Ratings:

Fitch "AAA" Moody's "Aaa" S&P "AAA"

#### **NEW ISSUE**

In the opinion of Bond Counsel, interest on the Bonds is not includable in gross income for purposes of federal income taxation under existing statutes, regulations, rulings and court decisions, subject to the condition described in "Tax Matters" herein, and interest on the Bonds is not treated as an item of tax preference under Section 57 of the Internal Revenue Code of 1986, as amended (the "Code") for purposes of the individual and corporate alternative minimum taxes. However, under the Code, such interest may be subject to certain other taxes affecting corporate holders of the Bonds. Under existing statutes, interest on the Bonds is exempt from personal and corporate income tax imposed by The State of Delaware. For a more complete discussion, see "Tax Matters" herein.

# \$125,000,000 THE STATE OF DELAWARE Consisting of \$32,425,000 Obligation Bonds - Series 2005A \$92,575,000 General Obligation Bonds - Series 2005B

Dated: February 1, 2005 Due: February 1, as shown on the Inside Front Cover

The Bonds consist of the \$32,425,000 General Obligation Bonds – Series 2005A (the "Series 2005A Bonds") and the \$92,575,000 General Obligation Bonds – Series 2005B (the "Series 2005B Bonds") (the Series 2005A Bonds and the Series 2005B are herein collectively referred to as the "Bonds"). The Bonds are general obligations of the State. The full faith and credit of the State will be pledged for the payment of the principal of and interest on the Bonds.

The Series 2005A Bonds have been sold to retail investors through a negotiated sale to a group of underwriters represented by Merrill Lynch & Co. The Series 2005B Bonds were awarded to Citigroup Global Markets Inc. through a competitive sale.

Interest on the Bonds is payable semiannually on February 1 and August 1 of each year commencing August 1, 2005.

Bonds maturing on or after February 1, 2014 are subject to redemption prior to maturity in whole or in part at any time and from time to time, at the option of the State, in any order of maturity selected by the State, beginning February 1, 2013, at a redemption price of 100% of the principal amount thereof, plus accrued interest as set forth more fully herein.

The Bonds will be issued in book-entry form as fully registered bonds in denominations of \$1,000 and integral multiples thereof. The investor will not receive physical delivery of Bond certificates. Principal and interest payments on the Bonds will be paid to The Depository Trust Company or its nominee as record owner of the Bonds and the investors should look for payment to the institution from which their Bonds were purchased.

The Bonds are offered when, as and if issued and received by the Underwriters subject to prior sale, to withdrawal or modification of the offer without notice, and subject to the approving legal opinion of Saul Ewing LLP, Bond Counsel, Wilmington, Delaware, and certain other conditions. Certain legal matters will be passed upon for the underwriters of the Series 2005A Bonds by their counsel Stradley Ronon Stevens & Young, LLP, Philadelphia, Pennsylvania. It is expected that the Bonds will be available through the facilities of The Depository Trust Company for delivery in New York, New York, on or about February 1, 2005.

Series 2005A MERRILL LYNCH & CO. Series 2005B CITIGROUP GLOBAL MARKETS INC.

The date of this Official Statement is January 12, 2005.

#### **INSIDE FRONT COVER**

#### MATURITIES, AMOUNTS, RATES AND YIELDS

#### **SERIES 2005A BONDS\***

Maturity	Principal	Interest		CUSIP Number
(February 1)	Amount (\$)	<u>Rate (%)</u>	Yield (%)	(246380)
2006	3,690,000	2.25	2.10	YV5
2007	2,330,000	2.25	2.24	YW3
2008	2,150,000	2.30	2.34	YX1
2009	1,705,000	2.45	2.48	YY9
2010	2,730,000	2.75	2.77	YZ6
2011	1,850,000	2.95	2.99	ZA0
2012	1,740,000	3.15	3.18	ZB8
2013	930,000	3.30	3.34	ZC6
2014	895,000	3.45	3.46	ZD4
2015	2,515,000	3.55	3.58	ZE2
2016	1,075,000	3.65	3.68	ZF9
2017	335,000	3.75	3.77	ZG7
2018	165,000	3.80	3.85	ZH5
2019	600,000	3.90	3.92	ZJ1
2020	825,000	3.90	3.99	ZK8
2021	1,505,000	4.00	4.05	ZL6
2022	850,000	4.10	4.11	ZM4
2023	1,360,000	4.15	4.17	ZN2
2024	2,050,000	4.20	4.23	ZP7
2025	3,125,000	4.25	4.29	ZQ5

<sup>\*</sup> The Series 2005A Bonds have been sold to retail investors through a negotiated sale to a group of underwriters represented by Merrill Lynch & Co and including Advest, Inc., Citigroup Global Markets Inc., A.G. Edwards & Sons, Inc., Ferris, Baker, Watts Inc., Janney Montgomery Scott LLC, Edward D. Jones & Co., Legg Mason Wood Walker, Inc., N.D. Meyer & Co., Morgan Stanley and Wachovia Bank, N.A.

#### **SERIES 2005B BONDS\***

Maturity	Principal	Interest		CUSIP Number
(February 1)	Amount (\$)	<u>Rate (%)</u>	<u>Yield (%)</u>	<u>(246380)</u>
2006	5,685,000	5.00	NRO	ZR3
2007	7,045,000	5.00	NRO	ZS1
2008	7,225,000	5.00	2.34	ZT9
2009	7,670,000	5.00	2.48	ZU6
2010	6,645,000	2.625	NRO	ZV4
2011	7,525,000	5.00	2.95	ZW2
2012	7,635,000	5.00	3.15	ZX0
2013	8,445,000	5.00	3.31	ZY8
2014	8,480,000	4.00	NRO	ZZ5
2015	6,860,000	4.00	NRO	A25
2016	2,050,000	4.00	NRO	A33
2017	2,790,000	4.00	NRO	A41
2018	2,960,000	4.00	NRO	A58
2019	2,525,000	4.00	NRO	A66
2020	2,300,000	4.00	NRO	A74
2021	1,620,000	4.00	NRO	A82
2022	2,275,000	4.00	NRO	A90
2023	1,765,000	4.00	NRO	B24
2024	1,075,000	4.125	NRO	B32

<sup>\*</sup> The Series 2005B Bonds have been awarded to Citigroup Global Markets Inc. through a competitive sale.

Ratings:

Fitch "AAA" Moody's "Aaa" S&P "AAA"

#### **NEW ISSUE**

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The Series 2005A Bonds have been sold to retail investors through a negotiated sale to a group of underwriters represented by Merrill Lynch & Co. The Series 2005B Bonds were awarded to Citigroup Global Markets Inc. through a competitive sale.

Interest on the Bonds is payable semiannually on February 1 and August 1 of each year commencing August 1, 2005.

Bonds maturing on or after February 1, 2014 are subject to redemption prior to maturity in whole or in part at any time and from time to time, at the option of the State, in any order of maturity selected by the State, beginning February 1, 2013, at a redemption price of 100% of the principal amount thereof, plus accrued interest as set forth more fully herein.

The Bonds will be issued in book-entry form as fully registered bonds in denominations of \$1,000 and integral multiples thereof. The investor will not receive physical delivery of Bond certificates. Principal and interest payments on the Bonds will be paid to The Depository Trust Company or its nominee as record owner of the Bonds and the investors should look for payment to the institution from which their Bonds were purchased.

The Bonds are offered when, as and if issued and received by the Underwriters subject to prior sale, to withdrawal or modification of the offer without notice, and subject to the approving legal opinion of Saul Ewing LLP, Bond Counsel, Wilmington, Delaware, and certain other conditions. Certain legal matters will be passed upon for the underwriters of the Series 2005A Bonds by their counsel Stradley Ronon Stevens & Young, LLP, Philadelphia, Pennsylvania. It is expected that the Bonds will be available through the facilities of The Depository Trust Company for delivery in New York, New York, on or about February 1, 2005.

Series 2005A MERRILL LYNCH & CO. Series 2005B CITIGROUP GLOBAL MARKETS INC.

The date of this Official Statement is January 12, 2005.

#### **INSIDE FRONT COVER**

#### MATURITIES, AMOUNTS, RATES AND YIELDS

#### **SERIES 2005A BONDS\***

Maturity	Principal	Interest		CUSIP Number
(February 1)	Amount (\$)	<u>Rate (%)</u>	Yield (%)	(246380)
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2007	2,330,000	2.25	2.24	YW3
2008	2,150,000	2.30	2.34	YX1
2009	1,705,000	2.45	2.48	YY9
2010	2,730,000	2.75	2.77	YZ6
2011	1,850,000	2.95	2.99	ZA0
2012	1,740,000	3.15	3.18	ZB8
2013	930,000	3.30	3.34	ZC6
2014	895,000	3.45	3.46	ZD4
2015	2,515,000	3.55	3.58	ZE2
2016	1,075,000	3.65	3.68	ZF9
2017	335,000	3.75	3.77	ZG7
2018	165,000	3.80	3.85	ZH5
2019	600,000	3.90	3.92	ZJ1
2020	825,000	3.90	3.99	ZK8
2021	1,505,000	4.00	4.05	ZL6
2022	850,000	4.10	4.11	ZM4
2023	1,360,000	4.15	4.17	ZN2
2024	2,050,000	4.20	4.23	ZP7
2025	3,125,000	4.25	4.29	ZQ5

<sup>\*</sup> The Series 2005A Bonds have been sold to retail investors through a negotiated sale to a group of underwriters represented by Merrill Lynch & Co and including Advest, Inc., Citigroup Global Markets Inc., A.G. Edwards & Sons, Inc., Ferris, Baker, Watts Inc., Janney Montgomery Scott LLC, Edward D. Jones & Co., Legg Mason Wood Walker, Inc., N.D. Meyer & Co., Morgan Stanley and Wachovia Bank, N.A.

#### **SERIES 2005B BONDS\***

Maturity	Principal	Interest		CUSIP Number
(February 1)	Amount (\$)	<u>Rate (%)</u>	<u>Yield (%)</u>	<u>(246380)</u>
2006	5,685,000	5.00	NRO	ZR3
2007	7,045,000	5.00	NRO	ZS1
2008	7,225,000	5.00	2.34	ZT9
2009	7,670,000	5.00	2.48	ZU6
2010	6,645,000	2.625	NRO	ZV4
2011	7,525,000	5.00	2.95	ZW2
2012	7,635,000	5.00	3.15	ZX0
2013	8,445,000	5.00	3.31	ZY8
2014	8,480,000	4.00	NRO	ZZ5
2015	6,860,000	4.00	NRO	A25
2016	2,050,000	4.00	NRO	A33
2017	2,790,000	4.00	NRO	A41
2018	2,960,000	4.00	NRO	A58
2019	2,525,000	4.00	NRO	A66
2020	2,300,000	4.00	NRO	A74
2021	1,620,000	4.00	NRO	A82
2022	2,275,000	4.00	NRO	A90
2023	1,765,000	4.00	NRO	B24
2024	1,075,000	4.125	NRO	B32

<sup>\*</sup> The Series 2005B Bonds have been awarded to Citigroup Global Markets Inc. through a competitive sale.

No dealer, broker, salesperson or other person has been authorized by The State of Delaware or by the Underwriters to give any information or to make any representation in connection with the Bonds or the matters described herein, other than those contained in this Official Statement, and, if given or made, such other information or representation must not be relied on as having been authorized by the State or by the Underwriters. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Bonds by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale. The information and expressions of opinion contained herein are subject to change without notice, and neither the delivery of this Official Statement, nor any sale made hereunder, shall, under any circumstances, create any implication that there has been no change in the matters described herein since the date thereof. Only the statements and information contained herein should be considered in making an investment decision with respect to the Bonds. This Official Statement is distributed in connection with the sale of the Bonds and may not be reproduced or used, in whole or in part, for any other purpose.

All estimates and assumptions herein have been made on the best information available and are believed to be reliable, but no representations whatsoever are made that such estimates or assumptions are correct or will be realized. So far as any statements herein involve matters of opinion, whether or not expressly so stated, they are intended merely as such and not as representations of fact. Neither the Official Statement nor any statement which may have been made orally or in writing is to be construed as a contract with the holders of the Bonds.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE BONDS ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

THE ORDER AND PLACEMENT OF MATERIALS IN THIS OFFICIAL STATEMENT, INCLUDING THE APPENDICES, ARE NOT TO BE DEEMED TO BE A DETERMINATION OF RELEVANCE, MATERIALITY OR IMPORTANCE, AND THIS OFFICIAL STATEMENT, INCLUDING THE APPENDICES, MUST BE CONSIDERED IN ITS ENTIRETY. THE OFFERING OF THE BONDS IS MADE ONLY BY MEANS OF THIS ENTIRE OFFICIAL STATEMENT.

The underwriters of the Series 2005A Bonds have provided the following sentence for inclusion in this Official Statement: The underwriters of the Series 2005A Bonds have reviewed the information in this Official Statement in accordance with and as part of their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the underwriters of the Series 2005A Bonds do not guarantee the accuracy, completeness or fairness of such information.

If and when included in this Official Statement, the words "expects," "forecasts," "projects," "intends," "anticipates," "estimates," "assumes" and analogous expressions are intended to identify forward-looking statements and any such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ

materially from those that have been projected. Such forward-looking statements speak only as of the date of this Official Statement. The State disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statement contained herein to reflect any changes in the State's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

All quotations from and summaries and explanations of provisions of laws and documents described herein do not purport to be complete and reference is made to said laws and documents for full and complete statements of their provisions.

Upon issuance, the Bonds will not be registered under the Securities Act of 1933, as amended, in reliance upon exemptions contained in such Act. The Bonds will not be listed on any stock or other securities exchange. Any registration or qualification of the Bonds in accordance with applicable provisions of securities laws of the states in which the Bonds may be registered or qualified and the exemption from registration or qualification in other states cannot be regarded as a recommendation thereof. Neither the Securities and Exchange Commission nor any other federal, state or other governmental entity or agency, except the State, will have passed upon the accuracy, completeness or adequacy of this Official Statement or approved the Bonds for sale. Any representation to the contrary may be a criminal offense.

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This publication is available on microfiche from the State Bureau of Archives and Records, Hall of Records, Box 1401, Dover, Delaware 19901. Document #25-01-10-01-04.

#### OFFICIAL STATEMENT

 $\mathbf{of}$ 

THE STATE OF DELAWARE
\$125,000,000
Consisting of
\$32,425,000 General Obligation Bonds - Series 2005A
\$92,575,000 General Obligation Bonds - Series 2005B

#### INTRODUCTION

This Official Statement (the "Official Statement"), which includes the cover page and the appendices, has been prepared by The State of Delaware (the "State") and provides certain information about the State and its \$32,425,000 General Obligation Bonds - Series 2005A (the "Series 2005A Bonds") and its \$92,575,000 General Obligation Bonds - Series 2005B (the "Series 2005B Bonds", together with the Series 2005A Bonds, the "Bonds").

Brief descriptions of the State, the authorizing Resolution (as defined below) of the State's Issuing Officers (as defined below), and the Bonds are included in this Official Statement. Such descriptions do not purport to be comprehensive or definitive. All references herein to the Resolution and the Bonds are qualified in their entirety by reference to such documents. All such descriptions are further qualified in their entirety by reference to laws relating to or affecting generally the enforcement of creditors' rights and general principles of equity. Copies of such documents are available for inspection at the offices of the Secretary of Finance of the State.

#### **DESCRIPTION OF THE BONDS**

#### **General Information**

The Bonds are general obligations of the State to be issued pursuant to a resolution adopted on January 12, 2005, (the "Resolution") by the Governor, the Secretary of Finance, the Secretary of State and the State Treasurer (the "Issuing Officers"). The Bonds will contain a pledge of the State's full faith and credit for the payment of the principal of and interest on the Bonds. The Bonds will be dated, bear interest, mature and are payable as described on the cover page of this Official Statement. The Bonds will be issued as fully registered bonds in denominations of \$1,000 and integral multiples thereof.

#### **Optional Redemption**

The Bonds maturing on or after February 1, 2014, are subject to redemption at the option of the State on or after February 1, 2013, and prior to maturity, in whole or in part at any time and from time to time, in any order of maturity selected by the State, at 100% of the principal amount of the Bonds to be redeemed, plus interest accrued and unpaid to the redemption date.

#### **Notice of Redemption**

Notice of redemption will be mailed to registered owners of Bonds not less than 30 days nor more than 60 days prior to any optional redemption date in the manner and upon the terms and conditions set forth in the Resolution. The State, so long as a book-entry system is used for determining ownership of Bonds, will send the notice of redemption to The Depository Trust Company ("DTC"). Any failure of DTC to mail such notice to any DTC participant will not affect the validity of the redemption of the Bonds.

#### **Authorization and Purpose**

The Bonds are issued pursuant to the State Constitution, statutes of the State, including acts of the General Assembly (the "General Assembly") authorizing the issuance of the Bonds (the "Authorization Acts") and the Resolution. The proceeds of the Bonds will be applied to pay for various capital facilities of the State and to provide financing for other capital projects, as authorized by the Authorization Acts.

The State will allocate the debt service with respect to the Bonds to various capital facilities. Although all of such Bonds are authorized to be sold as twenty-year bonds, the State has chosen to sell only \$62.5 million as twenty-year bonds and the remaining \$62.5 million as ten-year bonds. This rapid amortization is an effective strategy to reduce the State's overall indebtedness.

The State Constitution provides that any money borrowed by the State shall be used exclusively for the purpose for which it is borrowed, but that if any borrowed money remains after a project has been completed or abandoned, such money may be expended according to law. The Delaware Code provides that any funds borrowed pursuant to an Authorization Act and not expended for the purposes set forth therein shall be deposited in a special fund and applied with the approval of the Issuing Officers to the remaining costs of any project authorized by any prior Authorization Act.

#### SOURCES AND USES OF FUNDS

The sources and uses of funds to accomplish the purposes of the Bonds are expected to be as follows:

#### **Sources:**

Principal Amount of Bonds	\$125,000,000.00
Net Original Issue Premium	
Total Sources	\$ <u>129,755,776.85</u>

#### **Uses:**

Capital Projects	\$129,444,999.49
Underwriter's Discount	310,777.36
Total Uses	\$129,755,776.85

#### **SECURITY FOR BONDS**

The Bonds are direct obligations of the State to which the full faith and credit of the State will be pledged. The payment of principal of and interest on debt obligations of the State is made pursuant to appropriations by the General Assembly of the State. The State has always appropriated funds for and paid the principal of and interest on its debt obligations as they have come due.

If the State fails to make sufficient provision to pay the principal of and interest on the Bonds, or, at the time such amount is payable, sufficient funds are unavailable for such payment, a sufficient sum to pay such principal and interest is required by State law to be set apart by the State Treasurer from the first revenues thereafter received by the State. The State Treasurer may be required to set apart and apply such revenue to the payment of such principal and interest at the suit of any holder of the Bonds.

In the event the State fails to make timely payment of the principal of or interest on the Bonds, the owner of the Bond on which default in payment has occurred may also sue the State for breach of contract. In the opinion of the Attorney General of the State, the State may not successfully invoke the defense of sovereign immunity in an action alleging breach of contract by the State, and in the further opinion of the Attorney General, the Bonds pertaining thereto are such contracts. Any judgment against the State obtained in such an action, however, must be paid solely from funds appropriated by the General Assembly for the purpose of such payment.

#### **DEBT SERVICE REQUIREMENTS**

The following table sets forth the debt service requirements of general obligation bonds of the State, prior to and after giving effect to the issuance of the Bonds.

## General Obligation Debt Service<sup>(1)</sup> (in millions)

#### **Prior to Issuance of the Bonds**

#### **After Issuance of Bonds**

Fiscal Year Ending June 30	<u>Principal</u>	Interest	Debt <u>Service</u>	Total Principal Amount Outstanding	<u>Principal</u>	<u>Interest</u>	Debt <u>Service</u>	Total Principal Amount Outstanding
2005	107.9	46.2	154.1	904.9	107.9	46.2	154.1	1,029.9
2006	104.4	41.3	145.7	800.5	113.8	46.5	160.2	916.1
2007	99.5	36.0	135.5	701.0	108.8	40.8	149.7	807.3
2008	90.3	31.4	121.7	610.7	99.7	35.8	135.5	707.6
2009	84.6	26.9	111.6	526.0	94.0	30.9	124.9	613.5
2010	79.1	22.8	101.9	447.0	88.4	26.4	114.8	525.1
2011	71.7	19.1	90.9	375.2	81.1	22.4	103.6	444.0
2012	67.4	17.7	85.1	307.8	76.8	20.6	97.4	367.2
2013	57.9	14.4	72.3	249.9	67.3	16.9	84.2	299.9
2014	44.5	10.1	54.6	205.5	53.8	12.1	66.0	246.1
2015	31.9	8.4	40.3	173.5	41.3	10.0	51.3	204.8
2016	29.8	7.2	37.0	143.7	33.0	8.4	41.4	171.8
2017	28.1	6.0	34.0	115.6	31.2	7.1	38.3	140.6
2018	23.7	4.9	28.6	91.9	26.8	5.9	32.7	113.8
2019	22.1	3.8	25.9	69.8	25.2	4.7	29.9	88.5
2020	18.4	2.9	21.3	51.4	21.6	3.6	25.2	67.0
2021	16.2	2.1	18.3	35.2	19.3	2.7	22.0	47.7
2022	16.0	1.4	17.3	19.2	19.1	1.9	21.0	28.6
2023	12.6	0.7	13.3	6.7	15.7	1.1	16.8	12.9
2024	6.7	0.2	6.9	0.0	9.8	0.5	10.3	3.1
2025	<u>0.0</u>	0.0	<u>0.0</u>	0.0	<u>3.1</u>	<u>0.1</u>	<u>3.3</u>	0.0
	<u>\$1,012.8</u>	<u>\$303.5</u>	<u>\$1,316.3</u>		<u>\$1,137.8</u>	<u>\$344.7</u>	<u>\$1,482.5</u>	

<sup>(1)</sup> Totals may not add due to rounding.

#### BONDED INDEBTEDNESS OF THE STATE

#### **Authorization of General Obligation Debt**

General obligation bonds and bond anticipation notes of the State are issued and the proceeds thereof appropriated to various purposes pursuant to Authorization Acts of the General Assembly. Under the State Constitution, Authorization Acts become law upon the approval of three-quarters of all the elected members of each house of the General Assembly and the concurrence of the Governor. The Governor may veto a bill by returning the bill to the house of the General Assembly in which the bill originated within ten days of receipt, Sunday excepted. The General Assembly may override the Governor's veto by a three-fifths vote of all members in each house. No bill becomes law after final adjournment of the General Assembly unless previously approved by the General Assembly and approved by the Governor within 30 days after such adjournment. The Governor has veto power over line item appropriations.

Once an Authorization Act is enacted, the Issuing Officers are authorized by State law to issue bonds and bond anticipation notes thereunder. Bond anticipation notes may be issued for a term of one year and may be renewed, but all such renewal notes must mature not later than four years after the date of original issuance of such notes. No bond anticipation notes have been outstanding since fiscal 1978. Bonds are required to mature within 20 years from their date, may not provide for principal payments higher in later years than earlier years (except for refunding bonds, capital appreciation bonds, qualified zone academy bonds and retail bonds) and may have such other terms as the Issuing Officers may determine, subject to the limitations of the Authorization Acts and other provisions of law.

The Issuing Officers are authorized to issue bonds to refund bonds in advance of maturity provided that the refunding results in a present value savings to the State.

The Issuing Officers may also issue revenue anticipation notes, in an amount they determine necessary, to meet a casual deficiency of revenue in the budgetary General Fund to pay budgetary General Fund obligations or to pay existing debts. Revenue anticipation notes may be issued at any time and from time to time prior to June 25 in any State fiscal year. There has not been a State issue of revenue anticipation notes since fiscal 1977. If at any time during the fiscal year prior to June 15 there is a casual deficiency of revenue in the budgetary General Fund to pay budgetary General Fund obligations or to pay existing debts, the State may draw upon available balances in the State's budgetary Special Funds to pay such obligations or debts. Such draws are required to be reimbursed to the appropriate budgetary Special Funds as soon as sufficient budgetary General Fund monies become available, and in any case, the budgetary General Fund cannot evidence a negative balance after June 15 of such fiscal year.

#### **Debt Limits**

There is no Constitutional debt limit of the State.

In 1991, the State enacted legislation to replace the previous statutory debt limits with a three-part debt limit, effective July 1, 1991, as follows:

First, the aggregate principal amount of new "tax-supported obligations of the State" (hereinafter defined) which may be authorized in any one fiscal year (excluding refunding bonds) may not exceed 5% of estimated net budgetary General Fund revenue for that fiscal year, as determined by a Joint Resolution approved by a majority of the members elected to each house of the General Assembly and signed by the Governor in conjunction with the adoption of the annual Budget Appropriation Bill for that fiscal year (the "5% Rule"). The June 2004 estimate of net general fund revenues for fiscal year 2005 was \$2,765.1 million, thus a total of \$138.3 million of new tax-supported general obligation debt was permitted under the 5% rule and was authorized.

Additional tax-supported debt permitted under the 5% Rule is set out in the following table. The revenue figures are from the December 13, 2004 meeting of the Delaware Economic and Financial Advisory Council ("DEFAC"), at which meeting the projections for General Fund revenue were determined. DEFAC projections are dependent on a variety of economic factors affecting the State's projected revenues. The level of new tax-supported debt authorization permitted under the 5% Rule is set out in the following chart. The fiscal 2006 and fiscal 2007 estimates incorporate DEFAC's December 13, 2004 estimates. Fiscal 2008 and fiscal 2009 are based on the long-term growth rates adopted by DEFAC at its September 20, 2004 meeting. See "STATE FINANCIAL OPERATIONS - Revenue and Expenditure Forecasting" and "- Revenue Summary - Fiscal 2004 - Fiscal 2006E."

The 5% Rule (in millions)

	Fiscal <u>2005</u>	Fiscal <u>2006</u>	Fiscal <u>2007</u>	Fiscal <u>2008</u>	Fiscal <u>2009</u>
Estimated Net Budgetary General Fund Revenue	\$2,765.1	2,882.6	2,967.0	3,084.4	3,222.9
Projected New Tax- Supported Debt Authorizations	\$ 138.3	144.1	148.4	154.2	161.1

Second, no "tax-supported obligations of the State" and no "Transportation Trust Fund ("Trust Fund" or "TTF") debt obligations" (hereinafter defined) of the Delaware Transportation Authority may be incurred if the aggregate maximum annual payments on all such outstanding obligations exceed 15% of the estimated aggregate budgetary General Fund revenue, plus Trust Fund revenue for the fiscal year following the fiscal year in which such obligation is incurred (the "15% Test"). The Bonds comply with this test, as illustrated in the following table:

#### The 15% Test

(in millions)

	Fiscal 2006 <sup>(1)</sup>
General Obligation Debt Service	\$160.2
Less: Excluded Debt Service (2)	(36.3)
Other Tax-Supported Debt Service (3)	<u> 18.4</u>
Total Tax-Supported Debt Service	\$ <u>142.3</u>
Delaware Transportation Authority (TTF)	
Debt Service	\$ <u>99.7</u>
Total Debt Service	\$242.0
Estimated Aggregate Budgetary General Fund	
and TTF Revenue (4)	\$3,244.4
Total Debt Service as Percent of	
Total Revenue	7.5%

<sup>(1)</sup> Year of maximum annual debt service.

Third, no general obligation debt (with certain exclusions) may be incurred if the maximum annual debt service payable in any fiscal year on all such outstanding obligations will exceed the estimated cumulative cash balances (including all reserves) for the fiscal year following the fiscal year in which such obligation is incurred (the "Cash Balances Test"), as estimated by the Secretary of Finance. The Bonds also comply with the Cash Balances Test, as illustrated below:

#### **The Cash Balances Test**

(in millions)

	<b>Fiscal 2006</b> <sup>(1)</sup>
General Obligation Debt Service	\$ 160.2
Less: Excluded Debt Service (2)	(36.3)
Net General Obligation Debt Service	\$ 123.9
Projected Cumulative Cash Balances (3)	\$500.7

<sup>(1)</sup> Year of maximum annual debt service.

<sup>(2)</sup> Portion of general obligation debt service to be reimbursed by local school districts, the Trust Fund and the Delaware State Housing Authority.

<sup>(3)</sup> Includes projected payments on lease obligations of the State.

<sup>(4)</sup> Based upon December 13, 2004 revenue projections of DEFAC. See "STATE FINANCIAL OPERATIONS - Revenue and Expenditure Forecasting."

<sup>(2)</sup> Portion of general obligation debt service to be reimbursed by local school districts, the Trust Fund and the Delaware State Housing Authority.

<sup>(3)</sup> As estimated by the Secretary of Finance based upon December 13, 2004 budgetary General Fund revenue projections by DEFAC.

"Tax-supported obligations of the State" include a) all obligations of the State or any agency or authority thereof to which the State's full faith and credit is pledged; and b) all obligations of the State or any agency or authority thereof extending beyond one year with respect to the lease, occupancy or acquisition of property which are incurred in connection with debt financing transactions (for example, certificates of participation), and which are payable from taxes, fees, permits, licenses and fines imposed or approved by the General Assembly. Tax-supported obligations do not include a) obligations incurred to acquire a like principal amount of full faith and credit obligations issued by a local school district to the extent such local school district obligations are not in default; b) any obligations of the Delaware Transportation Authority; c) any tax or other revenue anticipation notes or bonds of the State; or d) obligations to the extent that the debt service with respect thereto is reasonably expected to be offset (as determined by the Secretary of Finance) by lease payments, user fees, federal grants or other payments from a non-budgetary General Fund source.

"Transportation Trust Fund debt obligations" include all debt obligations of the Delaware Transportation Authority, including all obligations extending beyond one year with respect to the lease, occupancy or acquisition of property which are incurred in connection with debt financing transactions (for example, certificates of participation), and which in any case are payable from the Trust Fund. Trust Fund debt obligations do not include any obligations to the extent that the debt service with respect thereto is reasonably expected to be offset (as determined by the Secretary of Finance) by lease payments, user fees, federal grants or other payments from a non-State source.

#### **General Obligation Debt**

On June 30, 2004, the outstanding general obligation debt of the State, a portion of which was supported by budgetary General Fund revenue and a portion of which was supported by budgetary Special Funds, was as follows:

#### **Outstanding General Obligation Debt**

(in millions)

#### General Obligation Debt Supported by Budgetary General Fund Revenue

State Facilities	\$472.7
School Facilities (State Share)	247.1
Subtotal	\$719.8

#### General Obligation Debt Supported by Budgetary Special Funds

Highways and Other Transportation	
Improvements	3.6
School Facilities (Local Share)	288.5
Housing Authority Loans	0.6
Subtotal	<u>292.7</u>
Total General Obligation Debt Outstanding	<u>1,012.5</u>

The Trust Fund reimburses the budgetary General Fund for the payment of debt service on previously issued transportation-related general obligation debt and Division of Motor Vehicle debt assumed as of July 1, 2003. As of June 30, 2004, \$3.6 million of transportation-related general obligation debt was outstanding.

The State pays between 60% and 80% of the cost of capital improvements for public school districts upon approval of such cost by the State Board of Education. The school districts pay the remaining percentage. The State issues bonds for 100% of the cost of approved school district projects pursuant to Authorization Acts and the school districts issue their own bonds (the "School District Bonds") to the State for their 20% to 40% share of capital costs at an interest rate not exceeding 1/4 of 1% above the interest rate on the corresponding State bonds. As debt service payments on the State's bonds become due, school districts are required to pay debt service on the School District Bonds from their tax receipts into the State's budgetary General Fund, and the State pays the total debt service from its budgetary General Fund appropriation.

No school district has ever defaulted on any such obligation to the State. This policy allows the local school districts to borrow capital funds at very competitive rates and to lessen the associated costs of issuance and market access

#### **Authorized but Unissued General Obligation Debt**

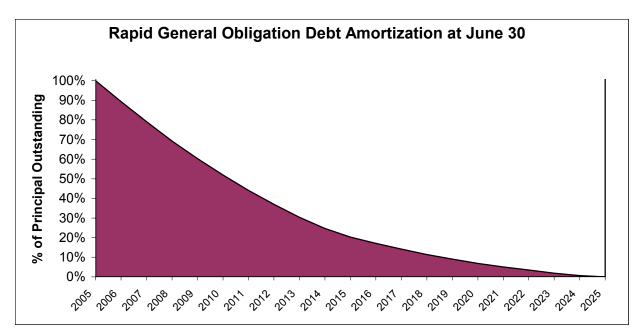
After the issuance of the Bonds, statutory authorization will exist for the issuance of additional general obligation debt of the State in the principal amount of \$254.0 million.

#### **General Obligation Note Debt**

There are no outstanding State general obligation notes or any notes of any authority or agency for whose debt the State has a contingent liability as of the date of this Official Statement.

#### **Debt Burden Comparisons**

The State's general obligation debt outstanding was \$1,012 million on June 30, 2004 with approximately 80% scheduled to mature within ten years and approximately 93% scheduled to mature within fifteen years. The following chart further demonstrates the State's commitment to the rapid retirement of its general obligation debt.



Delaware's debt burden reflects the centralized role of the State government in financing capital projects that are typically funded by local governments in other states, such as schools and correctional facilities. Fiscal 2000 data from the U.S. Bureau of the Census ranked Delaware 5<sup>th</sup> in terms of the percentage of overall debt that is concentrated at the state level. According to the U.S. Department of Education's National Public Education Financial Survey (2000-2001), on average, the burden of school funding is split equally between state government and local schools. However, in Delaware the state government assumes a greater responsibility by bearing approximately two-thirds of combined state and local public school funding. As of June 30, 2004, 28.5% of the State's outstanding debt was issued on behalf of local school districts. This debt is fully supported by the property tax revenues of those districts.

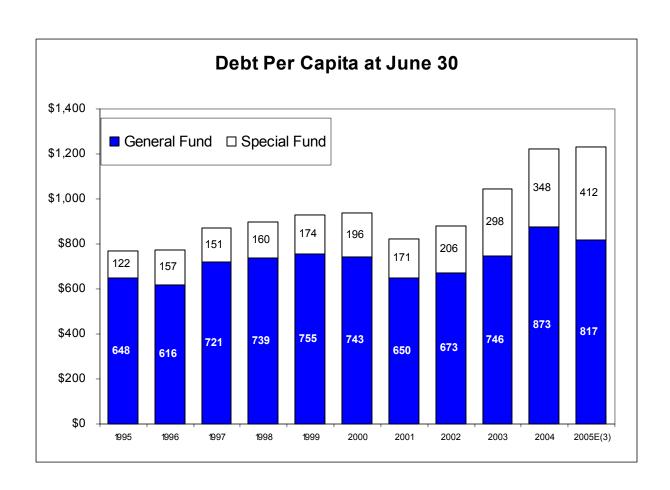
The State has instituted a number of measures designed to manage and reduce its indebtedness, as outlined below.

- **Aggressive Retirement of General Obligation Debt**: The State voluntarily retires its general obligation debt rapidly. Approximately 80% of current general obligation debt is scheduled to mature within ten years, as noted above.
- Strict Debt Limitations: In 1991, the State instituted new debt limits, one of which restricts new debt authorizations to 5% of budgetary General Fund revenue as projected on June 30 for the next fiscal year. Should revenue collections increase during the fiscal year, no additional authorizations are made. The debt limit also effectively eliminates the use of any "off balance sheet" financing instruments, such as certificates of participation. See "Bonded Indebtedness of the State Debt Limits" for further information concerning the State's debt limits.
- **Bond Premium Legislation**: In April 2004, legislation was enacted that gives the State additional flexibility in the use of any original issue premium earned on the sale of its bonds or notes. In addition to using proceeds attributable to any such premium to satisfy future

debt service, the State can apply the premium to refund, redeem or defease existing bonds or notes, or can apply the premium to any of the purposes for which such bonds or notes were issued.

- **Significant "Pay-As-You-Go" Financing**: Over the years, whenever revenues have permitted, the State has appropriated surplus cash for "pay-as-you-go" financing. Extraordinary revenue surpluses in the period from fiscal 1993-2001 allowed the State to appropriate cash on average at a rate of 52.6% of capital expenditures. With more modest revenue growth, the fiscal 2002 and 2003 pay-as-you-go financing levels were \$11.0 million and \$19.2 million, respectively. For fiscal 2004 and 2005, the pay-as-you-go financing levels were \$142.0 million and \$235.5 million, respectively. This level reflects Delaware's commitment to pay-as-you-go financing.
- **Debt Reduction**: During the period of 1995-2001, the State implemented a substantial debt reduction plan as extraordinary surpluses permitted. Tighter revenues in fiscal 2002, 2003 and 2004 precluded additional debt reduction efforts, but the State remains committed to debt reduction as a policy initiative as revenues allow.
- Numerous Bond Refundings: The State has undertaken a series of bond refundings which have lowered the overall debt service on outstanding State general obligation debt. The State refunded \$132.7 million of its general obligation bonds in August 2002 for a combined savings of over \$6.4 million, and refunded \$34.5 million of its general obligation bonds in April 2003 for a combined savings of \$2.3 million. In fiscal 2003, the State refunded over \$167 million of its general obligation bonds for a combined savings of \$8.7 million. In fiscal 2004, savings of \$2.9 million was realized after the State refunded \$74.6 million of its general obligation bonds. The State will continue to monitor opportunities to refund its outstanding bonds to lower future debt service requirements.

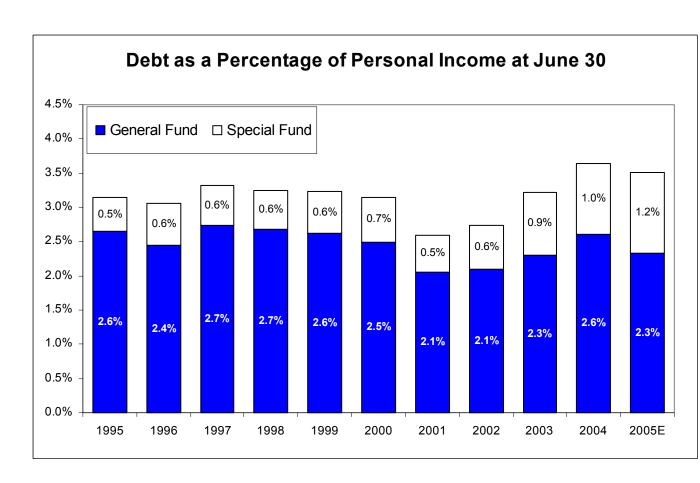
The result of these initiatives has been to reduce the rate of growth in Delaware's debt burden, as depicted on a fiscal year basis in the following three charts.



<sup>(1)</sup> Shaded area represents portion of general obligation debt funded by the budgetary General Fund. The remainder is funded by budgetary Special Funds.

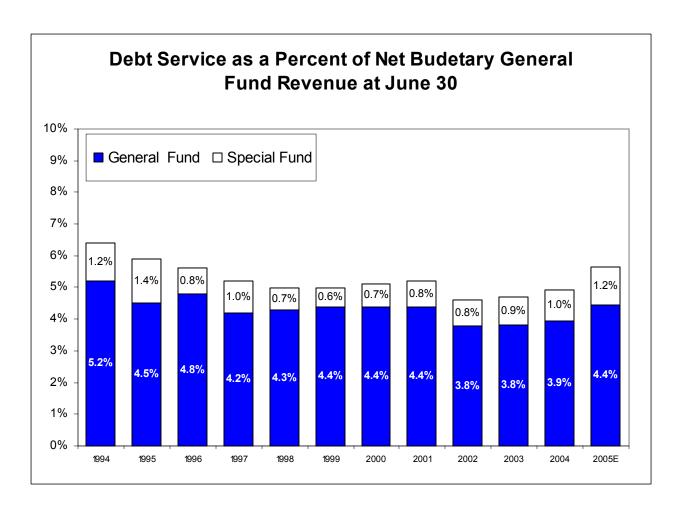
<sup>(2)</sup> Decrease in fiscal 2001 due to a shift in timing of bond sale to fiscal 2002.

<sup>(3)</sup> Assumes a population growth rate of 1.2%.



<sup>(1)</sup> Shaded area represents portion of general obligation debt funded by the budgetary General Fund. The remainder is funded by budgetary Special Funds.

<sup>(2)</sup> Personal Income estimates provided by Global Insight and Delaware Department of Finance.



<sup>(1)</sup> Shaded area represents portion of general obligation debt funded by the budgetary General Fund. The remainder is funded by budgetary Special Funds.

#### **Qualified Zone Academy Bonds**

The State issued \$649,000 Qualified Zone Academy Bonds ("QZAB") in fiscal 2002 and \$760,000 Qualified Zone Academy Bonds in fiscal 2003. The fiscal 2003 QZAB proceeds funded the renovation of the Charlton School in the Caesar Rodney School District, Kent County, Delaware. The fiscal 2002 QZAB proceeds assisted in the renovation of Georgetown and Showell elementary schools in the Indian River School District, Sussex County, Delaware.

The State issued \$908,000 QZABs in fiscal 2004 and \$224,177 QZABs in fiscal 2005 to finance the continued renovation of the Charlton School in the Caesar Rodney School District, Kent County, Delaware. The QZABs are general obligation bonds backed by the full faith and credit of the State for the repayment of principal, primarily through the use of a sinking fund with a bullet maturity.

The QZAB proceeds are used in conjunction with the State's general obligation bond proceeds. The State provides 60-80% of the capital funding to local school districts in the form of non-repayable appropriations. The QZABs will assist in funding this commitment.

#### **State Revenue Debt**

There is currently no State revenue debt outstanding, nor any plans to authorize any State debt other than State general obligation debt.

#### **Lease Obligations**

The State has entered into long-term leases with terms in excess of one year. Aggregate remaining lease payments total approximately \$117.0 million with \$55.6 million payable through fiscal 2009). Real estate rentals account for 80.0% of the aggregate payments and equipment rentals account for the remainder. All payments are subject to annual appropriation. The State may not be held contractually liable for the payments in the event that such appropriations are not made. See "Appendix B - Notes to the Financial Statements - #8, Lease Commitments." Lease obligations are subject to one of the State's debt limits, the 15% Test. See "BONDED INDEBTEDNESS OF THE STATE - Debt Limits" for a complete explanation.

### INDEBTEDNESS OF AUTHORITIES, UNIVERSITY OF DELAWARE AND POLITICAL SUBDIVISIONS

Oversight responsibility for the issuance of debt by the State and authorities deemed to be part of the State's financial reporting entity is centralized under the Secretary of Finance. The following section sets forth certain indebtedness of State authorities, Delaware State University, the University of Delaware and political subdivisions of the State. The State is not directly or contingently liable for debt service for any of the following indebtedness.

#### **Authorities**

#### **Delaware Transportation Authority**

The Delaware Transportation Authority (the "Authority") is a body corporate and politic constituting an instrumentality of the State. The Authority acts by resolution of the Secretary of the Department of Transportation (the "Department"), the Director of Finance of the Department and the Transportation Trust Fund Administrator. The Department has overall responsibility for coordinating and developing comprehensive, multi-modal transportation planning and policy for the State. The Authority assists in the implementation of this policy and has the power to develop a unified system of air, water, vehicular, public and specialized transportation in the State, subject to oversight by the Department and the State as hereinafter described.

To assist the Authority in financing a unified transportation system, the State created the Transportation Trust Fund (the "Trust Fund" or "TTF") within the Authority in 1987 to receive revenue and receipts of the Authority. The primary sources of funding of the Trust Fund are motor fuel taxes, motor vehicle document fees, motor vehicle registration fees, and other

transportation-related fees, all of which are imposed and collected by the State and transferred to the Trust Fund. The State has irrevocably pledged, assigned and continuously appropriated these taxes and fees to the Trust Fund. The other major source of funding for the Trust Fund is toll and concession revenue of the Delaware Turnpike and the Route 1 Toll Road. The Authority may apply Trust Fund revenue for transportation projects, subject to the approval of the State, and may pledge any or all of this revenue to secure financings for these projects.

As of December 1, 2004, the Delaware Transportation Authority had outstanding \$804.19 million in Transportation System Senior Revenue Bonds and \$57.52 million in Transportation System Junior Revenue Bonds. The Authority may issue bonds to refund prior Authority obligations.

Additional bonds secured on parity with the Senior Bonds or secured on parity with the Junior Bonds may be issued subject to the satisfaction of debt service coverage tests and certain other requirements. Under certain circumstances, additional revenue may be pledged by the Authority to secure its bonds, in which case such revenue may be taken into account in determining satisfaction of these debt service coverage tests. The Authority may also incur additional debt, which has a lien on revenue subordinate to the lien of other bonds. See "Appendix B - Notes to the Financial Statements - #6, Revenue Bonds."

In addition to debt service coverage tests and certain other requirements, future debt issues of the Authority are subject to one of the debt limits of the State. The debt limit mandates that the aggregate maximum annual payments on the State's tax-supported obligations and the TTF debt obligations of the Authority (plus certain lease obligations) may not exceed 15% of total budgetary General Fund revenue, plus Trust Fund revenue for the fiscal year following the fiscal year in which such debt is issued. See "BONDED INDEBTEDNESS OF THE STATE - Debt Limits" for a complete explanation.

The bonds of the Authority do not constitute a debt of the State or a pledge of the general taxing power or the faith and credit of the State or any political subdivision, agency or instrumentality thereof other than the Authority. The State's pledge and assignment to the Authority of motor fuel tax revenue, motor vehicle document fees, motor vehicle registration fees and other revenue pursuant to State law creates an obligation of the State, until there are no longer any Authority bonds remaining outstanding, to continue to impose and collect these taxes and fees at least at the rates in effect on the date of issuance of the Authority bonds and to transfer this revenue to the Authority. The State, however, has no obligation to increase these taxes or fees to provide sufficient revenue to meet payments of debt service on the Authority bonds.

#### **Delaware State Housing Authority**

The Delaware State Housing Authority ("DSHA"), created in 1968, had outstanding on June 30, 2004, \$293.8 million of tax-exempt revenue bonds and \$13.4 million of taxable revenue bonds. Approximately \$232.1 million of the outstanding tax-exempt bonds were issued to finance the purchase of single-family homes, and the remainder was issued to finance multi-family housing. In addition, DSHA recently issued \$29.6 million of single family mortgage revenue bonds. The security for these bonds is mortgage loan repayments, reserve funds, bond proceeds and other

revenue. The taxable bonds have been issued primarily to finance second mortgages, providing down payment and closing cost assistance to eligible first-time homebuyers. See "Appendix B - Notes to the Financial Statements - #6, Revenue Bonds."

DSHA bonds do not constitute a debt or liability of the State. The enabling legislation, however, provides that the General Assembly may, but is not obligated to, make appropriations to restore the DSHA's capital reserve fund if such fund is drawn upon to meet debt service payments on certain of the DSHA's bonds. As of June 30, 2004, there were no DSHA bonds outstanding which are entitled to the benefit of the capital reserve fund. To date, the General Assembly has not been requested to make any such "moral obligation" appropriations. The statutory debt limit of the DSHA is \$350.0 million in bonds carrying the moral obligation of the State.

#### The Delaware Economic Development Authority

The Delaware Economic Development Authority and its predecessors had outstanding \$1.9 billion in economic development revenue bonds on June 30, 2004, none of which are backed by the full faith and credit of the State.

#### **Delaware State University**

There were outstanding on June 30, 2004, \$12.2 million of revenue bonds issued by the Delaware State University. These bonds are secured by the University's pledge of certain of its net operating revenue and net non-operating revenue.

The following two Authorities are not part of the State's financial reporting entity. The State, however, exercises oversight regarding their debt activities.

#### **Delaware Solid Waste Authority**

The Delaware Solid Waste Authority was created in 1975 and is the sole entity in the State responsible for the planning and administration of a comprehensive statewide program for the management, storage, collection, transportation, utilization, processing (including resource recovery), and disposal of solid waste and sewage sludge. On June 30, 2004, the Authority had no outstanding solid waste revenue bonds.

#### **Delaware Health Facilities Authority**

The Delaware Health Facilities Authority, established in 1973, is authorized to issue revenue bonds and notes to finance projects for health care facilities located in the State. As of June 30, 2004, there were outstanding \$326.0 million of revenue bonds issued for the benefit of these facilities. The Authority has no taxing power and no source of funds other than from the contractual obligations of participating health care facilities.

#### **University of Delaware**

There were outstanding on June 30, 2004, \$146.1 million of revenue bonds issued by the University of Delaware for housing, dining and other auxiliary facilities. These bonds are secured by revenue generated by the facilities.

#### **Political Subdivisions**

The approximate aggregate principal amount of general obligation bond indebtedness of the three counties, the City of Wilmington, the other cities and towns and the school districts of the State is outlined in the table which follows, as of June 30, 2003.

#### **General Obligation Debt of Political Subdivisions**

(in millions)

New Castle County	\$132.0
Sussex County	
Kent County	
Wilmington	$193.1^{(1)}$
Other Cities and Towns	$87.2^{(2)}$
School Districts	$240.2^{(3)}$
Total	\$ 765.5

- (1) Of this total, \$28.38 million is supported by payments from the Diamond State Port Corporation, an instrumentality of the State (see "ECONOMIC BASE The Port of Wilmington"). Excludes \$22.3 million of Wilmington Parking Authority bonds guaranteed by the City of Wilmington.
- (2) Excludes \$44.7 million of revenue bonds and anticipation notes of governmental issuers for various water/sewer and electric facilities, which are deemed to be self-supporting.
- (3) Represents local shares sold by the State on behalf of the school districts (as reported in the earlier chart entitled "Outstanding General Obligation Debt").

Source: Chief fiscal officers of respective governmental entities.

Indebtedness of counties, towns, and cities, other than the City of Wilmington, has been incurred primarily for water and sewer projects and general municipal purposes, subject to various debt limits. The State is not liable for any of this indebtedness. Unlike most other states, the State, rather than the local governments, is principally responsible for capital expenditures for schools and correctional facilities.

School districts may not issue bonds (including bonds sold to the State by school districts to fund the 20% to 40% share of capital costs), except to refund outstanding bonds, in an aggregate amount causing bonded debt of the district, less sinking funds on hand for payment of such bonded debt, to exceed 10% of the assessed value of the real property in the district.

#### ECONOMIC BASE

The State is located on the eastern seaboard of the United States and is bordered by the Atlantic Ocean and the Delaware Bay, as well as by the states of New Jersey, Pennsylvania and Maryland. It has a land area of 1,955 square miles, ranking 49th in area in the United States. The State is 96 miles long and varies from 9 to 35 miles wide, with elevations ranging from sea level to 442 feet. As the first state to ratify the United States Constitution on December 7, 1787, Delaware is known as "The First State."

#### **Recent History**

In recent years, Delaware's economic performance has largely mirrored national trends. Delaware participated fully in the late 1990's economic expansion and followed the nation, too, through the economic downturn that followed. Despite its ties to the national economy, throughout the recent business cycle, Delaware consistently posted lower unemployment rates than the United States. Most recently, Delaware's labor markets have begun to stabilize and its economy, like the nation's, has shown signs of sustainable recovery. (For a summary of Delaware's most recent economic forecast, see "STATE FINANCIAL OPERATIONS – Economic Projections.")

Much of Delaware's success in maintaining a healthy economy over the last decade can be attributed to its ability to continue to attract new business. Delaware's low cost of doing business, combined with its business friendly legal system, has attracted 80% U.S. of business incorporations to date in 2004. Even though initial public offering (IPO) activity has suffered from economic and other factors, the State has continued to register a record number of business formations in the form of LLCs and LPs. While automobile and chemical manufacturing remains an important part of Delaware's economy, the rise in the State's banking and service sectors has given Delaware a broader economic base. The State's successful financial services sector, including MBNA, INGDirect, Juniper, HSBC and Bank of America, anticipates adding up to 2,000 new jobs by the end of 2005.

Since the adoption of the Financial Center Development Act in 1981, diversifying Delaware's economy has consistently ranked among State policymakers' highest priorities. Delaware continues to pursue high technology industries, including life sciences research and development, pharmaceuticals, agricultural biotechnology, human biotechnology and information technology. The State has made a significant investment to establish the Delaware Biotechnology Institute, a partnership involving State government, Delaware's higher education institutions and the private sector. The Institute is designed to expand the State's scientific base and create opportunities for the development of new technologies in the emerging life sciences field.

#### **Population**

Historically associated with a strong employment and income base, population growth is one of the most important indicators of the strength of a state's economy. Delaware experienced above-average population growth through the 1990's, outperforming both the mid-Atlantic region and the nation. Between 2002 and 2003, Delaware's population increased 1.4% to 817,491

inhabitants, compared to 0.5% growth for the region and 1.0% growth for the nation. As in past years, net in-migration continues to account for a significant share of the population growth.

The following table presents population trends of the State, the mid-Atlantic region and the United States for 1999 through 2003.

### **Population** (in thousands)

	<b>Delaware</b>		Mid-Atlantic Region (1)		<b>United States</b>	
	<b>Population</b>	<b>Change</b>	Population -	<b>Change</b>	<b>Population</b>	<u>Change</u>
1999	775	1.5%	45,536	0.6%	279,040	1.2%
2000	786	1.5	45,813	0.6	282,178	1.1
2001	796	1.2	46,056	0.5	285,094	1.0
2002	806	1.3	46,295	0.5	287,974	1.0
2003	818	1.4	46,520	0.5	290,810	1.0

<sup>(1)</sup> Mid-Atlantic region consists of Maryland, New Jersey, Pennsylvania, New York and Delaware.

Source: U.S. Department of Commerce.

#### **Major Political Subdivisions**

The State has three counties: Kent, New Castle, and Sussex. All of the cities and towns in the State are independent, incorporated municipalities. There are three major cities: Wilmington, the largest city, with a 2003 estimated population count of 72,051; Dover, the State capital and the site of a major U.S. Air Force base, with a 2003 estimated population count of 32,808 residents; and Newark, the site of the University of Delaware, with a 2003 estimated population count of 29,821.

The following table shows the population of the State's three counties for the years 1999 through 2003. Approximately 63% of the State's population lives in New Castle County, the northernmost county. Sussex County, the southernmost county, continues to show very strong growth, almost three times that experienced by New Castle County and approximately 9.0% greater than that experienced by Kent County.

#### **Population by County**

	New Castle	<b>Change</b>	<b>Kent</b>	<b>Change</b>	<b>Sussex</b>	<b>Change</b>
1999	496,079	1.2%	125,611	1.3%	153,300	3.0%
2000	501,850	1.2	127,096	1.2	157,451	2.7
2001	506,189	0.9	128,985	1.5	160,402	1.9
2002	510,403	0.8	131,505	2.0	164,037	2.3
2003	515,074	0.9	134,390	2.2	168,027	2.4

Source: U.S. Department of Commerce.

#### **Personal Income**

Personal income figures reflect income received from participation in production, as well as from government and business transfer payments. It is widely used as a measure of residents' economic well-being. The State's total personal income grew 4.0 % from 2002 to 2003, compared with 2.7% for the mid-Atlantic region and 3.2% for the nation. Total State personal income in 2003 was \$27.3 billion.

The following table provides per capita personal income comparisons for 1999 through 2003. (Per capita personal income is the annual total personal income of State residents divided by the population.) Per capita personal income of Delaware residents grew 2.6% from 2002 to 2003. State per capita personal income was 106% of U.S. per capita personal income in 2003. Delaware per capita personal income growth was greater than that of the mid-Atlantic region and the United States for that same year.

#### Per Capita Personal Income

	<u>Delaware</u>	<u>Change</u>	Mid-Atlantic <u>Region</u>	<u>Change</u>	United <u>States</u>	<u>Change</u>	Delaware as Percent of the United States
1999	\$28,925	2.4%	\$31,759	3.8%	\$27,939	3.9%	104%
2000	30,871	6.7	34,000	7.1	29,847	6.8	103
2001	31,955	3.5	34,743	2.2	30,580	2.5	104
2002	32,487	1.7	35,056	0.9	30,795	0.7	105
2003	33,321	2.6	35,846	2.3	31,459	2.2	106

Source: U.S. Department of Commerce.

#### **Unemployment Rates**

The State's average unemployment rate for the first ten months of 2004 was 3.7%, lower than the regional rate of 4.8% and the national rate of 5.6%. The following table presents the average annual unemployment rates for Delaware, the region and the U.S. from 2000 through October 2004.

#### **Unemployment Rates**

	<b>Delaware</b>	Mid-Atlantic <u>Region</u>	United <u>States</u>
2000	3.9	4.0	4.0
2001	3.4	4.2	4.7
2002	4.2	5.2	5.8
2003	4.0	5.2	6.0
2004 <sup>(1)</sup>	3.7	4.8	5.6

<sup>(1)</sup> Reflects a ten-month average.

Sources: U.S. Department of Labor and Delaware Department of Labor.

According to data released by the U.S. Bureau of Labor and Statistics, Delaware's October 2004 unemployment rate was ranked 11<sup>th</sup> lowest in the nation and compares to an average of 4.7% held by the neighboring states of Maryland, New Jersey and Pennsylvania.

#### **Employment**

For the first ten months of 2004, the State experienced an increase of 1.6% in non-agricultural employment. The pace of job growth is projected to increase in Delaware through 2005. The following table and graph compare growth rates in this sector.

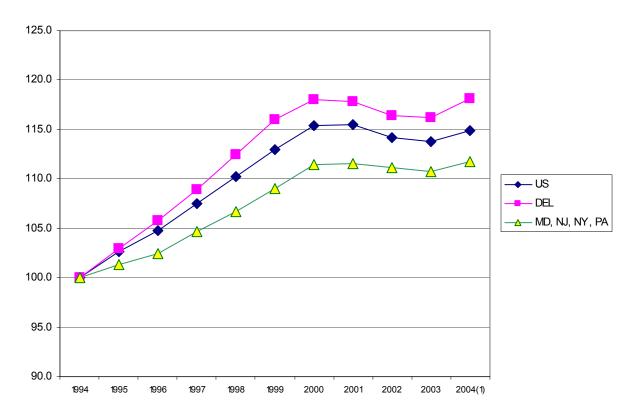
#### **Non-Agricultural Employment Growth Rates**

	<u>Delaware</u>	Mid-Atlantic <u>Region</u>	United <u>States</u>
1999	3.2%	2.2%	2.4%
2000	1.7	2.2	2.2
2001	(0.1)	0.1	0.0
2002	(1.2)	(0.4)	(1.1)
2003	(0.2)	(0.3)	(0.3)
2004 <sup>(1)</sup>	1.6	0.9	0.9

<sup>(1)</sup> Reflects a ten-month average.

Sources: U.S. Department of Labor and Delaware Department of Labor.

**Total Employment Growth (1994 = 100)** 



(1) Reflects a ten-month average.

Source: Delaware Department of Labor

Delaware experienced a sharp rise in total non-agricultural jobs during the first ten months of 2004. The rate of growth was much faster than that of the United States. Job growth has been spread among most major sectors. Only manufacturing experienced a decline. The largest gains occurred in Professional and Business Services, and Education and Health Services.

Overall, the largest employment sectors are within various service industries. The largest major sector is Professional and Business Services with 60,600 jobs. Included in this area are such industries as Professional, Scientific and Technical Services, Management of Companies, and Administrative and Support Services. The Professional and Business Service sector increased by 1,600 jobs in 2004 – a gain of 2.7%.

Education and Health Services also gained 1,600 jobs – an increase of 3.2% over 2003. Due to the aging population, health care is expected to continue to have rapid job growth for the balance of the decade. Like the nation as a whole, the demand for workers (e.g., nurses) has exceeded supply.

The Construction sector's employment increased to 25,300 jobs – a gain of 1,100 jobs or 4.5% over the year. The demand for residential construction has continued due to the improvement in the economy and relatively low mortgage rates.

Employment in Wholesale Trade and Retail Trade jumped by 1,100 jobs. Delaware has a competitive edge in this sector, as Delaware's lack of a sales tax has helped this sector continue to expand.

Employment in Leisure and Hospitality rose by 900 jobs. This represented an increase of 2.4%, which is slightly faster than the average increase for all industries.

"Other Services" (see table below) include industries such as repair services, personal care services, and civic and social agencies. This sector rose by 200 jobs in the first ten months of 2004.

Recent trends in employment in the State by major categories for 2000 through October 2004 are shown in the following table.

# **Employment** (in thousands)

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u> <sup>(3)</sup>
Civilian Labor Force Data					
Employed <sup>(1)</sup>	399.2	413.1	402.1	399.0	409.4
Unemployed	16.4	14.8	<u>17.8</u>	18.3	<u>16.0</u>
Total	<u>415.6</u>	<u>427.9</u>	<u>419.9</u>	417.3	<u>425.4</u>
NAICS Data					
Construction and Mining	24.6	24.6	24.5	24.2	25.3
Manufacturing	41.5	39.4	37.1	35.7	35.2
Wholesale Trade	13.2	13.4	13.6	14.2	14.7
Retail Trade	51.4	50.6	51.1	51.6	52.2
Transportation, Warehousing and Utilities	14.2	12.8	12.3	12.3	12.3
Information	8.1	8.1	7.7	7.4	7.5
Financial Activities	46.8	47.4	46.5	45.5	45.8
Professional and Business Services	65.7	65.3	60.7	59.0	60.6
Education and Health Services	45.5	47.4	48.7	49.9	51.5
Leisure and Hospitality	35.8	36.4	37.6	38.2	39.1
Other Services.	15.9	17.3	17.9	18.2	18.4
Government	<u>56.6</u>	56.9	57.1	<u>57.4</u>	<u>57.8</u>
Non-Agricultural			<del></del>	· <del></del>	
Employment Total <sup>(2)</sup>	<u>420.0</u>	<u>419.4</u>	<u>414.5</u>	<u>413.6</u>	<u>420.4</u>

<sup>(1)</sup> This indicator reflects the number of Delaware residents, 16 years of age or older, who worked at least one hour for pay or profit, and includes employment in agriculture, proprietors, self-employed, unpaid family workers and domestic workers.

<sup>(2)</sup> Based on reconstructed and restated data complying with the North American Industry Classification System (NAICS) (see discussion below). This indicator includes persons on Delaware non-agricultural establishment

payrolls, regardless of their place of residence, and does not include proprietors, self-employed, unpaid family workers, domestic workers and military personnel. The total may not add due to rounding.

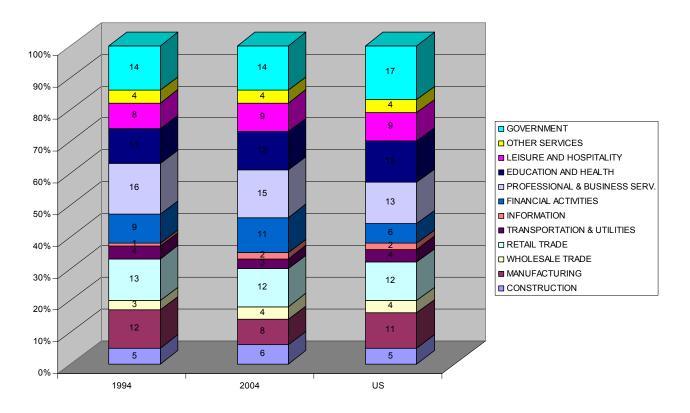
#### (3) Through October 2004.

Source: Delaware Department of Labor.

In 2003, Delaware, along with all other U.S. states and territories, implemented a new way of gathering and reporting economic data. The Standard Industrial Classification (SIC) System, which had been in place since the 1930's, has been replaced by the North American Industry Classification System (NAICS). NAICS is considered an improvement over SIC because NAICS was designed with the nation's modern economy in mind. NAICS differs from SIC in that it more fully recognizes the rise in the economy's service and information bases. Additionally, whereas SIC classified all employees working in a particular firm under a single code, NAICS makes distinctions within each firm. For example, within the same firm, production workers are classified under "manufacturing" but the CEO would be recognized separately as "headquarters" staff. Clearly, the change in the classification systems means that any comparisons of current NAICS based data with SIC based data is likely to produce unreliable results. Delaware, along with the U.S. Bureau of Labor and Statistics, have undertaken the difficult task of reconstructing and restating industry data since 1990 in NAICS format. Accordingly, readers should be aware that such data is not based upon an actual historical series and reliance thereon should be limited.

Over the past ten years, Delaware's employment has grown in most industries. Once heavily reliant on the manufacturing base, Delaware has experienced large gains in several of the service industries. Since 1993, the following sectors have had an increase in the percentage of Delaware jobs: Construction; Retail Trade; Information; Professional and Business Services; Education and Health; and Leisure and Hospitality. Professional and Business Services made up 17% of Delaware jobs, compared to 12% for the U.S. The diversification of the State's economic base will help Delaware to continue to weather the economic downturns and strengthen the State's economic position in future years.

#### Percentage Distribution of Employment 1994 - 2004



The following chart lists the private employers in the State with at least 900 positions, as of June 2004:

<u>Name</u>	<u>Nature</u>	Approx. Number of <u>Employees</u>
Financial Services		
MBNA America Bank	Commercial banking	11,000
J.P. Morgan Chase & Co.	Commercial banking	
	Commercial banking	
Wilmington Trust Company	Commercial banking	2,200
	Commercial banking	
	Financial services	
PFPC Inc.	Financial services	1,000
Manufacturing		
E.I. du Pont de Nemours & Co., Inc	Chemicals and energy; corporate headquarters Pharmaceuticals and specialty chemicals; sales;	9,400
	corporate headquarters	
	Automotive assembly	
	Automotive assembly	
	Electromedical apparatus	
ARTEVA	Chemicals	1,200
<b>Hospitals and Health Services</b>		
Christiana Care Health Services	Hospital complex	6,300
Alfred I. du Pont Institute	Children's health care facility	2,900
Bay Health Medical Center	Hospital complex	2,500
	Hospital complex	
	Hospital complex	
Agribusiness		
Mountaire Farms of Delmarva, Inc.	Food processor	3,400
Perdue Farms, Inc	Broilers, feed and grains	2,700
Retail		
	Retail chain	3,400
	Retail chain	2,200
	Retail groceries	1,600
	Retail chain	1,200
Sears	Retail chain	1,100
Lowe's Home Centers	Retail chain	1,000
Wawa Inc.	Convenience stores	900

#### **Other Services**

Dover Downs	Slots and racing	1,400
Delaware Park, LLC		1,400
YMCA	Civic and social organization	1,400
Comcast Cable	TV cable service	1,200

Source: Delaware Department of Labor.

The following table presents trends in manufacturing employment and distribution by industry sector for 2000 through October 2004.

# **Manufacturing Employment by Sector**<sup>(1)</sup> (in thousands)

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<b>2004</b> <sup>(2)</sup>
Number of employees	41.5	39.4	37.1	35.7	35.2
Distribution by Industry Sector					
Total Non-Durable Goods  Total Durable Goods		22.1 17.3	21.0 16.1	21.3 14.4	21.0 14.2

<sup>(1)</sup> Based on reconstructed and restated data complying with the North American Industry Classification System (NAICS) (see discussion above pertaining to table entitled "Employment" under "ECONOMIC BASE – Employment").

Source: Delaware Department of Labor.

#### **Chemical Industry**

The importance of the chemical industry to Delaware's economy stems historically from the fact that two large companies - E.I. du Pont de Nemours & Co., Inc. ("DuPont") and Hercules Incorporated ("Hercules"), maintain their global headquarters within the State. Both companies are engaged in corporate management, finance, research, engineering and related activities in support of their worldwide operations.

Founded in 1802, DuPont (NYSE: DD) is a science company and the State's second largest private employer, with approximately 9,400 employees in Delaware as of June 2004. DuPont's primary industry segments include chemicals, polymers, and diversified businesses, including agricultural and medical products. In November 2003, DuPont announced that its agreement to sell its nylon, polyester and Lycra business (INVISTA) to Koch Industries, Inc. to ensure its global

<sup>(2)</sup> Through October 2004.

competitiveness as a more focused, science-based company. INVISTA employs 1,100 people in Delaware, 600 of whom work at the nylon plant in Seaford. In June 2004, INVISTA announced it would locate two global headquarters in Delaware; its Performance Fiber business and its Apparel business as well as a vast majority of support operations for the capitalized intermediary business. Delaware was competing with sites in four countries and five other states to retain these headquarters.

Hercules Incorporated, (NYSE: HPC) established in 1912, produces and markets specialty chemicals used in making a variety of products for home, office and industrial markets. Hercules' production facilities include 35 major plants strategically located throughout the world as well as a research center in Wilmington, Delaware. Sales in 2003 were \$1.8 billion.

In addition, CIBA Specialty Chemicals (NYSE: CSB) announced that the company will expand its business operations in Newport, DE by adding 44 new jobs and further developing the site as its NAFTA business and manufacturing headquarters for its Coating Effects Business Segment. Some of this is to be accomplished through the relocation of positions from their Tarrytown, NY facility. CIBA anticipates spending over \$24 million in capital expenditures in the next five years. This includes the ability to produce a raw material which was previously manufactured overseas.

EVC Films, a division of European Vinyls Corporation (EVC), a Dutch company, announced that the company, a leading manufacturer of polyvinyl chloride (PVC) will open its North American Headquarters in Delaware including its first manufacturing facility in the United States. This business acquired an abandoned chemical site and will upgrade an existing facility. The expansion will ultimately add up to 125 new jobs to Delaware's workforce.

Uniquema, part of the ICI Group, announced plans to expand its Atlas Point, New Castle, DE manufacturing facility, which represents an \$8 million capital investment by the company. Delaware competed with North Carolina for this project initially.

#### **Life Sciences**

In 1999, AstraZeneca Inc. (NYSE: AZN) ("AstraZeneca"), formed by the merger of Stockholm-based Astra AB and London-based Zeneca Group PLC, one of the largest pharmaceutical companies in the world, selected Delaware as its U.S. headquarters. Wilmington is also the global home for the Central Nervous System therapy team, which includes both the commercial and research and development groups. The majority of the work done by the research and development group focuses on lead informatics, compound management and automation, and assay development and high throughput screening.

On April 20, 2004, AstraZeneca celebrated the opening of a state-of-the-art Automated Compound Management Facility (ACMF) at their Wilmington R&D campus. Part of a four-year, \$165 million investment in US research facilities, this latest \$13 million addition is one of four new AstraZeneca drug discovery research facilities of its kind worldwide.

With the ability to store over 2.8 million compound samples, the R&D Wilmington ACMF is a critical part of AstraZeneca's strategy to improve the speed and productivity of drug discovery and development. The ACMF has smoothed the progress of the company's worldwide initiative to rebuild their proprietary library of compounds. This new facility will ensure the quality of these compounds for future use by applying optimal storage conditions and best handling practices. With advanced technologies and automated processes, ACMF will enable scientists to do drug discovery research in ways that were not possible before.

As of June 2004, AstraZeneca employed 4,900 in Delaware and is expected to employ an additional 2,000 by the end of 2005. It is estimated that AstraZeneca has a product pipeline that will be worth \$7.2 billion by 2008. AstraZeneca is pursuing new endeavors internally and externally to keep its pipeline robust.

### **Research and Development**

Delaware's economy has long been a source of innovation and technological growth. Some of the state's most prominent firms, such as Agilent (NYSE: A), AstraZeneca, DuPont and W. L. Gore and Associates, are world renowned for their technical breakthroughs and resulting commercial success. Because of the presence of these firms and others like them, as well as its highly capable research universities, Delaware has the second highest concentration of scientists and engineers in the United States. In addition, Delaware is ranked among the top states in the nation when it comes to the number of patents issued per capita. This high quality workforce and innovative research and development environment provide excellent opportunities for technology-based business growth. The State also provides a variety of technology resource programs to foster commercialization.

The University of Delaware's outstanding reputation for research in cooperation with industry is well recognized in many areas. The University's innovative research efforts are illustrated through its partnerships with industry in composite materials, information science, biotechnology, alternative energy, virology and development of genetically engineered vaccines, and agrigenetics, including plant tissue culture research. Through its seven colleges, institutes and various centers, including the Center for Composite Materials, Center for Catalytic Science and Technology, and Center for Climatic Research, the University has fostered growth and development in the chemical, computer, energy, food, agricultural and marine sciences industries.

The University's Institute of Energy Conversion, one of the world's largest thin-film solar cell laboratories performing research and process development for industry, has been designated by the U.S. Department of Energy as a national center of excellence in photovoltaic research and education. The University of Delaware's Center for Composite Materials is one of three partners in an Army Research Laboratory Materials Center of Excellence.

The Delaware Technology Park (DTP) in Newark houses over 35 start-up high technology companies. It has created more than 500 jobs and has generated more than \$200 million in revenue, since it opened in 1992. From 1999 to 2002, DTP added four new buildings

totaling 240,000 square feet, and the expansion is expected to result in the creation of 1,500 more jobs and \$800 million in additional revenue to Delaware's economy by 2010.

The Delaware Biotechnology Institute (DBI), located in the Delaware Technology Park, is a partnership among government, academia and industry to help establish Delaware as a center of excellence in biotechnology and the life sciences. DBI's mission is to build a biotechnology network of people and facilities to enhance academic and private sector research, catalyze unique cross-disciplinary research and education initiatives and to foster the entrepreneurship that creates high quality jobs. DBI's 72,000 square foot research facility is designed to house 170 faculty and student researchers and features 38 laboratories, 6 state-of-the-art research instrumentation centers, and several large and small conference areas.

DBI led Delaware's effort towards gaining Experimental Program to Stimulate Competitive Research (EPSCoR) status with the National Science Foundation's Experimental Program Status Competitive Research. EPSCoR status provides Delaware and 22 other qualifying states and U.S. territories with a better chance for federal funding dollars. Eight federal agencies participate in this program with the National Institutes of Health (NIH) and the National Science Foundation (NSF), two of the most prominent agencies.

Leading-edge interdisciplinary research is at the core of DBI's work. Successful partnerships are already underway involving biology, biochemistry, engineering, marine, materials science and computational biology. Encompassing 12 academic departments at the University of Delaware alone, collaborations are also state-wide, national and international, with the participation of scientists from Delaware State University, Delaware Technical & Community College, and Wesley College. DBI-affiliated researchers are principal investigators in a growing portfolio of federal research grants from NSF, NIH, the U.S. Department of Agriculture (USDA) and numerous other government agencies and private foundations.

Delaware's industry, academia and state government led an effort to recruit the new Fraunhofer Center for Molecular Biotechnology to Delaware in 2001. This has resulted in the construction and fitout of labs at the Delaware Technology Park to pursue the development of vaccines from plants and the development of enzymes from plants. The pursuit of the production of pharmaceuticals and industrial enzymes from plants is an emerging growth sector in the bio/pharma world.

In October 2003, DuPont and the U.S. Department of Energy's National Renewable Energy Laboratory (NREL) announced a joint research agreement for the development of the world's first integrated "bio-refinery" that uses corn or other renewable resources, rather than traditional petrochemicals, to produce a host of valuable fuels and value-added chemicals. The \$7.7 million Cooperative Research and Development Agreement is a collaborative venture for DuPont and NREL to develop, build and test a bio-refinery pilot process that will make fuels and chemicals from the entire corn plant. The agreement is part of the larger \$38 million DuPont-led consortium known as the Integrated Corn-Based Bioproducts Refinery (ICBR) project. This project was awarded \$19 million in matching funds from the U.S. Department of Energy in 2002 to design and demonstrate the feasibility and practicality of alternative energy and renewable resource technology.

Nemours Biomedical Research at the Alfred I. DuPont Hospital announced the establishment of a Center for Pediatric Research (CfPR) in Wilmington, Delaware. The CfPR will develop and foster pediatric research programs to shorten the time it takes to safely transition research advances from the laboratory bench top to the patient's bedside. A team of researchers led by Dr. Thomas Shaffer and Dr. Carolyn Schanen has been awarded a Center of Biomedical Research Excellence (COBRE) grant by the National Institutes of Health (NIH) to establish the CfPR. By providing \$9.8 million over the next five years, the grant adds considerable substance to a backbone structure established by Nemours over the past few years. The grant allows the Hospital, the State of Delaware, and Nemours itself to take a giant step toward their shared goal of improving health care for children through research.

The Applied Optics Center located at Delaware State University focuses on developing and commercializing different applications of new laser technology. The Center concentrates on laser spectroscopy technology and laser diode-based devices. Core competencies include time and frequency-based laser spectroscopy and nonlinear and laser optics. Dade Behring (NASD: DADE), a major instruments maker whose research and development headquarters are located in Glasgow, Delaware, is the major industrial sponsor. Research with Dade includes enhanced detection of trace atoms and molecules in liquids and a laser-based spectrometer for various medical applications. An American Dental Association project includes laser curing of photopolymers. The Center is working with NASA in measuring greenhouse gas emissions by generating ultra-violet pulses through laser amplification.

## **Financial Services Industry**

Banks and other financial institutions have been a major focus of Delaware's economic development activity since 1981. In that year, landmark legislation was passed that opened Delaware to interstate banking, modernized the State's banking laws, and permitted the creation of new types of special purpose intermediaries. The 1981 Financial Center Development Act created strong economic incentives for the banking industry in Delaware, including a favorable state tax structure and a market based approach to lending that eliminated restrictive usury caps. These laws continue to create a favorable economic environment for banking. The State subsequently enacted additional legislation in order to sustain the State's competitive advantage in banking. In 1989, the Bank and Trust Company Insurance Powers Act was signed into law which allowed state-chartered banks and trust companies to underwrite and sell various types of insurance. In response to the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, the State enacted legislation in 1995 to keep Delaware's banking community competitive and to maintain Delaware's role as a financial services center. Additionally, in 1995 the State Bank Commissioner issued the "Incidental Powers Regulation", which is designed to keep Delaware competitive by allowing state-chartered banks and trust companies to exercise additional powers incident to a banking corporation.

As of December 31, 2003, there were 61 banks and trust companies in Delaware including full-service commercial banks, credit card banks, non-deposit and limited purpose trust companies, wholesale banks, and federal and state savings banks. Credit cards are a major industry in the State. Prominent credit card issuers in Delaware include MBNA America Bank, N.A., Chase Manhattan Bank (USA), N.A., and Discover Bank.

MBNA, the largest independent credit card issuer in the world, is the State's largest private employer, with 28,000 employees company-wide and approximately 10,500 employees in Delaware, as of September 30, 2004. The bank specializes in affinity credit cards (i.e., those linked to non-profit organizations, universities, clubs or hobbies with high consumer loyalty) and co-branded cards (i.e., partnerships with for-profit companies). MBNA managed \$117.8 billion of loans as of September 30, 2004, a \$5.1 billion or 4.5% increase over September 30, 2003. Net income for the first nine months of 2004 reached \$1.9 billion, an increase of 16.7% over the prior year, reflecting growth in MBNA's customer base (7.2 million new customers were added during the first nine months of 2004), as well as in loan activity.

#### Construction

Delaware's housing production during 2003 totaled 8,977 units, a 20.4% increase over 7,459 units in 2002. Single family construction increased by 12.3% to 6,812 units, while multifamily starts increased by 266%. The sale of mobile homes increased by 5.6% to 1,191 units.

The following table outlines total housing production in the State by county for 1999 through 2003. Housing production includes single and multifamily, public and private housing, as well as mobile homes. In 2003, single family housing (including condominiums) represented 76% of total production, multifamily units represented 11%, and mobile homes represented 13%.

### **Production of Housing Units**

	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
New Castle County	2,330	1,893	2,546	2,255	2,432
Kent County	905	817	1,088	1,452	2,170
Sussex County	2,186	2,194	2,029	2,624	3,184
Mobile Homes	<u>1,379</u>	<u>1,151</u>	940	<u>1,128</u>	<u>1,191</u>
Total	<u>6,800</u>	<u>6,055</u>	<u>6,603</u>	<u>7,459</u>	<u>8,977</u>

Source: Delaware State Housing Authority.

#### **Automotive Industry**

The State is home to two major automotive assembly plants. Employment at the two plants totals 4,000 jobs, less than 1.0% of the total jobs in Delaware. In October 2003, DaimlerChrysler began production of a newly designed Dodge Durango, its sport utility vehicle, at the Newark assembly plant, the only plant manufacturing the Durango. Over one million Dodge Durangos have been sold since the model's inception in 1997.

The General Motors Boxwood Road assembly plant near Newport ceased production of the Saturn L-Series in mid-2004, but is scheduled to begin producing the new Pontiac Solstice in April 2005. GM also plans to produce the new Saturn Sky at the Boxwood Road facility in 2006, a sports car that will be unveiled at Detroit's January 2005 auto show.

# **Incorporations**

As of November 2004, the total number of business entities registered with the Delaware Division of Corporations passed 625,000 with more than 9,000 new entities registering during October – the 14<sup>th</sup> consecutive month in which new filings surpassed the same month in the prior year. The principal driver of this growth has been alternative business entities, such as limited liability companies. The State continues to be the corporate home of over half of all publicly-traded firms in the United States. Delaware is the legal domicile of more than 58% of the companies listed in the "Fortune 500". Since 1989, Delaware has ranked within the top five states in the nation in the number of new business entity formations with more than 96,000 formed in 2003 alone.

Since 1985, significant changes have been made to Delaware's corporate laws, specifically in such important areas as directors' liability and corporate takeovers. In addition to the option of forming a Delaware corporation, the Delaware Code enables businesses to form as general partnerships, limited partnerships, limited liability companies and statutory trusts. Businesses may also qualify as limited liability partnerships or limited liability limited partnerships. These changes, combined with a well-developed body of case law; prompt resolution of commercial and corporate disputes by Delaware's Court of Chancery; and efficient, friendly service from the Delaware Division of Corporations have resulted in significant business formation activity.

In order to sustain its competitive edge over other states and countries, Delaware continues to adopt statutes that respond to changing business conditions. A 2003 law extends the corporate jurisdiction of the Court of Chancery to include jurisdiction over commercial technology disputes. The 2003 law also allows the Court to mediate many types of complex business disputes, providing a more cost-effective, confidential, and consensual method for resolving litigable controversies. A 2004 law provides tax incentives for businesses to form Headquarter Management Corporations in Delaware and locate headquarter services in Delaware. Recent laws simplify the process of converting from one type of business entity to another type of entity. The Division of Corporations continues to enhance its services by offering 1-hour processing service expanding Internet services to allow businesses to reserve corporate names, access general corporate information and file annual tax returns. All of these enhancements provide further incentives for entrepreneurs, businesses and investors to make Delaware their legal home.

Effective July 1, 2001, the Division of Corporations allowed for the filing of Uniform Commercial Code information via the Internet. In fiscal 2004, the Division processed 170,000 filings and 97,000 UCC searches with total general fund revenue of \$13.1 million.

# Agriculture

Agriculture comprises an important segment of Delaware's economy. According to statistics published by the U.S. Department of Agriculture, 42% of Delaware's land area is used

for farming. In 2003, Delaware farmers earned \$760.2 million in cash receipts from all commodities, an increase of 6% over the prior year. Higher value for broiler chickens and significantly higher production of soybeans and corn from the drought of 2002 accounted for the increase, more than offsetting a \$10.6 million decrease in value of vegetable production due to excessive precipitation.

Delaware had 2,300 farms in 2003, a decrease of 100 from a year earlier. Farms averaged 230 acres for a total of 530,000 acres in farms. In 2003, the total market value of agricultural land and buildings was \$2.16 billion, and the average value per operating unit was \$939,000. The average market value per acre of farmland and buildings in Delaware was \$4,000, more than three times the average value nationally. Only five states had a higher value per acre.

Delaware's net farm income increased in 2003 by 145%. This was a result of an 8% increase in value of production, a 3% decrease in cost of purchased inputs and a 173% increase in government payments. Delaware's broiler chicken production (pounds liveweight) decreased in 2003 by 2%, but value per pound increased by 4 cents per pound, increasing the value of production to \$543 million, a 10% increase.

The cash receipts from Delaware farms as compared to the U.S. total in 1999-2003 are outlined in the table below.

**Farm Cash Receipts** 

		Dela (dollars i	United States (dollars in billions)			
	Livestock & Livestock <u>Products</u>	<u>Crops</u>	Total Cash <u>Receipts</u>	Change from Previous <u>Year</u>	Total Cash <u>Receipts</u>	Change from Previous <u>Year</u>
1999	\$560	\$159	\$719	(8.0)%	\$187.6	(4.4)%
2000	555	178	733	1.2	192.1	2.4
2001	660	184	844	15.1	200.1	4.2
2002	547	171	718	(14.9)	195.1	(2.5)
2003	593	167	760	5.8	211.6	8.5

Sources: Delaware Department of Agriculture and National Agricultural Statistics Service/USDA.

#### The Port of Wilmington

The Port of Wilmington (the "Port") is the largest importer of bananas in the U.S. and is a significant east coast handler of imported fruit, juice and produce, particularly winter Chilean fruit, juice from Argentina, and New Zealand apples and kiwi. Other significant food items include frozen meat and pet food from Australia and New Zealand. The Port also handles import and export vehicles (General Motors, Volkswagen and Audi use the Port as either a point of entry into the United States, or a point of consolidation for export), steel, lumber, paper, dry bulk and liquid petroleum products.

The Port has a central location on the east coast and excellent access to rail and highway transportation systems. Warehouse facilities include 250,000 square feet of dry and 669,000 square feet of modern temperature controlled refrigerated space. The combination of relatively new facilities, operational experience, proximity to transportation networks and a skilled customer service and labor force have made the Port among the most successful ports in the very competitive mid-Atlantic and Northeast region.

Founded in 1923, the Port is owned and operated by the Diamond State Port Corporation ("DSPC"). In June 1995, the General Assembly authorized the creation of the DSPC, a membership corporation with the Department of State as the sole member, for the purpose of acquiring and operating the Port. On September 1, 1995, DSPC acquired substantially all of the Port's assets from the City of Wilmington. Under the terms of that agreement, DSPC agreed to make payments to the City equal to \$39.9 million over a 30-year period and to pay amounts equal to total debt service on approximately \$50.0 million of indebtedness previously incurred by the City for Port related assets. The Delaware Transportation Authority's Transportation Trust Fund has loaned funds to the DSPC to enable it to restructure certain of the DSPC's debt to the City and to fund capital projects. In addition, DSPC used funds borrowed from the Transportation Trust Fund to prepay commercial loans to Wilmington Trust and the Delaware River and Bay Authority. DSPC does not have the power to pledge the credit of the State.

The Port is part of the State's financial reporting entity and is considered an enterprise fund for the State's GAAP financial reporting purposes. See "Appendix B - Notes to the Financial Statements - #6, Revenue Bonds."

In fiscal 2004, a total of 4.2 million tons of cargo passed through the Port's facilities, a decline of 7% from the 4.5 million tons handled in fiscal year 2003. Lower cargo volumes produced corresponding reductions in operating revenue of 4% from \$26.8 million in fiscal year 2003 to \$25.7 million in fiscal year 2004.

Over \$120 million has been appropriated by the General Assembly to date for Port infrastructure improvements and debt restructuring, including \$15 million in fiscal 2005 and \$5.0 million in fiscal 2004. The Port is not required to repay these funds.

#### **Dover Air Force Base**

The federal government maintains a major U.S. Air Force base (the "Base") in Dover, Delaware. The 3,900 acre Base, established in 1941, is the nation's busiest military cargo terminal, a key airlift center and home to the 436th Airlift Wing. The 436th Airlift Wing provides command and support functions for assigned airlift operations, permitting worldwide movement of outsized cargo (including the military's largest tanks and heaviest weapons and equipment) and personnel. The unit flies 32 Lockheed C-5 Galaxy transport planes, known as "the free world's largest airlifter". Demand for the C-5 transports, maintenance staff and cargo expertise remain at record levels. In April 2002, the Air Force announced plans to base 12 new C-17 planes at Dover and invest \$90.0 million in construction funding to accommodate the new aircraft by 2008. The C-17 planes will replace the C-5 transports. In addition, the Base hosts the Charles C. Carson Center for Mortuary Affairs, the defense department's largest and only mortuary facility in the continental U.S. The Base employs approximately 4,000 active duty personnel and a total of 8,800 reservists, guards and civilians. The economic impact of the Base is estimated to be over \$380 million.

#### STATE FINANCIAL OPERATIONS

The State controls and records its financial transactions on a cash basis of accounting for its day-to-day operations in accordance with the various budgets and statutes passed by the General Assembly and approved by the Governor. See "FINANCIAL STRUCTURE - Budgetary Control and Financial Management Systems". The State's audited June 30, 2004, Basic Financial Statements as set forth in Appendix B, were prepared in accordance with accounting principals generally accepted in the United States of America (GAAP) using both the modified accrual basis and full accrual basis of accounting. The following discussion of State finances relates to the budgetary General and budgetary Special Funds of the State, as more fully set out in the financial statements included under Appendix A hereto.

#### **Revenue and Expenditure Forecasting**

The Delaware Economic and Financial Advisory Council ("DEFAC"), created in 1977, is comprised currently of 34 members appointed by the Governor. Current members of DEFAC include five cabinet-level officials, the State Treasurer, the Controller General, one other governmental official, five legislators, and 21 private citizens from the business, financial and academic communities.

DEFAC is mandated by executive order to submit to the Governor and the General Assembly budgetary General Fund and Transportation Trust Fund revenue forecasts six times each fiscal year in September, December, March, April, May and June for the current fiscal year and the succeeding two fiscal years. A forecast for the current fiscal year and the succeeding four fiscal years is generated once each year, not later than October 1. Budgetary General Fund and Transportation Trust Fund expenditure forecasts are generated for the current fiscal year in December, March, April, May and June. The various DEFAC forecasts contained in this Official Statement were provided as of December 13, 2004.

These revenue and expenditure forecasts are used in the State budget process to ensure compliance with the State's constitutional limits on spending and statutory debt limitations. See "FINANCIAL STRUCTURE - Appropriation Limit" and "BONDED INDEBTEDNESS OF THE STATE - Debt Limits." The subcommittees of DEFAC are the Expenditure and Revenue subcommittees, which meet prior to the DEFAC meetings. The full DEFAC meetings are open to the public and provide a general forum for members of the private and public sectors to exchange views on matters of economic and fiscal concern for the State.

DEFAC relies on projections of national economic trends, Global Insight, Inc. (formerly DRI-WEFA), the Department of Finance's econometric model, projections generated by the Department of Transportation, its members' knowledge of the State's particular economic strengths, and its members' understanding of the structure of the State's revenue system. The comparison of DEFAC's forecasts of budgetary General Fund revenue with actual year-end revenue are reviewed in the following table. These forecasts were generated 18 months and 9 months prior to the end of each fiscal year. DEFAC does not project the revenue impact of legislation until after its enactment.

**DEFAC Budgetary General Fund Revenue Projections** (in millions)

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
18 Months Before Fiscal Year-End	\$2,178.5	\$2,329.3	\$2,432.6	\$2,361.8	\$2,309.9
9 Months Before Fiscal Year-End	2,214.9	2,329.1	2,348.6	\$2,269.1	\$2,586.3
Actual Fiscal Year-End Revenue	2,279.0	2,329.0	2,425.7	\$2,436.4	\$2,735.5

#### **Economic Projections**

Based upon national forecasts by Global Insight, Inc. in December 2004, the State is expected to show continued economic growth. The following chart compares forecasted population, employment and personal income growth rates for fiscal 2005 through 2007 for Delaware and the United States, considered by DEFAC in making its revenue forecasts as presented herein.

# **Projected Economic Growth Rates**

	<u>_</u>	Delaware		<b>United States</b>			
	Fiscal <u>2005</u>	Fiscal <u>2006</u>	Fiscal <u>2007</u>	Fiscal <u>2005</u>	Fiscal <u>2006</u>	Fiscal <u>2007</u>	
Population Growth Employment Growth Personal Income Growth	1.3% 1.6 5.7	1.3% 1.4 5.1	1.3% 1.7 5.8	0.9% 1.6 5.3	0.9% 1.6 5.4	0.9% 1.2 5.7	

Sources: Delaware Department of Finance and Global Insight, Inc.

# Revenue Summary - Fiscal 2004 - Fiscal 2006E

The following table and chart include fiscal 2004 budgetary General Fund revenue from all sources as well as DEFAC's December 13, 2004, forecasts of budgetary General Fund revenue from all sources for fiscal 2005 and fiscal 2006. The estimates reflect the adjusted growth rates of 2.8%, and 5.0%, respectively, for fiscal 2005 and fiscal 2006, after adjusting for one-time events and State tax law changes. See "Fiscal Year Ended June 30, 2004", "Fiscal Year Ending June 30, 2005" and "Fiscal Year Ending June 30, 2006."

# **Budgetary General Fund Revenue**

(in millions)

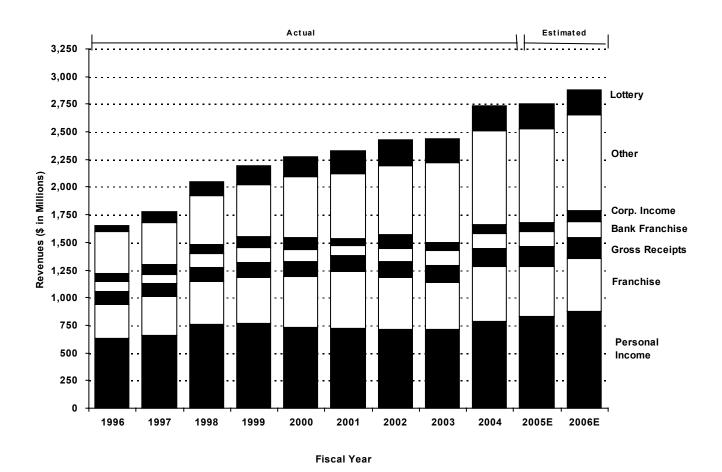
DEFAC Forecast as of December 13, 2004

	Fisc	al 2004	Fiscal	2005	Fiscal	2006
	Actual	Change	Actual	Change	Actual	Change
Personal Income Tax	906.4	7.9%	961.2	6.0%	1,018.0	5.9%
Less: Refunds	(125.2)	-3.4%	(133.6)	6.7%	(140.2)	5.0%
PIT Less Refunds	781.2	10.0%	827.6	5.9%	877.8	6.1%
Franchise Tax	515.8	15.1%	474.0	-8.1%	493.0	4.0%
Less: Refunds	(16.6)	-2.4%	(17.0)	2.7%	<u>(17.0)</u>	0.0%
Franchise Tax Less Refunds	499.3	15.8%	457.0	-8.5%	476.0	4.2%
Corporate Fees	49.5	26.3%	53.0	7.0%	55.6	5.0%
Limited Partnerships & LLC's	51.0	104.0%	59.1	15.9%	63.0	6.6%
Uniform Commercial Code	13.1	-20.0%	13.5	2.9%	13.9	3.0%
Corporation Income Tax	106.3	-2.0%	125.1	17.6%	133.5	6.7%
Less: Refunds	(25.4)	-39.9%	(45.0)	77.5%	(35.0)	-22.2%
CIT Less Refunds	81.0	22.1%	80.1	-1.1%	98.5	23.0%
Bank Franchise Tax	136.6	-3.4%	135.5	-0.8%	147.5	8.9%
Gross Receipts Tax	161.5	9.5%	177.5	9.9%	188.2	6.0%
Lottery	222.0	4.2%	229.0	3.2%	236.3	3.2%
Abandoned Property	302.0	30.5%	290.0	-4.0%	285.0	-1.7%
Hospital Board and Treatment	84.0	2.6%	53.2	-36.7%	55.1	3.6%
Dividends and Interest	9.0	-56.5%	11.0	21.6%	14.0	27.3%
Realty Transfer Tax	88.6	34.2%	100.0	12.9%	95.0	-5.0%
Estate Tax	13.4	-66.0%	10.6	-20.9%	1.7	-84.0%
Insurance Taxes	54.4	1.5%	57.8	6.3%	60.7	5.0%
Public Utility Tax	34.1	4.0%	36.5	7.1%	37.8	3.5%
Cigarette Taxes	75.7	106.1%	83.0	9.7%	84.7	2.0%
Other Revenues	103.2	-12.8%	107.3	4.0%	112.1	4.5%
Less: Other Refunds	<u>(24.1)</u>	-30.9%	(26.1)	8.5%	(20.3)	-22.2%
Total (1)	2,735.5	12.3%	2,755.6	0.7%	2,882.5	4.6%
Adjusted Growth Rate (2)		6.6%		2.8%		5.0%

Does not equal the sum of its components due to the rounding of actual amount.
 After adjusting for State tax law changes and other one-time events.

The following chart shows both the growth in and source of budgetary General Fund revenues since 1996 and provides estimates for fiscal 2005 and 2006.

# **Budgetary General Fund Revenue at June 30**



Source: For fiscal 2005 and 2006, DEFAC Report, December 13, 2004.

# **Expenditure Summary - Fiscal 2000 - Fiscal 2005E**

The following table compares total budgetary General Fund expenditures by major departments for the past five fiscal years and provides estimates for fiscal 2005. These figures include supplemental appropriations for capital projects and debt reduction, as described below. See also "BUDGETARY GENERAL FUND SUMMARIES - Budgetary General Fund Disbursements by Category of Expense."

# **Budgetary General Fund Expenditures**

(in millions)

	Fiscal <u>2000</u> <sup>(1)</sup>	Change	Fiscal <b>2001</b> <sup>(1)</sup>	Change	Fiscal <b>2002</b> <sup>(1)</sup>	Change	Fiscal <u>2003</u> <sup>(1)</sup>	Change	Fiscal <u>2004</u>	Change	Fiscal 2005E <sup>(2)</sup>	<u>Change</u>
Correction	\$160.5	13.0%	\$181.6	13.1%	\$179.2	(0.4%)	\$185.5	3.5%	\$189.6	2.2%	204.0	7.6%
Health and Social												
Services	521.3	7.5	570.5	9.4	617.6	8.2	639.4	3.5	652.6	2.1	731.7	12.1
Higher Education	211.5	7.5	219.2	3.6	213.7	(2.5)	205.2	(4.0)	207.5	1.1	240.5	15.9
Public Education	698.4	6.8	807.0	15.5	852.3	5.6	839.9	(1.5)	857.0	2.0	957.6	11.7
Safety & Homeland												
Security	91.1	2.1	93.7	2.9	96.1	2.6	99.7	3.6	95.4	(3.8)	99.2	4.0
Services to Children,												
Youth & Their												
Families	88.8	9.4	91.6	3.2	91.8	0.2	92.9	1.2	93.9	1.0	103.8	10.5
Other Expenditures	474.7	(5.9)	465.4	(2.0)	403.0	(13.4)	391.5	(2.9)	457.2	16.8	486.7	6.5
Total (1)	<u>\$2,246.2</u>	4.4%	\$2,429.0	8.1%	<u>\$2,453.8</u>	1.0%	<u>\$2,454.1</u>	0.0%	\$2,553.7	4.1	\$2,823.5	10.6

<sup>(1)</sup> Expenditures for fiscal 2000 through fiscal 2005E include certain one-time expenditure initiatives, certain "pay-as-you-go" capital projects, and/or debt deauthorization and defeasance.

<sup>(2)</sup> Based on fiscal 2005 budget.

The State has elected to dedicate substantial budgetary General Funds to "one-time" expenditures, as opposed to increasing the size of the base operating budget, based on the State's economy and performance. Since 1997, \$2.5 billion of budgetary General Funds has been appropriated for capital projects and an additional \$154.8 million has been appropriated for debt reduction initiatives. These appropriations are reflected as supplemental appropriations in the chart below. The result of these supplemental appropriations is a distortion in the budgetary General Fund expenditure pattern reflected in the chart above.

The table below depicts trends in State expenditures by the three major components; i.e., modest expenditure growth in the budgetary General Fund base budget for operations, significant variability in supplemental appropriations for one-time capital projects and debt reduction, and the effect of the carryover of these unspent capital funds on the overall spending levels. The nature of capital projects tends to delay the actual expenditure of capital funds to fiscal years subsequent to the fiscal year in which they were appropriated.

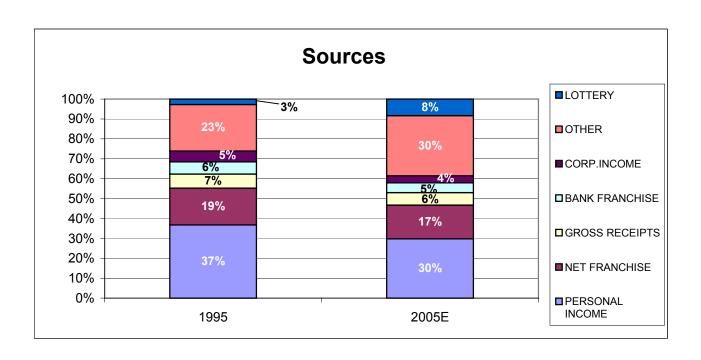
# **Adjusted Budgetary General Fund Expenditures** (in millions)

	<u>2000</u>	Change	<u>2001</u>	Change	2002	Change	2003	Change	<u>2004</u>	Change
Base Budget Supplemental	\$1,928.8	7.0%	\$2,079.8	7.8%	\$2,195.0	5.5%	\$2,264.1	3.1%	\$2,331.5	3.0%
Appropriations Prior Year	170.1	(15.6)	136.2	(19.9)	45.1	(66.9)	50.9	12.9	101.3	99.0
Carryover	147.3	(1.2)	213.1	44.7	213.8	0.3	139.1	(34.9)	120.9	(13.1)
Total	\$2,246.2	4.4%	\$2,429.1	8.1%	\$2,453.9	1.0%	\$2,454.1	.01%	\$2,553.7	4.1%

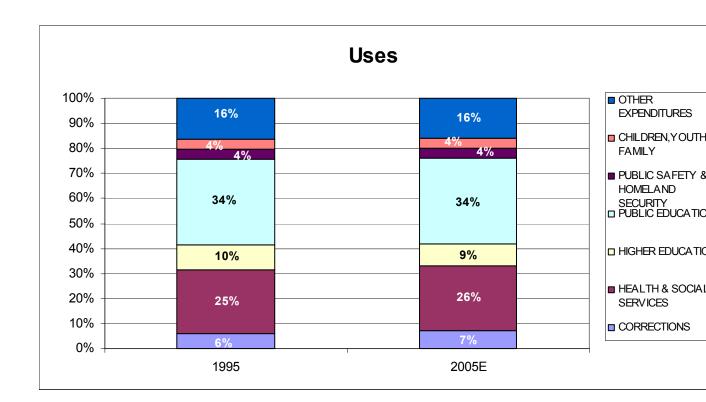
#### **Sources and Uses of State Funds**

The distribution of budgetary General Fund revenues and appropriations is shown in the following bar charts, which compare fiscal 2005 with ten years earlier.

# SOURCES AND USES OF STATE FUNDS



(1) Other sources include interest, public utility, cigarette, inheritance, abandoned property, alcoholic beverage, and insurance taxes.



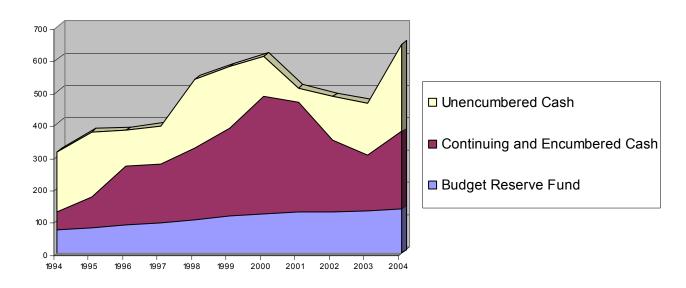
(1) Other uses include administrative services, fire prevention, National Guard, natural resources and environmental control, other elective offices, legislative and executive branches, and agriculture.

# FISCAL YEAR ENDED JUNE 30, 2004

The State ended fiscal 2004 with a cumulative cash balance of \$645.8 million. This balance represented 25.3% of the State's expenditures for the year. The Budget Reserve Account remained fully funded at the 5% level for the fiscal year, totaling \$136.5 million. An additional \$240.2 million was set aside for continuing and encumbered appropriations resulting in an unencumbered cash balance on June 30, 2004, of \$269.1 million.

The following graph reflects growth in the Budget Reserve Account and the changes in continuing and encumbered appropriations and the cumulative cash balances from fiscal 1994 to fiscal 2004.

Budgetary General Fund Cumulative Cash Balances at June 30



# Revenue

Net budgetary General Fund revenue for fiscal 2004 totaled \$2,735.5 million, a 6.6% increase from fiscal 2003 when adjusted for tax law changes and other one-time events. The unadjusted growth rate was 12.3%

**Personal income taxes**, after refunds, totaled \$781.2 million. The unadjusted growth rate was 10.0% compared to fiscal 2003.

**Franchise taxes**, after refunds, totaled \$499.3 million, a 15.8% increase from fiscal 2003. The adjusted growth rate was -5.5%.

**Corporate fees** reached \$49.5 million, a 26.3% increase from fiscal 2003. On an adjusted basis, corporation fees grew at 5.2%.

**Corporate income taxes**, after refunds, were \$81.0 million, a 22.1% increase from fiscal 2003.

Bank franchise taxes totaled \$136.6 million, -3.4% growth over fiscal 2003.

**Business and occupational gross receipts taxes** totaled \$161.5 million, an increase from fiscal 2003 of 9.5%.

**Lottery revenue** totaled \$222.0 million, a 4.2% increase from fiscal 2003.

**Abandoned property revenue** totaled \$302.0 million, a 30.5% increase from fiscal 2003.

### **Expenditures**

Budgetary General Fund expenditures for fiscal 2004 totaled \$2,553.7 million, a 4.1% increase over fiscal 2003. The fiscal 2004 budgetary General Fund operating budget totaled \$2,445.1 million, a 2.2% increase from fiscal 2003. Grants-in-aid appropriations of \$38.4 million and the budgetary General Fund contribution to the capital budget of \$166.9 million combined with \$24.9 million in additional supplemental appropriations brought total appropriations to \$2,650.5 million. This appropriation package was within the constitutionally-prescribed limit of 98% of estimated revenues.

#### **Balances**

The following table outlines revenue, expenditures and remaining cash balances for fiscal 2004.

# Actual Budgetary General Fund Balances - Fiscal 2004 (in millions)

Φ2 **7**2 5 5

Revenue	\$2,735.7
Expenditures	
Budget \$2,445.1	
Grants	
Supplemental <u>166.9</u>	
Total appropriations \$2,650.4	
Continued and encumbered (prior years) <u>173.3</u>	
Total spending authorizations \$2,823.7	
Less: Continued and encumbered (present year) (240.2)	
Less: Reversions (29.8)	
Total expenditures	<u>\$2,553.7</u>
Operating balance	\$181.8 <sup>(1)</sup>
Prior year cash balance	464.0
Cumulative cash balance	\$645.8 <sup>(1)</sup>
Less: Continued and encumbered (present year)	(240.2)
Less: Budget Reserve Account	(136.5)
Unencumbered cash balance	<u>\$269.1</u> <sup>(1)</sup>

<sup>(1)</sup> Does not equal the sum of its components due to rounding of actual amounts.

# FISCAL YEAR ENDING JUNE 30, 2005

Based upon the December 13, 2004 DEFAC revenue forecasts, net budgetary General Fund revenue for fiscal 2005 is projected to total \$2,755.6 million, a 0.7% increase over fiscal 2004.

#### Revenue

**Personal income taxes**, after refunds, are projected to total \$827.6 million, an increase of 5.9% over fiscal 2004.

**Franchise taxes**, after refunds, are projected to total \$457.0 million, an 8.5% decrease from fiscal 2004. After a one-time adjustment in fiscal 2004, fiscal 2005 revenue still declines, but improves to -4%

Corporate fees are projected to reach \$53.0 million, a 7.0% increase from fiscal 2004.

**Corporate income taxes**, after refunds, are estimated at \$80.1 million, a 1.1% decrease from fiscal 2004.

**Bank franchise taxes** are projected to total \$135.5 million, a 0.8% decrease from fiscal 2004.

**Business and occupational gross receipts taxes** are projected to total \$177.5 million, an expected increase of 9.9% over fiscal 2004.

**Lottery revenue** is projected to total \$229.0 million, 3.2% growth over fiscal 2004.

**Abandoned property revenue** is projected to total \$290.0 million, a 4.0% decrease from fiscal 2004.

### **Appropriations**

The fiscal 2005 budgetary General Fund operating budget totaled \$2,600.4 million, a 6.4% increase over fiscal 2004. Grants-in-aid appropriations of \$40.0 million and the budgetary General Fund contribution to the capital budget of \$235.0 million bring total appropriations to \$2,875.4 million. This appropriation package is within the constitutionally-prescribed limit of 98% of estimated revenues.

The fiscal 2005 capital budget totals \$772.5 million. Of that amount, \$138.3 million is allocated for general obligation capital projects, \$393.6 million is allocated for the capital program of the Department of Transportation funded through the Transportation Trust Fund and \$235.0 million of General Fund cash has been allocated for "pay as you go" capital projects. Of the allocation for general obligation capital projects, \$132.7 million is programmed for public school construction and renovation.

# **Balances**

The following table outlines estimated revenue, expenditures and remaining cash balances for fiscal 2005.

# Forecast Budgetary General Fund Balances - Fiscal 2005

(in millions)

Revenue	\$ <u>2,755.6</u> <sup>(1)</sup>
Expenditures         Budget       \$2,600.4         Grants       40.0         Supplemental       235.0         Total appropriations       \$2,875.4         Continued and encumbered (prior years)       240.2	
Total spending authorizations \$3,115.5  Less: Continued and encumbered (present year) (287.0)  Less: Reversions (5.0)	
Total expenditures	<u>\$2,823.5</u>
Operating balance	(67.9)
Prior year cash balance	645.8
Cumulative cash balance  Less: Continued and encumbered (present year)  Less: Budget Reserve Account	\$577.9 (287.0) (148.2)
Unencumbered cash balance	\$ 142.7

<sup>(1)</sup> Per December 13, 2004, DEFAC projection.

### FISCAL YEAR ENDING JUNE 30, 2006

Based upon the December 13, 2004 DEFAC revenue forecasts, net budgetary General Fund revenue for fiscal 2006 is projected to total \$2,882.6 million, a 4.6% increase over fiscal 2005.

#### Revenue

**Personal income taxes**, after refunds, are projected to total \$877.8 million, an increase of 6.1% over fiscal 2005.

**Franchise taxes**, after refunds, are projected to total \$476.0 million, a 4.2% increase over fiscal 2005.

Corporate fees are projected to reach \$55.6 million, 5.0% growth over fiscal 2005.

**Corporate income taxes**, after refunds, are estimated at \$98.5 million, a 23.0% increase from fiscal 2005.

**Bank franchise taxes** are projected to total \$147.5 million, an 8.9% increase from fiscal 2005.

**Business and occupational gross receipts taxes** are projected to total \$188.2 million, an expected increase of 6.0% over fiscal 2005.

**Lottery revenue** is projected to total \$236.3 million, a 3.2% increase over fiscal 2005.

**Abandoned property revenue** is projected to total \$285.0 million, reflecting a 1.7% decrease from fiscal 2005.

### **Proposed Budget**

During the fall of 2004, the Governor and her staff began developing the fiscal 2006 budget, which will be submitted to the General Assembly in January 2005. The Joint Finance Committee and the Capital Improvements (Bond Bill) Committee of the General Assembly will hold hearings in the winter and spring of 2005. Passage of the fiscal 2006 budget is expected to occur in June 2005. By law, the State is required to pass a budget within the 98% appropriation limit of revenues projected from the June 2005 DEFAC estimates (unless revenue adjustments are subsequently enacted and recognized in the Revenue Resolution).

#### TOBACCO SETTLEMENT

A coalition of State Attorneys General negotiated an agreement to settle various states' lawsuits against tobacco manufacturers, in order to recover state funds expended on health care for

smokers, consumer fraud and other claims. The master settlement agreement (the "Agreement") entered into by the State and participating tobacco manufacturers in late 1998 is expected to result in significant payments to the State through the year 2025. The size of payments to Delaware is subject to a number of possible offsets and adjustments outlined in the Agreement. Such offsets include, but are not limited to, the reduction in sales of products from participating manufacturers.

The State created a special fund called the "Delaware Health Fund" into which proceeds received as a result of the Agreement are deposited. The General Assembly and the Governor may authorize expenditure of these monies to expand access to health care and health insurance, make long-term investments in State-owned health care infrastructure, promote healthy lifestyles including tobacco, alcohol, and drug prevention, and promote preventive health care for Delawareans. The fund requires an annual appropriation by the General Assembly and is administered by the Secretary of Finance. As of October 1, 2004, approximately \$140 million has been received by the State from participating manufacturers. The State has not elected to securitize future tobacco settlement payments.

#### FINANCIAL STRUCTURE

#### General

The State budgets and controls its financial activities on the cash basis of accounting for its fiscal year (July 1 to June 30). In compliance with State law, the State records its financial transactions in either of two major categories, the budgetary General Fund or budgetary Special Funds. References to these two funds in this document include the terms "budgetary" or "budgetary basis" to differentiate them from the GAAP funds of the same name which encompass different funding categories. The budgetary General Fund provides for the cost of the State's general operations and is credited with all tax and other revenue of the State not dedicated to budgetary Special Funds. All disbursements from the budgetary General Fund must be authorized by appropriations of the General Assembly.

Budgetary Special Funds are designated for specific purposes. The appropriate budgetary Special Fund is credited with the tax or other revenue allocated to such fund and is charged with the related disbursements. Specific uses of the budgetary Special Funds include State parks operations and fees charged by the Public Service Commission and The Division of Professional Regulation. Federal payments and unemployment compensation are examples of non-appropriated budgetary Special Funds. Some budgetary Special Funds, such as the Delaware State Housing Authority and the State Pension Office, contain both appropriated funds for operations and non-appropriated funds for specific programs, such as public housing and pension benefits.

The Basic Financial Statements in Appendix B hereof have been prepared to conform to the standards of financial reporting set forth by the Governmental Accounting Standards Board (GASB) in its various statements and interpretations. GAAP (as defined below) reporting standards allow the accurate assessment of financial condition and enable the State to present its total fiscal operation in conformity with accounting principles generally accepted in the United States of America (GAAP).

In GAAP reporting, operations of the primary government and component units are recorded under three main fund types - Governmental, Proprietary and Fiduciary, as defined by GASB. The fund types and account groups are described in Note 1 of the accompanying GAAP Basic Financial statements in Appendix B. A reconciliation of budgetary General and Special Funds to GAAP is found in the Required Supplementary Information Section of the financial statements in Appendix B.

Capital assets are defined by the State as assets which have a cost of \$15,000 or more at the date of acquisition and have an expected useful life of one or more years. All land and buildings are capitalized regardless of cost. Purchased and constructed capital assets are valued at historical cost or estimated historical cost. Donated fixed assets are recorded at their fair market value at the date of donation

The State has elected to use the "modified approach" to account for certain infrastructure assets, as provided by GASB Statement No. 34. Under this process, the State does not record depreciation expense nor are amounts capitalized in connection with improvements to these assets, unless the improvements expand the capacity or efficiency of an asset. Roads and bridges maintained by the Department of Transportation are accounted for using the modified approach.

# **Budget Process**

As noted earlier, all disbursements from the budgetary General Fund and certain budgetary Special Funds must be authorized by appropriation of the General Assembly. In the fall of the fiscal year, each State agency submits to the Budget Office a request for operating and capital funds for the ensuing fiscal year. Public hearings on the requests are subsequently conducted. The Governor's proposed operating and capital budgets for the budgetary General Fund and budgetary Special Funds, including the Transportation Trust Fund, are then drafted and presented by the Governor to the General Assembly in January. The General Assembly's Joint Finance and Bond Bill Committees hold hearings and mark up the Governor's proposed operating and capital budgets, respectively. As amended, the budgets are expected to be passed prior to July 1 and signed by the Governor shortly thereafter.

State agencies currently participate in a uniform budgeting process whereby each agency submits with its budget request a department mission, key objectives, background and accomplishments, and activities and performance measures. This fully integrated budget submission provides much information to the public as well as to State decision-makers.

Federal funds are not appropriated but are subject to the review and approval of the State Budget Office and the Delaware State Clearinghouse Committee for Federal Aid Coordination. The Committee is comprised of 10 members, including the Secretary of Finance, Budget Director, Director of the Delaware Economic Development Office, the Controller General, and six legislators.

# **Appropriation Limit**

The State Constitution limits annual appropriations by majority vote of both houses of the General Assembly to 98% of estimated budgetary General Fund revenue, plus the unencumbered

budgetary General Fund balance from the previous year. An appropriation exceeding this limit may be made in the event of a declared emergency, with the approval of a three-fifths vote of the members of each house of the General Assembly, but no appropriation may be made exceeding 100% of estimated budgetary General Fund revenue plus the unencumbered budgetary General Fund balance from the previous fiscal year. In June 2004, the General Assembly authorized appropriations of \$2,875.4 million for fiscal 2005, within the projected 98% appropriation limit.

#### **Budget Reserve Account**

The Budget Reserve Account (commonly referred to as the "Rainy Day Fund") is designed to provide a cushion against unanticipated revenue shortfalls. The State Constitution provides that the excess of any unencumbered budgetary General Funds at the end of a fiscal year must be placed in a reserve account (the "Budget Reserve Account") within 45 days following the end of the fiscal year, provided that the amount of funds in the Budget Reserve Account does not exceed 5% of the estimated budgetary General Fund revenue used to determine the appropriation limit for that fiscal year. Transfers are made in August based on June revenue projections, with consideration given to year-end operating results of the previous fiscal year. Transfers of \$148.2 million have been made which fully funded the Budget Reserve Account for fiscal 2005. Money from the Budget Reserve Account may be appropriated only with the approval of a three-fifths vote of the members of each house of the General Assembly and only to fund an unanticipated budgetary General Fund deficit or to provide funds required as a result of the enactment of legislation reducing revenue. No funds have been withdrawn from the Budget Reserve Account since its inception in 1980.

#### **Tax Limitations**

The State Constitution was amended in May 1980 to limit tax and license fee increases or the imposition of any new taxes or fees. Any tax or license fee increase or the imposition of any new tax or license fee must be passed by a three-fifths vote of each house of the General Assembly, rather than by a simple majority vote, except for tax increases to meet debt service on outstanding obligations of the State for which insufficient revenue is available when such debt service is due. The amendment requires the State to appropriate, prior to each fiscal year of the State, sums sufficient to meet debt service in the following fiscal year, a practice the State has always followed.

#### **Internal Control Structure**

The State has established and maintains an internal control structure designed to ensure that the assets of the State are protected from loss, theft, or misuse, and to ensure that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with GAAP. The internal control structure is designed to provide reasonable, but not absolute, assurance that these objectives are met. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived and that evaluation of costs and benefits requires estimates and judgments by State officials. Determination as to the adequacy of the internal control structure is made within the above framework. State officials believe the State's internal control structure adequately safeguards assets and provides reasonable assurance of proper recording of financial transactions.

Disbursements from State funds are controlled by an encumbrance accounting system that is designed to provide information on the actual extent of the State's obligations (as determined by purchase orders issued) and to guard against over-committing available funds. Disbursements are controlled through the encumbrance system in such a way that purchase orders issued for goods and services cause a reduction in available appropriations. As a result, the amount of budgetary General Fund cash disbursements plus unliquidated encumbrances cannot exceed the amount appropriated by the General Assembly for any budget line.

"Available" funds may be set aside through the use of properly issued and approved purchase orders. "Available" funds for the budgetary General Fund means that the funds must be appropriated, and, in general, for budgetary Special Funds means that the cash must be on hand, except for federal grants, the Transportation Trust Fund and bond authorizations. For administrative reasons, certain types of transactions such as salary and fringe benefit expenses, debt service, certain budgetary Special Fund expenses, and purchases under \$2,500 do not require a formal encumbrance of funds as a prerequisite to processing expenditure documents.

At fiscal year end, cash is reserved to pay outstanding encumbrances (orders for goods and services not yet received or for which payment has not been made). Budgetary General Fund encumbrances are carried over as encumbered appropriations and paid out and recorded as disbursements in the succeeding fiscal year. All obligations created by purchase orders (encumbered amounts) are liquidated upon satisfactory receipt of goods and services. Budgetary General Fund appropriations, which have not been disbursed, continued or encumbered at fiscal year end, lapse. Such lapsed appropriations are referred to as reversions in the State's financial reports.

The State restricts commitments for budgetary General Fund expenditures by State agencies. Commitments to incur expenditures in excess of an appropriation (to be funded from unused funds appropriated to other agencies) must be approved by the Budget Director and the Controller General.

Although the majority of the State's financial transactions are processed through the accounting system, certain budgetary Special Funds have financial activity, such as investments, outside the system. For example, the Transportation Trust Fund, the Delaware State Housing Authority, the deferred compensation programs and Delaware State University all maintain certain financial activity outside the system. This activity is governed in adherence to legislative regulations as well as guidelines established by their respective boards. In addition, these entities are audited annually and produce published financial reports.

The Auditor of Accounts is required to make audits of all agencies collecting State revenue or expending State funds in excess of \$500,000 each year, and, to the extent possible, to make annual audits of the financial transactions of all other State agencies. The Auditor of Accounts also reviews certain records of the Secretary of Finance and State Treasurer on a quarterly basis to reconcile the State's bank accounts to such records.

#### **Tax Collection Procedures**

Most of the State's taxes are collected under a self-assessing system. Taxpayers prepare the tax forms and pay the amounts they determine are due. When the State determines that a payment is

less than the amount due, assessments may be made which can include applicable penalties and interest as allowed by law.

The State has continually instituted procedures to identify non-filers and increase compliance with its tax statutes. The procedures include comparing federal income tax records with State income tax records, comparing State records for various years, and cross-referencing the license tax files to licensee lists from the State's various regulatory boards.

Through the Attorney General's Office, the State employs legal procedures to effect payment of past due balances. These procedures include filing actions in the Justice of the Peace, Common Pleas and Superior Courts on bad checks received. Procedures have been instituted for the garnishment of wages and bank accounts and the sale of personal property through the County Sheriffs.

By statute, the State's accounts receivable may be removed from current active accounts only if the account is more than six years old and is determined to be uncollectible or if the potential recovery or administrative costs of collection would not warrant further collection efforts. Recently enacted legislation allows the Division of Revenue to write off the accounts of those who are deceased or bankrupt.

#### **Risk Management**

The State is exposed to various risks and losses related to employee health and accident, worker's compensation, environmental and a portion of property and casualty claims. It is the policy of the State to self insure its exposures when cost effective and commercially insure on the exposures that are specialized.

#### **Cash Management**

Investment of State funds is the responsibility of the Cash Management Policy Board (the "Board"). Created by State law, the Board establishes policies for the investment of all money belonging to the State or put on deposit with the State by its political subdivisions, except money in any State pension fund and money held for individuals under the State deferred compensation program. The Board is comprised of nine members, including the Secretary of Finance, the Secretary of State, the State Treasurer, the Controller General (all serving ex officio), and five members from the private sector appointed by the Governor and confirmed by the State Senate. The current members of the Board are:

John V. Flynn, Jr. (Chairman)	Managing Director, Banister International
Trisha Neely	Acting Secretary of Finance
Harriet Smith Windsor	Secretary of State
J. Douglas Hazelton	Executive Vice President & CRA Officer,
	MBNA America Bank
Margaret A. Iorii	Asst. Vice President, Merrill Lynch
Russell T. Larson	Controller General
David F. Marvin	Partner, Marvin & Palmer Associates, Inc.
Jack A. Markell	State Treasurer
Harold Slatcher	President & CEO, County Bank

The investment guidelines, adopted by the Board in January 1982 and most recently revised in 2004, provide, among other things, that no more than 10% of the portfolio may be invested in obligations of any one issuer other than the U.S. Government or agencies thereof.

The State has instituted a number of measures to augment its dividend and interest earnings. Among these are the implementation of a commercial bank lockbox for collection of corporate franchise taxes, bank franchise taxes and insurance premium taxes. In addition, the State is also receiving tax payments electronically for the following taxes on a voluntary basis: employer withholding taxes, corporate franchise taxes and bank franchise taxes. The State's motor fuel/special fuels tax is collected electronically on a mandatory basis.

#### **BUDGETARY GENERAL FUND SUMMARIES**

#### **Principal Receipts by Category**

All revenue derived by the State, unless otherwise provided by law, is credited to the budgetary General Fund. The principal receipts not credited to the budgetary General Fund are unemployment insurance taxes, transportation-related taxes for the Transportation Trust Fund, certain taxes on insurance companies and property taxes levied by local school districts. Such taxes are deposited in budgetary Special Funds of the State. The State does not levy *ad valorem* taxes on real or personal property and does not impose a general sales or use tax.

In addition to a lack of a general sales tax, Delaware's revenue structure is unique in that a significant portion of the revenues collected by the State are actually paid by other states' citizens. Delaware, in other words, "exports" a large portion of its revenue burden. While estimates vary, there is a general consensus that upwards of 1/3 of the State's budgetary General Fund revenues are borne by non-Delawareans. In 2003, the Tax Foundation, for example, concluded that over 36% of Delaware's state and local government revenues were paid by nonresidents – a higher percentage than any other state.

Most of Delaware's ability to export its revenue burden is due to the State's position as a center for corporate governance. In order to benefit from Delaware's superior corporate legal environment, companies with little tangible presence in Delaware pay annual taxes and fees to the State. In addition, Delaware's position as a banking center has positioned the State as a net exporter

of its Bank Franchise Tax. More recently, Delaware has been able to successfully export significant portions of its Abandoned Property and Lottery revenue streams.

The Lottery represents a significant source of revenue to the State. The Lottery consists of traditional lottery products in the form of daily drawings, lotto, instant tickets, and the multi-state Powerball. The video lottery is state-operated using video lottery machines or a network of linked video lottery machines restricted in operation to three locations authorized by statute. In June 2003, legislation was enacted to revise the video lottery distribution formula to increase the State's share of the video lottery proceeds in order to increase State revenues. The estimated increase in revenue for fiscal 2005 is \$7.0 million. In July 2004, the Commonwealth of Pennsylvania passed legislation to allow video lottery operations at various locations around the Commonwealth. Although the pace of implementation and ultimate impact on Delaware revenues are difficult to gauge, at its December 13, 2004, meeting DEFAC estimated that competition with Pennsylvania will commence in fiscal 2007 and cost Delaware roughly \$30 million annually. At least 30.0% of the revenue generated from the traditional lottery and video lottery games is contributed to the budgetary General Fund.

The taxes summarized below produce most of the budgetary General Fund revenue.

**Personal Income Tax:** Delaware's rates on taxable income range from zero on the first \$2,000 of net taxable income, to 5.95% on taxable income in excess of \$60,000. Taxable income consists of federal adjusted gross income, with certain modifications, less itemized deductions (or a standard deduction in lieu thereof). After the application of the rates to taxable income, a \$110 non-refundable personal tax credit is subtracted for each taxpayer and dependent claimed, providing a direct dollar-for-dollar reduction in final tax liability.

Since 1992, non-resident taxes have been computed as if the taxpayer were a State resident, multiplied by the ratio of Delaware income to total income. Tax returns and payments are due April 30.

Employers maintaining an office or transacting business within the State and making payment of any wages or other remuneration subject to withholding under the United States Internal Revenue Code are required to withhold State income tax on such wages or remuneration at prescribed rates. Filing frequency is determined based on the amount of an employer's withholdings between July 1 and June 30, immediately preceding the calendar year: under \$3,600 file quarterly; from \$3,600 to \$20,000 file monthly; and over \$20,000 file up to eight times per month.

Corporation Franchise Tax: An annual franchise tax is levied on business corporations organized under State laws, excepting banks and building and loan associations. The tax levy is based on either the corporation's total number of authorized shares of capital stock or on its gross assets. The basis yielding the lesser tax revenue is applied. Effective January 1, 2003, applying the authorized share basis, the tax is levied at a rate of \$35 for the first 3,000 authorized shares to \$112.50 for 10,000 authorized shares, plus \$62.50 for each additional 10,000 shares or fractional part thereof. Applying the gross assets basis, the tax is levied at a rate of \$250 for each \$1.0 million or fractional part thereof of the corporation's gross assets per authorized share. The maximum annual franchise tax is \$165,000 and the minimum tax is \$35. Tax payments for any corporation

whose annual franchise taxes exceed \$5,000 are required to be made quarterly. Other companies pay once each year, on March 1.

Corporation Income Tax: This tax is levied at the rate of 8.7% on net taxable income of both foreign and domestic corporations derived from sources within the State. Investment and holding companies, insurance companies and domestic international sales corporations, among others, are exempt. Fifty percent of the estimated tax for the taxpayer's current tax year and the balance due from the prior year is payable on the first day of the fourth month of the taxpayer's tax year, 20% of such estimated tax is payable on the 15th day of the sixth month, 20% on the 15th day of the ninth month and 10% on the 15th day of the twelfth month. Corporations with taxable income of \$200,000 or more in any of the last three years must pay 80% of their current year's estimated tax on a current basis.

Business and Occupational Gross Receipts Tax: The State imposes license requirements and related taxes on most occupations and businesses. License fees and taxes consist of a basic annual fee of \$75 (in some cases an additional \$25 per establishment is levied) plus a tax on gross receipts. Tax rates include 0.624% for contractors (with a monthly deduction from gross receipts of \$50,000); 0.384% for wholesalers (with a monthly deduction of \$50,000); 0.18% for manufacturers (with a monthly deduction of \$1,000,000); 0.192% for food processors (with a monthly deduction of \$50,000); 0.096% for commercial feed dealers and farm machinery retailers (with a monthly deduction of \$50,000); 0.72% for general retailers (with a monthly deduction of \$50,000); 0.624% for restaurants (with a monthly deduction of \$50,000); and 0.384% of aggregate gross receipts on most occupational licenses (with a monthly deduction of \$50,000). A use tax on leases of tangible personal property is levied on the lessee at the rate of 1.92% of lease rentals and on the lessor at the rate of 0.288% of rental payments received. Lessors are allowed a quarterly deduction of \$150,000.

**Public Utility Tax:** Gross receipts from the sale of telephone, telegraph, gas, electricity, and cable television services are subject to tax. Receipts from services sold to residential users are excluded, except for receipts from residential cable television services. Generally, public utilities are subject to a tax rate of 4.25%. Several exemptions/reductions apply. Receipts from sales of electricity to manufacturers, and agribusiness/food processors are taxed at 2.0%. Certain electrochemical processors and receipts from sales of electricity and gas to automobile manufacturers are exempt from the tax. Cable television service is taxed at 2.125%.

**Cigarette Tax:** Prior to June 30, 2003, the State levied an excise tax of 24 cents per package of 20 cigarettes. Effective August 1, 2003, the rate increased to 55 cents per package of 20 cigarettes. Other tobacco products are taxed at 15% of the wholesale price.

Inheritance and Estate Tax: Effective January 1, 1999, the inheritance tax was eliminated. Since the inheritance tax was eliminated, the State has continued to levy its estate tax. Delaware's estate tax, sometimes referred to as a "pick up" tax, applies only to those estates required to pay the federal estate tax. Recent changes in federal law, however, will effectively cause a phase-out by 2005 of Delaware's estate tax.

**Realty Transfer Tax:** Generally, the State levies a realty transfer tax at a rate of 1.5% of the consideration paid for any real property transferred. (Local governments are permitted to levy an

additional 1.5%.) A 1% tax is levied on the value of construction in excess of \$10,000 where the underlying property was acquired by the owner less than 12 months prior to the commencement of construction.

**Alcoholic Beverage Tax:** The State imposes an excise tax on the distribution of alcoholic beverages. Beer is taxed at the rate of \$4.85 per barrel; wine at 97 cents per gallon; liquor containing 25% or less alcohol by volume at \$2.50 per gallon; and liquor containing more than 25% at \$3.75 per gallon.

**Insurance Tax:** The State levies a tax of 1.75%, plus an additional 0.25% for the benefit of fire and police, on gross premiums, less dividends and returned premiums on cancelled policies, for most types of insurance. An annual privilege tax is levied on domestic insurers based upon annual gross receipts and subject to credits for payroll compensation for employee services performed in the State.

**Bank Franchise Tax:** The State levies a tax on banks at 8.7% on the first \$20 million of taxable income, 6.7% on such income between \$20 and \$25 million, 4.7% on such income between \$25 million and \$30 million, 2.7% on such income between \$30 million and \$650 million, and 1.7% on taxable income in excess of \$650 million.

#### **Budgetary General Fund Disbursements by Category of Expense**

The following table summarizes the budgetary General Fund disbursements of the State for fiscal years ended June 30, 2001 through 2004 and provides estimates for fiscal 2005, as projected by DEFAC in December 2004. See "STATE FINANCIAL OPERATIONS—"Expenditure Summary—Fiscal—2001—Fiscal 2005E" for a detailed explanation of the expenditure figures.

### **Budgetary General Fund Disbursements**

(in millions)

	Fiscal	Fiscal	Fiscal	Fiscal	Fiscal
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005E</u>
Salaries	\$914.5	\$956.0	\$966.3	\$971.6	1038.3
Debt Service	118.5	112.1	116.2	134.3	153.4
Contractual Services	216.0	226.3	216.1	223.9	233.8
Fringe Benefits, except					
Pensions	189.1	207.4	221.2	233.3	260.0
Pensions	84.2	98.1	106.3	127.8	148.3
Welfare and Assistance					
Grants	317.2	352.5	375.3	390.1	431.8
Other Grants	255.2	191.7	196.2	224.2	283.2
Other	334.3	309.8	256.5	<u>248.5</u>	<u>274.7</u>
Total Disbursements	<u>\$2,429.0</u>	<u>\$2,453.9</u>	\$2,454.1 <sup>(1)</sup>	$\$2,553.7^{(1)}$	<u>\$2,823.5</u>

<sup>(1)</sup> Increases in expenditures reflect in part one-time initiatives, cash for capital projects and debt reduction initiatives.

#### **Budgetary General Fund Disbursements by Purpose**

The State assumes substantial financial responsibility for a number of programs often funded by local units of government in other states, including public and higher education, social service programs and the correctional system. In addition, the State builds and maintains all roads and highways within the State except certain local streets within a municipality's corporate boundaries and certain private streets. See "INDEBTEDNESS OF AUTHORITIES, UNIVERSITY OF DELAWARE AND POLITICAL SUBDIVISIONS - Authorities - Delaware Transportation Authority" for additional information. The major State programs are described in more detail below.

#### **Public Education**

Delaware is one of only four states in the country which has not undergone a constitutional challenge to its public education funding. The State finances its public school operations from a combination of State, federal and local funds. In fiscal 2001, the State provided 65.2%, the federal government 9.0% and localities 25.8% of the cost for current operations and debt service. For fiscal 2001, the U.S. Department of Education, National Center for Educational Statistics reported that Delaware was exceeded only by four other states in terms of the percentage of public school revenues financed by the State. Public education base salary scales are set by State law, but the base salary may be supplemented by local funds. The local supplements vary in each school district in the State, depending on each district's contractual obligations with its employees and the district's ability and willingness to tax its constituents. For the 2003-2004 school year, the average State-local funded classroom teacher's salary is \$52,924, of which \$35,199 is paid from State funds and the balance paid from federal or local funds. The State share of public education costs is allocated to the school districts, subject to a number of formulae based primarily on enrollment. The State funds between 60% and 80% of school construction costs, based on an index of an individual district's ability to generate local share funding. The State also funds fringe benefits for school personnel in approximate proportion to the budgetary General Fund contribution to salaries, with the exception of health insurance which is 100% State funded for the basic plan. School districts reimburse the State for fringe benefit costs for personnel hired and paid under federally-funded programs and for the proportion of salary paid from local funds.

Budgetary General Fund expenditures for public education in fiscal 2004 totaled \$857.0 million. Appropriations of \$887.0 million have been made for fiscal 2005.

The following table sets forth public school enrollment (elementary and secondary), in September of the years indicated.

#### **Public School Enrollment**(1)

	<b>Enrollment</b>	<u>Change</u>
1999	112,262	0.4%
2000	113,699	0.9
2001	114,693	0.9
2002	115,566	0.8
2003	117,055	1.3
2004	118,413	1.2

<sup>(1)</sup> Excludes children of military personnel living on Dover Air Force Base who attend Base schools and whose education is federally-funded.

#### **Higher Education**

The State's higher education system consists of eight institutions, which enrolled 49,354 students in the 2002-2003 academic school year based upon fall student headcount (31,354 on a full time equivalent ("FTE") basis). The three State-supported institutions are Delaware Technical and Community College which enrolled 13,322 students (9,206 FTE); Delaware State University, a land grant college located in Dover which enrolled approximately 3,178 students (2,987 FTE); and the University of Delaware, a land grant college located in Newark, which enrolled 21,121 students (18,961 FTE). The five privately supported institutions of higher education in the State enrolled an additional 11,733 students in 2002-2003 (6,895 FTE).

Budgetary General Fund expenditures for higher education in fiscal 2004 were \$207.5 million. The State provides approximately 17% of the operating budget of the University of Delaware, 54% of the budget of Delaware Technical and Community College, and 52% of the budget of Delaware State University. Appropriations of \$210.7 million have been made for fiscal 2005, including \$115.1 million for the University of Delaware, \$59.9 million for Delaware Technical and Community College and \$35.5 million for Delaware State University.

#### **Social Services**

The principal social service programs administered by the State are: (1) Temporary Assistance to Needy Families ("TANF"); (2) General Assistance to low-income single individuals and children living with non-relatives who do not qualify for Supplemental Security Income ("SSI") or TANF payments ("General Assistance Program"); (3) service programs for qualified individuals including child care, employment and training services and work transportation; and (4) direct medical assistance to qualifying individuals ("Medicaid").

Since January 1974, the SSI Program has been administered and funded by the federal government. Beginning with fiscal 1975, the State elected to supplement federal SSI payments for individuals who received the State equivalent of SSI payments prior to January 1974.

Delaware's Medicaid program is funded at the federal financial participation ("FFP") rate of 50%. However, during the period from April 1, 2003 through June 30, 2004, the FFP was increased to 52.95% pursuant to Title IV of the Jobs and Growth Tax Relief Reconciliation Act

of 2003. During the period from October 1, 2004 through September 30, 2005, the FFP will be 50.38%. Delaware's TANF program is funded by a federal capped block grant and State budgetary General Funds. The State is required under federal law to maintain a prescribed level of historic State expenditures for benefits and services to individuals eligible for TANF. The State submits a quarterly budget of total quarterly anticipated expenditures for the Medicaid program to the U.S. Department of Health and Human Services. Upon approval of the budget, the U.S. Department of Health and Human Services issues a letter of credit against which the State may draw to meet its quarterly obligations. Adjustments based on actual expenditures are made in the ensuing quarter. General Assistance Program grants are entirely funded by the State.

The portion of the expenditures for the foregoing programs paid by the federal government is accounted for by the State through the non-appropriated budgetary Special Funds. The portion paid by the State is accounted for through the budgetary General Fund.

Since 1994, welfare caseloads in Delaware have dropped by approximately 50%. The average wage of those who have moved from welfare to work is \$7.54 per hour. The State provides health care, childcare and transportation to work for participants in the State's welfare reform program and provides transitional health care and subsidized childcare to income eligible individuals who have left the welfare rolls. The percentage of Delaware's population receiving cash assistance is 1.8%.

Since fiscal 1995, welfare caseloads and income maintenance expenditures have decreased, but the State's provision of health and childcare to the eligible welfare-to-work population as well as other changes in Medicaid eligibility, enrollment plus related costs have resulted in a corresponding increase. The following table indicates the trends of selected State social services expenditures for fiscal 2000 through fiscal 2004 and provides estimates for fiscal 2005.

# Social Services Expenditures (dollars in millions)

	Fiscal <u>2000</u>	Fiscal <u>2001</u>	Fiscal <u>2002</u>	Fiscal <u>2003</u>	Fiscal <u>2004</u>	Fiscal 2005E
AFDC/TANF						
Number of Recipients/month Total Expenditures/year State Share	15,645 \$20.0 \$3.3	13,598 \$18.0 \$2.8	13,564 \$18.4 \$2.8	14,111 \$18.8 \$2.8	14,237 \$19.1 \$2 9	14,987 \$20.1 \$2.8
GENERAL ASSISTANCE						
Number of Recipients/month Total Expenditures/year State Share	1,900 \$2.6 \$2.7	1,892 \$2.6 \$2.6	2,040 \$2.8 \$2.8	2,106 \$3.0 \$3.0	2,335 \$3.3 \$3.3	2,447 \$3.5 \$3.5
SSI						
Number of State Subsidized Recipients/month State Share	615 \$0.9	642 \$1.0	676 \$1.0	732 \$1.1	745 \$1.1	789 \$1.2
FOSTER CARE						
Number of Children/month Total Expenditures/year State Share	807 \$8.2 \$6.2	791 \$8.2 \$6.2	738 \$8.0 \$6.2	646 \$9.6 \$8.4	627 \$9.8 \$8.4	661 \$10.9 \$9.8
DAY CARE						
Number of Children/month Total Expenditures/year State Share	11,300 \$33.3 \$19.6	12,613 \$35.8 \$21.3	13,010 \$37.9 \$21.3	13,400 \$38.4 \$23.7	13,813 \$40.0 \$23.7	14,257 \$41.8 \$24.8
MEDICAID						
Number of Eligibles/month Total Expenditures/year State Share	92,475 \$511.0 \$255.5	100,249 \$575.0 \$286.4	108,040 \$644.7 \$322.4	118,575 \$702.8 \$346.1	130,411 \$730.3 \$345.9	137,258 \$802.0 \$395.2
COMMUNITY HEALTH						
State Expenditures/year	\$23.6	\$25.8	\$25.5	\$25.0	\$23.8	\$25.1

#### **Children's Services**

The Department of Services for Children, Youth and Their Families provides integrated service delivery for children and their families in its efforts to promote family stability through a child-centered, family-focused continuum of care. The Division of Family Services serves abused, neglected and dependent children, assisting approximately 4,400 children annually. The State spent \$28.7 million in fiscal 2003, \$29.7 million in fiscal 2004 and has budgeted \$29.9 million in fiscal 2005 for family services. The Division of Youth Rehabilitative Services handles delinquent youth in both pre- and post-adjudication through an array of alternative placements and State-owned secure facilities. The Division serves approximately 2,400 youth annually. Fiscal 2003 expenditures totaled \$34.0 million. Fiscal 2004 expenditures totaled \$34.1 million, and \$35.3 million has been budgeted for fiscal 2005. The Division of Child Mental Health Services provides programs for about 500 mentally ill or emotionally disturbed children and adolescents each year for which the State spent \$22.3 million in fiscal 2003 and \$20.4 million in fiscal 2004 and has budgeted \$21.5 million for fiscal 2005. The total Department budgetary General Fund budget for fiscal 2005 is \$97.5 million.

#### Corrections

The State is responsible for all adult correctional services. Sentencing in the State has evolved with the passage of Sentencing Accountability ("SENTAC") legislation whereby all offenders are sentenced to one of five levels ranging from Level I (administrative supervision) to Level V (incarceration). This structure allows the State flexibility to match offenders with the most appropriate sentence. Total budgetary General Fund expenditures for corrections in fiscal 2004 were \$189.6 million. The budget for fiscal 2005 is \$194.6 million. The Department of Correction is currently responsible for over 6,500 incarcerated offenders and over 19,000 offenders in the community (probation or parole).

The Department of Correction (DOC) population growth in recent years prompted the need to evaluate sentencing practices and code limitations. In 2003, legislation was enacted to control the rate of growth in the DOC population. House Bill 210 modified sentencing practices by reducing sentences for certain drug and motor vehicle offenses so as to provide additional prison space for the most violent offenders. Senate Bill 50 placed limitations on probation sentences, except to ensure public safety or to promote effective substance abuse treatment services, thereby reducing the number of defendants incarcerated for violations of probation. Although Delaware has not yet determined the impact of either pieces of legislation, both should have a significant positive effect on Delaware's rate of incarceration and will enable the Department of Correction to focus on the most violent offenders in order to protect public safety and to provide treatment and supervision for those offenders most in need of their services.

#### **BUDGETARY SPECIAL FUNDS SUMMARIES**

Each budgetary Special Fund is created by statute or administrative action for a specific purpose. The appropriate Fund is credited with the specific revenue or receipts allocated to such

Fund. Disbursements from budgetary Special Funds require specific appropriation by the General Assembly.

In general, money in budgetary Special Funds is not available for disbursement or encumbrance until funds are deposited therein with the result that disbursements plus outstanding encumbrances cannot exceed the available funds (except for federal funds and the Transportation Trust Fund). In the case of bond funds, total disbursements plus encumbrances cannot exceed authorizations. At fiscal year end, the available fund balance plus outstanding encumbrances are carried over into the succeeding fiscal year.

#### **Local School Property Taxes and Assessed Valuation**

These taxes are levied by local school districts upon the assessed value of real estate in the district, as determined for county taxation purposes, for the local share of school operating costs and debt service on capital improvements. All tax receipts of a district are credited to the appropriate budgetary Special Fund and operating expenses are disbursed from such Fund upon the presentation of warrants or drafts to the State Treasurer by the school board of the district. The State's share of operating and debt service costs are appropriated and disbursed from the budgetary General Fund.

The following table outlines the assessed and estimated full valuation of all taxable real property in the State as of July 1, 2004.

## **Real Property Valuations**

(in millions)

<b>County</b>	Assessed <u>Valuation (1)</u>	Estimated Full <u>Valuation</u>
New Castle	$$17,040.3^{(2)}$ 2,670.8^{(3)}$ 2,162.7^{(4)}$	\$44,389.9 9,241.2 21,522.5
Total	<u>\$21,873.8</u>	<u>\$75,153.6</u>

<sup>(1)</sup> Net of all legal exemptions.

Source: Delaware Department of Education.

#### **Unemployment Compensation**

Money deposited in the Unemployment Compensation Fund consists of employers' contributions and has at certain times in the past included advances from the federal government necessary to meet the excess of unemployment compensation benefits paid over the employers'

<sup>(2)</sup> Based on 100% of 1983 appraised value, as of the date of the most recent assessment which occurred in 1985.

<sup>(3)</sup> Based on 60% of appraised value, as of the date of the most recent assessment which occurred in 1987.

<sup>(4)</sup> Based on 50% of appraised value, as of the date of the most recent assessment which occurred in 1974.

contributions. The Unemployment Compensation Fund had a balance of \$222.2 million as of September 2004 and includes no federal advances. The State has not borrowed any federal funds since 1979 and anticipates that no borrowing will be necessary in fiscal 2005.

#### Federal Grants, Benefits and Reimbursements

All grants and reimbursements of money received from the federal government by the State are credited to budgetary Special Funds. The money is disbursed to the appropriate agency to be used for the purpose stated in the grant application without any further authority from the General Assembly. A committee representing the legislative and executive branches of government reviews State agency applications for federal funds and no agency may expend federal funds without approval by that committee.

The following chart indicates the distribution of federal funds expended by the State by Department in the fiscal years indicated below.

#### **Distribution of Federal Funds by Department**

	Fiscal <u>1999</u>	Fiscal <u>2000</u>	Fiscal <u>2001</u>	Fiscal <u>2002</u>	Fiscal <u>2003</u>	Fiscal <u>2004</u>
Health & Social Services	52.9%	52.8%	54.1%	55.8%	57.8%	58.5%
Transportation	15.8%	15.5%	15.7%	12.8%	12.1%	9.0%
Public Education	10.3%	10.6%	10.7%	11.1%	11.3%	12.1%
Housing Authority	4.5%	4.3%	4.5%	4.7%	4.4%	4.0%
Labor	4.4%	4.0%	3.9%	3.8%	3.7%	3.5%
Higher Education	2.6%	2.5%	2.3%	2.4%	2.8%	2.6%
Natural Resources	2.5%	2.9%	2.5%	2.9%	2.0%	3.5%
Other	<u>7.1%</u>	<u>7.3%</u>	6.4%	<u>6.4%</u>	<u>6.1%</u>	<u>6.8%</u>
	100.0%	<u>100.0%</u>	<u>100.0%</u>	100.0%	<u>100.0%</u>	100.0%

#### **Pension Fund Receipts**

State pension contributions are appropriated by the General Assembly in the annual budget to cover the liability on budgetary General Fund salaries and are disbursed each month from the budgetary General Fund. Each monthly disbursement is recorded as a receipt of the appropriate budgetary Special Fund and is disbursed from such budgetary Special Fund to meet pension benefits and operating costs. The balance is disbursed from the budgetary Special Fund and invested as part of the State pension plan. See "STATE PENSION PLAN" for additional information. Employee pension contributions are also recorded as budgetary Special Fund receipts and are disbursed together with the State's share of pension costs. Pension costs paid by the federal government for employees paid under federal programs are also recorded as budgetary Special Fund receipts and disbursements.

#### **Social Security Fund Receipts**

All Social Security contributions by State departments and agencies and political subdivisions are recorded as a receipt to the Social Security Fund and are remitted on a semi-monthly basis. Contributions are submitted to the U.S. Department of the Treasury semi-monthly, at which time a disbursement is recorded.

#### **Bond and Note Sales**

All proceeds received from the sale of bonds or bond anticipation notes are recorded as a receipt in a special account designated as the State Treasurer's Bond Account. The withdrawal of proceeds is recorded as a budgetary Special Fund disbursement. The principal and interest on the State's general obligation bonds are paid as a budgetary General Fund disbursement.

#### DEFERRED COMPENSATION PROGRAM

State employees may elect to participate in a deferred compensation plan. The plan is an eligible plan under Section 457 of the Internal Revenue Code (the "Code").

In accordance with federal law, the annual limit on a participant's pre-tax contributions was increased to \$3,000 in 2004, and will increase by \$1,000 per year to \$15,000 in 2006. The percentage of income limit was also raised to 100% of taxable salary. An additional, phased-in catch up contribution has been added for use by those age 50 and older. Those who meet the age requirement may contribute an additional \$3,000 in 2004. This amount will increase by \$1,000 each year to \$5,000 in 2006. After 2006, the "over 50" catch up amount will be indexed in increments of \$500 per year.

The State also provides a \$10 per-pay employer match to contributions by Deferred Compensation Program participants, which began on January 1, 2001. The plan is approved under Section 401(a) of the Code.

Assets purchased through the State's plan include a managed income portfolio, money market funds and a variety of mutual funds. The total market value of plan assets as of September 2004 was \$216.9 million.

#### STATE PENSION PLAN

The State of Delaware Employees Pension Plan (the "Plan"), established by the General Assembly, covers approximately 32,498 active employees and approximately 17,612 retired employees. All State employees (except State police and State judges) and all local school district employees who qualify as full-time and regular part-time employees participate in the Plan. The other plans funded by the State include a now closed State Police Pension Plan (for officers hired prior to July 1, 1980) which covers 27 active officers and 558 retirees, the new State Police Pension Plan which covers the 591 officers hired after July 1, 1980 and 33 retirees, and the State Judiciary

Pension Plan which covers 52 active employees and 37 retirees. The Plan and the other plans collectively are known as the Delaware Public Employees Retirement System (the "Fund").

The Fund is managed by a Board of Pension Trustees (the "Board") composed of five members from the private sector appointed by the Governor, and the Secretary of Finance and the Director of the State Personnel Office serving as ex-officio members. The current members of the Board are:

Philip S. Reese (Chairman)	Former Vice President and Treasurer, Conectiv
Robert W. Allen	President, Allen Petroleum
Trisha Neely(acting)	Secretary of Finance
Helen R. Foster, J.D.	President, CTW Consulting Associates
Jan M. King	Retired Treasurer, Hercules, Inc.
Nancy Shevock	Former Director, Delaware Transit Corp.
Dana Jefferson (acting)	Director, State Personnel Office

The custodian of the Fund's assets is Mercantile Safe Deposit and Trust Company, Baltimore, Maryland. The Fund's assets are managed by professional investment management firms. The total return on the Fund in fiscal 2004 was 15.9% compared to 19.1% for the Standard & Poor's 500.

The Plan provides retirement, disability and survivor benefits. In general, recipients are entitled to receive a service pension at various times during their years of credited service, i.e.: (1) age 65 with 5 years of credited service; or for employees who terminate on or after June 30, 1988, at age 62 with 5 years of credited service; (2) age 60 with 15 years of credited service; (3) a reduced service pension at age 55 with 15 years of credited service; (4) a reduced service pension at any age with 25 years of credited service; or (5) at any age with 30 years of credited service. The qualification requirement for disability or survivor benefits is 5 years of credited service.

Benefit payments are computed using the average monthly compensation for the 36 months of highest monthly compensation. This average is then multiplied by 1.85% for each year of credited service after January 1, 1997 to determine the actual monthly benefit. Retirees with credited service before December 31, 1996 get a multiplier of 2.00.

The Plan is funded on an actuarially sound basis, as determined by the Board, on the basis of actuarial analyses undertaken by Milliman USA, Inc. on an annual basis. The most recent valuation (as of June 30, 2004) was completed in September 2004. As of January 1, 1998, all employees contribute 3% of annual compensation above \$6,000. The State makes annual contributions to the Plan in amounts sufficient to meet both the normal cost of the Plan and to amortize the accrued unfunded liability of the Plan. The normal cost of the Plan is the amount of contributions required each year, with respect to each employee, to accumulate the reserves needed to meet the cost of earned benefits over the employee's working lifetime. The unfunded accrued liability of the Plan is the amount of contributions required to meet unpaid past normal costs.

Prior to July 1970, the State appropriated annually the amounts required to meet pension benefits payable in the year of appropriation. During the five year period from July 1, 1970 to

July 1, 1975, the State increased its annual contributions to the Plan and replaced that financing practice with a statutory policy of fully funding the Plan on an actuarial reserve basis. Since July 1, 1975, the State's annual contribution to the Plan has been equal to the sum of the normal cost of each year and the annual payment required to amortize the unfunded accrued liability over 40 years from July 1, 1975. Each year the Board certifies the required State contribution rate as a percentage of covered payroll, based on the results of the actuarial valuations of the Plan.

The unfunded accrued liability on an actuarial basis for the last five fiscal years is outlined in the table below. The Plan was overfunded in the amount of \$157.6 million as of June 30, 2004.

# Unfunded Accrued Liability

(in millions)

June 30, 2000	(\$639.5)
June 30, 2001	(\$526.8)
June 30, 2002	(\$434.4)
June 30, 2003	(\$330.5)
June 30, 2004	(\$157.6)

The new State Police Pension Plan (for all persons hired after June 30, 1980) and the State Judiciary Pension Plan also are funded on an actuarial reserve basis as determined by the Board, on the basis of annual actuarial analyses undertaken by Milliman USA, Inc. The new State Police Pension Plan was overfunded in the amount of \$5.6 million on June 30, 2004. The State Judiciary Pension Plan showed an unfunded accrued liability on June 30, 2004 of \$6.9 million. Benefits paid through the original State Police Pension Plan (for officers hired before July 1, 1980) are funded from current appropriations. As of June 30, 2004, this plan had an unfunded accrued liability of \$282.0 million.

Payment of each annual contribution is subject to appropriation by the General Assembly. In each year since fiscal 1971, the General Assembly has appropriated the contribution amounts recommended by the Board. The State contribution to the State Employees Plan in fiscal 2004 was \$57.4 million.

The following table sets forth certain information concerning the Plan for the fiscal years set forth below.

### **State Employees Pension Plan**

(in millions)

	Fiscal <u>2000</u>	Fiscal <u>2001</u>	Fiscal <u>2002</u>	Fiscal <u>2003</u>	Fiscal <u>2004</u>
Income					
Employee Contributions	\$ 29.6	\$ 31.8	\$ 33.4	\$ 35.1	36.0
State Contributions					
(budgetary General Fund and					
budgetary Special Funds)	76.9	58.7	50.1	66.0	85.2
Investment Income	<u>791.0</u>	<u>(275.6)</u>	<u>(300.5)</u>	<u>141.8</u>	<u>732.4</u>
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Total Income	\$ <u>897.5</u>	\$ <u>(184.9)</u>	\$ <u>(217.0)</u>	\$ <u>242.9</u>	\$ <u>855.6</u>
Disbursements					
Pension Benefits Paid	\$159.1	\$175.3	\$194.8	217.1	243.2
Refunds	2.4	2.5	2.4	2.6	2.3
Other Disbursements	7.6	8.2	8.4	9.0	<u>8.9</u>
Total Disbursements	\$ <u>169.1</u>	\$ <u>186.1</u>	\$ <u>205.7</u>	\$ <u>228.7</u>	\$ <u>254.4</u>
Excess of Income over					
Disbursements	\$ <u>728.3</u>	\$ <u>(371.1)</u>	\$ <u>(422.6)</u>	\$ <u>14.2</u>	\$ <u>599.2</u>
Total Plan Assets	\$ <u>5,428.9</u>	\$ <u>5,057.8</u>	\$ <u>4,635.3</u>	\$ <u>4,649.5</u>	\$ <u>5,248.0</u>

The growth in investment income in certain years as a percentage of total plan income has permitted changes in the actuarial assumptions and the reduction of employee contributions and has provided the ability to fund increases to pensioners. State pensioners have received 14 pension increases averaging a total of 41.45% since July 1984, based on date of retirement.

Additionally, the State provides comprehensive health coverage to its pensioners on a pay-as-you-go basis. Such coverage is not a mandated benefit of the State's pension plans. Pursuant to current accounting standards, that liability is not presently included in the State's financial statements. However, as a result of Government Accounting Standards Board (GASB), Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions ("GASB 45"), an actuarial valuation has determined that the State's total liability is estimated at \$2.1 billion. In accordance with GASB 45, the net liability expected to be recorded by the State when implemented in fiscal year 2007 is approximately \$200 million.

#### **EMPLOYEE RELATIONS**

The State currently has 28,543 full-time equivalent (FTE) positions budgeted for fiscal year 2005, an increase of 225 FTEs from fiscal 2004. This includes 16,517 positions in the executive branch, 11,094 in the public schools, and 931 in institutions of higher learning

(excluding employees of the University of Delaware, which is not considered part of the State's financial reporting entity).

Since July 1966, virtually all State employees have had the right to organize for the purpose of collective bargaining. Classification of bargaining units is determined by the Public Employee Relations Board ("PERB"). Collective bargaining in the executive branch is conducted by the Office of State Personnel on behalf of departments and agencies. With respect to non-merit system employees, such bargaining may include all terms and conditions of employment, including wages, hours and benefits. With respect to the merit system employees, individual bargaining units may not bargain wages, most benefits, classification plans or hiring practices. These agreements are subject to approval by the Governor and binding to the extent sufficient appropriations are made by the General Assembly. At present, approximately 7,000 of the State's merit system employees are organized and covered by collective bargaining agreements.

Employees of institutions of higher education, certified professional employees of the State public school system (teachers) and certain public school support personnel have the right to organize for the purpose of collective bargaining. Bargaining units representing such employees negotiate with their respective school districts regarding all matters relating to salaries, employee benefits and certain working conditions. Virtually all of these school employees are covered by collective bargaining agreements.

State employees in Delaware do not have the legal right to strike. Few work stoppages have occurred. As of January 2003, approximately two-thirds of employees eligible for union representation were covered by collective bargaining agreements. All payment contracts reached under such agreements are subject to appropriation by the General Assembly, except for the locally funded portion of school district employees' salaries and benefits.

In 1982, a State law was enacted establishing the PERB to oversee the conduct of labor negotiations between public school teachers and their boards of education. There are provisions for mediation and binding arbitration of collective bargaining disputes. Strikes, slow-downs and walkouts are prohibited; but, if they occur, school boards are required to seek injunctive relief. In 1986, legislation was enacted which extended the PERB's jurisdiction to police officers and firefighters. The PERB's jurisdiction was further expanded in 1994 to include all public employees in the State. In the same year, a State law was enacted establishing the Merit Employee Relations Board to address grievances and related issues of merit system employees.

#### **GOVERNANCE**

The chief executive officer of the State is the Governor, who is elected for a term of four years. The State Constitution limits any Governor to two terms, whether or not consecutive. The Governor appoints all members of the State judiciary, the cabinet, and the boards and councils. The Governor reports to the General Assembly at the start of each annual session in January on the "State of the State," recommends changes in legislation, and follows this report with an annual budget message and financial accounting of the State.

In addition to the Executive Office of the Governor (which includes the offices of Budget, Economic Development, Technology and Information and State Personnel), there are fourteen cabinet departments, as reflected in the table which follows. They include the following: the Department of State, which administers the Division of Corporations and the Division of Cultural and Historical Affairs; the Department of Finance, which performs financing, accounting, bond finance, revenue collection, fiscal policy functions and administers the State lottery; the Department of Administrative Services, which manages State facilities; the Department of Health and Social Services; the Department of Services for Children, Youth and Their Families; the Department of Natural Resources and Environmental Control; the Department of Labor; the Department of Transportation, which oversees the Division of Motor Vehicles; the Department of Safety and Homeland Security, which oversees the state police; the Department of Correction; the Department of Agriculture; the Department of Education; Delaware State Housing Authority; and the Delaware National Guard. Delaware is unusual in that the State government (as opposed to county or municipal governments) funds and administers substantially all correctional, public health, welfare, and transportation services for its residents.

Other elected officers include the Lieutenant Governor who presides over the Senate and the Board of Pardons; the State Treasurer, who is one of four Issuing Officers, signs all state checks and oversees the management of the State's bank accounts; the Auditor of Accounts who audits all State agencies' financial transactions; the Insurance Commissioner; and the Attorney General who is the chief legal officer of the State. All of the elected officers serve terms of four years.

The State's General Assembly is bicameral and consists of a 21-member Senate and a 41-member House of Representatives. The entire House stands for re-election every two years, while Senators are elected to four year staggered terms. Regular sessions of the General Assembly convene in January and adjourn by June 30th. Between regular sessions, the Governor or the presiding officers of either house may call special sessions. Proposed legislation is usually assigned to a standing committee for review. It may then receive consideration on the floor of both houses.

The judicial branch of the government includes a Supreme Court, which acts primarily as an appeals court, and the Court of Chancery, an equity court which has jurisdiction over corporate matters, trusts, estates, and other matters involving equitable jurisdiction. The Superior Court has jurisdiction over criminal and civil cases, except equity cases. The Family Court administers justice in cases involving domestic relations or dependent juveniles. The Court of Common Pleas is a court of limited jurisdiction over civil and criminal matters which the Superior Court would otherwise handle. The Justice of the Peace Courts handle criminal matters and civil cases where the amount in controversy is less than \$5,000.

The following is a list of certain elected officials, cabinet positions and other appointed officials.

#### Statewide Elected Officials

Governor	Ruth Ann Minner
Lieutenant Governor	John C. Carney, Jr.
Attorney General	M. Jane Brady

State Treasurer	Jack A. Markell
State Auditor	R. Thomas Wagner, Jr.
Insurance Commissioner	Matthew Denn

#### Cabinet Positions and Other Appointed Officials

Administrative Services	Gloria W. Homer
Agriculture	Michael T. Scuse
Budget	Jennifer W. Davis
Correction	Stanley W. Taylor, Jr.
Delaware Economic Development Office	Judy McKinney-Cherry
Education	Valerie A. Woodruff
Finance (Acting)	Trisha Neely
Health and Social Services	Vincent P. Meconi
Housing	Saundra R. Johnson
Technology and Information	Thomas M. Jarrett
Labor	Harold E. Stafford
Natural Resources and Environmental Control	John Hughes
National Guard	Frank D. Vavala
Personnel	Dana Jefferson (acting)
Safety and Homeland Security	David Mitchell
Services for Children, Youth and Their Families	Cari DeSantis
State	Harriet Smith Windsor
Transportation	Nathan Hayward, III

#### LITIGATION

The State is a defendant in various suits involving contract/construction claims, tax refunds claims, allegations of wrongful discharge and/or other employment-related claims, use of excessive force, civil rights violations, and automobile accident claims. Although the State believes it has valid defenses to these actions, the State has identified a potential aggregate exposure which could exceed \$40.8 million.

#### THE BOOK-ENTRY ONLY SYSTEM

The Depository Trust Company ("DTC"), New York, NY, will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each maturity of the Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments from over 85 countries that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Government Securities Clearing Corporation, MBS Clearing Corporation, and Emerging Markets Clearing Corporation, (NSCC, GSCC, MBSCC, and EMCC, also subsidiaries of DTCC), as well as by the New York Stock Exchange, Inc., the American Stock Exchange LLC, and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect

Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions and defaults. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners.

Redemption notices shall be sent to DTC. If less than all of the Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the State as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State, on the payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name", and will be the responsibility of such Participant and not of DTC nor its nominee or the State, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the State, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Bonds at any time by giving reasonable notice to the State. Under such circumstances, in the event that a successor depository is not obtained, Bond certificates are required to be printed and delivered.

The State may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Bond certificates will be printed and delivered.

The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the State believes to be reliable, but the State takes no responsibility for the accuracy thereof.

#### APPROVAL OF LEGAL MATTERS

Certain legal matters incident to the authorization and issuance of the Bonds are subject to the approval of Saul Ewing LLP, Wilmington, Delaware, Bond Counsel, whose approving legal opinion, substantially in the form set forth in Appendix D, will be available at the time of the delivery of the Bonds. Certain legal matters will be passed upon for the Series 2005A Underwriters (defined herein) by their counsel Stradley Ronon Stevens & Young, LLP, Philadelphia, Pennsylvania. Neither Bond Counsel nor counsel for the Series 2005A Underwriters has verified the accuracy, completeness or fairness of the statements contained in the Official Statement or will express an opinion as to the accuracy, completeness, or fairness of the statements contained in the Official Statement.

#### TAX MATTERS

#### **Tax Exemption-Opinion of Bond Counsel**

The Internal Revenue Code of 1986, as amended (the "Code") contains provisions relating to the tax-exempt status of interest on obligations issued by governmental entities which apply to the Bonds. These provisions include, but are not limited to, requirements relating to the use and investment of the proceeds of the Bonds and the rebate of certain investment earnings derived from such proceeds to the United States Treasury Department on a periodic basis. These and other requirements of the Code must be met by the State subsequent to the issuance and delivery of the Bonds in order for interest thereon to be and remain excludable from gross income for purposes of federal income taxation. The State has made covenants to comply with such requirements.

In the opinion of Bond Counsel, interest (including accrued original issue discount) on the Bonds is not includable in gross income for purposes of federal income taxation under existing statutes, regulations, rulings and court decisions. The opinion of Bond Counsel is subject to the condition that the State comply with all applicable federal income tax law requirements that must be satisfied subsequent to the issuance of the Bonds in order that interest thereon continues to be excluded from gross income. Failure to comply with certain of such requirements could cause the interest on the Bonds to be so includable in gross income retroactive to the date of issuance of the Bonds. The State has covenanted to comply with all such requirements. Interest on the Bonds is not treated as an item of tax preference under Section 57 of the Code for purposes of the individual and corporate alternative minimum taxes; however, under the Code, to the extent that interest on the Bonds is a component of a corporate holder's "adjusted current earnings", a portion of that interest may be subject to the corporate alternative minimum tax. Bond Counsel expresses no opinion regarding other federal tax consequences relating to the Bonds or the receipt of interest thereon. See discussion of "Alternative Minimum Tax", "Branch Profits Tax", "S Corporations with Passive Investment Income", "Social Security and Railroad Retirement Benefits", "Deduction for Interest

Paid by Financial Institutions to Purchase or Carry Tax-Exempt Obligations", "Property or Casualty Insurance Company" and "Accounting Treatment of Original Issue Discount and Amortizable Bond Premium" below.

In the opinion of Bond Counsel under existing statutes, interest on the Bonds is exempt from personal and corporate income tax imposed by the State.

#### **Alternative Minimum Tax**

The Code includes, for purposes of the corporate alternative minimum tax, a preference item consisting of, generally, seventy-five percent of the excess of a corporation's "adjusted current earnings" over its "alternative minimum taxable income" (computed without regard to this particular preference item and the alternative tax net operating loss deduction). Thus, to the extent that tax-exempt interest (including interest on the Bonds) is a component of a corporate holder's "adjusted current earnings", a portion of that interest may be subject to the alternative minimum tax.

#### **Branch Profits Tax**

Under the Code, foreign corporations engaged in a trade or business in the United States will be subject to a "branch profits tax" equal to thirty percent (30%) of the corporation's "dividend equivalent amount" for the taxable year. The term "dividend equivalent amount" includes interest on tax-exempt obligations.

#### **S Corporations with Passive Investment Income**

Section 1375 of the Code imposes a tax on the income of certain small business corporations for which an S Corporation election is in effect, and that have "passive investment income". For purposes of Section 1375 of the Code, the term "passive investment income" includes interest on the Bonds. This tax applies to an S Corporation for a taxable year if the S Corporation has Subchapter C earnings and profits at the close of the taxable year and has gross receipts, more than twenty-five percent (25%) of which are "passive investment income". Thus, interest on the Bonds may be subject to federal income taxation under Section 1375 of the Code if the requirements of that provision are met.

#### Social Security and Railroad Retirement Benefits

Under Section 86 of the Code, certain Social Security and Railroad Retirement benefits (the "benefits") may be includable in gross income. The Code provides that interest on tax-exempt obligations (including interest on the Bonds) is included in the calculation of "modified adjusted gross income" in determining whether a portion of the benefits received are to be includable in gross income of individuals.

# **Deduction for Interest Paid by Financial Institutions to Purchase or Carry Tax-Exempt Obligations**

The Code, subject to limited exceptions not applicable to the Bonds, denies the interest deduction for indebtedness incurred or continued to purchase or carry tax-exempt obligations, such as the Bonds. With respect to banks, thrift institutions and other financial institutions, the denial to such institutions is one hundred percent (100%) for interest paid on funds allocable to the Bonds and any other tax-exempt obligations acquired after August 7, 1986.

#### **Property or Casualty Insurance Company**

The Code also provides that a property or casualty insurance company may also incur a reduction, by a specified portion of its tax-exempt interest income, of its deduction for losses incurred.

#### Accounting Treatment of Original Issue Discount and Amortizable Bond Premium

The Series 2005A Bonds maturing on February 1, 2008 through 2025, inclusive, and the Series 2005B Bonds maturing on February 1, 2010 and on February 1, 2020 through 2024, inclusive, are herein referred to as the "Discount Bonds". In the opinion of Bond Counsel, under existing law, the difference between the initial public offering price of the Discount Bonds set forth on the inside cover page and the stated redemption price at maturity of each such Bond constitutes "original issue discount", all or a portion of which will, on the disposition or payment of such Bonds, be treated as tax-exempt interest for federal income tax purposes. Original issue discount will be apportioned to an owner of the Discount Bonds under a "constant interest method", which utilizes a periodic compounding of accrued interest. If an owner of a Discount Bond who purchases it in the original offering at the initial public offering price owns that Discount Bond to maturity, that Bondholder will not realize taxable gain for federal income tax purposes upon payment of the Discount Bond at maturity. An owner of a Discount Bond who purchases it in the original offering at the initial public offering price and who later disposes of the Discount Bond prior to maturity will be deemed to have accrued tax-exempt income in a manner described above; amounts realized in excess of the sum of the original offering price of such Discount Bond and the amount of accrued original issue discount will be taxable gain.

Purchasers of Discount Bonds should consider possible state and local income, excise or franchise tax consequences arising from original issue discount on the Discount Bonds. Prospective purchasers of the Discount Bonds should consult their tax advisors regarding the Delaware tax treatment of original issue discount.

The Series 2005A Bonds maturing on February 1, 2006 through 2007, inclusive, and the Series 2005B Bonds maturing on February 1, 2006 through 2009, inclusive and February 1, 2011 through 2018, inclusive, are hereinafter referred to as the "Premium Bonds". An amount equal to the excess of the initial public offering price of a Premium Bond set forth on the inside cover page over its stated redemption price at maturity constitutes premium on such Premium Bond. A purchaser of a Premium Bond must amortize any premium over such Premium Bond's term using constant yield principles, based on the purchaser's yield to maturity. As premium is amortized, the purchaser's

basis in such Premium Bond is reduced by a corresponding amount, resulting in an increase in the gain (or decrease in the loss) to be recognized for federal income tax purposes upon a sale or disposition of such Premium Bond prior to its maturity. Even though the purchaser's basis is reduced, no federal income tax deduction is allowed.

Purchasers of any Premium Bonds, whether at the time of initial issuance or subsequent thereto, should consult their own tax advisors with respect to the determination and treatment of premium for federal income tax purposes and with respect to state and local tax consequences of owning Premium Bonds.

#### OPINIONS AND CERTIFICATES AVAILABLE ON DELIVERY OF THE BONDS

Upon delivery of the Bonds, the State will make available the following opinions and certificates dated the date of delivery of the Bonds: (1) the opinion of Saul Ewing LLP, Bond Counsel, Wilmington, Delaware, substantially in the form set forth in Appendix D, to the effect that the Bonds are legal and valid general obligations of the State to which the State has pledged its full faith and credit; (2) the opinion of the Attorney General or a Deputy Attorney General to the effect that no litigation is pending or known to be threatened to restrain or enjoin the issuance of the Bonds, or in any manner questioning the validity of any proceedings authorizing the issuance of the Bonds, or the levy or collection of any material portion of taxes or other revenues of the State, or contesting the completeness, accuracy or fairness of the Official Statement; and that neither the corporate existence of the State nor the titles of the officials of the State signatories hereto to their respective offices is being contested; (3) a certificate of the Issuing Officers certifying as genuine the signatures of the Issuing Officers signing the Bonds; (4) a certificate of the State Treasurer acknowledging receipt of payment for the Bonds; (5) a certificate executed by the State Treasurer relating to federal tax matters under the Internal Revenue Code of 1986, and regulations promulgated thereunder; and (6) a certificate of the Issuing Officers stating: (a) that the Official Statement, as of the date of the Official Statement, did not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading; and (b) as of the date of delivery of and payment for the Bonds there has been no material adverse change in the condition, financial or otherwise of the State, from the date of the sale of the Bonds to the date of delivery of the Bonds and from that set forth in the Official Statement.

#### FINANCIAL ADVISOR

Public Financial Management, Inc. has been appointed financial advisor to the State and is acting in that capacity in connection with the sale of the Bonds.

#### **RATINGS**

Fitch Ratings, Moody's Investors Service and Standard & Poor's rate the general obligation bonds of the State. The current rating of all outstanding general obligation bonds of the State

assigned by Fitch Ratings is AAA, the rating assigned by Moody's Investors Service is Aaa and the rating assigned by Standard & Poor's is AAA. Fitch Ratings, Moody's Investors Service and Standard & Poor's have assigned the Bonds the ratings which appear on the cover hereof.

Such ratings reflect only the respective views of such organizations. An explanation of the significance of such ratings may be obtained from the respective organizations. There is no assurance that such ratings will continue for any period of time or that they will not be revised or withdrawn. A downward revision or withdrawal of the ratings may have an adverse effect on the market price of the Bonds. No rating assures the market value of the Bonds.

#### **UNDERWRITING**

The Series 2005A Bonds are being purchased by Merrill Lynch, Pierce, Fenner & Smith, Incorporated, as representative of a group of underwriters (the "Series 2005A Underwriters"). The Series 2005A Underwriters have agreed to purchase said Series 2005A Bonds at a purchase price of \$32,214,606.14 (which is equal to the aggregate principal amount of \$32,425,000 less net original issue discount of \$69,954.50 less underwriters' discount of \$140,439.36). The Series 2005A Underwriters' obligation to make such purchase is subject to certain terms and conditions set forth in the related purchase contract, the approval of certain legal matters by Bond Counsel and certain other conditions.

#### CONTINUING DISCLOSURE UNDERTAKING

Rule 15c2-12 under the Securities Exchange Act of 1934, as amended, (the "Rule") prohibits an underwriter from purchasing or selling municipal securities, such as the Bonds, unless it has determined that the issuer of such securities and/or other persons deemed to be "obligated persons" have committed to provide (i) on an annual basis, certain financial information, including financial information and operating data ("Annual Reports"), to each Nationally Recognized Municipal Securities Information Repository (a "NRMSIR") and the relevant state information repository (if any) and (ii) notice of various events described in the Rule, if material ("Event Notices"), to the Municipal Securities Rulemaking Board (the "MSRB") and to any such state information repository.

The State will agree with the purchasers of the Bonds, by executing a supplement to the Continuing Disclosure Agreement executed in connection with the issuance of its General Obligation Bonds - Series 1996A prior to the issuance of the Bonds, to provide Annual Reports with respect to itself to each NRMSIR and to any Delaware information repository that is formed. The State has determined that there currently is not any other obligated person for the purposes of the Rule. The State will provide Event Notices to the MSRB and to any Delaware information repository. The Continuing Disclosure Agreement appears as Appendix C to this Official Statement. Under the provisions of the State's Continuing Disclosure Agreement, the State is required to provide its Annual Report by May 1 of each year.

The execution and distribution of the Official Statement in connection with the sale of the Bonds has been duly authorized by the State.

THE STATE OF DELAWARE

RUTH ANN MINNER, Governor

TRISHA NEELY, Acting Secretary of Finance

HARRIET SMITH WINDSOR, Secretary of State

JACK A. MARKELL, State Treasurer

# APPENDIX A

# SUMMARY OF CASH BASIS FINANCIAL STATEMENTS For Fiscal Years 2000 Through 2004

# APPENDIX B

# BASIC FINANCIAL STATEMENTS For The Year Ended June 30, 2004

# APPENDIX C CONTINUING DISCLOSURE AGREEMENT

#### CONTINUING DISCLOSURE AGREEMENT

This Continuing Disclosure Agreement dated as of April 15, 1996 (the "Disclosure Agreement") is executed and delivered by THE STATE OF DELAWARE (as more fully defined below, the "State") in connection with the issuance of its General Obligation Bonds - Series 1996A. The State, intending to be legally bound, hereby covenants and agrees as follows:

SECTION 1. <u>Purpose of the Disclosure Agreement</u>. This Disclosure Agreement is being executed and delivered by the State for the benefit of the Holders from time to time of the Bonds and in order to assist the Participating Underwriters in complying with S.E.C. Rule 15c2-12(b)(5).

SECTION 2. <u>Definitions</u>. In addition to the definitions set forth in the 1996A Bond Resolution, which apply to any capitalized term used in this Disclosure Agreement unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

"Additional Bonds" shall mean any indebtedness of the State issued subsequent to the 1996A Bonds which the State has declared in writing to be covered by this Disclosure Agreement.

"Annual Report" shall mean any Annual Report provided by the State pursuant to, and as described in, Sections 3 and 4 of this Disclosure Agreement.

"Bond Resolution" shall mean the 1996A Bond Resolution and, to the extent relevant, any other bond resolution or authorizing document with respect to Additional Bonds.

"Bonds" shall mean the 1996A Bonds and any Additional Bonds, if any.

"Dissemination Agent" shall mean any agent of the State designated in writing by the State which has filed with the State a written acceptance of such designation.

"Holder" shall mean any registered holder of Bonds, provided however, that with respect to any Bond registered in a "street name" or the name of a nominee such as The Depository Trust Company, the term "holder" shall mean the beneficial owner of that Bond as defined in S.E.C. Rule 13d-3.

"Issuing Officers" shall mean the Governor, Secretary of Finance, Secretary of State and State Treasurer of the State.

"Listed Events" shall mean any of the events listed in Section 5(a) of this Disclosure Agreement.

"MSRB" shall mean the Municipal Securities Rulemaking Board, or any successor organization. The current address of the MSRB is:

#### MUNICIPAL SECURITIES RULEMAKING BOARD

Continuing Disclosure Information System 1640 King Street, Suite 300 Alexandria, VA 22314-2719 (202) 223-9503 (phone) (703) 683-1930 (fax)

"National Repository" shall mean any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule. Currently, the following are National Repositories:

#### BLOOMBERG MUNICIPAL REPOSITORY

Attn: Municipal Dept.
Bloomberg Business Park
100 Business Park Drive
Skillman, New Jersey 08558
(609) 279-3200 (phone)
(609) 279-3224 (phone)
(609) 279-5962 (fax)
[U.S. Mail: P.O. Box 840
Princeton, NJ 08542-0840]

#### THE BOND BUYER

Attn: Secondary Market Disclosure 395 Hudson Street, 3rd Fl. New York, New York 10004 (212) 807-3814 (phone) (212) 807-3868 (phone) (212) 989-9282 (fax) Internet: disclosure@muller.com

#### DISCLOSURE, INC.

Attn: Document Acquisitions/Municipal Securities 5161 River Road
Bethesda, Maryland 20816
(301) 951-1450 (phone)
(301) 718-2329 (fax)

R.R. DONNELLEY & SONS Municipal Securities Disclosure Archive 559 Main Street Hudson, Mass. 01749 (800) 580-3670 (phone) (508) 562-1969 (fax) Internet: http://www.municipal.com

KENNY INFORMATION SYSTEMS, INC.

Attn: Kenny Repository Service 65 Broadway, 16th Fl. New York, New York 10006 (212) 770-4595 (phone) (212) 797-7994 (fax)

MOODY'S NRMSIR

Attn: Public Finance Information Center 99 Church Street, 6th Floor New York, New York 10007-2701 (800) 339-6306 (phone) (212) 553-1460 (fax)

"1996A Bond Resolution" shall mean the bond resolution duly adopted by the Issuing Officers of the State with respect to the 1996A Bonds on April 23, 1996.

"1996A Bonds" shall mean the State's \$100,000,000 aggregate principal amount General Obligation Bonds - Series 1996A dated April 15, 1996.

"1996A Underwriter" shall mean Lehman Brothers.

"Obligated Person" shall have the meaning set forth in the Rule, provided that the sole objective criteria used to select the Obligated Person shall be the entity obligated to repay all debt service with respect to the relevant Bonds.

"Participating Underwriter" shall mean the 1996A Underwriter and any of the original underwriters of any Additional Bonds required to comply with the Rule in connection with offering of such Additional Bonds.

"Repository" shall mean each National Repository and the State Repository, if any.

"Rule" shall mean Rule 15c2-12 adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time, any successor provisions of similar import promulgated by the Securities and Exchange Commission in the future, and any applicable no-action letters and other authoritative interpretations of Rule 15c2-12 released by the Securities and Exchange Commission including, by way of example, the staff interpretive guidance dated June 23, 1995 from Robert L.D. Colby, Deputy

Director or the letter dated September 19, 1995 from Catherine McGuire, Chief Counsel, Division of Market Regulation addressed to John S. Overdorff, Esquire.

"State" shall mean The State of Delaware, or any successor Obligated Person that assumes either by operation by law or by contract both (i) the obligation to pay debt service on the Bonds and (ii) the obligations of the State under this Disclosure Agreement.

"State Repository" shall mean any public or private repository or entity designated by the State as a state repository for the purpose of the Rule. As of the date of this Agreement, there is no State Repository.

#### Section 3. <u>Provision of Annual Reports.</u>

- (a) The State shall, or shall cause the Dissemination Agent to, not later than the first day of the eleventh calendar month immediately following the end of the State's fiscal year, provide to each Repository an Annual Report which is consistent with the requirements of Section 4 of this Disclosure Agreement. Not later than fifteen (15) Business Days prior to said date, the State shall provide the Annual Report to the Dissemination Agent, if any. Given the State's current fiscal year, this obligation to provide an Annual Report occurs by not later than May 1 of each year, commencing May 1, 1997. The Annual Report may be submitted as a single document or as separate documents comprising a package, and may cross-reference other information as provided in Section 4 of this Disclosure Agreement; provided however that the audited financial statements of the State may be submitted separately from the balance of the Annual Report.
- (b) If the State is unable to provide the Annual Report to Repositories by the date required in subsection (a), the State shall send a notice to each Repository (or to the MSRB and the State Repository) in substantially the form attached as Exhibit A.
- (c) The Dissemination Agent, if any, shall: (i) determine each year prior to the date for providing the Annual Report the name and address of each National Repository and the State Repository, if any; and (ii) file a report with the State certifying that the Annual Report has been provided pursuant to this Disclosure Agreement, stating the date it was provided and listing all the Repositories to which it was provided.
- (d) Audited financial statements of the State not submitted as part of the Annual Report shall be provided to each Repository, if and when available to the State, and in any event not more than thirty (30) days after receipt thereof from the State's auditors. In the event that audited financial statements are not submitted as part of the Annual Report, the State shall provide in lieu thereof unaudited financial statements meeting the description set forth in Section 4(a)(i) hereof.
- (e) The State shall promptly provide written notice of any change in its fiscal year to the MSRB and to each Repository.

#### SECTION 4. Content of Annual Reports.

- (a) The State's Annual Report shall contain or incorporate by reference the information listed in Exhibit B with respect to the relevant fiscal year.
- (b) Notwithstanding the provisions of Section 4(a) above, in the event the State provides for the repayment of the Bonds through an economic defeasance, such that repayment of the principal of and interest on the Bonds are expected to be derived from escrowed securities, and not the general revenues of the State (the "Defeased Bonds"), the State's Annual Report with respect to such Defeased Bonds shall only contain or incorporate by reference a report by a certified public accountant (the "Verification Report") as to the mathematical accuracy of computations showing the sufficiency of the receipts from the escrowed securities to pay, when due, the principal, interest and redemption premium (if any) requirements of the Defeased Bonds; provided that the State receive an opinion of counsel with expertise in federal securities law to the effect that such Annual Report is permitted by the Rule. Any cross reference to the Verification Report may be contained in a footnote to the State's audited financial statements.
- (c) Any or all of the items required may be incorporated by reference from other documents, including official statements of debt issues of the State or related public entities, which have been submitted to each of the Repositories or the Securities and Exchange Commission. If the document incorporated by reference is a final official statement, it must be available from the MSRB. The State shall clearly identify each such other document so incorporated by reference.
- (d) If any information described in Section 4(a) above can no longer be generated because the operations to which such information relates have been materially changed or discontinued, a statement to that effect shall satisfy the obligations of the State under this Section 4, provided however that the State shall, to the greatest extent feasible, provide in lieu thereof similar information with respect to any substitute or replacement operations.

#### SECTION 5. Reporting of Significant Events.

- (a) This Section 5 shall govern the giving of notices of the occurrence of any of the following events with respect to the Bonds:
  - 1. Principal and interest payment delinquencies;
  - 2. Non payment-related defaults;
  - 3. Unscheduled draws on debt service reserves reflecting financial difficulties;
  - 4. Unscheduled draws on credit enhancements reflecting financial difficulties;
  - 5. Substitution of credit or liquidity providers, or their failure to perform;
  - 6. Adverse tax opinions or events affecting the tax-exempt status of the Bonds;

- 7. Modifications to rights of Bondholders;
- 8. Bond calls (other than mandatory sinking fund redemptions);
- 9. Defeasances of Bonds;
- 10. Release, substitution, or sale of property securing repayment of any Bonds; or
- 11. Rating changes.
- (b) If a Listed Event occurs, the State shall as soon as possible determine if such event would constitute material information for holders of Bonds, in accordance with the applicable "materiality" standard under then-current securities laws.
- (c) If the occurrence of a Listed Event would be material to holders of Bonds in accordance with the applicable "materiality" standard under then-current securities laws, the State shall in a timely manner file, or cause the Dissemination Agent to file, a notice of such occurrence with the MSRB and the State Repository (if any). Notwithstanding the foregoing, notice of Listed Events need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to holders of affected Bonds pursuant to the Bond Resolution, provided that such notice is given in a timely manner.

SECTION 6. Accounting Standards. The financial statements described in Section 4(a)(i) above shall be audited by either a certified public accountant or an independent public accountant and shall be prepared in accordance with both (a) generally accepted accounting principles applicable in the preparation of financial statements of municipalities and other public entities as such principles are from time to time promulgated by the Financial Accounting Standards Board, the Governmental Accounting Standards Board, or such other body recognized as authoritative by the American Institute of Certified Public Accountants or any successor body ("GAAP"), and (b) applicable federal and state auditing statutes, regulations, standards and/or guidelines; provided however that the State may from time to time modify its accounting principles to the extent necessary or desirable to comply with changes in either GAAP or applicable federal and state statutes, regulations, standards and/or guidelines. The State currently utilizes a combination of modified accrual and GAAP bases for its budgeting and reporting obligations. To the extent the State shifts solely to a GAAP basis, the State reserves the right to provide its Annual Report based solely on that basis. Any such modification of accounting standards to conform to changes in either GAAP or applicable federal or state auditing statutes, regulations, standards or guidelines shall not constitute an amendment to this Disclosure Agreement within the meaning of Section 9 hereof, provided that such modifications are disclosed in the first Annual Report to be provided subsequent to such modifications.

SECTION 7. <u>Termination of Reporting Obligation</u>. The State's obligations under this Disclosure Agreement shall terminate upon (a) the legal defeasance, prior redemption or payment in full of all of the Bonds or (b) the assumption by a successor Obligated Person of all of the obligations of the prior Obligated Person both hereunder and under the Bonds. The prior

State shall provide timely written notice to each Repository of any termination of its obligations hereunder.

SECTION 8. <u>Dissemination Agent</u>. The State may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Agreement, and may discharge any such agent, with or without appointing a successor Dissemination Agent.

SECTION 9. <u>Amendments</u>. (a) Notwithstanding any other provision of this Disclosure Agreement, the State may modify or amend this Disclosure Agreement if the following preconditions are satisfied:

- (i) the modification or amendment is being made in connection with a change of circumstances that arises from a change in legal requirements, change in law, change in the identity, nature or status of the State, or change in the type of business conducted by the State;
- (ii) this Disclosure Agreement, as amended, would have complied with the requirements of the Rule as of the date of issuance of the relevant Bonds, after taking into account any amendment or interpretations of the Rule, as well as any change in circumstances; and
- (iii) the modification or amendment does not materially adversely affect the interests of Holders, as determined either by a party unaffiliated with the State (such as a paying agent or nationally recognized bond counsel) or by an approving vote of a majority of Holders.

Compliance with the provisions of this Section 9(a) shall be conclusively evidenced by a written opinion of nationally recognized bond counsel to the effect that the modification or amendment satisfies the requirements of this Section 9(a).

Agreement as required by the Rule. To the extent required by the Rule, the State shall include as a component of the first Annual Report to be provided subsequent to the relevant amendment, a copy of the amendment, together with a notice explaining in narrative form both (i) the reasons for the amendment and (ii) the impact of the change in the type of operating data or financial information being provided. To the extent required by the Rule, if the amendment relates to changes in accounting principles to be followed in preparing financial statements, the first Annual Report to be provided subsequent to the relevant amendment shall also include a comparison between the financial statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles and a qualitative (and to the extent reasonably feasible, quantitative) discussion of the differences in the accounting principles and the impact of the change in the accounting principles upon the presentation of the financial information. Written notice of any such change in accounting principles shall be provided in a timely fashion to each Repository.

SECTION 10. <u>Additional Information</u>. Nothing in this Disclosure Agreement shall be deemed to prevent the State from disseminating any other information, using the means of dissemination set forth in this Disclosure Agreement or any other means of communication, or including disclaimers or any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Agreement. If the State chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Agreement, the State shall have no obligation under this Agreement to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

SECTION 11. <u>Default</u>. In the event of a failure of the State to comply with any provision of this Disclosure Agreement, a paying agent, any Participating Underwriter or any Holder may take such actions as may be necessary and appropriate, including seeking a writ of mandamus or specific performance by court order to cause the State to comply with its obligations under this Disclosure Agreement. A default under this Disclosure Agreement shall not be deemed an Event of Default under the Bond Resolution, and the sole remedy under this Disclosure Agreement in the event of any failure of the State to comply with this Disclosure Agreement shall be an action to compel performance; provided however that nothing herein shall limit any Holder's rights under applicable federal securities law.

SECTION 12. <u>Severability</u>. In case any section or provision of this Disclosure Agreement or any covenant, stipulation, obligation, agreement, or action, or any part thereof, made, assumed, entered into or taken under this Disclosure Agreement, or any application thereof, is for any reason held to be illegal or invalid or is at any time inoperable, such illegality, invalidity or inoperability shall not affect the remainder thereof or any other section or provision or the Disclosure Agreement, or any other covenant, stipulation, obligation, agreement, act or action, or part thereof, made, assumed, entered into or taken under this Disclosure Agreement, which shall at the time by construed and enforced as if such illegal or invalid or inoperable portion were not contained therein.

SECTION 13. <u>Entire Agreement</u>. This Disclosure Agreement contains the entire agreement of the State with respect to the subject matter hereof and supersedes all prior arrangements and understandings with respect thereto, provided however that this Disclosure Agreement shall be interpreted and construed with reference to and in *pari materia* with the Rule.

SECTION 14. <u>Captions</u>. The captions or headings herein shall be solely for convenience of reference and shall in no way define, limit or describe the scope or intent of any provisions or sections hereof.

SECTION 15. <u>Beneficiaries</u>. This Disclosure Agreement is being entered into solely for the benefit of the Participating Underwriters and Holders from time to time of the Bonds, and nothing in this Disclosure Agreement expressed or implied is intended to or shall be construed to give to any other person or entity any legal or equitable right, remedy or claim under or in

respect of this Disclosure Agreement or any covenants, conditions or provisions contained herein.

SECTION 16. <u>Governing Law</u>. This Disclosure Agreement shall be deemed to be a contract made under the laws of the State of Delaware, and all provisions hereof shall be governed and construed in accordance with the laws of the State of Delaware, without reference to the choice of law principles thereof.

	IN	WITN	NESS	WHE	REOF	, The	State	of	Delaw	are	has	cause	ed tl	his	Disc	losure
Agreement to	be o	duly e	execute	ed by	the Se	cretar	y of F	inar	ice as	of the	he d	ay an	d ye	ear	first	above
written.																

Sarah Jackson Secretary of Finance The State of Delaware

# EXHIBIT A

# NOTICE TO REPOSITORIES OF FAILURE TO FILE ANNUAL REPORT

Name of State:	The State of Delaware
Name of Bond Issue:	\$100,000,000 General Obligation Bonds - Series 1996A
Date of Issuance:	April 30, 1996
CUSIP:	
respect to the above-	HEREBY GIVEN that the State has not provided an Annual Report with named Bonds as required by Section 16 of the Bond Resolution adopted mely manner. [The State anticipates that the Annual Report will be filed by]
Dated:	
	THE STATE OF DELAWARE
	By:Authorized Officer
	Allinorized Utilicer

#### **EXHIBIT B**

#### CONTENTS OF ANNUAL REPORT

The Annual Report shall contain the following:

- 1. Audited financial statements for the prior fiscal year in form and content substantially the same as those appended to the State's Official Statement with respect to the 1996A Bonds.
- 2. A Summary of the Cash Basis Financial Statements for the prior fiscal year in form and content substantially the same as those appended to the State's Official Statement with respect to the 1996A Bonds.
- 3. An update of the type of information included in the below-listed tables and sections in the Official Statement to the extent not included in Item Nos. 1 or 2 above:
  - (a) General Obligation Debt Service (p. 3) updated for the issuance of general obligation debt through the prior fiscal year.
  - (b) The 5% Rule (p. 4) updated for the current fiscal year.
  - (c) The 15% Test and the Cash Balances Test (p. 5-6) updated for the current fiscal year.
  - (d) DEFAC Budgetary General Fund Revenue Projections (p. 29) updated for the prior fiscal year.
  - (e) Budgetary General Fund Revenue (p. 30) updated for the prior fiscal year.
  - (f) Budgetary General Fund Expenditures (p. 31) updated for the prior fiscal year.
  - (g) Sources and Uses of State Funds (p. 32) updated to compare the prior fiscal year to the fiscal year ten years prior.
  - (h) Budgetary General Fund Disbursements (p. 45) updated for the prior fiscal year.
  - (i) Public School Enrollment (p. 46) updated for the prior year.
  - (j) Welfare Expenditures (p. 47) updated for the prior fiscal year.
  - (k) Total Federal Funds (p. 50) updated for the prior fiscal year.

- 4. An update of the type of information included in the text and tables under the heading "Bonded Indebtedness of the State" beginning with the subsection "General Obligation Debt" through "State Revenue Debt" (p. 7-10) for the prior fiscal year. The information under the heading "Lease Obligations" shall be updated to cover the five fiscal year period beginning with the prior fiscal year.
- 5. An update of the type of information included in the text under the heading "Indebtedness of Authorities, Certain Higher Education Institutions and Political Subdivisions Authorities Delaware Transportation Authority" (p. 11) for the prior fiscal year; and "- Delaware State Housing Authority" (p. 12) updated for the prior fiscal year.
- 6. An update of the type of information included in the text and tables under the heading "Fiscal Year Ended June 30, 1995" (p. 33-35) for the prior fiscal year.
- 7. An update of the type of information included in the text and tables under the heading "State Pension Plan" (p. 51-53) for the prior fiscal year.
- 8. An update of the text appearing in the first paragraph under the heading "Employee Relations" (p. 53) for the prior fiscal year.

# APPENDIX D FORM OF OPINION OF BOND COUNSEL

#### [FORM OF OPINION OF BOND COUNSEL]

February 1, 2005

#### OPINION OF BOND COUNSEL

#### TO THE PURCHASERS OF THE ABOVE-CAPTIONED BONDS:

RE: The State of Delaware

\$32,425,000 General Obligation Bonds - Series 2005A \$92,575,000 General Obligation Bonds - Series 2005B

We have acted as bond counsel in connection with the issuance of \$32,425,000 General Obligation Bonds - Series 2005A and \$92,575,000 General Obligation Bonds - Series 2005B (collectively, the "Bonds") by The State of Delaware (the "State") on the date hereof. The Bonds are issued as fully registered Bonds as provided in the Bonds and in a resolution of the Issuing Officers of the State adopted January 12, 2005 (the "Resolution").

The Bonds are issued pursuant to the Constitution and laws of the State including Chapter 74, Title 29, Delaware Code, as amended and the Resolution.

As Bond Counsel, we have examined a certified copy of the Resolution and the form of Bonds. We have examined originals (or copies certified or otherwise identified to our satisfaction) of such other instruments, certificates and documents as we have deemed necessary or appropriate for the purposes of the opinion rendered below. In such examination, we have assumed the genuineness of all signatures, the authenticity of all documents submitted to us as originals and the conformity to the original documents of all documents submitted to us as copies.

We have relied on a certificate of the State as to the due execution and delivery of, and payment for, the Bonds. As to any facts material to our opinion we have, when such facts were not independently established, relied upon the aforesaid instruments, certificates and documents including the State's Federal Tax Certificate as to Arbitrage and Instructions as to Compliance with Provisions of Section 103(a) of the Internal Revenue Code of 1986, as amended, dated the date of issuance of the Bonds, and the statement of reasonable expectations of future events set forth in such certificate.

We have not verified the accuracy, completeness or fairness of the information set forth in any offering statement or other similar documents of the State delivered to the purchasers or prospective purchasers of the Bonds, and we take no responsibility therefor.

Based on the foregoing, we are of the opinion as of the date hereof and under existing law that:

- 1. The Bonds have been duly authorized, executed and delivered and constitute legal and valid general obligations of the State.
- 2. The State has pledged its faith and credit for the payment of the principal of and interest on the Bonds. The Constitution of the State does not contain any limitation upon the rate or amount of taxes which may be levied by the State for the payment of principal of and interest on the Bonds with the exception that any law which shall have the effect of increasing the rates of taxation on personal income for any year or part thereof prior to the date of the enactment thereof, or for any year or years prior to the year in which the law is enacted, would be void.
- 3. Interest (including accrued original issue discount) on the Bonds is not includable in gross income for purposes of federal income taxation under existing statutes, regulations, rulings and court decisions. The opinion set forth in the preceding sentence is subject to the condition that the State comply with all applicable federal income tax law requirements that must be satisfied subsequent to the issuance of the Bonds in order that interest thereon continues to be excluded from gross income for purposes of federal income taxation. Failure to comply with certain of such requirements could cause the interest on the Bonds to be includable in gross income retroactive to the date of issuance of the Bonds. The State has covenanted to comply with all such requirements. Interest on the Bonds is not treated as an item of tax preference under Section 57 of the Internal Revenue Code of 1986, as amended (the "Code") for purposes of the individual and corporate alternative minimum taxes; however, we call to your attention that under the Code, to the extent that interest on the Bonds is a component of a corporate holder's "adjusted current earnings", a portion of that interest may be subject to the corporate alternative minimum tax. We express no opinion regarding other federal tax consequences relating to the Bonds or the receipt of interest thereon.
- 4. Interest on the Bonds is excluded from taxable income for the purposes of personal and corporate income taxes imposed by the State.

It is to be understood that the rights of the holders of the Bonds and the enforceability thereof may be subject to bankruptcy, insolvency, reorganization, moratorium and other similar laws affecting creditors' rights heretofore or hereafter enacted to the extent constitutionally applicable and that their enforcement may also be subject to the exercise of judicial discretion in appropriate cases.