2 December 2022

Sovereign and Public Sector

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

STABLE OUTLOOK
AAA

Credit strengths

- Explicit guarantee from the State of Baden-Württemberg
- Supportive legal framework
- High strategic importance to Baden-Württemberg
- Sound asset quality and high capitalisation
- Strong liquidity and funding profile

Credit weaknesses

- Modest but stable profitability, driven by non-profit-maximising development mandate
- Undiversified loan portfolio

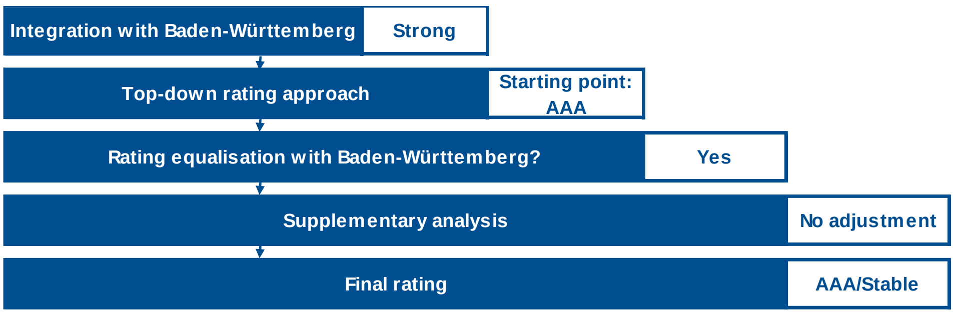
Rating rationale and Outlook

The AAA rating of Landeskreditbank Baden-Württemberg – Förderbank – (L-Bank) is equalised with the AAA/Stable rating of the German Federal State of Baden-Württemberg (Baden-Württemberg), given the state's explicit, unconditional, unlimited, statutory, direct, and irrevocable guarantee for L-Bank's obligations.

This is further underpinned by i) a mature and very supportive legal set-up, which makes changes to L-Bank's business model or guarantee structure unlikely; ii) the bank's high strategic importance to the Federal State as a key government-related entity implementing economic and social policies with a countercyclical role, supported by the stability of its resources; iii) high capitalisation and asset quality, and iv) a strong liquidity and funding profile with strong capital market access.

Challenges are L-Bank's modest but stable profitability and undiversified earnings, both foreseen by the bank's public policy mandate.

Figure 1: Our approach to rating L-Bank



Note: For further details, please see Scope's Government Related Entities Rating Methodology.

Source: Scope Ratings

The Stable Outlook reflects our assessment that the risks L-Bank faces are balanced.

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

Local and foreign currency

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

Lead analyst

Jakob Suwalski
+49 69 6677389 45
j.suwalski@scoperatings.com

Team leader

Dr Giacomo Barisone
+49 69 6677389 22
g.barisone@scoperatings.com

Related ratings

Federal State of Baden-Württemberg (AAA/Stable)

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Phone +49 69 6677389 0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Level of integration with government: top-down approach

Strong integration with Baden-Württemberg

L-Bank is the promotional bank of the Federal State of Baden-Württemberg, with total assets amounting to EUR 89.6bn at YE 2021, making it the fourth largest development bank in Germany. It operates out of its headquarters in Karlsruhe and a branch in Stuttgart with a staff of 1291 on average in 2021.

L-Bank is an institution under public law and delivers essential, competition-neutral services, making it a GRE as defined[1] by our GRE methodology. Its key area of promotion is the regional economy, to which it delivers services which are instrumental to the Federal State's implementation of policy objectives. Further details on L-Bank's business and financial profile are provided in the section on the bank's **stand-alone fundamentals**.

Top-down approach for rating analysis

We have used a 'top-down' approach to assign L-Bank's ratings, with Baden-Württemberg's AAA rating as the starting point. This is driven by our assessment of L-Bank's 'strong' integration with Baden-Württemberg (see **Qualitative Scorecard 1** in **Appendix I**) based on 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 regional development banks. Any changes to the bank's legal form are only permissible via a legal act of Baden-Württemberg which we deem an unlikely scenario.
- L-Bank's operating activities are performed on behalf of Baden-Württemberg and are governed and regulated by the L-Bank Act[2].

  The bank's activities have a 'high' strategic importance for its public sponsor. It fulfils a 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 crucial strategic position has been highlighted during the Covid-19 crisis. In 2020/21 the bank paid out emergency funds from the central and state government to businesses in Baden-Württemberg affected by the pandemic amounting to EUR 9.1bn. This year, the bank has set up special programmes to support municipalities in housing Ukrainian refugees and to further support investments in renewable energy production to increase energy resilience.

  Risks to L-Bank's position as the Federal State's development bank and its provision of competition-neutral activities (underpinned by a stable and supportive legal framework on national and European levels[3]) are remote.
- The Federal State of Baden-Württemberg is L-Bank's sole owner and exerts comprehensive operational and financial control. Heightened coordination needs during the Covid-19 pandemic made interactions between the bank and federate state more frequent, which we view positively.

Rating equalisation with the Federal State of Baden-Württemberg

Equalisation with Baden-Württemberg's AAA rating

L-Bank's rating is equalised with Baden-Württemberg's AAA/Stable rating. This is because the Federal State provides an explicit, unconditional, unlimited, statutory, direct

1 See point 1.1 of our Government Related Entities Rating Methodology for the definition of a GRE.
2 L-Bank Act, a specific law governing L-Bank.
3 An agreement called 'Verständigung II' in 2002 between the European Commission and the German federal government defines regulations for legally independent development banks engaging in competition-neutral infrastructure and development business. This ensures that German development banks will continue to benefit from state support. We therefore do not expect changes in the bank's ownership status, business model, policy role or guarantee structure that would be subject to amendments in the respective laws.

and irrevocable guarantee for obligations related to money borrowed, bonds issued and derivative transactions entered into by the bank. As the guarantee is set in public law, it can only be amended, revoked or restricted through a parliamentary act of the Federal State of Baden-Württemberg, which would only apply to future transactions entered into after the act is enacted. Any such change is unlikely.

Extensive guarantee framework provided by Baden-Württemberg

As is the case with other German regional development banks, L-Bank benefits from two additional ownership liability support mechanisms:

- an 'Anstaltslast' (institutional liability), which enables the 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
- 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. The guarantor liability is only relevant in certain and unlikely circumstances as L-Bank is exempt from insolvency procedures as it is chartered under public law.

Stand-alone fundamentals

Business profile determined by public policy mandate

L-Bank is a credit institution subject to the German Banking Act as well as prudential regulation and supervision by German Federal Financial Supervisory Authority BaFin and the German Bundesbank. Previously, L-Bank was subject to supervision by the Single Supervisory Mechanism (SSM) as a CRR credit institution under the Capital Requirements Directive. With the implementation of CRD V in June 2019, L-Bank was explicitly exempted from the directive, in line with other German development banks.

The bank's business model is driven by its non-profit-maximising mandate leading to modest profitability and undiversified earnings, which mostly comprise net interest income. L-Bank is self-supporting and funds itself via capital markets and credit facilities from other development banks, including Germany's KfW, as it does not take private-sector retail deposits. The bank's funding costs are low, underpinned by the extensive guarantee framework. L-Bank has never required financial support and we do not consider that financial support will be needed.

Other strengths are its high capitalisation, prudent risk management and strong asset quality, and very high liquidity buffers.

Business model and earnings

L-Bank's business focused on regional economy, housing

L-Bank's promotional banking focuses on the regional economy and housing market and is grouped into four development pillars:

- First, the bank provides development loans for regional economic development, the promotion of affordable housing and home ownership, and municipal infrastructure development. Loans are either on-lent to businesses via commercial banking partners, or directly lent to the public sector or for housing-related loans;
- L-Bank offers equity participations to promote start-ups;
- The bank invests in and manages technology parks to promote the business location; and
- L-Bank acts as the Land's agent for financial assistance, such as parental allowance.

Record-high business volumes in 2021 due to Covid-19

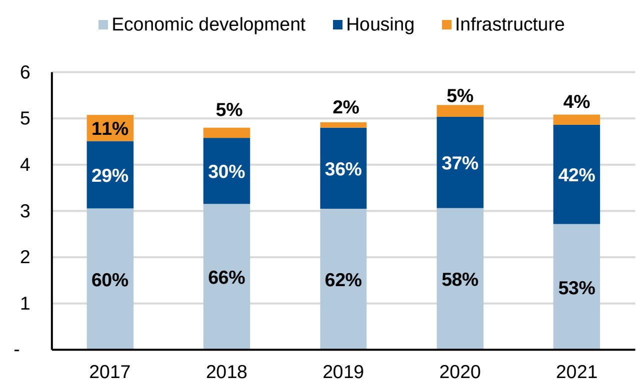
In 2021, the bank's overall activities amounted to EUR 15.2bn, up from EUR 12.1bn in 2020 and EUR 8.3bn in 2019. Volumes last year were elevated in the context of the balance sheet-neutral distribution of EUR 6.4bn in pandemic-related financial aid, after EUR 2.7bn in 2020. The volume of traditional development loans has been broadly stable over the last years, averaging around EUR 5bn, with typically 58% allocated towards economic development and around 38% for housing (**see Figure 2**).

2022 loan volumes should be in line with 2021

For 2022, we expect broadly stable development loan volumes. In the six months to June 2022, total signed loans for SME finance stood at around EUR 1.6bn (up 76% over the same period in 2021) and EUR 424m (up 66%) for business start-up finance. However, volumes are expected to slow down in the second half of the year as the economy cools due to Russia's war in Ukraine and the energy shock. Stable loan volumes highlight the continued demand for the bank's core products, as demand for Covid-19 financial support had already significantly declined in H1 2022 before it was discontinued as of 30 June.

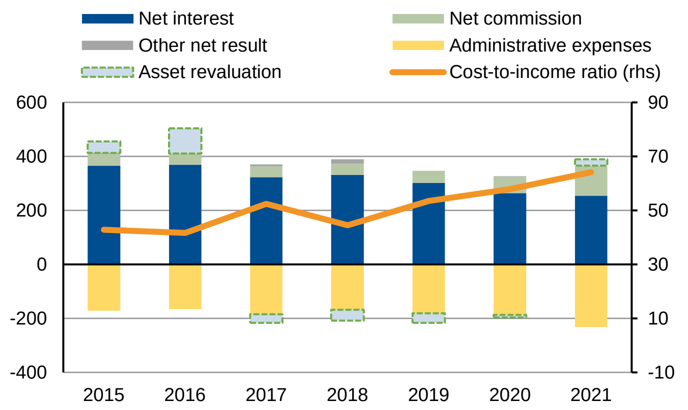
The bank continues to demonstrate an ability to adapt its products to current crises and policy priorities, including via i) setting up a loan programme for municipalities for the housing of Ukrainian refugees, ii) a programme for renewable energy projects, iii) expanding its guarantee products to a maximum EUR 15m from EUR 10m with a 50% counter-guarantee from its owner, and iv) supporting climate reporting and the green transition via interest-rate deductions of up to 15bps to businesses with CO_2 reporting and/or emissions reduction plans.

Figure 2: Development loan volume
EUR bn, % of total



Source: L-Bank, Scope Ratings

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



Source: L-Bank, Scope Ratings

Net interest is main income source, to be supported by rising interest rates

L-Bank's earnings are stable but undiversified, a reflection of its mandate. Net interest income is the primary source of revenue, representing around 85% of total operating income on average. It was around EUR 255m in 2021 and declined over the last three years as a consequence of the low-interest-rate environment (**Figure 3**). Net interest income relative to total assets over the past five years has been around 0.3%. The bank benefits from stable credit volumes, but net interest margins on loans are low. We view the recent rise in interest rates in the euro area as moderately positive for the bank's net interest income, as interest received from the bank's investment of its equity base should increase.

Net commission income, which mainly comprises compensation for the management of payments by Baden-Württemberg for the distribution of family benefits and financial aid, totalled EUR 110.4m in 2021, significantly up from EUR 61.2m a year ago due to compensation by Baden-Württemberg for the implementation of Covid-19 related programmes.

Some cost pressures

L-Banks's administrative expenses increased by 23% to EUR 229.6m in 2021 due to higher expenses for external personnel for processing Covid-19 financial support requests. This also led to an increase in the cost-to-income ratio to 64.1% in 2021, from 47% on average over 2015-19. We expect some cost pressures amid the inflationary environment, such as on staff and other expenses, and ongoing investments in digitalisation to modernise the bank's services.

Net income in 2021 declined to EUR 37.3m from EUR 50.4m a year earlier, due to lower net interest income and increased operating expenses. Valuation changes and provisions contributed positively to net income with EUR 24m.

Profitability and capitalisation

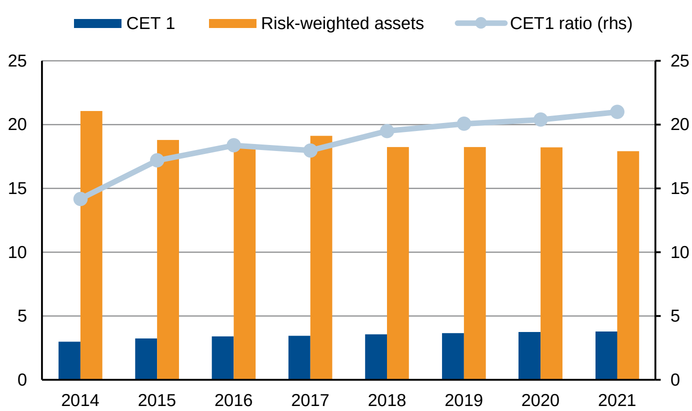
Modest profitability due to public policy mandate

L-Bank's profitability is modest, reflecting its public development banking mandate. Return on equity over the past five years averaged around 1.3%. Profitability benefits from L-Bank's excellent access to capital markets, itself underpinned by the explicit state guarantee. In past years, net profits have been retained, in line with the bank's statutes that at least half of annual net profits must be retained.

Adequate and rising regulatory capitalisation

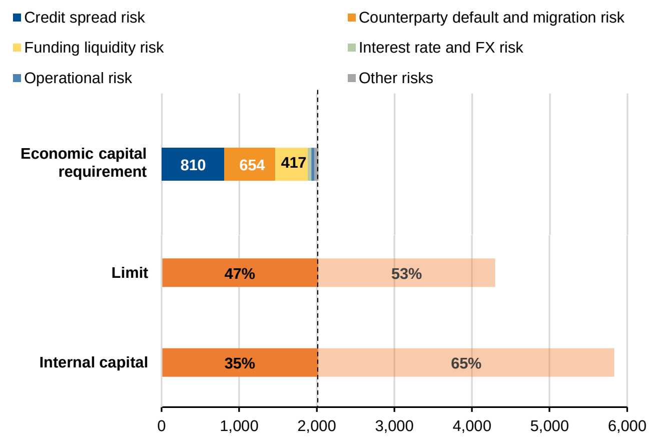
Earnings retention supports L-Bank's capitalisation. It's Common Equity Tier 1 (CET1) capital of EUR 3.8bn against risk-weighted assets of EUR 17.9bn results in a 21% CET1 capital ratio as of end-2021 (**Figure 4**). Between 2016 and 2021, risk-weighted assets were broadly stable while the CET1 ratio increased from around 18% to 21%, backed by earnings retention. L-Bank's average risk weight is relatively low at 21.5% over the last three years. The bank's leverage ratio increased to 7.8% in 2021 from 4.6% in 2020 due to changes in the Capital Requirements Regulation 2 in view of L-Bank's high exposures to promotional loans.

Figure 4: CET1 development
EUR bn, % of risk-weighted assets (rhs)



Source: L-Bank, SNL Financial, Scope Ratings

Figure 5: L-Bank's risk-bearing capacity
as of YE 2021; EUR m, %



Source: L-Bank, Scope Ratings

Prudent risk management ensures capital adequacy

The bank's risk management follows national prudential regulation, including BaFin's MaRisk requirements. L-Bank manages its capital according to the Internal Capital Adequacy Assessment Process, which is equivalent to the risk-bearing concept as defined in Article 25a of the German Banking Act.

Significant capital buffers

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 that may entail economic losses. At end-2021, the bank identified around EUR 2bn of value-at-risk, comprised mostly of credit and interest rate risk (**Figure 5**). L-Bank retains ample buffers both to internal limits (only 47% utilised at YE 2021) and capital (35%).

Portfolio risks and asset quality

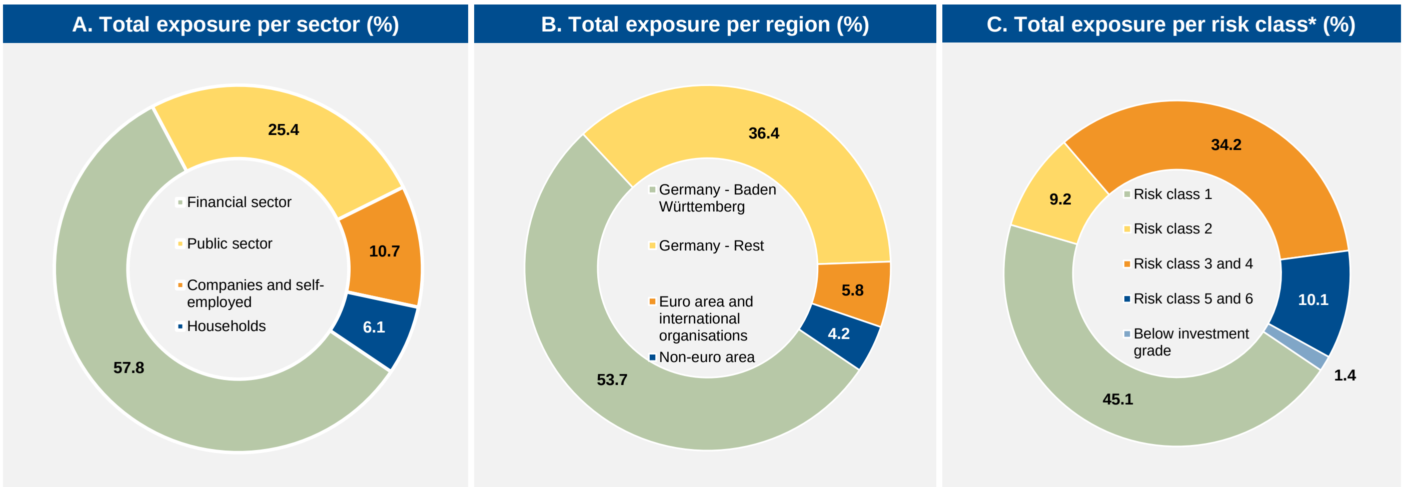
Portfolio concentrated on financial and public sectors

L-Bank's exposure is mostly towards financial institutions and public sector entities, at 58% and 25% of total exposure in 2021, respectively (**Figure 6**). L-Bank's portfolio is geographically concentrated, with 90% attributable to Germany and 54% to Baden-Württemberg. The high degree of sectoral and geographical concentration is a direct consequence of L-Bank's mandate and prudently managed via single obligor and concentration limits.

Most loans benefit from double-recourse protection

Most of L-Bank's exposure towards financial institutions are loans for on-lending to businesses at around EUR 21.6bn (23.4% of total exposure). Here, commercial banks assume 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 – shields L-Bank's asset quality from the pandemic's and energy shock's impact on certain corporate segments.

Figure 6: Exposure concentration and asset quality, YE 2021



* Risk class 1 corresponds to a AAA rating, class 2 to the AA category, classes 3 and 4 to the A category and classes 5 and 6 to the BBB category.
Source: L-Bank, SNL Financial, Scope Ratings

Other lending also well protected

In addition to on-lent funds via intermediary commercial banks, L-Bank's other, direct exposures also benefit from strong asset quality and protection. First, around EUR 23.5bn of total exposure was towards public sector entities of high credit quality. Second, the Bank's mortgage lending benefits from security of the underlying real estate.

Strong asset quality with low non-performing exposures

As a consequence of its conservative lending practices, L-Bank's loan book benefits from strong asset quality and a low share of non-performing exposures. Non-performing exposures of EUR 153m at YE 2021 represented 0.2% of L-Bank's total exposure, slightly up from EUR 118m (0.1%) in 2020. The strong average borrower quality is also reflected by the large share of exposures internally rated as risk class 1 or 2, i.e. AA- or above, of 54%, while only around 1% was internally assigned non-investment grade.

Overall conservative risk profile supports resilience to shocks

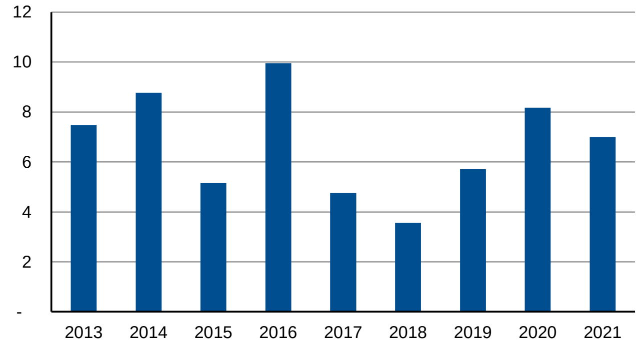
The bank's asset quality was resilient to the Covid-19 crisis over 2020-21 due to conservative lending and sizeable federal and state government financial support for the real economy. We expect some increases in risk provisions and non-performing exposures in the near term due to the impacts of the energy shock, but to remain low overall. In addition to its development-banking related assets, L-Bank's holds a conservatively managed portfolio of fixed-income securities worth EUR 23bn. Investments are usually held until maturity and derivative use is limited.

Funding and liquidity

Favourable financing conditions

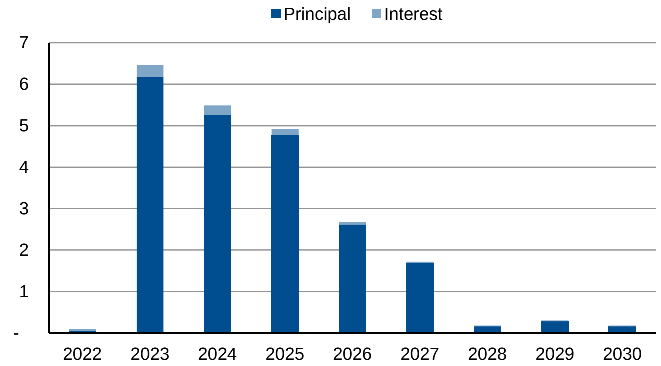
Equipped with the explicit liability support from the Federal State of Baden-Württemberg, L-Bank benefits from strong market access and the preferential regulatory treatment of its debt obligations. The bank predominantly funds its operations by issuing short- and long-term debt securities. L-Bank has a long-term debt issuance programme with an authorised size of EUR 30bn (of which EUR 19.2bn was utilised at YE 2021), as well as a commercial paper programme with a limit of EUR 20bn (utilisation at YE 2021: EUR 18.7bn). In line with other German development banks, refinancing conditions are very favourable. Annual refinancing averaged around EUR 7bn in the last three years (**Figure 7**) and the bank's redemption profile is smooth and will peak in 2023 at EUR 6.2bn (**Figure 8**).

Figure 7: Annual market funding
EUR bn



Source: L-Bank, Scope Ratings

Figure 8: Redemption profile up to 2030
EUR bn, as of 28 November 2022



Source: Bloomberg Financial L.P, Scope Ratings

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. The 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

The bank's established capital market access with a diversified investor base and its treasury portfolio of highly liquid securities ensure that liquidity is sufficient. Liquidity adequacy is ensured from a value-at-risk perspective as well as via liquidity coverage ratios and survival horizons under stressed scenarios.

Factoring of Environment, Social and Governance (ESG)

Governance and social considerations are material to L-Bank's credit rating and were included in Scope's assessment of: i) L-Bank's level of integration with the public sponsor, highlighting the supportive legal framework that requires the bank to comply with its statutes and fulfil its role as a competition-neutral public-law institution, including the provision of key services to support regional economic and social objectives; and ii) L-Bank's standalone fundamentals, highlighting its conservative risk profile.

Scope also considered long-term environmental developments alongside its assessment of rating-relevant credit risks, but these did not play a direct role in this rating action. Considerations include the bank's detailed reporting on its sustainability agenda via its non-financial reports and its efforts to be climate-neutral by 2040. The bank reported on its development banking activities and their impact in relation to the UN's Sustainable Development Goals. The bank's activities positively impact 12 out of the 17 goals, with a particular focus on climate and environmental protection transformation and digitalisation, small and medium-sized enterprises and equal opportunities.

The bank recently expanded its development loan products, adding a ‘Energiefinanzierung’ loan product targeted at funding sustainable investments. Further, and to support the Federal State’s climate goals, including climate neutrality by 2040, the bank introduced a ‘sustainability bonus’, i.e. interest-rate deductions of up to 15bps to businesses with CO_2 reporting and/or emissions reduction plans.

Appendix I. Qualitative scorecard

Qualitative Scorecard 1: L-Bank's level of integration with the Federal State of Baden-Württemberg

Analytical component	Weight	Assessments			
		Limited (1)	Medium (50)	High (100)	Not applicable
Legal status	40%	○	○	◉	○
Purpose & activities	20%	○	○	◉	○
Shareholder structure	20%	○	○	◉	○
Financial interdependencies	20%	○	○	○	◉

Integration score		100		
Indicative approach	***Score***	1 ≤ x < 33.3	33.3 ≤ x ≤ 66.7	**66.7 < x ≤ 100**
	Approach	Bottom-Up	Top-Down or Bottom-Up	**Top-Down**
Approach adopted				

Source: Scope Ratings

Appendix II. Statistics

	2014	2015	2016	2017	2018	2019	2020	2021
Balance sheet summary (EUR m)								
Assets								
Cash and interbank assets	20,809	21,097	22,501	23,995	23,508	28,966	37,216	43,062
Total net customer loans	23,475	25,670	26,894	24,168	22,645	22,862	22,941	21,571
Total securities	22,562	23,027	22,513	21,147	22,024	24,396	25,491	22,955
Other assets	3,344	3,502	3,167	1,360	1,432	1,398	1,112	2,009
Total assets	**70,190**	**73,295**	**75,075**	**70,670**	**69,609**	**77,623**	**86,760**	**89,597**
Liabilities								
Deposits from banks	21,113	23,063	24,718	25,269	25,863	25,988	28,812	30,216
Deposits from customers	7,096	8,097	7,623	8,009	9,013	10,757	10,133	10,593
Total debt	36,917	36,314	36,783	30,837	28,657	34,830	40,051	42,605
thereof: Senior debt	35,983	35,584	36,226	30,383	28,278	34,450	39,822	42,376
Other liabilities	1,820	2,425	2,507	3,040	2,412	2,334	3,999	2,341
Total liabilities	**66,945**	**69,900**	**71,631**	**67,155**	**65,945**	**73,909**	**82,995**	**85,755**
Equity								
Fund for general banking risk	530	630	630	650	700	700	700	740
Common equity	2,715	2,765	2,815	2,865	2,964	3,014	3,064	3,102
Share capital	250	250	250	250	250	250	250	250
Other common equity	2,465	2,515	2,565	2,615	2,714	2,764	2,814	2,852
Total liabilities and equity	**70,190**	**73,295**	**75,075**	**70,670**	**69,609**	**77,623**	**86,760**	**89,597**
Common equity tier 1 capital	2,986	3,232	3,384	3,438	3,556	3,659	3,712	3,761
Income statement summary (EUR m)								
Net interest income	375.5	365.4	368.9	323.4	331.4	302.0	263.2	254.8
Net fee and commission income	42.4	42.4	40.9	40.0	41.4	44.7	61.2	110.4
Net result from other income/expenses	-4.9	4.7	1.1	6.6	16.1	-1.4	2.5	-2.0
Administrative expenses	165.6	171.2	165.3	184.8	167.9	180.0	187.1	229.6
Operating result before risk provisions	**247.4**	**241.3**	**245.6**	**185.2**	**221.0**	**165.3**	**139.8**	**133.6**
Net income from asset revaluation	61.0	42.6	92.9	-31.7	-39.9	-35.1	-8.8	24.2
Operating result	**308.4**	**283.9**	**338.5**	**153.5**	**181.1**	**130.2**	**131.0**	**157.8**
Taxes on income	0.9	4.7	1.5	0.3	0.9	0.2	0.6	0.5
Expenses for subsidies and contribution to road construction	128.3	128.6	127.7	2.6	0.0	0.0	0.0	0.0
Addition to development funds	0.0	0.0	160.0	80.0	80.0	80.0	80.0	80.0
Addition to general banking risk funds	130.0	100.0	0.0	20.0	50.0	0.0	0.0	40.0
Net income	**49.2**	**50.6**	**49.3**	**50.6**	**50.2**	**50.0**	**50.4**	**37.3**
Profit carried forward	1.1	0.3	0.9	0.2	0.8	1.0	1.0	1.4
Net profit	**50.3**	**50.9**	**50.2**	**50.8**	**51.0**	**51.0**	**51.4**	**38.7**

Source: L-Bank, SNL Financial, Scope Ratings

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Conditions of use / exclusion of liability