FitchRatings

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January 5, 2004

Mr. David W. Singleton
Secretary of Finance
State of Delaware
Carvel State Office Buildilng, 8th Floor,
820 North French Street
Wilmington, Delaware 19801

Dear Mr. Singleton:

Fitch Ratings has assigned one or more ratings and/or otherwise taken rating action(s), as detailed on the attached Notice of Rating Action.

Ratings assigned by Fitch are based on documents and information provided to us by issuers, obligors, and/or their experts and agents, and are subject to receipt of the final closing documents. Fitch does not audit or verify the truth or accuracy of such information.

It is important that Fitch be provided with all information that may be material to its ratings so that they continue to accurately reflect the status of the rated issues. Ratings may be changed, withdrawn, suspended or placed on Rating Watch due to changes in, additions to or the inadequacy of information.

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The assignment of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement or other filing under U.S., U.K., or any other relevant securities laws.

We are pleased to have had the opportunity to be of service to you. If we can be of further assistance, please feel free to contact us at any time.

Sincerely,

David T. Litvack
Managing Director
Public Finance

DTL/ld

Enc: Notice of Rating Action
(Doc ID: 1365)

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Notice of Rating Action

Bond Description		Rating Type	Rating	Action	Eff Date	Notes
$157,935,000	State of Delaware General Obligation Bonds Series 2004A	Long Term	AAA	New Rating	30-Dec-2003	
$975,300,000	State of Delaware Outstanding General Obligation Bonds	Long Term	AAA	Affirmed	30-Dec-2003	

Tax Supported
New Issue

State of Delaware

Rating

General Obligation Bonds .... AAA

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New Issue Details

$157,935,000 General Obligation Bonds, Series 2004A, for competitive bids Jan. 7. The bonds will be due Jan. 1, 2005–2024 and will be optionally callable beginning Jan. 1, 2012 at par.

Security: General obligations of the State of Delaware; full faith and credit pledged.

■ Outlook

Delaware's premier credit standing centers on its considerable economic and financial resources, the latter buttressed by the well-institutionalized constitutional protections designed to ensure surplus operations. Historically a wealthy state although still dependent on chemical and auto manufacturing, the economy has been diversified by activist policies, which created a climate attractive to banking and related business services, as well as to pharmaceuticals and biomedical activities. The burden of debt, while above average on this small and highly centralized state, is tempered by an extremely rapid rate of amortization. While growth has paused, financial operations over the past two fiscal years exceeded expectations, bolstered last year by receipt of unexpected one-time receipts from an estate tax and an abandoned property settlement. Although revenues again have been upwardly revised for this year and next reflecting a stronger economic outlook, potential actions by neighboring states relating to video lottery could negatively impact that revenue's longer-term performance. The state's $50 million flexible federal fiscal relief funds remain unbudgeted.

■ Rating Comment

With the approximately $120 million new money portion of this issue (the rest is for refunding purposes) the state's tax-supported debt now amounts to $1.985 billion, presenting a burden of $2,533 per capita and 7.6% of personal income. As a highly centralized state, Delaware provides fully for many services frequently shared with local units elsewhere, contributing to the above-average debt burden. Levels, however, remain substantially below the double-digit ratios experienced during the state's very weak financial period of the mid-1970s. The burden of debt is also tempered by the extremely rapid amortization rate, with 79% of general obligation bonds due in 10 years; 94% mature in 15 years. Half the new money portion of this issue is in 10-year bonds. Under the state's statutory debt issuance limit of 5% of estimated general fund revenues, and based on the current revenue forecast, new general obligation debt authorization is limited to $125.7 million this year, rising to $162 million by fiscal 2008 as revenue growth improves. With the constrained revenue growth of the past few years, pay-as-you-go capital spending was considerably reduced to $11 million in fiscal 2002 and $19 million in fiscal 2003 but was substantially increased to $142 million in the current year, affording flexibility.

In recent years, financial operations have been very successful, with the growth of the banking industry and incorporations providing offsets to the very slow growth of the personal income tax. At the same time, the consensus forecasting group (DEFAC) took prompt actions over the past two years to reduce estimates when necessary.

Additionally, a tax package was approved in June for the current fiscal year adding some $179 million in revenues (including some $24 million in a one-time retroactive impact). This includes about $29 million from a cigarette tax increase, some $16 million from enhancements to the video lottery including longer operating hours, and about $100 million from increases in incorporation taxes and fees. An improved evaluation of abandoned property potential added another $49 million, with an increase of some $50 million–$60 million expected annually on an ongoing basis. September revenue estimates were thus increased by some $228 million or 9.7%, and with the improved economic outlook, the December DEFAC conference increased fiscal 2004's estimate by a further $32 million, to $2,618 million. This is some 11% over the June estimate. The projections for fiscal 2005, with a stronger job gain than previously forecast (2.5% instead of 1.4%), were also increased in the December meeting by $44 million, to $2,742 million, also an 11% increase from the June estimate. Incorporated in the forecast were reductions of $5 million in each year from lottery revenues. For the longer term, there are growing indications that both Pennsylvania and Maryland may also allow video lottery, and should both states approve it, Delaware could lose about half its current lottery revenues when fully implemented. Currently, lottery revenues are the state's fourth largest general fund revenue source, providing about $225 million annually.

Fiscal 2004 general fund revenues are now forecast for a 4.1% gain (adjusted for tax law changes and one-time events) instead of the initial expectation of a 3.1% decline, and fiscal 2005 revenues for a 5.2% adjusted increase. Fiscal 2004 expenditures are on target, at $2,606 million. Fiscal 2004 is now projected to close with an operating surplus of $12 million (instead of the original forecast for a $90 million operating deficit) and the year-end cash balance is now projected at $476 million including $137 million in the budget reserve. The unencumbered balance is projected at $184 million; there remains $50 million in flexible federal fiscal relief funds in a special revenue fund that is not included in the budgeted general fund accounts.

Delaware continues to post lower than average unemployment rates at 4.1% in November compared with 5.9% for the U.S. Employment in November was 0.3% below the same month a year ago, but 0.7% above the 2002 annual average, indicating some stabilization. While losses continued in most major sectors, gains of 1.6% occurred in education and health, 1.2% in construction, and 0.8% in financial activities. Personal income growth in the second quarter of 2003 (compared to the second quarter of 2002) of 4% far outstripped the U.S.'s 2.8% increase or the 2.3% Mideast regional gain. Per capita income of $32,307 in 2002 ranked Delaware 13th at 105% of the U.S., a slight decline. While major economic expansion has occurred, particularly in pharmaceutical and bio-medical activities, DuPont remains the state's second largest employer and it continues to downsize, recently announcing the sale of its fiber business (INVISTA) to Koch Industries; INVISTA employs about 1,100 in Delaware.

For further information on the State of Delaware, see Fitch Research dated Aug. 5, 2003, available on Fitch's web site at www.fitchratings.com.