S&P Global Ratings

RatingsDirect®

State of Delaware; Appropriations; General Obligation

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Credit Profile		
US$293.18 mil GO bnds ser 2021 due 02/01/2041		
Long Term Rating	AAA/Stable	New
Delaware GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings has assigned its 'AAA' rating, with a stable outlook, to the State of Delaware's series 2021A general obligation (GO) and GO refunding bonds, consisting of $230 million of new money for various capital projects and $63.2 million for a current refunding of a portion of the series 2013B bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating on Delaware's GO debt outstanding and its 'AA+' long-term rating on the state's appropriation debt outstanding. The outlook on all ratings is stable, reflecting Delaware's strong fiscal management that has allowed the state to proactively manage its budgets through the pandemic and has been key to the state's long-term credit stability.

Delaware's full-faith-and-credit pledge secures the 2021A bonds as well as the state's GO debt outstanding.

Credit overview

Through the pandemic, the state has continued regular Delaware Economic and Financial Advisory Council (DEFAC) meetings. This council has allowed the state to adjust revenue expectations and expenditure allocations as needed, keeping total expenditures for both fiscal 2020 and fiscal 2021 just over $4.5 billion. From these actions, coupled with additional federal aid, the state has been able to maintain a high level of liquidity and close fiscal 2020 with a small surplus, and fiscal 2021 is expected to close with an approximately 10% operating balance. Through February 2021, these positive fiscal outcomes have also allowed the state to build a $63.1 million Budget Stabilization Fund and maintain a fully funded $252.4 rainy-day fund. The governor's presented $4.7 billion fiscal 2022 general fund budget continues to build on these strengths, appropriating about 96% of DEFAC determined available revenues, below the 98% DEFAC guidance, continuing to fully fund the rainy-day fund at 5.2% of general fund operating expenditure, and sets aside more than $131 million, or another 2.8% in the budget stabilization.

S&P Global Ratings believes Delaware's credit stability, through multiple economic cycles, is underpinned by its history of proactive fiscal management, well-embedded strong financial policies and practices, and a demonstrated ability to maintain adequate reserves. Partially offsetting these established strengths is the growing credit pressure stemming from the state's unfunded other postemployment benefits (OPEB) liabilities, which we consider significant. In our view, inaction in addressing Delaware's elevated retiree health care liabilities over our outlook horizon could affect the state's credit quality.

The governor's fiscal 2022 budget proposal represents 3.5% growth over the adopted fiscal 2021, which was adopted in the early days of the pandemic. In our opinion, the relatively steady expenditure levels over the past three years are reflective of the budget controls we would expect from the state and is supported by the resilience of the revenue streams. The DEFAC's estimates as of March 2021 made minor adjustments to projected revenues compared with the council's previous forecast in December 2020. The latest projections show slightly increased revenues for fiscal 2022 at 3.1% higher than previously forecast. The forecast for fiscal 2023 was also increased slightly, with revenues now forecast to grow 0.8% over fiscal 2022 projected revenues. The current proposal also does not include any monies the state may receive from the American Rescue Plan (ARP), and Delaware is expecting to receive more than $900 million, or 19% of the fiscal 2022 budget proposal. Although primarily credit supportive, S&P Global Ratings sees potential risk from all governments receiving these funds in using this one-time money for recurring expenditures, but to date Delaware has not indicated it will likely use them.

The largest credit weakness is the state's OPEB funding status. Delaware's unfunded OPEB liabilities have grown significantly, despite the implementation of various reforms over the past two decades. As of fiscal 2020, the state's $9.4 billion share of the net OPEB liability (NOL) is among the largest in the nation on a per capita basis, at $9,486. Looking ahead, we expect annual contribution requirements will escalate, given that contributions are funded on a pay-as-you-go-basis, which effectively defers contributions until the moment benefits are due. We believe the state's history and ability to pass and implement retirement reforms positions Delaware well, compared with many other states without such flexibility. In 2019, the governor signed Executive Order 32 to reestablish a committee to study OPEB in Delaware and identify options available to the state. Implementation of the committee's recommendations were delayed as the state addressed the pandemic, but we expect continued actions to address the risk.

Environmental, social, and governance (ESG) factors

Our rating incorporates our view regarding health and safety risks posed by the COVID-19 pandemic and the variants still spreading throughout the country. However, we note the state's recent economy, liquidity, and budget performance have remained relatively stable despite the effects of the pandemic. Absent the implications of COVID-19, we consider the Delaware's social risks to be generally in line with the sector. Our rating also incorporates the elevated social risks posed by the pandemic and the risks introduced by the variants still spreading throughout the country that could affect public health and safety, although we note the state's recent economy, liquidity, and budget performance has remained relatively stable despite the effects of the pandemic. Despite having a higher-than-average age dependency ratio, Delaware is both managing any associated cost risk and the state is benefiting from population growth. We believe the state's environmental risks are elevated for the sector, given its geographical exposure to ocean storms and Delaware and Christiana river flooding, which could increase infrastructure costs and particularly affect coastline communities, some of which are also economically dependent on tourism. However, we believe Delaware's governance risks are below those of our view of the sector as a whole, as the state has strong constitutional provisions and operational practices that encourage good governance.

Stable Outlook

Downside scenario

We could lower the rating if we believe weakened long-term economic trends or rising costs expose the state to challenges uncharacteristic of the rating level. Downward pressure could also arise if the state's budget or reserve profile were to be challenged--stemming from elevated retiree health care liabilities, soft revenues, the outcome of current litigation surrounding education funding, or other factors--to a degree we feel is not commensurate with the rating level. Furthermore, inaction in addressing Delaware's elevated retiree health care liabilities over our outlook horizon could affect the state's credit quality.

Credit Opinion

Economic recovery from the depths of the recession is underway

The pandemic took a toll on the Delaware economy, causing 84,500 jobs to be lost in the March-April 2020 shutdown, the 10th most as a share of total employment, according to IHS Markit. To date, nearly half have returned, but many leisure and hospitality jobs remain lost. Many professional services jobs, including financial services and real estate, which have a relatively high concentration in Delaware, have felt a more limited impact from the efforts to control the virus, allowing state income tax revenues to hold relatively steady. For 2020, Delaware's unemployment peaked during the recession at 13.4%, but as of January 2021 was back down to 6.1%. Preliminary numbers for February 2021 indicate it may increase slightly again, but we expect the state's unemployment to be in line or below the national average over the next couple of years.

Overall economic performance has been historically stable, in our view, and likely will continue to be. Personal income, employment gains, and economic growth are forecast to be in line with the national rates through 2025, according to IHS Markit. The state is somewhat concentrated in financial services jobs, with 9.5% of 2020 jobs in this sector, which we believe exposes Delaware to some risk. However, we understand there has been diversification within this sector and the state is investing in various economic development programs to help further diversify. High-tech, chemical, and distribution companies are currently expanding in the state.

Strong pensions offset with weak OPEB funding

Delaware's pension liabilities are average in risk compared with other states, with what we consider a good funded ratio as of June 30, 2020, of 84.0% across the five pension plans for which the state reports liability. The state's unfunded liability, compared with income and population, is moderate, in our view. State contributions to four of its five pension plans are determined on an actuarial basis, with contributions historically meeting 100%, which we view as positive. The closed state police plan is funded on a pay-as-you-go basis. We also note that aggregate annual plan contributions for the pension system were slightly under our calculation of minimum funding progress or amounts necessary for the plans to cover a portion of the amortization in unfunded liability, as well as certain cost drivers of the annual change in the liability. We believe this could also weaken the strength of the state's pension liability profile over time.

Compared with other state pension systems, Delaware has funded its pension system well, in our opinion. The state reports a liability for five of the nine plans offered by the Delaware Public Employees' Retirement System (DPERS): state employees, special, new state police, judiciary, and closed state police. The state's three-year-average pension-funded ratio across these five plans is good, at 84% as of fiscal 2020. The State Employees Retirement System (SRS) represents 90.2% of the state's total unfunded pension liability as of June 30, 2020, and is 85.5% funded with the state's applicable net pension liability of $1.6 billion. Contributions for SRS, special, new state police, and judiciary plans are actuarially based, and funding has been historically met at 100% of the ADC, which we view as a credit positive. We view the SRS's current assumed rate of return of 7.0% as about average, but could result in contribution volatility over time, especially in combination with an open amortization period and level-percentage-of-pay amortization method.

Credit risks reside in the future treatment of funding OPEB obligations. In our view, Delaware's unfunded retiree health care liabilities are significant and will increase in future years, given the state's pay-as-you-go funding approach. Again, the state share of the NOL was $9.4 billion in fiscal 2020, which translates into a NOL per capita of $9,486. We believe Delaware's ability to pass and implement reforms will remain important to the state's credit profile. The state offers retiree health care benefits through a cost-sharing, multiple-employer, defined-benefit plan administered by DPERS. Coverage is available to retirees and eligible dependents covered under the state employees', new state police, judiciary, and closed state police pension plans.

Delaware has a history of making changes to manage the increasing liability. The state began prefunding its retiree health care benefits with lump sum payments and contributions based on a percentage of payroll in 2002 and 2003. It also established an OPEB trust in 2007. Since its inception, the trust has received some funds from abandoned property revenues and Medicare Part D subsidies. Contributions, however, have typically been on a pay-as-you-go basis. Consequently, the funded ratio is a very low 4.7% as of June 30, 2020. Lack of prefunding will likely cause reported unfunded OPEB liabilities and costs to escalate in future years if further reform efforts are not implemented. We expect the state's committee to study OPEB will lead to legislative changes to reduce this liability in 2021 and 2022.

Debt And Liability Profile

The state has focused its attention on reducing debt over time with clearly defined debt affordability parameters and a commitment to cash-funding capital projects, especially when the economy is performing well. We believe that this and rapid amortization of principal outstanding will contribute to a stable debt profile. We view total tax-supported debt, including GO and transportation bonds, as moderately high. Delaware issues debt for political subdivisions. It pays from 60%-80% of the cost of capital improvements for public school districts on approval of such costs; the school districts pay the remaining portions supported by local property taxes.

State-supported GO debt was $1.7 billion as of June 30, 2020, excluding $483.5 million which is supported by the local school districts. Delaware's other major bonding program is associated with the Delaware Transportation Authority, which issues revenue bonds supported primarily by motor fuel taxes, motor vehicle fees, and turnpike tolls. Delaware does not have any variable-rate debt outstanding, and it has not entered into any interest-rate swaps agreements or related derivative transactions.

Total tax-supported debt in fiscal 2019, including GO, transportation, and appropriation obligations, is moderately high relative to that of state peers, at $2,670 per capita and 4.7% of personal income. The state estimates total tax-supported debt service carrying charges, after excluding the local school district support, to be a moderate 6.0% of governmental spending in fiscal 2022. Debt amortization is rapid, in our opinion, with about 76% of state-supported debt scheduled to retire in the next 10 years, inclusive of this current issue. The fiscal 2022 plan includes GO bond authorization of $237.7 million and an authorization of $377.1 million from the transportation trust fund.

Litigation risks could affect revenues

In recent years, Delaware has faced several lawsuits about its claim to certain abandoned properties. The state is currently litigating claims involving 30 states that allege Delaware improperly accepted certain abandoned property that should have been escheated to those other states. These cases have been accepted for consideration by the U.S. Supreme Court, but the state reports that any resolution is likely to be at least a year away. As of March 3, 2021, the state's potential aggregate litigation exposure (across multiple claims) could exceed $206.6 million. In our opinion, abandoned property revenues are a significant revenue source for the state--in fiscal 2019 they were Delaware's third-largest revenue source (behind personal income taxes and franchise taxes). DEFAC expected fiscal 2021 gross abandoned property revenue to be like the fiscal 2020 amount of $554 million, or 12.2% of total general fund revenues. After refunds are considered, the net amount in fiscal 2020 is estimated at $440 million, or 9.8% of revenues, with the net fiscal 2021 amount expected to be 8.8%. The fiscal 2017 operating budget rewrote Delaware's unclaimed property laws in an effort to align them with other states.

In terms of other litigation, a lawsuit filed in January 2018 alleged, among other claims, that Delaware has failed to provide appropriate funding for certain categories of students with an adequate education, violating the state's constitution. The state settled all remaining claims in this case in October 2020 and expects legislation to be adopted in the current legislative session will formally end these claims.

Strong financial management a hallmark of the 'AAA' rating

S&P Global Ratings considers Delaware's management practices strong under its Financial Management Assessment (FMA) methodology. An FMA of strong indicates that practices are strong, well-embedded, and likely sustainable. The state's financial management highlights include regular general fund revenue and expenditure reports, multiyear revenue forecasting, a formal general fund reserve policy, and formal statutory debt affordability issuance guidelines. The state has implemented various debt management policies to decrease its debt burden and limit bond issuance. These measures have reduced Delaware's debt level, despite the broad role the state maintains in funding capital requirements for education, transportation, and corrections.

An executive order mandates DEFAC to submit budgetary general fund and transportation trust fund revenue forecasts to the governor and the general assembly six times a fiscal year--in September, December, March, April, May, and June--for the current fiscal year and the succeeding two fiscal years. Delaware uses these forecasts in the state budget process to ensure compliance with constitutional spending limits and statutory debt limitations. The state has a strong track record of implementing adjustments as needed.

Delaware's constitution, statutes, and internally developed policies guide the state's overall financial and budget management. Policy improvements have been made continuously and the state's track record of adhering to policies has been what we consider strong.

Key policies include:

- The regularly updated DEFAC general revenue and budget forecasts for current and future fiscal years, along with an annual DEFAC report that outlines current and subsequent fiscal-year performance and estimates;

- A constitutionally required annual operating appropriation limit of 98% of estimated budgetary general fund revenues and the previous year's unencumbered budgetary general fund balance;
- A constitutionally required general fund budget reserve account, funded at 5% of budgetary general fund revenues, to provide flexibility against any unexpected revenue declines;
- A cash management policy board that sets formal state investment policies and regularly monitors investments;
- Well-established debt management policies, including a three-part statutory debt affordability limit; and
- Multiyear revenue forecasts updated throughout the fiscal year, with a less formal process for general operating expenditures.

Delaware maintains a traditional multiyear capital improvement program. The state fully outlines its annual capital requirements in the annual capital budget, but officials make internal cost estimates for capital projects they expect to span multiple years.

The three-part statutory debt affordability limit includes the following:

- New tax-supported debt authorizations in any one fiscal year cannot exceed 5% of estimated net budgetary general fund revenue for that fiscal year.
- No new tax-supported debt and no transportation authority debt can be issued if the total maximum annual debt service (MADS) on debt outstanding exceeds 15% of estimated budgetary general fund revenues and transportation trust fund revenues for the fiscal year succeeding the fiscal year in which such debt is issued.
- No new state GO debt can be issued if, in any fiscal year, the MADS on existing GO debt exceeds the estimated cash balances, including all reserves, for the fiscal year subsequent to the fiscal year in which the debt is issued.

On a four-point scale, where '1.0' is the strongest and '4.0' is the weakest, S&P Global Ratings has assigned an overall score of '1.0' to Delaware's financial management.

Economic growth expected to continue

Delaware is bordered by Maryland, New Jersey, and Pennsylvania. In our opinion, the state has significant competitive advantages compared with other states, including: its geographic proximity to New York City, Philadelphia, Baltimore, and Washington, D.C.; its above-average share of highly skilled scientific and technical workers; a critical mass of chemical, pharmaceutical, and biomedical companies; modest but steady population growth; a low cost of living; and a favorable business-friendly regulatory climate. State income levels remain in line with the national average. At $56,768 per capita, the 2018 personal income was 95% of the national level. We believe Delaware's economy is relatively diverse following several decades of active economic development at the state level. Economic development initiatives have included targeted statutory and tax policy changes to encourage financial sector, business services, pharmaceutical, and biotech expansion, and have reduced the state's reliance on traditional manufacturing.

The state continues to see business growth despite the pandemic, including Barclays expanding its U.S. headquarters presence, Goldman Sachs adding a new consumer banking facility, Amazon completing four new facilities, and Incyte (a biopharmaceutical company) adding 400 more jobs.

On a four-point scale, where '1.0' is the strongest and '4.0' is the weakest, S&P Global Ratings has assigned an overall score of '1.8' to the state's economic factors.

Budgetary performance and fiscal 2020 results show resilience

The general fund relies on tax revenues from personal income and corporate income, as well as a corporate franchise tax, business and occupational gross receipts, a bank franchise tax, realty transfers, and cigarette taxes, among others. Additional significant general revenue streams include abandoned property and lottery receipts. Delaware does not levy ad valorem taxes on real or personal property and does not impose a general sales or use tax.

The budget reserve account has been a stabilizing factor to the state's overall financial profile and liquidity. The budget reserve account, or rainy-day fund, is funded at 5.5% of estimated budgetary general fund revenues. Officials can appropriate this money only with the approval of a three-fifths vote of the members of each house of the general assembly, and they can only use the money to fund an unexpected budgetary deficit or to provide funds required due to the enactment of legislation reducing revenue. Officials have not withdrawn any funds from the budgetary reserve account since its inception in 1980.

Delaware has the authority to interfund borrow from special funds, which are available to meet the state's liquidity needs. Delaware has not needed to issue external revenue anticipation notes for liquidity since fiscal 1977.

Delaware posted a $87.0 million operating surplus (1.7% of general fund expenditures) to its general fund as of June 30, 2020, following a posted a $41.6 million operating deficiency (0.8% of general fund expenditures) to its general fund as of June 30, 2019. Total general fund revenues decreased slightly by $6.2 million (0.1%) and general fund expenditures also decreased slightly, by $134.8 million (2.6%), demonstrating the strong fiscal year the state was having prior to the pandemic, as well as its ability to adjust to the varied revenue and expenditure trends and needs during the early part of the COVID-19-related recession. When incorporating other sources and uses of financial resources, the state's general fund finished fiscal 2020 with a total fund balance of $1.7 billion, a nearly 24% increase from $1.3 billion in fiscal 2019. Within this total, Delaware's unassigned fund balance was $911.3 million.

On a four-point scale, where '1.0' is the strongest and '4.0' is the weakest, S&P Global Ratings has assigned an overall score of '1.3' to Delaware's budgetary performance.

Government Framework

In our opinion, Delaware has a strong government framework. Due to well-established policies, the state has maintained what we view as a solid financial position, especially during recessionary periods, including the recent recession. The Delaware Constitution requires that the governor submit a balanced budget to the general assembly annually. Although there is no legal requirement to maintain a balanced budget during the year, DEFAC's frequent revenue and expenditures updates allow for timely adjustments. State statute provides the executive branch with the authority to make necessary adjustments after providing for the payment of principal and interest on Delaware's bonds, notes, or revenue notes. The state cannot carry forward operating deficits.

If Delaware fails to make sufficient provisions to pay principal and interest on any of the bonds, or if sufficient funds are unavailable at the time an amount is payable, state law requires the state treasurer to set apart a sum to pay principal and interest from the first revenues thereafter received by the state. Delaware does not permit for initiatives or referendums at the state or local level, and is the only state that does not require popular approval of constitutional amendments.

On a four-point scale, where '1.0' is the strongest and '4.0' is the weakest, S&P Global Ratings has assigned an overall score of '1.4' to Delaware's governmental framework.

Delaware's varied credit strengths and independent treasury function allow a rating above the U.S. Sovereign

Delaware's bonds are eligible to be rated above the sovereign because we believe the state can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria, "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013), U.S. states are considered to have moderate sensitivity to country risk. State-derived revenues are the sole source of security on the bonds, and the institutional framework in the U.S. is predictable, with significant state autonomy and flexibility.

Based on the analytic factors we evaluate for states, on a scale of '1.0' (strongest) to '4.0' (weakest), we have assigned a composite score of '1.6' to Delaware. We have notched up to 'AAA' as allowed as per our state rating methodology criteria, reflecting our view of the state's strong fiscal management, including timely budget adjustments informed by frequent revenue forecasts (conducted six times per year) and Delaware's history of structural solutions when faced with a shortfall. Additionally, the state has managed a stable reserve profile over multiple economic cycles; no funds have been withdrawn from the budget reserve account since its inception in 1980. It also reflects the state's position and income generation from Delaware's business-friendly legal system.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of April 5, 2021)		
Delaware GO		
Long Term Rating	AAA/Stable	Affirmed
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Sustainable Energy Util, Inc., Delaware		
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Long Term Rating	AA+/Stable	Affirmed