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New Issue

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Delaware (State of)

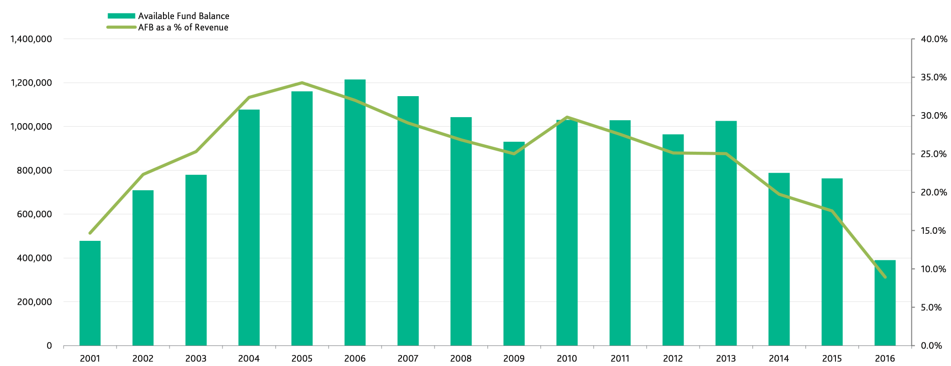
New Issue - Moody's Assigns Aaa to Delaware's $225M Ser. 2017 GO Bonds; Outlook Stable

Summary Rating Rationale

Moody's Investors Service has assigned an Aaa rating to the State of Delaware's $225 million General Obligation Bonds, Series 2017. The rating reflects Delaware's strong financial management characteristics and history of maintaining ample budgetary reserves. The outlook is stable.

Exhibit 1

Fiscal 2016 reserves declined due to increased abandoned property claims



Source: Delaware comprehensive annual financial reports

Credit Strengths

» Strong reserve levels to stabilize state finances in the event of a future economic downturn

» Financial management policies that include frequent revenue forecast updates and conservative budgeting

Credit Challenges

» Large debt burden relative to population and income

» Exposure to potential consolidation or downsizing in the financial services industry

Rating Outlook

Delaware's stable outlook is supported by the state's prudent structural governance features (including frequent revenue forecast revisions) that will keep the state in a strong position relative to peers through future economic cycles.

Factors that Could Lead to a Downgrade

» Depletion of reserves

» Economic contraction

» Weakened financial management

Key Indicators

Exhibit 2

Delaware	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Operating Fund Revenues (000s)	4,223,865	4,538,384	4,255,647	4,749,041	4,816,998
Balances as % of Operating Fund Revenues	22.8%	22.6%	18.5%	16.1%	8.1%
Net Tax-Supported Debt (000s)	2,325,311	2,300,239	2,280,579	2,256,218	2,327,815
Net Tax-Supported Debt/Personal Income	6.2%	5.7%	5.5%	5.2%	5.2%
Net Tax-Supported Debt/Personal Income 50 State Median	2.8%	2.6%	2.5%	2.5%	N/A
Debt/All Governmental Funds Revenue	37.9%	36.1%	34.2%	31.3%	32.8%
Debt/All Governmental Funds Revenue 50 State Median	23.8%	23.5%	23.0%	20.4%	N/A
Adjusted Net Pension Liability/All Govt Funds Revenue	98.6%	76.6%	62.4%	53.5%	N/A
Adjusted Net Pension Liability/All Govt Funds Revenue 50 State Median	63.9%	60.3%	59.2%	50.4%	N/A
Total Non-Farm Employment Change (CY)	0.3%	2.3%	2.2%	2.4%	0.6%
Per Capita Income as a % of US (CY)	98.4%	98.6%	97.6%	99.0%	N/A

Source: Moody's Analytics

Recent Developments

Recent developments are incorporated in the detailed rating considerations.

Detailed Rating Considerations

Economy

Delaware's economic expansion decelerated in the last quarter of calendar 2016. The state added just 2,900 jobs in calendar 2016, whereas the annual pace had been over 10,000 since 2013. Overall, the state economy is healthy. Per capita income is average and employment volatility is below-average.

The state continues to transition to a more services-based economy, as is the case with most other states. Sectors adding jobs include professional services, healthcare, and leisure and hospitality. Manufacturing is in a long-term secular decline. It lost 1,200 jobs in the state in 2016, and now accounts for just 5.7% of total jobs, the smallest share since records began in 1990. This explains the gradual decline in Delaware's living standards relative to the rest of the country. Between 2000 and 2015, Delaware's per capita income as a percentage of the US declined to 99% from 113%. Manufacturing jobs lost typically paid better than new service-sector jobs.

Financial services is a larger part of Delaware's economy than any other state. The financial sector produced $25 billion, or 42%, of Delaware's $60 billion total gross state product in 2015. This is double the 20% financial services share in the national economy. Credit card-processing is a niche industry that has developed as a result of the state's lack of usury laws. The financial sector has provided Delaware with both long-term employment stability and has been growing faster than the rest of the economy in recent months.

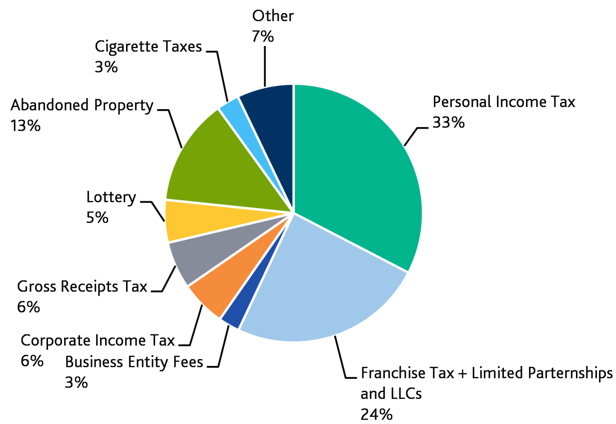
Finances and Liquidity

Delaware faces a $350 million budget gap for fiscal 2018. The gap is a result of revenues slowing down more than expected spending. The state projects flat revenue growth over the next few years. The state has prudently taken into account an aging demographic and a declining labor force participation rate. The state estimates that $201 million of the gap is attributable to a deficit in revenues to pay for current services and $149 million is attributable to new costs, including demographic growth in education ($49 million) and Medicaid ($13 million). The gap is manageable relative to a $4 billion general fund budget.

The state's revenue structure is unique in its dependence on revenues related to its unique competitive position as corporate home of over half of all publicly traded firms in the United States (see Exhibit). Franchise taxes, levied on corporations organized under state laws, account for a quarter of revenues and, after personal income taxes, are the state's second-largest source of revenue. Abandoned property, which is also related to its position as legal domicile of more than two-thirds of the Fortune 500, accounts for 13% of revenue. Bank franchise taxes and other corporate levies account for a further 5% of revenue.

Exhibit 3

Large slice of Delaware's $4B revenue pie relates to its role as preferred corporate domicile
Fiscal 2016 general fund revenues, millions



Source: State of Delaware

Delaware's reserves insulate it from potential future revenue downturns or unanticipated spending pressures. Reserves declined in fiscal 2016 and have been declining for a decade. The unassigned balance in the general fund declined to $390 million, or 9% of revenues, at the end of fiscal 2016 from $763 million, or 18% of revenues, in fiscal 2015. The decrease brings Delaware's financial reserve position in line with the median for Aaa-rated states. The state attributes the decline primarily to an increase in expected abandoned property refund claims. Delaware is the state most reliant on abandoned property, which generated $528 million, or 13% of total general fund revenue in fiscal 2016.

Delaware's competitive advantage as legal domicile

Delaware plays a unique role in corporate America as legal domicile for two-thirds of Fortune 500 companies and over half of all publicly-traded firms in the US. In recent years, Delaware has expanded this dominant position over the rest of the US. State corporate law is modern and flexible. The state's Court of Chancery has a well-developed body of jurisprudence. As of December 2016, there were 1.2 million businesses registered in the state. Delaware's long-standing position as preferred domicile enhances its economic and revenue stability.

Delaware's reserve position also includes a $221 million rainy day fund that is funded at the constitutional limit of 5% of revenues. The state has never tapped its rainy day fund since its inception in 1980.

Delaware's constitution requires the state to budget expenditures at 98% of available resources, which helps maintain budgetary balance. Unlike other states that suspend such statutory provisions in periods of financial duress, Delaware regularly sticks to this limit, which gives it an additional financial cushion to address potential future revenue downturns.

LIQUIDITY

Delaware has very strong liquidity. As of November 2016, Delaware had total available liquid resources of $1.8 billion, or 45% of expected fiscal 2017 general fund revenues. Delaware has not issued bond- or revenue-anticipation notes in 40 years.

Debt and Pensions

DEBT STRUCTURE

Delaware's debt burden is high relative to other states due to its funding capital projects on behalf of school districts. Delaware's $2.3 billion in net tax-supported debt was 5.2% of personal income in fiscal 2015, which ranked 7th-highest among states. The state has high fixed costs compared to other Aaa-rated states. The previous governor's fiscal 2018 budget recommends shifting capital costs to school districts, which would alleviate some of the fiscal pressure on the state.

Delaware has no outstanding variable-rate debt. This eliminates interest rate risk and the risk related to the extension of liquidity facilities.

Delaware's general obligation debt is paid out relatively rapidly, with 70% of outstanding debt scheduled to be repaid in 10 years and all general obligation debt is 20 years or less in maturity. This increases short-term funding pressure, but enhances long-term fiscal flexibility.

The amount of debt Delaware can issue is limited by a three-part statute. New debt issued in any one year has to be less than 5% of general fund revenue. Debt service, including bonds secured by transportation revenues, must be less than 15% of general fund and transportation revenue. The maximum annual debt service on general obligation debt must be less than the state's cash balances. The statutory nature of these debt limits exposes them to legislative change.

DEBT-RELATED DERIVATIVES

Delaware is not party to any debt-related derivatives.

PENSIONS AND OPEB

Delaware has an average pension liability for a state. Its $3.9 billion adjusted net pension liability as of fiscal 2015 was 68% of revenue, which ranked 30th-highest among states. The state regularly makes the actuarially determined contribution, which was $183 million in fiscal 2016, or 5% of the budget. Delaware contributed 112% of its tread-water contribution. The tread water contribution is the amount that would cover interest on the beginning-of-the-year net pension liability, plus employer service cost accruals during the year. The pension plan's poor negative 1.3% return in fiscal 2016 and rising interest rates will likely result in an increased liability.

The state has determined its liability for other post-employment benefits (OPEB) was $7.5 billion as of June 30, 2016. Like most states, Delaware has not significantly funded this liability. It has put away just $310 million, or 4% of what it owes, to pre-fund this liability. The state retains significant flexibility in addressing OPEB costs. In 2011 and 2013 the state enacted laws that shifted some of the burden to employees and the federal government, respectively. It made a $17.5 million contribution in fiscal 2016 and expects to make the same contribution in fiscal 2017, which itself is quite manageable relative to the size of its budget.

Governance

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. A panel of 33 gubernatorial appointees, known as the Delaware Economic and Financial Advisory Council (DEFAC), provides the state's revenue estimates. This panel, which includes officials from the public and private sector, meets six times a year and issues revenue and expenditure forecasts used by both the executive and legislative branches of government during the budget process. The state's requirements for consensus forecasts, well-managed expenditure growth, and a limit on appropriations support long-term prospects for financial strength. Delaware's otherwise strong management profile is tempered by a constitutional requirement that tax increases be approved by a three-fifths legislative majority, which reduces the state's financial flexibility.

Legal Security

The bonds are direct obligations of Delaware to which the full faith and credit of the state will be pledged.

Use of Proceeds

Bond proceeds will pay for various capital projects.

Obligor Profile

Delaware is the 45th-largest state by population and 42nd-largest by state gross domestic product. Per capita personal income was 99% of the US level as of 2015.

Methodology

The principal methodology used in this rating was US States Rating Methodology published in April 2013. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 4

Delaware (State of)

Issue	Rating
General Obligation Bonds, Series 2017	Aaa
Rating Type	Underlying LT
Sale Amount	$225,000,000
Expected Sale Date	02/23/2017
Rating Description	General Obligation

Source: Moody's Investors Service

REPORT NUMBER 1058988

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