MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns Aaa to Delaware's $325M Series 2014 General Obligation Bonds; outlook stable

Global Credit Research - 06 Oct 2014

Delaware has $2.3B of net tax-supported debt outstanding

DELAWARE (STATE OF)
State Governments (including Puerto Rico and US Territories)
DE

Moody's Rating

ISSUE		RATING
General Obligation Bonds - Series 2014C		Aaa
Sale Amount	$225,000,000	
Expected Sale Date	10/24/14	
Rating Description	General Obligation	
General Obligation Bonds - Series 2014B		Aaa
Sale Amount	$100,000,000	
Expected Sale Date	10/24/14	
Rating Description	General Obligation	

Moody's Outlook STA

Opinion

NEW YORK, October 06, 2014 --Moody's Investors Service has assigned an Aaa rating to the State of Delaware's General Obligation Bonds, Series 2014B and 2014C. The bonds, expected to have a par amount of approximately $325 million, will price on or around October 24.

SUMMARY RATING RATIONALE

Delaware's very strong financial management characteristics and history of maintaining ample budgetary reserves through recent economic cycles support a Aaa, the highest long-term debt rating, on the state's general obligation (GO) bonds.

STRENGTHS

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

* Very strong reserve levels to stabilize state finances in the event of a future economic downturn

CHALLENGES

* Large debt burden relative to population and income

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

DETAILED CREDIT DISCUSSION

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) at the end of the fiscal year. This funding may be accessed only by a three-fifths vote of the members of each chamber of the legislature 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 contained $202 million at the end of fiscal year 2014. It has never been used, and the state at this time does not plan to use it.

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.

FISCAL 2015 BUDGET: EXPENDITURE RESTRAINT AND INCREASED FRANCHISE FEES

The fiscal 2015 budget maintains spending within expected revenue growth and fully funds the rainy day fund. The budget totals $3.8 billion, or 2.5% more than the prior year. Cost drivers include a 2.9% increase in health and social services and a 2.0% increase in public education according to the September DEFAC meeting. DEFAC increased its forecast for general fund revenue growth in fiscal 2015 to 10.4% from 8.9% in June. Personal income taxes, about one third of general fund revenues, are expected to growth 3.2%, a reasonable assumption given the recovery in the state's labor market. Franchise and limited partnership taxes, 22% of general fund revenues, are expected to grow 8.2% in fiscal 2015 primarily because of an increase in limited liability company fees (to $300 from $250). This fee increase is modest and will not endanger Delaware's status as home to half of all publicly traded US firms, which is rooted in state corporate law and a well-developed body of case law.

The state's accumulation of significant reserves insulates it from potential future revenue downturns or unanticipated spending pressures. The $1.0 billion unassigned general fund balance as of fiscal 2013 represented 25% of revenues, one of the largest balances among all states. We expect the state to maintain this level of reserves through tight controls on spending, facilitated by its frequent revenue forecast revisions.

ECONOMIC RECOVERY CONTINUES

The state's economy has been recovering roughly in parallel to the rest of the nation. The state added 9,600 in the 12 months ending with August, but remains 3,000 shy of recouping all 48,600 jobs lost during the recession. The state's financial sector, 10% of the employment base and 42% of the gross state product, continues to grow steadily. Health and education has provided stability and jobs growth through the recession and subsequent recovery. The national resurgence in auto manufacturing largely bypassed Delaware and the state's manufacturing employment is stagnant.

RELATIVELY HIGH DEBT LEVELS

Delaware's debt burden is high relative to other states, with net tax-supported debt per capita of $2,485, compared to the national median net tax-supported debt per capita of $1,054. Delaware's debt amounts to about 5.7% of the state's personal income, based on the 2014 Debt Medians Report. This puts Delaware eighth 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.

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 and has not issued bond- or revenue-anticipation notes since the 1970s.

PENSION LIABILITY MANAGEABLE

Delaware's fiscal 2012 adjusted net pension liability, $5.8 billion , amounted to 98.6% of state governmental revenues, ranking 15th-highest among states, compared with a 63.9% median.

To address other post-employment benefit (OPEB) liabilities, the state created a dedicated trust for OPEB-related payments. The fund had $222 million as of December 31, 2013. Although this represents only 3.7% of the actuarial accrued liability, most states have not begun to fund OPEB liabilities. In 2011 the state enacted a law that made significant modifications to employee health care insurance and pension programs. The legislation established a fixed cost share in the state's health insurance programs for both active employees and retirees and increased the time to vest for retiree health benefits. Benefit reforms reduced the actuarial liability down from to $6.0 billion from $6.8 billion.

OUTLOOK

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

WHAT COULD MAKE THE RATING GO DOWN

o Significant increase in debt levels

o Economic contraction that undermines Delaware more than other states

o Erosion of trend of strong financial management

RATING METHODOLOGY

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

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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Analysts

Julius Vizner
Lead 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

Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
USA