State of Delaware

New Issue Report

Ratings

Long-Term Issuer Default Rating	AAA

New Issue

$107,200,000 General Obligation Refunding Bonds, Series 2019A	AAA

Outstanding Debt

General Obligation Bonds	AAA

Rating Outlook

Stable

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New Issue Summary

Sale Date: Aug. 14, 2019 by competitive bid

Series: General Obligation Refunding Bonds, Series 2019A

Purpose: Refund outstanding general obligation bonds for debt service savings.

Security: General obligation, full faith and credit of the state of Delaware.

Delaware's 'AAA' Issuer Default Rating (IDR) and GO bond rating is based on strong financial operations that are supported by proactive management and institutionalized protections designed to ensure surplus operations. The state has considerable economic resources, which have grown through deliberate policies to maintain a climate attractive to banking and related entities; however, revenue growth has been slow and is expected to only track inflation. Long-term liabilities are above the state median, reflecting in part debt issuance for purposes that are addressed at the local government level in other states. Pensions are well funded.

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. After several years of robust growth as the state emerged from the Great Recession, employment began to slow in 2016 and remains slightly below the pace of the U.S. Per capita personal income is slightly below the national average and while increasing continues to lag it. Both population and labor force growth remain solid and the unemployment rate remains low.

Key Rating Drivers

Revenue Framework: 'aa'
Financial operations are supported by a diverse array of revenue sources with the 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 sensitive to national economic trends.

Expenditure Framework: 'aaa'
While carrying costs for debt and retiree benefits are above the U.S. state median, Delaware has demonstrated ample expenditure flexibility and the broad expense-cutting ability common to most U.S. states. Moreover, the state abides by its statutory restriction to budget 98% of expected revenue, providing a cushion for revenue variability. Education is a key cost driver, as the state is highly involved with funding local education, including funding 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 above average for a U.S. state given the state's role in issuance for projects usually funded at the local level and have modestly ticked upward following years of decline. Pensions are well funded although other post-employment benefit (OPEB) obligations are sizable.

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AAA	Affirmed	Stable	7/31/19
AAA	Affirmed	Stable	4/13/06
AAA	Assigned	—	3/23/00

Related Research
Fitch Rates Delaware's $107MM GO Bonds 'AAA'; Outlook Stable (July 2019)

Related Criteria
U.S. Public Finance Tax-Supported Rating Criteria (April 2018)

Operating Performance: 'aaa'
The state has exceptional financial resilience and institutionalized protections are designed to ensure surplus operations. Strong financial management results in the maintenance of ample financial cushion even through economic downturns. The ongoing monitoring of revenues and operating expenditures mitigates the effect of volatility in revenues and allows for rapid gap closing.

Rating Sensitivities

The rating is sensitive to shifts in the state's fundamental credit characteristics including continuation of the state's conservative budgeting practices and strong economic foundation.

Credit Profile

Revenue Framework

General fund (GF) 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 the business domiciled in the state, typically accounts another 10% of GF revenues and is subject to significant volatility.

The state levies a personal income tax but not a general sales tax. The personal income tax provides about one-third of GF revenues and has recorded moderate growth over the past several years, offsetting more variable results in corporate-based taxes. Lottery revenues, which include gaming and account for just below 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 near the rate of inflation over the past ten years. Based on the current outlook for economic growth, the June 2019 Delaware Economic and Financial Advisory Council (DEFAC) meeting forecast essentially flat revenue growth (0.75%) for fiscal 2020, followed by slightly higher growth (2%) in fiscal 2021. The lower forecast for fiscal 2020 reflects in part the impact of the federal tax changes that resulted in higher than expected fiscal 2019 revenues. Fitch anticipates the long-term trend for revenue growth will remain in line with inflation and trail the pace of national economic growth given the rate of growth in Delaware's economy.

The state 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. The fiscal challenge of Medicaid is common to all U.S. states and the nature of the program as well as federal government rules limit the states' options in managing the pace of spending growth. Federal action to revise Medicaid's programmatic and financial structure appears less likely in the near term given divided control in Congress. 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. While Medicaid remains a notable cost pressure, spending requirements for debt service and pension obligations are manageable and pensions are well-funded. The state's contributions to OPEB have approximated its contributions to the pension system in recent years, reflecting a large unfunded OPEB liability relative to the stronger pension funded ratio. Pension contributions over the past several years have generally approximated the actuarially determined contribution.

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 2018 State Pension Update report, the state's total debt and net pension liabilities, as adjusted to a 6% return assumption, equaled 11.8% of 2017 personal income, a level of long-term liabilities that is above the state median but moderate overall. Based on the most recently available data, Delaware's long-term liabilities remain approximately 11.7% of 2018 personal income.

Pension reforms for the state employees' pension (SEP) system effective Jan. 1, 2012 aimed to bolster funding ratios through targeted benefit reductions and increased contributions by new employees. The unfunded actuarially accrued OPEB liability of over $7.6 billion equals 15% of 2018 state personal income. While Fitch views the OPEB liability as a more flexible obligation as compared to pensions, the relative size of the liability in the context of its relation to personal income and already above-average long-term liabilities is a concern. The governor has formed a commission to study OPEB, identify options to address related liabilities, and to report to DEFAC at its March 2020 meeting.

Operating Performance

Delaware's ability to respond to cyclical downturns rests with its conservative budget practices, maintenance of reserves, and proactive approach to tracking and forecasting revenues and expenditures throughout the budget cycle. For details, see Scenario Analysis, page 5.

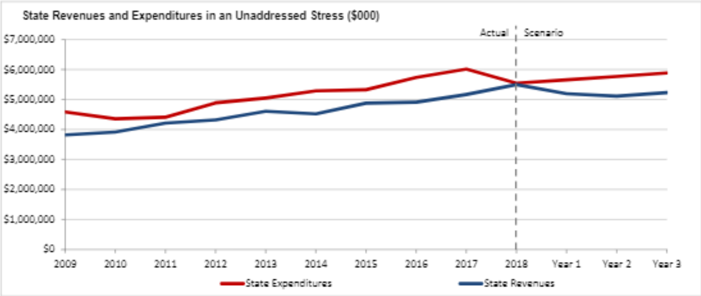
Delaware has exhibited strong budget management throughout this extended period of national economic expansion. Its conservative budgeting practices helped it to rapidly rebuild its financial resilience after the Great Recession and to maintain strong balances and financial cushion on an ongoing basis. The state has maintained the BRA above the 5% target and sizeable levels of unencumbered cash, although balances of the latter fluctuate with revenue performance and spending needs. Combined, the unencumbered cash balance and the BRA equaled a very strong estimated 14% of fiscal 2019 revenues at year-end, although this is expected to be reduced to support non-recurring expenditures, including for capital.

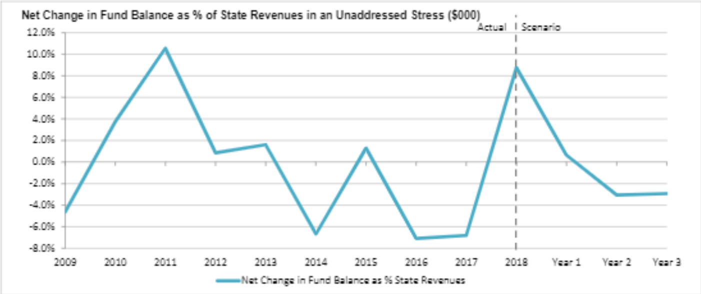
The state closely tracks revenue collections and expenditures during the year and forecasts are updated six times each fiscal year through comprehensive reviews by DEFAC. Frequent forecast updates have allowed the state to quickly respond to changing economic conditions, an important attribute as most of the state's revenues are economically sensitive with some baseline sluggishness that has required tax policy changes to fund rising expenditures. The state proactively reviews its tax policies and makes adjustments to ensure its budgets are balanced. These practices have proven to be critical to sustaining financial balance and support the state's strong operating performance.

The enacted operating budget for fiscal 2020 increases spending by approximately 4.2%, slightly higher than the governor proposed. The budget assumes some use of the accumulated cash balance, in part to finance non-recurring expenditures, and funds many of the governor's priorities. These include increased funding to schools with a higher concentration of low-income or non-English speaking students, increased school positions, and a 2% pay raise for teachers. State workers also will receive $1,000 pay raises. The budget sets aside just under $100 million per the constitutional 98% budgeting requirement, $252 million in the BRA, and $125 million in a budget stabilization fund, that was new in fiscal 2019 and is intended to provide additional buffer against revenue variability.

Delaware, State of (DE)

Scenario Analysis





Analyst Interpretation of Scenario Results:

Delaware's ability to respond to cyclical downturns rests with its conservative budget practices, maintenance of reserves, and proactive approach to tracking and forecasting revenues and expenditures throughout the budget cycle. Financial operations are supported by conservative fiscal policies, including 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.

The state's economic performance through the Great Recession closely matched the experience of the nation as a whole, with a sharp revenue decline in fiscal 2009. To achieve budgetary balance, the state applied almost the entirety of its unencumbered cash balance ($180 million) in fiscal 2009 and reduced expenditures by a comparable amount but did not appropriate from the BRA, which remained fully funded throughout the downturn. It is Fitch's expectation that Delaware will take similar action to maintain financial resilience through a moderate downturn scenario.

Scenario Parameters:	Year 1	Year 2	Year 3
GDP Assumption (% Change)	(1.0%)	0.5%	2.0%
Expenditure Assumption (% Change)	2.0%	2.0%	2.0%
Revenue Output (% Change)	(5.5%)	(1.6%)	2.4%

Revenues, Expenditures, and Net Change in Fund Balance	Actuals										Scenario Output		
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Year 1	Year 2	Year 3
Expenditures													
Total Expenditures	5,806,118	5,798,671	6,133,635	6,413,081	6,577,485	7,222,687	7,403,424	7,928,772	8,214,973	7,918,111	8,076,473	8,238,003	8,402,763
% Change in Total Expenditures	1.9%	(0.1%)	5.8%	4.6%	2.6%	9.8%	2.5%	7.1%	3.6%	(3.6%)	2.0%	2.0%	2.0%
State Expenditures	4,586,046	4,355,949	4,407,494	4,885,047	5,047,564	5,286,190	5,326,981	5,732,338	6,011,766	5,542,502	5,653,352	5,766,419	5,881,747
% Change in State Expenditures	(0.0%)	(5.0%)	1.2%	10.8%	3.3%	4.7%	0.8%	7.6%	4.9%	(7.8%)	2.0%	2.0%	2.0%
Revenues													
Total Revenues	5,040,205	5,359,006	5,934,908	5,848,027	6,135,404	6,454,990	6,955,374	7,106,316	7,368,150	7,870,802	7,614,430	7,580,870	7,751,392
% Change in Total Revenues	(0.4%)	6.3%	10.7%	(1.5%)	4.9%	5.2%	7.8%	2.2%	3.7%	6.8%	(3.3%)	(0.4%)	2.2%
Federal Revenues	1,220,072	1,442,722	1,726,141	1,528,034	1,529,921	1,936,497	2,076,443	2,196,434	2,203,207	2,375,609	2,423,121	2,471,584	2,521,015
% Change in Federal Revenues	9.8%	18.2%	19.6%	(11.5%)	0.1%	26.6%	7.2%	5.8%	0.3%	7.8%	2.0%	2.0%	2.0%
State Revenues	3,820,133	3,916,284	4,208,767	4,319,993	4,605,483	4,518,493	4,878,931	4,909,882	5,164,943	5,495,193	5,191,309	5,109,286	5,230,376
% Change in State Revenues	(3.3%)	2.5%	7.5%	2.6%	6.6%	(1.9%)	8.0%	0.6%	5.2%	6.4%	(5.5%)	(1.6%)	2.4%
Excess of Revenues Over Expenditures	(765,913)	(439,665)	(198,727)	(565,054)	(442,081)	(767,697)	(448,050)	(822,456)	(846,823)	(47,309)	(462,043)	(657,133)	(651,371)
Total Other Financing Sources	588,512	586,484	642,465	602,011	516,165	466,286	511,010	474,569	495,030	528,199	495,019	500,765	498,716
Net Change in Fund Balance	(177,401)	146,819	443,738	36,957	74,084	(301,411)	62,960	(347,887)	(351,793)	480,890	32,976	(156,368)	(152,655)
% Total Expenditures	(3.1%)	2.5%	7.2%	0.6%	1.1%	(4.2%)	0.9%	(4.4%)	(4.3%)	6.1%	0.4%	(1.9%)	(1.8%)
% State Expenditures	(3.9%)	3.4%	10.1%	0.8%	1.5%	(5.7%)	1.2%	(6.1%)	(5.9%)	8.7%	0.6%	(2.7%)	(2.6%)
% Total Revenues	(3.5%)	2.7%	7.5%	0.6%	1.2%	(4.7%)	0.9%	(4.9%)	(4.8%)	6.1%	0.4%	(2.1%)	(2.0%)
% State Revenues	(4.6%)	3.7%	10.5%	0.9%	1.6%	(6.7%)	1.3%	(7.1%)	(6.8%)	8.8%	0.6%	(3.1%)	(2.9%)

Notes: Scenario analysis represents an unaddressed stress on issuer finances. Fitch's downturn scenario assumes a -1.0% GDP decline in the first year, followed by 0.5% and 2.0% GDP growth in Years 2 and 3, respectively. Expenditures are assumed to grow at a 2.0% rate of inflation. For further details, please see Fitch's US Tax-Supported Rating Criteria.

The ratings above were solicited and assigned or maintained at the request of the rated entity/Issuer or a related third party. Any exceptions follow below.