

State of Saxony-Anhalt

Full Rating Report

Ratings

Foreign Currency	
Long-Term IDR	AAA
Short-Term IDR	F1+
Local Currency	
Long-Term IDR	AAA
Short-Term IDR	F1+

Outlooks

Long-Term Foreign-Currency IDR	Stable
Long-Term Local-Currency IDR	Stable

Financial Data

State of Saxony-Anhalt

	31 Dec 17	31 Dec 16
Operating revenue (EURm)	10,205.1	10,134.8
Debt (EURm)	20,163.2	20,299.2
Operating balance/operating revenue (%)	12.61	14.88
Debt service/current revenue (%)	46.7	54.18
Debt/current balance (yrs)	24.2	20.2
Operating balance/interest paid (x)	2.83	2.96
Capital expenditure/total expenditure (%)	8.22	7.37
Surplus (deficit) before debt variation/total rev. (exc. new debt) (%)	2.67	5.10
Current balance/capital expenditure (%)	67.93	89.49

Source: Fitch Ratings

Key Rating Drivers

Solidarity System Intact: The ratings of the State of Saxony-Anhalt (ST) reflect the stability and sustainability of the solidarity mechanism for German Laender. Under the federal German constitution, the central government (the Bund) and the states (the Laender) are jointly responsible for supporting a state in financial distress.

Strong Access to Liquidity: Active liquidity management, access to a EUR2 billion commercial paper (CP) programme, adequate treasury facilities and access to offered excess liquidity of the other German Laender prevent any delays in the provision of liquidity.

Financial Equalisation System: Through the financial equalisation system, different taxation powers and financial strengths are adjusted through horizontal financial transfers among the Laender (see *Institutional Framework* below). A net recipient, ST was given EUR676 million (6.5% of operating revenue) under the system in 2018.

High but Declining Debt: From 2020, Laender will have to achieve balanced budgets without new borrowing. ST implemented the national debt-brake rule in November 2010 and has reduced its net new debt requirements to zero since 2012. At end-2018, direct debt was EUR19.2 billion, down 4.6% yoy. ST aims to reduce its debt by EUR100 million annually in 2019-2022.

Its direct debt/current revenue ratio declined to 185% in 2018 (2017: 198%) and is expected to decline further to 170% in 2022, but it remains high compared to international peers.

Stable Operating Margin: Based on preliminary 2018 figures, ST's operating margin was 12.9% (2017: 12.6%). However, due to a decrease in interest expenses, the current margin improved to 9.4% (2017: 8.2%) and the current balance covered 76% of capex (2017: 68%). Under the financial plan for 2018-2022, the operating margin may decline in 2019/2020 and recover to 2018 levels in 2022. Fitch Ratings believes ST's fiscal performance should at least remain in line with that of 2018, as tax revenues should exceed 2019 expenditure.

Declining Interest Expenses: Interest expenses continued to decline in 2018, falling by 19.5% yoy to EUR366 million (2017: EUR455 million). ST actively manages its debt and is a frequent issuer in the capital markets. The low interest environment also helps the administration contain its annual interest expenses.

High Capex Ahead: In 2018, ST spent 10.1% of its total expenditure on capital investments, above the average for the last five years (8.7%) – of which transfers to municipalities constituted the largest share. Under the 2018-2022 financial plan, investments are expected to peak in 2020 at EUR1.9 billion (15% of total spending), and then decline to 11.5% of total expenditure in 2022. We assume ST will use some leeway, as capex has never been more than 15% of total expenditure over the past five years.

Rating Sensitivities

Sovereign Downgrade: A negative rating action would be triggered by a change in the ratings of Germany (AAA/Stable/F1+). Any change in the support system would necessitate a review of the ratings.

Related Research

[Fitch Affirms 11 German Laender at 'AAA'; Outlook Stable \(April 2019\)](#)

[Fitch's Rating Approach for the German Laender \(August 2015\)](#)

[German Laender Dashboard \(September 2018\)](#)

[Germany \(February 2019\)](#)

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Rating History

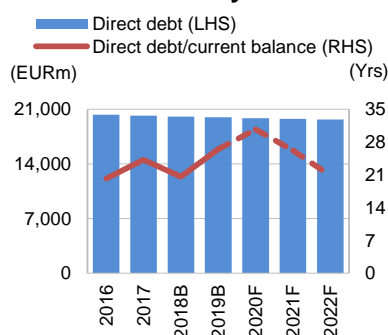
Date	Long-Term Foreign IDR	Long-Term Local IDR
2 Nov 18	AAA	AAA
6 Nov 03		AAA
25 Mar 99	AAA	

State of Saxony-Anhalt



Source: Fitch Ratings, Transaction document

Debt and Debt Payback



b - Budget, f - Forecast
Source: Fitch Ratings, State of ST

Principal Rating Factors

Summary: Strengths and Weaknesses

	Institutional framework	Debt and other liabilities	Economy	Finances	Management and admin
Status	Strength	Weakness	Neutral	Neutral	Strength
Trend	Stable	Positive	Stable	Positive	Stable

Source: Fitch Ratings

Overall Strengths

- Strong institutional framework
- Prudent debt management resulting in almost zero net new borrowing since 2012 and a slight reduction in debt stock
- Proactive approach to the coverage of future pension liabilities of employed staff
- Stringent expenditure policy

Overall Weaknesses

- High debt burden; high debt / current revenue ratios in international context
- Declining population due to emigration and ageing; consequent decrease in the workforce
- Less diversified economy

Institutional Framework

The ratings of ST are linked to those of Germany on the back of a strong mutual support system between the Laender, the extensive financial equalisation system, very good access to liquidity, and sophisticated cash management. This is underpinned by Article 20 of the German Constitution, which states that the 16 Laender are equal partners with the federal government and have the same rights and duties, even though in practice they are subordinate in some areas.

Debt, Liabilities and Liquidity

Driven by good economic progress and cost-consolidating measures established ahead of the debt brake starting from 2020, ST's debt growth decelerated and the state started reducing its direct debt in 2012, one year before schedule. However, indebtedness remains high compared to the other German states. Its debt per capita was EUR9,004 at end-2017 and remained the third highest among German states (excluding the three city-states), well above the average of EUR6,404. Consequently its relatively high debt-to-current revenue ratio limits the administration's expenditure flexibility. According to preliminary 2018 results, ST's debt-to-current revenue ratio was 193% (2017: 198%). Under the state's 2018-22 financial plan, the debt-to-current revenue ratio will remain high but is likely to decline to 177% by 2022.

ST's debt decreased by 0.7% to EUR20.2 billion at end-2017. Based on preliminary results, the state's debt declined further by 4.6% in 2018 to EUR19.2 billion. This is well above the EUR100 million decrease forecast in its 2018 budget, but the state moved EUR831 million of refinancing needs into 2019. Under the financial plan for 2018-2022, debt is expected to decline further by EUR100 million annually to below EUR20 billion in 2022. Fitch views this as realistic.

Related Criteria

International Local and Regional Governments Rating Criteria – Outside the United States (April 2016)

Debt^a Per Capita of the Laender, End-2017

Land	(EUR)
Bremen	30,231
Berlin	15,965
Saarland	14,033
Hamburg	12,443
Schleswig-Holstein	9,026
Saxony-Anhalt	9,004
North Rhine-Westphalia	7,790
Rhineland-Palatinate	7,666
Lower Saxony	7,207
Thuringia	6,902
Hessen	6,544
Brandenburg	6,053
Mecklenburg-Western Pomerania	5,123
Baden-Wuerttemberg	3,520
Bavaria	1,426
Saxony	1,133
Laender average	6,404
Bund	12,690

^a Capital market debt, preliminary
 Source: Fitch Ratings, Federal Ministry of Finance

The state's recent fiscal performance (see f below for more details) should help improve its debt and debt coverage ratios slightly. The 2019 budget forecasts operating revenue improving by about 5% yoy, while opex may increase by 3.7%, and this trend could continue until 2022. Against this background, the payback ratio (2017: 24 years) should improve to below 20 years in 2022.

Preliminary results show direct debt servicing was a low 22% in 2018 (2017: 47%) in terms of current revenue and 172% (2017: 372%) in terms of operating balance. This ratio is volatile, as it depends on the state's maturity profile which may have some peak years, but the period 2013-2017 shows an improving trend, supported by a stabilisation of the operating performance, an increase in operating revenues and a decline in interest expenditure. Therefore ST is likely to reduce its debt burden. A declining population puts pressure on the tax base and lower revenue reduces the debt coverage; ST will remain obliged to cut debt to remain on track with its current debt coverage.

The debt structure of the state is favourable. Some 89.4% (post swaps) of its debt is at fixed rates and there is no FX risk. A low exposure to foreign currencies is hedged entirely. The maturity profile of the state is showing no concentration risk. In 2019, ST needs to refinance EUR2,427 million (13% of its debt at end-2018) and about 38% of its direct debt will mature in the next five years. We believe the state's refinancing risk is very low, as it is a frequent issuer in the capital markets and is running two issuance programmes: a EUR2 billion CP-Programme which was largely used during 2018 as well as a EUR6 billion medium-term-note programme. In line with other German Laender, ST can also tap the "Inter-Laender Cash Pool" among the German states, which gives the state good access to liquidity in case of a shortfall.

For its civil servants' pension liabilities, ST has been proactively setting up actuarial provisions since 2006. The aim is to fully cover the pension liabilities of the civil servants employed since 2007 and partially cover those of staff employed before 2007 (these are not included in Appendices A & B of this report).

Other Fitch-classified debt, consisting of private public partnership (PPP) financial leasing, slightly declined to EUR78 million (2016: EUR125.2 million) in 2017.

Moderate Contingent Liabilities

ST's contingent liabilities mostly consist of guarantees, and remained at EUR1.9 billion at end-2017. ST directly and indirectly held shares in 50 companies and 19 public sector entities (Anstalten oeffentlichen Rechts) in 2017. There is no concentration risk towards a large single exposure, and Fitch believes the cumulative debt of the entities to have been below EUR150 million at end-2017 – a relatively low amount in the context of the state's direct debt. The business activities of these companies are diversified, and their debt represents a relatively small share of ST's budget, limiting the risk to the Land's budgetary performance.

Like other German states, ST wholly owns a development bank (Investitionsbank Sachsen-Anhalt) to support the state's economic and infrastructural development, as well as to provide loans to business activities that are in the interests of ST and may not be financed by commercial banks. The bank is supported by a deficiency guarantee (Gew aehrtraegerhaftung) and maintenance obligation (Anstaltslast) from ST. The state is ultimately liable for all the obligations of the bank. At end-2017, the bank had liabilities of about EUR1.7 billion (not included in Appendices A & B). Fitch believes risk stemming from these liabilities is limited for the state given the bank's assets and its conservative business profile, as well as the tight control by ST.

Economic Structure of ST, 2017

Sector (as % of GVA)	ST	Germany
Agriculture and forestry	1.6	0.67
Production	32.6	30.6
Services	65.8	68.7
Inhabitants per square kilometre	108	229

Source: Fitch Ratings, Arbeitskreis Volkswirtschaftliche Gesamtrechnung der Laender

GDP^a Per Capita of the Laender, 2017

Land	(EUR)
Hamburg	64,567
Bremen	49,570
Bavaria	45,810
Baden-Wuerttemberg	44,886
Hessen	44,804
North Rhine-Westphalia	38,645
Berlin	38,032
Lower Saxony	36,164
Saarland	35,460
Rhineland-Palatinate	35,455
Schleswig-Holstein	32,342
Saxony	29,856
Thuringia	28,747
Brandenburg	27,675
Saxony-Anhalt	27,221
Mecklenburg-Western Pomerania	26,560
Germany	39,477

^a At current prices
Source: Fitch Ratings, VGR der Laender, 2017

Unemployment Rates

(%)	2015	2016	2017	2018	0119
Germany	6.4	6.1	5.7	4.9	5.3
West	5.7	5.6	5.3	4.5	4.9
East	9.2	8.5	7.6	6.5	7.1
ST	10.2	9.6	8.1	7.3	8.0

Source: Fitch Ratings, Arbeitsagentur

Fitch views the municipalities' and the districts' support of the state as likely in case of financial hardship, although they are not legally liable to the state. Accordingly, Fitch considers municipalities' and districts' debt as contingent liabilities for the Land. At end-2017, the total debt of the municipalities and districts of ST was EUR2.7 billion.

Economy

Decreasing Population and Below Average Wealth

ST's economy has a concentration risk; it is focused on the manufacturing industry, primarily the production of intermediate goods, and the construction sector. In terms of gross value added, the construction sector accounted for 6.9% in 2016, above the German average of 4.8%, whereas the manufacturing industry's share of 25.7% of GVA was in line with the German average.

ST's wealth levels are well below the German average, with GDP per capita at EUR27,221 in 2017 (Germany: EUR 39,477). ST's real economic growth was 1%, below Germany's average of 1.9% in 1H18.

ST has one of the highest unemployment rates in the country (January 2019: 7.4%; Germany: 4.5%). The unemployment rate has declined significantly starting 2013, following the broader German trend but also driven by emigration.

According to ST's Statistics Office, ST had a population of 2,210,640 in 2018. This means the population declined by 15% in 2000-2018, and is expected to decline further by 11% to 1,990,324 by 2030. Moreover, the 25-55 age group is expected to decline by 27.7% at the same time, while the number of people aged 67 years and above is expected to increase by 17.2%. Considering this, ST will be doubly hit by demographic trends: it faces a loss of people contributing to the labour market as well as the health care sector and social insurance system, while the proportion of people requiring social aid will increase.

Against this backdrop, ST has launched an innovation strategy for 2014-2020, in which the creation of clusters in leading key sectors, such as manufacturing, health and medicine, logistics, pharmaceuticals and agriculture, is planned. This should help foster cooperation between traditional industries and scientific sectors, by gaining regional added value and generating new jobs.

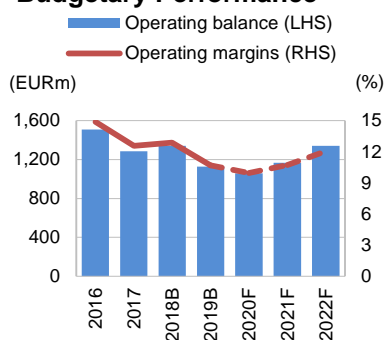
Finances

Stable Operating Performance

In 2017, ST's operating margin declined to 12.6% (2016: 14.9%). The decline was due to opex growth (3.4%) largely exceeding operating revenue growth (0.7%). Opex was well above the average of its last five years (2.8%), mainly driven by transfers to public sector units and municipalities. The current margin dropped less sharply to 8.2% (2016: 9.9%) due to continued decline in interest expenditure in 2017, and the current balance covered 68% of the state's capex requirements (2015: 89%). The state kept its surplus before debt variation (2017: 2.7%) for the sixth consecutive year. Preliminary figures for 2018 show that fiscal performance remained largely in line with that of 2017, that the current margin covered 76% of capex, and that ST reduced its direct debt by a solid 4.6% (see *Debt, Liabilities and Liquidity* above).

According to the state's budget and medium-term financial plan, the operating margin is likely to decline below last year's level to around 9.9% in 2020 and 12% in 2022. But under Fitch's baseline scenario, which considers the average growth rate for the last five years (2013-2017) of revenue and expenditure, the margin is expected to be 12.2% at end-2019 and slightly decline to about 10.2% in 2022. The average growth rate of ST's operating revenue in the last five years is below the estimated tax revenue growth of 2.7% for all the Laender in 2018. However, ST's tax revenue in 2018 is likely to be higher than forecast, and we expect tax revenue in 2019 to outperform the 2019 budget figures as well.

Budgetary Performance



b - Budget, f - Forecast
Source: Fitch Ratings, State of ST

The continued good progress of its tax revenues is very important for the state. Like the other eastern states of Berlin, Brandenburg, Mecklenburg-Western Pomerania, Saxony and Thuringia, ST is receiving additional transfers under Germany's Solidarity Pact II (development aid) and current EU grants. Transfers from the Solidarity Pact II are on a declining trend and ST will receive EUR330 million in 2019 (2018: EUR442 million) when the transfers mature. To compensate for any shortfall in transfers after 2019, it is important that taxes increase at least in line with budgetary forecasts, and that ST remains on target with its plan to limit opex growth.

Capital expenditure increased to 10.1% of total expenditure in 2018 from 8.2% in 2017. Current transfers to municipalities constitute the largest share of capex. The administration may use additional leeway resulting from operating performance for additional investments. Under the state's 2019 budget and financial plan for 2018-2022, capex's share of total expenditure may increase to about 15% in 2020 and then slightly decline to 11.5% in 2022. Capital revenue covered 49% of capex in 2018, and is expected to decrease to just above 32% in 2022. However our baseline scenario does not envisage ST will take on net new debt in 2019-2022 to finance capex, in line with the state's budget and own forecasts. Irrespective of this, ST will not be allowed to contract new debt to close funding gaps starting 2020, when the debt-brake rules apply.

ST: Parliament 2016-2021

Party	Seats
CDU	30
Alternative fuer Deutschland (AfD)	25
DIE LINKE	16
SPD	11
Green Party	5
Total	87

Source: Fitch Ratings

Management and Administration

The last parliamentary elections (Landtagswahlen) in ST took place on 13 March 2016 and the Christian Democrats (CDU) remained the ruling party. The coalition with the Social Democrats (SPD), which has been in place since 2006, was needed to form a government with an absolute majority. These parties, together with the Green Party, form the present government. The governing body of the Land consists of eight ministries and the state chancellery, with Dr Reiner Haseloff (CDU) as the prime minister. The Landtagswahlen are held every five years, and the next election takes place in 2021.

The administration manages debt prudently. Although the debt brake begins officially in 2020, it has applied the debt brake rule since 2012, and has not acquired any new borrowings since then. ST is keen to maintain disciplined expenditure by applying several cost cutting measures to gain additional leeway for investments without taking on net new debt. The financial plan for 2018-2022 expects the state's debt to decline by EUR100 million annually.

Appendix A

State of Saxony-Anhalt

(EURm)	2013	2014	2015	2016	2017
Taxes	5,612.3	5,612.4	6,075.2	6,523.1	6,661.4
Transfers received	3,705.7	3,641.0	3,553.0	3,450.3	3,362.7
Fees, fines and other operating revenue	190.0	189.9	187.4	161.4	181.0
Operating revenue	9,508.0	9,443.3	9,815.6	10,134.8	10,205.1
Operating expenditure	-8,000.7	-8,068.3	-8,320.0	-8,626.4	-8,918.3
Operating balance	1,507.3	1,375.0	1,495.6	1,508.4	1,286.8
Financial revenue	12.3	12.2	8.7	6.9	-
Interest paid	-632.4	-632.4	-550.8	-509.4	-454.7
Current balance	887.2	754.8	953.5	1,005.9	832.1
Capital revenue	597.8	662.7	970.6	669.7	683.8
Capital expenditure	-1,235.7	-1,235.8	-1,409.1	-1,124.0	-1,225.0
Capital balance	-637.9	-573.1	-438.5	-454.3	-541.2
Surplus (Deficit) before debt variation	249.3	181.7	515.0	551.6	290.9
New borrowing	4,018.0	4,207.0	4,425.2	5,233.2	4,175.3
Debt repayment	-4,278.4	-4,257.0	-5,194.4	-4,985.4	-4,311.2
Net debt movement	-260.4	-50.0	-769.2	247.8	-135.9
Overall results	-11.1	131.7	-254.2	799.4	155.0
Debt					
Short-term	-	-	-	-	-
Long-term	20,394.8	20,520.6	20,051.4	20,299.2	20,163.2
Direct debt	20,394.8	20,520.6	20,051.4	20,299.2	20,163.2
+ Other Fitch classified debt - pre-financing	118.1	118.1	82.3	82.3	78.0
Direct risk	20,512.9	20,638.7	20,133.7	20,381.5	20,241.2
- Cash, liquid deposits, sinking fund	858.9	1,173.0	-	-	-
Net direct risk	19,654.0	19,465.7	20,133.7	20,381.5	20,241.2
Guarantees and other contingent liabilities	2,742.0	2,257.4	1,905.5	1,932.7	1,921.1
Net indirect debt (public sector entities exc. gteed amount)	102.5	102.5	102.5	115.1	115.1 ^a
Net overall risk	22,498.5	21,825.6	22,141.7	22,429.3	22,277.4
Memo for direct debt					
% in foreign currency	-	-	-	-	-
% issued debt	100.0	100.0	100.0	100.0	100.0
% fixed interest rate debt	86.7	84.8	86.8	85.8	89.4

^a Data partly as of 2016 and prior years
Source: Fitch Ratings, State of Saxony-Anhalt

Appendix B

State of Saxony-Anhalt

	2013	2014	2015	2016	2017
Fiscal performance ratios					
Operating balance/operating revenue (%)	15.85	14.56	15.24	14.88	12.61
Current balance/current revenue ^a (%)	9.32	7.98	9.71	9.92	8.15
Surplus (deficit) before debt variation/total revenue ^b (%)	2.46	1.8	4.77	5.1	2.67
Overall results/total revenue (%)	-0.11	1.3	-2.35	7.39	1.42
Operating revenue growth (annual % change)	2.80	-0.68	3.94	3.25	0.69
Operating expenditure growth (annual % change)	2.79	0.84	3.12	3.68	3.38
Current balance growth (annual % change)	13.63	-14.92	26.32	5.5	-17.28
Debt ratios					
Direct debt growth (annual % change)	-1.14	0.62	-2.29	1.24	-0.67
Interest paid/operating revenue (%)	6.65	6.7	5.61	5.03	4.46
Operating balance/Interest paid (x)	2.38	2.17	2.72	2.96	2.83
Direct debt servicing/current revenue (%)	51.58	51.71	58.48	54.18	46.7
Direct debt servicing/operating balance (%)	325.8	355.59	384.14	364.28	370.37
Direct debt/current revenue (%)	214.22	217.02	204.1	200.16	197.58
Direct risk/current revenue (%)	215.46	218.27	204.94	200.97	198.39
Direct debt/current balance (yrs)	22.99	27.19	21.03	20.18	24.23
Net overall risk/current revenue (%)	236.32	230.82	225.38	221.16	218.34
Direct risk/current balance (yrs)	23.12	27.34	21.12	20.26	24.33
Direct debt/GDP (%)	37.33	36.55	34.74	34.36	33.22
Direct debt per capita (EUR)	8,879	9,112	8,952	9,058	8,997
Revenue ratios					
Operating revenue/budget operating revenue (%)	104.1	100.87	104.39	105.62	98.18
Tax revenue/operating revenue (%)	59.03	59.43	61.89	64.36	65.28
Modifiable tax revenue/total tax revenue (%)	-	-	-	-	-
Current transfers received/operating revenue (%)	38.97	38.56	36.2	34.04	32.95
Operating revenue/total revenue ^b (%)	93.97	93.33	90.93	93.74	93.72
Total revenue ^b per capita (EUR)	4,405	4,493	4,819	4,824	4,859
Expenditure ratios					
Operating expenditure/budget operating expenditure (%)	101.37	99.21	102.63	100.71	101.61
Staff expenditure/operating expenditure (%)	30.6	30.34	29.95	29.7	28.58
Current transfer made/operating expenditure (%)	58.1	58.45	58.57	58.37	59.71
Capital expenditure/budget capital expenditure (%)	90.69	65.67	109.99	64.8	79.84
Capital expenditure/total expenditure (%)	8.73	8.71	9.11	7.37	8.22
Capital expenditure/local GDP (%)	2.26	2.2	2.44	1.9	2.02
Total expenditure per capita (EUR)	6,159	6,303	6,908	6,803	6,653
Capital expenditure financing					
Current balance/capital expenditure (%)	71.8	61.08	67.67	89.49	67.93
Capital revenue/capital expenditure (%)	48.38	53.63	68.88	59.58	55.82
Net debt movement/capital expenditure (%)	-21.07	-4.05	-54.59	22.05	-11.09

n.a.: Not available

^a Includes financial revenue

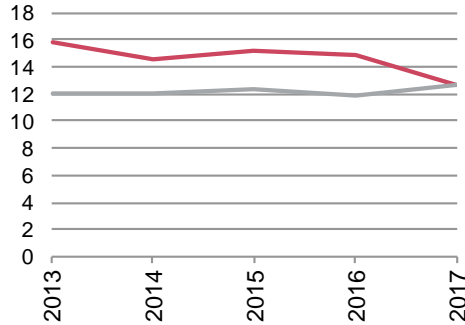
^b Excluding new borrowing

Source: Fitch Ratings, State of Saxony-Anhalt

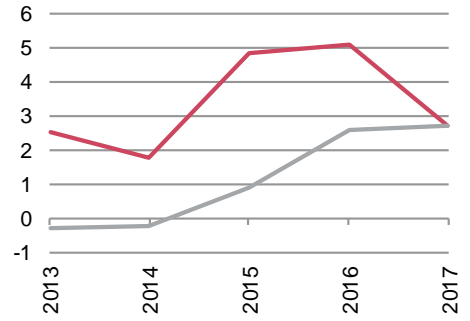
Appendix C
State of Saxony-Anhalt

Peer Comparison

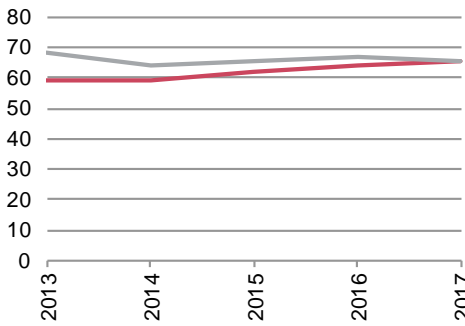
Operating Balance
% Operating revenue



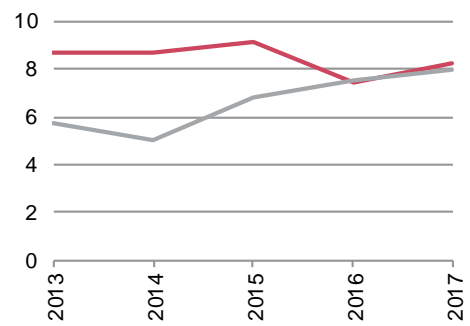
Surplus (Deficit)
% Total revenue



Taxes
% Operating revenue



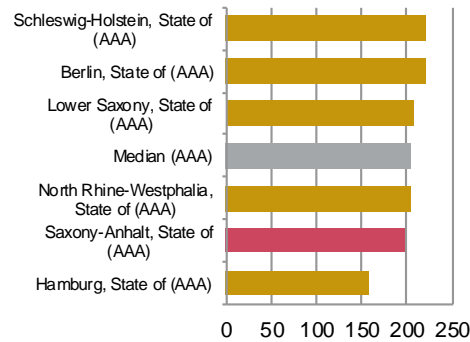
Capital Expenditure
% Total expenditure



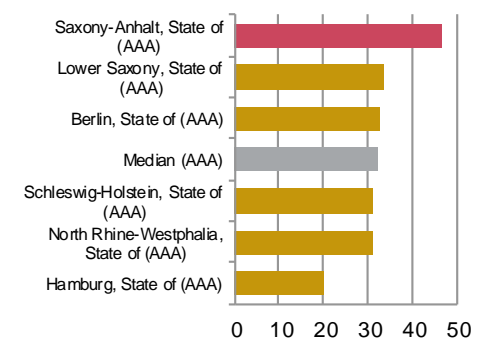
— State of Saxony-Anhalt

— AAA Peer Group Median

Debt To Current Revenue (%) 2017



Debt Servicing To Current Revenue (%) 2017



Source: Fitch Ratings

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