FitchRatings

State of Delaware

State of Delaware's 'AAA' IDR and GO bond rating are based on strong financial performance, supported by proactive management and institutionalized protections designed to ensure surplus operations. Long-term revenue growth has accelerated in recent years, and Fitch Ratings anticipates it will remain at least above the long-term level of inflation. Recent strong growth has allowed the state to fully fund two reserves to a combined 12% of revenues. The long-term liability burden is above the state median, reflecting in part debt issuance and recognition of obligations that are addressed at the local government level in most other states.

Public Finance
State General Obligation
U.S.A.

Rating

Long-Term IDR	AAA

Rating Outlook

Long-Term IDR	Stable

New Issue

$286,770,000 General Obligation Bonds, Series 2024A	AAA
$68,505,000 General Obligation Refunding Bonds, Series 2024B	AAA

Sale Date

April 30, 2024 by competitive bid

Outstanding Debt

General Obligation Bonds	AAA

Applicable Criteria

U.S. Public Finance State Governments and Territories Rating Criteria (April 2024)

Related Research

Fitch Rates Delaware's $355MM GOs 'AAA'; Outlook Stable (April 2024)

Analysts

Karen Krop
+1 212 908-0661
karen.krop@fitchratings.com

Bryan Quevedo
+1 415 732-7576
bryan.quevedo@fitchratings.com

Key Rating Drivers

Revenue Framework — 'aa'

Financial operations are supported by a diverse array of revenue sources, with personal income tax (PIT) accounting for the largest share, at approximately one-third. Delaware also leverages its status as the legal home to over half of all publicly traded corporations in the U.S., and assesses taxes on limited partnerships, franchises and other business entities. This structure results in a revenue framework that is somewhat more sensitive to national economic trends than is the case in most other states.

Expenditure Framework — 'aaa'

While carrying costs are above the U.S. states median, Delaware has demonstrated the broad expense-cutting ability common to most U.S. states and benefits from the cushion provided by its statutory restriction to budget 98% of expected revenue. Education is a key cost driver, as the state is highly involved with funding local education, including capital projects and employer pension contributions for school district employees.

Long-Term Liability Burden — 'aa'

The state's long-term liabilities are a moderate burden on resources. Debt levels are well above average for a U.S. state, in part due to Delaware's role in issuance for projects usually funded at the local level, and have recently ticked up primarily as a result of transportation-related borrowing. Pension liabilities are also above the median and remain relatively stable. Other post-employment benefit (OPEB) obligations are sizable, although reduced since fiscal 2022, when the discount rate used to calculate the liability was increased. The state also began contributing an amount equal to 1% of the prior year's budget in fiscal 2023 to accelerate funding of OPEB liabilities.

Operating Performance — 'aaa'

The state has exceptional financial resilience from strong management, which has contributed to the maintenance of ample cushion through economic cycles. The relatively frequent monitoring of revenues and operating expenditures mitigates the effect of volatility in revenues and allows for rapid gap closing.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

- A sustained slowing of revenue growth to below the level of long-term inflation.
- A sustained increase in the long-term liability burden closer to 20% of personal income or an inability of the state to address its large net OPEB liability.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Not applicable given the 'AAA' ratings.

Economic Resource Base

Delaware's economy is largely based on service-providing enterprises, including financial activities, professional and business services, and education and health organizations. The state has implemented deliberate policies to maintain a climate attractive to banking and related entities. Population growth has trended above that of the U.S. Per capita personal income growth and levels are slightly below the national averages.

IDR Current Developments

Delaware Economic Update

The pace of Delaware's labor market recovery has been mixed relative to the national pace through most of the post-pandemic recovery period. Nonfarm payrolls declined by about 15% at the pandemic's start (from February 2020 to April 2020), which matched the national decline. Delaware's employment is now 4.2% higher than it was before pandemic, and higher than the 3.6% post-pandemic increase in the national rate as of February 2024. Other indicators are not as strong. Headline unemployment in February of 4.0% slightly exceeded the U.S. rate of 3.9% for that month. The state's employment to population ratio (EPOP, a measure of labor force utilization) as of February 2024 was 58.1%, below its pre-pandemic level of 58.7% and among the lowest of the states, with the national rate at 60.7%.

Delaware Budget Update

The fiscal 2024 budget assumed revenues would decline on a yoy basis to $6.0 billion. Revenues are marginally outperforming the forecast and were revised slightly upward in March 2024 by the Delaware Economic and Financial

Advisory Council (DEFAC), to $6.25 billion. The budget appropriated 98% of anticipated revenues, maintained a fully funded rainy-day fund at 5% of estimated revenues ($316.4 million) and a separate budget stabilization account (BSA) at $402.6 million. These reserves combined provide a cushion of 12% of fiscal 2024 estimated revenues.

The $5.6 billion general fund budget financed priorities in education, higher education, water resources and economic development, among others, and controls ongoing spending by allocating funds to nonrecurring expenditures including for capital. It provided significant pay increases to state employees (3%–9%) and teachers (9%), and implemented a $15 minimum wage for state employees, all to address workforce and recruiting and retention challenges. The budget increased ongoing spending by $100 million for Medicaid and provided $29 million for school enrollment growth.

The governor's budget proposal for fiscal 2025 suggests relative fiscal stability for the state. Revenue growth assumptions are relatively flat, at $6.3 billion. The proposal would appropriate 98% of anticipated revenues, allow growth in ongoing spending targeted to the DEFAC benchmark, maintain two reserves — the budgetary reserve account at $328.8 million (5.4% of fiscal 2025 revenue) and the budget stabilization fund at $410 million (6.5% of fiscal 2025 revenue) — and allocate funds to nonrecurring expenditures including for capital. The budget funds employee raises, particularly for new teachers, covers healthcare cost inflation and continues investments in infrastructure, climate change response and economic development. The budget for fiscal 2025 is under consideration by the state legislature.

Credit Profile

Revenue Framework

General fund revenues are dependent on an unusual array of taxes related to business endeavors and financial institutions, linked to companies being legally domiciled in the state. Revenues include franchise and other fees levied on businesses and banks organized under state law, as well as corporate income taxes and other fees. These combine to provide approximately one-third of general fund revenues. Abandoned property, which includes accounts and securities derived from businesses domiciled in Delaware that revert to the state's general fund when left unclaimed for specific periods, typically accounts for another 10% of general fund revenues and is subject to significant volatility.

The state levies a PIT but not a general sales tax. The PIT provides about one-third of general fund revenues and has seen moderate growth over the past several years, offsetting more variable results in corporate-based taxes. Lottery revenues, which include gaming and account for just under 5% of revenues, have been pressured, reflecting growth and competition in nearby gaming venues outside the state.

Historical revenue growth, adjusted for the estimated effect of policy changes, has been above that of national GDP over the past 10 years. This reflects population growth that has been stronger than the U.S. average, as well as reliance on higher growth areas of the economy, including finance and other services. Although the CAGR in part reflects growth from lows after the global financial crisis, a continuation of this trend could indicate stronger long-term growth prospects consistent with an 'aaa' assessment.

Delaware has no legal limitations on its ability to raise revenues through base broadenings, rate increases or the assessment of new taxes or fees.

Expenditure Framework

As in most states, education and health and human services spending are Delaware's largest operating expenses. Education is the larger line item, as the state provides significant funding for local school districts and the public university and college system. The state's education commitment includes sharing the annual employer pension contribution for local school district employees with school districts. Health and human services spending is the second-largest area of spending, with Medicaid being the primary driver.

Fitch expects that the pace of spending growth, absent policy actions, will be in line with to marginally above that of natural revenue growth, driven primarily by Medicaid, and require regular budget adjustments to ensure ongoing balance. Federal action to revise Medicaid's fundamental programmatic and financial structure does not appear to be a near-term priority of the current federal administration or congressional leadership. As with all federal initiatives, Medicaid remains subject to regulatory changes that could affect various aspects of the program. In other major areas of spending such as education, Delaware is able to more easily adjust the trajectory of growth.

Overall, Delaware retains ample ability to adjust expenditures to meet changing fiscal circumstances. Spending requirements for debt service and retirement obligations are higher than for most states, but remain low at 8.3% of fiscal 2023 governmental funds expenditures.

Strong investment returns that have raised pension system funding levels have allowed the state to lower its contribution rate while still making full actuarial payments, creating additional flexibility within the budget.

Long-Term Liability Burden

As a small state with a minimal number of local governments, Delaware's service functions are highly centralized, leading to above-average long-term liabilities for a U.S. state. Per Fitch's November 2023 State Liability Update ("Post-Pandemic Asset Surge Lowers Pension Burdens," dated Nov. 15, 2023), the state's total debt and adjusted net pension liabilities equaled 7.9% of 2022 personal income, a level of long-term liabilities that is above the state median (4%) and that while considered low, has historically been in the moderate range absent strong pension performance that has reduced long-term liabilities, as of fiscal 2022. As of the end of fiscal 2023, long-term liabilities have returned to a more typical 10.4% of personal income.

Delaware's Public Employees Retirement System includes nine plans, covering state and local employees, with most of the state's direct liabilities in the State Employees Plan. Exceptional investment returns in 2021 eliminated the net pension liability for the State Employees Plan on a market value basis and reduced the state's long-term liability metric as calculated by Fitch based on the fiscal 2022 state audit. However, with investment losses in the subsequent year, the metric increased. Fitch anticipates that it will be somewhat volatile as investment returns revert to more typical levels.

The net OPEB liability of over $7.6 billion equals 11% of 2023 state personal income, a lower liability that reflects an increase in the discount rate used to calculate the liability. As is the case with pension system contributions, the state pays school district OPEB, adding to the high liability. While Fitch views the OPEB liability as a more flexible obligation than pensions, and also more uncertain because of the complex assumptions used to calculate it, the magnitude of the liability given Delaware's already above-average long-term liabilities is a potential rating concern.

The extent to which OPEB liabilities will affect Fitch's assessment of Delaware's long-term liability burden and its overall rating will depend on the state's ability to manage the liability going forward, including materially modifying benefits or contributions practices. While benefits changes are not being considered, the state has begun to set aside an additional 1% of prior-year appropriations in the OPEB trust fund, with an initial deposit of $48 million in fiscal 2023.

Operating Performance

Delaware's ability to respond to cyclical downturns rests with its prudent budget practices, maintenance of reserves and proactive approach to tracking and forecasting revenues and expenditures throughout the budget cycle. Structural balance is supported by a constitutional provision that limits appropriations to 98% of anticipated revenues in the subsequent fiscal year, plus the unencumbered prior-year budgetary general fund balance.

In addition to the availability of unencumbered cash balances, the state maintains a fully funded budget reserve account (BRA) at 5% of general fund revenue. The BRA may only be appropriated to fund an unexpected budgetary deficit and requires super-majority approval in both legislative bodies to access. In addition to the BRA, the state created and has funded an additional reserve, the Budget Stabilization Fund. This fund, in conjunction with adherence to an appropriations benchmark that tempers spending growth, provides additional financial resilience.

The Fitch Analytical Stress Test scenario analysis tool, which relates historical tax revenue volatility to GDP, indicates the modestly higher level of volatility in Delaware's revenue structure relative to other states. Delaware's revenues would be expected to decline 4.2% in a moderate downturn, relative to the state's median of 2.6%. Fitch believes the state's close tracking of both revenues and expenditures and frequent revenue forecast updates have historically allowed it to quickly respond to changing economic conditions.

The state closely tracks revenue collections and expenditures during the year and forecasts are updated at least five times each fiscal year through comprehensive reviews by DEFAC. The state proactively reviews its tax policies and makes adjustments to ensure its budgets are balanced on a structural basis, including full actuarial pension contributions. These practices have proven to be critical to sustaining financial balance and support the state's strong operating performance. Additionally, Delaware’s commitment to using recent revenue surpluses to build reserves to robust levels reflects its strong budget management during periods of economic expansion.

Peer Analysis

Delaware is the highest rated among its small state peers, which include West Virginia (AA), Maine (AA), North Dakota (not rated) and Rhode Island (AA), reflecting in large part its strong and consistent operating performance. Delaware also has stronger revenue growth prospects than most of its peers. Carrying costs and the long-term liability burden are above average for the entire peer group, though Delaware generally has weaker metrics.

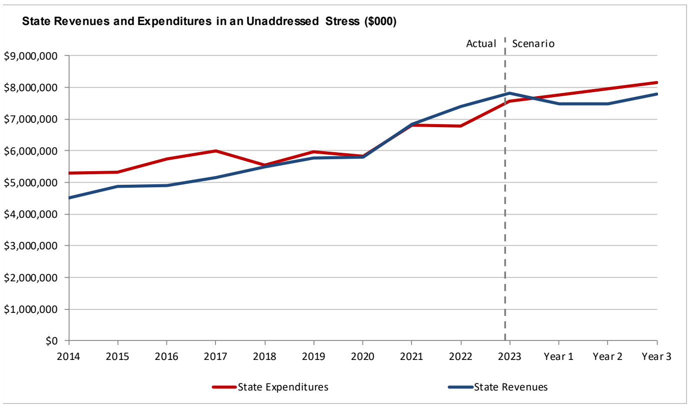
Environmental, Social and Governance Considerations

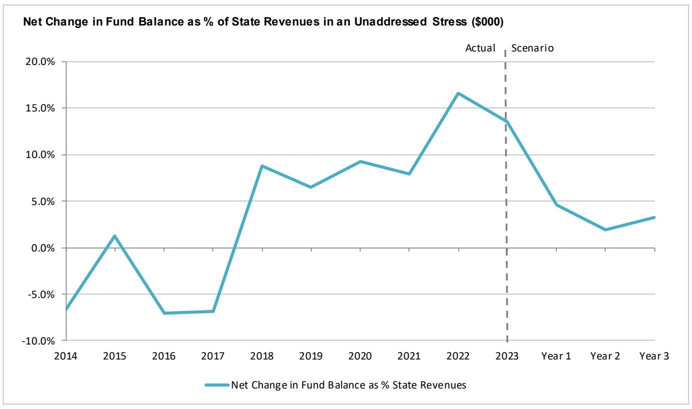
The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

Delaware, State of (DE)

Scenario Analysis

Ver 42





Analyst Interpretation of Scenario Results

Delaware's ability to respond to cyclical downturns rests with its prudent budget practices, maintenance of reserves, and proactive approach to tracking and forecasting revenues and expenditures throughout the budget cycle.

In addition to the availability of unencumbered cash balances, the state maintains a fully funded budget reserve account at 5% of general fund revenue. In addition to the BRA, the state created and has funded an additional reserve, the Budget Stabilization Fund, which, in conjunction to adherence to an appropriations benchmark that tempers spending growth, provides additional financial resilience.

Scenario Parameters:				Year 1	Year 2	Year 3
GDP Assumption (% Change)				(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)				2.5%	2.5%	2.5%
Revenue Output (% Change)	*Minimum Y1 Stress:* -1%	*Case Used:*	**Moderate**	(4.2%)	(0.2%)	3.9%

Revenues, Expenditures, and Net Change in Fund Balance	Actuals										Scenario Output		
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Year 1	Year 2	Year 3
Expenditures													
Total Expenditures	7,222,687	7,403,424	7,928,772	8,214,973	7,918,111	8,313,932	8,533,918	10,958,389	10,641,945	11,547,497	11,836,184	12,132,089	12,435,391
% Change in Total Expenditures	9.8%	2.5%	7.1%	3.6%	(3.6%)	5.0%	2.6%	28.4%	(2.9%)	8.5%	2.5%	2.5%	2.5%
State Expenditures	5,286,190	5,326,981	5,732,338	6,011,766	5,542,502	5,959,056	5,829,702	6,824,221	6,779,933	7,578,587	7,768,052	7,962,253	8,161,309
% Change in State Expenditures	4.7%	0.8%	7.6%	4.9%	(7.8%)	7.5%	(2.2%)	17.1%	(0.6%)	11.8%	2.5%	2.5%	2.5%
Revenues													
Total Revenues	6,454,990	6,955,374	7,106,316	7,368,150	7,870,802	8,124,847	8,513,431	10,960,972	11,274,523	11,799,993	11,566,965	11,657,005	12,055,621
% Change in Total Revenues	5.2%	7.8%	2.2%	3.7%	6.8%	3.2%	4.8%	28.7%	2.9%	4.7%	(2.0%)	0.8%	3.4%
Federal Revenues	1,936,497	2,076,443	2,196,434	2,203,207	2,375,609	2,354,876	2,704,216	4,134,168	3,862,012	3,968,910	4,068,133	4,169,836	4,274,082
% Change in Federal Revenues	26.6%	7.2%	5.8%	0.3%	7.8%	(0.9%)	14.8%	52.9%	(6.6%)	2.8%	2.5%	2.5%	2.5%
State Revenues	4,518,493	4,878,931	4,909,882	5,164,943	5,495,193	5,769,971	5,809,215	6,826,804	7,412,511	7,831,083	7,498,832	7,487,169	7,781,539
% Change in State Revenues	(1.9%)	8.0%	0.6%	5.2%	6.4%	5.0%	0.7%	17.5%	8.6%	5.6%	(4.2%)	(0.2%)	3.9%
Excess of Revenues Over Expenditures	(767,697)	(448,050)	(822,456)	(846,823)	(47,309)	(189,085)	(20,487)	2,583	632,578	252,496	(269,220)	(475,084)	(379,770)
Total Other Financing Sources	466,286	511,010	474,569	495,030	528,199	560,943	555,885	537,340	593,703	804,439	610,462	620,366	633,262
Net Change in Fund Balance	(301,411)	62,960	(347,887)	(351,793)	480,890	371,858	535,398	539,923	1,226,281	1,056,935	341,242	145,282	253,492
% Total Expenditures	(4.2%)	0.9%	(4.4%)	(4.3%)	6.1%	4.5%	6.3%	4.9%	11.5%	9.2%	2.9%	1.2%	2.0%
% State Expenditures	(5.7%)	1.2%	(6.1%)	(5.9%)	8.7%	6.2%	9.2%	7.9%	18.1%	13.9%	4.4%	1.8%	3.1%
% Total Revenues	(4.7%)	0.9%	(4.9%)	(4.8%)	6.1%	4.6%	6.3%	4.9%	10.9%	9.0%	3.0%	1.2%	2.1%
% State Revenues	(6.7%)	1.3%	(7.1%)	(6.8%)	8.8%	6.4%	9.2%	7.9%	16.5%	13.5%	4.6%	1.9%	3.3%

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's scenario analysis assumes the GDP and expenditure growth sequence shown in the 'Scenario Parameters' section. For further details, please see Fitch's US Tax-Supported Rating Criteria.

SOLICITATION & PARTICIPATION STATUS

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

For information on the participation status in the rating process of an issuer listed in this report, please refer to the most recent rating action commentary for the relevant issuer, available on the Fitch Ratings website.

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