S&P Global
Ratings

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State of Delaware; Appropriations; General Obligation

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Credit Profile		
US$260.0 mil GO bnds ser 2022 due 03/01/2042		
Long Term Rating	AAA/Stable	New
Delaware GO		
Long Term Rating	AAA/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AAA' rating to the State of Delaware's approximately $260 million series 2022 general obligation (GO) and GO refunding bonds, consisting of about $218 million of new money for various capital projects and about $33.5 million for a current refunding of a portion of the series 2014 bonds. At the same time, S&P Global Ratings affirmed its 'AAA' rating on Delaware's GO debt outstanding and its 'AA+' long-term rating on the state's appropriation debt outstanding. The outlook is stable.

Delaware's full faith and credit pledge secures the 2022 bonds as well as the state's GO debt outstanding.

Credit overview

Delaware's longstanding practice of at least five Delaware Economic and Financial Advisory Council (DEFAC) meetings per year, coupled with increased federal aid has allowed the state to remain fiscally strong through the COVID-19 pandemic. DEFAC's regular reporting has allowed the state to adjust revenue expectations and expenditure allocations as needed, resulting in regular general fund surpluses. The state has been able to maintain a high level of liquidity, and fiscal 2022 is expected to close with another surplus. Through December 2021, these positive fiscal outcomes have also allowed the state to build a $287.3 million budget stabilization fund (BSF) and maintain a fully funded $280.3 million rainy day fund. The governor's presented $4.9 billion fiscal 2023 general fund budget continues to build on these strengths, appropriating less than 98% of DEFAC-determined available revenues, meeting the 98% DEFAC guidance, continuing to fully fund the rainy day fund at 5.0% of general fund operating expenditure, and keeping the BSF at 5% of gross revenues. These reserve balances are an all-time nominal high level and the state does not expect to draw upon them in fiscal 2023.

The 'AAA' rating on Delaware's GO bonds also reflects our view of the state's:

- Demonstrated history of proactive fiscal management, well-embedded strong financial policies and practices;
- Strong and resilient budgetary performance during a period of pandemic-induced operating pressures, and the buildup of the rainy day fund and the BSF in fiscal 2022 to $567.6 million, or 11.9% of general fund expenditures; and
- Moderate debt with rapid amortization and overall strong funding and governance of pension liabilities.

We believe these strengths are partially offset by the growing credit pressure stemming from the state's unfunded other postemployment benefits (OPEB) liabilities, which we consider significant. The state is beginning to address the $9.4 billion liability in the governor's fiscal 2023 recommended budget by allocating 1% of the previous year's extraordinary revenues into the OPEB trust fund; in fiscal 2023 that would be about $47.7 million.

The governor's fiscal 2023 budget proposal represents 4.6% growth over the adopted fiscal 2022 budget. The DEFAC's estimates as of December 2021 made further positive adjustments to projected revenues as has been the case in recent DEFAC reports, reflecting the resilience of revenues in Delaware during the pandemic. The latest projections show slightly increased revenues for fiscal 2022 at 2.6% higher than forecast in October. The forecast for fiscal 2023 held steady, with revenues now expected to shrink 0.7% compared with fiscal 2022 projected revenues.

Delaware was allocated more than $4 billion in federal revenue from the various pandemic response bills. The $1 billion in CARES Act funds was used to respond to the virus' impact on the people and economy of the state. The state is using the $925 million from the American Rescue Plan for technology upgrades, housing assistance, and health care and hospital support, among other uses. The state will use the $2.4 billion it will receive from the Infrastructure Innovation and Jobs Act in conjunction with the existing state capital plan to address roadways, bridges, water and wastewater plant, and to improve transit access. Although these are primarily credit supportive, S&P Global Ratings sees potential risk from all governments receiving these funds in using this one-time money for recurring expenditures, but to date Delaware has treated these funds as nonrecurring.

The largest credit weakness is the state's OPEB funding status, as Delaware's unfunded OPEB liabilities have increased significantly. However, the implementation of various pension reforms over the past two decades demonstrates the state's ability to address long-term liabilities through legislative actions. As of fiscal 2020, the state's $9.4 billion share of the net OPEB liability (NOL) is among the largest in the nation on a per capita basis, at $9,515. Looking ahead, we expect annual contribution requirements will escalate because contributions are funded on a pay-as-you-go basis, which given medical cost trends nationally, could lead to OPEB costs outpacing annual revenue growth. We believe the state's history and ability to pass and implement retirement reforms positions Delaware well, compared with many other states without such flexibility. A 2019 gubernatorially established committee to study OPEB returned findings in a report released in November 2021, and the state is beginning to consider those recommendations.

Based on the analytic factors that we evaluate for states, we assigned a total score of '1.5' to Delaware under our state ratings methodology, in which '1.0' is the strongest score and '4.0' the weakest. This score corresponds to a 'AAA' GO rating.

The stable outlook reflects Delaware's strong fiscal management that has allowed the state to proactively manage its budgets through the pandemic and has been key to the state's long-term credit stability.

Environmental, social, and governance

We believe the state's environmental risks are elevated for the sector, given its geographical exposure to ocean storms and Delaware and Christiana River flooding, which could increase infrastructure costs and particularly affect coastline communities, some of which are also economically dependent on tourism. In response, in November 2021, Delaware adopted a climate action plan focusing on reducing greenhouse gases and maximizing resilience to climate change. The state also considers these risks within the capital plan. We consider Delaware's social risks to be generally in line with the sector. Despite having a higher-than-average age dependency ratio, Delaware is managing any associated cost risk and the state is benefiting from population growth. However, we believe Delaware's governance risks are below those of our view of the sector as a whole, as the state has strong constitutional provisions and operational practices that encourage good governance.

Stable Outlook

Downside scenario

We could lower the rating if we believe weakened long-term economic trends or rising costs expose the state to challenges uncharacteristic of the rating level. Downward pressure could also arise if the state's budget or reserve profile were to be challenged--stemming from elevated retiree health care liabilities, soft revenues, the outcome of current litigation surrounding unclaimed property, or other factors--to a degree we feel is not commensurate with the rating level. Furthermore, inaction in addressing Delaware's elevated retiree health care liabilities during our outlook horizon could affect the state's credit quality.

Credit Opinion

Debt And Liability Profile

The state has focused 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 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 $1.7 billion as of June 30, 2021, excluding $512.4 million that the local school districts support. Delaware's other major bond program is associated with the Delaware Transportation Authority, which issues revenue bonds supported primarily by motor fuel taxes, motor vehicle fees, and turnpike tolls. Delaware does not have any variable-rate debt outstanding, and it has not entered into any interest-rate swap agreements or related derivative transactions.

Total tax-supported debt in fiscal 2021, including GO, transportation, and appropriation obligations, is moderately high relative to that of state peers, at $3,434 per capita and 6.2% of personal income. Debt amortization is rapid, in our opinion, with about 70% of state-supported debt scheduled to be retired in the next 10 years, inclusive of this current issue.

Strong pensions offset with weak OPEB funding

Delaware's pensions are well funded compared with those of other states, with what we consider a strong funded ratio as of June 30, 2021, of 108% across the five pension plans for which the state reports liability. 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. We also note that aggregate annual plan contributions for the pension system exceeded our calculation of minimum funding progress or 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 continued funding of these liabilities at this level is a credit strength. Compared with other state pension systems, Delaware has funded its pension system well, in our opinion and we expect the state can maintain this high funded ratio.

The state reports a liability for five of the nine plans offered by the Delaware Public Employees' Retirement System (DPERS): state employees, special, new state police, judiciary, and closed state police. The state's three-year-average pension-funded ratio across these five plans is strong, at 92.2% as of fiscal 2021. The State Employees Retirement System (SRS) represents 90.1% of the state's total unfunded pension liability as of June 30, 2021, and is 110% funded, thanks to a 38.4% return in fiscal 2021 (the state reports this is the highest return on state-level pension funds nationally). Contributions for SRS, special, new state police, and judiciary plans are actuarially based, and funding has historically met 100% of the actuarially determined contribution, which we view as a credit positive. We view the SRS's current assumed rate of return of 7.0% as about average, but it could result in contribution volatility over time, especially in combination with an open amortization period and level-percentage-of-pay amortization method.

Credit risks reside in the future treatment of funding OPEB obligations. In our view, Delaware's unfunded retiree health care liabilities are significant and will increase in future years, given the state's pay-as-you-go funding approach. Again, the state share of the NOL was $9.4 billion in fiscal 2020, which translates into a NOL per capita of $9,515. We believe Delaware's ability to pass and implement reforms will remain important in supporting the state's credit profile. The state offers retiree health care benefits through a cost-sharing, multiple-employer, defined-benefit plan administered by DPERS. Coverage is available to retirees and eligible dependents covered under the state employees', new state police, judiciary, and closed state police pension plans.

Delaware has a history of making changes to manage the increasing liability. The state began prefunding its retiree health care benefits with lump-sum payments and contributions based on a percentage of payroll in 2002 and 2003. It also established an OPEB trust in 2007. Since its inception, the trust has received some funds from abandoned property revenues, Medicare Part D subsidies, and an annual percentage of payroll contributions. Contributions, however, have typically been on a pay-as-you-go basis. Consequently, the funded ratio is a very low 6.0% as of June 30, 2021. Lack of prefunding will likely cause reported unfunded OPEB liabilities and costs to escalate in future years if the state does not implement further reforms. We expect the state's committee to study OPEB will lead to legislative changes to reduce this liability in the years to come.

On a four-point scale, where '1.0' is the strongest and '4.0' is the weakest, S&P Global Ratings assigned an overall score of '2.1' to Delaware's debt and liability profile.

Economic resilience through the pandemic

Rising vaccination rates and government mandates to help control the spread of the virus have allowed Delaware's economy to mostly reopen. Overall economic performance has been historically stable, in our view, and this will likely continue. Personal income, employment gains, and economic growth are forecast to be in line with the national rates through 2025, according to IHS Markit. The state is somewhat concentrated in financial services jobs, with 10.3% of jobs in this sector in 2021, which we believe exposes Delaware to some risk. However, we understand there has been diversification within this sector and the state is investing in economic development programs to help further diversify. High tech, chemical, and distribution companies are expanding in the state, with multiple companies expecting to increase employees by 400-500. For 2020, Delaware's unemployment peaked during the recession at 13.4%, but as of December 2021 was back down to 5.0%, and we expect the state's unemployment will be in line with or below the national average over the next couple of years.

On a four-point scale, where '1.0' is the strongest and '4.0' is the weakest, S&P Global Ratings assigned an overall score of '1.8' to the state's economic factors.

While the U.S. economic recovery is well underway and the prospect that COVID-19 is transitioning from pandemic to endemic, supply chain disruptions remain the largest stumbling block, leading S&P Global Economics to lower its U.S. GDP growth forecast to 5.5% for 2021 and 3.9% for 2022 (from 5.7% and 4.1%, respectively). Although some supply constraints show signs of easing, S&P Global Economics expects price pressures will persist into 2022 and inflation will not reach the Federal Reserve's 2% target until late 2023. Despite the slowdown, GDP rose to a 37-year high in 2021, with solid readings for 2022, on continued economic demand from healthy balance sheets. The U.S. economy has felt less impact with each wave of the virus, and it has withstood the damage; however, real-time data incorporating the effects of the fast-spreading omicron variant show it could stymie mobility and soften economic measures at the start of 2022. We maintain our assessment of U.S. recession risk over the next 12 months at 10%-15%, which is our lowest assessment in six years. For more information, see "Economic Outlook U.S. Q1 2022: Cruising At A Lower Altitude," published Nov. 29, 2021, on RatingsDirect, and "U.S. Real-Time Data: High Prices Dampen Economic Activity And Moods," published Jan. 28, 2022.

Litigation risks could affect revenues

Delaware faces several lawsuits about its claim to certain unclaimed properties. The state is litigating claims involving 30 states that allege Delaware improperly accepted certain abandoned property that should have been escheated to those other states. A special master report largely sided with the litigants, but the state filed objections to the report, and the U.S. Supreme Court is expected to decide on the outcome soon. The state's potential aggregate litigation exposure (across multiple claims) could exceed $200 million. The state reports it has considered this potential exposure in its revenue forecasts and reserve levels, should the decision be adverse to the state.

Strong financial management a hallmark of the 'AAA' rating

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. The state has implemented various debt management policies to decrease its debt burden and limit bond issuance. These measures have reduced Delaware's debt level, despite the broad role the state maintains in funding capital requirements for education, transportation, and corrections.

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

Budgetary performance and fiscal 2020 results show resilience

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 5.1% of estimated fiscal 2022 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.

Delaware has the authority to use interfund borrowing from special funds, which are available to meet the state's liquidity needs. Delaware has not needed to issue external revenue anticipation notes for liquidity since fiscal 1977.

Delaware posted a $97 million operating surplus (1.6% of general fund expenditures) to its general fund as of June 30, 2021, following a similar-size operating surplus as of June 30, 2020. Like most states, Delaware's fiscal 2021 total general fund revenues increased significantly by $964.8 million (18.9%) and general fund expenditures also increased significantly, by $954.6 million (19.0%). We believe the adjustments made to spending demonstrates Delaware's ability to adjust to the varied revenue and expenditure trends during the budget year. When incorporating other sources and uses of financial resources, the state's general fund finished fiscal 2021 with a total fund balance of $2.1 billion, an 25% increase from $1.7 billion in fiscal 2020. Within this total, Delaware's unassigned fund balance was $1.2 billion.

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

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, 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.

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 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, S&P Global Ratings assigned an overall score of '1.4' to Delaware's governmental framework.

Delaware's varied credit strengths and independent treasury function allow a rating above the U.S. sovereign

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), 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.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Ratings Detail (As Of February 9, 2022)		
Delaware GO		
Long Term Rating	AAA/Stable	Affirmed
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Sustainable Energy Util, Inc., Delaware		
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Long Term Rating	AA+/Stable	Affirmed