MANAGEMENT'S DISCUSSION AND ANALYSIS

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

The following is a narrative overview and analysis of the State of North Carolina's (the State) financial performance for the fiscal year ended June 30, 2023. Please read it in conjunction with the transmittal letter at the front of this report and with the State's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

Government-wide Financial Statements

- The State's total net position increased by $9.56 billion or 12.35% as a result of this year's operations. Net position of governmental activities increased by $8.72 billion (12.28%) and net position of business-type activities increased by $838 million (or 13.16%). At year-end, net position of governmental activities and business-type activities totaled $79.75 billion and $7.21 billion, respectively.
- Component units reported net position of $26.19 billion, an increase of $2.6 billion or 11.04% from the previous year. The majority of the net position is attributable to the University of North Carolina System, a major component unit.

Fund Financial Statements

- The fund balance of the General Fund increased from $18.46 billion at June 30, 2022 (as restated) to $22.37 billion at June 30, 2023, an increase of 21.18%.
- The Highway Fund reported a fund balance of $1.2 billion at June 30, 2023, an increase of $18.73 million from the previous year with a restated fund balance of $1.18 billion at June 30, 2022. With the implementation of GASB 94, the Highway Fund restated a deferred inflow that restated and decreased the prior year's ending fund balance in the amount of $70.2 million. While this restatement created the comparative increase in fund balance, the primary activity of the Highway Fund indicates a decrease during the fiscal year. This decrease was mainly due to the expenditures for highway and other infrastructure maintenance as well as an increase in operating costs that surpassed revenues.
- The Highway Trust Fund reported a fund balance of $1.08 billion, a decrease of 33.93% from the previous year. The fund balance decrease is attributable to the overall increase in capital outlay expenditures outpacing revenues.
- The Unemployment Compensation Fund reported net position of $4.43 billion at June 30, 2023 compared to $3.79 billion at June 30, 2022, an increase of $639.90 million or 16.86%. The increase in net position is related to various fluctuations, many of which continue to relate to the impacts from the Coronavirus pandemic. Unemployment rates remained low during the 2022-23 fiscal year, with the lowest rate of 3.3% reported in June 2023.
- The N.C. State Lottery Fund reported net ticket sales of $4.34 billion, an increase of 11.72% from the previous year. As required by law, the Lottery transferred $1.016 billion to the General Fund to support educational programs.
- The N.C. Turnpike Authority (NCTA) reported net position of $325.44 million, an increase of 38.11% from the previous year. The NCTA reported operating income of $2.31 million, which represents an increase of $3.5 million from the prior year, related to a $4.5 million increase in operating revenues. NCTA also had a $23.11 million increase in nonoperating expenses due to a $9.13 million decrease in investment earnings and a $13.57 million increase in interest and fees related to interest paid on NCTA's bond debt during the fiscal year. NCTA also reported a $75.36 million increase in capital contributions and a $55.96 million increase in transfers in, which contributed to the increase in net position.
- The EPA Revolving Loan Fund reported net position of $2.19 billion, an increase of 5.43% from the previous year. Operating income was $7.33 million, and net nonoperating revenues of $86.63 million consisted primarily of federal capitalization grants.

Capital Assets

- The State's investment in capital assets (net of accumulated depreciation) was $69.21 billion, an increase of 5.34% from the previous fiscal year-end.
- Significant year-end construction in progress amounts were for state highway projects ($3.24 billion), an expressway project ($745.42 million), a new system for managing and administering social service benefits ($768.67 million), a relocation project for the DHHS campus ($55.56 million), a new statewide accounting system ($33.4 million) and a new skilled nursing facility for state veterans ($46.73 million).

Long-term Debt

- The State had total long-term debt outstanding (bonds, special indebtedness, and notes from direct borrowings) of $7.53 billion, a decrease of 8.62% from the previous fiscal year-end.
- In connection with the limited obligation bonds, all three rating agencies affirmed the triple-A credit rating for the State. The rating agencies recognized the State's historically conservative budgeting, financial management, and debt issuance practices. North Carolina remains one of only 14 states with a triple-A rating from all three rating agencies.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Government-wide Financial Statements

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

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

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

- *Governmental Activities* – Most of the State's basic services are reported under this category. Taxes and intergovernmental revenues generally fund these services.
- *Business-type Activities* – The State charges fees to customers to help it cover all or most of the cost of certain services it provides. The State's Unemployment Compensation Fund, the EPA Revolving Loan Fund, the N.C. State Lottery Fund, and the N.C. Turnpike Authority are the predominant business-type activities.
- *Discretely Presented Component Units* – Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. A description of the component units and an address for obtaining their separately issued financial statements can be found beginning on page 76. Discretely presented component units are combined and displayed in a separate discrete column in the government-wide financial statements to emphasize their legal separateness from the State. In addition, financial statements for major component units are presented in the notes to the financial statements (pages 184 and 185).

Fund Financial Statements

The fund financial statements provide more detailed information about the State's most significant funds (i.e., major funds) – not the State as a whole. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the State uses to keep track of specific sources of funding and spending for particular purposes. In addition to the major funds, page 266 begins the individual fund data for the nonmajor funds. The State's funds are divided into three categories (governmental, proprietary, and fiduciary) and they use different accounting approaches.

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

Proprietary funds – When the State charges customers for the services it provides, whether to outside customers or to agencies within the State, these services are generally reported in proprietary funds. Proprietary funds (enterprise and internal service) utilize accrual accounting, which is the same method used by private sector businesses. Enterprise funds are used to report activities for which fees are charged to external users for goods and services. The Unemployment Compensation Fund, the EPA Revolving Loan Fund, the N.C. State Lottery Fund, and the N.C. Turnpike Authority are the State's most significant enterprise funds. Internal service funds are used to report activities that provide goods and services to the State's other programs and activities on a cost-reimbursement basis, such as the State Property Fire Insurance Fund, the Motor Fleet Management Fund, Computing Services Fund, and the State Telecommunications Services Fund. Because the State's internal service funds predominantly benefit governmental rather than business-type functions, they have been included within governmental activities in the government-wide financial statements.

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

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

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found beginning on page 74 of this report.

Required Supplementary Information

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

Other Supplementary Information

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

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE

Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the State is improving or deteriorating. The State's assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources by $86.95 billion at the close of the most recent fiscal year (see total primary government column). The following table was derived from the government-wide Statement of Net Position:

Net Position as of June 30, 2023 and 2022

(dollars in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government		Total Percentage Change
	2023	2022 (as restated)	2023	2022 (as restated)	2023	2022 (as restated)	2022-23
Current and other non-current assets	$40,470,214	$35,833,931	$8,125,245	$ 7,641,834	$48,595,459	$43,475,765	11.78%
Capital assets, net	66,316,777	63,025,149	2,895,271	2,681,232	69,212,048	65,706,381	5.34%
Total assets	106,786,991	98,859,080	11,020,516	10,323,066	117,807,507	109,182,146	7.90%
Total deferred outflows of resources	4,056,216	3,276,214	88,088	73,654	4,144,304	3,349,868	23.72%
Long-term liabilities	16,558,592	16,718,011	2,824,217	2,871,214	19,382,809	19,589,225	(1.05%)
Other liabilities	11,831,809	11,040,860	1,001,354	1,081,746	12,833,163	12,122,606	5.86%
Total liabilities	28,390,401	27,758,871	3,825,571	3,952,960	32,215,972	31,711,831	1.59%
Total deferred inflows of resources	2,707,431	3,350,640	75,171	74,157	2,782,602	3,424,797	(18.75%)
Net position:							
Net investment in capital assets	62,526,432	59,317,526	598,131	493,076	63,124,563	59,810,602	5.54%
Restricted	1,788,260	2,017,711	166,230	204,494	1,954,490	2,222,205	(12.05%)
Unrestricted	15,430,683	9,690,546	6,443,501	5,672,033	21,874,184	15,362,579	42.39%
Total net position	$79,745,375	$71,025,783	$7,207,862	$ 6,369,603	$86,953,237	$77,395,386	12.35%

The largest component of the State's net position (72.6% for fiscal year 2023) reflects its investment in capital assets (land, buildings, machinery and equipment, state highway system, toll road system, and other capital assets), less related debt still outstanding that was used to acquire or construct those assets. An additional portion of net position represents restricted net position ($1.97 billion). Net position is restricted when constraints placed on its use is either 1) externally imposed by creditors, grantors, contributors or laws or regulations of other governments or, 2) legally imposed through constitutional provisions. The remaining portion, unrestricted net position, consists of net position that does not meet the definition of "net investment in capital assets" or "restricted."

The government-wide statement of net position for governmental activities reflects unrestricted net position of $15.43 billion at June 30, 2023, an increase of $5.74 billion from the prior year. The strong financial results for fiscal year 2023 (i.e., the excess of revenues over expenses of $7.82 billion) contributed to the increase in unrestricted net position. The State also had an increase of cash in fiscal year 2023 of $2.82 billion (10.57% increase). The increase in cash is attributable to $1.71 billion in new inflation and stabilization reserves. The State of North Carolina, like many other state and local governments, issues general obligation debt and special indebtedness and distributes the proceeds to state agencies, local governments, and component units. The proceeds are used to construct new buildings and renovate and modernize existing buildings throughout the State, including the State's community college and university campuses, assist county governments in meeting their public school building capital needs, and to provide grants and loans to local governments for clean water and natural gas projects. Of the $5.54 billion of bonds and special indebtedness outstanding for governmental activities at June 30, 2023, approximately $2.32 billion is attributable to debt issued as state aid to component units and local governments. The statements of net position of component unit and local government recipients reflect ownership of the related constructed capital assets without the burden of recording the debt obligation. However, by issuing such debt, the State is left to reflect significant liabilities on its statement of net position (reflected in the unrestricted net position component) without the benefit of recording the capital assets constructed or acquired with the proceeds from the debt issuances.

Additionally, as of June 30, 2023, the State's governmental activities have significant unfunded liabilities for compensated absences of $593.32 million, pension liabilities of $3.76 billion, net OPEB liabilities of $4.67 billion, workers' compensation of $617.25 million, and claims and judgments payable of $731.7 million (see Note 8 to the financial statements).

The State's overall net position increased $9.56 billion or 12.35% (total primary government) from the prior fiscal year. The net position of the governmental activities increased $8.72 billion or 12.28% and business-type activities increased $838.26 million or 13.16%. The following financial information was derived from the government-wide Statement of Activities:

Changes in Net Position for the Fiscal Years Ended June 30, 2023 and 2022
(dollars in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government		Total Percentage Change
	2023	2022 (as restated)	2023	2022 (as restated)	2023	2022 (as restated)	2022-23
Revenues:							
Program revenues							
Charges for services	$3,279,413	$3,108,005	$5,436,186	$4,889,659	$8,715,599	$7,997,664	8.98%
Operating grants and contributions	31,055,694	30,859,243	320,229	695,299	31,375,923	31,554,542	(0.57%)
Capital grants and contributions	1,266,732	1,149,590	75,564	248	1,342,296	1,149,838	16.74%
General revenues							
Taxes:							
Individual income tax	16,799,392	17,845,868	—	—	16,799,392	17,845,868	(5.86%)
Corporate income tax	1,728,595	1,624,384	—	—	1,728,595	1,624,384	6.42%
Sales and use tax	11,657,850	11,029,810	—	—	11,657,850	11,029,810	5.69%
Motor fuels tax	2,619,790	2,227,883	—	—	2,619,790	2,227,883	17.59%
Franchise tax	857,100	879,789	—	—	857,100	879,789	(2.58%)
Highway use tax	1,186,526	1,137,060	—	—	1,186,526	1,137,060	4.35%
Insurance tax	1,165,117	1,000,680	—	—	1,165,117	1,000,680	16.43%
Beverage tax	592,168	559,195	—	—	592,168	559,195	5.90%
Tobacco products tax	283,849	296,416	—	—	283,849	296,416	(4.24%)
Other taxes	339,835	372,624	—	—	339,835	372,624	(8.80%)
Tobacco settlement	156,549	171,849	—	—	156,549	171,849	(8.90%)
Federal COVID-19	673,203	1,525,132	—	—	673,203	1,525,132	(55.86%)
Unrestricted investment earnings	553,841	60,506	—	—	553,841	60,506	815.35%
Noncapital contributions	35,475	38,147	747	517	36,222	38,664	(6.32%)
Miscellaneous	79,241	67,754	—	1,318	79,241	69,072	14.72%
Total revenues	74,330,370	73,953,935	5,832,726	5,587,041	80,163,096	79,540,976	0.78%
Expenses:							
General government	2,764,844	3,032,569	—	—	2,764,844	3,032,569	(8.83%)
Primary and secondary education	15,512,806	15,442,974	—	—	15,512,806	15,442,974	0.45%
Higher education	5,665,180	5,473,516	—	—	5,665,180	5,473,516	3.50%
Health and human services	32,313,673	30,645,511	—	—	32,313,673	30,645,511	5.44%
Economic development	756,992	435,295	—	—	756,992	435,295	73.90%
Environment and natural resources	865,794	816,601	—	—	865,794	816,601	6.02%
Public safety, corrections and regulation	4,269,861	4,777,868	—	—	4,269,861	4,777,868	(10.63%)
Transportation	3,790,329	3,079,409	—	—	3,790,329	3,079,409	23.09%
Agriculture	396,929	249,195	—	—	396,929	249,195	59.28%
Interest on long-term debt	172,351	173,241	—	—	172,351	173,241	(0.51%)
Unemployment compensation	—	—	276,982	672,550	276,982	672,550	(58.82%)
N.C. State Lottery	—	—	3,332,492	2,960,246	3,332,492	2,960,246	12.57%
EPA Revolving Loan	—	—	50,852	17,314	50,852	17,314	193.70%
N.C. Turnpike Authority	—	—	224,730	235,152	224,730	235,152	(4.43%)
Regulatory programs	—	—	151,784	138,494	151,784	138,494	9.60%
Insurance programs	—	—	36,924	34,638	36,924	34,638	6.60%
North Carolina State Fair	—	—	16,728	12,657	16,728	12,657	32.16%
Other business-type activities	—	—	15,919	14,696	15,919	14,696	8.32%
Total expenses	66,508,759	64,126,179	4,106,411	4,085,747	70,615,170	68,211,926	3.52%
Increase in net position before contributions and transfers	7,821,611	9,827,756	1,726,315	1,501,294	9,547,926	11,329,050	(15.72%)
Contributions to permanent funds	9,925	9,605	—	—	9,925	9,605	3.33%
Transfers	888,056	853,042	(888,056)	(853,042)	—	—	—
Increase (decrease) in net position	8,719,592	10,690,403	838,259	648,252	9,557,851	11,338,655	(15.71%)
Net position - beginning - restated	71,025,783	60,335,380	6,369,603	5,721,351	77,395,386	66,056,731	17.17%
Net position - ending	$79,745,375	$71,025,783	$7,207,862	$6,369,603	$86,953,237	$77,395,386	12.35%

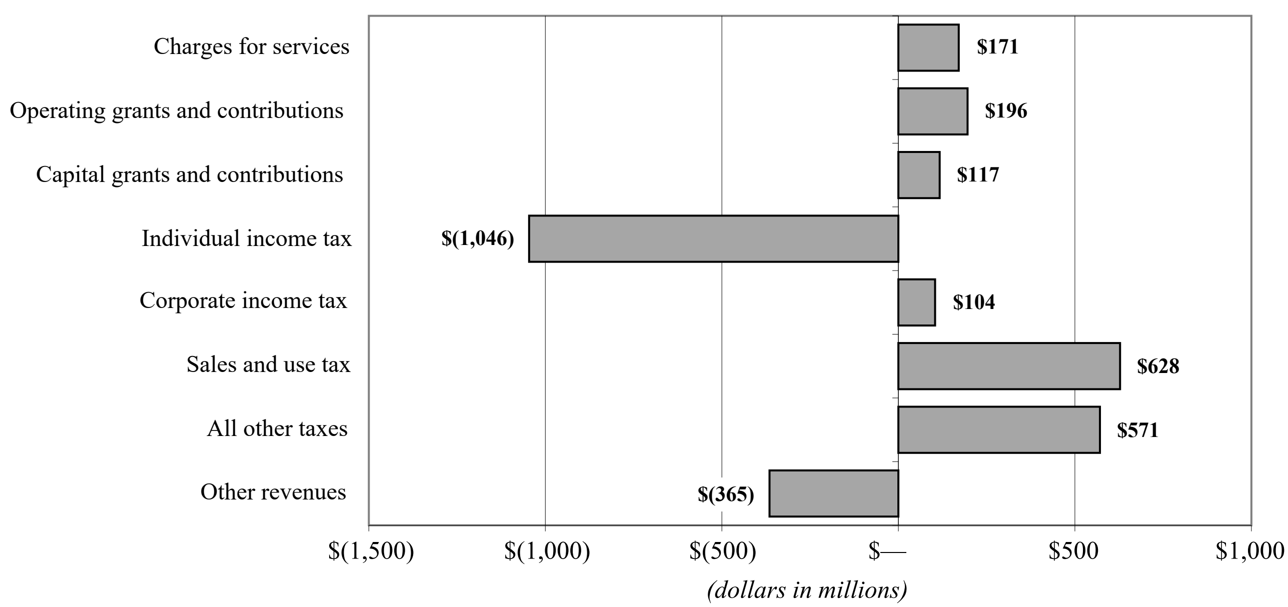
Governmental Activities. For fiscal year 2023, revenues outpaced expenses and when combined with contributions to permanent funds and transfers from the State's business-type activities, an increase in net position of $8.72 billion (12.28%) resulted for governmental activities. Total revenues increased by 0.51% ($376.44 million) while total expenses increased by 3.72% ($2.38 billion). Contributing to the increase in total revenues was a significant increase in investment earnings of $493.34 million (815.35%) due largely to higher interest rates during the year which increased the overall interest earnings on cash balances on hand. For fiscal year 2023, overall tax revenues increased by $256.51 million (0.69%) from last year. Corporate and sales and use taxes showed the largest increases primarily due to a continued strength in consumer spending during the year. Insurance taxes also increased because of an increase in the amount of taxable premiums written by insurers. While total expenses increased this year, the general government function expenses decreased $267.73 million (8.83%) primarily because of a decrease in grants, state aid and subsidies. The general government received less in federal funds for the Emergency Rental Assistance (ERA) and Homeowners Assistance Fund (HAF) grants. Primary and secondary education also received less in federal funds for its grant programs as well as Child Nutrition, while health and human services received reduced federal funds for programs such as testing/detection programs, low-income heating subsidy programs and Child Care subsidies.

In March 2021, the United States Congress enacted the American Rescue Plan Act (ARPA) and established the Coronavirus State and Local Fiscal Recovery Fund. These funds were allocated to each state, local government, and tribal government individually. The State Fiscal Recovery Funds reduced the impacts of the COVID-19 pandemic and decreased the spread of the virus; replaced lost revenue for governments; supported economic stabilization caused by the pandemic; and addressed public health and economic challenges that contributed to the unequal impact of the pandemic. North Carolina did not receive any additional Coronavirus State Fiscal Recovery funds in fiscal year 2023. The existing Coronavirus State Fiscal Recovery funds must be obligated by December 31, 2024 and expended by December 31, 2026.

For fiscal year 2023, the State's governmental activities recognized $5.47 billion of federal COVID-19 funds; $4.8 billion is included in operating grants and contributions (i.e., program revenues) and $673.2 million is reported as federal COVID-19, which is included in the other revenues source shown in the table above (i.e., general revenues). This was a decrease of $2.43 billion or 30.73%. The primary factor for the decrease is due to lower amounts of federal funds received for the ERA and HAF grants that are part of the COVID-19 relief. Also, the CARES ACT federal funds have been completely recognized, as that program has ended. Decreased federal funds for COVID-19 immunizations, testing and detection programs, Child Care subsidies funded by the CARES Act and ARPA ACT, and Child Nutrition services also contributed to the decrease in the federal COVID-19 funds during fiscal year 2023.

The following chart reflects the dollar change in governmental activities revenues by source between fiscal years 2022 and 2023:

Dollar Change in Governmental Activities Revenues by Source Between Fiscal Years 2022 and 2023



For fiscal year 2023, although spending increased in the majority of the State's functional areas, there were also decreases in spending in the functional areas of general government, health and human services and public safety. As noted above, general government expenditures decreased by $268 million in fiscal year 2023 primarily because of a decrease in grants, state aid and subsidies.

Public safety, corrections and regulation spending decreased by $508 million or 10.63% in fiscal year 2023. The primary factor in the decrease is in grants, state aid and subsidies. At the Department of Public Safety, many of the one-time COVID-19 grants were phased out, such as the Emergency Rental Assistance program.

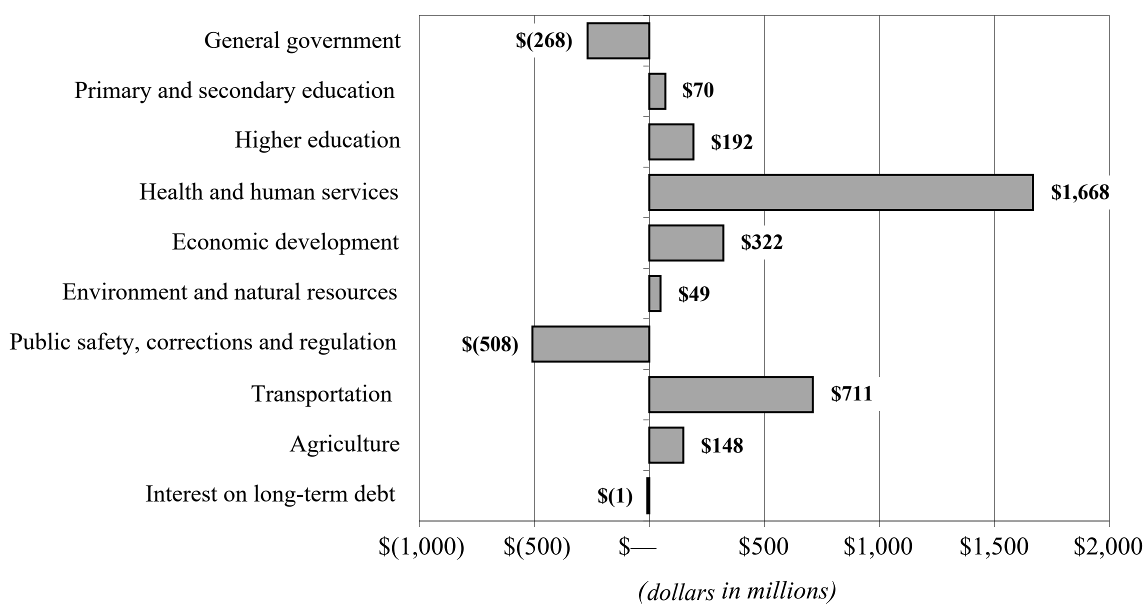
Total health and human services (HHS) spending increased by 5.44% or $1.67 billion in 2023. For comparison, HHS spending increased by 19.57% and 18.68% in fiscal years 2022 and 2021 respectively. The increase in expenditures is primarily due to an increase in federal reimbursement for the Healthcare Access and Stabilization Program and claims for fiscal year 2023. In fiscal year 2022, the DHHS had large increases in expenses due to software maintenance agreements for related COVID-19 projects established for pandemic response, testing and tracing. With the completion of these projects, the remainder was moved to operations and maintenance, thus resulting in a decrease in maintenance agreement charges in fiscal year 2023.

The largest increase in functional expenses is in transportation. Total expenses increased 23.09% ($711 million) from last year. The growth in this functional area is primarily due to increases in both the Highway Fund and the Highway Trust Fund. The Highway Fund expenditures increased due to the implementation of the ARIBA procurement system, higher outlay costs and increased spending for contract resurfacing and bridge projects. The Highway Trust Fund expenditures increased due to the increased activity in the STI Program, representing continued growth of statewide construction activities after the COVID-19 shutdown and cash restraints of fiscal year 2020. Economic development also had a large increase in functional expenses of $322 million (73.90%) from the prior fiscal year. The increase is attributed to $259 million in grants for new state grant programs such as Economic Development Partnership for the NC Travel and Tourism initiative and increased funding for film incentives.

The following chart reflects the dollar change in the functional expenses of governmental activities between fiscal years 2022 and 2023:

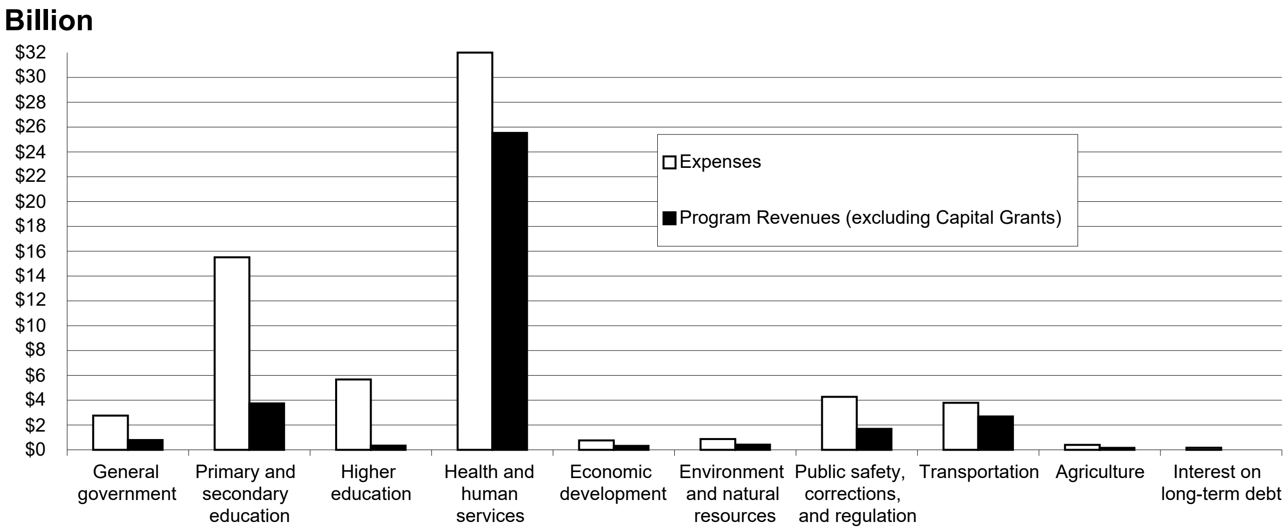
Dollar Change in Governmental Activities Functional Expenses

Between Fiscal Years 2022 and 2023



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

Expenses and Program Revenues - Governmental Activities
For the Fiscal Year Ended June 30, 2023



Business-type Activities. Business-type activities reflect an overall increase in net position of $838.26 million or 13.16%, primarily due to the increase in net position in the Unemployment Compensation Fund. The increase in net position of $639.9 million or 16.86% in the Unemployment Compensation Fund (Trust Fund) related to various fluctuations, many of which continue to relate to the impacts from the Coronavirus pandemic. The Trust Fund had a $476.1 million increase in operating income related to a $60.35 million or 9.14% increase in employer unemployment contributions and a $397.01 million decrease in unemployment benefits paid as the economy recovered and the need for benefits declined. Corresponding to the decrease in unemployment benefits paid, the Trust Fund also had a $452.48 million or 72.54% decrease in nonoperating revenues related to a $467.81 million decrease in federal COVID-19 aid received. The N.C. Turnpike Authority's (NCTA) net position increased by $89.81 million or 38.11% primarily due to a $75.36 million increase in capital contributions and a $55.96 million increase in transfers in from the Highway and Highway Trust Funds. There was also a $23.11 million or 29.7% increase in nonoperating expenses that offset the increases for the NCTA identified above. Nonoperating revenues (expenses) included $115.14 million of interest and fees expense related to debt issued, $10.41 million in investment earnings, and $3.88 million in Federal interest subsidy debt revenue. The net position increase of $112.83 million or 5.43% in the EPA Revolving Loan Fund is due to the Loan Fund continuing to focus on streamlining its processes resulting in more infrastructure projects completed during the year, using a cash flow model to better predict fund disbursements and revenue, and prioritizing the spending of funds from the U.S. EPA (federal) capitalization grant for these projects. The N.C. State Lottery Fund's net position did not change and will continue to remain constant as a result of legislative changes in the methodology used to calculate net revenues to be distributed to the State's governmental activities, as required by statute. A more detailed discussion of the State's business-type enterprise activities is provided in the following section (see Enterprise Funds).

FINANCIAL ANALYSIS OF THE STATE'S FUNDS

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

GOVERNMENTAL FUNDS

The focus of the State's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. At June 30, 2023, the State's governmental funds reported combined fund balances of $28.15 billion, an increase of 16.46% from the prior fiscal year-end (as restated). Of this amount, $7.67 billion is classified as unassigned fund balance in the General Fund (available for spending at the State's discretion). The remainder of fund balance is either nonspendable, restricted, committed, or assigned to indicate that it is: 1) not in spendable form (e.g., inventories), 2) restricted for particular purposes by external sources, 3) committed for particular purposes by the General Assembly, or 4) assigned for particular purposes by the Office of State Budget and Management. The major governmental funds are discussed individually below.

General Fund

The General Fund is the chief operating fund of the State. At June 30, 2023, the fund balance of the General Fund increased 21.18% ($3.91 billion) to $22.37 billion. While the General Fund revenues decreased by $409.44 million (0.61%), the expenditures also decreased by $265.87 million (.43%). The decrease in revenues is primarily due to decreased individual income tax revenues and decreased federal and federal COVID-19 relief funds. For the current fiscal year, the General Fund recognized $5.29 billion in federal COVID-19 relief funds, a decrease of $2.5 billion or 32.1% from the prior year. The Coronavirus Relief Funds (CRF) program has ended and the deadline for expending those funds was December 31, 2021. Also, the federal funding for grants such as the ERA and HEF were reduced from the prior year. The majority of the ARPA Act federal funds have been received, however, not recognized as revenue since the eligibility requirements have not been met. The decrease in expenditures is primarily due to a decrease in grants, state aid and subsidies. The Office of State Budget and Management (OSBM) had the largest decrease, $525.71 million or 29.76%, in grants, state aid and subsidies for COVID-19 programs providing general aid to local governments, hospitals, nonprofits, universities, community colleges and other component units of the State. The Department of Public Safety (DPS) had a decrease of $392.77 million or 44.62%, in grants, state aid and subsidies due to one-time COVID-19 grants being discontinued such as individual grants to sheriff departments, counties and formula grants to nongovernmental entities.

One of the major budget drivers for the General Fund, historically, has been the Medicaid program. Medicaid enrollment increased by 9.17% to 2.93 million individuals (27.06% of North Carolina's population). The enrollment growth was mostly attributable to the FFCRA requirement that any beneficiary receiving the enhanced FMAP coverage would not be dropped or reduced to a lesser benefit category during the COVID-19 PHE. The Federal government ended the PHE on May 11, 2023 and the Division of Health Benefits (DHB) has restarted terminations. State appropriation expenditures for Medicaid increased $734.48 million or 18.41%. Revenues decreased $1 million, mostly related to the phase-down of the 6.2 percentage point increase in FMAP. The rate dropped to 5 percentage points for the last quarter of fiscal year 2023. The Medicaid program ended the fiscal year with unspent state appropriations of $119 million, which were reverted to the General Fund. This is the tenth consecutive year the Medicaid Program has finished with cash on hand. Prior to fiscal year 2014, the Medicaid program experienced shortfalls of nearly $2 billion over a four-year period.

North Carolina's labor market has continued to grow through June 2023. The number of payroll jobs in North Carolina has increased steadily since the pandemic shutdown in 2020, according to the Bureau of Labor Statistics. By June 2023, the seasonally-adjusted unemployment rate had fallen to 3.3% and the number of nonfarm jobs was nearly 4.95 million. In June 2023, there were 116,000 more jobs than in June 2022 and 320,700 more than in June 2021. The trend annualized growth rate for employment was 2.1% during the fiscal year, which slowed from the prior year.

Total tax revenues in the General Fund decreased by $205.21 million or .61% in fiscal year 2023. The major driver in the tax revenue decrease is individual income tax revenues which decreased $1.05 billion or 5.86% in fiscal year 2023. The decrease can be attributed to a decrease of $812.9 million in net individual income tax collections on a cash basis, which was due to legislative tax law changes that impacted withholding amounts for tax years 2022 and 2023. Session Law 2021-180 lowered the individual income tax rate from 5.25% to 4.99% effective January 1, 2022, and to 4.75% effective January 1, 2023. While the overall tax revenues decreased, there was some increase in several of the tax categories. Corporate income tax increased $95.84 million or 5.88%, sales and use tax increased $638.29 million (5.80%), and insurance tax increased $162.56 million (16.23%) from the prior year. Sales and use tax revenues increased because of the growth in personal consumption expenditures. The Bureau of Economic Analysis reported that North Carolina's personal income has shown substantial growth during the fiscal year (5.8%).

Wage and salary income and personal consumption expenditures impact major sources of the State's tax revenues, such as personal income taxes and sales and use taxes. In fiscal year 2023, wage and salary income has increased 7.9% over the prior fiscal year, supporting larger income tax withholding. Despite the growth in wages and salaries, withholding tax collections increased less than 1% this fiscal year, due in large part to an increase in standard deduction amounts in tax year 2022 and decreases in tax rates for tax years 2022 and 2023. The National Bureau of Economic Analysis's data shows continued growth in personal consumption expenditures during the fiscal year, leading to growth in sales and use taxes as well as other state excise taxes.

The corporate income tax revenue remained fairly level, with only a minimal increase in fiscal year 2023. Corporate profits in the U.S. rose after the COVID-19 pandemic for several quarters. The profits peaked in the second quarter of 2022 and have leveled off in recent quarters. The corporate profits are a main contributor of the corporate income tax base, thus impacting the tax revenues. Because the corporations are required to make estimated tax payments each quarter, this lessened the growth of revenues being collected during fiscal year 2023. Insurance tax revenues increased primarily due to an increase in the amount of taxable premiums written by insurers, which resulted in an increase in gross premium tax liability and also the amount of installment payments made toward 2023 premium tax liabilities.

General Fund Budget Variances

The original General Fund budget, including state appropriations and appropriations supported by departmental receipts, serves as a starting point or plan for the Governor to execute the General Fund budget pursuant to the powers granted by the Constitution and State Budget Act. At the state level in North Carolina, it is not unusual for the budget to change during the fiscal year in relation to budget adjustments made to accommodate departmental receipts. The General Fund budget supported by state appropriation is a subset of the General Fund financial schedule presented in the ACFR as required supplementary information. The current ACFR schedule reflects all spending required to support the State's General Fund activities and the funding to support those activities, including state tax and non-tax revenues, federal revenues, student tuition, and other fees, licenses, and fines. Under current state budget management practice, particularly related to departmental federal receipts, primary emphasis is placed on comparisons of the final authorized budget and actual spending.

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

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

Variances – Original and Final Budget

In general, the variances between original and final budget are attributable to the timing and length of the budget preparation process as well as budget adjustments that occurred during fiscal year 2022-23. In January 2021, OSBM finalized the two-year base budget used by the General Assembly for the 2021-23 biennium. This was approximately 11 months prior to the ratification of the biennial budget which started July 1, 2021, and 18 months before the start of fiscal year 2022-23. The amounts budgeted for federal, intra-governmental transfers, fees/licenses/fines, contributions, gifts, grants, and miscellaneous receipts were all estimates. The final budget reflects all budget revisions made throughout the fiscal year based on adjustments to agency grant and receipt revenue and movement from state reserves. Consequently, significant variances are very likely to occur when the original budget is compared to the final budget.

Additional factors leading to variances between the original and final budget in fiscal year 2022-23 include the following:

1) Awarding of new unanticipated federal grants and increases and decreases in amounts for long standing federally supported programs. North Carolina received $5.4 billion in fiscal year 2021-22 from the ARPA in State Fiscal Recovery Funds. The funds were budgeted in fiscal year 2021-22 on a non-recurring basis, with budget adjustments totaling $1.5 billion made in fiscal year 2022-23 to reflect planned expenditures.
2) Statewide encumbrance carry-forward budgeted amounts from fiscal year 2021-22 totaled $1.2 billion, which increased the budget for fiscal year 2022-23 through administrative action.
3) Allocation of hurricane disaster funds that were appropriated and authorized in prior years but not expended until fiscal year 2022-23. State functions agriculture, environment and natural resources, and public safety, corrections and regulation were the biggest recipients.
4) Budgeting of cash balance for economic development grants and awarded obligations such as the Economic Development Project Reserve, Film and Entertainment grants, Rural Economic Development Infrastructure grants, and the Industrial Development Fund Utility Account.
5) Allocation of statewide reserves to agencies and universities, including salary pay plan reserve, disaster relief funding from the State Emergency Response and Disaster Relief fund, the Hurricane Florence Disaster Relief Reserve, Information

Technology Reserve, Retirement Supplement Reserve, Clean Water and Drinking Water Reserve, and State Capital and Infrastructure Fund.

6) Receipts and budgeting of over-realized receipts, prior year earned revenues, and unanticipated donations and grants.
7) Creation of the new Department of Adult Correction (DAC), formerly part of the Department of Public Safety (DPS), resulting in intergovernmental transactions that caused DPS's expenditures to exceed its certified budget due to transfers from DAC.

Variances - Final Budget and Actual Results

Actual total own-source General Fund revenue collected (tax, non-tax and tobacco settlement) was 13.14% higher than budgeted revenue amounts in fiscal year 2023. Tax revenues were 12.24% higher than anticipated primarily due to better-than-expected individual income, corporate income, and sales tax revenues. Non-tax revenues were also higher due to an increase in investment income. Due to the State's historically large cash balance, including both unappropriated General Fund money and reserves, along with rising interest rates, investment income revenues were 689% higher than anticipated. Investment income increased from $60 million in fiscal year 2022 to $480 million this fiscal year.

Collections for individual income taxes, which accounted for 50.64% of total General Fund tax revenue collections, were $1.33 billion (8.61%) higher than the budgeted revenue primarily due to higher-than-expected non-withholding tax payments. Non-withholding tax payments include quarterly estimated payments, final and extension payments and interest and penalties. Combined non-withholding payments were $893 million (18%) above the year-end target. Rising business profits for pass-through entities caused higher than expected collections in non-withholding payments. Withholding payments from wage earnings were $402 million (3.2%) above the year-end target. Sales and use tax collections, which comprised 35.14% of total General Fund tax revenues in fiscal year 2023, were $1.48 billion (14.49%) above the budgeted revenue. Inflation remained elevated for longer than anticipated in the May 2022 revised consensus revenue forecast, thus resulting in higher consumer spending. This higher inflation, rising consumer demand, as well as slower transition to service spending all account for the additional sales and use tax collections. Corporate income tax collections which accounted for 4.9% of total General Fund tax revenues in fiscal year 2023, were $480.31 million (41.6%) above their respective budgeted revenues.

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

Highway Fund

The Highway Fund dates back to 1921 when the General Assembly first imposed the gasoline tax. It accounts for most of the activities of the North Carolina Department of Transportation (NCDOT), including the maintenance and construction of the State's primary and secondary road systems, the Division of Motor Vehicles, transit, aviation, rail, and ferry system. The primary revenue sources of the Highway Fund are federal funds, 75% of motor fuels taxes, vehicle registration fees, driver's license fees, and 2% of sales tax revenues.

The Highway Fund reported a fund balance of $1.2 billion at June 30, 2023, an increase of $18.73 million from the previous year with a restated fund balance of $1.18 billion at June 30, 2022. With the implementation of GASB 94, the Highway Fund restated a deferred inflow that restated and decreased the prior year's ending fund balance in the amount of $70.2 million. While this restatement created the comparative increase in fund balance, the primary activity of the Highway Fund indicates a decrease during the fiscal year. The decrease in fund balance was the result of expenditures for maintaining the highway network and other infrastructure plus increases in operating costs that surpassed revenues.

Total revenues were $4.68 billion, an increase of 9.91% or $421.68 million, and total expenditures increased by 11.9% from $4.36 billion at June 30, 2022 to $4.88 billion at June 30, 2023. The primary factor for the increase in revenues and expenditures is the enaction of House Bill 103, Section 42.3.(a) (HB 103) which is effective for the fiscal year. This bill required the net proceeds of tax collected on aviation gasoline and jet fuel to be transferred to the Highway fund. HB 103 also required a percentage of the net proceeds from the State's sales tax to be transferred and used for transportation needs. For fiscal year 2023, 2% was transferred to the Highway Fund. In fiscal year 2024, the percentage transferred to the Highway Fund decreases to 1% and in fiscal year 2025 and thereafter, the percentage transferred will be 1.5%. Effective January 1, 2023, the motor fuels tax rate increased from 38.5 cents to 40.5 cents per gallon. Revenues also increased because of an increase in the monthly average of STIF interest rate from .02% in fiscal year 2022 to 2.22% in fiscal year 2023. Expenditures increased due to the implementation costs of the ARIBA procurement system, higher capital outlay costs, and increased spending for contract resurfacing and bridge projects. HB 103 required a transfer of $110 million from the Highway fund to the Highway Trust Fund for the purchase of property under the Undue Hardship Advance Acquisition Program.

The State issued $252.6 million in GARVEE bonds in September 2021. This innovative financing tool was used to accelerate the construction on a variety of transportation improvement projects across the State by leveraging future federal transportation revenues. At June 30, 2023, $31.05 million of original GARVEE proceeds were unspent.

Transportation is fundamental in continuing North Carolina's prosperity and quality of life as the state's population continues to grow. To address the growing demand on the transportation system, increased cost of supplies, and slow growing revenues, NCDOT continues to seek innovative solutions to meet the growing stress on the transportation system. Session Law 2020-91 revised the motor fuels tax distribution formula. Effective July 1, 2020, the distribution of motor fuels tax revenue for the Highway Fund increased from 71% to 81%. Effective July 1, 2021, the distribution increased to 80% and effective July 1, 2022, the distribution was reduced to 75%. Session Law 2020-91 also established a motor fuels tax floor. Beginning January 1, 2022, Session Law 2020-91 also required the motor fuel tax rate be calculated pursuant to the formula set in General Statute 105-449.80(a) using as the amount for the preceding calendar year the amount that the motor fuel tax rate would have been for the period beginning July 1, 2021 and ending December 31, 2021.

According to the N.C. Division of Highways, from 2021 to 2022, paved lane miles grew by 0.18%. Vehicle miles traveled increased by 0.92% from 2021 to 2022 as conditions from the COVID-19 pandemic continue to rebound. From 2021 to 2022, bridge deck area grew by 0.3%. These increases place a heavier burden on the existing infrastructure and accentuate the need for additional capacity, safety, and maintenance funding to address the deterioration in service created by the increase in traffic. Furthermore, many of the State's highways were built as farm-to-market roads and were not designed to handle the heavy traffic volumes of today. Other aging highways, such as the interstate highway system, will also require increasing investment to maintain acceptable condition.

New legislation affecting the Highway fund, Session Law 2023-134, Section 2.2.(j), establishes a Transportation Reserve of $450 million for fiscal year 2024 and $100 million for fiscal year 2025. Session Law 2023-134, Section 41.14C.(a)-(f) affects the operations of the Division of Motor Vehicles (DMV) by requiring NCDOT to conduct a study to determine if privatization of DMV operations would improve the Division's delivery of services. In addition, Section 41.14E,(a)-(b) required DMV to develop a plan for adding a fee to transactions where it accepts electronic payments to offset charges the Division pays for electronic payment service. Section 41.14D.(a) increases the fees for certain electric vehicles and plug-in hybrid vehicles.

Highway Trust Fund

Legislation creating the Highway Trust Fund was passed by the General Assembly in 1989. It was established to provide a dedicated funding mechanism to meet specific highway construction needs in North Carolina. Additionally, the Highway Trust Fund provides allocations for the debt service on limited obligation bonds issued for highway purposes. The principal revenue sources of the Highway Trust Fund are highway use taxes, 25% percent of motor fuels taxes, and various title and registration fees. The enabling legislation was amended in 2008 to require annual transfers to the NCTA to pay debt service or financing expenses for specified toll road construction projects (see Note 10B to the financial statements).

The fund balance of the Highway Trust Fund decreased 33.93% to $1.08 billion at June 30, 2023. The fund balance decrease is attributable to expenditures for the Strategic Transportation Improvement Program (STIP) and other projects surpassing revenues.

Total revenues were $1.87 billion, an increase of 14.26% from the prior year. Gasoline taxes increased 33.24% or $148.91 million and highway use taxes increased 4.98% or $51.2 million. As with the Highway fund, legislative action contributed to the increase in revenues for the Highway Trust Fund. The motor fuels distribution percentage increased from 20% in fiscal year 2022 to 25% in fiscal year 2023. Effective January 1, 2023, the motor fuels tax rate increased from 38.5 cents to 40.5 cents per gallon. The increase in highway use tax was due to an increase in the number of transactions to title a motor vehicle in fiscal year 2023 compared to last fiscal year. This was fueled by increased vehicle purchases as the supply chain issues eased and the continuation of new residents moving into North Carolina who must title a vehicle with North Carolina before registering their vehicle.

The Highway Trust Fund reported $2.41 billion in total transportation expenditures, an increase of 15.01% or $314.54 million from the prior year. The increase in expenditures is due to increased activity in the STIP, representing continued growth of statewide construction activities after the COVID-19 pandemic and cash restraints of fiscal year 2020. Expenditures also increased because of project participation from the Highway Trust Fund to Turnpike projects as well as the first payment of the Build NC Series 2022 bonds being made in fiscal year 2023.

In May 2022, the State issued $300 million in special indebtedness (limited obligation Build NC Bonds) as authorized by Session Law 2018-16, Session Law 2020-91 and Session Law 2021-189, which allow for up to $3 billion in bonds over a ten-year period. To date, there have been three issuances totaling $1.3 billion. The proceeds from the bonds can be used for certain regional and divisional transportation projects contained in the STIP. As of June 30, 2023, the unspent original proceeds of the Build NC Bonds (including Service Reserve Funds) were $183.5 million.

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

HB 103, Section 42.3.(a) applies to the Highway Trust Fund as well. Beginning in fiscal year 2024, 3% of the net proceeds from the State's sales tax will be transferred to the Highway Trust Fund. In fiscal year 2025 and thereafter, the percentage transferred to the Highway Trust Fund is 4.5%.

ENTERPRISE FUNDS

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

Unemployment Compensation Fund

The Unemployment Compensation Fund (Unemployment Insurance Trust Fund or "Trust Fund") reported net position of $4.43 billion at June 30, 2023 compared to $3.79 billion at June 30, 2022. The $639.90 million or 16.86% increase in net position is related to various fluctuations, many of which continue to relate to the impacts from the Coronavirus pandemic. Unemployment rates in North Carolina remained low during the 2023 fiscal year. The highest unemployment rates were experienced in the fall of 2022, with rates of 3.9%, and the lowest unemployment rate of 3.3% was reported in June 2023.

The Trust Fund's operating margin (operating revenues less operating expenses) was $468.07 million for fiscal year 2023, a $476.08 million increase (5,937.68%) from the prior year, predominantly as a result of a $397.01 million decrease (59.13%) in unemployment benefits paid. The unemployment benefits paid decreased significantly as the federal pandemic funding ended. Employer unemployment contributions were $720.98 million in the current fiscal year, an increase of $60.35 million related to an available quarterly tax credit for employers in the prior fiscal year, which was not available in the current year.

The Trust Fund reported $171.32 million in nonoperating revenues, which was a $452.48 million decrease (72.54%) from the prior fiscal year. This decrease is almost entirely due to a $467.81 million decrease in federal COVID-19 funds provided through the CARES ACT and the American Rescue Plan (ARP). Nonoperating revenues in the current fiscal year also included $68.98 million in investment earnings, an increase of $16.68 million (31.89%) due to higher interest rates and the 16.86% increase in net position mentioned above.

N.C. State Lottery Fund

The enabling legislation for the N.C. Education Lottery (NCEL) contains a requirement that the net revenues of the NCEL are transferred at least four times a year to the State's General Fund. The legislation defines net revenues as amounts remaining after accrual of expenses for prizes and operations, excluding balance sheet or prior-period expense adjustments of a specific nature. The NCEL transferred $1.016 billion to the General Fund in 2023 to support educational programs for the State. The amount transferred in 2022 was $929.8 million.

For fiscal year 2022-23, net ticket sales increased 11.72% or $455.53 million from the previous fiscal year to $4.34 billion. With this increase in ticket sales, the NCEL saw a corresponding increase in prize payouts of 12.57% or $319.7 million, and an overall increase in operating income of 8.89% or $82.96 million. Significant financial highlights include the following: awarded $1 million or more to an NCEL player for the 882nd time; and released 50 new instant scratch-off games into the marketplace generating gross instant ticket sales of $3 billion.

N.C. Turnpike Authority

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

- The Complete 540 project is a greenfield project in the greater Raleigh area in North Carolina that will link the towns of Apex, Cary, Clayton, Garner, Fuquay-Varina, Holly Springs, Knightdale and Raleigh. Phase 1 will extend the existing Triangle Expressway approximately 17.8 miles from N.C. 55 Bypass in Apex to I-40 in southeast Raleigh to partially complete the "Outer Loop". Unlimited Notice to Proceed was issued for three Design-Build Contracts on September 26, 2019. As of June 30, 2023, design for Phase 1 is complete except for minor design revisions encountered during construction. Right-of-way acquisition, utility relocations and construction are well underway for all three contracts. All 648 right-of-way parcels have been acquired or have entered the condemnation process, and construction is approximately 87% complete. Phase 1 is currently expected to open to traffic in Spring 2024.

The NCTA reported operating income of $2.31 million for fiscal year 2023, which represents an increase in net operating income (loss) of $3.5 million or 293.38% from the prior year. Contributing to the increase was a $4.5 million increase in operating revenues. Operating revenues predominantly consist of toll revenues, fees, and sales revenue from the sale of transponders. The increase in operating revenues was related to an increase in traffic levels that created a $5.35 million increase in toll revenues. Operating expenses only increased by .92% or $1 million, which is insignificant. In addition to the NCTA's operating income, there was also $100.94 million in nonoperating expenses (net), which represents a $23.11 million increase in net expenses (29.7%) or decrease in nonoperating revenues (expenses) from the prior year. Contributing to the decrease was a $9.13 million (46.73%) decrease in investment earnings as a result of NCTA investments getting drawn down to fund the construction of the Complete 540 project. In addition, there was a $13.57 million increase (13.36%) in interest and fees paid related to a NCTA's bond refunding in fiscal year 2023, resulting in no premium amortization for the year, which has been an offset to debt interest in prior years.

Funding for administrative expenses continues to be advanced, as needed, from the Highway Trust Fund to be repaid from NCTA revenue collections. Interest continues to accrue on the unpaid balance of the advance.

The high cost of building, operating, and maintaining a major highway facility is typically more than the revenue a new road can generate through tolls. The gap between what tolling can pay for and the cost of the road requires additional support from the State is known as gap funding. These annual transfers from the Highway Trust Fund to the NCTA are used to pay debt service and fund required reserves on bonds issued to finance turnpike projects. The transfers in include funds received from NCDOT's Highway Fund and Highway Trust Fund during fiscal year 2023 and the Federal Highway Administration State match. While the amount received from NCDOT's Highway Trust Fund for gap funding remained unchanged at $49 million, the transfers in from NCDOT's Highway Trust Fund increased by $38.41 million and by $17.57 million from the Highway Fund, a total increase of $55.98 million or 98.22% related to project participation for the construction of the Southern Wake Expressway (Complete 540 project). In addition, National Highway Performance Program (FHWA) funding was added and billed in fiscal year 2023 for the construction of Complete 540, providing additional funding of $75.36 million in federal capital grants.

NCTA's operating income, nonoperating net expenses and additional funding from transfers and federal capital grants all contributed to an increase of $89.81 million or 38.11% in net position to $325.44 million at the end of fiscal year 2023. In addition to factors identified above, the Complete 540 project has significant impacts on NCTA's balance sheet. Restricted investments decreased by $171.34 million or 35.29% as NCTA continues to use restricted investments for the construction of the Complete 540 project. Land and permanent easements increased by $34.71 million due to the continued right of way acquisitions for the project, and construction in progress increased by $212.28 million or 30.39% as the Complete 540 project construction continues.

EPA Revolving Loan Fund

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

The net position of the Loan Fund increased 5.43% or $112.83 million to $2.19 billion in fiscal year 2023. This increase in net position is due to the Loan Fund continuing to focus on streamlining its processes (requiring municipalities to follow specified timelines that resulted in more infrastructure projects being completed during the year), using a cash flow model to better predict fund disbursements and revenue, and prioritizing the spending of funds from the U.S. EPA (federal) capitalization grants for these projects (as opposed to funds from other sources). The amount of new loans issued during the current year was $142.23 million, an increase of $3.99 million or 2.88%, and the amount of principal received on existing loans during the year was $86.57 million, a $7.78 million or 8.24% decrease. As a result, Notes Receivable increased by $55.65 million. Funds are managed with a long-term focus, typically with more loans issued over time and growth in the net position represents the long-term focus in managing the portfolio.

Operating income (operating revenues less operating expenses) was $7.33 million, a decrease of $2.52 million. Operating revenues and expenses did not vary significantly from the prior year.

Net nonoperating revenues were $86.63 million, a $66.18 million or 323.62% increase from the prior year. Nonoperating revenues consist of noncapital grants (federal capitalization grants) and investment earnings, and nonoperating expenses consist primarily of payments for grants, aid, and subsidies. Noncapital grants were $115.71 million, a $43.8 million or 60.9% increase from the prior year, related to federal grants received for Drinking Water State Revolving Fund projects, including a $23.92 million increase in federal funding for the EPA State Revolving Fund and a $19.86 million increase in grants related to the EPA Drinking Water State Revolving Fund. Investment earnings were $12.88 million, an increase of $36.51 million or 154.52%. In the prior fiscal year, the EPA Revolving Loan Fund reported a $29.5 million unrealized loss, whereas the unrealized loss was only $6.8 million in the current fiscal year, a decrease in the unrealized loss of $22.7 million or 76.95%. Short-Term Investment Fund earnings increased by $13.39 million or 998.97%. Payments for grants, aid, and subsidies increased by $13.47 million or 48.36%. In addition, the EPA Revolving Loan Fund received $18.87 million in transfers for appropriated state match funds for Clean Water and Drinking Water projects, a $4.86 million or 34.63% increase from the prior year.

CAPITAL ASSET AND DEBT ADMINISTRATION

CAPITAL ASSETS

As of June 30, 2023, the State's investment in capital assets was $69.21 billion, an increase of 5.34% from the previous fiscal year-end (see table below).

Capital Assets as of June 30

(net of depreciation, dollars in thousands)

	Governmental Activities		Business-type Activities		Total	
	2023	**2022 (as restated)**	**2023**	**2022 (as restated)**	**2023**	**2022 (as restated)**
Land and permanent easements	$22,328,922	$21,478,222	$ 604,102	$ 569,389	$22,933,024	$ 22,047,611
Buildings	3,022,422	3,080,842	56,972	60,642	3,079,394	3,141,484
Machinery and equipment	872,120	800,731	7,344	7,530	879,464	808,261
Infrastructure:						
State highway system	34,111,784	32,430,494	—	—	34,111,784	32,430,494
NC toll road system	—	—	1,299,269	1,328,953	1,299,269	1,328,953
General infrastructure	230,241	234,036	5,844	6,174	236,085	240,210
Computer software	285,864	303,276	380	521	286,244	303,797
Subscription asset	246,142	189,976	2,691	—	248,833	189,976
Art, literature, and other artifacts	187,454	150,492	1,293	1,293	188,747	151,785
Construction in progress	3,632,415	3,038,804	911,150	698,766	4,543,565	3,737,570
Computer software in development	1,010,516	903,675	—	—	1,010,516	903,675
RTU Land and permanent easements	460	501	—	—	460	501
RTU Buildings	385,893	411,073	5,925	7,585	391,818	418,658
RTU Machinery and equipment	1,454	1,662	301	379	1,755	2,041
RTU General infrastructure	1,090	1,365	—	—	1,090	1,365
Total	$66,316,777	$63,025,149	$ 2,895,271	$ 2,681,232	$69,212,048	$ 65,706,381
Total percent change between fiscal years 2022 and 2023	**5.22 %**		**7.98 %**		**5.34 %**	

The largest component of capital assets is the state highway system. North Carolina has an 80,384 mile highway system, making it the second largest state-maintained highway system in the nation. The major capital asset activity during the current fiscal year included the following:

- The NCDOT reported year-end construction in progress of $3.16 billion for state highway projects. Additionally, the NCTA (business-type activity) reported year-end construction in progress of $745.42 million for the Complete 540 project. This project involves completing the 540 loop around the greater Raleigh area by extending the Triangle Expressway approximately 17.8 miles. NCTA also has $38.73 million construction in progress for the Mid-Currituck Bridge project. This project is a 7-mile roadway toll project, which includes a two-lane bridge, that spans the Currituck Sound and connects the Currituck county mainland to the Outer Banks; it also includes a second two-lane bridge that spans Maple Swamp on the Currituck county mainland.
- The Office of the State Controller (OSC) began replacing the State of North Carolina's legacy financial systems with the North Carolina Financial System (NCFS), an Oracle cloud-based solution, in 2021. The NCFS was implemented in three releases over the past three years, with the first release in April 2021 for the cash management system and the second release in July 2021 for the financial reporting system. At June 30, 2023, the OSC recorded $33.4 million in computer software in development for release three. On October 10, 2023, the OSC successfully launched release three of the NCFS for the accounting system.
- The Department of Military and Veterans Affairs (DMVA) constructed a skilled nursing care facility with 120 private rooms for state veterans in Kernersville, North Carolina. The Kernersville facility is the fifth full-service state veterans' home in North Carolina. The funding for the facility was through a $25.2 million grant from the U.S. Department of Veterans Affairs, State Veterans Home Construction Grant Program. At June 30, 2023, the DMVA recorded $46.73 million in construction and progress. The construction of the facility has since been completed and a ribbon cutting ceremony was held October 31, 2023 officially opening the facility to new residents.
- The Department of Administration (DOA) is collaborating with the Department of Health and Human Services on the Dorothea Dix campus relocation project pursuant to Session Law 2020-88, Section 1.(c). Phase 1 of this project consists of the planning expenses associated with the relocation of the campus. The relocation project is scheduled to be completed in April 2026. At June 30, 2023, the DOA reported $55.56 million in construction in progress for the first phase of the project.

- The Department of Health and Human Services (DHHS) is replacing seven major legacy IT systems. NC FAST, the new system for managing and administering social services benefits, will improve the way DHHS and the 100 county departments of social services conduct business. At year-end, computer software in development for NC FAST totaled $768.67 million.

As further detailed in Note 21E to the financial statements, the State has commitments of $6.41 billion for the construction of highway infrastructure ($6.23 billion for governmental activities and $178.58 million for business-type activities), which are expected to be financed by motor fuels tax collections, motor vehicle fees, toll collections, federal funds, and debt proceeds. Other commitments of $330.48 million for the construction and improvement of state government facilities are expected to be financed primarily by debt proceeds, state appropriations, and federal funds.

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

LONG-TERM DEBT

At year-end, the State had total long-term debt outstanding (bonds, special indebtedness, and notes from direct borrowings) of $7.53 billion, a decrease of 8.62% from the previous fiscal year-end (see table below).

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

	Governmental Activities		Business-type Activities		Total	
	2023	2022 (as restated)	2023	2022	2023	2022 (as restated)
General obligation bonds	$ 1,975,940	$ 2,309,790	$ —	$ —	$ 1,975,940	$ 2,309,790
Special Indebtedness:						
Limited obligation bonds	2,121,490	2,348,890	—	—	2,121,490	2,348,890
GARVEE bonds	918,940	1,023,210	—	—	918,940	1,023,210
Revenue bonds	—	—	1,787,362	2,323,816	1,787,362	2,323,816
Notes from direct borrowings	37,651	43,945	684,525	186,127	722,176	230,072
Total	$ 5,054,021	$ 5,725,835	$ 2,471,887	$ 2,509,943	$ 7,525,908	$ 8,235,778
Total percent change between fiscal years 2022 and 2023	**(11.73)%**		**(1.52)%**		**(8.62)%**	

The State issues two types of tax-supported debt: general obligation (GO) bonds and special indebtedness (i.e., debt not subject to a vote of the people). GO bonds are secured by the full faith, credit, and taxing power of the State and require approval by a majority of voters. The payments on special indebtedness are subject to appropriation by the General Assembly and also may be secured by a lien on facilities or equipment. The General Statutes (Chapter 142, Article 9) prohibit the issuance of special indebtedness except for projects specifically authorized by the General Assembly. Special indebtedness is also known as appropriation-supported debt. Limited obligation bonds may be issued by the State directly rather than through a conduit issuer. The use of alternative financing methods provides financing flexibility to the State and permits the State to take advantage of changing financial and economic environments. The GARVEE bonds are a revenue bond-type debt instrument where the debt service is to be paid solely from federal transportation revenues. The State did not issue any new general obligation bonds, special indebtedness bonds or GARVEE bonds for the fiscal year ended June 30, 2023.

The State's total long-term debt (bonds, special indebtedness, and notes from direct borrowings) reported in governmental activities has increased from $3.48 billion in 2002 to $5.05 billion in 2023, in part due to large issuances of non-GO debt (special indebtedness) for higher education capital projects in previous years. Prior to 2003, the State only issued general obligation debt. The NCTA had its first debt issuance in 2010. The NCTA's long-term debt has increased from $691.56 million in 2010 to $2.45 billion in 2023.

The following is a summary of recent debt authorizations.

Build NC Bond Act of 2018

The 2017-18 Session of the General Assembly authorized the issuance of up to $300 million annually over ten years, not to exceed $3 billion in total, of special indebtedness. The maturity of the bonds is limited to 15 years and the issuance is contingent upon the N.C. State Treasurer's recommendation. The Build NC Bonds will be repaid from appropriations from the Highway Trust Fund. The proceeds will enable the N.C. Department of Transportation to accelerate Regional and Divisional transportation projects authorized pursuant to the State's Strategic Transportation Investments Act (STI), build a debt service reserve fund and pay costs incurred in connection with the issuance of bonds. The Build NC Bond Act of 2018 became effective January 1, 2019. The State has issued $1.3 billion of Build NC Bonds to date, and approximately $1.1 billion remained outstanding at June 30, 2023.

Connect NC Bond Act of 2015
The 2015-16 Session of the General Assembly authorized, subject to a vote of the qualified voters of the State, the issuance of $2 billion of general obligation bonds of the State to be secured by a pledge of the faith and credit and taxing power of the State. The Connect NC Bonds were approved by a statewide voter referendum held on March 15, 2016. The general obligation bonds provided financing for various capital improvements throughout the State as follows: University of North Carolina System ($980 million), North Carolina Community Colleges ($350 million), local parks and infrastructure ($312.5 million), National Guard ($70 million), agriculture ($179 million), State parks and attractions ($100 million), and public safety ($8.5 million). The 2021 Session of the General Assembly (S. L. 2021-180) repealed the remaining authorization of the Connect NC general obligation bonds that had not been issued as of June 30, 2021 and replaces it with pay-as-you-go capital for the remaining amount of $400 million total authorization.

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

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

State of North Carolina
General Obligation Bond Credit Ratings

Rating Agency	Rating	Outlook
Fitch Ratings	AAA	Stable
Moody's Investors Service	Aaa	Stable
Standard & Poor's Rating Services	AAA	Stable

These ratings are the highest attainable from all three rating agencies. In 2023, Standard & Poor's, Moody's Investors Service, and Fitch Ratings, the top three rating agencies, all affirmed the triple-A bond rating for the State. A triple-A bond rating means that North Carolina has followed well-defined financial management policies and has demonstrated strong debt management practices. The rating agencies recognized the State's historically conservative budgeting, financial management, and debt issuance practices. North Carolina remains one of only 14 states with a triple-A rating from all three rating agencies.

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

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

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

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

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

FUTURE OUTLOOK

Next Year's Budget and Rates

In the 2023 Legislative Session the General Assembly passed House Bill 259 (Session Law 2023-134). The General Assembly appropriated $29.7 billion in the General Fund for fiscal year 2023-24, and $30.8 billion for fiscal year 2024-25. The budget provides compensation increases for educators and state employees, reservation of billions of dollars for significant statewide purposes, and additional investment in state and local capital and infrastructure. Specific priorities of the Appropriations Act include:

- Nearly $0.8 billion in fiscal year 2023-24 and $1.2 billion in fiscal year 2024-25 for salary increases for state employees and state-funded local employees: most state agency employees will receive a 4% pay increase in fiscal year 2023-24 and 3% increase in fiscal year 2024-25.
- Adjusted teacher salary schedule, with those paid on statewide teacher salary schedule receiving a 6.7% increase on average over the biennium as well as increased starting teacher pay to $39 thousand in fiscal year 2023-24 and $41 thousand in fiscal year 2024-25.
- New judicial pay structure, added Juvenile Justice positions to the Correctional Officer experience-based salary schedule and additional increases for certain other position types.
- $5 billion for capital projects and retiring state debt.
- $2.8 billion over the biennium for water and sewer infrastructure projects.
- $1.25 billion for a Regional Economic Development Reserve to fund local projects across the state.

House Bill 259 accelerates the personal income tax rate reductions over the next three years:

- from 4.6% to 4.5% in 2024,
- from 4.5% to 4.25% in 2025, and
- from 4.25% to 3.99% in 2026.

These reductions are expected to reduce General Fund revenue by $162 million in fiscal year 2023-24 and $620 million in fiscal year 2024-25. The budget also authorizes up to three additional personal income tax rate reductions of 0.5% each in subsequent years that become effective if General Fund revenue meets certain thresholds.

REQUESTS FOR INFORMATION

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