S&P Global Ratings

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Summary:

North Carolina Turnpike Authority North Carolina; Appropriations

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US$115.0 mil triangle expressway sys approp rev bnds (North Carolina) ser 2019 due 01/01/2049		
Long Term Rating	AA+/Stable	New

Rationale

S&P Global Ratings assigned its 'AA+' rating to the North Carolina Turnpike Authority's (NCTA) series 2019 Triangle Expressway System appropriation revenue bonds. The outlook is stable.

The rating is based on the application of S&P Global Ratings' "Issue Credit Ratings Linked To U.S. Public Finance Obligors' Creditworthiness" criteria (published Jan. 22, 2018). We rate these bonds one notch lower than the state of North Carolina's general creditworthiness ([AAA/Stable] general obligation [GO] rating) to reflect the appropriation risk associated with the annual payment.

We note that at the time of publishing this report, the bonds have not received all necessary approvals prior to issuance. The bonds are expected to be considered by the NCTA at its Oct. 31, 2019, board meeting and is also subject to the approval of the Local Government Commission.

The NCTA bonds are special obligations of the authority secured by an annual appropriation to the authority by the state from the North Carolina Highway Trust Fund (HTF). The bonds are not payable by appropriated funds from the general revenues of North Carolina, as is typical of state appropriation bonds. The state-appropriated funds supporting the debt service on the bonds are legislatively appropriated and limited to $25 million annually for the Triangle Expressway project.

The statute creating the HTF requires the General Assembly to appropriate these dollars to the NCTA, and that the appropriation cannot be changed unless the statute is amended. The North Carolina Department of Transportation (NCDOT), which administers the fund, has agreed in the indenture to provide quarterly payments to NCTA in equal amounts that flow directly into the indenture. We view the obligor involvement with the project as strong, given the significance of the projects being financed and the state's support for transportation with little political or administrative risk. However, we view the intended payment source as moderate, given its limitation to the highway trust fund. For fiscal year 2018, the highway trust fund totaled $1.5 billion with funding from the highway use tax of $821 million (53.1% of revenues), motor fuel tax receipts of $565 million (36.5%), and other revenues of $161 million (10.4%).

The series 2019 proceeds will be used to pay certain costs of an extension of the existing Triangle Expressway System from its existing eastern termination point to intersect with I-40 known as Complete 540–Phase 1.

Our opinion of the state's general creditworthiness reflects our view of the following credit factors:

- Strong economic growth expected to exceed that of the nation supported by diverse employment sectors;
- History of prudent fiscal management--this includes making difficult budget decisions to restore fiscal balance when necessary, as well as managing surpluses when they occur, to retain structural budget balance;
- Low-to-moderate debt burden with rapid amortization and state borrowing subject to debt-affordability guidelines, which we believe is an important credit factor for a growing state; and
- Well-funded pension system and progress in addressing other postemployment benefit (OPEB) liabilities, which are significant.

The state's very strong credit fundamentals are anchored by our view of its strong economic profile. The state continues to boast solid job growth with a favorable climate and high housing affordability that have led to in-migration. IHS projects the state's GDP growth will outpace that of the nation over the next five years.

In our view, North Carolina has consistently had well-defined financial management policies and a historical commitment to reserves despite budget challenges. Although the state has previously used nonrecurring reserves to help cover budget gaps, it also implemented deficit mitigation measures to reverse structural imbalance.

For fiscal 2019, the state has outperformed its revenue projections, with 2019 being one of its strongest years of revenue collections. Strong revenue collections were observed in all major categories, led by personal income receipts and very strong April collections. Of the state's three major revenues, personal income came in $461.3 million (3.6%), sales and use was $126.4 million (1.7%), and corporate income was $120.9 million (17.0%) over budget. In total, revenue collections were $896.6 million ahead of budget, or 3.7%.

2019-2021 budget under consideration

The state has not adopted a budget for the fiscal year that began July 1, 2019. However, we do not believe the late budget poses a significant credit risk since the state has been operating under the preceding fiscal year's budget that does not pose structural budget risks. Additionally, the lack of a timely budget is the result of policy disagreements rather than large structural financial gaps that need to be closed.

On June 28, 2019, the governor vetoed House Bill 966, the fiscal 2019-2021 biennial budget that totals $24.0 billion and $24.8 billion in each respective year. Among the items not included in the legislature's budget were a $3.9 billion GO bond referendum (Invest NC) for November 2020, Medicaid expansion to more than 500,000 residents, and various education spending increases the governor had proposed. It is unclear how much longer budget negotiations will continue before the state enacts a budget or if the legislature will have sufficient votes to override the governor's veto.

A late budget is not uncommon for North Carolina. Historically, the legislative session has several times extended past the end of the fiscal year, including 2015, when the fiscal 2016-2017 biennial budget was enacted in September. In 2016, the legislature amended the State Budget Act to allow the director of the budget to continue to allocate funds for expenditures at prior-year levels with no further legislative action if the budget does not pass by June 30. According to the act, when making allocations, the director will ensure the prompt payment of the principal and interest on bonds and notes of the state according to their terms.

For fiscal 2020, the governor's budget proposes available revenues at $25.3 billion and composed of the following taxes: 53% personal income, 31% sales and use, and 6% corporate income taxes. The largest proposed expenditures are education (57.8%), followed by health and human services (22.6%).

The governor's proposed 2020 budget recommends adding $225.6 million to the savings reserve to bring the balance up to $1.48 billion for fiscal 2020, following the fiscal 2019 appropriations for disaster recovery. This would bring the state's reserve balances to 5.9% of fiscal 2020 proposed expenditures. The state has a strong record of replenishing reserves after one-time use, particularly during disaster recovery activities.

For more information on the state's general creditworthiness, see our last full analysis on North Carolina, published May 31, 2019, on RatingsDirect.

North Carolina Highway Trust Fund

The North Carolina HTF provides a dedicated funding mechanism for meeting the state's highway construction needs. The HTF is separate from the highway fund, which accounts for most of the activities of NCDOT, including the maintenance and some construction of the state's primary and secondary road systems.

Revenues of HTF totaled $1.5 billion in fiscal 2018, an increase of 2.4% over the prior year and a 36.7% increase since 2013. HTF's primary revenue sources are 29% of the state's motor fuels tax (MFT), 100% of its highway use tax levied on motor vehicle purchases, other nontax revenue from certificate of title fee and other fees payable to the DMV, and interest and income earned by HTF. For fiscal 2018, MFT and highway use tax accounted for 52.0% and 37.3% of the funds revenues, respectively.

HTF also supports the state's 2018 Build NC Bond Act, an authorized $3 billion of appropriation-backed obligations of up to $300 million annually over the next 10 years (2019-2028). The debt is subject to the state's debt affordability limits; each issuance has a 15-year maturity limit, and the state treasurer is responsible for recommending issuances under the program.

In addition to the Build NC program, HTF provides additional GO debt service for various projects (approximately $52.1 million in 2018) and statutory commitments that include a fixed $49 million appropriated to NCTA for debt service, and $45 million to the North Carolina State Ports Authority for capital projects.

We note that the HTF monthly cash balance has declined over the past year due to increasing loans to the highway fund to accelerate construction projects. As of March 30, 2019, the total amount of the loans from HTF to the highway fund came to approximately $1.1 billion. The state treasurer has recognized the drain on HTF as result of these loans. The state treasurer, NCDOT, and OSBM are in the process of implementing cash management procedures. Such provision include the state treasurer, NCDOT, and OSBM agreeing that prior to the issuance of any Build NC bonds, they will execute a memorandum of understanding concerning the procedures, including reporting and notification provisions, and documentation for such loans and any other interfund transfers to or from HTF.

Despite the increased loan activity from HTF, we do not view it as a material credit weakness to the Build NC bonds or the NCTA appropriation revenue bonds. The state has consistently shown proactive management of its cash balances by implementing and following procedures when necessary. Additionally, the fund itself continues to show robust revenue growth as a result of increasing economic activity and population gains across the state.

Outlook

The stable outlook reflects North Carolina's commitment to strong fiscal management of its budget, reserve balances, debt, and retirement liabilities. The strengths of such commitment have been demonstrated by building reserves during economic expansion and replenishing them after one-time use, maintaining and monitoring compliance with its debt affordability guidelines, and proactively working to reduce its pension and OPEB obligations.

Downward pressure on the rating exists from increasing service and infrastructure demands as the result of a growing population. However, we expect the state's fiscal management practices in place and commitment to structural balance will allow it to address these pressures appropriately. If the state were to soften affordability guidelines or indicate a lack of commitment to its demonstrated prudent management of its strong fiscal condition, we may lower the rating.