

PRELIMINARY OFFICIAL STATEMENT DATED OCTOBER 5, 2010

NEW ISSUES

BOOK-ENTRY ONLY

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

OFFICIAL STATEMENT

STATE OF TENNESSEE
\$169,550,000* General Obligation Bonds, 2010 Series A
\$43,765,000* General Obligation Bonds, 2010 Refunding Series B

Dated: Date of Delivery

Due: Series A Bonds - May 1
Series B Bonds – August 1
as shown on inside front cover

| | |
|-------------------------------|--|
| <i>The Bonds</i> | Series A Bonds interest payable semi-annually May 1 and November 1, commencing May 1, 2011. Series B Bonds interest payable semi-annually February 1 and August 1, commencing February 1, 2011. Interest rates and reoffering yields/prices as shown on inside front cover. Fully registered bonds issued in denominations of \$5,000 or any integral multiple thereof. Series A Bonds maturing on or after May 1, 2019 are subject to optional redemption by the State on and after May 1, 2018 at par. Series B Bonds maturing on or after August 1, 2019 are subject to optional redemption by the State on and after August 1, 2018 at par. Term Bonds subject to mandatory sinking fund redemption at par. See “The Bonds” herein. |
| <i>Security</i> | Direct general obligations; pledge of full faith and credit. See “Security for the Bonds” herein. |
| <i>Ratings</i> | Fitch: AAA Moody’s: Aaa S & P: AA+. See “Ratings” herein. |
| <i>Book-Entry Only System</i> | The Depository Trust Company will act as securities depository for the Bonds. See “The Bonds” herein and Appendix D. |
| <i>Tax Exemption</i> | Interest on the Bonds is excluded from gross income for Federal income tax purposes to the extent and subject to the conditions, limitations and continuing compliance with tax covenants as described herein. The Bonds and the interest thereon are free from Tennessee taxes, subject to certain exceptions. See “Tax Matters” herein. |
| <i>Issuer’s Bond Counsel</i> | Hawkins Delafield & Wood LLP, New York, New York. |
| <i>Closing Settlement</i> | On or about October 27, 2010. |

____, 2010

*Subject to change

**MATURITIES, AMOUNTS, INTEREST RATES, PRICES/YIELDS
AND CUSIP NUMBERS**

STATE OF TENNESSEE
\$169,550,000* GENERAL OBLIGATION BONDS, 2010 SERIES A

| <u>Due May 1</u> | <u>Amount *</u> | <u>Interest Rate</u> | <u>Yield</u> | <u>Price</u> | <u>CUSIP** 880541</u> |
|----------------------|-----------------|--------------------------|--------------|--------------|---------------------------|
| 2012 | \$ 8,480,000 | | | | |
| 2013 | 8,480,000 | | | | |
| 2014 | 8,480,000 | | | | |
| 2015 | 8,480,000 | | | | |
| 2016 | 8,480,000 | | | | |
| 2017 | 8,480,000 | | | | |
| 2018 | 8,480,000 | | | | |
| 2019 | 8,480,000 | | | | |
| 2020 | 8,480,000 | | | | |
| 2021 | 8,480,000 | | | | |
| 2022 | 8,475,000 | | | | |
| 2023 | 8,475,000 | | | | |
| 2024 | 8,475,000 | | | | |
| 2025 | 8,475,000 | | | | |
| 2026 | 8,475,000 | | | | |
| 2027 | 8,475,000 | | | | |
| 2028 | 8,475,000 | | | | |
| 2029 | 8,475,000 | | | | |
| 2030 | 8,475,000 | | | | |
| 2031 | 8,475,000 | | | | |

STATE OF TENNESSEE
\$43,765,000* GENERAL OBLIGATION BONDS, 2010 REFUNDING SERIES B

| <u>Due Aug 1</u> | <u>Amount *</u> | <u>Interest Rate</u> | <u>Yield</u> | <u>Price</u> | <u>CUSIP** 880541</u> |
|----------------------|-----------------|--------------------------|--------------|--------------|---------------------------|
| 2012 | \$ 7,525,000 | | | | |
| 2019 | 7,380,000 | | | | |
| 2020 | 7,305,000 | | | | |
| 2021 | 7,240,000 | | | | |
| 2022 | 7,190,000 | | | | |
| 2023 | 7,125,000 | | | | |

***Subject to change**

**These CUSIP numbers have been assigned by Standard & Poor's CUSIP Service Bureau, a Division of The McGraw Hill Companies, Inc., and are included solely for the convenience of the Bondholders. The State of Tennessee is not responsible for the selection or use of these CUSIP numbers, nor is any representation made as to their correctness on the Bonds or as indicated herein.

THE FUNDING BOARD OF THE STATE OF TENNESSEE

Phil Bredesen, Governor, *Chairman*
Justin P. Wilson, Comptroller of the Treasury, *Secretary*
Tre Hargett, Secretary of State
David H. Lillard, Jr., State Treasurer
Dave Goetz, Commissioner of Finance and Administration

STAFF

Mary-Margaret Collier, Director of State and Local Finance, *Assistant Secretary*
Ann V. Butterworth, *Assistant Secretary*
Sandra Thompson, *State and Local Finance Assistant Director*
Cindy Liddell, *State and Local Finance Accountant*

ISSUER'S COUNSEL

Attorney General and Reporter of the State of Tennessee, Nashville, Tennessee

ISSUER'S BOND COUNSEL

Hawkins Delafield & Wood LLP, Attorneys at Law, New York, New York

FINANCIAL ADVISOR

Public Financial Management, Inc., Memphis, Tennessee

For the purpose of compliance with Rule 15c2-12 of the Securities and Exchange Commission, this document constitutes an Official Statement of the State with respect to the Bonds that has been deemed “final” by the State as of its date except for the omission of no more than the information permitted by subsection (b)(1) of Rule 15c2-12.

This Official Statement does not constitute an offering of any security other than the Bonds specifically offered hereby. No dealer, broker or other person has been authorized by the State to give any information or to make any representation other than as contained in this Official Statement, and if given or made, such other information or representation must not be relied upon as having been authorized by the State. This Official Statement does not constitute an offer to sell or a solicitation of an offer to buy, nor shall there be any sale of, the Bonds by any person in any jurisdiction in which it is unlawful to make such offer, solicitation or sale.

Certain information set forth herein has been provided by the State. Certain other information set forth herein has been obtained by the State from sources believed to be reliable, but it is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the State since the date hereof.

In making an investment decision, investors must rely on their own examination of the State and the terms of the offering, including the merits and risks involved.

The prices and other terms respecting the offering and sale of the Bonds may be changed from time to time by the Purchaser after such Bonds are released for sale, and the Bonds may be offered and sold at prices other than the initial offering prices, including sales to dealers who may sell the Bonds into investment accounts.

IN CONNECTION WITH THIS OFFERING, THE PURCHASER MAY OVER-ALLOT OR EFFECT TRANSACTIONS THAT STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

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STATE OF TENNESSEE
\$169,550,000* GENERAL OBLIGATION BONDS, 2010 SERIES A
\$43,765,000* GENERAL OBLIGATION BONDS, 2010 REFUNDING SERIES B

INTRODUCTION

This Official Statement, which includes the cover page and the inside cover page hereof, and the Appendices hereto, including the financial information incorporated by reference in Appendix A, is provided for the purpose of presenting information relating to the State of Tennessee (the “State”) in connection with the issuance of the State’s \$169,550,000* General Obligation Bonds, 2010 Series A (the “Series A Bonds”) and \$43,765,000* General Obligation Bonds, 2010 Refunding Series B (the “Series B Bonds”) (the Series A and Series B Bonds are referred to collectively as the “Bonds”).

The Bonds will be issued pursuant to the authority of and in full compliance with the provisions, restrictions and limitations of the Constitution and laws of the State, including Title 9, Chapter 9, Tennessee Code Annotated, and various bond authorizations enacted by the General Assembly of the State, and pursuant to a resolution adopted by the State Funding Board of the State on September 20, 2010. The Bonds are being issued to fund certain capital projects of the State, to provide for the retirement at maturity of a portion of the State’s outstanding General Obligation Commercial Paper (“CP”) issued to fund certain capital projects of the State, to refund certain outstanding general obligation bonds of the State and to pay certain costs of issuance. (See “Application of Bond Proceeds and Plan of Refunding”.)

The Bonds are direct general obligations of the State for which the State has pledged its full faith and credit for the payment of both principal and interest. As additional security for the Bonds and the interest thereon, there is also pledged the annual proceeds of certain specific taxes, revenues and fees required to be paid to the State. The Bonds, together with interest thereon, are entitled to the benefit of these taxes, revenues and fees and to share therein pro rata with any other obligations of the State that might be entitled to share therein as provided by Title 9, Chapter 9, Tennessee Code Annotated. (See “Security for the Bonds”.)

For a description of the governmental entity termination provisions of the Tennessee Governmental Entity Review Law, as amended, Sections 4-29-101 et seq., Tennessee Code Annotated (the “Governmental Entity Review Law”) and their effect on the State Funding Board, see “SECURITY FOR THE BONDS – Termination of Existence.”

THE BONDS

Description

The Bonds will be dated the date of their delivery, the Series A Bonds will mature on May 1 and the Series B Bonds will mature on August 1 of each of the years and in the principal amounts as shown on the inside cover page. The Series A Bonds will bear interest payable semi-annually on May 1 and November 1 commencing May 1, 2011, and the Series B Bonds will bear interest payable semi-annually on February 1 and August 1 commencing February 1, 2011, at the rates per annum as shown on the inside cover page. The Bonds will be issuable as fully registered bonds in denominations of \$5,000 or integral multiples thereof.

Book-Entry Only System

Upon initial issuance, the Bonds will be available only in book-entry form. The Depository Trust Company (“DTC”), New York, New York, will act as securities depository for the Bonds. The ownership of one fully registered Bond for each maturity of each series of the Bonds bearing interest at each interest rate, each in the aggregate principal amount of such maturity and bearing interest at such rate, will be registered in the name of Cede & Co. (DTC’s partnership nominee) and deposited with DTC. Beneficial owners of Bonds will not receive physical delivery of bond certificates, except under limited circumstances.

For a description of DTC and its book-entry only system, see “Appendix D – Book-Entry Only System”.

*Subject to change

Redemption*

Optional Redemption: At the option of the State, the Series A Bonds maturing on or after May 1, 2019 are subject to redemption prior to their respective stated maturities, from any monies that are available to the State for such purpose, at any time on and after May 1, 2018 as a whole, or in part from time to time in any order of maturity determined by the State, at a redemption price of par, together with accrued interest to the redemption date.

At the option of the State, the Series B Bonds maturing on or after August 1, 2019 are subject to redemption prior to their respective stated maturities, from any monies that are available to the State for such purpose, at any time on and after August 1, 2018 as a whole, or in part from time to time in any order of maturity determined by the State, at a redemption price of par, together with accrued interest to the redemption date.

Mandatory Sinking Fund Redemption: The Series __ Bonds maturing on ___ 1, 20___, shall constitute term bonds subject to mandatory sinking fund redemption and shall be redeemed prior to maturity in each of the years and in the respective principal amounts set forth in the table below, at a redemption price of par, together with accrued interest to the redemption date.

| <u>20XX Maturity</u> | | <u>20XX Maturity</u> | | <u>20XX Maturity</u> | |
|----------------------|---------------|----------------------|---------------|----------------------|---------------|
| <u>Year</u> | <u>Amount</u> | <u>Year</u> | <u>Amount</u> | <u>Year</u> | <u>Amount</u> |

Selection of Bonds to be Redeemed: If less than all of the Bonds of a maturity are to be redeemed, the particular Bonds or portions thereof of such series and maturity to be redeemed shall be selected by lot.

In any such event, for so long as a book-entry only system is in effect with respect to the applicable Series 2010 Bonds, DTC or its successor and Direct DTC Participants and Indirect DTC Participants (all as defined in Appendix D hereto) will determine the particular ownership interests of the Series 2010 Bonds of such Series and maturity to be redeemed. Any failure of DTC or its successor, or of a Direct DTC Participant or Indirect DTC Participant, to make such determination as described above will not affect the sufficiency or the validity of the redemption of the Series 2010 Bonds. See “Book-Entry-Only System” and Appendix D “Book-Entry-Only System”.

Notice of Redemption: Written notice shall be mailed to registered owners of the Bonds to be redeemed, at least thirty (30) days but no more than sixty (60) days prior to the redemption date, at the address that appears on the registration books, but failure to receive any such notice shall not affect the validity of the redemption proceedings. Any notice of redemption may provide that such redemption is conditional on the availability of sufficient moneys to pay the redemption price, plus interest accrued and unpaid to the redemption date. While DTC or its nominee is the registered owner of the Bonds, the State will give notice of redemption of the Bonds to DTC or its nominee or its successor and shall not be responsible for mailing notices of redemption to Direct DTC Participants, to Indirect DTC Participants or to the beneficial owners of the Bonds. Any failure of DTC or its nominee or its successor, or of a Direct DTC Participant or Indirect DTC Participant, to notify a beneficial owner of a bond of any redemption will not affect the sufficiency or the validity of the redemption of such bond. (See Appendix D – “Book-Entry Only System”). The State can give no assurance that DTC or its successor, the Direct DTC Participants or the Indirect DTC Participants will distribute such redemption notices to the beneficial owners of the Bonds, or that they will do so on a timely basis.

*Subject to change

APPLICATION OF BOND PROCEEDS AND PLAN OF REFUNDING

The Series A Bonds are being issued to (i) provide for the retirement at maturity of a portion of the State’s outstanding CP issued to fund certain capital projects of the State, (ii) finance certain capital projects and (iii) fund certain costs of issuance. CP will be retired on various dates within 90 days after the date of delivery of the Bonds.

The Series B Bonds are being issued to (i) refund certain outstanding General Obligation Bonds, 2003 Series A (the “2003 Series A Bonds”), as indicated in the table below (the “Refunded Bonds”) and (ii) fund certain costs of issuance. Less than all of certain maturities of the 2003 Series A Bonds listed below constitute Refunded Bonds. The column identified as “Principal Amount Not Refunded” indicates the principal amounts of the maturities of the 2003 Series A Bonds that will not be refunded and that will remain outstanding following the issuance of the Series B Bonds. The State will select the exact Refunded Bonds (which may include all or a portion of the bonds listed in the table below, or additional bonds of the same or additional series) at or about the time of sale of the Series B Bonds. Such selection will be based, in part, upon market conditions existing at that time. Accordingly, no assurance can be given as to the Refunded Bonds finally selected until after the sale of the Series B Bonds.

Proposed Refunded Bonds ¹ (2003 Series A)

| Maturity Date (August 1) | Outstanding Principal Amount | Refunded Bonds | Principal Amount Not Refunded | Redemption Date | Redemption Price | CUSIP ² |
|--------------------------------|------------------------------------|-------------------|--|--------------------|---------------------|------------------------|
| 2012 | \$7,585,000 | \$7,390,000 | \$195,000 | August 1, 2011 | 101% | 880541BY2 ³ |
| 2019 | 7,535,000 | 7,390,000 | 145,000 | August 1, 2011 | 101% | 880541CF2 ³ |
| 2020 | 7,545,000 | 7,390,000 | 155,000 | August 1, 2011 | 101% | 880541CG0 ³ |
| 2021 | 7,550,000 | 7,390,000 | 160,000 | August 1, 2011 | 101% | 880541CH8 ³ |
| 2022 | 7,560,000 | 7,390,000 | 170,000 | August 1, 2011 | 101% | 880541CJ4 ³ |
| 2023 | 7,505,000 | 7,375,000 | 130,000 | August 1, 2011 | 101% | 880541CK1 ³ |

The Refunded Bonds will be called for redemption on the redemption date and at the redemption price as stated in the table above, plus accrued interest to the redemption date. Such designations for redemption will be irrevocable upon issuance of the Bonds.

Pursuant to the resolution authorizing the Bonds, the State Funding Board will enter into a Refunding Trust Agreement with a third party bank (the “Refunding Trustee”). Proceeds of the Series B Bonds and other available monies will be used to acquire direct general obligations of or obligations the payment of principal of and interest on which are unconditionally guaranteed by the United States of America (the “Government Obligations”). The Government Obligations and the interest earned thereon will be sufficient, and will be used, together with other available monies, to pay (i) the redemption price of the Refunded Bonds on their redemption date and (ii) the interest on the Refunded Bonds due on and prior to such redemption date. The Government Obligations will be purchased from the Treasury Department of the United States of America or in the open market through a competitive bidding process. The State is required to deposit in the Refunding Trust Fund any additional amounts that may be necessary for any reason to enable the Refunding Trustee to pay the redemption price of, and interest on the Refunded Bonds.

The State will obtain verification of sufficiency of the amounts and Government Obligations deposited in the Refunding Trust Fund for the Refunded Bonds, and of certain yields, from The Arbitrage Group, Inc. (See “Verification Agent”).

¹ Subject to change

² The CUSIP numbers shown above have been assigned by Standard & Poor’s CUSIP Bureau, a division of the McGraw Hill Companies, Inc., and are included solely for the convenience of the Bondholders. Neither the State nor the Underwriters are responsible for the selection or use of these CUSIP numbers, nor is any representation made as to their correctness on the Refunded Bonds or as indicated herein.

³ This is the current CUSIP for the 2003 Series A Bonds of this maturity. Because less than all 2003 Series A Bonds of this maturity are being refunded, new CUSIP numbers will be issued for the Refunded Bonds and for the Principal Amount not Refunded and the number listed above will be suspended.

Upon issuance of the Series B Bonds, the Refunded Bonds will be irrevocably designated for redemption as described above and provision will be made by the State in the Refunding Trust Agreement for the giving of notice of redemption of the Refunded Bonds. Written notice of any such redemption shall be mailed to the registered owners of the Refunded Bonds to be redeemed not less than (30) days prior to the redemption date. While DTC or its nominee is the registered owner of the Refunded Bonds, the State shall not be responsible for mailing notices of redemption to Direct DTC Participants or Indirect DTC Participants or to the Beneficial Owners of the Refunded Bonds.

The refunding is being undertaken to realize debt service savings.

The proceeds of the Bonds are expected to be applied on the date of issue of the Bonds in the estimated amounts as follows:

Sources and Uses of Funds

| Sources of Funds: | <u>Series A Bonds</u> | <u>Series B Bonds</u> | <u>Total</u> |
|-----------------------------------|-----------------------|-----------------------|--------------|
| Par Amount | | | |
| Original Issue Premium (Discount) | | | |
| Cash on Hand | | | |
| Total | | | |
| Uses of Funds: | | | |
| Retirement of Commercial Paper | | | |
| Capital Projects Fund | | | |
| Deposit to Refunding Trust Fund | | | |
| Cost of Issuance | | | |
| Underwriters' Discount | | | |
| Total | | | |

SECURITY FOR THE BONDS

All general obligation bonds of the State, including the Bonds, are and will be direct general obligations of the State, payable as to both principal and interest from any funds or monies of the State from whatever source derived. The full faith and credit of the State is pledged to the payment of principal of and interest on all general obligation bonds. As additional security to support its general obligation bonds, including the Bonds, the State, pursuant to Section 9-9-103(a), Tennessee Code Annotated, has pledged (i) the annual proceeds of a tax of five cents per gallon upon gasoline; (ii) the annual proceeds of a special tax of one cent (1¢) per gallon on petroleum products; (iii) one-half of the annual proceeds of motor vehicle registration fees now or hereafter required to be paid to the State; and (iv) the annual proceeds of the franchise taxes imposed by the franchise tax law of the State (collectively, "Special Taxes"). All general obligation bonds share this pledge of Special Taxes on a pro rata basis. See "State Indebtedness" for the amounts of outstanding debt.

The Special Taxes collected for the last three fiscal years, as reported for each year in the June monthly Statement of Revenue Collections (prepared on a cash basis), and for the first two months of the current fiscal year were as follows (amounts have been rounded):

| | July - August | Fiscal Year Ended | | |
|---|----------------------------|------------------------------|-----------------------------|-----------------------------|
| | <u>2010*</u> | <u>June 30, 2010*</u> | <u>June 30, 2009</u> | <u>June 30, 2008</u> |
| Gasoline Tax | \$26,864,000 | \$151,915,000 | \$149,763,000 | \$155,602,000 |
| Special Petroleum Tax | 7,703,000 | 45,140,000 | 44,307,000 | 47,244,000 |
| One-half of Motor Vehicle Registration Fees | 19,778,000 | 116,113,000 | 117,090,000 | 123,131,000 |
| Franchise Tax | <u>9,612,000</u> | <u>551,412,000</u> | <u>524,685,000</u> | <u>644,694,000</u> |
| Total | <u>\$63,957,000</u> | <u>\$864,580,000</u> | <u>\$835,845,000</u> | <u>\$970,671,000</u> |

Source: TN Department of Revenue

*Amounts are unaudited

Pursuant to Section 9-9-106, Tennessee Code Annotated, the State Funding Board has a lien on the taxes, revenues and fees from the Special Taxes in the full amount required to pay principal of and interest on the State's general obligation bonds issued under Title 9, Chapter 9, Tennessee Code Annotated. Pursuant to Section 9-9-111, Tennessee Code Annotated, the State has covenanted not to decrease by legislative action the Special Taxes unless the State Funding Board certifies that the State is not in default in the payment of any outstanding debt and that Special Taxes at lower rates specified by the State Funding Board in such year or years (not to exceed two (2) years) will be sufficient to make all payments required to be made therefrom by the State on all of its obligations during the period that such decrease will be in effect.

The principal amount of general obligation bonds that the State may issue is limited by Section 9-9-104, Tennessee Code Annotated, which provides in part as follows:

[N]o bonds or other obligations will be made a charge upon the special revenues consisting of the proceeds of the gasoline tax, franchise tax, the special tax on petroleum products provided for by Section 67-3-1303 [currently Section 67-3-203] and motor vehicle registration fees pledged under the provisions of this chapter, in addition to the obligations and charges authorized by this chapter, unless the revenues pledged by Section 9-9-103 or the aggregate of the pledged gasoline tax, the special tax on petroleum products provided for by Section 67-3-1303 [currently Section 67-3-203], motor vehicle registration fees and one-third (1/3) of the entire annual proceeds of franchise and excise taxes imposed by the franchise and excise tax laws compiled in Title 67, Chapter 4, parts 9 and 8 [currently parts 21 and 20], whichever sum is lower, for the last preceding fiscal year shall have aggregated not less than one hundred fifty percent (150%) of the amount necessary to pay the annual interest upon all outstanding obligations and charges, for the payment of which such revenues are pledged, and the annual interest upon the obligations then proposed to be issued, together with the annual amount necessary for the amortization of the outstanding obligations and charges and the obligations then proposed to be issued; provided, that, in determining the outstanding obligations and charges there shall be excluded any outstanding bonds with respect to which refunding bonds have been issued and sold and the proceeds of which are to be applied to retire the outstanding bonds.

The amount of Special Taxes collected, on a cash basis, for the fiscal year ended June 30, 2010 was \$864,580,000 (unaudited). The aggregate of the pledged gasoline tax, the special tax on petroleum products, motor vehicle registration fees and one-third of the entire annual proceeds of franchise and excise taxes collected, on a cash basis, for the fiscal year ended June 30, 2010 was \$797,511,000 (unaudited). Pursuant to Section 9-9-104, Tennessee Code Annotated, the debt service limit is obtained by dividing the lesser amount (\$797,511,000) by one-point-five (1.5). Therefore, the debt service limit for the fiscal year ending June 30, 2011 is \$531,674,000. The greatest amount of principal and interest payable in any fiscal year on outstanding bonds for the payment, of which Special Taxes have been pledged, excluding the Bonds and CP, but including the Refunded Bonds, is not more than \$194,077,850.

Section 67-6-103(a)(5), Tennessee Code Annotated, currently provides that 0.9185% of the sales and use tax collections is appropriated to the State Funding Board for the payment of principal and interest on the State’s general obligation bonds. This statutory provision subsequently may be changed or eliminated. The total sales and use tax collections and the amounts allocated to debt service for the last three fiscal years as reported in the State’s Annual Financial Reports were as follows (amounts have been rounded):

| | Total Sales and Use Tax Collections (Accrual Basis) | Allocation to Debt Service (Modified Accrual Basis) |
|---------------|--|--|
| June 30, 2009 | 6,326,857,000 | \$44,977,000 |
| June 30, 2008 | 6,851,481,000 | 48,569,000 |
| June 30, 2007 | 6,819,570,000 | 48,532,000 |

Due to the implementation of GASB Statement 44 “Economic Condition Reporting: The Statistical Section,” the total sales and use tax collections are now reported on the accrual basis instead of the modified accrual basis. For a discussion of projected current year collections, see “State Finances – Financial Information and Budget Summary for Fiscal Years 2009-2010 and 2010-2011”.

The State is permitted by the State Constitution to levy ad valorem taxes on all of the taxable property within the State for the payment of the principal of and interest on the State’s general obligation indebtedness; however, the State does not currently levy such a tax.

All general obligation indebtedness of the State is on a parity and shares pro rata with all other general obligation indebtedness of the State, except that the Special Taxes secure only general obligation bonds. The State may issue, and currently is issuing as CP, general obligation bond anticipation notes, the payment of which the full faith and credit of the State, but not Special Taxes, is pledged. (See “State Indebtedness – Commercial Paper Program”.) In addition, the State is authorized to issue general obligation tax revenue anticipation notes, for the payment of which the full faith and credit of the State, but not Special Taxes, is pledged; however, the State has not heretofore issued any such notes. (See “State Indebtedness – Tax Revenue Anticipation Notes”.)

For a table of annual debt service requirements for all general obligation bonds, excluding the Bonds, see “State Indebtedness – Outstanding General Obligation Bonded Indebtedness”.

Remedies and Rights of Bondholders

Each Bond when duly issued will constitute a contract between the State and the registered owner of the Bond. If the State defaults in payment of any State obligation to which Special Taxes are pledged and/or other fees and taxes are pledged for this purpose, State law requires the State Treasurer or other appropriate authority to pay the amount required for the payment of such obligations out of the first monies received from such taxes and fees. Under State law, a holder or purchaser of any such obligation, including the Bonds, has a vested right in the performance of the covenants and pledges made by the State in the issuance of such obligations and may enforce by appropriate proceedings such covenants, pledges, and duties imposed on any State agency or officer in connection with the issuance of such obligations. The State has not generally waived immunity from suit or extended its consent to be sued and this may bar actions against such agencies and officers. Current State law provides that monetary claims against the State for breach of its contractual obligations and certain other causes may be heard and determined exclusively in the forum of the Tennessee Claims Commission, an administrative tribunal, where the State may be liable only for actual damages and certain costs.

Under the State Constitution, public money may be expended only pursuant to appropriations made by law. (See “State Finances.”) Such expenditures include, but are not limited to, the payment of debt service and funding any judgment in the Tennessee Claims Commission. Continuing appropriations exist for the payment of debt service on the State’s general obligation bonds, including the Bonds, from Special Taxes, in connection with the pledge of Special Taxes in Title 9, Chapter 9, Tennessee Code Annotated, and under current law, from a specified percentage of sales and use taxes as discussed above. Furthermore, Section 9-9-103(b), Tennessee Code Annotated, appropriates to the State Funding Board on a direct and continuing basis a sum sufficient for payment of debt service (principal, interest and premium, if any) on outstanding general obligation bonds and other

debt obligations (including notes) from any funds held in the State treasury not otherwise legally restricted, independent of an appropriation bill otherwise required by State law. Whether a continuing appropriation exists for the payment of a claim in the Tennessee Claims Commission for unpaid debt service is not clear, and in any event sovereign immunity and other legal principles may bar actions to compel the General Assembly to appropriate monies for such payments.

Termination of Existence

The Governmental Entity Review Law provides for the termination of various governmental entities on specified dates. That date for the State Funding Board is June 30, 2016. The law also provides that if the General Assembly does not extend the termination date of an entity, the existence of the entity will continue for an additional year without any diminution, reduction or limitation of its powers. However, the State is required to preserve the rights of the holders of any outstanding indebtedness of the entity at the time of termination and the obligations and rights of such entity shall accrue to the State.

STATE INDEBTEDNESS

General

The State Constitution forbids the expenditure of the proceeds of any debt obligation for a purpose other than the purpose for which it was authorized. Under State law, the term of bonds authorized and issued cannot exceed the expected life of the projects being financed. Furthermore, the amount of bonds issued cannot exceed the amount authorized by the General Assembly.

The procedure for funding State debt is provided by Chapter 9 of Title 9, Tennessee Code Annotated. The State Funding Board of the State of Tennessee is the entity authorized to issue general obligation indebtedness of the State. The State Funding Board is composed of the Governor, the State Comptroller of the Treasury, the Secretary of State, the State Treasurer, and the Commissioner of Finance and Administration. The State Funding Board issues all general obligation indebtedness in the name of the State pursuant to authorization by the General Assembly without concurrence or approval by any other governmental agency or by the electorate. Although the State Funding Board determines the terms of general obligation indebtedness, the interest rate on the general obligation indebtedness cannot exceed the State Formula Rate which is set forth in Section 47-14-103, Tennessee Code Annotated.

Bonds by Purpose

State law provides that the State may issue general obligation bonds or notes for one or more purposes, whether or not the purposes were authorized in the same legislative act. As of September 30, 2010, the State had \$1,560,650,000 (unaudited) of general obligation bonds outstanding for general governmental purposes.

Commercial Paper Program

Bond anticipation notes may be issued for purposes for which bonds have been authorized, if the notes are also authorized by legislative act. Notes have been authorized to be issued for the purposes of all existing bond authorizations.

In March 2000, the State instituted the CP program for authorized capital projects. CP has been and will be issued under the Commercial Paper Resolution, adopted by the members of the State Funding Board of the State on March 6, 2000, as amended, in a principal amount outstanding at any one time not to exceed \$350,000,000. CP constitutes bond anticipation notes and are direct general obligations of the State for the payment of which, as to both principal and interest, the full faith and credit of the State, but not Special Taxes, are pledged.

The State has entered into a Standby Commercial Paper Purchase Agreement (the "Standby Agreement") with the Tennessee Consolidated Retirement System ("TCRS") under which TCRS is obligated to purchase newly issued CP issued to pay the principal of other CP, subject to suspension or termination upon the occurrence of certain events. The Standby Agreement requires that the principal amount of CP maturing on any day shall not exceed \$100,000,000 or such greater principal amount as the State and TCRS may agree to.

CP may have varying maturities of not more than 270 days from their respective dates of issuance; provided, however, that no CP shall mature on a Business Day that will permit Rollover Purchased Commercial Paper to be issued and mature on a Business Day that is not later than one Business Day prior to the stated Expiration Date without regard to any early termination of the Standby Agreement. Currently, this date is April 1, 2015. CP is not subject to redemption prior to maturity.

As of September 30, 2010, \$310,090,000 (unaudited) principal amount of CP was outstanding under this program.

Tax Revenue Anticipation Notes

The State is authorized to issue general obligation tax revenue anticipation notes (“TRANS”) in anticipation of the receipt of tax revenues in the then current fiscal year of the State. TRANS, if issued, will constitute direct obligations of the State for the payment of which, as to principal and interest, the full faith and credit of the State, but not Special Taxes, are pledged. All TRANS must be redeemed in the same fiscal year in which they are issued. The State has not heretofore issued TRANS.

Outstanding General Obligation Bonded Indebtedness

As of September 30, 2010, there was \$1,560,650,000 (unaudited) State general obligation bonds outstanding, excluding the Bonds.

The annual debt service requirements for the outstanding long-term general obligation bonded indebtedness (excluding the Bonds and including the Refunded Bonds) are as follows:

| Fiscal Year | Principal | Interest | Total | Fiscal Year | Principal | Interest | Total |
|--------------------|------------------|-----------------|---------------|--------------------|------------------------|----------------------|------------------------|
| 2011 | 72,655,000 | 67,121,671 | \$139,776,671 | 2021 | \$73,570,000 | \$24,435,010 | \$98,005,010 |
| 2012 | 125,345,000 | 68,732,850 | 194,077,850 | 2022 | 73,635,000 | 21,038,651 | 94,673,651 |
| 2013 | 126,170,000 | 62,677,051 | 188,847,051 | 2023 | 65,730,000 | 17,749,912 | 83,479,912 |
| 2014 | 119,940,000 | 56,863,533 | 176,803,533 | 2024 | 65,755,000 | 14,666,805 | 80,421,805 |
| 2015 | 111,860,000 | 50,935,600 | 162,795,600 | 2025 | 57,415,000 | 11,766,898 | 69,181,898 |
| 2016 | 106,575,000 | 45,672,694 | 152,247,694 | 2026 | 57,590,000 | 9,039,936 | 66,629,936 |
| 2017 | 101,140,000 | 40,756,856 | 141,896,856 | 2027 | 50,315,000 | 6,459,325 | 56,774,325 |
| 2018 | 93,300,000 | 36,008,393 | 129,308,393 | 2028 | 45,000,000 | 4,147,070 | 49,147,070 |
| 2019 | 84,305,000 | 31,977,638 | 116,282,638 | 2029 | 37,700,000 | 2,219,414 | 39,919,414 |
| 2020 | 80,855,000 | 28,098,503 | 108,953,503 | 2030 | 11,795,000 | 589,750 | 12,384,750 |
| | | | | Totals | \$1,560,650,000 | \$600,957,560 | \$2,161,607,560 |

The State had authorized, as of September 30, 2010, \$1,900,156,467 (unaudited) of general obligation bonds that had not been issued, excluding an additional amount not to exceed 2.5% of certain authorized amounts to be used for funding discounts and the cost of issuance at the discretion of the State Funding Board and excluding the Bonds. Of such total amount, \$718,800,000 is for highway projects. Since 1978, highway construction has been funded with current revenue, but the State can give no assurance that this practice will continue. Of such total amount, \$175,000,000 is for the Tennessee transportation infrastructure improvement bond program, which is for the repair, replacement or rehabilitation of bridges. The State anticipates issuing general obligation commercial paper and bonds for this program.

Rate of Debt Retirement

The following table sets forth the rate of scheduled debt retirement of the State of Tennessee on all outstanding general obligation bonds as of September 30, 2010, excluding the Bonds and including the Refunded Bonds.

| Principal Amount Due In | Principal Amount | % of Total |
|--|-----------------------------|-------------------|
| 5 Years | \$555,970,000 | 35.62% |
| 10 Years | 1,022,145,000 | 65.49% |
| 15 Years | 1,358,250,000 | 87.03% |
| 20 Years | 1,560,650,000 | 100.00% |

STATE FINANCES

The Budget Process

The State budget originates in the executive branch with the Governor's annual budget recommendation to the General Assembly. Initially, budget preparation instructions are issued by the Department of Finance and Administration to all State agencies and departments. These instructions describe the Administration's guidelines related to continuing the current level of service (baseline budget) and proposed budget improvements. The instructions are to be used by agencies and departments in preparing their budgets for submission to the Department of Finance and Administration in October of each year.

During the fall, each department's budget request is reviewed, and improvement requests are analyzed by the Department of Finance and Administration. Conferences are held with departmental and agency representatives, the Director of Budget, and the Department of Finance and Administration staff to determine which, if any, of the proposals should be recommended.

Under State law, the Governor submits the recommended budget to the General Assembly at the start of the legislative session. The budget document must be presented to the General Assembly prior to February 1 of each year, except that a Governor in the first year of a four-year term of office must present a budget prior to March 1 of that year. However, the General Assembly may extend these deadlines by joint resolution. Subsequently, the Governor submits a General Appropriation Bill and bond authorization bills containing appropriations and general obligation bond authorizations required to finance the program levels and capital outlay proposed in the Governor's budget. Throughout the legislative session, the Finance, Ways and Means Committees and appropriate standing committees of the House and Senate hold budget hearings for each department to determine if changes should be made to the proposals.

During the 1997 legislative session, the Office of Legislative Budget Analysis was created to enable the General Assembly to strengthen its expertise in governmental budgeting and financing and in making public policy decisions. The office was created as an independent department of the legislature working for both the Senate and the House of Representatives and charged with reviewing and analyzing the State's budget and overall financial condition. The staff summarizes and analyzes the Governor's budget proposal for members of the General Assembly, secures budget justification data from the various state agencies, provides recommendations on budget proposals and provides assistance on financial matters to the standing committees, as directed.

Under the State Constitution, money may be drawn from the Treasury only through an appropriation made by law. The primary source of the annual expenditure authorization is the General Appropriation Act as approved by the General Assembly and signed by the Governor. These appropriations are generally limited to a one-year period of availability. The General Appropriation Act requires both a simple majority vote of the House and a simple majority vote of the Senate. Approval of the General Appropriation Bill usually occurs during the last week of the legislative session. Once signed by the speaker of each House of the General Assembly, the General Appropriation Act is sent to the Governor for signature. If the Governor does not act within ten days, excluding Sundays, the General Appropriation Act becomes law without signature. The Governor may reduce or eliminate specific line items in the General Appropriation Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a vote of a majority of the members elected to each House of the General Assembly.

Appropriations also may be included in legislation other than the General Appropriation Act. The individual bills containing appropriations must be heard by the Finance, Ways and Means Committee, and may be heard by the relevant standing committee, in each House of the General Assembly. After all related committees recommend passage; bills containing appropriations must be approved by a majority vote in each House of the General Assembly and be acted upon by the Governor. Bills of this character are also subject to reduction or elimination by individual line-item veto by the Governor and override by the General Assembly, as described above.

Funds necessary to meet an appropriation need not be in the Treasury at the time such appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

Development of Revenue Estimates

The development of the general fund revenue estimates begins with a forecast of national economic activity for the State budget period. The State currently contracts with The University of Tennessee Center for Business and Economic Research (“UT-CBER”) to prepare an annual Economic Report to the Governor containing short-term business cycle-sensitive forecasts as well as longer-term or trend forecasts for the year and to prepare quarterly updates throughout the year. UT-CBER subscribes to the macroeconomic forecasting services of Global Insight. The Global Insight Forecast becomes the principal input to the Tennessee Econometric Model which is utilized to develop a forecast of similar indicators of in-state activity.

At least annually, the State Funding Board secures from UT-CBER the estimated rate of growth of the State’s economy as measured by the forecast change in Tennessee personal income. The State Funding Board reviews the estimated rate of growth in Tennessee personal income and reports to the General Assembly its comments relating to the reasonableness of the estimate, including any different estimate deemed necessary.

The State Funding Board is further directed by statute to conduct public hearings to develop consensus ranges of estimates of State revenue for the current fiscal year and the next succeeding fiscal year. At the hearings representatives of state higher education institution business centers, including UT-CBER, present revenue estimates and economic forecasts. On December 1, or as soon thereafter as practical, the State Funding Board presents its consensus ranges of State revenue estimates, and a summary of the economic forecast on which the estimates are based, to the Governor and the Chairs of the Senate and House Finance, Ways and Means Committees. Although not mandated prior to final legislative action on the budget, the State Funding Board receives updated estimates and forecasts at public hearings in the spring and forwards any revision to prior estimates and the reasons therefore to the Governor and Chairs of the Senate and House Finance, Ways and Means Committee. The Commissioner of Finance and Administration has the responsibility for preparing the revenue estimates presented in the budget document.

Reserve for Revenue Fluctuations

In 1996, the General Assembly enacted legislation determining the allocation goal for the reserve for revenue fluctuations (“reserve”) to be five percent of estimated State tax revenues to be allocated to the general fund and education trust fund. Beginning with the budget for the Fiscal Year 1998-1999 and until this funding level is achieved, the Governor is to budget an allocation to the reserve in an amount at least equal to ten percent of the estimated growth in estimated State tax revenues to be allocated to the general fund and education trust fund. Amounts in the reserve may be utilized to meet State tax revenue shortfalls. Subject to specific provisions of the general appropriations bill, an amount not to exceed the greater of \$100 million or one-half (1/2) of the amount available in the reserve may be used by the Commissioner of Finance and Administration to meet expenditure requirements in excess of budgeted appropriation levels. Prior to using any amounts in the reserve for this purpose, the Commissioner shall notify the Secretary of the State Funding Board and the Chairs of the Finance, Ways and Means Committees of the Senate and the House of Representatives that the reserve funds are to be used for this purpose. The Commissioner shall report information concerning the need to utilize these funds to the various committees.

The reserve balance at the end of each of the last five fiscal years is as follows:

| <u>Fiscal Year</u> <u>Ended</u> | <u>Balance</u> |
|--|-----------------------|
| June 30, 2005 | 275,400,000 |
| June 30, 2006 | 324,700,000 |
| June 30, 2007 | 542,900,000 |
| June 30, 2008 | 750,000,000 |
| June 30, 2009 | 556,500,000 |
| June 30, 2010 | 453,100,000* |

*estimated and unaudited

The reserve is estimated to decrease by \$103.4 million for fiscal year ending June 30, 2010 and by \$195.8 million for the fiscal year ending June 30, 2011. The statutory goal for the reserve to be 5% of estimated State tax revenues to be allocated to the general fund and education trust fund is estimated not to be achieved for fiscal year ended June 30, 2010 and the fiscal year ending June 30, 2011. The State can give no assurance that the reserve for fiscal year ending June 30, 2010 and fiscal year ending June 30, 2011 will achieve the estimated goal of \$453.1 million and \$257.3 million. See "State Finances - Financial Information and Budget Summary for fiscal years 2009-2010 and 2010-2011".

Financial Control Procedures

The State Constitution requires, for current operations, expenditures for any fiscal year not to exceed the State's revenues and reserves, including the proceeds of any debt obligation, for that year. The State Constitution prohibits the issuance of debt for operating purposes maturing beyond the end of a fiscal year. State law permits tax anticipation borrowing but any amount borrowed must be repaid by the end of the fiscal year.

Generally, the executive branch controls the expenditure of State funds for the operation of State government. Two important concepts are involved in the execution of the General Appropriation Act: preparation of work programs and development of allotment controls. Analysts of the Division of Budget, Department of Finance and Administration, and fiscal personnel in the various State departments and agencies have the responsibility of reconciling the General Appropriation Act, as approved, with the submitted budget. State law requires that administrative agencies prepare a work program for each fiscal year. These work programs indicate separate annual spending requirements for payroll and other operating expenses necessary to carry out agency programs. The head of any agency may revise the work program during the fiscal year because of changed conditions and submit such revision for approval. If the Commissioner of Finance and Administration and the Governor approve the revision, then the same procedure for review, approval and control is followed as in making the original allotments. The aggregate of all allotments after the revision cannot exceed the total appropriations made to the agency for the fiscal year in question.

All expenditures of State administrative agencies are processed through the Department of Finance and Administration and are measured against work program allotments. Savings which may occur as a result of the difference between the amounts provided in the work program allotments for payroll and other operating expenditures and the amounts actually spent for those expenditures accumulate throughout the fiscal year unless a work program is revised to re-allot unspent amounts. Likewise, departmental revenue surpluses cannot be spent until approved by the Commissioner of Finance and Administration and, in some cases, reviewed by the Finance, Ways and Means Committees of the General Assembly. Such central spending control offers executive flexibility relative to any anticipated surplus or shortfall in the budget.

The Governor may effect spending reductions to offset unforeseen revenue shortfalls or unanticipated expenditure requirements for particular programs. These spending reductions can take the form of deferred equipment purchases, hiring freezes, and similar cutbacks. If necessary, the Governor may reduce portions of administrative budgets prior to allotment. Furthermore, the Governor is authorized to call special sessions of the General Assembly at any time to address financial or other emergencies.

Financial Information and Budget Summary for Fiscal Years 2009-2010 and 2010-2011

Financial Information

The second session of the 106th General Assembly in June of 2010, acting upon the State Funding Board's March 29, 2010 consensus recommendation (see "Revenue Growth" below), adopted revised revenue estimates for fiscal year 2009-2010 which recognized an additional revenue shortfall in total taxes in the amount of \$97.6 million and a General Fund shortfall of \$77.8 million. Including base revenue reductions submitted to the General Assembly on February 1, 2010, the total shortfall was \$258,900,000 in total taxes and \$231,000,000 in General Fund revenue. The 2009-2010 budget was adjusted and passed by the General Assembly to accommodate the revised revenue estimate. Fiscal year 2009-2010 revenue collections, excluding certain one-time excise tax payments, were \$241.7 million less than the original budgeted estimate.

The General Assembly passed and on June 25, 2010 the Governor signed the Appropriation Bill for the fiscal year 2010-2011 budget. The fiscal year 2010-2011 budget is balanced with one-time revenues and reserves supporting recurring expenditures. Revenue estimates for fiscal year 2010-2011 were reduced an additional \$109.4 million, including \$75.8 million in the general fund, from the recommended budget document estimates. Revision to various tax laws in 2010 increased the revenue estimate by \$25.3 million, less a one-time \$20 million sales tax disaster relief refund program.

On an accrual basis, August is the first month of fiscal year 2010-2011. For the first month of the fiscal year revenue collections were \$5.4 million less than the budgeted estimate and the general fund shortfall was \$10.7 million. Reserves are available as an additional hedge against a revenue shortfall. The Rainy Day Fund and TennCare Reserve balances are projected in excess of \$500 million at June 30, 2011.

Revenue Growth

The official budgeted revenue estimates are based on the State Funding Board's consensus recommendation adopted by the second session of the 106th General Assembly in June of 2010. The State Funding Board held meetings on March 19, 24, and 25, 2010 to hear presentations from various economists. The State Funding Board reconvened on March 29, 2010 and adopted the following revised consensus revenue growth projections:

| | Fiscal Year 2009-2010 | | Fiscal Year 2010-2011 | |
|-------------------|------------------------------|--------------------|------------------------------|--------------------|
| | <u>Low</u> | <u>High</u> | <u>Low</u> | <u>High</u> |
| Total State Taxes | -1.77% | -1.29% | 1.73% | 1.98% |
| General Fund Only | -2.31% | -1.78% | 2.05% | 2.30% |

The State Funding Board is scheduled to convene December 12, 2010 to hear and discuss updates on economic and revenue projections for the remainder of fiscal year 2010-2011.

Budget Summary

The fiscal year 2010-2011 revised budget reflects major base reductions, but it protects public education by fully funding the Basic Education Program (BEP). Higher education is maintained at 2007-2008 funding levels. The revised budget includes estimated funds from the U.S. Economic Recovery program in the amount of \$1.469 billion.

The TennCare Medicaid expansion program was launched in 1994. The program currently has 1.2 million enrollees consisting of 730,000 children and 470,000 adults. For fiscal year 2011, the State has budgeted for a 4% enrollment increase due to the economic downturn. The fiscal year 2010-2011 TennCare budget is \$8.3 billion including federal funds, and is 27.7% of the total State budget. Excluding federal funds, the recurring cost of the TennCare program is budgeted to be 23% of the total State tax collections.

In fiscal year 2006, TennCare reforms were implemented. Since that time the rate of growth in the TennCare budget has been reduced for each of the fiscal years as follows:

| TennCare Budget Growth | |
|-------------------------------|---------|
| (in millions) | |
| FY 2005 | \$254.3 |
| FY 2006 | 46.4 |
| FY 2007 | 78.9 |
| FY 2008 | 59.3 |
| FY 2009 | -103.0 |
| FY 2010 | -214.8* |
| FY 2011 | -169.1* |

*FY 2010 and 2011 exclude non-recurring enhanced Federal Medical Assistance Percentage savings and non-recurring hospital coverage assessment

In fiscal year 2010-2011, the TennCare Reserve is budgeted to be \$264 million and is equal to 11.2% of the state funds contributed to the TennCare program.

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The following tables compare sources and uses of funds for fiscal years 2009-2010 and 2010-2011:

2010-2011 Recommended Budget
Sources of Funds
As of June 30, 2010
Preliminary Enacted Budget #3 - Revised Revenue Estimate

| | Budget FY 2009-2010 | Budget FY 2010-2011 | Difference |
|-------------------------------------|--------------------------------|--------------------------------|-----------------------|
| Tax Revenue - Revised Estimate | | | |
| Sales and Use Taxes | \$ 6,130,100,000 | \$ 6,248,500,000 | \$ 118,400,000 |
| Other Taxes | 3,934,300,000 | 3,977,400,000 | 43,100,000 |
| Other Miscellaneous Revenues | 1,172,249,000 | 1,233,072,300 | 60,823,300 |
| Hospital Assessment Fee | - | 310,000,000 | 310,000,000 |
| Tobacco Funds | 137,500,000 | 134,800,000 | (2,700,000) |
| Lottery for Education Funds | 303,600,000 | 297,600,000 | (6,000,000) |
| Debt Service Fund Transfer | 107,000,000 * | - | (107,000,000) |
| Reserve Transfers and Adjustments | (156,386,700) * | 242,457,300 * | 398,844,000 |
| Reversion - Overappropriation | 467,638,000 * | 160,764,700 * | (306,873,300) |
| Rainy Day Fund Transfer | 103,434,200 * | 195,757,600 * | 92,323,400 |
| | \$ 12,199,434,500 | \$ 12,800,351,900 | \$ 600,917,400 |
| Federal Funds | 12,918,539,900 | 12,365,737,100 | (552,802,800) |
| Current Services and Other Revenues | 3,353,695,100 | 3,341,535,600 | (12,159,500) |
| Tuition and Student Fees | 1,207,966,400 | 1,283,566,400 | 75,600,000 |
| Bonds | 270,300,000 | 194,100,000 | (76,200,000) |
| | \$ 29,949,935,900 | \$ 29,985,291,000 | \$ 35,355,100 |
| | | | |
| * Reserves and Transfers | \$ 521,685,500 | \$ 598,979,600 | \$ 77,294,100 |

2010-2011 Recommended Budget
Uses of Funds
As of June 30, 2010
Preliminary Enacted Budget #3 - Revised Revenue Estimate

| Program | Budget FY 2009-2010 | Budget FY 2010-2011 | Difference |
|--|--------------------------------|--------------------------------|----------------------|
| General Government | \$ 941,565,100 | \$ 949,440,600 | \$ 7,875,500 |
| Education | 9,019,558,000 | 9,092,064,400 | 72,506,400 |
| Health and Social Services | 13,388,440,700 | 13,759,640,000 | 371,199,300 |
| Law, Safety, and Correction | 1,458,867,200 | 1,456,072,900 | (2,794,300) |
| Resources and Regulation | 953,305,000 | 872,024,000 | (81,281,000) |
| Business and Economic Development | 855,655,800 | 513,394,500 | (342,261,300) |
| Total General Fund | 26,617,391,800 | 26,642,636,400 | 25,244,600 |
| Transportation | 1,788,707,000 | 1,804,482,000 | 15,775,000 |
| Debt Service Requirements | 425,124,000 | 388,753,000 | (36,371,000) |
| Capital Outlay Program | 173,946,000 | 185,552,500 | 11,606,500 |
| Facilities Revolving Fund | 147,267,100 | 162,867,100 | 15,600,000 |
| Cities and Counties - State Shared Taxes | 797,500,000 | 801,000,000 | 3,500,000 |
| Total State Budget All Programs | \$ 29,949,935,900 | \$ 29,985,291,000 | \$ 35,355,100 |

Investment Policy

The State Funding Board is charged with the establishment of the investment policy for the State. The State Treasurer is responsible for the management of the State Pooled Investment Fund (SPIF) (which includes the State's cash, various dedicated reserves and trust funds of the State, and the Local Government Investment Pool) and the Intermediate Term Investment Fund (ITIF) (which includes various funds able to use a longer-term investment option).

The primary investment objective for the SPIF is safety of principal, followed by liquidity and yield. No investments may be purchased with a remaining maturity of greater than 397 calendar days and the weighted average maturity cannot exceed 90 days. Investment instruments authorized by the Investment Policy for the SPIF approved by the State Funding Board pursuant to Section 9-4-602, Tennessee Code Annotated, for purchase by the SPIF include (1) bonds, notes and treasury bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies; (2) repurchase agreements for obligations of the United States or its agencies; (3) certificates of deposit in banks and savings and loan associations recognized as state depositories pursuant to Section 9-4-107, Tennessee Code Annotated; provided, however,

certificates of deposit shall be collateralized in accordance with the provisions of Tennessee Code Annotated; (4) prime commercial paper that is rated in the highest category by at least two nationally recognized commercial paper rating agencies; (5) prime bankers' acceptances that are eligible for purchase by the Federal Reserve System; and (6) securities lending agreements whereby securities may be loaned for a fee; provided, however, eligible collateral as defined in Section 9-4-103, Tennessee Code Annotated, whose market value is at least equal to one hundred two percent (102%) of the market value of the borrowed securities shall be required for each loan and for purposes of this provision, eligible collateral shall include cash collateral, which shall be equal to at least one hundred percent (100%) of the market values of the borrowed securities. For each type of investment there are certain terms and conditions that must be met. All book entry securities purchased are held by the Federal Reserve Bank in the State Trust of Tennessee Account, or held by a custodian pursuant to a custodian agreement. Securities not eligible for book entry at the Federal Reserve Bank are held by a custodian pursuant to a custodian agreement.

The ITIF portfolio is designed to invest funds in longer-term investments than the SPIF in order to benefit from the normal steepness of the yield curve. The State Treasurer will seek to enhance total portfolio return by means of active portfolio management. The dollar weighted average maturity of the ITIF cannot exceed 3 years. An appropriate amount of the fund will be maintained in short term investments to cover emergency withdrawals. No security will be bought with a remaining life of over five years. Investment instruments authorized by the Investment Policy for the ITIF approved by the State Funding Board pursuant to Section 9-4-602, Tennessee Code Annotated, for purchase by the ITIF include (1) bonds, notes and treasury bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies; (2) obligations guaranteed as to principal and interest by the federal home loan mortgage corporation, federal national mortgage association, student loan marketing association and other United States government-sponsored corporations; (3) repurchase agreements for obligations of the United States or its agencies; and (4) prime commercial paper that is rated in the highest category by at least two nationally recognized commercial paper rating agencies. For each type of investment there are certain terms and conditions that must be met. All book entry securities purchased are held by the Federal Reserve Bank in the State Trust of Tennessee Account, or held by a custodian pursuant to a custodian agreement. Securities not eligible for book entry at the Federal Reserve Bank are held by a custodian pursuant to a custodian agreement.

The State Trust of Tennessee, a non-profit corporation established in 1979, is a limited member of the Federal Reserve Bank System.

In addition to the funds in the SPIF and the ITIF, the Tennessee Consolidated Retirement System (a pension trust fund), the Baccalaureate Education System Trust (a private-purpose trust), and the Chairs of Excellence Trust (a permanent fund) are authorized by statutes to invest in long-term investments, including bonds, debentures, preferred stock and common stock, and real estate subject to the approval of the applicable boards of trustees. (See Note 5 A "Deposits and investments" to the financial statements of the State; see Appendix A.).

Accounting Standards

The Governmental Accounting Standards Board ("GASB") is the body responsible for promulgating accounting and financial reporting standards that are followed by state and local governments desiring to present financial statements in accordance with generally accepted accounting principles ("GAAP"). The State adheres to GASB rules and issues audited financial statements in conformity with GAAP.

Other Post-Employment Benefits

The GASB recently issued GASB Statements (Nos. 43 and 45) that provide accounting and financial reporting requirements for retiree healthcare plans and employer participants, commonly known as Other Post-Employment Benefits ("OPEB").

State employees and teachers who meet specified criteria receive pension benefits provided to retirees through a defined benefit plan administered by the Tennessee Consolidated Retirement System. In addition to retirement benefits, certain qualified retirees may continue participation in health insurance sponsored by the State. Retirees who are not yet eligible for Medicare have access to the same benefits as current employees and pay monthly premiums that vary by years of service at retirement. The State has the flexibility to adjust the benefits and premium sharing provisions provided by insurance plans on an annual basis. After age 65, retirees participate in a Medicare supplemental plan. The State's financial support to this supplemental plan is a fixed amount based on years of service.

The first actuarial valuation of post-employment medical benefits, as of July 1, 2005, was performed to determine the impact of providing benefits to retired employees. The study used an attained age actuarial cost method and focused on each State-administered plan as a whole. All four plans were evaluated—State Employee Group, Teacher Group, Local Government Group, and Medicare Supplement. The State has no obligation for the Local Government Group Plan.

Second and third actuarial valuations of post-employment medical benefits, as of July 1, 2007 and July 1, 2009, have been completed. These studies were conducted using a projected unit credit actuarial cost method and focused on individual employers within each plan. Primarily as a result of the change in scope for the second and third valuations from the first, the valuations are not comparable. The State’s obligations resulting from the third study are summarized below. The annual required contribution (ARC) consists of the normal cost (the portion of the actuarial present value for OPEB benefits which is allocated to a valuation year by the actual cost method) and an amortization of the unfunded actuarial liability.

| | As of July 1, 2009* | |
|---|----------------------------|-------------------|
| | (expressed in thousands) | |
| | Unfunded | |
| | Actuarial Liability | ARC |
| State Employee Group Plan | | |
| State obligation for employees (including Component Units) | \$ 1,681,817 | \$ 160,613 |
| State obligation on behalf of teachers | 240,919 | 24,601 |
| Medicare Supplemental Plan | | |
| State obligation for employees (including Component Units) | 209,622 | 15,554 |
| State obligation on behalf of teachers | 158,789 | 11,517 |
| Total State Obligation | \$ 2,291,147 | \$ 212,285 |

* unaudited

The actuary reports may be reviewed at: <http://www.tennessee.gov/finance/act/OPEB.html>. The State has contracted with Buck Consultants, LLC to provide biannual OPEB valuations for the State Employee Group, Teacher Group, Local Government Group and Medicare Supplement plans for fiscal years ended June 30, 2010 through June 30, 2013. The next valuation, as of July 1, 2011, that will cover fiscal years 2011-2012 and 2012-2013 is expected to be available by April 15, 2012.

This data was reported in the State’s CAFR for fiscal year 2009-2010. For fiscal year 2009-2010, the State did not fund any actuarially determined OPEB liability and expects to use pay-as-you-go funding of actual costs of OPEB liabilities incurred for the fiscal year. Both active employees and pre-age 65 retirees are offered the same health care plan options. The State has the flexibility to adjust the various plan options on an annual basis. It will continue to analyze the cost of the choices available to current employees and retirees and the cost of the choices on the employees, retirees and the State’s cash flow to manage these expenditures going forward.

Financial Reporting and Budgeting Awards

The Government Finance Officers Association of the United States and Canada (the “GFOA”) has awarded Certificates of Achievement for Excellence in Financial Reporting to the State of Tennessee for its comprehensive annual financial report for the fiscal year ended June 30, 2008. This was the thirtieth consecutive year that the State has received this award. The Tennessee Consolidated Retirement System (“TCRS”) was also awarded a Certificate of Achievement for Excellence in Financial Reporting for its comprehensive annual financial report for the fiscal year ended June 30, 2008. This was the twenty-first consecutive year that TCRS received this award. The State and TCRS did not receive the award for the fiscal year ended June 30, 2009. To be awarded a Certificate of Achievement for Excellence, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report, the content of which conforms to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements.

The GFOA also presented its Distinguished Budget Presentation Award to the State for its annual budget for the fiscal years ended June 30, 1992 through June 30, 1995 and June 30, 1998 through June 30, 2011. To receive this award, a governmental unit must publish a budget document that meets program criteria as a policy document, as an operations guide, as a financial plan and as a communication device.

DEBT OF CERTAIN AGENCIES AND AUTHORITIES

The following entities are the corporate governmental agencies and instrumentalities of the State authorized to issue various debt instruments. The State is not liable for any debt instrument issued by any of the following entities, and no such debt instrument is a debt or obligation of the State and the full faith and credit of the State is not pledged to the payment thereof.

The Tennessee Local Development Authority

In 1978, the General Assembly created the Tennessee Local Development Authority (the "TLDA") [Sections 4-31-101 et seq., Tennessee Code Annotated]. TLDA is a corporate governmental agency and instrumentality of the State. TLDA is authorized to (i) loan funds to local governments for sewage treatment and waterworks (the "State Loan Programs"), capital projects, firefighting equipment, and airport facilities; (ii) loan funds to certain small business concerns for pollution control equipment; (iii) make funds available for loans for agricultural enterprises; (iv) make loans to not-for-profit organizations providing certain mental health, mental retardation, and alcohol and drug services; and (v) make loans to local government units to finance construction of capital outlay projects for K-12 educational facilities. In order to fund these loans, TLDA is empowered to issue its bonds and notes. The aggregate amounts outstanding for certain programs are limited as follows: \$10,000,000 for firefighting equipment; \$200,000,000 for airport facilities; \$50,000,000 for pollution control equipment; \$50,000,000 for mental health, mental retardation, and alcohol and drug services; \$30,000,000 for agricultural enterprises; \$15,000,000 for petroleum underground storage tank cleanup costs; and \$75,000,000 for capital outlay projects for K-12 educational facilities.

Bonds and notes issued by TLDA are secured by: (i) in the case of loans to local governments, monies received by TLDA under loan program agreements with the local governments and by the local government's allocation of state-shared taxes; (ii) in the case of loans to small business concerns, monies received under agreements with those concerns; (iii) in the case of agricultural loans, monies received under agreements with lenders and a pledge of any money, income or revenue from any source; (iv) in the case of loans to not-for-profit organizations, monies received under State grant agreements and a pledge of the department of mental health and mental retardation's annual budget; and (v) in the case of loans to local government units to finance construction of capital outlay projects for K-12 educational facilities, monies received by TLDA under loan agreements with local education agencies payable from taxes authorized to be levied for the purpose and certain proceeds of the Tennessee lottery for education.

Currently the only program being funded by TLDA is the State Loan Programs. As of September 30, 2010, TLDA had \$48,940,000 (unaudited) of bonds and \$53,060,000 (unaudited) of bond anticipation notes outstanding for this program.

The Tennessee State School Bond Authority

In 1965, the General Assembly created the Tennessee State School Bond Authority (the "Authority") [Sections 49-3-1201 et seq., Tennessee Code Annotated]. The Authority is a corporate governmental agency and instrumentality of the State of Tennessee. The Authority is authorized to issue its bonds and notes to finance capital outlay programs for higher educational facilities which may be required or convenient for the purposes of The University of Tennessee, including its branches and divisions, and for the purposes of the institutions of higher education under the supervision and administration of the Tennessee Board of Regents of the State University and Community College System of the State of Tennessee. In 1980, the General Assembly further authorized the Authority to issue its bonds or notes to provide funds for the making of student loans by the Tennessee Student Assistance Corporation; however, no such bonds or notes have been issued for this purpose. The Authority also is authorized to issue Qualified Zone Academy Bonds ("QZAB") and Qualified School Construction Bonds ("QSCB") to finance improvement loans to cities and counties for qualifying K-12 schools.

Generally, all outstanding higher educational facility debt obligations of the Authority are secured by financing charges payable under contracts and agreements entered into by the Authority and the Board of Trustees of The University of Tennessee and the Tennessee Board of Regents of the State University and Community College System of the State of Tennessee, as successor to the State Board of Education; legislative appropriations; and certain funds and accounts established by the Higher

Educational Facilities General Bond Resolutions of the Authority. The QZAB and QSCB bonds are part of a Federal government program in which a Federal income tax credit is given to investors in lieu of interest on the bonds. For certain of the QSCBs, a Federal income tax credit is given to bondholders in lieu of the payment of interest on bonds, and in certain other QSCBs an election is made by the Authority to receive direct interest subsidy payments from the United States Treasury, which if not needed to cure defaults under loan agreements with the borrowers, are transferred to them. The bonds are secured by a general obligation pledge, and a pledge of unobligated State-shared taxes of the borrowers.

As of September 30, 2010, the Authority had outstanding \$1,066,470,000 (unaudited) aggregate principal amount of higher educational facility bonds (including accretion of College Savings Bonds), \$79,633,000 (unaudited) of higher educational facility commercial paper, and \$57,210,000 (unaudited) aggregate principal amount of QZAB bonds. As of September 30, 2010, the total par amount of QSCBs outstanding was \$177,000,000. The Authority sold \$212,440,000 of QSCBs on September 22, 2010, and expects to close on or about October 7, 2010.

The Tennessee Housing Development Agency

In 1973, the General Assembly created the Tennessee Housing Development Agency (the “Agency”), [Sections 13-23-101 et seq., Tennessee Code Annotated (the “Tennessee Housing Development Agency Act”)]. The Agency is authorized, among other things, to issue its bonds and notes to make funds available for the financing of residential housing for persons and families of lower and moderate income.

The Agency has established a mortgage finance program and is making funds available for loans for residential housing for persons or families of lower and moderate income. Such loans are secured by eligible mortgages on the properties. The Agency has made, but does not currently make, loans for multi-family residential housing for rental occupancy.

In order to accomplish its objectives, the General Assembly has authorized the Agency to issue its bonds and notes, provided that the aggregate principal amount outstanding on such bonds and notes may not exceed \$2,930,000,000, excluding bonds and notes which have been refunded. The Agency's net indebtedness, excluding the bonds and notes which have been refunded, at September 30, 2010, was \$2,201,421,000 (unaudited).

Obligations of the Agency are secured by, among other things, mortgage loans made by the Agency from the proceeds of such obligations. The Tennessee Housing Development Agency Act provides a mechanism for certifying to the Governor and to the Commissioner of Finance and Administration amounts, if any, needed for debt service or operating expenses of the Agency and authorizes the General Assembly to appropriate, to expend and to provide for the payment of such amounts, but imposes no legal obligation upon the General Assembly to do so. These provisions of the Tennessee Housing Development Agency Act do not constitute a legally enforceable obligation of the State to pay any such amounts. Under the Constitution of the State, no monies may be withdrawn from the Treasury but in consequence of appropriations made by law.

Watkins Institute

Watkins Institute (the “Institute”) is an educational institution located in Nashville. Since 1881, the State has served as trustee of a trust providing for the maintenance of the Institute. On behalf of the State as trustee and with the approval of the State Senate, the Governor of the State appoints commissioners of the Institute, all as provided in the wills and codicils establishing the trust. In 1956, the Chancery Court of Davidson County determined that the Institute was a State agency for the purpose of providing capital improvements through the issuance of bonds. As of September 30, 2010, the amount of outstanding bonds was \$2,800,832 (unaudited).

State Veterans' Homes Board

In 1988, the General Assembly created the Tennessee State Veterans' Homes Board (the “Veterans’ Homes Board”) [Sections 58-7-101 to 58-7-112, inclusive, Tennessee Code Annotated]. A political subdivision and instrumentality of the State, the Veterans’ Home Board is authorized to issue its debt instruments to finance public homes for the support and care of honorably discharged veterans of the United States armed forces. Such homes will be established only if Federal Veterans' Administration funds are available to provide a share of the construction and operation costs. Prior to the issuance of any debt instruments, the Veterans’ Homes Board must receive the approval of the State Funding Board. The Veterans’ Homes Board has no outstanding bonds. Loans to the Veterans’ Homes Board were funded through the issuance of general obligation bonds authorized by the General Assembly.

THE TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

The Tennessee Consolidated Retirement System (“TCRS”) was established in 1972 to administer a retirement program for the public employees of the State. In 1972, the seven existing State retirement systems were closed, and all assets and liabilities of these superseded systems were transferred to the TCRS. TCRS membership consists of state employees, higher education employees, teachers, and local government employees. Local governments have the option to join TCRS and are responsible for the pension liabilities associated with their employees.

TCRS provides retirement, disability and death benefits to TCRS members and their beneficiaries. These benefits are available to members at various times depending on their ages and creditable service records. Benefits are determined by a formula using the highest five-year average salary and years of service of each employee. Benefits are funded from contributions of members and employers. Contributions are determined on an actuarial reserve basis and provide funding for both normal and accrued liability costs. Effective July, 1981, pursuant to noncontributory legislation, contributions of up to five percent (5%) of the earnable compensation of most classes of state and higher education employees, formerly paid by those employees, were assumed by the State.

Through June 30, 2010, employers contributed \$836.7 million (unaudited) to TCRS while contributory members contributed \$255.0 million (unaudited). The earnings on investments totaled \$2.7 billion (unaudited) for the System through June 30, 2010. As a result of the positive cash flow for the TCRS, the reserves increased to \$28.6 billion (unaudited) as of June 30, 2010. The investment objective for TCRS is to obtain the highest available return on investments consistent with the preservation of principal while maintaining sufficient liquidity to react to the changing environment and to pay beneficiaries in a timely manner. TCRS emphasizes a conservative, high quality portfolio to ensure the soundness of TCRS and the ability to provide the needed funds upon a member's retirement. Funds in TCRS are actively managed with a diversified portfolio of high quality domestic and international stocks and bonds, real estate, mortgages and money market instruments. The investment policy of TCRS is established by the Board of Trustees of TCRS and may be more restrictive than the statutory authority.

An experience study of TCRS is conducted every four years. The last experience study was conducted as of June 30, 2008 and the resulting assumptions were adopted for the July 1, 2009 actuarial valuation. The 2008 experience study utilized an investment assumption at 7 1/2%, reduced the COLA assumption to 2.5%, and revised mortality projections. Results of the experience study will be used for the period July 1, 2008 – June 30, 2012.

In addition, an actuarial valuation is made every two years. The actuarial valuation as of July 1, 2009 incorporated the 2008 experience study assumptions. The results of the actuarial valuation performed on July 1, 2009 have been incorporated into contribution rates effective July 1, 2010. For actuarial purposes, beginning with the July 1, 2009 valuation, a 10-year smoothing methodology was utilized for gain and loss recognition in the determination of actuarial assets. Previous valuations utilized a 5 year smoothing period. The July 1, 2007 actuarial valuation produced the contribution rates utilized during the fiscal year ending June 30, 2010.

The July 1, 2009 actuarial valuation noted an unfunded accrued liability of TCRS of approximately \$3.6 billion, of which \$2.7 billion related to State employees and K-12 teachers and the remainder being associated with local governments participating in TCRS. As of June 30, 2010, TCRS had 214,711 active members and 112,133 retired members and, as of June 30, 2009, TCRS had 213,276 active members and 107,702 retired members.

The Governmental Accounting Standard Board “GASB” issued Statement No. 25 “*Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*”, requiring information in the notes to the financial statements relating to the funding progress of a pension plan. Expressing the unfunded actuarial accrued liability as a percentage of annual covered payroll approximately adjusts for the effect of inflation and aids analysis of the progress made in accumulating sufficient assets to pay benefits when due. Generally, the smaller this percentage is, the stronger the system.

The funded status of each plan is as follows:

State Employees, Teachers and Higher Education Employees Pension Plan (SETHEEPP)/ Political Subdivision Pension Plan (PSPP) (Unaudited)

Schedule of Funding Progress

(Dollars Expressed in Thousands)

| | Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) Frozen Entry Age (b) | Unfunded AAL (UAAL) (b-a) | Funded Ratio (a/b) | Annual Covered Payroll (c) | UAAL as a Percentage of Covered Payroll ((b-a)/c) |
|-----------------|---|--|---|--|-----------------------------------|---|--|
| SETHEEPP | 07/01/09 | \$ 26,335,199 | \$ 29,054,967 | \$ 2,719,768 | 90.64% | \$ 6,054,528 | 44.92% |
| | 07/01/07 | 26,214,995 | 27,240,151 | 1,025,156 | 96.24% | 5,742,866 | 17.85% |
| PSPP | 07/01/09 | 5,304,455 | 6,143,775 | 839,320 | 86.34% | 2,282,081 | 36.78% |
| | 07/01/07 | 4,897,974 | 5,475,620 | 577,646 | 89.45% | 2,081,964 | 27.75% |

The schedule of funding progress is intended to present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. Since the TCRS has previously calculated the annual required contribution (ARC) using the aggregate actuarial cost method and the requirement to present the Schedule of Funding Progress using the entry age actuarial cost method is effective beginning for the year ended June 30, 2008, only the funded status information relating to the most recent actuarial valuation date is provided. Additional required historical information will be provided in subsequent years once available.

The SETHEEP is comprised of a number of employee groups including state employees, teachers, and state judges and attorneys general. The unfunded actuarial accrued liability for the SETHEEP group was reestablished and amortized over a 20-year period in the July 1, 2009 actuarial valuation. The PSPP represents 482 participating entities at July 1, 2009. Many of the entities in the PSPP also reestablished the unfunded accrued liability and amortized it over a 20-year period during the most recent actuarial valuation.

The information presented in the required supplementary Schedule of Funding Progress was determined as part of the latest actuarial valuations as of July 1, 2009. Additional information follows:

| | SETHEEPP | PSPP |
|---------------------------------------|----------------------------------|----------------------------------|
| Remaining amortization period | 20 Years closed period | (1) closed period |
| Asset valuation method | 10-year Moving Market Average | 10-year Moving Market Average |
| Actuarial assumptions: | | |
| Investment rate of return | 7.50% | 7.50% |
| Projected salary increases | 4.75%(2) | 4.75%(2) |
| Includes inflation at | 3.00% | 3.00% |
| Cost-of-living adjustments | 2.50% | 2.50% |
| Increase in Social Security wage base | 3.50% | 3.50% |

(1) The length of the amortization period varies by political subdivision, not to exceed 30 years.

(2) Uniform rate that approximates the effect of a graded salary scale.

LITIGATION

Due to its size and broad range of activities, the State and its officers and employees are involved in a number of legal actions. In view of the financial condition of the State, it is the opinion of the Commissioner of Finance and Administration that the State's financial condition will not be materially affected by such litigation, based on information known at the date of this Official Statement.

On January 1, 1994, after receiving a waiver from the United States Department of Health and Human Services, the State replaced a substantial portion of its Medicaid Program with a managed care demonstration project called TennCare. TennCare has been the subject of much litigation, and several cases remain active.

Grier, et al. v. Goetz, et al. (U.S. District Court, M. D. Tenn.) deals with the procedural protections to be afforded all enrollees when TennCare services are denied, delayed, suspended, or terminated. A revised consent decree setting out these procedural protections was entered on October 26, 1999, and modified by order entered September 25, 2003. The 2003 Revised Consent Decree has been further modified pursuant to a series of orders entered in 2005 granting in part and denying in part a Motion to Modify the Revised Consent Decree filed by the State on June 15, 2005. The State's largely successful Motion to Modify has enabled the State to enact much needed reforms to the TennCare program such as placing limits on the prescription drugs the State must provide when prescribed without prior authorization, allowing the State to impose and enforce numerical limits on certain benefits, allowing the State to modify the rules of medical necessity, allowing the State to dismiss without hearing enrollee appeals that fail to raise a valid factual dispute, and restoring TennCare's ability, as the single-state Medicaid agency, to have adverse decisions by an administrative law judge reviewed by the Commissioner or his designee.

In a separate aspect of this decades-old case, the Court vacated a 1987 injunction that had operated to prohibit the State from redetermining the continuing TennCare / Medicaid eligibility of enrollees who had lost their Supplemental Security Income (SSI) benefits. Starting in May 2009 the State began to move forward with redetermining the Medicaid eligibility of this group of former SSI recipients, using procedures approved by the Court. The process of redetermining the eligibility of TennCare enrollees for other Medicaid categories as they lose SSI-based eligibility is ongoing.

John B., et al. v. Goetz, et al. (U.S. District Court, M. D. Tenn.) is a class action brought on behalf of all TennCare enrollees under the age of 21, alleging that the State was not meeting its obligation to provide these children with the early and periodic screening, diagnosis, and treatment (EPSDT) services required by the federal Medicaid Act. The case was settled by a consent decree in March 1998. In an opinion filed in December 2001, following a hearing on plaintiffs' motion for a finding of contempt, the court found that the State was in violation of federal EPSDT law. The Court did appoint a special master to assist it in monitoring the State's compliance. In June 2004, plaintiffs' counsel filed another motion to show cause why the State should not be found in contempt for its alleged failure to comply with the 1998 consent decree in this case. That motion was followed, in August 2004, by the plaintiffs' motion for further relief, requesting an order directing the Court-appointed Special Master and his experts to develop a proposed remedial plan to bring the State into compliance with all provisions of the consent decree at the earliest possible time. In an order entered in October 2004, the Court granted the plaintiffs' motion for further relief, without an evidentiary hearing, finding that, while the State had made progress toward compliance, further relief was necessary to ensure that the medical needs of the approximately 550,000 TennCare-enrolled children are met. In granting further relief, the Court put forward a detailed and comprehensive proposed remedial plan, drafted by the Special Master and his experts, to which the State objected in its entirety both on substantive grounds and because the plan appeared to have been developed following *ex parte* communications between the Court and the Special Master.

Before the State's objections to the remedial plan were ruled upon and before this plan was imposed on the State, this case was placed on moratorium and the Special Master's duties were suspended. When the moratorium was lifted in November 2005, the remedial plan was vacated and the Special Master, subsequently removed as special master, was asked to remain as an advisor to the Court. Additionally, in early 2006 Judge Nixon, who had been presiding over this matter, recused himself and the case was transferred to Judge Haynes. Under Judge Haynes the Court has indicated that it intends to hold a hearing in which the State will bear the burden of demonstrating it is in compliance with the Consent Decree and federal EPSDT law. In addition, assuming the State does not demonstrate its compliance, the Court will consider and rule upon what remedial plan should be imposed on the State including but not limited to the 2004 remedial plan that had been vacated. A date for the hearing has not been set, but the parties have been engaged in extensive discovery regarding the State's compliance with the Consent Decree in preparation for that hearing. Those discovery activities have themselves given rise to a number of disputes, one of which

culminated in the filing by plaintiffs of a motion to compel discovery. That motion was granted by the Court and could result in the award to plaintiffs of their costs and attorneys' fees, in an amount not yet determined.

On September 17, 2009, the district court entered an order denying the State's motion to vacate the Consent Decree. The State appealed that decision to the Sixth Circuit Court of Appeals, which granted a stay of further proceedings in the lower court. Oral argument on the State's appeal was held on April 27, 2010. No decision has yet been entered.

Crabtree, et al. v. Goetz, et al. (U.S. District Court, M.D. Tenn.), was brought by several TennCare enrollees who are receiving high levels of home health (HH) and/or private duty nursing (PDN) services. The plaintiffs, totaling in excess of 50 enrollees, challenged, as violative of Title II of the Americans with Disabilities Act, certain changes to the TennCare program's benefit structure. Specifically, while previously available in unlimited amounts, HH services for adults are now limited to a specified number of hours per week and PDN is no longer a covered benefit for adults, with the exception of certain technology-dependent individuals (i.e., ventilator and trach patients). The district court granted plaintiffs' motion for a preliminary injunction, ordering that TennCare temporarily refrain from imposing the reductions in HH and PDN as to the plaintiffs. The cost of these services, typically being provided 24 hours a day, 7 days a week to each plaintiff, ranges from approximately \$190,000 to \$350,000 annually, per plaintiff. No date has yet been set for a hearing on plaintiffs' request for a permanent injunction. This case was dismissed in January 2010 pursuant to a Settlement Agreement.

United States of America v. State of Tennessee (Arlington Developmental Center) (U.S. District Court, W. D. Tenn.) is a case brought pursuant to the Civil Rights of Institutionalized Persons Act, alleging that the constitutional rights of residents at Arlington were being violated. The trial was in August, 1993. A remedial order was approved on September 1, 1994. Since entry of the remedial order, six separate contempt actions have been filed. Some of these have resulted in fines against the State. The Court subsequent to the remedial order has issued an order interpreting the third category of the definition of class, i.e., persons at risk of being placed at Arlington Developmental Center, to consist of all individuals who reside in West Tennessee and who have demonstrated medical needs sufficient to require institutional care in the absence of home or community-based services. This interpretation increases the number of class members from 452 to an estimated 3,000. A notice of appeal was filed with the Sixth Circuit Court of Appeals and a stay granted. A new settlement agreement was reached to resolve the at risk class definition interpretation. Under the new definition, the scope of the class has been more narrowly defined than in the order entered by the District Court and pending in the Sixth Circuit. It is not possible at this time to know how many additional individuals will be added to the Arlington class under this new settlement agreement or the potential liability to the State to provide additional services to these individuals. But, it is expected to be substantially less than under the prior order. In addition, the State has agreed to close Arlington Developmental Center, which closure is expected by October 15, 2010. Once Arlington Developmental Center is closed, no new class members will be added. On September 30, 2009, the District Court granted the State's motion to terminate the grant contract with the Community Services Network of West Tennessee, Inc ("CSN"). CSN was ordered as a remedy for a finding of contempt in 1999. CSN was created to provide health care services to class members outside of TennCare, including nurse case management services. The vast majority of services provided by CSN were not eligible for federal financial participation. In the current fiscal year, CSN's budget was estimated to be \$19.8 million. The State proposed to provide health care services to class members, including nurse case management services through a TennCare MCO. This will allow the State to receive federal financial participation for these services. With the savings from the termination of the contract with CSN, the State has proposed to provide nurse case management services through this MCO contract to all individuals with mental retardation enrolled in the Medicaid waivers statewide. The State also expects some additional savings to be available to offset current budget reductions.

At this time, there is one lawsuit pending against the State of Tennessee that could affect the payments the State receives under the 1998 Tobacco Master Settlement Agreement ("MSA"). This lawsuit is *Grand River Enterprises Six Nations Ltd., et al. v. Pryor, et al* (U.S. District Court, Southern District of New York, No. 02-05068). In *Grand River*, a Canadian tobacco company that has not signed the MSA (a Non-Participating Manufacturer) has filed suit against Tennessee and thirty other states asserting that the defendant states' tobacco laws violate the Sherman Antitrust laws and various provisions of the United States Constitution. Early during the proceedings, the District Court dismissed Tennessee and the other non-New York defendants based on the lack of personal jurisdiction. The Second Circuit Court of Appeals reversed this ruling, finding that negotiations of the MSA occurring in New York, involving Tennessee and the other defendant states, created personal jurisdiction in the Southern District of New York. The case has progressed through the discovery process and on August 12, 2009, Tennessee and the other defendant states filed a motion for summary judgment, seeking a dismissal of all claims. A ruling on the states' motion is expected this winter. However, if the plaintiff were ultimately to prevail, then Tennessee could lose a substantial portion of its tobacco payment, not to exceed 65% of its annual payment.

In addition to the above lawsuit, the State could receive reduced MSA payments pursuant to provisions contained in the MSA that allow for the Participating Manufacturers (“PMs”) to withhold payments under certain circumstances. These provisions, referred to in the MSA as the “Non-Participating Manufacturer (“NPM”) Adjustment”, may be applied to the settlement payments received by the Settling States, including Tennessee. In order for the adjustment to apply, there are several pre-conditions that must be satisfied. First, there must be more than a two percent (2%) market share loss experienced by the PMs. Second, the disadvantages experienced by the PMs as a result of the MSA must have been a significant factor contributing to their market share loss. States that have enacted a model escrow statute and “diligently enforced” it during the time period in question have a safe-harbor against the adjustment.

In March of 2006, the economic firm selected by the Settling States (including Tennessee) and PMs determined that the disadvantages experienced by the PMs during 2003 as a result of the MSA’s provisions were a significant factor in the PMs’ loss of market share. As a result of this determination, the PMs withheld approximately \$18 million from Tennessee’s 2006 MSA payment. The States, including Tennessee, have commenced arbitration against the PMs to determine whether each State diligently enforced its model escrow statute during 2003. This arbitration will be decided by a three-member panel of retired federal judges, in accordance with the procedures set forth in the MSA. If Tennessee is found to have diligently enforced its tobacco escrow laws during 2003, it will recover the \$18 million that was withheld from the 2006 MSA payment. Once the current arbitration is concluded, there will likely be subsequent arbitrations to determine if the State diligently enforced statutes during later years and whether Tennessee is entitled to recover money withheld from MSA payments for 2007 through 2010.

On June 30, 2009, the Settling States, including Tennessee, and the PMs entered into an agreement whereby the parties stipulated that the cost disadvantages experienced by the PMs during 2007, 2008 and 2009 as a result of the MSA were a significant factor in the PMs’ loss of market share during such years. As a result of this stipulation, the PMs were entitled to withhold approximately \$15.6 million from the April 2020 payment. In return, the Settling States received a \$5 million payment to the States’ Tobacco Enforcement Fund in 2009 and will receive the same payments in 2010 and 2011.

The multi-state arbitration to determine whether Tennessee and the other States diligently enforced their escrow statutes during 2003 is in the preliminary stages. The States and PMs have filed statements of claims and are preparing to file briefs on preliminary legal issues that will be decided by the arbitration panel prior to the evidentiary hearings. It is anticipated that the evidentiary, “diligent enforcement”, hearings will begin this winter.

In addition, the Independent Auditor responsible for disbursing settlement payments may elect to preliminarily make adjustments to the State’s tobacco settlement payments without resorting to litigation. These potential adjustments, most notably relating to sales volume, have been made in the past and may be made in the future. The State may vigorously dispute any such adjustments or withholdings, but it could take years to have those disputes resolved. Lastly, litigation in other states may have a material effect on the tobacco settlement payments in the State.

Pfizer, Inc. v. Reagan Farr, Commissioner of Revenue, State of Tennessee (Davidson County Chancery No. 09-1946-II) and *Pharmacia Corp. v. Reagan Farr, Commissioner of Revenue, State of Tennessee* (Davidson County Chancery No. 09-1945-II) are related tax refund cases concerning the sale of the companies’ (Pharmacia is a wholly-owned subsidiary of Pfizer) “consumer healthcare products division” (the “CPD”) in 2006 that these companies claim had no constitutionally significant connection to Tennessee. The companies also contend that the CPD was a business segment unrelated to and separate from their established “pharmaceutical products division” that had operations in Tennessee. Consequently, they allege that the gains from the sale are not taxable because they are non-business earnings under Tennessee’s excise tax statute and because they arose from outside of the unitary business that they conduct within Tennessee. Alternatively, the companies seek a variance from their statutorily-determined excise tax liability on the grounds that their sales through a distribution channel operated by McKesson Corporation (which has a distribution center in Memphis) have distorted the amount of the taxpayers’ income apportioned to Tennessee under the statutory formula. In total, Pfizer seeks a refund of over \$84 million and Pharmacia of over \$40 million.

TAX MATTERS

Federal Tax Matters

General

In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the State, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein, (i) interest on the Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the “Code”), (ii) interest on the Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations under the Code, (iii) interest on the Series A Bonds is not included in the adjusted current earnings of corporations for purposes of calculating the alternative minimum tax and (iv) interest on the Series B Bonds is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. In rendering its opinion, Bond Counsel has relied on certain representations, certifications of fact, and statements of reasonable expectations made by the State in connection with the Bonds, and Bond Counsel has assumed compliance by the State with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of interest on the Bonds from gross income under Section 103 of the Code.

Bond Counsel expresses no opinion regarding any other Federal tax consequences with respect to the Bonds. Bond Counsel renders its opinion under existing statutes and court decisions as of the issue date, and assumes no obligation to update its opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation or otherwise. Bond Counsel expresses no opinion as to the effect of any action hereafter taken or not taken, in reliance upon an opinion of other counsel, on the exclusion from gross income for Federal income tax purposes of interest on the Bonds.

For the proposed form of opinion of Bond Counsel relating to Federal tax matters, see Appendix C.

Certain Ongoing Federal Tax Requirements and Covenants

The Code establishes certain ongoing requirements that must be met subsequent to the issuance and delivery of the Bonds in order that interest on the Bonds be and remain excluded from gross income under Section 103 of the Code. These requirements include, but are not limited to, requirements relating to use and expenditure of gross proceeds of the Bonds, yield and other restrictions on investments of gross proceeds, and the arbitrage rebate requirement that certain excess earnings on gross proceeds be rebated to the Federal government. Noncompliance with such requirements may cause interest on the Bonds to become included in gross income for Federal income tax purposes retroactive to their issue date, irrespective of the date on which such noncompliance occurs or is discovered. The State has covenanted to comply with certain applicable requirements of the Code to assure the exclusion of interest on the Bonds from gross income under Section 103 of the Code.

Certain Collateral Federal Tax Consequences

The following is a brief discussion of certain collateral Federal income tax matters with respect to the Bonds. It does not purport to address all aspects of Federal taxation that may be relevant to a particular owner of a Bond. Prospective investors, particularly those who may be subject to special rules, are advised to consult their own tax advisors regarding the Federal tax consequences of owning and disposing of the Bonds.

The Series A Bonds are not taken into account (subject to certain limitations) in determining the portion of a financial institution’s interest expense subject to the pro rata interest disallowance rule of Section 265(b) of the Code for costs of indebtedness incurred or continued to purchase or carry certain tax-exempt obligations. The Series A Bonds, however, are taken into account in the calculation of the amount of a financial institution’s preference items under Section 291 of the Code.

Prospective owners of the Bonds should be aware that the ownership of such obligations may result in collateral Federal income tax consequences to various categories of persons, such as corporations (including S corporations and foreign corporations), financial institutions, property and casualty and life insurance companies, individual recipients of Social Security and railroad retirement benefits, individuals otherwise eligible for the earned income tax credit, and taxpayers deemed to have incurred or continued indebtedness to purchase or carry obligations the interest on which is excluded from gross income for Federal income tax purposes. Interest on the Bonds may be taken into account in determining the tax liability of foreign corporations subject to the branch profits tax imposed by Section 884 of the Code.

Original Issue Discount

Original issue discount (“OID”) is the excess of the sum of all amounts payable at the stated maturity of a Bond (excluding certain “qualified stated interest” that is unconditionally payable at least annually at prescribed rates) over the issue price of that maturity. In general, the “issue price” of a maturity means the first price at which a substantial amount of the Bonds of that maturity was sold (excluding sales to bond houses, brokers, or similar persons acting in the capacity as underwriters, placement agents, or wholesalers). In general, the issue price for each maturity of the Bonds is expected to be the initial public offering price set forth on the inside cover page of this Official Statement. Bond Counsel is of the opinion that, for any Bonds having OID (a “Discount Bond”), OID that has accrued and is properly allocable to the owners of the Discount Bonds under Section 1288 of the Code is excludable from gross income for Federal income tax purposes to the same extent as other interest on the Bonds.

Bond Premium

In general, if an owner acquires a Bond for a purchase price (excluding accrued interest) or otherwise at a tax basis that reflects a premium over the sum of all amounts payable on that Bond after the acquisition date (excluding certain “qualified stated interest” that is unconditionally payable at least annually at prescribed rates), that premium constitutes “bond premium” on that Bond (a “Premium Bond”). In general, under Section 171 of the Code, an owner of a Premium Bond must amortize the bond premium over the remaining term of the Premium Bond, based on the owner's yield over the remaining term of the Premium Bond, determined based on constant yield principles (in certain cases involving a Premium Bond callable prior to its stated maturity date, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such bond). An owner of a Premium Bond must amortize the bond premium by offsetting the qualified stated interest allocable to each interest accrual period under the owner's regular method of accounting against the bond premium allocable to that period. In the case of a tax-exempt Premium Bond, if the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to that accrual period, the excess is a nondeductible loss. Under certain circumstances, the owner of a Premium Bond may realize a taxable gain upon disposition of the Premium Bond even though it is sold or redeemed for an amount less than or equal to the owner's original acquisition cost.

Owners of any Premium Bonds should consult their own tax advisors regarding the treatment of bond premium for Federal income tax purposes, including various special rules relating thereto, and state and local tax consequences, in connection with the acquisition, ownership, amortization of bond premium on, sale, exchange or other disposition of Premium Bonds.

Information Reporting and Backup Withholding

Information reporting requirements apply to interest on tax-exempt obligations, including the Bonds. In general, such requirements are satisfied if the interest recipient completes, and provides the payor with a Form W-9, “Request for Taxpayer Identification Number and Certification,” or if the recipient is one of a limited class of exempt recipients. A recipient not otherwise exempt from information reporting who fails to satisfy the information reporting requirements will be subject to “backup withholding,” which means that the payor is required to deduct and withhold a tax from the interest payment, calculated in the manner set forth in the Code. For the foregoing purpose, a “payor” generally refers to the person or entity from whom a recipient receives its payments of interest or who collects such payments on behalf of the recipient.

If an owner purchasing a Bond through a brokerage account has executed a Form W-9 in connection with the establishment of such account, as generally can be expected, no backup withholding should occur. In any event, backup withholding does not affect the excludability of the interest on the Bonds from gross income for Federal income tax purposes. Any amounts withheld pursuant to backup withholding would be allowed as a refund or a credit against the owner's Federal income tax once the required information is furnished to the Internal Revenue Service.

State of Tennessee Tax Matters

In the opinion of Bond Counsel to the State, under existing laws of the State, the Bonds and the interest thereon are free from taxation by the State or any county, municipality or taxing district of the State, except for inheritance, transfer and estate taxes, and except to the extent such interest may be included within the measure of privilege taxes imposed pursuant to the laws of the State.

Bond Counsel expresses no opinion regarding any other state or local tax consequences with respect to the Bonds. Bond Counsel renders its opinion under existing statutes and court decisions as of the issue date and assumes no obligation to update its opinion after the issue date to reflect any future action, fact or circumstance, or change in law or interpretation or otherwise. Bond Counsel expresses no opinion as to the effect of any action hereafter taken or not taken, in reliance upon an opinion of other counsel, under state and local tax law.

For the proposed form of opinion of Bond Counsel relating to State tax matters, see Appendix C.

Miscellaneous Tax Matters

Tax legislation, administrative actions taken by tax authorities, or court decisions, whether at the Federal or state level, may adversely affect the tax-exempt status of interest on the Bonds under Federal or state law and could affect the market price or marketability of the Bonds.

Prospective purchasers of the Bonds should consult their own tax advisors regarding the foregoing matters.

FINANCIAL ADVISOR

Public Financial Management, Inc. ("PFM") is employed by the State to perform professional services in the capacity of financial advisor. In its role as financial advisor to the State Funding Board, PFM has provided advice on the plan of financing and structure of the Bonds, reviewed certain legal and disclosure documents, including this Official Statement, for financial matters, and reviewed and verified the results of the competitive sale of the bonds held on October ____, 2010. PFM has not independently verified the factual information contained in this Official Statement, but relied on the information supplied by the State and other sources and the State's certification as to the Official Statement.

VERIFICATION AGENT

The arithmetical accuracy of certain computations included in the schedules provided by PFM on behalf of the State relating to (a) computation of forecasted receipts of principal and interest on the obligations deposited under the Refunding Trust Agreement and the forecasted payments of principal and interest to redeem the Refunded Bonds, and (b) computation of the yields on the Refunding Bonds and the obligations deposited under the Refunding Trust Agreement was examined by The Arbitrage Group, Inc. Such computations were based solely upon assumptions and information supplied by PFM on behalf of the State. The Arbitrage Group, Inc. has restricted its procedures to examining the arithmetical accuracy of certain computations and has not made any study or evaluation of the assumptions and information upon which the computations are based and, accordingly, has not expressed an opinion on the data used, the reasonableness of the assumptions, or the achievability of the forecasted outcome.

UNDERWRITING

Through a competitive sale, _____ was awarded the Series A Bonds and _____ was awarded the Series B Bonds. The Series A Bonds were purchased at a net price of \$_____ (which includes an Underwriters' discount of \$_____, including a net original issue premium (discount) of \$_____). The Series B Bonds were purchased at a net price of \$_____ (which includes an Underwriters' discount of \$_____, including a net original issue premium (discount) of \$_____).

CERTIFICATION AS TO OFFICIAL STATEMENT

The State will confirm to the successful bidders for the Bonds, by a certificate signed on its behalf by the Comptroller of the Treasury and delivered at the closing for the Bonds, to the effect that at the time of the acceptance of the bids, and at the time of the closing, (i) the information and statements, including financial statements of or pertaining to the State contained in this Official Statement, were and are correct in all material respects, and (ii) insofar as the State and its affairs, including its financial affairs, are concerned, this Official Statement did not and does not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading. The State, by such certificate, will further confirm to the effect and insofar as the descriptions and statements, including financial data, of or pertaining to other governmental bodies, nongovernmental bodies, and their respective activities contained in this Official Statement are concerned, such descriptions, statements, and data have been obtained from sources believed by the State to be reliable, and that the State has no reason to believe that they are untrue or incomplete in any material respect.

RATINGS

Fitch Ratings (“Fitch”), Moody's Investors Service, Inc. (Moody’s), and Standard & Poor's Ratings Services (“Standard & Poor’s”) have given the Bonds ratings of AAA, Aaa, and AA+, respectively. Such ratings reflect only the respective views of such organizations and an explanation of the significance of a rating may be obtained only from the rating agency furnishing the same. There is no assurance that any rating will be maintained for a given period of time or that it will not be revised downward or withdrawn entirely by the rating agency if in its judgment, circumstances so warrant. Any such downward revision or withdrawal of ratings may have an adverse affect on the market price of the Bonds.

APPROVING LEGAL OPINIONS

The validity of the Bonds will be approved by the legal opinions of Hawkins Delafield & Wood LLP, New York, New York, Bond Counsel to the State. For the proposed forms of Bond Counsel opinions relating to the Bonds, see Appendix C. Certain legal matters will be passed upon by the Attorney General and Reporter of the State of Tennessee, as counsel to the State Funding Board. No representation is made to the holders of the Bonds that any such counsel have verified the accuracy, completeness or fairness of the statements in this Official Statement, and such counsel assume no responsibility to the holders of the Bonds except for the matters that will be set forth in their respective opinions.

CONTINUING DISCLOSURE

The State has authorized Continuing Disclosure Undertakings (the “Undertaking”) with respect to the Bonds to assist in complying with U.S. Securities and Exchange Commission Rule 15c2-12(b)(5) (the “Rule”). The Undertakings will be for the benefit of the holders of the respective Bonds, and beneficial owners will be third-party beneficiaries thereof. The form of the undertaking is included herein as Appendix E.

The State has not failed to comply in any material respect with any previous undertaking in a written contract or agreement specified in the Rule.

FORWARD LOOKING STATEMENTS

The statements contained in this Official Statement, and in any other information provided that are not purely historical, are forward-looking statements, including statements regarding the expectations, hopes, intentions, or strategies regarding the future.

Readers should not place undue reliance on forward-looking statements. All forward-looking statements included in this Official Statement are based on information available on the date hereof, and assumes no obligation to update any such forward-looking statements.

The forward-looking statements herein are necessarily based on various assumptions and estimates and are inherently subject to various risks and uncertainties, including risks and uncertainties relating to the possible invalidity of the underlying assumptions and estimates and possible changes or developments in social, economic, business, industry, market, legal and regulatory circumstances and conditions and actions taken or omitted to be taken by third parties, including customers, suppliers, business partners and competitors, and legislative, judicial and other governmental authorities and officials. Assumptions related to the foregoing involve judgments with respect to, among other things, future economic, competitive, and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and, therefore, there can be no assurance that the forward-looking statements included in this Official Statement would prove to be accurate

MISCELLANEOUS

Any statements in this Official Statement involving matters of opinion or estimates, whether or not expressly so stated, are intended as such and not as representatives of fact. No representation is made that such statements will be realized.

All financial and other information presented in this Official Statement has been provided by the State from its records, except for information expressly attributed to other sources. The presentation of information, including tables of receipts from taxes and other revenues, is intended to show recent historic information, and it is not intended to indicate future or continuing trends in the financial position or other affairs of the State. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future.

References to and summaries of provisions of the Constitution and laws of the State or of any other documents referred to in this Official Statement are qualified in their entirety by reference to the complete provisions thereof.

This Official Statement is not to be construed as a contract or agreement between the State and the purchasers or holders of any of the Bonds.

STATE OF TENNESSEE

By: Justin P. Wilson
Comptroller of the Treasury;
Secretary of the Funding
Board of the State of
Tennessee

Financial Statements

The Comprehensive Annual Financial Report (“CAFR”) of the State, including the audited Basic Financial Statements, for the fiscal year ended June 30, 2009 has been filed with the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access (“EMMA”) system (see “Continuing Disclosure” and Appendix E) and is obtainable from them in accordance with their procedures. A printed version is also available upon request to the State Funding Board, James K. Polk State Office Building, Suite 1600, 505 Deaderick Street, Nashville, Tennessee 37243-1402, telephone (615) 401-7872, fax (615) 741-5986. The 2009 CAFR and certain prior year CAFRs are posted on the State’s website at <http://tn.gov/finance/act/cafr.html>.

The following reports, each of which are included in the 2009 CAFR and have been posted on the State’s website, are incorporated herein by reference:

Auditor’s Report

Management’s Discussion and Analysis

Basic Financial Statements:

Government-wide Financial Statements:

Statement of Net Assets

Statement of Activities

Fund Financial Statements:

Balance Sheet-Governmental Funds

Statement of Revenues, Expenditures, and Changes in Fund Balances-Governmental Funds

Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities

Statement of Net Assets-Proprietary Funds

Statement of Revenues, Expenses, and Changes in Fund Net Assets-Proprietary Funds

Statement of Cash Flows-Proprietary Funds

Statement of Fiduciary Net Assets-Fiduciary Funds

Statement of Changes in Fiduciary Net Assets-Fiduciary Funds

Notes to the Financial Statements

Required Supplementary Information:

Infrastructure Assets Reported Using the Modified Approach

Other Post Employment Benefits Schedule of Funding Progress – Primary Government

Other Post Employment Benefits Schedule of Funding Progress – Component Units

Two-Year Claims Development Table – Access TN Insurance Fund

Schedule of Revenues, Expenditures, and Changes in Fund Balances-Budget and Actual-Major Governmental Funds

Reconciliation of Budget to GAAP-Note to RSI

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Statistical Section

The Comprehensive Annual Financial Report (“CAFR”) of the State, including selected statistical data (unaudited), for the fiscal year ended June 30, 2009 has been filed with the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access (“EMMA”) system (see “Continuing Disclosure” and Appendix E) and is obtainable from them in accordance with their procedures. A printed version is also available upon request to the State Funding Board, James K. Polk State Office Building, Suite 1600, 505 Deaderick Street, Nashville, Tennessee 37243-1402, telephone (615) 401-7872, fax (615) 741-5986. The 2009 CAFR and certain prior year CAFRs are posted on the State’s website at <http://tn.gov/finance/act/cafr.html>.

The following statistical data, all of which is included in the 2009 CAFR and has been posted on the State’s website, is incorporated herein by reference:

- Financial Trends
- Revenue Capacity
- Debt Capacity
- Demographic and Economic Information
- Operating Information
- Component Units

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Form of Proposed Opinion of Bond Counsel

[Closing Date]

The Honorable Governor and Members of
the Funding Board of the State of Tennessee
Nashville, Tennessee 37243

Dear Sirs:

STATE OF TENNESSEE
GENERAL OBLIGATION BONDS
2010 SERIES A, \$ _____
2010 REFUNDING SERIES B, \$ _____

At your request we have examined into the validity of \$_____ General Obligation Bonds, 2010 Series A (the “Series A Bonds”), and \$_____ General Obligation Bonds, 2010 Refunding Series B (the “Series B Bonds”) (collectively the “Bonds) of the State of Tennessee (the “State”). The Bonds are dated as of _____, 2010 and mature, are subject to redemption prior to maturity, are payable and bear interest, all as provided in the resolution of the Funding Board hereinafter mentioned.

The Bonds recite that they are issued under and pursuant to and in full compliance with the Constitution and laws of the State, including specifically Title 9, Chapter 9, Tennessee Code Annotated, various Public Acts of the General Assembly of the State of Tennessee, and a resolution adopted by the Funding Board of the State of Tennessee on September 20, 2010, to fund capital projects of the State and to provide for the retirement at maturity of certain of the State’s general obligation bond anticipation notes heretofore issued as commercial paper.

We have examined the Constitution and statutes of the State; certified copies of proceedings of the Funding Board of the State of Tennessee and Public Acts of the General Assembly of the State of Tennessee authorizing the issuance of the Bonds, and an executed Bond, and have made such other examination of law and fact, as we have considered appropriate for purposes of this opinion.

Based on the foregoing, we are of the opinion that:

(1) The Bonds have been authorized and issued in accordance with the Constitution and laws of the State, and constitute valid general obligations of the State for the payment of which as to both principal and interest the full faith and credit of the State is pledged. As additional security for all of the Bonds and interest thereon there is also pledged the annual proceeds of a tax of up to five cents per gallon upon gasoline; the annual proceeds of a special tax of one cent per gallon on petroleum products; one-half of the annual proceeds of motor vehicle registration fees now or hereafter required to be paid to the State, and the annual proceeds of the franchise taxes imposed by the franchise tax law of the State. All of the Bonds, together with interest thereon, are entitled to the benefit of the foregoing taxes, fees, and revenues and to share therein pro rata with any other obligations of the State that might be entitled to share therein as provided by Sections 9-9-101 to 9-9-208, inclusive, Tennessee Code Annotated. The State has not waived immunity from suit or extended its consent to be sued. Monetary actions against the State for breach of contractual obligations may be heard and determined under current law

exclusively in the Tennessee Claims Commission, an administrative tribunal, where the State may be liable only for actual damages and certain costs.

(2) Under existing statutes and court decisions, (i) interest on the Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Internal Revenue Code of 1986, as amended (the "Code"), (ii) interest on the Bonds is not treated as a preference item in calculating the alternative minimum tax imposed on individuals and corporations, (iii) interest on the Series A Bonds is not included in the adjusted current earnings of corporations for purposes of calculating the alternative minimum tax and (iv) interest on the Series B Bonds is included in the adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax. In rendering the opinions in this paragraph (2), we have relied on certain representations, certifications of fact, and statements of reasonable expectations made by the State in connection with the Bonds, and have assumed compliance by the State with certain ongoing covenants to comply with applicable requirements of the Code to assure the exclusion of the interest on the Bonds from gross income under Section 103 of the Code. Under the Code, noncompliance with such requirements may cause the interest on the Bonds to be included in gross income for Federal income tax purposes retroactive to the date of issuance thereof, irrespective of the date on which such noncompliance occurs or is discovered.

(3) Under the existing laws of the State, the Bonds and the interest thereon are free from taxation by the State or any county, municipality or taxing district of the State, except for inheritance, transfer and estate taxes and except to the extent such interest may be included within the measure of privilege taxes imposed pursuant to the laws of the State.

The opinions expressed in paragraph (1) above are subject to applicable bankruptcy, insolvency, reorganization, moratorium and other laws heretofore or hereafter enacted affecting creditors' rights, and are subject to the application of principles of equity relating to or affecting the enforcement of contractual obligations, whether such enforceability is considered in a proceeding in equity or at law.

We express no opinion herein as to (i) Federal, state or local tax consequences arising with respect to the Bonds, or the ownership or disposition thereof, except as stated in paragraphs (2) and (3) above, (ii) the effect of any action taken or not taken, in reliance upon an opinion of other counsel, on the exclusion from gross income for Federal income tax purposes of interest on the Bonds, or under state or local tax law, or (iii) the accuracy, adequacy, sufficiency or completeness of the Official Statement dated _____ (or any update or amendment thereof or supplement thereto) relating to the Bonds, or any other financial or other information which has been or may be supplied to purchasers or prospective purchasers of the Bonds.

This opinion is issued as of the date hereof, and we assume no obligation to update, revise or supplement this opinion to reflect any future action, fact or circumstance, or change in law or interpretation or otherwise.

Very truly yours,

BOOK-ENTRY ONLY SYSTEM

The Depository Trust Company (“DTC”), New York, New York, will act as securities depository for the Bonds. The Bonds will be issued as fully-registered bonds registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each maturity of the Bonds of each series bearing interest at each interest rate, each in the aggregate principal amount of such maturity of each series bearing interest at such rate, and will be deposited with DTC.

DTC, the world’s largest depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 100 countries that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has Standard & Poor’s highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

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

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

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory and regulatory requirements as may be in effect from time to time. Beneficial Owners of the Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of the Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

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

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

Principal and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State or any Paying Agent, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC or the State or any Paying Agent, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the State or any Paying Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct or Indirect Participants.

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

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

THE FOREGOING INFORMATION CONCERNING DTC AND DTC'S BOOK-ENTRY ONLY SYSTEM HAS BEEN OBTAINED FROM DTC, A SOURCE THAT STATE BELIEVES TO BE RELIABLE, BUT THE STATE TAKES NO RESPONSIBILITY FOR THE ACCURACY THEREOF. NEITHER THE STATE, THE UNDERWRITERS, NOR THE PAYING AGENT AND REGISTRAR CAN MAKE ANY ASSURANCE THAT DTC OR THE DTC PARTICIPANTS WILL ACT IN A MANNER DESCRIBED HEREIN, NOR WILL THEY HAVE ANY RESPONSIBILITY OR OBLIGATION TO THE DTC PARTICIPANTS OR BENEFICIAL OWNERS FOR (1) SENDING TRANSACTION STATEMENTS; (2) MAINTAINING, SUPERVISING OR REVIEWING, OR THE ACCURACY OF, ANY RECORDS MAINTAINED BY DTC OR ANY DTC PARTICIPANT; (3) PAYMENT OR THE TIMELINESS OF PAYMENT BY DTC ANY DIRECT DTC PARTICIPANT, OR BY ANY DIRECT DTC PARTICIPANT OR INDIRECT DTC PARTICIPANT TO ANY BENEFICIAL OWNER OF ANY AMOUNT DUE TO ANY BENEFICIAL OWNER IN RESPECT TO THE PRINCIPAL OR REDEMPTION PREMIUM, IF ANY, OR INTEREST ON BONDS; (4) DELIVERY OR TIMELY DELIVERY BY DTC OR ANY DTC PARTICIPANT TO ANY BENEFICIAL OWNER OF ANY NOTICE (INCLUDING NOTICE OF REDEMPTION) OR OTHER COMMUNICATIONS TO ANY BENEFICIAL OWNER WHICH IS REQUIRED OR PERMITTED UNDER THE TERMS OF THE BOND DOCUMENTS TO BE GIVEN TO BONDHOLDERS; (5) THE SELECTION OF THE BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF ANY PARTIAL REDEMPTION OF BONDS; OR (6) ANY ACTION TAKEN BY DTC OR ITS NOMINEE AS THE REGISTERED OWNER OF THE BONDS.

So long as Cede & Co. is the registered owners of the Bonds, as nominee for DTC, references in the Official Statement to the Bondholders or registered owners of the Bonds (other than under the caption "Tax Matters" in the Official Statement) shall mean Cede & Co. or any other DTC nominee, as aforesaid, and shall not mean the Beneficial Owners of the Bonds.

FORM OF CONTINUING DISCLOSURE UNDERTAKING

This Continuing Disclosure Undertaking (the "Undertaking") is dated and made as of _____, 2010 by the State of Tennessee (the "State") in connection with the issuance of the State's \$_____ aggregate principal amount of General Obligation Bonds, 2010 Series A and General Obligation Bonds, 2010 Refunding Series B (collectively the "Bonds"). As authorized by Section 10 of the resolution (the "Bond Resolution") of the Funding Board of the State of Tennessee (the "Funding Board") adopted on September 20, 2010, authorizing the Bonds, the State agrees as follows:

ARTICLE I

Definitions

Section 1.1. Definitions. The following terms used in this Undertaking shall have the following respective meanings:

(1) "Annual Financial Information" means (i) updated versions of the following financial information and operating data contained in, or incorporated by reference pursuant to an Appendix to, the Official Statement with respect to the State, for each fiscal year of the State:

- Collections for Special Taxes
- Total Sales and Use Tax Collections
- Allocation of Sales and Use Tax to Debt Service
- General Obligation Bonds Outstanding
- Maximum and Actual Principal Amounts of Commercial Paper Outstanding
- Outstanding General Obligation Bonded Indebtedness, by Fiscal Year and Maturity
- Outstanding Debt of Certain Agencies and Authorities
 - Tennessee Local Development Authority
 - Tennessee State School Bond Authority
 - Tennessee Housing Development Agency
 - Watkins Institute
 - State Veterans' Homes Board
- Tennessee Consolidated Retirement System
 - Employers and Contributory Members Contributions
 - Reserves
 - Accrued Liability
 - Accrued Liability Attributable to State
 - Active/Inactive Members
 - Supplementary Information:
 - Schedules of Funding Progress (if required)
 - Unfunded Liability by groups (if required)
 - Supplementary Information (if required by use of frozen entry age actuarial method)
 - Additional Information relating to Required Supplementary Information
- The statistical data incorporated by reference in Appendix B to the Official Statement

and (ii) the information regarding amendments to this Undertaking required pursuant to Sections 4.2(c) and (d) of this Undertaking. Annual Financial Information shall include Audited Financial Statements, if available, or Unaudited Financial Statements.

The descriptions contained in clause (i) above of financial information and operating data constituting Annual Financial Information are of general categories or types of financial information and operating data. When such descriptions include information that no longer can be generated because the operations to which it related have been materially changed or discontinued, a statement to that effect shall be provided in lieu of such information.

(2) "Audited Financial Statements" means the annual financial statements of the State, audited by the Comptroller of the Treasury, Division of State Audit, as now required by State law (or such other auditor as hereafter may be required or permitted by State law). Audited Financial Statements shall be prepared in accordance with GAAP.

(3) "Counsel" means Hawkins Delafield & Wood LLP or other nationally recognized bond counsel or counsel expert in federal securities laws, in each case acceptable to the State.

(4) "GAAP" means generally accepted accounting principles for governmental units as prescribed by the Governmental Accounting Standards Board, the Financial Accounting Standards Board, or any successor to the duties and responsibilities of either of them.

(5) "Material Event" means any of the following events with respect to the Bonds, if material:

- (i) principal and interest payment delinquencies;
- (ii) non-payment related defaults;
- (iii) unscheduled draws on debt service reserves reflecting financial difficulties;
- (iv) unscheduled draws on credit enhancements reflecting financial difficulties;
- (v) substitution of credit or liquidity providers, or their failure to perform;
- (vi) adverse tax opinions or events affecting the tax-exempt status of the security;
- (vii) modifications to rights of security holders;
- (viii) bond calls;
- (ix) defeasances;
- (x) release, substitution, or sale of property securing repayment of the securities;
and
- (xi) rating changes.

(6) "MSRB" means the Municipal Securities Rulemaking Board established pursuant to the provisions of Section 15B (b) (1) of the Securities Exchange Act of 1934, as amended, or any successor thereto or to the functions of the MSRB contemplated by this Undertaking.

(7) "Official Statement" means the Official Statement dated _____, 2010 of the State relating to the Bonds.

(8) "Rule" means Rule 15c2-12 promulgated by the SEC under the Securities Exchange Act of 1934, as amended (17 CFR Part 240, §240.15c2-12), as in effect on the effective date hereof, including any official interpretations thereof.

(9) "SEC" means the United States Securities and Exchange Commission.

(10) "Unaudited Financial Statements" means the same as Audited Financial Statements, except that they shall not have been audited.

ARTICLE II

The Undertaking

Section 2.1. Purpose. This Undertaking is being executed, delivered and made solely to assist the underwriters of the Bonds in complying with subsection (b)(5) of the Rule.

Section 2.2. Annual Financial Information.

(a) The State shall provide Annual Financial Information with respect to each fiscal year of the State, commencing with the fiscal year ending June 30, 2010, by no later than 7 months (except in the case of the fiscal year ending June 30, 2010, one year) after the end of the respective fiscal year, to the MSRB.

(b) The State shall provide, in a timely manner, notice of any failure of the State to provide the Annual Financial Information by the date specified in subsection (a) above to the MSRB.

Section 2.3 Audited Financial Statements. If not provided as part of Annual Financial Information by the date required by Section 2.2(a) hereof because not available, the State shall provide Audited Financial Statements, when and if available, to the MSRB.

Section 2.4 Notices of Material Events.

(a) If a Material Event occurs, the State shall provide, in a timely manner, notice of such Material Event to the MSRB.

(b) Any such notice of a defeasance of Bonds shall state whether the Bonds have been escrowed to maturity or to an earlier redemption date and the timing of such maturity or redemption.

Section 2.5 Additional Disclosure Obligations. The State acknowledges and understands that other State and federal laws, including but not limited to the Securities Act of 1933 and Rule 10b-5 promulgated under the Securities Exchange Act of 1934, may apply to the State and that, under some circumstances, additional disclosures or other action in addition to those required by this Undertaking may be required to enable the State to fully discharge all of its duties and obligations under such laws.

Section 2.6. Additional Information. Nothing in this Undertaking shall be deemed to prevent the State from disseminating any other information, using the means of dissemination set forth in this Undertaking or any other means of communication, or including any other information in any Annual Financial Information or notice of a Material Event hereunder, in addition to that which is required by this Undertaking. If the State chooses to do so, the State shall have no obligation under this Undertaking to update such additional information or include it in any future Annual Financial Information or notice of a Material Event hereunder.

Section 2.7. No Previous Non-Compliance. The State represents that since July 3, 1995, it has not failed to comply in any material respect with any previous Undertaking in a written contract or agreement specified in paragraph (b)(5)(i) of the Rule.

ARTICLE III

Operating Rules

Section 3.1. Reference to Other Documents. It shall be sufficient for purposes of Section 2.2 hereof if the State provides Annual Financial Information by specific reference to documents (i) available to the public on the MSRB Internet web site (currently www.emma.msrb.org) or (ii) filed with the SEC. The provisions of this paragraph shall not comply to notices of Material Events pursuant to Section 1.4 hereof.

Section 3.2. Submission of Information. Annual Financial Information may be set forth or provided in one document or a set of documents, and at one time or in part from time to time.

Section 3.3 Filing with Certain Dissemination Agents or Conduits. The State may from time to time designate an agent to act on its behalf in providing or filing notices, documents and information as required of the State under this Undertaking, and revoke or modify any such designation.

Section 3.4 Transmission of Notices, Documents and Information.

(a) Unless otherwise required by the MSRB, all notices, documents and information provided to the MSRB shall be provided to the MSRB's Electronic Municipal Markets Access (EMMA) system, the current Internet Web address of which is www.emma.msrb.org.

(b) All notices, documents and information provided to the MSRB shall be provided in an electronic format as prescribed by the MSRB (currently, portable document format (pdf) which after January 1, 2010, must be word-searchable except for non textual elements) and shall be accompanied by identifying information as prescribed by the MSRB.

Section 3.5 Fiscal Year.

(a) The State's current fiscal year is July 1 - June 30. The State shall promptly notify the MSRB of each change in its fiscal year.

(b) The State shall provide Annual Financial Information at least annually notwithstanding any fiscal year longer than 12 calendar months.

ARTICLE IV

Effective Date, Termination, Amendment and Enforcement

Section 4.1. Effective Date; Termination.

(a) This Undertaking shall be effective upon the issuance of the Bonds.

(b) The State's obligations under this Undertaking shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Bonds.

(c) This Undertaking, or any provision hereof, shall be null and void in the event that the State (1) receives an opinion of Counsel to the effect that those portions of the Rule which require this Undertaking, or such provision, as the case may be, do not or no longer apply to the Bonds, whether because such

portions of the Rule are invalid, have been repealed, or otherwise, as shall be specified in such opinion, and (2) delivers copies of such opinion to the MSRB.

Section 4.2. Amendment.

(a) This Undertaking may be amended without the consent of the holders of the Bonds, if all of the following conditions are satisfied: (1) such amendment is made in connection with a change in circumstances that arises from a change in legal (including regulatory) requirements, a change in law (including rules and regulations) or in interpretations thereof, or a change in the identity, nature or status of the State or the type of business conducted thereby, (2) this Undertaking as so amended would have complied with the requirements of the Rule as of the date hereof, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances, (3) the State shall have received an opinion of Counsel to the same effect as set forth in clause (2) above, (4) the State shall have received either an opinion of Counsel or a determination by a person, in each case unaffiliated with the State, to the effect that the amendment does not materially impair the interests of the holders of the outstanding Bonds, and (5) the State shall have delivered copies of such opinion(s) and amendment to the MSRB.

(b) This Undertaking may be amended without the consent of the holders of the Bonds if all of the following conditions are satisfied: (1) an amendment to the Rule is adopted, or a new or modified official interpretation of the Rule is issued, after the effective date hereof which is applicable to this Undertaking, (2) the State shall have received an opinion of Counsel to the effect that performance by the State under this Undertaking as so amended will not result in a violation of the Rule as so amended or officially interpreted and (3) the State shall have delivered copies of such opinion and amendment to the MSRB.

(c) To the extent any amendment to this Undertaking results in a change in the categories or types of financial information or operating data provided pursuant to this Undertaking, the first Annual Financial Information provided thereafter shall include a narrative explanation of the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

(d) If an amendment is made pursuant to Section 4.2(a) hereof to the accounting principles to be followed by the State in preparing its financial statements, the Annual Financial Information for the fiscal year in which the change is made shall present a comparison between the financial statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles. Such comparison shall include a qualitative and, to the extent reasonably feasible, quantitative discussion of the differences in the accounting principles and the impact of the change in the accounting principles on the presentation of the financial information.

Section 4.3. Contract; Benefit; Third-Party Beneficiaries; Enforcement.

(a) The provisions of this Undertaking shall constitute a contract with and inure solely to the benefit of the holders from time to time of the Bonds, except that beneficial owners of Bonds shall be third-party beneficiaries of this Undertaking and shall be deemed to be holders of Bonds for purposes of Section 4.3(b) hereof. The provisions of this Undertaking shall create no rights in any person or entity except as provided in this subsection (a).

(b) The obligations of the State to comply with the provisions of this Undertaking shall be enforceable by any holder of outstanding Bonds; however, the holders' rights to enforce the provisions of this Undertaking shall be limited solely to a right, by action in mandamus or for specific performance, to compel performance of the State's obligations under this Undertaking.

(c) Any failure by the State to perform in accordance with this Undertaking shall not constitute a default or an event of default under the Bond Resolution or State law and shall not result in any

acceleration of payment of the Bonds, and the rights and remedies provided by the Bond Resolution and applicable State law upon the occurrence of such a default or an event of default shall not apply to any such failure.

(d) This Undertaking shall be construed and interpreted in accordance with the laws of the State, and any suits and actions arising out of this Undertaking shall be instituted in a court of competent jurisdiction in the State; provided, however, that to the extent this Undertaking addresses matters of federal securities laws, including the Rule, this Undertaking shall be construed in accordance with such federal securities laws and official interpretations thereof.

Section 4.4. Effective Date. This Undertaking shall be effective upon the issuance and delivery by the State of the Bonds.

STATE OF TENNESSEE

By _____
Mary-Margaret Collier
Assistant Secretary, Funding Board
of the State of Tennessee, *and*
Director, Office of State and Local Finance,
State of Tennessee

