17 June 2022

Sovereign and Public Sector

Land of Berlin
Rating Report

STABLE OUTLOOK

AAA

Credit strengths

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

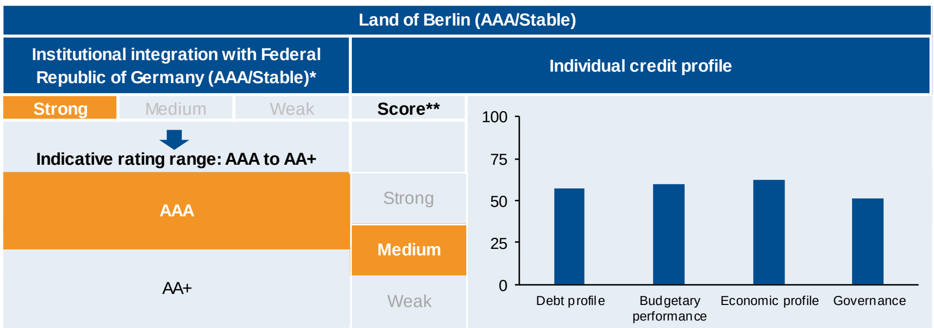
Credit weaknesses

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

Rating rationale and Outlook: The AAA rating is underpinned by the highly integrated institutional framework under which the Land of Berlin (Berlin) operates, characterised by a very strong revenue equalisation system and the federal solidarity principle, which results in a close alignment of Länder's creditworthiness with the German federal government's AAA/Stable ratings. In addition, the rating reflects Berlin's conservative budgetary management, commitment to fiscal consolidation, favourable debt profile, excellent capital market access, prudent liquidity management and strong economic base. In addition, sizeable federal support measures have mitigated the adverse effects of the Covid-19 crisis on the economy and Berlin's finances. Finally, the federal government has also taken measures to cushion the adverse impact of the Russia-Ukraine war and provided direct support to federal states.

Credit challenges relate to high direct debt, low revenue flexibility given limited leeway to adjust revenue via own taxes, unfunded pension commitments weighing on long-term expenditure flexibility as well as sizeable but manageable contingent liabilities. The Stable Outlook reflects our assessment that the risks to the ratings over the next 12 to 18 months are balanced.

Figure 1: Our rating approach for the Land of Berlin



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

Source: Scope Ratings

Positive rating-change drivers

- Not applicable

Negative rating-change drivers

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

Ratings & Outlook

Foreign and local currency

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

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Bloomberg: RESP SCOP

Institutional framework

Integrated framework results in strong alignment of creditworthiness

Like all of Germany's Länder[1], Berlin benefits from a mature, highly predictable and integrated institutional framework. The key elements are: i) a strongly interconnected revenue equalisation mechanism enshrined in the German constitution; ii) wide-ranging participation of the Länder in national legislation and veto rights; iii) equal involvement of the Länder in negotiations on federal reforms; and iv) a solidarity principle that ensures extraordinary system support in a budgetary emergency.

The federal system under which the German Länder operate is the most integrated system among European sub-sovereigns. We assess the system as having 'high': i) institutionalised support; ii) fiscal interlinkage; and iii) political coherence both between the Länder and with the federal government. Consequently, our assessment results in an indicative downward rating distance of a maximum of one notch between the German sovereign and the rating of each individual Land (**Figure 2**).

Figure 2: Framework assessment

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

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

Source: Scope Ratings

Institutionalised support

Institutionalised support in case of budgetary emergency

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

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

Covid-19: Federal debt brake emergency clause invoked in 2020-22

Regarding borrowing limits, Länder must comply with debt brake legislation[2] that prohibits them from running structural financing deficits unless hit by a severe economic downturn or a natural disaster. The debt brake also caps the structural annual deficit of the central government at 0.35% of GDP. The German federal parliament used the emergency clause of the debt brake in 2020-22 in response to the Covid-19 crisis. Separately, Berlin invoked the safeguard clause of its debt brake in 2020 in order to implement credit authorisations of EUR 7.3bn to absorb the budgetary impacts of Covid-19.

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

Federal government as a shock absorber during recent crises

Since the Covid-19 pandemic and in response to the Russian invasion of Ukraine, the federal government has assumed the role of primary shock absorber, shouldering a large part of the costs for businesses and households caused by pandemic restrictions and the inflationary pressures of the war. These extraordinary shocks have led to deficits at the federal level of EUR 131bn in 2020, EUR 216bn in 2021 and an expected EUR 140bn in 2022. Finally, the federal government created a fund equipped with up to EUR 30bn to support the states that were affected by the 2021 floods that occurred in Germany. This supportive stance taken by the federal government underpins our view of the high supportiveness of Germany's institutional framework.

Strong budgetary rules and oversight

The finances of the Länder and their compliance with debt limits are monitored by the Stability Council, established in 2010 as a joint body of the German Federation and the Länder. The Stability Council monitors restructuring programmes and compliance with budgetary targets as defined in fiscal consolidation agreements between the federal government and the Länder. The Council comprises the finance ministers of each Land and the federal ministers of finance and economic affairs.

The Stability Council and the debt brake are important pillars for integrated financial relations between central and regional German governments, which leads us to assess integration between the two levels of government as 'high'.

Autonomous funding and equal Basel risk weights

We view the level of funding support as high based on their history of stand-alone capital market issuance combined with aligned risk weights to the sovereign.[3]

Fiscal interlinkage

Shared tax authority for high-revenue taxes

The Länder and the federal government share a taxation authority and decide together on rates and revenue distribution for high-revenue common taxes (personal income and VAT). The latest reform to federal financial relations was implemented in 2020 and resulted in a higher share of VAT revenues distributed among the Länder. VAT distribution fully compensates for different taxing powers, replacing the previous two-step process of horizontal equalisation between the Länder. The federal government and the Länder have separate taxation authorities for taxes generating less revenue.

Berlin benefits from the reformed equalisation scheme

The German system is shaped by a federal financial equalisation system that strongly aligns different fiscal capacities among the regions. A reformed equalisation system took effect in 2020, with horizontal distribution occurring via deductions and top-ups to collected VAT, as well as vertical transfers from the federal government. As in the previous system, Berlin is the largest net beneficiary with total transfers of EUR 5.3bn in 2021, though on a per capita basis, the Land is no longer the largest recipient. The net effect of the change is positive for all Länder as contributions from the federal government are greater under the new system. As a result, we maintain our assessment that the fiscal equalisation system contributes materially to high integration.

Political coherence

Federal reforms further strengthen political coherence

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

[3] Regulatory treatment of a sub-sovereign exposure in comparison with respective sovereign exposure for banks is defined under the European Banking Authority's Capital Requirements Regulation (CRR).

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

Individual credit profile

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

Individual credit profile of 'Medium' strength

Berlin's individual credit profile is underpinned by the Land's: i) favourable debt profile, prudent liquidity management and excellent capital market access; ii) conservative budgetary management, which has enabled a gradual build-up of budgetary reserves in recent years, along with moderate revenue and expenditure flexibility compared to other German Länder; iii) large and diversified economic base with solid growth prospects and favourable demographic long-term trends; and iv) high quality of governance.

Credit challenges relate to high direct debt levels, limited revenue flexibility with little room for increases via own taxes and high pension liabilities weighing on long-term expenditure flexibility, as well as sizeable, yet manageable, contingent liabilities. The Covid-19 crisis has led to higher debt and a temporary budgetary deterioration due to revenue losses and additional expenditure, although not as severe as initially expected for 2020/21. However, we expect Berlin's solid underlying budgetary performance coupled with prudent financial management and good growth prospects will enable it to weather the Covid-19 economic and fiscal shocks, and the repercussions from the war in Ukraine.

Debt burden and liquidity profile

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

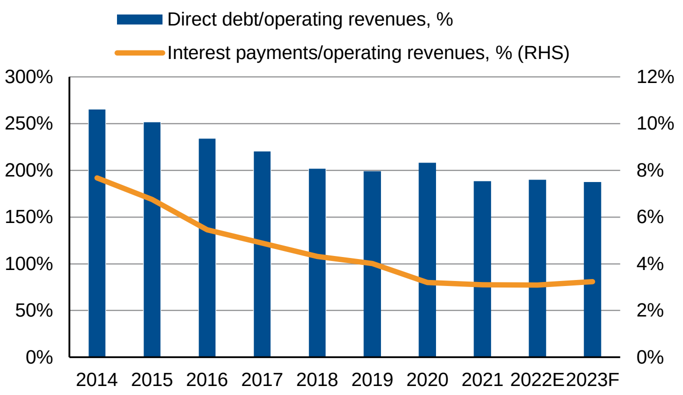
In 2020, after eight years of debt reduction, Berlin's budgetary response to the Covid-19 crisis caused direct debt to rise to EUR 63.7bn from EUR 57.6bn in 2019. In 2021, Berlin's nominal debt stock increased further to EUR 65.9bn, above its previous peak in 2012. Debt relative to operating revenues amounted to 189% at YE 2021, down from 208% a year before, and still well below a peak of 289% in 2012 (**Figure 3**). We expect debt to stabilise at its current level in nominal terms and trend down relative to operating revenue from an expected 190% this year to around 175% at YE 2025.

…as the Land issued EUR 7.3bn in new debt.

In response to the pandemic, Berlin's parliament invoked the safeguard clause of the state's debt brake and implemented credit authorisations of EUR 7.3bn[4]. Berlin made use of the full envelope of authorisations to issue the corresponding amount of debt. Funds raised but not needed in 2020 of EUR 5.4bn were placed in a pandemic reserve earmarked for tax revenue shortfalls and pandemic-related expenditures. In 2021, largely due to significantly higher-than-expected tax revenue, the size of the pandemic reserve was broadly unchanged at EUR 5.4bn at YE 2021.

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

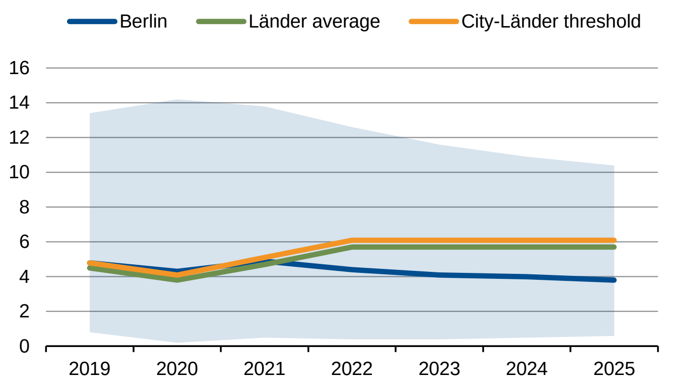
Figure 3: Debt and interest burden



Source: Senatsverwaltung für Finanzen Berlin, Scope Ratings

Figure 4: Interest-to-adjusted tax ratio

%



Source: German Stability Council, Scope Ratings.

N.B. The shaded area represents the minimum-maximum range for national peers

Excellent market access and conservative debt management

The risks associated with Berlin's high debt stock are mitigated by a favourable debt profile and excellent market access. Berlin's debt service has been on a declining trend as a result of an increase in the average maturity of outstanding debt, a gradual pre-pandemic debt reduction and declining interest rates. Berlin employs a conservative debt management strategy with very limited foreign currency and interest rate risks. At YE 2021, the average maturity of outstanding debt was 8.5 years, lengthened from 7.8 years in 2018. Almost all debt issued by Berlin is denominated in euro (99.8% at YE 2021), and Berlin hedges interest rate risk, such that after swaps, 96.9% of debt was at fixed rate at YE 2021.

Although debt service will remain high over the coming years at around EUR 5.3bn-5.4bn, or 15% of operating revenue, it is significantly down from EUR 9.7bn or 45% of operating revenue in 2013. The mandatory redemption plan for debt incurred under the 2020 pandemic credit authorisation foresees annual instalments of EUR 270m between 2023 and 2049, leading to manageable additional debt service requirements. However, due to better-than-expected budgetary outcomes in 2020 and 2021, Berlin plans to increase the redemption amount in 2023 to EUR 810m, using the expected remaining portion of the pandemic reserve at YE 2023.

Low and declining interest payment burden

Berlin's interest expenses are in line with the safe-haven status of the Länder. The average cost of outstanding debt was 1.26% in 2021, further down from 1.42% in 2020. As a consequence, interest payments relative to operating revenue also declined, to 3.1% in 2021 from 9.7% in 2012, thereby raising Berlin's financial flexibility. The latest stability report submitted to the Stability Council stated that Berlin was expected to meet all four financial thresholds[5] over the financial planning period and comply with the debt brake. This is also supported by the increasing margin between the Land's interest-to-adjusted tax ratio and the Stability Council threshold (**Figure 4**).

Prudent liquidity management

We view liquidity management as sound due to comprehensive inter-year cash planning and the availability of numerous sources of liquidity. Berlin also benefits from prudent financial planning and maintains a sizeable cash buffer throughout the year. Following the pandemic-related funding of EUR 7.3bn, which was allocated to a pandemic reserve, at YE 2021 the reserve still amounted to EUR 5.4bn, significantly raising Berlin's cash balance over 2020/21. The Land's cash flows, especially inflows, are prone to seasonal variability driven by the tax calendar. Additional continued access to liquidity to bridge

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

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.

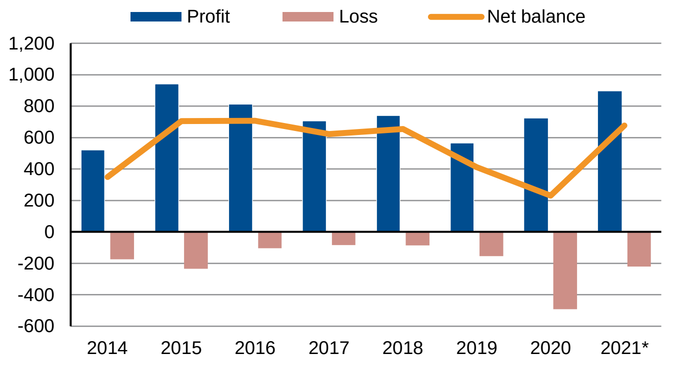
Low-risk guarantees

Berlin also has a moderate level of contractual guarantees outstanding. As of 2021, outstanding guarantees stood at EUR 4.6bn, up EUR 1.6bn from the previous year due to guarantees issued for the purchase of the electricity grid operator. Before 2021, guarantees had steadily declined from EUR 26.6bn in 2010. There is a limited risk that the obligations of entities and projects guaranteed by the Berlin will crystallise onto the Land's balance sheet.

Contractual guarantees are primarily related to three sectors. A third of the outstanding guarantees, or EUR 940m, are for Berlin public companies, especially the Berlin water works, whose financial results have been consistently positive in recent years. Similarly, outstanding guarantees relating to subsidised housing transactions conducted by Investitionsbank Berlin and KfW amounted to EUR 619m. Guarantees for debt held by social housing associations also do not pose a material credit concern, because the associations generate stable rental income. Finally, guarantees for Berlin Brandenburg Airport amount to EUR 1.1bn.

Figure 5: Profits and losses of Berlin's holdings

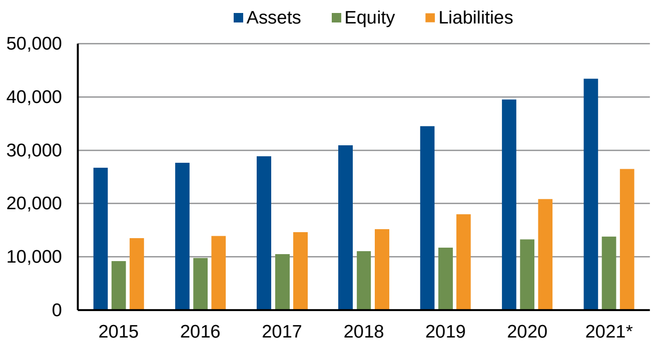
EUR m



* Based on preliminary information. Source: Senatsverwaltung für Finanzen Berlin, Scope Ratings

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

EUR m



* Based on preliminary information. Source: Senatsverwaltung für Finanzen Berlin, Scope Ratings

Shareholdings play critical role in investment policy

Berlin's shareholdings play a critical role in the state's investment policy. The roughly 40 majority-owned companies fulfil a significant public-sector mandate for Berlin by helping to boost the city's regional economy. They have a record of positive annual results, which supported high and sustained investment volumes. The Covid-19 crisis has adversely affected the profitability of several of the Land's holdings in 2020 and 2021 (**Figure 5**).

The shareholdings most affected by pandemic restrictions were Berlin Brandenburg Airport, the exhibition centre Messe Berlin, and the hospital operator Vivantes. The budgetary impact on the Land however is overall moderate. To further strengthen the financial position of its shareholdings, Berlin plans to inject around EUR 1.2bn in equity in 2022/23. Total liabilities at Berlin's holdings increased to EUR 26.5bn in 2021 from EUR 20.9bn in 2020 (**Figure 6**). Correspondingly, assets increased to EUR 43.4bn in 2021, from EUR 39.5bn in the previous year. Equity increased to EUR 14bn in 2021 from EUR 13bn in 2020. Most of the shareholdings' liabilities were incurred by the Land's regional development bank and social housing associations.

Budgetary performance and flexibility

Good budgetary performance before the pandemic

Berlin's track record of solid budgetary performance has been underpinned by controlled expenditure growth between 2012 and 2019, with high operating surpluses averaging 14% of operating revenue. The administration has shown a strict commitment to fiscal consolidation through effective cost control, with growth in operating expenditure matching that for operating revenue over 2012-2019. Consistently high operating surpluses have enhanced Berlin's ability to cover interest payments and capital expenditure. As a result, after investment activities and interest payments, Berlin posted surpluses between 2012 and 2019 averaging 2.6% of total revenues, which supported a gradual reduction of its direct debt until YE 2019.

High level of investment strengthens budgetary flexibility

Berlin benefits from a high share of investment relative to total expenditure at an average 10.5% between 2015 and 2019. Despite high nominal investment in 2021, the ratio decreased to 8.3% due to high pandemic-influenced total expenditure.

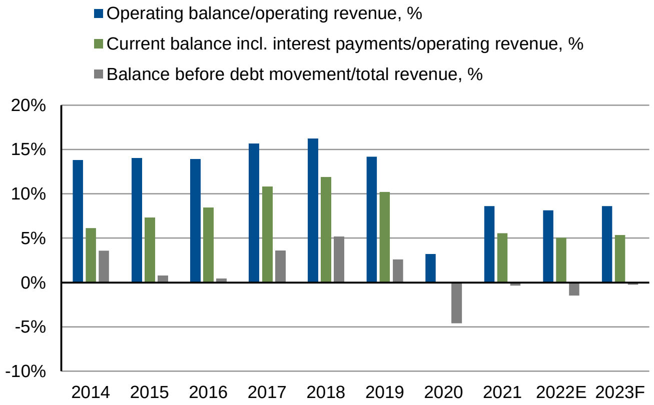
Berlin's investment strategy is based on three pillars: i) the core budget including funds from the federal government's municipal investment promotion programme; ii) the SIWA fund (a special fund for infrastructure investments); and iii) infrastructure investments by the Land's shareholdings, which improve budgetary flexibility. While the core budget and SIWA contributed above EUR 2.5bn per year in investments, Berlin's major holdings have regularly undertaken EUR 2.5bn in infrastructure investments in recent years. Including investments under SIWA, total investment spending amounted to EUR 3.3bn in 2021.

Budgetary reserves provide additional budgetary leeway

Conservative budgets and accommodative financing conditions have significantly reduced Berlin's interest payment burden over the last ten years, strengthening budgetary flexibility. The Land has expanded its social infrastructure in recent years to respond to rapid population growth and a constrained local property market. Berlin also has around EUR 1.8bn remaining as budgetary reserves (earmarked mostly for investments), accumulated via allocations of previous budgetary surpluses to the SIWA fund. The reserves can be used beyond an accrued fiscal year, providing additional budgetary leeway and partially mitigating shocks from economic downturns.

Figure 7: Budgetary performance

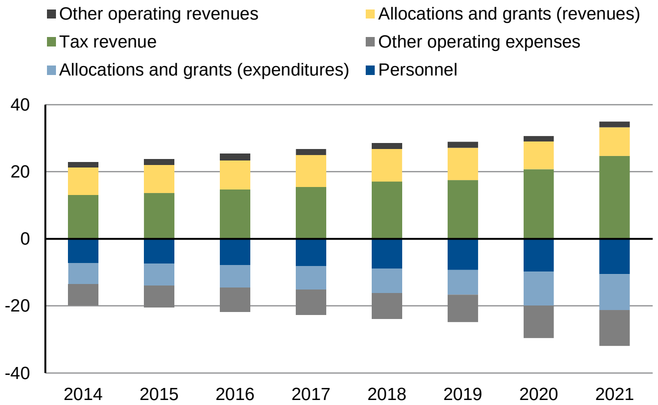
%



Source: Senatsverwaltung für Finanzen Berlin, Scope Ratings

Figure 8: Components of operating balance

EUR bn



Source Senatsverwaltung für Finanzen Berlin, Scope Ratings

2020/21 results affected by the pandemic

Before the pandemic hit in 2020, Berlin recorded eight successive years of surplus averaging around 2.6% of total revenue over 2012-19 (**Figure 7**). The 2020 and 2021 financial years were heavily impacted by Covid-19, leading to a deficit of 4.6% of total revenue in 2020 and 0.3% in 2021. At the same time, these results significantly outperformed our initial expectations and levels budgeted for by Berlin.

In 2020, tax revenue was EUR 1.6bn lower than budgeted, while additional pandemic-related costs (healthcare, transfers to businesses and fiscal support to some of the Land's shareholdings) amounted to EUR 3.4bn, or 11% of operating expenditure, including funds from the federal government channelled via Berlin's budget to support businesses affected by lockdowns.

2021 budgetary outcomes outperformed expectations, partly due to one-off effects

In 2021, a strong rebound in tax revenue resulted in a contained deficit of around EUR 120m, significantly outperforming an initially budgeted level of EUR 3.8bn and despite significant expenditure increases. Tax revenue stood at EUR 24.7bn, up 19% from 2020. Among a recovery of shared taxes, such as VAT and personal income tax, this was also due to pandemic-related one-off effects that shifted some corporate tax revenue from 2020 to 2021 and are thus unlikely to occur again in 2022/23. Total expenditure was up 8% in 2021 YoY, mostly due to higher staff and pension costs, transfers and other operating costs. A significant part of the cost increase was due to pandemic-related expenditures, such as direct healthcare spending, and transfers to businesses.

Ukraine-Russia war adds to Covid-19 budgetary implications

We also expect lasting structural consequences from the pandemic. Additional debt service expenses from the EUR 7.3bn in pandemic-related new debt will represent expenditure of about EUR 270m, or 0.8% of 2021 operating revenue, while additional interest expenses will be manageable. The permanent increase of the federal government's share in payments for cost of accommodation for job seekers from 50% to 75% will lead to cost savings of at least EUR 450m per year.

At the same time, progressive revisions to tax estimates underpin our view that Berlin's tax revenue will likely surpass pre-pandemic trend levels in 2022 and 2023. In its estimates from October 2019, Berlin budgeted with total tax revenue of EUR 26.1bn for 2022, while the latest estimates from May 2022 indicate a level of EUR 26.7bn. However, structurally higher spending, partly also due to direct costs for integrating and housing Ukrainian refugees as well as inflationary pressures from the war, will require Berlin to re-balance spending and investment activity. In the financial planning for 2024/25, tight expenditure control will be necessary in view of high spending and investment needs as well as the pandemic reserve likely being exhausted at YE 2023.

Balanced accounts expected over the medium term

Over the medium term, we expect Berlin to return to small budgetary surpluses below 1% of total revenue after 2023 owing to tax revenue rebounding to above its pre-crisis trend which is counterbalanced by rising operating expenditure. Consequently, we expect Berlin to adhere to its long-term consolidation strategy, supported by a commitment to fiscal consolidation, conservative budget management, low debt service costs, budgetary flexibility, and economic and demographic outperformance of national peers.

Rigid operating expenditure structure

Berlin has limited flexibility to adjust operating expenditure due to its rigid structure, since minimum legislative requirements and the socially sensitive nature of several expenditure items make most items difficult to trim. Personnel costs amounted to one third of operating expenditure in 2021 (down from 37% on average from 2015-19), while transfers to districts represented 34%, up from 31% on average from 2015-19 (**Figure 8**).

Strong and diversified tax base, stable transfers from the Bund

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

Increasing pension burden

Going forward, pension expenditure will constitute an increasing budgetary burden. In 2020, pension payments amounted to 8% of total expenditure, below the national average of 9%. This is because after reunification, civil servants in the new Länder were not included in the pension scheme but in a pay-as-you-go system under the Pension Transition Act. To ease the pressure from pension obligations, Berlin provides mandatory payments to the pension contribution plan (required by German law). These totalled a cumulative EUR 1.3bn at YE 2020, resulting in largely unfunded pension commitments. The fund is not designed to cover future liabilities but serves as a buffer during an economic downturn. According to an external actuary appointed by Berlin, pension obligations for the next 30 years amount to around EUR 68bn.

Economy and social profile

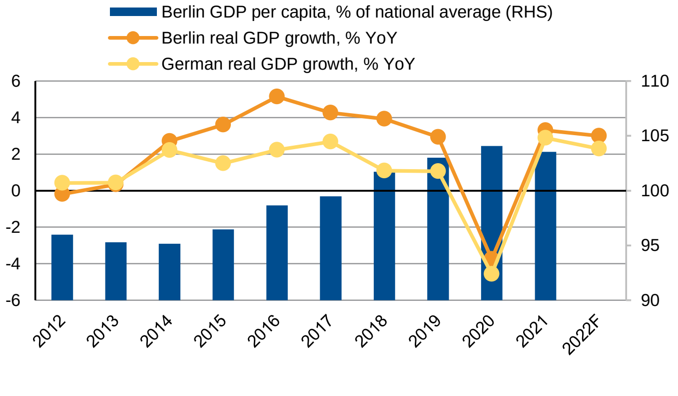
Covid-19 led to a recession in 2020 with a rebound in 2021

Berlin's economy was affected by the Covid-19 crisis in 2020, with real GDP declining by 3.8%. The recession was more pronounced than in 2009 (-1.1%), but less severe than for Germany as a whole, where real GDP declined by 4.6%. The relative resilience of Berlin's economy was supported by: i) the public sector's above-average share in gross value added, which counterbalanced the high degree of gross value-added creation in the tourism and recreation sectors; ii) continued growth in 2020 of services that were more resilient and adaptable to the pandemic, such as information and communication services; and iii) sustained growth in industrial sectors (6.3% of 2021 gross value added) such as pharmaceuticals. In 2021, Berlin's economy recovered by 3.3%, a slightly higher rate than the German average of 2.9%. We expect the recovery to continue in 2022 with growth of around 2.5% (**Figure 9**), which however represents a significant haircut to earlier growth estimates due to the repercussions of the Russian invasion of Ukraine. Downside risks relate to a sudden stop of Russian gas imports.

In line with the recovery in economic activity and employment protection measures, the labour market in Berlin has performed robustly over 2021 and into 2022. After peaking at 10.6% in February 2021, the unemployment rate has been gradually decreasing to 8.5% in May 2022, around 0.7pp higher than its pre-pandemic level (**Figure 10**).

Figure 9: Real GDP growth

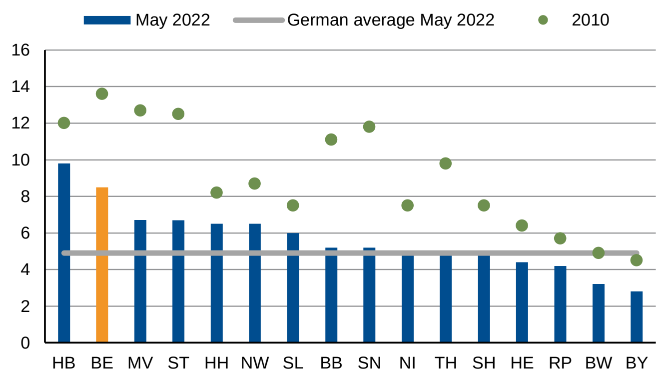
% YoY, % of national average (RHS)



Source: Federal Statistical Office, Scope Ratings

Figure 10: Unemployment rate

% total labour force



Source: Federal Statistical Office, Scope Ratings

Strong pre-crisis growth trend driven by the service sector

Until early 2020, Berlin's economy had expanded strongly over recent years, with real GDP growth exceeding the German average since 2014. As a result, GDP per capita rose above the national average for the first time since 2000, to 101.7% of the German average in 2018 and 103.5% in 2021, highlighting the Land's success in economic convergence. In parallel, the labour market also improved markedly until YE 2019, with the unemployment rate declining to 7.8% (2.8pp above the national average).

Favourable demographics compared to other Länder

Berlin benefits from favourable social and demographic profiles. With around 3.7m inhabitants in 2021, the German capital is also by far the country's largest city. The city's population has been growing dynamically, due to Berlin's attractiveness and net immigration from other European countries, with an average additional 43,000 inhabitants each year over 2011-2019. Population growth has moderated however, to a negative 5,400 in 2020 and a positive balance of around 5,700 in September 2021 YTD. This deceleration was largely attributed to Covid-19 related uncertainties and restrictions as well as a change in preferences away from living in metropolitan areas.

Quality of governance

Stable political environment

Berlin's stable political environment was again confirmed after last elections in September 2021. These resulted in a renewal of the incumbent three-party coalition (the centre-left Social Democratic Party, 36 seats; the Greens, 32 seats; and the Left Party, 24 seats). We thus expect broad policy-continuity until the next scheduled elections in 2026. Opposition parties are the Christian Democratic Union, the Alternative for Germany and the Free Democratic Party.

Administration firmly committed to fiscal consolidation…

Berlin's fiscal policy has been effective at balancing investment and consolidation needs. Berlin's stable political environment underpins our expectation that its administration will focus on long-term-oriented policies in response to the Covid-19 and Russia-Ukraine crises. Policies will need to balance a return to a balanced budget while maintaining high investment levels due to the growing city's infrastructure needs, such as for schooling.

… and responsive to short-and medium-term challenges.

Berlin's senate reacted promptly to the Covid-19 shock, making the necessary adjustments to the budget for 2020/21 and ensuring access to liquidity for the regional real economy via direct fiscal support or liquidity funds to the hardest-hit businesses. To support small and medium-sized businesses, the Land set up emergency measures ('Corona Soforthilfe') including extraordinary grants. Other measures included the pre-emptive establishment of a coronavirus treatment centre to increase healthcare capacity and expanding testing and vaccination capacities.

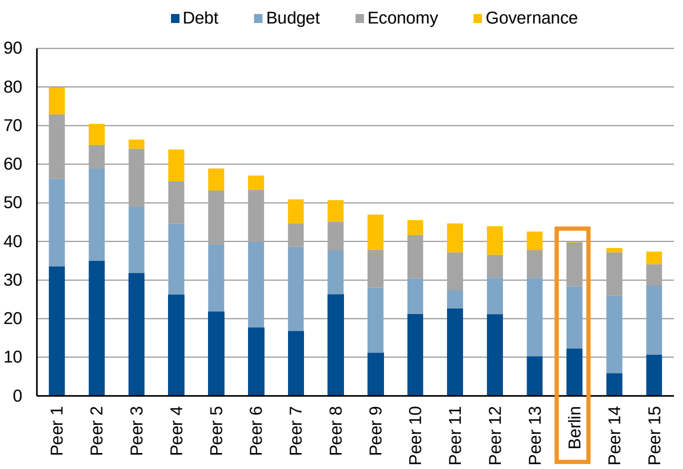
Further, the Berlin senate has also been responsive to longer-term social and environmental challenges. Core policy objectives are to invest into schooling infrastructure and social housing to alleviate high housing costs in the capital. To align the capital with the Paris agreement and carbon neutrality goals, policy objectives include a reduction of CO_2 emissions by 70% relative to 1990 levels by 2030 and climate neutrality (95% reduction) by 2045.

Unique administrative organisation

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

Appendix I: CVS/QS results and mapping table

Figure 11: CVS results Land of Berlin



Source: Scope Ratings

Figure 12: QS results Land of Berlin

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

Source: Scope Ratings

Rating mapping table

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

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

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

Appendix II: Statistical table

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Financial performance	in EUR m (unless noted otherwise)									
Operating revenue	21,530	21,795	22,909	23,791	25,362	26,724	28,482	28,925	30,608	34,970
Operating revenue growth, %	*9.0%*	*1.2%*	*5.1%*	*3.8%*	*6.6%*	*5.4%*	*6.6%*	*1.6%*	*5.8%*	*14.3%*
Tax revenue	11,616	11,921	13,127	13,626	14,767	15,399	17,027	17,534	20,732	24,653
Allocations and grants	8,400	8,355	8,182	8,496	8,593	9,600	9,756	9,616	8,302	8,616
Other operating revenue	1,514	1,520	1,601	1,669	2,002	1,725	1,699	1,775	1,573	1,700
Operating expenditure	18,358	18,952	19,747	20,445	21,833	22,536	23,865	24,824	29,620	31,959
Operating expenditure growth, %	*1.6%*	*3.2%*	*4.2%*	*3.5%*	*6.8%*	*3.2%*	*5.9%*	*4.5%*	*19.3%*	*7.9%*
Personnel	6,759	6,938	7,207	7,487	7,807	8,221	8,854	9,310	9,859	10,505
Allocations and grants	5,879	6,088	6,290	6,452	6,755	6,923	7,215	7,370	9,983	10,713
Other operating expenditure	5,719	5,926	6,251	6,506	7,271	7,392	7,795	8,144	9,778	10,741
Operating balance	3,172	2,843	3,162	3,346	3,528	4,188	4,617	4,101	988	3,010
Net interest payments	2,097	1,921	1,759	1,607	1,385	1,306	1,229	1,148	971	1,071
Current balance	1,075	922	1,403	1,739	2,143	2,882	3,388	2,953	17	1,939
Capital balance	-425	-469	-549	-1,553	-2,026	-1,882	-1,879	-2,175	-1,450	-2,061
Balance before debt movement	650	453	854	187	118	1,000	1,509	778	-1,432	-122
New borrowing (credit market)	7,820	7,384	8,064	7,136	7,039	5,425	4,511	2,967	10,209	3,470
Debt redemption (credit market)	8,015	7,836	8,405	8,324	7,228	7,381	7,262	4,539	6,213	5,714
Financial ratios										
Balance before debt movement/total revenue, %	2.9%	2.0%	3.6%	0.8%	0.4%	3.6%	5.1%	2.6%	-4.6%	-0.3%
Operating balance/operating revenue, %	14.7%	13.0%	13.8%	14.1%	13.9%	15.7%	16.2%	14.2%	3.2%	8.6%
Interest payments/operating revenue, %	9.7%	8.8%	7.7%	6.8%	5.5%	4.9%	4.3%	4.0%	3.2%	3.1%
Current balance/operating revenue, %	5.0%	4.2%	6.1%	7.3%	8.5%	10.8%	11.9%	10.2%	0.1%	5.5%
Capital expenditure/total expenditure, %	6.6%	6.3%	6.4%	10.0%	11.2%	10.7%	9.8%	10.9%	7.0%	8.3%
Debt										
Direct debt	62,256	61,607	60,804	59,906	59,436	58,994	57,600	57,555	63,705	65,923
Guarantees	8,776	8,890	7,510	6,901	5,928	5,152	4,255	3,016	3,007	4,616
Overall debt risk (direct debt plus guarantees)	71,032	70,497	68,314	66,807	65,364	64,146	61,855	60,571	66,712	70,539
Debt ratios										
Direct debt/operating revenue, %	289.2%	282.7%	265.4%	251.8%	234.4%	220.8%	202.2%	199.0%	208.1%	188.5%
Overall debt risk (incl. guarantees)/operating revenue, %	329.9%	323.5%	298.2%	280.8%	257.7%	240.0%	217.2%	209.4%	218.0%	201.7%
Interest payments/direct debt, %	3.4%	3.1%	2.9%	2.7%	2.3%	2.2%	2.1%	2.0%	1.5%	1.6%
Debt per inhabitant (EUR)	18,213	17,799	17,347	16,831	16,486	15,744	15,008	14,773	17,386	17,964
Economic performance										
GDP at market prices	109,772	112,881	118,519	124,914	133,210	141,322	149,976	157,471	154,537	162,950
share in Germany's GDP, %	*4.0%*	*4.0%*	*4.0%*	*4.1%*	*4.2%*	*4.3%*	*4.5%*	*4.5%*	*4.6%*	*4.6%*
GDP per capita (EUR)	32,762	33,215	34,395	35,741	37,551	39,320	41,325	43,058	42,145	44,472
% of Germany's GDP per capita	*96.0%*	*95.3%*	*95.1%*	*96.5%*	*98.6%*	*99.5%*	*101.7%*	*103.0%*	*104.1%*	*103.5%*
Population (ths)	3,375	3,422	3,470	3,520	3,575	3,613	3,645	3,669	3,664	3,670
Real GDP growth, %	-0.2%	0.3%	2.7%	3.6%	5.1%	4.3%	3.9%	2.9%	-3.8%	3.3%
Unemployment rate, % of labour force	12.3%	11.7%	11.1%	10.7%	9.8%	9.0%	8.1%	7.8%	9.7%	9.8%

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

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