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Fitch Rates Delaware's $172MM GO Bonds 'AAA'

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Fitch Ratings-New York-27 June 2006: Fitch Ratings assigns an 'AAA' rating to the State of Delaware's $172 million general obligation (GO) bonds, composed of up to $43 million to be offered for retail distribution by a group of underwriters led by Merrill Lynch & Co. the week of July 10 (series 2006A) and the remainder to be sold competitively on July 13 (series 2006B). Fitch also affirms the 'AAA' rating on the state's approximately $1 billion outstanding GO bonds. The Rating Outlook is Stable.

Delaware's premier credit standing centers on its considerable economic and financial resources, the latter of which is buttressed by institutionalized protections designed to ensure surplus operations. The state's economy, historically wealthy but dependent on chemical and auto manufacturing, has diversified through deliberate policies that have created a climate attractive to banking and related business services, as well as pharmaceuticals. There is no state sales tax, aiding in the state's comparative cost advantage. An above-average debt burden is tempered by a rapid rate of amortization, with 79% of GO bonds due in 10 years.

Fiscal 2006 has been another year of strong financial operations. Independent revenue forecasts are updated frequently throughout the year and have been consistently revised upward, most recently on June 19. The current forecast projects that fiscal 2006 general fund revenue will be 10% above the prior year. Fiscal 2005 ended with the budget reserve and unencumbered cash equal to 13.0% of revenues and fiscal 2006 is expected to bring this down to a still high 11.2%. The 5% budget reserve has been fully funded since it was created in 1980. The budget for fiscal 2007 is expected to be passed on time.

Aiding Delaware's financial performance has been steady economic growth. Since the recession of the early 1990s, population, employment, and personal income gains have generally exceeded the national averages. Employment grew 1.6% in 2005, slightly above the national rate. Unemployment remains well below the national rate. Personal income growth lagged that of the U.S. in 2005; however, the state's personal income per capita remains the 10th highest in the country, at 107% of the U.S. average.

As a small state with a minimal number of local governments, Delaware's service functions are highly centralized, leading to an upper moderate debt burden. Net tax-supported debt equals about $1.9 billion after this sale, or 6.0% of 2005 personal income, with 50% of debt issued through the transportation authority. This ratio remains well below the double-digit levels experienced in the state's very weak fiscal period of the mid-1970s, reflecting steps taken by the state to reduce its bonding for capital. The state employees' pension system is overfunded, and Delaware has been at the forefront of states in evaluating ways to address its other post-employment benefits (OPEB) liability, currently estimated at $4 billion. To date, the state has accumulated $24 million in assets towards this liability and the fiscal 2007 budget includes a percentage-of-payroll contribution that would generate about $5 million.

Recent challenges for the state have included the January 2006 Bank of America purchase of MBNA, the state's largest private employer. In addition, exposure exists regarding lottery revenues (currently 8% of general fund revenues), as the video lottery has been approved in Pennsylvania and considered in Maryland. However, the state has enacted legislation to enhance its competitive position in both of these areas. In February, Bank of America announced that it would maintain MBNA's bank charter in Delaware, and the MBNA job loss forecast has been reduced to 2,000 (out of about 10,000 pre-purchase), roughly half of earlier conservative estimates. As in many states, transportation is a funding pressure, and Delaware has been exploring a variety of options to generate additional resources for this purpose.

The bonds will mature Aug. 1, 2007-2026 and are callable beginning Aug. 1, 2014.

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