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, 2021. 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 $9.16 billion or 16.01% as a result of this year's operations. Net position of governmental activities increased by $9 billion (17.41%) and net position of business-type activities increased by $165 million (or 2.97%). At year-end, net position of governmental activities and business-type activities totaled $60.68 billion and $5.72 billion, respectively.
- Component units reported net position of $21.32 billion, an increase of $5.11 billion or 31.5% 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 $6.59 billion at June 30, 2020 (as restated) to $11.88 billion at June 30, 2021, an increase of 80.38%.
- The fund balance of the Highway Fund increased from negative $330.19 million at June 30, 2020 to $692.83 million at June 30, 2021, an increase of $1.02 billion from the previous year. This increase was mainly due to an increase in cash resulting from a reduction in construction and maintenance expenditures.
- The Highway Trust Fund reported a fund balance of $1.84 billion, an increase of 50.35% from the previous year. The fund balance increase was mainly due to an increase in cash resulting from fewer expenditures in construction and maintenance projects.
- The Unemployment Compensation Fund reported net position of $3.18 billion at June 30, 2021 compared to $3.02 billion at June 30, 2020, an increase of $154.09 million or 5.1%. The increase in net position is due almost entirely to various fluctuations created by impacts from the Coronavirus pandemic, including the gradually decreasing unemployment rates since the last quarter of the 2019-20 fiscal year.
- The N.C. State Lottery Fund reported net ticket sales of $3.81 billion, an increase of 26.16% from the previous year. As required by law, the Lottery transferred $936.8 million to the General Fund to support educational programs.
- The N.C. Turnpike Authority (NCTA) reported net position of $282.53 million, a decrease of 19.83% from the previous year. The NCTA had an operating loss of $45.07 million, a loss increase of $26.41 million or 141.47% from the prior year due to a decrease in toll revenues. The NCTA also had a $10.03 million increase in nonoperating expenses due to a $6.37 million increase in interest and fees related to debt issued during the fiscal year.
- The EPA Revolving Loan Fund reported net position of $2.01 billion, an increase of 3.57% from the previous year. Operating income was $6.82 million, and net nonoperating revenues of $50.18 million consisted primarily of federal capitalization grants and investment earnings.

Capital Assets

- The State's investment in capital assets (net of accumulated depreciation) was $62.06 billion, an increase of 3.77% from the previous fiscal year-end.
- Significant year-end construction in progress amounts were for State highway projects ($2.27 billion), an expressway project ($364.8 million), a new system for managing and administering social service benefits ($723.5 million), a new laboratory complex ($89.31 million), and a new skilled nursing facility for state veterans ($40.46 million).

Long-term Debt

- The State had total long-term debt outstanding (bonds, special indebtedness, and notes from direct borrowings) of $8.39 billion, an increase of 12.21% from the previous fiscal year-end. The State issued $400 million in general obligation bonds for its governmental activities. The Highway Trust Fund issued $700 million in special indebtedness limited obligation bonds for regional and divisional transportation projects. Additionally, the NCTA, a business-type activity, issued $573.45 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 54 and 55) 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 56 and 57) 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 80. 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 184 and 185).

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 256 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, and custodial 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 78 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 $66.4 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, 2021 and 2020
(dollars in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government		Total Percentage Change 2020-21
	2021	2020 (as restated)	2021	2020 (as restated)	2021	2020 (as restated)	
Current and other non-current assets	$26,896,480	$19,599,397	$6,820,390	$ 6,691,138	$33,716,870	$26,290,535	28.25%
Capital assets, net	59,619,798	57,559,801	2,439,910	2,244,625	62,059,708	59,804,426	3.77%
Total assets	86,516,278	77,159,198	9,260,300	8,935,763	95,776,578	86,094,961	11.25%
Total deferred outflows of resources	2,544,873	2,361,920	65,713	63,347	2,610,586	2,425,267	7.64%
Long-term liabilities	16,962,803	16,679,814	2,951,590	2,433,214	19,914,393	19,113,028	4.19%
Other liabilities	8,875,772	8,843,459	599,103	966,723	9,474,875	9,810,182	(3.42%)
Total liabilities	25,838,575	25,523,273	3,550,693	3,399,937	29,389,268	28,923,210	1.61%
Total deferred inflows of resources	2,541,477	2,314,243	54,771	43,682	2,596,248	2,357,925	10.11%
Net position:							
Net investment in capital assets	56,803,432	55,581,833	516,526	513,378	57,319,958	56,095,211	2.18%
Restricted	1,868,783	1,458,418	255,800	178,212	2,124,583	1,636,630	29.81%
Unrestricted	2,008,884	(5,356,649)	4,948,223	4,863,901	6,957,107	(492,748)	1,511.9%
Total net position	$60,681,099	$51,683,602	$5,720,549	$ 5,555,491	$66,401,648	$57,239,093	16.01%

The largest component of the State's net position (86.32% for fiscal year 2021) 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. An additional portion of net position represents restricted net position ($2.12 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 unrestricted net position of $2.01 billion at June 30, 2021, an increase of $7.37 billion from the prior year. 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 $6.44 billion of bonds and special indebtedness outstanding for governmental activities at June 30, 2021, approximately $3.18 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, 2021, the State's governmental activities have significant unfunded liabilities for compensated absences of $610.18 million, pension liabilities of $3.08 billion, net OPEB liabilities of $5.35 billion, workers' compensation of $693.47 million, and claims and judgments payable of $731.7 million (see Note 8 to the financial statements). These unfunded liabilities reduce unrestricted net position for governmental activities. However, the strong financial results for fiscal year 2021 (i.e., the excess of revenues over expenses of $8.16 billion) contributed to the increase in unrestricted net position.

The State's overall net position increased $9.16 billion or 16.01% (total primary government) from the prior fiscal year. The net position of the governmental activities increased $9 billion or 17.41% and business-type activities increased $165.06 million or 2.97%. The following financial information was derived from the government-wide Statement of Activities:

Changes in Net Position for the Fiscal Years Ended June 30, 2021 and 2020
(dollars in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government		Total Percentage Change
	2021	2020 (as restated)	2021	2020 (as restated)	2021	2020 (as restated)	2020-21
Revenues:							
Program revenues							
Charges for services	$2,951,088	$2,725,410	$4,658,211	$3,557,565	$7,609,299	$6,282,975	21.11%
Operating grants and contributions	23,540,962	19,246,548	6,907,326	4,737,551	30,448,288	23,984,099	26.95%
Capital grants and contributions	1,281,167	1,328,260	21,393	3,681	1,302,560	1,331,941	(2.21%)
General revenues							
Taxes:							
Individual income tax	15,368,872	13,121,892	—	—	15,368,872	13,121,892	17.12%
Corporate income tax	1,327,813	726,186	—	—	1,327,813	726,186	82.85%
Sales and use tax	9,826,411	8,556,460	—	—	9,826,411	8,556,460	14.84%
Motor fuels tax	2,067,262	2,054,235	—	—	2,067,262	2,054,235	0.63%
Franchise tax	882,332	640,865	—	—	882,332	640,865	37.68%
Highway use tax	1,003,310	847,919	—	—	1,003,310	847,919	18.33%
Insurance tax	722,958	661,881	—	—	722,958	661,881	9.23%
Beverage tax	533,088	462,401	—	—	533,088	462,401	15.29%
Tobacco products tax	303,060	288,933	—	—	303,060	288,933	4.89%
Other taxes	334,913	290,178	—	—	334,913	290,178	15.42%
Tobacco settlement	167,417	148,929	—	—	167,417	148,929	12.41%
Federal COVID-19	3,117,857	173,448	—	—	3,117,857	173,448	1,697.57%
Unrestricted investment earnings	15,662	133,251	—	—	15,662	133,251	(88.25%)
Noncapital contributions	91,696	—	1,309	—	93,005	—	100.00%
Miscellaneous	102,661	76,395	—	—	102,661	76,395	34.38%
Total revenues	63,638,529	51,483,191	11,588,239	8,298,797	75,226,768	59,781,988	25.84%
Expenses:							
General government	2,500,096	1,441,776	—	—	2,500,096	1,441,776	73.40%
Primary and secondary education	12,936,328	11,971,116	—	—	12,936,328	11,971,116	8.06%
Higher education	5,142,660	4,815,552	—	—	5,142,660	4,815,552	6.79%
Health and human services	25,629,768	21,594,958	—	—	25,629,768	21,594,958	18.68%
Economic development	665,102	525,242	—	—	665,102	525,242	26.63%
Environment and natural resources	821,398	708,815	—	—	821,398	708,815	15.88%
Public safety, corrections and regulation	4,536,568	4,228,118	—	—	4,536,568	4,228,118	7.30%
Transportation	2,793,445	2,979,441	—	—	2,793,445	2,979,441	(6.24%)
Agriculture	286,217	313,068	—	—	286,217	313,068	(8.58%)
Interest on long-term debt	170,435	171,372	—	—	170,435	171,372	(0.55%)
Unemployment compensation	—	—	7,317,289	5,707,104	7,317,289	5,707,104	28.21%
N.C. State Lottery	—	—	2,875,899	2,290,926	2,875,899	2,290,926	25.53%
EPA Revolving Loan	—	—	17,458	13,785	17,458	13,785	26.64%
N.C. Turnpike Authority	—	—	193,813	186,369	193,813	186,369	3.99%
Regulatory programs	—	—	130,081	131,503	130,081	131,503	(1.08%)
Insurance programs	—	—	35,262	51,815	35,262	51,815	(31.95%)
North Carolina State Fair	—	—	7,086	15,981	7,086	15,981	(55.66%)
Other business-type activities	—	—	12,780	15,421	12,780	15,421	(17.13%)
Total expenses	55,482,017	48,749,458	10,589,668	8,412,904	66,071,685	57,162,362	15.59%
Increase in net position before contributions and transfers	8,156,512	2,733,733	998,571	(114,107)	9,155,083	2,619,626	249.48%
Contributions to permanent funds	7,472	5,919	—	—	7,472	5,919	26.24%
Transfers	833,513	652,776	(833,513)	(652,776)	—	—	
Increase (decrease) in net position	8,997,497	3,392,428	165,058	(766,883)	9,162,555	2,625,545	248.98%
Net position - beginning - restated	51,683,602	48,291,174	5,555,491	6,322,374	57,239,093	54,613,548	4.81%
Net position - ending	$60,681,099	$51,683,602	$5,720,549	$5,555,491	$66,401,648	$57,239,093	16.01%

Governmental Activities. For fiscal year 2021, 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 $9 billion (17.41%) resulted for governmental activities. Total revenues increased by 23.61% ($12.16 billion) while total expenses increased by 13.81% ($6.73 billion). The growth in revenues is mainly attributable to the increase in operating grants and contributions, taxes, and other revenues. Operating grants and contributions increased by $4.29 billion or 22.31% due to higher spending in federally supported programs, such as Medicaid, disaster relief, and the Governor's Education Emergency Relief (GEER) fund as well as increases in federal COVID-19 funds (see below). Individual, corporate, and sales and use taxes increased $4.12 billion primarily due to continued economic recovery from the COVID-19 pandemic. The increase in other revenues is also attributable to increases in federal COVID-19 funds (see below)

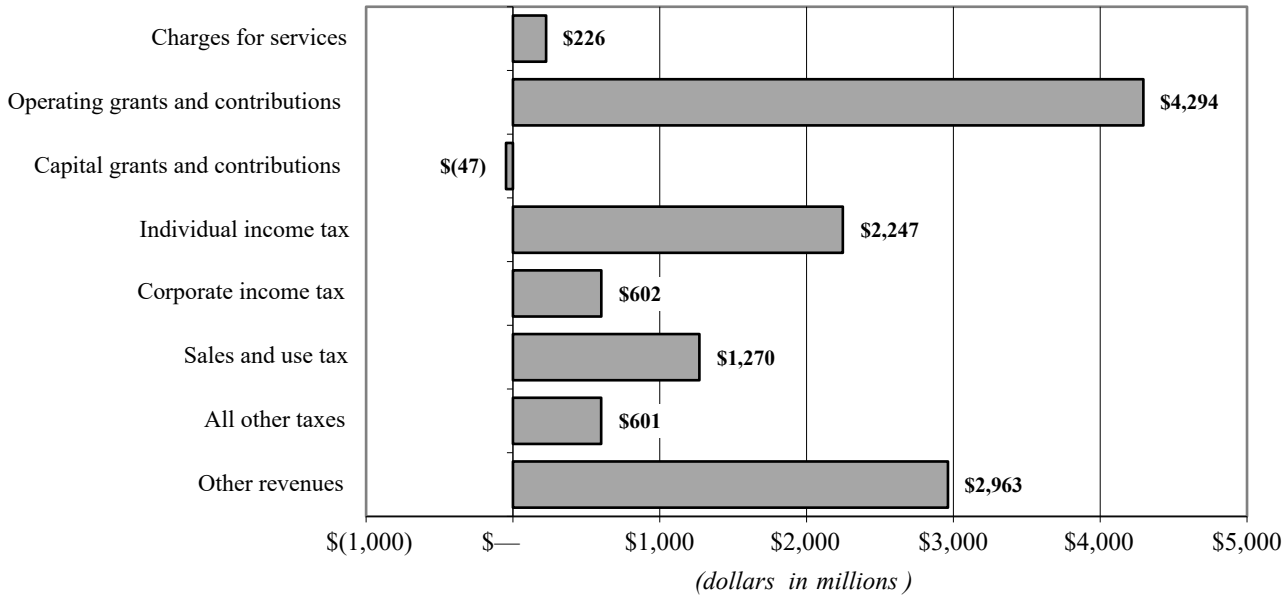
In the prior fiscal year, the U.S. Congress enacted a series of laws, including the Families First Coronavirus Response Act (FFCRA) and the Coronavirus Aid, Relief, and Economic Security (CARES) Act; these laws were a direct response to the economic and societal crises resulting from the COVID-19 pandemic. One purpose of the FFCRA was to provide a 6.2 percentage point increase to the Federal Medical Assistance Percentage (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.

For fiscal year 2021, federal COVID-19 funds increased $4.45 billion or 384.32%. The primary factor for the increase is the $3.11 billion recognition of revenues in governmental activities related to the CARES Act funds that were provided to agencies in fiscal year 2020 but were unspent at the end of the prior year. The requirements were met during fiscal year 2021 allowing the revenues to be recognized. Other factors that contributed to the increase in federal COVID-19 funds was a higher FMAP of 6.2% (enacted in the FFCRA) for the Medicaid and Title IV-E Foster Care and Adoption Assistance programs; federal funds for the Emergency Rental Assistance and Homeowners Assistance programs; and federal funds for the GEER fund. The State's governmental activities recognized $5.60 billion of federal COVID-19 funds; $2.48 billion is included in operating grants and contributions (i.e. program revenues) and $3.12 billion is reported as federal COVID-19, which is included in the other revenues source shown in the table below (i.e. general revenues).

In March 2021, the United States Congress enacted the American Rescue Plan Act (ARPA) and established the Coronavirus State and Local Fiscal Recovery Fund. These funds were allocated to each state, local government, and tribal government individually. As of June 30, 2021, North Carolina had received $2.7 billion of the Coronavirus State Fiscal Recovery funds. The State Fiscal Recovery Funds reduce the impacts of the COVID-19 pandemic and decrease the spread of the virus; replace lost revenue for governments; support economic stabilization caused by the pandemic; and address public health and economic challenges that contributed to the unequal impact of the pandemic.

The following chart reflects the dollar change in governmental activities revenues by source between fiscal years 2020 and 2021:

Dollar Change in Governmental Activities Revenues by Source
Between Fiscal Years 2020 and 2021



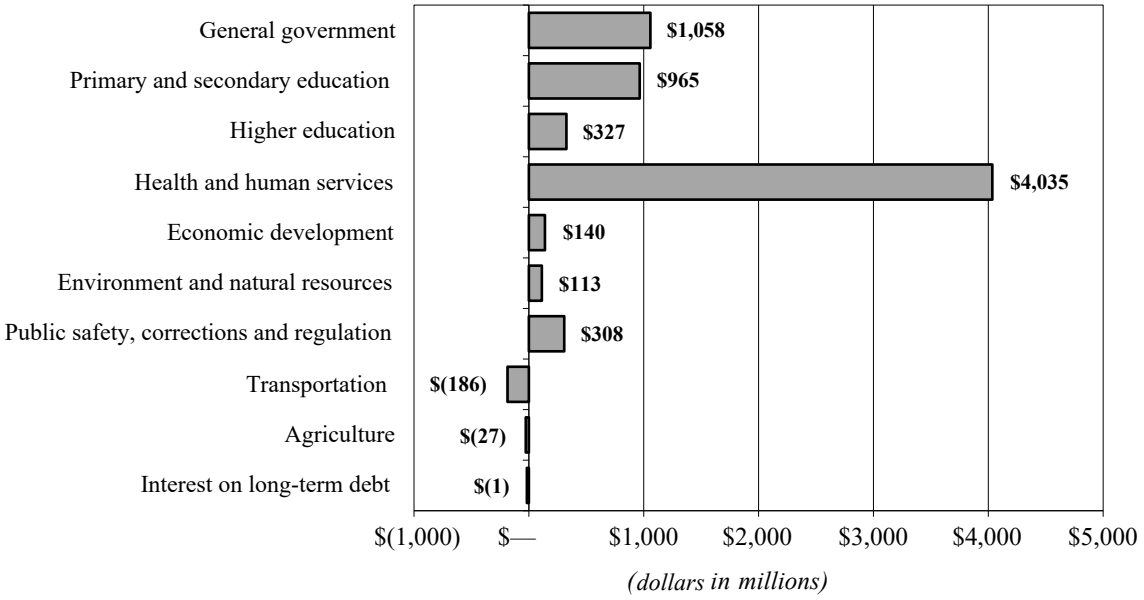
For fiscal year 2021, spending increased in the majority of the State's functional areas, with an exception in transportation. Transportation expenses decreased by $186 million or 6.24% primarily due to the reduction of various construction and maintenance projects in progress as a result of the cash shortage in the prior year.

Total health and human services (HHS) spending increased by 18.68% or $4.03 billion in 2021. For comparison, HHS spending increased by 10.36% and 2.57% in fiscal years 2020 and 2019, 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 (PHE). A significant factor was the temporary provider rate increases implemented by Medicaid in response to the COVID -19 PHE. 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. Enrollment in Medicaid increased during the fiscal year due to an FFCRA requirement that as a condition of receiving enhanced FMAP, coverage for any beneficiary cannot be dropped or reduced to a lesser benefit during a PHE. 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 2021 were to general government and primary and secondary education. Total expenses increased 73.40% ($1.06 billion) for general government and 8.06% ($965.21 million) for primary and secondary education. The growth in these functional areas is primarily due to increased spending for COVID-19 aid programs including general aid distributed to local governments, hospitals, nonprofits, universities, colleges and other component units of the State and aid for the Extra Child Grant Program; and increased state aid provided to local education agencies (LEAs) for continued COVID-19 related expenditures.

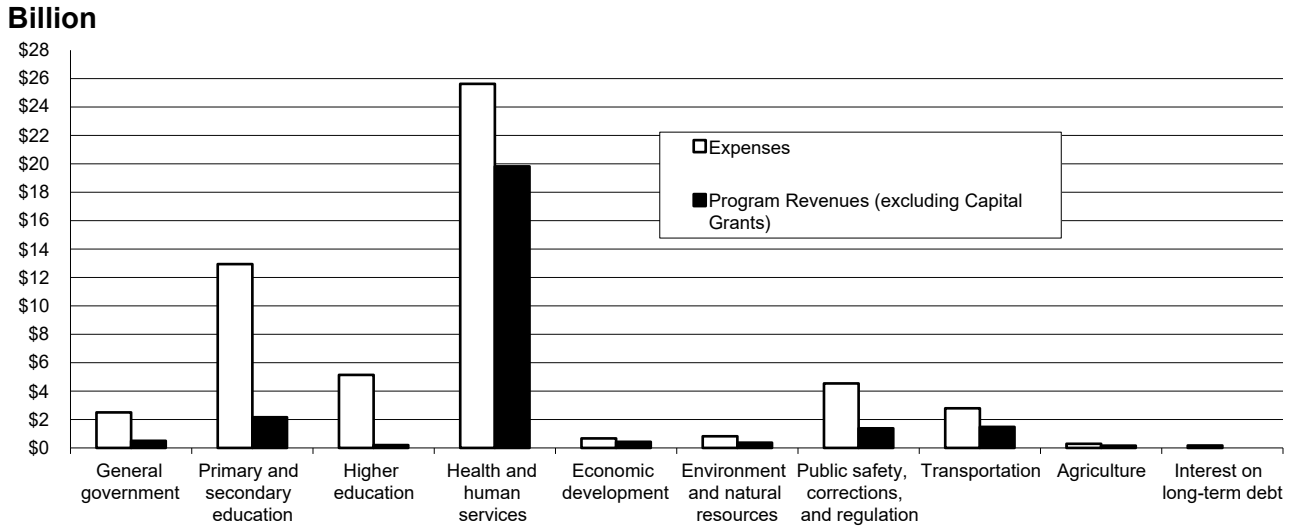
The following chart reflects the dollar change in the functional expenses of governmental activities between fiscal years 2020 and 2021:

Dollar Change in Governmental Activities Functional Expenses
Between Fiscal Years 2020 and 2021



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, 2021



Business-type Activities. Business-type activities reflect an overall increase in net position of $165.06 million or 2.97%, primarily due to the increase in net position in the Unemployment Compensation Fund. The increase in net position of $154.09 million or 5.1% in the Unemployment Compensation Fund (Trust Fund) is due almost entirely to various fluctuations created by the Coronavirus pandemic. The Trust Fund received an increase of $1.98 billion or 44.16% from the prior year in federal COVID-19 funding, while there was also a corresponding increase of $1.6 billion in unemployment benefits paid. In addition, unemployment rates have continued to decrease since the fourth quarter of the prior fiscal year. The N.C. Turnpike Authority's net position decreased by $69.87 million or 19.83% mainly due to the NCTA incurring an operating loss of $45.07 million, mostly due to decreases in toll revenues. Net nonoperating expenses also increased by $10.03 million, mainly due to a $6.37 million increase in interest and fees related to debt issued during the fiscal year. The net position increase of $69.42 million or 3.57% 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, 2021, the State's governmental funds reported combined fund balances of $17.47 billion, an increase of 70.70% from the prior fiscal year-end (as restated). Of this amount, $7.4 billion is classified as unassigned fund balance in the General Fund (available for spending at the State's discretion) 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, 2021, the fund balance of the General Fund increased 80.38% ($5.29 billion) to $11.88 billion. The unassigned fund balance increase is due, in part, to the overall increases in tax revenues including individual income tax, sales and use tax, and corporate income tax. General Fund revenues increased by $11.66 billion (25.96%) while expenditures increased by $7.15 billion (15.88%). The increase in revenues is primarily due to increased tax revenues, federal and federal COVID-19 funds received. For the current fiscal year, the General Fund recognized $5.24 billion in federal COVID-19 funds. These CARES ACT funds were derived from the recognition of amounts that were unspent at the end of fiscal year 2020, and ultimately spent and recognized as revenues in fiscal year 2021. The increase in expenditures is primarily due to the federal and federal COVID-19 funds spent by the various State functions. The expenditures supported aid programs, increased DHHS SNAP caseloads, increased medical expenses, and increased contracted and temporary personal services all related to the COVID-19 pandemic.

One of the major budget drivers for the General Fund, historically, has been the Medicaid program. Medicaid enrollment increased by 13.55% to 2.46 million individuals (23.22% of North Carolina's population). For comparison, Medicaid enrollment increased 4.35% and 0.46%, respectively, in fiscal years 2020 and 2019. The enrollment growth was mostly attributable to the FFCRA requirement that any beneficiary receiving the enhanced FMAP coverage would not be dropped or reduced to a lesser benefit category during the COVID-19 PHE. State appropriation expenditures for Medicaid increased by $124 million or 3.26%. The Medicaid program ended the fiscal year with unspent state appropriations of $201 million, which were reverted to the General Fund. This is the eighth 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 increased by $4.5 billion or 18.29% in fiscal year 2021. Individual income tax revenues increased $2.25 billion or 17.12% and sales and use tax revenues increased $1.26 billion or 14.79% in fiscal year 2021. Corporate income tax also increased $575.29 million or 78.92% from the prior year. During fiscal year 2021, North Carolina's economy was impacted by the effects of the COVID-19 pandemic and the federal and state government responses to counter these negative effects, such as direct payments to households and more support for businesses and laid-off workers. North Carolina's labor market has rebounded since the COVID-19 shutdown in the spring of 2020. The number of payroll jobs in North Carolina rebounded in the summer of 2020 and has increased steadily since then, according to the Bureau of Labor Statistics. The Bureau of Economic Analysis reported that North Carolina's personal income has shown substantial growth during the fiscal year, leading to the individual income tax revenue growth.

During the fiscal year, there were two rounds of federal economic impact payments to North Carolina households that increased personal income. In addition, the State of North Carolina issued payments to households with eligible children under the Extra Credit Grant program. Although these payments are not taxable under the State's income tax, sales and use taxes and other excise taxes would be positively impacted by these payments. The federal government also provided pandemic unemployment compensation payments and other unemployment assistance. The unemployment compensation payments are taxable and the N.C. Department of Revenue (DOR) collected withholding taxes from these payments. Wage and salary income growth was higher than the prior fiscal year and the State's income tax withholding remained strong during the fiscal year due to the rise in wages and salaries and the shift to higher income workers. Personal consumption expenditures also showed growth from the prior year. The growth is attributed to the State's improved economy as well as the economic impact payments by the federal government. This growth increased the disposable incomes of consumers.

The corporate income tax revenue increase is consistent with the trend in the United States. Corporate profits in the U.S. have risen in recent quarters, contributing to an increase in corporate tax revenues. In addition the DOR implemented the Voluntary Corporate Transfer Pricing Resolution Initiative during the fiscal year to work with corporate taxpayers to expedite resolution of corporate intercompany pricing issues. This initiative also contributed to the increase in corporate income tax revenues.

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 ACFR as required supplementary information. The current ACFR 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.

Variances – 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 base budget for the 2019-21 biennium 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.

In addition to the normal administrative adjustments that occurred during the year, FY 2020-21 was unusual due to the Coronavirus health emergency that struck in the third and fourth quarter of the FY 2019-20 and continued throughout FY 2020-21. The global pandemic resulted in North Carolina receiving $3.5 billion in federal aid in the fourth quarter of FY 2019-20 that could be spent in FY 2020-21. Additionally, North Carolina received federal funds from the ARPA enacted in March of 2021.

In 2020, the General Assembly enacted a series of bills that established a base budget plus various supplemental appropriations for the fiscal biennium. For fiscal year 2021, the General Assembly enacted a General Fund budget that provided $24.49 billion in net appropriations.

Additional factors leading to variances between the original and final budget in fiscal year 2020-21 include the following:

1) Awarding of new unanticipated federal grants to manage the COVID-19 pandemic and increases and decreases in amounts for long-term standing federally supported programs. North Carolina received an additional $1.2 billion for Medicaid due to an increase in the FMAP. Additionally, $1.5 billion in federal Coronavirus Relief Funds have been budgeted and expended during the biennium.
2) Statewide encumbrance carry-forward budgeted amounts from fiscal year 2019-20 totaled $583.9 million, which increased the budget for fiscal year 2020-21 through administrative action.
3) Allocation of hurricane disaster funds that were appropriated and authorized in prior years but not expended until fiscal year 2020-21. 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.

Variances - Final Budget and Actual Results

Actual total own-source General Fund revenue collected (tax, non-tax, and tobacco settlement) was 10.43% higher than budgeted revenue amounts in fiscal year 2021. Tax revenues were 7.52% higher than anticipated primarily due to better than expected individual income, corporate income, and sales tax revenues due to federal fiscal stimulus. Non-tax revenues from sources included in certified revenues were 1.6% higher than budget. A shortfall in judicial fees and short-term investment income was offset by higher-than-anticipated revenue from Disproportionate Share Hospital payments and Master Settlement Agreement payments. The $711.4 million (315.74%) variance 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 54.85% of total General Fund tax revenue collections, were $1 billion (6.75%) higher than the budgeted revenue due primarily to higher-than-expected estimated and final payments, as well as higher than expected withholding from unemployment benefits. Withholding payment from wage earnings were $1.68 billion (16.6%) above the year-end target. Quarterly payments, final and extension payments for tax year 2020 returns, and refunds all came in higher than expected. Sales and use tax collections, which comprised 31.28% of total General Fund tax revenues in fiscal year 2021, were $400 million (4.64%) above the budgeted revenue. The federal stimulus and shift in spending patterns away from services and towards more goods due to pandemic contributed to strong consumer spending and resulting sales and use tax revenues. Corporate income tax collections which accounted for 5.24% of total General Fund tax revenues in fiscal year 2021, were $474.26 million (45.72%) above their respective budgeted revenues. Corporate profits reached all-time highs in the second half of 2020 which contributed to a surge in corporate tax revenue.

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, aviation, rail, and ferry system. The primary revenue sources of the Highway Fund are federal funds, 81% of motor fuel taxes, vehicle registration fees, and driver's license fees.

The fund balance of the Highway Fund increased substantially from negative $330.19 million at June 30, 2020 to $692.83 million at June 30, 2021, an increase of 309.83%. The increase in fund balance was mainly due to decreased expenditures during the fiscal year. Cash constraints, due to pandemic revenue decreases within the Highway Fund at June 30, 2020, required a decrease in spending across most activities in the Highway Fund in the current year, including contract maintenance and construction. Construction and maintenance expenditures also decreased in an effort to maintain the cash balance required by general statute, which resulted in a higher cash balance and a lower accounts payable balance. The cash and cash equivalents balance increased by $952.51 million from June 30, 2020 to June 30, 2021. The decrease in liabilities was also due to the Highway Fund's repayment of the advance from the Highway Trust Fund which decreased by $390 million, at June 30, 2021. The decrease in liabilities and increase in cash were offset somewhat by a decrease in restricted investments due to the use of Grant Anticipation Revenue Vehicle (GARVEE) bond funds for expenditures during the year.

Total revenues were $4.22 billion, an increase of 8.59% or $334 million, while total expenditures decreased by 15.95% to $3.28 billion. The increase in total revenue was primarily a result of an increased motor fuel tax revenues of $191.10 million and increased fees, license and fines revenue of $115.43 over the prior fiscal year. The decrease in expenditures was primarily due to the reduction of construction and maintenance activities and other expenses as a result of the cash shortage at June 30, 2020, which resulted in limited expenditures in the current year in order to recover.

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, 2021, $166.05 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).
According to the N.C. Division of Highways, over a 10-year period (2011 to 2020), paved lane miles grew by 2.6%, and vehicle miles traveled increased by 2.1%. From 2019 to 2020, the vehicle miles traveled dropped by 13.5% due to the decrease in travel

because of the COVID pandemic but is expected to rebound and increase as pandemic impacts lessen. From 2019 to 2020, bridge deck area grew by 1.4%. These increases and expected continued increases place 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. Other aging highways, such as the interstate highway system, will also 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, 19% percent of motor fuel 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). In 2017, the enabling legislation was amended to require annual transfers to the State Ports Authority to be used to pay debt service or related financing costs and expenses on revenue bonds or notes issued by the State Ports Authority. Funds appropriated to the State Ports Authority could also be used for capital projects.

The fund balance of the Highway Trust Fund increased 50.35% to $1.84 billion at June 30, 2021. The fund balance increase is attributable to an increase in cash due to fewer expenditures during the year, and an increase in restricted investments due to the issuance of additional Build NC bonds. Pandemic revenue decreases resulted in cash constraints within the Highway Trust Fund at June 30, 2020, which resulted in fewer expenditures in the current year in order to recover. Expenditures were also decreased in an effort to maintain the cash balance required by general statute, which resulted in a higher cash balance and a lower accounts payable balance. The cash balance increased by $663.41 million from June 30, 2020 to June 30, 2021. The Build NC bonds were issued in November 2020 and at June 30, 2020, $177.46 million of the special indebtedness proceeds were unspent compared to $425.33 million at June 30, 2021. The increase in assets and decrease in expenditures was somewhat offset by the decrease in the advance owed to the Highway Trust Fund from the Highway fund which decreased by $390 million, at June 30, 2021.

Total revenues were $1.56 billion, relatively unchanged from the prior year. Motor fuel taxes decreased 30.80% or $172.98 million while highway use taxes increased 18.54% or $155.39 million. The decrease in motor fuel taxes was mostly due to the change in the Motor Fuel Tax Distribution as a result of Session Law 2020-91, as discussed below and under the Highway Fund section. The increase in highway use tax was due to an increase the number of transactions to title a motor vehicle in fiscal year 2021 compared to fiscal year 2020. This was fueled by vehicle purchases and new residents moving into North Carolina who must title a vehicle with North Carolina before registering their vehicle. The Highway Trust Fund reported $1.71 billion in total transportation expenditures, a decrease 12.85% or $252.23 million from the previous year. The decrease in expenditures was largely due to the decrease in capital outlay. This decrease was a result of the low cash balance in fiscal year 2020, which was due to the COVID pandemic and large projected decrease in future revenues that led the department to delay the bid process or put on hold various contractual and maintenance projects in progress across the state.

In November 2020, the State issued $700 million in special indebtedness (limited obligation bonds), as authorized by Session Law 2020-91 and 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 Statewide Transportation Improvement Plan (STIP). As noted above, the unspent proceeds were $425.33 million at June 30, 2021. Legislative language is pending concerning the possible change to the Build NC bond cash ceiling.

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 fuels 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 fuels 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 $3.18 billion at June 30, 2021 compared to $3.02 billion at June 30, 2020. The $154.09 million increase in net position is related to various fluctuations created almost entirely by impacts from the Coronavirus pandemic. Unemployment rates in North Carolina have gradually decreased during fiscal year 2021. As businesses began reopening in June 2020 and into the 2021 fiscal year, unemployment rates were as high as 8.8% in July 2020 but dropped to 4.6% by June 2021.

The Trust Fund's operating margin (operating revenues less operating expenses) decreased by $1.25 billion, a 22.88% decrease from the prior year, predominantly as a result of a $1.6 billion increase in unemployment benefits paid. Increases in benefit payments are directly related to additional federal funds received as nonoperating revenues from the CARES Act and ARPA programs. In addition to the increase in benefit payments, there was also a $353.29 million increase (143.6%) in revenues, which is attributable to employer tax credits provided in the spring of 2020 which reduced employer contribution revenues in the prior year. These tax credits were not available to employers in the 2021 fiscal year.

Contributing to the increase in net position, nonoperating revenues increased by $2.23 billion for the 2020-21 fiscal year due to receiving $6.76 billion in federal funds, including $6.48 billion in COVID-19 funds, a $2.26 billion or 50.13% increase in federal funds received. Investment earnings decreased by $26.49 million from the prior fiscal year due to decreased balances in the Unemployment Trust Fund as well as declines in interest rates. While nonoperating revenues have historically provided significant support for the total yearly benefits, for the 2021 fiscal year the nonoperating revenues sustained the Trust Fund by supporting 93.36% of the total benefits paid for the year.

In addition, there was a $39 million transfer in for the 2021 fiscal year related to the Increased Benefit Assistance (IBA) program, a North Carolina unemployment benefit initiative that increased the calculated weekly benefit amount by $50 each week 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 $936.8 million to the General Fund in 2021 to support educational programs for the State. The amount transferred in 2020 was $729.4 million.

For fiscal year 2020-21, net ticket sales increased 26.16% or $789.12 million from the previous fiscal year to $3.81 billion. With this increase in ticket sales, the NCEL saw a corresponding increase in prize payouts of 25.79% or $504.84 million, and an overall increase in operating income of 27.87% or $203.83 million. Significant financial highlights include the following: awarded $1 million or more to an NCEL player for the 639th time; and released 54 new instant scratch-off games into the marketplace generating gross instant ticket sales of $2.6 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 concession 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.

The NCTA reported a $45.07 million operating loss for fiscal year 2021, a loss increase of $26.41 million or 141.47% from the prior year. Contributing to that loss was a $25.43 or 30.78% decrease in operating revenues, mostly due to a $24.15 million or $36.28% decrease in toll revenues. Toll revenues decreased primarily due to a change in accounting estimate for bad debt expense from the direct write-off method to the allowance method, resulting in an increase in bad debt allowance of $17.65 million from a one-time adjustment in fiscal year 2021 of $17.66 million. The remaining decrease of $6.5 million or 9.56% in toll receipts for the Triangle Expressway is primarily due to a decrease in traffic levels due to the pandemic. Operating revenues consist of toll revenues, fees, and sales revenue from the sale of transponders. Fees, licenses, and fines decreased by $3.16 million to $8.47 million, a 27.2% decrease. Total operating expenses stayed predominantly even with fiscal year end 2020 increasing only by $0.98 million. The $7.91 million decreases in supplies and materials were offset by an increase of $3.84 million in services and $4.75 million in other operating expenses. In addition to the NCTA's operating loss, there was also a $10.03 million increase in nonoperating expenses or 13.89%, predominantly due to a $6.37 million increase in interest and fees related to the 2020 Complete 540 bonds issued.

Funding for administrative expenses continues 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 that 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. The transfers in include the funds received from NCDOT's Highway Fund and Highway Trust Fund during fiscal year 2021 and the Federal Highway Administration State match. While the amounts received from NCDOT's Highway and Highway Trust for gap funding remained unchanged at $49 million, transfers in for project participation decreased by $121.79 million from the Highway Trust Fund and by $13.68 million from the Highway Fund, a total decrease of $135.47 million or 73.07%. The decrease in project participation is due to decreasing expenditures for the Complete 540 and Mid-Currituck Bridge projects and using bond proceeds from bonds issued in fiscal year 2020 instead of using Strategic Transportation Improvement (STI) funds received from the Highway Trust Fund and the Highway Fund. Offsetting the transfers in from DOT's Highway Fund and Highway Trust Fund, NCTA repaid DOT $13.89 million as a transfer out during fiscal year 2021, which represents a $132.36 million or 90.5% decrease from the prior year. In fiscal year 2020, NCTA repaid DOT for project participation with proceeds from the sale of bonds, which was not done in fiscal year 2021. NCTA has shifted to debt financing, and as a result, capital grants awarded based on Federal Highway Administration (FHWA) participation has declined. However, NCTA did receive $21.39 million in federal capital grants during the year, creating a $18.07 million increase from the prior year.

Both NCTA's operating loss and increase in nonoperating expenses contributed to a $69.87 million or 19.83% decrease in net position to $282.53 million at the 2021 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 $312.49 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 $74.48 million due to the continued right of way acquisitions for the project, and construction in progress for the project increased by $147.20 million. Bonds payable increased by $505.30 million with the issuance of the 2020 Triangle Expressway System Senior Lien Turnpike Revenue Bond Anticipation Note and the 2021 Monroe Expressway System State Appropriation Revenue Refunding Bonds. Corresponding to the debt issued during the year, interest payable increased by $23.56 million.

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 3.57% or $69.42 million to $2.01 billion in fiscal year 2021. 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 $131.31 million, a decrease of $15.9 million or 10.8%, and the amount of principal received on existing loans during the year was $257.76 million, a $151.19 million or 141.86% increase. As a result, notes receivable decreased by $126.45 million. The small reduction in loans being issued during fiscal year 2021 is not unusual for a year-over-year fluctuation. Funds are managed with a long-term focus, typically with more loans issued over time. But in any given year, there may be a slight decrease from the previous year. With interest rates being low during the 2021 fiscal year, more communities chose to pay off their existing loans, resulting in an increase in principal payments received during fiscal year 2021.

Operating income (operating revenues less operating expenses) was $ 6.82 million, a decrease of $3.71 million or 35.24% from the prior year. The decrease in operating income was due predominantly to a $3.57 million decrease in operating revenues from a $4.38 million or 25.62% decrease in interest earnings on loans. Operating expenses did not change significantly from the prior year and were $9.14 million for fiscal year 2021, which represents a $0.15 million or 1.62% increase.

Net nonoperating revenues were $50.18 million, a decrease of $24.01 million or 32.36%. 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 were $57.25 million, a $5.97 million or 11.64% increase from the prior year. Investment earnings were $1.14 million, a decrease of $26.56 million or 95.87%. In addition to declining interest rates, investment earnings decreased from the prior year due to the Loan Fund reporting an unrealized gain of $14.01 million in fiscal year 2020 and reporting a combination of realized and unrealized losses of $7.53 million in 2021. Payments for grants, aid and subsidies increased by $3.76 million or 82.82%. In addition, the EPA Revolving Loan Fund received $12.56 million in transfers for appropriated state match funds for Clean Water and Drinking Water projects, a $17.54 million or 58.27% decrease from the prior year. The decrease in transfers for fiscal year 2021 is due to the Loan Fund receiving one-time Additional Supplemental Appropriations for Disaster Recovery Act (ASADRA) funds in fiscal year 2020, which required an additional 20% State match, which was not available for fiscal year 2021.

CAPITAL ASSET AND DEBT ADMINISTRATION

CAPITAL ASSETS

As of June 30, 2021, the State's investment in capital assets was $62.06 billion, an increase of 3.77% from the previous fiscal year-end (see table below).

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

	Governmental Activities		Business-type Activities		Total	
	2021	2020 (as restated)	2021	2020	2021	2020 (as restated)
Land and permanent easements	$20,643,403	$20,083,620	$ 549,128	$ 474,653	$21,192,531	$20,558,273
Buildings	2,856,993	2,865,861	54,113	56,441	2,911,106	2,922,302
Machinery and equipment	799,418	836,165	8,658	8,938	808,076	845,103
Infrastructure:						
State highway system	31,103,285	29,266,797	—	—	31,103,285	29,266,797
NC toll road system	—	—	1,358,637	1,388,319	1,358,637	1,388,319
General infrastructure	233,081	234,493	6,584	6,596	239,665	241,089
Computer software	288,560	274,513	644	831	289,204	275,344
Art, literature, and other artifacts	147,441	147,082	1,290	1,286	148,731	148,368
Construction in progress	2,755,714	3,138,670	460,856	307,561	3,216,570	3,446,231
Computer software in development	791,903	712,600	—	—	791,903	712,600
Total	$59,619,798	$57,559,801	$2,439,910	$2,244,625	$62,059,708	$59,804,426
Total percent change between fiscal years 2020 and 2021	**3.58 %**		**8.7 %**		**3.77 %**	

The largest component of capital assets is the state highway system. North Carolina has an 80,242 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 $2.27 billion for state highway projects. Additionally, the NCTA (business-type activity) reported year-end construction in progress of $364.8 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 $37.3 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 $89.31 million.
- The Department of Military and Veterans Affairs is constructing a skilled nursing care facility with 120 private rooms for state veterans in Kernersville, North Carolina. The project is expected to cost in excess of $50 million and is a cooperative effort between the State of North Carolina and the U.S. Department of Veterans Affairs which provided over $27 million in grant funds. The facility is scheduled to be completed in February 2022. At year-end, construction in progress for the Kernersville Veterans Home totaled $40.46 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 $723.5 million.

As further detailed in Note 21E to the financial statements, the State has commitments of $4.703 billion for the construction of highway infrastructure ($4.384 billion for governmental activities and $319 million for business-type activities), which are expected to be financed by motor fuels tax collections, motor vehicle fees, toll collections, federal funds, and debt proceeds. Other commitments of $137.21 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 $8.39 billion, an increase of 12.21% 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	
	2021	2020	2021	2020	2021	2020
General obligation bonds	$ 2,648,385	$ 2,605,380	$ —	$ —	$ 2,648,385	$ 2,605,380
Special Indebtedness:						
Limited obligation bonds	2,275,750	1,774,945	—	—	2,275,750	1,774,945
GARVEE bonds	875,865	959,525	—	—	875,865	959,525
Revenue bonds	—	—	2,365,938	1,917,358	2,365,938	1,917,358
Notes from direct borrowings	40,185	43,937	185,991	177,925	226,176	221,862
Total	$ 5,840,185	$ 5,383,787	$ 2,551,929	$ 2,095,283	$ 8,392,114	$ 7,479,070
Total percent change between fiscal years 2020 and 2021	**8.48 %**		**21.79 %**		**12.21 %**	

During the 2021 fiscal year, the State issued $400 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. The Highway Trust Fund issued $700 million Build NC special indebtedness limited obligation bonds as part of the $3 billion transportation package approved by the General Assembly. The bond proceeds will be used to finance regional and divisional transportation projects contained in the Statewide Transportation Improvement Plan (STIP). Additionally, the NCTA, a business-type activity, issued $573.45 million in revenue bonds that will be used to finance the Complete 540 project and the Mid-Currituck Bridge project.

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 $5.84 billion in 2021, 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 $2.55 billion in 2021.

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). The 2021 Session of the General Assembly (S. L. 2021-180) repealed the remaining authorization of the Connect NC general obligation bonds that had not been issued as of June 30, 2021 and replaces it with pay-as-you-go capital for the remainder of the $2 billion total authorization.

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

Rating Agency	Rating	Outlook
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 2020-21 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 debt 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 2021 Regular Session, the General Assembly enacted Senate Bill 105, establishing Session Law 2021-180. The General Assembly appropriated $25.92 billion in the General Fund for fiscal year 2021-22. The budget provided salary increases and bonuses for state employees and cost of living supplements for retirees, including a 2.5% salary increase in each year of the biennium for most state employees, new pay plans for Correctional Officers and Law Enforcement Officers, and pandemic bonuses. The budget also included $3.13 billion in fiscal year 2021-22 and $1.51 billion in fiscal year 2022-23 for capital projects, repairs and renovations, and projects funded through the State Capital Infrastructure Fund (SCIF).

Session Law 2021-180 contains several tax changes that will reduce General Fund tax revenues by $1.33 billion in fiscal year 2021-22 and $1.99 billion in fiscal year 2022-23. The tax reductions with the largest fiscal impact during the biennium include:

- Reducing the individual income tax rate from 5.25% to 4.99% in fiscal year 2022 and 4.75% in fiscal year 2023;
- Increasing the standard deduction by nearly 20% (to $25,500 for married couples);
- Increasing the child deduction by $500 and expanding eligibility to incomes up to $140,000;
- Exempting military pension income from taxation;
- Allowing business deductions for expenses paid using proceeds from federal pandemic relief programs; and
- Eliminating the real and tangible property tax bases in the franchise tax.

The budget also includes further tax reductions beyond the biennium, including phasing down the individual income tax rate to 3.99% over six years and phasing out the corporate income tax over five years starting in fiscal year 2025.

Session Law 2021-180 and Session Law 2021-25 also appropriated over $7.8 billion in federal grants authorized under the American Rescue Plan Act (ARPA) funds as well as $5.4 billion in ARPA State Fiscal Recovery Funds (SFRF) and $277 million in ARPA Coronavirus Capital Project Funds (CCPF). Among many other items, SFRF and CCPF funds support state employee bonuses, the expansion of high-speed internet, water and sewer investments, and small business recovery grants.

State Health Plan

In calendar year 2022, 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). For Medicare retirees, The State Health Plan (SHP) will continue to offer two fully insured Medicare Advantage products with integrated prescription drug plans and a self-insured 70/30 PPO Plan.

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, 2022. This decision was made given the expectation that employer premiums would return to funding levels before legislation passed in June 2020.

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.