

## CREDIT OPINION

2 April 2021

 Rate this Research

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# Delaware (State of)

## Update to credit analysis

### Summary

[Delaware](#) (Aaa stable) maintains a strong credit position supported by healthy and stable finances, and strong management and governance. The state's well-established process for monitoring revenue and its statutory limits on annual spending growth are important tools that aid financial management. These tools and the state's continued growth in reserves provide a cushion should challenges associated with the coronavirus pandemic persist. The state's most recent financial forecast assumes further growth in available reserves through the end of fiscal 2021, which will close on June 30.

Employment recovery in Delaware since the onset of the pandemic has been in line with the nation as a whole. Before the onset of the pandemic, Delaware had lagged the US on several measures of growth. Over the longer term, however, the state could benefit from its attraction to new residents given its lower cost of living relative to nearby peers.

Compared to highly rated states, Delaware's leverage is high and consists mostly of unfunded pensions and retiree healthcare liabilities. The high leverage largely stems from the state reporting direct and total responsibility for funding post-employment benefits of local school districts.

Exhibit 1

### Delaware's outstanding net tax-supported debt

Type of debt	Principal outstanding (\$m)	Moody's rating
General obligation	\$2,023	Aaa
Appropriation - sustainable energy	\$58	Aa2
Special tax - DTA transportation system	\$723	Aa1
Special tax - DTA US 301 revenue	\$213	Aa3
Special tax - DTA US 301 TIFIA loan	\$243	Aa3
Special tax - DTA GARVEEs	\$195	A1
Other debt	\$18	N/A

The amounts above incorporate fiscal 2020 year-end values adjusted for subsequent borrowings and maturities.

Source: State of Delaware and Moody's Investors Service

## Credit strengths

- » Healthy budget reserves, liquidity and GAAP-basis fund balance
- » Strong financial management and governance indicated by frequent revenue forecasting and statutory limit on spending
- » Lower business costs and cost of living relative to neighboring states could continue to attract new residents as certain economic sectors have the potential to expand

## Credit challenges

- » Low industrial diversity among US states given economic concentration in financial services
- » Heavy dependence on business taxes and a role as the preferred legal home of many publicly traded companies

## Rating outlook

The stable outlook is supported by the state's strong reserves and structural governance features, which will help preserve a sound financial position relative to peers.

## Factors that could lead to an upgrade

Not applicable.

## Factors that could lead to a downgrade

- » Growth in spending that the state accommodates with nonrecurring resources or a material use of reserves
- » A sustained and material slowdown in economic expansion that is a drag on revenue growth
- » Growth in long-term liabilities that outpaces expansion of the state's economy

## Key indicators

Exhibit 2

Delaware (State of)	2016	2017	2018	2019	2020	50-State Median (2019)
Operating Fund Revenues (000s)	4,816,998	4,854,688	5,265,653	5,438,612	5,540,869	12,439,906
Available Balances as % of Operating Fund Revenues	13.6%	5.7%	13.0%	18.6%	25.3%	9.1%
Nominal GDP (billions)	69.3	69.9	74.2	77.1	76.5	250.6
Nominal GDP Growth	-3.2%	0.9%	6.1%	3.9%	-0.8%	3.6%
Total Non-Farm Employment Growth	1.0%	0.8%	1.1%	1.0%	-7.6%	0.9%
Fixed Costs as % of Own-Source Revenue	13.7%	14.2%	13.2%	12.4%	12.2%	7.8%
Adjusted Net Pension Liabilities (000s)	3,406,059	6,373,422	5,831,614	5,361,945	6,809,721	11,258,253
Net Tax-Supported Debt (000s)	2,939,056	2,985,593	3,101,007	3,202,999	3,255,154	3,864,531
(Adjusted Net Pension Liability + Net Tax-Supported Debt) / GDP	9.2%	13.4%	12.0%	11.1%	13.2%	6.9%

Source: Delaware's audited financial statements, the US Bureau of Economic Analysis and Moody's Investors Service

## Profile

Delaware is the sixth-smallest state in the US, based on its estimated population of just under 975,000. The state's estimated 2019 gross domestic product of \$75.4 billion, ranks 41st among states. Delaware's personal income per capita is \$54,300, or roughly 96% of the national level.

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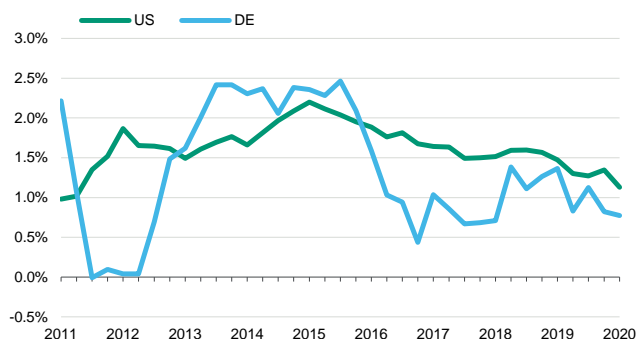
## Detailed credit considerations

### Economy

Delaware is recovering jobs on par with the nation at large. As of the final quarter of calendar year 2020, Delaware's total nonfarm employment was 5% below its level as of the first quarter of 2020. The long-term economic impact of the coronavirus outbreak on Delaware is uncertain, as it is for the other forty-nine states. Preceding the onset of the pandemic, Delaware's economic performance over the past decade lagged the US a bit on several measures (Exhibits 3-6).

Exhibit 3

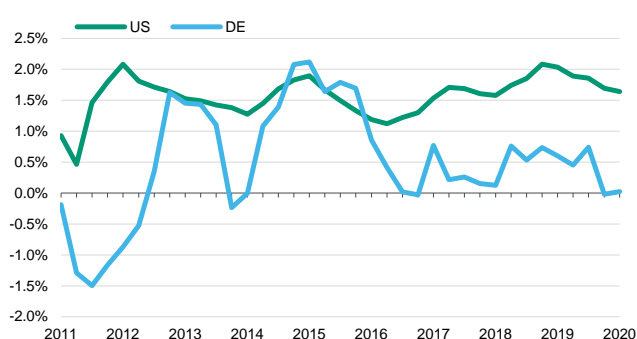
#### Year-over-year change in quarterly nonfarm employment



Source: Bureau of Labor Statistic

Exhibit 4

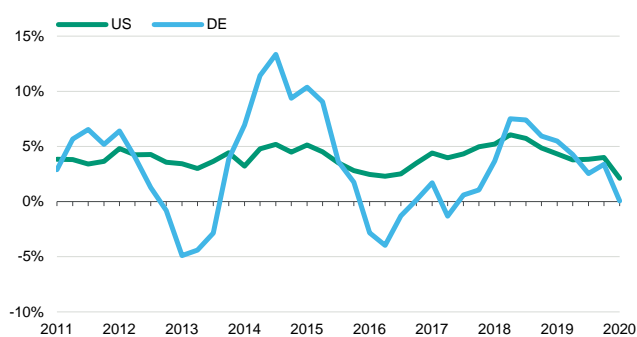
#### Year-over-year change in quarterly high wage jobs



Source: Moody's Analytics

Exhibit 5

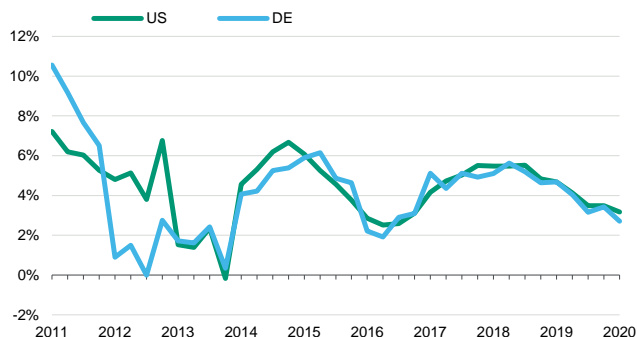
#### Year-over-year change in quarterly nominal GDP



Source: US Bureau of Economic Analysis

Exhibit 6

#### Year-over-year change in quarterly personal income



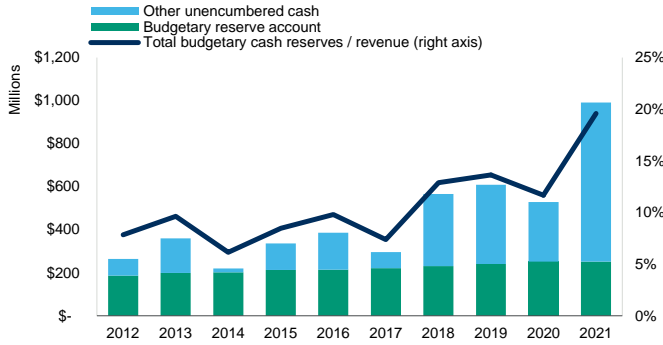
Source: US Bureau of Economic Analysis

Despite slower job growth than the nation, however, income growth has been sound. Over the longer term, Delaware may also benefit from favorable demographic trends. Aside from the District of Columbia, Delaware is unique in its Mid-Atlantic locale for its positive net migration, both on a domestic basis and total basis. Delaware's population of residents aged 25-54 (prime working age) is also trending more favorably relative to its neighbors. The state's low cost of living and absence of a general sales tax may make it a draw for new residents in years to come.

### Finances

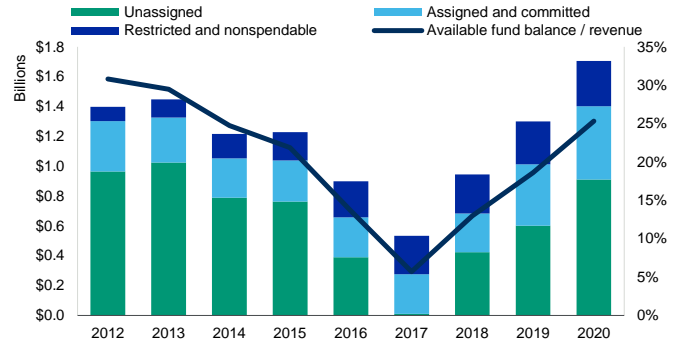
Delaware's finances remain in strong shape. The state's current forecast suggests it is on pace to retain its formal budget reserves and increase other unencumbered cash balances in fiscal 2021. On a GAAP basis, Delaware closed fiscal 2020 with further improvement in general fund balance (Exhibit 8), which does not incorporate federal CARES Act funds.

Exhibit 7  
Budgetary-basis reserves by fiscal year ending June 30



2021 figures reflect the state's most recent financial forecast. Other unencumbered cash includes the state's budget stabilization fund. All figures above do not include federal CARES Act funds.  
Source: DEFAC, the governor's fiscal 2022 budget presentation and Moody's Investors Service

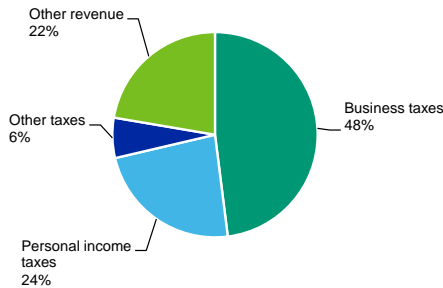
Exhibit 8  
GAAP-basis general fund balance by fiscal year ending June 30



Available fund balance is the sum of unassigned, assigned and committed fund balances. The figures above do not include federal CARES Act funds.  
Source: Delaware's comprehensive annual financial reports and Moody's Investors Service

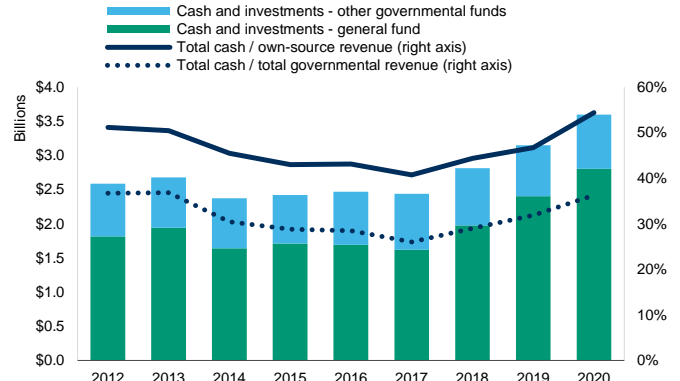
Delaware adheres to a strong limit on appropriations. The state can only appropriate 98% of estimated available funds (sum of general fund revenue and unencumbered cash outside of the budgetary reserve account), and this can only be waived with approval of three-fifths of the legislature. This limit creates a buffer against revenue underperformance. Delaware is the preferred legal home for publicly traded companies and is dependent on taxes it levies on businesses. The state derives half of its general fund revenue and more than a quarter of its total governmental revenue from potentially volatile taxes on businesses (Exhibit 9). The two largest components of business-related revenue are franchise taxes levied on corporations based in the state and abandoned property revenue.

Exhibit 9  
Composition of fiscal 2020 general fund revenue



Source: Delaware's comprehensive annual financial report

Exhibit 10  
Cash and investment balances by fiscal year ending June 30



All figures exclude federal CARES Act fund balances. Cash and investments in other funds and both own-source and total revenue incorporate figures of the Department of Transportation.  
Source: Delaware's comprehensive annual financial reports and Moody's Investors Service

**Liquidity**

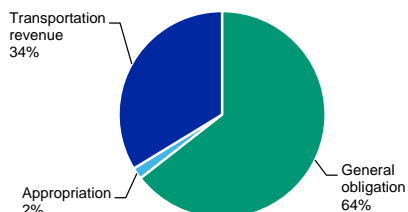
Delaware's liquidity is strong and the state reports most of its pooled cash and investments in its general fund. Across governmental activities, liquidity has remained stable for several years (Exhibit 10 above) and Delaware has not had to issue bond- or revenue anticipation notes in more than 40 years.

**Debt and pensions**

General obligation bonds account for nearly two-thirds of Delaware's outstanding net tax-supported debt, but unfunded postemployment benefits liabilities comprise a much larger share of total leverage (Exhibits 11 & 12). Delaware's total leverage is high relative to GDP among states, but, relative to revenue, Delaware's burden is much closer to the state median. A share of Delaware's revenue is derived from economic activity outside the state because of the state's taxes and franchise fees on businesses incorporated

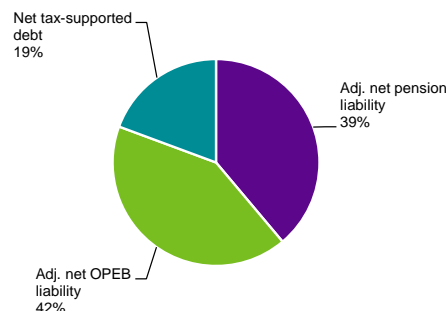
in the state. This largely accounts for the difference in the debt and pension burdens as shares of GDP and revenue relative to other states.

Exhibit 11  
Tax-supported debt mostly consists of general obligation bonds...



Source: Delaware's audited financial statements and Moody's Investors Service

Exhibit 12  
...while the principal components of leverage are unfunded postemployment benefits liabilities



Source: Delaware's audited financial statements and Moody's Investors Service

Aside from general obligation bonds, net tax-supported debt mostly consists of bonds issued by the Delaware Transportation Authority, a component of the Delaware Department of Transportation. The state has a small amount of debt outstanding secured by annual appropriations of the legislature. The state's general obligation bonds include about \$500 million of bonds paid with school district property taxes. The state accounts for the property taxes in its audited financial statements and, because the taxes are part of the state's revenue base, we include these bonds in net tax-supported debt.

It is important to note that Delaware's pension and OPEB burdens account for all assets and liabilities of plans covering employees of local school districts, which is not the case for all states.

**Legal security**

Exhibit 1 above details the different types of bonds outstanding that we consider to be net tax-supported debt of Delaware. Exhibit 13 below details the legal security associated with each type of bond.

Exhibit 13  
Legal security of Delaware's net tax-supported debt

Type of debt	Legal security
General obligation	Full faith and credit obligations of the state backed by the state's authority to levy taxes without limitation as to rate or amount
Appropriation - sustainable energy	Installment payments made by state agencies to the Delaware Sustainable Energy Utility, Inc., a nonprofit corporation created by the state. State agencies make payments from funds appropriated by the state
Special tax - DTA transportation system	Senior claim on Transportation Trust Fund into which the state deposits certain taxes, tolls and fees
Special tax - DTA US 301 revenue	Senior lien on US 301 tolls plus subordinated claim on the Transportation Trust Fund
Special tax - DTA US 301 TIFIA loan	Subordinated lien on US 301 tolls plus further subordinated claim on the Transportation Trust Fund
Special tax - DTA GARVEEs	Federal highway grants

Source: Respective bond offering documents and Moody's Investors Service

**Debt structure**

All of Delaware's debt is fixed rate.

### Debt-related derivatives

The state is not party to any debt-related derivative agreements.

### Pensions and OPEB

Delaware's fiscal 2020 fixed costs were just over 12% of its own-source revenue, which consists of all governmental revenue and transportation revenue less federal revenue. Fixed costs consist of debt service, pension contributions and payments of other postemployment benefits (OPEB). For the pension contribution, we calculate a pension "tread water" indicator, which is an estimate of the payment to a government's pension plans that keeps reported net pension liabilities from growing, assuming other actuarial assumptions hold. For fiscal 2020, we estimate Delaware's "tread water" indicator at about \$250 million. The state's actual pension contribution was \$273 million.

In September 2019, the governor reissued an executive order creating a Retirement Benefit Study Committee and directing that committee to identify options for eliminating or reducing the state's unfunded OPEB liability. The order directs the committee to commence regular meetings no later than September 30, 2019 and to present preliminary findings no later than March 2020. Given the lack of a constitutional protection of retiree healthcare benefits in Delaware, it is possible that the committee could determine a reduction in benefits or a shift in the financing of benefits from the state to employees and retirees to be prudent options and recommend those actions to the governor. There could still be political obstacles to implementing these kinds of adjustments, but they would present the state with some options to reduce its obligations without a significant increase in spending.

## ESG considerations

### Environmental

As a US state with a wealthy and diverse economy, the flexibility to raise revenue, and support from the federal government, Delaware will continue to demonstrate high resilience to environmental risks. In general, US states face low credit risk stemming from environmental events, the most likely to occur being natural disasters. When disaster strikes, states typically incur minimal costs, with the federal government, via FEMA, taking a large role in funding recovery.

That said, Delaware's small size and location on the Atlantic Ocean raises its exposure to flood and storm risk relative to many states. Delaware and its local governments are primarily exposed to cyclone risk and, based on data of Moody's affiliate Four Twenty Seven, the state ranks eighth among all states in terms of this specific risk. An estimated 10% of Delaware's dwelling units are located in a 100/500 year floodplain, which is equal to the median ratio among states with coastlines. Statewide, close to 10% of wages are earned in hurricane storm surge flood zones according to the US Bureau of Labor Statistics, though nearly half of this exposure is located in zones vulnerable only to the highest category of storm.

Delaware is actively managing coastline development and we expect the state's significant credit strengths mitigate exposure to environmental risks.

### Social

Key social considerations for US states include demographics, health services and housing. As discussed above, Delaware's population trends remain stable and employment and income are growing, albeit more slowly than the US overall. Support for health services by the federal government, mainly through Medicaid grants, represents a vulnerability for states and Delaware is no exception. Delaware is no more vulnerable to federal funding decisions in this regard than most states. According to data of the federal government, approximately 25% of Delaware residents are currently enrolled in Medicaid and the Children's Health Insurance Program (CHIP), a ratio only a bit higher than the 24% of the national population enrolled. Housing affordability has not fallen in Delaware as it has in many part of the US. The state's strong demographics could boost the housing market in the coming years, but it will likely take much more rapid growth to significantly deteriorate housing affordability in the state.

### Governance

Governance is a material consideration for the sector and all of the state's ratings. Delaware's Aaa rating is supported in large part on legal and governance provisions that will encourage the state to maintain a strong financial profile over a long period. The DEFAC, a panel of 31 gubernatorial appointees, provides the state's revenue estimates and calculates its spending authority. This panel, which includes officials from the public and private sector, meets six times each year and issues revenue and expenditure forecasts used by both the executive and legislative branches of government during the budget process.

The state's requirements for consensus forecasts, well-managed expenditure growth, and a limit on appropriations support long-term prospects for financial strength. Delaware's otherwise strong management profile is tempered by a constitutional requirement that tax increases be approved by a three-fifths legislative majority, which reduces the state's financial flexibility.

## Rating methodology and scorecard factors

The US States and Territories Rating Methodology includes a scorecard, which summarizes the 10 rating factors generally most important to state and territory credit profiles. Because the scorecard is a summary, and may not include every consideration in the credit analysis for a specific issuer, a scorecard-indicated outcome may or may not map closely to the actual rating assigned.

Exhibit 14

### US state and territories rating methodology scorecard

Delaware (State of)

Rating Factors	Measure	Score
<b>Factor 1: Economy (25%)</b>		
a) Per Capita Income Relative to US Average [1]	96.5%	Aa
b) Nominal Gross Domestic Product (\$ billions) [1]	\$76.5	Aaa
<b>Factor 2: Finances (30%)</b>		
a) Structural Balance	Aaa	Aaa
b) Fixed Costs / State Own-Source Revenue [2]	12.2%	Aa
c) Liquidity and Fund Balance	Aaa	Aaa
<b>Factor 3: Governance (20%)</b>		
a) Governance / Constitutional Framework	Aaa	Aaa
<b>Factor 4: Debt and Pensions (25%)</b>		
a) (Moody's ANPL + Net Tax-Supported Debt) / State GDP [2] [3]	13.2%	Aa
<b>Factors 5 - 10: Notching Factors [4]</b>		
Adjustments Up: None	0	
Adjustments Down: Pension or OPEB Characteristics	-0.5	
<b>Rating:</b>		
a) Scorecard-Indicated Outcome		Aa1
b) Actual Rating Assigned		Aaa

[1] Economy measures are based on data from the most recent year available.

[2] Fixed costs and debt and pensions measures are based on data from the most recent debt and pension medians report published by Moody's.

[3] ANPL stands for adjusted net pension liability.

[4] Notching factors 5-10 are specifically defined in the US States and Territories Rating Methodology.

Source: US Bureau of Economic Analysis, Delaware's audited financial statements and Moody's Investors Service



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