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Summary:
North Carolina Turnpike Authority; Appropriations

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Table Of Contents

Summary:

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Credit Profile		
US$98.415 mil Monroe Expwy sys approp state approp rev rfdg bnds Taxable ser 2020 dtd 10/29/2020 due 07/01/2041		
Long Term Rating	AA+/Stable	New

Rating Action

S&P Global Ratings assigned its 'AA+' rating to North Carolina Turnpike Authority's $97 million series 2020 Monroe Expressway System state appropriation revenue refunding bonds. The outlook is stable.

The series 2020 bonds are special obligations of the state payable primarily from a $24 million annual appropriation by the General Assembly from the state's Highway Trust Fund (HTF), which is separate and distinct from the state's general fund.

The 2020 bonds are being issued to refund a portion of the authority's outstanding series 2011 Monroe Connector System state appropriation revenue bonds and to pay for certain costs of issuance. Projected savings are level throughout the life of the bonds and there is no extension of maturities.

Credit overview

We rate the bonds one notch lower than North Carolina's general creditworthiness (as reflected in our 'AAA' general obligation [GO] rating on the state) to account for the appropriation risk associated with the HTF funds.

In our view, these bonds have a strong relationship to the obligor and are providing funding for projects we believe are significantly important to the state. We consider the intended payment source of revenues to the HTF to be moderate. In our opinion, there is no unusual political, timing, or administrative risk related to the debt payment.

The outlook on the series 2020 bonds reflects the outlook on North Carolina.

The stable outlook on the state reflects our view that North Carolina will continue to exercise proactive fiscal management to steer through the challenges of the sudden-stop recession. It also reflects the state's commitment to strong fiscal management of the budget, reserve balances, debt, and retirement liabilities. The state has demonstrated the strength of such commitments by building reserves during the recent 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 other postemployment benefit obligations. Furthermore, we anticipate that the underlying strengths and structural features of North Carolina's economy will support growth after economic shocks recede.

Environmental, social, and governance factors

Our view of the environmental, social, and governance risks for the bonds aligns with those on the state.

We view North Carolina's social risks in line with that of the sector as a whole, supported by strong economic growth and demographic trends over the past decade. In addition, we view the state's governance risks as being in line with the sector and the state has historically maintained a strong management and policy framework to respond to developing risks. However, environmental risk is somewhat elevated compared with that of other states due to some 300 miles of coastline along the Atlantic Ocean and susceptibility to adverse weather events. In our view, North Carolina has undertaken efforts to address this risk including directing all cabinet agencies to integrate climate adaption and resiliency planning into their planning and operations and creating a statewide climate risk assessment and resilience plan.

We view the risks posed by the pandemic to public health and safety as a social risk, which, if sustained, could weaken North Carolina's economy, liquidity, and budgetary performance. For more information on the potential effects of the pandemic on state credit conditions, see "The COVID-19 Outbreak Weakens U.S. State And Local Government Credit Conditions" (published on April 2, 2020) and "U.S. States Mid-Year Sector View: States Will Continue To Be Tested In Unprecedented Ways" (published on July 13, 2020), both on RatingsDirect.

Stable Outlook

Downside scenario

We believe North Carolina faces significant budgetary challenges in the wake of the pandemic. Although unexpected given the state's historical track record and current revenue projections, we could lower the rating on North Carolina if solutions to budgetary gaps relied extensively on one-time items or if there were no plans to rebuild reserves following withdrawals.

In addition, we believe the rating could be pressured from increasing service, infrastructure, and capital demands as the result of a growing population and recurring severe weather events. However, we expect North Carolina's fiscal management practices in place and commitment to structural balance will allow the state to address these pressures appropriately. If the state were to soften affordability guidelines or indicate a lack of commitment to demonstrated prudent management of its strong fiscal condition, we could lower the rating.

Upside scenario

Any upward rating potential for the bonds is currently limited by both the state 'AAA' GO rating and the linkage to the state established to account for the appropriation risk associated with the HTF funds.

For more information on the State of North Carolina, please see our latest analysis published Sept. 25, 2020.

Credit Opinion

Bonds provisions and structure

State statutes provide for a continuing annual appropriation of $24 million from the HTF to the authority to pay debt service or related financing costs and expenses issued for the construction of the Monroe Expressway System. According to the trust agreement, the North Carolina Department of Transportation (NCDOT), which administers the HTF, has agreed to provide equal quarterly payments from the HTF to the authority on Nov. 16, Feb. 16, May 16, and Aug. 16, each year. The trust agreement requires these quarterly payments to be immediately transferred from the revenue fund to the interest and principal accounts, respectively, of the debt service fund.

Semiannual debt service payments for the bonds are due July 1, and Jan. 1, each year. Although the first debt service payment is due just one day following the close of North Carolina's fiscal year, we believe there are provisions in place which mitigate the risk of late budget adoption. Specifically, provisions are in place that allow the director of the budget to continue to allocate funds for debt payment with no further legislative action if the budget does not pass by June 30. The state's budget director is statutorily required to make prompt payment of all indebtedness according to their terms in the event of a continuing resolution.

There is a debt service reserve, created by the original trust agreement, funded at the maximum interest subsidy payment expected to be received in the current or any future fiscal year.

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.

The HTF's primary revenue sources are the state's motor fuels tax (MFT), highway use tax levied on motor vehicle purchases, other nontax revenue from certificate of title fee and other fees payable to the Department of Motor Vehicles, and interest and income earned by the HTF. Recent legislation reduced the proportion of MFT revenues directed to the HTF in order to increase funding to the highway fund for NCDOT. The HTF had historically received 29% of MFT collections while the remaining balance was directed to the highway fund. Session law 2020-91 directs MFT revenues as follows: 19% to the HTF and 81% to the highway fund in fiscal 2021, 20% to the HTF and 80% to the highway fund in fiscal 2022, and 25% to the HTF and 75% to the highway fund in fiscal 2023 and thereafter. We do not currently anticipate that the reductions in MFT revenues to the HTF will materially affect the ability of the HTF to support the bonds.

The COVID-19 pandemic caused revenues to the HTF to decline in fiscal 2020 following years of growth during the economic expansion. Specifically, revenues of the HTF totaled $1.56 billion in fiscal 2020, a decline of 2.8% from the $1.6 billion collected in fiscal 2019; leading up to the recession, growth had averaged 3.8% from 2017 through 2019. In July 2020, North Carolina passed legislation that established a 36.1-cent floor for the MFT rate per gallon that management reports is expected to prevent further declines in MFT collections.

In addition to the debt service on Build NC bonds, HTF provides additional GO debt service for various projects (approximately $59.8 million outstanding as of fiscal 2019 was fully retired on June 1, 2020) and statutory commitments that include a fixed $49 million appropriated to the North Carolina Turnpike Authority 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 two years due in part to increasing loans to the highway fund to accelerate construction projects. As of Sept. 30, 2020, the total amount of the loans from the HTF to the highway fund came to approximately $940.3 million. The state treasurer has recognized the drain on HTF as result of these loans. The state treasurer, NCDOT, and the Office of State Budget and Management (OSBM) have begun to implement cash management procedures including entering into a memorandum of understanding. The agreement, effective Oct. 2, 2020, concerns the procedures, including reporting and notification provisions, and documentation for such loans and any other interfund transfers to or from HTF.

The state has consistently shown proactive management of its cash balances by implementing and following procedures when necessary. Most recently, session law 2020-91 requires NCDOT to develop a comprehensive cash-spending plan to spend money from any source, including federal funds and proceeds from any Build NC bonds. NCDOT is required to present the plan to the Board of Transportation (BOT), the newly created position of transportation oversight manager at the OSBM, and the state budget director for approval. Within 30 days of receipt of the plan, the BOT, the transportation oversight manager, and the state budget director shall either approve the plan or report any objections, with specificity, to various members of the General Assembly and the Fiscal Research Division if the General Assembly is not in session.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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