

Land of Hesse

Rating Report

Rating rationale and Outlook

The Land of Hesse's (Hesse) AAA rating is driven by:

A highly integrated Institutional Framework characterised by a strong revenue equalisation system, where Hesse is a net payer among the Länder, and a strong federal solidarity principle, among other factors. This results in a close alignment of the Länder's creditworthiness with the German federal government's [AAA/Stable](#) ratings.

A strong Individual Credit Profile, underpinned by i) sound budgetary management with recurring operating surpluses and a strong commitment to the Land's debt brake; ii) conservative debt and liquidity management, with excellent market access and a favourable debt profile; iii) low contingent liabilities with a well-equipped and conservatively managed pension fund for its civil servants; and iv) above-average revenue flexibility.

Credit challenges relate to limited expenditure flexibility, coupled with rising spending pressures, which weigh on budgetary margins over the forecast horizon.

Foreign currency

Long-term issuer rating/Outlook

AAA/Stable

Senior unsecured debt

AAA/Stable

Short-term issuer rating/Outlook

S-1+/Stable

Local currency

Long-term issuer rating/Outlook

AAA/Stable

Senior unsecured debt

AAA/Stable

Short-term issuer rating/Outlook

S-1+/Stable

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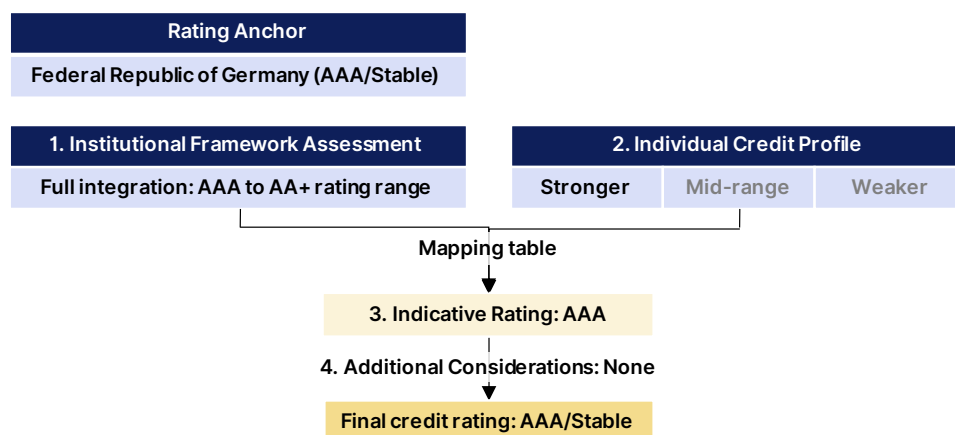
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Figure 1: Land of Hesse's rating drivers



Note: For further details, please see Scope's Sub-sovereigns Rating Methodology.
Source: Scope Ratings

Credit strengths and challenges

Credit strengths	Credit challenges
<ul style="list-style-type: none"> • Integrated institutional framework • Sound budgetary management and performance • Excellent debt and liquidity management and market access, strong liquidity position • Low contingent liabilities • Above-average revenue flexibility, net payer in the financial equalisation system 	<ul style="list-style-type: none"> • Limited expenditure flexibility, spending pressures

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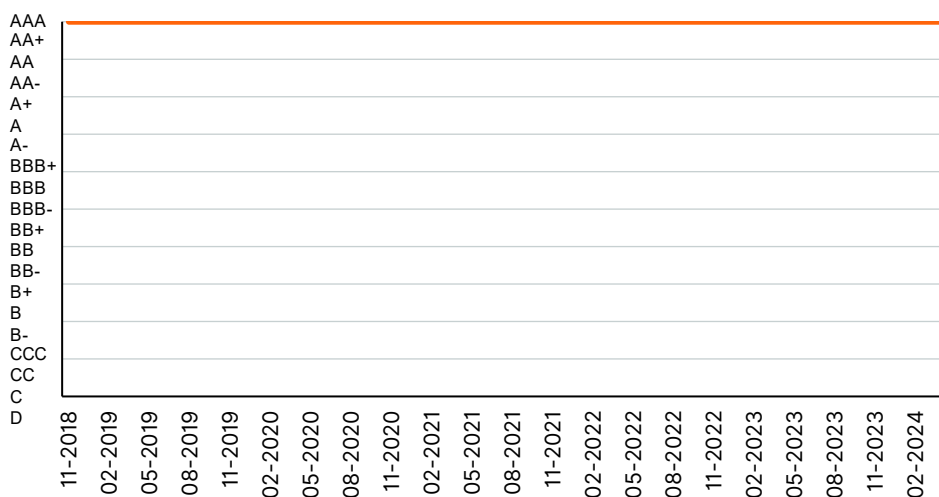
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Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced.

Positive rating-change drivers	Negative rating-change drivers
<ul style="list-style-type: none"> • N/A 	<ul style="list-style-type: none"> • Downgrade of Germany's sovereign rating • Changes in the institutional framework, resulting in notably weaker individual credit profile • Deterioration of individual credit profile

Figure 2: Rating history¹



Source: Scope Ratings

¹ Foreign-currency long-term issuer rating. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment

Institutional framework

German Länder² benefit from a mature, highly predictable, and integrated institutional framework. The key elements are: i) a strongly interconnected revenue equalisation mechanism enshrined in the constitution; ii) strict fiscal rules and monitoring, iii) wide-ranging participation and veto-rights of the federal states in the national legislation; iv) equal entitlement of federal states regarding negotiations on federal reforms; and v) a solidarity principle that ensures extraordinary system support during budgetary emergencies.

Federal framework results in close rating alignment...

The federal system under which the Länder operate is the most integrated among the European sub-sovereign systems we cover. This is driven by our assessments of 'full integration' for extraordinary support and bailout practices, ordinary budgetary support and fiscal equalisation, fiscal rules and oversight, and revenue and spending powers. We assess funding practices as 'medium integration' (see [Appendix I](#) for an overview).

The framework assessment for the German Länder results in an **indicative downward rating adjustment of up to one notch** from Germany's AAA/Stable rating.

...with distance of up to one notch from the sovereign rating.

Extraordinary support and bail-out practices

Our framework assessment acknowledges a record of extraordinary financial support. Länder have been granted exceptional financial support from the federal government in five instances: Bremen (1992, 2006), Saarland (1992, 2005) and Berlin (2002). The court approved claims on the grounds of the solidarity principle, or *Bundestreueprinzip*, under which the Länder and the federal government are required to support each other in the event of a budgetary emergency. A claim by Berlin was denied 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 would still be possible as a last resort if the budget and/or debt situation were later assessed as extreme. We consider the *Bundestreueprinzip* to be an implicit bail-out rule, as it requires the provision of federal support in times of budgetary stress.

Strong solidarity principle ensures extraordinary support

More recently, the federal government confirmed its role as a primary countercyclical shock absorber during the Covid-19 and energy crises in 2020-2023. Over these years, the federal government financed most anti-crisis measures and direct grants to the Länder to mitigate the impact on their finances. This led to federal budget deficits of an average 3.3% of GDP over 2020-2022, compared with an average deficit of the Länder of 0.14% over the same period.

Federal government as shock absorber during recent crises

Ordinary budgetary support and fiscal equalisation

The federal financial equalisation system strongly aligns different fiscal capacities across the Länder. A reformed equalisation system took effect in 2020, with horizontal distribution occurring among the Länder via deductions and top-ups to collected VAT, as well as vertical transfers from the federal government. The net effect of the system change is positive for all Länder as contributions from the federal government are greater under the reformed system.

Comprehensive fiscal equalisation system

Hesse is a net contributor to the system. In the past 29 years, it has contributed over EUR 1bn each year. In 2023, total deductions to collected VAT amounted to EUR 3.4bn, or over 10% of operating revenue. Hesse's contributions have been the second highest after Bavaria ([AAA/Stable](#)) among the Länder since 2012 in per capita terms.

Hesse is a net contributor to the system since 1995

Funding practices

Länder governments have broad autonomy in their funding choices. There is no use of sovereign on-lending, and Länder can decide autonomously on their borrowing programmes within the framework of the debt brake. Short-term liquidity is available via access to shared liquidity among

Autonomous borrowing, access to shared liquidity

² We use the term 'Land' (or collectively 'Länder') and 'state' interchangeably to refer to German federal states.

the Länder and the federal government, essentially eliminating liquidity risk. Basel III risk-weights for Länder debt securities are aligned at 0% with the central government. The Länder have a history of joint bond issuance, having issued such instruments on 64 occasions, although not all of the 16 Länder participated. Hesse has not participated in any of the past issues.

Fiscal rules and oversight

Since 2020, the Länder have to comply with debt brakes under which they cannot run structural financing deficits unless, for example, hit by a severe economic downturn or a natural disaster.³ The federal debt brake caps the structural annual deficit of the central government at 0.35% of GDP. The German federal parliament used the emergency clause of the debt brake in 2020-2023 in response to the Covid-19 and energy crises. Similarly, Hesse invoked the safeguard clause of its debt brake to implement support measures and credit authorisations to mitigate the impact of Covid-19 (special fund 'Sondervermögen Hessens gute Zukunft sichern').

Compliance with the debt brake and Länder finances are monitored by the Stability Council. The Council monitors restructuring programmes and compliance with budgetary targets and comprises the Länder's finance ministers and the federal ministers of finance and economic affairs. If the Council determines that a Land is threatened with a budgetary emergency, it agrees on a restructuring programme with the affected authority.

In late 2023, Germany's constitutional court ruled the Second Supplementary Budget Act 2021 of the federal government as unconstitutional. Crucially, the ruling effectively limits the previously commonly used budgetary practice of using emergency credit authorisations to create budgetary reserves for spending in future years, thus also impacting budgetary practices of the Länder.

This ruling did not affect Hesse's budgetary and financial planning. In Hesse, the special fund set up to tackle the Covid-19 pandemic was closed on 1 January 2022 and all measures and debt taken on (EUR 3.6bn) were transferred to the Land's core budget.

Debt brake anchors borrowing; stability council conducts oversight

15 November 2023 constitutional court ruling had implications for the Länder...

... but no impact on Hesse's budgetary and financial planning.

Revenue and spending powers

The Länder and the federal government share a taxation authority and jointly decide on rates and revenue distribution for high-revenue common taxes (income and VAT). The latest reform of federal financial relations (in 2017) took effect in 2020 and resulted in a higher share of VAT revenue being distributed among the Länder. The VAT distribution fully compensates for the variation in taxing powers, replacing the previous process of horizontal payments between the Länder. Alongside common taxes, the central government and the Länder have separate taxation authorities for lower revenue-generating taxes.

Under the reform agreed in 2017, the Länder have assigned limited executive and legislative rights to the central government in certain policy areas, including physical and digital infrastructure and the higher education system, in return for higher payments from the equalisation system. In line with earlier reforms (*Föderalismusreformen II*), we observe that the higher the share of common national legislation (*konkurrierende Gesetzgebung*), the more integrated the system becomes.

Shared tax authority with the federal government

Federal reforms strengthen political coherence

Political coherence and multi-level governance

The German federal system is very predictable and supportive. Major reforms are discussed and agreed upon well in advance and in consultation with the Länder, which can directly influence national policymaking via the upper house of parliament.

³ The debt brake is a legal framework that prohibits structural deficits for the Länder from 2020 onwards; article 109 (3) of the Basic Law stipulates that the Länder may incur deficits in a case of, for example, a recession or a natural disaster provided they pass respective legislation at the state level.

Individual credit profile (ICP)

We assess Hesse’s ICP as ‘Stronger’ among German Länder. This places the Land’s indicative rating at AAA given our mapping table. For details, see [Appendix II](#) and [Appendix III](#).

‘Stronger’ ICP, leading to indicative AAA rating

Hesse’s individual credit strengths are: i) sound budgetary management with recurring operating surpluses and a strong commitment to the debt brake; ii) conservative debt and liquidity management, with excellent market access and a favourable debt profile; iii) low contingent liabilities with a well-equipped pension fund; and iv) above-average revenue flexibility.

Challenges are limited expenditure flexibility, coupled with broad-based spending pressures, most prominently on personnel costs, which make up a large share of operating expenditures.

In 2020, the Covid-19 pandemic led to a temporary budgetary deterioration due to revenue losses and additional expenditure, as well as higher borrowing under the debt brake emergency clause. At the same time, significant central government transfers cushioned the direct impact on budgets. Budgetary performance recovered in 2021/22, allowing the state to enter 2023 with budgetary reserves. In 2023, some overperformance vis-à-vis the budget, apart from tax revenue, allowed the state to broadly maintain its reserves and to forego planned net borrowing of EUR 211m.

We expect remaining budgetary reserves, together with some consolidation measures, to allow Hesse to adhere to its commitment to the debt brake in coming years and therefore limit borrowing. Projected fiscal deficits are driven by expenditure pressures common to all Länder, especially on personnel, investment and interest, and moderate revenue growth given sluggish national economic performance and federal measures, such as the ‘Wachstumschancengesetz’.

Debt and liquidity

Debt burden and trajectory

Hesse’s conservative debt management has contributed to a stable debt trajectory and declining debt-to-operating-revenue ratio, highlighting its commitment to fiscal prudence and sustainability.

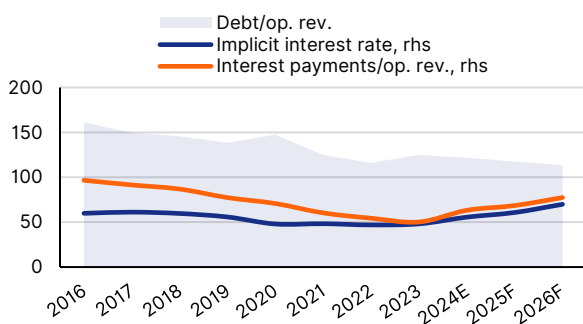
Stable and moderate debt levels

Hesse’s debt to operating revenue ratio is slightly below the Länder average. The Land’s debt of around EUR 41bn amounted to 125% of operating revenue at YE 2023 (**Figure 3**), down from 162% at YE 2016. While nominal debt remained broadly stable since 2016, with the exception of 2020 and 2021 due to Covid-related borrowings, operating revenue increased by around 24%.

Since 2016, Hesse resorted to moderate net borrowing in its core budget only in 2020 reflecting pressures due to the Covid-19 pandemic. In previous years and in line with the Land’s consolidation efforts before the debt brake became binding in 2020, the Land redeemed EUR 200m per year (**Figure 4**). Net borrowing spiked in 2020 due to emergency borrowing via its Covid fund.

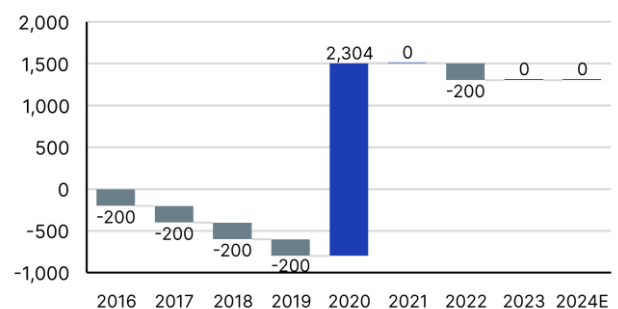
After years of net debt redemptions, Covid-19 led to higher borrowing in 2020/21

Figure 3: Debt and interest burden, %



Sources: Land of Hesse, Destatis, Scope Ratings

Figure 4: Net borrowing*, EUR m



* 'Nettokreditaufnahme', includes net borrowing for special fund 'Hessens gute Zukunft sichern'.

Sources: Land of Hesse, Scope Ratings

In the near- to medium term, we expect Hesse to continue to limit additional borrowing in line with its financial plan for 2023 to 2027. This should keep nominal debt broadly stable at around EUR 41bn, while it is expected to decline as a share of operating revenue, to around 114% in 2026.

Gradually falling debt trajectory...

Since 2011, the debt brake is part of Hesse's constitution (Art. 141) and prohibits *structural* net borrowing from 2020. Flexibility remains to balance economic fluctuations and in the event of natural disasters and exceptional emergencies, as seen during the Covid-19 pandemic. The debt brake as an element of the Land's constitution means that even in the case of a change of the debt brake rules at national level, in Hesse, a referendum would be required to make any changes to the rule, a key difference to most other German Länder. The Land's government remains committed to the debt brake at the state level in its current form.

... due to strict commitment to the debt brake.

Debt profile and affordability

Hesse's debt profile is favourable and exhibits low interest-rate risks and no foreign-currency risks. The Land's debt profile significantly limits refinancing risks, which we deem remote for all Länder due to their excellent market access. Debt service (including interest payments) amounted to EUR 6-7bn annually since 2018 and rose to EUR 8.5bn in 2022. The debt redemption profile is smooth with annual redemptions between around EUR 4-6bn in coming years (Figure 5).

Conservative debt management...

Hesse's interest payments are low as a consequence of proactive debt management and the safe-haven status of the German Länder, although they are rising along with the ECB's monetary tightening and increases in the ECB policy rate since 2022. Debt affordability remains excellent, with the implicit interest rate standing at 1.9% in 2023, which we expect to rise only moderately to 2.8% in 2026. As a share of operating revenue, we expect interest payments to increase moderately to around 3% by 2026, from 2% in 2023.

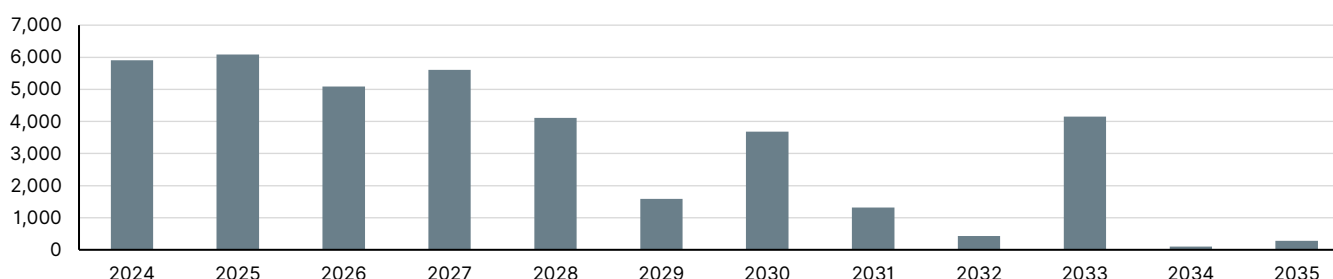
... and favourable funding conditions...

Hesse's conservative debt management limits maturity, foreign-currency, and interest-rate risk. The weighted average maturity is 10.6 years, there are no unhedged foreign-exchange risks and most of Hesse's debt is fixed rate, with less than 3% at variable rates ensuring predictability. The state's funding strategy envisages a moderate and gradual increase in the share of variable-rate debt to potentially up to 10% of the total stock in the medium term. Derivatives are used to hedge foreign-exchange and interest-rate risk. Since 2021, the Land can only enter new derivative contracts to hedge foreign-exchange risks and to eliminate the risk of receiving negative, variable interest rates in existing derivative contracts. Derivative usage should decline in future years.

... ensure a low-risk debt profile.

Figure 5: Debt profile to 2035

EUR m



Source: Land of Hesse, Scope Ratings

Contingent liabilities

We assess the Land of Hesse's contingent liability risk as low. This is due to: i) limited contingency risk stemming from its shareholdings and guarantees; ii) ongoing provision for its pension liabilities and comparatively well-funded pension fund; and iii) low contingency risks stemming from its municipalities, also due to proactive management of legacy municipal short-term debt (or

Low contingent liability risk...

'Kassenkredite') in 2018 via its 'Hessenkasse' programme. Finally, due to the Land's accrual-based accounting, its reporting is more transparent than for most Länder which only publish cash-based accounts.

First, contingency risks stemming from Hesse's shareholdings are low. The focus lies on economic policy, infrastructure, art and culture, and research, science and technology. The most relevant out of the Land's 49 direct shareholdings as of YE 2022 were its 8.1% stake in Landesbank Hessen-Thüringen Girozentrale (Helaba), for which it is also liable for grandfathered bonds of EUR 399m, as well as Messe Frankfurt GmbH (40% share), Fraport AG Frankfurt Airport Services Worldwide (31.31%), Flughafen GmbH Kassel (68%) and Flughafen Frankfurt-Hahn GmbH (17.5%) and Nassauische Heimstätte Wohnungs- u. Entwicklungsgesellschaft mbH (61.4%).

Similarly, risks regarding guarantees are assessed as limited. At YE 2022, overall guarantees amounted to around EUR 1.7bn, or 5% of operating revenue in 2023. Guarantees mostly related to economic policy, social housing and hospitals.

Second, in line with other Länder, Hesse has unfunded pension liabilities due to pensions related to its civil servants. With the '*Altersspargbuch Hessen*' the Land set up a pension fund to partially cover its pension provisions, which it builds up over time with mandatory and additional transfers from the core budget. At YE 2022, the fund's assets were worth around EUR 5.1bn, opposite pension provisions of EUR 86.4bn, thus providing a funding ratio of around 6%. Returns from the invested funds can only be used for transfers to the Land's core budget once the funding ratio reaches 10%. The funds invested in fixed income, stocks, corporate bond exchange-traded funds (ETFs) and real estate funds adhere to sustainability criteria, e.g. the stocks portfolio is invested according to the STOXX ESG Länder Fossil Free Eurozone index since 2019 and in line with the EU Paris-Aligned Benchmark since 2023.

Finally, contingency risks relating to the Land's municipalities, for which it is financially responsible, are limited, not least due to the state's proactive management of municipal legacy debt in 2018 via its 'Hessenkasse' programme. The Land took over around EUR 5bn in short-term debt of 179 municipalities, which in turn support debt amortisation with favourable conditions. In addition to supporting indebted cities, Hesse also supported other municipalities with its investment programme 'Kommunales Investitionsprogramm', worth EUR 630m.

Liquidity position and funding flexibility

Hesse's liquidity management is prudent, supported by careful cash planning, diverse liquidity sources, and ample reserves. Its market access is assessed as excellent.

We view Hesse's liquidity management as conservative and prudent due to comprehensive inter-year cash planning and the availability of numerous sources of liquidity, as well as available cash buffers. 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 liquidity shortages is negligible.

Finally, Hesse's funding access is excellent as a financially stronger Land and one of the larger issuers among German Länder with annual funding volumes of around EUR 5-6bn. The Land also issued its first green bond in 2021 with a volume of EUR 600m and a 10-year maturity. In 2023, the Land issued a second green 10-year bond of EUR 1bn, representing the largest green benchmark bond issuance of a German Land to date.

We generally view ESG-labelled bond issuance as credit positive, as it increased the capital market presence and visibility as an issuer and widened the Land's investor base.

... from shareholdings and guarantees.

EUR 5bn pension fund partially covers pension provisions; forward-looking and conservative management

'Hessenkasse' proactively supported municipal finances

Assured liquidity, conservative cash management

As a financially stronger Land and a relatively larger issuer, Hesse enjoys excellent market access...

... which it recently also expanded via green bond issuance.

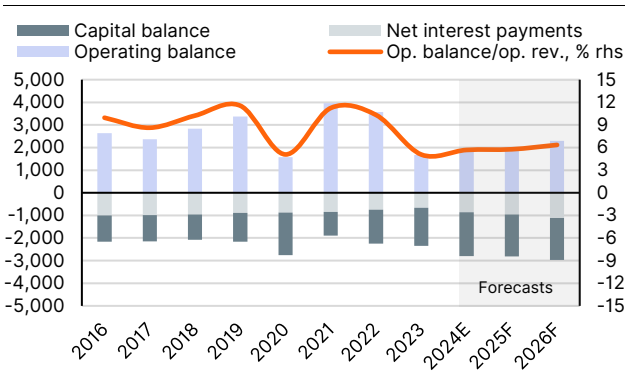
Budget

Budgetary performance and outlook

Hesse displayed robust budgetary performance between 2016 and 2019, with operating margins of an average of 10% of operating revenues (**Figure 6**), in line with other Länder given an accommodative monetary and economic backdrop and consolidation efforts before the implementation of the debt brake at state level in 2020. Operating surpluses supported the Land's ability to cover interest payments and capital expenditure without additional borrowing.

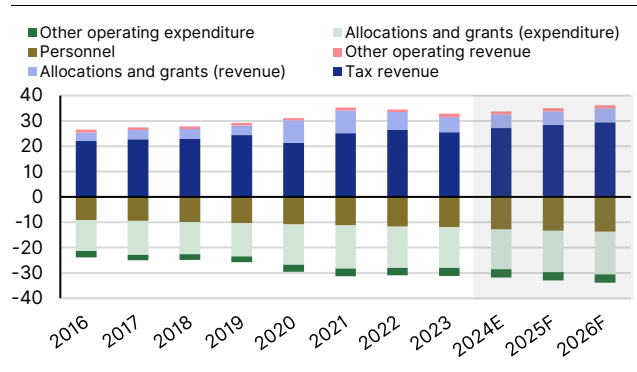
Track record of solid budgetary performance, fiscal surpluses until 2019

Figure 6: Budgetary performance, EUR m (lhs); % (rhs)



Sources: Land of Hesse, Destatis, Scope Ratings

Figure 7: Components of operating balance, EUR bn



Sources: Land of Hesse, Destatis, Scope Ratings

From 2020, the Covid-19 shock impacted budgetary planning and fiscal outcomes. To finance any Covid-19 related measures, Hesse created the special fund 'Hessens gute Zukunft sichern' with credit authorisations of EUR 12bn under the state's debt brake's emergency safeguard clause. Eventually, only EUR 3.6bn of credit authorisations were used and the fund was closed in early 2022. Debt taken on under the fund must be redeemed under mandatory rules, with EUR 200m annual redemption payments starting in 2024.

Covid-19 crisis led to a deficit in 2020

The Land's core budget balance turned to a deficit (before debt movement) of EUR 1.18bn, or 3.7% of total revenue in 2020. This deficit was financed with EUR 180m in net borrowing and a withdrawal from budgetary reserves of EUR 1bn. A drop in tax revenues of over 12% coupled with an increase in operating expenditures of over 14%, mostly driven by higher transfer expenditure, led to the deterioration in the operating balance.

In 2021, the budgetary performance recovered strongly, mainly driven by a EUR 2.4bn overperformance of tax revenue versus budgeted levels. This allowed the state to return to operating and overall surpluses, redeem EUR 1.4bn in debt and forego budgeted credit authorisations of EUR 816m. In 2022, a better-than-expected result allowed the Land to redeem another EUR 200m and to set aside EUR 1.7bn via budgetary reserves.

Budgetary performance recovered strongly in 2021/22.

In 2023, the budgetary performance deteriorated from the previous year, with tax revenue underperforming vs. budgeted levels by around EUR 1bn, driving a decline in operating revenue of 5% YoY. In addition, operating expenditure increased by around 1%, driven mostly by higher personnel and transfer expenditure. This led to a reduction in the operating margin to 5.1% of operating revenue, from 10.3% in 2022. This decline, combined with moderately higher interest expenses and elevated capital expenditure led to a deterioration in the overall budgetary margin (after capital accounts) to -2.0% of total revenue, from 3.7% in 2022.

Budgetary deterioration in 2023 from 2022, tax revenue below budgeted levels

In 2024, we expect an amending budget to be passed, due to the new government's 'Sofort-Programm 11+1 für Hessen'. The total volume envisaged amounts to around EUR 25m. One of the 12 projects is the 'Hessengeld', subsidies in support of first-time buyers of residential real estate.

Amending budget expected for 2024 due to new government's near-term policy measures

For 2024 to 2026, we expect continued deficits after capital accounts of an average 2.2% of total revenue due to multiple budgetary headwinds. While the budgetary performance will benefit from tax revenue growth of an average 4.9% per year, high operating and investment spending will largely offset increased tax revenue. Spending pressures arise from higher spending on personnel, not least due to the increase in salaries of employees agreed in early 2024 and corresponding pay rises for civil servants, higher operating transfers to municipalities and high planned capital expenditure.

Deficits of around 2.2% expected over 2024-26

We expect remaining budgetary reserves of around EUR 2bn, together with some consolidation measures, to allow Hesse to adhere to its commitment to the debt brake. However, spending pressures will make balancing budgets for the financial planning period until 2027 challenging, as seen by budgeted but yet unidentified lower expenditure and higher revenue ('Globale Minderausgaben' und 'Globale Mehreinnahmen') totaling around EUR 1.3bn per year from 2025, or around 4% of operating revenue in 2023.

Revenue flexibility

As for all German Länder, Hesse's revenue flexibility is generally limited, as a large share of operating revenue stems from shared taxes. In line with constitutional arrangements, the Länder receive shared taxes, largely revenues from personal income taxes, VAT and corporate taxes. These revenues are initially collected by regional tax offices but are later redistributed at a national level in accordance with revenue-sharing agreements and additional transfer mechanisms.

Länder have overall moderate revenue flexibility...

However, vis-à-vis peers, Hesse enjoys above-average flexibility, as a net payer to the financial equalisation system, and a lower share of transfers to operating revenue than the Länder average.

... but Hesse enjoys above-average flexibility.

Expenditure flexibility

Hesse's expenditure flexibility is limited, given a high share of expenditure that is difficult to adjust, including a sizeable share of spending on personnel amounting to 38% of operating expenditure in 2023. Further, transfer expenditure, including to its municipalities, is also rigid and earmarked over multiple years. Given inflationary trends since 2022, Hesse is experiencing increases in spending, which are likely to persist. In early 2024, it reached an agreement with its employees for pay rises over 2024 and 2025, which will lead to additional expenditure of an estimated EUR 1.5bn in total. Additionally, a recent ruling by the administrative court of justice (VGH) found the remuneration of civil servants not to be in line with the constitutional requirements ('Alimentationsprinzip'), leading to pay rises in 2023 and 2024.

Limited expenditure flexibility given high personnel and transfer expenditure

Finally, a contingency risk stems from an upcoming decision regarding the remuneration of civil servants between 2013 and 2020 by the constitutional court. A decision is expected this or next year. If the constitutional court were to confirm the assessment of Hesse's administrative court that civil servants' pay was too low, the Land would face significant costs. The overall budgetary effect would depend on the timeframe, especially regarding its potential retroactive applicability.

Outstanding constitutional court decision regarding civil servants' remuneration is a risk

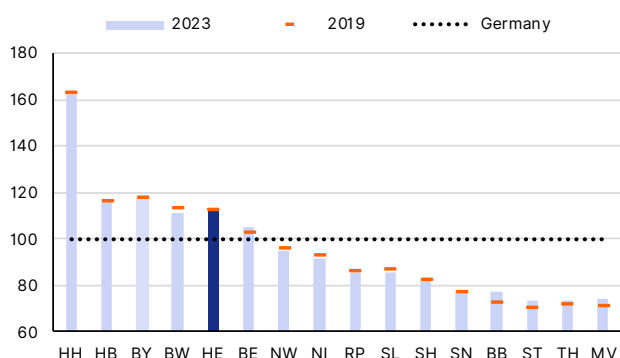
Economy

Wealth levels and economic resilience

Hesse's economic profile is relatively strong vis-à-vis peers, with a relatively higher GDP per capita than the German average (**Figure 8**) and a considerable economic size with a contribution to national GDP of around 8.5% in 2023. In the last few years, Hesse's real GDP grew in line with the German average. In 2023, Hesse's economy grew by 1.2%, versus a drop in real GDP of 0.3% in Germany. The Land's strong relative economic performance is also reflected in the fact that Hesse is a long-standing contributor to the federal equalisation system.

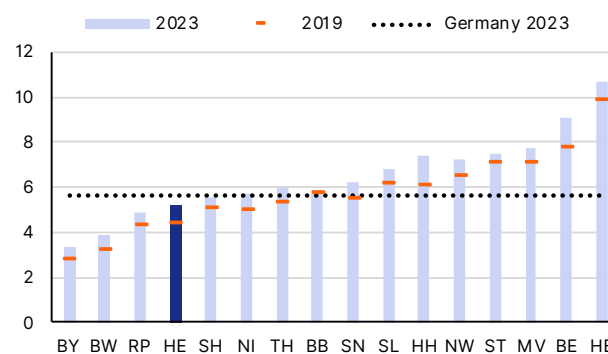
Hesse's economic profile is relatively strong

Figure 8: GDP per capita, % of national average



Sources: Statistische Ämter des Bundes und der Länder, Scope Ratings

Figure 9: Unemployment rate, %



Sources: Destatis, Scope Ratings

Hesse’s regional economy is relatively more reliant on services, including financial services with Frankfurt at the centre, as well as information and communication services. Consequently, Hesse is less affected by the challenges brought about by the green and energy transition and higher and more volatile energy prices than Länder with a traditionally bigger focus on heavy industry. Additionally, Frankfurt has recently been chosen as the location for the EU’s new anti-money laundering authority (AMLA), which will further contribute to the region’s attractiveness as a regional, national and international financial centre.

Sectoral focus on services

Economic sustainability

We view Hesse as well-placed to navigate the current challenging macroeconomic environment and benefit from long-term trends, in line with findings of the ‘Zukunftsrat Wirtschaft’. The council was set up in March 2023 to support multi-party dialogue and make recommendations for economic policy. Main economic policy measures, in addition to federal measures, are the announced ‘Hessengeld’ to stimulate the construction sector, while medium-term economic policy measures are also implemented by the Land’s development bank, the Wirtschafts- und Infrastrukturbank Hessen.

Hesse is in a good position to leverage current trends

The labour market has performed strongly since the Covid-19 crisis, although the unemployment rate has risen recently, in line with other Länder, to 5.6% as of March 2024 (Figure 9).

Finally, we assess Hesse’s medium-term growth potential to be in line with the national average at around 0.7% per year. This is partly driven by relatively favourable demographic dynamics. Hesse’s population has been growing in the last decade, also due to high net migration, including an influx of refugees from Ukraine, particularly in 2022. Population growth is expected to slow considerably.

Governance

Governance and financial management

Since January 2024, CDU and SPD are in a coalition with Boris Rhein (CDU) as minister president who has been in office since May 2022. We expect broad policy continuity, with an amending budget expected for 2024 to allow for the budgeting of some near-term policy measures by the new government, most prominently the announced ‘Hessengeld’, which will lead to moderately higher spending.

New government since January 2024

The state government’s track record of formulating and implementing fiscal policy targeted at long-term fiscal sustainability and its commitment to the debt brake have been highlighted since the Covid-19 shock in 2020, with the state reacting with its special fund and working towards a swift return to fiscal consolidation. At the same time, authorities will face the challenge of balancing

Administration committed to financial consolidation

future budgets via tightly controlling spending. For example, consolidation needs of around EUR 450m annually ('globale Minderausgaben') have been identified for 2024-27 on the spending side.

Finally, we deem Hesse's debt and liquidity management as comprehensive and effective, in line with the high governance standards of the German Länder.

Environmental and social considerations

Environmental factors and resilience

Regarding exposure to transition and physical risks, we see Hesse as broadly in line with the nationwide average. Hesse's economic structure is relatively less reliant on energy-intensive industry and does not face costs related to the phase-out of coal, like some other Länder, placing it relatively more favourably in the green and energy transition.

To promote climate protection and to adapt to the effects of climate change, Hesse has adopted its first climate act last year with the binding goal of reaching net greenhouse gas neutrality until 2045, which is in line with the nationwide goal. On the road to significantly reducing emissions (65% of the 1990 emissions by 2030), Hesse has already made progress. The emissions in 2020 were 65% lower compared to 2008. Further, the state envisages 100% of electricity and heat energy coming from renewables sources by 2045. Until 2030, the regional administration is expected to be net carbon neutral.

Recent legislation also includes the climate plan with 90 concrete measures to enable the state's climate act, as well as a change to the state's energy act, with a wide range of measures aimed at enabling the state's climate ambitions. In addition to legislative steps, Hesse has earmarked EUR 5.6bn in climate spending in its financial plan until 2027. The Land's two outstanding green bonds used funding proceeds mostly for public transport, forestry and energy-efficient renovation of the administration's housing stock.

The state's commitment to sustainability was further manifested in 2018 with the inclusion of sustainability as a state objective in the constitution, after the state had published the first Sustainability Strategy already in 2008. Since 2022, Hesse reports expenditures in the annual report/financial statements matched to the United Nations Sustainable Development Goals.

Finally, the Land's pension fund is managed according to strict sustainability criteria, and the Land is a signatory to the UN PRIs.

Social factors and resilience

A key risk related to social factors across Germany is the ageing population and shortage of skilled workers. Even though Hesse's old age dependency ratio at YE 2022 (persons aged 65 and over relative to persons aged 15-64) of 32.7% lies below the ratio across Germany of 34.7%, it is projected to increase to by around 5pps to 2030, a trajectory more favourable than the German average. Population changes vis-a-vis peers are crucial for financial equalisation and other flows, with no significant effect on Hesse due to its moderately positive demographic trend.

Another key factor is the integration of refugees and the financing of associated spending needs. The expenditures in 2022 rose beyond EUR 1bn, also because of increased funding needs to accommodate Ukrainian refugees. Given persistent geopolitical crises, these expenditures are expected to stay elevated at least in 2024.

Finally, education, security and healthcare all represent important spending areas for German Länder, which all feature prominently in the new coalition's near-term policy measures 'Sofort-Programm 11+1 für Hessen'.

Transition and physical climate risks broadly in line with German average

Hesse aims to be carbon neutral by 2045, in line with federal legislation

Sustainability as a constitutional state objective

An ageing population is a key social risk, but Hesse is moderately affected

Accommodation and integration of refugees a key social factor

Appendix I. Institutional Framework Assessment

To assess the institutional framework, we apply a Qualitative Scorecard (QS1) centred around 6 components. We assess each analytical component on a five-point scale ranging from a score of 0 for 'low' integration to 100 for 'full' integration. The institutional framework score, ranging from 0 to 100, is calculated as a simple average of these assessments. The score is then used to determine a rating range from the rating anchor level, within which the sub-sovereign's rating can be positioned.

Our assessment of intergovernmental integration between the Länder and the Federal Republic of Germany (AAA/Stable) results in an indicative **downward rating range of up to one notch** from the German sovereign, within which the Länder can be positioned according to their individual credit strengths.

Institutional Framework scorecard (QS1)

Analytical component	Full integration (100)	Strong integration (75)	Medium integration (50)	Some integration (25)	Low integration (0)
Extraordinary support and bail-out practices	●				
Ordinary budgetary support and fiscal equalisation	●				
Funding practices			●		
Fiscal rules and oversight	●				
Revenue and spending powers	●				
Political coherence and multilevel governance	●				

Integration score	92
Downward rating range	0-1

Institutional framework score	100 > x ≥ 90	90 > x ≥ 80	80 > x ≥ 70	70 > x ≥ 60	60 > x ≥ 50	50 > x ≥ 40	40 > x ≥ 30	30 > x ≥ 20	20 > x ≥ 10	10 > x ≥ 0
Indicative rating range	0-1	0-2	0-3	0-4	0-5	0-6	0-7	0-8	0-9	0-10

Appendix II. Individual Credit Profile

Risk pillar	Analytical component	Assessment		
Debt and liquidity	Debt burden & trajectory	Stronger	Mid-range	Weaker
	Debt profile & affordability	Stronger	Mid-range	Weaker
	Contingent liabilities	Stronger	Mid-range	Weaker
	Liquidity position & funding flexibility	Stronger	Mid-range	Weaker
Budget	Budgetary performance & outlook	Stronger	Mid-range	Weaker
	Revenue flexibility	Stronger	Mid-range	Weaker
	Expenditure flexibility	Stronger	Mid-range	Weaker
Economy	Wealth levels and economic resilience	Stronger	Mid-range	Weaker
	Economic sustainability	Stronger	Mid-range	Weaker
Governance	Governance and financial management	Stronger	Mid-range	Weaker

Additional environmental and social factors	Assessment		
Environmental factors and resilience	Positive impact	No impact	Negative impact
Social factors and resilience	Positive impact	No impact	Negative impact

ICP score	75
Indicative notching	0

Appendix III. Mapping table

We derive the indicative rating by mapping the result of the institutional framework assessment to the ICP score. For Hesse, this results in an indicative rating aligned with the sovereign rating of AAA. No additional considerations apply.

Institutional framework assessment		Individual credit profile score							
Score	Downward rating range	100 > x ≥ 80	80 > x ≥ 70	70 > x ≥ 60	60 > x ≥ 50	50 > x ≥ 40	40 > x ≥ 30	30 > x ≥ 20	20 ≥ x > 0
100 > x ≥ 90	0-1	0	0	0	0	0	0	-1	-1
90 > x ≥ 80	0-2	0	0	-1	-1	-1	-1	-2	-2
80 > x ≥ 70	0-3	0	-1	-1	-1	-2	-2	-3	-3
70 > x ≥ 60	0-4	0	-1	-1	-2	-2	-3	-3	-4
60 > x ≥ 50	0-5	0	-1	-1	-2	-2	-3	-4	-5
50 > x ≥ 40	0-6	0	-1	-1/-2	-2/-3	-2/-3	-3/-4	-4/-5	-6
40 > x ≥ 30	0-7	0	-1/-2	-1/-2	-2/-3	-3/-4	-4/-5	-5/-6	-7
30 > x ≥ 20	0-8	0	-1/-2	-2/-3	-3/-4	-4/-5	-5/-6	-6/-7	-8
20 > x ≥ 10	0-9	0	-1/-2	-2/-3	-3/-4	-4/-5	-5/-6	-7/-8	-9
10 > x ≥ 0	0-10	0	-1/-2	-2/-3	-3/-4	-5/-6	-7/-8	-9/-10	-10

Note: Mapping table under section 4 of Scope's Sub-sovereigns Rating Methodology, as applied to the rating anchor's AAA-ratings.

Appendix IV. Statistical table

	2018	2019	2020	2021	2022	2023	2024E	2025F	2026F
Budgetary performance (EUR m)									
Operating revenue	27,744	29,174	31,098	35,260	34,548	32,859	33,786	35,029	36,169
Operating revenue growth, %	1.2%	5.2%	6.6%	13.4%	-2.0%	-4.9%	2.8%	3.7%	3.3%
Tax revenue	22,962	24,401	21,315	25,126	26,424	25,521	27,180	28,403	29,426
Allocations and grants	3,853	3,843	8,885	9,019	7,010	5,884	5,356	5,361	5,503
Other operating revenue	930	930	898	1,114	1,113	1,454	1,250	1,265	1,240
Operating expenditure	24,906	25,805	29,518	31,296	30,982	31,193	31,867	33,009	33,875
Operating expenditure growth, %	-0.6%	3.6%	14.4%	6.0%	-1.0%	0.7%	2.2%	3.6%	2.6%
Personnel	9,936	10,371	10,863	11,288	11,700	12,003	12,842	13,379	13,790
Allocations and grants	12,675	13,108	15,863	17,057	16,288	15,987	15,697	16,294	16,756
Other operating expenditure	2,294	2,326	2,792	2,951	2,994	3,203	3,328	3,336	3,328
Operating balance	2,839	3,369	1,580	3,964	3,566	1,666	1,918	2,020	2,294
Interest received	10	11	4	3	10	111	60	40	30
Interest paid	964	903	880	851	752	771	915	1,000	1,150
Net interest paid	954	892	876	848	742	660	855	960	1,120
Current balance	1,884	2,477	704	3,116	2,824	1,006	1,064	1,060	1,174
Capital balance	-1,121	-1,264	-1,883	-1,045	-1,508	-1,685	-1,946	-1,848	-1,845
Balance before debt movement	763	1,213	-1,178	2,071	1,316	-679	-882	-788	-671
New borrowing (credit market)	5,640	5,781	6,600	3,716	7,549	7,666	5,908	6,085	4,591
Debt redemption (credit market)	5,835	5,986	6,420	5,191	7,749	7,666	5,908	6,085	4,591
Net borrowing (core budget)	-195	-205	181	-1,475	-200	0	0	0	0
Debt (EUR m)									
Direct debt	40,396	40,474	45,882	44,054	40,070	41,133	41,133	41,133	41,133
Guarantees	1,506	1,501	1,798	1,750	1,698	1,698	1,698	1,698	1,698
Overall debt risk (direct debt plus guarantees)	41,902	41,975	47,680	45,804	41,768	42,831	42,831	42,831	42,831
Financial ratios									
Debt/operating revenue, %	145.6%	138.7%	147.5%	124.9%	116.0%	125.2%	121.7%	117.4%	113.7%
Debt/operating balance, years	14.2	12.0	29.0	11.1	11.2	24.7	21.4	20.4	17.9
Interest payments/operating revenue, %	3.5%	3.1%	2.8%	2.4%	2.2%	2.0%	2.5%	2.7%	3.1%
Implicit interest rate, %	2.4%	2.2%	1.9%	1.9%	1.9%	1.9%	2.2%	2.4%	2.8%
Operating balance/operating revenue, %	10.2%	11.5%	5.1%	11.2%	10.3%	5.1%	5.7%	5.8%	6.3%
Balance before debt movement/total revenue, %	2.6%	4.1%	-3.7%	5.6%	3.7%	-2.0%	-2.5%	-2.2%	-1.8%
Transfers and grants/operating revenue, %	13.9%	13.2%	28.6%	25.6%	20.3%	17.9%	15.9%	15.3%	15.2%
Capital expenditure/total expenditure, %	7.8%	7.0%	8.2%	7.2%	6.8%	9.5%	10.1%	9.7%	8.7%
Economy and demographics									
Nominal GDP, EUR m	286,128	295,686	287,825	306,230	325,836	351,139			
GDP per capita, EUR	45,747	47,107	45,755	48,654	51,368	54,806			
GDP per capita, % of national GDP per capita	112.7%	112.7%	111.8%	111.9%	111.0%	112.4%			
Real GDP growth, %	0.5%	1.4%	-5.1%	4.0%	1.5%	1.2%			
Population, '000s	6,265.8	6,288.1	6,293.2	6,295.0	6,391.4				
Unemployment rate, % labour force	4.6%	4.4%	5.4%	5.2%	4.8%	5.2%			

Source: Land of Hesse, Destatis, Statistische Ämter des Bundes und der Länder, Scope Ratings

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