STANDARD & POOR'S

Global Credit Portal
RatingsDirect®

May 3, 2010

Delaware; General Obligation

Primary Credit Analyst:
Danielle Leonardis, New York (1) 212-438-2053; danielle_leonardis@standardandpoors.com

Secondary Credit Analyst:
Robin Prunty, New York (1) 212-438-2081; robin_prunty@standardandpoors.com

Table Of Contents

Delaware; General Obligation

Credit Profile		
US$172.295 mil GO bnds ser 2010A due 07/01/2020		
Long Term Rating	AAA/Stable	New
Delaware		
Long Term Rating	AAA/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AAA' rating, and stable outlook, to Delaware's series 2010A general obligation (GO) bonds and affirmed its 'AAA' rating, with a stable outlook, on the state's previously issued GO debt.

In our opinion, the rating reflects the state's:

- Diversified economy, which has experienced a decline during the current recession due to weakness in the financial service and manufacturing sectors;
- Strong financial management, aided by the Delaware Economic & Financial Advisory Council (DEFAC), which provides frequent and objective projections;
- Consistently strong general fund reserves and liquidity;
- Moderate overall debt burden with strong debt management policies in place; and
- Well-funded pension system -- Other postemployment benefit (OPEB) liabilities are significant, but the state has been actively managing the liability.

Officials plan to use bond proceeds from this issue to refund various maturities from several of the state's GO bond series outstanding for net present value savings targeting debt service savings in fiscal 2012.

Delaware's financial position remains healthy despite ongoing revenue declines over the past two years. DEFAC provides the state with objective and frequently updated financial and economic projections, which has allowed the state to manage revenue volatility proactively over the past year. In addition to DEFAC, Delaware maintains an array of prudent fiscal and debt policies that it has enhanced over time and that, in our view, have contributed to a strong overall budget management framework. DEFAC adjusts revenues six times throughout the fiscal year, which allows for the implementation of timely budget adjustments.

Delaware has a long history of implementing difficult and politically unpopular measures to balance its budget and maintain balance throughout the fiscal year. Given the duration of the current recession, this has been, in our opinion, an important credit factor. Although revenue declines have been pronounced over the past year, the state has left its budget stabilization fund intact. Given the state's forecast of a slow economic recovery and the elimination of federal stimulus funding after fiscal 2011, we believe this will provide flexibility to meet future budget challenges. The Delaware Constitution establishes the budget reserve, funded at 5% of estimated budgetary general fund revenues.

The state ended fiscal 2009 with a positive, albeit diminished, general fund cash balance after making significant budget adjustments throughout the fiscal year to address a cumulative gap of almost $400 million, or 11% of budgeted revenues. As with most other states, Delaware identified a sizable budget gap of $800 million to start fiscal 2010. The state closed the gap with a balance of revenue enhancements, federal stimulus funds, and expenditure reductions. According to DEFAC's April 2010 revenue forecast, revenues were performing slightly better than previously forecast. We would expect continued budget adjustments in the revenue forecasts coming from both the May and June DEFAC meetings, especially in light of the modestly optimistic upward trend of projected revenues based on current economic conditions.

Standard & Poor's considers Delaware's management practices "strong" under its Financial Management Assessment (FMA) methodology, indicating 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 economy is relatively diverse following several decades of active economic development at the state level. Performance over time has been, in our view, relatively stable with unemployment consistently below the nation's rate for the past 20 years. Development initiatives have encouraged financial sector, business services, and pharmaceutical and biotech expansion; in our view, this has lessened the state's reliance on cyclical manufacturing. While unemployment has increased sharply in-line with national trends, the February 2010 rate of 9.2% was still below the nation's rate. State income levels remain above the national average.

Delaware has implemented various debt management policies over time to decrease the state's debt burden and limit bond issuance. These measures have been successful in reducing the state's debt level despite the broad role the state maintains in funding capital requirements for education and corrections, which are more traditionally done at the local level. Most of Delaware's debt limitations are imbedded in statute and strictly adhered to by the state. Current debt levels are elevated compared with Delaware's state peers when measured on a per capita basis at $3,452, or 8.7% of personal income. Debt service carrying charges were a moderate 5.2% of fiscal 2009 general fund expenditures. Delaware has always maintained a rapid amortization schedule for GO bonds outstanding.

Outlook

The stable outlook reflects Standard & Poor's expectation that the state's proactive budget management will contribute to balanced operations through the current economic downturn. Despite weakness in key sectors, the state's economic growth prospects remain, in our view, favorable. Strong controls on debt issuance and the state's well-funded pension system should, in our view, minimize budget pressures.

Financial Management Assessment: 'Strong'

Standard & Poor's considers Delaware's management practices "strong" under its FMA methodology, indicating practices are strong, well embedded, and likely sustainable.

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

- The 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

revenues 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 revenues to provide flexibility against any unexpected revenue declines;
- A cash management policy board that sets formal state investment policies and regularly monitors investments; and
- A three-part statutory debt affordability limit.

The three-part statutory debt affordability limit includes:

- 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 revenues and transportation trust fund revenues 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, the MADS on GO debt outstanding exceeds the estimated cash balances, including all reserves, for the fiscal year subsequent to the fiscal year in which the debt is issued.

Delaware, however, does not maintain a traditional multiyear capital improvement program. The state fully outlines its annual capital requirements in the annual capital budget, but officials make internal cost estimates 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.

Economy: Well Balanced Despite Financial Sector Concentration

Delaware's economy, like many other state economies, has faced some challenges in the wake of the national economic downturn. The manufacturing sector and the credit card component of the financial service sector, as well as the construction sector, have been the most affected. Delaware has the nation's highest concentration of financial employment with more than 70 bank and trust companies based in the state. According to IHS Global Insight, although employment for the financial activities sector has decreased, the overall sector remains almost 11% of the state's employment base, reflecting the ongoing number of businesses incorporating in the state. According to the Delaware Department of Labor, as of December 2009, the banking sector had more than 25,500 employees. Government, nonetheless, remains the leading industry employer with 62,200 employees. Among private industry sectors, health care and retail trade are the leading employers with 56,600 and 49,600 employees, respectively. The manufacturing sector has been the most severely hit with the closing of the state's two automobile manufacturing plants: The Chrysler facility in August 2007 and the General Motors Corp. (GM) facility in June 2009. More recently, the Valero Refinery closed in November 2009. Since the closure announcements:

- University of Delaware purchased the former Chrysler site to convert it into a multipurpose educational and research site with an already established partnership with nearby Aberdeen Proving Ground.
- Fisker Automotive acquired the former GM plant to build affordable hybrid cars.
- PBF Energy Partners purchased the Valero site to resume production as early as April 2011.

Although the manufacturing sector has experienced losses, it is our opinion these new projects should aid in establishing new employment growth opportunities and should modestly help diversify the economy. According to

IHS Global Insight, manufacturing payrolls, year over year, lost more than 4,000 employees in the second quarter of 2009. In 2009, the manufacturing sector accounted for 6.8% of total state employment, significantly lower than the 13.2% in 1990.

Delaware has passed a number of laws, beginning with the 1981 Financial Center Development Act, to make the state more favorable for banking, credit card, and other financial firms to locate there. JP Morgan Chase and Bank of America, the nation's first- and third-largest credit card issuers, located in Wilmington, Del., control a combined 30% of the U.S. market. Although these banks have suffered in the wake of the financial market turmoil of the past year, they continue to maintain a major presence in the state. Bank of America now employs about 10,000, making it the state's leading private employer. Other leading employers in the financial services industry include Discover Bank and Barclays Bank Delaware. Barclays has recently announced it will look to add 500 new jobs over the next five years and a 70,000-square-foot customer contact center. Despite the recent weakness of the financial service sector, we believe it will remain a strong anchor of the state's economy.

E.I. du Pont de Nemours & Co., long the state's leading employer, is now the state's second leading employer with roughly 8,000 employees, 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. Officials expect growth industries such as biotechnology, life sciences, and pharmaceuticals 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, $30 million by Air Liquide, and continued investment by AstraZeneca Inc. -- is significant.

The U.S. Department of Defense's Base Realignment and Closure (BRAC) Commission list keeps Dover Air Force Base, the Kirkwood U.S. Army Reserve Center, and New Castle County Airport Air Guard Station viable. Dover Air Force Base, the nation's busiest military cargo terminal and key airlift center, currently employs more than 6,400 military personnel (3,900 active duty and 1,500 reservists) and 1,000 civilians.

Delaware's current population totals 885,000, signifying a 7% increase over 2004 U.S. Census estimates. Average annual population growth between 2004 and 2009 was about 1%, which exceeded the mid-Atlantic region and the nation as a whole. The state's median household effective buying income is 108% of the national average while per capita effective buying income is 105%.

Delaware's housing construction sector has just recently begun to level off; more recently, it is staying above its year-earlier levels. Overall, housing starts have experienced an 18.9% decrease from 2008. Single-family and mobile home sales saw the largest declines, followed by multifamily starts between 2007 and 2009. Furthermore, the downward trend in housing starts has accounted for a total job loss of about 4,000. Delaware, however, continues to lag the nation in foreclosure rates.

Overall, while Delaware's income growth has, in large part, matched the nation's growth, employment growth has not. Nonagricultural employment growth was a negative 4.7% in 2009, above the mid-Atlantic region's negative 3.2% and the nation's negative 4.3%. Nonetheless, while Delaware's historically low unemployment spiked to 9.2% in February 2010, it remained below the nation's rate.

According to the April 2010 DEFAC report, projections have state employment growth at a negative 3.0%, 0.7%, and 2.2% for fiscals 2010, 2011, and 2012, respectively. Delaware's projected employment growth is, in general, slower compared with national growth. Forecasts have personal income growth at 0.7%, 3.8%, and 4.8% for fiscals 2010, 2011, and 2012, respectively. Population should grow by 1.1%, 1.4%, and 1.4% in 2010, 2011, and 2012, respectively. Population and personal income forecasts are generally favorable when compared with national estimates.

Finances: Budget Management Is Strong

Fiscal 2009

Delaware's tax and revenue structure is broad. The general fund relies on tax revenues from personal income and corporate income, as well as a corporate franchise tax; business and occupational gross receipts; a bank franchise tax; realty transfers; and cigarette taxes, among others. Additional significant general revenue streams include abandoned property and lottery receipts. On a generally accepted accounting principles (GAAP) basis, business taxes accounted for 49.0% of general fund revenues in fiscal 2009, followed by the personal income tax at 27.8%, fees and charges at 10.5%, other tax revenues at 7.0%, other revenues at 3.3%, and interest income at less than 1.0%. Delaware does not levy a consumer sales tax. Delaware's major general government expenditures consist of public education (roughly 33.0% of fiscal 2009 expenditures); health and social services (27.5%), including Medicaid; general government (14.2%); and judicial and public safety (13.7%).

Fiscal 2009 on a GAAP basis ended with a $169.36 million general fund operating reduction that brought the ending general fund balance to $1.056 billion, or a still-very-strong 26.8% of operations. Of that amount, $744.4 million, or a very strong 18.9% of operating expenditures, is unreserved. This is the third operating reduction since fiscal 2003. Although expenditure cuts were made and some capital improvements postponed, certain revenue streams (personal income tax, corporate income tax, bank franchise fees, realty transfer tax, and interest income) came in under budget. The state, however, has indicated it will continue to monitor revenues and take the necessary steps to maintain its 98% appropriation rule, as well as not use the rainy day fund to balance future budgets. On a GASB 34 basis, the state's primary government net assets decreased by $486.3 million to $5.20 billion in fiscal 2009 from $5.71 billion in fiscal 2008. The state closed fiscal 2009 with a cumulative cash balance of $378.47 million, or 11.5% of the state's annual expenditures. The budget reserve account (rainy day fund) remained fully funded at the 5% level, totaling $186.43 million. An additional $183.7 million was set aside for continuing and encumbered appropriations, resulting in a much-reduced unencumbered cash balance of $8.4 million, down from $108.3 million in 2008.

The fiscal 2010 update

The state continues to experience challenges in fiscal 2010 due to the ongoing economic downturn. The April 2010 DEFAC meeting, however, raised revenue expectations modestly. Management continues to take significant measures, on both the revenue and expenditure sides, in bridging an initial $600 million projected budget gap while continuing to address revenue shortfalls. To date, measures taken have allowed the state to eliminate the budgetary gap.

Based on the April 2010 DEFAC revenue forecast, fiscal 2010 general fund revenues were budgeted to see a 2.9% increase over fiscal 2009 to $3.24 billion. The 2010 budgetary general fund operating budget totals $3.09 billion, an 8.1% decrease from the previous year. When including grants-in-aid appropriations of $35.4 million, total appropriations increase to $3.127 billion, a decline of 8.3% over fiscal 2009. The appropriation is within the state's constitutional limit of 98% of estimated revenues. Estimates have fiscal 2010 with an unencumbered cash balance of $170.5 million, significantly higher than the $8.4 million in fiscal 2010. The budget reserve fund remains fully funded at $186.4 million, or 5% of budget. The budget reserve fund (rainy day fund) was established in 1980, and it has never been tapped.

Steps taken on the revenue side include state plans to use $155 million of stimulus money (from the total $232.8 million American Recovery and Reinvestment Act of 2009 funding designation for 2010); increasing certain tax revenues, including personal income, franchise, estate, cigarette, gross receipts, public utility, and tax amnesty taxes (effective either Jan. 1, 2009, or Jan. 1, 2010) to generate an additional $196.1 million, including sports lottery money totaling $53.0 million; and the reallocation of special fund revenues (primarily from the transportation trust fund and open space fund) to total $43 million, as well as several smaller initiatives. In fiscal 2011, American Recovery and Reinvestment Act of 2009 funding is expected to total $123.5 million; it is designated for Medicaid and education. No additional American Recovery and Reinvestment Act of 2009 funding is expected after 2011.

On the expenditure side, the state was able to achieve budgetary reductions through the elimination of 485 positions through attrition and the deauthorization of more than 500 positions during the year, reducing consulting costs by 10.0%, including 2.5% pay cuts and ongoing hiring reviews and spending controls. At the same time, the state looked for opportunities for shared services. To that end, several departments were slated for elimination and/or consolidation, including the department of finance. After careful consideration and acknowledgement of the additional attention required for the additional lottery revenues stemming from table gaming, however, the state will maintain the department.

Fiscal 2011

On Jan. 28, the governor presented the fiscal 2011 operating and capital budget. It bridged a projected revenue gap of $253 million, or roughly 8% of forecast revenues in December 2009. To close the budget gap, the state proposed a combination of revenue adjustments and spending reductions. Positive revenue adjustments of $78.5 million came from an upward revision of lottery revenues ($40.5 million), abandoned property revenues ($24.0 million), and realty transfer taxes ($14.0 million). In addition, the rebalancing of the budget reserve fund contributed another $10.8 million. Cost-cutting measures included department consolidations and personnel reductions. DEFAC met on April 19, 2010 and raised revenue estimates modestly upward for fiscals 2010, 2011, and 2012 by 2.90%, 1.65%, and 4.40%, respectively. After adjusting for tax law changes and other nonrecurring items, however, estimates reflect an underlying growth rate of a negative 0.70%, 3.55%, and 4.00% for fiscals 2010, 2011, and 2012, respectively. Nonetheless, in doing so, DEFAC has now begun to point to recovery, albeit at a slow pace.

DEFAC's April 2010 session raised revenue expectations for fiscal 2011 by $64.6 million to $3.293 billion. The primary driver of revenue increases across all years is the increased value of equity securities, pertaining to abandoned property collections. Much of the equities contributing to the increase are associated with the reduction of the dormancy period to three years from five years. Since that estimate, equity values have doubled. Also contributing to the revenue increase were personal income; corporate income; and franchise taxes, due to last year's revenue enhancement measures, which are all tracking upward in each of the three years of the forecast, a trend that cautiously began in March 2010. Abandoned property saw the largest increase -- $121.0 million in fiscal 2010 and $90.0 million in fiscal 2011 -- partly due to reducing the dormancy period from five years to three years. Lottery results were mixed with estimated revenues down in 2010, reflecting the poor weekend weather, while fiscal 2011 estimates were increased by $40.5 million with the expectation of table games beginning this summer. Cigarette tax estimates remained unchanged for both fiscals 2010 and 2011. The fiscal 2011 budget includes the use of $123.0 million of stimulus money. As in previous years, the budget considers only 98% of revenue estimates, maintains the budget reserve account (rainy day fund), and fully funds the pension obligation. In our opinion, there will be additional DEFAC meetings before the start of fiscal 2011 with further revenue adjustments possible. The budget reserve account is fully funded.

Delaware Economic & 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 34-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. DEFAC generates a five-year revenue forecast once a year around September. Corresponding expenditure forecasts are required in December, March, April, May, and June. DEFAC's process is open to the public.

Regular DEFAC forecasting has allowed Delaware to take early action recently as revenues tightened during the recession. Moreover, DEFAC revenue forecasts allow 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 problem's size. With nearly 30 years of history, the DEFAC process has become part of the prudent and conservative culture of Delaware's financial management.

Debt: An Average Burden With Rapid Amortization

Compared with other states, facets of Delaware's overall debt burden, through fiscal 2009, including gas-tax-supported debt and school-supported GO debt, are moderate. Estimated debt per capita is $3,452, or 8.7% of per capita personal income. When excluding the $536.5 million of school-supported GO debt and the gas tax-supported Delaware Transportation Authority revenue bond debt, Delaware's debt burden drops to an average $1,196 per capita based on $3.055 billion of GO debt outstanding, including this issuance.

Delaware's debt service carrying charges were a moderate 5.2% of fiscal 2009 general fund expenditures. A Amortization is very rapid with officials planning to retire 75% of forthcoming and existing GO debt over 10 years and 100% over 20 years. Delaware does not have any variable-rate debt outstanding, and the state has not entered into any interest rate swap agreements 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 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: $236.0 million in fiscal 2005, $282.0 million in fiscal 2006, $243.0 million in fiscal 2007, and $77.9 million in fiscal 2008. The fiscal 2010 capital budget totals $284.5 million: $211.6 million for GO projects and $72.9 million for department of transportation projects funded through the transportation fund. The state has not allocated general fund cash for pay-as-you-go capital projects in fiscal 2010.

Pensions And Other Postemployment 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 2009, the State Employees' Pension Plan was modestly underfunded at 99%, the first time the plan has not been overfunded in several years. Fiscal 2009 saw a 16% decline on investments. The state's fiscal 2009 contribution to this plan totaled $96.6 million, or 2.9% of general fund expenditures. One of DPERS' nine pension funds, the Closed State Police Pension Plan, has a 0.2% funded ratio since the state funds this plan through pay-as-you-go financing. 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 the GASB 45 OPEB accounting disclosure. Using actual data as of July 1, 2009, an actuarial valuation was conducted that projected a total unfunded OPEB liability of $5.6 billion and an annual required contribution estimated at $516.2 million for fiscal 2009 based on a discount rate of 5%. The state, through legislation effective July 1, 2007, created an OPEB trust fund that currently has $85 million accumulated. The state plans to manage the annual required contribution over time with continued contributions, savings initiatives, and a review of benefits. In fiscal 2007, the amount contributed as a percent of payroll was approximately $5 million, which increased to $10 million in fiscals 2008 and 2009. For fiscal 2010, the state has committed $10 million of abandoned property revenues in excess of $374 million.

Related Criteria And Research

USPF Criteria: GO Debt, Oct. 12, 2006