

**RATING ACTION COMMENTARY**

# **Fitch Rates Delaware's \$33MM GO Bonds 'AAA'; Outlook Stable**

Thu 04 Jun, 2020 - 12:12 PM ET

Fitch Ratings - New York - 04 Jun 2020: Fitch Ratings has assigned an 'AAA' rating to the following state of Delaware GO bonds:

--\$33.1 million GO refunding bonds, series 2020B.

The bonds will refund outstanding GO bonds for debt service savings, including for budgetary relief in fiscal 2021. The bonds are scheduled to be sold via negotiation on or about June 7, 2020.

Fitch has also affirmed the following State of Delaware ratings:

--Issuer Default Rating (IDR) at 'AAA';

--\$1.97 billion in outstanding GO bonds at 'AAA'.

The Rating Outlook is Stable.

**SECURITY**

The bonds are a general obligation, full faith and credit obligation of the state of Delaware.

## **ANALYTICAL CONCLUSION**

Delaware's 'AAA' Issuer Default Rating (IDR) and GO bond rating are based on strong financial operations that are supported by proactive management and institutionalized protections designed to ensure surplus operations. The state has considerable economic resources, which have grown through deliberate policies to maintain a climate attractive to banking and related entities; however, long-term revenue growth has been slow and is expected to only track inflation. Long-term liabilities are above the state median, reflecting, in part, debt issuance for purposes that are addressed at the local government level in most other states. Pensions are well funded.

## **ECONOMIC RESOURCE BASE**

Delaware's economy is largely based on service-providing enterprises, including financial activities, professional and business services, and education and health organizations. After several years of relatively strong employment growth as the state emerged from the Great Recession, growth began to slow in 2016 and remained slightly below the pace of U.S. growth leading into the downturn. Per capita personal income is slightly below the national average, and rising at a slower pace than the national average.

On March 12, 2020, in efforts to mitigate coronavirus' spread, the governor declared a state of emergency and subsequently closed all nonessential businesses in the state. Between the week which ended March 14 and May 28, initial unemployment claims in Delaware totaled approximately 102 thousand, or 21.9% of the labor force. This compares to 23.8% nationally and ranks Delaware 25th highest on this metric. Delaware kept many industries open, including manufacturing, most professional services and some retail. The state has moved into the first phase of reopening closed businesses, including the state's beaches, some personal services, and some retail with curbside pick-up, with continued social distancing requirements and low occupancy.

## **KEY RATING DRIVERS**

### **Revenue Framework: 'aa'**

Financial operations are supported by a diverse array of revenue sources with the personal income tax (PIT) accounting for the largest share at approximately one-third. Delaware also leverages its status as the legal home to over half of all publicly-traded corporations in the U.S. and assesses taxes on limited partnerships, franchises and other business entities. This structure results in a revenue framework that is sensitive to national economic trends.

### **Expenditure Framework: 'aaa'**

While carrying costs for debt and retiree benefits are above the U.S. states median, Delaware has demonstrated ample expenditure flexibility and the broad expense-cutting ability common to most U.S. states. Moreover, the state abides by its statutory restriction to budget 98% of expected revenue, providing a cushion for revenue variability. Education is a key cost driver as the state is highly involved with funding local education, including funding employer pension contributions for school district employees.

### **Long-Term Liability Burden: 'aa'**

The state's long-term liabilities are a moderate burden on resources. Debt levels are above average for a U.S. state given the state's role in issuance for projects usually funded at the local level and have modestly ticked upward following years of decline. Pensions are well funded although other post-employment benefit (OPEB) obligations are sizable.

### **Operating Performance: 'aaa'**

The state has exceptional financial resilience strong financial management that has contributed to the maintenance of ample financial cushion through the economic cycle. The ongoing monitoring of revenues and operating expenditures mitigates the effect of volatility in revenues and allows for rapid gap closing.

## **RATING SENSITIVITIES**

Factors that could, individually or collectively, lead to a positive rating action/upgrade:

--Not applicable.

Factors that could, individually or collectively, lead to a negative rating action/downgrade:

--An inability to address the fiscal challenges triggered by the expected short-term but severe economic contraction, as evidenced by an inability to make sufficient budget adjustments, leaving the state less financially resilient at the end of the recovery period.

--Economic contraction extending well into the second half of the year or beyond, consistent with Fitch's coronavirus downside scenario, which triggers sustained and deep revenue declines and materially erodes the state's gap-closing capacity.

## **BEST/WORST CASE RATING SCENARIO**

International scale credit ratings of Public Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit

<https://www.fitchratings.com/site/re/10111579>.

## **CURRENT DEVELOPMENTS**

The recent outbreak of the coronavirus and related government containment measures worldwide creates an uncertain global environment for U.S. state and local governments and related entities in the near term. As severe limitations on economic activity only began very recently, most state governments' fiscal and economic data do not reflect any credit impairment. Material changes in revenues and expenditures are occurring across the country and likely to worsen in the coming weeks and months as economic activity suffers and public health spending increases. Fitch's ratings are forward looking, and Fitch will monitor developments in state and local governments as a result of the virus outbreak as it relates to severity and duration, and incorporate revised expectations for future performance and assessment of key risks.

In its baseline scenario, Fitch assumes sharp economic contractions hit major economies in the 1H20 at a speed and depth that is unprecedented since World War II. Recovery begins from the 3Q20 onward as the health crisis subsides after a short but severe global recession. GDP remains below its fourth quarter 2019 level until mid-2022. Additional details, including key assumptions and implications of the baseline scenario and a downside scenario, are described in the April 2020 report "Fitch Ratings Coronavirus Scenarios: Baseline and Downside Cases - Update" and "Fitch Ratings Updates Coronavirus Scenarios for U.S. State and Local Tax-Supported Issuers" on [www.fitchratings.com](http://www.fitchratings.com).

### **Federal Aid Provides Some Support for State Budgets**

Enacted federal aid measures will benefit state budgets, although details remain fluid. The Families First Coronavirus Response included a 6.2% increase in the Federal Medical Assistance Percentage (FMAP) for Medicaid for every quarter of the national emergency declared by the president on March 13. FMAP is the rate at which the federal government reimburses states for Medicaid spending. Delaware is receiving roughly \$35 million for each quarter of the national emergency.

Under the Coronavirus Aid, Relief and Economic Security (CARES) Act enacted on March 27, the U.S. Treasury department distributed \$150 billion to state and local governments using a population-based formula. The statute limits the use of funds to coronavirus expense reimbursement rather than to offset anticipated state tax revenue losses. Delaware and its one eligible local government, New Castle County,

received \$1.25 billion from the U.S. Treasury, of which \$927 million flowed directly to the state.

The Federal Reserve's \$500 billion Municipal Liquidity Facility (MLF) provides a potential source of short-term liquidity for state and local governments. Under the MLF, the New York Federal Reserve Bank will set up a special purpose vehicle (SPV) to directly purchase short-term debt issued by states, the District of Columbia and the largest counties and cities. Under terms of the program, Delaware could borrow up to \$1.2 billion to address the state's own cash flow needs.

### Delaware Liquidity Update

Fitch considers Delaware well positioned to address liquidity pressure emanating from the coronavirus pandemic and related economic downturn with no interruption in timely payments for key operating expenses, including debt service. The general fund cash position was strong leading into the downturn, with positive revenue performance contributing to an increase in the unencumbered general fund cash balance from \$377.5 million at the beginning of fiscal 2020 to \$593.5 million just prior to the onset of the emergency. The state anticipates drawing on the unencumbered cash balance to address the impact of the downturn including the shift of the state tax filing deadline to July 15 in conformance with the federal tax filing deadline. The budget had also set aside just under \$100 million per the constitutional 98% budgeting requirement, \$252 million in the budget reserve account (BRA), and \$126 million in the budget stabilization fund (BSF). The two reserve accounts provide a cushion of 8.6% of fiscal 2020 revenues. The state has indicated that it does not currently expect to utilize interfund or cash flow borrowing for liquidity purposes, although it notes that there are sizeable balances (\$2.9 billion) in state special funds should liquidity become tight.

### Delaware Budget Update

As is the expectation for most U.S. states, Fitch anticipates Delaware's revenue collections, particularly for the personal and corporate income taxes, and the gross receipts tax, to experience weakness through this period of reduced activity. The Delaware Economic and Financial Advisory Council (DEFAC) has lowered the general fund revenue forecast for fiscal 2020 by \$325 million as of May 2020, as compared to the December 2019 forecast, and by \$195 million (4.2%) as compared to the original budget, leading to a year-over-year decline of 3.8%. In addition to drawing down general fund cash, the state has taken action to control spending and

increase reversions to the general fund. The state has indicated that it does not intend to draw on the rainy fund in fiscal 2020.

The May DEFAC forecast anticipates a 2.5% revenue increase in fiscal 2021, as compared to the lowered fiscal 2020 forecast, taking into account the receipt of deferred tax revenues in July. The budget for fiscal 2021 is still under consideration by the Delaware legislature. With a minimal balance expected to be carried into fiscal 2021, the budget will likely rely on spending reductions, federal coronavirus relief funds, and some use of reserves to balance. The current refunding also provides some immediate budgetary relief.

Delaware's history of exceptional financial resilience and strong budget management may be tested by the depth and duration of this downturn. Fitch coronavirus baseline scenario indicates a first-year decline in Delaware's revenues of 20.8%, followed by a 9.1% increase and cumulative result over the three-year scenario of a 10.1% decline. This compares to the state median decline of 16.6% in the first year and negative 5.7% over the three-year scenario. Fitch believes the state would be challenged to address Fitch's downside scenario, which identifies a 39.9% first-year revenue decline. However, Delaware's close tracking of both revenues and expenditures and frequent revenue forecast updates have historically allowed it to quickly respond to changing economic conditions. These practices have proven to be critical to sustaining financial balance and Fitch anticipates the state will take appropriate action to maintain balance should revenue expectations weaken.

## **CREDIT PROFILE**

For additional information on Delaware, please see "Fitch Rates Delaware's \$300MM GO Bonds 'AAA'; Outlook Stable" dated Jan. 8, 2020.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

## RATING ACTIONS

ENTITY/DEBT	RATING		
Delaware, State of (DE) [General Government]	LT IDR	AAA	Affirmed
● Delaware, State of (DE) /General Obligation - Unlimited Tax/1 LT	LT	AAA	Affirmed

[VIEW ADDITIONAL RATING DETAILS](#)

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**APPLICABLE CRITERIA**

[U.S. Public Finance Tax-Supported Rating Criteria \(pub. 27 Mar 2020\) \(including rating assumption sensitivity\)](#)

**APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

FAST States & Locals - Fitch Analytical Stress Test Model, v2.4.0 (1)

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Delaware, State of (DE)

EU Endorsed

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