

## CREDIT OPINION

21 December 2021



### RATINGS

#### Saxony-Anhalt, Land of

Domicile	Germany
Long Term Rating	Aa1
Type	Senior Unsecured - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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# Land of Saxony-Anhalt (Germany)

## Update to credit analysis

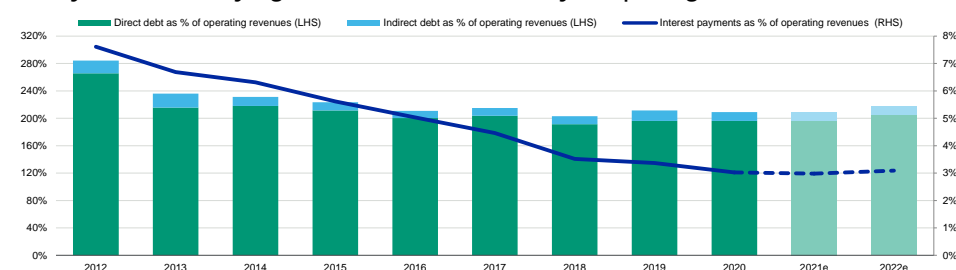
### Summary

The credit profile of the [Land of Saxony-Anhalt](#) (Aa1 stable) reflects the expected economic recovery, the very supportive federal equalisation system, its overall strong governance and management practices, and its good access to capital markets. At the same time, it takes into account the Land's very high debt, which is likely to peak at nearly 220% of operating revenue in 2022, and low fiscal flexibility. The Land will continue to report financial deficits for at least the following two years.

The credit profile also reflects the very high likelihood that the [Government of Germany](#) (Aaa stable) would provide support if the Land were to face acute liquidity stress.

Exhibit 1

### Saxony-Anhalt has very high debt, but debt affordability is improving



2021-22e - Moody's estimate.

Sources: Issuer, German Statistics Office and Moody's Investors Service

### Credit strengths

- » Strong financial equalisation system, which ensures federal transfers and revenue predictability
- » Sound debt management and good capital market access

### Credit challenges

- » Budgetary pressure, which weighs on financial performance
- » Very high debt burden
- » Modest tax base, with limited financial flexibility to raise additional revenue

## Rating outlook

The stable rating outlook reflects our expectation that Saxony-Anhalt will be able to gradually return to balanced budgets and declining debt burdens after the effects of the coronavirus pandemic abate.

## Factors that could lead to an upgrade

A substantial reduction in the Land's debt burden, combined with an improvement in its financial performance, could lead to a rating upgrade.

## Factors that could lead to a downgrade

A significant deterioration in Saxony-Anhalt's fiscal metrics beyond our expectation, leading to an abrupt increase in its debt, could trigger a downgrade. A downgrade of Germany's sovereign rating or a change in the fundamental support structure for the Länder sector could also result in a downgrade of the Land's rating.

## Key indicators

Exhibit 2

### Land of Saxony-Anhalt

	2017	2018	2019	2020	2021e	2022e
Population (in mn)	2.2	2.2	2.2	2.2	2.2	2.2
GDP per capita (in EUR)	27,261	27,997	29,123	28,652	29,800	31,300
GDP per capita as % of national average	69.1	69.2	70.2	71.5	70.9	70.2
Intergovernmental revenues as % of operating revenues	32.9	31.0	29.8	33.2	32.0	31.0
Interest payments as % of operating revenues	4.5	3.5	3.4	3.0	3.0	3.1
Gross operating balance (GOB) as % of operating revenues	7.2	8.2	8.4	0.1	2.1	4.0
Capital expenses (Capex) as % of total expenses	11.5	11.8	14.5	12.6	10.7	14.5
Financing result (surplus or deficit) as % of total revenues	1.7	1.8	-0.8	-7.9	-2.8	-9.2
Net direct and indirect debt (NDID) as % of operating revenues	215.1	203.1	211.4	209.2	208.5	217.9
Short-term direct debt as % of total direct debt	16.8	21.4	13.9	13.7	5.5	7.5

2021-22e - Moody's forecast.

Sources: Issuer, German Statistics Office and Moody's Investors Service

## Detailed credit considerations

The credit profile of Saxony-Anhalt, as expressed in its Aa1 stable rating, combines a Baseline Credit Assessment (BCA) of aa3 and a very high likelihood of extraordinary support from the federal government in the event that the Land faces acute liquidity stress.

### Baseline Credit Assessment

#### Strong financial equalisation system, which ensures federal transfers and revenue predictability

The institutional framework, which encompasses the legislative background and financial flexibility, is reflected in the arrangements determining intergovernmental relations at all levels, and jurisdictional powers and responsibilities. The framework is mature and highly developed, with minor changes occurring at a measured pace and in a transparent manner.

Germany has one of the strongest equalisation systems worldwide. The German federal constitution guarantees that Länder receive appropriate levels of funding and prescribes high fiscal homogeneity among them. Under the financial equalisation system, Saxony-Anhalt benefits from special financial subsidies because of its status as a financially relatively weaker region. With the amended financial equalisation scheme from 2020, the Länder sector (at the expense of the federal government) benefitted financially because of a higher share in value-added tax revenue, higher general federal transfers and higher supplementary transfers. Intergovernmental revenue makes up nearly one-third of the Land's revenue.

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Another institutional factor to align Länder budgets and discipline is a constitutional requirement (debt-brake mechanism) that mandates each region to maintain structurally balanced budgets from 2020. However, the federal constitutional requirement has been suspended for 2020, 2021 and 2022 because of the extraordinary emergency situation, which allows for the funding of measures to alleviate the economic and social impact of the pandemic.

#### **Sound debt management and good capital market access**

Saxony-Anhalt's reporting is transparent, timely and accurate, while budgetary management is characterised by a high degree of prudence. Like other German Länder, the Land shows strong institutional capacity.

Active debt management and sound liquidity ease the burden of Saxony-Anhalt's relatively high debt-service requirements. Foreign-currency risks are fully hedged, while the Land's outstanding debt has an average maturity of around nine years. More than 90% of debt has a fixed interest rate, with limited interest rate risk, but there is some exposure to derivatives. The Land actively uses forward interest hedges and thereby has locked in very low interest rates for a significant portion of its maturities.

The share of short-term debt has been declining over the recent years, from about 20% of direct debt five years ago to less than 10% of direct debt in 2021-22. We observe lower volume of maturing debt, thanks to its tendency towards longer maturities when refinancing maturing debt in recent years. We also note a lower utilisation of Saxony-Anhalt's commercial paper (CP) programme, a unique feature among German Länder. The Land uses its CP programme to maintain access to various investor groups and invests its excess liquidity at highly rated counterparties within a year.

The Land has financial relationships with a broad range of investors, which are willing to grant continued access to liquidity based on their confidence in the German Länder solidarity system. Its bonds are eligible for the European Central Bank's current purchasing programmes, which supports the very low interest levels.

In the money markets, the Land has access to the inter-Länder liquidity pool, whereby individual Länder offer their surplus cash to other Länder, as well as access to the German state financing agency (BRD Finanzagentur GmbH).

Interest expenses accounted for a modest 3.0% of operating revenue in 2020, having decreased steadily and significantly from levels of up to 9% in the past decade. Saxony-Anhalt's overall amortisation profile is relatively balanced, and its access to capital markets is very good, based on a broad set of instruments and a sophisticated state treasury.

#### **Budgetary pressure weighs on financial performance**

The pandemic and the resulting economic and financial effects have burdened Saxony-Anhalt's finances, requiring several budget updates. A recently decided budget update for 2021 indicates additional debt funding requirements to cover higher spending needs, such as healthcare-related costs or other pandemic-related spending.

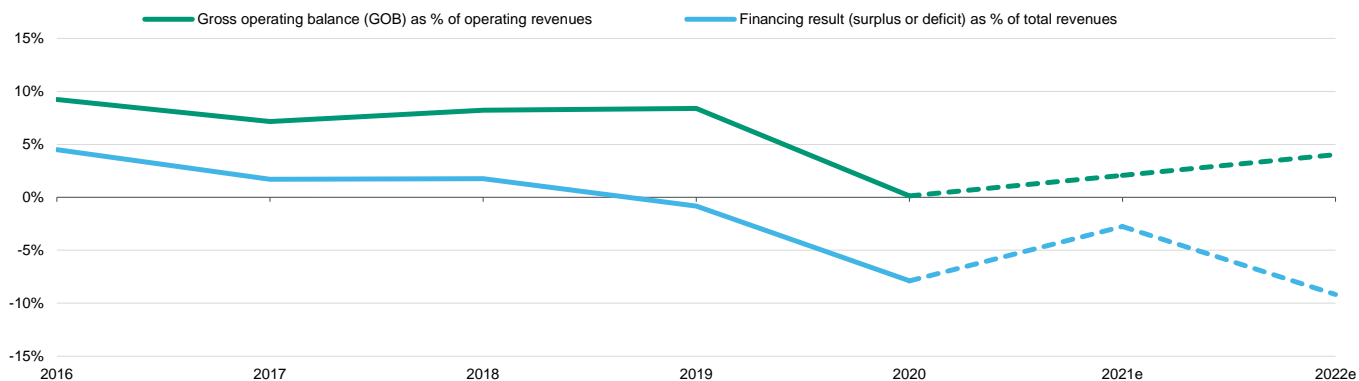
For 2021 and 2022, we expect the uncertainty surrounding the predictability and planning of budget and execution to persist as the pandemic evolves. Saxony-Anhalt's financial performance will remain strained because of a volatile economic recovery. A steady economic recovery will depend on effective management of the ongoing health crisis, progress in immunisation levels and policy support from the central government, particularly as the [Omicron variant poses hurdles to global recovery as new restrictions take effect](#).

In 2020, the Land's operating balance dropped significantly to 0.1% of operating revenue, down from 8.4% a year earlier. We expect only a slight improvement to 2% of operating revenue in 2021, with further steady, although slow, improvement thereafter.

In 2020, tax revenue fell as a result of the pandemic and the related slowdown in economic activity. However, because of the central government transfers, which were higher than previously expected, the Land was able to limit the financial impact that year. With economic recovery, [tax revenue will start to grow steadily](#) from 2021 onwards.

The Land reported a financial deficit of 8% of total revenue in 2020, following a nearly balanced budget in 2019. We expect the financial result to remain negative at least two more years.

Exhibit 3

**The pandemic is driving the weakening operating and financial performance**

2021-22e - Moody's estimate.

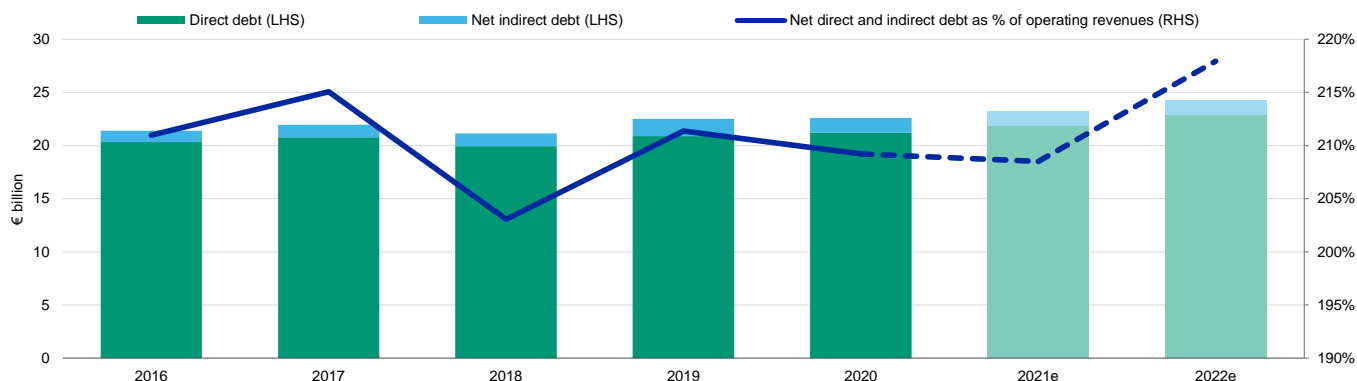
Sources: Issuer, German Statistics Office and Moody's Investors Service

**Very high debt burden**

The Land's direct debt remained stable at 196% of operating revenue as of year-end 2020, and we expect it remains stable as of 2021. We expect direct debt to peak at more than 200% of operating revenue in 2022, before declining slowly thereafter. The ratio is very high in an international context and is somewhat above the German Länder average.

If we include indirect debt (for example, some guarantees), Saxony-Anhalt's net direct and indirect debt (NDID) ratio stands at 209% of operating revenue as of year-end 2020, and we expect it remains stable in 2021. The Land's indirect debt mainly consists of guarantees for subsidiary company debt, housing projects, and small and medium-sized businesses. As the Land is planning to issue new debt to finance a special fund (Sondervermögen), we expect the NDID ratio to peak at nearly 220% of operating revenue in 2022 before starting to decline slowly.

Exhibit 4

**Saxony-Anhalt's very high debt levels to increase temporarily again because of the pandemic**

2021-22e - Moody's estimate.

Sources: Issuer, German Statistics Office and Moody's Investors Service

Saxony-Anhalt's contingent liabilities are very limited compared with those of most German Länder. The Land holds a relatively low number of participations in companies and other entities, which overall are self-supporting. Saxony-Anhalt holds and provides guarantees to a regional development bank (Investitionsbank Sachsen-Anhalt), which provides services to local small and medium-sized enterprises, supports real estate development and lends to the local government sector. Investitionsbank Sachsen-Anhalt is part of [Norddeutsche Landesbank GZ](#) (Nord/LB, A3 stable), in which the Land holds a small stake of 7%. In 2021, the Land decided to take steps to set up Investitionsbank Sachsen-Anhalt as an individual institution (that is legally separate from Nord/LB)<sup>1</sup>.

Similar to those of all German Länder, Saxony-Anhalt's pension obligations are only partially funded. The Land established a pension fund and aims to cover obligations of all newly employed civil servants from 2007. Saxony-Anhalt's unfunded obligations are significantly lower than those of many West German Länder. In general, pension obligations could limit budget flexibility and affect a region's creditworthiness. However, we regard the setup of a pension fund as a forward-looking first step towards addressing the budget impact of unfunded liabilities.

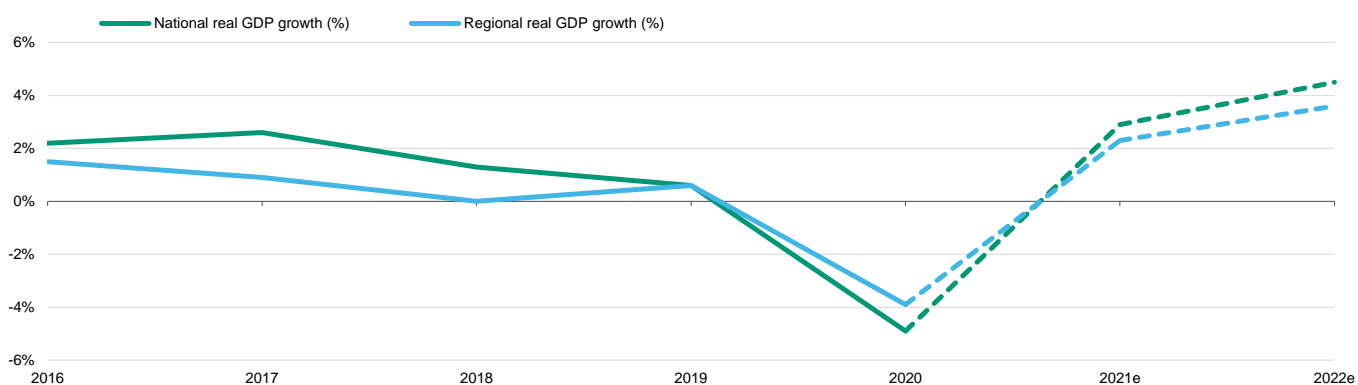
#### Modest tax base, with limited financial flexibility for raising additional revenue

In general, Saxony-Anhalt, like other German Länder, has little flexibility to adjust revenue or expenditure in its budget. Significant budgetary pressure persists for Saxony-Anhalt, although its budgetary discipline is good.

Saxony-Anhalt's economy is still in transition, but the Land's restructuring efforts are taking effect. Growth remains weaker than that for the western Länder. Overall, GDP growth is often slightly below the national rate (see Exhibit 4), unlike in 2020, when the German economic growth declined by more than 4%, while Saxony-Anhalt's real GDP declined by 3.9%. The Land's total GDP accounts for only 2% of Germany's national GDP, and Saxony-Anhalt's per capita GDP is around 70% of the German average.

Exhibit 5

#### Saxony-Anhalt's economy has been somewhat less burdened by the pandemic unlike Germany as a whole



2021-22e - Moody's forecast.

Sources: Issuer, German Statistics Office and Moody's Investors Service

The restructuring of the economy following the reunification of Germany in 1990 had an impact on population trends, with the population dropping to 2.2 million in 2015 from 2.6 million in 2005 and 2.8 million in 1995. The pace of outward migration has slowed, although it remains potentially negative for the economy and for the budget because both the original tax base and transfer payments are based on population figures.

#### Extraordinary support considerations

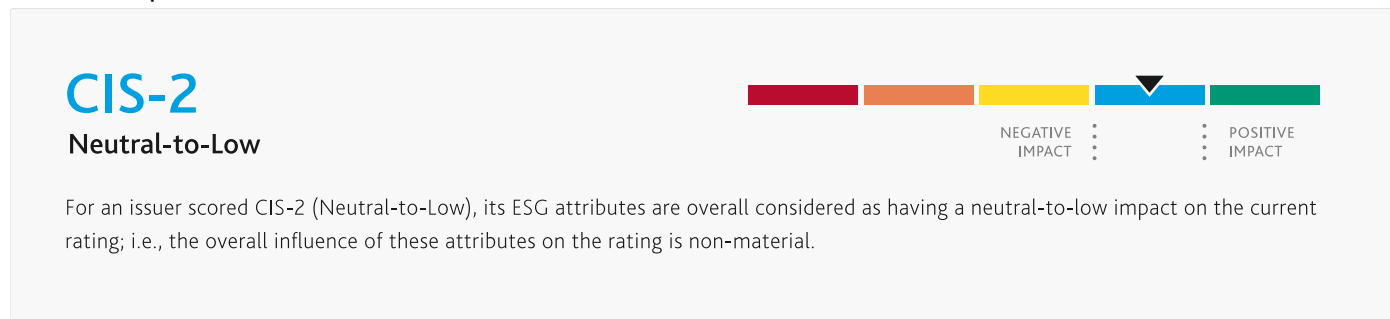
The very high likelihood of extraordinary support from the Federal Government of Germany reflects our assessment of the high reputational risk for Germany as a whole in case of default by a Land, and the Bundestreuekonzept, according to which all German Länder must express mutual solidarity in the event that one of them or the Federal Republic faces a severe budgetary crisis. Also, the debt volumes and structure of German Länder are extremely complex and an event of nonpayment would be considered to have a corresponding impact on Germany as a whole. In our opinion, the principle of solidarity is firmly entrenched in the Grundgesetz (basic law), thereby providing a reassurance that, if required, financial support for a member in distress would be forthcoming. We have, therefore, incorporated two notches of uplift, to Aa1 from aa3, into Saxony-Anhalt's final rating.

## ESG considerations

### Land of Saxony-Anhalt's ESG Credit Impact Score is neutral-to-low CIS-2

Exhibit 6

#### ESG Credit Impact Score



Source: Moody's Investors Service

The Land of Saxony-Anhalt's ESG Credit Impact Score is neutral-to-low (**CIS-2**), reflecting neutral-to-low exposure to environmental risks and moderately negative social risk, along with very strong governance and policy effectiveness that mitigates the region's susceptibility to these risks.

Exhibit 7

#### ESG Issuer Profile Scores



Source: Moody's Investors Service

### Environmental

The environmental issuer profile score is neutral-to-low (**E-2**), reflecting neutral-to-low risks for all environmental factors. Despite its traditionally high exposure to heavy industries, the Land's carbon emission levels are somewhat above the per capita German average, with Saxony-Anhalt promoting carbon transition schemes.

### Social

The moderately negative social issuer profile score (**S-3**) reflects risks foremost on demographics (which scores highly negative) as well as labour and income (which scores moderately negative), somewhat counterbalanced by broadly neutral-to-low risks from most other social factors, except for health and safety (which scores positive). The main risk is driven by the region's relatively adverse demographics with migration and age structure weaker than for Germany overall. The trend of ageing population will result in declining labour supply and higher pension and social cost. We view the coronavirus pandemic as a social risk under our ESG framework, given the substantial implications for public health and safety in the region.

### Governance

The positive governance issuer profile score (**G-1**) reflects the nationally very strong institutional and governance framework. Budgetary discipline in Germany is a constitutional requirement, which requires each of the regions to maintain structurally balanced budgets. Budget planning in Saxony-Anhalt is prudent, transparent and predictable.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on [www.moody.com](http://www.moody.com). To view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

All of these considerations are further discussed in the Detailed credit considerations section above. Our approach to ESG is explained in our report on how the [scores depict limited impact of ESG factors in advanced economy RLGs, negative in emerging markets](#) and our cross-sector methodology [General Principles for Assessing Environmental, Social and Governance Risks Methodology](#).

## Rating methodology and scorecard factors

The assigned BCA of aa3 is in line with the scorecard-indicated BCA. The matrix-generated BCA of aa3 reflects an Idiosyncratic Risk score of 4 (presented below) on a 1-9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and a Systemic Risk score of Aaa, as reflected in the sovereign bond rating of Germany.

For details about our rating approach, please refer to [Rating Methodology: Regional and Local Governments](#), published on 16 January 2018.

Exhibit 8

### Land of Saxony-Anhalt Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
<b>Factor 1: Economic Fundamentals</b>				<b>6.60</b>	<b>20%</b>	<b>1.32</b>
Economic Strength [1]	9	70.77%	70%			
Economic Volatility	1		30%			
<b>Factor 2: Institutional Framework</b>				<b>3</b>	<b>20%</b>	<b>0.60</b>
Legislative Background	1		50%			
Financial Flexibility	5		50%			
<b>Factor 3: Financial Position</b>				<b>4.50</b>	<b>30%</b>	<b>1.35</b>
Operating Margin [2]	5	3.65%	12.5%			
Interest Burden [3]	5	3.19%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	9	209.21%	25%			
Debt Structure [5]	3	13.71%	25%			
<b>Factor 4: Governance and Management</b>				<b>1</b>	<b>30%</b>	<b>0.30</b>
Risk Controls and Financial Management	1					
Investment and Debt Management	1					
Transparency and Disclosure	1					
<b>Idiosyncratic Risk Assessment</b>						<b>3.57 (4)</b>
<b>Systemic Risk Assessment</b>						<b>Aaa</b>
<b>Suggested BCA</b>						<b>aa3</b>

[1] Local GDP per capita as a percentage of national GDP per capita.

[2] Gross operating balance/operating revenue.

[3] Interest payments/operating revenue.

[4] Net direct and indirect debt/operating revenue.

[5] Short-term direct debt/total direct debt.

Source: Moody's Investors Service, fiscal 2020

## Ratings

Exhibit 9

Category	Moody's Rating
<b>SAXONY-ANHALT, LAND OF</b>	
Outlook	Stable
Senior Unsecured	Aa1
Commercial Paper -Dom Curr	P-1
Other Short Term -Dom Curr	(P)P-1

Source: Moody's Investors Service

## Endnotes

1 We do not count guarantees provided for Investitionsbank Sachsen-Anhalt as indirect debt as we view them as contingent liabilities.

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