STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

RatingsDirect®

Delaware; Appropriations; General Obligation

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Credit Profile		
US$225.0 mil GO bnds ser 2014C due 07/01/2034		
Long Term Rating	AAA/Stable	New
US$100.0 mil GO rfg bnds ser 2014B due 07/01/2026		
Long Term Rating	AAA/Stable	New

Rationale

Standard & Poor's Ratings Services has assigned its 'AAA' rating, and stable outlook, to Delaware's general obligation (GO) bonds, series 2014B and 2014C. At the same time, Standard & Poor's 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 rating reflects what we view as the state's:

- Relatively diverse economy, which continues to expand at a modest pace and in line with national trends;
- Strong financial and budget management;
- 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 addressing other postemployment benefits (OPEB) liabilities, which are significant.

We understand that bond proceeds will be used to fund various capital projects, including school projects, and to advance-refund a portion of the state's GO outstanding.

We believe Delaware's economy is relatively diverse following several decades of active economic development at the state level. Performance has been stable, in our view, with unemployment consistently below the nation's rate for the past 20 years. The 6.7% rate for 2013 compares favorably with the national rate of 7.4% and the mid-Atlantic region's 7.6%. As the state's labor force participation increases in 2014, the labor market is expanding with employment growth in professional and financial activities jobs, in particular. Based on IHS Global Insight Inc. projections, the state could return to pre-recession employment levels by third-quarter 2015. Economic development initiatives have included targeted statutory and tax policy changes to encourage financial sector, business services, pharmaceutical, and biotech expansion, and have reduced the state's reliance on traditional manufacturing. Although Delaware lost several large manufacturing firms during the recession, many of the sites have been acquired and are undergoing redevelopment. State income levels remain in line with the national average.

Delaware has a long history of what we view as prudent fiscal management. This includes making difficult decisions to restore budget balance when necessary, as well as managing surpluses when they occur, to retain structural budget balance.

The Delaware Economic and Financial Advisory Council (DEFAC) updates the revenue forecast six times per fiscal year. Since December 2013, DEFAC revised its fiscal 2014 revenue estimates downward by 4% to $3.57 billion driven primarily by softer collections in abandoned property and corporation tax revenue. Despite the revenue decline, the state reports a fully funded $201.7 million budget reserve fund of 5% at fiscal year-end, although estimated unencumbered cash levels of $18 million in fiscal 2014 are well below the state's December 2013 estimates. In June 2014, Delaware enacted its $3.8 billion fiscal 2015 general fund budget, which was about 2.5% above the fiscal 2014 budget and within the constitutionally prescribed limit of 98% of estimated general fund revenues. Budgeted appropriations reflect higher state Medicaid and public education spending due to a reduction in the state's Federal Medical Assistance Percentage (FMAP) and increasing K-12 enrollment. Projected fiscal 2015 revenue includes the redirection of certain escheat revenue into the general fund and certain corporation franchise tax and limited liability company (LLC) fee increases. The enacted fiscal 2015 budget also includes $212.5 million to fully fund the budget reserve account at 5% of estimated budgetary revenue in addition to an estimated unencumbered cash balance of $83.2 million at fiscal 2015 year-end. Delaware has not withdrawn funds from the budget reserve account since its inception in 1980. We believe the state's record of maintaining these reserves provides significant flexibility to respond to any deterioration in the macroeconomic outlook or other potential budget gaps.

Standard & Poor's 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, multiyear 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.

The state's pension funds have historically been well-funded with a long history of contributing the actuarial required contribution (ARC). Although the state's OPEB liability is substantial, it has been actively managing this in the past several years.

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 '1.5' to Delaware.

Outlook

The stable outlook reflects what we view as the state's healthy reserve and liquidity position, which has been relatively stable over a range of economic cycles. Proactive budget management has been a key to Delaware's credit stability and we believe that this will be an important consideration over our two-year outlook horizon, given the continued modest pace of economic recovery and spending pressures in key program areas of education and Medicaid as well as federal health care reform implementation.

Government Framework

In our opinion, Delaware has a strong government framework. Due to well-established policies, the state has maintained what we view as a solid financial position, especially during recessionary periods, including the recent recession. The Delaware Constitution requires that the governor submit a balanced budget to the general assembly annually. Although there is no legal requirement to maintain a balanced budget during the year, the DEFAC's frequent revenue and expenditures updates allow for timely adjustments. State statute provides the executive branch with the authority to make necessary adjustments after providing for the payment of principal and interest on Delaware's bonds, notes, or revenue notes. The state cannot carry forward operating deficits.

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 support the government framework. The state has what we regard as considerable revenue-raising ability; it can increase income tax and license fees as well as implement the imposition or the levy of new taxes or license fees with the concurrence of three-fifths of all members of each house. Public and higher education, and health and social services are the state's leading expenditures, accounting for more than 60% in fiscal 2013. Delaware pays 60%-80% of public school capital improvements on approval by the state board of education, with the school district paying the difference.

As debt service becomes due, the school districts are required to pay debt service into the state's budgetary general fund from their tax receipts; then the state pays the total debt service from its budgetary general fund appropriations. If Delaware fails to make sufficient provisions to pay principal and interest on any of the bonds, or if sufficient funds are unavailable at the time an amount is payable, state law requires the state treasurer to set apart a sum to pay principal and interest from the first revenues thereafter received by the state. Delaware does not permit for initiatives or referendums at the state or local level, and it is the only state that does not require popular approval of constitutional amendments.

On a four-point scale, where '1.0' is the strongest and '4.0' is the weakest, Standard & Poor's has assigned an overall score of '1.4' to Delaware's governmental framework.

Financial Management

Delaware's constitution, statutes, and internally developed policies guide its overall financial and budget management. Policy improvements have been made continuously and the state's track record of adhering to policies has been what we consider strong.

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

Key policies include:

- 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;
- Well-established debt management policies, including a three-part statutory debt affordability limit; and
- Multiyear revenue forecasts updated throughout the fiscal year with a less formal process for general operating expenditures.

Delaware maintains 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 they expect to span multiple years.

The three-part statutory debt affordability limit includes the following:

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 total maximum annual debt service (MADS) on debt outstanding 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.

No new state GO debt can be issued if, in any fiscal year, the MADS on existing 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.

Budget management framework

An executive order mandates DEFAC to submit budgetary general fund and transportation trust fund revenue forecasts to the governor and the general assembly six times a fiscal year -- in September, December, March, April, May, and June -- for the current fiscal year and the succeeding two fiscal years. Delaware uses these forecasts in the state budget process to ensure compliance with constitutional spending limits and statutory debt limitations. The state has a strong track record of implementing adjustments as needed.

On a four-point scale, where '1.0' is the strongest and '4.0' is the weakest, Standard & Poor's has assigned an overall score of '1.0' to Delaware's financial management.

Economy

Delaware's economy has continued to improve after the recession, led by employment growth in the professional and business services and financial activities sectors in the second quarter of 2014 compared to a year earlier, despite stagnant employment levels in the manufacturing sector. The largest employment sectors in 2013 included trade transportation and utilities (18%), education and health services (16%), government (15%), and professional and business services (13.6%). Despite some contraction during the recession, the financial services sector continues to account for a relatively larger proportion of employment in Delaware than it does nationally at 10.3% of total state employment in 2013 compared with 5.8% nationally. Although Dover Air Force Base is one of the state's major employers, overall federal government employment is limited and accounts for about 1.3% of total nonfarm employment, according to IHS Global Insight. The state's unemployment rate in July 2014 was 6.2%, which was in line with that of the nation.

The financial services sector remains well-anchored with about 80 bank and trust companies operating in the state with more than 26,000 employees, and remains a steady focus of economic development at the state level, with regular statutory and tax policy changes focused on creating economic incentives. Delaware's corporate statutes incentivize businesses to locate their headquarters in the state, which is the legal home for more than half of all publicly-traded firms in the U.S. Primary employers in the state among financial institutions include Bank of America NA, JPMorgan Chase & Co., Barclays Bank Delaware, and Capital One Financial Corp. Other leading private employers include the DuPont Co. and Christiana Healthcare System.

The other important segment of the economy and state tax base are the volume of business entities registered in Delaware, which now exceeds 1 million, after 152,000 were added in 2013 alone, according to the state. Delaware attributes its flexible corporate and legal entity statutes as well as its competitive business and legal environment to this significant level of new business formation.

Other economic development initiatives have centered on biotechnology, life sciences, and pharmaceuticals, which have been growth areas. Delaware's targeted investment in these industries and their proximity to aligned industry clusters in Maryland and New Jersey should position the state well for expansion. The state has established workforce development and education initiatives to foster innovation in targeted industries and is developing an incentive program to foster economic development in downtown districts across the state. The University of Delaware is developing the former site of a Chrysler plant into a research and health sciences complex. The state also introduced a sports lottery and legalizing internet gaming program to diversify and bolster its gambling industry, which faces increasing competition. After pharmaceutical company AstraZeneca plc announced job cuts as part of a restructuring, JPMorgan Chase purchased a 58-acre portion of its campus in Fairfax.

Delaware's population growth, averaging more than 1% annually in the past decade, has been relatively strong compared with that of the U.S. Per capita personal income is also above the national average, although we note it has increased more slowly than that of the nation in the previous decade. Personal income was 101% of the U.S. average in 2013 compared with 109% in 2003.

DEFAC updated Delaware's economic forecast in September 2014. We believe DEFAC's forecasts are reasonable and in line with our projections of the national recovery. The state projects personal income growth of 3.2% and employment growth of 2.2% in fiscal 2015. IHS Global Insight projects similar 1.9% employment growth but higher personal income growth of 4.7% in 2015. IHS Global Insight also forecasts real gross state product (GSP) to increase by 1.97% in 2015. Delaware's GSP per capita has historically remained well above GDP per capita and represented 128% of the U.S. in 2013; however, Delaware's GSP growth has lagged the national rate in the previous four years.

On a four-point scale, where '1.0' is the strongest and '4.0' is the weakest, Standard & Poor's has assigned an overall score of '1.5' to the state's economic factors.

Budgetary Performance

Delaware's tax and revenue structure is broad, in our opinion. 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. Delaware does not levy ad valorem taxes on real or personal property and does not impose a general sales or use tax. The budget reserve account has been a stabilizing factor to the state's overall financial profile and liquidity. The budget reserve account, or rainy-day fund, is funded at 5% of estimated budgetary general fund revenues. Officials can appropriate this money only with the approval of a three-fifths vote of the members of each house of the general assembly, and they can only use the money to fund an unexpected budgetary deficit or to provide funds required due to the enactment of legislation reducing revenue. Officials have not withdrawn any funds from the budgetary reserve account since its inception in 1980. In addition, the state has the authority to inter-fund borrow from special funds, which are available to meet the state's liquidity needs; the state has not needed to issue external revenue anticipation notes for liquidity needs since fiscal 1977.

Fiscal 2014 year-end estimates and enacted fiscal 2015 budget

Fiscal 2014 budgetary general fund expenditures exceeded actual fiscal 2014 revenue as estimated by the September DEFAC by $221 million after revenue collections fell short of projections. Although estimated unencumbered cash balances fell to $18 million at fiscal 2014 year-end from $160.5 million in the previous year, the state did not access its budget reserve account, which ended the year with an estimated $201.7 million, or 5% of expenditures.

DEFAC's most recent September 2014 revenue estimate for fiscal 2015 approaches $3.95 billion and reflects 10.4% revenue growth compared to fiscal 2014 actual collections after incorporating corporation franchise tax and LLC fee increases ($41.6 million), as well as the redirection of previously segregated abandoned property revenue into the general fund ($68.9 million). In addition, a delay in the timing of certain corporation tax receipts that were originally expected in fiscal 2014 lends to inflation in fiscal 2015 receipts. Excluding this revenue, state officials estimate fiscal 2015 revenue projections represent about 5% growth compared with fiscal 2014 levels. Personal income is the largest tax source (31% of total revenues) and is projected to rise by 3.2% compared with fiscal 2014. Revenue from franchise taxes and limited partnership and LLC fees, net of refunds, represent 22% of the total.

The transfer of abandoned property revenue to the general fund follows a statutory change in 2013 that was intended to limit the amount of general fund reliance on this source. In addition, in fiscal 2014, the state committed future annual abandoned property receipts above $514 million to be used for kindergarten to grade 12 education, debt reduction, and OPEB costs, which also somewhat limits the general fund's reliance on these receipts although it still accounts for about 14% of total revenues in fiscal 2015 and is the third-largest revenue source for the general fund. Given unclaimed property laws, the large presence of corporate headquarters located in Delaware results in the state accounting for 10% of all abandoned property in the country. Delaware implemented a voluntary disclosure program for companies to comply with its unclaimed property laws. The program allows participants to shorten the look-back period and avoid audits. Delaware believes that greater participation among the corporations could help to raise the baseline annual abandoned property revenue to the state and reduce some of its costs as well as some of the uncertainty and delays in revenue related to involuntary audits.

The $3.8 billion general fund budget for fiscal 2015 incorporates higher funding for public education and health and social services as state-supported public school enrollment growth has averaged 1% annually in the past five years and Delaware continues with implementation of the Affordable Care Act, including the expansion of Medicaid. A key budget driver for fiscal 2015 is a lower FMAP for current Medicaid caseloads. The rate was lowered to 53% from 55% based on the relative improvement in Delaware's income levels. The budget also included a small salary increase for state employees. Continued enrollment increases and any further FMAP changes could represent significant funding pressure given that, combined, they represent 63% of total general fund spending. The state's rainy-day fund remains fully funded in the fiscal budget, at $212.5 million.

Fiscal 2013

On a generally accepted accounting principles (GAAP) basis, Delaware's total fiscal 2013 ending general fund balance increased by 3.6% from the previous year to almost $1.5 billion, or 23.5% of operating expenditures. Of that total, $1 billion was unassigned. Total general fund revenue has increased since fiscal 2009 to $4 billion in fiscal 2013, due primarily to growing combined personal income and corporate taxes. Approximately half of the state's general revenues are composed of business taxes and 27.6% of fiscal 2013 general fund revenue came from personal taxes. The state accounts for non-appropriated federal and local school district special funds outside of the general fund on a GAAP basis.

Delaware reported a $637 million total general fund balance in fiscal 2013, including continuing and encumbered appropriations of $276 million, an undesignated fund balance, and the budget reserve account of $199 million, fully funded at 5% of estimated budgetary general fund revenue. The state has not historically used its budget reserve account to fund operations.

On a four-point scale, where '1.0' is the strongest and '4.0' is the weakest, Standard & Poor's has assigned an overall score of '1.3' to Delaware's budgetary performance.

Debt And Liability Profile

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. We view total tax-supported debt, including GO and transportation bonds, as moderately high. Delaware issues debt for political subdivisions. It pays from 60%-80% of the cost of capital improvements for public school districts on approval of such costs; the school districts pay the remaining portions supported by local property taxes. State-supported GO debt was almost $1.3 billion as of June 30, 2014, excluding $538 million, which is supported by the local school districts. Delaware's other major bonding program is associated with the Delaware Transportation Authority, which issues revenue bonds supported primarily by motor fuel taxes, motor vehicle fees, and turnpike tolls. Total tax-supported debt in fiscal 2013 including GO, transportation, and appropriation obligations, is moderately high relative to that of state peers, at $2,396 per capita and 5.3% of personal income. We estimate total tax-supported debt service carrying charges, after excluding the local school district support, were a moderate 5.9% of governmental spending in fiscal 2013. Debt amortization is rapid, in our opinion, with about 70% of GO principal scheduled to retire in the next 10 years.

The capital budget for fiscal 2014 totals $421 million. The plan includes GO debt issuance of $242 million. The 2014 legislature rejected a proposed 10-cent motor fuel tax increase for overall transportation infrastructure investment and bonding. Instead, the $155 million capital projects budget included authorization for an additional $20 million of transportation trust fund debt supported, in part, by a weekend toll rate increase. Statutes provide for public-private partnerships but the state has not pursued such financings to date.

Delaware does not have any variable-rate debt outstanding, and it has not entered into any interest-rate swap agreements or related derivative transactions.

Pensions and OPEBs

Compared with other state pension systems, the state has funded its pension system well, in our opinion. 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 2013, the plan had what we view as a strong funded ratio of 91.1%. The state's fiscal 2013 contribution to this plan totaled $161 million, or about 4% of general fund expenditures. One of DPERS' nine pension funds, the Closed State Police Pension Plan, has a 0.9% funded ratio because the state funds this plan through pay-as-you-go financing. The liability for this plan is significant in our view, at $291 million. Other than the police pension plan, Delaware has funded its remaining pension plans well. The state lowered its long-term investment return assumption for the State Employees' Pension Plan to 7.2% in fiscal 2015 from 7.5%, following a previous reduction in the assumed rate from 8.0% in fiscal 2011, which is more consistent with historical long-term performance, in our view, despite a favorable 11.0% actual market value return in fiscal 2013.

As of June 30, 2013, Delaware's unfunded actuarially accrued liability for OPEBs is what we consider a sizable $5.8 billion, or $6,228 per capita, using a blended rate of return assumption of 4.25%. The ARC is estimated at $398 million in fiscal 2013, compared to actual contributions of $209 million (4.8% of general fund expenditures). The state has actively managed this liability, in our view, and we expect these efforts to continue. In 2007, Delaware created an OPEB trust fund, which had limited assets of $222 million accumulated as of July 1, 2013.

Legislation from 2011 instituted various reforms to the state's pension and OPEB. The legislation establishes a fixed cost share in Delaware's health insurance programs for both active employees and retirees and increases the time to vest for retiree health care benefits. The liability was also lowered by the state's participation in an employer group waiver plan (effective Jan. 1, 2013), which offsets costs of retiree pharmacy benefits subsidized by the Centers for Medicare and Medicaid Services. Fiscal 2014 legislation redirects a portion of any abandoned property revenue collections above $514 million in the general fund to OPEB contributions, which could help to build the OPEB trust and moderate costs in the future.

On a four-point scale, where '1.0' is the strongest and '4.0' is the weakest, Standard & Poor's has assigned an overall score of '2.5' to Delaware's debt and liability profile.

Related Criteria And Research

Related Criteria

- Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions, Nov. 19, 2013
- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Financial Management Assessment, June 27, 2006

Related Research

- U.S. State And Local Government Credit Conditions Forecast, July 8, 2014

Ratings Detail (As Of October 8, 2014)		
Delaware GO bnds		
Long Term Rating	AAA/Stable	Affirmed
Delaware GO		
Long Term Rating	AAA/Stable	Affirmed
Sustainable Energy Util, Inc., Delaware		
Delaware		
Sustainable Energy Utility, Inc. (Delaware) rev		
Long Term Rating	AA+/Stable	Affirmed