State of North Carolina

Debt Affordability Study

February 1, 2025

Debt Affordability Advisory Committee

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STATE OF NORTH CAROLINA
DEBT AFFORDABILITY ADVISORY COMMITTEE

February 1, 2025

To: Governor Josh Stein
Senator Phil Berger, President Pro Tempore of the North Carolina Senate
Representative Destin Hall, Speaker of the North Carolina House of Representatives
Fiscal Research Division

Attached is the February 1, 2025 report of the Debt Affordability Advisory Committee submitted pursuant to North Carolina General Statute 142-101. The report was created to serve as a tool for sound debt management practices by the State of North Carolina.

The report provides the Governor and the General Assembly with a basis for assessing the impact of future debt issuance on the State's fiscal position and enables informed decision-making regarding both financing proposals and capital spending priorities. A secondary purpose of the report is to provide a methodology for measuring, monitoring and managing the State's debt levels, thereby protecting North Carolina's bond ratings of AAA/Aaa/AAA (as rated by S&P, Moody's, and Fitch, respectively). The methodology used by the Committee to analyze the State's debt position (1) incorporates trends in debt levels and peer group comparisons and (2) provides recommendations within adopted guidelines. The analysis includes the projected issuance of all authorized but unissued debt.

The Committee is reiterating its recommendation that the State recognize the magnitude of its unfunded pension and other post-employment benefit ("OPEB") obligations that cover retiree healthcare costs and to continue to address these liabilities with a continuing annual appropriation of $100 million to the Unfunded Liability Solvency Reserve ("Solvency Fund") created by S.L. 2018-30. The Committee likewise is recommending continuing the single target calculation utilizing the limitation that debt service and the continuing annual appropriation to the Solvency Fund not exceed 4% of revenues.

I believe that these recommendations continue to address our unfunded liabilities and represent action to preserve and protect the State's triple triple-A rating.

Respectfully submitted,

Bradford B. Briner
State Treasurer of North Carolina
Chair, Debt Affordability Advisory Committee

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Debt Affordability Advisory Committee Membership

Mr. Bradford B. Briner, State Treasurer, Chair

Mr. McKinley Wooten, Jr., Secretary of Revenue

Ms. Kristin Walker, State Budget Director

Mr. Dave Boliek, State Auditor

Mr. Nels Roseland, State Controller

Mr. Frank H. Aikmus, Senate Appointee

Mr. Eugene W. "Gene" Chianelli, Jr., House Appointee

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SUMMARY

Background and Context

A study of debt affordability is an essential management tool that provides a comprehensive assessment of a government's ability to issue debt for its capital needs. S&P Global Ratings ("S&P"), one of the three major bond rating agencies, has stated that *"Most of the 'AAA' states have a clearly articulated debt management policy. Evaluating the impact of new or authorized but unissued bond programs on future operating budgets as well as unfunded liabilities are an important element of debt management and assessing debt affordability."* Control of debt burden is one of the key factors used by rating agencies' analysts in assessing credit quality. Other factors include economic vitality and diversity, fiscal performance and flexibility, administrative capabilities of government and environmental risk factors.

The Debt Affordability Advisory Committee (the "Committee" or "DAAC") is required to annually advise the Governor and the General Assembly of the estimated debt capacity of the General, Highway and Highway Trust Funds for the upcoming ten fiscal years. The legislation also directs the Committee to recommend other debt management policies it considers desirable and consistent with the sound management of the State's debt. The Committee hereby presents its study (the "Study") for 2025.

Debt Controls and Ratings

Debt capacity is a limited and scarce resource. The Study enables the State to structure its future debt issuances within existing and future resource constraints by providing a comparison of its current debt position to relevant industry and peer group standards. The Study can thus be used to further develop and implement the State's capital budget and is premised on the concept that resources, not only needs, should guide the State's debt issuance program. The Committee's adopted guidelines attempt to strike a balance between providing sufficient debt capacity to allow for the funding of essential capital projects and imposing sufficient discipline, so that the State does not create a situation that results in loss of future budgetary flexibility and a deteriorating credit position.

The State's ratings were affirmed in 2024 at AAA (S&P), Aaa (Moody's), and AAA (Fitch). The State's debt ratios remain at or below the median levels for the State's peer group comprised of all fifteen states currently rated "triple-A" by all three rating agencies. North Carolina's debt is considered manageable at current levels.

The Committee has adopted debt service as a percentage of revenues as the controlling metric that determines the State's debt capacity. Over the ten-year planning horizon, the State's DAAC general fund revenue projections show a positive growth trend not excessively impacted from earlier declines in economic activity or recent increases in interest rates. Debt service projections incorporate the future issuance of $1.7 billion Build NC Bonds (Refer to "Debt Structuring Assumption on page 35).

The General Fund model results indicate the State's General Fund has debt capacity of approximately $1.76 billion in each of the next 10 years (or up to approximately $9.96 billion in the first year) after incorporating the Committee's recommended policy that directs continuing annual appropriations of $100 million to the Unfunded Liability Solvency Reserve (the "Solvency Fund") to address the State's unfunded Pension and OPEB liabilities. S.L. 2021-180, s. 2.2.(a) has allocated $40 million to the Solvency Fund for FY 2022 and $10 million for FY 2023. The actual ratio of general fund supported debt service to revenues is projected to peak at 1.40% this fiscal year.

Table 1

General Fund
Debt Capacity using 4.0% debt service/revenues target ratio
$100 million per year to be used to address unfunded liabilities
(In millions of dollars)

Fiscal Year	2025	2026	2027	2028	2029
$ to Unfunded Liabilities	$100.0	$100.0	$100.0	$100.0	$100.0
Total Additional Debt Capacity per Year *	$9,963.7	$168.4	$239.9	$775.3	$943.3
Debt Capacity Available each and every Year	$1,766.0	$1,766.0	$1,766.0	$1,766.0	$1,766.0

* In addition to that already authorized but unissued. Assumes additional debt capacity is authorized and issued in stated fiscal year.

The Transportation model results indicate transportation debt capacity of approximately $127.5 million in each of the next 10 years or approximately $765.0 million in the first year. (See Section II – Transportation Debt Affordability – page 21); project funding is not projected to be significantly curtailed). Absent any future authorizations, Transportation debt service as a percentage of Transportation revenues peaks at 5.05% in FY 2031.

Table 2

Transportation
Net Tax-Supported Debt Capacity using 6.0% debt service/revenues target ratio
(In millions of dollars)

Fiscal Year	2025	2026	2027	2028	2029
Total Additional Debt Capacity per Year *	$765.0	$0.0	$0.0	$0.0	$0.0
Debt Capacity Available Each and Every Year	$127.5	$127.5	$127.5	$127.5	$127.5

* In addition to that already authorized but unissued. Assumes additional debt capacity is authorized and issued in stated fiscal year.
GAP Funding for North Carolina Turnpike Authority projects assumed to total $49 million annually.

On a combined basis, the General Fund and Transportation Funds' debt service is projected to peak at approximately 1.63% of combined revenues in FY 2025.

Table 3

General Fund and Transportation Funds
Combined Debt Service / Revenue Percentages

Fiscal Year	2025	2026	2027	2028	2029
General Fund	1.40%	1.14%	1.05%	0.94%	0.81%
Transportation *	2.97%	3.43%	3.86%	4.23%	4.51%
Combined	1.63%	1.48%	1.47%	1.45%	1.38%

Note: Percentages are based on forecasted revenues and debt service.

* GAP Funding for North Carolina Turnpike Authority projects assumed to total $49 million annually.

Refunding & Early Redemption Opportunities
Over the past ten fiscal years, the State has refunded approximately $1.9 billion of outstanding debt, achieving budgetary savings of over $209 million. Refunding opportunities are monitored throughout the year.

The State Treasurer, acting under the authority granted by S.L. 2023-134, Section 40.1.(j)(ii), directed the purchase of the $20 million par State of North Carolina Public Improvement ("Connect NC") General Obligation Bonds, Series 2020A, (full 2040 maturity) for $14.4M representing 71.9% of par. The Treasurer declared the bond CUSIP cancelled in February 2024.

Interest Rate Levels
Interest rates have continued to be moderate by historical standards but rose sharply in calendar 2022 and 2023 and remained higher in 2024 mostly due to the US Federal Reserve's campaign to reduce the rate of inflation. The 10-year benchmark Treasury closed at 4.58% on December 31, 2024. This is above the long-term average of 4.25%. Without unanticipated shocks to the economy or other negative factors, most economists see interest rates possibly declining later in the year. Major changes to interest rates that would significantly affect the State's capacity calculations still remain unlikely.

Other Recommendations
(See Appendix A for further discussion)

- **Unfunded Pension and Other Post-Employment Benefits ("OPEB") Obligations**
  The State currently has unfunded Pension and OPEB obligations totaling $48.8 billion. The Committee recommends that the General Assembly continue to adopt policies to address these liabilities, including a continuing appropriation to the Solvency Fund. See General Fund Analysis-Other beginning on page 16 and Appendix A.

- **Control of Debt Authorization Authority and Management**
  In the Committee's view, the prioritization of capital projects and the issuance of obligations or entering into financial arrangements that create debt or debt-like obligations that increase

the State's debt burden should remain the prerogative of the General Assembly. Centralized debt authorization, issuance, and management are considered one of North Carolina's credit strengths. Sponsoring agencies whose mission is to provide a particular service or assets are not in the best position to make decisions that prioritize the use of the State's debt capacity.

- **State-Aid Intercept**
  The Committee strongly opposes proposals utilizing a back-up pledge of State appropriations to provide support for debt issued by other entities.

- **Structural Budget Balance and Continued Replenishment of Reserves Should Continue to be a Priority**
  These are key ratings drivers contributing to the State's "AAA" rating.

- **Consider General Obligation Bonds as the Preferred Financing Vehicle**
  The Committee recommends that the State consider General Obligation ("GO") Bonds generally approved by voters as the preferred, but not exclusive, financing vehicle to provide funding for the State's capital projects.

SECTION I: GENERAL FUND DEBT AFFORDABILITY

Review of General Fund Debt

Outstanding Debt

The State issues two kinds of tax-supported debt: General Obligation ("GO") Bonds and various kinds of "Special Indebtedness," which are also known as non-GO debt or appropriation-supported debt. GO Bonds are secured by the full faith, credit and taxing power of the State. The payments on all other kinds of long-term debt, including Limited Obligation Bonds, Certificates of Participation ("COPs"), lease-purchase revenue bonds and other debt-like obligations are subject to appropriation by the General Assembly. Appropriation-supported debt may sometimes also be secured by a lien on facilities or equipment.

Debt that is determined to be self-supporting or supported by non-General Fund tax revenues does not constitute net tax-supported debt but is included in the definition of "gross" tax-supported debt used by some rating analysts.

The State's outstanding debt positions as of June 30, 2024 is detailed below.

Chart 1

State of North Carolina Outstanding Net Tax-Supported Debt

The State's total outstanding debt at June 30, 2024 totaled approximately $7.36 billion of which $4.2 billion was tax-supported.

Tax-Supported	Amounts ($ millions)
☐ General Obligation Debt	$1,645.1
○ General Fund ($1,645.1)	
○ Highway Fund ($0)	
☐ Special Indebtedness	$1,887.8
○ General Fund ($831.0)	
○ Highway Fund ($1,056.8)	
☐ NCTA Gap-Funded Appropriation Bonds	$656.5
☐ Other Debt-like Obligations (1)	$7.8
Total General Fund Tax-Supported Debt	$2,483.9
Total Highway Tax-Supported Debt	$1,713.3
Total Tax-Supported Debt	$4,197.2
Non Tax-Supported	
☐ GARVEEs	$845.7
☐ NC Turnpike Authority (includes TIFIA)	$2,185.2
☐ Guaranteed Energy Savings Contracts (2)	$133.1
Total Debt	$7,361.2

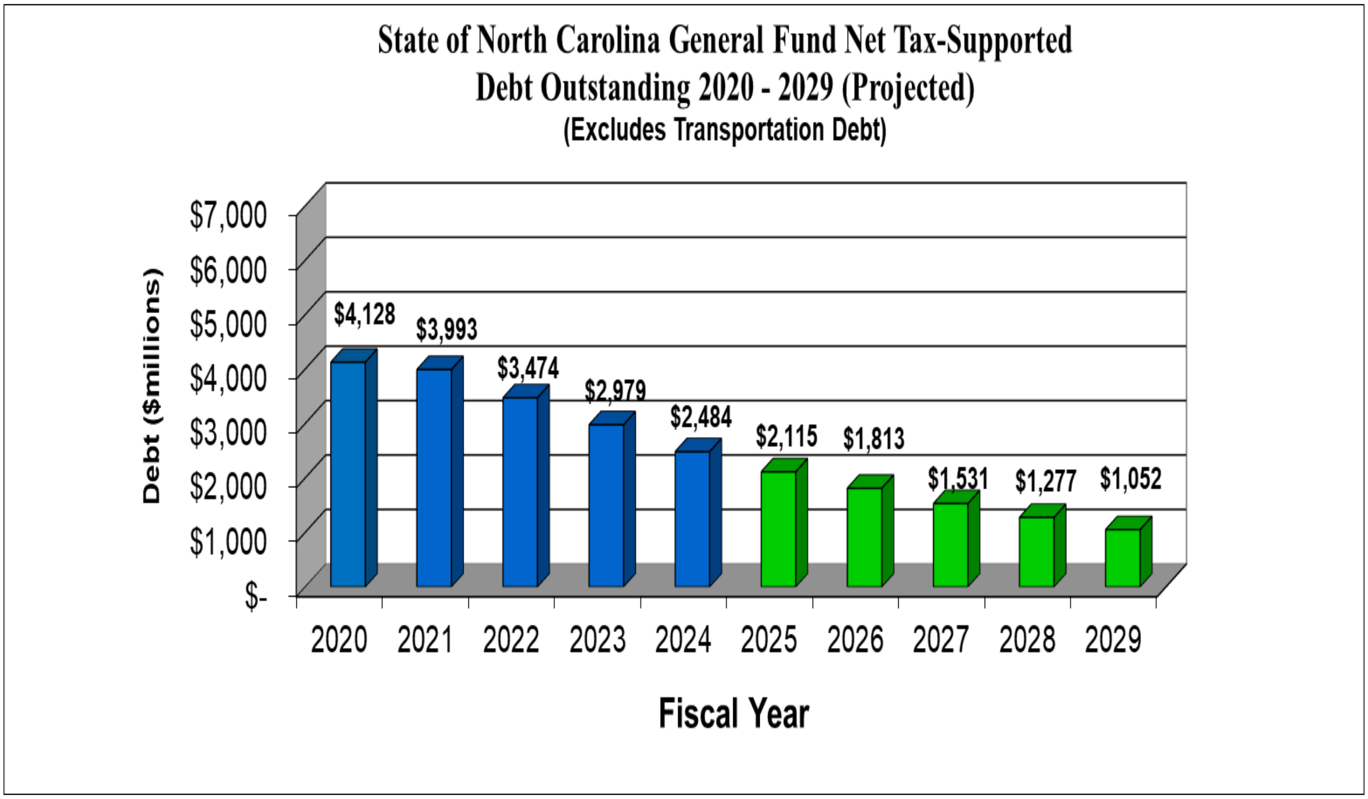
(1) Installment Purchases etc.

(2) Total GESCs entered into through June 30, 2024 was $310 million.

Trends in Amounts of General Fund Debt

The State's outstanding net tax-supported general fund debt was approximately $2.5 billion on June 30, 2024. The amount of outstanding debt is projected to begin to decline over the next several years. Chart 2 below illustrates the outstanding amounts of General Fund net tax-supported debt over the last five years and projects the amount outstanding through FY 2029. Absent additional authorizations, the absolute level of General Fund tax-supported debt is not projected to exceed approximately $2.1 billion over the projection period and will decline by approximately 85% over the next 10 years.

Chart 2

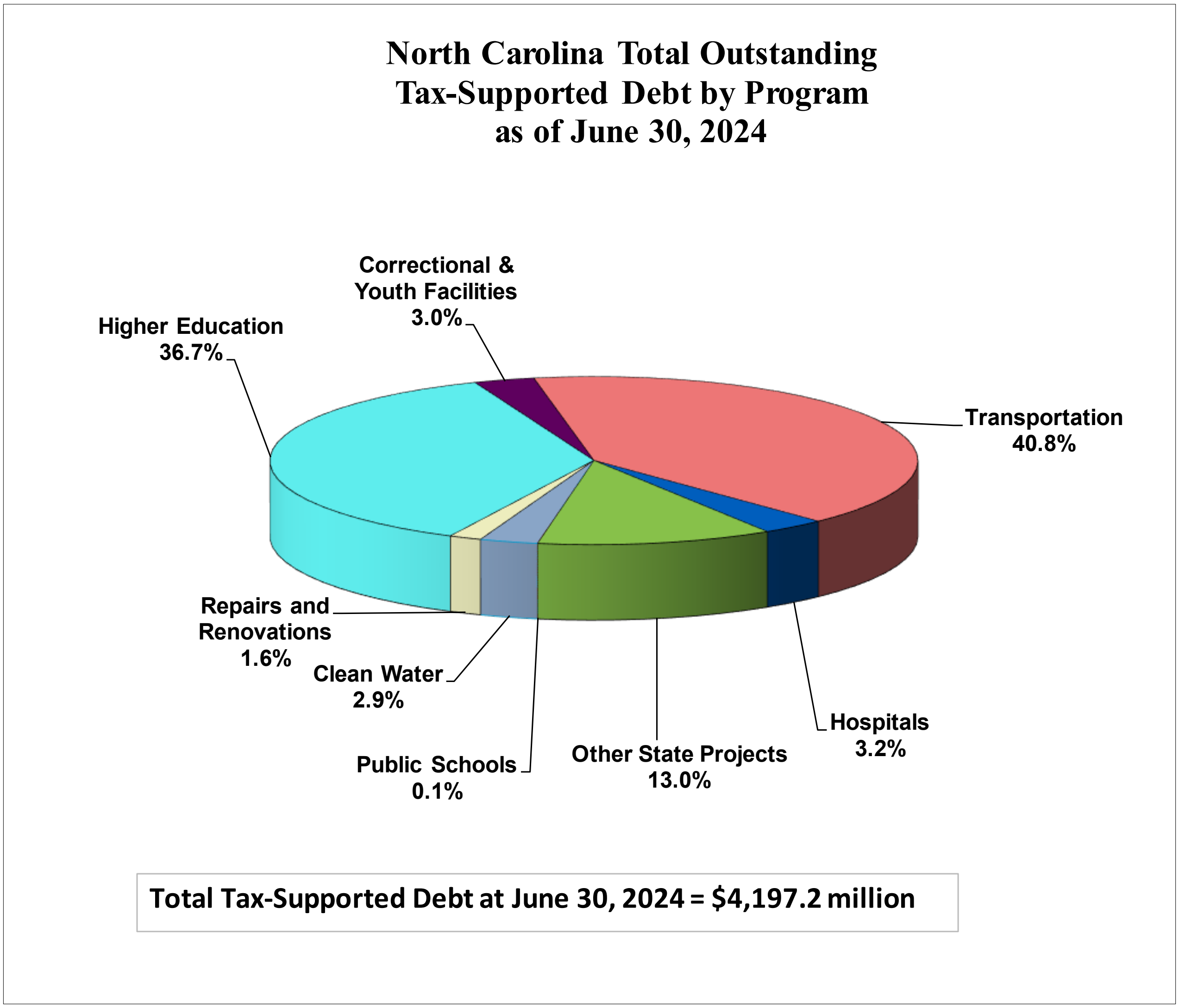


The State issues debt on a cash flow basis and bond issues are timed to provide funds as needed, typically creating a lag between when debt is authorized and when it is actually issued. As of December 31, 2024, the State did not have any General Fund authorized but unissued tax-supported debt.

Uses of Total Outstanding Tax-Supported Debt

The following chart illustrates the uses for which the State has issued tax-supported debt (General Fund and Transportation) based on the amounts outstanding on June 30, 2024. The State has used the proceeds of its debt programs for many purposes with the two largest being to provide facilities and infrastructure for higher education (36.7%) and transportation (40.8%).

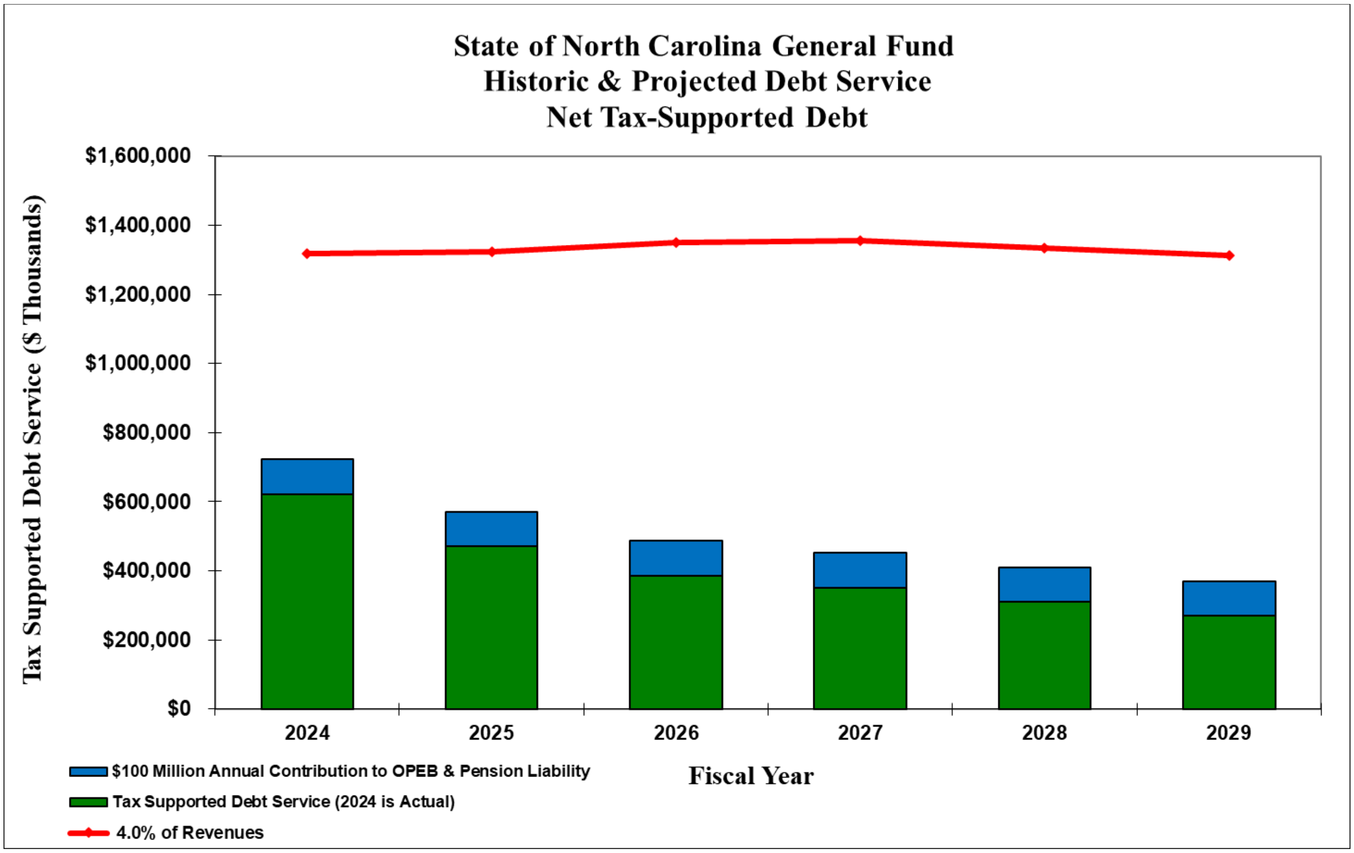
Chart 3



Debt Service

General Fund debt service as a percentage of revenues is projected to peak FY 2024 at 1.4%. The absolute amount of annual debt service peaks at approximately $471.4 million in FY 2025. As illustrated in the chart below, after providing $100 million annually for Pension and OPEB liabilities, there is available capacity to issue additional debt while remaining within the 4.00% target. The model calculates the additional debt that could be serviced by this capacity.

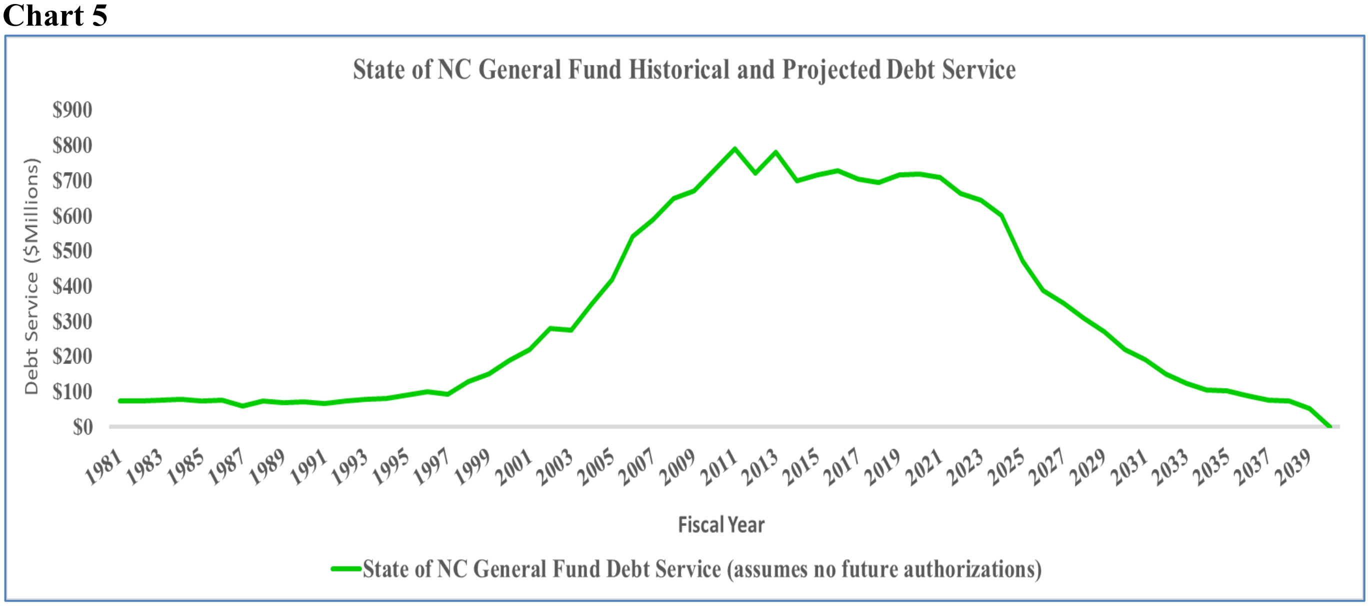
Chart 4



General Fund Historical and Projected Debt Service

As illustrated in Chart 5 below, debt service on general fund tax-supported debt (assuming no future authorizations) will continue to decline and terminate by the end of fiscal year 2039.

Chart 5



General Obligation Bonds versus Special Indebtedness

GO indebtedness is usually considered to be the highest quality of all the various types of debt or debt-like instruments and usually carries the highest credit rating because the full faith and credit of the State is pledged to its repayment. Several factors contribute to the high rating, including the legal protections inherent in constitutionally permitted debt, investor confidence in the pledge of the full faith and credit of the State, and the presumption of the availability of the government's full resources. GO bonds are generally the most transparent of the various types of State debt obligations and typically carry the lowest interest cost. Fiscal Research Division estimates that the costs of holding a GO bond referendum to be extremely modest and does not add substantially to the cost of the projects being financed.

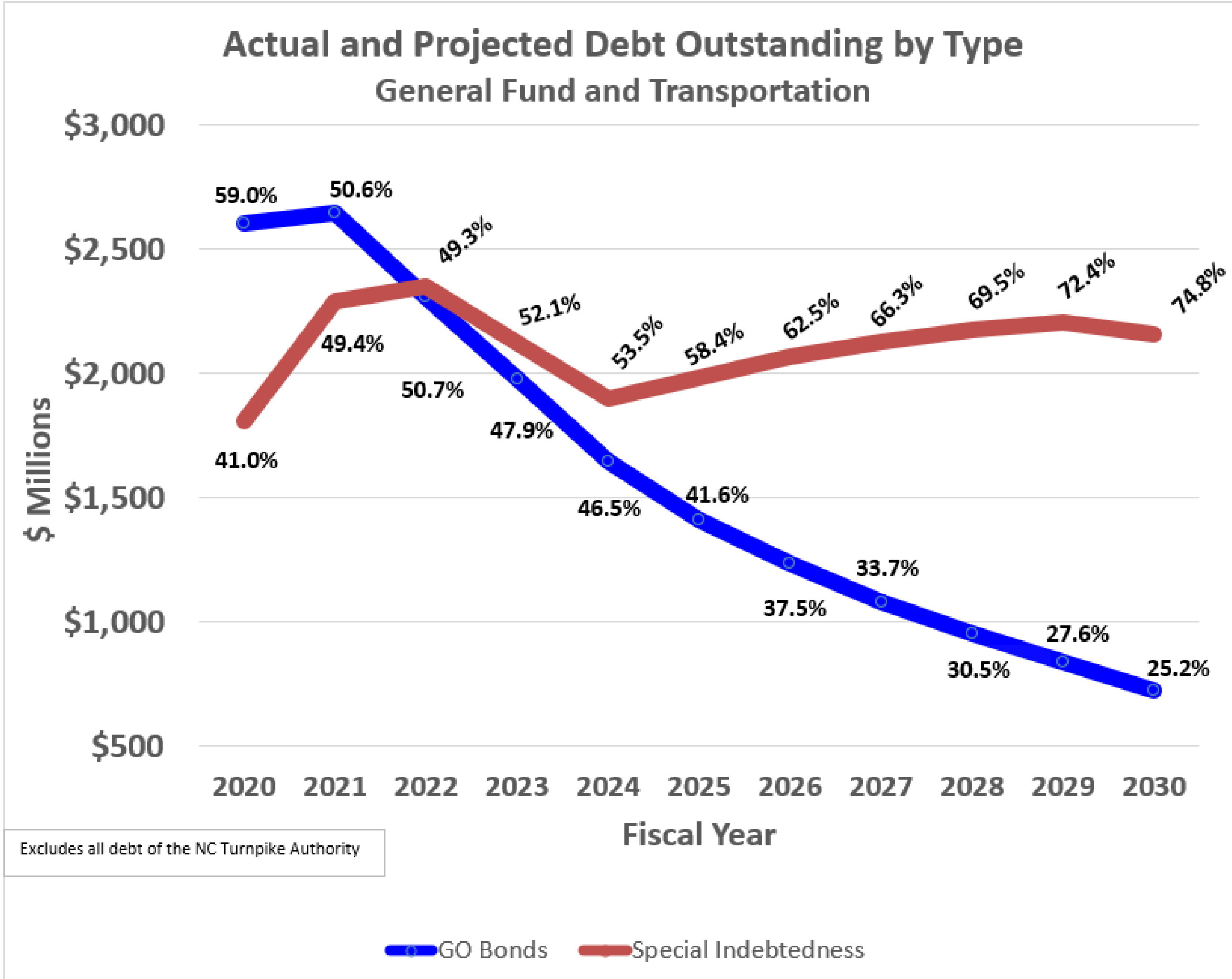
Special Indebtedness as defined in G.S. 142-82 ("SI"), is a commonly used financing vehicle employed by most states and localities. Such obligations are paid from annual appropriated amounts for debt service. Depending upon market conditions, additional credit support and structure, the financial markets usually assess an interest rate penalty of 5-25 basis points for the State's appropriation-supported debt when compared with the State's GO bonds. Using the more conservative penalty, this translates into approximately $3.4 million of additional interest over the life of a typical $100 million General Fund-supported debt issue.

The rating agencies note that most states have incorporated alternative financing methods, including lease-revenue, appropriation-supported or special-tax debt into their liability profile. Projecting both the payoff of existing debt (most GO) and the issuance of the Build NC Bonds (SI), Special Indebtedness debt now represents approximately 53% of the State's debt portfolio.

The State is currently limited in the amount of Special Indebtedness supported by the General Fund it may issue by the provisions of S.L. 2013-78 that limits the amount of Special Indebtedness that may be authorized to 25% of the total general fund-supported debt authorized after January 1, 2013. Currently the State has the ability to authorize approximately $577 million of additional Special Indebtedness under these limits. There is no analogous provision relating to SI supported by Transportation funds.

The amount of the State's historic and projected outstanding appropriation-supported debt is shown below in Chart 6, with the percentage of appropriation-supported debt to total debt (including Transportation debt) noted.

Chart 6



Two-Thirds Bonds
North Carolina's Constitution permits the State to issue GO bonds without a referendum, to the extent of two-thirds of the amount of GO bonds that have been paid down over the previous biennium. The State has $448.3 million of Two-Thirds GO bond capacity. Two-Thirds capacity is a subset of total capacity.

Review of State Credit Ratings and Comparative Ratios

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.

Chart 7

North Carolina Credit Rating Matrix

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

The State's general obligation bonds are rated AAA with a "stable" outlook by Fitch, AAA with a "stable" outlook by S&P and Aaa with a "stable" outlook by Moody's Investors Service. These ratings are the highest ratings attainable from all three rating agencies.

North Carolina has enjoyed a long history of AAA ratings on the State's general obligation bonds and is currently well positioned to weather future economic downturns. The Rating Agencies, in 2024 rating reports, have identified the following factors that could lead to a downgrade or downward rating pressure:

- Tax cuts leading to operating deficits that pull available fund balance below 15% on a sustained basis.
- Economic slowdown causing material fiscal strain.
- Significant difficulty passing budgets or other fiscal governance weakening.
- The State experiences misalignment of revenue with expenditure growth.

Comparison of Debt Ratios to Selected Medians

A comparison to peer group medians illustrates how North Carolina ranks in tax-supported debt metrics among its peer group. As the analyses published by rating agencies combine General Fund and Transportation tax-supported debt, the data presented is comprehensive and comparable.

Chart 8 below compares North Carolina to its other fifteen peer group states rated "triple-A" by all three credit rating agencies (often termed "triple triple-A" or "AAA"). Our peer group states are of a diverse nature, but all demonstrate adherence to certain underlying core values including prudent use (in some cases, extremely modest use) of debt. As shown in Chart 8, the State's debt ratios are at or below the median levels for its peer group.

Chart 8

North Carolina Net Tax-Supported Comparative Debt Ratios [1]

State	Ratings (Fitch/S&P/Moody's)	Debt to Personal Income % [1]	Debt per Capita [1]	Debt as % Of GDP [1]	Debt Service Ratio [2]
Tennessee	AAA/AAA/Aaa	0.4%	271	0.40%	1.40%
Indiana	AAA/AAA/Aaa [3]	0.6%	366	0.50%	0.70%
Iowa	AAA/AAA/Aaa [3]	0.6%	408	0.50%	0.30%
Missouri	AAA/AAA/Aaa	0.6%	397	0.60%	2.50%
South Dakota	AAA/AAA/Aaa [3]	0.8%	560	0.70%	1.60%
Texas	AAA/AAA/Aaa	1.0%	654	0.80%	1.30%
North Carolina	AAA/AAA/Aaa	1.0%	635	0.90%	2.00%
Florida	AAA/AAA/Aaa	1.0%	711	1.00%	3.20%
Utah	AAA/AAA/Aaa	1.1%	693	0.80%	4.00%
Georgia	AAA/AAA/Aaa	1.8%	1,100	1.50%	5.10%
Minnesota	AAA/AAA/Aaa [5]	2.1%	1,542	1.80%	4.60%
Ohio	AAA/AAA/Aaa [5]	2.5%	1,558	2.10%	4.10%
Virginia	AAA/AAA/Aaa	2.8%	2,035	2.50%	4.20%
Maryland	AAA/AAA/Aaa	3.9%	2,952	3.50%	5.80%
Delaware	AAA/AAA/Aaa	6.8%	4,526	4.80%	5.40%
	Peer Group Median	1.0%	$693	0.90%	3.20%

Projected General Fund (GF) Tax-Supported Debt Ratios [4]

North Carolina	Debt to Personal Income %	Debt per Capita	GF Tax-Supported Debt Service as a % of DAAC Revenues
2024 (Actual)	0.4%	$227	1.82%
2025	0.3%	190	1.40%
2026	0.2%	160	1.14%
2027	0.2%	134	1.05%

(1) Source: Moody's Investor Services report dated October 7, 2024.
(2) Source: S&P report dated October 23, 2024, defined as debt service as a % of general fund spending.
(3) Implied by all three rating agencies. Have not issued GO debt.
(4) North Carolina projections are based on February 1, 2025 DAAC Report. All other data reported 1 year in arears.
(5) Minnesota and Ohio were recently upgraded.

General Fund Guidelines, Debt Affordability Model and Results

General Fund Debt Capacity Recommendations

The Committee has adopted targets and outside guidelines to analyze and/or serve as the basis for calculating the recommended amount of General Fund–supported debt that the State could prudently authorize and issue over the next 10 years. Each measure is discussed in more detail below.

1. Net Tax-Supported Debt Service after a continuing appropriation of $100 million to the Solvency Fund as a percentage of General Tax Revenues should be targeted at no more than 4.00% and not exceed 4.75%;
2. Net Tax-Supported Debt as a percentage of Personal Income should be targeted at no more than 2.5% and not exceed 3.0%; and
3. The amount of debt to be retired over the next ten years should be targeted at no less than 55% and not decline below 50%.

Net Tax-Supported Debt Service as a Percentage of General Tax Revenues (4.0% Target, 4.75% Ceiling)

The Committee has adopted the measure of annual debt service arising from net tax-supported debt as a percentage of general tax revenues as the basis to evaluate the State's existing and projected debt burden for the General Fund and as the basis for calculating how much additional debt the State can prudently incur. The Committee believes that by measuring what portion of the State's resources is committed to debt-related fixed costs, the target ratio is a measure of the State's budgetary flexibility and its ability to respond to economic downturns.

Because there is often a time lag, sometimes of multiple years, between when debt is authorized and issued, the Committee determined that an optimized solution, whereby a fixed amount of debt could be authorized and issued each and every year over the model horizon, provides a more useful management tool. This solution facilitates capital planning more effectively than a measure that assumes that all available debt capacity is utilized in the year in which it is available. It provides decision makers with an estimate of how much debt could be issued annually (over the full 10 years) without exceeding the limits even if the amounts authorized at any one time are much larger. In practice, the limit imposed by the year(s) of the least capacity over the model horizon drives the calculation process.

Model Solution

Illustrated below is the actual amount of new tax-supported debt that could be authorized and issued, by year, using the 4% debt service to revenue target and providing $100 million to the Solvency Fund annually.

Table 4

General Fund

Debt Capacity using 4.0% debt service/revenues target ratio

$100 million per year to be used to address unfunded liabilities

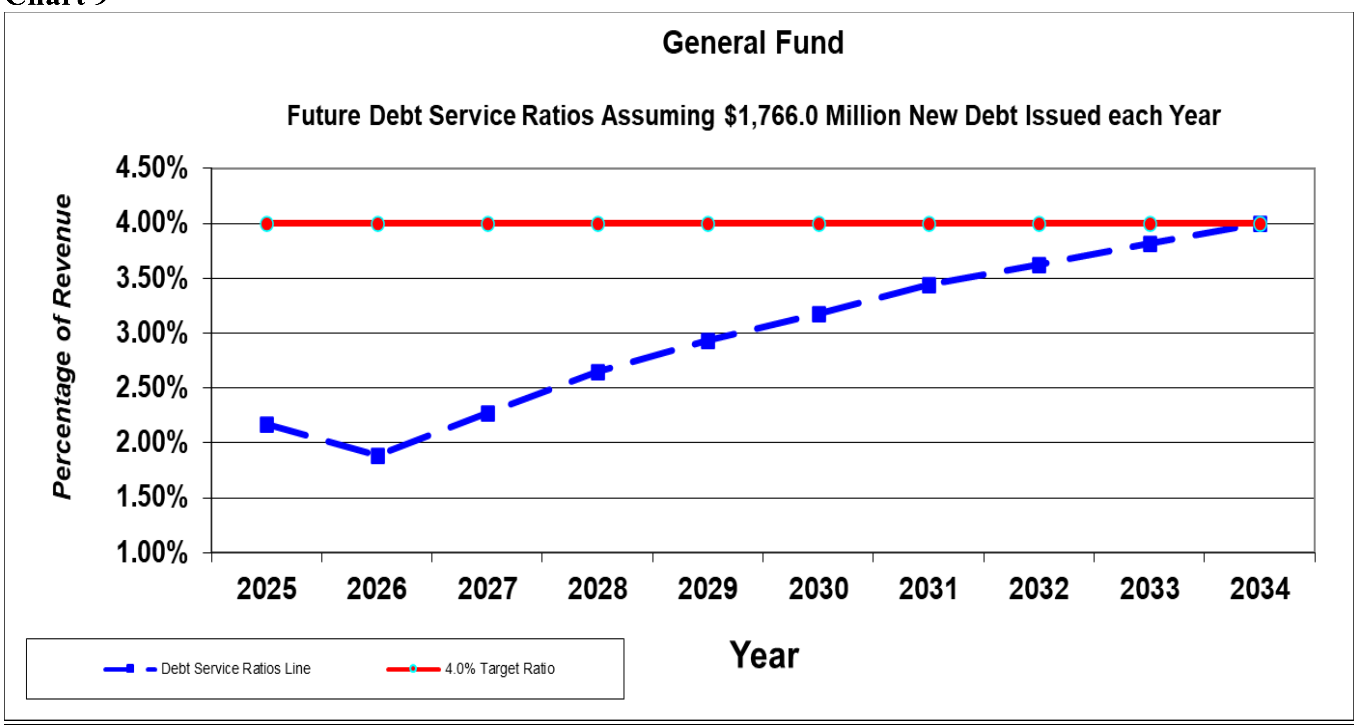
(In millions of dollars)

Fiscal Year	2025	2026	2027	2028	2029
$ to Unfunded Liabilities	$100.0	$100.0	$100.0	$100.0	$100.0
Total Additional Debt Capacity per Year *	$9,963.7	$168.4	$239.9	$775.3	$943.3
Debt Capacity Available each and every Year	$1,766.0	$1,766.0	$1,766.0	$1,766.0	$1,766.0

* In addition to that already authorized but unissued. Assumes additional debt capacity is authorized and issued in stated fiscal year.

See Appendix B for more details on the specific revenue items utilized by the model, the revenue projections utilized throughout the model horizon, debt, and debt structure assumptions.

Chart 9

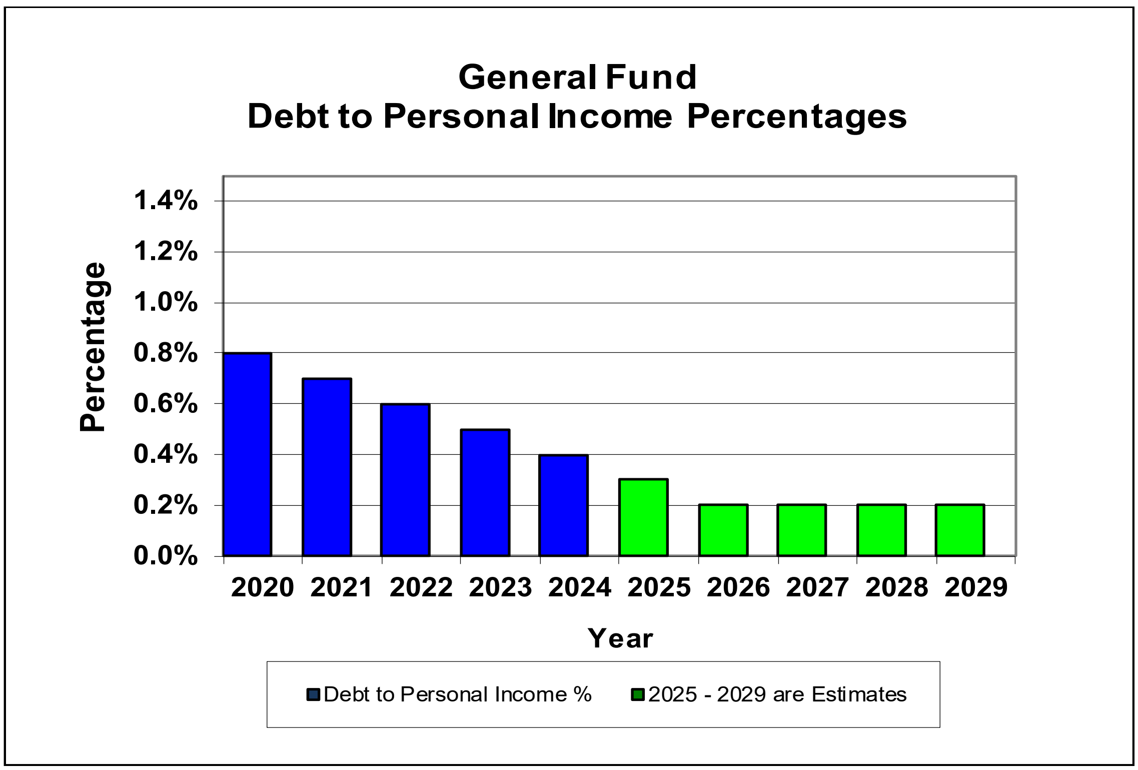


Sensitivity Analysis
The model results are highly sensitive to changes in revenue and interest rate assumptions. A one percent change, either up or down, in general tax revenues in each and every year of the model horizon will change the amount of annual debt capacity each and every year by approximately $20 million. A variation in revenues of $100 million per year will impact the amount of new debt that may be issued each and every year by approximately $5 million. A one percent change, either up or down, in the interest rate assumption for all incremental model debt will change the amount of annual debt capacity each and every year by approximately $135 million.

Net Tax-Supported Debt to Personal Income (2.5% Target, 3% Ceiling)
As required by statute, the Committee has also established guidelines for evaluating the State's debt burden as a measure of personal income.

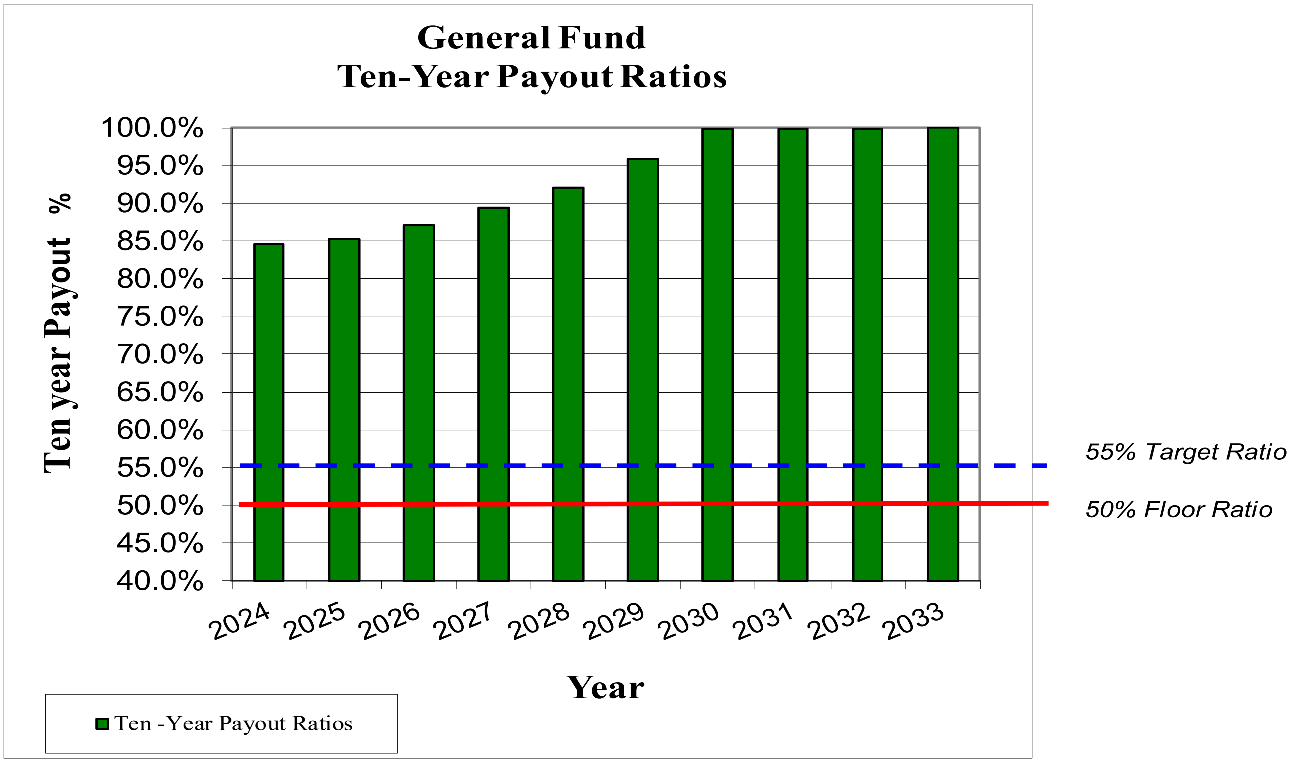
The ratio of General Fund tax-supported debt to personal income peaked at 1.8% over 10 years ago and is anticipated to remain well below 1.0% and dropping to approximately 0.20% in 2026. Chart 10 illustrates the amount of tax-supported debt as a percentage of personal income.

Chart 10



Ten-Year Payout Ratio (55% Target, 50% Minimum)
The rating agencies consider the payout ratio (a measure of the period of time over which a State pays off its debt) as a credit factor. A fast payout ratio is a positive credit attribute. As illustrated in Chart 11 below, the State's payout ratio, the principal amounts payable in the next 10 fiscal years as a percent of total principal due, exceeds its targeted level and is projected to improve further. The chart below illustrates that approximately 85% of the State's General Fund debt will be retired over the next 10 years.

Chart 11



General Fund Analysis – Other

Pension and OPEB Unfunded Liabilities

The primary pension and Other Post-Retirement Benefits (OPEB) plans covering North Carolina's teachers and state employees have total unfunded liabilities of $48.8 billion as reported in North Carolina's 2024 Annual Comprehensive Financial Report ("ACFR"). On a funding basis, the combined total of the State's actuarially determined pension and OPEB contributions are in excess of 15% of the General Fund budget.

Teachers' and State Employees' Retirement System ("TSERS")

The State has fully funded the Annual Required Contributions ("ARC") for the TSERS in 82 of the last 83 years, and the Net Pension Liability is $14.8 billion as reported in the 2024 ACFR. For the fiscal year ending in 2025, the Actuarially Determined Employer Contribution ("ADEC") is approximately $3.0 billion.

During 2018, the plan's discount rate (assumed rate of return) was reduced from 7.20% to 7.00%. In early 2021, the discount rate was further reduced from 7.00% to 6.50% as recommended by a regular experience review conducted by the plan's independent consulting actuaries. The increase in the ADEC resulting from the discount rate reduction is being recognized gradually over the five years beginning July 1, 2022, and once fully recognized, it is estimated to be $0.5 billion per year, compared to what the ADEC otherwise would have been. The Board of Trustees' Employer Contribution Rate Stabilization Policy ("ECRSP"), which calls for additional contributions in some years with a goal of keeping future employer contributions more stable, may serve to mitigate the year-over-year volatility of employer contributions.

The State's "AAA" peer group is presented below. Of note, when the adjusted net pension liability was combined with the net tax-supported debt burden as a percentage of Gross Domestic Product, North Carolina ranked tied for 8th lowest overall debt burden when compared with all states and tied for 5th lowest overall debt burden among our 15-state peer group.

Table 5[1]

FY 2023 Debt and Moody's-Adjusted Pensions Information - "Triple-AAA" Peer Group			
State	Moody's FY23 Adj. NPL (ANPL), $000	ANPL Per Capita	ANPL as % of GDP	ANPL + Net Tax-Supported Debt as % of GDP
Iowa	2,181,226	680	0.9%	1.4%
Tennessee	5,092,812	715	1.0%	1.4%
Utah	2,733,415	800	1.0%	1.8%
South Dakota	869,704	946	1.2%	1.9%
Florida	17,275,185	764	1.1%	2.1%
North Carolina	**9,497,734**	**877**	**1.2%**	**2.1%**
Georgia	12,870,266	1,167	1.5%	3.0%
Indiana	13,858,865	2,020	2.8%	3.3%
Ohio	12,660,336	1,074	1.4%	3.5%
Missouri	13,008,918	2,100	3.0%	3.6%
Virginia	9,019,725	1,035	1.3%	3.8%
Minnesota	9,707,263	1,692	2.0%	3.8%
Texas	107,243,217	3,516	4.2%	5.0%
Delaware	5,377,249	5,211	5.5%	10.3%
Maryland	40,650,262	6,577	7.9%	11.4%
Peer Median	9,707,263	1,074	1.4%	3.3%
Peer Average	17,469,745	1,945	2.4%	3.9%

Source – Moody's Investors Service – Sector Profile (US States) Report dated October 7, 2024.

OPEB

The State's OPEB plan covers retiree healthcare costs administered by the State and funded through the Retiree Health Benefit Fund ("RHBF"). As reported in the 2024 ACFR, the State's Net OPEB Liability ("NOL") was $34.0 billion, a 27% increase from the prior year. The increase is primarily attributable to the increase in the Medicare Advantage Premiums attributable to the Inflation Reduction Act. Updated trends and member election accounted for smaller increases offset by plan changes to remove GLP-1 coverage for obesity treatment and by an increase in the discount rate. The Actuarially Determined Employer Contribution is estimated to be $2.65 billion. The funding ratio for the RHBF (the ratio of assets to the liability) decreased to 9.8%, compared to 10.7% last year. An

[1] Moody's performs certain adjustments to the Net Pension Liabilities reported by each state in order to improve comparability. Therefore, the information below does not correspond to the assumptions or reporting approaches used by each state, including North Carolina's assumption of 6.50% annual investment return.

Employee Benefit Trust Fund (the "Solvency Fund") has been established to augment the assets of the RHBF (see Appendix D.) S.L. 2021-180 has allocated $40 million to the Solvency Fund for Fiscal Year 2022 and $10 million for Fiscal Year 2023. The General Assembly adjusted the percentage of salary to the RHBF in FY 2023 to account for the $40 million drafted in FY 2022. The FY 2024 percentage of salary contributions accounted for the remaining $10 million. Session Law 2023-134 modified the allocation of the Solvency Fund to go 100% to the RHBF instead of shared with the TSERS fund.

A table showing how North Carolina compares with the "AAA" peer group for FY 2023 based on information compiled by S&P and sourced from state ACFR and GASB 74 reports is shown below.

Table 6

North Carolina Comparative OPEB Position (Source: 2023 ACFRs and GASB 74 Reports)

State	Total OPEB Liability ($M)	Fiduciary Net Position ($M)	Net OPEB Liability ($M)	NOL Per Capita	State's Proportionate Share of Combined Plan NOL ($M)	State's Proportionate Share of Combined Plan NOL Per Capita	Funded Ratio (%)	Contributions as % of Static Funding[1]	Contributions as a % of Minimum Funding[2]
Ohio	14,809	17,438	(2,629)	(222)	365	31	117.8	13.1	14.3
Utah	260	277	(17)	(5)	(28)	(8)	106.5	60.3	63.2
Indiana	351	271	80	12	85	12	77.3	83.1	75.5
Tennessee	1,166	865	300	42	1,357	190	74.2	408.8	373.9
Virginia	7,363	3,969	3,394	389	1,424	163	53.9	63.5	54.2
Georgia	14,964	4,168	10,796	976	3,066	278	27.9	56.7	41.7
North Carolina	**30,133**	**3,459**	**26,674**	**2,451**	**5,319**	**491**	**11.5**	**60.9**	**43.8**
South Carolina	14,797	1,691	13,107	2,433	2,524	470	11.4	55.3	39.6
Delaware	8,914	687	8,227	7,938	7,421	7,192	7.7	55.3	39.4
Missouri	2,876	200	2,676	431	2,637	426	6.9	49.7	34.6
Texas	66,603	4,060	62,544	2,035	48,613	1,594	6.1	33.7	25.2
Maryland	11,582	463	11,119	1,788	11,869	1,921	4.0	88.3	60.4
Florida	18,970	535	18,435	805	7,843	347	2.8	25.1	14.6
Nebraska	27	0	27	13	27	13	0.0	86.8	61.4
Idaho	84	0	84	43	84	43	0.0	44.3	32.0
Iowa	205	0	205	64	428	133	0.0	58.2	45.3
Minnesota	732	0	732	127	732	127	0.0	60.9	44.4
Washington	4,250	0	4,250	541	4,250	544	0.0	23.3	17.8
South Dakota[3]	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Median	5,806	499	3,035	410	1,974	234	7.3	57.5	42.7
Average	11,005	2,116	8,889	1,103	5,445	776	28.2	73.7	60.1

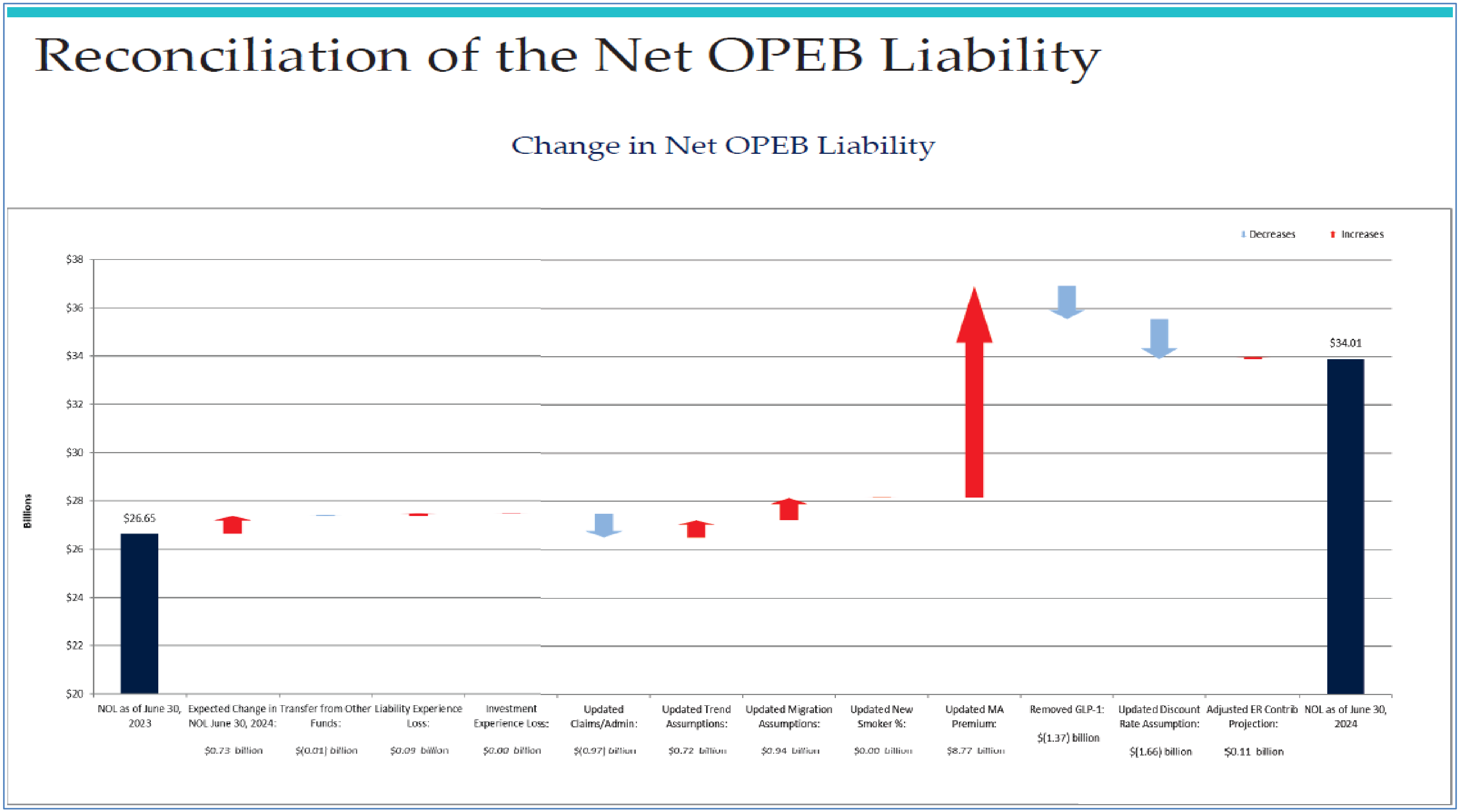
1) Static Funding is calculated as service costs plus unfunded interest costs.

2) Minimum funding progress is calculated as static funding plus 1/30 of the unfunded liability. Minor OPEB plans not offering medical benefits were excluded.

3) South Dakota does not report labilitiy for retiree health carebenefits.

FY 2024 Changes in Net OPEB Liability

Table 7



The Seagal Group, Inc.

Effective FY 2024, all funds in the Unfunded Solvency Reserve Fund will go toward the Retiree Health Benefit Trust in an effort to address OPEB liabilities.

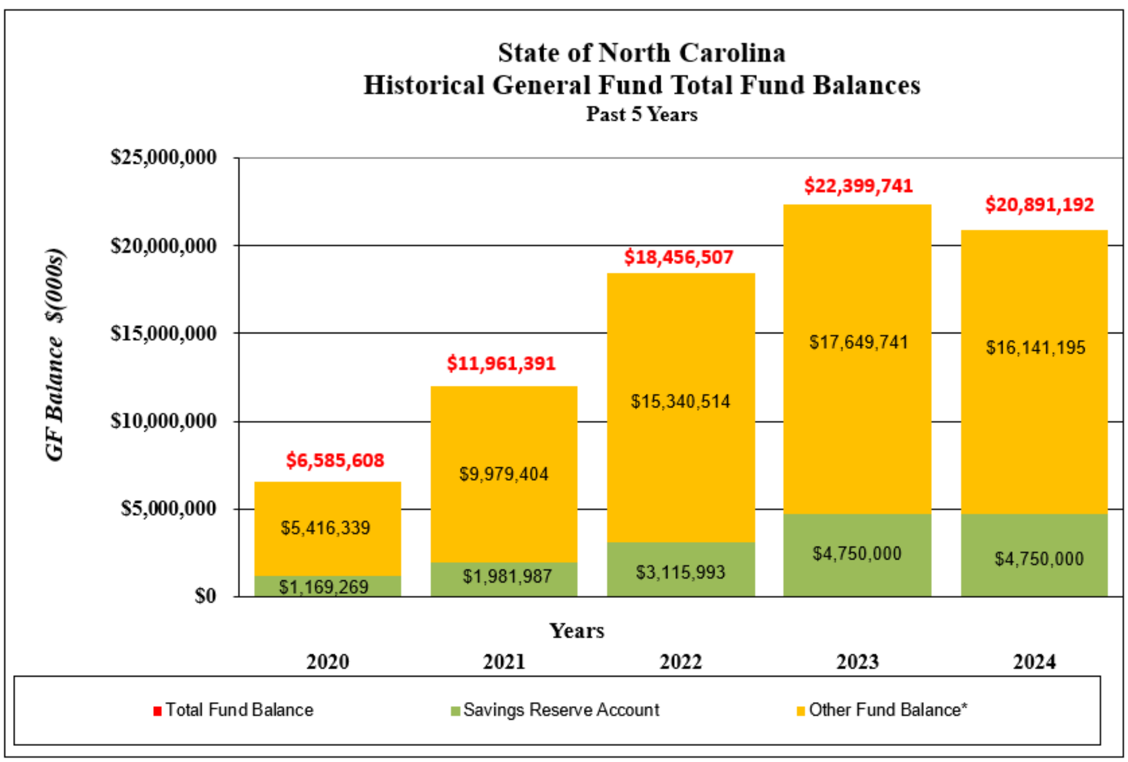
Level of Reserves
The State ended FY 2024 with a positive fund balance in the General Fund of approximately $20.9 billion as calculated under generally accepted accounting principles ("GAAP"). This represents a significant turnaround from the negative ending balances experienced during the recession which reached ($778) million on June 30, 2009. The Savings Reserve ("Rainy Day Fund") which is part of the fund balance of the General Fund, was reported at $4.75 billion in the FY 2024 ACFR.

S.L. 2022-74 established the Stabilization and Inflation Reserve to make appropriation funds available to be used for costs associated with inflation and other measures necessary to stabilize the State economy. The Stabilization and Inflation Reserve had a balance of $1.0 billion on June 30, 2024.

G.S. 143C-4-2(f) directs OSBM and the Fiscal Research Division ("FRD") to establish a new target balance for the Savings Reserve ("Rainy Day Fund") by February 1st of each year. The 2024 target was set at 11.7% of the prior year operating budget. The 2025 target is scheduled to be set on or before February 1st. The Committee continues to recommend that sustainable structural budgetary balance and continuing provision for an adequate level of reserves remain a priority.

Chart 12 illustrates the State's historic General Fund Balance on a GAAP basis over the last five years. The Savings Reserve ("Rainy Day Fund") is a budgetary reserve account and is not reported as an individual item in the GAAP basis financial statements, but it is included as part of the fund balance.

Chart 12



*Major Components of "Other Fund Balance" are: Non-Reverting Departmental Funds, Stabilization and Inflation Reserve, Economic Development Project Reserve, Medicaid Contingency Reserve, State Emergency Response/Disaster Recovery Reserve, Carryforward Reserve, and Unreserved.

SECTION II: TRANSPORTATION DEBT AFFORDABILITY

<u>Review of Transportation Funds, Debt and Other Commitments</u>

Transportation Funds

<u>Highway Fund</u>

The Highway Fund accounts for most of the activities of the Department of Transportation ("DOT"), including the construction and maintenance of the State's primary and secondary road systems, the Division of Motor Vehicles, transit, aviation, rail and ferry system. The primary revenue sources are federal funds, motor fuels taxes (75%), vehicle registration fees, and driver's license fees.

<u>Highway Trust Fund ("HTF")</u>

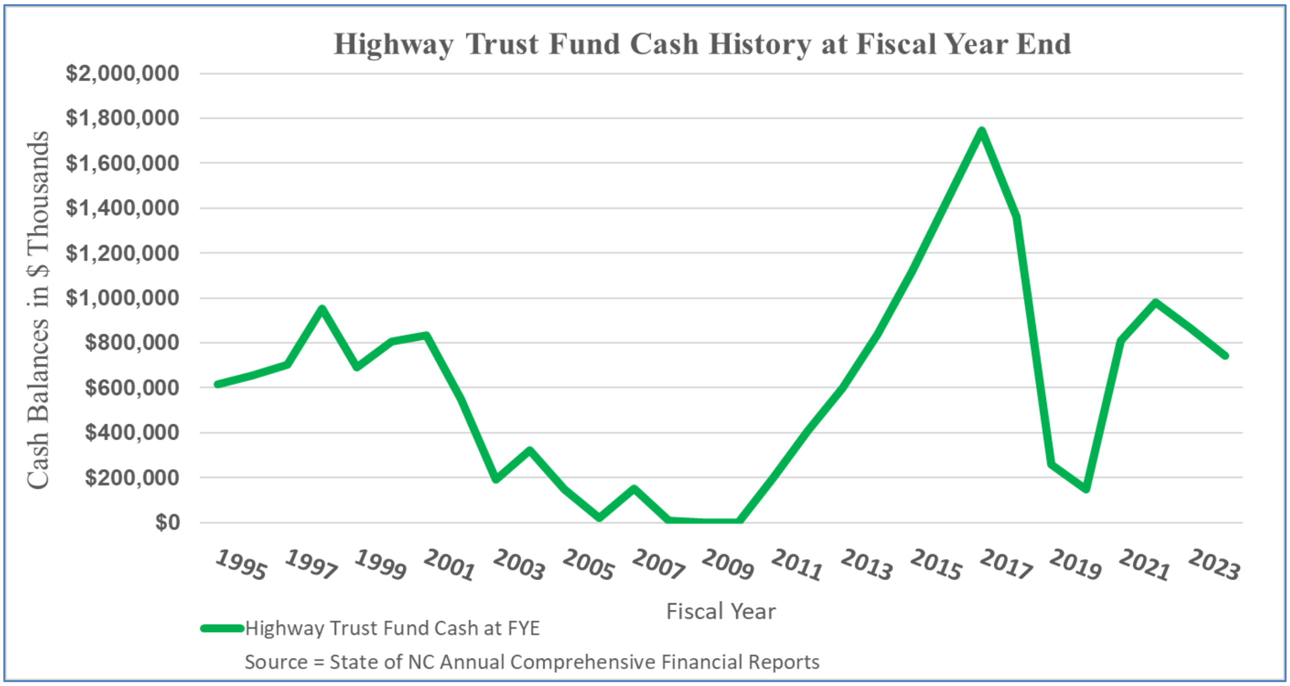
The Highway Trust Fund was established to provide a dedicated funding mechanism to meet specific highway construction needs in North Carolina. The principal revenue sources are highway use taxes, motor fuels taxes (25%) and various fees.

HTF is the only source of repayment for the Build NC bonds; thus, actions which diminish the HTF's resources have the potential to impair the ratings of the Build NC program. Chart 13 on the following page illustrates HTF historical cash balance.

The Highway Fund and the Highway Trust Fund are in many ways managed as a combined entity as interfund transfers occur on a routine basis to (1) transfer revenues and proceeds from one fund required by State statute or budget to collect the revenue to the fund required by State statute or budget to expend them and (2) provide unrestricted revenues collected in the Highway Trust Fund to finance operating and capital programs accounted for in accordance with budgetary authorizations. Due to the interdependent nature of these funds, the Committee has determined that it is most useful to calculate the available debt capacities of these funds (collectively "Transportation Funds") on an aggregate, rather than individual, basis. The resulting debt capacity is termed the "Transportation" debt capacity and is reported separately from, but is then combined with, General Fund capacity.

From total budgeted sources in FY 2024, the Transportation Funds in total allocated approximately $5.5 billion (or 76%) to capital intensive infrastructure improvements (Transportation Improvement Plan ("TIP") Construction, Highway Maintenance and Other Construction).

Chart 13



Transportation Debt

Highway Debt

The State has no current GO debt outstanding related to transportation projects. The GO Bonds authorized by the State Highway Bond Act of 1996 were fully retired as of June 30, 2020.

Build NC Bonds

The Build NC Bond Act of 2018 (S.L. 2018-16) authorized the issuance of bonds for regional and divisional transportation projects contained in the Statewide Transportation Improvement Plan. As of June 30, 2024, the State has issued $1.6 billion (of the authorized $3.0 billion) bonds with an outstanding balance of $1.1 billion.

The Department of Transportation exceeded the maximum cash balance limit required under S.L. 2018-16 Build NC Bond Act; thus, no Build NC bonds were issued during FY 2024. S.L. 2024-15 eliminated the maximum cash balance limit. Pending Council of State approval, a $300M Build NC bond sale is scheduled for April 2025.

General Obligation Bonds versus Special Indebtedness-Transportation Rating/Cost Implications

As discussed above, the State's GO Highway Bonds (retired on June 1, 2020) were issued as GO Bonds and were not secured by any transportation revenues but enjoyed an implied General Fund back-up. As a result, the bonds were rated on a parity with the State's other GO Bonds ("AAA"), permitting them to be issued at the lowest possible interest rates. If the Bonds had not been on a parity basis but been rated on a stand-alone basis based solely on transportation backing, they may not have been rated at the same level as the State's GO Bonds. As described below, at least one rating agency explicitly rates bonds supported by transportation revenues at two notches below the State's "AAA" rating.

Special Indebtedness, backed solely by Transportation funds, may not always be rated as highly as the appropriation-supported bonds backed by the General Fund. For example, the "gap-funded" bonds issued for the Triangle Expressway project where transportation appropriations provide for the payment of debt service were only rated Aa2 by Moody's, AA- by Fitch and AA by S&P at the time of issue. (Note that Moody's, S&P and Fitch have since upgraded the bonds to Aa1/AA+/AA+).

Authorized as Special Indebtedness, the Build NC Bonds are likely to experience an interest rate penalty of 5-25 basis points, depending upon market conditions, compared to a more favorable interest rate had they been authorized as GO debt. This penalty ranges from approximately $13.5 million to $67.6 million over the life of the entire amount of $3 billion.

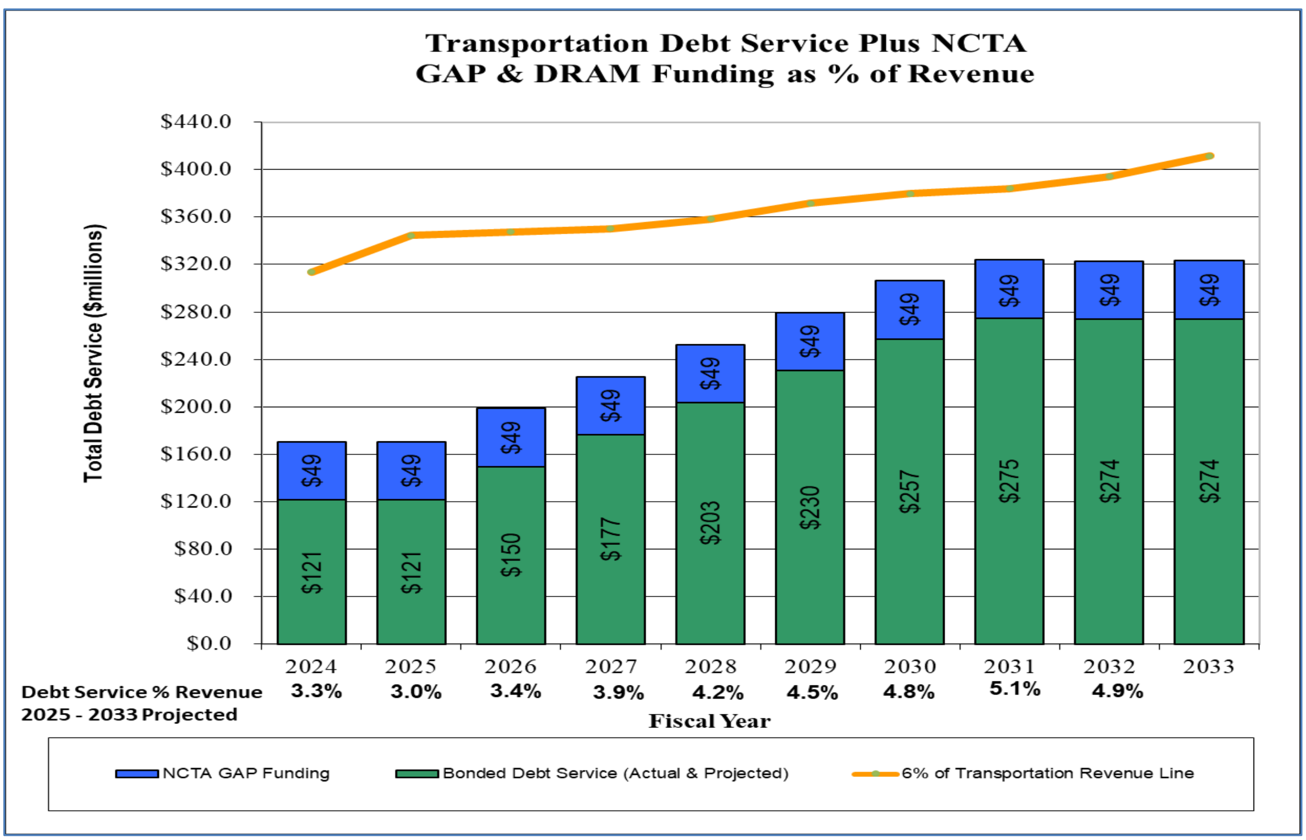
Of additional consideration is that bond counsel has determined that any bonding structure that involves a true pledge of transportation revenues, the source of which is state-wide taxes or user fees, would most likely require a voter referendum.

As a result of these factors, the Committee does not advocate the use of transportation-supported stand-alone Special Indebtedness and instead advocates the use of GO Bonds for Transportation debt.

Debt Service on Transportation Debt

The amount of projected debt service supported by Transportation funds will increase as the Build NC Bonds are issued to nearly $324 million in FY 2031. Debt service, both on an absolute basis and as a percentage of Transportation revenues, is illustrated below. As discussed in more detail in Appendix C, appropriation of funds to support debt obligations under the Build NC Bonds, bonds issued by the North Carolina Turnpike Authority and any "availability payments" or other long-term contractual arrangements that support Public Private Partnerships ("P3") projects or similar arrangements are treated the same as any other debt service obligation. This is consistent with rating agency treatment. See Appendix C for further details and a discussion of transportation debt capacity limitations.

Chart 14



Other Commitments

Grant Anticipation Revenue Vehicle Bonds ("GARVEEs")

GARVEEs represent a financing vehicle that provides significant funds to the State to accelerate transportation improvement projects. The program is not supported by State Transportation or General Fund revenues; therefore, GARVEEs are not technically a part of the Transportation debt affordability model. GARVEEs are a revenue bond-type debt instrument where the debt service is to be paid solely from future federal transportation revenues and has no other State support. (G.S. 136-18 (12b) as codified by S.L. 2005-403 ("the GARVEE Act"))

The State has issued multiple series of GARVEEs and the outstanding amount on December 31, 2024, was $846 million. The NC GARVEE ratings assigned by Moody's, S&P, and Fitch are, respectively: AA/Aa3/A+. The low amount of GARVEE debt service relative to the federal reimbursements (approximately $116.1 million debt service reimbursements received for FY 2024 versus actual FY 2024 collections of approximately $1.654 billion actual total federal highway receipts) means that federal sequestration should not impair bondholder payments.

Pending Council of State and Local Government Commission approval, a new GARVEE issuance is anticipated in the Spring of 2025.

North Carolina Turnpike Authority

North Carolina Turnpike Authority ("NCTA") as a part of the Department of Transportation is authorized to construct and operate toll roads within the State and to issue revenue bonds to finance the costs. The General Assembly has authorized funding to "pay debt service or related financing costs" for various series of revenue bonds issued by the NCTA (called "gap funding"). The NCTA on June 30, 2024 had $656.5 million of such bonds outstanding that provided funding for two projects: the Triangle Expressway project and the Monroe Connector project. The NCTA also had approximately $2.2 billion (includes $693.4 million in Transportation Infrastructure Finance and Innovation Act "TIFIA" loans) in toll-supported debt outstanding for these projects.

NCTA Build America Bonds ("BABs") and Federal Sequestration

As part of the plan of finance for both the Triangle Expressway project and the Monroe Connector project, the NCTA issued BABs. These bonds depend upon a federal subsidy to make a portion of the interest payments due to bondholders. The BABs federal subsidy was reduced by approximately $97,000 for FY 2024 due to federal sequestration.

On April 8, 2024, NCTA closed on approximately $183 million of Monroe Expressway System State Appropriation Revenue Refunding Bonds to refund the outstanding principal amount of the Monroe Connector System State Appropriation Bonds, Series 2010A (Federally Taxable – Build America Bonds (BABs)). On June 30, 2024, NCTA had no remaining Build America Bonds outstanding.

On April 2, 2024, the Monroe State Appropriation Revenue Bonds, Series 2010A Debt Service reserve account had a balance of $4,026,565. On April 8, 2024, the reserve was liquidated in its entirety and used to help refund the Revenue Bonds. The Monroe TIFIA Reserve has a current market value of $13,073,577. The Senior Lien Reserve has a current market value of $12,637,920.

Complete 540 Phase 2 Toll Revenue Bonds

On January 30, 2024, NCTA closed on approximately $340.4 million of Complete 540 Phase 2 Toll Revenue Bonds and entered into a new TIFIA loan in the amount of approximately $417.2 million. The Complete 540 Phase 2 project is an extension of the Triangle Expressway System comprising of a 10-mile extension from I-40 to I-87/ U.S. 64/U.S. 264 in Knightdale North Carolina.

Mobility Partners (I-77 Toll Lanes) TIFIA Restructuring
In April 2024, DOT approved a refinancing by I-77 Mobility Partners of the balance of the TIFIA loan on the I-77 toll lanes project. The refinancing resulted in elimination of the DOT DRAM payments obligation for this project.

Other Transportation Expenditures
Consistent with its treatment for General Fund debt affordability, the Committee does not advocate including non-debt related Transportation obligations or commitments in the definition of liabilities when measuring debt capacity. It is useful, however, to review the level of ongoing administrative and other recurring expenses/transfers when analyzing the level of flexibility in the Transportation Funds. From FY 2020, the levels of these commitments are shown below both with and without debt service as a percentage of total Transportation Revenues, including federal revenues. Over the last five years, between approximately 7.6% and 8.8% of total Transportation Revenues are allocated to administrative costs and transfers.

Chart 15

Transportation Expenses by Year

($ Dollars in Millions)

	2020	2021	2022	2023	2024
Total Transportation Revenues (1)	$5,448.8	$5,783.3	$5,895.3	$6,548.6	$6,949.3
Administration (2)	$282.3	$298.2	$270.1	$322.2	$359.5
Powell Bill Transfers	147.5	132.6	124.8	146.3	197.0
Transfers to Other State Agencies	43.5	44.2	50.7	55.6	55.8
General Fund Transfers	-	-	-	-	-
Expenditures excluding Debt Service	$473.3	$475.0	$445.6	$524.1	$612.3
% Total Transportation Revenues	8.7%	8.2%	7.6%	8.0%	8.8%
Debt Service					
Bonds	$91.3	$72.6	$ 96.2	$ 124.7	$ 124.7
GAP Funding	49.0	49.0	49.0	49.0	49.0
Total Debt Service (3)	$ 140.3	$ 121.6	$ 145.2	$ 173.7	$ 173.7
Total Expenditures	613.6	596.6	590.8	697.8	786.0
% Expenditures/Revenues	11.3%	10.3%	10.0%	10.7%	11.3%

(1) Includes Federal Revenues.
(2) Prior year administrative expenses have been restated to be net of receipts.
(3) State tax-supported debt service.

Loan from the Highway Trust Fund to the North Carolina Turnpike Authority
The DOT Board of Transportation and the North Carolina Turnpike Authority Board of Directors approved a short-term loan from the Highway Trust Fund to NCTA in the amount of $100 million. These funds were used to begin long lead-time items to support the Complete 540 Phase 2 project, including advanced right of way acquisition, tower relocation (FAA and Cell Tower), etc. This loan was repaid in full as of February 8, 2024 from the proceeds of the new Series 2024 Complete 540 Phase 2 Revenue Bonds (see above).

Transportation Debt Guidelines, Affordability Model and Results

The rating agencies view all debt supported by state-wide, generally applied taxes and/or user fees to be "Tax-Supported Debt". This combined treatment extends to all General Fund-supported, and to Highway Fund and Highway Trust Fund-supported ("Transportation Funds") debt. Some analysts apply the same treatment to debt supported by non-State revenues such as GARVEE bonds. The Committee recognizes that the rating agencies compare the State to its peers utilizing a broad measure of Transportation and General Fund debt and has reviewed the State's relative status on this basis (see Chart 8).

However, the State of North Carolina has a long history of viewing the debt supported by the General Fund as tax-supported debt and its Highway Bonds as being non-tax supported (in this case, Highway Trust Fund-supported) debt. The State's existing debt affordability model excludes both transportation revenues and transportation debt service as components of the General Fund calculation. Continuing this practice, the Committee has determined that it should adopt a measure of Highway Fund and Highway Trust Fund debt capacity that is separate and distinct from that calculated for the General Fund. Although not common, this practice has been discussed with the rating agencies who understand North Carolina's incremental and separate approach to debt affordability measurement.

The Committee also recognizes the inherent differences between the General Fund and the Transportation Funds, not only in terms of the revenue streams, but also in terms of the commitments on those revenues. In addition, the State's transportation "enterprise" is, by its nature, a long-lived, capital intensive, rapidly growing program. As such, a customized individual debt capacity model is appropriate to measure the debt capacities of the Transportation Funds and the Committee believes that an individual Transportation debt capacity calculation is consistent with the legislative intent of S.L. 2007-551.

Due to the interdependent nature of the Highway and Highway Trust Funds as discussed earlier, the Committee has determined that it is more useful to calculate the available debt capacities of these Funds on an aggregate, rather than individual, basis. The resulting debt capacity is termed the "Transportation" debt capacity.

The Committee has adopted annual transportation-related debt service as a percentage of State transportation revenues as the measure to evaluate the level of Transportation debt capacity. By measuring what portion of the State's transportation resources is committed to debt-related fixed costs, this ratio reflects the flexibility (or lack thereof) to allocate transportation resources to other priorities.

Revenues Used in the Transportation Model Calculation

The model uses a definition of State transportation revenues that includes an aggregate of all State-level revenues deposited into the Highway Fund and the Highway Trust Fund including the motor fuels tax, highway use tax, motor vehicle license tax, sales and use tax and certain non-tax revenue such as investment income. Consistent with the model mechanics for the General Fund, there is no deduction for projected transfers to the General Fund, Powell Bill transfers or other non-debt commitments. Federal transportation revenues are specifically excluded from the definition of revenues used to calculate Transportation debt capacity as federal revenues have been pledged to the State's GARVEE program and are not available to back other transportation-related debt.

Debt Used in the Transportation Model Calculation

The model uses a definition of State transportation debt service that includes Build NC Bonds, Highway GO Bonds, gap funding, availability payments and other long-term contractual payments to support P3 or other structures (see Appendix C for further discussion of DRAM payments) but excludes the GARVEEs supported by federal revenues. There are currently no tax-supported capital lease obligations that need to be included. Highway Trust Fund support for debt issued by the North Carolina Turnpike Authority is included as a liability for model purposes.

Debt Structuring Assumptions

The standard calculation of the Transportation debt affordability model assumes that model debt is fixed-rate 25-year maturity debt with an average interest cost of 6.15% and a level debt service profile after the first year. This year, the Build NC Bonds were loaded into the model with the following assumptions:

- Fixed rate debt issued at 4%
- Level debt service after the first year
- 15-year final maturity
  $300 million issued in FY 2024-25 forward (Build NC Bond Act (as amended) expires 12/31/2031).

Transportation Debt Capacity Guidelines

The Committee has adopted a guideline of 6% for transportation-related debt service as a percentage of state transportation revenues. In doing so, the Committee determined that the Transportation Funds enjoy a greater degree of budgetary flexibility than does the General Fund, and the Committee determined that the State's Transportation funds could support a higher ongoing level of debt service as a percentage of revenues than was deemed appropriate for the General Fund. However, the Committee also determined not to adopt the same 20% guideline (S.L. 2020-91, s. 4.5(a) increased from 15% to 20%) for Transportation debt capacity as was contained in the GARVEE legislation because GARVEEs have higher annual debt service requirements due to their shorter maturity. Note that when the GARVEEs were first issued, 12 years was the standard maturity in the marketplace. This has commonly been replaced with a 15-year maturity structure, with some advisors recommending a 20-year structure. The effect is that a longer maturity allows more GARVEE debt to be issued than originally contemplated under the limitations adopted.

Table 8

Transportation
Net Tax-Supported Debt Capacity using 6.0% debt service/revenues target ratio
(In millions of dollars)

Fiscal Year	2025	2026	2027	2028	2029
Total Additional Debt Capacity per Year *	$765.0	$0.0	$0.0	$0.0	$0.0
Debt Capacity Available Each and Every Year	$127.5	$127.5	$127.5	$127.5	$127.5

* In addition to that already authorized but unissued. Assumes additional debt capacity is authorized and issued in stated fiscal year.
GAP Funding for North Carolina Turnpike Authority projects assumed to total $49 million annually.

Model Assumptions regarding Revenue Growth
The model uses consensus estimates for the revenues over the model horizon (see Appendix C).

Sensitivity Analysis
A one percent charge, either up or down, in transportation revenues in each and every year of the model horizon will change the amount of first year debt capacity by approximately $48.5 million. If the interest rate assumption for all incremental debt is lowered by 100 basis points (1%), an approximately $67.1 million of debt capacity in the first-year capacity is created.

Comparative Transportation Ratios

Using FY 2024 information where available, the State's transportation-related debt service as a percentage of State transportation revenues appears modest when compared with a peer group composed primarily of states in the Southeast region. Within the peer group, both Missouri and South Carolina utilize an approach that limits transportation debt separately from other state-level debt. Finally, Tennessee has not issued state-level debt for transportation purposes.

Chart 16

Transportation Historical Peer Group Comparisons

State	Ratings [(1)]	Maturity Limit (Yrs.)	Transportation DS % of Transportation Revenues [(2)]	
			Ratio	Year
Tennessee [(3)]	AAA/AAA/Aaa	N/A	0.00%	2024
North Carolina	**AAA/AAA/Aaa**	**25**	**3.26%**	2024
South Carolina [(4)]	AAA/AA+/Aaa	25*	0.00%	2024
Florida [(5)]	AAA/AAA/Aaa	30	9.56%	2024
Virginia [(6)]	AAA/AAA/Aaa	40*	3.26%	2024
Kentucky [(7)]	AA-/A+/Aa2	30*	7.52%	2023
Missouri [(8)]	AAA/AAA/Aaa	(9)*	31.79%	2024
Texas [(10)]	AAA/AAA/Aaa	20*	4.36%	2024
Georgia [(11)]	AAA/AAA/Aaa	25*	6.48%	2023
	Median		***4.36%***	
	Average		***7.36%***	

[(1)] Fitch / Standard & Poor's / Moody's (updated in 2024).

[(2)] Excludes GARVEE debt service (if any) and Federal Revenues.

[(3)] Tennessee finances transportation on a pay-as-you-go basis.

[(4)] Currently no State Highway Revenue Bonds Outstanding.

[(5)] Department of Transportation debt service on Right-of-Way Acquisition and Bridge Construction Bonds as a percentage of motor fuel & diesel fuel sales tax revenue.

[(6)] Ratio calculated by (Total Debt Service - GARVEE Debt Service) / (Total Revenue - Federal Revenue - GARVEE Bonds).

[(7)] Ratio calculated road fund debt service divided by road fund revenues excluding other governmental agencies revenue.

[(8)] Ratio calculated on Missouri state road bonds First, Second, and Third Lien + State Appropriations Mega Lien Projects debt service divided by net pledged revenues.

[(9)] The term of the bonds issued will be structured such that the average life of the bonds shall on average exceed the useful life of the projects constructed by a minimum of two times. Bonds should in most cases be structured to repay principal in all debt service payments, no interest only deferral.

[(10)] Texas state revenue includes motor fuels taxes, vehicle registration fees and other, smaller state revenues. Ratio calculated on first tier State Highway Fund revenue bonds debt service divided by revenues.

[(11)] Calculated Georgia State Road And Tollway Authority FY 2023 end of year revenues divided by revenue bonds payable.

* State Statutory Maturity Limit. Each state may have a shorter limit to final maturity in their debt management policy.

SECTION III: Transportation and General Fund Ratios Combined

The Committee adopted the 6% Transportation guideline after analyzing the State's position relative to its peer group on an aggregate basis (General Fund and Transportation Funds combined), consistent with rating agency practice. Illustrated below is how the State appears on a combined basis utilizing debt service as a percentage of revenue percentages for both the General Fund and the Transportation Funds. The Committee notes that the combined ratio is projected to decline through FY 2029.

Table 9

General Fund and Transportation Funds
Combined Debt Service / Revenue Percentages

Fiscal Year	2025	2026	2027	2028	2029
General Fund	1.40%	1.14%	1.05%	0.94%	0.81%
Transportation *	2.97%	3.43%	3.86%	4.23%	4.51%
Combined	1.63%	1.48%	1.47%	1.45%	1.38%

Note: Percentages are based on forecasted revenues and debt service.

* GAP Funding for North Carolina Turnpike Authority projects assumed to total $49 million annually.

Appendix A
Other Recommendations

1. **Policy Recommendation regarding continuing a 4% calculation target for General Fund Debt capacity and providing for ongoing appropriations to the Solvency Fund**
   The Committee is recommending that the 4% of revenues be continued as the targeted limitation for debt capacity. Within this single calculation, a level continuing appropriation of $100 million to the Solvency Fund is recommended to begin to address the pension and OPEB liabilities which totaled $48.8 billion on June 30, 2024. Under this policy, the amount of available debt capacity is significant, totaling approximately $1.76 billion per year for the next 10 years.

   Rating agencies have created new tests to compare units of government carrying these unfunded liabilities. Additionally, investors and citizens have taken increased interest in how governments are responding to challenges caused by the increasing levels of these liabilities. The rating agencies have applauded the steps the State has taken recognizing the pension and OPEB liabilities in the DAAC Study and establishing the Solvency Fund as a mechanism to accumulate assets to address these liabilities. The 2020 General Assembly through the existing mechanism, deposited an additional $30 million directly into the Retiree Health Benefit Trust to help address OPEB liabilities. S.L. 2021-180 has allocated $40 million to the Solvency Fund for Fiscal Year 2022 and $10 million for Fiscal Year 2023. Without continued meaningful action to address these liabilities, the positive credit that the State has accrued will erode.

   The Committee believes that a continuing annual appropriation of $100 million directed to the Solvency Fund will allow the State to begin accumulating assets to address its unfunded pension and OPEB liabilities without jeopardizing the funding of critical infrastructure projects. The state takes a very proactive approach to addressing its pension and OPEB liabilities, leading to the sixth-lowest (Table 5) ranking ANPL plus ANOL (adjusted net OPEB liability) to GDP ratio among states.

2. **Control of Debt Authorization Authority**
   As an alternative to traditional debt structures, various agencies historically have proposed “off balance sheet” types of arrangements and/or specialized financing structures to provide funding for capital projects, including various lease structures and other agreements arranging for payments made over time subject to the availability of funds. Not only do such structures typically result in more expensive financing and issuing costs, but they also circumvent the State’s historically conservative debt management practices. The Committee continues to strongly recommend that the State of North Carolina maintain its historically conservative debt management practices with regard to (1) centralized debt authorization, (2) centralized debt management and issuance and (3) classification of debt and debt-like obligations when determining the debt burden. These practices are among those considered by the rating agencies when assigning their “triple-A” ratings to the State and ultimately allow the State to maintain a healthy financial position.

   The Committee believes that centralized debt management is a key best financial management practice and should be embraced by the State as a matter of policy.

3. **State Aid Intercept**
   The Committee has noted prior discussion that would provide for the timely payment of special obligation bonds issued for the constituent institutions of the University of North Carolina by

requiring the State to "intercept" General Fund appropriations to those entities in order to make debt service payments on "self-liquidating" indebtedness issued pursuant to G.S. Chapter 116D. Similar proposals have been discussed and put forth by other State entities. In essence, this back-stop of debt service obligations by the State's General Fund provides a form of bond insurance resulting in higher credit ratings and provides the issuer (constituent institutions of the University of North Carolina) with debt service savings.

The Committee strongly opposes on policy grounds providing credit support for debt issues whose source of repayment was and is represented to be project revenues. The use of State appropriations is not currently permitted to be used to pay debt service on such debt issues. In addition, the proposals have not provided for appropriate levels of State oversight and control for debt issues that may potentially utilize the State's debt capacity and increase its debt burden.

4. Consider General Obligation Bonds as the preferred financing method

The Committee notes that the State has recently relied extensively, although not exclusively, on the authorization of Special Indebtedness to finance capital projects. Due to the potential debt service savings and increased transparency, the Committee believes that General Obligation bonds should be considered the preferred, but not the exclusive, method to debt finance the State's capital needs.

5. Structural Budget Balance and Reserve Replenishment

The Committee confirms its view that North Carolina's priorities of achieving structural budgetary balance and maintaining healthy reserve fund balances are strong evidence of financial stability and flexibility. The Committee recognizes that long term budgetary stability and adequate reserve funds are key factors in maintaining our triple, triple-A bond rating. The Committee further recognizes the following critical issues were recently noted and will be monitored by bond rating agencies:

- Adequate reserves must be maintained to address economic downturns.
- Ensuring operating revenues and tax rates are sustainable and align with expenditures.
- Timely budgets and sound fiscal governance are essential moving forward.

Appendix B

General Fund Revenues and Liabilities and Debt Affordability Model 10-Year Solutions

DAAC Revenues

The model uses general tax revenues adjusted for one-time or non-recurring items, statutory transfers to the Savings Reserve Fund ("Rainy Day Fund") plus certain investment income and miscellaneous revenues ("DAAC Revenues"). The Office of State Budget and Management ("OSBM") and Fiscal Research Division ("FRD") have been consulted to provide consensus projections through FY 2035.

General tax revenues adjusted for one-time or non-recurring items plus certain other revenue items deemed available to service debt from the most recently available *Annual Comprehensive Financial Report.* The following items are included:

General Fund Tax Revenues

- Individual Income Tax
- Corporate Income Tax
- Sales & Use Tax
- Franchise Tax
- Insurance Tax
- Beverage Tax
- Tobacco Products Tax
- Other Taxes

Other General Fund Revenue Items

- Investment Income
- Miscellaneous Revenues

Revenue Growth and Other Assumptions

The 10-year General Fund revenue projections start with certified revenues for the 2024-25 fiscal year, based on the May 2024 consensus revenue forecast, and OSBM revenue projections for all subsequent years. OSBM's revenue projections are based on revenue collections and economic forecasts as of early November 2024 and does not incorporate direct or indirect effects of potential changes to federal policies.

The average projected growth rate for General Fund revenue, after any statutory transfers to the Savings Reserve or Unfunded Liability Solvency Reserve, over the next ten years is 2.1%, with an average growth rate of 0.4% between FY 2024-25 and FY 2029-30 and 3.8% between FY 2029-30 and FY 2034-35. This pattern reflects the fiscal impact of S.L. 2023-134, which reduced the individual income tax rate to 4.5% in 2024 and will further reduce the rate to 4.25% in 2025 and 3.99% in 2026. The legislation also includes up to three additional 0.5% reductions in the individual income tax rate that are contingent upon revenue collections exceeding statutory thresholds (also known as triggers), potentially lowering it to a minimum of 2.49%.

The forecast anticipates that revenue collections will be above the FY 2025-26 threshold and trigger a 0.5% reduction in the individual income tax rate to 3.49% in 2027. However, the timing and number of tax rate reductions are sensitive to small changes in revenue projections and may differ significantly from current projections. In particular, revenue projections for FY 2026-27 and FY 2032-33 are only slightly below the trigger thresholds for those years, and revenue collections in either year exceeding projections by a small amount would trigger a second 0.5% rate reduction. An additional 0.5% rate reduction effective in 2028 would reduce revenues by an estimated $2.2 billion in FY 2028-29 and $2.8 billion in FY 2033-34.

Additionally, S.L. 2021-180 reduces the corporate income tax rate gradually from 2.5% in 2024 to 0% in 2030. These tax rate reductions, combined with projected growth in the general economy, result in little revenue growth through FY 2029-30. Stable tax policy after 2030 results in stronger revenue growth (3.8% on average) between FY 2029-30 and FY 2034-35.

OSBM projects that DAAC non-tax revenue, which includes Treasurer's investment income and miscellaneous revenues, will decrease by approximately 6% in the 2025-27 biennium due to an expected gradual decline in short-term interest rates leading to lower investment income. The projections include an adjustment for the statutorily required deposit to the Savings Reserve and/or Unfunded Liability Solvency Reserve (ULSR) in the years after the current biennium, but there are no adjustments related to the statutory deposits to the State Capital and Infrastructure Fund.

In consultation with OSBM and FRD, DAAC consensus revenue projections are:

Table 10

General Fund Revenue ($ millions) [1]
Used in the Debt Affordability Model *

Fiscal Year	Revenues ($ millions)	Growth Rate	Fiscal Year	Revenues ($ millions)	Growth Rate
2024	$33,086.8	0.5%	**2030**	34,369.2	2.4%
2025	33,727.8	1.9%	**2031**	35,285.7	2.7%
2026	33,884.1	0.5%	**2032**	36,680.6	4.0%
2027	33,384.3	-1.5%	**2033**	38,162.1	4.0%
2028	32,844.2	-1.6%	**2034**	39,751.7	4.2%
2029	33,551.2	2.2%	**2035**	41,361.4	4.0%

* General Fund recurring tax revenues, miscellaneous revenues and Treasurer's investments per OSBM / FRD.
[1] Fiscal Years 2025 - 2035 revenue forecast as of December 2024. Fiscal Year 2024 is budgetary actual.

<u>Liabilities Used in the General Fund Model Calculation</u>
The model uses a definition of net tax-supported debt that includes all outstanding and authorized, but unissued, GO Bonds, Special Indebtedness, and other debt like obligations that are owed to a third party over a predetermined schedule payable from General Fund tax revenues. Excluded are obligations of Component Units, Transportation debt actually paid from Transportation revenues, unfunded amounts in the Pension Plans, Employment Security borrowings, OPEB liabilities, and Energy Performance Contracts. Mandatory payments due to contractors or others under P3s, “Design/Build/Finance” or other such arrangements would be included as a liability for the model.

To calculate net tax-supported debt, credit analysts take into account all debt supported by general tax revenues. This debt position shows the amount of indebtedness serviced from an issuer’s General Fund; that is, it reflects the debt service payments made directly from tax revenues and is known as net tax-supported debt. Although a consensus appears to exist among credit analysts as to the appropriateness of using net tax-supported debt as the standard for determining an issuer’s debt position, there is less unanimity about the precise calculation. The Committee has determined to exclude self-supporting debt from its calculations.

The model includes the actual debt service from all outstanding net tax-supported debt and for all authorized, but currently unissued, tax-supported debt if such issuance does not require further action on the part of the General Assembly.

The following is a list of those liabilities that are included in the General Fund model (outstanding amounts as of June 30, 2024):

- GO Bonds supported by General Fund Tax Revenue - $1.645 billion
- General Fund appropriation-supported debt
    - Limited Obligation Bonds - $831.0 million
    - Other debt like obligations - $7.8 million

Liabilities not included in the General Fund model (outstanding amounts as of June 30, 2024):

- $ 34.0 billion — OPEB
- $ 21.2 billion — Obligations of the University of North Carolina System or other Component Units
- $ 14.8 billion — Pension liabilities
- $ 1.1 billion — Highway Construction Special Indebtedness supported by the Highway Trust Fund
- $133.1 million — Energy Performance Contract obligations where such obligations are guaranteed and approved pursuant to G.S. 142-64 and not supported by separate appropriations ($310.0 million issued)

Note: Although these liabilities may not constitute tax-supported debt, some are obligations of the State or various component units and the State's General Fund, although not legally obligated to, could be called upon to service these obligations if necessary.

Debt Structuring Assumptions

The General Fund model uses a standard fixed-rate 20-year level principal or payment structure and the following assumptions in this year's debt affordability model calculations:

- The State does not have any outstanding Variable Rate Debt and is not expected to issue any over the model horizon.
- The State does not currently have any general fund authorized but unissued GO or non-GO debt.
- Incremental model debt will be structured with a fixed rate 20-year maturity, a 6% interest rate, and an overall level debt service profile after the initial year.

Note on Interest Rate Assumptions

The DAAC model assumes consistency between the issuing assumptions used in the study and those used for budgetary planning. The issuance of future authorized bonds could be at lower rates than those stated above, especially in the early years. Such savings are not expected to significantly impact the results of the Study.

General Fund: 10-Year Model Solutions

Debt Service/Revenue Target at 4.00%

Table 11

General Fund
Debt Capacity using 4.0% debt service/revenues target ratio
$100 million per year used to address unfunded liabilities

(In millions of dollars)

Fiscal Year	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
$ to Unfunded Liabilities	$100.0	$100.0	$100.0	$100.0	$100.0	$100.0	$100.0	$100.0	$100.0	$100.0
Total Additional Debt Capacity per Year *	$9,963.7	$168.4	$239.9	$775.3	$943.3	$763.1	$1,097.6	$982.9	$960.5	$768.2
Debt Capacity Available each and every Year	$1,766.0	$1,766.0	$1,766.0	$1,766.0	$1,766.0	$1,766.0	$1,766.0	$1,766.0	$1,766.0	$1,766.0

* In addition to that already authorized but unissued. Assumes additional debt capacity is authorized and issued in stated fiscal year.

Debt Service/Revenue Target at 4.75%

Table 12

General Fund
Net Tax-Supported Debt Capacity using 4.75% debt service/revenues target ratio
$100 million per year used to address unfunded liabilities

(In millions of dollars)

Fiscal Year	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
$ to Unfunded Liabilities	$100.0	$100.0	$100.0	$100.0	$100.0	$100.0	$100.0	$100.0	$100.0	$100.0
Total Additional Debt Capacity per Year *	$12,878.5	$125.4	$193.5	$836.1	$1,013.7	$841.9	$1,217.5	$1,110.3	$1,097.3	$906.7
Debt Capacity Available each and every Year	$2,145.0	$2,145.0	$2,145.0	$2,145.0	$2,145.0	$2,145.0	$2,145.0	$2,145.0	$2,145.0	$2,145.0

* In addition to that already authorized but unissued. Assumes additional debt capacity is authorized and issued in stated fiscal year.

Appendix C

Transportation Revenues and Liabilities and Debt Affordability Model 10-Year Solutions

State Transportation Revenues

The Transportation debt affordability model uses all state transportation revenues plus other revenue items deemed available to service debt for the most recent fiscal year. The following items are included:

- Motor Fuels Tax
- Highway Use Tax
- Motor Vehicle Revenues
    - Vehicle registration and title fees
    - Driver's license fees
    - International registration plan fees
    - Penalties
    - Equipment inspection fees
    - Other
- Investment Income
- Sales & Use Tax allocation
- Other misc.
- *Federal Transportation Revenues are excluded*

Revenue Growth

The Office of State Budget and Management (OSBM) and the Fiscal Research Division (FRD), in conjunction with the North Carolina Department of Transportation (DOT), issued a consensus revenue forecast for the Highway Fund and Highway Trust Fund in May 2024. The projections include certified revenues for FY 2024-25, based on OSBM-FRD consensus projections, and joint DOT-OSBM projections for all subsequent years. Under the forecast, combined Highway Fund and Highway Trust Fund revenues grow 0.9% in FY 2025-26 and 0.8% in FY 2026-27 and increase at an average growth rate of 2.6% per year after the 2025-27 biennium.

Growth in motor fuels tax revenue stagnates in the forecast due to the gradual replacement of less-efficient combustion vehicles with higher-efficiency combustion vehicles and vehicles powered in part or wholly by electricity. The forecast also assumes a stabilizing market for new and used motor vehicle sales and continued growth in fee revenues. However, many of the federal policies promoting higher-efficiency and alternative-fuel vehicles could be rolled back or eliminated in the years to come, resulting in less growth in revenues from registration fees for electric and plug-in hybrid vehicles but higher state motor fuel tax collections. The pace and direction of technological advancements in batteries and vehicle efficiency is also uncertain. The result is higher-than-usual uncertainty in the 10-year revenue forecast, particularly in the late 2020s and 2030s.

Beginning in FY 2023, a portion of Sales and Use Tax Revenues net proceeds collected under G.S. Chapter 105, Article 5 at the State's general rate of tax set in G.S. 105-164.4(a) will be transferred quarterly to the Highway Fund and Highway Trust Fund. The Transfer Percentages are as follows:

Fiscal Year	Percentage to Highway Fund	Percentage to Highway Trust Fund
2022-23	2%	0%
2023-24	1%	3%
2024-25 and thereafter	1.5%	4.5%

The table below shows Sales and Use Tax transfer estimates (G.S. 105-164.4(a) through FY 2034-35.

Table 13

Sales and Use Tax Transfer Projections ($ millions)

Fiscal Year	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035
Highway Fund	$ 177.7	$ 181.5	$ 185.9	$ 191.2	$ 196.7	$ 203.3	$ 210.2	$ 217.2	$ 224.5	$ 232.0	$ 239.8
Highway Trust Fund	533.0	544.4	557.8	573.5	590.0	609.8	630.7	651.5	673.4	696.0	719.4
Total	$710.7	$725.8	$743.7	$764.6	$786.7	$813.0	$840.9	$868.6	$897.8	$928.0	$959.2

Note: FY 2024-25 is the final year of the three-year phase-in of a transfer of sales and use tax revenues from the General Fund to the Highway Fund and Highway Trust Fund. In FY 2024-25, 6% ($711M) of General Fund sales and use tax revenues are projected to be transferred, with 75% ($533M) of this amount going to the Highway Trust Fund and 25% ($178M) going to the Highway Fund.

Table 14

Transportation Revenues ($ millions)

Fiscal Year	Revenues ($ millions)	Growth Rate	Fiscal Year	Revenues ($ millions)	Growth Rate
2024	$5,230.9	9.2%	**2030**	6,328.7	2.1%
2025	5,742.3	9.8%	**2031**	6,409.4	1.3%
2026	5,791.2	0.9%	**2032**	6,570.0	2.5%
2027	5,835.1	0.8%	**2033**	6,861.9	4.4%
2028	5,973.2	2.4%	**2034**	7,004.1	2.1%
2029	6,195.6	3.7%	**2035**	7,140.8	2.0%

* Revenue amounts per transportation consenus forecast (OSBM, FRD & DOT)
Fiscal Year 2024 is budgetary actual. Includes Sales & Use Tax transfer projections illustrated in Chart 13.

Transportation Liabilities

The model uses the debt service from all outstanding and authorized but unissued Highway Bonds (GO and Build NC Bonds) and includes transportation-related and installment purchase contracts if appropriate. Debt service arising from the State's GARVEE program is not included as a State

Transportation Liability as the GARVEEs are supported solely by federal transportation revenues.

The General Assembly has authorized funding to "pay debt service or related financing costs" for various series of revenue bonds issued by the North Carolina Turnpike Authority. The funds so appropriated are legally pledged to support the bonds and bondholders will depend upon the appropriations continuing. Therefore, the model treats the gap funding as the equivalent of debt service because it represents ongoing Highway Trust Fund support of debt. $49 million of gap funding is treated as debt service for each year over the 10-year model horizon. DOT has also pledged certain operating and maintenance funds to secure debt, if necessary, to provide adequate coverage levels. At the present, it appears that such funding will not be required. However, these funds would be treated as additional gap funding for model purposes if DOT were to be required to make such payments.

Availability Payments

The model counts "availability payments" as debt-like obligations. These payments are contractually owed to the contractor or other service provider on a delayed schedule that stretches beyond the standard construction period. Sometimes entered into as part of Public Private Design/Build/Finance and/or other arrangements, the delayed payments represent debt service for contractor-provided financing. The debt-like characteristics of availability payments (even if "subject to appropriation") mean that the payments are treated as a liability for the purposes of the model. The availability payment arrangements that DOT entered into in connection with the I-485 project have been satisfied.

Developer Ratio Adjustment Mechanism (DRAM) payments

In connection with the I-77 P3 project, DOT agreed to make certain payments over time to support the project. The maximum amount of such payments may not exceed $12 million annually or $75 million in the aggregate. The actual amounts were subject to the actual performance triggers of the project. As stated earlier, in April 2024, a refinancing by the I-77 Mobility Partners of the balance of the TIFIA loan on the I-77 toll lanes resulted in elimination of the DOT DRAM payment obligation for this project. During the period that DRAM payment performance triggers were in place, no performance triggers were met, and DOT made no DRAM payments.

Debt Issuance Assumptions

The following assumptions were used in this year's Transportation debt affordability model calculations because the Build NC Bonds have specific structuring limitations, and their issuance utilizes all of the available Transportation debt capacity:

- There is no remaining authorized but unissued highway GO debt and $1.7 billion of authorized but unissued non-GO Build NC bonds on December 31, 2024.
- The Build NC Bonds will be structured with a fixed rate 15-year maturity, a 4.00% interest rate and an overall level debt service profile after the first year.

Transportation: 10-Year Model Solution

Table 15

Transportation

Net Tax-Supported Debt Capacity using 6.0% debt service/revenues target ratio

(In millions of dollars)

Fiscal Year	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Total Additional Debt Capacity per Year *	$765.0	$0.0	$0.0	$0.0	$0.0	$0.0	$131.8	$220.7	$107.5	$457.9
Debt Capacity Available each and every Year	$127.5	$127.5	$127.5	$127.5	$127.5	$127.5	$127.5	$127.5	$127.5	$127.5

* In addition to that already authorized but unissued. Assumes additional debt capacity is authorized and issued in stated fiscal year.

Appendix D

Public Private Partnerships
Review of Recent Debt-Related Legislation

Public Private Partnerships-Debt

As the State enacts laws that permit the procurement and financing of assets through the use of Public Private Partnerships ("P3's"), care should be taken to ensure that sound debt management and authorization practices are in place in the review and approval process. The term P3 can describe a wide variety of arrangements in which a private sector entity plays a key role in the acquisition of an asset and/or the provision of a service. While P3s may appear to provide a new source of funds in a time of diminished revenues and debt capacity, such agreements often contain financing arrangements with the private entity that results in that entity incurring debt or obligations secured, directly or indirectly by governmental payments or charges to the citizens of that government.

P3s do not create additional debt capacity although it may appear so if the agreements are not viewed as debt or debt-like obligations. However, P3 agreements are often a commitment of funds in order to acquire an asset and that must be treated like debt when determining debt capacity. Failure to make the contractual payments could result in loss of the asset and create a default of a contractual liability to another party and would typically impact the credit rating of the government. The rating agency treatment is clear: when a state's payments are used to support or secure debt issued by a private party, other public entity, and conduit issuer or through a lease arrangement, such debt will be counted toward the state's debt burden. Sponsoring agencies whose mission is to provide a particular service or asset are not in the best position to make decisions that prioritize the use of a state's debt capacity or require a state to enter into debt-like arrangements. That decision should be made by the state's legislative body which represents all the citizens of the state and is equally responsible for providing all services to all citizens.

Review of Recent Debt-Related and other Legislation

<u>Build NC Bond Act of 2018, G.S. § 142-97</u>

S.L. 2018-16, s. 4; as amended by S.L. 2019-251; S.L. 2020-91; S.L. 2021-180; S.L. 2021-189; and S.L. 2024-15, ss. 9, 10 (a)-(c)

The Build NC Bond Act (the "Act") authorizes the issuance by the State Treasurer of up to $3 billion bonds for regional and divisional transportation projects contained in the Statewide Transportation Improvement Plan subject to a number of constraints including Council of State approval; cash balances, measured at specific times, that dip below $1 billion; a recommendation from the Treasurer that the Bonds be issued; an issuance limitation of no more than $300 million per year (the amount authorized to be issued in FY 2021 was increased to $700 million by S.L. 2020-91); and compliance with the limitations contained in the DAAC Study. The Bonds, authorized as Special Indebtedness, are also subject to the provisions of Chapter 142, Article 9 (the State Capital Facilities Finance Act).

The Act's authorization originally expired December 31, 2028. Session Law 2024-15, s. 9, extended the Act's authorization expiration date to December 31, 2031. The Bonds are to be paid by appropriations from the Highway Trust Fund. The bonds are limited to a 15-year final maturity. The maximum cash balance limit was increased to $2 billion for the 2021-2023 fiscal biennium but the maximum cash balance limit requirement was removed for bonds sold on or before June 30, 2022 (by S.L. 2021-180, s. 41.3., as rewritten by S.L. 2021-189, s.7.1). The maximum cash balance requirement was repealed in its entirety by S.L. 2024-15 s. 10. In addition, S.L. 2024-15, s. 10 provided a special one-time adjustment to the Department of Transportation's consultation period with the Legislature and State Treasurer from six months to just three months prior to an expected issuance, and this adjustment expired on January 1, 2025.

State Pension/Retiree Health Benefit Fund Solvency, G.S. § 143C-4-10

S.L. 2018-30, s. 1; as amended by S.L. 2020-48, s. 2.2(a), (c); S.L. 2021-180, s. 39.24(a); and S.L. 2023-134, s. 39.28(a)

The legislation established the "Unfunded Liability Solvency Reserve" (the "Solvency Fund") as a reserve within the General Fund that will be used to accumulate funds to be used to reduce the State's unfunded pension and OPEB liabilities. To the extent that the Savings Reserve balance has reached its statutory maximum, the Solvency Fund will receive amounts that otherwise would have gone to the Savings Reserve. The Solvency Fund may also receive additional appropriations. The General Assembly allocated $40 million to the Solvency Fund for Fiscal Year 2022 and $10 million for Fiscal Year 2023 in S.L. 2021-180, s. 2.2.(a). As originally enacted, funds in the reserve were to be used to reduce the long-term unfunded liabilities associated with both the Retiree Health Benefit Trust and the Teachers' and State Employees' Retirement System ("TSERS"), proportionate to the unfunded liabilities of the respective programs. Effective with the fiscal year beginning July 1, 2023, Session Law 2023-134 eliminated the shared allocation of the Solvency Fund monies - the monies are now to be allocated in full to the Retiree Health Benefit Trust instead of a shared allocation with the TSERS fund.

State Capital and Infrastructure Fund ("SCIF"), G.S. § 143C-4-3.1

S.L. 2017-57, s. 36.12(b); as amended by S.L. 2018-5, s. 36.8(a); S.L. 2020-81, s. 4(f); S.L. 2021-180, ss. 5.7(a), 40.12; S.L. 2022-74, s. 40.3(a); S.L. 2023-134, s. 40.5(c)

Session Law 2017-57 established a new fund to be used to address ongoing capital and infrastructure needs effective July 1, 2019. Amendments to the statute provide for specific dollar transfers from the General Fund to the SCIF for fiscal years beginning with the 2021-2022 fiscal year. Monies in the SCIF are to be used to pay debt service (first priority) and then fund new capital projects and repair and renovation projects. The Committee notes that the use of such funds for capital projects circumvents its recommendation that a continuing appropriation of $100 million be directed to the Solvency Fund.

Transfer to Highway Fund, G.S. § 105-164.44M (b)

S.L. 2022-74, s. 42.3(a); as amended by S.L. 2024-15, s. 18(a)

A portion of sales tax revenues collected under G.S. § 105-164.44M(b) will be transferred to the Highway Fund and Highway Trust Fund, with the first such transfers having occurred in State Fiscal Year 2023. For State Fiscal Year 2024, 1% was transferred to the Highway Fund and 3% was transferred to the Highway Trust Fund. From State Fiscal Year 2025 forward, 1.5% will be transferred to the Highway Fund and 4.5% will be transferred to the Highway Trust Fund for an estimated total of $711 million in State Fiscal Year 2025 (See Appendix C). Effective July 1, 2024, the sales tax revenue transfers must occur monthly rather than quarterly (S.L. 2024-15, s. 18(a)).

Redemption or Purchase of State Bonds

S.L. 2023-134, s. 40.1.(j)

On September 22, 2023, budget legislation (S.L. 2023-134 – Current Operations Appropriations Act of 2023) was enacted by the North Carolina General Assembly (NCGA) and became law on October 3, 2023. As part of the budget legislation, the General Assembly allocated funds to redeem or purchase and cancel State bonds that have debt service paid from the State Capital and Infrastructure Fund if (i) the cost of redeeming or purchasing and canceling those bonds is less than the estimated market value the bonds would have if not redeemed or purchased and canceled or (ii) the bonds were purchased by one or more of the funds listed in G.S. 147-69.2(a) between May 1, 2023 and October 31, 2023, in a principal amount not to exceed forty million dollars.