PUBLIC FINANCE

Delaware

Credit Profile		
US$215.705 mil GO bnds ser 2008 due 03/01/2028		
Long Term Rating	AAA/Stable	New
Delaware		
Long Term Rating	AAA/Stable	Affirmed

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Rationale

Standard & Poor's Ratings Services assigned its 'AAA' rating, and a stable outlook, to Delaware's series 2008 GO bonds. In addition, Standard & Poor's affirmed its 'AAA' rating on the state's previously issued debt.

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

- Excellent financial management,
- Consistently strong general fund reserve levels and liquidity,
- Strong local economy despite current weakness in the financial services sector, 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-ending revenues typically exceed projections. In addition, Delaware maintains an array of prudent fiscal and debt policies in order to ensure sustained healthy financial performance.

Based on generally accepted accounting principles (GAAP), fiscal 2007 ended with a $30.97 million general fund operating reduction bringing the ending general fund balance to $1.34 million, or a still strong 38.7% of operations. Of that amount, $956 million is unreserved, representing a very strong 27.6% of operating expenditures. This is the first operating reduction since fiscal 2003. According to management, the state decided to use some of its fund balance for one-time capital projects and for operations instead of reducing services, given its high fund balance level. The state plans to maintain its strong financial position and does not plan to rely on its fund balance for operations going forward. Based on the Governmental Accounting Standards Board (GASB) statement 34, Delaware's primary government net assets increased by $276 million to $5.84 billion in fiscal 2007 from $5.56 billion in fiscal 2006.

Based upon the December 2007 DEFAC revenue forecast, the fiscal 2008 general fund revenue was budgeted to grow 2.7% higher than fiscal 2007 to $3.38 billion. The 2008 budgetary general fund appropriation totals $3.28 billion, a 5.9% increase over fiscal 2007. The appropriation is within the state's constitutional limit of 98% of estimated revenues and unencumbered cash and at the end of the fiscal year is estimated to be $48.8 million. The state is expecting a significant downward revision of its revenue estimates by DEFAC in March for fiscals 2008 and 2009.

Standard & Poor's considers Delaware's management practices "strong" under its 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. For 2006, the unemployment rate was 4.0%, down slightly from the 2005 unemployment average of 4.2%. As of January 2007, Delaware's unemployment rate was 3.4% according to the U.S. Department of Labor-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. The affect of the slowdown in the financial sector is not yet known, however, the state expects to revise its revenue estimates in March.

Compared with other states, facets of Delaware's overall debt burden (through fiscal 2007) are above average, as estimated debt per capita is $2,730, translating to 5.98% of per capita personal income. However, roughly 37% of that is supported by the local school districts' property tax revenue. Including the support, overall debt burden is reduced to $2,165 per capita and 4.7% of personal income**.** As well, debt service carrying charges are low at 4.2% of fiscal 2007 general fund expenditures. Moreover, amortization is very rapid, with 78% of forthcoming and existing GO debt 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. The state's economy is strong and diverse. Despite the near-term economic issues surrounding the financial sector slowdown, Standard & Poor's expects the state to be able to manage its financial position throughout the downturn.

Economy: Well-Balanced Despite Financial 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 Inc., 10% of Delaware's nonagricultural jobs were in financial services, compared with 6.1% for the nation. The state does not expect the slowdown in the financial services sector to be as significant on the state's economy as the recession in 1991 or the slowdown in 2003. Although, the DEFAC is planning to adjust its revenue forecasts significantly in March 2008.

Delaware has passed a number of laws to make the state more favorable for banking, credit card, and other financial firms to locate there, beginning with the 1981 Financial Center Development Act. The first and the 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, and although it had been speculated that 4,000 jobs would be cut, the state forecasts only 2,000 job losses resulting from the merger. More importantly, the Delaware-based credit card operation will remain intact. Keeping in line with its conservative nature, the state has incorporated the potential affects from the merger into its revenue forecasts. Other major employers in the financial services industry in Delaware 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, which is down from a high of 22,500 in 1992. As DuPont continues to position itself to become a global leader in the 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 research and development operations—$80 million by DuPont, $15 million by Hercules Inc., $30 million by Air Liquide, and continued investment by AstraZeneca Inc.—is significant.

The manufacturing sector in 2006 accounted for 7.7% of total employment in the state, down from 13% in 1990 and well below the U.S. share of 10.3%. The state's manufacturing sector includes two major automobile plants: DaimlerChrysler Corp. and General Motors Corp. (GM). DaimlerChrysler's Newark, Del. 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 losses, 500 are scheduled from Chrysler with the rest from ancillary manufacturers. The company recently 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 augmentation of Dover Air Force Base by roughly 250 direct positions, while the Kirkwood U.S. Army Reserve Center and New Castle County Airport Air Guard Station will experience very slight direct job losses.

Delaware's current population totals 865,000, and signifies a 6% increase over the 2003 census estimates. Average annual population growth between 2003 and 2007 was about 1.5%, 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.

Delaware's housing construction experienced a reduction during 2006; it decreased by 19.8% from the previous year to 7,881 units. However, Delaware continues to lag the nation in foreclosure rates and, according to RealtyTrac Inc., Delaware ranked among the 10 lowest states in total foreclosures in October 2007.

According to the December 2007 DEFAC report, Delaware's actual employment growth in 2007 was 0.3%, while personal income grew by 5.3% and real GDP was up by 2.1% over the previous year. In addition, the DEFAC forecasted the state's employment growth at 0.6%, 0.5%, and 0.7% for fiscals 2008, 2009, and 2010 respectively. Delaware's projected employment growth is generally slower compared with the nation. Personal income growth is forecast at 4.7%, 4.1%, and 4.4% for fiscals 2008, 2009, and 2010, respectively—revised down from the September forecast. Population is expected to grow by 1.3%, 1.3%, and 1.2% over the same period. Population and personal income forecasts are generally favorable when compared with national estimates.

Finances: Strong Performance

Fiscal 2007

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 GAAP basis, business taxes accounted for 45% of general fund revenues in fiscal 2007 , followed by the personal income tax at 27.5%, fees and charges at 9%, other revenue at 7.7%, other tax revenues at 7% and interest income at less than 2%. Delaware does not levy a consumer sales tax.

Delaware's major general government expenditures consist of public education (roughly 32% of fiscal 2007 expenditures); health/social service, which includes Medicaid (27%); general government (16%), and judicial/public safety (13%). On a budgetary basis, Delaware's Medicaid and public assistance costs increased by $63.5 million or 13.2% in 2007. The state's approach to Medicaid is to control cost growth and manage efficiently while not reducing program benefits.

Fiscal 2008 update

Based upon the December 2007 DEFAC revenue forecast, the fiscal 2008 general fund revenue was budgeted to grow 2.7% higher than fiscal 2007 to $3.38 billion. The 2008 budgetary general fund appropriation totals $3.28 billion, a 5.9% increase over fiscal 2007. The appropriation is within the state's constitutional limit of 98% of estimated revenues and unencumbered cash at the end of the fiscal year is estimated to be $48.8 million. Personal income taxes are projected to total $1.033 billion, an increase of 2.5% over fiscal 2007. Franchise taxes are up 4.9% over the previous year, business entity fees are up 6.9%, and corporate income taxes are projected to be up by 3.9%. Bank franchise taxes were projected to be down by 17.8% due to an alternative structure that was put in place.

Fiscal year 2008 revenue was decreased by $12.3 million, or 0.4% as of the December DEFAC meeting, and fiscal year 2009 revenue was decreased by $28.9 million, or 0.8% in the economically sensitive categories of personal income tax and gross receipts tax. However, the state is expecting a significant downward revision of its revenue estimates by DEFAC in March for fiscals 2008 and 2009. The state can halt spending through reversions and the governor ordered the reversion of $50 million to $75 million for fiscal 2008. The $10 million in expenditures has already been reverted and the state expects it will close the fiscal year near the 98% of estimated revenue.

Fiscal 2009 governor's recommended budget

Governor Minner proposed a general fund operating budget of $3.41 billion, an increase of 3.8% over the previous year. The bond and capital improvement act totals $473.3 million, with roughly half for state capital projects and the rest for transportation authorizations. Grants in aid total $58.4 million. The governor's priorities include: improving public education, health and safety, and funding the state's long-term liabilities. In terms of education, the governor's budget includes $132.7 million in public school construction, $9.8 million in public school enrollment, and an additional $2.6 million for full day kindergarten.

The budget also includes $36.3 million for Medicaid caseload increases (client base is expected to reach over 153,000)and $16.2 million for cancer council recommendations, among other health and safety initiatives. The state is seeing an increase in the demand for core services due to increased in education enrollment, Medicaid enrollment and services for youth and superior court caseloads. The state is focusing on efficiencies to bring down the costs associated with these services and has already save $20 million in Medicaid through these efforts.

Due to the expected significant revision in forecasted revenues by DEFAC at the March meeting, the Governor has already asked for a reduction of 3% in the proposed appropriations and may ask for more.

Delaware Economic And Financial Advisory Council: Conservative Forecasting

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, however, 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 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. Moreover, DEFAC revenue forecasts enable the state to ensure compliance with constitutional limits on annual appropriations and debt. With the current makeup being bipartisan and representative, the branches of government can then take action on resolving 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'

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

Among the highlights of the state's management techniques are:

- 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 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 outstanding debt exceeds 15% of estimated budgetary general fund revenue and transportation trust fund revenue for the fiscal year succeeding the fiscal year in which such debt is issued; and
- No new state GO debt can be issued if, in any fiscal year, MADS on outstanding 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.

However, Delaware does not maintain a traditional multiyear capital improvement program. 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. Finally, despite the fact that DEFAC provides intricate multiyear revenue forecasts, the state does not formally project multiyear general operating expenditures.

Debt: Average Burden With Rapid Amortization

Compared with other states, facets of Delaware's overall debt burden (through fiscal 2007) including gas-tax supported and GO debt of the schools, are above average, as estimated debt per capita is $2,730, translating to 5.98% of per capita personal income. When $482 million in school supported GO debt and the gas tax-supported Delaware Transportation Authority revenue bond debt is excluded, Delaware's debt burden drops to an average $971 per capita, based on $829 million in outstanding GO debt through fiscal 2007.

Delaware's debt service carrying charges are low at 4.2% of fiscal 2007 general fund expenditures. Amortization is very rapid, with 78% of forthcoming and existing GO debt retired over 10 years and 100% over 20 years. Delaware does not have any variable-rate debt outstanding, 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 over the past couple of years—$236 million in fiscal 2005, $282 million in fiscal 2006, and $243 million in fiscal 2007 and budgeted $77.9 million in 2008. The fiscal 2008 capital budget totals $539.5 million, of that amount, $170.7 million is for general obligation projects, $200.1 million is for projects at the Department of Transportation funded through the transportation fund. The governor's proposed capital budget for fiscal 2009 totals $473.3 million of which $177.4 million is for general obligation projects, $62.2 million for pay as you go, and $233.7 million for transportation.

Pensions And Other Postretirement Employee 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 2007, the State Employees' Pension Plan was 103.7% funded, or overfunded by $230 million. The state's fiscal 2007 contribution to this plan totaled $97 million, or 2.4% of general fund expenditures. One of DPERS's nine pension funds, the Closed State Police Pension Plan, has a 0.2% funded ratio as the state funds 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 No. 67, the state conducted a comprehensive study of the potential effects of GASB 45 other postretirement employee benefits (OPEB) accounting disclosure. An actuarial valuation was conducted that projected a total unfunded OPEB liability of $3.2 billion and an annual required contribution (ARC) estimated at $350 million for fiscal 2008 based on a discount rate of 8%. The state, through legislation effective July 1, 2007, created an OPEB trust fund and currently has $65 million accumulated. The state plans to fund the ARC over a six-year period using a combination of funding strategies, savings through a variety of health care initiatives and plans to minimize benefit modifications. The state's pay-as-you-go OPEB appropriation totaled about $102.5 million (2.57% of general fund expenditures) in fiscal 2007.