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Delaware; Tax Secured, General Obligation

Credit Profile

US\$132 mil GO bnds ser
2005D dtd 09/15/2005 due
09/01/2006-2025

AAA

Sale date: 08-SEP-2005

AFFIRMED

\$771.200 mil. Delaware

AAA

OUTLOOK:

STABLE

Rationale

The 'AAA' rating on Delaware's GO bonds series 2005D and outstanding GO debt reflects the state's:

- Long history of strong financial management, including long-range planning, prudent debt policies, and conservative budgeting practices;
- Resilient local economy centered on financial services;
- Above-average per capita income levels; and
- Low debt burden, with manageable projected bonding requirements.

Rationale

The state's full faith and credit pledge secures the bonds.

Outlook

Economy

Finances

Debt

Delaware Economic And Financial Advisory Council

Delaware's financial position continues to be strong. Audited fiscal 2004 results show a \$1.2 billion fund balance, equal to more than 39% of expenditures, up from a seven-year low of \$762.5 million, or 23%, in fiscal 2001. The unreserved fund balance also increased to \$929 million, or 31% of expenditures, in fiscal 2004, from \$350 million, or 10%, in fiscal 2001. On a GASB 34 basis, the state's net assets increased to \$4.98 billion in fiscal 2004 from approximately \$4.65 billion in fiscal 2003. The increase is due to an increase of more than \$331 million in the primary government's net assets, coupled with a net asset decline in business-type activities of roughly \$64 million. Unrestricted primary government net assets increased for the second consecutive year by nearly \$200 million: to \$1.285 billion at fiscal year-end 2004 from \$1.030 billion at fiscal year-end 2003. Given the fiscal 2005 adopted budget of \$2.6 billion, unrestricted net assets are strong.

Delaware maintained strong financial operations and revenue growth in fiscal 2005, ending with revenues of \$146 million, 5.2% over fiscal 2004 actual collections. Revenues were 9.3% higher when adjusted for legislative changes. The primary revenues performed as follows:

- Personal income increased 13%,
- Corporate income tax revenues decreased 1.5% (3% increase, adjusted),
- Gross receipts increased 9.4%, and
- Lottery receipts increased 5.4%.

Reserves total \$701.4 million, an increase of \$55.4 million from fiscal 2004.

The fiscal 2006 budget's total general fund revenues are \$3 billion, 4.5% over fiscal 2005. The state continues the conservative practice of budgeting just 98% of the projected net revenues and fiscal 2005 carry-overs. As of the June 2005 Delaware Economic and Financial Advisory Council (DEFAC) meeting, fiscal 2006 revenues are currently projected at \$3.063 billion.

The state's annual unemployment rate has been below that of the nation for more than 20 years. Over the past 12 months, the unemployment rate was 4.05%, up slightly from the 2004 unemployment average of 3.9%, which was well below the nation's 5.1% rate. Median income remains well above the national average, and income growth has mirrored national trends.

Delaware's GO debt burden is low at approximately \$1,234 per capita, with

\$1.04 billion in GO debt as of June 30, 2005. Amortization remains rapid, with about 70% of debt retired over 10 years and 100% over 20 years. The state remains well within its debt-affordability model guideline.

Outlook

The stable outlook reflects the expectation that the state's prudent financial and debt management practices will lead to continued sound financial operations.

Economy

Delaware has the highest concentration of finance employment in the nation, with 61 banks and trust companies based in the state. Delaware has passed a number of laws to make the state more favorable for banking and financial firms to locate there, beginning with the 1981 Financial Center Development Act. MBNA America Bank, the largest credit card lender in the world and the leading employer in the state (roughly 11,000 employees), anchors Delaware's credit card industry. MBNA recently was purchased by Bank of America; it has been rumored that 6,000 jobs would be cut nationally because of the merger. The Delaware-based credit card operation, however, is expected to remain intact. Gov. Ruth Minner has been working closely with Bank of America, looking for ways to expand Delaware-based operations. ING Direct is continuing to grow in the state; with the renovations of a second building in Wilmington, ING expects to fill 700 new positions. J.P. Morgan Chase & Co (2,900 employees) is investing \$300 million in the state to create two new data centers, and the Wilmington facility is the world headquarters for the corporation's credit card business. Other major employers in the financial services industry in the state include: Bank One (2,400), Wilmington Trust Co. (2,200), and Discover Card (1,200).

E.I. du Pont de Nemours and Co., long the state's leading employer, is now second to MBNA, with roughly 9,400 employees, which is down from a high of 22,500 in 1992. Invista was spun-off from DuPont in 2004, as a textile fibers manufacturer, but decided to keep the 350 management position jobs in Delaware. As DuPont continues to position itself to become a global leader in the life sciences, it will attempt to achieve greater economies of scale and contain costs, but, as a result, is shifting some manufacturing operations from Delaware to the Far East. Growth industries such as biotechnology and pharmaceuticals are expected to offset losses in the state's chemical manufacturing industry over the long term. To this end, the announcement of investment in R&D operations, 480 million by Dupont and \$15 million by Hercules, is significant.

The diversified manufacturing sector also includes two automobile plants--DaimlerChrysler Corp. and General Motors Corp. (GM)--which employ a total of 3,000. The recent announcement of a new line of Miada sport-type car has buoyed the automaker's expectations. DaimlerChrysler's Newark, Del. plant, where the newly redesigned Durango sports utility vehicle is assembled, employs 2,100. The GM plant (1,900 employees) was recently retooled to produce the midsize Saturn, but with that model ceasing production, the future of the plant was uncertain. GM recently announced that two new models will be produced at the plant over the coming years, so many jobs will be retained. Health services firms in the state have experienced steady employment gains. The state's demographic expansion has driven, and is expected to continue to drive, the health industry's long-term expansion. AstraZeneca, the world's third-largest pharmaceutical company, with Wilmington as the site of its North American headquarters, currently employs 4,900 in the state, and continues to build on its campus. Delaware military bases are expected to gain through the Base Realignment and Closure (BRAC) process.

Per capita household effective buying income improved to 111% of the national average in 2003, up from a low of 107% in 2001. Per capita effective buying income is 106% of the national average.

Finances

Delaware's strong financial operations continue, with the financial position

very healthy. The audited fiscal 2004 unreserved general fund balance was \$929.2 million and 30.5% of expenditures, including a "rainy day" fund that was fully funded at \$136.5 million at the start of fiscal 2005. The total general fund balance remained strong at \$1.2 billion, or 39.8% of expenditures, in fiscal 2004. On a GASB 34 basis, net assets grew more than \$330 million, or 7.1%, to \$4.98 billion.

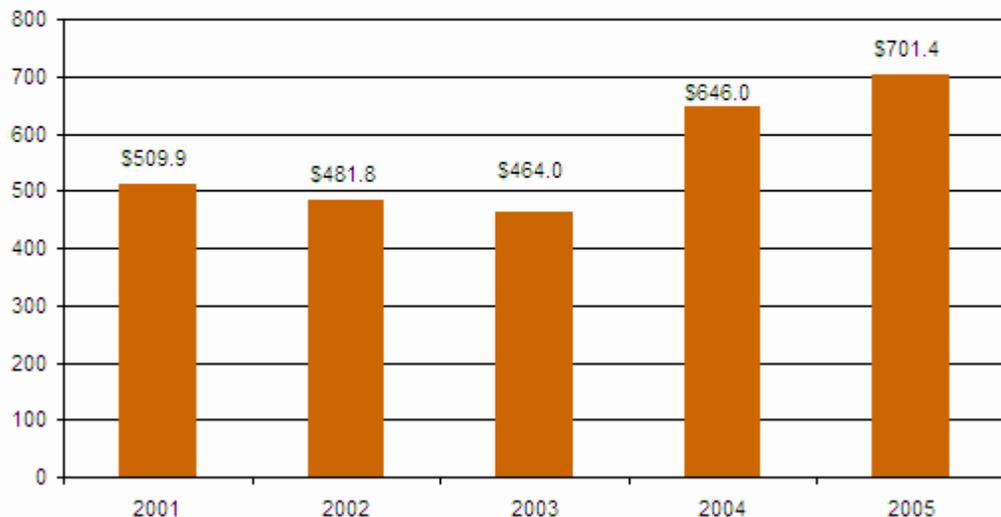
The state maintained strong financial operations and revenue growth through fiscal 2005, ending with revenues of \$146.0 million, 5.2% over fiscal 2004 actual collections. Revenues were 9.3% higher when adjusted for legislative changes.

The fiscal 2006 budget's total general fund revenues are \$3.0 billion, 4.5% over fiscal 2005. The state continues the conservative practice of budgeting just 98% of the projected net revenues and fiscal 2005 carry-overs. As of the June 2005, Delaware Economic and Financial Advisory Council (DEFAC) meeting, the fiscal 2006 revenues are currently projected at \$3.063 billion.

In 2005, reserves total \$701.4 million, which includes a rainy day fund of \$150 million, unencumbered cash of \$170 million, and contingency and other cash of \$284 million. The state projects a revenue surplus of \$151.0 million driven by 7.4% growth in net personal income tax revenues and 4.1% growth in franchise tax revenues. The gross receipt tax rate has been reduced by 20% on businesses. This reduces revenues by an estimated \$16 million-\$17 million in fiscal 2006; \$47 million for fiscal 2007. Medicaid spending is budgeted to increase by \$55.9 million, or 13.0% over fiscal 2005, while health insurance and pension contributions will increase by \$11.3 million and \$14.6 million, respectively. Employee salaries are budgeted to increase by \$47.7 million.

Chart 1

Reserve Trend (Mil \$)



Delaware has completed two separate actuarial valuations to determine the effect of GASB 45 on the state budget in 2007. GASB 45 address new accounting standards for other postemployment benefits (OPEB), and Delaware projects the effect on the budget to be \$209 million in additionally required budgeted expenditures. The actuarial forecast of fiscal 2008, including Medicare Part D savings, results in a \$3.1 billion liability. The state has set aside \$30 million toward this liability and is looking for funding options.

Debt

Delaware's GO debt burden is favorable at \$1,421 per capita. Debt ratios are higher at \$2,312 per capita when \$761.6 million of gas-tax-supported Delaware Transportation Authority debt and \$117.0 million of appropriation debt are factored in. Delaware maintains the practice of issuing debt for political subdivisions. The state pays between 60% and 80% of the cost of capital improvements for public school districts upon approval of such costs. The district pays the remaining portion. The state also issues bonds on behalf of the school district and pays 100% of the cost, if authorized. State statutes prescribe strict debt limits, with GO and lease debt limited to 5% of estimated general fund revenues. As of June 30, 2004, Delaware's state employee pension plan was overfunded by \$158 million, with a 103% funding ratio.

The fiscal 2005 capital budget is \$772.5 million. Of this, \$138.3 million is allocated for statewide nontransportation projects, \$393.6 million for transportation trust fund projects, and \$235 million for pay-as-you-go capital contributions, mainly for transportation projects. Future debt includes another roughly \$100 million issuance in August 2005.

Delaware Economic And Financial Advisory Council

Created in 1977 in response to the fiscal challenges of the mid-1970s, the Delaware Economic and Financial Advisory Council (DEFAC) meets at least six times a year to forecast revenue and expenditures. DEFAC is a 36-member council appointed by the governor; historically, however, it has been bipartisan and has had representation from all branches of government, various business community representatives, and state academics. Mandated by executive order, DEFAC must submit annual budgetary general fund and transportation fund revenue forecasts to the governor and state Legislature in September, December, March, April, May, and June for the current fiscal year and succeeding two years. In times of economic uncertainty, DEFAC can meet more frequently. A five-year revenue forecast is to be generated once a year by October. Corresponding expenditure forecasts are required in December, March, April, May, and June. The DEFAC process is open to the public.

Regular DEFAC forecasting has allowed Delaware to take early action in recent years, as revenues have tightened. With the current makeup being bipartisan and representative, the branches of government can then take action on resolving any revenue shortfall or expenditure excess without the common debate over the size of the problem. With 25 years of history, the DEFAC process has become part of the prudent and conservative culture of Delaware's financial management.

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