FitchRatings

Public Finance
Germany

Laender 61

Five Federated States

Rating

Rating type	Rating	Amount (EURbn)	Final maturity
IDR	AAA	1.0	8 Oct 2027

Transaction Summary

Joint Issue: This issue of EUR1.0 billion 0.01% fixed-rate bonds is the second German Laender jumbo issue of 2021 and the 61st Laender joint jumbo issue overall. The bonds are issued under German law and are the several and not the joint liability of the Laender involved, according to a fixed distribution between them. The bonds are senior unsecured and rank pari passu with all previous and future obligations of the issuers.

Division of Proceeds: Two of the participating states – Bremen and Schleswig-Holstein – will each receive EUR250 million, two – Rhineland-Palatinate and Saarland – will each receive EUR150 million, while Hamburg will receive EUR200 million.

Laender Credit Quality Supports Rating: Fitch Ratings has assigned this issue a final Long-Term Local-Currency Issuer Default Rating (IDR) of 'AAA'. The rating reflects the creditworthiness of the five German federated states (Laender) involved in the joint issue. The final rating is due to the receipt of final documents conforming to information already received.

Key Rating Drivers

Creditworthiness of Laender: Fitch affirmed the ratings of the German Laender on 16 April 2021. The creditworthiness of the Laender is based on the strong support mechanisms that apply to all members of the federation and the extensive liquidity facilities from which they benefit; these ensure timely payment and equate the creditworthiness of the states to that of Germany (AAA/Stable/F1+)

Support Mechanisms: Fitch has identified support mechanisms that apply uniformly to all members of the German federation, comprising the federal government (Bund) and the 16 federated states, which include the five states involved in this joint issue. Differences in their individual economic and financial performances are irrelevant, as all Laender are equally entitled to financial support in the event of financial distress.

Implicit Guarantee: The solidarity and implicit guarantee mechanisms linking the federal government and the Laender ensure an equal and minimum risk of default for all. Fitch does not believe the strength of the support mechanisms will change in the medium term.

Liquidity Is Underpinned: Hamburg acts as paying agent. The liquidity of the issue is underpinned by the safe cash-management system operated by the Laender (overnight cash exchanges between Laender and Bund when necessary, and recourse to appropriate short-term credit lines). The issue is zero risk-weighted and is eligible for a repo at the ECB. The objective of the Laender jumbo joint issue is to offer investors a large and liquid bond, with a portfolio exposure to several issuers.

Bonds to Fund Laender's Operations: The bonds will fund the general budget operations of the Laender, according to their respective constitutions and financial ordinances.

Rating Considerations

Solidarity Is Enshrined in the Constitution

According to the German Constitution (Article 20), the 16 Laender are equal partners with the federal government and have the same rights and duties, even though in practice they are subordinate in some areas. The distribution of responsibilities between the Bund and the Laender guarantees their integration into federal decision-making processes. On average, between half and two-thirds of federal laws require the Laender's approval through the Bundesrat, one of the two legislative bodies in Germany and the one in which the Laender are represented.

Applicable Criteria

Rating Criteria for International Local and Regional Governments (September 2021)

Related Research

Fitch Affirms 11 German Laender at 'AAA'; Outlook Stable (April 2021)

German Laender – Framework Report (September 2021)

German Laender – Peer Review 2021 (September 2021)

Analysts

Guido Bach
+49 69 768 076 111
guido.bach@fitchratings.com

Nazim Dadashov
+49 69 768 076 149
nazim.dadashov@fitchratings.com

Issuer Contacts

Dr. Christoph Hünecken
+49 40 428 231 670
christoph.huenecken@fb.hamburg.de

Matthias Oelke
+49 431 988 4129
matthias.oelke@fimi.landsh.de

The constitution recognises the need to iron out disparities in standards of living throughout the country and gives the Laender the opportunity to exercise financial independence. German financial federalism implies the need to balance resources between the constituent parts of the federation (the 16 Laender and the Bund). This has led to the tax-sharing system and the double income-equalisation system (for further information, see *Institutional Framework for German Subnationals* under *Related Research* above).

Mandatory Support for Laender Facing Financial Difficulties

In 1992, a ruling of the German Federal Constitutional Court highlighted the Bundestreuekonzept as a "solidarity principle", according to which all members of the federal republic are jointly responsible for supporting a Land in financial distress. If a Land experiences extreme budgetary hardship, it is entitled to financial assistance from all other federal members, as in the cases of Saarland and Bremen after 1994. It is unlikely that support would not be forthcoming for any member of the federation that experienced financial distress.

Fitch considers that the decision made by the Federal Constitutional Court on 19 October 2006 on Berlin's appeal for extraordinary financial support reaffirmed the validity of the Bundestreuekonzept. This was despite the Court's rejection of Berlin's appeal for extraordinary support because the capital city had not reached a situation of extreme budgetary hardship.

At the same time, the Court reaffirmed the obligation for the federal government and the other Laender to provide financial support as a last resort ("ultima ratio"), should a Land become unable to fulfil its constitutional duties. In Fitch's view, this confirms the strong support of German financial federalism, which has been one of the key rating factors (alongside the equalisation system and the Laender's cash management) underpinning the 'AAA' rating that Fitch has assigned to the German Laender since 1999.

Extensive Equalisation Scheme Compensates for Financial Disparity

This constitutional support system works together with the far-reaching tax-sharing and equalisation system to establish a preventative framework to help the Laender avoid financial difficulties. The main taxes, which are personal income, corporate and VAT, are shared between the Bund, the Laender and the local authorities. Tax rates are set by federal law, minimising competition between Laender, but giving them almost no tax discretion.

The three-stage equalisation process (Laenderfinanzausgleich) significantly reduces financial disparities between the Laender. The first two steps consist of sharing VAT and other tax proceeds among the Laender themselves, while the third element takes the form of additional federal transfers to the weakest Laender. Differences in financial strength are almost entirely balanced out.

Safe Liquidity Management Prevents Delay in Support

With respect to timeliness, Fitch believes that the issuers, as German Laender, run safe and predictable liquidity-management procedures. Laender cash management covers one year so that a liquidity crisis could not arise unexpectedly. The Laender are tax collectors and their expenditure tends not to be volatile; they have substantial, predictable cash flow.

Their liquidity has two kinds of short-term arrangement: daily cash transfers between the Laender as an alternative to the capital markets; and credit and back-up lines individually negotiated by each Land, which are available at short notice. German Laender are on an equal footing with banks in the interbank market and therefore have good access to liquidity through a wide range of public and private banks.

Debt Brake

The Federalism Reform II (Föderalismusreform II) aimed to prepare the Bund and the Laender for the commonly agreed debt limit. As a result, both layers were required to balance their budgets without taking on new debt. Only the Bund will be allowed to increase net debt, up to 0.35% of GDP (structural debt).

Exemptions will be allowed during economic downturns to stimulate the economy and in extraordinary circumstances, such as natural disasters, when rapid support is required. Should the Bund or a Land make use of those exemptions, it will have to set up measures to reduce this debt within a specific period.

The rules apply from 2011 but following the global financial crisis, both the Bund and Laender permitted a transition period for the introduction of the new rules until 2015 (for the Bund) and 2019 (for the Laender). Since the fiscal year 2020 was significantly influenced by the Covid-19 pandemic, Bund and Laender reported large deficits following extensive supporting measures. The Bund and Laender agreed that this is an exception and the corresponding debt will be subject to specific repayment schedules.

Statistical Overview of the Relevant Laender

	Population, 2020 (000s)	GDP, 2020 (EURbn at current prices)	GDP per capita, 2020 (EUR at current prices)	Public debt (according to SFK4 reporting), 1H21 (EURbn)	Public debt (according to SFK4 reporting) per capita, 1H21 (EUR)
Bremen	680	31.6	46,469	21.7	31,943
Hamburg	1,845	118.1	64,022	25.1	13,221
Rhineland-Palatinate	4,093	141.9	34,673	31.3	7,543
Saarland	985	33.6	34,125	14.4	14,479
Schleswig-Holstein	2,906	97.2	33,452	29.9	9,902

Source: Fitch Ratings, Volkswirtschaftliche Gesamtrechnungen der Laender, German Federal Ministry of Finance

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.