S&P Global Ratings

RatingsDirect®

Delaware; Appropriations; General Obligation

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Credit Profile		
US$364.395 mil GO bnds ser 2023A due 05/01/2043		
Long Term Rating	AAA/Stable	New
US$34.305 mil GO rfdg bnds ser 2023B due 08/01/2026		
Long Term Rating	AAA/Stable	New
Delaware GO		
Long Term Rating	AAA/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'AAA' long-term rating to the State of Delaware's approximately $365 million general obligation (GO) bonds, series 2023A; and approximately $34 million GO refunding bonds, series 2023B.
- At the same time, we affirmed our 'AAA' long-term rating on the state's GO debt outstanding and our 'AA+' long-term rating on the state's appropriation debt outstanding.
- The outlook on all ratings is stable.

Security

Delaware's full faith and credit pledge secures the series 2023 bonds as well as the state's GO debt outstanding. Proceeds will be used to finance various projects in the state's capital program and to refund portions of the series 2013A bonds.

Credit overview

Delaware's demonstrated history of proactive fiscal management and well-embedded strong financial policies underpin the rating. The 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 and build reserves as the economy has emerged from health restrictions. DEFAC's regular reporting allows 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 2023 is expected to close with another surplus. Through December 2022, these positive fiscal outcomes have also allowed the state to build a $402.6 million budget stabilization fund (BSF) and maintain a fully funded $316.4 million rainy day fund, or a very strong 14% of fiscal 2023 expenditures. The governor's presented $5.5 billion fiscal 2024 general fund budget continues to build on these strengths, appropriating less than 98% of DEFAC-determined available revenues, continuing to fully fund the rainy day fund at 5.0% of general fund operating expenditure, and keeping the BSF at more than 5% of gross revenues while increasing the fund to $421.5 million. These reserve balances are at an all-time high nominal level, and the state does not expect to draw upon them in fiscal 2024.

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

- Strong economy that continues to diversify;

- Strong and resilient budgetary performance; and
- Moderate debt with rapid amortization and overall strong funding and governance of pension liabilities.

We believe these strengths are partially offset by credit pressure stemming from the state's unfunded other postemployment benefits (OPEB) liabilities, which we consider significant. As of June 30, 2022, the state's $8.4 billion share of the net OPEB liability is among the largest in the nation on a per capita basis, at $8,327. The state has been looking at ways to manage this liability and in fiscal 2023 allocated 1% of the previous year's extraordinary revenues ($48 million) into the OPEB trust fund. This 1% carveout is again included in the governor's fiscal 2024 budget proposal and would contribute an additional $51 million to the fund. The implementation of these and other pension and OPEB reforms over the past two decades demonstrates the state's ability to address long-term liabilities through legislative actions. 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.

The governor's fiscal 2024 budget proposal represents 7.4% growth over the adopted fiscal 2023 budget, reflecting both inflationary costs and continued revenue collection surpluses. The proposed budget complies with all state budget stabilization requirements and is balanced even with DEFAC's estimates as of March 2023 showing slightly lower fiscal 2024 revenue compared with estimated actual fiscal 2023. The DEFAC forecast for fiscal 2025 returns to a recent trend of growth, with revenues now expected to increase 2.4% compared with fiscal 2023 projected revenues. We expect the budget will be adopted before the start of the fiscal year, but the May DEFAC meeting could influence this, should estimates change.

Delaware was allocated more than $4 billion in federal revenue from the various pandemic response bills. 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; however, to date, Delaware has treated these funds as nonrecurring. The state is preparing to perform Medicaid eligibility reviews now that the benefit maintenance requirement has been lifted in conjunction with the public health emergency. The state Medicaid rolls grew to almost 290,000 eligible participants in fiscal 2023from approximately 235,000 in fiscal 2022. The state expects the work will continue through the step-down periods of the enhanced federal medical assistance percentage payments, ending in December 2023, but any additional cost is expected to be manageable within the budget.

Delaware faces several lawsuits about its claim to certain unclaimed properties. In February 2023, the U.S. Supreme Court decided in favor of litigants regarding an unclaimed property case surrounding check products. A special master has been remanded by the court to determine damages and the outcome of that action may be months away. The state's potential exposure could exceed $300 million. The state reports it has considered this potential exposure in its revenue forecasts and reserve levels and should it be made to pay the full amount, it would not meaningfully limit current liquidity.

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.

Environmental, social, and governance

ESG credit indicators: E-2, S-2, G-2

We believe the state's physical risks have an overall neutral influence on our credit ratings but given its geographical exposure to ocean storms and river flooding, could increase infrastructure costs and have a potential to disrupt tourism. Delaware has a climate action plan focusing on reducing greenhouse gases and maximizing resilience to climate change and considers these risks within the capital plan. We consider Delaware's social and governance risks to be generally neutral to our credit rating analysis. Despite having a higher-than-average age dependency ratio, Delaware is managing any associated cost risk and the state is benefiting from population growth.

Outlook

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

Downside scenario

We could lower the rating if the state's budget or reserve profile were to be challenged--stemming from elevated retiree health care liabilities, soft revenues during cyclical periods, the outcome of current litigation surrounding unclaimed property, or other factors--to a degree we feel is not commensurate with the rating level.

Credit Opinion

Debt and liability profile

The state limits tax-supported debt authorized in any given year to no more than 5% of estimated general fund revenue. This, coupled with clearly defined debt affordability parameters, rapid amortization (70% within 10 years), and a commitment to cash-funding capital projects, when available, will contribute to a stable debt profile. Total tax-supported debt in fiscal 2022, including GO, transportation, and appropriation obligations, is moderately high compared with that of state peers, at $2,432 per capita and 4.0% of personal income. Factoring in this issuance, debt per capita increases slightly to $2,785. Delaware 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 $1.6 billion as of June 30, 2022, excluding $713.8 million that the local school districts support. Delaware does not have any variable-rate debt outstanding, and it has not entered into any interest-rate swap agreements or related derivative transactions.

Strong pensions offset by 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, 2022, the combined funded ratio across the five pension plans for which the state reports liability has declined to 87.4% from of 108% in 2021. 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.

Credit risks reside in the future treatment of funding OPEB obligations, as this liability is larger than that of peers. 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 the Delaware Public Employees' Retirement System. Coverage is available to retirees and eligible dependents covered under the state employees', new state police, judiciary, and closed state police pension plans.

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 stability through the forecast

Overall economic performance has been stable historically, in our view, and this will likely continue. Personal income, employment gains, and economic growth are forecast to be approximately in line with national rates through 2026, according to S&P Global Market Intelligence. There has been diversification within the state's economic sectors in recent years. High tech, chemical, and distribution companies are expanding in the state, with multiple companies expecting to increase employees by 400-500. For 2022, Delaware's unemployment rate was 4.4%, slightly higher than the 3.6% national average, and we expect the state's unemployment will be in line with the national average over the next couple of years.

S&P Global Economics believes that the U.S. economy will fall into a shallow recession in 2023, although increased credit tightening, stemming from recent events in the banking sector, has increased the chances of a hard landing. Supply-chain disruptions continue in certain sectors and, while inflation likely peaked in third-quarter 2022 and although prices have moderated for goods products, prices for services, excluding housing, remain elevated. Our U.S. GDP growth forecast is 0.7% for 2023 and a 1.2% for 2024. We now expect U.S. GDP to decline by 0.3 percentage points from its peak in first-quarter 2023 to its third-quarter trough. If correct, this will beat the 2001 recession as the softest recession in recent history, since 1960. Although safeguards from the Federal Reserve and other regulators have stabilized conditions, banking concerns increase risks of a worse outcome. We expect the national unemployment rate, at 3.6% in February 2023 and just above its pre-pandemic level, will rise in 2023 and peak at 5.4% in second-quarter 2024 before declining in late 2025. See "Economic Outlook U.S. Q2 2023: Still Resilient, Downside Risks Rise," published March 27, 2023, on RatingsDirect.

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 '1.9' to the state's economic factors.

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, 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.

Fiscal performance shows increasing flexibility

Delaware posted a record $1.2 billion general fund operating surplus (17.9% of general fund expenditures) as of June 30, 2022, following a $430 million surplus (7.1% of expenditures) on June 30, 2021. This is the fifth consecutive net general fund result above 7.0% of expenditures. When incorporating other sources and uses of financial resources, the state's general fund finished fiscal 2022 with a total fund balance of $3.3 billion, a 55% increase from $2.1 billion in fiscal 2021. Within this total, Delaware's unassigned fund balance was $2.3 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 '1.2' 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.

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 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of April 14, 2023)		
Delaware GO		
Long Term Rating	AAA/Stable	Affirmed
Delaware GO		
Long Term Rating	AAA/Stable	Affirmed
Delaware GO		
Long Term Rating	AAA/Stable	Affirmed

Ratings Detail (As Of April 14, 2023) (cont.)		
Sustainable Energy Utility Inc., Delaware		
Delaware (State of), Delaware		
Sustainable Energy Util, Inc. (Delaware) APPROP		
Long Term Rating	AA+/Stable	Affirmed