Moody's Investors Service

New Issue: Delaware (State of)

MOODY'S ASSIGNS Aaa RATING TO DELAWARE'S $132 MILLION GENERAL OBLIGATION BONDS

State
DE

Moody's Rating

ISSUE		RATING
General Obligation Bonds, Series 2005D		Aaa
Sale Amount	$132,000,000	
Expected Sale Date	09/02/05	
Rating Description	General Oligation Bonds	

Opinion

NEW YORK, Sep 1, 2005 -- Moody's has assigned a Aaa rating to the State of Delaware's general obligation bonds, Series 2005D. The rating reflects a state economy that held up better than that of many other states, tightly managed finances, and a debt burden that is among the highest in the country but that remains manageable. The state's economy outpaced the nation's during the 1990s expansion, enabling the state to shore up its reserves and balances, and insulating the state as the economy slowed. Delaware is now performing better than most of the Aaa-rated states in terms of its economic and revenue performances. The rating outlook for the state's general obligation bonds is stable.

Credit Strengths are:

-- Sound financial management

-- Strong revenues and healthy reserves

Credit Challenges are:

-- High debt burden

-- Relatively low economic diversity

ECONOMY REMAINS SLIGHTLY AHEAD OF NATION

Given Delaware's historic concentration in manufacturing, it is noteworthy during the nationwide manufacturing slowdown that many economic indicators held up. This is partly due to the state's improved economic diversity relative to historical norms. Because of its small size, Delaware's economy will always show less diversity than larger states, but trends are positive. The banking industry has served as a counterbalance to the state's two large manufacturing industries, chemicals and automobiles, both of which are cyclical industries and have endured cutbacks over recent years. Construction-related employment has also been strong in recent years, reflecting the state's dynamic real estate market. In addition, the growing presence of the biotechnology industry and commercial banks (including credit card banks) in the state have added to the economic diversity of Delaware and have offered many highly paid jobs which have in turn contributed significantly to the state's high personal income levels. It should also be noted that Bank of America recently acquired MBNA, Delaware's largest employer. While some restructuring of the respective firms is expected, the particular implications of this acquisition for Delaware's economy and employment levels are still unknown.

While state employment growth slowed during the recession, roughly tracking national trends, Delaware's economy has stabilized. Delaware's 1.5% employment growth in 2004 remained slightly ahead of the 1.1% US average. The state's unemployment rates have also remained at or below the country's in recent years. Most recently, Delaware's December 2004 unemployment rate of 4.1% was markedly below the 5.4% national rate. Delaware's personal income per capita remains high at 106% of the national figure, although down slightly from previous years.

SOUND FINANCIAL MANAGEMENT

Demonstrated sound financial management and sustained revenue growth through the 1990s are the strongest features of the state's credit and enabled Delaware to weather revenue softening better than some other states during the national recession. Delaware's constitution requires the state to budget expenditures at 98% of available resources, which helps achieve ongoing balance. There is also a constitutionally mandated budget reserve, requiring that unencumbered budgetary General Funds be transferred to the reserve account up to 5% of General Fund revenue. This funding may be accessed only by a three-fifths vote of the members of each house and may be used only to close a General Fund deficit or to make up for a legislatively driven revenue shortfall.

Revenue estimates are made by a 31-member panel appointed by the governor, known as the Delaware Economic and Financial Advisory Council (DEFAC). This panel, which includes officials from the public and private sectors, issues revenue and expenditure forecasts that are used by both the Executive and Legislative branches during the budget process. This consensus forecasting, well-managed expenditure growth, appropriations limits, and consistent year-end cash surpluses all contribute to the state's financial strength.

REVENUE ESTIMATES REMAIN STRONG; RAINY DAY FUND FULLY FUNDED

After a couple of years of sluggish revenue growth during the recession, net general fund receipts bounced back, and grew 6% and 5.2% in fiscal 2004 and 2005 respectively, when adjusted for legislative changes and other one time events, totaling $2,878 million at the end of fiscal year 2005. In particular, the two largest sources of revenues, personal income and corporate franchise tax revenues, continued to improve during that period, increasing 13% and 3% (when adjusted for a one-time collection in 2004) respectively. In addition, the state ended the year with a fully funded Rainy Day Fund at $148 million. While many states tapped or even depleted their Rainy Day Fund to address its revenue softening over the past few years, Delaware has consistently maintain it untouched.

The most recent June 2005 DEFAC forecast, projects a 6.4% revenue increase in fiscal 2006. Personal income tax receipts are still expected to continue to increase 8% over fiscal 2005 and franchise tax revenues 4.2%. Lottery revenues are also expected to increase 3.2% to a significant $241 million. While increased competition of slots betting in neighboring states is anticipated over the next few years, its anticipated impact on Delaware lottery revenues has been delayed. Maryland, again, failed to legalize slot machines during its past legislative session, and Pennsylvania, which did approve slots at racetracks, has had a slower than anticipated implementation period, which in turn translates into a delayed impact on Delaware revenues.

Subsequent to the June DEFAC forecast, however, the General Assembly, as part of its 2006 Budget, passed a revenue package reducing the State's gross receipt tax and introduced various other revenue measures. Together, they are expected to result in a revenue reduction of $56.6 million in fiscal 2006, leading to a slightly reduced 4.5% total expect revenue growth for fiscal 2006.

DEBT BURDEN REMAINS HIGH

Delaware's high debt position has always been its weakest credit factor. While the state does have various statutory debt limits, these limits are fairly generous and have not significantly decreased the state's debt burden. More specifically, total authorized debt may not exceed 5% of estimated General Fund revenues. While the state's debt ratios have inched down over the years, Delaware tax-supported debt as a percent of personal income ranks 7th among the fifty states at 5.5%, well above the 2005 state debt median of 2.4%. Delaware's net tax-supported debt per capita of $1,865 also ranks 7th among states, well above the $703 state median. In part, the high debt burden results from the state's role in funding public school construction, a role assumed by local school districts in most other states.

The marginal decline in debt ratios over the past few years reflects an informal state policy to whittle down its debt position through decreased authorizations, defeasances, and increased pay-go capital. This policy, which achieved some momentum in years prior to the recession, shifted by necessity as Delaware's revenue picture dimmed. In fiscal 2000, the state authorized $40 million less of bonding capacity than the $110.7 million that the 5% test would have otherwise allowed. However, for fiscal 2001 and 2002, the legislature authorized the maximum amount of general obligation debt allowable: $117.2 million for 2001 and $118.2 million for 2002 (plus an additional $30 million of debt authorized from prior years). For fiscal 2003, the legislature also authorized the maximum general obligation debt allowable, $118 million, to which $40 million was added from previous years' unissued debt caps, totaling $158 million, and in fiscal 2004, $180,000 was added to the maximum allowable GO debt amount, totaling $125.7 million. In fiscal 2005 and 2006, the legislature authorized $138.3 million and $150.3 respectively, mostly reflecting the 5% test. The contribution of pay-go capital has also played a critical role in paring state debt but diminished as revenues tightened. The level of pay-go decreased from $197 million in fiscal 2001 to $11.0 million in 2002 and $19.3 million in 2003. For fiscal 2004 and 2005, once again reflecting the improved revenue picture, the level of pay-go financing was increased to $142 million and $235 million. This amount is expected to increase further in fiscal 2006, at an estimated $281.6 million, reflecting the state's increased commitment of cash to the bond bill.

Moody's anticipates that while the state intends to further increase its amount GOs outstanding and its debt levels will likely remain significantly above the state median, they will remain at the 5% test level, and still be manageable for the state. It should be noted that while Delaware's debt burden is substantial, it does have conservative elements built into it, including declining debt service and a rapid amortization, with approximately 80% of general obligation debt scheduled to mature within ten years.

Outlook

The credit outlook for the state is stable. While the state's debt burden is likely to remain proportionately high among states, Delaware performed better than many states during the national economic slowdown and will continue to experience economic and fiscal growth. The state's Aaa rating speaks to Delaware's financial flexibility, which should continue to give the state latitude in managing this significant debt burden.

What could change the rating - UP

-- At the Aaa, the State of Delaware is at the highest rating level

What could change the rating - DOWN

-- Significant increase debt levels

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