Landeskreditbank Baden-Württemberg - Förderbank - (L-Bank)
Rating Report

SCOPE AAA STABLE OUTLOOK

Credit strengths

- Explicit guarantee from German Federal State of Baden-Württemberg
- Supportive legal framework
- Strategic importance
- Sound asset quality and high capitalisation
- Strong liquidity and funding profile

Credit weaknesses

- Modest but stable profitability
- Limited loan portfolio diversification

Rating rationale and Outlook: The AAA rating of L-Bank reflects: i) the explicit, unconditional, unlimited, direct and irrevocable guarantee of the German Federal State of Baden-Württemberg (AAA/Stable) for L-Bank's obligations; ii) the mature and very supportive legal set-up, making changes in L-Bank's business model or guarantee structure unlikely; iii) the bank's high strategic importance to the federal state as a key government-related entity (GRE) implementing economic and social policies; iv) high capitalisation and asset quality; and v) a strong liquidity and funding profile with excellent capital market access. L-Bank's modest but stable profitability and limited loan portfolio diversification, both foreseen by L-Bank's public policy mandate, are challenges. The Stable Outlook reflects our assessment that the risks L-Bank faces are balanced.

Figure 1: Scope's approach to rating L-Bank

1. Level of integration with Federal State of Baden-Württemberg		
Integral / Strong ▼ Top-down approach		
2. Top-down approach		
Baseline		
Federal State of Baden-Württemberg's rating (AAA/Stable)		
−		
Negative adjustment factors		
Criteria for equalisation?		
Yes	No	
Control and regular government support		
High	Medium	Low
Likelihood / willingness of exceptional support		
High	Medium	Low
+ −		
3. Supplementary / Stand-alone analysis		
Positive adjustment	No adjustment	Negative adjustment

N.B. The orange colouring indicates the outcome of the analysis. Source: Scope Ratings GmbH

Positive rating-change drivers

- Not applicable

Negative rating-change drivers

- Downgrade of the Federal State of Baden-Württemberg
- Changes to guarantee framework, leading to weaker government 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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Related ratings

Scope affirms and publishes Baden-Württemberg's credit rating of AAA and Stable Outlook

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Level of integration with government

Strong level of integration with the federal state's economic development activities

Landeskreditbank Baden-Württemberg - Förderbank - (L-Bank), operating via its head office in Karlsruhe and a branch in Stuttgart, is the promotional bank of the German Federal State of Baden-Württemberg (AAA/Stable) and the fourth largest promotional bank in Germany with total assets of EUR 78bn at end-2019. L-Bank operates as an institution under public law and delivers essential, competition-neutral services, making it a GRE as defined[1] in Scope's GRE methodology. Its key area of promotion is the regional economy, with the provision of a wide range of funding instruments including promotional loans, equity participations and housing and municipal infrastructure financing. Further details on L-Bank's business and financial profile are presented in the section for L-Bank's **stand-alone fundamentals**.

Scope's top-down approach is used for the rating analysis

We used a 'top-down' approach to assign L-Bank's ratings, with the Federal State of Baden-Württemberg's AAA rating as the starting point. This is driven by our assessment of L-Bank's 'strong' integration with the Federal State of Baden-Württemberg (see **Qualitative Scorecard 1** in **Appendix I**), given the following considerations:

- L-Bank's public legal status as an 'Anstalt des öffentlichen Rechts' (public law institution) legally exempts it from insolvency procedures and German income tax, in line with most other German federal state development banks. Any changes to the bank's legal form are permissible only via a legal act of the Federal State of Baden-Württemberg. We deem this scenario to be unlikely.
- L-Bank's operating activities are performed on behalf of the Federal State of Baden-Württemberg with the purpose of providing key services in the public interest to support regional economic and social objectives.
- The Federal State of Baden-Württemberg is L-Bank's sole owner.

Explicit government support

Equalisation of L-Bank's rating with Baden-Württemberg's given the explicit guarantee

L-Bank's rating is fully aligned with the Federal State of Baden-Württemberg's (AAA/Stable) as L-Bank benefits from an explicit, unconditional, unlimited, direct and irrevocable guarantee from the federal state for the bank's obligations in respect of money borrowed, bonds issued, and derivative transactions entered into (see **Appendix II** for a summary of the guarantor). As the guarantee is laid down in public law, it can only be amended, revoked or restricted through a parliamentary act of Baden-Württemberg and would only apply to future transactions entered into with L-Bank after that act is enacted. We deem this scenario to be unlikely.

Extensive guarantee framework provided by the federal state

As is the case with other German regional development banks, L-Bank benefits from two additional ownership liability support mechanisms: i) an 'Anstaltslast' (institutional liability), which enables L-Bank to assert a claim against Baden-Württemberg, upon which the federal state must settle any financial shortfall on an unlimited and timely basis, thus providing L-Bank with the necessary resources to carry out required functions (i.e. creditors have no right to claim against the federal state); and ii) a 'Gewährträgerhaftung' (guarantor liability), which comprises the guarantor's unlimited legal liability to step in for L-Bank's liabilities in case of the bank's liquidation. Therefore, this is only relevant in certain, unlikely circumstances given that L-Bank is exempt from insolvency procedures as it is chartered under public law.

[1] Under Scope's GRE rating methodology, a GRE is defined as an issuer that fulfils both of the following conditions: i) it is directly or indirectly majority owned; and ii) its activities fulfil a public-sector mandate by implementing government policies or delivering essential public services.

Government control and regular government support

Strong oversight, with specific laws governing L-Bank

Further, under the 'top-down' approach, we assign a 'medium' level of government control and regular support for L-Bank (see **Qualitative Scorecard 2** in **Appendix I**). This is based on:

- Baden-Württemberg's 'high' ability to exert control over L-Bank's activities as their scope and content are defined and regulated by law[2] (L-Bank Act).
- The 'limited' regular financial support for L-Bank despite our expectation that timely financial support would be given prior to any potential call on the guarantees for L-Bank. Our evaluation reflects L-Bank's low but sufficiently high profits and excellent access to capital markets, which enable it to fulfill its promotional duties without recourse to federal state contributions.

Guided by L-Bank's statutes, government exercises operational, management and financial control

Baden-Württemberg's control over L-Bank enables the federal state to: i) alter L-Bank's strategy or mandate, which is defined and regulated by public law; ii) appoint and dismiss key personnel, including members of governing and oversight bodies – the supervisory board consists mainly of Baden-Württemberg representatives and members delegated by the federal state; and iii) intervene in decisions, including the distribution of profits. L-Bank must preserve its capital through profit retention to comply with its statutes and fulfil its role as a competition-neutral public-law institution. At least half of annual profits must be retained.

L-Bank is a self-supporting GRE

L-Bank finances its investment programme via capital markets. There is no track record of direct financial support for L-Bank. We do not consider regular financial support to be needed. On this basis, we capture the benefit of the guarantee framework, which allows L-Bank to operate without regular financial support from the Federal State of Baden-Württemberg.

Likelihood of exceptional support

Very high likelihood of government support

The extensive three-fold guarantee framework provided by Baden-Württemberg almost certainly ensures it would provide timely financial support to L-Bank if needed.

High strategic importance given L-Bank's role as the federal state's development bank

L-Bank's 'high' strategic importance is reflected in its central role in supporting key regional economic and social objectives by financing economic development, housing developments and infrastructure projects, and providing financial aid. L-Bank's key strategic position was recently highlighted in its role as the sole distributor of emergency grants (Soforthilfe Corona*)* to businesses in Baden-Württemberg affected by the Covid-19 crisis. Risks to L-Bank's strong position as the federal state's sole development bank and its provision of competition-neutral activities, which are underpinned by a stable and supportive legal framework, are deemed remote. This is because a change to L-Bank's public status would fundamentally undermine its access to low-cost funding and, in turn, its clearly defined public mission.

No change in ownership or explicit support expected

In a formal understanding established in March 2002, the European Commission confirmed that L-Bank's promotional activities do not fall under illegal state aid and will continue to benefit the statutory guarantee from the Federal State of Baden-Württemberg. Further, L-Bank was considered a CRR credit institution under the Capital Requirements Directive and was thus subject to supervision under the Single Supervisory Mechanism. In June 2019 with the implementation of CRD V, L-Bank was explicitly exempted from the directive. Consequently, L-Bank is now supervised by the German Federal Financial Supervisory Authority (BaFin) in cooperation with the Deutsche Bundesbank under the Kreditwesengesetz. Against this regulatory backdrop, we do not expect changes in L-

[2] L-Bank Act (a specific law governing L-Bank): https://www.l-bank.info/en/for-investors/investor-relations/l-bank-act.html.

Bank's ownership status, business model, policy role or guarantee structure that would be subject to amendments in the respective laws.

Stand-alone fundamentals

Business profile and risk positioning are determined by the public policy mandate

L-Bank is a credit institution subject to financial prudential regulation. Its public policy mandate and non-profit status are reflected in its modest profitability and stable although undiversified earnings, while the extensive guarantee framework supports L-Bank's excellent capital market access and favourable refinancing conditions. High and rising capitalisation buffers with prudent management of the bank's regulatory capital, the high quality of assets and double-recourse loan protection underpin the robustness of L-Bank's balance sheet.

Business model and earnings

L-Bank's business is focused on the regional economy and housing market…

L-Bank's promotional banking is focused on the regional economy and housing market. In addition to development banking activities, the bank holds a conservatively managed treasury portfolio. As L-Bank is not allowed to take retail customer deposits, it funds its activities on the capital markets and via facilities from national and multilateral development banks.

…and activities are split between four promotional pillars

L-Bank's activities are split into four promotional pillars: i) development loans granted to support the regional economy and promote affordable housing, home-ownership, and municipal infrastructure; ii) equity participations; iii) development of Baden-Württemberg as an investment location through the bank's technology parks; and iv) provision of financial assistance on behalf of Baden-Württemberg. L-Bank's activities take the form of on-lending via commercial banks for loans granted to SMEs, direct lending to the public sector, direct lending to businesses and individuals for housing-related loans, equity participations and guarantees.

Business performance affected by persistently low interest rates

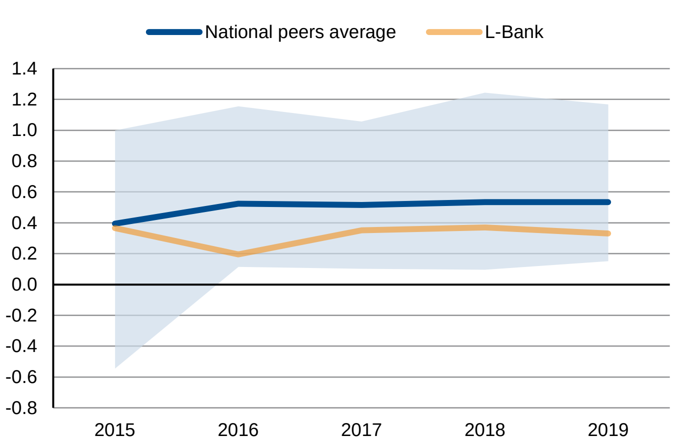
Due to its public mandate, L-Bank's earnings are stable although undiversified. L-Bank's net interest income relative to total assets over the past five years was around 0.3%, below the national peer[3] average of 0.5% (**Figure 2**, next page). While supporting investments and demand for housing loans in Baden-Württemberg and thereby resulting in stable credit volumes, net interest margins on loans, the bank's primary activity, are limited.

Earnings centered on interest income

Net interest income, L-Bank's primary source of revenue decreased by 9% to EUR 302m in 2019. Net commission income, which mainly comprises the management of payments by Baden-Württemberg for the distribution of family benefits and financial aid, totalled EUR 44.7m. Other net operating income amounted to negative EUR 1.4m. L-Bank's administrative expenses increased by 7.2% to EUR 180m in 2019, partly due to higher IT costs as part of its digitalisation strategy and building-related expenditure (**Figure 3**, next page). Consequently, L-Bank's cost-to-income ratio increased from 44.5% to 53.5% in 2019, still below the average for peers of 74%. Net income has remained stable in recent years and totalled EUR 50m in 2019.

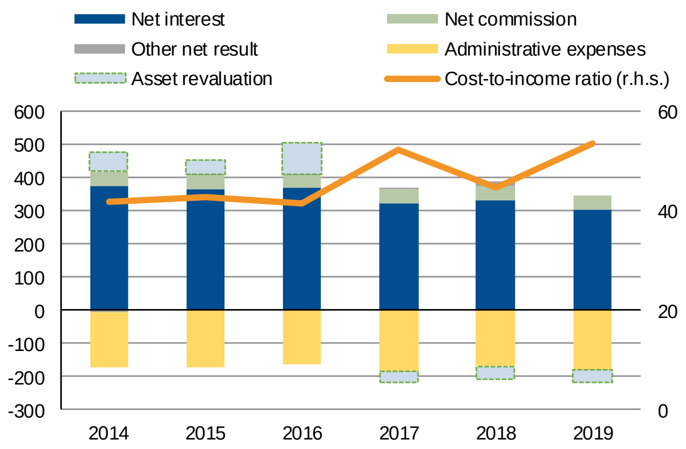
[3] National peers refer to the 12 largest German regional development banks excluding L-Bank.

Figure 2: Net interest income/average assets
%



N.B. The light blue area shows the range for national peers.
Source: SNL, Scope Ratings GmbH

Figure 3: Operating result breakdown
EUR m (LHS); % (RHS)



Source: L-Bank, Scope Ratings GmbH

Development banking stable in 2020; financial aid to increase significantly due to Covid-19 aid

We expect a stable volume of development banking activities this year, due to the resilience of Baden-Württemberg's growing housing market and high competitiveness of the regional manufacturing sector and thus stable demand for financing. The regional economic shock caused by the pandemic is reflected in the notable increase in the bank's financial aid in the context of the balance sheet-neutral distribution of federal and state grants to businesses. We expect the bank's performance to be relatively resilient to the crisis' effects, as most of the bank's direct exposures to ultimate borrowers are related to public and social housing sectors, which benefit from direct central government crisis support. Going forward, the bank's financial performance will be supported on an ongoing basis by administrative relief through its exemption from European banking supervision[4].

Profitability and capitalisation

Modest profitability owing to public policy mandate and low interest rate environment

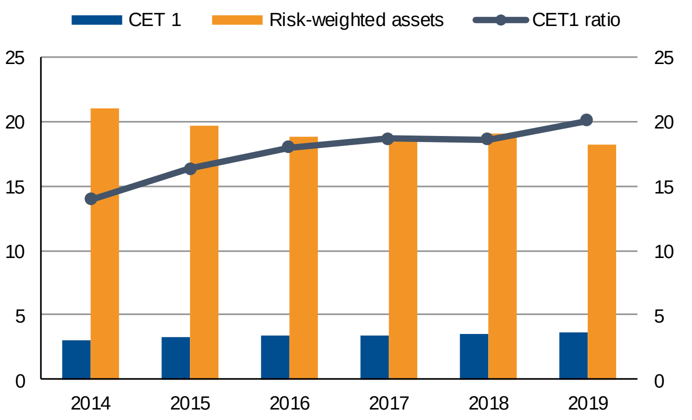
L-Bank's development banking activities are reflected in its low but stable returns on average assets over the past five years, which average 0.07% and are in line with the national peer average of 0.06%. Profitability has been supported by L-Bank's excellent access to capital markets, which is underpinned by the explicit guarantee. We expect profitability to remain subdued in view of the low interest rate environment and a stable lending book. In past years, net profits were retained.

Adequate and rising regulatory capitalisation supported by earnings retention

L-Bank's capitalisation was well above regulatory requirements at year-end 2019, with Common Equity Tier 1 (CET 1) capital of EUR 3.7bn and risk-weighted assets of EUR 18.2bn, resulting in a 20.1% CET1 capital ratio (**Figure 4**, next page). L-Bank's capitalisation has increased steadily in recent years as it consistently opted to retain net profits. Between 2014 and 2019, risk-weighted assets have declined by 13% despite an increase in total assets by 11% and the CET1 ratio increased from around 14% to around 20%, underpinned by conservative capital management. We expect capital buffers to rise further in 2020 given L-Bank's decision to retain EUR 50m of net profits.

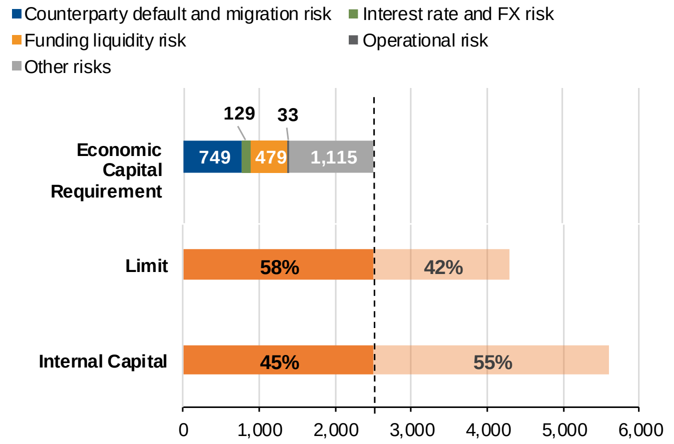
[4] The provisions of the Bank Recovery and Resolution Directive and the Single Resolution Mechanism, including the bank's contribution to the Single Resolution Fund no longer apply after the exemption, which should lead to moderate cost savings.

Figure 4: CET1 capital development
EUR bn, % (Basel III fully phased-in, RHS)



Source: L-Bank, SNL, Scope Ratings GmbH

Figure 5: L-Bank's risk-bearing capacity
EUR m, %



Source: L-Bank, Scope Ratings GmbH

Prudent risk management ensures capital adequacy…

L-Bank prudently manages its regulatory capital under both a normative and economic approach, strengthening its risk-bearing capacity. To this end, management defines the bank's total risk appetite by setting limits on total risk-weighted assets and on value at risk per risk type.

… and significant capital buffers of internal capital under economic capital requirements

Under the economic capital requirement approach, the bank ensures that, in a stressed scenario, internal capital would be sufficient to meet risks stemming from activities (e.g. credit, liquidity and operational risks) that may entail economic losses (value at risk). At end-2019, the bank identified EUR 2.5bn of value at risk, comprised mostly of credit and liquidity risks. Internal capital was EUR 5.6bn, indicating 55% in unused internal capital, which implies a significant buffer to available resources (**Figure 5**). Further, to ensure economic capital requirements remain manageable, the bank limits value at risk to EUR 4.3bn. At end-2019, 42% of the value-at-risk limit was unused.

Portfolio risks and asset quality

Concentrated exposures due to development business model…

Most of L-Bank's activities are composed of direct loans to customers (30% of total assets in 2019), and loans to the financial sector (33%), mostly for on-lending to regional SMEs, with commercial banks assuming the credit risk on the ultimate borrower (i.e. the 'house-bank principle'). L-Bank's double-recourse loan protection – that is, its direct claim against the ultimate borrower as well as the intermediary bank to whom it provided the initial loan – further reduces capital requirements and mitigates credit risks.

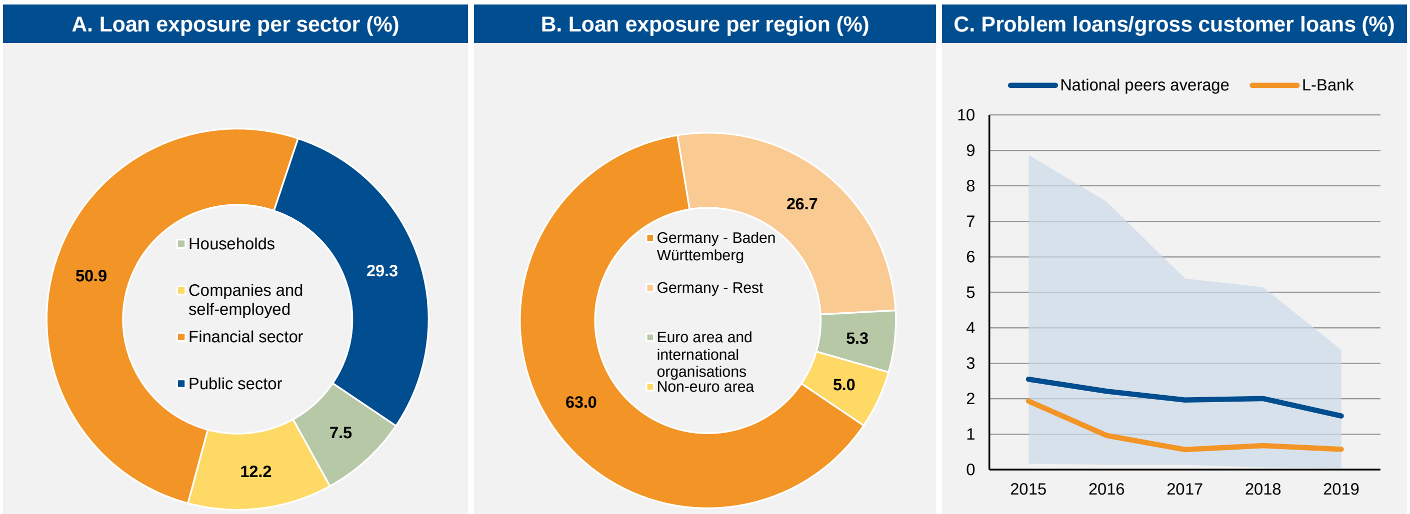
… with the quality of the loan book affected by the regional economy…

L-Bank's exposure is concentrated among financial and public sectors, at respectively 51% and 29% of the overall loan portfolio in 2019 (**Figure 6-A,** next page). L-Bank's loan exposure is also exposed to regional concentration risks, with 90% of the portfolio attributable to Germany and 63% to Baden-Württemberg (**Figure 6-B**). Both sectoral and geographical concentration are a consequence of L-Bank's mandate and are prudently managed by the bank via single obligor, country and concentration limits. Longer-term risks relate to transition risks in the automotive sector, to which Baden-Württemberg's export-oriented economy is particularly exposed.

…and mitigated by strong asset quality

L-Bank's loan book has strong asset quality and a very low non-performing exposure. Its share of problem loans relative to gross customer loans has been steadily decreasing and reached 0.6% in 2019, much lower than the national peer average of 1.5% (**Figure 6-C**). The low non-performing exposure reflects L-Bank's conservative lending strategy focused on low-risk borrowers with strong credit fundamentals, the benefits of on-lending to commercial banks, and the high share of secured lending. The high average borrower quality is reflected by the high share of exposures internally rated AA- or above of 46% and only 1% having a non-investment grade rating at the end of 2019.

Figure 6: Total loan[5] concentration risks and problem loans



N.B. The light blue area in the right-hand chart shows the range for national peers.
Source: L-Bank, SNL, Scope Ratings GmbH

Conservative investment strategy and limited market price risks

L-Bank continues to pursue a conservative investment strategy, holding a portfolio of fixed-income securities worth EUR 24bn (31% of total assets) as well as EUR 238m in strategic equity holdings at the end of 2019, including the bank's technology parks.

Funding and liquidity

Favourable refinancing conditions

L-Bank benefits from excellent market access and preferential regulatory treatment of its obligations thanks to the explicit liability support provided by the federal state.

L-Bank predominantly funds its operations by issuing short- and long-term debt securities. L-Bank has a long-term debt issuance programme with an authorised size of EUR 30bn (of which EUR 17.2bn was utilised at year-end 2019), as well as a commercial paper programme used for short-term refinancing, which has a funding limit of EUR 20bn, increased from EUR 15bn in December 2019 (utilisation at year-end 2019: EUR 14.1bn). In line with other German development banks, refinancing conditions are very favourable.

L-Bank's debt securities carry a 0% regulatory risk weight, are recognised as Level 1 high-quality liquid assets for liquidity coverage ratio requirements and are eligible for preferential treatment under Solvency II. L-Bank's bonds are also eligible for the ECB's monetary policy operations, including its asset purchase programmes. We expect L-Bank to continue to tap capital markets at very favourable rates.

Assured liquidity: L-Bank remains compliant with all regulatory capital requirements

L-Bank's established capital market access with a diversified investor base and its treasury portfolio of highly liquid securities ensure liquidity is sufficient. Liquidity adequacy is ensured from a value-at-risk perspective and via liquidity coverage ratios and survival horizons under stressed scenarios, on top of regulatory liquidity and funding ratios.

[5] Includes outstanding amounts, arrears, irrevocable loan commitments and undrawn, externally approved lines of credit associated with loans.

Appendix I. Qualitative scorecards

Qualitative Scorecard 1: Level of integration with the government

Criteria	Level of integration with government	
	Integral / Strong	*Limited / Weak*
Legal status & resolution framework	◉ Public; insolvency, bankruptcy and resolution laws unlikely to apply	○ Private; insolvency, bankruptcy and resolution laws do apply
Purpose/activities	◉ Good/service is backed by constitution or in the public interest	○ Good/service has mostly a commercial purpose
Shareholder structure, funding & control	◉ Significant public ownership/funding & control	○ Mostly private ownership/limited public funding & control
Approach*	**Top-down**	

* Two of the three parameters indicate the chosen approach for most instances.

Source: Scope Ratings GmbH

Qualitative Scorecard 2: 'Top-down' approach

Top-down approach	Analytical considerations		Assessment				Outcome & indicative notching	
				High	*Medium*	*Limited*		
	Equalisation factor		Statutory guarantee or laws to similiar effect		◉ Yes	○ No	Equalisation	
Control and regular government support	Organisational structure	Legal status	○ N/A	◉ Government department or similar	○ Legal structure with significant government involvement	○ Legal structure with limited government involvement	Medium	High
		Ownership of & rights to GRE's assets	○ N/A	◉ Mostly government	○ Somewhat government	○ Public and private		
	Government control	Mission, mandate and strategy	○ N/A	◉ Mostly directed by government	○ Government-influenced	○ Mostly independent		
		Financial, operating and investment policies	○ N/A	◉ Mostly directed by government	○ Government-influenced	○ Mostly independent		
		Key personnel and oversight bodies	○ N/A	◉ Mostly directed by government	○ Government-influenced	○ Mostly independent		
	Financial support	Funding options	○ N/A	○ Mostly via government	○ Balanced mix of government and private funds	◉ Mostly private funds		
		Support agreements	○ N/A	○ Regular cash or capital injections	○ Active/open credit lines or similar	◉ No regular use of support mechanisms		
		Track record	◉ N/A	○ History of timely support under all circumstances	○ History of support under select circumstances	○ Support not yet required		
Likelihood of exceptional support	Strategic importance to government		○ N/A	◉ High strategic importance/central policy role	○ Medium strategic importance/important policy role	○ Low strategic importance/secondary policy role	High	
	Ease of substitution		◉ N/A	○ Good/service is difficult to replace	○ Prospects of private players entering the market	○ Private sector operators provide same good/service		
	Default implications		◉ N/A	○ Large; default likely to affect government's creditworthiness	○ Some financial or reputational damage expected	○ Limited impact		

Overall assessment	Indicative notches
Equalisation	0
High	0-1
Medium	1-2
Limited	2-3

Indicative notching	0
Additional adjustment	0
Final indicative notching	0

Source: Scope Ratings GmbH

Appendix II. Summary of the guarantor: Federal State of Baden-Württemberg

Institutional framework

Integrated framework results in strong alignment with sovereign creditworthiness

Like all of Germany's federal states, Baden-Württemberg (AAA/Stable) benefits from a mature, predictable and integrated institutional framework. We view the established German institutional framework, with a proven record of institutional support from the national government and strong policy coordination, as very supportive of Baden-Württemberg's economic recovery and financial capacity to withstand budgetary pressures from the Covid-19 crisis. The federal government has assumed the primary role of economic stabiliser by implementing substantial deficit spending policies to absorb the costs of higher unemployment and support economic output.

Figure 7: Institutional framework assessment

Institutional framework assessment: German federal states

Category	Weight	Sub-weight		Assessment: Integration	Assessment: Score	*Weighted score*
Institutionalised support	*50%*	*25%*	Transfer & bailout regime	**Full**	100	25
		15%	Borrowing limits	**Full**	100	15
		10%	Funding support	**Full**	100	10
Fiscal interlinkage	*35%*	*20%*	Tax authority	**Full**	100	20
		15%	Fiscal equalisation	**Full**	100	15
Political coherence	*15%*	*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

We consider the federal system under which the German federal states operate to be the most integrated among European sub-sovereigns. Consequently, we determine an indicative downward rating distance of a maximum one notch between the German sovereign (AAA) and the rating of the individual state (**Figure 7**). This assessment is informed by:

'High' institutionalised support: legislative procedure allows for rules-based financial support

- **the track record of providing rule-based support** on the grounds of a solidarity principle that ensures extraordinary system support in situations of budgetary emergency;
- **credible fiscal rules**, with the Stability Council and the debt brake as important pillars for integrated financial relations between central and regional German governments, acknowledging the temporary suspension of the regular debt brake provision to mitigate the budgetary impact of Covid-19;

'High' fiscal interlinkage: legal rules to lower differences in living standards

- **a strongly interconnected revenue equalisation mechanism** enshrined in the German constitution that largely aligns fiscal capacities among the regions;
- **the highly integrated tax authority**, with a high degree of shared decision-making on taxes and a high share of common taxes;

'High' political coherence: clear distribution of responsibilities

- **wide-ranging participation – and veto-rights** – by the federal states in national legislation, with equal entitlement of the federal states regarding negotiations on federal reforms, requiring high coordination between government levels; and
- **the high share of common national legislation** and the increasing political and financial involvement of the central government in regional policy.

Baden-Württemberg's individual credit profile

Baden-Württemberg has one of the strongest credit profiles among peers…

We assess Baden-Württemberg's individual credit profile as 'strong' in a national and international context and expect the federal state to return to balanced budgets and maintain its commitment to start reducing its debt by 2024. This is underpinned by:

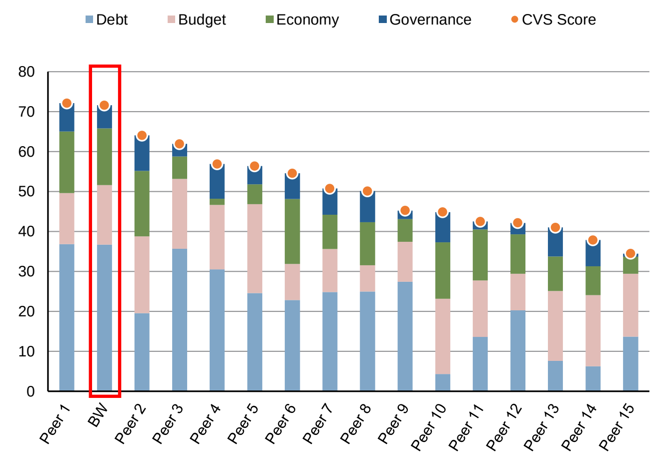
- **the sizeable cash reserves** vis-à-vis other German Länder, stemming from its sound financial management;
- **conservative budget management**, reflected by continuous cost control and a track record of high operating surpluses and comfortable surpluses before debt movement, despite high investment levels vis-à-vis national peers;
- **a resilient, highly competitive economy** with a strong manufacturing base; and
- **high-quality governance**, as highlighted in the recent pandemic.

These factors, combined with predictable cash flows and excellent access to liquidity and capital markets, like all other federal states, which demonstrate investor confidence in the German framework, help limit the Covid-19 impact on Baden-Württemberg's finances.

…though facing some credit challenges in the medium to long term.

Credit challenges relate to the bank's high debt levels in an international comparison and limited revenue flexibility given that the federal states mainly receive shared taxes. This is on top of Baden-Württemberg being a significant net contributor to the German fiscal equalisation system, which weakens the link between its tax revenues and economic performance. In addition, similar to the budgets of other former West German federal states, Baden-Württemberg's budget is burdened by high pension payments, weighing on long-term expenditure flexibility.

Figure 8: Core Variable Scorecard (CVS) scores vs peers



Source: Scope Ratings GmbH

Figure 9: Qualitative Scorecard (QS)

Individual credit profile - qualitative assessment (QS)					
Category	**Weight**	**Qualitative Scorecard**	**Risk** *Low*	*Medium*	*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

To assign Baden-Württemberg's individual credit profile score, we used a quantitative Core Variable Scorecard (CVS, **Figure 8**), to assess its credit profile relative to peers for several indicators, and performed qualitative assessments (**Figure 9**). Baden-Württemberg's overall CVS score is the second highest among the German federal states. This highlights its very strong credit profile, underpinned by good budgetary results with high investment levels and a low interest-payment burden, owing to its refinancing strategy and the status of German federal states as safe havens. Its GDP per capita is one of the highest in Europe while its unemployment rate is the lowest in Germany. Finally, regional governance indicators compare favourably in both a national and international context.

Appendix III. Consolidated financial figures

	2014	2015	2016	2017	2018	2019
Balance sheet summary (EUR m)						
Assets						
Cash and interbank assets	20,809	21,097	22,501	23,995	23,508	28,966
Total net customer loans	23,475	25,670	26,894	24,168	22,645	22,862
Total securities	22,562	23,027	22,513	21,147	22,024	24,396
Other assets	3,344	3,502	3,167	1,360	1,432	1,398
Total assets	***70,190***	***73,295***	***75,075***	***70,670***	***69,609***	***77,623***
Liabilities						
Deposits from banks	21,113	23,063	24,718	25,269	25,863	25,988
Deposits from customers	7,096	8,097	7,623	8,009	9,013	10,757
Total debt	36,917	36,314	36,783	30,837	28,657	34,830
thereof: Senior debt	35,983	35,584	36,226	30,383	28,278	34,450
Other liabilities	1,820	2,425	2,507	3,040	2,412	2,334
Total liabilities	***66,945***	***69,900***	***71,631***	***67,155***	***65,945***	***73,909***
Equity						
Fund for general banking risk	530	630	630	650	700	700
Common equity	2,715	2,765	2,815	2,865	2,964	3,014
Share capital	250	250	250	250	250	250
Other common equity	2,465	2,515	2,565	2,615	2,714	2,764
Total liabilities and equity	***70,190***	***73,295***	***75,075***	***70,670***	***69,609***	***77,623***
Common equity tier 1 capital	*2,986*	*3,232*	*3,384*	*3,438*	*3,556*	*3,659*
Income statement summary (EUR m)						
Net interest income	375.5	365.4	368.9	323.4	331.4	302.0
Net fee and commission income	42.4	42.4	40.9	40.0	41.4	44.7
Net result from other income/expenses	-4.9	4.7	1.1	6.6	16.1	-1.4
Administrative expenses	165.6	171.2	165.3	184.8	167.9	180.0
Operating result before risk provisions	***247.4***	***241.3***	***245.6***	***185.2***	***221.0***	***165.3***
Net income from asset revaluation	61.0	42.6	92.9	-31.7	-39.9	-35.1
Operating result	***308.4***	***283.9***	***338.5***	***153.5***	***181.1***	***130.2***
Taxes on income	0.9	4.7	1.5	0.3	0.9	0.2
Expenses for subsidies and contribution to road construction	128.3	128.6	127.7	2.6	0.0	0.0
Addition to development funds	0.0	0.0	160.0	80.0	80.0	80.0
Addition to general banking risk funds	130.0	100.0	0.0	20.0	50.0	0.0
Net income	***49.2***	***50.6***	***49.3***	***50.6***	***50.2***	***50.0***
Profit carried forward	1.1	0.3	0.9	0.2	0.8	1.0
Net profit	***50.3***	***50.9***	***50.2***	***50.8***	***51.0***	***51.0***

Source: L-Bank, SNL

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