State of North Carolina

Debt Affordability Study

February 1, 2009

Debt Affordability Advisory Committee

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STATE OF NORTH CAROLINA
DEBT AFFORDABILITY ADVISORY COMMITTEE

February 1, 2009

To: Governor Beverly Perdue
Lieutenant Governor Walter Dalton, President of the North Carolina Senate
Senator Marc Basnight, President Pro Tempore of the North Carolina Senate
Representative Joseph Hackney, Speaker of the North Carolina House of Representatives
Members of the 2009 General Assembly through the Fiscal Research Division

Attached is the February 1, 2009 report of the Debt Affordability Advisory Committee submitted to you pursuant to North Carolina General Statute §142-101. The report was created to serve as a tool for sound debt management practices by the State of North Carolina.

The report provides the Governor and the General Assembly with a basis for assessing the impact of future debt issuance on the State's fiscal position and enables informed decision-making regarding both financing proposals and capital spending priorities. A secondary purpose of the report is to provide a methodology for measuring, monitoring and managing the State's debt levels, thereby protecting North Carolina's bond ratings of AAA/Aaa/AAA.

The 2007 Session of the General Assembly authorized amendments to General Statute §142-101. Pursuant to those amendments, The Committee also presents its recommendation of available debt capacity for the Highway and Highway Trust Funds.

The methodology used by the Committee to analyze the State's debt position incorporates historical and future trends in debt levels, peer group comparisons and provides recommendations within adopted guidelines. The Committee has also provided recommendations regarding other debt and financial management related policies considered desirable and consistent with the sound management of the State's debt. Such recommendations were developed incorporating management practices consistent with those utilized by the most highly-rated states.

Respectfully submitted,

Janet Cowell, State Treasurer
Chair, Debt Affordability Advisory Committee

Members of the Debt Affordability Advisory Committee:

Ms. Janet Cowell, State Treasurer

Mr. Kenneth Lay, Secretary of Revenue

Mr. Charles Perusse, State Budget Officer

Ms. Beth Wood, State Auditor

Mr. David McCoy, State Controller

Mr. Christopher Henson, Senate Appointee

Mr. James V. Porto, House Appointee

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Executive Summary

Studies of debt affordability are essential management tools that help to provide a comprehensive assessment of a government's ability to issue debt for its capital needs. Standard & Poor's, one of the three major bond rating agencies, stated in a 2005 report that "Most of the 'AAA' states have a clearly articulated debt management policy. Evaluating the impact of new or authorized but un-issued bond programs on future operating budgets is an important element of debt management and assessing debt affordability."

Control of tax-supported debt is a key factor affecting credit quality. North Carolina currently maintains a reasonable level of debt when compared with its peer group composed of the other states rated "triple A" by all three bond rating agencies.

The Debt Affordability Advisory Committee (the "Committee" or "DAAC") is required to annually advise the Governor and the General Assembly of the estimated debt capacity of the General, Highway and Highway Trust Funds for the upcoming ten Fiscal Years. The legislation also directs the Committee to recommend other debt management policies it considers desirable and consistent with the sound management of the State's debt. The Committee hereby presents its Study for 2009.

General Fund Debt Capacity Recommendations
The Committee has adopted the following targets and outside guidelines to measure the recommended amount of General Fund – supported debt that the State could prudently authorize and issue over the next 10 years:

- Net Tax-Supported Debt Service as a percentage of General Tax Revenues should be targeted at no more than 4% and not exceed 4.75%;
- Net Tax-Supported Debt as a percentage of Personal Income should be targeted at no more than 2.5% and not exceed 3.0%; and
- The amount of debt to be retired over the next ten years should be targeted at no less than 55% and not decline below 50%.

The Committee adopts the ratio of net tax-supported debt service as a percentage of revenues as the preferred ratio for the base calculations. It further determines that a measure of annual debt capacity over a given time period provides a more useful management tool for policymakers than a measure that assumes that available debt capacity is utilized as soon as it is available.

Due to weaker than anticipated revenues and also due to increased authorizations of debt in recent years, the model calculates that the State could annually authorize $50.2 million of new General Fund tax-supported debt over the model horizon and remain within its targeted ratios.

Table 1

General Fund
Net Tax-Supported Debt Capacity using 4.0% debt service/revenues target ratio
(In Millions of dollars)

Fiscal Year	2009	2010	2011	2012	2013
Total Additional Debt Capacity per Year *	$188.1	$14.2	$0.6	$222.0	$548.1
Debt Capacity Available Each and Every Year	50.2	50.2	50.2	50.2	50.2

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

<u>Transportation Debt Capacity Recommendations</u>
As required by § 142-10, the report also includes a calculation of transportation debt capacity. Due to the interdependent nature of the Highway Fund and the Highway Trust Fund, the Committee has determined that it is more useful to calculate the available debt capacities of these Funds on an aggregate basis. The Debt Affordability Advisory Committee has adopted the measure of annual debt service arising from transportation-related debt as a percentage of state transportation revenues as its basis to evaluate the level of Transportation debt capacity. By measuring what portion of the State's transportation resources is committed to debt-related fixed costs, this ratio reflects the flexibility (or lack thereof) to allocate transportation resources to other priorities.

The Committee has adopted a guideline of 6% for transportation-related debt service as a percentage of state transportation revenues. In doing so, the Committee determined that an increased use of debt is appropriate to fund the State's capital intensive transportation infrastructure needs. Due to weaker than anticipated transportation revenues through Fiscal Year 2012-2013 but also to the appropriation of substantial funds to support debt to be issued by the North Carolina Turnpike Authority, the model does not project any available Transportation debt capacity until Fiscal Year 2011-2012.

Table 2

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

Fiscal Year	2009	2010	2011	2012	2013
Total Additional Debt Capacity per Year *	$0.0	$0.0	$0.0	$32.6	$60.6
Debt Capacity Available Each and Every Year	N/A	N/A	N/A	N/A	N/A

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

Other Recommendations

The Committee confirms its view that North Carolina's priorities of achieving structural budgetary balance and rebuilding the State's reserve funds are strong evidence of financial stability and flexibility. The Committee also recognizes that legislative action has targeted an 8% level of reserves in the State's Budget Stabilization Fund (also known as the "Rainy Day Fund") and believes this targeted level is consistent with previous Committee recommendations and should serve the State well in the event of an economic turndown.

In the current economic climate, the Committee recognizes that drawdowns of the State reserves may be inevitable. However, the Committee recommends that fund balances be replenished as quickly as possible and that budgetary structural balance, a key factor in maintaining our "triple A" bond rating, is established and maintained.

General Obligation Bonds versus Special Indebtedness

The State has relied extensively on the authorization of Special Indebtedness (for example, Certificates of Participation and lease revenue bonds) to provide debt financing for capital projects since 2000. Such 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 "GO" bonds and typically carries a higher interest rate, which increases the cost of projects so financed. The State's General Fund percentage of non-voter approved Special Indebtedness is projected to exceed the median level for states in its peer group. Therefore the Committee recommends that the State consider the authorization of General Obligation debt as the preferred method to provide debt financing for its capital needs.

Conclusions

Currently, all of the State's debt ratios are at or below the median levels for the State's peer group composed of states rated "triple A" by all three rating agencies. North Carolina's debt is considered manageable at current levels.

After three years of strong revenue growth the State now anticipates a less robust environment. The model's revenue component has been adjusted accordingly and annual General Fund debt capacity to authorize new debt is projected to be $50.2 million over the 10-year model horizon. The Committee recognizes that the State's $2 billion of authorized but unissued debt provides a significant opportunity for economic stimulus. The combined debt capacity of the Highway Fund and the Highway Trust Fund has been exhausted through Fiscal Year 2011-2012 and recovers only modestly thereafter over the 10-year model horizon. On a combined basis, the General Fund and Transportation Funds debt service is projected to peak at approximately 4.22% of revenues in Fiscal Year 2011-2012.

Introduction and Background

In 2003, the North Carolina Department of State Treasurer prepared the first Debt Affordability Study to provide a methodology for measuring, monitoring and managing the State's debt capacity. In 2004, the General Assembly adopted legislation creating a Debt Affordability Advisory Committee to annually advise the Governor and the General Assembly on the estimated debt capacity of the State for the upcoming ten Fiscal Years. In 2007, the Debt Affordability Committee was directed by the General Assembly to develop recommendations regarding the debt capacities of the Highway Fund and Highway Trust Fund as well as for the State's General Fund.

Debt capacity is a limited and scarce resource. It should be used only after evaluating the expected results and foregone opportunities. The Study enables the State to structure its future debt issuances within existing and future resource constraints by providing a comparison of its current debt position to relevant industry and peer group standards. The Study can thus be used to help develop and implement the State's capital budget. The Study is premised on the concept that resources as well as needs should guide the State's debt issuance program.

Although the State's debt burden remains manageable, establishing guidelines for future debt issuance and financial performance is a critical part of prudent debt management and can keep the debt burden from becoming excessive. The Committee recognizes that such guidelines must strike a balance between providing sufficient debt capacity to allow for the funding of essential capital projects and imposing sufficient discipline so that the State does not create a situation that results in a loss of future budgetary flexibility that could lead to a deteriorating credit position. Control of debt burden is one of the four key factors used by rating agencies' analysts in assessing credit quality. The other three are economic vitality and diversity, fiscal performance and flexibility and the administrative capabilities of government.

The Debt Affordability Advisory Committee has recommended both target and maximum (ceilings) debt ratios to use as guidelines to measure and control the State's General Fund debt burden. The adoption of such guidelines demonstrates that the State is committed to decreasing capital spending or finding new sources of revenue rather than imposing an excessive debt burden on future budgets. The Committee has also provided a guideline to measure the amount of debt supported by the Highway Fund and the Highway Trust Fund that the State could prudently incur.

PART A
GENERAL FUND DEBT AFFORDABILTIY

Section I – Review of General Fund Debt

Outstanding Debt

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

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

The State's outstanding gross and net tax-supported debt positions as of June 30, 2008 are shown below.

Chart 1

State of North Carolina Outstanding Net Tax-Supported Debt

	June 30, 2008
General Obligation Bonds Total	$ 5,533,634,403
Less: Payable from Highway Trust Fund	648,025,000
Net General Fund Tax-Supported General Obligation Bonds	$ 4,885,609,403
Appropriation Supported Indebtedness:	
Certificates of Participation / Lease Revenue Bonds	$ 1,233,136,764
Less: Self-Supporting payable from Energy Performance Contracts, [1] Tobacco and Health and Wellness Trust Funds	247,520,062
Net Tax-Supported Certificates of Participation / Lease Revenue Bonds	$ 985,616,702
Plus: Installment Purchase Contracts / Equipment & Capital Leases [2]	55,871,665
Net Appropriation-Supported Indebtedness	$ 1,041,488,367
Total General Fund and Highway Tax-Supported Debt	$ 6,822,642,832
Less: Self - Supporting / HighwayTrust Fund Debt	895,545,062
Net General Fund Tax-Supported Debt	$ 5,927,097,770

[1] HB 1264 Debt Supported by the Clean Water, Natural Heritage and Parks and Recreation Trust Funds is not considered to be self-supporting because these Trust Funds flow through the General Fund.
[2] Source: Office of State Budget & Management pursuant to G.S. 147-33.72H.

General Obligation Bonds versus Special Indebtedness

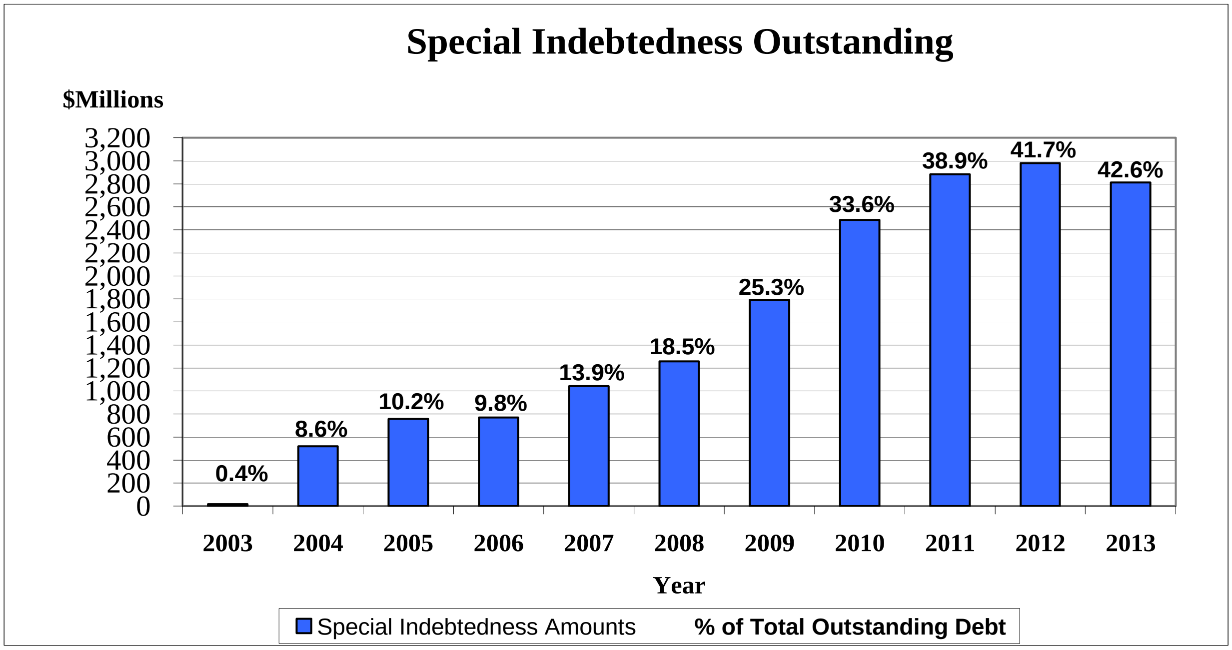
Prior to 2001, the State issued only GO debt. Such debt is usually considered to be the highest quality of all the various types of debt or debt-like instruments and usually carries the highest credit rating. Several factors contribute to the high rating including the legal protections inherent in constitutionally permitted debt, investor confidence in the pledge of the full faith and credit of the State and the presumption of the availability of the government's full resources. GO bonds are generally the most transparent of the various types of State debt obligations and typically carry the lowest interest cost. The General Assembly did authorize $107 million of General Obligation debt for the Green Square project in 2008.

Special Indebtedness, also termed appropriation-supported debt, is a relatively recent financing vehicle employed by the State. Sometimes secured by a specific stream of revenues, a lease payment or financing agreement (and sometimes by a security interest in the project being financed), or totally unsecured, such obligations are paid from annual appropriated amounts for debt service. Depending upon the credit and structure, appropriation-supported debt is usually assessed an interest rate penalty ranging from 5 to 20 basis points when compared with the State's GO bonds. Although modest, the interest rate penalty does increase the cost of the projects being financed.

Most states have diversified their debt portfolios and utilize these non-GO structures, which include Limited Obligation Bonds, Certificates of Participation and lease revenue bonds. However, the State of North Carolina has relied extensively on authorizing this type of financing since 2000.

The amount of the State's outstanding appropriation-supported debt is shown below, with the percentage of appropriation-supported debt to total debt noted. Also shown is a projection of the amount and percentage of appropriation-supported debt through Fiscal Year 2012-2013, assuming issuance of all existing debt authorizations and no new authorizations.

Chart 2



Note: % of Total Outstanding Debt includes debt funded by the Highway and the Highway Trust Fund.

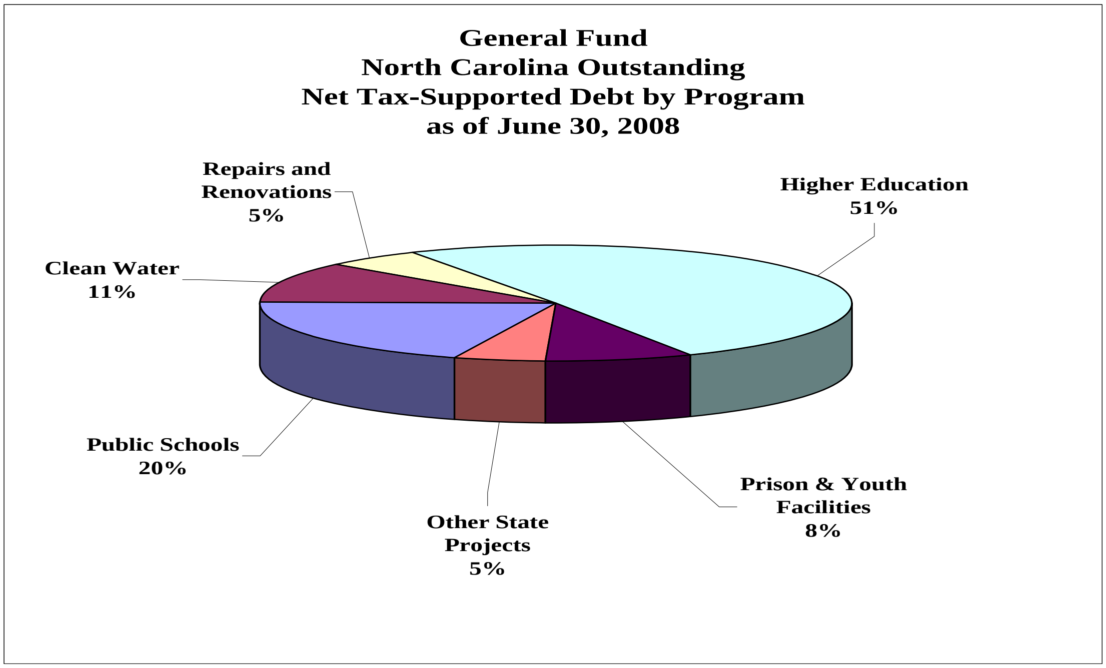
In December 2006, FitchRatings published a report analyzing the amount of non-GO debt currently carried by all 50 states. They found that the higher-rated states tend to have the highest amount of GO debt relative to their total debt positions. For example, for “triple A” states, the median ratio of GO debt to total tax-supported debt was 74%, while the ratio for all “double A” states (without modifiers) was 70%. The State of North Carolina’s debt is currently in the range of the medians reported for the “triple A” states. However, including all authorized but unissued debt, the percentage of non-GO debt is projected to increase well beyond the medians for “triple A” states and exceed the median for “double A” states as well.

The Committee therefore recommends that the State consider the authorization of General Obligation debt as the preferred method to provide debt financing.

Uses of Outstanding General Fund Tax-Supported Debt

The following chart illustrates the uses for which the State has issued net tax-supported debt calculated on the amount outstanding. The State has used the proceeds of its debt programs for many purposes with the two largest being to provide facilities and infrastructure for higher education (51%) and public schools (20%).

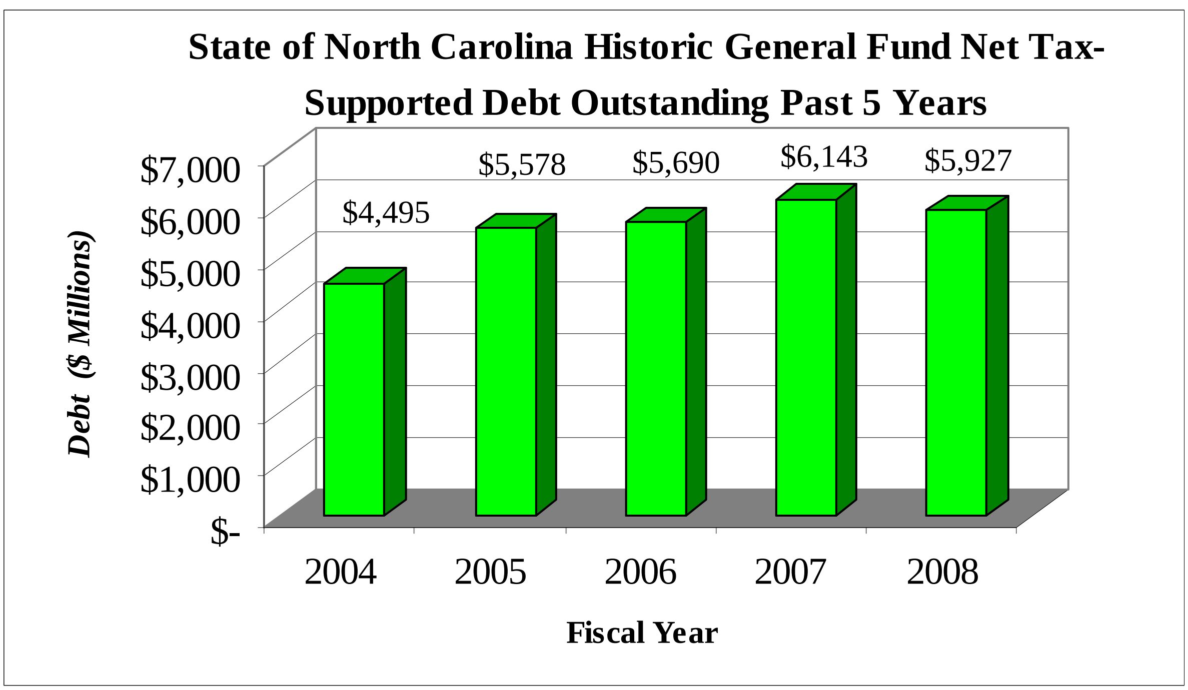
Chart 3



Growth in State General Fund Debt

Net tax-supported debt has shown overall growth as the State has used debt financing to address the requirements of a growing population for education and other capital needs. Tax-supported debt increased from approximately $4.5 billion at June 30, 2004 to $5.9 billion at June 30, 2008. Chart 4 below illustrates the outstanding amounts of General Fund net tax-supported debt over the last five years.

Chart 4



General Fund - Authorized but Unissued Debt

The State issues debt on a cash flow basis. Bond issues are timed to provide funds as they are actually needed. Therefore there is typically a lag between when debt is authorized and when it is actually issued. As of the end of December 2008, the amount of such authorized but unissued net tax-supported debt totaled approximately $2.0 billion, composed of $107 of General Obligation debt and the remainder of appropriation-supported debt. For planning purposes, the State anticipates issuance of all currently authorized but unissued debt by the end of Fiscal Year 2011-2012.

Chart 5 below shows the projected pace of net General Fund tax-supported debt issuance over the next four years. As discussed previously, Special Indebtedness payable from non tax-supported revenue is excluded.

Chart 5

Currently Authorized but Unissued General Fund Net Tax-Supported Debt

Plan of Issuance as of December 31, 2008

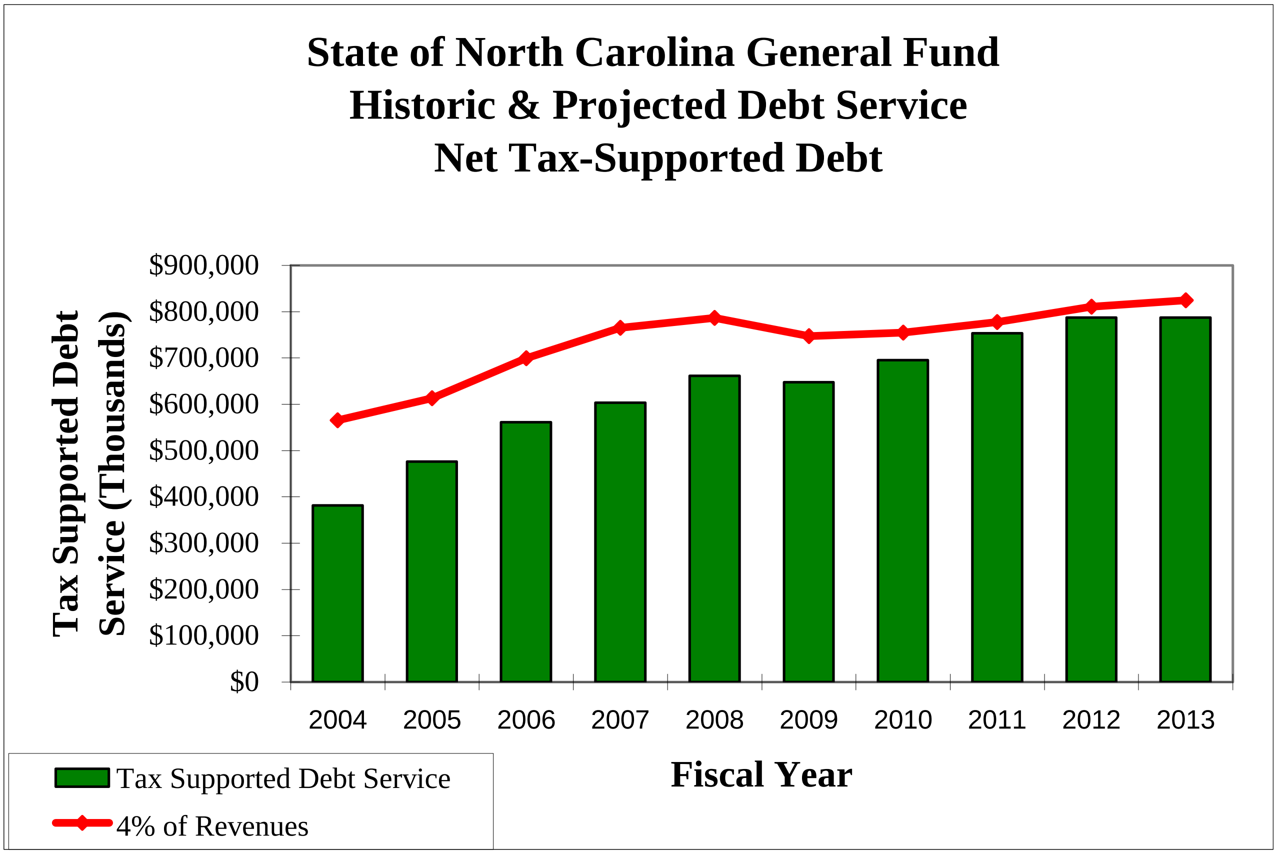
(Dollars in Millions)

	General Obligation	*Special Indebtedness*					
	GO Total	University Projects	Psychiatric Hospitals	Parks & Land	Correctional Facilities	State Projects & Other	Total
Authorized & Unissued as of December 31, 2008	$107.0	$989.8	$296.9	$145.0	$277.8	$198.7	$2,015.2
Assumed Issued							
FY 2009	107.0	94.9	4.5	85.7	63.5	89.2	$444.8
FY 2010	0.0	379.7	134.9	59.3	96.7	50.8	$721.4
FY 2011	0.0	318.7	97.3	0.0	72.7	36.3	$525.0
FY 2012	0.0	196.5	60.2	0.0	44.9	22.4	$324.0
Total:	$107.0	$989.8	$296.9	$145.0	$277.8	$198.7	$2,015.2

Debt Service

Over the last five years, the amount the State spends on debt service has risen, both on an absolute basis and as a percentage of general tax revenues. This trend is expected to continue, as the absolute amount of outstanding debt increases except for a modest decline in this fiscal year due to the timing of the issuances. Both the State's historic and projected debt service, incorporating the debt service on all authorized but unissued amounts, is illustrated below in Chart 6.

Chart 6



As the State continues to issue debt that has already been authorized, the absolute level of General Fund tax-supported debt is projected to increase and will stand at approximately $6.43 billion by the end of Fiscal Year 2010-2011. After declining slightly in Fiscal Year 2008-2009, debt service will increase through Fiscal Year 2011-2012, declining thereafter. As a percentage of general tax revenues, General Fund-supported debt service peaks in Fiscal Year 2011-2012 at 3.93%. The ratio of debt to personal income is projected to remain constant at to 1.9% through Fiscal Year 2010-2011 and to decline thereafter. The ten-year payout ratio, which stood at 55% at June 30, 2008, is projected to meet or exceed its target through the model horizon.

Section II - Review of State Credit Ratings and Comparative Ratios

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

Chart 7

North Carolina Credit Rating Matrix

State of North Carolina

General Obligation Bond Credit Ratings

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

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

Comparison of Debt Ratios to Selected Medians

A comparison to peer group medians is helpful because absolute values are more useful with a basis for comparison. In addition, the rating agencies combine General Fund and Transportation tax-supported debt in their comparative analysis. The primary source for this information is Moody's 2008 State Debt Medians and Standard & Poor's 2007 Public Finance Report Card.

How North Carolina compares with its peers for the three debt ratios evaluated is presented below. The peer group is composed of states rated "triple A" by all three credit rating agencies. As shown in Chart 8, the State's debt ratios are at or below the median levels for its peer group.

Chart 8

General Fund
North Carolina Comparative Debt Ratios *

State	Ratings (Fitch/S&P/Moody's)	Debt to Personal Income	Debt per Capita	2006 Total Debt Service as % of General Fund Expenditures
Delaware	AAA/AAA/Aaa	5.2%	$2,002	3.9%
Georgia	AAA/AAA/Aaa	3.0%	954	3.0%
Maryland	AAA/AAA/Aaa	3.0%	1,297	5.6%
Missouri	AAA/AAA/Aaa	2.1%	675	1.5%
North Carolina	AAA/AAA/Aaa	2.8%	898	2.0%
Utah	AAA/AAA/Aaa	1.9%	542	3.5%
Virginia	AAA/AAA/Aaa	1.9%	764	3.2%
	Peer Group Median	2.8%	$898	3.2%
	NC Ratio to Median	100.0%	100.0%	62.5%

Tax-Supported Debt Ratios

North Carolina	Debt to Personal Income	Debt per Capita	Tax-Supported Debt Service as a % of DAAC Revenues
2008 (Actual)	1.9%	$645	3.4%
2009	1.9%	$639	3.5%
2010	1.9%	$660	3.7%
2011	1.9%	$656	3.9%

* Source: Moody's 2008 State Debt Medians, Standard & Poor's June 2007 Public Finance Report Card and selected calculated information.

North Carolina projections are based on February 1, 2009 DAAC Report.

Section III - General Fund Debt Affordability Model

The Debt Affordability Committee has adopted the measure of annual debt service arising from net tax-supported debt as a percentage of general tax revenues as its basis to evaluate the State's existing and projected debt burden for the General Fund. The Committee notes that policymakers control both variables that determine this ratio. By measuring what portion of the State's resources is committed to debt-related fixed costs, this ratio reflects the State's budgetary flexibility and ability to respond to economic downturns.

The results of the model are presented both as a total aggregate and as an annual amount which smoothes the solution over time. The result is the amount of new debt that the State can afford to authorize and issue each and every year while staying within its targeted ratios. Section IV and Appendix A contain the detailed presentation of the model solutions.

Debt Used in the General Fund Model Calculation

The model uses a definition of net tax-supported debt that includes General Obligation Bonds, Special Indebtedness, Capital Lease Obligations, Installment/Equipment Leasing Obligations and any other such obligations that are owed to a third party over a predetermined schedule from General Fund Revenues. Obligations of Component Units, Highway Fund debt paid from Highway Fund revenues, non tax-supported special indebtedness paid from non-general fund supported trust funds and other self-supporting or non-tax supported debt such as revenue bonds and short term tax anticipation notes are excluded from the definition of net tax-supported debt. Also excluded are obligations termed Other Post Employment Benefits ("OPEB") estimated to total $28.6 billion. See Appendix A for more discussion of OPEB and its exclusion from the model.

Model Assumptions regarding Revenue Growth

The Committee recognizes that it cannot predict the future level of interest rates or the pace of revenue growth and recognizes the sensitivity of the model results to such factors. Changes in revenue estimates have a particularly significant impact on the calculation of available debt capacity. In consultation with the Office of State Budget and Management ("OSBM"), the Committee has departed from its historic practice of assuming a 3% average annual growth assumption for revenues used in the Debt Affordability model ("DAAC revenues"). For Fiscal Years 2008-2009 and thereafter, revenues are reduced from the levels anticipated in last year's report. See Part C, Appendix A (page 31) for more details.

Debt Structuring Assumptions

The following assumptions were used in this year's debt affordability model calculations:

- The interest rate on existing Variable Rate Debt will average 4%.
- The State has $107 million of General Obligation ("GO") debt remaining to be issued. The debt will be structured with a 20-year level principal and the interest cost is estimated to be 5.75%.
- Non-GO debt will be structured with a 20-year maturity with an overall level debt service profile after the first year the assumed interest cost is 6%.
- Incremental model debt will be structured with a fixed rate 20-year maturity, a 6% interest rate, and an overall level principal payment profile after the initial years.

SECTION IV – General Fund Guidelines and Model Results

Net Tax-Supported Debt Service as a Percentage of General Tax Revenues

The Committee adopted the following target and ceiling guidelines as the preferred measure used to determine the amount of net tax-supported debt that can be prudently authorized by the State:

- Net Tax-Supported Debt Service as a percentage of General Fund DAAC Revenues should be targeted at no more than 4% and not exceed 4.75%.

The Committee adopted a revision in the manner that the amount of debt affordability is presented for the 2006 report, recognizing that a measure of affordability that assumes that all additional debt that the State has the capacity to authorize is issued in the year it is available is not consistent with current practice. There is often a time lag, sometimes of multiple years, between when debt is authorized and when it is issued. The adopted annual measure smoothes the amount of debt the State can afford to prudently authorize each and every year for the model horizon without exceeding its target ratios. In practice, the limit imposed by the year of the least capacity over the model horizon (2012) drives the smoothing.

4% Target Ratio/Debt Service Impact

Illustrated below the first line is the actual amount of new tax-supported debt that could be authorized and issued by year staying within the 4.0% target ratio. One important source of capacity is the retirement of existing debt. As the State retires debt, the amount retired becomes a resource of future capacity. The amount of debt to be retired totals nearly $2.1 billion through Fiscal Year 2012-2013. Finally, the debt service arising from the presumed authorization and issuance of $50.2 million annually is illustrated.

Table 3

General Fund

Net Tax-Supported Debt Capacity using 4.0% debt service/revenues target ratio

(In Millions of dollars)

Fiscal Year	2009	2010	2011	2012	2013
Total Additional Debt Capacity per Year *	$188.1	$14.2	$0.6	$222.0	$548.1
Debt Capacity Available Each and Every Year	50.2	50.2	50.2	50.2	50.2

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

Table 4

General Fund

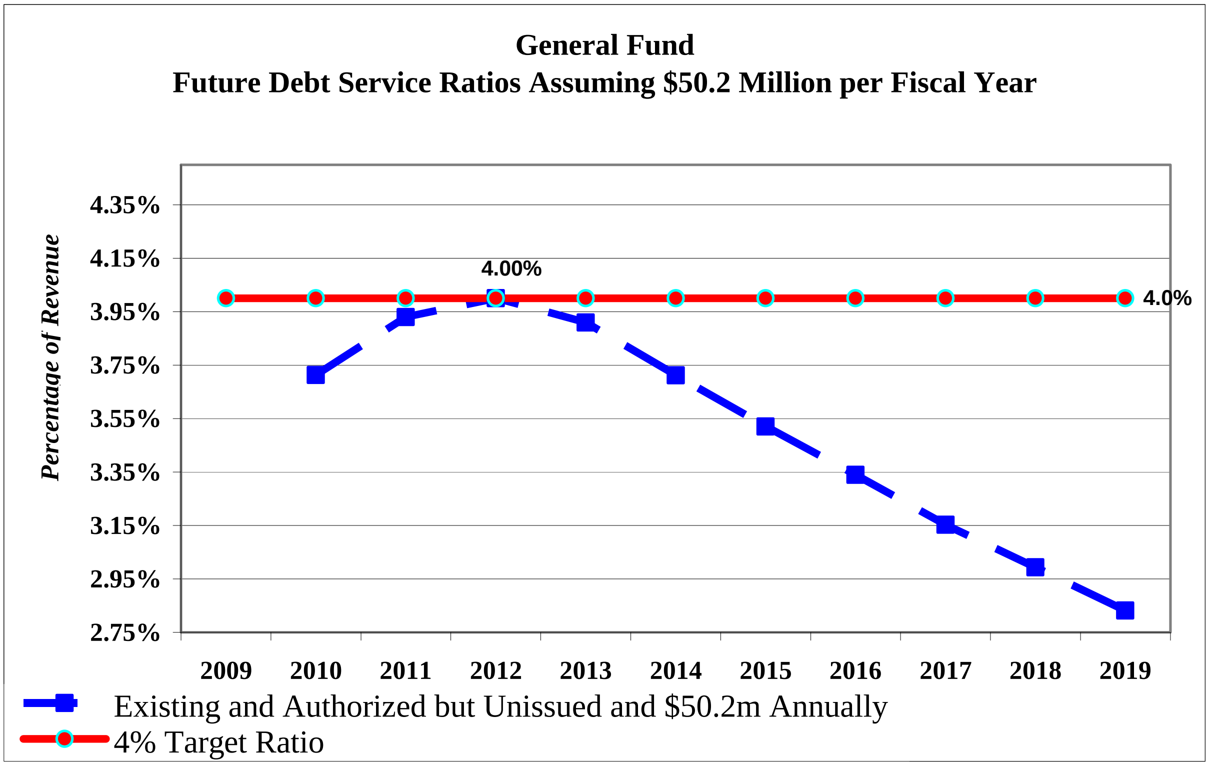
Retirement of Outstanding Debt Compared to the Annual Debt Capacity

(In Millions of Dollars)

Fiscal Year	2009	2010	2011	2012	2013
Retirement of Outstanding Debt	$368	$392	$428	$454	$470
Debt Capacity in Excess of Retirement of Debt	0.0	0.0	0.0	0.0	0.0
Additional Debt Service on Debt Capacity ($50.2 Million/Yr)	0.0	5.7	10.5	13.9	19.2

A chart showing the ratio of debt service to revenues that is the result, assuming the annual $50.2 million is authorized and issued, is shown below in Chart 9.

Chart 9



Sensitivity Analysis on 4% Target Solution

The model results are highly sensitive to changes in revenue assumptions. Specifically, a one percent change, either up or down, in general tax revenues in each and every year of the model solution horizon will change the amount of annual debt capacity each and every year by approximately $27 million. A variation in revenues of $100 million per year will impact the amount of new debt that may be prudently issued each and every year by approximately $12 million. Note that these relationships may not hold for large variations (especially declines) in revenue.

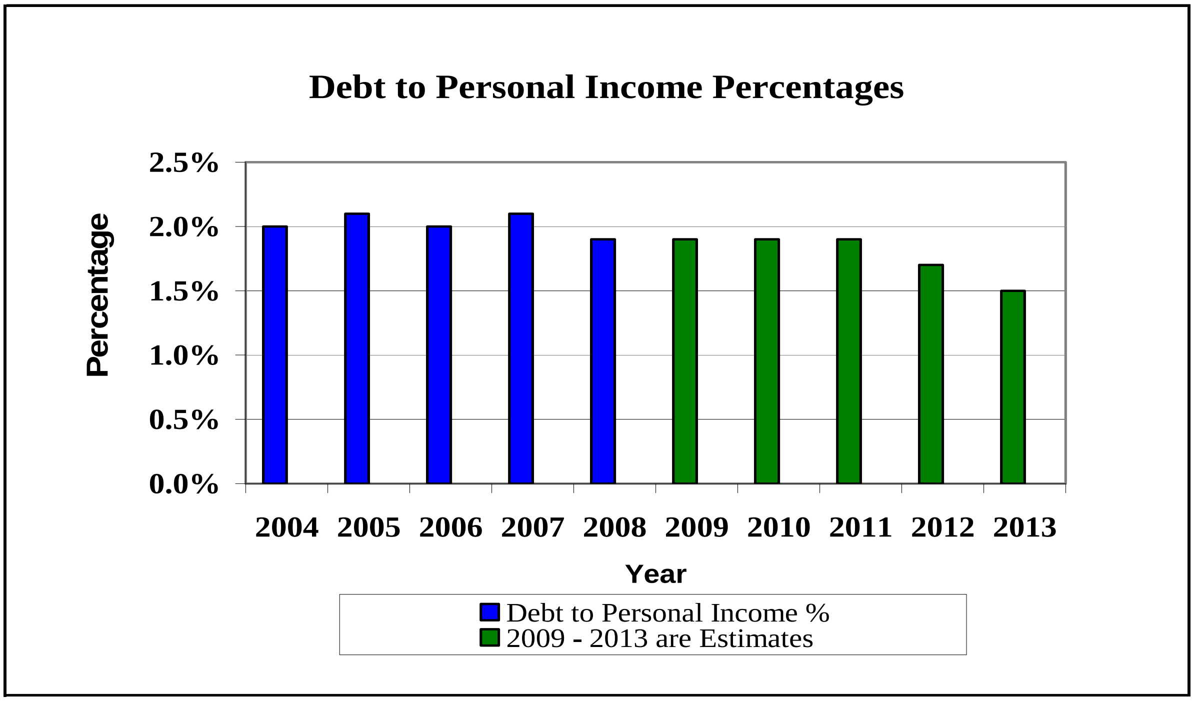
Net Tax-Supported Debt to Personal Income

The Committee has also established guidelines for evaluating the State's debt burden as a measure of personal income, as follows:

- Net Tax-supported Debt as a percentage of Personal Income should be targeted at no more than 2.5% and not exceed 3.0%.

Chart 10 below shows that the amount of tax-supported debt as a percentage of personal income had been rising but peaked in Fiscal Year 2006-2007.

Chart 10



Source: Population and Personal Income statistics provided by "Moody's Economy.com" courtesy of the North Carolina General Assembly Fiscal Research Division.

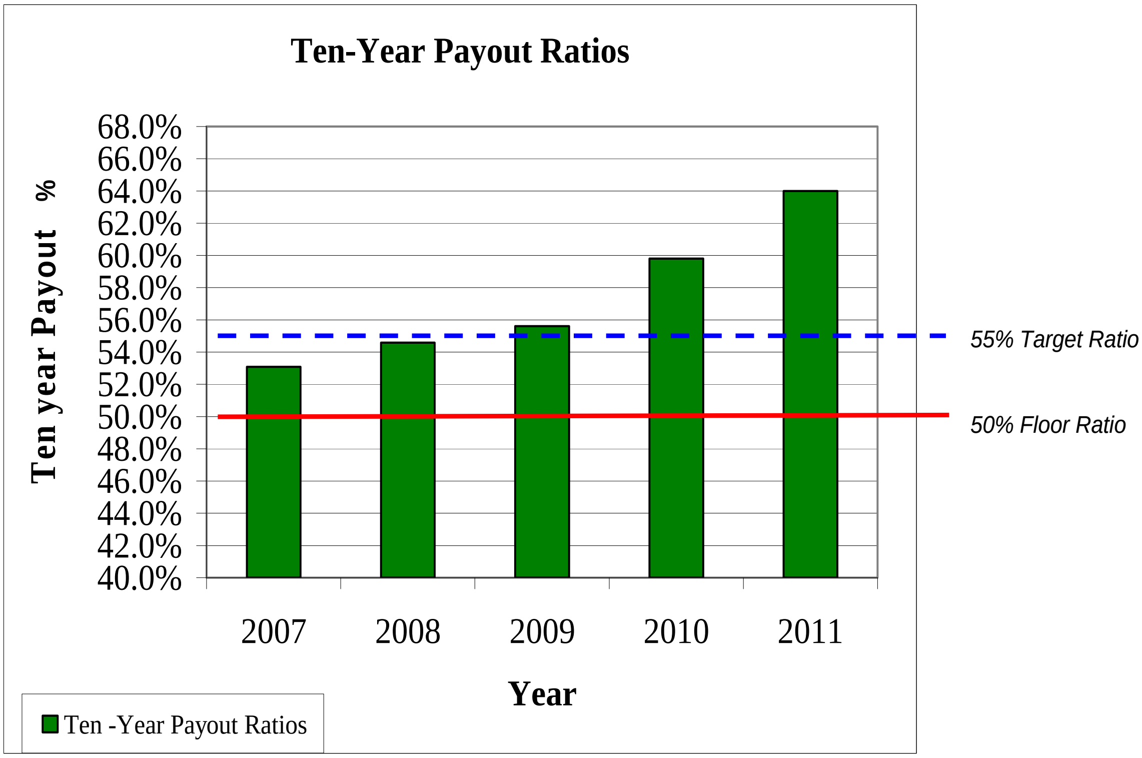
Ten-Year Payout Ratio

A short period of time within which a State retires outstanding debt obligations is considered a positive credit attribute. The Committee has adopted the following guideline regarding the payment structure of the State's debt:

- The amount of debt to be retired over the next ten years should be targeted at no less than 55% and should not decline below 50%.

Chart 11 below illustrates that the State's payout ratio has reached its targeted level and is projected to improve further.

Chart 11



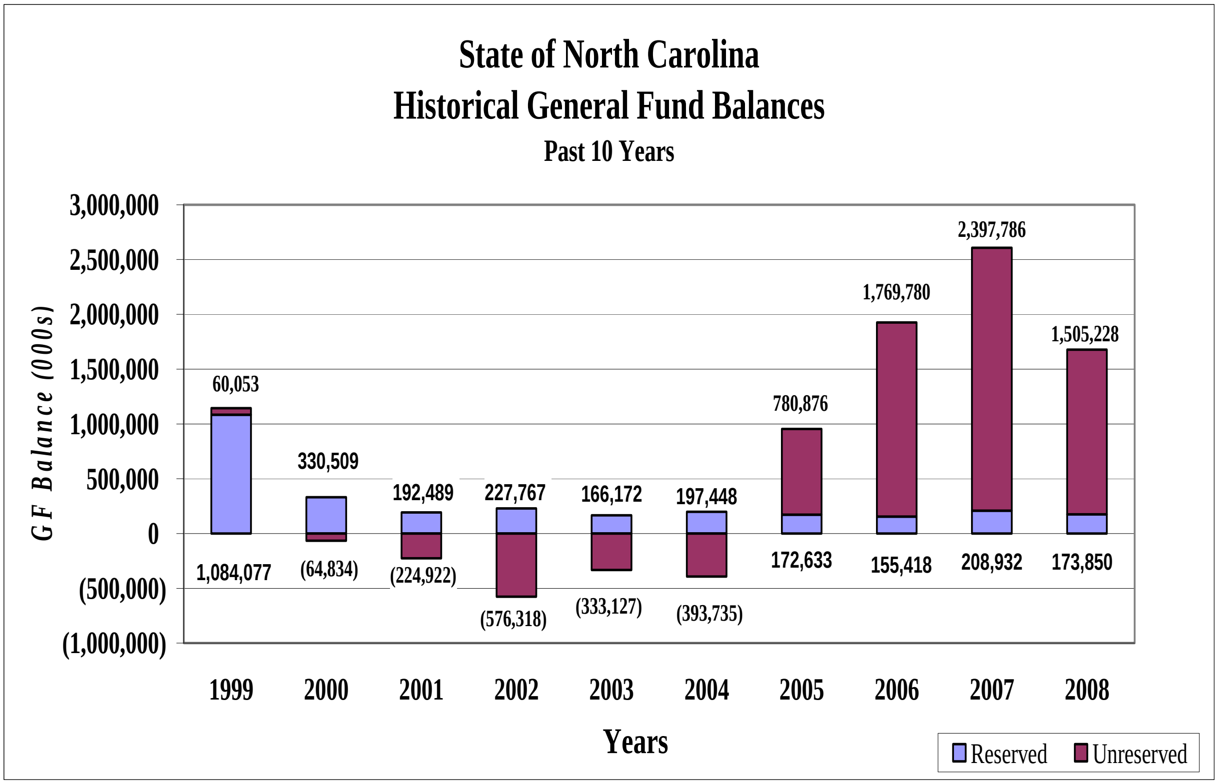
Level of Unreserved Fund Balance

As discussed previously, the rating agencies place emphasis on budgetary reserves. In a report dated December 22, 2005, Standard & Poor's stated that "…reserves are critical to managing economic cycles and providing substantial flexibility to manage the budget and capital requirements of a government."

The State ended Fiscal Year 2007-2008 with a fund balance of $1.68 billion, a decline of $958 million on a budgetary basis. The Rainy Day Fund remained at $787 million or about 4.3% of the prior year's operating budget. In the current economic climate, the Committee recognizes that further draw-downs of the State's reserves may be inevitable. However, the Committee recommends that balances be replenished as quickly as possible and that budgetary structural balance, a key factor in rating agency analysis, is established and maintained.

Chart 12 depicts the State's historic General Fund Balance on a GAAP basis over the last ten years. The Rainy Day Fund is a budgetary reserve account and is not reported in the GAAP basis financial statements. The funds which make up the account are reported as part of the unreserved fund balance.

Chart 12


State of North Carolina
Historical General Fund Balances
Past 10 Years
3,000,000
2,500,000
2,000,000
1,500,000
1,000,000
500,000
0
(500,000)
(1,000,000)
GF Balance (000s)
60,053
1,084,077
330,509
(64,834)
192,489
(224,922)
227,767
(576,318)
166,172
(333,127)
197,448
(393,735)
780,876
172,633
1,769,780
155,418
2,397,786
208,932
1,505,228
173,850
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
Years
Reserved
Unreserved

PART B
TRANSPORTATION DEBT AFFORDABILITY

Section I – Review of Transportation Funds, Debt and Other Commitments

Highway Fund

The Highway Fund accounts for most of the activities of the Department of Transportation ("DOT"), including the construction and maintenance of the State's primary and secondary road systems. In addition, it supports areas such as the NC Ferry System and the Division of Motor Vehicles and provides revenue to municipalities for local street projects (termed "Powell Bill Transfers") and to other State agencies. The principal revenues are motor fuels taxes, motor vehicle registration fees, driver's license fees and federal aid.

Highway Trust Fund

The Highway Trust fund was established by Chapter 692 of the 1989 Session Laws to provide a dedicated funding mechanism to meet the State's highway construction needs. The Highway Trust Fund also provides allocations for secondary road construction, to municipalities for local street projects and provides transfers to both the General Fund and the Highway Fund. The principal revenues are highway use taxes, motor fuels taxes and various fees.

The Highway Fund and the Highway Trust Fund are in many ways managed as a combined entity. Certain transportation revenues are deposited in each fund on a formulaic basis. For example, the Highway Fund receives ¾ of the Motor Fuels Tax and the Highway Trust Fund receives the remaining ¼. However, various combined expenditures are routinely paid from one fund or another. For example, salary expenses associated with the management of the Highway Trust Fund are actually paid out of the Highway Fund and debt service on the existing Highway GO Bonds is paid from the Highway Trust Fund. Powell Bill transfers are made from both Funds. Due to the interdependent nature of these Funds, the Committee has determined that it is most useful to calculate the available debt capacities of these Funds ("Transportation Funds") on an aggregate, rather than individual, basis. The resulting debt capacity is termed the "Transportation" debt capacity.

On a combined basis, the Highway Fund and Highway Trust Fund are primarily involved with construction and maintenance of the State's highways. From total budgeted sources for Fiscal Year 2007-2008, the Transportation Funds allocated approximately 41% ($1.567 billion) to Transportation Improvement Plan ("TIP") Construction, 24% ($898 million) to Highway Maintenance and 6% ($245 million) to Other Construction. In total, over 70% of the budget was dedicated to capital intensive infrastructure improvements.

Highway Debt

The State has a long history dating back to 1921 of authorizing debt to fund transportation projects. The most recent authorization of $950 million of GO Bonds (the "1996 Bonds") was enacted in 1996 by Chapter 590 of the Session Laws of the 1995 General Assembly, as amended ("The State Highway Bond Act of 1996" or "the 1996 Act"). The 1996 Bonds authorized debt to finance the capital costs of urban loops ($500 million, Intrastate System projects ($300 million) and secondary highway system paving projects ($150 million). All the Bonds authorized by the 1996 Act have been issued and as of June 30, 2008 the amount outstanding was $648 million. These are the only Highway Bonds currently outstanding.

The 1996 Act stated the General Assembly's intention to pay the debt service on the Bonds from the Highway Trust Fund, but did not pledge the Highway Trust Fund revenues to make such payments. Although the Act contained amendments regarding the priorities of the payment of funds from the Highway Trust Fund to provide for the payment of debt service, *such funds are not pledged* to secure the Bonds. Instead, the bonds are secured by "the faith and credit and taxing power of the State". As such, the bond rating agencies did not analyze the ability of the Highway Trust Fund to service the debt when assigning their ratings.

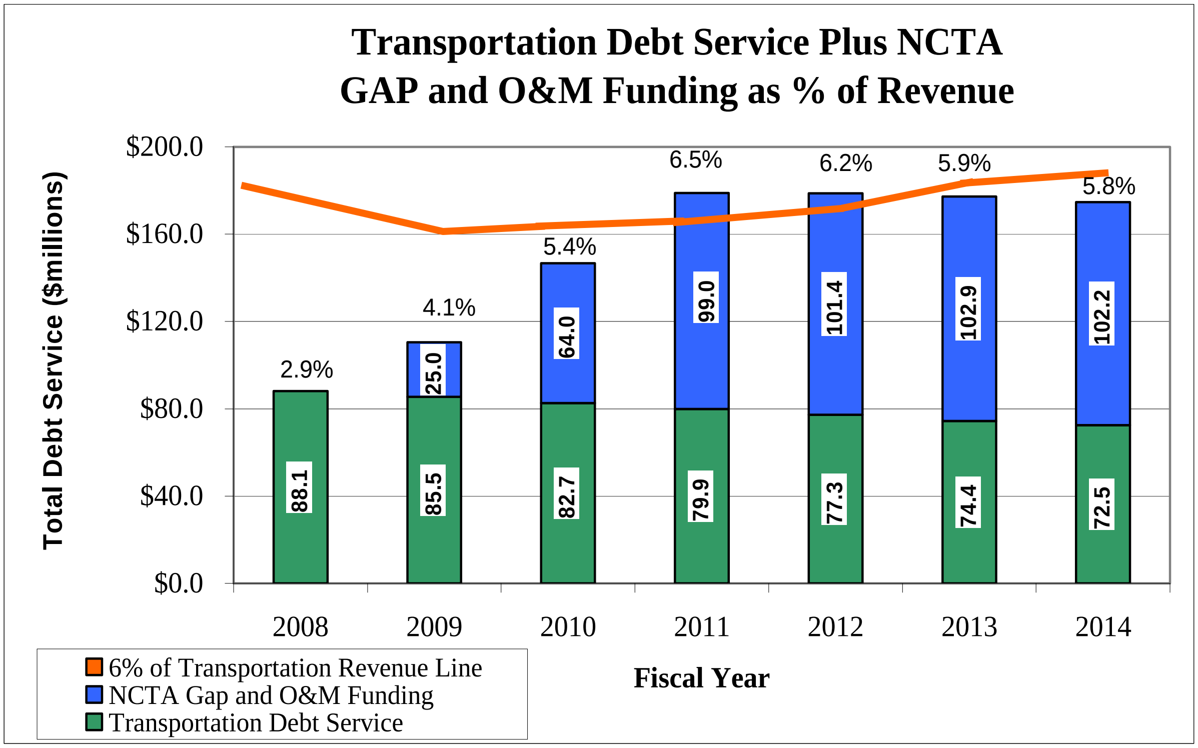
General Obligation Bonds versus Special Indebtedness-Transportation Implications

As discussed above, the State's outstanding Highway Bonds were issued as GO Bonds and are not secured by any Transportation revenues. As a result, the bonds were rated on a parity with the State's other GO Bonds. Therefore the Bonds were able to achieve the lowest possible interest rates, consistent with the State's high credit ratings. Potentially, the Bonds would not have been rated at the same level as the State's GO Bonds on a stand-alone basis. In addition, Bond Counsel has determined that any structure that pledged Transportation revenues consisting of state-wide taxes or user fees would most likely require a voter referendum. Therefore, the Committee advocates the use of GO Bonds for Transportation debt.

Debt Service

Debt Service on Highway Bonds peaked in 2006 at $93.6 million. In the future, the amount of actual debt service will decline as outstanding Bonds are retired. Debt service, both on an absolute basis and as a percentage of Transportation revenues, is illustrated below. As discussed in more detail in Part C, Appendix B (page 36) appropriation of funds to support debt obligations issued by the North Carolina Turnpike Authority are treated the same as any other debt service obligation. Including those commitments causes the Transportation Debt Affordability limits to be exceeded in Fiscal Years 2010-2011 and 2011-2012 by approximately $15 and $7 million, respectively.

Chart 13



<u>Grant Anticipation Revenue Vehicle Bonds ("GARVEEs")</u>

A review of Transportation-related debt would be incomplete without a discussion of the State's GARVEE program. Although not supported by State Transportation or General Fund revenues and, therefore, not technically a part of the Transportation debt affordability model, GARVEEs do represent a financing vehicle that will provide significant funds to the State to accelerate transportation projects.

North Carolina General Statute §136-18(12(b) as codified by Session Law 2005-403 ("the GARVEE Act") authorized the State to issue GARVEEs to accelerate the funding of transportation improvement projects across the State. GARVEEs are a revenue bond-type debt instrument where the debt service is to be paid solely from future federal transportation revenues and has no other State support.

Rather than authorizing a stated amount, the GARVEE Act limited the amount that could be issued by providing that the maximum debt service on all GARVEE issues may not exceed 15% of the expected annual federal revenue, and that the outstanding principal amount may not exceed the total amount of federal transportation funds authorized to the State in the prior federal Fiscal Year.

The State issued its first series of GARVEEs in October, totaling $287.6 million. The assigned rating agencies AA-/AA-/Aa3, two steps lower than the State's typical non-GO debt ratings. The lower rating reflects the absence of any State backing for the GARVEEs.

Other Transportation Expenditures

Consistent with its treatment for General Fund debt affordability, the Committee does not advocate including non-debt related Transportation obligations or commitments in the definition of liabilities when measuring debt capacity. It is useful, however, to review the level of ongoing administrative and other recurring expenses/transfers when analyzing the level of flexibility in the Transportation Funds. Historically, the levels of these commitments are shown below both with and without debt service as a percentage of total Transportation Revenues, including federal revenues. On average, approximately 26% of the total Transportation revenues are allocated to administrative costs, transfers and debt service.

Chart 14

Transportation Expenses by Year

(Dollars in Millions)

	2004	2005	2006	2007	2008
Total Transportation Revenues *	$3,401.7	$3,681.5	$3,851.5	$3,784.9	$3,788.4
Administration-Salaries/Benefits	$135.9	$145.8	$156.7	$161.4	$174.0
Administration-Other	120.1	129.4	146.0	152.4	144.9
Powell Bill Transfers	120.8	135.3	136.8	137.9	149.2
Transfers to Other State Agencies	220.3	239.1	244.3	261.7	289.2
General Fund Transfers	252.4	242.5	252.6	57.5	172.7
Subtotal Commitments ex Debt Service	$849.5	$892.1	$936.4	$770.9	$930.0
% Total Transportation Revenues	25%	24%	24%	20%	25%
Debt Service	$32.2	$69.1	$93.6	$91.2	$88.1
Total Commitments	$881.7	$961.2	$1,030.0	$862.1	$1,018.1
% Commitments/Revenues	26%	26%	27%	23%	27%

*Includes Federal revenues

Section II – Comparative Transportation Ratios

When viewed as a stand-alone enterprise, the State's transportation-related debt service as a percentage of State transportation revenues appears modest when compared with a peer group composed primarily of states in the Southeast region but also certain other states selected after consultation with DOT. Within the peer group, both Missouri and South Carolina utilize an approach that limits transportation debt separately from other state-level debt. In contrast, Georgia measures available debt capacity on a combined basis, but has dedicated a great deal of that capacity toward transportation priorities as shown in Chart 15 below. Finally, Tennessee does not issue state debt for transportation purposes.

Chart 15

Transportation Peer Group Comparisons

State	Ratings (Fitch/S&P/Moody's)	2006 Transportation Debt Service as % of Transportation Revenues (1)	Typical Maturity / Years
Florida	AA+/AAA/Aa1	6.0%	20
Georgia (2)	AAA/AAA/Aaa	21.0%	20
Kentucky	AA-/AA-/Aa2	12.1%	20
Missouri	AAA/AAA/Aaa	6.7%	20
North Carolina	AAA/AAA/Aaa	3.4%	20
South Carolina	AAA/AA+/Aaa	10.8%	15
Tennessee	AA+/AA+/Aa1	0.0%	N/A
Texas	AA+/AA/Aa1	5.9%	20
Virginia	AAA/AAA/Aaa	3.8%	25
Median		6.0%	
Average		7.75%	

(1) Excludes Garvee debt service (if any) and Federal Revenues.
(2) Allocated Debt Service for 2007.

Section III – Transportation Debt Affordability Model

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

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

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

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

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

Revenues Used in the Transportation Model Calculation

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

Debt Used in the Transportation Model Calculation

The model uses a definition of State transportation debt service that includes outstanding Highway GO Bonds but excludes the GARVEEs supported by Federal revenues. There are currently no capital lease or installment purchase contracts that need to be included. Highway Trust Fund support for debt issued by the North Carolina Turnpike Authority is included as a liability for model purposes.

Model Assumptions regarding Revenue Growth and Sensitivity Analysis

In consultation with NCDOT, Transportation Revenues have been reduced from the levels previously projected. Revenues are not projected to equal those received in Fiscal Year 2007-2008 until Fiscal Year 2012-2013. See Part C, Appendix B (page 35-36) for more details. Transportation Revenues would need to exceed projections for Fiscal Year 2010-2011 (the year of maximum stress) by approximately $245 million to generate any Transportation debt capacity.

Debt Structuring Assumptions

The following assumptions were used in this year's debt affordability model calculations:

- There is no remaining authorized but unissued GO or non-GO debt.
- Incremental model debt will be structured with a fixed rate 25-year maturity, a 6.15% interest rate and an overall level debt service profile after the first year.

It is the Committee's determination that a 25-year structure, with a correspondingly higher interest rate, can be justified for analyzing debt that will be used to finance long-lived transportation infrastructure projects. The Committee notes that Virginia also utilizes a 25 year structure for transportation debt.

Section IV – Transportation Debt Guidelines and Model Results

Debt Service as Percentage of Revenues Guideline

The Committee has adopted a guideline that transportation-related debt service should not exceed 6% of State Transportation revenues. The Committee adopted this guideline after analyzing the State's position relative to its peer group on both a combined (General Fund and Transportation Funds) and individual basis. It also reviewed the other ongoing commitments of the Transportation Funds. The Transportation Funds enjoy a greater degree of budgetary flexibility than does the General Fund, and the Committee determined that the State's Transportation funds could support a higher ongoing level of debt service as a percentage of revenues than was deemed appropriate for the General Fund. The Committee has also determined not to adopt the same 15% guideline for Transportation debt capacity as was contained in the GARVEE legislation because GARVEEs have higher annual debt service requirements due to their shorter maturity.

Finally, in 2008, the Committee noted that were the State to issue the maximum amount of permitted Transportation debt, the State's overall combined debt position would be above the 4% ceiling on a combined basis but still below the 4.75% ceiling assuming the General Fund maintained its 4% target. For example, if Transportation debt service totaled $176 million (6% of 2007 Transportation Revenues) and the General Fund debt service totaled $765 million (4% of 2007 DAAC revenues), on a combined basis the State's overall debt service to revenue percentage would have been 4.27%. Although the 6% guideline results in a 4.27% measure overall, exceeding the 4% target, the Committee recognizes the large capital needs in the transportation area and believes that 4.27% is not excessive. Assuming no new debt is authorized and issued, the current combined debt service to revenue percentage peaks at 4.22% in Fiscal Year 2011-2012.

As stated previously, the rating agencies analyze the State's debt on an aggregate basis. Therefore, for the first year of calculating Transportation debt capacity on an individual basis, the Committee has adopted a guideline that permits the State to remain close to its target overall and below the 4.75% ceiling. Depending upon the reactions by the rating agencies and financial markets, the Committee may choose to revisit the 6% guideline for Transportation Debt in the future.

Due to the projected declines in Transportation revenues coupled with sizeable commitments to support debt issued by the North Carolina Turnpike Authority, the model does not project any available Transportation debt capacity unit Fiscal Year 2011-2012.

Table 5

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

Fiscal Year	2009	2010	2011	2012	2013
*Total Additional Debt Capacity per Year **	$0.0	$0.0	$0.0	$32.6	$60.6
Debt Capacity Available Each and Every Year	N/A	N/A	N/A	N/A	N/A

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

Table 6

Transportation
Retirement of Outstanding Debt Compared to the Annual Debt Capacity
(In Millions of Dollars)

Fiscal Year	2009	2010	2011	2012	2013
Retirement of Outstanding Debt	$85.5	$82.7	$80.0	$77.3	$74.4
Debt Capacity in Excess of Retirement of Debt	0.0	0.0	0.0	0.0	0.0
Additional Debt Service on Debt Capacity	N/A	N/A	N/A	N/A	2.5

Sensitivity Analysis on 6% Transportation Model Solution

As is true for the General Fund debt capacity solution, the Transportation debt capacity solution is sensitive to changes in revenue assumptions. However in the current environment, Transportation Revenues would need to exceed projections for Fiscal Year 2010-2011 (the year of maximum stress) by approximately $245 million to generate any Transportation debt capacity.

PART C
Appendix A

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

DAAC Revenues

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

General Fund Tax Revenues

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

Other General Fund Revenue Items

- Investment Income
- Miscellaneous Revenues

Revenue Growth and other Assumptions

Changes to revenue estimates have a significant impact on the calculation of available debt capacity because of the multiplier effect of compounding growth over the ten-year period. Such projections are especially important when they reflect changing or differing economic outlooks.

In consultation with OSBM, DAAC revenues have been reduced to the following levels:

Table 7

General Fund Revenue ($ millions)
Revenue Adjustments

Fiscal Year	Adjusted Revenues ($ millions)	Original Revenues ($ millions) [1]	Diff ($m)	Fiscal Year	Adjusted Revenues ($ millions)	Original Revenues ($ millions) [1]	Diff ($m)
2008	$19,661.7	$19,698.6	($36.9)	**2014**	$21,240.1	$23,521.2	($2,281.1)
2009	18,684.7	20,289.6	(1,604.9)	**2015**	21,877.3	24,226.8	(2,349.5)
2010	18,871.5	20,898.3	(2,026.8)	**2016**	22,533.6	24,953.6	(2,420.0)
2011	19,437.7	21,525.2	(2,087.5)	**2017**	23,209.6	25,702.2	(2,492.6)
2012	20,020.8	22,171.0	(2,150.2)	**2018**	23,905.9	26,473.3	(2,567.4)
2013	20,621.4	22,836.1	(2,214.7)	**2019**	24,623.1	27,267.5	(2,644.4)

[1] February 1, 2008 DAAC

Liabilities

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

The model uses a definition of net tax-supported debt that includes General Obligation Bonds, Special Indebtedness, Capital Lease Obligations, and any other obligations that are owed to a third party over a predetermined schedule and paid from General Fund Revenues. Obligations of Component Units, Highway Fund debt that is paid from Highway Fund revenues, non tax-supported special indebtedness that is paid from trust funds and other self-supporting debt is excluded. Energy Performance Contract liabilities are also excluded.

Other Post Employment Benefits ("OPEB")
In order to comply with Governmental Accounting Standards Board (GASB) Statements No. 43 and 45, the State Health Plan had an actuarial study completed that estimates the size of the State's unfunded liability for Other Post Employment Benefits. The bond rating agencies have been clear that OPEB liabilities do not represent a hard liability in the same way that debt service does and should not be considered tax-supported debt unless bonds are actually issued to fund part or all of the liability. They have also consistently assured the State that these liabilities do not represent a threat to the State's credit rating in the short-term. Over the longer term, the State will need to develop a realistic plan to meet these obligations.

The model includes the actual debt service from all outstanding net tax-supported debt and for all authorized, but currently unissued tax-supported debt if such issuance does not require further action on the part of the General Assembly. The following is a list of those liabilities that are included in the General Fund model (outstanding amounts as of June 30, 2008):

- General Obligation Bonds supported by General Fund Tax Revenue - $4,885,609,403.
- Appropriation-Supported Indebtedness (collectively "Special Indebtedness")
    - Certificates of Participation supported by General Funds $750,571,702. Also including
        - Chapter 1264 projects supported by the Clean Water, Natural Heritage and Parks and Recreation Trust Funds where funds flow through the General Fund - $41,609,770.
    - Capital Leases, Installment Purchase Contracts and Equipment lease obligations determined pursuant to G.S. 147-33.72H - $55,871,665.
    - Lease Revenue or Lease-Purchase Revenue Bonds - $235,045,000.

Liabilities not included in the General Fund model (outstanding amounts as of June 30, 2008):

- Highway Construction General Obligation Debt supported by separate taxes - $648,025,000.
- Appropriation-Supported Indebtedness (collectively "Special Indebtedness")
    - Certificates of Participation supported by non-General Funds including
        - Chapter 1264 projects supported by the Health and Wellness/Tobacco Trust Funds - $215,308,298 (issued), $225,022,851 (authorized but unissued).
- Short Term Tax Anticipation Notes (not supported by General Tax Revenue) - $0.

- Obligations of the University of North Carolina System, the North Carolina Housing Finance Agency or other Component Units – $8,230,952,000.

- Energy Performance Contract obligations where such obligations are guaranteed and approved pursuant to G.S. 142-64 and not supported by separate appropriations - $32,211,764.

- Other Post Employment Benefits ("OPEB")

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

Debt Structuring Assumptions

The following assumptions were used in this year's debt affordability model calculations:

- The rate on existing Variable Rate Debt will average 4%.
- The interest costs on all authorized GO and non-GO issues will be 5.75% and 6%, respectively.
- Non-GO debt will be structured with a 20-year maturity with an overall level debt service or principal payment profile after the first year.

- GO debt will be structured with a 20-year level principal payment profile after the first year.
- The incremental model debt is assumed to be fixed-rate, 20-year maturity debt with an average interest cost of 6% and a level debt service payment profile after the initial years.

GAAP Unreserved General Fund Balance

The State's Unreserved General Fund Balance ("UGFB") is comprised both of Designated and Undesignated items. Designated items are those for which tentative plans for use in a future period have been established by the General Assembly. Examples include the Disaster Relief Fund and Repairs and Renovation Fund. Of the total UGFB of $1,505.2 billion at Fiscal Year end 2008, Designations totaled $686.0 million with the remainder being Undesignated. The State's Rainy Day Fund is a budgetary reserve account which is not reported in the GAAP basis financial statements of the State. The funds which make up this account are reported as part of the Undesignated balance.

General Fund

10-Year Model Solutions

<u>4% Debt Service/Revenue Target</u>

Table 8

General Fund

Net Tax-Supported Debt Capacity using 4.0% debt service/revenues target ratio

(In Millions of dollars)

Fiscal Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Additional Debt Capacity per Year [1]	$188.1	$14.2	$0.6	$220.0	$548.1	$397.5	$501.8	$517.3	$473.2	$562.2
Debt Capacity Available each and every Year	50.2	50.2	50.2	50.2	50.2	50.2	50.2	50.2	50.2	50.2

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

Table 9

General Fund

Retirement of Outstanding Debt Compared to the Annual Debt Capacity

(In Millions of Dollars)

Fiscal Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Retirement of Outstanding Debt	$368.3	$392.2	$427.8	$454.2	$469.6	$469.8	$469.8	$470.7	$458.9	$471.1
Debt Capacity in Excess of Retirement of Debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Additional Debt Service on Debt Capacity ($50.2 million/Yr)	0.0	5.7	10.5	13.9	19.2	24.4	29.4	34.3	39.0	43.5

4.75% Debt Service/Revenue Target

Table 10

General Fund
Net Tax-Supported Debt Capacity using 4.75% debt service/revenues target ratio
(In Millions of dollars)

Fiscal Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Additional Debt Capacity per Year [1]	$2,267.1	$0.0	$0.0	$213.4	$189.9	$85.9	$683.9	$563.3	$601.3	$652.6
Debt Capacity Available each and every Year	561.8	561.8	561.8	561.8	561.8	561.8	561.8	561.8	561.8	561.8

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

Table 11

General Fund
Retirement of Outstanding Debt Compared to the $561.8 Million Annual Debt Capacity
(In Millions of Dollars)

Fiscal Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Retirement of Outstanding Debt	$368.3	$392.2	$427.8	$454.2	$469.6	$469.8	$469.8	$470.7	$458.9	$471.1
Debt Capacity in Excess of Retirement of Debt	193.5	169.6	134.0	107.6	92.2	92.0	92.0	91.1	102.9	90.7
Additional Debt Service on Debt Capacity ($561.8 million / year)	0.0	45.1	86.4	127.1	171.0	222.4	283.8	345.7	405.5	463.4

PART C
Appendix B

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

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

State Transportation Revenues

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

Revenue Growth

Changes to revenue estimates have a significant impact on the calculation of available debt capacity. In consultation with NCDOT, Transportation Revenues have been reduced to the following levels:

Table 12

Transportation Revenues ($ millions)
Revenue Adjustments

Fiscal Year	Adjusted Revenues ($ millions)	Original Revenues ($ millions) [1]	Diff ($m)	Fiscal Year	Adjusted Revenues ($ millions)	Original Revenues ($ millions) [1]	Diff ($m)
2008	$2,998.6	$2,962.1	$36.5	**2014**	$3,034.6	$3,181.8	(147.2)
2009	2,678.6	2,997.6	(319.0)	**2015**	3,071.0	3,220.0	(149.0)
2010	2,698.6	3,033.6	(335.0)	**2016**	3,107.9	3,258.7	(150.8)
2011	2,738.6	3,070.0	(331.4)	**2017**	3,145.2	3,297.8	(152.6)
2012	2,868.6	3,106.8	(238.2)	**2018**	3,182.9	3,337.3	(154.4)
2013	2,998.6	3,144.1	(145.5)	**2019**	3,221.1	3,377.4	(156.3)

[1] February 1, 2008 DAAC

Transportation Liabilities

The model uses the debt service from all outstanding Highway Bonds and would include transportation-related capital lease obligations and installment purchase contracts if appropriate. There is no currently authorized but unissued transportation-related debt to include, but the model would count such debt and the resulting debt service as part of Transportation Liabilities if there were. At 6/30/08, there were $648 million outstanding Highway Bonds.

Debt Service arising from the State's GARVEE program is not included as a State Transportation Liability because the GARVEEs are supported solely by federal transportation revenues.

In 2008, "GAP" funding was authorized by S.L. 2008-201 to "pay debt service or related financing costs" for revenue bonds issued by the North Carolina Turnpike Authority. The funds so appropriated are all legally pledged to support the bonds and bondholders will depend upon the appropriation continuing. Therefore, the model treats the gap funding as the equivalent of debt service since it represents ongoing Highway Trust Fund support of debt. $25 million of GAP funding is authorized for Fiscal Year 2008-2009, $64 million in Fiscal Year 2009-2010 and $99 million thereafter for each Fiscal Year in the 10-year model horizon NCDOT has also pledged certain operating and maintenance funds to secure debt which is also treated as GAP Funding for model purposes. Note that maximum Highway related debt service previously peaked at $93.6 million in Fiscal Year 2005-2006.

Debt Issuing Assumptions

This year's Transportation debt affordability model assumes that model debt is fixed-rate 25-year maturity debt with an average interest cost of 6.15% and a level debt service profile after the first year.

Table 13

Transportation

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

(In Millions of dollars)

Fiscal Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Additional Debt Capacity per Year [1]	$0.0	$0.0	$0.0	$32.6	$60.6	$91.6	$73.1	$62.6	$62.9	$59.6
Debt Capacity Available each and every Year	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

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

Table 14

Transportation

Retirement of Outstanding Debt Compared to the Annual Debt Capacity

(In Millions of Dollars)

Fiscal Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Retirement of Outstanding Debt	$85.5	$82.7	$80.0	$77.3	$74.4	$72.5	$69.7	$67.0	$64.3	$61.5
Debt Capacity in Excess of Retirement of Debt	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Additional Debt Service on Debt Capacity	N/A	N/A	N/A	N/A	2.5	7.3	14.7	20.5	25.4	30.4