

## State of Delaware

### ***Rationale***

The 'AAA' rating on Delaware's GO debt reflects the state's:

Excellent financial management,

- Consistently strong general fund reserve levels and liquidity,
- Resilient local economy centered on financial services, and
- Moderate overall debt burden.

Delaware's financial position continues to be strong and is greatly enhanced by the Delaware Economic and Financial Advisory Council (DEFAC), which provides the state with objective and frequently updated financial and economic projections. Comparisons of historical revenue estimates illustrate DEFAC's conservative forecasting nature, as actual year-end revenues typically exceed projections. In addition, Delaware maintains an array of prudent fiscal and debt policies in order to ensure sustained healthy financial performance.

On a GAAP basis, the state had a \$57 million general fund operating surplus at fiscal year-end 2006, bringing the ending general fund balance to \$1.37 billion, or 36.7% of operations. Of that amount, \$1.04 billion is unreserved, representing a very strong 27.8% of operating expenditures. On a GASB 34 basis, the state's primary government net assets increased by \$357 million to \$5.56 billion in fiscal 2006 from roughly \$5.2 billion in fiscal 2005. Since fiscal 2003, Delaware's general fund has closed each year with an operating surplus; strong revenue performance, particularly from personal income taxes, is a primary factor behind the recent positive performance.

While below original estimates, based upon the April 16, 2007, DEFAC revenue forecast, the fiscal 2007 general fund budgeted revenue was raised to \$3.27 billion, or 3.1% higher than fiscal 2006. The 2007 budgetary general fund appropriation totals \$3.1 billion, a 9.4% increase over fiscal 2006. The appropriation is within the state's constitutional limit of 98% of estimated revenues; unencumbered cash at fiscal year-end is estimated to be \$56.4 million.

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Delaware's management practices are considered strong under Standard & Poor's Financial Management Assessment (FMA). 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 reports, multiyear revenue forecasting, a formal general fund reserve policy, and three debt issuance guidelines.

Delaware's annual unemployment rate has been below that of the nation for more than 20 years. In 2006, the unemployment rate was 4.0%, down slightly from 4.2% in 2005. By January 2007, the unemployment rate had dropped to 3.4%, according to the U.S. Department of Labor's Bureau of Labor Statistics. The state's aggregate employment and labor force have posted positive gains in recent years. Delaware's income levels remain above the national average.

Compared with other states, facets of Delaware's overall debt burden (through fiscal 2006) are above average: Estimated debt per capita is \$2,374, translating to 5.4% of per capita personal income. However, debt service carrying charges are a low 3.9% of fiscal 2006 general and local school district fund expenditures. In addition, amortization is very rapid, with 78% of forthcoming and existing GO debt to be retired over 10 years and 100% over 20 years. Delaware remains well within its three-part debt-affordability guidelines.

### ***Outlook***

The stable outlook reflects Delaware's excellent financial management, robust general fund reserves and liquidity, healthy economy, and moderate overall debt position. The stable outlook also signifies Standard & Poor's expectation that the state's prudent fiscal and debt management practices will lead to sustained sound financial operations. Despite potential near-term economic issues surrounding the Bank of America-MBNA merger and the idling of the Daimler-Chrysler plant in Newark, Delaware's long-term economic outlook remains moderately positive for job growth and output.

### ***Economy: Benefits From Finance Sector Concentration***

Delaware has the highest concentration of finance employment in the nation, with more than 60 banks and trust companies based in the state. According to Global Insight, 10% of Delaware's nonagricultural jobs were in financial services, compared with the national rate of 6.1%. Delaware has passed a number of laws, beginning with the 1981 Financial Center Development Act, to make the state more favorable for banking, credit card, and other financial firms to locate there. The first- and third-largest U.S. credit card issuers, JP Morgan Chase and MBNA America Bank (now Bank of America), together control 30% of the U.S. market and are located in Wilmington. Bank of America purchased MBNA in 2005; although it had been speculated that 4,000 jobs would be cut, the state estimates that the merger resulted in just 2,000 job losses. More importantly, the Delaware-based credit card operation will remain intact. Keeping in line with its conservative nature, the state has incorporated the merger's potential effects into its revenue forecasts. DEFAC forecasts finance/insurance/real estate sector employment to decline by 0.5% in fiscal 2007 and 1.1% in fiscal 2008. Other major employers in Delaware's financial services industry include J.P. Morgan Chase & Co. (5,200), Wilmington Trust Co. (2,100), Citicorp (1,400), and Discover Card Bank (1,200).

E.I. du Pont de Nemours and Co. (DuPont), long the state's leading employer, is now second to Bank of America, with roughly 8,000 employees, down from a high of 22,500 in 1992. As DuPont continues to position itself to become a global leader in life sciences, it will attempt to achieve greater

economies of scale and contain costs. Growth industries such as biotechnology, life sciences, and pharmaceuticals are expected to offset losses in the state’s chemical manufacturing industry over the long term. To this end, the announcement of investment in R&D operations—\$80 million by Dupont, \$15 million by Hercules Inc., \$30 million by Air Liquide, and continued investment by AstraZeneca Inc. —is significant.

In December 2006, the manufacturing sector accounted for 7.5% of total employment in the state, down from 13% in 1990 and well below the national level of 10.3%. The state’s manufacturing sector includes two major automobile plants: DaimlerChrysler Corp. and General Motors Corp. (GM). DaimlerChrysler’s Newark plant, where the newly redesigned Durango sports utility vehicle is assembled, employs 2,100. According to Global Insight, the state economy will lose 1,200 jobs during 2007 due to Chrysler’s restructuring plan, announced in February 2006. Of these job losses, 500 are scheduled from Chrysler, with the rest from ancillary manufacturers. Chrysler announced in February 2007 that it would idle the Newark assembly facility in late 2009.

The U.S. Department of Defense’s Base Realignment and Closure (BRAC) commission list includes the addition of roughly 250 direct positions at Dover Air Force Base, while the Kirkwood U.S. Army Reserve Center and New Castle County Airport Air Guard Station will experience very slight direct job losses.

According to the U.S. Census Bureau, Delaware’s current population is 853,476, an 8.3% increase from the 2000 U.S. Census estimate. Average annual population growth between 2000 and 2006 was about 1.38%, which exceeded both the Mid-Atlantic region and the nation as a whole. The state’s median household effective buying income is 110% of the national average, while per capita effective buying income is 107% of the national average.

At the March 2007 DEFAC meeting, Delaware’s employment growth for fiscals 2007, 2008, and 2009 was forecasted at 0.8%, 0.9%, and 1.0%, respectively. Delaware’s projected employment growth is generally slower than the nation. Personal income growth was forecast at 5.7%, 5.3%, and 5.3% for fiscals 2007, 2008, and 2009, respectively. Population is expected to grow by a respective 1.4%, 1.3%, and 1.2% over the same period. Population and personal income forecasts are generally favorable when compared with national estimates.

Table 1

<i>Delaware Economic Data</i>							
	<i>2006</i>	<i>2005</i>	<i>2004</i>	<i>2003</i>	<i>2002</i>	<i>2001</i>	<i>2000</i>
Real GSP (bil \$)	52.9	51.5	49.3	47.0	44.5	43.8	42.4
Employment (000s)	410.1	419.5	411.7	406.7	403.9	404.1	402.8
Unemployment rate (%)	4.0	4.2	4.0	4.2	4.0	3.5	3.3
Personal income (bil \$)	32.5	31.3	29.7	27.6	26.5	25.5	24.3
Personal income growth (%)	3.9	5.4	7.4	4.1	3.9	5.2	8.3
Population (000s)	854.7	845.1	831.8	819.4	807.4	796.8	787.4
Net migration (000s)	2.1	2.3	2.1	1.9	1.7	1.5	1.5
Housing starts, private single-family (000s)	7.8	7.4	7.7	6.8	6.3	4.7	4.2
Housing starts, private multifamily (000s)	0.6	0.5	0.8	0.6	0.3	0.4	0.5
New vehicle registrations (000s)	58.0	55.7	58.7	57.4	54.6	54.2	57.3

Source: Global Insight.

### ***Finances: Excellent Reserves And Liquidity***

Delaware's tax and revenue structure is fairly broad. The general fund relies on tax revenues from personal income and corporate income, as well as a corporate franchise, business/occupational gross receipts, bank franchise, realty transfer, and cigarette taxes, among others. Additional significant general revenue streams include abandoned property and lottery receipts. On a budgetary basis, the personal income tax accounted for roughly 32% of total general fund revenues in fiscal 2006, with other major revenue sources including the corporate franchise tax (16%), abandoned property (10%), lottery (8%), the business/occupational gross receipts tax (6%), the corporate income tax (5%), and the bank franchise tax (4%). Delaware does not levy a consumer sales tax.

Delaware's major general government expenditures are public education (roughly 32% of fiscal 2006 expenditures); health/social service, which includes Medicaid (27%); general government (16%); and judicial/public safety (13%). Delaware's Medicaid costs increased at an estimated average annual rate of roughly 10% between fiscals 2001 and 2006. The state's share of the cost of its Medicaid program totaled roughly \$450 million in fiscal 2006. The state's approach to Medicaid is to control cost growth and manage efficiently while not reducing program benefits.

While below original estimates, based on the April 16, 2007, DEFAC revenue forecast, the fiscal 2007 general fund budgeted revenue was raised to \$3.27 billion, or 3.1% higher than fiscal 2006. Personal income tax was budgeted with a 1.9% increase over fiscal 2006; other increases included franchise taxes (1.8%), abandoned property (5.2%), and lottery revenue (2.5%). The 2007 budgetary general fund appropriation totals \$3.1 billion, a 9.4% increase over fiscal 2006. Grants in aid appropriations and the general fund contribution to capital—\$50 million and \$243.3 million, respectively—bring the total appropriation to \$3.395 billion. The appropriation is within the state's constitutional limit of 98% of estimated revenues; unencumbered cash at fiscal year-end is estimated to be \$56.4 million.

Gov. Ruth Ann Minner's recommended fiscal 2008 general fund operating budget totals \$3.25 billion, which is 4.7% above the fiscal 2007 budget. State capital projects total \$224.6 million, including \$168.4 million in GO bonds; transportation capital spending is budgeted at \$330.2 million. Given its continued excellent financial management, Delaware's financial situation is projected to remain balanced through fiscal 2009. Fiscal 2008's general fund revenues, as of the March DEFAC estimate, are budgeted to grow by roughly 2.2% from revised fiscal 2007 revenues. Personal income tax revenues (38% of total revenues) are budgeted for a 5.5% growth from fiscal 2007 revised estimates, while franchise taxes (16%) are budgeted to grow by 3.0%.

The fiscal 2008 budget continues to fund long-term liabilities such as education, transportation, health care, and other postemployment benefits (OPEB). Public education (one-third of appropriations) is budgeted to grow by 5.5%, while health and social services will grow by 4.6%. The budget also continues to increase OPEB contributions in response to GASB 45; the state's goal is to fully fund the OPEB annual required contribution within six years. Fiscal 2008's major proposed revenue initiatives include an array of transportation fee increases in order to help fund the multiyear transportation capital plan, as well as a 45-cents-per-pack cigarette tax increase to fund health care initiatives. DEFAC's forecasts regularly update maximum permitted spending levels for ensuing budget years under the state's 98% appropriation limit guidelines. A major economic development is the likely shutdown (and loss of roughly 2,100 jobs) of the DaimlerChrysler plant in Newark by the end of 2009,

though a financial impact is not expected in fiscal 2008. It is notable that the state has successfully weathered previous various economic challenges, such as the acquisition of MBNA by Bank of America.

Table 2

**Delaware Financial Data**

	—Fiscal year-end June 30—						
(Mil \$)	2006	2005	2004	2003	2002	2001	2000
<b>General Fund-GAAP</b>							
General fund revenues	3,552	3,135	3,055	2,699	2,926	3,306	3,118
General fund expenditures	3,740	3,272	3,051	2,938	3,291	3,271	2,978
Net transfers and other adjustments	244	234	263	266	283	(185)	(107)
Net general fund operating surplus (deficit)	57	98	267	27	(82)	(150)	33
Total general fund balance	1,371	1,314	1,216	949	922	763	912
Unreserved general fund balance	1,039	999	929	643	580	350	553
"Rainy day" operating reserve funds	175	161	148	136	129	128	126
Combined unreserved general fund + reserve fund balance/general fund expenditures (%)	36.7	40.2	39.8	32.3	28.0	22.1	29.6
Net surplus (deficit)/general fund expenditures (%)	1.5	3.0	8.8	0.9	(2.5)	(4.6)	1.1
<b>Debt</b>							
Direct GO debt	1,045	1,027	1,013	854	710	654	738
Tax-supported revenue debt	953	862	816	863	676	634	670
Appropriation debt	0	0	0	0	0	0	0
All tax-supported state debt	1,998	1,889	1,829	1,717	1,386	1,288	1,408
Per capita GO state debt (\$)	1,242	1,237	1,239	1,060	893	832	942
Per capita all tax-supported state debt (\$)	2,374	2,276	2,236	2,131	1,742	1,638	1,797
All tax-supported debt to personal income (%)	5.4	5.3	5.3	5.2	4.3	4.2	4.8
GO and appropriation debt service/operating fund expenditures (%)	3.9	4.2	3.9	3.6	3.2	5.5	5.8

Basis of Accounting: Modified accrual, GASB 34 (2002-2005).

**Delaware Economic and Financial Advisory Council**

Created in 1977 in response to the fiscal challenges of the mid-1970s, DEFAC meets at least six times a year to forecast government revenues. DEFAC is a 31-member council appointed by the governor; historically, it has been bipartisan and has had representation from all branches of government, various business community representatives, and state academics. Mandated by executive order, DEFAC must submit annual budgetary general fund and transportation fund revenue forecasts to the governor and state legislature in September, December, March, April, May, and June for the current fiscal year and the succeeding two years. In times of economic uncertainty, DEFAC can meet more frequently. A five-year revenue forecast is to be generated once a year around September. Corresponding expenditure forecasts are required in December, March, April, May, and June. The DEFAC process is open to the public.

Regular DEFAC forecasting has allowed Delaware to take early action in recent years as revenues tightened during the recession. In addition, DEFAC revenue forecasts enable the state to ensure compliance with constitutional limits on annual appropriations and debt. The council's current

bipartisan and representative makeup allows the branches of government to take action to resolve any revenue shortfall or expenditure excess without the common debate over the size of the problem. With nearly 30 years of history, the DEFAC process has become part of the prudent and conservative culture of Delaware's financial management.

### ***Financial Management Assessment: 'Strong'***

Delaware's management practices are considered strong under Standard & Poor's Financial Management Assessment (FMA). An FMA of strong indicates that practices are strong, well embedded, and likely sustainable.

Highlights of the state's management techniques include:

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 revenue and the previous year's unencumbered budgetary general fund balance;
- A constitutionally required general fund budget reserve account funded at 5% of the budgetary general fund revenue in order to provide flexibility against any unexpected revenue declines;
- A cash management policy board that sets formal state investment policies and regularly monitors investments; and
- Three debt affordability guidelines.

The debt affordability guidelines are:

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 aggregate maximum annual debt service (MADS) on existing debt exceeds 15% of estimated budgetary general fund revenue and transportation trust fund revenue for the fiscal year succeeding the fiscal year in which the debt is issued; and
- 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.

Delaware does not maintain a traditional multiyear capital improvement program (CIP). The state's annual capital requirements are fully outlined in its annual capital budget, though internal cost estimates are made for capital projects expected to span multiple years. Despite the fact that DEFAC provides intricate multiyear revenue forecasts, the state does not formally project multiyear general operating expenditures.

### ***Debt: Moderate Overall***

Compared with other states, facets of Delaware's overall debt burden (through fiscal 2006) are above average; estimated debt per capita is \$2,374, translating to 5.4% of per capita personal income. When \$953 million in gas tax-supported Delaware Transportation Authority revenue bond debt is excluded, Delaware's debt burden drops to \$1,242 per capita, based on \$1.045 billion in existing GO debt through fiscal 2006.

Delaware's debt service carrying charges are a low 3.9% of fiscal 2006 general and local school district fund expenditures, down from 4.2% in fiscal 2005. Amortization is very rapid, with 78% of forthcoming and existing GO debt to be retired over 10 years and 100% over 20 years. Delaware does not have any existing variable-rate debt, nor has the state entered into any interest rate swap agreement or related derivative transaction.

Delaware issues debt for political subdivisions. The state pays between 60% and 80% of the cost of capital improvements for public school districts upon approval of such costs; the school districts pay the remaining portions. Delaware's other major bonding program is associated with the Delaware Transportation Authority. Transportation authority debt consists of revenue bonds supported primarily by motor fuel taxes, motor vehicle fees, and turnpike tolls.

The state has committed significant pay-as-you-go resources to fund capital in recent years: \$236 million in fiscal 2005 and \$282 million in fiscal 2006. The fiscal 2007 capital budget totals \$597.5 million; of that amount, \$163.8 million is for general obligation projects, \$176.3 million is for Department of Transportation projects funded through the transportation fund, and \$243.3 million is general fund cash for pay-as-you-go capital projects.

### ***Pensions And Other Postemployment Benefits***

Compared with other state pension systems, Delaware's pension system is well funded. The Delaware Public Employees' Retirement System (DPERS) consists of nine separate pension funds, with the State Employees' Pension Plan representing the largest plan by assets. As of fiscal 2006, the State Employees' Pension Plan was overfunded by \$97.7 million. The state's fiscal 2006 contribution to this plan totaled \$129 million, or 3.4% of general fund expenditures. One of DPERS's nine pension funds, the Closed State Police Pension Plan, has a 0.3% funded ratio, with the state funding this plan on a pay-as-you-go basis. Other than the Closed State Police Pension Plan, the remaining pension plans are well funded.

Pursuant to Executive Order Number 67, the state conducted a comprehensive study of the potential effects of GASB 45's OPEB accounting disclosure. An actuarial valuation was conducted that projected a total unfunded OPEB liability between \$3.2 billion and \$4.4 billion, at discount rates of 5.5% and 8.0%, respectively. The state's pay-as-you-go OPEB appropriation totaled roughly \$99 million (2.6% of general fund expenditures) in fiscal 2006. The state study also included a detailed array of potential options in addressing OPEB. At this point, the state plans to deposit 0.3% of payroll (equal to roughly \$5 million) in fiscal 2007 into an OPEB trust fund that was originally established in 2000. By fiscal year-end 2008, state management expects to have roughly \$70 million in the OPEB trust fund; ARC payments are expected to be fully funded over a period of six years.

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