S&P Global
Ratings

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Summary:

State of Delaware; Appropriations; General Obligation

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Credit Profile		
US$234.2 mil GO bnds ser 2018A due 02/01/2038		
Long Term Rating	AAA/Stable	New
US$15.8 mil GO bnds (Port of Wilmington Projs) ser 2018B due 02/01/2020		
Long Term Rating	AAA/Stable	New
Delaware GO		
Long Term Rating	AAA/Stable	Affirmed

Rationale

S&P Global Ratings has assigned its 'AAA' rating, and stable outlook, to the State of Delaware's series 2018A general obligation (GO) bonds and series 2018B GO bonds (Port of Wilmington projects). At the same time, S&P Global Ratings affirmed its 'AAA' rating, with a stable outlook, on Delaware's GO debt outstanding and its 'AA+' long-term rating, and stable outlook, on the state's appropriation debt outstanding.

The 2018 bonds are secured by the general obligation of the state and its full faith and credit pledge.

The rating reflects what we view as Delaware's:

- Strong financial and budget management;
- Relatively diverse economy, which continues to expand at a modest pace and in line with national trends;
- Consistently strong general fund reserves and liquidity even during recessionary periods;
- Moderate overall debt burden, with what we consider strong debt management policies in place; and
- Well-funded pension system and progress in recent years in addressing other postemployment benefits (OPEB) liabilities, which are significant.

Delaware expects to close its fiscal 2018 year with an increased budgetary balance after reporting declines in fiscal 2017 on both a budgetary and a generally accepted accounting principles basis. The state projects that on a budgetary basis, the general fund's unencumbered cash balance for fiscal 2018 will rise to 4.1% of expenditures at fiscal end 2018 from 1.8% at fiscal end 2017; fiscal 2017's balance decreased to 1.8% of expenditures from 4.4% at fiscal end 2016. The state's fiscal 2017 audit also reflected a lower available general fund balance of 2.4% on a GAAP basis, down from 9.4% at fiscal end 2016. The state's budgetary rainy day fund, however, grew slightly in fiscal 2017 to $231.6 million (5.4% of expenditures), which we consider good.

In our opinion, Delaware has historically exhibited what we view as prudent fiscal management and we expect this trend to continue. In years past, the state has made difficult decisions to restore budget balance when necessary while managing surpluses to retain structural budget balance. The state's fiscal 2018 enacted operating budget totaling $4.2

billion (including grants in aid and dedicated cash to the bond and capital improvement acts) closed a $386 million shortfall as of March 2017 (9.2% of expenditures) through a majority of recurring measures.

Delaware's fiscal 2019 budget proposal, as presented by Gov. Carney on Jan. 25, 2018, totals $4.25 billion and represents 3.49% expenditure growth from the fiscal 2018 budget. Operating resources available for appropriation total $4.39 billion (including $170.2 million of unencumbered cash from fiscal 2018) and comply with the state's constitutionally required annual operating appropriation limit of 98% of estimated budgetary general fund revenues and the previous year's unencumbered budgetary general fund balance. In our opinion, the budget proposal's expenditure growth is somewhat high given that it outpaces projected revenue growth of 1.81% ($76.6 million) over the same time period, from fiscal 2018 to fiscal 2019, according to the latest Delaware Economic and Financial Advisory Council (DEFAC) projections from December 2017. The budget proposal uses higher-than-anticipated revenues for the fiscal year to fund one-time spending and bond issuances for a variety of projects including transportation, school construction, and environmental projects and fully funds the rainy-day fund at $236.3 million, or a good 5.5% of general fund operating expenditures.

The effects of federal tax reform on Delaware are expected to be incorporated in DEFAC's March 2018 revenue projections; the governor's fiscal 2019 budget proposal incorporates DEFAC's December forecast, which does not include potential tax reform effects. The state expects a small reduction in revenues for two to three years followed by increases thereafter. In our opinion, Delaware's prudent fiscal management will be an important factor in the state's credit profile as Delaware manages through the current and upcoming budget cycles.

The DEFAC's estimates as of December 2017 made minor adjustments to projected revenues compared with the council's previous forecast in September 2017. The latest projections show revenues in fiscal 2018 and fiscal 2020 down slightly (by less than 0.1%), while revenues in fiscal 2019 are forecast to marginally increase (by 0.5%).

Previously, the September forecast made larger adjustments. The September 2017 forecast for fiscal 2018 was raised by $242.5 million, or a considerable 5.7% of the $4.2 billion of revenue that was expected for the fiscal year. Similarly, fiscal 2019 estimates were raised by $278.4 million or a large 6.5% of the estimated $4.3 billion of revenue. The most significant changes to the revenues in both fiscal 2018 and fiscal 2019 in the September 2017 forecast were increases to net franchise taxes and realty transfer taxes, which were both updated in the state's enacted fiscal 2018 operating budget. In DEFAC's September meeting, net franchise tax estimates increased $122.1 million (12.2%) for fiscal 2018 and $126.9 million (12.5%) for fiscal 2019. In addition, realty transfer tax estimates were raised by $62.6 million (73%) in fiscal 2018 and $72.9 million in fiscal 2019 (81%). Effective Aug. 1, 2017, the state increased its levy on realty transfer taxes to 2.5% from 1.5%. DEFAC meets six times a year to prepare revenue estimates for the state budget; the next meeting is scheduled for March.

The state's comprehensive annual financial report (CAFR) as of June 30, 2017 reports that on a generally accepted accounting principles basis, the total general fund balance in fiscal 2017 decreased $379 million from fiscal 2016 bringing the ending unassigned general fund balance to $11.4 million, or 0.2% of general fund expenditures, which we consider very weak. However, the total available fund balance and total fund balance are considerably larger at 2.4% and 10.1%, of operating expenditures (down from 9.4% and 17.8% in fiscal 2016), respectively. The state reports that the largest single contributor to the decline in unassigned fund balance is the increase in escheat liability. According to the CAFR, the escheat liability increased $187.5 million (48.1%) with more anticipated claims due to the automated claims process. In addition, taxes receivable decreased by $40 million due to a change in the method of calculation. The CAFR reports total general fund revenues increased by $190 million (4.3%), primarily due to increases in other revenue ($102 million), personal taxes ($69 million), and licenses, fees, permits, and fines ($38 million).

The state faces a significant OPEB liability that has grown despite reform efforts in recent years. These efforts included pre-funding the obligation in 2002 and 2003 with lump sum payments and establishing an OPEB trust in 2007--the funded ratio for this trust is currently very low, in our opinion, at 4.1% under Governmental Accounting Standards Board (GASB) Statement No. 74 reporting. Additional reforms to curb the state's liability were also introduced in 2011 and 2013. As it stands, Delaware's net OPEB liability (NOL) as of the June 30, 2017, under GASB Statement No. 74 reporting is $8.3 billion, which we consider significant. This amount is much higher than the $1.8 billion aggregate net pension liability of the state's pension plans (which are well funded in our opinion). The NOL in 2017 of $8.3 billion is 16% higher compared with the prior-year total of $7.2 billion under previous GASB reporting standards due in part to a decrease in the discount rate to 3.58% from 3.75% after incorporating a 20-year 'AA' muni bond rate rather than the previous blended rate. On a per-capita basis, we estimate the unfunded liability to be $8,671 and rank it among the highest in the nation. We understand that there are no immediate plans to introduce additional OPEB reforms, although the state successfully implemented reform and made various changes to benefits in previous years to actively manage the estimated liability. In our opinion, the state's ability to effectively manage its OPEB liability will be an important credit factor over time.

Delaware's pension liabilities are average, in our view, with what we consider a good three-year average funded ratio of 84.5% across the five pension plans for which the state reports liability. In addition, the state's unfunded liability compared with income and population is moderate in our view. We consider the funding discipline of Delaware's pension plans to be adequate. State contributions to four of its five pension plans are determined on an actuarial basis with contributions historically meeting 100%, which we view as positive. The closed state police plan is funded on a pay-as-you-go basis given the only minimal plan assets, although actual contributions met actuarially determined levels in fiscal 2016. We also note that aggregate annual plan contributions for the pension system were under our calculation of amounts necessary for the plans to cover a portion of the amortization in unfunded liability as well as certain cost drivers of the annual change in the liability. We believe this could also weaken the strength of the state's pension liability profile time.

Economic performance has been historically stable, in our view; however, economic growth is forecast to be somewhat limited in the next four years. According to IHS Markit, employment and GDP growth are forecasted below national levels. From 2018 to 2021, employment growth is expected to be 0.7% for the state, which is under 1.0% for the U.S. The state's GDP growth is expected to increase 1.9% compared to the national growth rate of 2.3%. Delaware's labor force returned to its pre-recessionary peak at the end of 2014, ahead of IHS Markit's projections, due primarily to strong growth in professional and financial activities jobs. The state is somewhat concentrated in financial services jobs with 4.7% more jobs in this sector compared the national average, which we believe exposes the state to some risk. However, we understand there has been diversification within this sector. The state's unemployment has been consistently below the nation's rate for the past 20 years, at 4.4% for 2016 compared with 4.9% for the nation.

However, as of December 2017, the state's unemployment rate is 4.6% compared with 4.1% for the nation.

S&P Global Ratings considers Delaware's debt ratios moderate. State-supported GO debt was approximately $2.4 billion as of June 30, 2017, excluding $497 million, which is supported by the local school districts. Total tax-supported debt in fiscal 2017, including GO, transportation, and appropriation obligations, is moderately high relative to that of state peers, at $2,564 per capita and 5.4% of personal income. We estimate total tax-supported debt service carrying charges, after excluding the local school district support, were a moderate 5.1% of governmental spending in fiscal 2017. Debt amortization is rapid, in our opinion, with about 65% of state-supported debt scheduled to retire in the next 10 years. The state has focused its attention on reducing debt over time with clearly defined debt affordability parameters and a commitment to cash-funding capital projects, especially when the economy is performing well. We believe that this and rapid amortization of principal outstanding will contribute to a stable debt profile.

In terms of recent litigation, 30 states have presented claims that allege Delaware improperly accepted certain abandoned property that should have been escheated to those other states. In an attempt to avoid multiple, duplicative complaints, the state filed a Bill of Complaint in the U.S. Supreme Court on May 27, 2016. The complaint seeks to resolve the open district court matters and avoid future, similar litigation from other states. However, on June 9, 2016, 21 states filed suit against Delaware in the U.S. Supreme Court for the very same issue, with an estimated $162 million asserted against Delaware. The state reports that any resolution is likely to be at least a year away. As of Jan. 10, 2018, the state's potential aggregate litigation exposure (across multiple claims) could exceed $215.8 million. S&P Global Ratings will continue to monitor the lawsuit to gauge the potential impact to the state. In our opinion, abandoned property revenues are a significant revenue source for the state--in fiscal 2018 they are expected to be the state's third-largest revenue source (behind personal income taxes and franchise taxes). Estimated net abandoned property revenues of $554 million in fiscal 2018 represent 13.1% of total general fund revenues. The state reports that the fiscal 2018 operating budget rewrites Delaware's unclaimed property laws to align them with other states.

S&P Global Ratings considers Delaware's management practices strong under its financial management assessment (FMA) methodology. 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 and expenditure reports, multi-year revenue forecasting, a formal general fund reserve policy, and formal statutory debt affordability issuance guidelines. Delaware has implemented various debt management policies to decrease its debt burden and limit bond issuance. These measures have reduced the state's debt level despite the broad role it maintains in funding capital requirements for education, transportation, and corrections.

Delaware's bonds are eligible to be rated above the sovereign because we believe the state can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions" (published Nov. 19, 2013, on RatingsDirect), U.S. states are considered to have moderate sensitivity to country risk. State-derived revenues are the sole source of security on the bonds, and the institutional framework in the U.S. is predictable with significant state autonomy and flexibility.

Based on the analytic factors we evaluate for states, on a scale of '1.0' (strongest) to '4.0' (weakest), we have assigned a composite score of '1.6' to Delaware. We have notched up to 'AAA' as allowed as per our state rating methodology criteria because in our view the state's primary credit profile is still strong and we believe remains in line with comparable 'AAA' rated peers.

Outlook

The stable outlook reflects what we view as Delaware's strong fiscal management that has allowed the state to proactively manage its budgets and has been key to the state's credit stability. We believe this will be an important consideration over our two-year outlook horizon, especially given a somewhat sluggish economy that we believe faces challenges that could pressure future budgets. In addition, strong management will be essential to control the state's OPEB liabilities, which are significant in our view. The outlook also reflects the state's healthy reserve and liquidity position, which has been relatively stable over a range of economic cycles. We believe Delaware's strong reserve position adds cushion to the state's budgetary position and note that no funds have been withdrawn from the budget reserve account since its inception in 1980, which we believe is evident of strong fiscal management. Although not likely, if the state's reserve position were to decline precipitously due to revenue softening or the outcome of current litigation surrounding the abandoned property program--which is a large revenue source for the state--this could put downward pressure on the rating. Downward pressure could also arise from possible future structural budget imbalance or decreased budgetary flexibility stemming from soft revenues, high fixed costs related to elevated OPEB liabilities, or significant changes in federal policy including health care funding, among other factors. In addition, we could take action if we believe weakened long-term economic trends exposes the state to challenges uncharacteristic of the rating level.

Ratings Detail (As Of January 26, 2018)		
Delaware GO		
Long Term Rating	AAA/Stable	Affirmed
Delaware GO		
Long Term Rating	AAA/Stable	Affirmed
Sustainable Energy Util, Inc., Delaware		
State of Delaware, Delaware		
Sustainable Energy Utility, Inc. (Delaware) APPROP		
Long Term Rating	AA+/Stable	Affirmed

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.