Laender 63

Six Federated States

Rating

Rating type	Rating	Amount (EURbn)	Final maturity
Long-term senior unsecured	AAA	1.0	26 April 2030

Applicable Criteria

International Local and Regional Governments Ratings Criteria (September 2021)

Related Research

Fitch Affirms 11 German Laender at 'AAA'; Outlook Stable (October 2022)

German Laender – Framework Report (September 2021)

German Laender – Peer Review 2022 (December 2022)

Analysts

Guido Bach
+49 69 768076 111
guido.bach@fitchratings.com

Stefanie Wezel
+49 69 768 076 102
stefanie.wezel@fitchratings.com

Issuer Contact

Dr. Frank Nagel
+49 6131 164 266
frank.nagel@fm.rlp.de

Michael Hasselberg
+49 681 501 1697
m.hasselberg@finanzen.saarland.de

Transaction Summary

Joint Issue: This issue of EUR1 billion 3% fixed-rate bonds is the first German federated states (Laender) jumbo issue of 2023 and the 63rd Laender joint jumbo issue overall. The bonds are issued under German law and are the several but 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, Mecklenburg-Western Pomerania and Schleswig-Holstein – will each receive EUR166 million and two of the participating states – Rhineland-Palatinate and Saarland – will each receive EUR168 million.

Laender Credit Quality Supports Rating: Fitch Ratings has assigned this issue a final senior unsecured rating of 'AAA'. The rating reflects the creditworthiness of the six German 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 7 October 2022. 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. Such support ensures timely payment and equates 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 six states involved in this joint issue. The 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: Rhineland-Palatinate 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 of the Laender, according to their respective constitutions and financial ordinances.

Rating Considerations

Solidarity Enshrined in 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 where the Laender are represented.

The constitution recognises the need to smooth out disparities in standards of living throughout the country while giving the Laender the opportunity to exercise financial independence. German financial federalism aims to balance resources between the constituent parts of the federation (the 16 Laender and the Bund), as underlined by a tax-sharing system and a double income-equalisation system (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 single federal state (Land) in financial distress. If a Land experiences extreme budgetary hardship, it is entitled to financial assistance from all other Laender, as in the cases of Saarland and Bremen after 1994. We, therefore, view it unlikely that support would not be forthcoming for any member of the federation that may be in financial distress.

Fitch believes the decision 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 extreme budgetary hardship.

At the same time, the Court reaffirmed the obligation for the federal government and 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

The 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 among 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 among the Laender. The first two steps consist of sharing VAT and other tax proceeds among the Laender, while the third element takes the form of additional federal transfers to the weakest Land. The differences in financial strength are almost entirely balanced out.

Safe Liquidity Management Prevents Delay in Support

Fitch believes that the issuers, like the rest of the Laender, practise safe and predictable liquidity management. The Laender manages sufficient cash to cover one year of liquidity needs so that a liquidity crisis could not arise unexpectedly. The Laender are tax collectors, their expenditure tends not to be volatile and they have substantial, predictable cash flow.

Liquidity in the short term is managed via daily cash transfers between the Laender as an alternative to the capital markets, and through credit and back-up lines individually negotiated by each Land, which are available at short notice. The 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) is aimed at preparing the Bund and the Laender for a commonly agreed debt limit. As a result, both layers are 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 swift 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 2020 was significantly influenced by the Covid-19 pandemic, the 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 2022 (000s)	GDP, 2022 (EURbn at current prices)	GDP per capita 2022 (EUR at current prices)	Public debt[a] 2022 (EURbn)	Public debt[a] per capita 2022 (EUR)
Bremen	680	38.7	56,901	22.4	32,924
Hamburg	1,875	144.2	76,910	25.1	13,375
Mecklenburg-Western Pomerania	1,628	53.4	32,837	8.3	5,067
Rhineland-Palatinate	4,151	171.7	41,366	28.0	6,739
Saarland	989	38.5	38,925	13.0	13,127
Schleswig-Holstein	2,946	112.8	38,274	32.6	11,066

[a] According to SFK4 reporting.
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.