Land of Berlin
Rating Report

AAA
STABLE OUTLOOK

Credit strengths

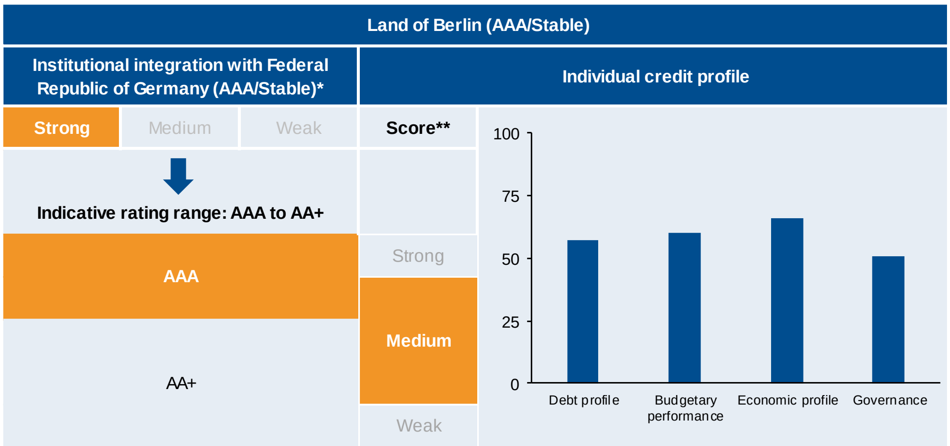
- Integrated institutional framework
- Conservative budgetary management
- Commitment to fiscal consolidation
- Favourable debt profile
- Excellent capital market access
- Prudent liquidity management
- Solid economic base

Credit weaknesses

- High direct debt levels
- Sizeable, though largely low-risk, contingent liabilities
- Unfunded pension commitments
- Limited revenue flexibility

Rating rationale and Outlook: The AAA rating is underpinned by the highly integrated institutional framework under which Berlin operates, characterised by a very strong revenue equalisation system and the federal solidarity principle. In addition, the rating reflects the Land of Berlin’s conservative budgetary management, commitment to fiscal consolidation, favourable debt profile, excellent capital market access, prudent liquidity management and solid economic base. Coupled with strong co-operation on the policy response between the German Länder and the federal level during the crisis, these factors have also enabled Berlin to weather the Covid-19 economic shock. Credit challenges relate to high direct debt, low revenue flexibility given limited leeway to adjust revenues via own taxes, unfunded pension commitments weighing on long-term expenditure flexibility as well as sizeable but manageable contingent liabilities. The Stable Outlook reflects our assessment that the risks to the ratings over the next 12 to 18 months are balanced.

Figure 1: Scope’s approach to rating the Land of Berlin



N.B. * Across countries/government layers (Federal Republic/German states). ** Based on a relative comparison with national peers. From 1 (weakest) to 100 (strongest).

Source: Scope Ratings GmbH

Positive rating-change drivers

- Not applicable

Negative rating-change drivers

- Downgrade of Germany’s sovereign rating
- Changes in the institutional framework, resulting in notably weaker support

Ratings & Outlook

Foreign currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

Local currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

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Bloomberg: RESP SCOP

Institutional framework

Integrated framework results in strong alignment of creditworthiness

Like all Germany's Länder, the Land of Berlin benefits from a mature, highly predictable and integrated institutional framework. The key elements are: i) a strongly interconnected revenue equalisation mechanism enshrined in the German constitution; ii) wide-ranging participation of the Länder in national legislation, including veto rights; iii) equal involvement of the Länder in negotiations on federal reforms; and iv) a solidarity principle that ensures extraordinary system support in a budgetary emergency.

We view the federal system under which the German Länder[1] operate as the strongest integrated system among European sub-sovereigns. We assess the system as having 'high': i) institutionalised support; ii) fiscal interlinkage; and iii) political coherence, between the Länder and also between the Länder and the Federal Republic of Germany (AAA/Stable). Consequently, our assessment results in an indicative downward rating distance of a maximum of one notch between the German sovereign and the rating of each individual Land (see **Figure 2)**.

Figure 2: Framework assessment

Institutional framework assessment: German Länder					
Category	Weight		**Assessment:** Integration	Score	Weighted score
Institutionalised support	25%	Transfer & bailout regime	**Full**	100	25
	15%	Borrowing limits	**Full**	100	15
	10%	Funding support	**Full**	100	10
Fiscal interlinkage	20%	Tax authority	**Full**	100	20
	15%	Fiscal equalisation	**Full**	100	15
Political coherence	10%	Distribution of powers	**Full**	100	10
	5%	Common policymaking	**Full**	100	5
			Integration with the sovereign	**Σ**	**100**

Integration score	0-10	10-20	20-30	30-40	40-50	50-60	60-70	70-80	80-90	90-100
Indicative notch range	0-10	0-9	0-8	0-7	0-6	0-5	0-4	0-3	0-2	0-1

Source: Scope Ratings GmbH

Institutionalised support

Institutionalised support in case of budgetary emergency

Länder have requested additional financial support from the federal government in five instances: Bremen in 1992 and 2006, Saarland in 1992 and 2005 and Berlin in 2002. For Bremen's and Saarland's requests, the Federal Constitutional Court approved claims based on the 'Bundestreueprinzip', under which the Länder and the Bund (the central government) are required to provide each other with mutual support in the event of a budgetary emergency. Berlin's claim was rejected in 2006, with the court arguing that the city-state was not in an extreme budgetary situation. However, the judges noted that federal emergency support remains possible as a last resort if the budget and/or debt situation is assessed as extreme compared to that of other Länder.

As such, we consider the 'Bundestreueprinzip' to be an implicit bail-out rule, as it requires the provision of federal support in times of severe budgetary stress. We therefore define the degree of integration as high.

Debt brake suspended to counteract Covid-19 effects

Since 2020, the Länder must comply with a 'debt brake'[2], under which they cannot run structural financing deficits unless hit by a severe economic downturn or a natural disaster. The debt brake also caps the structural annual deficit of the central government at 0.35% of GDP. The German parliament used the emergency clause of the debt brake in 2020 and 2021 in response to the Covid-19 crisis. Separately, the Land of Berlin invoked the safeguard clause of its debt brake in 2020 in order to implement support

[1] We use 'state' and the German terms 'Land'/'Länder' (singular/plural) interchangeably to refer to the German federal states.
[2] The debt brake is a legal framework that prohibits structural deficits from 2020 onwards; article 109 (3) of the Basic Law stipulates that the Länder may incur deficits in the case of a recession or natural disaster provided they pass respective legislation at the Land level.

measures and credit authorisations to mitigate the budgetary impact of Covid-19. The federal government has assumed the role as a primary shock absorber through deficit spending of EUR 390bn to date (or 12% of 2020 GDP). This has covered a large part of the costs to the economy caused by ongoing pandemic restrictions and direct healthcare spending. Various programmes also directly supported Länder finances.

The finances of the Länder and their compliance with debt limits are monitored by the Stability Council, which was established in 2010 as a joint body of the central government and the Länder. The Stability Council monitors restructuring programmes and compliance with budgetary targets as defined in fiscal consolidation agreements between the Bund and the Länder. The Council comprises the finance ministers of each Land and the federal ministers of finance and economic affairs. The Stability Council and the debt brake are important pillars for integrated financial relations between the central and regional German governments, which leads us to assess integration between the two levels of government as high.

Fiscal interlinkage

Shared tax authority with the Bund on high-revenue taxes

The Länder and the federal government share the tax authority, deciding together on rates and revenue distribution for high-revenue common taxes (income and VAT). The latest reform on federal financial relations (in 2017) took effect in 2020 and has resulted in a higher distributed share of VAT revenues to the Länder. The VAT distribution also compensates to a large extent for the different taxing powers, thereby replacing the former two-step process of horizontal equalisation payments between the Länder. Alongside common taxes, the central government and the Länder have separate tax authority over other taxes generating less revenue.

Highly integrated tax authority

We assess the tax authority as highly integrated, based on the large share of common taxes and the clear separation of tax authority over taxes generating less revenue. The German system is shaped by a financial equalisation system that strongly aligns the regions' different fiscal capacities. The reformed equalisation system came into effect in 2020, with distribution occurring via VAT. The net effect should be positive for all the Länder as contributions from the federal government are greater under the new system. As a result, we maintain our assessment that the fiscal equalisation system contributes materially to high integration.

Political coherence

Federal reforms further strengthen the high level of political coherence

In 2017, the German government and the Länder agreed to reshape financial relations in the federal system, to be generally binding from 2020. In return for higher payments from the equalisation system, the regions have assigned limited executive and legislative rights to the central government in formerly autonomous policy areas, including physical and digital infrastructure and the higher education system. In conformity with earlier federal reforms ('Föderalismusreformen II'), we observe that the higher the share of common national legislation ('konkurrierende Gesetzgebung'), the more integrated the German federal system becomes.

The high share of common national legislation and the increasing political and financial involvement of the central government in regional policy areas lead us to assess the degree of common policymaking as high. This has been highlighted during the Covid-19 crisis, with major measures coordinated between the federal and state levels.

Individual credit profile

The Land of Berlin is one of three German city-states and the country's capital. It has about 3.7m inhabitants. The state's main responsibilities include healthcare and education, which are predominantly financed via shared taxes, transfers and other income.

Berlin's individual credit profile is underpinned by the Land's: i) favourable debt profile, prudent liquidity management and excellent capital market access; ii) conservative budgetary management, which has enabled a gradual build-up of budgetary reserves in recent years, along with average revenue and expenditure flexibility compared to other German Länder; iii) large and diversified economic base with good growth prospects and favourable demographic long-term trends; and iv) high quality of governance. Credit challenges relate to limited revenue flexibility with little room for revenue increases via own taxes and high pension liabilities weighing on long-term expenditure flexibility, as well as sizeable, yet manageable, contingent liabilities. The Covid-19 crisis has led to higher debt levels and a temporary budgetary deterioration due to revenue losses and additional expenditure. However, Berlin's solid underlying budgetary performance coupled with prudent financial management and good growth prospects should enable it to weather the Covid-19 economic shock.

Debt burden and liquidity profile

Covid-19 crisis caused debt to rise sharply

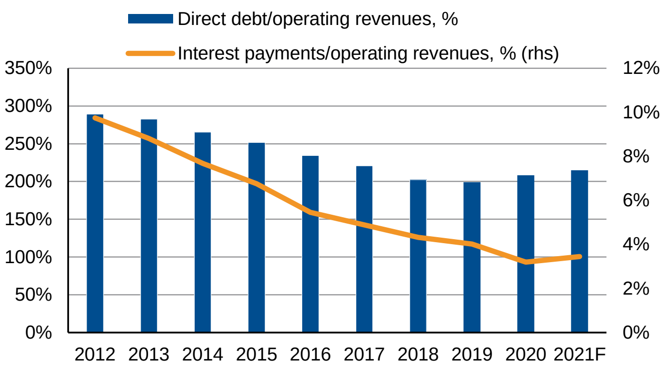
In 2020, after eight years of debt reduction, Berlin's budgetary response to the Covid-19 crisis caused direct debt to rise sharply by EUR 6.2bn, from EUR 57.6bn to EUR 63.7bn. This amounts to 208% of operating revenues, up from 199% in 2019, but still well below the 2012 peak of 289% (see **Figure 3**). In 2021, the completion of remaining funding under the 2020 credit authorisation will increase Berlin's nominal debt stock to EUR 65.9bn, above its previous peak in nominal terms in 2012. Thus, we expect Berlin's debt burden to peak this year at about 215% of operating revenues and gradually decline thereafter.

The Covid-19 crisis has reversed Berlin's debt reduction trend

In response to the Covid-19 crisis and in line with most other Länder, parliament invoked the safeguard clause of Berlin's debt brake and adopted budgetary measures allowing for EUR 7.3bn of new debt issuance in 2020[3]. The Land made use of the full envelope of issuance, and funds not used in 2020 of EUR 5.4bn (instead of the planned EUR 4.1bn) were placed in a reserve earmarked for potential tax revenue shortfalls and additional support measures. Separate approvals must be obtained for uses of the reserve not defined under current budgetary laws.

Figure 3: Debt and interest burden

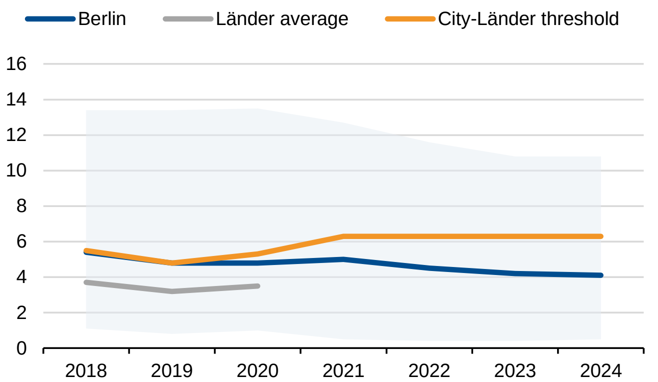
% of operating revenues



Source: Senatsverwaltung für Finanzen Berlin, Scope Ratings GmbH

Figure 4: Interest-to-adjusted tax ratio

%



Source: German Stability Council, Scope Ratings GmbH
N.B. Shaded area represents the minimum-maximum range for national peers

[3] Law on the adoption of the Berlin budget for fiscal years 2020 and 2021 (Haushaltsgesetz 2020/2021 - HG 20/21) of 17 December 2019 (GVBl. p. 830), last amended by law of 17 December 2020 (GVBl. p. 1487).

Risks associated with Berlin's high debt stock are mitigated by a favourable debt profile and excellent market access. Debt service was also on a declining trend as a result of an increase in the average maturity of outstanding debt, gradual debt reduction and the long-term declining trend in interest rates. Although debt service remains high at EUR 5.4bn or 18% of operating revenues in 2020, it is significantly down from EUR 9.7bn or 45% of operating revenues in 2013. The mandatory redemption plan for debt incurred under the safeguard clause foresees annual instalments of EUR 270m between 2023 and 2049, leading to manageable additional debt service requirements.

Low interest payment burden

Berlin's interest expenses are in line with the safe-haven status of the Länder. The average cost of outstanding debt was 1.42% in 2020, further down from 1.68% in 2019. This low cost of debt is continuing to decrease, resulting in interest payments declining relative to operating revenues, to 3.2% in 2020 from 9.7% in 2012, thereby raising Berlin's financial flexibility. The latest Stability Report to the Stability Council stated that Berlin was expected to meet all four financial thresholds[4] by 2020 and comply with the debt brake. This is also supported by the increasing margin between the Land's interest-to-adjusted tax ratio and the Stability Council threshold starting from 2021 (see **Figure 4**).

Well-established capital market access and sound debt management

As for all German Länder, we assess Berlin's access to capital markets as excellent. This was evident during 2020 when funding conditions remained excellent, demonstrating investor confidence in the German framework. In addition, Berlin employs a conservative debt management strategy with no foreign currency risks and limited interest rate risks. At end-2020, the average maturity of outstanding debt was significantly up vis-à-vis 2019, at 8.41 years, and refinancing needs for 2020 had decreased to EUR 5.4bn, below the Land's revised strategic annual redemption target of EUR 5.5bn. Going forward, in view of the low interest rate environment, Berlin's debt management strategy foresees: i) no new foreign currency exposure; ii) the majority of issuance at fixed interest rates; and iii) a limited and declining use of interest rate derivatives.

Prudent liquidity management

We view liquidity management as sound due to comprehensive inter-year cash planning and the availability of numerous sources of liquidity. The Land of Berlin also benefits from prudent financial planning and maintains a sizeable cash buffer throughout the year. Berlin upped its funding activity in 2020 in response to the pandemic. Funds not used in 2020 were placed in a reserve, thus increasing Berlin's cash balance markedly at the end of 2020. The Land's cash flows, especially inflows, are prone to seasonal variability driven by the tax calendar. Additional continued access to liquidity to bridge intraday needs, if required, is available through credit facilities from major financial institutions. An additional source of liquidity is also provided by commercial cash transactions between the German Länder, which lend excess liquidity to each other. In combination with excellent market access, the risk of potential liquidity shortages is negligible.

Contractual guarantees carry low risks

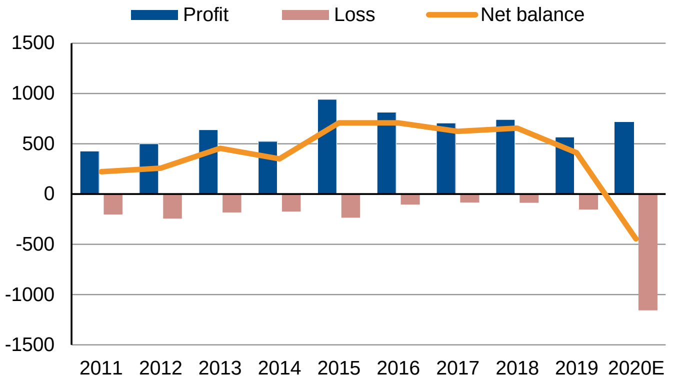
As of 2020, outstanding guarantees issued by the Land of Berlin stood at EUR 3bn, broadly unchanged from the previous year and steadily declining from EUR 26.6bn in 2010. In our opinion, there is a limited risk that the obligations of entities and projects guaranteed by the Land of Berlin will crystallise on its balance sheet. Contractual guarantees are primarily related to three sectors. A third of the outstanding guarantees (EUR 970m in 2020 versus EUR 1bn in 2019) are mainly for Berlin public companies, especially the Berlin water works, whose financial results have been consistently positive in recent years. Outstanding guarantees relating to subsidised housing transactions conducted by Investitionsbank Berlin and KfW amounted to EUR 0.8bn in 2020 (versus EUR 0.9bn in 2019). Guarantees for debt held by social housing associations are not relevant to the budget, in our opinion, because the associations generate stable rental

[4] The four ratios are the structural budget balance per inhabitant, the credit finance ratio, the interest-to-adjusted tax ratio and debt per inhabitant.

income. Guarantees for Berlin Brandenburg Airport amount to EUR 1.1bn (versus EUR 963m in 2019).

Figure 5: Profits and losses of Land of Berlin holdings

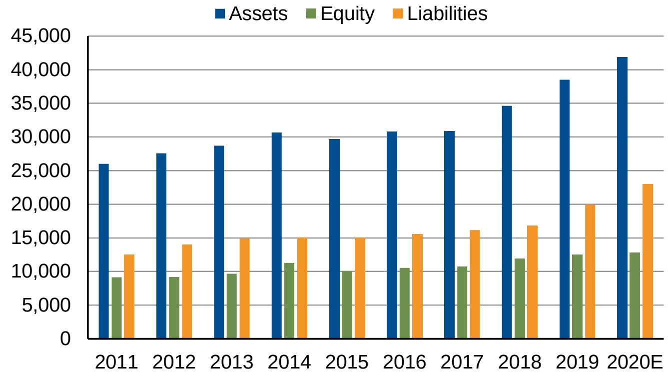
EUR m



Source: Senatsverwaltung für Finanzen Berlin, Scope Ratings GmbH

Figure 6: Assets, liabilities and equity of the Land's shareholdings

EUR m



Source: Senatsverwaltung für Finanzen Berlin, Scope Ratings GmbH

Shareholdings play critical role in investment policy

Berlin's shareholdings play a critical role in the Land of Berlin's investment policy. The companies fulfil a significant public-sector mandate for the Land of Berlin by helping to boost the city's regional economy. They have a strong track record of positive annual results overall, with all major units being profitable in 2019 (except for the Berlin Brandenburg Airport project and local transport provider BVG), which supported high and sustained investment volumes. The Covid-19 crisis has adversely affected the profitability of several of the Land's holdings, especially in 2020 (see **Figure 5**).

The shareholdings most affected by the crisis are Berlin Brandenburg Airport, exhibition centre Messe Berlin, and Berlin hospital operator Vivantes. The budgetary impact on the Land is limited. In addition, while total liabilities at Berlin's holdings increased to EUR 22.9bn in 2020 from EUR 19.9bn in 2019, leverage remains low with a ratio of total liabilities to assets of 0.55, pointing to greater financial flexibility (see **Figure 6**). The high level of assets is partly due to the Land's holdings in real estate and housing sectors in which values have risen.

Budgetary performance and flexibility

Track record of good budgetary performance

Berlin's track record of solid budgetary performance has been underpinned by controlled expenditure growth between 2012 and 2019, with high operating surpluses averaging 14.5% of operating revenues. The administration has shown a strict commitment to fiscal consolidation through effective cost control, with growth in operating expenditure slower than for operating revenues over 2012-2019. Consistently high operating surpluses have enhanced Berlin's ability to cover interest payments and capital expenditure. As a result, after investment activities and interest payments, Berlin posted surpluses between 2012 and 2019, averaging 2.6% of total revenues and supporting a gradual reduction of its direct debt until end-2019.

High level of investment strengthens budgetary flexibility

Berlin benefits from a high share of investment relative to total expenditure at 11% in 2019. Despite rising investment, the ratio decreased due to the denominator effect to 6% in 2020 given high pandemic-related expenses via federal and the Land's support programmes. A high share of investment spending enables some capital expenditure to be postponed in case of need, strengthening expenditure flexibility.

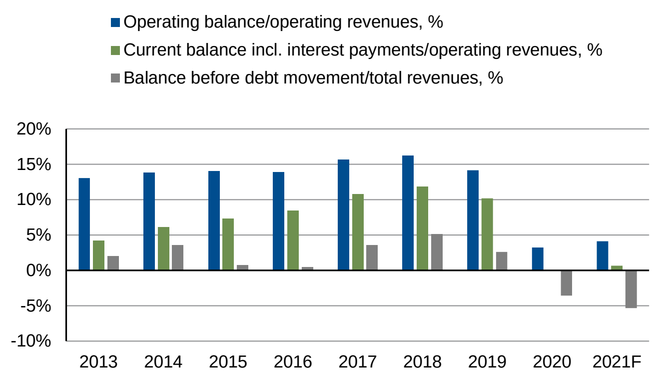
Berlin's investment strategy is based on three pillars: i) the core budget including funds from the federal government's municipal investment promotion programme; ii) the SIWA fund; and iii) infrastructure investments by the Land's shareholdings, which improve budgetary flexibility. While the core budget and SIWA contribute above EUR 2bn annually in investments, Berlin's major holdings have regularly undertaken EUR 2.5bn in infrastructure investments in recent years. In 2020, the Land's investment activity was delayed due to construction bottlenecks, among other effects. Taking into account investment activity under SIWA, investment activity was EUR 2.8bn in 2020.

Budgetary reserves provide additional budgetary leeway

Conservative budgets and accommodative financing conditions have halved Berlin's interest payment burden since 2012, strengthening budgetary flexibility. The Land has expanded its social infrastructure in recent years to respond to rapid population growth and a constrained local property market. Berlin also has around EUR 4bn of budgetary reserves (earmarked mostly for investments), accumulated via allocations of previous budgetary surpluses to the SIWA fund. The reserves can be used beyond an accrued fiscal year, providing additional budgetary leeway and partially mitigating shocks from economic downturns.

Figure 7: Budgetary performance

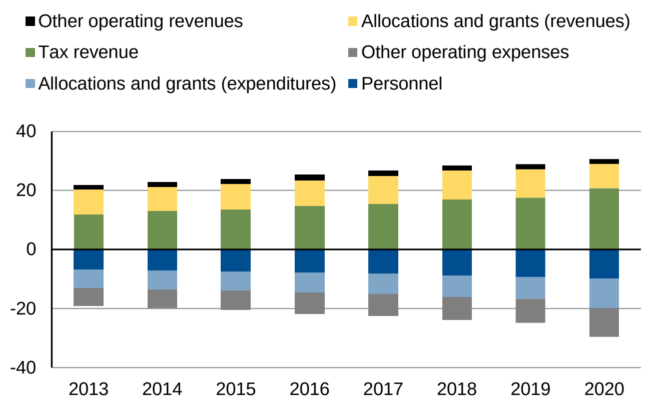
%



Source: Senatsverwaltung für Finanzen Berlin, Scope Ratings GmbH

Figure 8: Components of operating balance

EUR bn



Source Senatsverwaltung für Finanzen Berlin, Scope Ratings GmbH

Financing deficit in 2020, also expected for 2021

In 2020, after eight successive years of surpluses, Berlin reported a budgetary deficit (before debt movement) of EUR 1.4bn, or 3.6% of total revenues (see **Figure 7**). Tax revenues were EUR 1.6bn lower than budgeted, and 2% lower than tax revenue for 2019 (excluding effects from the reformed fiscal equalisation system). On the expenditure side, additional pandemic-related costs (healthcare, transfers to businesses and fiscal support to some of the Land's shareholdings) amounted to EUR 3.4bn, or 11% of operating expenditure, including funds from the federal government channelled via Berlin's budget to support businesses affected by lockdowns. For 2021, we expect another deficit of around 5% of total revenues. This is due to the prolonged effect of lower-than-budgeted tax revenues, partly exacerbated by the lockdowns in early 2021 and corresponding reduced economic activity as well as additional pandemic-related expenditure. To cover the expected deficit, Berlin plans to use funds from the EUR 5.4bn remaining in the reserve created for the pandemic in 2020.

The Covid-19 crisis will structurally weigh on Berlin's budget over the forecast horizon

We also expect lasting structural consequences from the pandemic. On the expenditure side, additional debt service expenses from the EUR 7.3bn in debt incurred in 2020 will represent expenses of about EUR 270m, or 0.9% of 2020 operating revenue, while additional interest expenses will be manageable given low borrowing costs. The permanent increase of the federal government's share in payments for cost of accommodation for job seekers from 50% to 75% will lead to cost savings of about EUR 450m per year. On the revenue side, we expect structural annual tax revenue shortfalls of around 3% of planned revenue in 2022/23 and thus do not anticipate an immediate reversion to the pre-crisis tax revenue level. Berlin's 2020-2024 financial planning has been re-balanced by controlling personnel and other operating costs and re-prioritising investment activity.

Rigid operating expenditure structure

In keeping with its responsibilities as a Land, Berlin's operating expenditure has a rigid structure, because minimum legislative requirements and the socially sensitive nature of several expenditure items make most items difficult to trim. Personnel costs represent the largest single expenditure item at 33% of operating expenditures in 2020 (down from 38% in 2019 because of the increase in operating expenditure), while transfers to districts represented 34%, up from 30% in 2019 due to higher transfers related to the pandemic (see **Figure 8**). The remainder consists of material and administrative costs.

Strong and diversified tax base, with stable transfers from the Bund

Like all German Länder, Berlin has limited flexibility to adjust its revenues. The German financial equalisation system weakens the link between a Land's tax revenues and its economic performance, which has also dampened the effects of the Covid-19 shock. In line with constitutional arrangements between the Länder and the Bund, Berlin receives shared taxes, largely revenues from personal income taxes, VAT and corporate taxes (see **Figure 8**). These revenues are initially collected by Berlin's tax offices but are later redistributed at a national level in accordance with revenue-sharing agreements and additional transfer mechanisms. Berlin has also made use of its city-state status to introduce municipal fees, which have supported budget consolidation. In addition, Berlin is a net recipient of the reformed financial equalisation system (EUR 5.1bn received in 2020).

Balanced accounts expected over the medium term

Over the medium term, we expect Berlin to return to small budgetary surpluses owing to rising operating expenses needed to address the growing population as well as structural revenue shortfalls caused by the pandemic. Consequently, we expect Berlin to adhere to its long-term consolidation strategy, supported by the administration's commitment to fiscal consolidation, conservative budget management, low debt service costs, the option to adjust budgets in view of the high investment level, and the Land's economic and demographic outperformance vis-à-vis national peers.

Increasing pension burden

Going forward, pension expenditure will constitute an increasing budgetary burden. In 2019, pension payments amounted to 8% of total expenditure, below the national average of 9%. This is because after reunification, civil servants in the new Länder were not included in the pension scheme but in a pay-as-you-go system under the Pension Transition Act. To ease the pressure from pension obligations, Berlin provides mandatory payments to the pension contribution plan (required by German law). These totalled around EUR 1.2bn in 2019, resulting in largely unfunded pension commitments. However, the fund is not designed to cover future liabilities but instead serves as a buffer to ensure pensioners receive payments during an economic downturn when revenues are lower. According to an external actuary appointed by Berlin, pension obligations for the next 30 years amounted to EUR 57bn in 2019 and will increase up to EUR 68bn within the next five years.

Economy and social profile

Covid-19 led to a recession in 2020, rebound expected in 2021

Like all German Länder, Berlin's economy was significantly affected by the Covid-19 crisis in 2020, with real GDP declining by 3.3%. The recession was more pronounced than in 2009 (-1.1%), but less severe than for Germany as a whole, where real GDP declined by 4.8%. The resilience of Berlin's economy was supported by: i) the public sector's above-average share in gross value added, which counterbalanced the high degree of gross value-added creation in the tourism and recreation sectors; ii) continued growth in 2020 of services that were more resilient and adaptable to the pandemic, such as information and communication services; and iii) sustained growth in industrial sectors (7.3% of 2020 gross value added) such as pharmaceuticals. For 2021, we expect a robust recovery in line with the German average of 3.5%, given an accelerated vaccination campaign in Q2 2021, with downside risks posed by virus variants and renewed restrictions on mobility in the second half of the year.

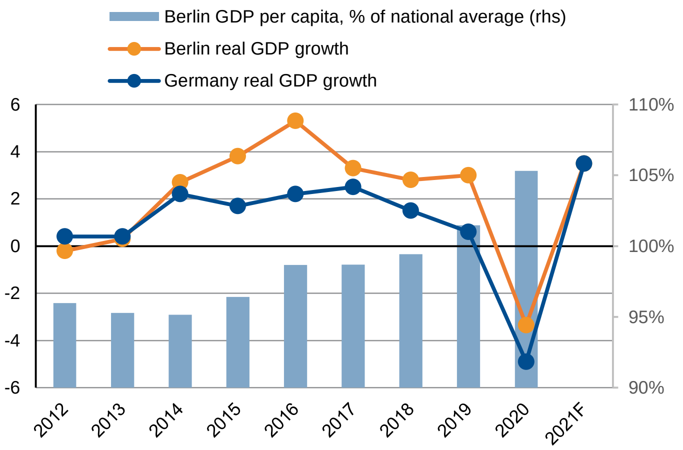
In line with the decline in economic activity, Berlin's labour market was also adversely affected. The number of unemployed rose to a peak of around 215,000 in July 2020 versus around 156,000 a year earlier (+38% vs 28% national average year-on-year increase). This resulted in an unemployment rate of 10,8% in July 2020 versus 7.7% at end-2019. Job losses were mainly in sectors hit hard by the pandemic like restaurants and administrative and support service activities. At end May 2021, the number of unemployed moderated somewhat to around 200,000 and the unemployment rate stood at 10.1% versus the German average of 5.9%.

Strong pre-crisis growth trend driven by services sector

Until early 2020, Berlin's economy had expanded strongly over recent years, with real GDP growth exceeding the German average since 2014 (see **Figure 9**). As a result, GDP per capita rose above the national average for the first time since 2001, to 103.3% of the German average in 2019 and 105.3% in 2020 (see **Figure 9**), highlighting the Land's success in economic convergence with national peers. In parallel, the labour market also improved markedly until end-2019, with the unemployment rate declining to 7.8% (2.8 percentage points above the national average), significantly down from 13.6% in 2010.

Figure 9: Real GDP growth, 2010-20

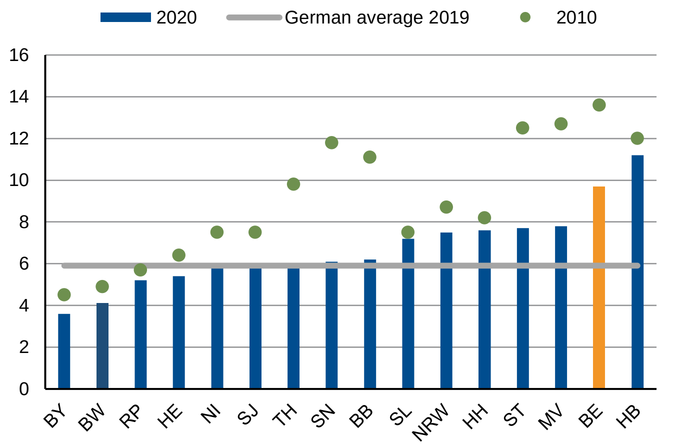
% YoY, % of national average (rhs)



Source: Federal Statistical Office, Scope Ratings GmbH

Figure 10: Unemployment rate

% total labour force



Source: Federal Statistical Office, Scope Ratings GmbH

Favourable demographics compared to other Länder

Berlin benefits from favourable social and demographic profiles. With around 3.7m inhabitants in 2020, the German capital is also the country's largest city by far. Population growth has been strong, with an average 40,000 inhabitants added each year over 2011-2020. This was mainly due to net immigration from other European countries, reflecting Berlin's attractiveness compared to other European capitals. This trend has moderated however, to 25,000 in 2019 and just 6,800 year-on-year in September 2020. The shift in 2020 is largely attributed to uncertainties and restrictions due to Covid-19 as well as a change in preferences away from for living in metropolitan areas such as Berlin.

Quality of governance

Stable political environment

We view the government and administration of the Land of Berlin as stable. The last regional elections, held in September 2016, resulted in a three-party coalition (the centre-left Social Democratic Party, 38 seats; the Left Party, 27 seats; and the Greens, 27 seats). This coalition gained 92 of the 160 seats in the regional parliament and replaced the two-party coalition of the Social Democratic Party and Christian Democratic Union. Opposition parties are the Christian Democratic Union, the Alternative for Germany and the Free Democratic Party. The next elections are scheduled for September 2021.

Administration firmly committed to fiscal consolidation

Since 2016, Berlin's fiscal policy has been effective at balancing investment and consolidation needs. Berlin's stable political environment also underpins our expectation that its administration will focus on long-term-oriented policies in response to the Covid-19 crisis. These will need to strike a balance between fiscal stimulus during the crisis and fiscal prudence thereafter.

The administration acted promptly to the Covid-19 shock, making the necessary adjustments to the budget for 2020/21 and ensuring access to liquidity for the regional real economy via direct fiscal support or liquidity funds for the hardest-hit businesses. To support small and medium-sized businesses, the Land set up emergency measures ('Corona Soforthilfe') including extraordinary grants. Other measures included the pre-emptive establishment of a coronavirus treatment centre to increase healthcare capacity as well as the procurement of mobile devices to improve online teaching. At the same time, spending controls were reinforced.

Unique administrative organisation

The Land of Berlin is divided into 12 local districts ('Bezirke'), whose populations range from around 240,000 (Spandau) to 400,000 (Pankow). Each district has its own identification with elected local mayors and councils; revenues mostly come from financial allocations ('Globalsumme') from the Land of Berlin. The administrative organisation between the senate and the districts is unique in Germany: the districts fulfil certain functions, administrative tasks are not clearly separated between government levels, and financial transfers differ across years and districts.

Methodology

The methodology used for these Credit Ratings and/or Outlooks (Rating Methodology: Sub-Sovereigns, 12 May 2021) is available on https://www.scoperatings.com/#!methodology/list.

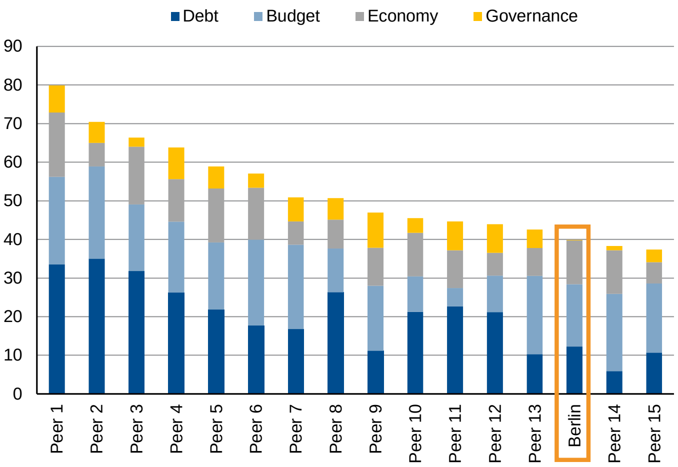
Scope Ratings GmbH and Scope Ratings UK Limited apply the same methodologies/models and key rating assumptions for their credit rating services, while Scope Hamburg GmbH's methodologies/models and key rating assumptions are different from those of Scope Ratings GmbH and Scope Ratings UK Limited.

Information on the meaning of each rating category, including definitions of default and recoveries can be viewed in the "Rating Definitions - Credit Ratings and Ancillary Services" published on https://www.scoperatings.com/#!governance-and-policies/rating-scale. Historical default rates of the entities rated by Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA. Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's definitions of default and rating notations can be found at https://www.scoperatings.com/#governance-and-policies/rating-scale. Guidance and information on how Environmental, Social or Governance factors (ESG factor) are incorporated into the rating can be found in the respective sections of the methodologies or guidance documents provided on https://www.scoperatings.com/#!methodology/list.

The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Appendix I: CVS/QS results and mapping table

Figure 11: CVS results Land of Berlin



Source: Scope Ratings GmbH

Figure 12: QS results Land of Berlin

Individual credit profile - qualitative assessment (QS)					
Category	Weight	Qualitative Scorecard	Risk: Low	Risk: Medium	Risk: High
Debt burden and liquidity profile	40%	Debt profile			
		Contingent liabilities			
		Funding and liquidity			
Budget performance and flexibility	30%	Budget management			
		Expenditure flexibility			
		Revenue flexibility			
Economy and social profile	20%	Growth & diversification			
		Labour & demographics			
Governance	10%	Recent events & policy risk			
		Transparency & accountability			

Source: Scope Ratings GmbH

Rating mapping table

Indicative rating: notch adjustment – *downwards* – from sovereign rating

Indicative sub-sovereign rating			Individual credit profile: Strong ≥ 75	Strong ≥ 65	Medium ≥ 55	Medium ≥ 45	Medium ≥ 35	Weak ≥ 25	Weak < 25
			Indicative maximum notch adjustment from sovereign rating:						
Institutional framework: Integration with sovereign	Full	0 - 1	0	0	0	-1	-1	-1	-1
	Full	0 - 2	-1	-1	-1	-1	-1	-2	-2
	Full	0 - 3	-1	-1	-1	-2	-2	-2	-3
	Medium	0 - 4	-1	-1	-2	-2	-3	-3	-4
	Medium	0 - 5	-1	-2	-2	-3	-3	-4	-5
	Medium	0 - 6	-2	-2	-3	-3	-4	-5	-6
	Medium	0 - 7	-2	-2	-3	-4	-5	-5	-7
	Low	0 - 8	-2	-3	-4	-4	-5	-6	-8
	Low	0 - 9	-2	-3	-4	-5	-6	-7	-9
	Low	0 - 10	-3	-4	-5	-6	-7	-8	-10

Issuer
Land of Berlin
Country
Germany
Sovereign rating
AAA
Indicative rating adjustment
0
Additional considerations
-
Final rating
AAA

Appendix II: Statistical table

	2012	2013	2014	2015	2016	2017	2018	2019	2020E
Financial performance				in EUR m (unless noted otherwise)					
Operating revenue	21,530	21,795	22,909	23,791	25,362	26,724	28,482	28,925	30,608
Operating revenue growth, %	*9.0%*	*1.2%*	*5.1%*	*3.8%*	*6.6%*	*5.4%*	*6.6%*	*1.6%*	*5.8%*
Tax revenue	11,616	11,921	13,127	13,626	14,767	15,399	17,027	17,534	20,732
Allocations and grants	8,400	8,355	8,182	8,496	8,593	9,600	9,756	9,616	8,302
Other operating revenue	1,514	1,520	1,601	1,669	2,002	1,725	1,699	1,775	1,573
Operating expenditure	18,358	18,952	19,747	20,445	21,833	22,536	23,865	24,824	29,620
Operating expenditure growth, %	*1.6%*	*3.2%*	*4.2%*	*3.5%*	*6.8%*	*3.2%*	*5.9%*	*4.5%*	*19.3%*
Personnel	6,759	6,938	7,207	7,487	7,807	8,221	8,854	9,310	9,859
Allocations and grants	5,879	6,088	6,290	6,452	6,755	6,923	7,215	7,370	9,983
Other operating expenditure	5,719	5,926	6,251	6,506	7,271	7,392	7,795	8,144	9,778
Operating balance	3,172	2,843	3,162	3,346	3,528	4,188	4,617	4,101	988
Net interest payments	2,097	1,921	1,759	1,607	1,385	1,306	1,229	1,148	971
Current balance	1,075	922	1,403	1,739	2,143	2,882	3,388	2,953	17
Capital balance	-425	-469	-549	-1,553	-2,026	-1,882	-1,879	-2,175	-1,450
Balance before debt movement	650	453	854	187	118	1,000	1,509	778	-1,432
New borrowing (credit market)	7,820	7,384	8,064	7,136	7,039	5,425	4,511	2,967	10,209
Debt redemption (credit market)	8,015	7,836	8,405	8,324	7,228	7,381	7,262	4,539	6,213
Financial ratios									
Balance before debt movement/total revenue, %	2.9%	2.0%	3.6%	0.8%	0.4%	3.6%	5.1%	2.6%	-3.6%
Operating balance/operating revenue, %	14.7%	13.0%	13.8%	14.1%	13.9%	15.7%	16.2%	14.2%	3.2%
Interest payments/operating revenue, %	9.7%	8.8%	7.7%	6.8%	5.5%	4.9%	4.3%	4.0%	3.2%
Current balance/operating revenue, %	5.0%	4.2%	6.1%	7.3%	8.5%	10.8%	11.9%	10.2%	0.1%
Capital expenditure/total expenditure, %	6.6%	6.3%	6.4%	10.0%	11.2%	10.7%	9.8%	10.9%	5.7%
Debt									
Direct debt	62,256	61,607	60,804	59,906	59,436	58,994	57,600	57,555	63,705
Guarantees	8,776	8,890	7,510	6,901	5,928	5,152	4,255	3,016	3,007
Overall debt risk (direct debt plus guarantees)	71,032	70,497	68,314	66,807	65,364	64,146	61,855	60,571	66,712
Debt ratios									
Direct debt/total revenue, %	275.9%	270.8%	255.1%	242.4%	226.1%	213.0%	196.3%	193.1%	158.8%
Direct debt/operating revenue, %	289.2%	282.7%	265.4%	251.8%	234.4%	220.8%	202.2%	199.0%	208.1%
Overall debt risk (incl. guarantees)/operating revenue, %	329.9%	323.5%	298.2%	280.8%	257.7%	240.0%	217.2%	209.4%	218.0%
Interest payments/direct debt, %	3.4%	3.1%	2.9%	2.7%	2.3%	2.2%	2.1%	2.0%	1.5%
Debt per inhabitant (EUR)	18,213	17,799	17,347	16,831	16,486	15,744	15,008	14,773	17,390
Economic performance									
GDP at market prices	109,910	112,603	117,927	125,249	133,603	139,683	147,057	153,291	154,634
share in Germany's GDP, %	*4.0%*	*4.0%*	*4.0%*	*4.1%*	*4.2%*	*4.3%*	*4.3%*	*4.5%*	4.6%
GDP per capita (EUR)	32,803	33,133	34,223	35,837	37,662	38,864	40,568	41,967	42,221
% of Germany's GDP per capita	*95.6%*	*94.5%*	*94.3%*	*96.0%*	*98.2%*	*98.0%*	*99.3%*	*103.3%*	105.3%
Population (ths)	3,351	3,399	3,446	3,495	3,547	3,594	3,625	3,657	3,663
Real GDP growth, %	-0.2%	0.3%	2.3%	3.3%	5.3%	3.3%	2.8%	3.0%	-3.4%
Unemployment rate, % of labour force	12.3%	11.7%	11.1%	10.7%	9.8%	9.0%	8.1%	7.8%	9.7%

Source: Senatsverwaltung für Finanzen Land Berlin, Ministry of Finance, Federal Statistical Office, Scope Ratings GmbH

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