

CREDIT OPINION

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New Issue

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Delaware (State of)

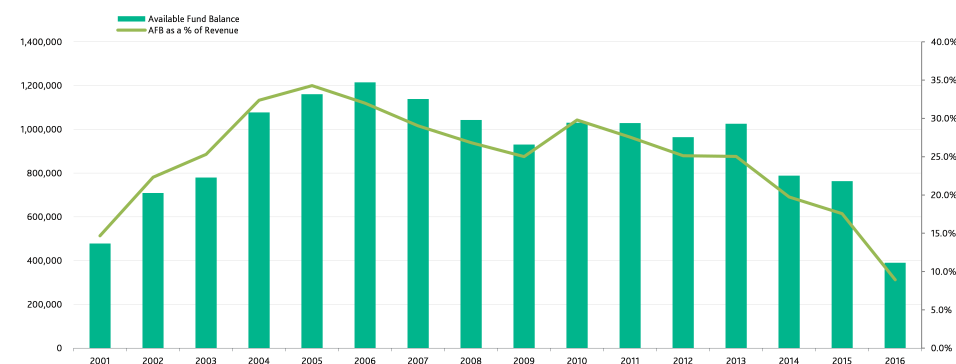
New Issue - Moody's Assigns Aaa to Delaware G.O. Bonds;
 Outlook Stable

Summary Rating Rationale

Moody's Investors Service has assigned Aaa ratings to the State of Delaware's \$234 million of General Obligation Bonds, Series 2017A; to its \$16 million of General Obligation Bonds (AMT), Series 2017B, and to the state's \$110 million of General Obligation Refunding Bonds, Series 2017C. The ratings reflect Delaware's strong financial management characteristics and history of maintaining ample budgetary reserves. The outlook is stable.

Exhibit 1

Fiscal 2016 reserves declined



Source: Delaware comprehensive annual financial reports

Credit Strengths

- » Strong reserves and liquidity
- » Financial management policies that include frequent revenue forecast updates and conservative budgeting

Credit Challenges

- » Large debt burden and high fixed costs relative to its peer group of Aaa-rated states
- » High economic concentration in financial services

Rating Outlook

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

Factors that Could Lead to a Downgrade

- » Depletion of financial reserves
- » Greater loss of output or employment than peer states during the national economic contraction
- » Weakened financial management

Key Indicators

Exhibit 2

Delaware	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
Operating Fund Revenues (000s)	4,223,865	4,538,384	4,255,647	4,749,041	4,816,998
Balances as % of Operating Fund Revenues	22.8%	22.6%	18.5%	16.1%	8.1%
Net Tax-Supported Debt (000s)	2,325,311	2,300,239	2,280,579	2,256,218	2,421,656
Net Tax-Supported Debt/Personal Income	6.2%	5.7%	5.5%	5.2%	5.4%
Net Tax-Supported Debt/Personal Income 50 State Median	2.8%	2.6%	2.5%	2.5%	2.5%
Debt/Own-Source Governmental Funds Revenue	37.9%	36.1%	48.2%	44.0%	46.9%
Debt/Own-Source Governmental Funds Revenue Median	37.4%	36.1%	35.8%	34.4%	32.7%
ANPL/Own-Source Govt Funds Revenue	87.5%	68.7%	79.8%	68.4%	59.8%
ANPL/Own-Source Govt Funds Revenue Median	94.2%	87.6%	81.8%	83.0%	82.2%
Total Non-Farm Employment Change (CY)	0.6%	2.1%	2.2%	2.3%	1.1%
Per Capita Income as a % of US (CY)	98.4%	98.5%	97.6%	99.0%	98.2%

Source: Moody's Investors Service

Recent Developments

Recent developments are incorporated in the detailed rating considerations.

Detailed Rating Considerations

Economy

Delaware's economy has slowed after a burst of high growth in 2014 and 2015. Gross state product increased just 0.3% in calendar 2016. Total nonfarm jobs increased just 2,400 in the twelve months ending September 2017. Although stagnant, the state economy remains stable. Going forward, we believe the [economy](#) will resume faster growth over the rest of fiscal 2018 because of conditions favorable to its dominant position in consumer credit and the state's low cost of living and business costs compared to other states.

The state continues to transition to a more services-based economy, as is the case with most states. Sectors adding jobs include healthcare and leisure and hospitality on its beaches.

Manufacturing employment is flat. At 25,900, it is the same as in 2010. Manufacturing has a shrinking role in the state's economy. Manufacturing output of \$3.5 billion accounted for just 5.8% of the state economy, the smallest share on record. The decline in manufacturing has coincided with a gradual decline in Delaware's living standards relative to the rest of the country, as measured by per-capita income. Manufacturing jobs typically pay better than new service-sector jobs for the same level of education.

Financial services are a larger part of Delaware's economy than any other state. The financial sector produced \$27 billion, or 44%, of Delaware's \$61 billion total gross state product in 2016. This is more than double the 20% national share. Credit card-processing is a niche industry that developed as a result of the state's business-friendly environment. The financial sector has provided Delaware with both long-term employment stability and growth.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Finances and Liquidity

The state ultimately passed a balanced budget for fiscal 2018 after solving a sizeable \$385 million gap that was 9% of revenue. The budget was passed a few days later. The gap was caused by a slowdown in revenue growth to 1.7% in fiscal 2017 (unaudited) and increases in mandatory spending on healthcare and education. The gap was closed with a mix of cuts and tax increases. As a result of the tax increases, the state expects revenues to grow 5.6% in fiscal 2018. The fiscal 2018 budget contains zero growth in spending.

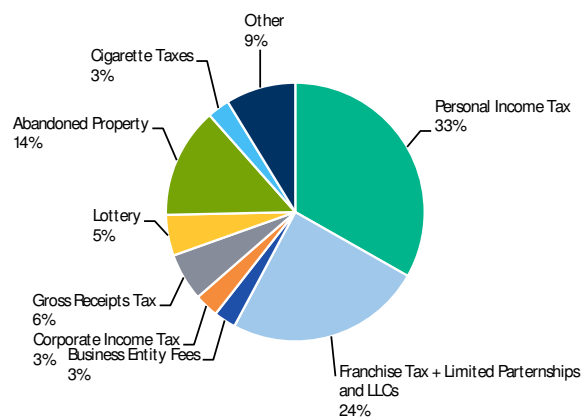
We expect that Delaware's underlying growth will continue to be muted, as is the case for most states, through the end of fiscal 2018. Delaware expects revenues to grow 1.2% in fiscal 2019 and about 3% in fiscal years 2019 through 2022. Its modest growth forecasts will contribute to structural balance in the next fiscal year. Continued expenditure restraint will be also be required to maintain budget discipline and its strong reserve position.

The state's revenue structure is unusual in its dependence on revenue derived from serving as the legal home for publicly traded companies. The state serves this role for half of all publicly traded firms in the nation, more than any other state. Franchise taxes levied on corporations organized under Delaware laws account for a quarter of revenues and, after personal income taxes, are the state's second-largest source of revenue (see Exhibit). Abandoned property, which is also related to the state's position as legal domicile of more than two-thirds of the Fortune 500, accounts for 13% of revenue. Bank franchise taxes and other corporate levies account for a further 5% of revenue.

Exhibit 3

Much of Delaware's revenue is derived from the state's role as a preferred corporate domicile

Fiscal 2017 general fund revenues, millions



Source: State of Delaware (unaudited)

Delaware's reserves insulate it from potential future revenue downturns or unanticipated spending pressures. Reserves declined in fiscal 2016 and have been declining for a decade. The unassigned balance in the general fund declined to \$390 million, or 9% of revenues, at the end of fiscal 2016 from \$763 million, or 18% of revenues, in fiscal 2015. The decrease brings Delaware's financial reserve position in line with the median for Aaa-rated states. The state attributes the decline primarily to an increase in expected abandoned property refund claims. Delaware makes greater budgetary use than other states of assets derived from abandoned property, which generated \$554 million (unaudited), or 14% of total general fund revenue in fiscal 2017.

Delaware's competitive advantage as legal domicile

Delaware plays a unique role in corporate America as legal domicile for two-thirds of Fortune 500 companies and more than half of all publicly traded firms in the US. In recent years, Delaware has expanded its dominant position in this field. Delaware's corporate laws are modern and have broad acceptance in the US. The state's Court of Chancery has a well-developed body of jurisprudence as it relates specifically to corporate law. As of October 2017, there were 1.3 million businesses registered in the state. Delaware's long-standing position as preferred domicile enhances its economic and revenue stability.

Delaware's reserve position also include a \$231.6 million rainy day fund that is funded at the constitutional limit of 5% of revenues as of August 2017. The state has never tapped its rainy day fund since its inception in 1980.

Delaware's constitution requires the state to budget expenditures at 98% of available resources, which helps maintain budgetary balance. Unlike other states that suspend such statutory provisions in periods of financial duress, Delaware regularly sticks to this limit, which gives it an additional financial cushion to address potential future revenue downturns.

LIQUIDITY

Delaware has very strong liquidity. As of September 2017, Delaware had total available liquid resources of \$1.6 billion, or 39% of expected fiscal 2018 general fund revenues. Delaware has not had to issue bond- or revenue-anticipation notes in more than 40 years because of its strong liquidity.

Debt and Pensions

DEBT STRUCTURE

Delaware's debt burden is high relative to other states due to its funding of capital projects on behalf of school districts. Delaware's \$2.5 billion in net tax-supported debt was 5.4% of personal income in fiscal 2015, which ranked sixth-highest among states and was more than twice the 50-state median of 2.5%. The state has high fixed costs compared to other Aaa-rated states.

Delaware has no outstanding variable-rate debt. The state's practice of relying on fixed-rate debt limits its vulnerability to rising interest rates and also to the potential liquidity risks that certain types of variable rate debt entail.

Delaware's general obligation debt is paid out relatively rapidly, with 70% of outstanding debt scheduled to be repaid in 10 years and all general obligation debt is 20 years or less in maturity. This increases short-term funding pressure, but enhances long-term fiscal flexibility.

The amount of debt Delaware can issue is limited by a three-part statute. New debt issued in any one year must be less than 5% of general fund revenue. Debt service, including bonds secured by transportation revenues, must be less than 15% of general fund and transportation revenue. The maximum annual debt service on general obligation debt must be less than the state's cash balances. The statutory nature of these debt limits exposes them to legislative change.

DEBT-RELATED DERIVATIVES

Delaware is not party to any debt-related derivatives.

PENSIONS AND OPEB

Delaware has an average pension liability relative to its revenues for a state. Its \$3.4 billion adjusted net pension liability as of fiscal 2016 was 60% of revenue, well below the 50-state median of 82%. The state regularly makes the actuarially determined contribution, which was \$187 million in fiscal 2017, or 5% of the budget. Delaware contributed 112% of its tread-water contribution. The tread water contribution is the amount that would cover interest on the beginning-of-the-year net pension liability, plus employer service cost accruals during the year.

The state has determined its liability for other post-employment benefits (OPEB) was \$8.6 billion as of June 30, 2017. Like most states, Delaware has not significantly funded this liability. It has put away just \$355 million, or 4% of what it owes, to pre-fund this liability.

The state estimates that its OPEB Actuarially Required Contribution for fiscal 2018 is \$543 million, of which it only expects to cover \$237 million, or less than half.

The state retains significant flexibility in addressing OPEB costs. In 2011 and 2013, the state enacted laws that shifted some of the burden to employees and the federal government, respectively.

Governance

The Aaa rating assigned to Delaware's general obligation bonds is based in large part on legal provisions that will encourage the state to maintain a strong financial profile over a long period. A panel of 31 gubernatorial appointees, known as the Delaware Economic and Financial Advisory Council (DEFAC), provides the state's revenue estimates. This panel, which includes officials from the public and private sector, meets six times a year and issues revenue and expenditure forecasts used by both the executive and legislative branches of government during the budget process. The state's requirements for consensus forecasts, well-managed expenditure growth, and a limit on appropriations support long-term prospects for financial strength. Delaware's otherwise strong management profile is tempered by a constitutional requirement that tax increases be approved by a three-fifths legislative majority, which reduces the state's financial flexibility.

Legal Security

The bonds are secured by the full faith and credit of the state.

Use of Proceeds

Series 2017A bond proceeds will provide for various capital projects. Series 2017B bond proceeds will finance a private activity project at the Port of Wilmington. Series 2017C bond proceeds will advance refund certain outstanding general obligation bonds.

Obligor Profile

Delaware is the 6th smallest state by ranks 45th among US states by population (with 952,065 as of 2016) and 41st based on state gross domestic product, which amounted to \$61 billion in calendar 2016. Per- capita annual personal income in 2016 was \$48,697, which was just below the national average.

Methodology

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

Ratings

Exhibit 4

Delaware (State of)

Issue	Rating
General Obligation Bonds (AMT), Series 2017B	Aaa
Rating Type	Underlying LT
Sale Amount	\$15,800,000
Expected Sale Date	11/30/2017
Rating Description	General Obligation
General Obligation Bonds, Series 2017A	Aaa
Rating Type	Underlying LT
Sale Amount	\$234,200,000
Expected Sale Date	11/30/2017
Rating Description	General Obligation
General Obligation Refunding Bonds, Series 2017C	Aaa
Rating Type	Underlying LT
Sale Amount	\$110,000,000
Expected Sale Date	11/30/2017

Rating Description
Source: Moody's Investors Service

General Obligation

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