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North Carolina (State of)

Failure to pass budget is credit negative, though stopgap funding allays adverse effects

On 31 October, the North Carolina (Aaa stable) General Assembly adjourned without passing a biennial budget for fiscal 2019-21 (which ends 30 June 2021). The lack of a budget for more than four months reflects governance weakness and is credit negative. Although the state ended fiscal 2019 with a budgetary surplus of nearly $900 million, the lack of agreement on budget priorities amid a time of economic expansion and healthy revenue growth does not augur well for budgeting and strong governance during times of economic and revenue stagnation or declines.

Sticking points in the budget included differences between the governor and state legislature on spending priorities, notably Medicaid expansion and teacher pay. The impasse intensified when the state General Assembly passed a budget on 27 June and the governor vetoed it a day later.

A continuing appropriation and the passage of several standalone measures alleviate most spending limitations at this time. Although North Carolina is largely insulated during the current impasse, the delay could begin to hurt local governments and other downstream entities through an interruption in state aid. There are also cases of interrupting implementation of state policy. For example, North Carolina planned to launch Medicaid managed care this month, but has delayed the start because of the budget delay. The last time the state had a protracted budget delay was in 2015, when the next year's budget was not signed into law until 18 September.

The General Assembly passed House Bill 111 (2019-21 Base Budget/Certain Agencies) on 31 October. This bill appropriates each agency's base budget, which accounts for $23.9 billion in general fund expenditures in fiscal 2020 and $24.0 billion in fiscal 2021. The base budget accounts for the previous biennium's authorized recurring spending level with limited adjustments made to eliminate one-time spending increases or decreases, adjust for annualizing a recurring program that was appropriated for partial year funding, make adjustments for lease increases and other statutorily allowed increases.

The presence of the base budget and the North Carolina constitution allows for the payment of debt service even if fiscal 2020 debt service increases over fiscal 2019 levels. In addition to House Bill 111, the governor has signed several standalone spending measures, including money for school security, prison safety, disaster relief, various community college items and pay raises for state employees, community college employees and correctional officers.

Most local governments will not have material ill effects from the lack of a budget, although there are potential limitations. Counties with new state funds included in the 2019-21 Appropriations Act may need to delay the start of intended capital projects. Local boards of education (BOE) that heavily depend on the state for operating funds face the most limitations. Increases in student populations and associated staffing requirements have the potential to cause some disruption. Counties routinely supplement the local BOEs' operating budgets and are required by state law to provide for their capital needs; therefore, some BOEs may ask counties for additional funds. County boards in some circumstances will have to consider covering additional education expenditures with budget reductions or reserves, although the decisions are within the counties' control to make.

The General Assembly's adjournment resolution states that overrides of a governor's vetoes cannot take place until January, which means no action on the budget bill will occur until next year. Two bills passed by the legislature, but not yet approved by the governor, would reduce state revenue, including a corporate franchise tax cut and increases in the standard deduction for income tax filers. All of the spending bills passed by the legislature to date would result in fiscal 2020 appropriations similar to those in the budget vetoed by the governor, totaling nearly $24 billion.

In addition to the late budget, the state is facing cash flow issues within its Department of Transportation (DOT). The DOT has requested general fund support because of large expenses related to storm damages, including Hurricane Dorian in early September, and settlements resulting from a state Supreme Court ruling that the DOT cannot reserve land for future roads without paying for the land. The ruling led to hundreds of landowners seeking compensation from the DOT. House Bill 967 (DOT Financial Preservation and Accountability Act) recommends transferring $360 million from the state's general fund to help cover the settlements as well as another $300 million loan from the state's savings reserve to help with projects delayed by Hurricane Dorian. The transfer of $360 million would equal about 1.5% of general revenue.

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