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, 2022. 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 $11.33 billion or 17.05% as a result of this year's operations. Net position of governmental activities increased by $10.68 billion (17.58%) and net position of business-type activities increased by $652 million (or 11.4%). At year-end, net position of governmental activities and business-type activities totaled $71.4 billion and $6.37 billion, respectively.

— Component units reported net position of $23.55 billion, an increase of $2.21 billion or 10.35% 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 $11.96 billion at June 30, 2021 (as restated) to $18.43 billion at June 30, 2022, an increase of 54.06%.

— The fund balance of the Highway Fund increased from $692.83 million at June 30, 2021 to $1.25 billion at June 30, 2022, an increase of $555.62 million from the previous year. This increase was mainly due to the issuance of GARVEE bonds and increase in transfers in.

— The Highway Trust Fund reported a fund balance of $1.63 billion, a decrease of 11.48% from the previous year. The fund balance decrease is attributable to the overall increase in capital outlay expenditures outpacing the increase in revenues.

— The Unemployment Compensation Fund reported net position of $3.79 billion at June 30, 2022 compared to $3.18 billion at June 30, 2021, an increase of $616.35 million or 19.39%. The increase in net position is due almost entirely to various fluctuations created by impacts from the Coronavirus pandemic, including the continued decreasing unemployment rates since the last quarter of the 2019-20 fiscal year.

— The N.C. State Lottery Fund reported net ticket sales of $3.89 billion, an increase of 2.15% from the previous year. As required by law, the Lottery transferred $929.8 million to the General Fund to support educational programs.

— The N.C. Turnpike Authority (NCTA) reported net position of $260.63 million, a decrease of 7.75% from the previous year. The NCTA had an operating loss of $1.19 million, which represents a decrease in operating loss of $43.88 million from the prior year due to an increase of $50.09 million in operating revenues. The NCTA also had a $4.39 million decrease in nonoperating expenses due to a $15.04 million increase in investment earnings related to a global adjustment and a $10.68 million increase in interest and fees related to interest paid on NCTA's bond debt during the fiscal year.

— The EPA Revolving Loan Fund reported net position of $2.06 billion, an increase of 2.2% from the previous year. Operating income was $9.86 million, and net nonoperating revenues of $20.45 million consisted primarily of federal capitalization grants.

Capital Assets

— The State's investment in capital assets (net of accumulated depreciation) was $65.83 billion, an increase of 5.29% from the previous fiscal year-end.

— Significant year-end construction in progress amounts were for state highway projects ($2.76 billion), an expressway project ($611.89 million), a new system for managing and administering social service benefits ($749.45 million), and a new skilled nursing facility for state veterans ($45.03 million).

Long-term Debt

— The State had total long-term debt outstanding (bonds, special indebtedness, and notes from direct borrowings) of $8.24 billion, a decrease of 1.99% from the previous fiscal year-end. The Highway Trust Fund issued $300 million in special indebtedness limited obligation bonds for regional and divisional transportation projects.

— 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 13 states with a triple-A rating from all three rating agencies.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

Government-wide Financial Statements

The Statement of Net Position and the Statement of Activities are two financial statements that report information about the State, as a whole, and about its activities that should help answer this question: Is the State, as a whole, better off or worse off as a result of this year's activities? These statements include all non-fiduciary assets, deferred outflows of resources, liabilities, and deferred inflows of resources using the accrual basis of accounting. The current year's revenues and expenses are taken into account regardless of when cash is received or paid. The Statement of Net Position (pages 54 and 55) presents all of the State's assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the sum of these components reported as "net position." Over time, increases and decreases in net position measure whether the State's financial position is improving or deteriorating.

The Statement of Activities (pages 56 and 57) presents information showing how the State's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying events giving rise to the change occur, regardless of the timing of related cash flows. Therefore, revenues and expenses are reported in these statements for some items that will only result in cash flows in future fiscal periods (e.g. uncollected taxes and earned but unused vacation leave).

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

- *Governmental Activities* – Most of the State's basic services are reported under this category. Taxes and intergovernmental revenues generally fund these services.
- *Business-type Activities* – The State charges fees to customers to help it cover all or most of the cost of certain services it provides. The State's Unemployment Compensation Fund, the EPA Revolving Loan Fund, the N.C. State Lottery Fund, and the N.C. Turnpike Authority are the predominant business-type activities.
- *Discretely Presented Component Units* – Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. A description of the component units and an address for obtaining their separately issued financial statements can be found beginning on page 80. Discretely presented component units are combined and displayed in a separate discrete column in the government-wide financial statements to emphasize their legal separateness from the State. In addition, financial statements for major component units are presented in the notes to the financial statements (pages 184 and 185).

Fund Financial Statements

The fund financial statements provide more detailed information about the State's most significant funds (i.e., major funds) – not the State as a whole. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the State uses to keep track of specific sources of funding and spending for particular purposes. In addition to the major funds, page 258 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 78 of this report.

Required Supplementary Information

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

Other Supplementary Information

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

FINANCIAL ANALYSIS OF THE STATE AS A WHOLE

Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the State is improving or deteriorating. The State's assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources by $77.77 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, 2022 and 2021

(dollars in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government		Total Percentage Change
	2022	2021 (as restated)	2022	2021 (as restated)	2022	2021 (as restated)	2021-22
Current and other non-current assets	$35,824,347	$26,898,167	$7,621,107	$ 6,827,847	$43,445,454	$33,726,014	28.82%
Capital assets, net	63,154,087	60,079,073	2,676,466	2,442,217	65,830,553	62,521,290	5.29%
Total assets	98,978,434	86,977,240	10,297,573	9,270,064	109,276,007	96,247,304	13.54%
Total deferred outflows of resources	3,276,214	2,544,873	73,654	65,713	3,349,868	2,610,586	28.32%
Long-term liabilities	16,521,036	17,382,305	2,865,871	2,955,033	19,386,907	20,337,338	(4.67%)
Other liabilities	11,057,695	8,875,772	1,059,934	599,031	12,117,629	9,474,803	27.89%
Total liabilities	27,578,731	26,258,077	3,925,805	3,554,064	31,504,536	29,812,141	5.68%
Total deferred inflows of resources	3,280,430	2,544,454	73,968	62,174	3,354,398	2,606,628	28.69%
Net position:							
Net investment in capital assets	59,631,130	56,843,205	493,653	515,390	60,124,783	57,358,595	4.82%
Restricted	2,014,178	1,868,783	204,494	255,800	2,218,672	2,124,583	4.43%
Unrestricted	9,750,179	2,007,594	5,673,307	4,948,349	15,423,486	6,955,943	121.73%
Total net position	$71,395,487	$60,719,582	$6,371,454	$ 5,719,539	$77,766,941	$66,439,121	17.05%

The largest component of the State's net position (77.31% for fiscal year 2022) reflects its investment in capital assets (land, buildings, machinery and equipment, state highway system, toll road system, and other capital assets), less related debt still outstanding that was used to acquire or construct those assets. An additional portion of net position represents restricted net position ($2.22 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 $9.75 billion at June 30, 2022, an increase of $7.74 billion from the prior year. The strong financial results for fiscal year 2022 (i.e., the excess of revenues over expenses of $9.81 billion) contributed to the increase in unrestricted net position. The State also had an increase of cash in fiscal year 2022 of $7.61 billion (39.92% increase). The increase in cash is attributable to the receipt of $1.66 billion in funds from the State Capital Infrastructure Fund (SCIF) as well as increased tax collections revenue for the fiscal year. The State of North Carolina, like many other state and local governments, issues general obligation debt and special indebtedness and distributes the proceeds to state agencies, local governments, and component units. The proceeds are used to construct new buildings and renovate and modernize existing buildings throughout the State, including the State's community college and university campuses, assist county governments in meeting their public school building capital needs, and to provide grants and loans to local governments for clean water and natural gas projects. Of the $6.31 billion of bonds and special indebtedness outstanding for governmental activities at June 30, 2022, approximately $2.74 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, 2022, the State's governmental activities have significant unfunded liabilities for compensated absences of $586 million, pension liabilities of $1.49 billion, net OPEB liabilities of $6.31 billion, workers' compensation of $638.54 million, and claims and judgments payable of $731.7 million (see Note 8 to the financial statements).

The State's overall net position increased $11.33 billion or 17.05% (total primary government) from the prior fiscal year. The net position of the governmental activities increased $10.68 billion or 17.58% and business-type activities increased $651.92 million or 11.4%. The following financial information was derived from the government-wide Statement of Activities:

Changes in Net Position for the Fiscal Years Ended June 30, 2022 and 2021
(dollars in thousands)

	Governmental Activities		Business-type Activities		Total Primary Government		Total Percentage Change
	2022	2021 (as restated)	2022	2021 (as restated)	2022	2021 (as restated)	2021-22
Revenues:							
Program revenues							
Charges for services	$3,110,489	$2,949,224	$4,891,624	$4,658,265	$8,002,113	$7,607,489	5.19%
Operating grants and contributions	30,859,243	23,540,962	695,299	6,907,326	31,554,542	30,448,288	3.63%
Capital grants and contributions	1,149,590	1,281,167	248	21,393	1,149,838	1,302,560	(11.72%)
General revenues							
Taxes:							
Individual income tax	17,845,868	15,368,872	—	—	17,845,868	15,368,872	16.12%
Corporate income tax	1,624,384	1,327,813	—	—	1,624,384	1,327,813	22.34%
Sales and use tax	11,029,810	9,826,411	—	—	11,029,810	9,826,411	12.25%
Motor fuels tax	2,227,883	2,067,262	—	—	2,227,883	2,067,262	7.77%
Franchise tax	879,789	882,332	—	—	879,789	882,332	(0.29%)
Highway use tax	1,137,060	1,003,310	—	—	1,137,060	1,003,310	13.33%
Insurance tax	1,000,680	722,958	—	—	1,000,680	722,958	38.41%
Beverage tax	559,195	533,088	—	—	559,195	533,088	4.90%
Tobacco products tax	296,416	303,060	—	—	296,416	303,060	(2.19%)
Other taxes	372,624	334,913	—	—	372,624	334,913	11.26%
Tobacco settlement	171,849	167,417	—	—	171,849	167,417	2.65%
Federal COVID-19	1,525,132	3,117,857	—	—	1,525,132	3,117,857	(51.08%)
Unrestricted investment earnings	60,506	15,662	—	—	60,506	15,662	286.32%
Noncapital contributions	38,147	91,696	517	1,309	38,664	93,005	(58.43%)
Miscellaneous	67,754	102,661	1,318	—	69,072	102,661	(32.72%)
Total revenues	73,956,419	63,636,665	5,589,006	11,588,293	79,545,425	75,224,958	5.74%
Expenses:							
General government	3,033,443	2,500,096	—	—	3,033,443	2,500,096	21.33%
Primary and secondary education	15,459,082	12,936,328	—	—	15,459,082	12,936,328	19.50%
Higher education	5,473,516	5,142,660	—	—	5,473,516	5,142,660	6.43%
Health and human services	30,645,511	25,629,768	—	—	30,645,511	25,629,768	19.57%
Economic development	435,295	664,528	—	—	435,295	664,528	(34.50%)
Environment and natural resources	816,601	821,398	—	—	816,601	821,398	(0.58%)
Public safety, corrections and regulation	4,777,868	4,536,568	—	—	4,777,868	4,536,568	5.32%
Transportation	3,079,409	2,793,445	—	—	3,079,409	2,793,445	10.24%
Agriculture	249,195	286,217	—	—	249,195	286,217	(12.93%)
Interest on long-term debt	173,241	170,435	—	—	173,241	170,435	1.65%
Unemployment compensation	—	—	672,550	7,317,289	672,550	7,317,289	(90.81%)
N.C. State Lottery	—	—	2,960,246	2,875,899	2,960,246	2,875,899	2.93%
EPA Revolving Loan	—	—	37,447	17,458	37,447	17,458	114.50%
N.C. Turnpike Authority	—	—	210,152	193,813	210,152	193,813	8.43%
Regulatory programs	—	—	139,202	130,118	139,202	130,118	6.98%
Insurance programs	—	—	37,099	35,153	37,099	35,153	5.54%
North Carolina State Fair	—	—	12,657	7,086	12,657	7,086	78.62%
Other business-type activities	—	—	14,696	12,780	14,696	12,780	14.99%
Total expenses	64,143,161	55,481,443	4,084,049	10,589,596	68,227,210	66,071,039	3.26%
Increase in net position before contributions and transfers	9,813,258	8,155,222	1,504,957	998,697	11,318,215	9,153,919	23.64%
Contributions to permanent funds	9,605	7,472	—	—	9,605	7,472	28.55%
Transfers	853,042	833,513	(853,042)	(833,513)	—	—	
Increase (decrease) in net position	10,675,905	8,996,207	651,915	165,184	11,327,820	9,161,391	23.65%
Net position - beginning - restated	60,719,582	51,723,375	5,719,539	5,554,355	66,439,121	57,277,730	15.99%
Net position - ending	$71,395,487	$60,719,582	$6,371,454	$5,719,539	$77,766,941	$66,439,121	17.05%

Governmental Activities. For fiscal year 2022, 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 $10.68 billion (17.58%) resulted for governmental activities. Total revenues increased by 16.22% ($10.32 billion) while total expenses increased by 15.61% ($8.66 billion). The growth in revenues is mainly attributable to the increase in operating grants and contributions, taxes, and other revenues. Operating grants and contributions increased by $7.32 billion or 31.09% due to higher spending in federally supported programs, such as Medicaid, Title IV-E Foster Care and Adoption Assistance programs, Rental Emergency and Homeowner assistance programs, and the Elementary and Secondary School Emergency Relief fund (ESSER fund) as well as increases in federal COVID-19 relief funds (see below). Individual, corporate, and sales and use taxes increased $3.98 billion primarily due to continued economic recovery from the COVID-19 pandemic. The increase in other revenues is also attributable to increases in federal COVID-19 relief funds (see below).

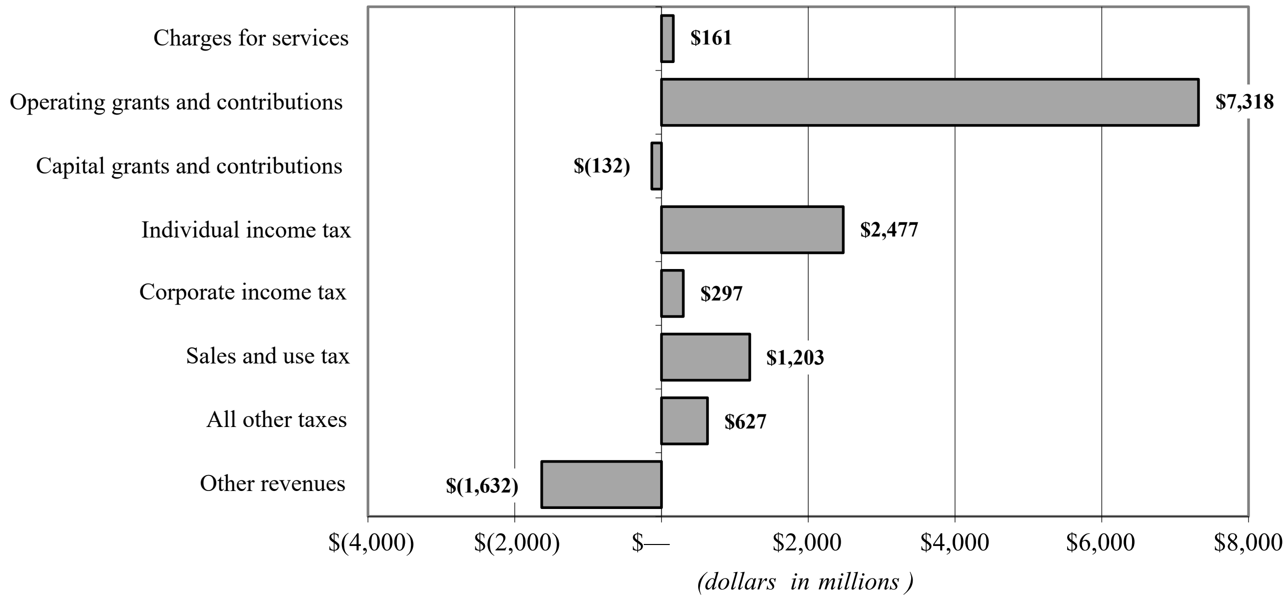
In fiscal year 2020, the U.S. Congress enacted a series of laws, including the Families First Coronavirus Response Act (FFCRA) and the Coronavirus Aid, Relief, and Economic Security (CARES) Act; these laws were a direct response to the economic and societal crises resulting from the COVID-19 pandemic. One purpose of the FFCRA was to provide a 6.2 percentage point increase to the Federal Medical Assistance Percentage (FMAP) for Medicaid, extending broad fiscal relief to states since Medicaid is a countercyclical program. The CARES Act provided widespread assistance to individuals, corporations, and state and local governments. Funding to the State from the CARES Act was allocated directly through the federal Coronavirus Relief Funds (CRF), new initiative programs and new grants. In response to the CARES Act and requirements set forth for the State's CRF, the N.C. General Assembly passed spending bills that allocated the federal CRF monies to areas impacted by the pandemic. They also established the North Carolina Pandemic Recovery Office (NCPRO) to oversee and coordinate the funds made available under COVID-19 Recovery Legislation. The deadline for expending CRF was December 31, 2021.

In March 2021, the United States Congress enacted the American Rescue Plan Act (ARPA) and established the Coronavirus State and Local Fiscal Recovery Fund. These funds were allocated to each state, local government, and tribal government individually. As of June 30, 2022, North Carolina had received $5.41 billion of Coronavirus State Fiscal Recovery funds. The State Fiscal Recovery Funds reduce the impacts of the COVID-19 pandemic and decrease the spread of the virus; replace lost revenue for governments; support economic stabilization caused by the pandemic; and address public health and economic challenges that contributed to the unequal impact of the pandemic. The Coronavirus State Fiscal Recovery funds must be obligated by December 23, 2024 and expended by July 1, 2026.

For fiscal year 2022, the State's governmental activities recognized $7.9 billion of federal COVID-19 funds; $6.38 billion is included in operating grants and contributions (i.e. program revenues) and $1.53 billion 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 an increase of $2.3 billion or 41.07%. The primary factor for the increase is from continued higher federal matching for FMAP of 6.2% (enacted in the FFCRA) for the Medicaid and Title IV-E Foster Care and Adoption Assistance programs; federal funds for the Elementary and Secondary School Emergency Relief Fund (ESSER); and federal funds for the Rental Emergency and Homeowners Assistance programs.

The following chart reflects the dollar change in governmental activities revenues by source between fiscal years 2021 and 2022:

Dollar Change in Governmental Activities Revenues by Source
Between Fiscal Years 2021 and 2022



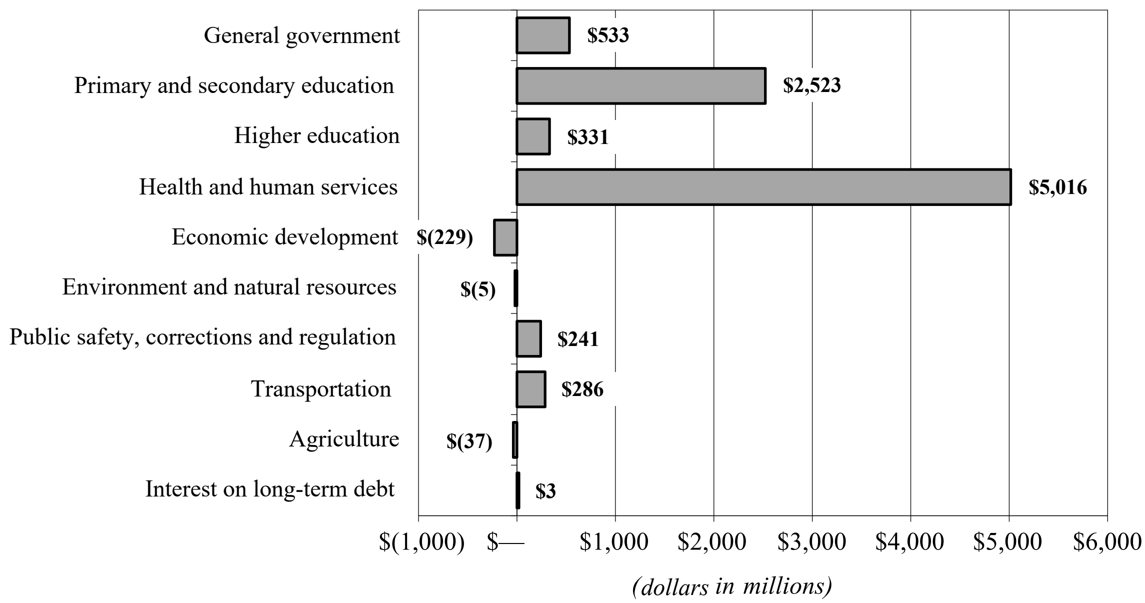
For fiscal year 2022, spending increased in the majority of the State's functional areas, with an exception in Economic Development. Economic Development expenses decreased by $229.23 million or 34.5% primarily due to the reduction in emergency-staffed personnel assisting with unemployment claims, a decrease in contracted services related to COVID-19 relief programs, and an overall decrease in unemployment claims expenditures due to the expiration of the CARES ACT and COVID relief funds.

Total health and human services (HHS) spending increased by 19.57% or $5.02 billion in 2022. For comparison, HHS spending increased by 18.68% and 10.36% in fiscal years 2021 and 2020 respectively. The increase in health and human services is primarily due to the launch of Medicaid managed care on July 1, 2021. Under managed care, the Division of Health Benefits made monthly capitated payments to Prepaid Health Plans while also paying fee-for-service claims to provide for services performed in the prior fiscal year. Another factor is the continued growth in the number of Medicaid enrollees and additional temporary COVID rate increases. Enrollment in Medicaid increased 9.13% during the fiscal year due to an FFCRA requirement that as a condition of receiving enhanced FMAP, coverage for any beneficiary cannot be dropped or reduced to a lesser benefit during a Public Health Emergency (PHE). Medicaid is a federal entitlement program, which means individuals found eligible for Medicaid have legal rights to receive services and cannot be denied coverage by the State. In North Carolina, Medicaid is administered by the State and counties and financed with federal and state funds. Medicaid serves as the State's safety net program for eligible individuals who lose jobs and health insurance coverage. As such, it is sensitive to economic volatility. Because the State receives federal matching funds for this program, there was also a corresponding increase in operating grants and contributions (i.e. program revenues).

Other significant increases in functional expenses for fiscal year 2022 were to general government and primary and secondary education. Total expenses increased 21.33% ($533.35 million) for general government and 19.5% ($2.52 billion) for primary and secondary education. The growth in these functional areas is primarily due to increased spending for COVID-19 aid programs including general aid distributed to local governments, hospitals, nonprofits, universities, colleges, and other component units of the State; and increased state aid provided to local education agencies (LEAs) for continued COVID-19 related programs.

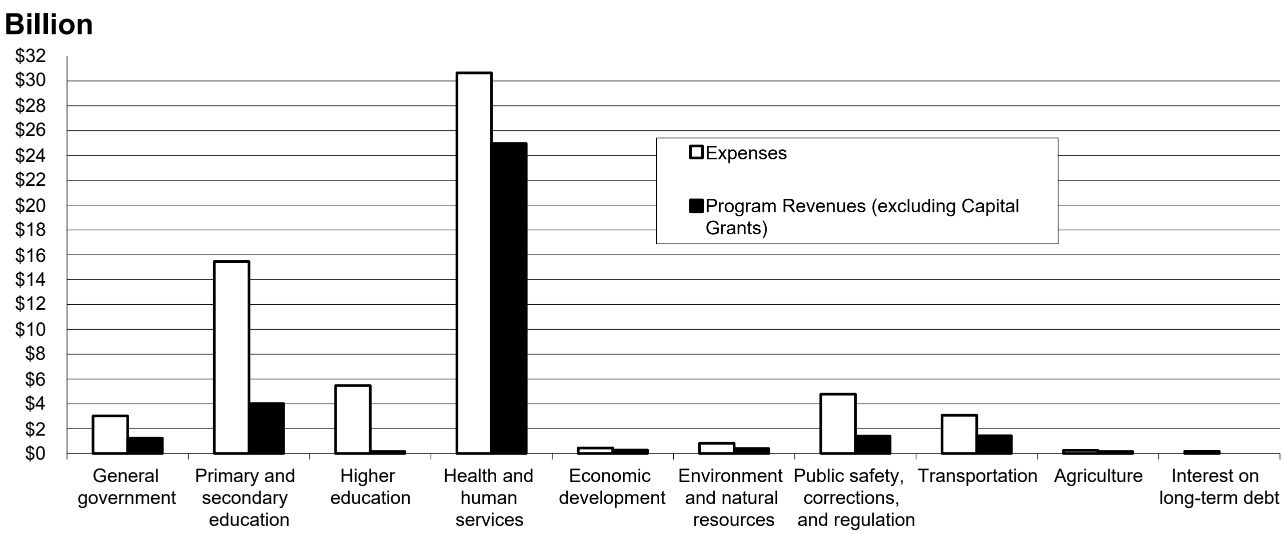
The following chart reflects the dollar change in the functional expenses of governmental activities between fiscal years 2021 and 2022:

Dollar Change in Governmental Activities Functional Expenses
Between Fiscal Years 2021 and 2022



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, 2022



Business-type Activities. Business-type activities reflect an overall increase in net position of $651.92 million or 11.4%, primarily due to the increase in net position in the Unemployment Compensation Fund. The increase in net position of $616.35 million or 19.39% in the Unemployment Compensation Fund (Trust Fund) is due almost entirely to various fluctuations created by the Coronavirus pandemic. The Trust Fund had a $6.64 billion 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 $6.2 billion or 90.86% decrease in nonoperating revenues related to a $5.9 billion decrease in federal COVID-19 aid received. The N.C. Turnpike Authority's net position decreased by $21.9 million or 7.75% primarily due to reporting nonoperating expenses of $77.83 million offset by $57.02 million in transfers in from the Highway and Highway Trust Funds. Nonoperating expenses included $101.58 million of interest and fees expense related to debt issued, which was offset by $19.54 million in investment earnings and $4.02 million in Federal interest subsidy debt revenue. The net position increase of $44.19 million or 2.2% 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, 2022, the State's governmental funds reported combined fund balances of $24.21 billion, an increase of 38.56% from the prior fiscal year-end (as restated). Of this amount, $7.25 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, 2022, the fund balance of the General Fund increased 54.06% ($6.47 billion) to $18.43 billion. General Fund revenues increased by $10.45 billion (18.47%) while expenditures increased by $9.22 billion (17.68%). The increase in revenues is primarily due to increased tax revenues, federal and federal COVID-19 relief funds received. For the current fiscal year, the General Fund recognized $7.79 billion in federal COVID-19 relief funds. These funds derived from two tranches of ARPA Act federal funds, with the first tranche originally received at the end of fiscal year 2021, then transferred to OSBM during early fiscal year 2022. The second tranche of $4 billion was received during fiscal year 2022. However, most of these federal funds were not spent at June 30, 2022 and therefore were recognized as unearned revenue. The increase in expenditures is primarily due to the federal and federal COVID-19 relief funds spent by the various state functions. The expenditures supported aid programs, adoption services and foster care programs, increased DHHS SNAP caseloads, and increased contracted and temporary personal services for DHHS Central Admin support related to the COVID-19 pandemic.

One of the major budget drivers for the General Fund, historically, has been the Medicaid program. Medicaid enrollment increased by 9.13% to 2.69 million individuals (25.22% of North Carolina's population). For comparison, Medicaid enrollment increased 13.55% and 4.35%, respectively, in fiscal years 2021 and 2020. The enrollment growth was mostly attributable to the FFCRA requirement that any beneficiary receiving the enhanced FMAP coverage would not be dropped or reduced to a lesser benefit category during the COVID-19 PHE. State appropriation expenditures for Medicaid increased by $61.3 million or 1.56%. The Medicaid program ended the fiscal year with unspent state appropriations of $49 million, which were reverted to the General Fund. This is the ninth 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 rebounded since the COVID-19 shutdown in the spring of 2020. The number of payroll jobs in North Carolina rebounded in the summer of 2020 and has increased steadily since then, according to the Bureau of Labor Statistics. By June 2022, the unemployment rate had fallen to 3.4% and the number of nonfarm jobs exceeded 4.75 million. These jobs have consistently exceeded the level in February 2019 since October 2021. In June 2022, there were 155,200 more jobs than in June 2021 and 480,100 more than in June 2020. However, North Carolina's labor force participation rate has not rebounded. The national labor force participation rate in February 2020 was estimated to be 61.3%, while the rate was 60.5% in June 2022. North Carolina's labor force participation rate is slightly better than the national trend where the labor force participation rate fell from 63.4% to 62.2% during this period.

Total tax revenues in the General Fund increased by $4.35 billion or 14.94% in fiscal year 2022. Individual income tax revenues increased $2.48 billion or 16.12% and sales and use tax revenues increased $1.2 billion or 12.25% in fiscal year 2022. Corporate income tax also increased $325.74 million or 24.97% and Insurance tax increased $278.69 million or 38.55% from the prior year. The Bureau of Economic Analysis reported that North Carolina's personal income has shown substantial growth during the fiscal year (4.7%), leading to the individual income tax revenue growth. Federal programs designed to provide relief from the pandemic impacts to the economy helped elevate North Carolina's personal income amounts.

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 2022, wage and salary income has increased 11.7% over the prior fiscal year, supporting larger income tax withholding. The State's income tax withholding remained strong during the fiscal year due to the rise in wages and salaries and the shift to higher-income workers. 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 increase is consistent with the trend in the United States. Corporate profits in the U.S. have risen in recent quarters, contributing to an increase in corporate tax revenues. 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 2022 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 2021-22. 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 in November 2021 for the biennium which started July 1, 2021, and a full year prior to the budget certification for fiscal year 2021-22. The amounts budgeted for federal, intra-governmental transfers, fees/licenses/fines, contributions, gifts, grants, and miscellaneous receipts were all estimates. The final budget reflects all budget revisions made throughout the fiscal year based on adjustments to agency grant and receipt revenue and movement from state reserves. Consequently, significant variances are very likely to occur when the original budget is compared to the final budget.

In addition to the normal administrative adjustments that occurred during the year, fiscal year 2020-22 was unusual due to the Coronavirus health emergency that struck in the third and fourth quarter of the fiscal year 2019-20 and continued throughout fiscal year 2021-22. The global pandemic resulted in North Carolina receiving $3.5 billion in federal aid in the fourth quarter of fiscal year 2019-20 that could be spent through December 31, 2021. Additionally, North Carolina received federal funds from the ARPA enacted in March of 2021.

Additional factors leading to variances between the original and final budget in fiscal year 2021-22 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 an additional $1.5 billion for Medicaid due to an increase in the FMAP. Additionally, the State budgeted and expended approximately $1.5 billion in federal Coronavirus Relief Funds during the biennium.
2) Statewide encumbrance carry-forward budgeted amounts from fiscal year 2020-21 totaled $699 million, which increased the budget for fiscal year 2021-22 through administrative action.
3) Allocation of hurricane disaster funds that were appropriated and authorized in prior years but not expended until fiscal year 2021-22. State functions agriculture, environment and natural resources, and public safety, corrections and regulation were the biggest recipients.
4) Allocation of statewide reserves to agencies and universities, totaling $4.6 billion including the SCIF, Medicaid Transformation Funds, Information Technology Reserves, Public School Contingency Reserve, salary pay plan reserve, and disaster relief funding from the State Emergency Response and Disaster Relief fund and the Hurricane Florence Disaster Relief Reserve.
5) Receipts and budgeting of over-realized receipts, prior year earned revenues, and unanticipated donations and grants.

Variances - Final Budget and Actual Results
Actual total own-source General Fund revenue collected (tax, non-tax, and tobacco settlement) was 16.86% higher than budgeted revenue amounts in fiscal year 2022. Tax revenues were 16.98% higher than anticipated primarily due to better-than-expected individual income, corporate income, and sales tax revenues. Non-tax revenues from sources included in certified revenues were 14.1% higher than budget. A shortfall in judicial fees was offset by higher-than-budgeted collections from all other major General Fund nontax revenue sources. Disproportionate Share receipts were higher than anticipated due to adjustments to allotments from prior federal fiscal years. Tobacco Settlement collections were higher than budgeted in part because of an unanticipated settlement unrelated to the Master Settlement Agreement and the exclusion of the statutory transfer to the Golden LEAF Foundation from budgeted revenues.

Collections for individual income taxes, which accounted for 54.5% of total General Fund tax revenue collections, were $3.26 billion (22.77%) higher than the budgeted revenue primarily due to higher-than-expected final and extension payments. Withholding payment from wage earnings were $883 million (7.4%) above the year-end target. Quarterly payments from business owners were also higher than expected and refunds were lower than expected. Higher individual income tax collections were from elevated capital gains realizations, rapid growth in business profits and wages, and lower than expected refunds from taxpayers who benefited from a retroactive tax change allowing deductions for business expenses paid with forgiven Paycheck Protection Program loans. Sales and use tax collections, which comprised 31.64% of total General Fund tax revenues in fiscal year 2022, were $589.4 million (6.13%) above the budgeted revenue. Inflation, particularly for consumer goods affected by global supply chain challenges, remained elevated for longer than anticipated in the June 2021 revised consensus revenue forecast. This higher inflation, rather than rising consumer demand, accounts for most of the additional sales and use tax collections. Corporate income tax collections which accounted for 5.04% of total General Fund tax revenues in fiscal year 2022, were $505.94 million (45.18%) above their respective budgeted revenues. Corporate profits surged by nearly 30% in fiscal year 2021 and continued growing at a more moderate pace in fiscal year 2022.

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, 80% of motor fuels taxes, vehicle registration fees, and driver's license fees.

The fund balance of the Highway Fund increased from $692.83 million at June 30, 2021 to $1.25 billion at June 30, 2022, an increase of 80.20%. The increase in fund balance was primarily due to the issuance of GARVEE bonds ($252.6 million) and an increase in transfers in of $310.94 million. The cash and cash equivalents balance increased by $257.42 million from June 30, 2021 to June 30, 2022.

Total revenues were $4.26 billion, an increase of 0.78% or $32.74 million, and total expenditures increased by 33% from $3.28 billion at June 30, 2021 to $4.36 billion at June 30, 2022. The increase in total revenues was due to increased motor fuels tax collections as overall vehicle travel increased as pandemic restrictions were eased and eliminated. Another contributing factor for increased revenues was an increase in motor fuels tax rate from 36.1 cents to 38.5 cents effective January 1, 2022. Capital outlay and Grants led the increase in expenditures. Contract resurfacing and bridge maintenance project ramp-up post-pandemic were the main contributors to the capital outlay increase. The transfers in increase is primarily due to funds for economic development projects and grants for airport projects. Thus, economic development had a large increase due to $170 million in participation funds from the Department of Commerce Job Development Investment Grant Fund for projects in Randolph and Guilford counties. The increase in directed grants was due to $115.11 million from the SCIF that was distributed to 18 airports across the state.

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, 2022, $193.88 million of the GARVEE proceeds were unspent.

Transportation is fundamental in continuing North Carolina's prosperity and quality of life as the state's population continues to grow. To address the growing demand on the transportation system, increased cost of supplies, and slow growing revenues, NCDOT continues to seek innovative solutions to meet the growing stress on the transportation system. Session Law 2020-91 revised the motor fuels tax distribution formula. Effective July 1, 2020, 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. Effective January 1, 2021, and ending December

31, 2021, the motor fuels excise tax rate shall be the greater of 36.1 cents per gallon or the rate calculated pursuant to G.S. 105-449.80(a).

According to the N.C. Division of Highways, from 2020 to 2021, paved lane miles grew by 0.10%. Vehicle miles traveled dropped by 13.5% from 2019 to 2020 due to the decrease in travel because of the COVID pandemic but rebounded in 2021 to an increase of 11.18%. From 2020 to 2021, bridge deck area grew by 0.25%. These increases place a heavier burden on the existing infrastructure and accentuates the need for additional capacity, safety, and maintenance funding to address the deterioration in service created by the increase in traffic. Furthermore, many of the State's highways were built as farm-to-market roads and were not designed to handle the heavy traffic volumes of today. Other aging highways, such as the interstate highway system, will also require increasing investment to maintain acceptable condition.

Highway Trust Fund

Legislation creating the Highway Trust Fund was passed by the General Assembly in 1989. It was established to provide a dedicated funding mechanism to meet specific highway construction needs in North Carolina. Additionally, the Highway Trust Fund provides allocations for the debt service on limited obligation bonds issued for highway purposes. The principal revenue sources of the Highway Trust Fund are highway use taxes, 20% 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 11.48% to $1.63 billion at June 30, 2022. The fund balance decrease is attributable to the overall increase in capital outlay expenditures outpacing the increase in revenues.

Total revenues were $1.64 billion, an increase of 5.08% from the prior year. Motor fuels taxes increased 15.26% or $59.32 million and highway use taxes increased 3.57% or $35.48 million. The change in the motor fuel distribution percentage (as discussed below) along with post-pandemic recovery and increased travel were the main factors in the overall increase. The increase in highway use tax was due to an average increase in collection amount per transaction in fiscal year 2022 compared to fiscal year 2021. 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. Another contributing factor for increased revenues was an increase in the motor fuels tax rate from 36.1 cents to 38.5 cents effective January 1, 2022. The Highway Trust Fund reported $2.1 billion in total transportation expenditures, an increase of 22.45% or $384.12 million from the previous year. STI capital outlay led this increase due to post-pandemic project ramp-up, additional Build NC funds, and increased construction contract issuance in fiscal year 2022.

In November 2020, the State issued $700 million in special indebtedness (limited obligation bonds) and $300 million in May 2022, as authorized by Session Law 2018-16, Session Law 2020-91 and Session Law 2021-189, which allows for up to $3 billion in bonds over a ten-year period. The proceeds from the bonds can be used for certain regional and divisional transportation projects contained in the Statewide Transportation Improvement Plan (STIP). As of June 30, 2022, the unspent proceeds were $373.67 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. Session Law 2020-91 also established a motor fuels tax floor.

New legislation affecting both the Highway Fund and Highway Trust Fund, House Bill 103, amends General Statute 105-164.44M to require the net proceeds of tax collected on aviation and jet fuel be transferred to the Highway Fund and Highway Trust Fund, effective fiscal year 2022-2023. The percentages to be transferred are as follows:

Fiscal Year	Percentage to Highway Fund	Percentage to Highway Trust Fund
2022-2023	2%	0%
2023-2024	1%	3%
2024-2025 and thereafter	1.5%	4.5%

Data developed by Fiscal Research estimates this transfer will reduce General Fund revenues by $193.1 million in fiscal year 2022-2023, and increasing to a $684.8 million reduction in fiscal year 2026-2027.

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 (Trust Fund) reported net position of $3.79 billion at June 30, 2022 compared to $3.18 billion at June 30, 2021. The $616.35 million or 19.39% increase in net position is related to various fluctuations created almost entirely by impacts from the Coronavirus pandemic. Unemployment rates in North Carolina have continued to decline since the start of the pandemic in the spring of 2020, when businesses were shut down and unemployment rates hit a high of 12.9%. At the end of the 2021 fiscal year, the unemployment rate was 4.6%, and at the end of June 2022, the unemployment rate was 3.4%.

The Trust Fund's operating margin (operating revenues less operating expenses) was negative $8.02 million for fiscal year 2022, a $6.7 billion increase (99.88%) from the prior year, predominantly as a result of a $6.64 billion decrease in unemployment benefits paid. In the prior fiscal year, the Trust Fund received nonoperating revenues from the CARES Act and American Rescue Plan (ARP) programs to pay federal benefits. As these programs are ending, the same level of federal funding was not needed in the current fiscal year to provide for the remaining unemployment benefits. In addition to the significant decrease in unemployment benefits paid, the Trust Fund also had a $68.27 million (11.53%) increase in employer unemployment contributions received. As the economy continued to recover during fiscal year 2022, employer contributions increased as additional employers were added.

Contributing to the increase in net position, the Trust Fund had nonoperating revenues of $623.8 million, a decrease of $6.2 billion or 90.86%. Nonoperating revenues include: $52.3 million of investment earnings, a $15.06 million or 22.36% decrease from the prior year; $572.6 million of federal COVID-19 funds, a $5.9 billion or 91.16% decrease from fiscal year 2021; and miscellaneous expenses of $1.08 million, a $6.16 million or 85.12% decrease from the prior year. There was also a $287.27 million (100%) decrease in noncapital grants as a result of no Extended Benefit program payments being made during the year. Investment earnings declined due to a reduction in the federal interest rate paid, creating a reduction in interest revenue received. Nonoperating revenues have historically provided significant support for the total yearly benefits. For the 2021 fiscal year, the nonoperating revenues supported 93.36% of the total benefits paid for the year, and in fiscal year 2022, nonoperating revenues provided 92.91% of the support.

In addition, in the 2021 fiscal year, there was a $39 million transfer in that provided for the Increased Benefit Assistance (IBA) program, a North Carolina unemployment benefit initiative that increased the calculated weekly benefit amount by $50 each week for eligible claimants. This benefit was not provided in 2022.

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 $929.8 million to the General Fund in 2022 to support educational programs for the State. The amount transferred in 2021 was $936.8 million.

For fiscal year 2021-22, net ticket sales increased 2.15% or $81.68 million from the previous fiscal year to $3.89 billion. With this increase in ticket sales, the NCEL saw a corresponding increase in prize payouts of 3.31% or $81.54 million, and an overall decrease in operating income of 0.24% or $2.2 million. Significant financial highlights include the following: awarded $1 million or more to an NCEL player for the 708th time; and released 52 new instant scratch-off games into the marketplace generating gross instant ticket sales of $2.6 billion.

N.C. Turnpike Authority

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

- The 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 March 31, 2022, design for Phase 1 is complete with the exception of 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 55% complete. Phase 1 is currently expected to open to traffic in Spring 2024.

The NCTA reported a $1.19 million operating loss for fiscal year 2022, which represents a decrease in operating loss of $43.88 million or 97.36% from the prior year. Contributing to the increase was a $50.09 million increase in operating revenues. Operating revenues predominantly consist of toll revenues, fees, and sales revenue from the sale of transponders. Toll revenues increased by $29.66 million, due to an increase in traffic levels and a change in accounting estimate initiated in the prior year for bad debt expense. In fiscal year 2021, there was a one-time adjustment allowance of $17.7 million when the NCTA changed from the direct write-off method to the allowance method, creating a significant increase in the bad debt allowance for tolls in the prior year. In addition, there was a $10.84 million increase in fees, licenses, and fines from the prior year, a 128.07% increase, related to a $10.19 million increase in receipts for late payments fees. Also contributing to the operating revenue increase was a $9.34 million increase (163.23%) in miscellaneous revenues due to a differential revenue accrual for the I-77 Express Lanes. Operating expenses increased by $6.21 million or 6.07%, which is insignificant. Supplies and materials decreased by $4.19 million, services increased by $2.26 million, and other operating expenses increased by $8.27 million. In addition to the NCTA's operating loss, there wase also $77.82 million in nonoperating expenses (net), which represents a $4.39 million decrease or 5.34% from the prior year. Contributing to the net nonoperating expense decrease was a $15.04 million (334.54%) increase in investment earnings related to a global adjustment from Wells Fargo in November of 2021 to the NCTA's 20 Capital Interest Accounts and a $10.68 million (11.75%) increase in interest and fees related to interest paid on NCTA's bond debt.

Beginning in fiscal year 2022, revenue collections provided the funding for administrative expenses. Previously, funding for administrative expenses were 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 requiring 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 2022 and the Federal Highway Administration State match. While the amount received from NCDOT's Highway and Highway Trust for gap funding remained unchanged at $49 million, the transfers in for project participation increased by $2.98 million from the Highway Trust Fund and by $4.1 million from the Highway Fund, a total increase of $7.1 million or 14.18%.

Both NCTA's operating loss and nonoperating expenses contributed to a $21.9 million or 7.75% decrease in net position to $260.63 million at the 2022 fiscal year end. In addition to factors identified above, the Complete 540 project has significant impacts on NCTA's balance sheet. Restricted investments decreased by $313.77 million or 39.26% as NCTA continues to use restricted investments, which have been funded with prior year bond proceeds, for the construction of the Complete 540 project. Land and permanent easements increased by $19.1 million due to the continued right of way acquisitions for the project, and construction in progress increased by $248.84 million or 55.33%, 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 2.2% or $44.19 million to $2.06 billion in fiscal year 2022. 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 $138.24 million, an increase of $6.93 million or 5.28%, and the amount of principal received on existing loans during the year was $94.35 million, a $163.41 million or 63.4% decrease. As a result, Notes Receivable increased by $43.89 million. The variances in loans issued and principal received during fiscal year 2022 is not unusual for a year-over-year fluctuation. Funds are managed with a long-term focus, typically with more loans issued over time. But in any given year, there may be a slight decrease from the previous year. With interest rates being low during the 2021 fiscal year, more communities chose to pay off their existing loans in 2021, resulting in a decrease in principal payments received during fiscal year 2022.

Operating income (operating revenues less operating expenses) was $ 9.86 million, an increase of $3.04 million or 44.55% from the prior year. The increase in operating income was due predominantly to a $3.46 million or 21.7% increase in operating revenues. Operating revenues went from $15.96 million in the prior year to $19.42 million in fiscal year 2022. Sales and services increased by $4.68 million due to the increase in closing fees associated with the State Revolving funds issued. Closing fees are reported as sales and services when received. Loan closing fees are 2% of the issuance, and grant closing fees are 1.5%. The increase is directly related to an increase in loans and grants issues in the 2022 fiscal year. Interest earnings on loans decreased by $1.22 million. Operating expenses did not change significantly from the prior year and were $9.56 million for fiscal year 2022, which represents a $0.43 million or 4.65% increase.

Net nonoperating revenues were $20.45 million, a decrease of $29.73 million or 59.25%. 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 $71.91 million, a $14.66 million or 25.61% increase from the prior year, related to federal grants received for Drinking Water State Revolving Fund projects. Investment earnings were a negative $23.63 million, a decrease of $24.77 million or 2,167.02%. The decrease in investment earnings is due predominantly to the Loan Fund reporting unrealized losses of $29.5 million in fiscal year 2022, an increase of $22.92 million in unrealized losses from the prior year. Payments for grants, aid and subsidies increased by $19.57 million or 236.14% related to grants and loans to local municipalities for Clean Water and Drinking Water projects. In addition, the EPA Revolving Loan Fund received $14.02 million in transfers for appropriated state match funds for Clean Water and Drinking Water projects, a $1.46 million or 11.63% increase from the prior year.

CAPITAL ASSET AND DEBT ADMINISTRATION

CAPITAL ASSETS

As of June 30, 2022, the State's investment in capital assets was $65.83 billion, an increase of 5.29% 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	
	2022	2021 (as restated)	2022	2021 (as restated)	2022	2021 (as restated)
Land and permanent easements	$21,524,138	$20,652,733	$ 569,389	$ 549,128	$22,093,527	$ 21,201,861
Buildings	2,950,614	2,877,194	60,642	53,302	3,011,256	2,930,496
Machinery and equipment	783,481	804,462	7,987	8,393	791,468	812,855
Infrastructure:						
State highway system	32,430,490	31,103,285	—	—	32,430,490	31,103,285
NC toll road system	—	—	1,328,953	1,358,637	1,328,953	1,358,637
General infrastructure	230,355	233,871	6,174	6,524	236,529	240,395
Computer software	303,276	315,483	521	644	303,797	316,127
Art, literature, and other artifacts	148,872	147,576	1,293	1,290	150,165	148,866
Construction in progress	3,473,971	2,735,268	698,766	460,856	4,172,737	3,196,124
Computer software in development	903,675	791,903	—	—	903,675	791,903
RTU Land and permanent easements	501	464	—	—	501	464
RTU Buildings	402,075	413,343	2,741	3,443	404,816	416,786
RTU Machinery and equipment	1,483	2,066	—	—	1,483	2,066
RTU General infrastructure	1,156	1,425	—	—	1,156	1,425
Total	$63,154,087	$60,079,073	$2,676,466	$ 2,442,217	$65,830,553	$ 62,521,290
Total percent change between fiscal years 2021 and 2022	**5.12 %**		**9.59 %**		**5.29 %**	

The largest component of capital assets is the state highway system. North Carolina has an 80,318 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 $611.9 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 $38.04 million construction in progress for the Mid-Currituck Bridge project. This project is a 7-mile roadway toll project, which includes a two-lane bridge, that spans the Currituck Sound and connects the Currituck county mainland to the Outer Banks; it also includes a second two-lane bridge that spans Maple Swamp on the Currituck county mainland.
- The Department of Military and Veterans Affairs is constructing a skilled nursing care facility with 120 private rooms for state veterans in Kernersville, North Carolina. The project is 95% complete. It has a budget of nearly $59 million and is a cooperative effort between the State of North Carolina and the U.S. Department of Veterans Affairs, which provided over $27 million in grant funds. The revised occupancy timeframe for the facility is spring 2023. At year-end, construction in progress for the Kernersville Veterans Home totaled $45.03 million.
- The Department of Health and Human Services (DHHS) is replacing major legacy IT systems. NC FAST, the new system for managing and administering social services benefits, will improve the way DHHS and the 100 county departments of social services conduct business. At year-end, computer software in development for NC FAST totaled $749.45 million.

As further detailed in Note 21E to the financial statements, the State has commitments of $6.095 billion for the construction of highway infrastructure ($6.04 billion for governmental activities and $55.26 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 $344.23 million for the construction and improvement of state government facilities are expected to be financed primarily by debt proceeds, state appropriations, and federal funds.

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

LONG-TERM DEBT

At year-end, the State had total long-term debt outstanding (bonds, special indebtedness, and notes from direct borrowings) of $8.24 billion, a decrease of 1.99% 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	
	2022	**2021 (as restated)**	**2022**	**2021**	**2022**	**2021 (as restated)**
General obligation bonds	$ 2,309,790	$ 2,648,385	$ —	$ —	$ 2,309,790	$ 2,648,385
Special Indebtedness:						
Limited obligation bonds	2,348,890	2,275,750	—	—	2,348,890	2,275,750
GARVEE bonds	1,023,210	875,865	—	—	1,023,210	875,865
Revenue bonds	—	—	2,323,816	2,365,938	2,323,816	2,365,938
Notes from direct borrowings	43,403	50,619	186,127	185,991	229,530	236,610
Total	$ 5,725,293	$ 5,850,619	$ 2,509,943	$ 2,551,929	$ 8,235,236	$ 8,402,548
Total percent change between fiscal years 2021 and 2022	**(2.14)%**		**(1.65)%**		**(1.99)%**	

During the 2022 fiscal year, the State issued $432 million in limited obligation bonds. The State issued $132 million in limited obligation refunding bonds to refund certain maturities of the 2011B limited obligation bonds and 2011C limited obligation bonds. The State issued the 2021 refunding bonds pursuant to the provisions of the State Capital Facilities Finance Act found in General Statute Chapter 142, Article 9, as amended, a resolution of the North Carolina Council of State, and the approval of the State Treasurer. The refunding bonds achieved a net present value savings to the State of approximately $23.6 million. The Highway Trust Fund issued $300 million Build NC special indebtedness limited obligation bonds as part of the $3 billion transportation package approved by the General Assembly. The bond proceeds will be used to finance regional and divisional transportation projects contained in the Statewide Transportation Improvement Plan (STIP), build a debt service reserve fund, and pay the costs incurred in connection with the issuance of the bonds.

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

The State's total long-term debt (bonds, special indebtedness, and notes from direct borrowings) reported in governmental activities has increased from $3.48 billion in 2002 to $5.73 billion in 2022, in part due to large issuances of non-GO debt (special indebtedness) for higher education capital projects. Prior to 2003, the State only issued general obligation debt. The NCTA had its first debt issuance in 2010. The NCTA's long-term debt has increased from $691.56 million in 2010 to $2.51 billion in 2022.

The following is a summary of recent debt authorizations.

Build NC Bond Act of 2018

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

Connect NC Bond Act of 2015

The 2015-16 Session of the General Assembly authorized, subject to a vote of the qualified voters of the State, the issuance of $2 billion of general obligation bonds of the State to be secured by a pledge of the faith and credit and taxing power of the State. The Connect NC Bonds were approved by a statewide voter referendum held on March 15, 2016. The general obligation bonds will provide financing for various capital improvements throughout the State as follows: University of North Carolina System ($980 million), North Carolina Community Colleges ($350 million), local parks and infrastructure ($312.5 million), National Guard ($70 million), agriculture ($179 million), State parks and attractions ($100 million), and public safety ($8.5 million). The 2021 Session of the General Assembly (S. L. 2021-180) repealed the remaining authorization of the Connect NC general obligation bonds that had not been issued as of June 30, 2021 and replaces it with pay-as-you-go capital for the 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 2022, 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 13 states with a triple-A rating from all three rating agencies.

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

Limitations on Debt

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

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

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

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

FUTURE OUTLOOK

Next Year's Budget and Rates

In the 2021-2022 Regular Session, the General Assembly enacted Session Law 2022-74 (House Bill 103). The General Assembly appropriated $27.9 billion in the General Fund for fiscal year 2022-23, which is $1.8 billion above the fiscal year 2021-22 amount, a 7% increase. The fiscal year 2022-23 revised net General Fund appropriations are $922 million greater than the fiscal year 2022-23 appropriations as provided in Session Law 2021-180 (2021 Appropriations Act). 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 2022 Appropriations Act include:

- $369 million to augment the fiscal year 2022-23 salary increases enacted in the 2021 Appropriations Act for state employees and state-funded local employees: most state agency employees will receive a 3.5% pay increase, with teachers receiving a 4.2% increase on average; noncertified public school employees will receive the greater of 4% or an increase to $15 per hour.
- $66 million for labor market salary adjustments to address specific staffing issues by providing targeted salary increases to recruit and retain employees.
- $36 million to increase a budgeted one-time retiree supplement from 3% to 4%.
- $876 million in new reservations for Economic Development Projects.
- $500 million in additional funds transferred into the savings reserve account, which when combined with the $1.13 billion already reserved for fiscal year 2022-23, will bring the total balance to its highest-ever level of $4.75 billion.
- $945 million in total reservations to the State Emergency Response and Disaster Relief Reserve.
- $3.2 billion in mandatory and discretionary funding transferred to the SCIF to support a number of previously authorized capital projects.
- $431 million in Lottery and other state funds provided for the Needs-Based Public School Capital Fund, to increase the number of school construction and renovation grants available to low-wealth counties.

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.