Moody's Investors Service

Global Credit Research
New Issue
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New Issue: **Delaware (State of)**

MOODY'S ASSIGNS Aaa RATING TO DELAWARE'S $225 MILLION GENERAL OBLIGATION BONDS

STABLE OUTLOOK APPLIES TO CURRENT ISSUE AND MORE THAN $1.8 BILLION IN NET TAX-SUPPORTED DEBT OUTSTANDING

State
DE

Moody's Rating

ISSUE	RATING
General Obligation Bonds, Series 2009	Aaa

Sale Amount	$225,000,000
Expected Sale Date	01/14/09
Rating Description	General Obligation

Opinion

NEW YORK, Dec 22, 2008 -- Moody's Investors Service has assigned a rating of Aaa and a stable outlook to the State of Delaware's approximately $225 million of General Obligation Bonds - Series 2009, which are expected to price in early January, 2009, and have a final maturity date of 2029. The highest rating assigned to the state's general obligation debt is based on strong financial management characteristics and a history of maintaining ample budgetary reserves throughout recent economic cycles. Proceeds of the bonds will be used to finance various capital projects.

Credit strengths:

* Strong financial management and fiscal policies, including frequently updated revenue forecasts and conservative budgeting

* Fully funded pension plan

* Proactive management of declining revenues

Challenges:

* Shortfalls have opened up for current fiscal year and next budget year

* Large debt burden relative to population and income

* Exposure to further consolidation or downsizing, respectively, in the financial services and domestic automobile manufacturing industries

HIGHEST RATING REFLECTS FINANCIAL MANAGEMENT STRENGTHS

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. Delaware's constitution requires the state to budget expenditures at 98% of available resources, which helps maintain budgetary balance. There is also a constitutional mandate that unencumbered budgetary general fund resources, as much as 5% of general fund revenue in any fiscal year, be transferred to a budget reserve (Rainy Day Fund). This funding may be accessed only by a three-fifths vote of the members of each house and may be used only to close a general fund deficit or to provide funds needed as a result of the enactment of legislation reducing revenue. The Rainy Day Fund is currently fully funded, at over $185 million.

Revenue estimates are made by a 31-member panel appointed by the governor, known as the Delaware Economic and Financial Advisory Council (DEFAC). This panel, which includes officials from the public and private sectors, meets six times per year and issues revenue and expenditure forecasts that are used by both the executive and legislative branches of government during the budget process. These provisions for consensus forecasts, well-managed expenditure growth, and a limit on appropriations have led to the state's long-term prospects for sustained financial strength. The state's otherwise strong management profile is tempered by a constitutional requirement that tax increases be approved by a three-fifths majority in the legislature.

DECEMBER REVENUE PROJECTIONS SHOW FURTHER DECLINES

The state held a regularly scheduled DEFAC meeting in September, 2008. The next scheduled DEFAC meeting was set to take place in December, but based on the underperformance of revenue collections, the state decided to convene another DEFAC a month early, in November, 2008. Although the November DEFAC took place just two months after the prior DEFAC meeting, virtually all tax revenue forecasts for fiscal 2009 and 2010 were cut. Personal income tax projections were brought down by $44 million in 2009 and $70 million in 2010 (compared to the September 2008 DEFAC projections). Corporate income tax projections were brought down by $30 million in 2009 and $34 million in 2010.

The state then convened its regularly scheduled DEFAC meeting in December, which brought down revenue projections even further. Total receipts for 2009 were brought down $35.5 million from the November DEFAC, with much of the decline caused by personal income tax downward revisions. General Fund revenue is now expected to show a 3.9% decline in fiscal 2009 compared with 2008. Receipts for fiscal year 2010 were brought down $61 million compared to November's DEFAC, with downward revisions in personal income taxes, corporate income taxes, and the gross receipts tax. The shortfall for the current fiscal year is now projected at $200 million (6% of General Fund revenues), and the gap for 2010 is estimated at $500 million, or 15% of General Fund revenues.

The state has proposed 7% cuts from agencies, excluding K-12 education and higher education. This is estimated to be worth approximately $130 million. The state is also considering deauthorizing capital projects, which could be worth $30 million to $50 million. To solve the gap for fiscal year 2010, which is currently estimated at $500 million, the state has proposed 15% cuts from state agencies, and is considering other possible solutions.

ECONOMY SEEING EFFECT OF NATIONAL HOUSING DOWNTURN

Delaware recovered more quickly from the 2001 recession than many other states. When the national economy returned to a job-creation mode in 2004, Delaware's non-farm employment growth rate was significantly faster, at 2.2% versus a 1.1% national pace. The rebound was enough for Delaware to surpass its pre-recession peak total non-farm employment level. The state has enjoyed a lower unemployment rate than the nation in recent years (5.4% versus the nation's 6.5% in October 2008), and wealth trends have also been positive. Delaware's increasing population is a reflection of its healthy employment base. Delaware's population growth in the 1990s exceeded that of both the mid-Atlantic region and the nation. Between 2001 and 2006, Delaware's population expanded by 7.3%, compared to 1.9% growth for the region and 5.0% for the nation as a whole.

Delaware, like most other states, is now in recession, as the effects of the national housing downturn have spread to other sectors of the economy. Many economic indicators for the state are showing downward trends, although still tracking above the national average. The unemployment rate in Delaware has increased in recent months but is more than a percentage point below the US average. And while Delaware's total employment showed 0% growth in October on a year-over-year basis, this is better than the 0.9% decline the nation recorded.

DEBT BURDEN HAS GROWN AT PACE BELOW 50-STATE MEDIAN

Delaware's debt burden has increased at a slower pace than the 50 states overall in recent years. Its net tax-supported debt totaled $2,002 on a per-capita basis in Moody's 2008 State Debt Medians report, compared with $1,599 five years earlier. This 25% increase compares with 47% growth in the median level for all states' debt per capita. Delaware's debt amounts to about 5.2% of the state's personal income, based on the 2008 debt medians report. This is relatively high and puts Delaware seventh in the ranking of the states for this measure. The state's relatively high debt burden reflects its role in financing facilities, such as schools and prisons, which in other states would receive capital through local entities. A 1991 state law imposes several constraints on Delaware's debt, including a requirement that in any fiscal year the state can only authorize new debt equal to as much as 5% of budgetary general fund revenue projected for the year. Although these limits appear fairly generous, the state's debt burden has decreased since they were enacted.

The state has no outstanding variable rate debt.

MAIN PENSION PLAN IS FULLY FUNDED

Delaware benefits from a well-funded pension system. The Delaware Employees Pension Plan is currently more than 100% funded. To deal with other post-employment benefits (OPEB) liabilities (estimated at $3.2 billion), the state created a dedicated trust to receive OPEB-related payments. Currently, $65 million has accumulated in the fund.

MOST RECENT RATING ACTION

The most recent rating action with respect to the State of Delaware was on February 25, 2008, when the rating of Aaa with a stable outlook was assigned to the State of Delaware's approximately $216 million of General Obligation Bonds - Series 2008A.

The principal methodology used in rating this issue was the State Rating Methodology, which can be found at www.moodys.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issue can also be found in the Credit Policy & Methodologies directory.

Outlook

The outlook for Delaware is stable. The state's relatively high debt burden must be balanced against strong financial management practices grounded in the state constitution, as well as the state's proactive management of declining revenues.

What could move the rating--DOWN:

* Significant increase in debt levels relative to the economy

* Significant economic contraction

* Erosion of trend of strong financial management

Analysts

Emily Raimes
Analyst
Public Finance Group
Moody's Investors Service

Edward Hampton
Backup Analyst
Public Finance Group
Moody's Investors Service

Contacts

Journalists: (212) 553-0376
Research Clients: (212) 553-1653

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