

Laender 62

Six Federated States

Transaction Summary

Joint Issue: This issue of EUR1.0 billion 1.25% fixed-rate bonds is the first German Laender jumbo issue of 2022 and the 62nd 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: Four of the participating states – Bremen, Hamburg, Saarland and Schleswig-Holstein – will each receive EUR200 million and two of the participating states – Mecklenburg-Western Pomerania and Rhineland-Palatinate – will each receive EUR100 million.

Laender Credit Quality Supports Rating: Fitch Ratings has assigned this issue a final Long-Term senior unsecured Rating of 'AAA'. The rating reflects the creditworthiness of the six 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: Mecklenburg-Western Pomerania 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

Rating

Rating type	Rating	Amount (EURbn)	Final maturity
Long-term senior unsecured	AAA	1.0	4 May 2029

Applicable Criteria

International Local and Regional Governments
Rating Criteria (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)

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Bundesrat, one of the two legislative bodies in Germany and the one in which the Laender are represented.

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 *German Laender - Framework Report* 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), 2021 (EURbn)	Public debt (according to SFK4 reporting) per capita, 2021 (EUR)
Bremen	684	31.6	46,469	22.1	32,260
Hamburg	1,845	118.1	64,022	25.9	13,758
Mecklenburg- Western Pomerania	1,609	61.5	28,590	11.7	5,252
Rhineland- Palatinate	4,093	141.9	34,673	29.0	6,967
Saarland	985	33.6	34,125	13.7	13,742
Schleswig- Holstein	2,906	97.2	33,452	31.7	10,673

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

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