

*MANAGEMENT'S
DISCUSSION AND
ANALYSIS*

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

The following is a narrative overview and analysis of the State of North Carolina's (the State) financial performance for the fiscal year ended June 30, 2020. Please read it in conjunction with the transmittal letter at the front of this report and with the State's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

Government-wide Financial Statements

- The State's total net position increased by \$2.47 billion or 4.53% as a result of this year's operations. Net position of governmental activities increased by \$3.24 billion (or 6.72%) while net position of business-type activities decreased by \$767.06 million (or 12.14%). At year-end, net position of governmental activities and business-type activities totaled \$51.43 billion and \$5.55 billion, respectively.
- Component units reported net position of \$16.21 billion, an increase of \$818.09 million or 5.31% from the previous year. The majority of the net position is attributable to the University of North Carolina System, a major component unit.

Fund Financial Statements

- The fund balance of the General Fund increased from \$5.96 billion at June 30, 2019 (as restated) to \$6.43 billion at June 30, 2020, an increase of 7.95%.
- The fund balance of the Highway Fund increased from negative \$595.63 million at June 30, 2019 to a negative \$330.19 million at June 30, 2020, an increase of 44.57% from the previous year. This increase was mainly due to a decrease in liabilities. Construction and maintenance expenditures and supplies and material expenditures decreased due to the cash shortage, resulting in an overall decrease in accounts payable.
- The Highway Trust Fund reported a fund balance of \$1.22 billion, a decrease of 29.42% from the previous year. The fund balance decrease was mainly due to a decrease in assets resulting from the use of proceeds from the Build NC Bonds for transportation projects.
- The Unemployment Compensation Fund reported net position of \$3.02 billion at June 30, 2020 compared to \$3.88 billion at June 30, 2019, a decrease of \$859.72 million or 22.14%. The decrease in net position is due almost entirely to the Coronavirus pandemic and significant increase in the unemployment rate and unemployment benefits paid for the last quarter of the 2019-20 fiscal year.
- The N.C. State Lottery Fund reported net ticket sales of \$3.02 billion, an increase of 5.48% from the previous year. As required by law, the Lottery transferred \$729.4 million to the General Fund to support educational programs.
- The N.C. Turnpike Authority (NCTA) reported net position of \$352.4 million, a decrease of 12.08% from the previous year. While toll revenues increased \$8.6 million or 14.91%, the NCTA had an operating loss of \$18.67 million. The NCTA also had a \$20.03 million increase in nonoperating expenses due to interest expense increases related to debt issued during the fiscal year.
- The EPA Revolving Loan Fund reported net position of \$1.94 billion, an increase of 6.28% from the previous year. Operating income was \$10.53 million, and net nonoperating revenues of \$74.19 million consisted primarily of federal capitalization grants and investment earnings.

Capital Assets

- The State's investment in capital assets (net of accumulated depreciation) was \$59.75 billion, an increase of 5.49% from the previous fiscal year-end.
- Significant year-end construction in progress amounts were for State highway projects (\$2.74 billion), an expressway project (\$225.75 million), a new system for managing and administering social service benefits (\$679.38 million), and a new laboratory complex (\$66.6 million).

Long-term Debt

- The State had total long-term debt outstanding (bonds, special indebtedness, and notes from direct borrowings) of \$7.48 billion, an increase of 6.03% from the previous fiscal year-end. The State issued \$600 million in general obligation bonds for its governmental activities. Additionally, the NCTA, a business-type activity, issued \$486.95 million in revenue bonds.
- In connection with the general obligation bonds, all three rating agencies affirmed the triple-A credit rating for the State. The rating agencies recognized the State's historically conservative budgeting, financial management, and debt issuance practices. North Carolina remains one of only thirteen states with a triple-A rating from all three rating agencies.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is an introduction to the State's basic financial statements, which comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains additional required supplementary information (pension and other postemployment benefits trend information and General Fund budgetary schedule) and other supplementary information (combining financial statements) in addition to the basic financial statements. These components are described below.

Government-wide Financial Statements

The Statement of Net Position and the Statement of Activities are two financial statements that report information about the State, as a whole, and about its activities that should help answer this question: Is the State, as a whole, better off or worse off as a result of this year's activities? These statements include all non-fiduciary assets, deferred outflows of resources, liabilities, and deferred inflows of resources using the accrual basis of accounting. The current year's revenues and expenses are taken into account regardless of when cash is received or paid. The Statement of Net Position (pages 50 and 51) presents all of the State's assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the sum of these components reported as "net position." Over time, increases and decreases in net position measure whether the State's financial position is improving or deteriorating.

The Statement of Activities (pages 52 and 53) presents information showing how the State's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will only result in cash flows in future fiscal periods (e.g. uncollected taxes and earned but unused vacation leave).

In the government-wide financial statements, the State's activities are divided into three categories:

- *Governmental Activities* – Most of the State's basic services are reported under this category. Taxes and intergovernmental revenues generally fund these services.
- *Business-type Activities* – The State charges fees to customers to help it cover all or most of the cost of certain services it provides. The State's Unemployment Compensation Fund, the EPA Revolving Loan Fund, the N.C. State Lottery Fund, and the N.C. Turnpike Authority are the predominant business-type activities.
- *Discretely Presented Component Units* – Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. A description of the component units and an address for obtaining their separately issued financial statements can be found beginning on page 74. Discretely presented component units are combined and displayed in a separate discrete column in the government-wide financial statements to emphasize their legal separateness from the State. In addition, financial statements for major component units are presented in the notes to the financial statements (pages 178 and 179).

Fund Financial Statements

The fund financial statements provide more detailed information about the State's most significant funds (i.e., major funds) – not the State as a whole. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the State uses to keep track of specific sources of funding and spending for particular purposes. In addition to the major funds, page 249 begins the individual fund data for the nonmajor funds. The State's funds are divided into three categories (governmental, proprietary, and fiduciary) and they use different accounting approaches.

Governmental funds – Most of the State's basic services are reported in the governmental funds, which focus on how cash and other financial assets that can readily be converted to cash flow in and out (i.e., inflows and outflows of spendable resources) and the balances left at year-end that are available for spending (i.e., balances of spendable resources). Consequently, the governmental fund financial statements provide a detailed short-term view that helps users determine whether there are more or fewer financial resources that can be spent in the near future to finance the State's programs. The State prepares the governmental fund financial statements using the modified accrual basis of accounting and a current financial resources measurement focus. Because this information does not encompass the additional long-term focus of the government-wide statements, a reconciliation schedule, which follows each of the governmental fund financial statements, explains the relationships (or differences) between them. Information is presented separately in the governmental fund financial statements for the General Fund, the Highway Fund, and the Highway Trust Fund, all of which are considered to be major funds. Data for all other governmental funds are combined into a single aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining statements elsewhere in this report.

Proprietary funds – When the State charges customers for the services it provides, whether to outside customers or to agencies within the State, these services are generally reported in proprietary funds. Proprietary funds (enterprise and internal service) utilize accrual accounting, which is the same method used by private sector businesses. Enterprise funds are used to report activities for which fees are charged to external users for goods and services. The Unemployment Compensation Fund, the EPA Revolving Loan Fund, the N.C. State Lottery Fund, and the N.C. Turnpike Authority are our most significant enterprise funds. Internal service funds

are used to report activities that provide goods and services to the State's other programs and activities on a cost-reimbursement basis, such as the State Property Fire Insurance Fund, the Motor Fleet Management Fund, Computing Services Fund, and the State Telecommunications Services Fund. Because the State's internal service funds predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. Information is presented separately in the proprietary fund financial statements for the Unemployment Compensation Fund, the EPA Revolving Loan Fund, the N.C. State Lottery Fund, and the N.C. Turnpike Authority, all of which are considered to be major funds. Conversely, separately aggregated columns are presented for the nonmajor enterprise funds and the internal service funds. Individual fund data for the nonmajor enterprise funds and internal service funds is provided in the form of combining statements elsewhere in this report.

Fiduciary funds – Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the State's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds. The State's fiduciary activities are reported in separate Statements of Fiduciary Net Position and Changes in Fiduciary Net Position. These funds include pension and other employee benefit trust funds, private-purpose trust funds, investment trust funds, and agency funds.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found beginning on page 72 of this report.

Required Supplementary Information

Required Supplementary Information (RSI) follows the basic financial statements and notes to the financial statements. The RSI is mandated by the GASB and includes: 1) pension plan and employer trend information related to the net pension liability, employer contributions, and investment returns, 2) information related to the total pension liability for pension plans not administered through a trust, 3) other postemployment benefits (OPEB) trend information related to the net OPEB liability, employer contributions, and investment returns, and 4) General Fund budgetary comparison schedules reconciling the statutory to the generally accepted accounting principles fund balances at fiscal year-end.

Other Supplementary Information

Other supplementary information includes the introductory section; combining financial statements for nonmajor governmental funds, nonmajor enterprise funds, internal service funds, fiduciary funds, and nonmajor discretely presented component units; a statement of cash flows for the State Health Plan, a major component unit, which does not issue separate financial statements; and the statistical section.

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE

Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the State is improving or deteriorating. The State's assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources by \$56.98 billion at the close of the most recent fiscal year (see total primary government column). The following table was derived from the government-wide Statement of Net Position:

Net Position as of June 30, 2020 and 2019 (dollars in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government		Total Percentage Change
	2019		2019		2019		2019-20
	2020	(as restated)	2020	(as restated)	2020	(as restated)	
Current and other non-current assets.....	\$ 19,522,925	\$ 15,565,889	\$ 6,686,115	\$ 6,536,920	\$ 26,209,040	\$ 22,102,809	18.58%
Capital assets, net.....	57,504,322	54,696,395	2,244,625	1,940,446	59,748,947	56,636,841	5.49%
Total assets.....	77,027,247	70,262,284	8,930,740	8,477,366	85,957,987	78,739,650	9.17%
Total deferred outflows of resources.....	2,361,920	2,269,300	63,347	63,418	2,425,267	2,332,718	3.97%
Long-term liabilities.....	16,679,814	15,974,879	2,433,214	1,860,948	19,113,028	17,835,827	7.16%
Other liabilities.....	8,961,689	5,465,019	965,840	309,302	9,927,529	5,774,321	71.93%
Total liabilities.....	25,641,503	21,439,898	3,399,054	2,170,250	29,040,557	23,610,148	23.00%
Total deferred inflows of resources.....	2,314,243	2,896,623	43,682	52,125	2,357,925	2,948,748	(20.04%)
Net position:							
Net investment in capital assets.....	55,526,354	52,846,067	513,378	562,921	56,039,732	53,408,988	4.93%
Restricted.....	1,458,418	1,248,281	178,212	114,803	1,636,630	1,363,084	20.07%
Unrestricted.....	(5,551,351)	(5,899,285)	4,859,761	5,640,685	(691,590)	(258,600)	(167.44%)
Total net position.....	\$ 51,433,421	\$ 48,195,063	\$ 5,551,351	\$ 6,318,409	\$ 56,984,772	\$ 54,513,472	4.53%

The largest component of the State's net position (98.34% for fiscal year 2020) reflects its investment in capital assets (land, buildings, machinery and equipment, state highway system, toll road system, and other capital assets), less related debt still outstanding that was used to acquire or construct those assets. Restricted net position is the next largest component (\$1.64 billion). Net position is restricted when constraints placed on its use is either 1) externally imposed by creditors, grantors, contributors or laws or regulations of other governments or, 2) legally imposed through constitutional provisions. The remaining portion, unrestricted net position, consists of net position that does not meet the definition of "net investment in capital assets" or "restricted."

The government-wide statement of net position for governmental activities reflects a negative \$5.55 billion unrestricted net position balance. The State of North Carolina, like many other state and local governments, issues general obligation debt and special indebtedness and distributes the proceeds to state agencies, local governments, and component units. The proceeds are used to construct new buildings and renovate and modernize existing buildings throughout the State, including the State's community college and university campuses, assist county governments in meeting their public school building capital needs, and to provide grants and loans to local governments for clean water and natural gas projects. Of the \$5.89 billion of bonds and special indebtedness outstanding for governmental activities at June 30, 2020, approximately \$3.26 billion is attributable to debt issued as state aid to component units and local governments. The statements of net position of component unit and local government recipients reflect ownership of the related constructed capital assets without the burden of recording the debt obligation. However, by issuing such debt, the State is left to reflect significant liabilities on its statement of net position (reflected in the unrestricted net position component) without the benefit of recording the capital assets constructed or acquired with the proceeds from the debt issuances. Additionally, as of June 30, 2020, the State's governmental activities have significant unfunded liabilities for compensated absences of \$607.05 million, pension liabilities of \$2.63 billion, net OPEB liabilities of \$6.04 billion, workers' compensation of \$717.42 million, and claims and judgments payable of \$731.7 million (see Note 8 to the financial statements). These unfunded liabilities also contribute to the negative unrestricted net position balance for governmental activities.

The State had significant increases to other liabilities during the fiscal year. This increase is attributable to the funds the State received from the Coronavirus Aid, Relief, and Economic Security (CARES) Act that were not expended by fiscal year end. As of June 30, 2020, the U.S. Treasury allocated \$3.59 billion from the federal Coronavirus Relief Fund (federal CRF) to the newly created State of North Carolina's Coronavirus Relief Fund (State's CRF), of which \$173.45 million were expended; the unspent

remainder of \$3.41 billion was recorded as unearned revenue. However, this increase does not impact the State's net position as the liability was offset by the assets reported for the CARES Act.

The State's overall net position increased \$2.47 billion or 4.53% (total primary government) from the prior fiscal year. The net position of the governmental activities increased \$3.24 billion or 6.72% and business-type activities decreased \$767.06 million or 12.14%. The following financial information was derived from the government-wide Statement of Activities:

Changes in Net Position for the Fiscal Years Ended June 30, 2020 and 2019
(dollars in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government		Total Percentage Change 2019-20
	2019		2019		2019		
	2020	(as restated)	2020	(as restated)	2020	(as restated)	
Revenues:							
Program revenues							
Charges for services.....	\$ 2,612,957	\$ 2,631,425	\$3,558,088	\$ 3,625,877	\$ 6,171,045	\$ 6,257,302	(1.38%)
Operating grants and contributions.....	19,211,056	16,980,579	4,736,461	203,779	23,947,517	17,184,358	39.36%
Capital grants and contributions.....	1,328,260	1,317,197	3,681	27,578	1,331,941	1,344,775	(0.95%)
General revenues							
Taxes:							
Individual income tax.....	13,121,892	13,242,924	—	—	13,121,892	13,242,924	(0.91%)
Corporate income tax.....	726,186	779,886	—	—	726,186	779,886	(6.89%)
Sales and use tax.....	8,556,460	8,436,190	—	—	8,556,460	8,436,190	1.43%
Gasoline tax.....	2,054,235	2,118,180	—	—	2,054,235	2,118,180	(3.02%)
Franchise tax.....	640,865	754,936	—	—	640,865	754,936	(15.11%)
Highway use tax.....	847,919	838,571	—	—	847,919	838,571	1.11%
Insurance tax.....	661,881	577,430	—	—	661,881	577,430	14.63%
Beverage tax.....	462,401	435,471	—	—	462,401	435,471	6.18%
Tobacco products tax.....	288,933	294,030	—	—	288,933	294,030	(1.73%)
Other taxes.....	290,178	276,828	—	—	290,178	276,828	4.82%
Tobacco settlement.....	148,929	155,818	—	—	148,929	155,818	(4.42%)
Federal COVID-19.....	173,448	—	—	—	173,448	—	100.00%
Unrestricted investment earnings.....	133,251	153,490	—	—	133,251	153,490	(13.19%)
Miscellaneous.....	76,395	84,549	—	2,879	76,395	87,428	(12.62%)
Total revenues.....	<u>51,335,246</u>	<u>49,077,504</u>	<u>8,298,230</u>	<u>3,860,113</u>	<u>59,633,476</u>	<u>52,937,617</u>	<u>12.65%</u>
Expenses:							
General government.....	1,441,776	1,392,293	—	—	1,441,776	1,392,293	3.55%
Primary and secondary education.....	11,974,701	11,697,451	—	—	11,974,701	11,697,451	2.37%
Higher education.....	4,815,552	4,788,720	—	—	4,815,552	4,788,720	0.56%
Health and human services.....	21,594,958	19,567,645	—	—	21,594,958	19,567,645	10.36%
Economic development.....	525,242	505,806	—	—	525,242	505,806	3.84%
Environment and natural resources.....	708,815	666,594	—	—	708,815	666,594	6.33%
Public safety, corrections and regulation.....	4,230,658	3,792,606	—	—	4,230,658	3,792,606	11.55%
Transportation.....	2,979,441	3,907,427	—	—	2,979,441	3,907,427	(23.75%)
Agriculture.....	313,068	392,214	—	—	313,068	392,214	(20.18%)
Interest on long-term debt.....	171,372	163,799	—	—	171,372	163,799	4.62%
Unemployment compensation.....	—	—	5,707,104	169,967	5,707,104	169,967	3,257.77%
N.C. State Lottery.....	—	—	2,290,926	2,154,116	2,290,926	2,154,116	6.35%
EPA Revolving Loan.....	—	—	13,785	23,657	13,785	23,657	(41.73%)
N.C. Turnpike Authority.....	—	—	186,369	132,456	186,369	132,456	40.70%
Regulatory programs.....	—	—	131,503	121,652	131,503	121,652	8.10%
Insurance programs.....	—	—	51,423	22,362	51,423	22,362	129.96%
North Carolina State Fair.....	—	—	15,981	18,197	15,981	18,197	(12.18%)
Other business-type activities.....	—	—	15,421	17,015	15,421	17,015	(9.37%)
Total expenses.....	<u>48,755,583</u>	<u>46,874,555</u>	<u>8,412,512</u>	<u>2,659,422</u>	<u>57,168,095</u>	<u>49,533,977</u>	<u>15.41%</u>
Increase in net position							
before contributions and transfers.....	2,579,663	2,202,949	(114,282)	1,200,691	2,465,381	3,403,640	(27.57%)
Contributions to permanent funds.....	5,919	4,916	—	—	5,919	4,916	20.40%
Transfers.....	652,776	613,895	(652,776)	(613,895)	—	—	0.00%
Increase (decrease) in net position.....	<u>3,238,358</u>	<u>2,821,760</u>	<u>(767,058)</u>	<u>586,796</u>	<u>2,471,300</u>	<u>3,408,556</u>	<u>(27.50%)</u>
Net position - beginning - restated.....	48,195,063	45,373,303	6,318,409	5,731,613	54,513,472	51,104,916	6.67%
Net position - ending.....	<u>\$ 51,433,421</u>	<u>\$ 48,195,063</u>	<u>\$ 5,551,351</u>	<u>\$ 6,318,409</u>	<u>\$ 56,984,772</u>	<u>\$ 54,513,472</u>	<u>4.53%</u>

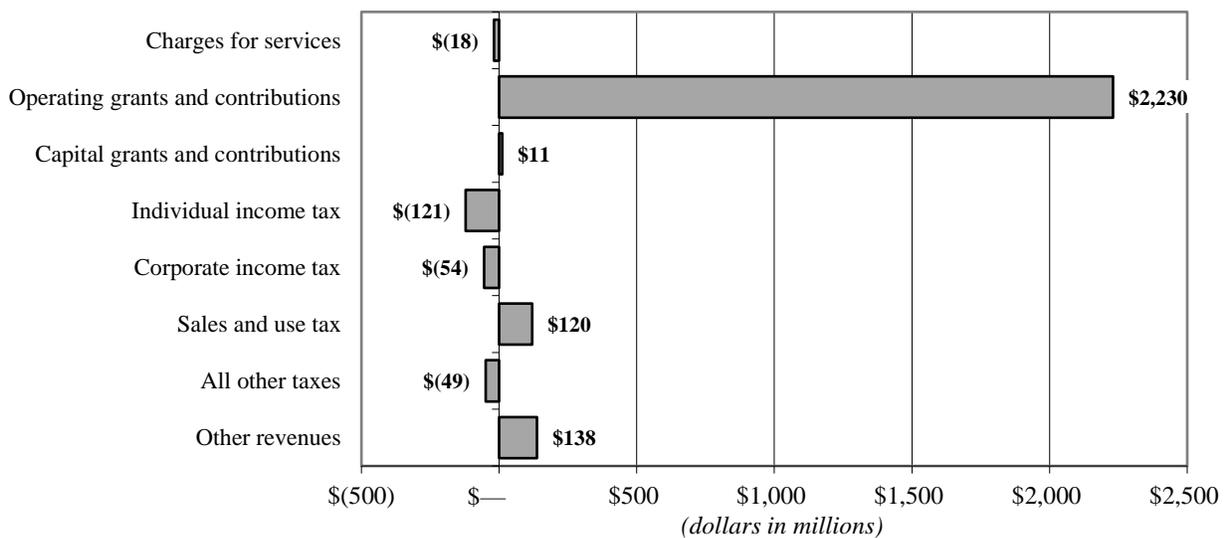
Governmental Activities. For fiscal year 2020, revenues outpaced expenses and when combined with contributions to permanent funds and transfers from the State’s business-type activities, an increase in net position of \$3.24 billion (6.72%) resulted for governmental activities. Total revenues increased by 4.6% (\$2.26 billion) while total expenses increased by 4.01% (\$1.88 billion). The growth in revenues is mainly attributable to the increase in operating grants and contributions and other revenues. Operating grants and contributions increased by \$2.23 billion or 13.14% due to higher spending in federally supported programs, such as Medicaid and disaster relief for Hurricane Florence as well as increases in federal COVID-19 funds (see below). The 35.08% increase in other revenues is also attributable to increases in federal COVID-19 funds (see below).

In March 2020, the U.S. Congress enacted a series of laws, including the Families First Coronavirus Response Act (FFCRA) and the CARES Act; these laws were a direct response to the economic and societal crises resulting from the COVID-19 pandemic. One purpose of the FFCRA was to provide a 6.2 percentage point increase to the Federal Matching Assistance Percentages (FMAP) for Medicaid, extending broad fiscal relief to states since Medicaid is a countercyclical program. The CARES Act provided widespread assistance to individuals, corporations and state and local governments. Funding to the State from the CARES Act was allocated directly through the federal CRF, new initiative programs and new grants. In response to the CARES Act and requirements set forth for the State’s CRF, the N.C. General Assembly passed spending bills that allocated the federal CRF monies to areas impacted by the pandemic. They also established the North Carolina Pandemic Recovery Office (NCPRO) to oversee and coordinate the funds made available under COVID-19 Recovery Legislation. During the 2020 fiscal year, the State’s governmental activities recognized \$1.16 billion of COVID-19 funds (federal COVID-19 funds); \$983.33 million is included in operating grants and contributions (i.e. program revenues) and \$173.45 million is reported as federal COVID-19, which is included in the other revenues source shown in the table below (i.e. general revenues). Additional details on the COVID-19 funds received in fiscal year 2020 are below:

- During the 2020 fiscal year, the State’s governmental activities recognized \$540.55 million related to the enhanced FMAP under the FFCRA for Medicaid. An additional \$5.24 million was received under FFCRA related to other programs. This new funding under the FFCRA for fiscal year 2020 was reported as part of the increase in operating grants and contributions and represents 24.47% of the change in this revenue source.
- The State’s agencies received \$437.54 million of CARES Act federal revenues, representing the remaining portion of the \$983.33 million increase in operating grants and contributions for COVID-19. These CARES Act federal funds supported various State functions and represent 19.62% of the \$2.23 billion increase in operating grants and contributions.
- By the end of the fiscal year, the N.C. General Assembly had appropriated roughly two-thirds of the \$3.59 billion federal CRF received. Of this amount, \$173.45 million was expended by the end of the fiscal year and, therefore, recognized as federal COVID-19 general revenues in the State’s governmental activities (also discussed on page 31). These CARES Act federal funds also supported various State functions.

The following chart reflects the dollar change in governmental activities revenues by source between fiscal years 2019 and 2020:

**Dollar Change in Governmental Activities Revenues by Source
Between Fiscal Years 2019 and 2020**



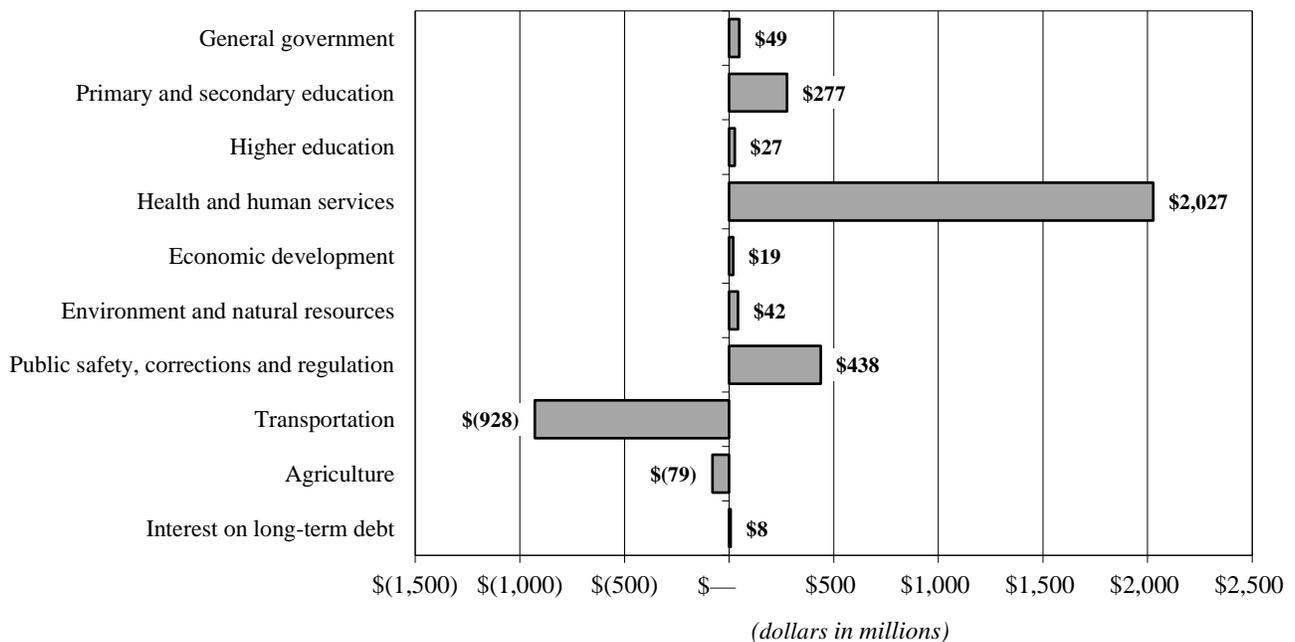
For fiscal year 2020, spending increased in the majority of the State’s functional areas, with the major exception being transportation. Transportation expenses decreased by \$927.99 million or 23.75% primarily to the reduction of construction and maintenance activities as a result of the cash shortage and revenue decreases in gasoline tax due to the COVID-19 pandemic.

Total health and human services (HHS) spending increased by 10.36% or \$2.03 billion in 2020. For comparison, HHS spending increased by 2.57% and 1.09% in fiscal years 2019 and 2018, respectively. The increase in health and human services is primarily due to increased spending for Medicaid (the State’s largest public assistance program) in response to the COVID-19 public health emergency. Medicaid is a federal entitlement program, which means individuals found eligible for Medicaid have legal rights to receive services and cannot be denied coverage by the State. In North Carolina, Medicaid is administered by the State and counties and financed with federal and state funds. Medicaid serves as the State’s safety net program for eligible individuals who lose jobs and health insurance coverage. As such, it is sensitive to economic volatility, and during the fiscal year, the State experienced increased enrollment in the Medicaid program due to the economic downturn. Because the State receives federal matching funds for this program, there was also a corresponding increase in operating grants and contributions (i.e. program revenues).

Other significant increases in functional expenses for fiscal year 2020 were to public safety, corrections, and regulation and primary and secondary education. Total expenses increased 11.55% (\$438.05 million) for public safety, corrections, and regulation and 2.37% (\$277.25 million) for primary and secondary education. The growth in these functional areas is primarily due to increased spending for COVID-19 related costs; public safety, corrections and regulation incurred costs related to COVID-19 testing supplies and primary and secondary education had increased state aid provided to local education agencies (LEAs) for increased spending related to COVID-19. Additionally, public safety, corrections and regulation had increased expenses for disaster relief for public and individual assistance programs, contracted personal services and grant aid.

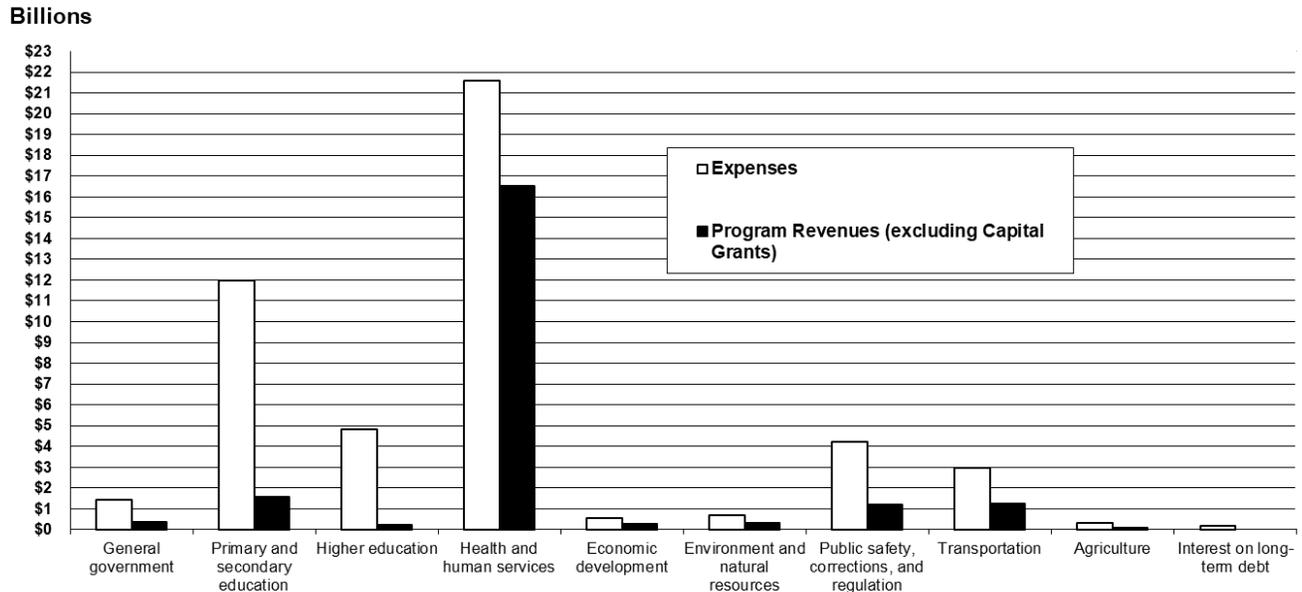
The following chart reflects the dollar change in the functional expenses of governmental activities between fiscal years 2019 and 2020:

**Dollar Change in Governmental Activities Functional Expenses
Between Fiscal Years 2019 and 2020**



The following chart depicts the total expenses and total program revenues of the State’s governmental functions. This format identifies the extent to which each governmental function is self-financing through fees and intergovernmental aid or draws from the general revenues of the State.

**Expenses and Program Revenues - Governmental Activities
For the Fiscal Year Ended June 30, 2020**



Business-type Activities. Business-type activities reflect an overall decrease in net position of \$767.06 million or 12.14%, primarily due to the decrease in net position in the Unemployment Compensation Fund. The decrease in net position of \$859.72 million or 22.14% in the Unemployment Compensation Fund is due almost entirely to the impacts of the Coronavirus pandemic, with increased unemployment during the fourth quarter of the fiscal year and increased unemployment benefit claims paid. The net position decrease of \$48.4 million or 12.08% for the N.C. Turnpike Authority is due to the NCTA incurring an operating loss of \$18.67 million and having a \$20.23 million increase in interest expense as a result of issuing new debt during the fiscal year. The net position increase of \$114.81 million or 6.28% in the EPA Revolving Loan Fund is due to the Loan Fund continuing to focus on streamlining its processes resulting in more infrastructure projects completed during the year, using a cash flow model to better predict fund disbursements and revenue, and prioritizing the spending of funds from the U.S. EPA (federal) capitalization grant for these projects. The N.C. State Lottery Fund’s net position did not change and will continue to remain constant as a result of legislative changes in the methodology used to calculate net revenues to be distributed to the State’s governmental activities, as required by statute. A more detailed discussion of the State’s business-type enterprise activities is provided in the following section (see Enterprise Funds).

FINANCIAL ANALYSIS OF THE STATE'S FUNDS

The State uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

GOVERNMENTAL FUNDS

The focus of the State's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. At June 30, 2020, the State's governmental funds reported combined fund balances of \$10.08 billion, an increase of 5.26% from the prior fiscal year-end (as restated). Of this amount, \$1.66 billion is classified as unassigned fund balance in the General Fund (available for spending at the State's discretion) and negative \$892.97 million in the Highway Fund. The remainder of fund balance is either nonspendable, restricted, committed, or assigned to indicate that it is: 1) not in spendable form (e.g., inventories), 2) restricted for particular purposes by external sources, 3) committed for particular purposes by the General Assembly, or 4) assigned for particular purposes by the Office of State Budget and Management. The major governmental funds are discussed individually below.

General Fund

The General Fund is the chief operating fund of the State. At June 30, 2020, the fund balance of the General Fund increased 7.95% (\$473.48 million) to \$6.43 billion. While the General Fund saw increases in both revenues and expenditures, they mostly offset each other during the 2020 fiscal year. General Fund revenues increased by \$2.35 billion (5.53%) while expenditures increased by \$2.45 billion (5.75%). The increases in both revenues and expenditures are primarily due to increased federal and federal COVID-19 funds received and then spent by the various State functions. For the current fiscal year, the General Fund recognized \$1.16 billion in federal COVID-19 funds; these funds were derived from two key funding streams for states, the CARES Act and the FFCRA. The CARES Act allocated funds to state and local governments providing relief and assistance from the effects of the COVID-19 pandemic. The FFCRA provided a temporary FMAP increase to states assisting in additional Medicaid costs.

One of the major budget drivers for the General Fund, historically, has been the Medicaid program. Medicaid enrollment increased by 4.35% to 2.17 million individuals (20.45% of North Carolina's population). For comparison, Medicaid enrollment increased 0.46% and 3.6%, respectively, in fiscal years 2019 and 2018. The enrollment growth was mostly attributable to the sharp downturn in the economy and the increase in unemployment, from 4.2% in June 2019 to 7.5% in June 2020, due to the COVID-19 pandemic beginning in February 2020. State appropriation expenditures for Medicaid increased by \$46.24 million or 1.23%. Medicaid ended the fiscal year with unspent State appropriations of \$81 million, which were reverted to the General Fund. This is the seventh consecutive year the Medicaid Program has finished with cash on hand. Prior to fiscal year 2014, the Medicaid program experienced shortfalls of nearly \$2 billion over a four-year period.

Total tax revenues in the General Fund remained nearly unchanged for the fiscal year, decreasing by 0.15% to \$24.62 billion. Individual income tax revenues decreased \$121.03 million (0.91%). Estimated payments in the fourth quarter of the 2020 fiscal year were down \$231.8 million, nearly 50% from the prior year. Estimated payments received in July 2020 and accrued in the current fiscal year were up \$172.1 million more than the prior year but does not completely offset the reduction in the last quarter. The changes in amounts reported for the fourth quarter and accrued for July payments are due to a combination of the COVID-19 pandemic-related shutdown and the extension the N.C. Department of Revenue issued on March 20, 2020. This extension allowed taxpayers to file State income and franchise tax returns through July 15, 2020 to mirror relief provided by the Internal Revenue Service on Federal income tax returns. Franchise tax decreased by \$104.26 million (13.89%). Like individual income tax, franchise tax had a significant decrease in fourth quarter payments and saw higher payments in July. However, unlike individual income tax, franchise tax received in July is not accrued; it is calculated on a net worth type basis and is paid for the privilege of operating in the coming year. The decreases in individual income and franchise taxes were mostly offset by increases in sales and use and insurance taxes; sales and use tax increased \$118.26 million (1.4%) and insurance tax increased \$83.4 million (14.44%). The increase in sales and use tax is attributed to an improved economy through February 2020 as well as the enactment of North Carolina General Statute 105-164.4J. This General Statute became effective February 1, 2020 and requires marketplace facilitators to collect and remit sales tax. For the fourth quarter of fiscal year 2020, the increase in sales tax collected and remitted by marketplace facilitators helped to offset the loss of sales tax revenue from business closures due to COVID-19. Insurance tax increased due to a combination of taxpayers taking fewer tax credits than in previous years as well as increased collections from audits of past years' tax credits.

General Fund Budget Variances

The original General Fund budget, including state appropriations and appropriations supported by departmental receipts, serves as a starting point or plan for the Governor to execute the General Fund budget pursuant to the powers granted by the Constitution and State Budget Act. At the state level in North Carolina, it is not unusual for the budget to change during the fiscal year in relation to budget adjustments made to accommodate departmental receipts. The General Fund budget supported by state appropriation is a subset of the General Fund financial schedule presented in the CAFR as required supplementary information. The current CAFR schedule reflects all spending required to support the State's General Fund activities and the funding to support those activities,

including state tax and non-tax revenues, federal revenues, student tuition, and other fees, licenses, and fines. Under current state budget management practice, particularly related to departmental federal receipts, primary emphasis is placed on comparisons of the final authorized budget and actual spending.

At the state level, budgetary cuts related to state appropriations are implemented by decreasing allowable actual expenditures, as opposed to decreasing the state appropriation through a formal legislative process. The Governor and state agencies maintain legal authority to spend the dollars originally appropriated to them; furthermore, in past years the actual spending has been limited by the collection of tax and non-tax revenue. In extremely rare cases, the General Assembly has held special sessions to formally amend the authorized and certified state appropriation budget.

The portion of the original budget comprising departmental receipts is not intended to be the sole controlling point to manage the State's General Fund budget. The final budget includes amendments for departmental receipts collected during the fiscal year as allowed by law. General Fund departmental receipts are typically authorized for expenditure within the activity that generated the receipt. Historically, final estimated receipts have varied significantly from the original estimate at the beginning of the fiscal year. State agencies by law must spend departmental receipts prior to spending tax and nontax supported appropriations. If departmental receipts are higher than expected, appropriated dollars may go unspent and be re-appropriated in a subsequent fiscal year.

Variance – Original and Final Budget

In general, the variances between original and final budget are attributable to the timing and length of the budget preparation process and the budgeting of federal funds for the fiscal year. The original budget for fiscal year 2020 was prepared and finalized in December 2018 as part of the two-year base budget adopted by the General Assembly. This was approximately six months prior to the adoption of the adjusted biennial budget on June 30, 2019. The amounts budgeted for federal, intra-governmental transfers, fees/licenses/fines, contributions, gifts, grants, and miscellaneous receipts were all estimates. The final budget reflects all budget revisions made throughout the fiscal year based on adjustments to agency grant and receipt revenue and movement from state reserves. Consequently, significant variances are very likely to occur when the original budget is compared to the final budget.

Additional factors leading to variances between the original and final budget in fiscal year 2019-20 include the following:

- 1) Awarding of new unanticipated federal grants due to additional FMAP funds to manage the COVID-19 pandemic and increases and decreases in amounts for long-term standing federally supported programs.
- 2) Statewide encumbrance carry-forward budgeted amounts from fiscal year 2018-19 totaled \$670.4 million, which increased the budget for fiscal year 2019-20 through administrative action.
- 3) Allocation of hurricane disaster funds that were appropriated and authorized in prior years but not expended until fiscal year 2020. State functions agriculture, environment and natural resources, and public safety, corrections and regulation were the biggest recipients.
- 4) Allocation of statewide reserves to agencies and universities, including salary pay plan reserve, and disaster relief funding from the State Emergency Response and Disaster Relief fund and the Hurricane Florence Disaster Relief Reserve.
- 5) Receipts and budgeting of over-realized receipts, prior year earned revenues, and unanticipated donations and grants.

Variance - Final Budget and Actual Results

Actual total own-source General Fund revenue collected (tax, non-tax, and tobacco settlement) was 2.25% below budgeted revenue amounts in fiscal year 2020. Tax revenues were 4.5% lower than anticipated, primarily due to postponed payment and filing deadlines for individual income, corporate income, and franchise taxes. Sales and use tax collections were also significantly lower than projected due to the COVID-19 pandemic. The \$458.33 million (200.32%) increase in the non-tax fees, licenses, and fines is due primarily to the exclusion of fund-balance carryforwards in budgeted non-tax revenues.

Collections for individual income taxes, which accounted for 50.84% of total General Fund revenue collections, were \$615.4 million (4.72%) lower than the certified amount due primarily to postponing filing and payment deadlines as discussed on the previous page. Quarterly payments, final and extension payments for tax year 2019 returns, and refunds all came in lower than expected due to the shift in filing and payment deadlines. Sales and use tax collections, which comprised 32.02% of total General Fund revenues in fiscal year 2020, were \$382.71 million (4.67%) below the certified amount. The collapse in business activity associated with the initial outbreak of COVID-19 in March 2020 and subsequent stay-at-home orders caused net state sales and use tax collections to fall more than 10% below the monthly targets from March through June. The implementation of a new requirement for online marketplace facilitators to collect and remit sales tax on North Carolina purchases beginning in February 2020 prevented revenues from falling even further.

Departmental federal funds received by agencies were less than the final authorized budgeted federal fund revenues. A variance between the budget and actual federal funds occurs because actual federal fund receipts are reflective of the actual expenditures. Therefore, if qualifying federal costs are not incurred by an agency, the actual receipt of federal funds could be significantly less than the budget.

Highway Fund

The Highway Fund dates back to 1921, when the General Assembly first imposed the gasoline tax. It accounts for most of the activities of the North Carolina Department of Transportation (NCDOT), including the maintenance and construction of the State's primary and secondary road systems, the Division of Motor Vehicles, transit, rail, and ferry system. The primary revenue sources of the Highway Fund are federal funds, 71% of gasoline taxes, vehicle registration fees, and driver's license fees.

The fund balance of the Highway Fund increased from negative \$595.63 million at June 30, 2019 to negative \$330.18 million at June 30, 2020, an increase of 44.57%. The increase in fund balance was mainly due to a decrease in liabilities. Cash constraints within the Highway Fund due to disaster spending and pandemic revenue decreases resulted in a decrease in spending across most activities in the fund including contract maintenance and construction. Construction and maintenance expenditures and supplies and material expenditures decreased due to the cash shortage, resulting in an overall decrease in accounts payable. The decrease in liabilities was also due to the Highway Fund's repayment of the current loan payable and a portion of the advance from the Highway Trust Fund, which decreased by \$75.05 million and \$168 million, respectively at June 30, 2020. The decrease in liabilities was offset somewhat by a decrease in assets. Restricted investments decreased due to the use of Grant Anticipation Revenue Vehicle (GARVEE) bonds funds for expenditures during the year.

Total revenues decreased by 1.5% to \$3.89 billion due to a decrease in gasoline tax revenues as a result of reduced travel related to the COVID-19 pandemic and a decrease in hurricane disaster relief reimbursements from the Federal Emergency Management Agency (FEMA) in fiscal year 2020 when compared to 2019. Total expenditures decreased by 20.37% to \$3.9 billion primarily due to the reduction of construction and maintenance activities as a result of the cash shortage and revenue decreases due to the COVID-19 pandemic.

The State issued \$600 million in GARVEE bonds in June 2019. This innovative financing tool was used to accelerate the construction on a variety of transportation improvement projects across the State by leveraging future federal transportation revenues. At June 30, 2020, \$471.5 million of the GARVEE proceeds were unspent.

Transportation is fundamental in continuing North Carolina's prosperity and quality of life as the state's population continues to grow. To address the growing demand on the transportation system, increased cost of supplies, and slow growing revenues, NCDOT continues to seek innovative solutions to meet the growing stress on the transportation system. Session Law 2020-91 revised the motor fuels tax distribution formula. Effective July 1, 2020, it revised the distribution of motor fuel tax revenue for the Highway Fund from 71% to 81%. Effective July 1, 2021, it changes the distribution to 80% and beginning July 1, 2022 to 75%. Session Law 2020-91 also established a motor fuel tax floor. Effective January 1, 2021, and ending December 31, 2021, the motor fuel excise tax rate shall be the greater of 36.1 cents per gallon or the rate calculated pursuant to G.S. 105-449.80(a).

Population growth is placing an increasing demand on the State's transportation system. North Carolina's population grew from 9.66 million in 2011 to 10.6 million in 2020, an increase of 9.71%. According to the N.C. Division of Highways, over a 10-year period (2009 to 2018), paved lane miles grew by 2.7% while bridge deck area grew by approximately 24%. During this same 10-year period, vehicle miles traveled increased by 17.44%. This increase places a heavier burden on the existing infrastructure and accentuates the need for additional capacity, safety, and maintenance funding to address the deterioration in service created by the increase in traffic. Furthermore, many of the State's highways were built as farm-to-market roads and were not designed to handle the heavy traffic volumes of today, and other highways such as the interstate highway system, which is approaching its 64th anniversary, require increasing investment to maintain acceptable condition.

Highway Trust Fund

Legislation creating the Highway Trust Fund was passed by the General Assembly in 1989. It was established to provide a dedicated funding mechanism to meet specific highway construction needs in North Carolina. Additionally, the Highway Trust Fund provides allocations for the debt service on general obligation bonds issued for highway purposes. The principal revenue sources of the Highway Trust Fund are highway use taxes, 29% percent of gasoline taxes, and various title and registration fees. The enabling legislation was amended in 2008 to require annual transfers to the NCTA to pay debt service or financing expenses for specified toll road construction projects (see Note 10B to the financial statements).

The fund balance of the Highway Trust Fund decreased 29.42% to \$1.22 billion at June 30, 2020. The fund balance decrease is mainly due to a decrease in assets. This is attributable, in part, to the decrease in restricted investments due to the use of proceeds from Build NC bonds for certain regional and divisional transportation projects contained in the Statewide Transportation Improvement Plan (STIP). The bonds were issued in June 2019 and at June 30, 2020, \$177.46 million of the special indebtedness proceeds were unspent compared to \$356.6 million at June 30, 2019. The decrease also was attributable to the reduction in the Highway Trust Fund's cash balance caused by payment of expenditures in excess of revenues, due to decreased revenues as a result of the COVID-19 pandemic. The decrease in assets also was due to repayment from the Highway Fund of the current loan receivable and a portion of the advance to the Highway Fund. The decrease in fund balance also was attributable to the increase in accounts payable because of the cash shortage and timing of invoice payments.

Total revenues were \$1.56 billion, a decrease of 2.84% or \$45.57 million. The decrease is due mostly to the reduced motor fuel revenues because of the decreased travel caused by the COVID-19 pandemic. The Highway Trust Fund reported \$1.96 billion in total transportation expenditures, an increase 9.59% or \$171.8 million from the previous year. The increase in expenditures was largely due to the increase in capital outlay resulting from increased construction and maintenance expenditures that were paid for by Build NC program bond funding. The increase in expenditures also was attributable to the first year of principal and interest payments made on the Build NC program bonds.

In June 2019, the State issued \$300 million special indebtedness (limited obligation bonds). The bonds were the first issued under the Build NC program, authorized by Session Law 2018-16, which allows for up to \$3 billion in bonds over a ten-year period. The proceeds from the bonds can be used for certain regional and divisional transportation projects contained in the (STIP).

As discussed under the Highway Fund section, Session Law 2020-91 revised the motor fuels tax distribution formula. Effective July 1, 2020, it revised the distribution for motor fuel tax revenue for the Highway Trust Fund from 29% to 19%. Beginning July 1, 2021, it changes the distribution to 20% and then to 25% beginning July 1, 2022. Session Law 2020-91 also established a motor fuel tax floor.

ENTERPRISE FUNDS

The State's enterprise funds or business-type activities provide the same type of information found in the government-wide financial statements, but in more detail. The major enterprise funds are discussed individually below.

Unemployment Compensation Fund

The Unemployment Compensation Fund (Unemployment Insurance Trust Fund or "Trust Fund") reported net position of \$3.02 billion at June 30, 2020 compared to \$3.88 billion at June 30, 2019. The \$859.72 million decrease in net position is almost entirely a result of the impact from the Coronavirus pandemic. Unemployment rates were low during the entire 2018-2019 fiscal year, ending with a rate of 4.2% at June 2019. The first three quarters of the 2019-2020 fiscal year continued to experience decreasing unemployment rates until the fourth quarter. April 2020's unemployment rate hit 12.9% as businesses shut down. With most of North Carolina's businesses remaining closed during May, the unemployment rate continued to be high at 12.8%. As businesses partially reopened in June, unemployment came down to 7.5% by the end of the fiscal year.

Contributing to the decrease in net position, the Trust Fund's operating margin (operating revenues less operating expenses) decreased by \$5.8 billion, a 1,728% decrease from the prior year, predominantly as a result of a \$5.54 billion increase in unemployment benefits paid. Most of these benefit payments were from the federal programs passed in the CARES Act with the Federal Pandemic Unemployment Compensation (FPUC) program, the additional \$600 weekly benefit, being the largest. In addition to the increase in benefit payments, there was also a \$259.36 million decrease (51.32%) in revenues, due to legislation that gave employers a tax credit for the first quarter of calendar year 2020.

Nonoperating revenues increased by \$4.51 billion for the 2019-20 fiscal year due to receiving \$4.49 billion in federal unemployment benefit funding related to the CARES Act. During severe economic downturns, nonoperating revenues have historically provided significant support for additional unemployment benefit assistance. For the 2020 fiscal year, the nonoperating revenues sustained the Trust Fund by supporting 80.6% of the total benefits paid for the year.

Following the close of the 2020 fiscal year, two additional unemployment programs related to the COVID-19 pandemic were created that have a significant impact on the Trust Fund operations and funding. The Lost Wages Assistance (LWA) program provides an additional \$300 per week to supplement unemployment benefits for those who receive at least \$100 a week of unemployment benefits and are out of work due to COVID-19. The LWA program has been awarded \$718.91 million in federal funding through Federal Emergency Management Agency (FEMA) with a state match requirement supported by \$50 million from the State's CRF.

North Carolina also established the Increased Benefit Assistance (IBA) program as an additional unemployment benefit initiative. The IBA program has received \$87 million in allocations from the State's CRF to provide an increase of \$50 each week in the calculated weekly benefit for eligible claimants.

N.C. State Lottery Fund

The enabling legislation for the N.C. Education Lottery (NCEL) contains a requirement that the net revenues of the NCEL are transferred at least four times a year to the State's General Fund. The legislation defines net revenues as amounts remaining after accrual of expenses for prizes and operations, excluding balance sheet or prior-period expense adjustments of a specific nature. The NCEL transferred \$729.4 million to the General Fund in 2020 to support educational programs for the State. The amount transferred in 2019 was \$709.2 million.

For fiscal year 2019-20, net ticket sales increased 5.48% or \$156.59 million from the previous fiscal year to \$3.02 billion. With this increase in ticket sales, the NCEL saw a corresponding increase in prize payouts of 6.09% or \$112.3 million, and an overall increase

in operating income of 2.84% or \$20.21 million. Significant financial highlights include the following: awarded \$1 million or more to an NCEL player for the 537th time; and released 54 new instant scratch-off games into the marketplace generating gross instant ticket sales of \$2.1 billion.

N.C. Turnpike Authority

Major accomplishments for the N.C. Turnpike Authority (NCTA) include the following:

- The Triangle Expressway is North Carolina's first modern toll road extending from the interchange of I-40 and N.C. 147 on the north end, to the N.C. 55 Bypass in the south, to partially complete the "Outer Loop" around the greater Raleigh area. The NCTA has added two interchanges to the existing Triangle Expressway: The Old Holly Springs-Apex Road interchange, now named the Veridea Parkway interchange, and the Morrisville Parkway interchange. The Veridea Parkway opened to traffic in April 2017, and the Morrisville Parkway opened to traffic in February 2020. These interchanges provide increased connectivity and access to the Triangle Expressway and are considered part of the Triangle Expressway System for accounting purposes. In addition to the two interchanges, construction commenced for Phase I of the Complete 540 Project in 2019. Phase I will extend the Triangle Expressway to I-40 in southern Wake County and is expected to open to traffic in 2023. Phase II of Complete 540 will extend the project from I-40 to I-540.
- The I-77 Express Lanes project is structured as a private partnership agreement between the North Carolina Department of Transportation and I-77 Mobility Partners, LLC and is the first toll project established as a public-private partnership in the State of North Carolina. The I-77 Express Lanes project is approximately 26 miles long between the I-77 and I-277 junction in Charlotte and N.C. 150 in Mooresville. The Turnpike Authority is responsible for account management, billing, and customer service for the express lanes. The northern 13 miles of the express lanes opened in June 2019, and the remaining lanes opened in late 2019.

While operating revenues increased by \$17.46 million to \$82.61 million, the NCTA had an operating loss of \$18.67 million. The operating loss increased by 566.17% or \$15.86 million due to a \$33.32 million or 49.03% increase in operating expenses for the 2020 fiscal year. Operating revenues consist of toll revenues, fees, and sales revenue from the sale of transponders. Toll revenues increased by \$8.64 million to \$66.58 million, a 14.91% increase. Fees, licenses and fines increased by \$5.38 million to \$11.63 million, an 86.15% increase. The increase in operating expenses is predominantly due to a \$14.46 million increase in supplies and materials, a \$5.65 million increase in depreciation, and an \$8.65 million increase in other expenses. The increase in supplies and materials represents contract payments related to the Monroe Expressway that are no longer capitalized as construction in progress after it was capitalized in the prior fiscal year. Likewise, the increase in depreciation is also related to the depreciation on the Monroe Expressway. The increase in other expenses is a result of the Turnpike Authority receiving full standard overhead allocations from the North Carolina Department of Transportation (NCDOT) during the fiscal year. In prior years, the NCTA was only responsible for partial overhead allocations. In addition to the NCTA's operating loss, there was also a \$20.03 million increase in nonoperating expenses or 38.39%, predominantly due to a \$20.23 million increase in interest and fees related to the 2019 Complete 540 bonds issued.

Starting in July 2020, NCTA will be responsible for two-thirds of administrative expenses. The other one-third of the costs will continue to be advanced, as needed, from the Highway Trust Fund to be repaid from NCTA revenue collections. Interest continues to accrue on the unpaid balance of the advance.

The high cost of building, operating, and maintaining a major highway facility is typically more than the revenue a new road can generate through tolls. The gap between what tolling can pay for and the cost of the road requires additional support from the State is known as gap funding. These annual transfers from the Highway Trust Fund to the NCTA are used to pay debt service and fund required reserves on bonds issued to finance turnpike projects. NCTA received \$185.4 million in transfers from NCDOT's Highway Fund and Highway Trust Fund during fiscal year 2020, an increase of \$107.06 million or 136.66%. NCDOT's project participation increased during the year as construction and right of way acquisitions continued to move forward on the Complete 540 project and expenditures increased on the Mid-Currituck Bridge. Offsetting the transfers in from DOT's Highway Fund and Highway Trust Fund, NCTA repaid DOT \$146.26 million as a transfer out during fiscal year 2020 for project participation incurred with proceeds from the sale of bonds for the Complete 540 project. NCTA also received \$3.32 million in federal capital grants during the year, a \$24.04 million decrease from the prior year. As the NCTA has shifted to debt financing, capital grants awarded based on Federal Highway Administration (FHWA) participation has declined.

Both NCTA's operating loss and increase in nonoperating expenses contributed to a \$48.4 million or 12.08% decrease in net position to \$352.4 million at the 2020 fiscal year end. In addition to factors identified above, the Complete 540 project had significant impacts on NCTA's balance sheet. Restricted investments increased by \$203.01 million as NCTA invested proceeds from the sale of bonds during the year that were issued to support the Complete 540 project. Land and permanent easements increased by \$167.89 million due to the continued right of way acquisitions for the project, and construction in progress for the project increased by \$164.7 million. Notes from direct borrowings increased by \$46.5 million due to the NCTA making the final draw on their TIFIA (Transportation Infrastructure Finance and Innovation Act) loan for the Monroe Expressway project. Bonds payable increased by \$510.89 million with the issuance of the 2019 Triangle Expressway System Senior Lien Turnpike Revenue Bonds and Triangle

Expressway System Appropriation Revenue Bonds for the Complete 540 project. Corresponding to the debt issued during the year, interest payable increased by \$20.39 million.

The use of the Triangle Expressway and the Monroe Expressway and the resulting toll revenues are influenced by numerous factors. The COVID-19 pandemic has had an adverse impact on travel. The pandemic, and the social distancing measures implemented in response to it, have resulted in decreased traffic volume generally on all State roads, including on the Triangle Expressway and the Monroe Expressway. Diminished use of the expressways may also be occurring because of the relative lack of congestion on alternative non-toll roads. The level of toll revenues has been negatively affected by such decreased traffic levels, but the degree and duration of the impact is difficult to predict at this time.

EPA Revolving Loan Fund

The Environmental Protection Agency (EPA) Revolving Loan Fund (Loan Fund) is comprised of the Clean Water State Revolving Fund and the Drinking Water State Revolving Fund established by General Statute 159G-22 and receives federal and state funds. This Loan Fund was established to provide loans and grants as allowed under federal laws for wastewater projects and public water systems to meet the water infrastructure needs of the State.

The net position of the Loan Fund increased 6.28% to \$1.94 billion in fiscal year 2020. This increase in net position is due to the Loan Fund continuing to focus on streamlining its processes (requiring municipalities to follow specified timelines that resulted in more infrastructure projects being completed during the year), using a cash flow model to better predict fund disbursements and revenue, and prioritizing the spending of funds from the U.S. EPA (federal) capitalization grant for these projects (as opposed to funds from other sources). The amount of new loans issued during the current year was \$147.21 million, an increase of \$75.36 million or 104.88%, and the amount of principal received on existing loans during the year was \$106.57 million, a \$9.3 million or 9.56% increase. As a result, Notes Receivable increased by \$40.64 million.

Operating income (operating revenues less operating expenses) was \$10.53 million, a 1.12% increase from the prior year. Net nonoperating revenues were \$74.19 million, an increase of \$4.1 million or 5.85%. Nonoperating revenues consist of noncapital grants (federal capitalization grants) and investment earnings, and nonoperating expenses consist primarily of payments for grants, aid, and subsidies. Noncapital grants decreased 14.61% to \$51.28 million, and investment earnings were \$27.7 million, an increase of \$4.48 million or 19.32%. Payments for grants, aid and subsidies decreased by \$8.43 million or 65.03%. Noncapital grants decreased primarily due to changes in federal appropriations. Grants, aid, and subsidies decreased primarily as a result of changes in federal requirements for additional subsidization. In addition, the EPA Revolving Loan Fund received \$30.09 million in transfers for appropriated state match funds for Clean Water and Drinking Water projects, a \$17.48 million increase or 138.54% from the prior year. The increase in the appropriated state match anticipates additional noncapital grant awards during the 2020-21 fiscal year for additional supplemental disaster relief appropriations.

CAPITAL ASSET AND DEBT ADMINISTRATION

CAPITAL ASSETS

As of June 30, 2020, the State's investment in capital assets was \$59.75 billion, an increase of 5.49% from the previous fiscal year-end (see table below).

Capital Assets as of June 30
(net of depreciation, dollars in thousands)

	Governmental		Business-type		Total	
	Activities		Activities			
	2020	2019 (as restated)	2020	2019 (as restated)	2020	2019 (as restated)
Land and permanent easements.....	\$ 20,051,608	\$ 19,287,419	\$ 474,653	\$ 306,888	\$ 20,526,261	\$ 19,594,307
Buildings.....	2,859,190	2,729,390	56,441	59,024	2,915,631	2,788,414
Machinery and equipment.....	825,715	813,870	8,938	9,326	834,653	823,196
Infrastructure:						
State highway system.....	29,266,797	27,479,968	—	—	29,266,797	27,479,968
NC toll road system.....	—	—	1,388,319	1,418,003	1,388,319	1,418,003
General infrastructure.....	231,343	229,302	6,596	6,933	237,939	236,235
Computer software.....	274,513	289,609	831	955	275,344	290,564
Art, literature, and other artifacts.....	144,501	140,595	1,286	1,277	145,787	141,872
Construction in progress.....	3,138,055	3,093,913	307,561	138,040	3,445,616	3,231,953
Computer software in development.....	712,600	632,329	—	—	712,600	632,329
Total.....	<u>\$ 57,504,322</u>	<u>\$ 54,696,395</u>	<u>\$ 2,244,625</u>	<u>\$ 1,940,446</u>	<u>\$ 59,748,947</u>	<u>\$ 56,636,841</u>
Total percent change between fiscal years 2019 and 2020	5.13 %		15.68 %		5.49 %	

The largest component of capital assets is the state highway system. North Carolina has an 80,159 mile highway system, making it the second largest state-maintained highway system in the nation. The major capital asset activity during the current fiscal year included the following:

- The NCDOT reported year-end construction in progress of \$2.74 billion for state highway projects. Additionally, the NCTA (business-type activity) reported year-end construction in progress of \$225.75 million for the Complete 540 project. This project involves completing the 540 loop around the greater Raleigh area by extending the Triangle Expressway 28 miles. NCTA also has \$35.6 million construction in progress for the Mid-Currituck Bridge project. This project is a 7-mile roadway toll project, which includes a two-lane bridge, that spans the Currituck Sound and connects the Currituck county mainland to the Outer Banks; it also includes a second two-lane bridge that spans Maple Swamp on the Currituck county mainland.
- The Department of Agriculture and Consumer Services is constructing a new state-of-the art laboratory complex to replace four labs whose average age is more than 40 years. The Agricultural Sciences Center will contain offices and labs that perform tests for the following divisions in the department: Food and Drug Protection, Stands, Structural Pest Control and Pesticides and Veterinary. The new laboratory complex is financed from the Connect NC bonds approved by voters in March 2016. At year-end, construction in progress for the Agricultural Sciences Center totaled \$66.6 million.
- The Department of Health and Human Services (DHHS) is replacing major legacy IT systems. NC FAST, the new system for managing and administering social services benefits, will improve the way DHHS and the 100 county departments of social services conduct business. At year-end, computer software in development for NC FAST totaled \$679.38 million.

As further detailed in Note 21E to the financial statements, the State has commitments of \$5.755 billion for the construction of highway infrastructure (\$5.302 billion for governmental activities and \$453 million for business-type activities), which are expected to be financed by gasoline tax collections, motor vehicle fees, toll collections, federal funds, and debt proceeds. Other commitments of \$157.24 million for the construction and improvement of state government facilities are expected to be financed primarily by debt proceeds, state appropriations, and federal funds.

More detailed information about the State's capital assets is presented in Note 5 to the financial statements.

LONG-TERM DEBT

At year-end, the State had total long-term debt outstanding (bonds, special indebtedness, and notes from direct borrowings) of \$7.48 billion, an increase of 6.03% from the previous fiscal year-end (see table below).

Outstanding Debt as of June 30
Bonds, Special Indebtedness, and Notes From Direct Borrowings
(dollars in thousands)

	Governmental Activities		Business-type Activities		Total	
	2020	2019	2020	2019	2020	2019
General obligation bonds.....	\$ 2,605,380	\$ 2,424,075	\$ —	\$ —	\$ 2,605,380	\$ 2,424,075
Special Indebtedness:						
Limited obligation bonds.....	1,774,945	1,946,915	—	—	1,774,945	1,946,915
GARVEE bonds.....	959,525	1,046,580	—	—	959,525	1,046,580
Revenue bonds.....	—	—	1,917,358	1,456,614	1,917,358	1,456,614
Notes from direct borrowings.....	43,937	47,676	177,925	132,087	221,862	179,763
Total	<u>\$ 5,383,787</u>	<u>\$ 5,465,246</u>	<u>\$ 2,095,283</u>	<u>\$ 1,588,701</u>	<u>\$ 7,479,070</u>	<u>\$ 7,053,947</u>
Total percent change between fiscal years 2019 and 2020		(1.49)%		31.89 %		6.03 %

During the 2020 fiscal year, the State issued \$600 million in general obligation bonds for its governmental activities. The general obligation bonds were issued pursuant to the Connect NC Bond Act of 2015 (see below) and will provide financing for various capital improvements throughout the State as authorized in the Act. Also, the NCTA, a business-type activity, issued \$486.95 million in revenue bonds. The revenue bond proceeds will be used to finance the construction of the Triangle Expressway.

The State issues two types of tax-supported debt: general obligation (GO) bonds and special indebtedness (i.e., debt not subject to a vote of the people). GO bonds are secured by the full faith, credit, and taxing power of the State and require approval by a majority of voters. The payments on special indebtedness are subject to appropriation by the General Assembly and also may be secured by a lien on facilities or equipment. The General Statutes (Chapter 142, Article 9) prohibit the issuance of special indebtedness except for projects specifically authorized by the General Assembly. Special indebtedness is also known as appropriation-supported debt. Limited obligation bonds may be issued by the State directly rather than through a conduit issuer. The use of alternative financing methods provides financing flexibility to the State and permits the State to take advantage of changing financial and economic environments. The GARVEE bonds are a revenue bond-type debt instrument where the debt service is to be paid solely from federal transportation revenues.

The State's total long-term debt (bonds, special indebtedness, and notes from direct borrowings) reported in governmental activities has increased from \$3.48 billion in 2002 to \$5.38 billion in 2020, in part due to large issuances of non-GO debt (special indebtedness) for higher education capital projects. Prior to 2003, the State only issued general obligation debt. The NCTA had its first debt issuance in 2010. The NCTA's long-term debt has increased from \$691.56 million in 2010 to \$2.1 billion in 2020.

The following is a summary of recent debt authorizations.

Build NC Bond Act of 2018

The 2017-18 Session of the General Assembly authorized the issuance of up to \$300 million annually over ten years, not to exceed \$3 billion in total, of special indebtedness. The maturity of the bonds is limited to 15 years and the issuance is contingent upon the N.C. State Treasurer's recommendation. The Build NC Bonds will be repaid from appropriations from the Highway Trust Fund. The proceeds will enable the N.C. Department of Transportation to accelerate Regional and Divisional transportation projects authorized pursuant to the State's Strategic Transportation Investments Act (STI). The Build NC Bond Act of 2018 became effective January 1, 2019.

Connect NC Bond Act of 2015

The 2015-16 Session of the General Assembly authorized, subject to a vote of the qualified voters of the State, the issuance of \$2 billion of general obligation bonds of the State to be secured by a pledge of the faith and credit and taxing power of the State. The Connect NC Bonds were approved by a statewide voter referendum held on March 15, 2016. The general obligation bonds will provide financing for various capital improvements throughout the State as follows: University of North Carolina System (\$980 million), North Carolina Community Colleges (\$350 million), local parks and infrastructure (\$312.5 million), National Guard (\$70 million), agriculture (\$179 million), State parks and attractions (\$100 million), and public safety (\$8.5 million).

Credit Ratings

Credit ratings are the rating agencies' assessment of a governmental entity's ability and willingness to repay debt on a timely basis. As a barometer of financial stress, credit ratings are an important factor in the public credit markets and can influence interest rates a borrower must pay.

The State's general obligation bond credit ratings are as follows:

State of North Carolina General Obligation Bond Credit Ratings		
<u>Rating Agency</u>	<u>Rating</u>	<u>Outlook</u>
Fitch Ratings	AAA	Stable
Moody's Investors Service	Aaa	Stable
Standard & Poor's Rating Services	AAA	Stable

These ratings are the highest attainable from all three rating agencies. During the 2019-20 fiscal year, the State issued general obligation bonds. In connection with these bonds, Standard & Poor's, Moody's Investors Service, and Fitch Ratings, the top three rating agencies, all affirmed the triple-A bond rating for the State. A triple-A credit rating means that North Carolina has followed well-defined financial management policies and has demonstrated strong debt management practices. The rating agencies recognized the State's historically conservative budgeting, financial management, and debt issuance practices. North Carolina remains one of only 13 states with a triple-A rating from all three rating agencies.

Special indebtedness is not subject to a vote of the people, and its repayment is based on the State's annual debt service appropriation. For these reasons, special indebtedness is rated lower than the State's general obligation bonds and typically carries a higher interest rate.

Limitations on Debt

The Constitution of North Carolina (Article 5, Section 3) imposes limitations upon the increase of certain state debt. It restricts the General Assembly from contracting debts secured by a pledge of the faith and credit of the State, unless approved by a majority of the qualified voters of the State, except for the following purposes:

1. To fund or refund a valid existing debt;
2. To supply an unforeseen deficiency in the revenue;
3. To borrow in anticipation of the collection of taxes due and payable within the current fiscal year to an amount not exceeding 50 percent of such taxes;
4. To suppress riots or insurrections; or to repel invasions;
5. To meet emergencies immediately threatening the public health or safety, as conclusively determined in writing by the Governor; and
6. For any other lawful purpose, to the extent of two-thirds of the amount by which the State's outstanding indebtedness shall have been reduced during the preceding biennium.

The 2013-14 Session of the General Assembly enacted legislation (Session Law 2013-78) to limit the amount of special indebtedness that the State may incur. According to this law, special indebtedness authorized by legislation enacted after January 1, 2013 cannot exceed 25% of the total bond indebtedness of the State supported by the General Fund that was authorized pursuant to legislation enacted after January 1, 2013.

More detailed information about the State's long-term liabilities is presented in Note 8 to the financial statements.

FUTURE OUTLOOK

Next Year's Budget and Rates

In the 2019 Regular Session, the General Assembly enacted a series of bills that established a base budget plus various supplemental appropriations for the 2019-2021 fiscal biennium. For fiscal year 2021, the General Assembly enacted a General Fund budget that provides \$24.49 billion in net appropriations, a 0.32% increase over the enacted budget in fiscal year 2020. The budget provides nonrecurring funding for Medicaid and NC Health Choice programs. Additionally, the modified budget also includes funding for additional resources to support the implementation of the Raise the Age legislation, \$39 million, to manage the increased population of offenders anticipated due to the change.

During the 2020 Session, the quickly emerging COVID-19 pandemic imperiled the original forecast of the State's revenue position. To ensure the fiscal year 2021 State budget balanced and that pressing funding priorities were addressed, the General Assembly reconvened in April and June 2020 and enacted a series of bills appropriating the federal CRF received from the CARES Act as well as State funds. During these sessions, 32 session laws have directly impacted State appropriations and/or revenues. Most of these session laws appropriated the federal CRF received from the CARES Act. By the end of fiscal year 2020, the General Assembly had appropriated roughly \$2.46 billion of the \$3.59 billion federal CRF received. The remainder of the State's CRF was appropriated during July and September 2020.

State Health Plan

In calendar year 2021, active employees and pre-65 retirees can choose between two self-insured plans: the 80/20 PPO Plan (80/20 Plan) or the 70/30 PPO Plan (70/30 Plan). Both the 70/30 Plan and the 80/20 Plan have been adjusted to reduce the member copayment of Primary Care, Specialist, and some Therapeutic services (Speech, Occupational, Physical, and Chiropractic) for providers that are a part of the Clear Pricing Project (CPP). All copayments to non-CPP providers will not change. Preferred insulin will be offered at a \$0 copay to members, and ABA Therapy services will no longer have an annual limit.

Additionally, the Board of Trustees of the State Health Plan for Teachers and State Employees approved employee and retiree premium rates to remain at their current levels effective January 1, 2021. This decision was made given the expectation that savings from the lower Medicare Advantage products with integrated prescription drug plans (MA-PDP) will offset the anticipated medical and pharmacy cost increases and the employer contribution decreases.

Additionally, Session Laws 2020-45 and 2020-41 appropriated the maximum allowable premium charged to employers and the RHBF for the fiscal year ending 2021. This new legislation reduced the expected increase in allowable premiums as appropriated from Session Law 2019-209 from 5.4 percent to 0.3 percent for fiscal year 2021. Administratively, since the Plan sets rates on a calendar year basis instead of a fiscal year, this will cause premiums to decrease rather than the increases appropriated. The 2021 premium will decrease by 2.0 percent; however, this decrease is expected to be made up in 2022 if a fiscal year appropriation increase returns to a 4.0 percent level, causing a 10.1 percent employer premium increase.

REQUESTS FOR INFORMATION

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the State's finances and to demonstrate the State's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the North Carolina Office of the State Controller, Accounting and Financial Reporting Section, 1410 Mail Service Center, Raleigh, N.C. 27699-1410. In addition, this financial report is available on the Office of the State Controller's internet home page at <https://www.osc.nc.gov/public-information/reports>.