Moody's Investors Service

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New Issue: Delaware (State of)

# MOODY'S ASSIGNS Aaa RATING TO DELAWARE'S $175 MILLION GENERAL OBLIGATION BONDS

## STATE HAS MORE THAN $7 BILLION IN NET TAX-SUPPORTED DEBT OUTSTANDING

State
DE

**Moody's Rating**

| ISSUE | RATING |
| --- | --- |
| General Obligation Bonds, Series 2007 | Aaa |

| | |
| --- | --- |
| **Sale Amount** | $175,000,000 |
| **Expected Sale Date** | 05/03/07 |
| **Rating Description** | General Obligation Series 2007A |

**Opinion**

NEW YORK, Apr 27, 2007 -- Moody's Investors Service has assigned a rating of Aaa and a stable outlook to the State of Delaware's approximately $175 million of General Obligation Bonds - Series 2007A, which are expected to be priced on May 3. The highest rating assigned to the state's general obligation debt is based on strong financial management characteristics and a history of maintaining ample budgetary reserves throughout recent economic cycles. Proceeds of the bonds will be used to finance various capital projects. Approximately half of the bonds will be sold as 20-year bonds, and the other half will be sold as 10-year bonds.

Strengths:

o Financial management practices that are expected to maintain strong reserve levels

o Revenues coming in strong in the current fiscal year

o Fundamentally strong economy, characterized by above-average employment and population growth

o Fully funded pension

Challenges:

o Large debt burden relative to population and income

o Exposure to consolidation or downsizing, respectively, in the financial services and domestic automobile manufacturing industries

HIGHEST RATING REFLECTS FINANCIAL MANAGEMENT STRENGTHS

The highest rating level assigned to Delaware's general obligation bonds is based in large part on legal provisions that Moody's believes will lead the state to maintain a strong financial profile over a long period. Delaware's constitution requires the state to budget expenditures at 98% of available resources, which helps maintain budgetary balance. There is also a constitutional mandate that unencumbered budgetary general fund resources, as much as 5% of general fund revenue in any fiscal year, be transferred to a budget reserve (Rainy Day Fund). 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 provide funds needed as a result of the enactment of legislation reducing revenue. The Rainy Day Fund is currently fully funded at over $175 million.

Revenue estimates are made by a 29-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 of government during the budget process. These provisions for consensus forecasts, wellmanaged expenditure growth, and a limit on appropriations have led to year-end cash surpluses and contribute to the state's long-term prospects for sustained financial strength. The state's otherwise strong management profile is tempered by a constitutional requirement that tax increases be approved by a three-fifths majority in the legislature.

FY 2007 REVENUE PROJECTIONS STRONG

Based on the April 2007 DEFAC revenue forecasts, General Fund revenues for fiscal 2007 are projected to total $3.27 billion, or 3.1% over fiscal 2006. The projections for total revenues have not changed significantly since the December 2006 DEFAC forecast (which was used as the basis for the governor's recommended fiscal year 2008 budget), although some of the taxes have been adjusted more than others. Personal income tax revenues for fiscal 2007 were brought down almost 2% from the December to the April forecasts, and corporation income tax revenues were brought down 10%. Other revenue forecasts, including lottery and bank franchise taxes, were lifted slightly. The April 2007 DEFAC forecasts for fiscal 2008 project a conservative 2.4% growth in net receipts, with declines in lottery and some smaller revenues more than offset by increases in personal income tax, corporation tax, and franchise tax revenues.

FISCAL 2008 BUDGET TO CONTAIN INCREASED EDUCATION FUNDING

In January 2007 the governor proposed a fiscal 2008 budget that would increase spending by 4.73%, to $3.25 billion. The governor's proposed budget would increase spending on health and social services by 3%, on children, youth and families by 2.7%, on public education by 5.5%, and on higher education by 2.5%. The state has implemented Medicaid cost-control measures, including establishing a preferred drug list, revising prescription-drug reimbursement rates, and requiring prior authorization for prescriptions. The proposed fiscal 2008 budget incorporates 2.8% tax revenue growth, as forecast by the December 2006 DEFAC meeting.

Because of the increasing demands on the state's transportation system, as well as the rising costs of land and materials, the Department of Transportation has identified shortfalls of funding. To address this concern, the governor in 2005 established a committee to recommend options for providing additional funding to the Department. The task force identified a $2.7 billion potential shortfall. After redefining priorities (pushing back less necessary projects and making adjustments to the project timetables), the shortfall was reduced to $1.5 billion. The governor's revenue package proposal includes increasing vehicle registration fees, increasing the documentation fee, and increasing motor fuel taxes and tolls. The package is estimated to produce revenues of over $900 million over the six-year construction planning period.

SLOT MACHINE LEGISLATION IN NEARBY STATES POSES RISK TO LOTTERY REVENUE

Pennsylvania has passed legislation that allows video slot machines at race tracks and other venues, effective in January 2007. As a result, Delaware's fiscal 2007 revenue forecast reflects a $15 million reduction in lottery revenue and the fiscal 2008 forecast reflects a $32 million reduction, representing the potential loss of all of Delaware's Pennsylvania patrons. Maryland has proposed legislation to put slot machines at race tracks as well. If the legislation passes, Delaware will adjust its revenue forecast accordingly. Competition from Maryland may have a greater effect on Delaware's revenue than that from Pennsylvania will. Delaware has changed the existing law regarding slot machines, and now does not require the General Assembly to vote each time the state wants to make a change to slot machine

ECONOMY STRONG IN RECENT YEARS, ALTHOUGH SLOWING IN 2007

Delaware recovered more quickly from the 2001 recession than many other states. When the national economy returned to a job-creation mode in 2004, Delaware's non-farm employment growth rate was significantly faster, at 2.2% versus a 1.1% national pace. The rebound was enough for Delaware to surpass its pre-recession peak total non-farm employment level. The state has enjoyed a lower unemployment rate than the nation in recent years (3.6% versus the nation's 4.6% in 2006), and wealth trends have also been positive. The state's personal income per capita improved to 108% of the national level in 2005 from 105% in 2001. Delaware's manufacturing employment declined for six consecutive years from 1999-2005, leaving the sector's loss at 25% since 1999, but then remained essentially flat in 2006. Delaware's increasing population is a reflection of this healthy employment base. Delaware's population growth in the 1990s exceeded that of both the mid-Atlantic region and the nation. Between 2001 and 2006, Delaware's population expanded by 7.3%, compared to 1.9% growth for the region and 5.0% for the nation as a whole.

While the Delaware economy has fared well in recent years, the state economy has undergone a slowdown in fiscal 2007, in part due to national factors such as the declining housing market and high oil prices. Employment growth has been sluggish in the state in recent months, and construction employment, which had been one of the main drivers of employment growth for the state, has been declining.

WEAKNESSES INCLUDE EXPOSURE TO CONSOLIDATING INDUSTRIES

Additional sources of potential economic weakness include the state's exposure to the declining domestic auto industry, to the consolidating financial services industry, and to the cyclical chemical manufacturing industry. The state is home to two auto manufacturing facilities, one operated by DaimlerChrysler AG's

Chrysler Group and the other operated by General Motors Corp. The DaimlerChrysler plant is expected to close by 2009. The number of jobs that will be lost is unknown, although estimates put the figure at over 2,000. It is also home to the former MBNA Corp., a credit card-issuing bank that has been acquired by Bank of America Corp. Bank of America has eliminated more than 3,100 jobs in Delaware since January 2006, according to the Department of Labor. In the chemicals industry, Delaware is home to DuPont.

DEBT BURDEN HAS GROWN AT PACE BELOW 50-STATE MEDIAN

Delaware's debt burden has increased at a slower pace than the 50 states overall in recent years. Its net tax-supported debt totaled $1,998 on a per-capita basis in Moody's 2007 State Debt Medians report, compared with $1,650 five years earlier. This 21% increase compares with 37% growth in the median level for all states' debt per capita. Delaware's debt amounts to about 5.5% of the state's personal income, based on the 2007 debt medians report. This is relatively high and puts the state fifth in the ranking of the states for this measure. The state's relatively high debt burden reflects the state's role in financing facilities, such as schools and prisons, that in other states would receive capital through local entities. A 1991 state law imposes several constraints on Delaware's debt, including a requirement that in any fiscal year the state can only authorize new debt equal to as much as 5% of budgetary general fund revenue projected for the year. Although these limits appear fairly generous, the state's debt burden has decreased since they were enacted.

MAIN PENSION PLAN IS FULLY FUNDED

Delaware benefits from a well funded pension system. The Delaware Employees Pension Plan was funded at over 100% on June 30, 2006. Like other states, Delaware will have to comply with new accounting standards on other post-employment benefits (or OPEB) in coming years. Delaware has performed an initial actuarial valuation that puts size of these unfunded liabilities (primarily for health insurance) at between $3.2 billion and $4.4 billion. The state will create a dedicated trust to receive OPEB-related payments to begin to address this liability. The state began pre-funding the obligation with lump sum payments and began contributing a percentage of payroll in fiscal 2007. In total, it is expected that $70 million will be accumulated in the trust by the end of this fiscal year.

**Outlook**

The outlook for Delaware is stable. The state's relatively high debt burden must be balanced against strong financial management practices grounded in the state constitution, as well as the state's above-average economic and fiscal growth and its financial flexibility.

What could move the rating down:

o Significant increase in debt levels relative to the economy

o Significant economic contraction

o Erosion of trend of strong financial management

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