the proceeds of the tax collection to the holders of general obligation bonds, *pari passu*, subject to the inherent constitutional limitations referred to below.

It is also the opinion of counsel that, while the mandatory injunctive remedies would be available and while the general obligation bonds of the State are entitled to constitutional protection against the impairment of the obligation of contracts, such constitutional protection and the enforcement of such remedies would not be absolute. Enforcement of a claim for payment of the principal of or interest on the bonds could be subject to the provisions of any statutes that may be constitutionally enacted by the United States Congress or the Maryland General Assembly extending the time for payment or imposing other constraints upon enforcement.

There is no general debt limit imposed by the Maryland Constitution or public general laws, but a special committee created by statute annually submits to the Governor an estimate of the maximum amount of new general obligation debt that prudently may be authorized. Although the committee's responsibilities are advisory only, the Governor is required to give due consideration to the committee's findings in preparing a preliminary allocation of new general debt authorization for the next ensuing fiscal year.

Consolidated Transportation Bonds are limited obligations issued by the Maryland Department of Transportation, the principal of which must be paid within 15 years from the date of issue, for highway, port, transit, rail or aviation facilities or any combination of such facilities. Debt service on

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Consolidated Transportation Bonds is payable from those portions of the excise tax on each gallon of motor vehicle fuel and the motor vehicle titling tax, all mandatory motor vehicle registration fees, motor carrier fees, and the corporate income tax as are credited to the Maryland Department of Transportation, plus all departmental operating revenues and receipts. Holders of such bonds are not entitled to look to other sources for payment.

The Maryland Department of Transportation also issues its bonds to provide financing of local road construction and various other county transportation projects and facilities. Debt service on these bonds is payable from the subdivisions' share of highway user revenues held to their credit in a special State fund.

The Maryland Transportation Authority operates certain highway, bridge and tunnel toll facilities in the State. The tolls and other revenues received from these facilities are pledged as security for revenue bonds of the Authority issued under and secured by a trust agreement between the authority and a corporate trustee.

The Maryland Stadium Authority is responsible for financing and directing the acquisition and construction of one or more new professional sports facilities in Maryland. Currently, the Stadium Authority operates the newly opened Oriole Park at Camden Yards. The Stadium Authority is authorized to issue revenue bonds, subject to the approval of the Board of Public Works.

The Authority's financings, as well as any future financing for a football stadium, are lease-backed revenue obligations, payment of which is secured by, among other things, an assignment of revenues to be received under a lease of the sports facilities from the Authority to the State of Maryland; rental payments due from the State under that lease will be subject to annual appropriation by the Maryland General Assembly. The State anticipates that revenues to fund the lease payments will be generated from a variety of sources, including in each year sports lottery revenues, the net operating revenues of the Authority and funds from the City of Baltimore.

Certain other instrumentalities of the State government are authorized to borrow money under legislation which expressly provides that the loan obligations shall not be deemed to constitute a debt or a pledge of the faith and credit of the State. The Community Development Administration of the Department of Housing and Community Development, the Board of Trustees of St. Mary's College of Maryland, the Maryland Environmental Service, the Board of Regents of the University of Maryland System, the Board of Regents of Morgan State University, and the Maryland Food Center Authority have issued and have outstanding bonds of this type. The principal of and interest on bonds issued by these bodies are payable solely from various sources, principally fees generated from use of the facilities or enterprises financed by the bonds.

The Water Quality Revolving Loan Fund is administered by the Water Quality Financing Administration in the Department of the Environment. The Fund may be

used to provide loans, subsidies and other forms of financial assistance to local government units for wastewater treatment projects as contemplated by the 1987 amendments to the federal Water Pollution Control Act. The Administration is authorized to issue bonds secured by revenues of the Fund, including loan repayments, federal capitalization grants, and matching State grants.

The University of Maryland System, Morgan State University, and St. Mary's College of Maryland are authorized to issue revenue bonds for the purpose of financing academic and auxiliary facilities. Auxiliary facilities are any facilities that furnish a service to students, faculty, or staff, and that generate income. Auxiliary facilities include housing, eating, recreational, campus, infirmary, parking, athletic, student union or activity, research laboratory, testing, and any related facilities.

On August 7, 1989, the Governor issued an Executive Order assigning to the Department of Budget and Fiscal Planning responsibility to review certain proposed issuances of revenue and enterprise debt other than private activity bonds. The Executive Order also provides that the Governor may establish a ceiling of such debt to be issued during the fiscal year, which ceiling may be amended by the Governor.

Although the State has authority to make short-term borrowings in anticipation of taxes and other receipts up to a maximum of \$100 million, in the past it has not issued short-term tax anticipation and bond anticipation notes or made any other similar short-term borrowings. However, the State has

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issued certain obligations in the nature of bond anticipation notes for the purpose of assisting several savings and loan associations in qualifying for Federal insurance and in connection with the assumption by a bank of the deposit liabilities of an insolvent savings and loan association.

The State has financed the construction and acquisition of various facilities through in conditional purchase, sale-leaseback, and similar transactions. All of the lease payments under these arrangements are subject to annual appropriation by the Maryland General Assembly. In the event that appropriations are not made, the State may not be held contractually liable for the payments.

Savings and Loan Matters. During the first half of calendar year 1985, several State-chartered savings and loan associations, the savings accounts of which were privately insured, experienced unusually heavy withdrawals of funds by depositors. The resulting decline in the associations' liquid assets led to the appointment of receivers for the assets of six associations and the creation of an agency of the State to succeed, by statutory merger, the private insurer. The savings accounts of all savings and loan associations operating in the State of Maryland must be insured by either the State agency or the Federal Savings and Loan Insurance Corporation. The State agency assumed the insurance liabilities of the private insurer with respect to deposits made prior to May 18, 1985, and insures amounts deposited after that date up to a certain limit. The legislation establishing the insurance agency provides that: 'It is the policy of this State that funds will be appropriated to the insurance agency to the extent necessary to protect holders of savings accounts in member associations.' As of December 31, 1989, depositors of all non-disputed insured accounts at associations in receivership have been paid in full. The insurance agency believes that the allowance for estimated insurance losses will be sufficient to provide for the agency's ultimate liability.

Ratings. The general obligation bonds of the State of Maryland have been rated by Moody's Investors Service, Inc. as Aaa, by Standard & Poor's Corporation as AAA, and by Fitch Investors service, Inc. as AAA.

Local Subdivision Debt. The counties and incorporated municipalities in Maryland issue general obligation debt for general governmental purposes. The general obligation debt of the counties and incorporated municipalities is generally supported by ad valorem taxes on real estate, tangible personal property and intangible personal property subject to taxation. The issuer typically pledges its full faith and credit and unlimited taxing power to the prompt payment of the maturing principal and interest on the general obligation debt and to the levy and collection of the ad valorem taxes as and when such taxes become necessary in order to provide sufficient funds to meet the debt service requirements. The amount of debt which may be authorized may in some cases be limited by the requirement that it not exceed a stated percentage of the assessable base upon which such taxes are levied.

In the opinion of counsel, the issuer may be sued in the event that it fails to perform its obligations under the general obligation debt to the holders of the debt, and any judgments resulting from such suits would be enforceable against the issuer. Nevertheless, a holder of the debt who has obtained any such judgment may be required to seek additional relief to compel the issuer to levy and collect such taxes as may be necessary to provide the funds from which a judgment may be paid. Although there is no Maryland law on this point, it is the opinion of counsel that the appropriate courts of Maryland have jurisdiction to entertain proceedings and power to grant additional relief,

such as a mandatory injunction, if necessary, to enforce the levy and collection of such taxes and payment of the proceeds of the collection of the taxes to the holders of general obligation debt, pari passu, subject to the same constitutional limitations on enforcement, as described above, as apply to the enforcement of judgments against the State.

Local subdivisions, including counties and municipal corporations, are also authorized by law to issue special and limited obligation debt for certain purposes other than general governmental purposes. The source of payment of that debt is limited to certain revenues of the issuer derived from commercial activities operated by the issuer, payments made with respect to certain facilities or loans, and any funds pledged for the benefit of the holders of the debt. That special and limited obligation debt does not constitute a debt of the State, the issuer or any other political subdivision of either within the meaning of any constitutional or statutory limitation. Neither the State nor the issuer or any other political subdivision of either is obligated to pay the debt or the interest on the debt except from the revenues of the issuer specifically pledged to the payment of the debt. Neither the faith and credit nor

the taxing power of the State, the issuer or any other political subdivision of either is pledged to the payment of the debt. The issuance of the debt is not directly or indirectly or contingently an obligation, moral or other, of the State, the issuer or any other political subdivision of either to levy any tax for its payment.

Washington Suburban Sanitary District Debt. The Washington Suburban Sanitary District operates as a public corporation of the State to provide, as authorized, water, sewerage and drainage systems, including water supply, sewage disposal, and storm water drainage facilities for Montgomery County, Maryland and Prince George's County, Maryland. For the purpose of paying the principal of and interest on bonds of the District, Maryland law provides for the levy, annually, against all the assessable property within the District by the County Council of Montgomery County and the County Council of Prince George's County of ad valorem taxes sufficient to pay such principal and interest when due and payable.

Storm water drainage bonds for specific projects are payable from an ad valorem tax upon all of the property assessed for county tax purposes within the portion of the District situated in the county in which the storm water project was, or is to be, constructed. Storm water drainage bonds of the District are also guaranteed by such county, which guaranty operates as a pledge of the full faith and credit of the county to the payment of the bonds and obligates the county council, to the extent that the tax revenues referred to above and any other money available or to become available are inadequate to provide the funds necessary to pay the principal of and the interest on the bonds, to levy upon all property subject to taxation within the county ad valorem taxes in rate and in amount sufficient to make up any such deficiency.

Substantially all of the debt service on the bonds, except storm water drainage bonds, is being paid from revenues derived by the District from water consumption charges, front foot benefit charges, and sewage usage charges. Notwithstanding the payment of principal of and interest on those bonds from those charges, the underlying security of all bonds of the District is the levy of ad valorem taxes on the assessable property as stated above.

Special Authority Debt. The State and local governments have created several special authorities with the power to issue debt on behalf of the State or local government for specific purposes, such as providing facilities for non-profit health care and higher educational institutions, facilities for the disposal of solid waste, funds to finance single family and low-to-moderate income housing, and similar purposes. The Maryland Health and Higher Educational Facilities Authority, the Northeast Maryland Waste Disposal Authority, the Housing Opportunities Commission of Montgomery County, and the Housing Authority of Prince George's County are some of the special authorities which have issued and have outstanding debt of this type.

The debts of the authorities issuing debt on behalf of the State and the local governments are limited obligations of the authorities payable solely from and secured by a pledge of the revenues derived from the facilities or loans financed with the proceeds of the debt and from any other funds and receipts pledged under an indenture with a corporate trustee. The debt does not constitute a debt, liability or pledge of the faith and credit of the State or of any political subdivision or of the authorities. Neither the State nor any political subdivision thereof nor the authorities shall be obligated to pay the debt or the interest on the debt except from such revenues, funds and receipts. Neither the faith and credit nor the taxing power of the State or of any political subdivision of the State or the authorities is pledged to the payment of the principal of or the interest on such debt. The issuance of the debt is not directly or indirectly an obligation, moral or other, of the State or of any political subdivision of the State or of the authority to levy or to pledge any form of taxation whatsoever, or to make any appropriation, for their payment. The authorities have no taxing power.



Hospital Bonds. The rates charged by non-governmental Maryland hospitals are subject to review and approval by the Maryland Health Services Cost Review Commission. Maryland hospitals subject to regulation by the Commission are not permitted to charge for services at rates other than those established by the Commission. In addition, the Commission is required to permit any nonprofit institution subject to its jurisdiction to charge reasonable rates which will permit the institution to provide, on a solvent basis, effective and efficient service in the public interest.

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Under an agreement between Medicare and the Commission, Medicare agrees to pay Maryland hospitals on the basis of Commission-approved rates, less a 6% differential. Under this so-called 'Medicare Waiver', Maryland hospitals are exempt from the Medicare Prospective Payment System which pays hospitals fixed amounts for specific services based upon patient diagnosis. No assurance can be given that Maryland will continue to meet any current or future tests for the continuation of the Medicare Waiver.

In setting hospital rates, the Commission takes into account each hospital's budgeted volume of services and cash financial requirements for the succeeding year. It then establishes the rates of the hospital for the succeeding year based upon the projected volume and those financial requirements of the institution which the Commission has deemed to be reasonable. Financial requirements allowable for inclusion in rates generally include budgeted operating costs, a 'capital facilities allowance', other financial considerations (such as charity care and bad debts) and discounts allowed certain payors for prompt payment. Variations from projected volumes of services are reflected in the rates for the succeeding year. The Commission, on a selective basis by the application of established review criteria, grants Maryland hospitals increases in rates to compensate for inflation experienced by hospitals and for other factors beyond the hospitals' control.

Regulations of the Commission provide that overcharges will in certain circumstances be deducted from prospective rates. Similarly, undercharges will in certain circumstances not be recoverable through prospective rates.

The Commission has entered into agreements with certain hospitals to adjust rates in accordance with a prospectively approved, guaranteed inpatient revenue per admission program. Those agreements are in addition to the rate adjustment methodology discussed above. Under the program, a hospital's revenue per admission is compared to the revenue per admission, as adjusted, for a base year. Variations from the adjusted base year revenues per admission are added or deducted, as the case may be, from the hospital's gross revenue and rates for the following year.

There can be no assurance that the Commission will continue to utilize its present rate-setting methodology or approve rates which will be sufficient to ensure payment on an individual hospital's obligations. Future actions by the Commission or the loss of the Medicare Waiver may adversely affect the operations of individual hospitals.

#### MARYLAND TAXES

In the opinion of Weinberg and Green, Baltimore, Maryland, special counsel on Maryland tax matters, under existing Maryland law:

1. The Maryland Trust will not be recognized as an association taxable as a corporation, and the income of the Maryland Trust will be treated as the income of the Holders of Units ('Holder'). The Maryland Trust is not a 'financial institution' subject to the Maryland Franchise Tax measured by net earnings. The Maryland Trust is not subject to Maryland property taxes imposed on the intangible personal property of certain corporations.

2. A Holder will not be required to include the Holder's share of the earnings of, or distributions from, the Maryland Trust in the Holder's Maryland taxable income to the extent that such earnings or distributions represent interest excludable from gross income for Federal income tax purposes received by the Maryland Trust on obligations of the State of Maryland, or the Government of Puerto Rico, or the Government of Guam and their respective political subdivisions and authorities. Interest on Debt Obligations is subject to the Maryland Franchise Tax imposed on 'financial institutions' and measured by net earnings.

3. In the case of taxpayers who are individuals, Maryland presently imposes an income tax on items of tax preference with reference to such items as defined in the Internal Revenue Code, as amended, for purposes of calculating the federal alternative minimum tax. Interest paid on certain private activity bonds is a preference item for purposes of calculating the federal alternative minimum tax. Accordingly, if the Maryland Trust holds such bonds, 50% of the interest on such bonds in excess of a threshold amount is taxable by Maryland.

4. A Holder may recognize taxable gain or loss, which will be capital gain or loss except in the case of a dealer or a financial institution,

Holder's pro rata portion of the Debt Obligations in the Maryland Trust. A Holder will be considered to have disposed of all or part of the Holder's pro rata portion of each Debt Obligation when the Holder sells or redeems all or some of the Holder's Units. A Holder will also be considered to have disposed of all or part of the Holder's pro rata portion of a Debt Obligation when all or part of the Debt Obligation is disposed of by the Maryland Trust or is redeemed or paid at maturity. Capital gains included in the gross income of Holders for federal income tax purposes may be subtracted from income for Maryland income tax purposes only to the extent that the gain is derived from the disposition of Debt Obligations issued by the State of Maryland and its political subdivisions. Profits realized on the sale or exchange of Debt Obligations are subject to the Maryland Franchise Tax imposed on 'financial institutions' and measured by net earnings.

5. Units of the Maryland Trust will be subject to Maryland inheritance and estate tax only if held by Maryland residents.

6. Neither the Debt Obligations nor the Units will be subject to Maryland personal property tax.

7. The sales of Units in Maryland or the holding of Units in Maryland will not be subject to Maryland Sales or Use Tax.

#### THE MASSACHUSETTS TRUST

RISK FACTORS--The Commonwealth of Massachusetts and certain of its cities and towns have at certain times in the recent past undergone serious financial difficulties which have adversely affected and, to some degree, continue to adversely affect their credit standing. These financial difficulties could adversely affect the market values and marketability of, or result in default in payment on, outstanding bonds issued by the Commonwealth or its public authorities or municipalities, including the Debt Obligations deposited in the Trust. The following description highlights some of the more significant financial problems of the Commonwealth and the steps taken to strengthen its financial condition.

The effect of the factors discussed below upon the ability of Massachusetts issuers to pay interest and principal on their obligations remains unclear and in any event may depend on whether the obligation is a general or revenue obligation bond (revenue obligation bonds being payable from specific sources and therefore generally less affected by such factors) and on what type of security is provided for the bond. In order to constrain future debt service costs, the Executive Office for Administration and Finance established in November, 1988 an annual fiscal year limit on capital spending of \$925 million, effective fiscal 1990. In January, 1990, legislation was enacted to impose a limit on debt service in Commonwealth budgets beginning in fiscal 1991. The law provides that no more than 10% of the total appropriations in any fiscal year may be expended for payment of interest and principal on general obligation debt of the Commonwealth (excluding the Fiscal Recovery Bonds discussed below). It should also be noted that Chapter 62F of the Massachusetts General Laws establishes a state tax revenue growth limit and does not exclude principal and interest due on Massachusetts debt obligations from the scope of the limit. It is possible that other measures affecting the taxing or spending authority of Massachusetts or its political subdivisions may be approved or enacted in the future.

The Commonwealth has waived its sovereign immunity and consented to be sued under contractual obligations including bonds and notes issued by it. However, the property of the Commonwealth is not subject to attachment or levy to pay a judgment, and the satisfaction of any judgment generally requires legislative appropriation. Enforcement of a claim for payment of principal or interest on bonds and notes of the Commonwealth may also be subject to provisions of federal or Commonwealth statutes, if any, hereafter enacted extending the time for payment or imposing other constraints upon enforcement, insofar as the same may be constitutionally applied. The United States Bankruptcy Code is not applicable to states.

Cities and Towns. During recent years limitations were placed on the taxing authority of certain Massachusetts governmental entities that may impair the ability of the issuers of some of the Debt Obligations in the Massachusetts Trust to maintain debt service on their obligations. Proposition 2 1/2, passed by the voters in 1980, led to large reductions in property taxes, the major source of income for

cities and towns. As a result, between fiscal 1981 and fiscal 1989, the aggregate property tax levy declined in real terms by 15.6%.

Since Proposition 2 1/2 did not provide for any new state or local taxes to

replace the lost revenues, in lieu of substantial cuts in local services the Commonwealth began to increase local aid expenditures. In 1981 constant dollars, total direct local aid expenditures increased by 58.5% between fiscal years 1981 and 1989, or 5.9% per year. During the same period, the total of all other local revenue sources declined by 5.87% or 0.75% per year. Despite the substantial increases in local aid from fiscal 1981 to fiscal 1989, local spending increased at an average rate of 1% per year in real terms. Direct local aid for fiscal 1987, 1988, and 1989 was \$2.601 billion, \$2.769 billion, and \$2.961 billion, respectively. Direct local aid declined in the three subsequent years to \$2.937 billion in fiscal 1990, \$2.608 billion in 1991 and \$2.328 billion in 1992 and increased to \$2.547 billion in 1993. It is estimated that fiscal 1994 expenditures for direct local aid will be \$2.737 billion, which is an increase of approximately 7.5% above the fiscal 1993 level. The additional amount of indirect local aid provided over and above the direct local aid is estimated to have been \$1.313 billion in fiscal 1991, \$1.265 billion in fiscal 1992 and \$1.717 billion in fiscal 1993 and is estimated to be approximately \$1.717 billion in fiscal 1994.

Many communities have responded to the limitations imposed by Proposition 2 1/2 through statutorily permitted overrides and exclusions. Override activity peaked in fiscal 1991, when 182 communities attempted votes on one of the three types of referenda questions (override of levy limit, exclusion of debt service, or exclusion of capital expenditures) and 100 passed at least one question, adding \$58.5 million to their levy limits. In fiscal 1992, 67 of 143 communities had successful votes totalling \$31.0 million. In fiscal 1993, 83 communities attempted a vote; two-thirds of them (56) passed questions aggregating \$16.4 million.

A statewide voter initiative petition which would effectively mandate that, commencing with fiscal 1992, no less than 40% of receipts from personal income taxes, sales and use taxes, corporate excise taxes and lottery fund proceeds be distributed to certain cities and towns in local aid was approved in the general election held November 6, 1990. Pursuant to this petition, the local aid distribution to each city or town was to equal no less than 100% of the total local aid received for fiscal 1989. Distributions in excess of fiscal 1989 levels were to be based on new formulas that would replace the current local aid distribution formulas. If implemented in accordance with its terms (including appropriation of the necessary funds), the petition as approved would shift several hundred million dollars to direct local aid. However, local aid payments explicitly remain subject to annual appropriation, and fiscal 1992 and fiscal 1993 appropriations for local aid did not meet, and fiscal 1994 appropriations for local aid do not meet, the levels set forth in the initiative law.

**Pension Liabilities.** The Commonwealth had funded its two pension systems on essentially a pay-as-you-go basis. The funding schedule is based on actuarial valuations of the two pension systems as of January 1, 1990, at which time the unfunded accrued liability for such systems operated by the Commonwealth (and including provision for Boston teachers) totalled \$8.865 billion. The unfunded liability for the Commonwealth related to cost of living increases for local retirement systems was estimated to be an additional \$2.004 billion as of January 1, 1990. An actuarial valuation as of January 1, 1992 shows that, as of such date, the total unfunded actuarial liability for such systems, including cost-of-living allowances, was approximately \$8.485 billion representing a reduction of approximately \$2.383 billion from January 1, 1990.

The amount in the Commonwealth's pension reserve, established to address the unfunded liabilities of the two state systems, has increased significantly in recent years due to substantial appropriations and changes in law relating to investment of retirement system assets. Total appropriations and transfers to the reserve in fiscal years 1985, 1986, 1987 and 1988 amounted to approximately \$680 million. Comprehensive pension legislation approved in January 1988 committed the Commonwealth, beginning in fiscal 1989, to normal cost funding of its pension obligations and to a 40-year amortization schedule for its unfunded pension liabilities. Total pension costs increased from \$659.7 million in fiscal 1989 to \$868.2 million in fiscal 1993. Pension funding is estimated to be \$951.0 million in fiscal year 1994. As of June 30, 1993, the Commonwealth's pension reserves had grown to approximately \$3.877 billion.

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**State Budget and Revenues.** The Commonwealth's Constitution requires, in effect, that its budget be balanced each year. The Commonwealth's fiscal year ends June 30. The General Fund is the Commonwealth's primary operating fund; it also functions as a residuary fund to receive otherwise unallocated revenues and to provide monies for transfers to other funds as required. The condition of the General Fund is generally regarded as the principal indication of whether the Commonwealth's operating revenues and expenses are in balance; the other principal operating funds (the Local Aid Fund and the Highway Fund) are customarily funded to at least a zero balance.

Limitations on Commonwealth tax revenues have been established by enacted legislation and by public approval of an initiative petition which has become law. The two measures are inconsistent in several respects, including the methods of calculating the limits and the exclusions from the limits. The

initiative petition does not exclude debt service on the Commonwealth's notes and bonds from the limits. State tax revenues in fiscal 1988 through fiscal 1993 were lower than the limits. The Executive Office for Administration and Finance currently estimates that state tax revenues will not reach the limit imposed by either the initiative petition or the legislative enactment in fiscal 1994.

Budgeted expenditures for fiscal 1989 totalled approximately \$12.643 billion. Budgeted revenues totalled approximately \$11.970 billion, approximately \$672.5 million less than total expenditures. Under the budgetary basis of accounting, after taking account of certain fund balances, fiscal 1989 ended with a deficit of \$319.3 million. Under the GAAP basis of accounting, excluding fiduciary accounts and enterprise funds, the Commonwealth ended fiscal 1989 with a deficit of \$946.2 million. This deficit reflected an operating gain in the capital projects funds due to additional borrowings to reduce prior year deficits. If the capital project funds are excluded, the Comptroller calculated a GAAP deficit of \$1.002 billion in fiscal 1989.

Fiscal 1989 tax revenues were adversely affected by the economic slowdown that began in mid-1988. In June, 1988, the fiscal 1989 tax revenue estimate was for 10.9% growth over fiscal 1988. Fiscal 1989 ended with actual tax revenue growth of 6.5%.

The fiscal 1989 budgetary deficit caused a cash deficit in the Commonwealth operating accounts on June 30, 1989 in the amount of approximately \$450 million. The State Treasurer was forced to defer until early July certain fiscal 1989 expenditures including the payment of approximately \$305 million in local aid due June 30, and with legislative authorization, issued temporary notes in July in the amount of \$1.1 billion to pay fiscal 1989 and fiscal 1990 costs.

Fiscal year 1990 resulted in total expenditures of approximately \$13.260 billion. Budgeted revenues and other services for fiscal 1990 were approximately \$12.008 billion. Tax revenues for fiscal 1990 were approximately \$8.517 billion, a decrease of approximately \$314 million or 3.6% from fiscal 1989. The Commonwealth suffered an operating loss of approximately \$1.25 billion and ended fiscal 1990 with a budgetary deficit of \$1.104 billion. The Commonwealth had a cash surplus of \$99.2 million on June 30, 1990 as a result of deferring until fiscal 1991 the payment of approximately \$1.26 billion of local aid due June 30, 1990.

On July 28, 1990, the legislature enacted Chapter 151 which provides, among other matters, for the Commonwealth Fiscal Recovery Loan Act of 1990 and grants authorization for the Commonwealth to issue bonds in an aggregate amount up to \$1.42 billion for purposes of funding the Commonwealth's fiscal 1990 deficit and certain prior year Medicaid reimbursement payments. Chapter 151 also provides for the establishment of the Commonwealth Fiscal Recovery Fund, deposits for which are derived from a portion of the Commonwealth's personal income tax receipts, are dedicated for this purpose and are to be deposited in trust and pledged to pay the debt service on these bonds. Under Chapter 151, the Commonwealth issued \$1.363 billion of Dedicated Income Tax Bonds to cover the anticipated fiscal 1990 deficit.

Total expenditures for fiscal 1991 are estimated to have been \$13.659 billion. Total revenues for fiscal 1991 are estimated to have been \$13.634 billion, resulting in an estimated \$21.2 million operating loss. Application of the adjusted fiscal 1990 fund balances of \$258.3 million resulted in a final fiscal 1991 budgetary surplus of \$237.1 million. State finance law required that approximately \$59.2 million of the fiscal year surplus be placed in the Stabilization Fund described above. Amounts credited to the Stabilization Fund are not generally available to defray current year expenses without subsequent specific legislative authorization.

After payment in full of the local aid distribution of \$1.018 billion due on June 28, 1991, retirement of all of the Commonwealth's outstanding commercial paper and repayment of certain other short-term borrowings, as of the end of fiscal 1991, the Commonwealth had a cash balance of \$182.3 million. The fiscal 1991 year-end cash position compared favorably to the Commonwealth's cash position at the end of the prior fiscal year, June 30, 1990, when the Commonwealth's cash short-fall would have exceeded \$1.1 billion had payment of local aid not been postponed.

Upon taking office in January 1991, the new Governor undertook a comprehensive review of the Commonwealth's budget. Based on projected spending of \$14.105 billion, it was then estimated that \$850 million in budget balancing measures would be needed prior to the close of fiscal 1991. At that time, estimated tax revenues were revised to \$8.845 billion, \$903 million less than was estimated at the time the fiscal 1991 budget was adopted. The Governor proposed a series of legislative and administrative actions, designed to eliminate the projected deficit. The legislature adopted a number of the Governor's recommendations and the Governor took certain other administrative actions, not requiring legislative approval, including \$65 million in savings from the adoption of a state employee furlough program. It is estimated that spending reductions achieved through savings incentives and withholding of allotments totalled \$484.3 million in the aggregate for fiscal 1991.

In addition to recommending spending reductions to close the projected budget deficit, the administration, in May 1991, filed an amendment to its Medicaid state plan that enabled it to claim 50% Federal reimbursement on uncompensated care payments provided to certain hospitals in the Commonwealth.

In fiscal 1992, Medicaid accounted for more than half of the Commonwealth's appropriations for health care. It is the largest item in the Commonwealth's budget. It has also been one of the fastest growing budget items. During fiscal years 1989, 1990 and 1991, Medicaid expenditures were \$1.83 billion, \$2.12 billion and \$2.77 billion, respectively. A substantial amount of expenditures in recent years was provided through supplemental appropriations, repeating the experience that Medicaid expenditures have exceeded initial appropriation amounts. These annual amounts, however, do not take account of the practice of retroactive settlement of many provider payments after audit review and certification by the Rate Setting Commission. In fiscal 1990, payments of approximately \$488 million were made to hospitals and nursing homes for rate settlements dating back as far as 1980, through the Medical Assistance Liability Fund established to fund certain Medicaid liabilities incurred, but not certified for payment, in prior years. This amount is not factored into the annual totals for Medicaid expenditures listed above. Including retroactive provider settlements, Medicaid expenditures for fiscal 1992 were \$2.818 billion and for fiscal 1993 were \$3.151 billion. The Executive Office for Administration and Finance estimates that fiscal 1994 Medicaid expenditures will be approximately \$3.252 billion, an increase of 3.9% over fiscal 1993 expenditures. For fiscal 1994, no supplemental Medicaid appropriations are currently expected to be necessary. The Governor had proposed a managed care program to be implemented commencing in January, 1992 in order to address the considerable annual cost increases in the Medicaid program. Medicaid is presently 50% funded by federal reimbursements.

In fiscal 1992 total revenues and other sources of the budgeted operating funds totalled \$13.728 billion, an increase over fiscal 1991 revenues of .7%. (Actual fiscal 1992 tax revenues exceeded original estimates and totalled \$9.484 billion, an increase over fiscal 1991 collections of 5.4%). Fiscal 1992 expenditures and other uses of budgeted operating funds totalled approximately \$13.420 billion, a decrease from fiscal 1991 expenditures by 1.7%. Fiscal year 1992 revenues and expenditures resulted in an operating gain of \$312.3 million. Through the use of the prior year ending fund balances of \$312.3 million, fiscal 1992 budgetary fund balances totalled \$549.4 million. Total fiscal 1992 spending authority continued into fiscal 1993 is \$231.0 million.

After payment in full of the quarterly local aid distribution of \$514 million due on June 30, 1992, retirement of the Commonwealth's outstanding commercial paper (except for approximately \$50 million of bond anticipation notes) and certain other short-term borrowings, as of June 30, 1992, the Commonwealth showed a year-end cash position of approximately \$731 million for fiscal year 1992. The ending balance compares favorably with the cash balance of \$182.3 million at the end of fiscal 1991. As of June 1993, the Commonwealth showed a year-end cash position of \$622.2 million

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for fiscal year 1993. As of January 19, 1994, the Commonwealth estimates a 1994 year-end cash position of approximately \$725.4 million.

The budgeted operating funds of the Commonwealth ended fiscal 1993 with a surplus of revenues and other sources over expenditures and other uses of \$13.1 million and aggregate ending fund balances in the budgeted operating funds of the Commonwealth of approximately \$562.5 million. Budgeted revenues and other sources for fiscal 1993 totalled approximately \$14.710 billion, including tax revenues of \$9.930 billion. Total revenues and other sources increased by approximately 6.9% from fiscal 1992 to fiscal 1993, while tax revenues increased by 4.7% for the same period. In July, 1992, tax revenues had been estimated to be approximately \$9.685 billion for fiscal 1993. This amount was subsequently revised during fiscal 1993 to \$9.940 billion.

Commonwealth budgeted expenditures and other uses in fiscal 1993 totalled approximately \$14.696 billion, which is \$1.280 billion or approximately 9.6% higher than fiscal 1992 expenditures and other uses. Fiscal 1993 budgeted expenditures were \$23 million lower than the initial July 1992 estimates of fiscal 1993 budget expenditures.

On July 19, 1993, the Governor signed into law the budget for fiscal 1994, totalling \$15.463 billion. This represented a \$694 million increase over the then estimated budgeted expenditures of \$14.976 billion for fiscal 1993. On January 14, 1994, the Governor signed into law supplemental appropriations totalling approximately \$157.9 million. Including an additional \$8.1 million in fiscal 1994 supplemental appropriation recommendations that the Governor plans to file, and an approximate \$100 million contingency reserve in fiscal 1994 for possible additional spending, fiscal 1994 budgeted expenditures are currently estimated to be approximately \$15.716 billion. Budgeted revenues and other sources to be collected in fiscal 1994 are estimated to be approximately \$15.535 billion, which includes tax revenues of approximately \$10.694 billion (as compared to \$9.930 billion in fiscal 1993). This budget includes \$175 million as

part of an education reform bill passed by the legislature. The fiscal 1994 budget is based on numerous spending and revenue estimates, the achievement of which cannot be assured. As of January 10, 1994, the Legislature had overridden \$21.0 million of the Governor's vetoes relating to the fiscal 1994 budget. Commonwealth expenditures and other uses in fiscal 1994 are currently estimated to be approximately \$15.500 billion, which is \$788 million or approximately 5.36% higher than those of fiscal 1993. Based on currently estimated revenues and expenditures, the Executive Office for Administration and Finance projects a fiscal 1994 ending balance of approximately \$382.0 million, of which approximately \$315.5 million will be in the Stabilization Fund.

On July 19, 1993, a 60-day hiring freeze on all executive branch agencies was instituted to help ensure that agency expenditures remain within their fiscal 1994 budget authorizations. On August 16, 1993, the Commonwealth announced that approximately 1,280 state employees would be laid off in the near future, in addition to approximately 350 employees already laid off in fiscal 1994.

On January 21, 1994, the Governor presented his Budget Submission for fiscal year 1995 providing for expenditures of \$16.14 billion, a \$424 million, or 2.7%, increase over current fiscal year 1994 projections. These proposed expenditures for fiscal year 1995 include direct local aid of \$2.997 billion. This budget is based on total anticipated revenues of \$16.144 billion, which represents a \$609 million, or 3.9%, increase over fiscal year 1994 estimates. The Governor's budget recommendation is based on a tax revenue estimate of \$11.226 billion, an increase of approximately 5.0%, as compared to currently estimated fiscal 1994 tax revenues of \$10.694 billion.

The liabilities of the Commonwealth with respect to outstanding bonds and notes payable as of January 1, 1994 totalled \$12.555 billion. These liabilities consisted of \$8.430 billion of general obligation debt, \$1.036 billion of dedicated income tax debt (the Fiscal Recovery Bonds), \$104 million of special obligation debt, \$2.742 billion of supported debt, and \$243 million of guaranteed debt.

Capital spending by the Commonwealth was approximately \$595 million in fiscal 1987, \$632 million in fiscal 1988 and \$971 million in fiscal 1989. In November 1988, the Executive Office for Administration and Finance established an administrative limit on state financed capital spending in the Capital Projects Funds of \$925.0 million per fiscal year. Capital expenditures decreased to \$936 million, \$847 million, \$694.1 million and \$575.9 million in fiscal 1990, 1991, 1992 and fiscal 1993, respectively. Capital expenditures are projected to increase to \$886.0 million in fiscal 1994. The

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growth in capital spending accounts for a significant rise in debt service during the period. Payments for the debt service on Commonwealth general obligation bonds and notes have risen at an average annual rate of 20.4% from \$649.8 million in fiscal 1989 to \$942.3 million in fiscal 1991. Debt Service payments in fiscal 1992 were \$898.3 million, representing a 4.7% decrease from fiscal 1991. This decrease resulted from a \$261 million one-time reduction achieved through the issuance of refunding bonds in September and October of 1991. Debt service expenditures were \$1.139 billion for fiscal 1993 and are projected to be \$1.220 billion for fiscal 1994. These amounts represent debt service payments on direct Commonwealth debt and do not include debt service on notes issued to finance the fiscal 1989 deficit and certain Medicaid-related liabilities, which were paid in full from non-budgeted funds. Also excluded are debt service contract assistance to certain state agencies and the municipal school building assistance program projected to total of \$359.7 million in the aggregate in fiscal 1994. In addition to debt service on bonds issued for capital purposes, the Commonwealth is obligated to pay the principal of and interest on the Fiscal Recovery Bonds described above. The estimated debt service on such Bonds currently outstanding (a portion of which were issued as variable rate bonds) ranges from approximately \$279 million (interest only) in fiscal 1994 through fiscal 1997 and approximately \$130 million in fiscal 1998, at which time the entire amount of the Fiscal Recovery Bonds will be retired.

In January, 1990 legislation was enacted to impose a limit on debt service in Commonwealth budgets beginning in fiscal 1991. The law provides that no more than 10% of the total appropriations in any fiscal year may be expended for payment of interest and principal on general obligation debt (excluding the Fiscal Recovery Bonds) of the Commonwealth. This law may be amended or appealed by the legislature or may be superseded in the General Appropriation Act for any year. From fiscal year 1987 through fiscal year 1994 estimated, this percentage has been substantially below the limited established by this law.

Legislation enacted in December, 1989 imposes a limit on the amount of outstanding direct bonds of the Commonwealth. The limit for fiscal 1994 is \$7.872 billion. The law provides that the limit for each subsequent fiscal year shall be 105% of the previous fiscal year's limit. The Fiscal Recovery Bonds will not be included in computing the amount of bonds subject to this limit.

In August, 1991, the Governor announced a five-year capital spending plan. The plan, which represents the Commonwealth's first centralized multi-year

capital plan, sets forth, by agency, specific projects to receive capital spending allocations over the next five fiscal years and annual capital spending limits. Capital spending by the Commonwealth, which exceeded \$900 million annually in fiscal 1989, 1990 and 1991, declined to \$694.1 million in fiscal 1992 and \$575.9 in fiscal 1993. For fiscal 1994 through 1998, the plan forecasts annual capital spending for the Commonwealth of between \$813 million and \$886 million per year, exclusive of spending by the Massachusetts Bay Transit Authority. Total expenditures are forecast at \$4.25 billion, an amount less than the total amount of agency capital spending requests for the same period. Planned spending is also significantly below legislatively authorized spending levels.

Unemployment. From 1980 to 1989, the Massachusetts unemployment rate was significantly lower than the national average. The Massachusetts unemployment rate averaged 9.0%, 8.5% and 6.9% in calendar 1991, 1992 and 1993, respectively. The Massachusetts unemployment rate in December, 1993 was 6.3% as compared to 6.6% for November, 1993 and 8.6% for December of 1992, although the rate has been volatile throughout this period. The Massachusetts unemployment rate in January, 1994 was 7.2%, this rate is not comparable to prior rates due to a new rate computation which became effective in 1994.

The balance in the Massachusetts Unemployment Compensation Trust Fund had been exhausted as of September 1991 due to the continued high levels of unemployment. As of December 31, 1992, the Massachusetts Unemployment Compensation Trust Fund balance was in deficit by \$377 million. As of November 30, 1993, the Fund was in deficit by \$163 million. The deficit is now expected to be approximately \$120 million by the end of calendar 1993. Benefit payments in excess of contributions are being financed by use of repayable advances from the federal unemployment loan account. Legislation enacted in May 1992 increased employer contributions in order to reduce advances from the federal loan account. The additional increases in contributions provided by the new legislation

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should result in a positive balance in the Unemployment Compensation Trust Fund by the end of December 1994 and rebuild reserves in the system to over \$1 billion by the end of 1996.

Litigation. The Attorney General of the Commonwealth is not aware of any cases involving the Commonwealth which in his opinion would affect materially its financial condition. However, certain cases exist containing substantial claims, among which are the following.

The United States has brought an action on behalf of the U.S. Environmental Protection Agency alleging violations of the Clean Water Act and seeking to enforce the clean-up of Boston Harbor. The Massachusetts Water Resources Authority (the 'MWRA') has assumed primary responsibility for developing and implementing a court approved plan and time table for the construction of the treatment facilities necessary to achieve compliance with the federal requirements. The MWRA currently projects the total cost of construction of the waste water facilities required under the court's order as approximately \$3.5 billion in current dollars. Under the Clean Water Act, the Commonwealth may be liable for any costs of complying with any judgment in this case to the extent that the MWRA or a municipality is prevented by state law from raising revenues necessary to comply with such a judgment.

In a recent suit filed against the Department of Public Welfare, plaintiffs allege that the Department has unlawfully denied personal care attendant services to severely disabled Medicaid recipients. The Court has denied plaintiffs' motion for a preliminary injunction and has not yet acted on plaintiffs' motion for reconsideration of that decision. If plaintiffs prevail on their claims, the suit could cost the Commonwealth as much as \$200 million.

In a suit filed against the Commissioner of Revenue, plaintiffs challenge the inclusion of income from tax exempt obligations in the measure of the bank excise tax. The Appellate Tax Board issued a finding of fact and report in favor of the Commissioner of Revenue on September 30, 1993. An appeal has been filed. Approximately \$400 million is at issue.

There are also several tax matters in litigation which may result in an aggregate liability in excess of \$195 million.

Ratings. Beginning on May 17, 1989, Standard & Poor's downgraded its ratings on Massachusetts general obligation bonds and certain agency issues from AA+ to AA. The ratings were downgraded three additional times to a low of BBB on December 31, 1989. On July 14, 1989, Standard & Poor's also downgraded its rating on temporary general obligation notes and various agency notes from SP-1+ to SP-1 and on general obligation short-term notes and on short-term agency debt from SP-1 to SP-2. Bonds rated BBB may have speculative characteristics. The rating remained at BBB until September 9, 1992 when Standard & Poor's raised its rating to A. At this same time, such bonds were removed from CreditWatch. On October 14, 1993, Standard & Poor's raised its rating from A to A+.

On June 21, 1989, Moody's Investors Service downgraded its rating on

Massachusetts general obligation bonds from Aa to A. The ratings were further reduced on two occasions to a low on March 19, 1990 of Baa where it remained until September 10, 1992 when Moody's increased its rating to A.

Fitch Investors Service, Inc. lowered its rating on the Commonwealth's bonds from AA to A on September 29, 1989. As of December 5, 1991, its qualification of the bonds changed from Uncertain Trends to Stabilizing Credit Trend. On October 13, 1993, Fitch Investors raised its rating from A to A+.

Ratings may be changed at any time and no assurance can be given that they will not be revised or withdrawn by the rating agencies, if in their respective judgments, circumstances should warrant such action. Any downward revision or withdrawal of a rating could have an adverse effect on market prices of the bonds.

#### MASSACHUSETTS TAXES

In the opinion of Wayne, Lazares & Chappell, Boston, Massachusetts, special counsel on Massachusetts tax matters, under existing Massachusetts law and regulations:

1. For Massachusetts income tax purposes, the Massachusetts Trust will be classified as a fixed investment trust, as that term is defined in Section 62.8.1 of Title 830 of the Code of

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Massachusetts Regulations and, therefore, will not be subject as an entity to Massachusetts income taxation.

2. Holders who are subject to Massachusetts income taxation under Chapter 62 of the Massachusetts General Laws will not be required to include their share of the earnings of the Massachusetts Trust in their Massachusetts gross income to the extent that such earnings represent interest received by the Massachusetts Trust on obligations issued by Massachusetts, its political subdivisions or their agencies or instrumentalities the interest on which is exempt from taxation under Massachusetts law, and on obligations issued by the Government of Puerto Rico or by the Government of Guam.

3. The Massachusetts Trust's gains and losses to the extent included in the Federal gross income of Holders who are subject to Massachusetts income taxation under Chapter 62 of the Massachusetts General Laws, will be included as gains and losses in the Holders' Massachusetts gross income, except those gains specifically exempted from Massachusetts income taxation under the statutes authorizing issuance of the obligations held by the Massachusetts Trust. However, in some cases losses will not be allowed in the determination of a Holder's Massachusetts gross income when such losses are realized by the Massachusetts Trust on the sale of obligations issued pursuant to statutes specifically exempting gains from Massachusetts income taxation. No judgment can be made in the abstract.

4. Gains and losses realized upon sale or redemption of Units of the Massachusetts Trust by Holders who are subject to Massachusetts income taxation under Chapter 62 to the extent included in the Federal gross income of such Holders will be included as gains and losses in the Holders' Massachusetts gross income, except those gains attributable to obligations held by the Massachusetts Trust which are issued pursuant to statutes specifically exempting gains from Massachusetts income taxation. However, in some cases, losses will not be allowed in the determination of a Holder's Massachusetts gross income when such losses are attributable to obligations issued pursuant to statutes specifically exempting gains from Massachusetts income taxation. No judgment can be made in the abstract.

5. Distributions to Holders who are subject to Massachusetts income taxation under Chapter 62 of the Massachusetts General Laws will be subject to tax only to the extent provided in paragraphs 2, 3 and 4 above.

The opinions expressed above apply only to Holders who are individuals. In addition, these opinions are subject to the opinion of Davis Polk & Wardwell that the Massachusetts Trust is not an association taxable as a corporation for Federal income tax purposes and will be treated as a grantor trust for Federal income tax purposes.

#### THE MICHIGAN TRUST

RISK FACTORS--Due primarily to the fact that the leading sector of the State's economy is the manufacturing of durable goods, economic activity in the State has tended to be more cyclical than in the nation as a whole. While the State's efforts to diversify its economy have proven successful, as reflected by the fact that the share of employment in the State in the durable goods sector has fallen from 33.1 percent in 1960 to 17.3 percent in 1991, durable goods manufacturing still represents a sizable portion of the State's economy. As a result, any substantial national economic downturn is likely to have an adverse effect on the economy of the State and on the revenues of the State and some of



its local governmental units. Recently, as well as historically, the average monthly unemployment rate in the State has been higher than the average figures for the United States. For example, for 1992 the average monthly unemployment rate in this State was 8.8% as compared to a national average of 7.4% in the United States.

The Michigan Constitution limits the amount of total revenues of the State raised from taxes and certain other sources to a level for each fiscal year equal to a percentage of the State's personal income for the prior calendar year. In the event the State's total revenues exceed the limit by 1% or more, the Constitution requires that the excess be refunded to taxpayers. The State Constitution does not prohibit the increasing of taxes so long as revenues are expected to amount to less than the revenue limit and authorizes exceeding the limit for emergencies when deemed necessary by the governor and a

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two-thirds vote of the members of each house of the legislature. The State Constitution further provides that the proportion of State spending paid to all local units to total spending may not be reduced below the proportion in effect in the 1978-79 fiscal year. The Constitution requires that if the spending does not meet the required level in a given year an additional appropriation for local units is required for the following fiscal year. The State Constitution also requires the State to finance any new or expanded activity of local units mandated by State law. Any expenditures required by this provision would be counted as State spending for local units for purposes of determining compliance with the provisions cited above.

The State Constitution limits State general obligation debt to (i) short-term debt for State operating purposes; (ii) short-and long-term debt for purposes of making loans to school districts; and (iii) long-term debt for a voter-approved purpose. Short-term debt for operating purposes is limited to an amount not in excess of fifteen (15%) percent of undedicated revenues received by the State during the preceding fiscal year and must mature in the same fiscal year in which it is issued. Debt incurred by the State for purposes of making loans to school districts is recommended by the Superintendent of Public Instruction who certifies the amounts necessary for loans to school districts for the ensuing two (2) calendar years. These bonds may be issued without vote of the electors of the State and in whatever amount required. There is no limit on the amount of long-term voter-approved State general obligation debt. In addition to the foregoing, the State authorizes special purpose agencies and authorities to issue revenue bonds payable from designated revenues and fees. Revenue bonds are not obligations of the State and in the event of shortfalls in self-supporting revenues, the State has no legal obligation to appropriate money to meet debt service payments. The Michigan State Housing Development Authority has a capital reserve fund pledged for the payment of debt service on its bonds derived from State appropriation. The act creating this Authority provides that the Governor's proposed budget include an amount sufficient to replenish any deficiency in the capital reserve fund. The legislature, however, is not obligated to appropriate such moneys and any such appropriation would require a two-thirds vote of the members of the legislature. Obligations of all other authorities and agencies of the State are payable solely from designated revenues or fees and no right to certify to the legislature exists with respect to those authorities or agencies.

The State finances its operations through the State's General Fund and special revenue funds. The General Fund receives revenues of the State that are not specifically required to be included in the Special Revenue Fund. General Fund revenues are obtained approximately 63% from the payment of State taxes and 37% from federal and non-tax revenue sources. The majority of the revenues from State taxes are from the State's personal income tax, single business tax, use tax, sales tax and various other taxes. Approximately 60% of total General Fund expenditures are for State support of public education and for social services programs. Other significant expenditures from the General Fund provide funds for law enforcement, general State government, debt service and capital outlay. The State Constitution requires that any prior year's surplus or deficit in any fund must be included in the next succeeding year's budget for that fund.

In recent years, the State of Michigan has reported its financial results in accordance with generally accepted accounting principles. For each of the five fiscal years ending with the fiscal year ended September 30, 1989, the State reported positive year-end balances and positive cash balances in the combined General Fund/School Aid Fund. For the fiscal years ended September 30, 1990 and 1991, the State reported negative year-end General Fund balances of \$310.4 million and \$169.4 million, respectively, but ended the 1992 fiscal year with its General Fund in balance. A positive cash balance in the combined General Fund/School Aid Fund was recorded at September 10, 1990. In each of the last three fiscal years, the State has undertaken mid-year actions to address projecting year-end budget deficits, including expenditure cuts and deferrals and one-time expenditures or revenue recognition adjustments. In the fiscal year ended September 30, 1993, the State took mid-year action to eliminate a projected year-end General Fund deficit of \$370 million. Since 1991, the State has experienced deteriorating cash balances which have necessitated short-term borrowings and the deferral of certain scheduled cash payments to local units of government. The State borrowed \$700 million for cash flow purposes in the 1992

fiscal year and \$900 million in the 1993 fiscal year. The State has a Budget Stabilization Fund which, after a transfer of \$230 million to the General Fund for the 1991 fiscal year,

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had an accrued balance of \$182 million as of September 30, 1991 and the balance of \$20.1 million as of September 30, 1992.

In April, 1986, Moody's upgraded Michigan's general obligation credit rating from A to A-1 and Standard & Poor's raised its rating on the State's general obligation bonds from A+ to AA-. In October, 1989, Standard & Poor's raised its rating again to AA. Early in 1992, Standard & Poor's maintained this rating.

The State's economy could continue to be affected by changes in the auto industry, notably consolidation and plant closings resulting from competitive pressures and over-capacity. In particular, General Motors Corporation has scheduled closings of several of its plants in Michigan in 1993 and 1994. The impact these closures will have on the state's revenues and expenditures is not currently known. The financial impact on the local units of government in the areas in which plants are closed could be more severe than on the State as a whole. State appropriations and State economic conditions in varying degrees affect the cash flow and budgets of local units and agencies of the State, including school districts and municipalities, as well as the State of Michigan itself.

Amendments to the Michigan Constitution which place limitations on increases in State taxes and local ad valorem taxes (including taxes used to meet debt service commitments on obligations of taxing units) were approved by the voters of the State of Michigan in November 1978 and became effective on December 23, 1978. To the extent that obligations in the Portfolio are tax-supported and are for local units and have not been voted by the taxing unit's electors and have been issued on or subsequent to December 23, 1978, the ability of the local units to levy debt service taxes might be affected.

State law provides for distributions of certain State collected taxes or portions thereof to local units based in part on population as shown by census figures and authorizes levy of certain local taxes by local units having a certain level of population as determined by census figures. Reductions in population in local units resulting from periodic census could result in a reduction in the amount of State collected taxes returned to those local units and in reductions in levels of local tax collections for such local units unless the impact of the census is changed by State law. No assurance can be given that any such State law will be enacted. In the 1991 fiscal year, the State deferred certain scheduled payments to municipalities, school districts, universities and community colleges. While such deferrals were made up at later dates, similar future deferrals could have an adverse impact on the cash position of some local units. Additionally, the State reduced revenue sharing payments to municipalities below that level provided under formulas by \$10.9 million in the 1991 fiscal year and \$34.4 million in the 1992 fiscal year and froze the 1993 revenue sharing payments at the 1992 level.

In December, 1993, the Michigan Legislature adopted school finance reform legislation providing, among other things, for submission of a ballot proposal on March 15, 1994, to amend the State's Constitution to increase the State sales tax rate from 4% to 6% and to place a cap on property assessment increases for all property taxes. The legislation further provides that if the constitutional amendment is accepted by the State's voters, the State's income tax rate will be cut from 4.6% to 4.4%, while if the proposal is rejected, the income tax rate will be increased to 6%. In either case, some property taxes will be reduced and school funding will be provided from a combination of property taxes and state revenues, some of which will be provided from new or increased State taxes. The legislation also contains other proposals that may reduce or alter the revenues of local units of government, and tax increment bonds could be particularly affected. While the ultimate impact of the proposed constitutional amendment and related legislation cannot yet be accurately predicted, investors should be alert to the potential effect of such measures upon the operations and revenues of Michigan local units of government.

The foregoing financial conditions and constitutional provisions could adversely affect the State's or local unit's ability to continue existing services or facilities or finance new services or facilities, and, as a result, could adversely affect the market value or marketability of the Michigan obligations in the Portfolio and indirectly affect the ability of local units to pay debt service on their obligations, particularly in view of the dependency of local units upon State aid and reimbursement programs.

The Portfolio may contain obligations of the Michigan State Building Authority. These obligations are payable from rentals to be paid by the State as part of the State's general operating budget. The

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foregoing financial conditions and constitutional provisions could affect the ability of the State to pay rentals to the Authority and thus adversely affect payment of the State Building Authority Bonds.

The Portfolio may contain general obligation bonds of local units pledging the full faith and credit of the local unit which are payable from the levy of ad valorem taxes on all taxable property within the jurisdiction of the local unit. If the general obligation bonds were issued on or before December 22, 1978, or if issued thereafter and approved by a majority vote of the electors of the local unit, the local unit has the right and the duty to impose ad valorem taxes for debt service without limitation as to rate or amount. If the obligations were issued after December 22, 1978, and not approved by the electors of the local unit, then the right and duty of the local unit to levy taxes is limited to taxes levied within charter, statutory or constitutional tax rate limitations applicable to that local unit and taxes may not be levied for debt service in excess of those limitations. For those limited tax obligations, no assurance can be given that if the taxing power is not sufficient to meet debt service and operating requirements, a court might not require the taxes be applied first to the operations of the local unit and then to the payment of debt service on the general obligations. The ability of the local unit to pay debt service commitments out of the ad valorem taxes levied for such purposes may be adversely affected by a larger than anticipated delinquency in the rate of tax collection or as a result of an administrative or judicial delay in the time for collection of ad valorem tax assessments. In addition, several major industrial corporations have instituted challenges of their ad valorem property tax assessments in a number of local municipal units in the State. If successful, such challenges may have an adverse impact on the ad valorem tax bases, which could adversely affect the ability of the local taxing unit to raise funds for operating and debt service requirements.

The Portfolio may contain obligations issued by various school districts pledging the full faith and credit of the school district. The ability of the school district to pay debt service may be adversely affected by those factors described above for general obligation bonds and, if the obligations were not voted by that school's electors by the restructuring of school operating funding as described above. The school district obligations also may be qualified for participation in the Michigan School Bond Loan Fund. If the bonds are so qualified, then in the event the school district is for any reason unable to pay its debt service commitments when due, the school district is required to borrow the deficiency from the School Bond Loan Fund and the State is required to make the loan. The School Bond Loan Fund is funded by means of debt obligations issued by the State. In the event of fiscal and cash flow difficulties of the State the availability of sufficient cash or the ability of the State to sell debt obligations to fund the School Bond Loan Fund may be adversely affected and this could adversely affect the ability of the State to make loans it is required to make to school districts issuing qualified school bonds in the event the school district's tax levies are insufficient therefor.

The Portfolio may contain obligations issued in the past fifteen years during periods in which interest rates were higher than at present. To the extent such obligations are callable prior to maturity the issuer may elect to redeem the obligations in order to realize substantial savings in debt service.

#### MICHIGAN TAXES

In the opinion of Miller, Canfield, Paddock and Stone, Detroit, Michigan, special counsel on Michigan tax matters, under existing Michigan law:

The Michigan Trust and the owners of Units will be treated for purposes of the Michigan income tax laws and the Single Business Tax in substantially the same manner as they are for purposes of Federal income tax laws, as currently enacted. Accordingly, we have relied upon the opinion of Messrs. Davis, Polk & Wardwell as to the applicability of Federal income tax under the Internal Revenue Code of 1986, as amended, to the Michigan Trust and the Holders of Units.

Under the income tax laws of the State of Michigan, the Michigan Trust is not an association taxable as a corporation; the income of the Michigan Trust will be treated as the income of the Holders of Units of the Michigan Trust and be deemed to have been received by them when received by the Michigan Trust. Interest on the Debt Obligations in the Michigan Trust which is exempt from tax under the Michigan income tax laws when received by the Michigan Trust will retain its status as tax exempt interest to the Holders of Units of the Michigan Trust.

For purposes of the Michigan income tax laws, each Holder of Units of the Michigan Trust will be considered to have received his pro rata share of interest on each Debt Obligation in the

Michigan Trust when it is received by the Michigan Trust, and each Holder will have a taxable event when the Michigan Trust disposes of a Debt Obligation (whether by sale, exchange, redemption or payment at maturity) or when the Unit Holder redeems or sells his Unit, to the extent the

transaction constitutes a taxable event for Federal income tax purposes. The tax cost of each Unit to a Unit Holder will be established and allocated for purposes of the Michigan income tax laws in the same manner as such cost is established and allocated for Federal income tax purposes.

Under the Michigan intangibles tax, the Michigan Trust is not taxable and the pro rata ownership of the underlying Debt Obligations, as well as the interest thereon, will be exempt to the Holders of Units to the extent the Michigan Trust consists of obligations of the State of Michigan or its political subdivisions or municipalities or obligations of the Government of Puerto Rico, or of any, other possession, agency or instrumentality of the United States.

The Michigan Single Business Tax replaced the tax on corporate and financial institution income under the Michigan Income Tax, and the intangibles tax with respect to those intangibles of persons subject to the Single Business Tax the income from which would be considered in computing the Single Business Tax. Persons are subject to the Single Business Tax only if they are engaged in 'business activity', as defined in the Act. Under the Single Business Tax, both interest received by the Michigan Trust on the underlying Debt Obligations and any amount distributed from the Michigan Trust to a Unit Holder, if not included in determining taxable income for Federal income tax purposes, is also not included in the adjusted tax base upon which the Single Business Tax is computed, of either the Michigan Trust or the Unit Holders. If the Michigan Trust or the Unit Holders have a taxable event for Federal income tax purposes, when the Michigan Trust disposes of a Debt Obligation (whether by sale, exchange, redemption or payment at maturity) or the Holder redeems or sells his Unit, an amount equal to any gain realized from such taxable event which was included in the computation of taxable income for Federal income tax purposes (plus an amount equal to any capital gain of an individual realized in connection with such event but deducted in computing that individual's Federal taxable income) will be included in the tax base against which, after allocation, apportionment and other adjustments, the Single Business Tax is computed. The tax base will be reduced by an amount equal to any capital loss realized from such a taxable event, whether or not the capital loss was deducted in computing Federal taxable income in the year the loss occurred. Holders should consult their tax advisor as to their status under Michigan law.

In rendering the above Opinion, special Michigan counsel also advises that, as the Tax Reform Act of 1986 eliminates the capital gain deduction for tax years beginning after December 31, 1986, the Federal adjusted gross income, the computation base for the Michigan income tax, of a Unit Holder will be increased accordingly to the extent such capital gains are realized when the Michigan Trust disposes of a Debt Obligation or when the Unit Holder redeems or sells a Unit, to the extent such transaction constitutes a taxable event for Federal income tax purposes.

#### THE MINNESOTA TRUST

RISK FACTORS--The State of Minnesota and other governmental units and agencies, school systems and entities dependent on government appropriations or economic activity in Minnesota have, in recent years, suffered cash deficiencies and budgetary difficulties due to changing economic conditions. Similar unfavorable economic trends, such as a renewed recession, and other factors described below could adversely affect the Debt Obligations and the value of the Portfolio.

Recessions in the national economy and other factors have had an adverse impact on the economy of Minnesota and State budgetary balances. As a consequence, during the budgetary bienniums ended in 1981, 1983, 1987, 1991 and 1993, the State found it necessary to revise revenue forecasts downward and the State legislature was required to take remedial action to bring the State's budget into balance on a number of occasions. The State is constitutionally required to maintain a balanced budget.

In 1991 the legislature prepared a budget for the 1991-1993 biennium which provided for a \$15.1 billion general fund budget, including expenditures of \$14.6 billion, with maintenance of a budgetary reserve at \$400 million and a projected unrestricted balance of \$100 million. Primarily as a consequence of the recession, in February 1992 the Department of Finance projected a budgetary

shortfall of \$569 million by the end of the 1991-1993 biennium. In response, the legislature enacted \$262 million in expenditure reductions, \$149 million in revenue increases and a \$160 million drawdown of the budgetary reserve to bring the budget into projected balance at the end of the biennium with a budgetary reserve of \$240 million remaining. Improving revenues in late 1992 and early 1993 led to the adoption of minor budgetary revisions by the legislature, resulting in an increase in the budgetary reserve to \$360 million and an additional unrestricted balance of \$195 million at the end of the biennium on June 30, 1993.

Addressing the 1993-1995 biennium, the 1993 legislative session, including a special session called to resolve budgetary differences between the Governor and legislature following appropriation vetoes, enacted revenue and expenditure proposals which provided for revenues of \$16.2 billion, expenditures of \$16.5 billion and maintenance of the budgetary reserve at \$360 million. The major revenue increase was in the health care provider tax. The principal expenditure increases were for elementary and secondary education and health and human services. In November 1993 the Department of Finance reported that increased income tax receipts and lower spending resulted in an improvement in estimates used for budgetary purposes. Under current law any excess revenue would initially be used to increase the budgetary reserve and the disposition of any additional amounts would become the subject of legislative debate.

Authorizations for bonding to support capital expenditures have raised concern about the cost of debt service and the capacity of the State to authorize additional major bonding. The legislature has directed a portion of receipts from the State's lottery to assist in servicing bonded debt. The total of State general obligation bonds outstanding as of November 1, 1993 was approximately \$1.8 billion.

Economic and budgetary difficulties could require the State, its agencies, local units of government, schools and other instrumentalities which depend for operating funds and debt service on State revenues or appropriations or on other sources of revenue which may be affected by economic conditions to expand revenue sources or curtail services or operations in order to meet payments on their obligations. The Sponsors are unable to predict whether or to what extent adverse economic conditions may affect the State, other units of government, State agencies, school districts and other affected entities and the impact thereof on the ability of issuers of Debt Obligations in the Portfolio to meet payment obligations. To the extent any difficulties in making payment are perceived, the market value and marketability of Debt Obligations in the Portfolio, the asset value of the Minnesota Trust and interest income to the Minnesota Trust could be adversely affected.

In action related to the budgetary and funding difficulties experienced by the State during the 1980-1983 recession, Standard & Poor's reduced its rating on the State's outstanding general obligation bonds from AAA to AA+ in August 1981 and to AA in March 1982. Moody's lowered its rating on the State's outstanding general obligation bonds from Aaa to Aa in April 1982. In January 1985, Standard & Poor's announced an upgrading in its rating for the State's outstanding general obligation bonds from AA to AA+. The AA+ and Aa ratings were applied most recently to the State's issuance of \$92 million in general obligation refunding bonds dated November 1, 1993.

Certain issuers of obligations in the State, such as counties, cities and school districts, rely in part on distribution, aid and reimbursement programs allocated from State revenues and other governmental sources for the funds with which to provide services and pay those obligations. Accordingly, legislative decisions and appropriations have a major impact on the ability of such governmental units to make payments on any obligations issued by them. In addition, certain State agencies, such as the Minnesota Housing Finance Agency, University of Minnesota, Minnesota Higher Education Coordinating Board, Minnesota State University Board, Minnesota Higher Education Facilities Authority, Minnesota State Armory Building Commission, Minnesota State Zoological Board, Minnesota Rural Finance Authority, Minnesota Public Facilities Authority, Minnesota Agricultural and Economic Development Board and Iron Range Resources and Rehabilitation Board, also issue bonds which generally are not debts of the State. The payment of these obligations is generally subject to revenues generated by the agencies themselves, the projects funded or discretionary appropriations of the legislature. The particular source of payment and security is detailed in the instruments themselves and related offering materials. In one instance, after default by the Minnesota State Zoological Society in installment payments supporting tax-exempt certificates of participation

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issued to construct a monorail system, the legislature refused to appropriate funds to supply the deficiency. A subsequent decision of the Minnesota Supreme Court sustained the legislature's position that no State obligation had been created.

The State is also a party to other litigation in which a contrary decision could adversely affect the State's tax revenues or fund balances, the most significant of which are as follows. First, based upon a decision of the United States Supreme Court in a similar Tennessee case, a Minnesota District Court held the Minnesota excise tax on banks, which taxes interest on federal obligations but exempts interest paid on State political subdivision obligations, to be unconstitutional. The court also found that the tax was an improper income tax rather than a franchise tax. The taxes in suit, for the years 1979-1983, have been estimated to be \$188 million. Including years subsequent to 1983 total refund claims could exceed \$300 million. On appeal, the Minnesota Supreme Court affirmed the District Court's finding that the tax was discriminatory but reversed findings that the tax was an income tax and that the plaintiffs were entitled to refunds. The United States Supreme Court vacated the

judgment of the Minnesota Supreme Court and remanded the case for further consideration in light of a recent United States Supreme Court decision which held that an earlier tax decision should apply retroactively to claims arising on facts antedating such earlier decision. The Minnesota Supreme Court reaffirmed its earlier decision, the plaintiffs filed a petition for further review by the United States Supreme Court and the United States Supreme Court again vacated the Minnesota Supreme Court decision and remanded the case to the Minnesota Supreme Court for reconsideration in light of another recent United States Supreme Court decision. Further proceedings are anticipated. Second, the State's corporate alternative minimum tax in effect from 1987 to 1989 has been challenged on constitutional grounds. Taxes collected under the law amounted to approximately \$160 million. Third, the Minnesota charitable gambling tax has also been challenged on constitutional grounds. The Minnesota Tax Court and Supreme Court held the tax to be constitutional. The plaintiffs have requested review by the United States Supreme Court. Refund claims could exceed \$26 million per tax year. Fourth, retired federal employees have filed suit for a declaratory judgment that a portion of their pension distributions are not subject to tax in Minnesota. A State District Court ruled that refunds were due to the plaintiffs. The Minnesota Supreme Court reversed the District Court. A petition for review by the United States Supreme Court is possible. An adverse decision could result in substantial refunds and a revenue loss of \$8 million per year to the State. Fifth, a case has been filed claiming a regulatory taking of property based on a denial of a permit to fill property for development. The amount sought is \$8 million but an adverse decision could establish a precedent for additional substantial claims. Sixth, a corporate plaintiff has filed an action seeking substantial tax refunds, potentially exceeding \$10 million, alleging improprieties in the computation and collection of taxes from 1974 through 1981. Adverse decisions in the foregoing and other cases which individually or collectively may exceed several million dollars in amount could require extraordinary appropriations or expenditure reductions and could have a material adverse effect on the financial condition of the State, its agencies or subdivisions. The Sponsors are unable to make any prediction concerning the ultimate outcome or impact of decisions in these cases.

#### MINNESOTA TAXES

In the opinion of Doherty, Rumble & Butler Professional Association, Minneapolis, Minnesota, special counsel on Minnesota tax matters, under existing Minnesota law:

The Minnesota Trust is not an association taxable as a corporation for Minnesota income tax purposes. Minnesota imposes its income tax on the taxable net income of individuals, estates and trusts resident in Minnesota and on certain nonresident taxpayers having activities or contacts within Minnesota. Taxable net income is the portion of a taxpayer's Federal taxable income (subject to certain variations and determined pursuant to the Internal Revenue Code as amended through December 31, 1992) which is properly allocable to Minnesota. Exclusion from 'taxable net income' for Minnesota income tax purposes for individuals, trusts and estates of interest on most obligations of the State of Minnesota, its political and governmental subdivisions, municipalities, and governmental agencies and instrumentalities depends on the availability of a Federal exclusion.

Each Holder of Units in the Minnesota Trust which is an individual, trust or estate resident in Minnesota will be treated as the owner of a proportionate, undivided interest in the Minnesota

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Trust, and the income of the Minnesota Trust will be treated as the income of such Holders for Minnesota income tax purposes. Accordingly, interest on Debt Obligations held by the Minnesota Trust which would be exempt from Federal and Minnesota income taxation when paid directly to an individual, trust or estate will be exempt from Minnesota income taxation with respect to such Holders when received by the Minnesota Trust and distributions of the proceeds of interest received by the Minnesota Trust on such Debt Obligations will not be a taxable event under Minnesota law.

Holders of Units of the Minnesota Trust which are individuals, trusts or estates resident in Minnesota will be required to recognize any taxable gain or loss realized on the disposition of a Debt Obligation by the Minnesota Trust (whether by sale, exchange, redemption or payment at maturity) or upon the disposition by the Holder of Units.

Taxable income for corporations under Minnesota law is computed on the basis of Federal law with certain modifications. Interest on bonds issued by the State of Minnesota and its subdivisions, municipalities, agencies and instrumentalities is generally not exempt from Minnesota taxes measured by corporate income. Accordingly, no opinion is given with respect to the Minnesota tax effects of an investment in the Minnesota Trust by corporations.

The Units of the Minnesota Trust and any of the Debt Obligations held in the Minnesota Trust are not subject to any property taxes imposed by Minnesota or its state and local subdivisions. The Units of the Minnesota Trust, however, will be subject to the Minnesota estate tax if held by an

individual who is domiciled in Minnesota at death. Investors should consult with their own personal tax advisors concerning any potential Minnesota estate tax liability.

#### THE MISSISSIPPI TRUST

RISK FACTORS--The financial condition of the State may be affected by international, national and regional economic, political and environmental conditions beyond the State's control, which in turn could affect the market value and income of the obligations of the Mississippi Trust and could result in a default with respect to such obligations. The following information constitutes a brief summary of certain legal, governmental, budgetary and economic matters of the State which may or may not affect the financial situation in Mississippi, but does not purport to be a complete listing or description of all such factors. None of the following information is relevant to Puerto Rico or Guam Debt Obligations which may be included in the Mississippi Trust. Such information was compiled from publicly available information as well as from oral statements from various State agencies. Although the Sponsors and their counsel have not verified the accuracy of the information, they have no reason to believe that such information is not correct.

Budgetary and Economic Matters. The State operates on a fiscal year beginning July 1 and ending June 30, with budget preparations beginning on approximately August 1, when all agencies requesting funds submit budget requests to the Governor's Budget Office and the Legislative Budget Office. The budgets, in the form adopted by the legislature, are implemented by the Department of Finance and Administration.

State operations are funded by General Fund revenues and Special Fund receipts. For the fiscal year ending June 30, 1993, \$3.84 billion in revenues were collected by the Special Fund. The major source of such receipts was \$2.2 billion from federal grants-in-aid, including \$1.2 billion for public health and welfare and \$383.9 million for public education.

The General Fund revenues are derived principally from sales, income, corporate and excise taxes, profits from wholesale sales of alcoholic beverages, interest earned on investments, proceeds from sales of various supplies and services, and license fees. For the fiscal year ending June 30, 1993, of the \$2.47 billion in General Fund receipts, sales taxes accounted for 42.0%, individual income taxes for 26.3%, and corporate income taxes for 9.8%. Sales taxes, the largest source of General Fund revenues, can be adversely affected by downturns in the economy. Total sales tax collections for fiscal year 1993 were \$47.7 million over 1992 fiscal year collections. In an effort to increase revenues, the legislature increased the State sales tax from 6% to 7%, effective as of June 1, 1992.

Mississippi's recent legalization of dockside gaming is having a significant impact on the State's revenues. As of December 31, 1993, seventeen dockside casinos had opened in the State and

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approximately 8 more are projected to be in operation by July of 1994. During calendar year 1993 gaming license fees and tax revenues for the State amounted to \$57.25 million.

Each year the legislature appropriates all General Fund and most Special Fund expenditures. Those Special Funds that are not appropriated by the legislature are subject to the approval of the Department of Finance and Administration. In the fiscal year ending June 30, 1993, 54.4% of the General Fund was expended on public and higher education. The areas of public health and public works were the two largest areas of expenditures from the Special Fund. The Education Enhancement Fund collections (funded from the 1% increase in sales taxes) totalled nearly \$126 million. These funds are appropriated by the Legislature for educational purposes.

The Department of Finance and Administration has the authority to reduce allocations to agencies if revenues fall below the amounts projected during the budgeting phase and may also, in its discretion, restrict a particular agency's monthly allotment if it appears that an agency may deplete its appropriations prior to the close of the fiscal year. Despite budgetary controls, the State has experienced cash flow problems in the past. In the 1991 fiscal year, because State revenue collections fell below projections and due to a General Fund cash balance on July 1, 1991 below expectations, across-the-board budget reductions totaling approximately \$85.1 million were suffered by State agencies to avoid a year-end deficit. In fiscal year 1992, total revenue collections were nearly \$48 million below projections. As a result of this shortfall, State agencies were forced to implement an estimated 3.5% cut in their respective budgets. However, collections are improving as fiscal year 1993 revenue collections were nearly \$154.5 million or 7.75% above projections, and year to date fiscal year 1994

general fund revenues are running 15% above projection as of 1/31/94.

The population of Mississippi grew by 2.1% between 1980 and 1990. Despite this growth, Mississippi continues to rank 31st among the 50 states, with a population of 2.6 million people. In 1993, the average State unemployment rate was 6.2%, a marked improvement over the state's 1992 level of 8.1%.

The 1993 average numbers show that the manufacturing sector of the economy, the largest employer in the State, employed approximately 252,100 persons or 24.8% of the total nonagricultural employment. Within the manufacturing sector, the three leading employers by product category were the apparel industry, the food products industry, and the furniture industry. The average employment for these industries was 32,500, 30,800 and 26,600, respectively. The average number of persons employed by the agricultural sector of the State's labor force declined from 129,300 in 1960 to 24,100 for June 1993. However, agriculture contributes significantly to the State's economy as agriculture-related cash receipts amounted to \$2.65 billion for 1991. The State continues to be a large producer of cotton and, as a result of research and promotion, the agricultural sector has diversified into the production of cattle, poultry, catfish, rice, blueberries and muscadines.

Mississippi has not been without its setbacks, for instance, the NASA solid fuel rocket motor plant in Tishomingo County, which was originally scheduled to open in 1995 and expected to result in approximately 3,500 jobs was closed due to recent federal budget reduction.

Total personal income in Mississippi increased 37.2% from 1987 to 1992 to a level of approximately \$36.9 million as compared to a 35.4% increase for the United States during the same period. However, Mississippi's per capita income of \$14,088 in 1992 was well below the national average of \$19,841. The number of bankruptcies filed in Mississippi in 1993 was 10,188, a 15% decrease over the 1992 level of 12,004, but still much higher than the 1986 level of 6,839.

**Bonds.** The State, counties, municipalities, school districts, and various other districts are authorized to issue bonds for certain purposes. Mississippi has historically issued four types of bonds: general obligation, revenue, refunding and self-supporting general obligation. In the 1991 and 1992 fiscal years, the State issued general obligation and revenue bonds in amounts totaling \$100.54 million and \$127.57 million, respectively. In fiscal year 1993, the State issued bonds totalling approximately \$217 million, \$127.9 million of which were refund issues allowing the State to reduce interest rates on existing debt. The total bond indebtedness of the State has increased from a level of \$460.3 million on July 1, 1986 to \$696 million as of July 1, 1993.

The issuance of bonds must be authorized by legislation governing the particular project to be financed. Such legislation provides the State Bond Commission, comprised of the Governor as

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Chairman, the State Attorney General as Secretary and the State Treasurer as a member, with the authority to approve and authorize the issuance of bonds.

The general obligation bonds of the State are currently rated Aa by Moody's Investors Service, Inc. and AA-by Standard and Poor's Corporation. There can be no assurance that the conditions such ratings are based upon will continue or that such ratings will not be revised downward or withdrawn entirely by either or both agencies.

**Litigation.** The Attorney General's Office has reviewed the status of cases in which the State is a defendant wherein the obligations of the State's financial resources may be materially adversely affected. The following cases, though not an entire list, are a representative sampling of the most significant cases which could materially affect the State's financial position: (1) a suit against the Mississippi Department of Archives and History alleging discrimination; (2) two actions on the constitutionality of the State income tax on state retirement benefits; (3) an action against the State and certain public officials challenging the constitutionality of the Statewide system of higher education; and (4) an action against the State Tax Commission challenging the apportionment formula for taxation of multi-state corporations.

**Summary.** The financial condition of the State of Mississippi may be affected by numerous factors, most of which are not within the control of the State or its subdivisions. The Sponsors are unable to predict to what extent, if any, such factors would affect the ability of the issuers of the Debt Obligations to meet payment requirements.

#### MISSISSIPPI TAXES

In the opinion of Butler, Snow, O'Mara, Stevens & Cannada, Jackson, Mississippi, special counsel on Mississippi tax matters, under existing Mississippi law:

1. The Mississippi Trust will be classified, for purposes of the Mississippi income tax, as a grantor trust, not as an association taxable



as a corporation.

2. The Mississippi Trust will not, itself, be subject to the Mississippi income tax. All of the interest income, gains, and losses realized and expenses paid by the Mississippi Trust will be deemed, for purposes of the Mississippi income tax, to have been realized and paid directly by the Holders, in proportion to their Units.

3. The Holders will not be subject to the Mississippi income tax on interest income realized by the Mississippi Trust on obligations of the United States or its possessions, or on securities issued under the provisions of the Federal Farm Loan Act of July 17, 1916, or on bonds issued by the War Finance Corporation, or on obligations of the State of Mississippi or its political subdivisions.

4. The holders who are individuals residing within or corporations organized, located and operating solely within the State of Mississippi will take into account for Mississippi income tax purposes their respective proportionate shares of (a) the interest income, other than that described in Paragraph 3 above, realized and expenses paid by the Mississippi Trust and (b) the gains and losses realized by the Mississippi Trust on the sale or exchange or other disposition of its assets. The Holders who are individuals or corporations but are not described in the preceding sentence will take into account for Mississippi income tax purposes those items of interest income and expenses and those gains and losses in accordance with the Mississippi principles of multistate taxation of individuals and corporations.

5. The Holders will not be subject to the Mississippi income tax on any distribution from the Mississippi Trust, except for a distribution in redemption or sale of Units. In a redemption or sale of Units, the Holders will be deemed to have sold, for the amount realized from the redemption or sale, as the case may be, their proportionate respective shares of each asset in the Mississippi Trust. The extent to which the Holders will take into account for the Mississippi income tax purposes their gains and losses from the redemption or sale of Units will depend upon whether they are individuals or corporations and upon what nexus they have with the State of Mississippi, as discussed in Paragraph 4 above.

6. The State of Mississippi imposes no gift tax.

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7. The Units of the Holders who are individuals residing within the State of Mississippi will be subject, upon the deaths of those Holders, to the Mississippi estate tax.

8. The Units of the Holders who are individuals residing without the State of Mississippi will not be subject, upon the deaths of those Holders, to the Mississippi estate tax.

9. No political subdivision of the State of Mississippi imposes any income, gift, or estate tax.

10. Neither the Units nor the assets of the Mississippi Trust will be subject to an ad valorem tax imposed by the State of Mississippi or any of its political subdivisions.

#### THE MISSOURI TRUST

RISK FACTORS--Hancock Amendment. Article X, Sections 16-24 of the Constitution of Missouri, often referred to as the Hancock Amendment (the 'Hancock Amendment'), imposes limitations on the amount of State taxes which may be imposed by the General Assembly of Missouri (the 'General Assembly') as well as on the amount of local taxes, licenses and fees (including taxes, licenses and fees used to meet debt service commitments on debt obligations) which may be imposed by local governmental units (such as cities, counties, school districts, fire protection districts and other similar bodies) in the State of Missouri in any fiscal year.

The State limit is tied to total State revenues for fiscal year 1980-81, as defined in the Hancock Amendment, adjusted annually in accordance with the formula set forth in the amendment, which adjusts the limit based on increases in the average personal income of Missouri for certain designated periods. The details of the amendment are complex and clarification from subsequent legislation and further judicial decisions may be necessary. If the total State revenues exceed the State revenue limit imposed by Section 18 of Article X by more than one percent, the State is required to refund the excess. The Hancock Amendment does not prohibit the increasing of taxes by the State so long as State revenues are expected to amount to less than the revenue limit and authorizes exceeding the limit if, upon the request of the Governor, the General Assembly declares an emergency by a two thirds vote. Under the emergency provisions, the revenue limit may be exceeded only in the fiscal year during which the emergency was declared, and the emergency must be declared prior to incurring expenses which constitute part of the emergency request. The State

revenue limitation imposed by the Hancock Amendment also does 'not apply to taxes imposed for the payment of principal and interest on bonds, approved by the voters' and authorized by the Missouri Constitution. The revenue limit can also be exceeded by a constitutional amendment authorizing new or increased taxes or revenues adopted by the voters of the State of Missouri.

The Hancock Amendment further provides that the state financed proportion of the costs of any existing activity or service required of counties and other political subdivisions cannot be reduced. In addition, State government expenses cannot exceed the sum of the State's revenues (limited as described above) plus Federal funds and any surplus from a previous fiscal year.

Section 22(a) of Article X of the Missouri Constitution sets forth the limitation on new taxes, licenses and fees and increases in taxes, licenses and fees by local governmental units in Missouri. It prohibits counties and other political subdivisions (essentially all local governmental units) from levying new taxes, licenses and fees or increasing the current levy of an existing tax, license or fee 'without the approval of the required majority of the qualified voters of that county or other political subdivision voting thereon.'

If the required majority of qualified electors voting on the issuance of debt obligations approves the issuance of the debt obligations and the levy of taxes or impositions of licenses or fees necessary to meet the payments of principal and interest on such debt obligations, taxes, licenses or fees may be imposed or existing taxes, licenses or fees may be increased to cover the principal and interest on such debt obligations without violating the Hancock Amendment. Missouri Constitutional or statutory provisions other than the Hancock Amendment may require greater than majority voter approval for valid issuance of certain debt obligations.

Taxes may also be increased by counties and other political subdivisions (but not by the State), without regard to the limitations of the Hancock Amendment, for the purpose of paying principal and interest on bonds, other evidences of indebtedness, and obligations issued in anticipation of the

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issuance of bonds if such bonds and other obligations were authorized to be issued prior to the adoption of the Hancock Amendment.

When a local governmental unit's tax base with respect to certain fees or taxes is broadened, the Hancock Amendment requires the tax levy or fees to be reduced 'to yield the same estimated gross revenue as on the prior base.' It also effectively limits any percentage increase in property tax revenues to the percentage increase in the general price level (plus the value of new construction and improvements), even if the assessed valuation of property in the local governmental unit, excluding the value of new construction and improvements, increases at a rate exceeding the increase in the general price level.

To the extent that the payment of general obligation bonds issued by the State of Missouri or a unit of local government in the Portfolio is dependent on revenues from the levy of taxes and such obligations have been issued subsequent to the date of the Hancock Amendment's adoption, November 4, 1980, the ability of the State of Missouri or the appropriate local unit to levy sufficient taxes to pay the debt service on such bonds may be affected, unless there has been specific voter approval of the issuance of such bonds and the levy of such taxes as are necessary to pay the principal and interest on such bonds and obligations.

Debt obligations issued by certain State issuers, including those of the Board of Public Buildings of the State of Missouri and the Department of Natural Resources of the State of Missouri, are payable either solely or primarily from the rentals, incomes and revenues of specific projects financed with the proceeds of the debt obligations and are not supported by the taxing powers of the State or of the issuer of the bonds. The Hancock Amendment may most strongly affect state revenue bonds, since they are dependent in whole or in part on appropriations of the General Assembly to provide sufficient revenues to pay principal and interest. unless such bonds are approved by the voters of Missouri, under the Hancock Amendment, taxes cannot be raised to cover the state appropriations necessary to provide revenues to pay principal and interest on the bonds. Consequently, there may be insufficient state revenues available to permit the General Assembly to make appropriations adequate to enable the issuer to make timely payment of principal and interest on such State revenue bonds. For example, in the case of the Board of Public Buildings of the State of Missouri, the payment of principal and interest on debt obligations is dependent solely on the appropriation by the General Assembly of sufficient funds to pay the rentals of State agencies occupying buildings constructed by the Board of Public Buildings. State park revenue bonds of the Department of Natural Resources of the State of Missouri are in part dependent on revenues generated by operations of the particular project and in part on General Assembly appropriations. Consequently, payment of principal and interest on such State revenue bonds or other obligations, relating to specific projects and not supported by the taxing power of the State of Missouri, may not be made or may not be made in a timely fashion because of (i) the inability of the General

Assembly to appropriate sufficient funds for the payment of such debt obligations (or to make up shortfalls therein) due to the limitations on State taxes and expenditures imposed by the Hancock Amendment, (ii) the inability of the issuer to generate sufficient income or revenue from the project to make such payment or (iii) a combination of the above.

As described above, general obligation bonds and revenue bonds of local governmental units, including counties, cities and similar municipalities, sewer districts, school districts, junior college districts and other similar issuers, may also be affected by the tax, license and fee limitations of the Hancock Amendment. Unless the required voter approval of such debt obligations and the imposition of taxes to pay them is obtained prior to their issuance, the Hancock Amendment imposes limitations on the imposition of new taxes and the increase of existing taxes which may be necessary to pay principal and interest on general obligation bonds of local issuers. The limitations contained in the Hancock Amendment may also affect the payment of principal and interest on bonds and other obligations issued by local governmental units and supported by the revenues generated from user fees, licenses or other fees and charges, unless the requisite voter approval of the issuance of such bonds or other obligations, and the approval of the assessment of such fees or other charges as may be necessary to pay the principal and interest on such bonds or other obligations, has been obtained prior to their issuance.

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Debt obligations of certain other State and local agencies and authorities are not, by the terms of their respective authorizing statutes, obligations of the State or any political subdivision, public instrumentality or authority, county, municipality or other state or local unit of government. Illustrative of such issuers are the Missouri Housing Development Commission, the State Environmental Improvement and Energy Resources Authority, the Health and Educational Facilities Authority of the State of Missouri, the Missouri Higher Education Loan Authority, the Industrial Development Board of the State of Missouri, the Missouri Agricultural and Small Business Development Authority and other similar bodies organized on a local level under similar state authorizing statutes such as the various local industrial development authorities, planned industrial expansion authorities and land clearance for redevelopment authorities. The debt obligations of such issuers are payable only from the revenues generated by the project or program financed from the proceeds of the debt obligations they issue, and the Hancock Amendment has no application.

Industry and Employment. While Missouri has a diverse economy with a distribution of earnings and employment among manufacturing, trade and service sectors closely approximating the average national distribution, the national economic recession of the early 1980's had a disproportionately adverse impact on the economy of Missouri. During the 1970's, Missouri characteristically had a pattern of unemployment levels well below the national averages. However, since the 1980 to 1983 recession periods Missouri unemployment levels generally approximated or slightly exceeded the national average. A return to a pattern of high unemployment could adversely affect the Missouri debt obligations acquired by the Missouri Trust and, consequently, the value of the Units in the Trust.

The Missouri portions of the St. Louis and Kansas City metropolitan areas contain approximately 1,864,100 and 956,997 residents, respectively, constituting over fifty percent of Missouri's 1990 population census of approximately 5,079,385. St. Louis is an important site for banking and manufacturing activity, as well as a distribution and transportation center, with eight Fortune 500 industrial companies (as well as other major educational, financial, insurance, retail, wholesale and transportation companies and institutions) headquartered there. Kansas City is a major agribusiness center and an important center for finance and industry. Economic reversals in either of these two areas would have a major impact on the overall economic condition of the State of Missouri. Additionally, the State of Missouri has a significant agricultural sector which is experiencing farm-related problems comparable to those which are occurring in other states. To the extent that these problems were to intensify, there could possibly be an adverse impact on the overall economic condition of the State of Missouri.

Defense related business plays an important role in Missouri's economy. In addition to the large number of civilians employed at the various military installations and training bases in the State, aircraft and related businesses in Missouri are the recipients of substantial annual dollar volumes of defense contract awards. The contractor receiving the largest dollar volume of defense contracts in the United States in 1992 was McDonnell Douglas Corporation. McDonnell Douglas Corporation is the State's largest employer, currently employing approximately 25,800 employees in Missouri. Recent changes in the levels of military appropriations and the cancellation of the A-12 program has affected McDonnell Douglas Corporation in Missouri and over the last three years it has reduced its Missouri work force by approximately 30%. There can be no assurances there will not be further changes in the levels of military appropriations, and, to the extent that further changes in military appropriations are enacted by the United States Congress, Missouri could be disproportionately affected.

In the opinion of Bryan Cave, St. Louis, Missouri, special counsel on Missouri tax matters, under existing Missouri law:

For Missouri income tax purposes under Chapter 143 of the Missouri Revised Statutes, the Missouri Trust will be treated as having the same organizational characteristics as it is accorded for Federal income tax purposes. In reliance upon the opinion of Davis Polk & Wardwell, New York, New York, counsel to the Sponsors, the Missouri Trust is not an association taxable as a corporation under Missouri law, with the result that the income of the Missouri Trust will be deemed to be income of the Holders of the Units, and that each Holder of Units in the Missouri Trust will be treated as the owner

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of a proportionate, undivided interest in the Missouri Trust, and the income of the Missouri Trust will be treated as the income of such Holders.

Income, gains and losses from the Missouri Trust will be required to be reported as Missouri gross, adjusted gross, distributable or taxable income, gains or losses of individual, trust or corporate Holders of Units (and partners in partnerships which are Holders of Units) only when, and to the extent that such income (i) is included in Federal gross, adjusted gross or taxable income; (ii) is interest on certain governmental obligations excluded from Federal gross income by

Section 103 of the Internal Revenue Code of 1986, as amended, and is not interest on obligations of the State of Missouri or any of its political subdivisions or authorities or obligations issued by the Government of Puerto Rico or by its authority or by the Government of Guam or by its authority; or (iii) is not interest on obligations of the United States and its territories and possessions or of any authority, commission or instrumentality of the United States and its territories and possessions to the extent exempt from Missouri income taxes under the laws of the United States. Non-resident individual, trust or corporate Holders of Units (including non-resident partners in partnerships or non-resident beneficiaries of trusts which are Holders of Units) may also exclude income, gains and losses from the Missouri Trust from Missouri gross, adjusted gross, distributable or taxable income to the extent that such income is not from sources within Missouri.

#### THE NEW JERSEY TRUST

RISK FACTORS--Prospective investors should consider the recent financial difficulties and pressures which the State of New Jersey and certain of its public authorities have undergone.

The State's 1994 Fiscal Year budget became law on June 30, 1993.

The New Jersey State Constitution prohibits the legislature from making appropriations in any fiscal year in excess of the total revenue on hand and anticipated, as certified by the Governor. It additionally prohibits a debt or liability that exceeds 1% of total appropriations for the year, unless it is in connection with a refinancing to produce a debt service savings or it is approved at a general election. Such debt must be authorized by law and applied to a single specified object or work. Laws authorizing such debt provide the ways and means, exclusive of loans, to pay as it becomes due and the principal within 35 years from the time the debt is contracted. These laws may not be repealed until the principal and interest are fully paid. These Constitutional provisions do not apply to debt incurred because of war, insurrection or emergencies caused by disaster.

Pursuant to Article VIII, Section II, par. 2 of the New Jersey Constitution, no monies may be drawn from the State Treasury except for appropriations made by law. In addition, the monies for the support of State government and all State purposes, as far as can be ascertained, must be provided for in one general appropriation law covering one and the same fiscal year. The State operates on a fiscal year beginning July 1 and ending June 30. For example, 'fiscal 1994' refers to the year ended June 30, 1994.

In addition to the Constitutional provisions, the New Jersey statutes contain provisions concerning the budget and appropriation system. Under these provisions, each unit of the State requests an appropriation from the Director of the Division of Budget and Accounting, who reviews the budget requests and forwards them with his recommendations to the Governor. The Governor then transmits his recommended expenditures and sources of anticipated revenue to the legislature, which reviews the Governor's Budget Message and submits an appropriations bill to the Governor for his signature by July 1 of each year. At the time of signing the bill, the Governor may revise appropriations or anticipated revenues. That action can be reversed by a two-thirds vote of each House. No supplemental appropriation may be enacted after adoption of the act, except where there are sufficient revenues on hand or anticipated, as certified by the Governor, to meet the appropriation. Finally, the Governor may, during the course of the year, prevent the expenditure of various appropriations when revenues are below those anticipated or when he determines that such expenditure is not in the best interest of the State.

By the beginning of the national recession, construction activity had already been declining in New Jersey for nearly two years. As the rapid acceleration of real estate prices forced many would-be homeowners out of the market and high non-residential vacancy rates reduced new commitments for

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offices and commercial facilities, construction employment began to decline; also growth had tapered off markedly in the service sectors and the long-term downtrend of factory employment had accelerated, partly because of a leveling off of industrial demand nationally. The onset of recession caused an acceleration of New Jersey's job losses in construction and manufacturing, as well as an employment downturn in such previously growing sectors as wholesale trade, retail trade, finance, utilities and trucking and warehousing.

The economic recovery is likely to be slow and uneven in both New Jersey and the nation. Some sectors, like commercial and industrial construction, will undoubtedly lag because of continued excess capacity. Also, employers in rebounding sectors can be expected to remain cautious about hiring until they become convinced that improved business will be sustained. Other firms will continue to merge or downsize to increase profitability. As a result, job gains will probably come grudgingly and unemployment will recede at a correspondingly slow pace.

The State has made appropriations for principal and interest payments for general obligation bonds for Fiscal Years 1990 through 1993 in the amounts of \$372.1 million and \$388.5 million and \$410.6 million and \$444.3 million, respectively. For Fiscal Year 1994, the State has made appropriations of \$119.9 million for principal and interest payments for general obligation bonds. Of the \$15,490.0 million appropriated in Fiscal Year 1994 from the General Fund, the Property Tax Relief Fund, the Gubernatorial Elections Fund, the Casino Control Fund and the Casino Revenue Fund, \$6,562.0 million (42.3%) was appropriated for State Aid to Local Governments, \$3,789.6 million (24.5%) is appropriated for Grants-in-Aid, \$4,574.6 million (29.6%) for Direct State Services, \$119.9 million (0.7%) for Debt Service on State general obligation bonds and \$443.9 million (2.9%) for Capital Construction.

State Aid to Local Governments was the largest portion of Fiscal Year 1994 appropriations. In Fiscal Year 1994, \$6,562 million of the State's appropriations consisted of funds which are distributed to municipalities, counties and school districts. The largest State Aid appropriation, in the amount of \$4,824.1 million, is provided for local elementary and secondary education programs. Of this amount, \$2,538.2 million was provided as foundation aid to school districts by formula based upon the number of students and the ability of a school district to raise taxes from its own base. In addition, the State provided \$582.5 million for special education programs for children with disabilities. A \$293.0 million program was also funded for pupils at risk of educational failure, including basic skills improvement. The State appropriated \$767.2 million on behalf of school districts as the employer share of the teachers' pension and benefits programs, \$263.8 million to pay for the cost of pupil transportation and \$57.4 million for transition aid, which guaranteed school districts a 6.5% increase over the aid received in Fiscal Year 1991 and is being phased out over four years.

Appropriations to the Department of Community Affairs totalled \$650.4 million in State Aid monies for Fiscal Year 1994. The principal programs funded were the Supplemental Municipal Property Tax Act (\$365.7 million); the Municipal Revitalization Program (\$165.0 million); municipal aid to urban communities to maintain and upgrade municipal services (\$40.4 million); and the Safe and Clean Neighborhoods Program (\$58.9 million). Appropriations to the State Department of the Treasury totalled \$312.5 million in State Aid monies for Fiscal Year 1994. The principal programs funded by these appropriations were payments under the Business Personal Property Tax Replacement Programs (\$158.7 million); the cost of senior citizens, disabled and veterans property tax deductions and exemptions (\$41.7 million); aid to densely populated municipalities (\$33.0 million); Municipal Purposes Tax Assistance (\$30.0 million); and payments to municipalities for services to state owned property (\$34.9 million).

Other appropriations of State Aid in Fiscal Year 1994 include welfare programs (\$477.4 million); aid to county colleges (\$114.6 million); and aid to county mental hospitals (\$88.8 million).

The second largest portion of appropriations in Fiscal Year 1994 is applied to Direct State Services: the operation of State government's 19 departments, the Executive Office, several commissions, the State Legislature and the Judiciary. In Fiscal Year 1994, appropriations for Direct State Services aggregated \$4,574.6 million. Some of the major appropriations for Direct State Services during Fiscal Year 1994 are detailed below.

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\$602.3 million was appropriated for programs administered by the Department of Human Services. Of that amount, \$448.2 million was appropriated for mental health and mental retardation programs, including the operation of seven

psychiatric institutions and nine schools for the retarded.

The Department of Labor is appropriated \$51.4 million for the administration of programs for workers' compensation, unemployment and disability insurance, manpower development, and health safety inspection.

The Department of Health is appropriated \$37.6 million for the prevention and treatment of diseases, alcohol and drug abuse programs, regulation of health care facilities, and the uncompensated care program.

\$673.0 million is appropriated to the Department of Higher Education for the support of eight State colleges, Rutgers University, the New Jersey Institute of Technology, and the University of Medicine and Dentistry.

\$932.6 million is appropriated to the Department of Law and Public Safety and the Department of Corrections. Among the programs funded by this appropriation were the administration of the State's correctional facilities and parole activities, the registration and regulation of motor vehicles and licensed drivers and the investigative and enforcement activities of the State Police.

\$99.8 million is appropriated to the Department of Transportation for the various programs it administers, such as the maintenance and improvement of the State highway system and subsidies for railroads and bus companies.

\$156.4 million is appropriated to the Department of Environmental Protection for the protection of air, land, water, forest, wildlife and shellfish resources and for the provision of outdoor recreational facilities.

The primary method for State financing of capital projects is through the sale of the general obligation bonds of the State. These bonds are backed by the full faith and credit of the State. tax revenues and certain other fees are pledged to meet the principal and interest payments required to pay the debt fully. No general obligation debt can be issued by the State without prior voter approval, except that no voter approval is required for any law authorizing the creation of a debt for the purpose of refinancing all or a portion of outstanding debt of the State, so long as such law requires that the refinancing provide a debt service savings.

In addition to payment from bond proceeds, capital construction can also be funded by appropriation of current revenues on a pay-as-you-go basis. This amount represents 2.9 percent of the total budget. In fiscal 1994, the amount is \$166.4 million for transportation projects.

The aggregate outstanding general obligation bonded indebtedness of the State as of June 30, 1993 was \$3,549.7 billion. The debt service obligation for outstanding indebtedness is \$119.9 million for fiscal year 1994.

All appropriations for capital projects and all proposals for State bond authorizations are subject to the review and recommendation of the New Jersey Commission on Capital Budgeting and Planning. This permanent commission was established in November, 1975, and is charged with the preparation of the State Capital Improvement Plan, which contains proposals for State spending for capital projects.

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 Tort Claims Act N.J.S.A. 59:1-1 et seq. In addition, at any given time there are various contract claims against the State and State agencies seeking recovery of monetary damages. The State is unable to estimate its exposure for these claims and cases. An independent study estimated an aggregate potential exposure of \$50 million for tort claims pending, as of January 1, 1982. It is estimated that were a similar study made of claims currently pending the amount of estimated exposure would be higher. Moreover, New Jersey is involved in a number of other lawsuits in which adverse decisions could materially affect revenue or expenditures. Such cases include challenges to its system of educational funding, the methods by which the State Department of Human Services shares

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with county governments the maintenance recoveries and costs for residents in state psychiatric hospitals and residential facilities for the developmentally disabled.

Other lawsuits, that could materially affect revenue or expenditures include a suit by a number of taxpayers seeking refunds of taxes paid to the Spill Compensation Fund pursuant to NJSA 58:10-23.11, a suit alleging that unreasonably low Medicaid payment rates have been implemented for long-term care facilities in New Jersey, a suit alleging unfair taxation on interstate commerce, a suit by Essex County seeking to invalidate the State's method of funding the judicial system and a suit seeking return of moneys paid by various counties for maintenance of Medicaid or Medicare eligible residents of institutions and facilities for the developmentally disabled and a suit challenging the imposition of premium tax surcharges on insurers doing business

in New Jersey, and assessments upon property and casualty liability insurers pursuant to the Fair Automobile Insurance Reform Act.

Legislation enacted June 30, 1992, called for revaluation of several public employee pension funds, authorized an adjustment to the assumed rate of return on investment and refunds \$773 million in public employer contributions to the State from various pension funds, reflected as a revenue source for Fiscal Year 1992 and \$226 million in Fiscal Year 1993 and each fiscal year thereafter. Several labor unions filed suit seeking a judgment directing the State Treasurer to refund all monies transferred from the pension funds and paid into the General Fund. An adverse determination would have a significant impact on Fiscal Years 1992 and 1993 revenue estimates.

Bond Ratings--Citing a developing pattern of reliance on non-recurring measures to achieve budgetary balance, four years of financial operations marked by revenue shortfalls and operating deficits, and the likelihood that financial pressures will persist, on August 24, 1992 Moody's lowered from Aaa to Aa1 the rating assigned to New Jersey general obligation bonds. On July 6, 1992, Standard & Poor's affirmed its AA+ ratings on New Jersey's general obligation and various lease and appropriation backed debt, but its ratings outlook was revised to negative for the longer term horizon (beyond four months) for resolution of two items cited in the Credit Watch listing: (i) the Federal Health Care Facilities Administration ruling concerning retroactive medicaid hospital reimbursements and (ii) the state's uncompensated health care funding system, which is under review by the United States Supreme Court. On August 25, 1992, Moody's lowered its rating from Aaa to Aa-1 on the state's general obligation bonds. The downgrade reflects Moody's concern that the state's chronic budgetary problems detract from bondholder security. The Aa-1 rating from Moody's is equivalent to Standard & Poor's AA rating.

#### NEW JERSEY TAXES

In the opinion of Shanley & Fisher, P.C., Morristown, New Jersey, special counsel on New Jersey tax matters, under existing New Jersey law:

1. The proposed activities of the New Jersey Trust will not cause it to be subject to the New Jersey Corporation Business Tax Act.

2. The income of the New Jersey Trust will be treated as the income of individuals, estates and trusts who are the Holders of Units of the New Jersey Trust for purposes of the New Jersey Gross Income Tax Act, and interest which is exempt from tax under the New Jersey Gross Income Tax Act when received by the New Jersey Trust will retain its status as tax exempt in the hands of such Unit Holders. Gains arising from the sale or redemption by a Holder of his Units or from the sale or redemption by the New Jersey Trust of any Debt Obligation are exempt from taxation under the New Jersey Gross Income Tax Act, as enacted and construed on the date hereof, to the extent such gains are attributable to Debt Obligations the interest on which is exempt from tax under the New Jersey Gross Income Tax Act.

3. Units of the New Jersey Trust may be subject, in the estates of New Jersey residents, to taxation under the Transfer Inheritance Tax Law of the State of New Jersey.

#### THE NEW MEXICO TRUST

All in all, 1993 was a very good year for both the New Mexico state economy and the economy of Albuquerque and its metropolitan area. The short term outlook continues to be excellent. However, New Mexico remains vulnerable to defense related job losses in the future, and the location of about

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half of the state's health care industry in Albuquerque makes its economy vulnerable to future health care reform effects.

#### RISK FACTORS--The State Economy.

The Debt Obligations included in the Portfolio of the New Mexico Trust may include special or general obligations of the State or of the municipality or authority which is the issuer. Special obligations are not supported by taxing powers. The risks, particular source of payment and security for each of the Debt Obligations are detailed in the instruments themselves and in related offering materials. There can be no assurance concerning the extent to which the market value or marketability of any of the Debt Obligations will be affected by the financial or other condition of the State, or by changes in the financial condition or operating results of underlying obligors. Further, there can be no assurance that the discussion of risks disclosed in related offering materials will not become incomplete or inaccurate as a result of subsequent events.

According to reports of the Bureau of Business and Economic Research of the University of New Mexico ('BBER') through December 1993 and covering preliminary reports of economic results for 1993, New Mexico's economy performed exceptionally well in 1993, with diversified growth by sector and region

throughout the state. Personal income growth was up strongly in 1993 (7.4%), well above the national average (4.6%), but New Mexico still ranks very low with respect to per capita income. New Mexico's job growth in 1993 was second in the nation. This performance is due to unique factors and the absence in New Mexico of certain key impediments to growth which have impacted other states. Although New Mexico is highly dependent on defense spending, the state has so far escaped any major defense cuts. Indeed, U.S. Air Force facilities are expanding and Sandia National Laboratories has gained additional funds for arms control and energy research. Job losses in defense related activities which have occurred have been fairly minor from an overall state perspective.

Reflecting the comparatively minor role of exports in the state economy, New Mexico was not adversely affected by the national slowdown of exports during 1993 due to recessions in Japan and continental Europe. Also, New Mexico largely escaped the negative impacts of corporate downsizing which affected other parts of the United States, reflecting the small number of large businesses headquartered in the state.

New Mexico's trade and construction sectors returned to employment growth during early 1992. Construction boomed during 1993, across the board, in residential construction, non-residential construction other than buildings and non-residential construction, as well. Mining employment has been adversely impacted by low oil prices and very low gas prices, which improved during 1992. Production of natural gas continued to increase during 1993 and a long term coal purchase agreement between an out-of-state utility and a mine in northeast New Mexico has had a favorable impact. This sector suffered a steep employment decline in late 1991 and further layoffs have occurred in copper and other metals extraction businesses. The manufacturing sector lost more than 2,500 jobs over the four quarters beginning with the second quarter of 1991, and 1,500 jobs during 1992. However, during the first quarter of 1993, manufacturing employment remained steady.

#### RISK FACTORS--The Economy of Albuquerque and its Metropolitan Area.

A significant proportion of the New Mexico Trust's Portfolio may consist of Debt Obligations of issuers located in, or whose activities may be affected by economic conditions in, the Albuquerque metropolitan area. Albuquerque is the largest city in the State of New Mexico, accounting for roughly one-quarter of the State's population. Located in the center of the State at the intersection of two major interstate highways and served by both rail and air, Albuquerque is the major trade, commercial and financial center of the State.

In 1993, the economy of the Albuquerque metropolitan statistical area ('MSA') outperformed the state as a whole. The Albuquerque MSA accounts for almost 43% of the jobs in New Mexico, and in 1993, accounted for 55% of all new jobs statewide.

Employment. The City's expansion was broad-based during the 1980's, with all major sectors experiencing employment growth. Growth stalled in the final quarter of 1990, as the national economy experienced recession, but resumed in the second half of 1991. During calendar 1993, all sectors in the MSA experienced job growth.

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Over half of nonagricultural civilian employment in the Albuquerque MSA is in the trade and service sectors. Historically, the service sector has grown at roughly twice the rate of growth of the trade sector. During 1993, the services sector rate of growth slowed from historical levels, reflecting the influence of a reduction in the rate of growth in the health services sector. The importance of trade and services reflects the continued importance of tourism to the Albuquerque economy. Albuquerque has benefitted from the recent fascination with the Southwest and from efforts to promote the City and to attract major conventions to the expanded Convention Center. Lodgers' tax receipts, hotel occupancy rates and average room rates all have steadily increased.

While it has declined in importance as a direct employer, the government sector still accounts for 20% of the Albuquerque MSA's total nonagricultural employment. Not included in this calculation are the 7,500 jobs at Sandia National Laboratories and about 6,200 military jobs at Kirtland Air Force Base. The University of New Mexico ('UNM'), the Albuquerque Public Schools system, Sandia and Kirtland are the largest employers in the Albuquerque area. Current discussions of defense cutbacks create considerable uncertainty over future funding for operations at Kirtland and Sandia. The uncertain political and budgetary climate renders projections as to the magnitude of employment reductions which may result from such cuts highly speculative. However, Kirtland employment increased during 1992 and additional employment is expected as a result of the expansion of an air force training wing and from the relocation of units based elsewhere to Albuquerque. Construction is proceeding on major facilities that will serve the expanded missions at the base. At Sandia, employment has remained steady, and its current budget is expected to increase over the prior year. However, potential future cuts in military spending cast a cloud over the outlook. Recent actions by Congress have expanded the missions of Sandia and other Department of Energy research labs beyond nuclear weapons to include (1) arms control verification, (2) nuclear waste clean-up and (3)



technology research and development. While this broadening of the lab's mission is encouraging, the transition to a new funding base with more reliance on the private sector could result in workforce reductions over the next few years. The fact that many Sandia employees are at or near retirement age and are believed to be likely to remain in the Albuquerque area would blunt the economic impact of cutbacks.

The finance, insurance and real estate employment sectors experienced a modest increase in employment in 1992, the first increase seen in this sector since 1987. This sector has seen major reorganizations and consolidations of local financial institutions. The reorganization of AT&T and large lay-offs at the State's major electric utility have contributed to holding down employment growth in the transportation, communications and public utilities sector.

The Albuquerque economy experienced a construction boom during the mid-1980's, but construction employment decreased in every year from 1985 to 1991. A major increase in jobs occurred during 1992 and the construction sector led the Albuquerque economy in 1993, spurred by low interest rates, pent up demand for housing and retail and public works construction projects. In early 1993, this sector received an immense boost when Intel Corporation announced that, beginning at once, it would expand its microprocessor production facility in Rio Rancho, within the MSA, creating as many as 3,000 construction jobs as of Spring, 1993.

The manufacturing employment sector within the Albuquerque MSA returned to overall job growth during 1993, with a net addition of 1,600 jobs (6.6% growth), bringing an end to a period of job losses or no job growth, experienced since the first quarter of 1990. There has also been growth in manufacturing activity outside the City, within the greater Albuquerque metropolitan area. Rio Rancho, which is located approximately 20 miles northwest of downtown Albuquerque in Sandoval County, has had considerable success in attracting new manufacturing facilities. Employment at Intel Corporation's Rio Rancho plant has seen steady, significant increases since 1988, and the current expansion is expected to add 1,000 new manufacturing jobs.

Income. According to U.S. Department of Commerce data, Albuquerque MSA personal income has grown at an annual rate of not less than 6.0% since 1986. In 1990, annual per capita personal income for the Albuquerque MSA, the State of New Mexico and the United States was \$17,518, \$14,254 and \$18,696, respectively.

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Population. Population in Bernalillo County is estimated at 480,577 for 1990, with 384,736 representing the official census estimate of population within the City. (The population of the State is estimated at 1,515,069.)

For the City as a whole, BBER projects an excellent near-term economic outlook, based in large part on the income, tax and employment multiplier effect of the new employees and construction workers engaged in the construction and manufacturing activity at the Intel microprocessor production facility in Rio Rancho.

The 1994 year is expected to be a strong one economically for New Mexico and Albuquerque, assuming that there are no major defense cuts within the state during the year. Federal tax increases, which may restrain economic growth nationally, are expected to have a minor impact in New Mexico because of the relatively small number of high income taxpayers who are most likely to be adversely affected, and the wider impact of changes in the earned income credit which will decrease federal income taxes or increase tax refunds for earned income credit claimants. The impact of federal health care reform is difficult to predict, as major health care institutions are downsizing to become more cost efficient, at the same time that demand for health services may increase substantially with large numbers of now uninsured New Mexicans benefitting from universal or more widely available health insurance.

The Sponsors believe that the information summarized above describes some of the more significant general considerations relating to Debt Obligations included in the New Mexico Trust. For a discussion of the particular risks associated with each of the Debt Obligations and other factors to be considered in connection therewith, reference should be made to the Official Statements and other offering materials relating to each of the Debt Obligations which are included in the portfolio of the New Mexico Trust. The sources of the information set forth herein are official statements, other publicly available documents, and statements of public officials and representatives of the issuers of certain of the Debt Obligations. While the Sponsors have not independently verified this information, they have no reason to believe that such information is incorrect in any material respect.

#### NEW MEXICO TAXES

In the opinion of Rodey, Dickason, Sloan, Akin & Robb, P.A., Albuquerque, New Mexico, special counsel on New Mexico tax matters:

Under existing New Mexico income tax laws, the New Mexico Trust is not an association taxable as a corporation; the income of the New Mexico Trust

will be treated as the income of Holders of Units of the New Mexico Trust and will be deemed to be received by them when received by the New Mexico Trust. Interest on the Debt Obligations in the New Mexico Trust which is excludable from net income under the New Mexico income tax laws when received by the New Mexico Trust will retain such status with respect to the Holders of Units of the New Mexico Trust for purposes of New Mexico income tax laws.

For purposes of the New Mexico income tax laws, each Holder of Units of the New Mexico Trust will be considered to have received his pro rata share of interest on each Debt Obligation in the New Mexico Trust when it is received by the New Mexico Trust, and each Holder will recognize gain or loss for purposes of the New Mexico income tax laws when the New Mexico Trust disposes of a Debt Obligation (whether by sale, exchange, redemption or payment at maturity) or when the Holder redeems or sells his Unit to the extent the transaction constitutes a taxable event for Federal income tax purposes. A Holder's tax cost (or basis) for his pro rata portion of a Debt Obligation will be established and allocated for purposes of the New Mexico income tax laws in the same manner as such cost is established and allocated for Federal income tax purposes.

For purposes of the New Mexico income tax laws, a Holder of Units will not be allowed a deduction for interest paid on any indebtedness incurred or continued to purchase or hold Units to the extent that the interest income related to the ownership of the Units is excludable from net income under the New Mexico income tax laws. Furthermore, under the New Mexico tax laws, a Holder of Units, other than a corporate Holder, is not entitled to a deduction for such Holder's

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share of fees and expenses of the New Mexico Trust to the extent that the fees and expenses are incurred in connection with the production of tax-exempt income.

Because New Mexico income tax laws are based in part upon Federal income tax law, the foregoing opinions concerning New Mexico income taxes are based on the opinion of Davis Polk & Wardwell concerning Federal income tax aspects of the New Mexico Trust.

Special New Mexico counsel has also advised that Holders should consult their own tax advisors regarding collateral New Mexico income tax consequences relating to the ownership of the Units, including, but not limited to, the inclusion of tax-exempt income attributable to ownership of Units in 'modified gross income', as that term is used in the New Mexico Income Tax Act, as amended, for purposes of determining eligibility for and the amount of the New Mexico low income comprehensive tax rebate, the New Mexico child day care credit, the New Mexico low income food and medical gross receipts tax rebate and the New Mexico elderly taxpayers' property tax rebate. Units of the New Mexico Trust may be subject, in the estates of Holders of Units who are New Mexico residents, to estate taxation under the New Mexico Estate Tax Act.

#### THE NEW YORK TRUST

RISK FACTORS--Prospective investors should consider the financial difficulties and pressures which the State of New York and several of its public authorities and municipal subdivisions have undergone. The following briefly summarizes some of these difficulties and the current financial situation, based principally on certain official statements currently available; copies may be obtained without charge from the issuing entity, or through the Agent for the Sponsors upon payment of a nominal fee. While the Sponsors have not independently verified this information, they have no reason to believe that it is not correct in all material respects.

New York State. In recent fiscal years, there have been extended delays in adopting the State's budget, repeated revisions of budget projections, significant revenue shortfalls (as well as increased expenses) and year-end borrowing to finance deficits. These developments reflect faster long-term growth in State spending than revenues and that the State was earlier and more severely affected by the recent economic recession than most of the rest of the country, as well as its substantial reliance on non-recurring revenue sources. The State's general fund incurred cash basis deficits of \$775 million, \$1,081 million and \$575 million, respectively, for the 1990-1992 fiscal years. Measures to deal with deteriorating financial conditions included transfers from reserve funds, recalculating the State's pension fund obligations (recently ruled illegal), hiring freezes and layoffs, reduced aid to localities, sales of State property to State authorities, and additional borrowings (including issuance of additional short-term tax and revenue anticipation notes payable out of impounded revenues in the next fiscal year). The general fund realized a \$671 million surplus for the fiscal year ended March 31, 1993, and a \$299 million surplus is projected for the current fiscal year.

Approximately \$5.3 billion of State general obligation debt was outstanding at October 31, 1993. The State's net tax-supported debt (restated to reflect LGAC's assumption of certain obligations previously funded through issuance of

short-term debt) was \$23.4 billion at March 31, 1993, up from \$11.7 billion in 1984. A taxpayer filed various lawsuits challenging the constitutionality of appropriation-backed debt issued by State authorities without voter approval. A temporary restraining order against issuance of debt by the Metropolitan Transportation Authority and the New York State Thruway Authority was lifted in July 1993; an appeal is pending. A proposed constitutional amendment passed by the Legislature in 1993 would prohibit lease-purchase and contractual obligation financing for State facilities, but would authorize the State without voter referendum to issue revenue bonds within a formula-based cap, secured solely by a pledge of certain State tax receipts. It would also restrict State debt to capital projects included in a multi-year capital financing plan. The proposal is subject to approval by the next Legislature and then by voters. S&P reduced its rating of the State's general obligation bonds on January 13, 1992 to A-(its lowest rating for any state). Moody's reduced its ratings of State general obligation bonds from A1 to A on June 6, 1990 and to Baa1, its rating of \$14.2 billion of appropriation-backed debt of the State and State agencies (over two-thirds of the total debt) on January 6, 1992.

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In May 1991 (over 2 months after the beginning of the 1992 fiscal year), the State Legislature adopted a budget to close a projected \$6.5 billion gap (including repayment of \$905 million of fiscal 1991 deficit notes). Measures included \$1.2 billion in new taxes and fees, \$0.9 billion in non-recurring measures and about \$4.5 billion of reduced spending by State agencies (including layoffs), reduced aid to localities and school districts, and Medicaid cost containment measures. After the Governor vetoed \$0.9 billion in spending, the State adopted \$0.7 billion in additional spending, together with various measures including a \$100 million increase in personal income taxes and \$180 million of additional non-recurring measures. Due primarily to declining revenues and escalating Medicaid and social service expenditures, \$0.4 billion of administrative actions, \$531 million of year-end short-term borrowing and a \$44 million withdrawal from the Tax Stabilization Reserve Fund were required to meet the State's cash flow needs.

On April 2, 1992, the State adopted a budget to close a projected \$4.8 billion gap for the State's 1993 fiscal year (including repayment of the fiscal 1992 short-term borrowing) through a combination of \$3.5 billion of spending reductions (including measures to reduce Medicaid and social service spending, as well as further employee layoffs, reduced aid to municipalities and schools and reduced support for capital programs), deferral of scheduled tax reductions, and some new and increased fees. The State Comptroller concluded that the budget includes \$1.18 billion of nonrecurring measures (the Division of the Budget reported a figure of \$450 million). The City and its Board of Education sued the Governor and various other State officials in March 1993, claiming that the State's formula for allocating aid to education discriminated against City schools by at least \$274 million in the 1993 fiscal year.

To close a projected budget gap of nearly \$3 billion for the fiscal year ending March 31, 1994, the State budget contains various measures including deferral of scheduled income tax reductions for a fourth year, some tax increases, and \$1.6 billion in spending cuts, especially for Medicaid, and further reduction of the State's work force. The budget includes increased aid to schools, as well as a formula to channel more aid to districts with lower-income students and high property tax burdens. State legislation requires deposit of receipts from the petroleum business tax and certain other transportation-related taxes into funds dedicated to transportation purposes. Nevertheless, \$516 million of these monies were retained in the general fund during this fiscal year. The Division of the Budget has estimated that non-recurring income items other than the \$671 million surplus from the last fiscal year aggregate \$318 million. \$89 million savings from bond refinancings will be deposited in a reserve to fund litigation settlements, particularly to repay monies received under the State's abandoned property law, which the State will be required to give up as described below.

The Governor has proposed a budget for the fiscal year beginning April 1, 1994, which would increase spending by 3.8% (greater than inflation for the first time in six years). Tax revenue projections are based on assumed modest growth in the State economy. An estimated \$130 million would come from proposed lottery games and \$70 million, from requiring bottling companies to pay the State unredeemed deposits on bottles and cans. The proposal would reduce or phase out certain business taxes over several years, provide a tax credit for low income families and increase aid to education by \$198 million (\$88 million to New York City), especially the poorer districts. The litigation fund would be increased to over \$300 million. However, the State would not increase its share of Medicaid costs and would reduce coverage and place additional restrictions on certain health care services. (The Governor in November proposed to close certain State psychiatric facilities over the next several years and apply most of the savings to additional clinical care, rehabilitation and vocational training.) Over \$1 billion would be saved by further postponement of scheduled reductions in personal income taxes and in taxes on hospital income; another \$300 million represents rolling over the projected surplus from the current fiscal year. Other non-recurring measures would be reduced to \$78 million. There can be no assurance that the Legislature will enact the budget as proposed. In November 1993 the State's Court of Appeals ruled unconstitutional 1990

legislation which postponed employee pension contributions by the State and localities (other than New York City). The amounts to be made up, estimated to aggregate \$4 billion (half from the State), would be repaid in increasing amounts over 12-20 years under a plan proposed by the State Comptroller, trustee of the State pension system, and previous contribution levels will not be exceeded until 1999. State and other estimates are subject to uncertainties including the effects of Federal tax legislation and economic developments.

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The Division of the Budget has cautioned that its projections are subject to risks including adverse decisions in pending litigations (particularly those involving Federal Medicaid reimbursements and payments by hospitals and health maintenance organizations), and that economic growth may be weaker than projected.

The State normally adjusts its cash basis balance by deferring until the first quarter of the succeeding fiscal year substantial amounts of tax refunds and other disbursements. For many years, it also paid in that quarter more than 40% of its annual assistance to local governments. Payment of these annual deferred obligations and the State's accumulated deficit was substantially financed by issuance of short-term tax and revenue anticipation notes shortly after the beginning of each fiscal year. The New York Local Government Assistance Corporation ('LGAC') was established in 1990 to issue long-term bonds over several years, payable from a portion of the State sales tax, to fund certain payments to local governments traditionally funded through the State's annual seasonal borrowing. The legislation will normally limit the State's short-term borrowing, together with net proceeds of LGAC bonds (\$4.0 billion to date), to a total of \$4.7 billion. The State's latest seasonal borrowing, in May 1993, was \$850 million. The Governor's budget for the 1995 fiscal year would finally eliminate this seasonal borrowing program.

Generally accepted accounting principles ('GAAP') for municipal entities apply modified accrual accounting and give no effect to payment deferrals. On an audited GAAP basis, the State's government funds group recorded operating deficits of \$1.2 billion and \$1.4 billion for the 1990 and 1991 fiscal years. For the same periods the general fund recorded deficits (net of transfers from other funds) of \$0.7 billion and \$1.0 billion. Reflecting \$1.6 billion and \$881 million of payments by LGAC to local governments out of proceeds from bond sales, the general fund realized surpluses of \$1.7 billion and \$2.1 billion for the 1992 and 1993 fiscal years, respectively, leaving an accumulated deficit of \$2.551 billion.

For decades, the State's economy has grown more slowly than that of the rest of the nation as a whole. Part of the reason for this decline has been attributed to the combined State and local tax burden, which is the second highest in the nation (about 40% above the national average). The State's dependence on Federal funds and sensitivity to changes in economic cycles, as well as the high level of taxes, may continue to make it difficult to balance State and local budgets in the future. The total employment growth rate in the State has been below the national average since 1984. The State lost 524,000 jobs in 1990-1993. The jobless rate was 9.3% in January 1993 and 7.1% in January, 1994.

New York City (the 'City'). The City is the State's major political subdivision. In 1975, the City encountered severe financial difficulties, including inability to refinance \$6 billion of short-term debt incurred to meet prior annual operating deficits. The City lost access to the public credit markets for several years and depended on a variety of fiscal rescue measures including commitments by certain institutions to postpone demands for payment, a moratorium on note payment (later declared unconstitutional), seasonal loans from the Federal government under emergency congressional legislation, Federal guarantees of certain City bonds, and sales and exchanges of bonds by The Municipal Assistance Corporation for the City of New York ('MAC') to fund the City's debt.

MAC has no taxing power and pays its obligations out of sales taxes imposed within the City and per capita State aid to the City. The State has no legal obligation to back the MAC bonds, although it has a 'moral obligation' to do so. MAC is now authorized to issue bonds only for refunding outstanding issues and up to \$1.5 billion should the City fail to fund specified transit and school capital programs. The State also established the Financial Control Board ('FCB') to review the City's budget, four-year financial plans, borrowings and major contracts. These were subject to FCB approval until 1986 when the City satisfied statutory conditions for termination of such review. The FCB is required to reimpose the review and approval process in the future if the City were to experience certain adverse financial circumstances. The City's fiscal condition is also monitored by a Deputy State Comptroller.

The City projects that it is beginning to emerge from four years of economic recession. Since 1989 the gross city product has declined by 10.1% and employment, by almost 11%, while the public assistance caseload has grown by over 25%. Unemployment averaged 10.8% in 1992, reaching 13.4% in January 1993, the highest level in 25 years. It dropped to 10.8% in January, 1994. The number of persons on welfare exceed 1.1 million, the highest level since 1972, and one

currently receiving some form of public assistance. The State Comptroller concluded that this recession 'is clearly the worst the City has experienced since the 1970s'.

While the City, as required by State law, has balanced its budgets in accordance with GAAP since 1981, this has required exceptional measures in recent years. The FCB has commented that City expenditures have grown faster than revenues each year since 1986, masked in part by a large number of non-recurring gap closing actions. To eliminate potential budget gaps of \$1-\$3 billion each year since 1988 the City has taken a wide variety of measures. In addition to increased taxes and productivity increases, these have included hiring freezes and layoffs, reductions in services, reduced pension contributions, and a number of nonrecurring measures such as bond refundings, transfers of surplus funds from MAC, sales of City property and reduction of reserves. The FCB concluded that the City has neither the economy nor the revenues to do everything its citizens have been accustomed to expect. The current downturn in the real estate market could substantially lower the City's operating limit on real estate taxes in future years.

The City closed a budget gap for the 1993 fiscal year (estimated at \$1.2 billion) through actions including service reductions, productivity initiatives, transfer of \$0.5 billion surplus from the 1992 fiscal year and \$100 million from MAC. A November 1992 revision proposed to meet an additional \$561 million in projected expenditures through measures including a refunding to reduce current debt service costs, reduction in the reserve and an additional \$81 million of gap closing measures. Over half of the City's actions to balance that budget were non-recurring.

The Financial Plan for the City's current fiscal year (ending June 30, 1994) relies on increases in State and Federal aid, as well as the 1993 \$280 million surplus and a partial hiring freeze, to close a gap, resulting primarily from recent labor settlements and declines in property tax revenues. However, overall spending would increase by about the rate of inflation. The Plan contains over \$1.3 billion of one-time revenue measures including bond refundings, sale of various City assets and borrowing against future property tax receipts. While the State budget for the current fiscal year increased aid to City schools, it failed to provide Medicaid and other requested mandate relief, cut back on State aid to other programs and anticipates increased City contributions to meet the New York City Transit Authority's current operations and capital program. The private-sector members of the FCB in May 1993 criticized reliance on questionable one-time revenues and unlikely additional state and Federal aid, and called for immediate actions toward achieving permanent structural balance. On July 2, 1993, the previous Mayor ordered spending reductions of about \$130 million for the current fiscal year and \$400 million for the 1995 fiscal year. Various fiscal monitors have criticized increased reliance on non-recurring revenues in the current fiscal year, with attendant increases in the gaps for future years. They warn that in addition to the uncertainty of relying on projected increases in State and Federal aid, the principal risks are in debt service, funding for the Health and Hospitals Corporation and overtime costs. In December 1993, a report commissioned by the City was released, describing the nature of the City's structural deficit. It projects that the City will need to identify and implement \$5 billion in annual gap closing measures by 1998. The report suggests a variety of possible measures for City consideration. A new Mayor and City Comptroller assumed office in January 1994. While the Mayor rejected out of hand many of the proposals such as tax increases, the State Comptroller urged him to reconsider the report.

In February 1994, the new Mayor proposed a preliminary budget to eliminate a projected \$2.3 billion budget gap for the fiscal year beginning July 1, 1994, reduce overall spending for the first time in over a decade, reduce non-recurring revenue measures, and begin cutting taxes (to encourage job growth). Proposals include spending cuts including reduction of 15,000 jobs over the next 18 months (partially by using \$200 million of MAC surplus to encourage early retirements) unless equivalent productivity savings are negotiated with the unions, partial employee payment of health insurance costs, and further deferral of City pension fund contributions. It also projects increases aggregation of about \$400 million in State and Federal aid, including the State's taking on the City's share of Medicaid costs. The previously proposed delay of \$3.2 billion in capital spending until fiscal 1998 would be retained. The Mayor is exploring the possibility of privatizing some of the City's services. The budget must be passed by the Democratic-controlled City council and many of the proposals also need

approval by the State and others. Budget gaps of \$3.2 billion and \$3.3 billion are projected for the 1996 and 1997 fiscal years.

A major uncertainty is the City's labor costs, which represent about 50% of its total expenditures. The City's workforce grew by 34% during the 1980s. A January 1993 agreement covering approximately 44% of the City workers followed

negotiations lasting nearly two years. Workers will receive wage and benefit raises totalling 8.25% over 39 months ending March 1995. Although this is less than the inflation rate, the settlement achieved neither any of the productivity savings that the then Mayor had previously counted on to help balance the City's budget nor are the increases beyond those previously budgeted offset by labor concessions. An agreement announced in August provides wage increases for City teachers averaging 9% over the 48 1/2 months ending October 1995. The City is seeking to negotiate workforce productivity initiatives, savings from which would be shared with the workers involved. The Financial Plan assumes no further wage increases after the 1995 fiscal year. Also, costs of some previous wage increases were offset by reduced contributions to pension funds; if fund performance is less than the 9% annual earnings projected, the City could incur increased expenses in future years.

Budget balance may also be adversely affected by the effect of the economy on economically sensitive taxes. Reflecting the downturn in real estate prices, estimates of property tax revenues have been reduced. Other uncertainties include additional expenditures to combat deterioration in the City's infrastructure (such as bridges, schools and water supply), costs of developing alternatives to ocean dumping of sewage sludge (which the City expects to defray through increased water and sewer charges), cost of the AIDS epidemic, problems of drug addiction and homelessness and the impact of any future State assistance payment reductions. An independent report in 1991 concluded that 50% of City roads need resurfacing or reconstruction. In September 1993 the City reported that 56.4% of its bridges are structurally deficient and need repairs; some repairs have been halted due to environmental concerns. In response to evidence of widespread errors and falsification in 1986-89 inspections of City schools for presence of asbestos, the City in August 1993 conducted an emergency reinspection program. The costs of additional asbestos removal, at least \$119 million, may require curtailment or deferral of other school repairs and maintenance. The City, to avoid capital expenditures of an estimated \$4-\$5 billion on water filtration facilities, is increasing regulatory, enforcement and other efforts to protect the watershed area that is the source of most of the City's drinking water. In early 1993, the U.S. Environmental Protection Agency granted an interim exemption, but there can be no assurance that these efforts will result in continued exemption. Recent court decisions found that the City has failed to provide adequate shelter for many homeless persons and fined and held several City officials in contempt for failure to comply with a State rule requiring provision of immediate shelter for homeless persons. In late February, the State's Court of Appeals ruled that the City's recycling program does not comply with City law; although the costs cannot presently be estimated as the program's implementation schedule is being renegotiated, additional expenditures by the City will probably be needed. Elimination of any additional budget gaps will require various actions, including by the State, a number of which are beyond the City's control. Voters in 1993 approved a proposed charter under which Staten Island would secede from the City. Secession will require enabling legislation by the State Legislature; it would also be subject to legal challenge by the City. The effects of secession on the City cannot be determined at this time, but questions include responsibility for outstanding debt, a diminished tax base, and continued use of the Fresh Kills landfill, the City's only remaining garbage dump. A similar measure with respect to Queens was approved by the New York State Senate.

The City sold \$2.3 billion, \$1.4 billion and \$1.8 billion of short-term notes, respectively, during 1992, 1993 and current fiscal years. At September 30, 1993, there were outstanding \$20.0 billion of City bonds (not including City debt held by MAC), \$4.5 billion of MAC bonds and \$0.8 billion of City-related public benefit corporation indebtedness, each net of assets held for debt service. Standard & Poor's and Moody's during the 1975-80 period either withdrew or reduced their ratings of the City's bonds. S&P currently rates the City's debt A-with a negative outlook while Moody's rates City bonds Baa1. City-related debt almost doubled since 1987, although total debt declined as a percentage of estimated full value of real property. The City's financing program projects long-term financing during fiscal years 1994-1997 to aggregate \$18.5 billion. The City's latest Ten Year Capital Strategy plans capital expenditures of \$51.6 billion during 1994-2003 (93% to be City funded). The State

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Comptroller has criticized recent City bond refinancings for producing short-term savings at the expense of greater overall costs, especially in future years. Annual debt service is projected to increase to about \$3.2 billion by fiscal 1997 (from \$1.2 billion in fiscal 1990).

Other New York Localities. In 1992, other localities had an aggregate of approximately \$15.7 billion of indebtedness outstanding. In recent years, several experienced financial difficulties. A March 1993 report by Moody's Investors Service concluded that the decline in ratings of most of the State's largest cities in recent years resulted from the decline in the State's manufacturing economy. Seventeen localities had outstanding indebtedness for deficit financing at the close of their respective 1992 fiscal years. On October 19, 1992, citing a 'protracted and contentious political stalemate' leaving Nassau County with six to eight weeks before running out of cash, Moody's reduced the County's general obligation rating from A to Baa. A budget adopted in December 1992 after a prolonged stalemate plans to eliminate the \$121 million

cumulative deficit without increasing property taxes or the mortgage tax. The budget includes \$65 million of long-term borrowing authorized by State legislation, transfer of a \$31 million surplus from the police budget and sale of some real estate. Several of the projections are subject to uncertainties. In response to requests from an unprecedented 10 local government units (including Nassau and Suffolk counties) in 1992 for legislative authority to issue bonds to fund deficits, the State Comptroller recommended legislation to establish earlier State oversight of municipal deficits. In September, 1992, the Comptroller proposed regulations which would prohibit use of certificates of participation by municipalities for deficit financing or refundings. Some local leaders complained that the deficits resulted from reduced State aid accompanied by increases in State-mandated expenditures. Any reductions in State aid to localities may cause additional localities to experience difficulty in achieving balanced budgets. If special local assistance were needed from the State in the future, this could adversely affect the State's as well as the localities' financial condition. Most localities depend on substantial annual State appropriations. Legal actions by utilities to reduce the valuation of their municipal franchises, if successful, could result in localities becoming liable for substantial tax refunds.

State Public Authorities. In 1975, after the Urban Development Corporation ('UDC'), with \$1 billion of outstanding debt, defaulted on certain short-term notes, it and several other State authorities became unable to market their securities. Since 1975 the State has provided substantial direct and indirect financial assistance to UDC, the Housing Finance Agency ('HFA'), the Environmental Facilities Corporation and other authorities. Practical and legal limitations on these agencies' ability to pass on rising costs through rents and fees could require further State appropriations. 18 State authorities had an aggregate of \$63.5 billion of debt outstanding at September 30, 1993. At September 30, 1993, approximately \$0.5 billion of State public authority obligations was State-guaranteed, \$7.7 billion was moral obligation debt (including \$4.8 billion of MAC debt) and \$19.5 billion was financed under lease-purchase or contractual obligation financing arrangements with the State. Various authorities continue to depend on State appropriations or special legislation to meet their budgets.

The Metropolitan Transportation Authority ('MTA'), which oversees operation of the City's subway and bus system by the City Transit Authority (the 'TA') and operates certain commuter rail lines, has required substantial State and City subsidies, as well as assistance from several special State taxes. Projections of TA revenues were reduced due to declining ridership, increasing fare evasion, reductions in State and City aid and declining revenues from City real estate taxes. It was reported in December 1993 that a twenty-year trend in declining bus ridership is expected to continue. While the MTA used bond refinancings and other measures to avert a commuter rail line fare increase in 1992, measures including a fare increase eliminated the TA's 1992 budget gap. Measures to balance the TA's 1993 budget included increased funding by the City, increased bridge and tunnel tolls and allocation of part of the revenues from the Petroleum Business Tax. Cash basis gaps of \$500-800 million are projected for each of the 1995, 1996 and 1997 years. Measures proposed to close these gaps include various additional State aid and possible fare increases.

The MTA's Chairman recently proposed a financial strategy for the next five years, including a variety of fare changes; however, even if these are approved, an estimated \$700 million in additional funds will be needed from State and City financial assistance. Substantial claims have been made

against the TA and the City for damages from a 1990 subway fire and a 1991 derailment. The MTA infrastructure, especially in the City, needs substantial rehabilitation. A one-year \$1.6 billion 1992 MTA Capital Plan was approved. In December 1993, a \$9.5 billion MTA Capital Plan was finally approved for 1992-1996, although \$500 million is contingent on increased contributions from the City; the City has until late 1994 to decide if it will make these contributions. In response to a constitutional challenge to implementing a \$6 billion State transportation borrowing plan without voter approval, a temporary restraining order was issued in May 1993, but was lifted in July. It is anticipated that the MTA and the TA will continue to require significant State and City support. Moody's reduced its rating of certain MTA obligations to Baa on April 14, 1992.

Because of reduced rates under the State's revised medical reimbursement programs, as well as proposals to reduce reimbursement of hospital capital costs and to change Medicaid funding, New York hospitals have experienced increasing financial pressure. To mitigate unprecedented rate increases by Empire State Blue Cross, the State in January 1993 made available \$100 million from the medical malpractice fund. A Federal District Court ruled in February 1993 that State surcharges of up to 24% on hospital bills paid by commercial insurance companies and health maintenance organizations, much of which is used to subsidize care of uninsured patients, violate Federal law; however, the Court permitted continuance of the system pending appeal of the ruling.

The State and the City are defendants in numerous legal proceedings, including challenges to the constitutionality and effectiveness of various

welfare programs, alleged torts and breaches of contract, condemnation proceedings and other alleged violations of laws. Adverse judgments in these matters could require substantial financing not currently budgeted. For example, in addition to real estate certiorari proceedings, claims in excess of \$343 billion were outstanding against the City at June 30, 1993, for which it estimated its potential future liability at \$2.2 billion. Another action seeks a judgment that, as a result of an overestimate by the State Board of Equalization and Assessment, the City's 1992 real estate tax levy exceeded constitutional limits. In March 1993, the U.S. Supreme Court ruled that if the last known address of a beneficial owner of accounts held by banks and brokerage firms cannot be ascertained, unclaimed funds therein belong to the state of the broker's incorporation rather than where its principal office is located. New York has obtained about \$350 million of abandoned funds that could have to be paid to other States. It has agreed to pay Delaware \$200 million over a five-year period. The case has been remanded to a special master to determine disposition of these monies.

Final adverse decisions in any of these cases could require extraordinary appropriations at either the State or City level or both.

#### NEW YORK TAXES

In the opinion of Davis Polk & Wardwell, special counsel for the Sponsors, under existing New York law:

Under the income tax laws of the State and City of New York, the Trust is not an association taxable as a corporation and income received by the Trust will be treated as the income of the Holders in the same manner as for Federal income tax purposes. Accordingly, each Holder will be considered to have received the interest on his pro rata portion of each Debt Obligation when interest on the Debt Obligation is received by the Trust. In the opinion of bond counsel delivered on the date of issuance of the Debt Obligation, such interest will be exempt from New York State and City personal income taxes except where such interest is subject to Federal income taxes (see Taxes). A noncorporate Holder of Units of the Trust who is a New York State (and City) resident will be subject to New York State (and City) personal income taxes on any gain recognized when he disposes of all or part of his pro rata portion of a Debt Obligation. A noncorporate Holder who is not a New York State resident will not be subject to New York State or City personal income taxes on any such gain unless such Units are attributable to a business, trade, profession or occupation carried on in New York. A New York State (and City) resident should determine his tax basis for his pro rata portion of each Debt Obligation for New York State (and City) income tax purposes in the same manner as for Federal income tax purposes. Interest income on a Holder's pro rata portion of the Debt Obligations is generally not excludable from income in computing New York State and City corporate franchise taxes.

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#### THE NORTH CAROLINA TRUST

RISK FACTORS--See Portfolio for a list of the Debt Obligations included in the North Carolina Trust. The portions of the following discussion regarding the financial condition of the State government may not be relevant to general obligation or revenue bonds issued by political subdivisions of the State. Those portions and the sections which follow regarding the economy of the State, are included for the purpose of providing information about general economic conditions that may or may not affect issuers of the North Carolina Obligations. None of the information is relevant to any Puerto Rico or Guam Debt Obligations which may be included in the Portfolio of the North Carolina Trust.

General obligations of a city, town or county in North Carolina are payable from the general revenues of the entity, including ad valorem tax revenues on property within the jurisdiction. Revenue bonds issued by North Carolina political subdivisions include (1) revenue bonds payable exclusively from revenue-producing governmental enterprises and (2) industrial revenue bonds, college and hospital revenue bonds and other 'private activity bonds' which are essentially non-governmental debt issues and which are payable exclusively by private entities such as non-profit organizations and business concerns of all sizes. State and local governments have no obligation to provide for payment of such private activity bonds and in many cases would be legally prohibited from doing so. The value of such private activity bonds may be affected by a wide variety of factors relevant to particular localities or industries, including economic developments outside of North Carolina.

Section 23-48 of the North Carolina General Statutes appears to permit any city, town, school district, county or other taxing district to avail itself of the provisions of Chapter 9 of the United States Bankruptcy Code, but only with the consent of the Local Government Commission of the State and of the holders of such percentage or percentages of the indebtedness of the issuer as may be required by the Bankruptcy Code (if any such consent is required). Thus, although limitations apply, in certain circumstances political subdivisions might be able to seek the protection of the Bankruptcy Code.



State Budget and Revenues. The North Carolina State Constitution requires that the total expenditures of the State for the fiscal period covered by each budget not exceed the total of receipts during the fiscal period and the surplus remaining in the State Treasury at the beginning of the period. The State's fiscal year runs from July 1st through June 30th.

In 1990 and 1991 the State had difficulty meeting its budget projections. The General Assembly responded by enacting a number of new taxes and fees, which generated an estimated \$665.5 million in fiscal year 1991-92. Revenues for 1992-93 were estimated to include an additional \$95.6 million and helped produce a budget surplus (approximately \$342 million) for the 1992-93 fiscal year. In addition, the 1993 session of the General Assembly reduced allowable departmental operating expenditures by \$120.3 and \$122.8 million for fiscal years 1993-94 and 1994-95 respectively, and authorized continuation funding of approximately \$8.33 billion for fiscal year 1993-94 and \$8.60 billion for fiscal year 1994-95. The savings reductions were based on recommendations from the Governor, the Government Performance Audit Committee and selected savings identified by the General Assembly.

Both the nation and the State have experienced a modest economic recovery in recent months. However, it is unclear what effect these developments, as well as the reduction in government spending or increase in taxes, may have on the value of the Debt Obligations in the North Carolina Trust. No solid upward economic trend has developed, and both the State and the national economies must be watched carefully.

The fiscal condition of the State might be affected adversely by litigation concerning the legality of certain State tax provisions following the March 1989 decision of the United States Supreme Court that it is unconstitutional for a state to exempt from state income taxation retirement benefits paid by the state or its local governments, but not to exempt retirement benefits paid by the federal government.

Based on that decision, certain federal retirees and federal military personnel plaintiffs brought an action in federal court against the North Carolina Department of Revenue and certain officials of the State alleging the unconstitutionality of taxes collected under prior North Carolina tax statutes and seeking damages for the illegally collected taxes paid on federal retirement or military pay for the years

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1985-88 (covering the asserted 3 year limitations period), plus interest. Swanson, et al. v. Powers, et al. (United States District Court for the Eastern District of North Carolina, No. 89-282-CIV-5-H) ('Swanson Federal'). The individual plaintiffs in Swanson Federal also brought an action in North Carolina state court seeking refunds of the illegal taxes. Swanson, et al. v. State of North Carolina, et al. (Wake County, North Carolina Superior Court, No. 90 CVS 3127) ('Swanson State').

The amounts claimed by federal retirees in the Swanson actions have not been precisely calculated. Plaintiffs have asserted that the plaintiff class contains about 100,000 taxpayers; the State has asserted that the claims would aggregate at least \$140 million (which might not include interest).

In Swanson State the North Carolina Supreme Court found for the State, ruling that the State would not be required to refund taxes illegally collected prior to the U.S. Supreme Court's decision. The U.S. Supreme Court vacated the judgment and remanded the case to the North Carolina Supreme Court for reconsideration in light of the U.S. Supreme Court's holding in Harper v. Virginia Dept. of Taxation (No. 91--794) (Decided 6/18/93) ('Harper'). In Harper, which also involved the disparate income tax treatment of retired state and federal employees and the question of retroactive application of the law, the U.S. Supreme Court held that the Commonwealth of Virginia must provide 'meaningful backward-looking relief' to the plaintiffs, if the Commonwealth did not have a predeprivation process adequate to satisfy due process requirements. The case was remanded to the Supreme Court of Virginia to determine whether a remedy was required and, if so, what form it would take.

The impact of Harper on the estimated \$140 million of refund claims in Swanson State has yet to be determined. The North Carolina Supreme Court, after hearing arguments on November 17, 1993, must determine whether North Carolina law provides an adequate predeprivation process, and if not, what remedy should be fashioned to satisfy due process requirements.

The decision in Harper also reactivated the damage claims in Swanson Federal, and the federal court will begin hearing arguments on these claims in February, 1994.

General. The population of the State has increased 13% from 1980, from 5,880,095 to 6,647,351 as reported by the 1990 federal census. Although North Carolina is the tenth largest state in population, it is primarily a rural state, having only five municipalities with populations in excess of 100,000. The labor force has undergone significant change during recent years. The State has moved from an agricultural to a service and goods producing economy. Those

persons displaced by farm mechanization and farm consolidations have, in large measure, sought and found employment in other pursuits. Due to the wide dispersion of non-agricultural employment, the people have been able to maintain, to a large extent, their rural habitation practices. During the period 1980 to 1992, the State labor force grew about 22% (from 2,855,200 to 3,487,500). Per capita income during the period 1980 to 1990 grew from \$7,999 to \$16,203, an increase of 102.6%.

The current economic profile of the State consists of a combination of industry, agriculture and tourism. As of May 1993, the State was reported to rank tenth among the states in non-agricultural employment and eighth in manufacturing employment. Employment indicators have varied somewhat in the annual periods since June of 1989, but have demonstrated an upward trend since 1991. The following table reflects the fluctuations in certain key employment categories.

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<S>	<C>	<C>	<C>	<C>	<C>
CATEGORY (ALL SEASONALLY ADJUSTED)	JUNE 1989	JUNE 1990	JUNE 1991	JUNE 1992	JUNE 1993
CIVILIAN LABOR FORCE	3,286,000	3,312,000	3,228,000	3,495,000	3,504,000
NONAGRICULTURAL EMPLOYMENT	3,088,000	3,129,000	3,059,000	3,135,000	3,203,400
GOODS PRODUCING OCCUPATIONS (MINING, CONSTRUCTION AND MANUFACTURING)	1,042,200	1,023,100	973,600	980,800	993,600
SERVICE OCCUPATIONS	2,045,800	2,106,300	2,085,400	2,154,200	2,209,800
WHOLESALE/RETAIL OCCUPATIONS	713,900	732,500	704,100	715,100	723,200
GOVERNMENT EMPLOYEES	482,200	496,400	496,700	513,400	515,400
MISCELLANEOUS SERVICES	563,900	587,300	596,300	638,300	676,900
AGRICULTURAL EMPLOYMENT	54,900	58,900	88,700	102,800	88,400

The adjusted unemployment rate in June 1993 was 5.4% of the labor force, as compared with 7% nationwide.

Gross agricultural income in 1992 was \$5.26 billion, including approximately \$5,181,695,000 income from commodities. As of 1992, the State was tenth in the nation in gross agricultural income. According to the State Commissioner of Agriculture, in 1992 the State ranked first in the nation in the production of flue-cured tobacco, total tobacco, turkeys and sweet potatoes; second in the value of poultry and poultry products, in the production of cucumbers for pickles and in trout production; fourth in commercial broilers, strawberries and peanuts; sixth in burley tobacco and hogs; and seventh in the number of chickens (excluding broilers), pecans and apples.

The diversity of agriculture in North Carolina and a continuing push in marketing efforts have protected farm income from some of the wide variations that have been experienced in other states where most of the agricultural economy is dependent on a small number of agricultural commodities. North Carolina is the third most diversified agricultural state in the nation.

Nevertheless, tobacco production is the second leading source of agricultural income in the State, accounting for 20.3% of gross agricultural income. Tobacco farming in North Carolina has been and is expected to continue to be affected by major Federal legislation and regulatory measures regarding tobacco production and marketing and by international competition. Measures adverse to tobacco farming could have negative effects on farm income and the North Carolina economy generally. The largest single source for agricultural income in the State is poultry and eggs, which accounted for revenues of approximately \$1.6 billion in 1992 and 31% of gross agricultural income.

The number of farms has been decreasing; in 1993 there were approximately 59,000 farms in the State (down from approximately 72,000 in 1987, a decrease of about 18% in six years). However, a strong agribusiness sector supports farmers with farm inputs (fertilizer, insecticide, pesticide and farm machinery) and processing of commodities produced by farmers (vegetable canning and cigarette manufacturing).

The State Department of Commerce, Travel and Tourism Division, statistics office, reports that in 1992 approximately \$7.8 billion was spent on tourism in the State, with 1993 revenues from tourism expected to exceed \$8 billion. The statistics office estimates a 6% annual average revenue growth rate in the tourism industry. In 1991, traveler expenditures directly generated more than 155,000 jobs within the State, 5.1 percent of total nonagricultural employment in that year.

Bond Ratings. Currently, Moody's rates North Carolina general obligation bonds as Aaa and Standard & Poor's rates such bonds as AAA. Standard & Poor's also reaffirmed its stable outlook for the State in October 1993.

Standard & Poor's reports that North Carolina's rating reflects the State's strong economic characteristics, sound financial performances, and low debt levels.

The Sponsor believes the information summarized above describes some of the more significant events relating to the North Carolina Trust. The sources of this information are the official statements of issuers located in North Carolina, State agencies, publicly available documents, publications of rating agencies and news reports of statements by State officials and employees and by rating agencies.

The Sponsor and its counsel have not independently verified any of the information contained in the official statements and other sources and counsel have not expressed any opinion regarding the completeness or materiality of any matters contained in this Prospectus other than the tax opinions set forth below under North Carolina Taxes.

#### NORTH CAROLINA TAXES

In the opinion of Hunton & Williams, Raleigh, North Carolina, special counsel on North Carolina tax matters, under existing North Carolina law:

Upon the establishing of the North Carolina Trust and the Units thereunder:

1. The North Carolina Trust is not an 'association' taxable as a corporation under North Carolina law with the result that income of the North Carolina Trust will be deemed to be income of the Holders.

2. Interest on the Debt Obligations that is exempt from North Carolina income tax when received by the North Carolina Trust will retain its tax-exempt status when received by the Holders.

3. Holders will realize a taxable event when the North Carolina Trust disposes of a Debt Obligation (whether by sale, exchange, redemption or payment at maturity) or when a Holder redeems or sells his Units (or any of them), and taxable gains for Federal income tax purposes may result in gain taxable as ordinary income for North Carolina income tax purposes. However, when a Debt Obligation has been issued under an act of the North Carolina General Assembly that provides that all income from such Debt Obligation, including any profit made from the sale thereof, shall be free from all taxation by the State of North Carolina, any such profit received by the North Carolina Trust will retain its tax-exempt status in the hands of the Holders.

4. Holders must amortize their proportionate shares of any premium on a Debt Obligation. Amortization for each taxable year is achieved by lowering the Holder's basis (as adjusted) in his Units, with no deduction against gross income for the year.

5. In order for the Units to be exempt from the North Carolina tax on intangible personal property: (a) at all times either (i) the corpus of the North Carolina Trust must be composed entirely of North Carolina Debt Obligations or, pending distribution, amounts received on the sale, redemption or maturity of the North Carolina Debt Obligations, or (ii) (if Puerto Rico or Guam Debt Obligations are included in the North Carolina Trust) at least 80% of the fair market value of the Debt Obligations, excluding amounts received on the sale, redemption or maturity of the Debt Obligations, must be attributable to the fair market value of the North Carolina Debt Obligations; and (b) the Trustee periodically must supply to the North Carolina Department of Revenue at such times as required by the Department of Revenue a complete description of the North Carolina Trust and also the name, description and value of the obligations held in the corpus of the North Carolina Trust.

The opinion of Hunton & Williams is based, in part, on the opinion of Davis Polk & Wardwell regarding Federal tax status and upon current interpretations and rulings of the North Carolina Department of Revenue, which are subject to change.

#### THE OHIO TRUST

RISK FACTORS--The following summary is based on publicly available information which has not been independently verified by the Sponsors or their legal counsel.

Employment and Economy. Economic activity in Ohio, as in many other industrially developed states, tends to be more cyclical than in some other states and in the nation as a whole. Ohio ranked third in the nation in 1991 personal income derived from manufacturing. Although manufacturing (including auto-related manufacturing) remains an important part of Ohio's economy, the greatest growth in employment in Ohio in recent years, consistent with national trends, has been in the non-manufacturing area. Payroll employment in Ohio showed a steady upward trend until 1979, then decreased until 1982. It reached an all-time high in the summer of 1993 after a slight decrease in 1992 and then decreased slightly but is now increasing. Growth in recent years has been concentrated among

non-manufacturing industries, with manufacturing tapering off since its 1969 peak. Over three-fourths of the payroll workers in Ohio are employed by non-manufacturing industries.

The average monthly unemployment rate in Ohio was 6.1% in December, 1993.

With 15.7 million acres in farm land, agriculture and 'agribusiness' are also important segments of the economy in Ohio. Agribusiness, the farmer-to-consumer team, provides an estimated 750,000 jobs or approximately 15% of total Ohio employment. By many measures, agriculture is Ohio's leading industry contributing nearly \$4.1 billion to the state's economy each year.

Ohio continues to be a major 'headquarters' state. Of the top 500 industrial corporations (based on 1992 sales) as reported in 1993 by Fortune magazine, 33 had headquarters in Ohio, placing Ohio fourth as a 'headquarters' state for industrial corporations. Ohio places sixth as a 'headquarters' state for service corporations (24 of the top 500).

The State Budget, Revenues and Expenditures and Cash Flow. Ohio law effectively precludes the State from ending a fiscal year or a biennium with a deficit. The State Constitution provides that no appropriation may be made for more than two years and consistent with that provision the State operates on a fiscal biennium basis. The current fiscal biennium runs from July 1, 1993 through June 30, 1995.

Under Ohio law, if the Governor ascertains that the available revenue receipts and balances for the general revenue fund or other funds for the then current fiscal year will probably be less than the appropriations for the year, he must issue orders to the State agencies to prevent their expenditures and obligations from exceeding the anticipated receipts and balances. The Governor implemented this directive in some prior years, including fiscal years 1992 and 1993.

Consistent with national economic conditions, in the 1990-91 biennium, Ohio experienced an economic slowdown producing some significant changes in certain general revenue fund revenue and expenditure levels for the fiscal year 1991. For example, there were lower than earlier forecasted revenues from sales and use taxes (including auto) and corporate franchise and personal income taxes. Also, expenditures for human services were greater than had been expected. Several executive and legislative measures were taken to address the anticipated shortfall in revenues and increase in expenditures. As a result, the Ohio Office of Budget and Management (the 'OBM') reported a positive general revenue fund balance of approximately \$135.4 million at the end of fiscal year 1991.

State and national fiscal uncertainties during the 1992-93 biennium required several actions to achieve the ultimate positive general revenue fund ending balances. OBM subsequently projected a fiscal year 1992 imbalance--a receipts shortfall resulting primarily from lower collection of certain taxes, particularly sales, use and personal income taxing and higher expenditure levels in certain areas, particularly human services including Medicaid. As an initial action, the Governor ordered most state agencies to reduce general revenue fund appropriation spending in the final six months of fiscal year 1992 by a total of approximately \$184 million. Debt service obligations were not affected by this order. The General Assembly authorized, and the OBM made in June 1992, a \$100.4 million transfer to the general revenue fund from the budget stabilization fund and certain other funds. Other revenue and spending actions, legislative and administrative, resolved the remaining general revenue fund imbalance for fiscal year 1992.

As a first step toward addressing a \$520 million general revenue fund shortfall for fiscal year 1993 then estimated by OBM, the Governor ordered, effective July 1, 1992, selected general revenue fund appropriations reductions totalling \$300 million (but such reductions did not include debt service). Subsequent executive and legislative actions provided for positive biennium-ending general revenue fund balances for the current biennium. The general revenue fund ended the 1992-93 biennium with a fund balance of approximately \$111 million and a cash balance of approximately \$394 million. The general revenue fund appropriations bill for the current biennium was passed on June 30, 1993.

Because the schedule of general revenue fund cash receipts and disbursements do not precisely coincide, temporary general revenue fund cash flow deficiencies often occur in some months of a fiscal year, particularly in the middle months. Statutory provisions provide for effective management of these temporary cash flow deficiencies by permitting adjustment of payment schedules and the use of total operating funds. A general revenue fund cash flow deficiency occurred in two months of fiscal year

1990, with the highest being \$252.4 million. In fiscal year 1991, there were general revenue fund cash flow deficiencies in nine months, with the highest

being \$582.6 million; in fiscal year 1992 there were general revenue fund cash flow deficiencies in ten months, with the highest being \$743.1 million. In fiscal year 1993, general revenue fund cash flow deficiencies occurred in August 1992 through May 1993, with the highest being \$768.6 million in December. OBM currently projects general revenue fund deficiencies in seven months of fiscal year 1994.

State and State Agency Debt. The Ohio Constitution prohibits the incurrence or assumption of debt by the State without a popular vote except for the incurrence of debt to cover causal deficits or failures in revenue or to meet expenses not otherwise provided for which are limited to \$750,000 and to repel invasions, suppress insurrection or defend the State in war. Under interpretations by Ohio courts, revenue bonds of the State and State agencies that are payable from net revenues of or related to revenue producing facilities or categories of such facilities are not considered 'debt' within the meaning of these constitutional provisions.

At various times since 1921, the voters of Ohio, by thirteen specific constitutional amendments (the last adopted in 1993), authorized the incurrence of up to \$4.664 billion in State debt to which taxes or excises were pledged for payment. Of that amount, \$715 million was for veterans' bonuses. As of March 1, 1994, of the total amount authorized by the voters, excluding highway obligations and general obligation park bonds discussed below, approximately \$3.115 billion has been issued, of which approximately \$2.514 billion has been retired and approximately \$592.6 million remains outstanding. The only such State debt still authorized to be incurred are portions of the Highway Obligation Bonds, the Coal Development Bonds, and the State general obligation bonds for local government infrastructure projects and parks.

No more than \$500 million in highway obligations may be outstanding in any one calendar year. As of March 1, 1994, approximately \$430.6 million of highway obligations were outstanding. No more than \$100 million in State obligations for coal development may be outstanding at any one time. As of March 1, 1994, \$43.1 million of such bonds were outstanding.

Not more than \$1.2 billion of State general obligation bonds to finance local capital infrastructure improvements may be issued at any one time, and no more than \$120 million can be issued in a calendar year. As of March 1, 1994, approximately \$525.2 million of those bonds were outstanding.

The Ohio Constitution authorizes State bonds for certain housing purposes, but tax moneys may not be obligated or pledged to those bonds. In addition, the Ohio Constitution authorizes the issuance of obligations of the State for certain purposes, the owners or holders of which are not given the right to have excises or taxes levied by the State legislature to pay principal and interest. Such debt obligations include the bonds and notes issued by the Ohio Public Facilities Commission and the Ohio Building Authority.

A statewide economic development program assists with loans and loan guarantees, the financing of facilities for industry, commerce, research and distribution. The law authorizes the issuance of State bonds and loan guarantees secured by a pledge of portions of the State profits from liquor sales. The General Assembly has authorized the issuance of these bonds by the State Treasurer, with a maximum amount of \$300 million, subject to certain adjustments, currently authorized to be outstanding at any one time. Of an approximate \$148.0 million issue in 1989, approximately \$96.3 million is outstanding. The highest future year annual debt service on those 1989 bonds, which are payable through 2000, is approximately \$18.3 million.

An amendment to the Ohio Constitution authorizes revenue bond financing for certain single and multifamily housing. No State resources are to be used for the financing. As of January 31, 1994, the Ohio Housing Financing Agency, pursuant to that constitutional amendment and implementing legislation, had sold revenue bonds in the aggregate principal amount of approximately \$226.17 million for multifamily housing and approximately \$3.898 billion for single family housing.

A constitutional amendment adopted in 1990 authorizes greater State and political subdivision participation in the provision of housing for individuals and families in order to supplement existing State housing assistance programs. The General Assembly could authorize State borrowing for the new

programs and the issuance of State obligations secured by a pledge of all or a portion of State revenues or receipts, although the obligations may not be supported by the State's full faith and credit.

A 1986 act (the 'Rail Act') authorizes the Ohio High Speed Rail Authority (the 'Rail Authority') to issue obligations to finance the costs of inter-city high speed rail service projects within the State either directly or by loans to other entities. The Rail Authority has considered financing plan options and the possibility of issuing bonds or notes. The Rail Act prohibits, without express approval by joint resolution of the General Assembly, the collapse of any escrow of financing proceeds for any purpose other than payment of the original

financing, the substitution of any other security, and the application of any proceeds to loans or grants. The Rail Act authorizes the Rail Authority, but only with subsequent General Assembly action, to pledge the faith and credit of the State but not the State's power to levy and collect taxes (except ad valorem property taxes if subsequently authorized by the General Assembly) to secure debt service on any post-escrow obligations and, provided it obtains the annual consent of the State Controlling Board, to pledge to and use for the payment of debt service on any such obligations, all excises, fees, fines and forfeitures and other revenues (except highway receipts) of the State after provision for the payment of certain other obligations of the State.

Schools and Municipalities. The 612 public school districts and 49 joint vocational school districts in the State receive a major portion (approximately 46%) of their operating funds from State subsidy appropriations known as the Foundation Program. They must also rely heavily upon receipts from locally-voted taxes. Some school districts in recent years have experienced varying degrees of difficulty in meeting mandatory and discretionary increased costs. Current law prohibits school closings for financial reasons.

Original State appropriations for the 1992-93 biennium provided for an increase in school funding over funding for the preceding biennium. The reduction in appropriations spending for fiscal year 1992 included a 2.5% overall reduction in the annual Foundation Program appropriations and a 6% reduction in other primary and secondary education programs. The reductions were in varying amounts, and had varying effects, with respect to individual school districts. State appropriations for the current biennium provide for an increase in State school funding appropriations over those in the preceding biennium. The \$8.9 billion appropriated for primary and secondary education is intended to provide for 2.4% and 4.6% increases in State aid in the two fiscal years of the biennium.

In previous years school districts facing deficits at year end had to apply to the State for a loan from the Emergency School Advancement Fund. This Fund met all the needs of the school districts with potential deficits in fiscal years 1979 through 1989. New legislation replaced the Fund with enhanced provisions for individual district local borrowing, including direct application of Foundation Program distributions to repayment if needed. As of fiscal year 1993, 43 districts received loans and advances totaling approximately \$94.5 million under this program.

Litigation contesting the Ohio system of school funding has been filed in two county common pleas courts (efforts are being made to move one action to federal court). The complaints essentially request a declaratory judgment that the State's statutory system of funding public elementary and secondary education violates various provisions of the Ohio Constitution and request the State to devise a constitutionally acceptable system of school funding. Since the trial that has begun in one of these cases is not yet completed, and since in any case, the trial court judgments are subject to appeal, it is not possible at this time to state whether either suit will be successful.

Various Ohio municipalities have experienced fiscal difficulties. Due to these difficulties, the State established an act in 1979 to identify and assist cities and villages experiencing defined 'fiscal emergencies'. A commission appointed by the Governor monitors the fiscal affairs of municipalities facing substantial financial problems. To date, this act has been applied to twelve cities and twelve villages. The situations in nine of the cities and seven of the villages have been resolved and their commissions terminated.

State Employees and Retirement Systems. The State has established five public retirement systems, three of which cover both State and local government employees, one covers State government employees only, and one covers local government employees only. Those systems provide retirement, disability retirement and survivor benefits. Federal law requires newly-hired State

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employees to participate in the federal Medicare program, requiring matching employer and employee contributions, each now 1.45% of the wage base. Otherwise, State employees covered by a State retirement system are not currently covered under the federal Social Security Act. The actuarial evaluations reported by these five systems showed aggregate unfunded accrued liabilities of approximately \$17,143 billion covering both State and local employees.

The State engages in employee collective bargaining and currently operates under staggered two-year agreements with all of its 21 bargaining units. The State is in negotiations, which are now in the fact-finding contract negotiation process, for extension of the two-year agreement expiring January 31, 1994 with its largest bargaining unit representing approximately 37,000 employees.

Health Care Facilities Debt. Revenue bonds are issued by Ohio counties and other agencies to finance hospitals and other health care facilities. The revenues of such facilities consist, in varying but typically material amounts, of payment from insurers and third-party reimbursement programs, such as Medicaid, Medicare and Blue Cross. Consistent with the national trend, third-party reimbursement programs in Ohio have begun new programs, and modified

benefits, with a goal of reducing usage of health care facilities. In addition, the number of alternative health care delivery systems in Ohio has increased over the past several years. For example, the number of health maintenance organizations licensed by the Ohio Department of Insurance increased from 12 on February 14, 1983 to 30 as of February 8, 1994. Due in part to changes in the third-party reimbursement programs and an increase in alternative delivery systems, the health care industry in Ohio has become more competitive. This increased competition may adversely affect the ability of health care facilities in Ohio to make timely payments of interest and principal on the indebtedness.

#### OHIO TAXES

In the opinion of Vorys, Sater, Seymour and Pease, Columbus, Ohio, special counsel on Ohio tax matters, under existing Ohio law:

The Ohio Trust is not an association subject to the Ohio corporation franchise tax or the Ohio tax on dealers in intangibles and the Trustees will not be subject to the Ohio personal income tax.

In calculating a Holder's Ohio personal income tax or the Ohio corporation franchise tax, a Holder will not be required to include in the Holder's 'adjusted gross income' or 'net income,' as the case may be, the Holder's share of interest received by or distributed from the Ohio Trust on any Debt Obligation in the Ohio Trust, the interest on which is exempt from Ohio personal income or corporation franchise taxes, as the case may be.

In calculating a Holder's Ohio personal income tax or the Ohio corporation franchise tax, a Holder will be required to include in the Holder's 'adjusted gross income' or 'net income,' as the case may be, capital gains and losses which the Holder must recognize for Federal income tax purposes (upon the sale or other disposition of Units by the Holder or upon the sale or other disposition of Debt Obligations by the Ohio Trust), except gains and losses attributable to Debt Obligations specifically exempted from such taxation by the Ohio law authorizing their issuance. A Holder subject to the Ohio corporation franchise tax may, in the alternative if it results in a larger amount of tax payable, be taxed upon its net worth and, for this purpose, is required to include in its net worth the full value, as shown on the books of the corporation, of all Units which it owns.

For purposes of Ohio municipal income taxation, the Holder's share of interest received by or distributed from the Ohio Trust on Debt Obligations or gains realized by the Holder from the sale, exchange or other disposition of Units by the Holder or from the sale, exchange or other disposition of Debt Obligations by the Ohio Trust, as a result of the repeal of the Ohio tax on intangible personal property, might be required to be included in a Holder's taxable income if (1) such interest or gain is not exempt from Ohio municipal income taxes by virtue of a specific statutory or constitutional exemption from such taxes (regarding which no blanket opinion is being given), and (2) the Ohio municipality in which the Holder resides was taxing such income on or before April 1, 1986 and such tax was submitted to and approved by the voters of such municipality in an election held on November 8, 1988.

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Assuming that the Ohio Trust will not hold any tangible personal property nor any real property, neither Debt Obligations held by the Ohio Trust nor Units of the Ohio Trust held by individuals are subject to any property tax levied by the State of Ohio or any political subdivision thereof.

Units of the Ohio Trust held by individuals may be subject to Ohio estate taxes.

Neither the Sponsors nor Vorys, Sater, Seymour and Pease has made any review of the proceedings relating to the issuance of the Debt Obligations (except in such cases as Vorys, Sater, Seymour and Pease has acted or will act as counsel to such issuing authorities); nor has Vorys, Sater, Seymour and Pease made any review of the proceedings relating to the issuance of the Units. The opinion of Vorys, Sater, Seymour and Pease is based, in part, on (i) the opinion of Davis, Polk & Wardwell regarding Federal tax matters affecting the Fund, (ii) the assumption that the opinions of bond counsel for the Debt Obligations comprising the Ohio Trust all concluded that interest on each of the respective Debt Obligations of the Ohio Trust will be exempt from Ohio personal income and corporation franchise taxes, and (iii) the Ohio Revised Code, Ohio case law and interpretations of Ohio law by the Ohio Department of Taxation. Vorys, Sater, Seymour and Pease has not examined and expresses no opinion regarding (1) matters not arising under Ohio law, or (2) the tax status under Ohio law of specific Debt Obligations which the Fund may hold or acquire, except for those cases in which it has acted or will act as bond counsel in connection with the issuance of such Debt Obligations. No opinion is expressed or intended and no assurances are given that the opinions of Vorys, Sater, Seymour and Pease will not be modified as a result of future legislative, administrative or judicial

actions.

#### THE OREGON TRUST

RISK FACTORS--Introduction. Oregon's public finances were dramatically altered in November 1990 by the adoption of Ballot Measure No. 5 by the voters of the State of Oregon. The Measure, which amended the Oregon Constitution by the addition of a new Article XI, Section 11b, limited property taxes for non-school government operations to \$10 per \$1,000 of real market value beginning in the 1991-92 fiscal year. Property taxes for school operations were limited to \$15 per \$1,000 of real market value in the 1991-92 fiscal year, while ultimately declining to \$5 per \$1,000 of real market value in the 1995-96 fiscal year. The Measure also required the State of Oregon to use the State General Fund revenues to pay school districts replacement dollars through the 1995-96 fiscal year for most of the revenues lost by the school districts because of the Measure's limitations on their tax levies.

The State Legislative Revenue Office reports that as a result of Ballot Measure No. 5 non-school districts lost approximately \$84.9 million of revenues during the 1991-93 fiscal biennium (with Oregon cities losing approximately \$43.1 million). Because of the Ballot Measure, school districts lost \$565.8 million of tax revenues in the 1991-93 fiscal biennium.

Among the possible alternatives to the restrictions imposed by Ballot Measure No. 5 is the adoption of a State sales tax, the revenues from which would be dedicated to funding public education programs, up to and including community colleges. A sales tax proposal, which would have amended the State constitution, was approved by the 1993 Legislature and referred to Oregon voters for consideration during the November 1993 election. Oregon voters rejected the sales tax proposal, however, causing a great deal of uncertainty with respect to the State's future fiscal policy.

The Measure contains many confusing and ill-defined terms, which may ultimately be resolved by litigation in Oregon courts. In an attempt to define some of these terms, and to provide guidance to Oregon municipalities, the 1991 Oregon Legislature approved a comprehensive revision of the statutes applicable to the issuance of municipal debt in Oregon. A section of the 1991 legislation, which excluded tax increment financing for urban renewal bonds indebtedness from the limits of Ballot Measure No. 5, was declared invalid by the Oregon Supreme Court in September, 1992. The Court, which affirmed an earlier ruling of the Oregon Tax Court, determined that tax increment financing plans imposed a 'tax' on property subject to the limitations of Ballot Measure No. 5. A proposed State constitutional amendment which would have revalidated tax increment financing was referred to the Oregon voters in May 1993 and rejected. The City of Portland has outstanding \$89 million in principal

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amount of urban renewal bonds. The Portland City Council has committed the City to honor the payment of the urban renewal bonds from alternative sources.

The Measure defines the term 'tax' as 'any charge imposed by a governmental unit upon property or upon a property owner as a direct consequence of ownership of that property,' excepting only from that definition 'incurred charges and assessments for local improvements.' All Oregon issuers are required to analyze the charges they assess to determine if they constitute 'taxes,' which are then limited by the constraints of the Measure. Moreover, debt service payments for revenue and special assessment bonds are required to be reviewed in the light of the Measure to determine if the charges made by the municipal issuer for these debt service payments will constitute 'taxes' limited by the Measure. The comprehensive legislative revision of Oregon municipal debt contains statutory guidelines to assist a municipality in determining if the charges assessed are 'taxes' limited under the Measure.

Debt service on bonded indebtedness may be adversely affected by Ballot Measure No. 5 if the tax levied to provide funds for the servicing of the debt will be included in the calculation of the maximum permitted tax levy under the Measure. Taxes levied to pay for bonded debt will generally be included in the limitations prescribed by the Measure, unless

- \* The bonded indebtedness was specifically authorized by the Oregon Constitution (as, for example, the Oregon Veterans' Bonds), or
- \* (i) The bonded indebtedness was incurred or will be incurred 'for capital construction or improvements,' (ii) the bonds issued for the capital construction or improvements are general obligation bonds, and (iii) the bonds were either issued before November 6, 1990, or, if issued after that date, were approved by the electors of the issuer.

To provide for this limitation on the authority to tax, the Oregon legislation creates two classifications of bonds secured by the taxing authority of a municipal issuer: 'general obligation bonds,' which are bonds secured by an authority to tax unlimited by the Measure, and 'limited tax bonds,' which are bonds secured by an authority to levy taxes only within the overall limits imposed on a municipal issuer by the Measure.



The 1991 Legislature also attempted to grant more financing flexibility to Oregon municipalities facing the rigors of the Measure. Prior to the 1991 legislation, for example, only revenues of a revenue producing facility financed with revenue bonds could be pledged to the payment of the revenue bonds. The statutory revisions now permit Oregon municipal issuers to pledge any revenues (other than revenues derived from property taxes) to the payment of revenue bonds, even if the proceeds of the bonds are not utilized for the financing of the facility producing the revenues.

The effects of Ballot Measure No. 5 could cause a reduction in the ratings for debt obligations issued by the State and its political subdivisions, as well as Oregon municipalities, unless revenue increases and expense reductions can continue to be demonstrated and adopted. Rating changes, if any, may also depend upon the specific impact of the Measure on the revenues of the issuer and the effect of the Measure on the revenues utilized to pay the debt service of the rated indebtedness.

Fiscal Matters. The State's Executive Department reports that the modest acceleration experienced by Oregon's economy at the end of 1993 is expected to continue into 1994. The construction sector, boosted by low interest rates, in-migration, and appreciating home values, is projected by the Executive Department to pull the State's economy to a higher growth path. The Executive Department also projects that continued gains in high technology manufacturing, an expanding service sector, and strong small business income growth will further lift the economy. Despite these indications of an improving economy, however, the Executive Department reports that several factors will continue to prevent robust growth. The Executive Department projects that structural changes in the Oregon economy will limit the State's overall economic growth rate, with further job reductions anticipated in the timber industry as the federal forest plan is implemented. According to the Executive Department, if the plan is delayed and federal timber sales remain near zero, timber harvests and employment will fall below expectations. The Executive Department also projects that government employment will remain weak as state and local government revenue shrinks relative to the overall economy. Furthermore, with the rejection by the Oregon voters of a state-wide

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sales tax in November 1993, a great deal of uncertainty surrounds future State fiscal policy, which uncertainty, according to the Executive Department, could have negative impacts beyond those anticipated in its economic forecasts.

The Executive Department reports that wage and salary employment in the State increased at a seasonally-adjusted annual rate of 1.2 percent in the third quarter of 1993, up from 0.4 percent in the previous three-month period. Though improving slightly, the Executive Department reports that the payroll survey upon which the wage and salary employment estimate is based appears to be understating the strength of the economy in many states, including Oregon. The Executive Department's total employment estimate, which includes the self-employed, shows a 2.5 percent increase over the past year, compared to 1.9 percent for the payroll survey, which the Executive Department reports is likely due to the growth of small business, particularly consulting firms. Other factors which the Executive Department cite as indicating growth in the economy include an increase in the average workweek level for Oregon manufacturers, which was 1.8 percent above the rate for the previous year, and an increase in personal income tax withholding collections in the third quarter of 1993, which were 7.6 percent above the amount during the third quarter of 1992.

The Executive Department projects that Oregon wage and salary income growth will accelerate to 7.2 percent in 1994, up from the 1993 pace of 3.8 percent. Although some of this increase is due to the expectation of improving economic conditions, the Executive Department reports that much of the increase is the result of timing shifts induced by the change in federal income tax rates which took effect on January 1, 1993, with high income wage earners electing to take bonuses at the end of 1992 rather than waiting for the next year in anticipation of the rate change. The Executive Department also projects Oregon's wage and salary jobs to increase by 30,400 in 1994, compared with 21,900 in 1993. In 1992, personal income grew by 6.0% while net job growth was 20,200.

Oregon's attractive quality of life and relatively low cost of living are expected by the Executive Department to continue to draw new residents into the State. Deteriorating economic conditions in Washington and continued weakness in California are also expected to fuel the movement to Oregon. The Executive Department reports that Oregon's population increased 2.0% (62,000) in 1993 and projects an increase of 1.9% (59,000) in 1994. Net in-migration is expected to make up approximately 30,000 to 35,000 of the population increase each year.

The Oregon Constitution requires that the State budget be balanced during each fiscal biennium. Should the State experience budgetary difficulties similar to the effects of the national recession on Oregon during the first half of the 1980's, the State, its agencies, local units of government, schools and private organizations which depend on State revenues and appropriations for both operating funds and debts service could be required to expand revenue sources or curtail certain services or operations in order to meet payments on their

obligations. To the extent any difficulties in making payments are perceived, the market value and marketability of outstanding debt obligations in the Oregon Trust, the asset value of the Oregon Trust and interest income to the Oregon Trust could be adversely affected.

The budget for the 1993-95 biennium includes a General Fund budget of \$6.350 billion, representing an increase of 15.3% over 1991-93 expenditures. Total appropriations for all funds in the 1993-95 budget are \$19.962 billion, representing an increase of 11.3% over the 1991-93 expenditures. This total includes, in addition to the General Fund, \$10.241 billion in Other Funds and \$3.370 billion in Federal Funds.

The obligation of the State under Ballot Measure No. 5 to replace most of the lost revenues of school districts will have an adverse effect on the State's General Fund in the 1991-93 fiscal biennium. These replacement dollars are estimated by the State Legislative Revenue Office to total \$467.1 million during the 1991-93 fiscal biennium, \$1,565.8 million during the 1993-95 biennium, and \$1,382.6 million during the 1995-96 fiscal year. Under Ballot Measure No. 5, the State's obligation to replace school revenues terminates after fiscal year 1995-96. The financial impact of the Measure will depend, in part, on the effect of legislation passed during the 1991 and 1993 legislative sessions and possible future legislative actions and court decisions.

Debt Obligations. The State of Oregon issued \$357.0 million in bonds, notes and certificates of participation ('COPs') during the fiscal year ended June 30, 1993, a decrease of 31.0% from the

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\$517.5 million in bonds, notes and COPs issued in the fiscal year ended June 30, 1992. Of the fiscal year 1992-93 total, \$195.7 million were general obligations, \$111.5 million were revenue obligations, and \$49.7 million were COPs. During fiscal year 1992-93, local Oregon governments issued approximately \$1.625 billion in debt, an increase of approximately 87.2% from the fiscal year 1991-92 issuances of \$867.8 million.

The State of Oregon had outstanding \$4.713 billion in general obligations at December 31, 1993 representing a decrease of 6.2% from the total outstanding general obligations of \$5.023 billion at December 31, 1992. Oregon local governments had \$5.430 billion in total debt outstanding at December 31, 1993, representing an increase of 5.2% from the total outstanding of \$5.163 billion at December 31, 1992.

Veterans' Bond Program. At December 31, 1993, the State of Oregon had outstanding approximately \$3.871 billion of Oregon Veterans' Welfare Bonds and Notes, representing a decrease of 9.68 percent from the total outstanding of \$4.286 billion at December 31, 1992. The Veterans' Bonds and Notes are utilized to finance the veterans' mortgage loan program, administered by the Oregon Department of Veterans' Affairs. The Veterans' Bonds and Notes are general obligations of the State of Oregon.

In June 1988 the Oregon Attorney General issued an opinion relating to periodic transfers dating back to 1951 of surplus monies from the Oregon War Veterans' Fund to the State's General Fund. The Oregon War Veterans' Fund, created in 1945 to provide home and farm loans to veterans, also provides funding for specifically enumerated veterans and veterans' organizations. The Attorney General opined that the State was obligated to return the amounts transferred, with interest. The Oregon Legislature acted on the matter during the 1989 legislative term, appropriating \$77.2 million to the Oregon War Veterans' Fund from the General Fund. Of the amount appropriated, \$58.9 million was transferred on July 1, 1989, and the balance was transferred in 1990. As a result of these cash transfers, as well as lower than expected defaults and other changes in the assumptions underlying the forecasting model of the Department of Veterans' Affairs, the Department has eliminated its earlier projected deficits for the Veterans' Bond program's sinking fund.

These earlier revenue shortfalls and projected deficits in the Veterans' Bond program had an adverse effect on the ratings of all Oregon general obligation bonds. Standard & Poor's increased its rating on Oregon general obligations from A+ to AA-, however, after reviewing the 1989 transfer of monies from the State's General Fund to the Oregon War Veterans' Fund. Similarly, the Moody's rating of the State's outstanding general obligation bonds was increased from A1 to Aa in January 1990.

The effects of Ballot Measure No. 5 could cause a reduction in these ratings (as well as a reduction in ratings of the debt of other Oregon municipalities), unless revenue increases and expense reductions can be demonstrated and adopted. The rating changes, if any, may also depend upon the specific impact of the Measure on the revenues of the issuer, and the effect of the Measure on the revenues utilized to pay the debt service of the rated indebtedness.

Taxes and Other Revenues. The State relies heavily on the personal income tax. The personal income tax generated \$3.853 billion of the total 1989-91 biennium General Fund revenues of \$4.682 billion and \$4.551 billion of the total

1991-93 biennium General Fund revenues of \$5.419 billion. The State's Department of Revenue estimates that the personal income tax will generate \$5.213 billion of the total General Fund revenues of \$6.210 billion projected for the 1993-95 biennium. The State corporate income and excise tax generated \$297.4 million in revenues during the 1989-91 biennium and \$335.9 million in revenues during the 1991-93 biennium, and is projected by the Department of Revenue to generate \$416.2 million in revenues during the 1993-95 fiscal biennium. The State created a lottery, which commenced operations in May 1985. Revenues generated by the lottery are used for economic development. State lottery officials report that revenues generated from the regular lottery sales for the 1992-93 fiscal year totaled \$258.6 million, with \$62.7 million of that amount having been made available to fund economic development in the State. State lottery officials also report that the State's video poker program, which commenced operation in March 1992, generated revenues of \$172.2 million, net of prizes awarded, during the 1992-93 fiscal year, with \$77.6 million of that amount being made available to fund economic development in the State. State lottery officials

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currently forecast \$275.5 million from regular lottery sales and \$236.8 million, net of prizes awarded, from video poker sales for the 1993-94 fiscal year, with \$66.1 million and \$117.7 million of those amounts, respectively, projected to be available to fund economic development in the State.

Under existing state tax programs, if the actual corporate income and excise taxes received by the State in a fiscal biennium exceed by two percent or more the amount estimated to be received from such taxes for the biennium, the excess must be refunded as a credit to corporate income and excise taxpayers in a method prescribed by statute. Similarly, if General Fund revenue sources (other than corporate income and excise taxes) received in the biennium exceed by two percent or more the amount estimated to be received from such sources during the biennium, the excess must be refunded as a credit to personal income taxpayers.

Authority to levy property taxes is presently vested with the governing body of each local government unit. In addition to the restrictions of Ballot Measure No. 5, other constitutional and statutory provisions exist which limit the amount that a governing body may levy:

1. Levy Within 6 Percent Limitation (Tax Base Levy). A tax base, approved by a majority of voters at a statewide general or primary election, represents permanent authority to annually levy a dollar amount which cannot exceed the highest amount levied in the three most recent years in which a levy was made, PLUS six percent thereof. A local unit is permitted to have but one tax base levy and proceeds may be used for any purpose for which the unit may lawfully expend funds.

2. Levy Outside 6 Percent Limitation (Special, Serial or Continuing Levy). Special and serial levies are temporary taxing authorities permitting the levy of a specific dollar amount for one year (Special) or for two or more years up to ten years (Serial). Continuing levies are those approved by voters prior to 1953, are permanent in nature and are limited in amount by the product of the voted tax rate and the assessed value of the unit. Since 1978 Serial levies may also be established based on a specified tax rate but the term may not exceed three years. Not more than four serial levy measures may be proposed in a given year.

3. Levy Not Subject to 6 Percent Limitation (Debt Levy). Local units are required to annually levy an amount sufficient to pay principal and interest costs for a bonded debt. Bond measures to be paid from future tax levies must first be approved by a majority of those voting unless otherwise provided by law.

Responding to a number of school closures occurring as a result of tax levy failures during the last decade, Oregon voters approved a school 'Safety Net' measure in 1987 designed to prevent future closures and maintain schools at the standards required by the State. The law provides that in the event a school district levy is defeated, upon making a finding that schools may close for lack of funds, the school board is authorized to levy property taxes no greater than the amount levied in the prior year and to adjust the district budget accordingly for the period through the next date set to vote on the levy.

Litigation. The following summary of litigation relates only to matters as to which the State of Oregon is a party and as to which the State of Oregon has indicated that the individual claims against the State exceed \$5 million. Other litigation may exist with respect to individual municipal issuers as to which the State of Oregon is not a party, but which, if decided adversely, could have a materially adverse effect on the financial condition of the individual municipal issuer.

1. SAIF Fund Transfers. During 1983, three special sessions of the Legislature were convened to balance the previously approved budget for the 1981-83 fiscal biennium. Among the actions required to balance the budget were the reduction of expenditures during the biennium by more than \$215 million and the transfer to the State's General Fund in June 1983 of \$81 million from the

surplus of the State Accident Insurance Fund ('SAIF'). The State was sued in litigation challenging the legality of the transfer of this surplus from SAIF to the General Fund. Although the validity of the action was upheld at the trial and intermediate appellate levels, the Oregon Supreme Court, affirming the trial and appellate court decisions in part and reversing them in part, held that the transfer of the \$81 million was not proper. The Court did not, however, require that the funds be repaid to SAIF, nor did the Court award the plaintiff any damages.

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As a result of the decision, a coalition of Oregon businesses filed a class action lawsuit against the State seeking the return of the entire \$81 million, plus interest accrued. The lawsuit alleged that 30,000 Oregon businesses were denied potential dividend payments when the Legislature improperly transferred the SAIF reserves to the General Fund. The trial court ruled that the plaintiffs could not maintain the suit as a class action, and dismissed all claims against the State other than the plaintiffs' claims for breach of contract. Subsequently, the trial court granted summary judgment, in part, in the State's favor, dismissing the claims against all but five of the State defendants.

The claims against the remaining defendants were consolidated and tried in December 1990. The trial court granted a directed verdict for two of the defendants, and the jury returned a defense verdict for the remaining three. The plaintiffs appealed the verdicts to the Oregon Court of Appeals in March 1991. In December 1992, the Oregon Court of Appeals reversed the trial court's judgment in favor of the State, holding that the trial court should have heard the case as a class action, under which the classes of policyholders could have had an opportunity to offer proof that they sustained damages in the form of dividends or reduced premiums that the policyholders would have received if the Legislature had not made the 1983 transfer of surplus reserves from SAIF. However, in May 1993, the Oregon Supreme Court granted both the plaintiffs' and the State's petitions for review of the Court of Appeals' decision and on November 19, 1993, the Oregon Supreme Court issued an opinion ruling that the State must return to SAIF the \$81 million that the Legislature transferred to the General Fund. The supreme court remanded the case to the trial court to fashion a decree based upon evidence of what SAIF would have done with the money if it had not been transferred to the General Fund. On December 28, 1993, the State filed a motion for reconsideration of the Oregon Supreme Court's opinion. The motion for reconsideration stayed any action by the trial court. If the supreme court denies the State's motion for reconsideration, the ultimate decision of the trial court could include an award of interest on the sums to be returned to the General Fund. The State estimates that under such a decision the State's repayment obligation could equal or exceed \$150 million.

2. Mental Health Care. Plaintiffs in a lawsuit filed against the State in May 1992 have challenged the constitutionality of certain conditions at, and the treatment of, 300 patients in the forensics wards of the Oregon State Hospital. Although the plaintiffs claim no damage award, the State has indicated that compliance with the entry of the injunction that the plaintiffs seek could potentially cost the State several million dollars annually. If the plaintiffs prevail, the State could also be liable for the plaintiffs' attorney fees, which the State believes could amount to several hundred thousand dollars.

3. Spotted Owl Timber Sale Cases. The State is currently facing potential claims in connection with twenty-two State timber sales involving timber lands that spotted owls may be using as habitats. Although only a few suits have been brought against the State at this time, the State anticipates that other similar cases will be filed. While the State has indicated that it is not now possible to estimate the probable outcome of these claims, it estimates that the total potential exposure to the State may exceed \$11.6 million.

4. State Employee Claims for Overtime Pay. A class action suit has been commenced in the United States District Court on behalf of all State employees who have been deemed by the State to be exempt from the federal Fair Labor Standards Act overtime provisions. Plaintiffs claim that they are not salaried employees exempt from the overtime payment requirements of the Fair Labor Standards Act because they are required to account for hours worked. According to the State, the potential class totals an estimated 10,000 current and former State employees. The plaintiffs seek back pay for overtime during the three-year period preceding filing of the action, plus statutory liquidated damages in an equal amount, and attorney fees. In June 1993, the federal District Court granted the State's motion for summary judgment and dismissed the claim. Plaintiffs appealed the decision to the United States Court of Appeals for the Ninth Circuit. Although both sides have filed briefs on appeal, no date has yet been set for oral argument.

5. Department of Corrections Harassment Litigation. Four former and current female employees of the Oregon Department of Corrections filed a civil rights action during September 1992 against that department in the United States District Court for the District of Oregon. The plaintiffs claim almost \$9 million in damages, plus attorney fees, alleging that they had been subjected to sexual harassment

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while working for the department. The State has indicated that is not possible to estimate a probable outcome or the extent of the State's exposure to liability at this time.

6. Taxation of Pension Benefits. Several cases have been filed in the Oregon Tax Court and the State Circuit Courts alleging that a 1991 increase in the Public Employee Retirement System ('PERS') benefits, to offset State taxation of the PERS benefits, violates a holding by the United States Supreme Court in *Davis v. Michigan Dept. of Treasury*. The *Davis* case holds that state statutes may not provide disparate tax treatment of state and federal pension benefits. The State has indicated that it is not possible to estimate the potential impact of liability under these cases at this time.

The plaintiffs in another matter have requested class certification (which the State expects to be granted), in an action filed against the State and other public entities regarding the taxation of Oregon public employment retirement benefits. If certified, the class will be all PERS retirees and some currently employed PERS members. Class certification has also been requested, and the State expects such certification to be granted, for a class of defendants composed of all employers participating in PERS. The plaintiffs seek enforcement of the Oregon Supreme Court's decision in *Hughes v. State*. In *Hughes*, the Court ruled that a statutory amendment repealing a tax exemption for retirement benefits violated the constitutional provision against impairment of contract for benefits received from work performed prior to the date of amendment. The court deferred to the Oregon Legislature to fashion a remedy; the Legislature failed to provide a remedy, however, during the 1993 legislative session. Plaintiffs seek to require public employers to pay breach of contract damages or to increase benefits due to taxation of previously untaxed pensions.

According to the State, the form and amount of liability which may be incurred by the State for these cases is uncertain. The State has indicated that if the court accepts a remedy of increased benefits paid to the affected retirees, the impact on the General Fund would be indirect in the form of increased contributions to PERS. The indirect liability to State agencies under a benefits remedy is estimated by the State to be \$10-13 million per year over a 30-year period, with only about one-third of that amount payable by agencies funded from the General Fund.

Local governments have asserted defenses based upon breach of contract theories and are seeking indemnification from the State. If the local governments are successful, liability would be imposed directly on the General Fund. If the court determines that the remedy must be the direct payment of monetary damages in the amount of tax revenues generated from the PERS benefits, the State believes that the potential impact on the General Fund would be much higher than under a remedy of increased benefit payments.

7. Out-of-State Insurance Company Claims. In August 1993, several out-of-state insurance companies filed a lawsuit against the State challenging the State's gross premiums tax on out-of-state insurers. The lawsuit alleges that the tax violates the Equal Protection Clause of the 14th Amendment to the United States Constitution because the tax treats domestic and 'foreign' insurers differently. The insurance companies seek a declaration that the Oregon gross premium tax is unconstitutional, refunds of all premiums paid from 1982 to date, and the recovery of their attorney's fees. Although the State has indicated that it is not possible to predict a probable outcome of the case at this time, in hearings before the 1993 Oregon Legislative Assembly concerning the gross premium tax laws, estimates of the State's potential refund liability ranged from \$27.4 million to \$174.6 million.

8. State Video Poker Games. Several individuals filed a lawsuit against the State challenging the legality of video poker games conducted by the Oregon State Lottery. The challengers contend that the games violate Oregon's constitutional prohibition against casinos, and that the 6 percent allocation of revenues from these games to counties for law enforcement and treatment of gambling disorders does not comply with the constitutionally mandated application of gambling revenues for 'economic development' purposes.

In October 1991, the trial court granted the State's motion for judgment on the pleadings in the State's favor, and the plaintiffs appealed to the Oregon Court of Appeals. The court of appeals reversed the trial court's decision and remanded the case to the trial court to take evidence on what constitutes prohibited 'casino-type' gambling. The State appealed the decision of the court of appeals to the Oregon Supreme Court, which heard oral arguments on January 4, 1994. If the supreme court

invalidates the games, the Lottery would be deprived of the ability to generate substantial revenues. State Lottery officials have forecast that video poker games will generate \$117.7 million to fund economic development in the State during the 1993-94 fiscal year.

9. Increase in State Medicaid Reimbursement Amounts. An association of 'for profit' nursing homes has filed a lawsuit against the State alleging that the amount of reimbursement paid by the State to nursing homes is too low and

violates federal law. Under federal law, states are required to reimburse facilities for costs that must be incurred by efficient and economic providers. The plaintiff claims that State reimbursement costs do not comply with this federal requirement. The State believes that the potential liability, if plaintiff is successful, would be the difference between the amount paid by the State under its current rules and the greater amount (if any) the court determines the State should pay. While the State has indicated that it is not possible to estimate the amount of such increases at this time, it believes that the liability to the State in terms of future compliance with any increase for reimbursement rates would likely be well over \$5 million.

#### OREGON TAXES

In the opinion of Perkins Coie, Portland, Oregon, special counsel on Oregon tax matters, under existing Oregon law:

1. The Oregon Trust is not an association taxable as a corporation for Oregon excise tax purposes. The income of the Oregon Trust will be treated as the income of the Holders of the Units of the Oregon Trust and be deemed to have been received by them when received by the Oregon Trust.

2. Holders of Units in the Oregon Trust who are subject to Oregon personal income taxation under Chapter 316 of the Oregon Revised Statutes will not be required to include their share of the earnings of, or distributions from, the Oregon Trust in their Oregon gross income to the extent that such earnings or distributions represent tax-exempt interest for Federal income tax purposes received by the Oregon Trust on obligations issued by Oregon, its political subdivisions or their agencies or instrumentalities, the interest on which is exempt from taxation under Oregon law, and on obligations issued by the government of Puerto Rico or by its authority or by the government of Guam or by its authority.

3. The Oregon Trust's capital gains and capital losses, included in the Federal gross income of Holders of Units in the Oregon Trust who are subject to Oregon personal taxation under Chapter 316 of the Oregon Revised Statutes, will be included as capital gains and losses in the Holder's Oregon personal gross income.

4. Gains and losses realized upon the sale or redemption of Units by Holders who are subject to Oregon personal income taxation under Chapter 316 of the Oregon Revised Statutes will be includable in their Oregon personal gross income.

5. Corporations subject to the Oregon corporate excise tax under Chapter 317 of the Oregon Revised Statutes will be subject to the tax on most or all of the income from the Oregon Trust, depending on the nature of the obligation held by the Oregon Trust.

#### THE PENNSYLVANIA TRUST

RISK FACTORS--Prospective investors should consider the financial difficulties and pressures which the Commonwealth of Pennsylvania and certain of its municipal subdivisions have undergone. Both the Commonwealth and the City of Philadelphia are experiencing significant revenue shortfalls. There can be no assurance that the Commonwealth will not experience a further decline in economic conditions or that portions of the municipal obligations contained in the Portfolio of the Pennsylvania Trust will not be affected by such a decline. Without intending to be complete, the following briefly summarizes some of these difficulties and the current financial situation, as well as some of the complex factors affecting the financial situation in the Commonwealth. It is derived from sources that are generally available to investors and is based in part on information obtained from various agencies in Pennsylvania. No independent verification has been made of the following information.

STATE ECONOMY. Pennsylvania has been historically identified as a heavy industry state although that reputation has changed recently as the industrial composition of the Commonwealth diversified

when the coal, steel and railroad industries began to decline. The major new sources of growth in Pennsylvania are in the service sector, including trade, medical and the health services, education and financial institutions. Pennsylvania's agricultural industries are also an important component of the Commonwealth's economic structure, accounting for more than \$3.6 billion in crop and livestock products annually while agribusiness and food related industries support \$38 billion in economic activity annually.

Non-agricultural employment in the Commonwealth declined by 5.1 percent during the recessionary period from 1980 to 1983. In 1984, the declining trend was reversed as employment grew by 2.9 percent over 1983 levels. Since 1984, non-agricultural employment has continued to grow each year. The growth in employment experienced in Pennsylvania is comparable to the nationwide growth in employment which has occurred during this period. As a percentage of total non-agricultural employment within the Commonwealth, non-manufacturing

employment has increased steadily since 1980 to its 1992 level of 81.3 percent of total employment. Consequently, manufacturing employment constitutes a diminished share of total employment within the Commonwealth. In 1992, manufacturing employment represented 18.7 percent of all non-agricultural employment in the Commonwealth while the services sector accounted for 29.3 percent and the trade sector accounted for 22.7 percent.

The Commonwealth is currently facing a slowdown in its economy. Moreover, economic strengths and weaknesses vary in different parts of the Commonwealth. In general, heavy industry and manufacturing have been facing increasing competition from foreign producers. During 1992, the annual average unemployment rate in Pennsylvania was 7.5 percent compared to 7.4 percent for the United States. For January 1993 the unadjusted unemployment rate was 6.7 percent in Pennsylvania and 7.3 percent in the United States, while the seasonally adjusted unemployment rate for the Commonwealth was 6.0 percent and for the United States was 7.3 percent.

**STATE BUDGET.** The Commonwealth operates under an annual budget which is formulated and submitted for legislative approval by the Governor each February. The Pennsylvania Constitution requires that the Governor's budget proposal consist of three parts: (i) a balanced operating budget setting forth proposed expenditures and estimated revenues from all sources and, if estimated revenues and available surplus are less than proposed expenditures, recommending specific additional sources of revenue sufficient to pay the deficiency; (ii) a capital budget setting forth proposed expenditures to be financed from the proceeds of obligations of the Commonwealth or its agencies or from operating funds; and (iii) a financial plan for not less than the succeeding five fiscal years, which includes for each year projected operating expenditures and estimated revenues and projected expenditures for capital projects. The General Assembly may add, change or delete any items in the budget prepared by the Governor, but the Governor retains veto power over the individual appropriations passed by the legislature. The Commonwealth's fiscal year begins on July 1 and ends on June 30.

All funds received by the Commonwealth are subject to appropriation in specific amounts by the General Assembly or by executive authorization by the Governor. Total appropriations enacted by the General Assembly may not exceed the ensuing year's estimated revenues, plus (less) the unappropriated fund balance (deficit) of the preceding year, except for constitutionally authorized debt service payments. Appropriations from the principal operating funds of the Commonwealth (the General Fund, the Motor License Fund and the State Lottery Fund) are generally made for one fiscal year and are returned to the unappropriated surplus of the fund if not spent or encumbered by the end of the fiscal year. The Constitution specifies that a surplus of operating funds at the end of a fiscal year must be appropriated for the ensuing year.

Pennsylvania uses the 'Fund' method of accounting for receipts and disbursements. For purposes of government accounting, a 'fund' is an independent fiscal and accounting entity with a self-balancing set of accounts, recording cash and/or other resources together with all related liabilities and equities. In the Commonwealth, over 120 funds have been established by legislative enactment or in certain cases by administrative action 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 only be made pursuant to appropriation measures enacted by

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

Financial information for the principal operating funds of the Commonwealth is maintained on a budgetary basis of accounting, which is used for the purpose of insuring compliance with the enacted operating budget. The Commonwealth also prepares annual financial statements in accordance with generally accepted accounting principles ('GAAP'). Budgetary basis financial reports are based on a modified cash basis of accounting as opposed to a modified accrual basis of accounting prescribed by GAAP. Financial information is adjusted at fiscal year-end to reflect appropriate accruals for financial reporting in conformity with GAAP.

**RECENT FINANCIAL RESULTS.** From fiscal 1984, when the Commonwealth first prepared its financial statements on a GAAP basis, through fiscal 1989, the Commonwealth reported a positive unreserved-undesignated fund balance for its government fund types (General Fund, Special Revenue Fund and Capital Projects Fund) at the fiscal year end. At the end of fiscal 1990 and fiscal 1991, the unreserved-undesignated fund balance was a negative \$205.8 million and a negative \$1,189.2 million, respectively, a drop of \$579.6 million and \$983.4

million, respectively, from the year-earlier amounts. The decline in the fiscal 1990 unreserved-undesignated fund balance for government fund types was largely the result of a \$718.2 million operating deficit in the General Fund which caused the total fund balance of the General Fund to fall to a negative \$119.8 million at June 30, 1990. The decline in the fiscal 1991 unreserved-undesignated fund balance was principally the result of operating deficits of \$1,076.6 million and \$66.2 million, respectively, in the General Fund and the State Lottery Fund.

Rising demands on state programs caused by the economic recession, particularly for medical assistance and cash assistance programs, and the increased costs of special education programs and correction facilities and programs, contributed to increased expenditures in fiscal 1991 while tax revenues for the 1991 fiscal year were severely affected by the economic recession. Total corporation tax receipts and sales and use tax receipts during fiscal 1991 were, respectively, 7.3 percent and 0.9 percent below amounts collected during fiscal 1990. Personal income tax receipts also were affected by the recession but not to the extent of the other major General Fund taxes, increasing only 2.0 percent over fiscal 1990 collections.

The Commonwealth experienced a \$454 million general fund deficit as of the end of its 1991 fiscal year. The deficit reflected below-estimate economic activity and growth rates of economic indicators and total tax revenue shortfalls of \$817 million (4.1 percent) below those assumed in the enacted budget. Economic conditions also affected expenditure trends during the 1991 fiscal year, with expenditures for medical assistance costs and other human service programs running \$512 million above estimates assumed in the 1991 budget. In January 1991, the Commonwealth initiated a number of cost-saving measures, including the firing of 2,000 state employees, deferral of paychecks and reduction of funds to state universities, which resulted in approximately \$871 million in cost savings.

Total general fund revenues for fiscal 1992 were \$14,516.8 million which is approximately 22 percent higher than fiscal 1991 revenues of \$11,877.3 million due in large part to tax increases. The increased revenues funded substantial increases in education, social services and corrections programs. As a result of tax increases and certain appropriation lapses, fiscal 1992 ended with an \$8.8 million surplus after having started the year with an unappropriated balance deficit of \$454 million.

**FISCAL 1993 BUDGET.** On June 30, 1992 the Pennsylvania legislature presented the Governor with a \$14.126 billion general fund budget for the 1993 fiscal year, which began on July 1, 1992. Before signing the budget, the Governor deleted approximately \$73 million in certain state expenditures such as aid to county courts and district justices. As a result, the budget for the 1993 fiscal year was approximately \$14.046 billion, which is approximately \$105 million more than the fiscal 1992 budget. On February 9, 1993, the Governor announced that he anticipated that the fiscal 1993 budget would be in balance at the end of the fiscal year.

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**FISCAL 1994 BUDGET.** On May 28, 1993, the Governor signed a \$15 billion general fund budget, an increase of approximately five percent from the fiscal 1993 budget. A substantial amount of the increase is targeted for medical assistance programs and prisons.

**DEBT LIMITS AND OUTSTANDING DEBT.** The Constitution of Pennsylvania permits the issuance of the following types of debt: (i) debt to suppress insurrection or rehabilitate areas affected by disaster; (ii) electorate approved debt; (iii) debt for capital projects subject to an aggregate debt limit of 1.75 times the annual average tax revenues of the preceding five fiscal years; and (iv) tax anticipation notes payable in the fiscal year of issuance.

Under the Pennsylvania Fiscal Code, the Auditor General is required annually to certify to the Governor and the General Assembly certain information regarding the Commonwealth's indebtedness. According to the most recent Auditor General certificate, the average annual tax revenues deposited in all funds in the five fiscal years ended June 30, 1993 was \$14.5 billion, and, therefore, the net debt limitation for the 1994 fiscal year is \$27.1 billion. Outstanding net debt totaled \$4.0 billion at June 30, 1993, a decrease of \$42.2 million from June 30, 1992. At September 1, 1993, the amount of debt authorized by law to be issued, but not yet incurred was \$15.1 billion.

**DEBT RATINGS.** All outstanding general obligation bonds of the Commonwealth are rated AA-by S&P and A1 by Moody's.

**CITY OF PHILADELPHIA.** The City of Philadelphia experienced a series of general fund deficits for fiscal years 1988 through 1992, which have culminated in the City's present serious financial difficulties. In its 1992 Comprehensive Annual Financial Report, Philadelphia reported a cumulative general fund deficit of \$71.4 million for fiscal year 1992.

In June 1991, the Governor of Pennsylvania signed into law legislation establishing the Pennsylvania Inter-Governmental Cooperation Authority ('PICA'),



a five-member board which would oversee the fiscal affairs of the City of Philadelphia. The legislation empowers PICA to issue notes and bonds on behalf of Philadelphia and also authorizes Philadelphia to levy a one-percent sales tax the proceeds of which would be used to pay off the bonds. In return for PICA's fiscal assistance, Philadelphia was required, among other things, to establish a five-year financial plan that includes balanced annual budgets. Under the legislation, if Philadelphia does not comply with such requirements, PICA may withhold bond revenues and certain state funding.

In May 1992, the City Council of Philadelphia approved the Mayor's first five-year plan and adopted a fiscal 1993 budget. On June 5, 1992, PICA sold approximately \$480 million in bonds at yields ranging from 5.25 percent to 6.88 percent. The proceeds of the bonds were used to cover shortfalls accumulated over the last four fiscal years, projected deficits for fiscal year 1992 and fiscal year 1993, construction projects and other capital expenditures. In accordance with the enabling legislation, the authority was guaranteed a percentage of the wage tax revenue expected to be collected from Philadelphia residents to permit repayment of the bonds. In connection with PICA's issuance of the bonds, S&P raised the rating on Philadelphia's general obligation bonds to 'BB.' Moody's rating is currently 'Ba.'

In January 1993, Philadelphia anticipated a cumulative general fund budget deficit of \$57 million for fiscal year 1993. In response to the anticipated deficit, the Mayor unveiled a financial plan eliminating the budget deficit for fiscal year 1993 through significant service cuts that included a plan to privatize certain city-provided services. Due to an upsurge in tax receipts, cost-cutting and additional PICA borrowings, Philadelphia completed fiscal year 1993 with a balanced general fund budget.

In January 1994, the Mayor proposed a \$2.3 billion city general fund budget that included no tax increases, no significant service cuts and a series of modest health and welfare program increases. At that time, the Mayor also unveiled a \$2.2 billion program (the 'Philadelphia Economic Stimulus Program') designed to stimulate Philadelphia's economy and stop the loss of 1,000 jobs a month. However, the success of the Philadelphia Economic Stimulus Program has been predicated upon several contingencies including, among others, \$250 million in revenues from riverboat gambling over the next three years, which first must be approved by the state legislature, and \$100 million in federal 'empowerment zone' subsidies, which Philadelphia may or may not receive. Currently, the 1994

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Philadelphia general fund budget is running at a deficit of approximately \$10 million. The Mayor has predicted that the general fund will be balanced by the end of fiscal year 1994.

LITIGATION. The Commonwealth is a party to numerous lawsuits in which an adverse final decision could materially affect the Commonwealth's governmental operations and consequently its ability to pay debt service on its obligations. The Commonwealth also faces tort claims made possible by the limited waiver of sovereign immunity effected by Act 152, approved September 28, 1978.

#### PENNSYLVANIA TAXES

The following summarizes the opinion of Dechert Price & Rhoads, Philadelphia, Pennsylvania, special counsel on Pennsylvania tax matters, under existing law:

1. The Pennsylvania Trust will be recognized as a trust and will not be taxable as a corporation for Pennsylvania state and local tax purposes.

2. Units of the Pennsylvania Trust are not subject to any of the personal property taxes presently in effect in Pennsylvania to the extent of that proportion of the Trust represented by Debt Obligations issued by the Commonwealth of Pennsylvania, its agencies and instrumentalities, or by any county, city, borough, town, township, school district, municipality or local housing or parking authority in the Commonwealth of Pennsylvania ('Pennsylvania Obligations'). The taxes referred to above include the County Personal Property Tax, the additional personal property taxes imposed on Pittsburgh residents by the School District of Pittsburgh and by the City of Pittsburgh. Fund Units may be taxable under the Pennsylvania inheritance and estate taxes.

3. The proportion of interest income representing interest income from Pennsylvania Obligations distributable to Holders of the Pennsylvania Trust is not taxable under the Pennsylvania Personal Income Tax or under the Corporate Net Income Tax imposed on corporations by Article IV of the Pennsylvania Tax Reform Code, nor will such interest be taxable under the Philadelphia School District Investment Income Tax imposed on Philadelphia resident individuals.

4. Although there is no published authority on the subject, counsel is of the opinion that any insurance proceeds paid in lieu of interest on defaulted tax-exempt debt obligations will be exempt from the Pennsylvania Personal Income Tax either as payment in lieu of tax-exempt interest or as

payments of insurance proceeds which are not included in any of the classes of income specified as taxable under the Pennsylvania Personal Income Tax Law. Further, because such insurance proceeds are excluded from the Federal income tax base, such proceeds will not be subject to the Pennsylvania Corporate Net Income Tax. Proceeds from insurance policies are expressly excluded from the Philadelphia School District Investment Income Tax and, accordingly, insurance proceeds paid to replace defaulted payments under any Debt Obligations will not be subject to this tax.

5. The disposition by the Pennsylvania Trust of a Pennsylvania Obligation (whether by sale, exchange, redemption or payment at maturity) will not constitute a taxable event to a Holder under the Pennsylvania Personal Income Tax if the Pennsylvania Obligation was issued prior to February 1, 1994. Further, although there is no published authority on the subject, counsel is of the opinion that (i) a Holder of the Pennsylvania Trust will not have a taxable event under the Pennsylvania state and local income taxes referred to in the preceding paragraph upon the redemption or sale of his Unit to the extent that the Trust is then comprised of Pennsylvania Obligations issued prior to February 1, 1994 and (ii) the disposition by the Trust of a Pennsylvania Obligation (whether by sale, exchange, redemption or payment at maturity) will not constitute a taxable event to a Holder under the Corporate Net Income Tax or the Philadelphia School District Investment Income Tax if the Pennsylvania Obligation was issued prior to February 1, 1984. (The School District tax has no application to gain on the disposition of property held by the taxpayer for more than six months.) Gains on the sale, exchange, redemption, or payment at maturity of a Pennsylvania Obligation issued on or after February 1, 1994, will be taxable under all of these taxes, as will gains on the redemption or sale of a unit to the extent that the Trust is comprised of Pennsylvania Obligations issued on or after February 1, 1994.

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6. To the extent the value of Units is represented by obligations of the Commonwealth of Puerto Rico or obligations of the territory of Guam, such value will not be subject to Pennsylvania personal property taxes to the extent required by Federal statutes. The proportion of income received by Holders derived from interest on such obligations is not taxable under any of the Pennsylvania State and local income taxes referred to above. Although Federal law does not expressly exclude from taxation gain realized on the disposition of obligations of Puerto Rico or of Guam, because interest is exempt on such obligations, Pennsylvania does not tax gain from the disposition of such obligations under the Personal Income Tax.

#### THE TENNESSEE TRUST

In 1978, the voters of the State of Tennessee approved an amendment to the State Constitution requiring that (1) the total expenditures of the State for any fiscal year shall not exceed the State's revenues and reserves, including the proceeds of debt obligations issued to finance capital expenditures and (2) in no year shall the rate of growth of appropriations from State tax revenues exceed the estimated rate of growth of the State's economy. No debt obligation may be authorized for the current operation of any State service or program unless repaid within the fiscal year of issuance.

In response to public demand for better public education throughout the State, the 1992 Tennessee General Assembly temporarily raised the State sales tax by one-half of one percent to 6%, effective April 1, 1992. This increase became permanent as a result of the 1993 legislative session. This increase establishes the maximum total State and local sales tax rate at 8.75%. State Department of Revenue collections for the fiscal year ended June 30, 1993 increased 5.5% over fiscal 1992, or \$43.9 million over original estimates. In the first four months of fiscal year 1993, revenue collections were \$48.9 million over estimates. In late 1993, the State's rainy day fund reached \$150 million--the highest in the State's history. Adjusted for inflation, taxable sales grew by 7.5% from the third quarter of 1992 to the third quarter of 1993, triple the long-range inflation-adjusted average of 2.5%. State revenue collections for June 1993 increased 9.8% over June 1992, after factoring out new taxes. August 1993 revenue collection figures were 10.5% over August 1992 figures. State revenue collections in December, 1993 increased 7.2% over those in December 1992.

Although the issue of instituting a State income tax is still being discussed by legislators, most political observers in Tennessee doubt such a proposal will be passed within the next two-three years. Few candidates for governor have said they would work for major changes in the current tax system.

The Tennessee economy generally tends to rise and fall in a roughly parallel manner with the U.S. economy, although in recent years Tennessee has experienced less economic growth than the U.S. average. Like the U.S. economy, the Tennessee economy entered recession in the last half of 1990 and continued throughout the majority of 1991 and into 1992 as the Tennessee index of leading economic indicators trended downward throughout the period. The Tennessee economy gained strength during 1992 and this renewed vitality continued into 1993. Current indicators are for the State to enjoy a year of economic gains in

1994, although the two-year forecast horizon covering 1994 and 1995 is not expected to be a boom period for the state. One forecast is for slow growth through 1994, with a projected growth of real taxable sales in 1994 of 1.9%.

The Tennessee index of leading economic indicators fluctuated in 1992 and, in late 1993, leading indicators and coincident indicators generally were up, except for a 5.2% drop in October, 1993. In July, 1993, the composite index was up 1.52%; in August, 1993, it was up 3.81%; and in September, it was up 7.60%. In June, 1993, the composite index was up 1.37% over the same month one year earlier.

In economic development, 1992 was Tennessee's third-best year since records have been kept, although it must still be regarded as languid, since above average growth normally occurs during the first two years of an economic expansion. Current statistics show that inflation-adjusted personal income grew 4.8% from the second-quarter of 1991 to the second quarter of 1992. A growth of 2.4% in non-agricultural employment occurred between the third quarter of 1991 and the third quarter of 1992. According to the U.S. Department of Labor, average annual pay in Tennessee increased 5.9% in 1992, to \$22,807. The national average was 5.4% and \$25,903 in pay. For the year ended June 30, 1993, however, Tennessee led the nation in bankruptcy filings with a rate twice the national average.

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Historically, the Tennessee economy has been characterized by a greater concentration in manufacturing employment than the U.S. as a whole. The economy is, however, undergoing a structural change through the increase in service sector employment. Service sector employment has climbed steadily since 1960, increasing its share of overall state employment from 13.0% to 24.3% in 1993. From the third quarter of 1992 to the third quarter of 1993, 40.9% of employment growth occurred in the services sector. Over the same period, employment in durable goods manufacturing has been flat and employment in the nondurable goods sector has been in decline. Tennessee's unemployment rate dropped to 5.1% for November, 1993, which was its lowest level in over three years. By November, 1993, only one county had an unemployment rate over 10% for the first time since 1974. Tennessee's unemployment rate dropped to an average 5.6% during the third quarter of 1993.

Tennessee's population increased 6.2% from 1980 to 1990, less than the national increase of 10.2% for the same period. At December 1992 the State's population reached approximately 4.9 million. Population growth in Tennessee is expected to come mostly in the major metropolitan areas over the next 10-15 years. The overall state population is expected to grow 5.5% between 1990 and 2000, then 4.6% for the period between 2000 and 2010. Greatest growth is expected to occur in the Nashville MSA, and the largest population decline is expected in the rural counties of northwest Tennessee. This declining rate of population, coupled with the structural changes in the Tennessee economy and the increased competition from domestic and international trading partners, comprise three trends that are likely to influence the state's long-term outlook.

Manufacturing employment in Tennessee declined in 1993 when manufacturing employment in October 1993 showed a decrease of approximately 1.12% over the same month in 1992. Total non-agricultural employment in Tennessee was approximately 2,309,000 in the first quarter of 1994, which represented an increase over the same quarter in 1993 of 2.02%. Manufacturing employment is one component of non-agricultural employment. Non-agricultural employment in Tennessee is relatively uniformly diversified with approximately 23% in the manufacturing sector, approximately 23% in the wholesale and retail trade sector, approximately 22% in the service sector, and approximately 16% in government. The State also continued to attract new manufacturing facilities. Sector employment figures for fiscal year 1993-94 are not available at this time.

Tennessee's general obligation bonds are rated Aaa by Moody's and AA+ by Standard & Poor's. Tennessee's smallest counties have Moody's lower ratings ranging from Baa to B in part due to these rural counties' limited economies that make them vulnerable to economic downturns. Tennessee's four largest counties have the second highest of Moody's nine investment grades, Aa. There can be no assurance that the economic conditions on which these ratings are based will continue or that particular obligations contained in the Portfolio of the Tennessee Trust may not be adversely affected by changes in economic or political conditions.

The Sponsors believe that the information summarized above describes some of the more significant matters relating to the Tennessee Trust. For a discussion of the particular risks with each of the Debt Obligations, and other factors to be considered in connection therewith, reference should be made to the Official Statements and other offering materials relating to each of the Debt Obligations included in the portfolio of the Tennessee Trust. The foregoing information regarding the State does not purport to be a complete description of the matters covered and is based solely upon information provided by State agencies, publicly available documents and news reports of statements by State officials and employees. The Sponsors and their counsel have not independently verified this information and the Sponsors have no reason to believe that such

information is incorrect in any material respect. None of the information presented in this summary is relevant to Puerto Rico or Guam Debt Obligations which may be included in the Tennessee Trust.

#### TENNESSEE TAXES

In the opinion of Hunton & Williams, Knoxville, Tennessee, special counsel on Tennessee tax matters, under existing Tennessee law and assuming that (i) the Tennessee Trust is a grantor trust under the grantor trust rules of Sections 671-677 of the Code:

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1. The Tennessee Trust will not be subject to the Tennessee individual income tax, also known as the Hall Income Tax; the Tennessee corporate income tax, also known as the Tennessee Excise Tax; or the Tennessee Franchise Tax.

#### 2. Tennessee Code Annotated

Section 67-2-104(g) specifically exempts from the Hall Income Tax distributions from the Tennessee Trust to Holders of Units to the extent such distributions represent interest on bonds or securities of the United States government or any agency or instrumentality thereof or on bonds of the State of Tennessee, or any county, municipality or political subdivision thereof, including any agency, board, authority or commission. The Tennessee Department of Revenue has taken the administrative position that distributions attributable to interest on obligations issued by Puerto Rico and Guam are exempt from the Hall Income Tax.

3. The Tennessee Trust will not be subject to any intangible personal property tax in Tennessee on any Debt Obligation in the Tennessee Trust. The Units of the Tennessee Trust also will not be subject to any intangible personal property tax in Tennessee but may be subject to Tennessee estate and inheritance taxes.

Holders of Units should consult their own tax advisor as to the tax consequences to them of an investment in and distributions from the Tennessee Trust.

#### THE TEXAS TRUST

RISK FACTORS--The State Economy. Texas continues to experience a gradual, although uneven, economic recovery. The state's economic recovery appeared to be strengthening during the state fiscal year ended August 31, 1993, as the state added almost 125,000 jobs. After underperforming the national economy during most of the second half of the 1980's, Texas' economic growth exceeded the growth of the national economy for the fourth straight year in fiscal 1993. The gross state product grew at an inflation-adjusted rate of 2.6% during 1992 (compared to the national rate of 2.0%). However, while the state's economic growth during 1992 exceeded that for 1991 (when gross state product increased 1.9%), growth was slower than in fiscal 1990, when the state's gross product advanced 2.9%. State finances continue to face challenges from an uncertain national economy. Further, higher demands for state services will continue to pressure government finances, as does spending in response to various court orders. Texas' credit rating in recent periods has caused the state to pay higher interest rates on state bonds than those historically enjoyed by the State. Some local governments and other political subdivisions also have had their credit ratings lowered from their historical levels.

Although there are indications that the Texas economy is fundamentally stronger than it has been in the recent past, various economic problems continue to be experienced throughout the state. The state's energy industry, has somewhat stabilized in comparison to its situation after its collapse in the early 1980's that caused immediate and substantial problems not only for oil and oil-related industries but for the entire state and has been showing signs of recovery. During fiscal 1993, employment in the state's energy industry remained essentially unchanged from fiscal 1992 stopping a trend of substantial job losses in prior years. During recent years, the state had experienced a significant loss of jobs attributable to oil companies pursuing more attractive drilling opportunities overseas and consolidations of the domestic workforce. The oil and gas rig count, an industry barometer, grew only slightly in 1993 and remains well below historical highs. However, oil and natural gas production have continued to trend downward further reducing a once important source of revenue to the state government. Oil and gas remains an important contributor to the state's economy, but its relative importance is declining as the state's economy becomes increasingly more diversified. The businesses of drilling, production, refining, chemicals and energy-related manufacturing are contributing to the state's economy to a lesser extent than was the case in the early 1980's. The Texas economy is continuing to diversify and become more like the national economy. As a consequence it is vulnerable to changes in the value of the dollar and increasing federal budget deficits and is affected by international events and trade policies more than ever before. A manifestation of this trend was the downward trend in industrial production in the state during the early 1990's, which was triggered by the weak national economy. However, industrial production increased in Texas by 5.1% during fiscal

1993 compared to fiscal 1992 and Texas experienced an increase in manufacturing jobs in 1993 as the national economy improved. In addition, Texas, reflecting the national trend, is continuing to move toward a service-based economy. It is unclear what effect current national and world events will have on the state.

The banking, thrift, real estate and construction industries, despite some apparent rebounding, generally continue to be sources of concern in the Texas economy. All of Texas' major bank holding companies have been acquired by out-of-state banks or have been reorganized with assistance from agencies of the federal government. In addition, many Texas thrifts have been closed by federal regulators, have been reorganized with assistance from agencies of the federal government, or remain in receiverships or conservatorships. Although the banking and thrift industries have stabilized and total bank assets, equity capital and retail loans appear to be increasing, the total amount of business loans made by Texas banks continues to be at a very low level compared to the level of loan activity in the early 1980's. While the construction sector of the state's economy remains relatively depressed compared to the boom levels of the early and mid-1980's, residential construction has increased significantly as a result of falling mortgage rates. However, continuing high vacancy rates in the State's major office markets have held back the demand for nonresidential construction. Further, the decrease in the share of the federal budget devoted to defense has negatively affected, and will continue to undermine, defense-related contracting and employment in Texas.

The two major sources of state revenue are state taxes and federal funds. Other revenue sources include income from licenses, fees and permits, interest and investment income, the state lottery, income from sales of goods and services and land income (which includes income from oil, gas and other mineral royalties as well as from leases on state lands). The major sources of state government tax collection are the sales tax, the franchise tax and the motor fuels tax. During 1991, the Texas Legislature significantly modified the state franchise tax and the tax on certain motor fuels to raise additional revenues, and made changes to other tax laws, including some changes to the sales tax.

As of February 1, 1994, general obligation bonds issued by the State of Texas were rated AA by Standard & Poor's, and Aa by Moody's.

Limitations on Bond Issuances and Ad Valorem Taxation. Although Texas has few debt limits, certain tax limitations imposed on counties and cities are in effect debt limitations. The requirement in Texas that counties and cities provide for the collection of an annual tax sufficient to retire any bonded indebtedness they create operates as a limitation on the amount of indebtedness which may be incurred, since counties and cities may never incur indebtedness which cannot be satisfied by revenue received from taxes imposed within the tax limits. The same requirement is generally applicable to indebtedness of the State of Texas. However, voters have authorized from time to time, by constitutional amendment, the issuance of general obligation bonds of the state for various purposes.

To the extent the Texas Debt Obligations in the Portfolio are payable, either in whole or in part, from ad valorem taxes levied on taxable property, the limitations described below may be applicable. The Texas Constitution prohibits the state from levying ad valorem taxes on property. The Texas Constitution limits the rate of growth of appropriations from tax revenues not dedicated to a particular purpose by the Constitution during any biennium to the estimated rate of growth for the Texas economy, unless both houses of the Texas Legislature, by a majority vote in each, find that an emergency exists. In addition, the Texas Constitution authorizes cities having more than 5,000 inhabitants to provide further limitations in their city charters regarding the amount of ad valorem taxes which can be assessed. Furthermore, certain provisions of the Texas Constitution provide for exemptions from ad valorem taxes, of which some are mandatory and others are available at the option of the particular county, city, town, school district or other political subdivision of the state. The following is only a summary of certain laws which may be applicable to an issuer of the Texas Debt Obligations regarding ad valorem taxation.

Counties and political subdivisions are limited in their issuance of bonds for certain purposes (including construction, maintenance and improvement of roads, reservoirs, dams, waterways and irrigation works) to an amount up to one-fourth of the assessed valuation of real property. No county, city or town may levy a tax in any one year for general fund, permanent improvement fund, road and

bridge fund or jury fund purposes in excess of \$.80 on each \$100 assessed valuation. Cities and towns having a population of 5,000 or less may not levy a tax for any one year for any purpose in excess of 1 1/2% of the taxable property (\$1.50 on each \$100 assessed valuation), and a limit of 2 1/2% (\$2.50 on each \$100 assessed valuation) is imposed on cities having a population of more than 5,000. Hospital districts may levy taxes up to \$.75 on each \$100 assessed

valuation. School districts are subject to certain restrictions affecting the issuance of bonds and the imposition of taxes.

The general laws of the State of Texas pertaining to ad valorem taxation of property by political subdivisions have been codified into the Property Tax Code. Reference is hereby made thereto for identification of property subject to taxation; property exempt from taxation and other exemptions granted and allowed, if claimed; the appraisal of property for purposes of taxation; and the procedures to be followed and limitations applicable to the levy and collection of ad valorem taxes. Governing bodies of taxing units may not adopt tax rates that exceed certain specified rates until certain procedural requirements are met (including, in certain cases, holding a public hearing preceded by a published notice thereof). Certain statutory requirements exist which set forth the procedures necessary for the appropriate governmental body to issue and approve bonds and to levy taxes. To the extent that such procedural requirements are not followed correctly, the actions taken by such governmental bodies could be subject to attack and their validity questioned.

In 1989 the Texas Supreme Court declared that the Texas system then in effect of funding for public schools did not meet the requirements of the Texas Constitution. The Court found that the prior state funding system violated the constitutional provision requiring the state to provide an efficient means of funding public education because the system resulted in discrimination against low-wealth school districts. In 1990, the Texas Legislature enacted legislation designed to establish a constitutional system of financing public education. However, a state district court subsequently ruled that the funding system effected by that legislation was also unconstitutional, and the Texas Supreme Court affirmed the district court's ruling. In 1991, the Governor of Texas signed into law a public education finance reform bill (the '1991 Public Education Finance Bill') that dramatically increased revenue for hundreds of relatively poor school districts, which resulted in increased property taxes and was expected to increase property taxes in the future. An important feature of the bill was the creation of new taxing units called 'county education districts'.

On January 30, 1992, the Texas Supreme Court declared the public school finance system enacted in the 1991 Public Education Finance Bill to be unconstitutional and ordered that a new finance system be adopted by the Texas Legislature by June 1, 1993. The Court deferred the effect of its ruling to June 1, 1993 so as not to interfere with the collection of 1991 and 1992 county education district taxes. Shortly prior to the June 1 deadline, the Texas Legislature enacted legislation adopting a new school finance system. The law attempts to reduce the disparity of revenues per student in low-wealth school districts compared to high-wealth school districts by providing high-wealth districts with several options for effectively sharing portions of their ad valorem tax revenue with low-wealth districts. The 1993 legislation also abolished county education districts. Certain school districts have already filed suit in state court challenging the legislation. Although a state court upheld the 1993 school finance legislation, it is impossible to predict (i) the ultimate outcome of an existing challenge or any future challenges to the legislation, or (ii) what effect future court action with regard to the issue or school finance might have on state revenue (including, without limitation, additional taxes that might be enacted).

TEXAS TAXES--In the opinion of Hughes & Luce, L.L.P., Dallas, Texas, special counsel, pursuant to Texas law existing as of January 31, 1994, applicable to individuals who are residents of Texas for Texas tax purposes:

1. The Texas franchise tax functions as an income tax in certain respects. The Texas franchise tax is imposed on corporations, limited liability companies and certain banks, limited banking associations and savings and loan associations. Assuming that the Texas Trust is not a corporation, limited liability company, bank, limited banking association, or savings and loan association (in each case, for Texas franchise tax purposes), the income of the Texas Trust will not be subject to an income tax levied by the State of Texas or any political subdivision thereof.

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2. The income derived from the Texas Trust by Holders who are individuals will not be subject to any income tax levied by the State of Texas or any political subdivision thereof.

3. Assuming that the Texas Trust will not hold any tangible property, neither Debt Obligations held by the Texas Trust nor Units of the Texas Trust held by individuals are subject to any property tax levied by the State of Texas or any political subdivision thereof.

4. Units of the Texas Trust held by individuals may be subject to Texas inheritance taxes.

Neither the Sponsors, Davis Polk & Wardwell nor Hughes & Luce, L.L.P. (except in such cases as Hughes & Luce, L.L.P., has acted or will act as counsel to such issuing authorities), has made or will make any review of the proceedings relating to the issuance of the Debt Obligations nor has Hughes &

Luce, L.L.P., made any review of the proceedings relating to the issuance of the Units.

#### THE VIRGINIA TRUST

RISK FACTORS--The Constitution of Virginia limits the ability of the Commonwealth to create debt. An amendment to the Constitution requiring a balanced budget was approved by the voters on November 6, 1984.

General obligations of cities, towns or counties are payable from the general revenues of the entity, including ad valorem tax revenues on property within the jurisdiction. The obligation to levy taxes could be enforced by mandamus, but such a remedy may be impracticable and difficult to enforce. Under section 15.1--227.61 of the Code of Virginia, a holder of any general obligation bond in default may file an affidavit setting forth such default with the Governor. If, after investigating, the Governor determines that such default exists, he is directed to order the State Comptroller to withhold State funds appropriated and payable to the entity and apply the amount so withheld to unpaid principal and interest.

The economy of the Commonwealth of Virginia is based primarily on manufacturing, the government sector, agriculture, mining and tourism.

The Commonwealth has maintained a high level of fiscal stability for many years due in large part to conservative financial operations and diverse sources of revenue. The budget for the 1994-96 biennium submitted by former Governor Wilder before expiration of his term of office in January, 1994, does not contemplate any significant new taxes or increases in the scope or amount of existing taxes.

In *Davis v. Michigan* (decided March 28, 1989), the United States Supreme Court ruled unconstitutional Michigan's statute exempting from state income tax the retirement benefits paid by the state or local governments and not exempting retirement benefits paid by the federal government. At the time of this ruling, under legislation subsequently amended in 1989 to provide uniform exemptions for all pensioners, Virginia exempted state and local but not federal government benefits. Several suits for refunds, some with multiple plaintiffs, were filed. A state trial court ruling in favor of the Commonwealth was affirmed by the Virginia Supreme Court on March 1, 1991, but on June 28, 1991, the decision of the Virginia Supreme Court was vacated by the United States Supreme Court and the case remanded to the Virginia Supreme Court for reconsideration in light of an intervening United States Supreme Court decision on retroactive application of decisional constitutional law. On November 8, 1991, the Virginia Supreme Court affirmed its March 1, 1991, ruling denying refunds. On June 18, 1993, the U.S. Supreme Court reversed the November 8, 1991, ruling of the Virginia Supreme Court and remanded the case to the Virginia Supreme Court for further proceedings consistent with the opinion of the U.S. Supreme Court. On July 30, 1993, the Virginia Supreme Court remanded the case to the trial court for consideration of means of relief. The estimated maximum potential financial impact on the Commonwealth of claims for refunds by all federal pensioners is approximately \$498.7 million, including interest through September 30, 1993.

The Commonwealth has a Standard & Poor's rating of AAA and a Moody's rating of Aaa on its general obligation bonds. There can be no assurance that the economic conditions on which these ratings are based will continue or that particular bond issues may not be adversely affected by changes in economic or political conditions.

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#### VIRGINIA TAXES

In the opinion of Hunton & Williams, Richmond, Virginia, special counsel on Virginia tax matters, under existing Virginia law and assuming that the Virginia Trust is a grantor trust under the grantor trust rules of Sections 671-679 of the Code:

1. The Virginia Trust will be taxable as a grantor trust for Virginia income tax purposes with the result that income of the Virginia Trust will be treated as income of the Holders of Units of the Virginia Trust. Consequently, the Virginia Trust will not be subject to any income or corporate franchise tax imposed by the Commonwealth of Virginia, or its subdivisions, agencies or instrumentalities.
2. Interest on the Debt Obligations in the Virginia Trust that is exempt from Virginia income tax when received by the Virginia Trust will retain its tax exempt status in the hands of the Holders of Units of the Virginia Trust.
3. A Holder of Units of the Virginia Trust will realize a taxable event when the Virginia Trust disposes of a Debt Obligation (whether by sale, exchange, redemption or payment at maturity) or when the Holder of Units redeems or sells his Units, and taxable gain for Federal income tax purposes may result in taxable gain for Virginia income tax purposes. Certain Debt Obligations, however, have been issued under Acts of the

Virginia General Assembly that provide that all income from such Debt Obligations, including any profit from the sale thereof, shall be free from all taxation by the Commonwealth of Virginia. To the extent any such profit is exempt from Virginia income tax, any such profit received by the Virginia Trust will retain its tax exempt status in the hands of the Holders of Units of the Virginia Trust.

4. The Virginia Trust will not be subject to any intangible personal property tax in Virginia on any Debt Obligations in the Virginia Trust. In addition, Units of the Virginia Trust held for investment purposes will not be subject to any intangible personal property tax in Virginia.

5. The Units may be subject to Virginia estate tax if held by a Virginia resident or, in certain cases, by an individual who at the time of his death was not a resident of the United States.

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DEFINED

ASSET FUNDSSM

SPONSORS:  
Merrill Lynch,  
Pierce, Fenner & Smith Inc.  
Unit Investment Trusts  
P.O. Box 9051  
Princeton, N.J. 08543-9051  
(609) 282-8500  
Smith Barney Inc.  
Unit Trust Department  
Two World Trade Center--101st Floor  
New York, N.Y. 10048  
1-800-298-UNIT  
Prudential Securities Incorporated  
One Seaport Plaza  
199 Water Street  
New York, N.Y. 10292  
(212) 776-1000  
Dean Witter Reynolds Inc.  
Two World Trade Center--59th Floor  
New York, N.Y. 10048  
(212) 392-2222  
EVALUATOR:  
Kenny S&P Evaluation Services  
65 Broadway  
New York, N.Y. 10006  
INDEPENDENT ACCOUNTANTS:  
Deloitte & Touche  
1633 Broadway  
3rd Floor  
New York, N.Y. 10019  
TRUSTEE:  
The Bank of New York  
Unit Investment Trust Department  
P.O. Box 974  
Wall Street Station  
New York, N.Y. 10268-0974  
1-800-221-7771

MUNICIPAL INVESTMENT  
TRUST FUND  
New York Series--28  
(A Unit Investment Trust)  
PROSPECTUS PART A  
This Prospectus does not contain all of the information with respect to the investment company set forth in its registration statement and exhibits relating thereto which have been filed with the Securities and Exchange Commission, Washington, D.C. under the Securities Act of 1933 and the Investment Company Act of 1940, and to which reference is hereby made. No person is authorized to give any information or to make any representations with respect to this investment company not contained in this Prospectus; and any information or representation not contained herein must not be relied upon as having been authorized. This Prospectus does not constitute an offer to sell, or a solicitation of an offer to buy, securities in any state to any person to whom it is not lawful to make such offer in such state.  
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