

Land of Berlin Rating Report



STABLE
OUTLOOK
AAA

Credit strengths

- Highly supportive institutional framework
- Commitment to fiscal consolidation
- Excellent capital market access
- Prudent liquidity management
- Favourable debt profile
- Downward debt trajectory

Credit weaknesses

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

Ratings & Outlook

Foreign currency

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

Local currency

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

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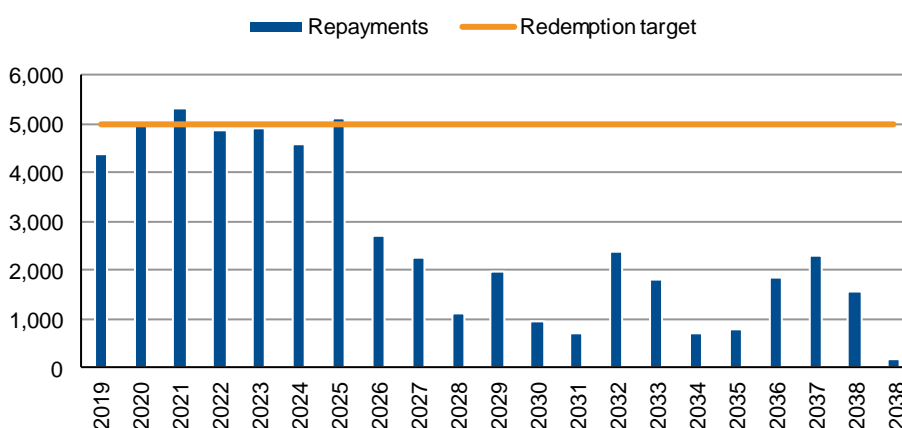
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Rating rationale and Outlook: The AAA rating reflects the very supportive German institutional framework under which the Land of Berlin operates, sustained budgetary surpluses and the administration's commitment to fiscal consolidation, the firm downward trajectory of the Land's debt burden, prudent liquidity management and solid economic growth. However, these supportive factors are balanced by challenges related to still-high direct debt, unfunded pension liabilities and limited fiscal flexibility. In addition, although Berlin's contingent liabilities are sizeable, the risks they pose to the city's balance sheet are mostly low. The Stable Outlook reflects our assessment that the risks Berlin faces remain well balanced.

The German institutional framework is characterised by a very strong revenue equalisation system, together with the federal solidarity principle. This ensures a high degree of cohesion among the Länder and prevents individual Länder from getting into financial difficulties. This view is underpinned by highly predictable cash flows, good access to short-term liquidity and deep capital markets, making liquidity risks negligible. It is our opinion that these factors align the credit profiles of the Länder and the federal government (the Bund, AAA, Stable Outlook).

Figure 1: Debt redemption schedule (EUR m)



Source: Senatsverwaltung für Finanzen Land Berlin, Scope Ratings GmbH

Positive rating-change drivers

Not applicable

Negative rating-change drivers

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

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Institutional framework

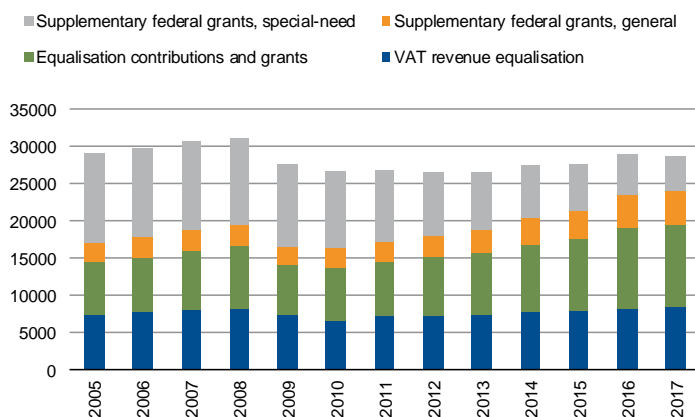
Extensive financial equalisation, stable solidarity system

The Land of Berlin, like all Germany's Länder¹, benefits from a mature institutional framework including a unique and well-designed solidarity system. The key elements of the system are: i) a strong multi-step revenue equalisation mechanism; ii) a crucial national role for each Land in the delivery of public services and governance functions; iii) the ability of the Länder to influence arrangements and reforms made by the federal government as part of an intergovernmental system including revenue and expenditure mandate sharing; and iv) a solidarity principle² that ensures extraordinary system support in exceptional circumstances.

Strong framework aligns credit profiles between the Länder and the federal government

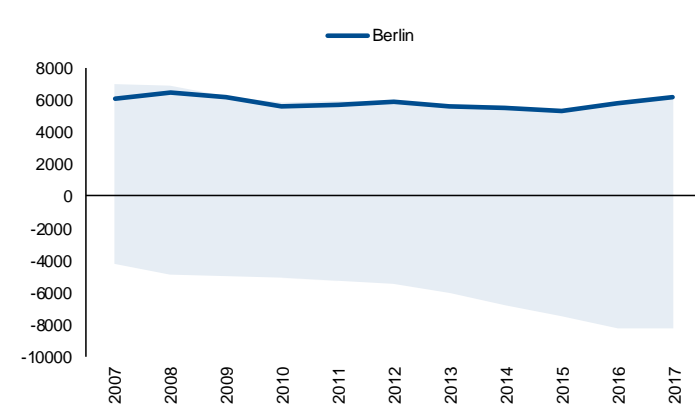
We view the institutional framework under which the German Länder operate as one of the strongest among European sub-sovereigns. The framework ensures the robust overall adequacy of revenues to cover expenditures, underpinned by safe, predictable cash management and strong access to short-term liquidity and deep capital markets. In addition, the framework is highly predictable with small changes occurring at a measured pace and in a transparent manner, effective control levels, and the institutionalisation of budgetary processes and financial multi-year planning, resulting in an overall alignment of credit profiles between the Länder and the federal government³.

Figure 2: Distribution of equalisation flows, EUR m



Source: Federal Ministry of Finance, Federal Statistical Office, Scope Ratings GmbH; *price-adjusted, chain-linked

Figure 3: Equalisation flows & consolidation aid, EUR m



Source: Federal Ministry of Finance, Scope Ratings GmbH
NB: The shaded area is the spread between the highest and the lowest data points.

Berlin has been a long-term recipient of payments from the equalisation system

The highly effective revenue equalisation mechanism is designed to protect all of the Länder against revenue shortfalls and to bring the financial strength of weaker German Länder closer to that of stronger ones. However, the requirement to contribute to weaker Länder limits revenue flexibility. In addition, the equalisation mechanism delinks a Land's credit profile from its regional economic fundamental metrics, aligning them instead with the macroeconomic characteristics of the sovereign. The Land of Berlin has been a long-term recipient of payments from the German revenue equalisation system (see **Figure 3**), reflecting its location in the former East Germany, its special status as a 'city-state' and its lower financial strength before equalisation.

Strong ability to influence reforms of the institutional framework

At the end of 2016, the German government and the Länder agreed to restructure the equalisation system, well in advance of the introduction of new regulations in 2020. Under

¹ We use the colloquial German terms to refer to the German federal states, individually as 'Land' and collectively as 'Länder'. We also footnote translations of important concepts in German with the original German term.

² Bundestreueprinzip

³ German Länder: Credit quality driven by strong institutional framework (Scope Ratings, 17 July 2017).

the new system, VAT equalisation between the Länder will be redefined, including the termination of the solidarity pact with Eastern German Länder and a consolidated redistribution of VAT revenues. The new scheme includes a redistribution of the Länder's VAT share supplemented by a higher VAT share from the federal level. This will result in additional revenues for each Land overall, thereby ensuring the high acceptance of the new system. The reform of the equalisation system will potentially lead to a stronger alignment of the Länder with the federal government because the Bund will have more influence on legislative and planning processes that were formerly authorised only by the Länder, particularly in the field of IT and infrastructure. Previously, the regional governments had rejected conditionality clauses with the argument that conditionality would erode their political authority and budgetary independence. It is our view that: i) the reform process strengthens the high predictability of the German framework; and ii) the reform outcome demonstrates the strong bargaining position of the Länder as well as their considerable ability to influence reforms to the institutional framework.

Debt brake implementation in 2020

From 2020 onwards, a 'debt brake-mechanism' will also be implemented⁴. None of the Länder will be allowed to run structural financing deficits. However, the framework does allow new borrowing during economic downturns or, for example, in the event of natural disasters. The finances of the Länder and their compliance with debt limits is monitored by the Stability Council which was 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 Bund and Länder. It comprises the Länder's finance ministers and the federal ministers of finance and economic affairs. We expect the introduction of the debt brake rule to further align the budgets of the Länder with the federal level based on their eligibility to resort to federal funds in cases of critical budgetary situations.

The 'Bundestreueprinzip' as an implicit bail-out rule

In five instances, the Länder of Bremen (1992, 2006), Saarland (1992, 2005) and Berlin (2002) claimed their right to emergency support from the federal government on the basis of extreme budgetary situations. The claims were approved by the court on the grounds of the established 'Bundestreueprinzip', which states that the Länder and the Bund are required to provide each other with mutual support. In its decision on Berlin the court denied the claim to federal support, but the judges decided that federal emergency support is possible as ultima ratio if the budget and/or debt situation is assessed as extreme compared to that of other Länder. It is our opinion that this interpretation of the allegiance principle can be viewed as an implicit bail-out rule, which requires federal support to be provided in times of budgetary stress.

Cash and liquidity management improves stability

Finally, the Länder also benefit from excellent access to short-term liquidity and capital markets, reflecting the depth of the German capital market and sophisticated treasury management. Liquidity management plans are set for one year and based on predictable cash flows. Additional continued access to liquidity to bridge 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. Furthermore, while cash outflows are typically not subject to large deviations, we believe that inflows are calculated conservatively.

Economy and social profile

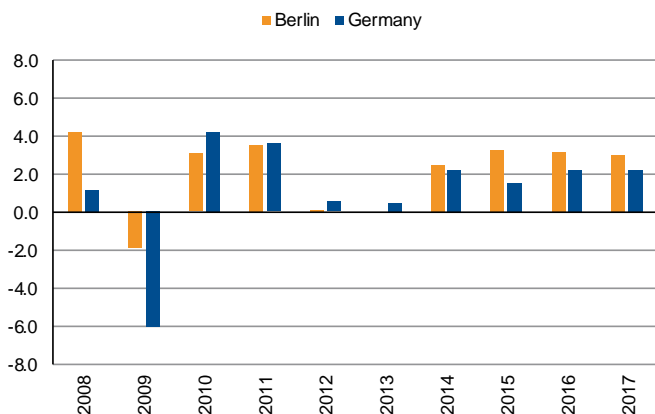
Favourable demographics

Berlin benefits from a favourable social profile and positive demographics. With around 3.6m inhabitants (based on the population census for 2011), the capital of Germany is by far the largest city in Germany. The population has been growing dynamically, by around

⁴ 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 recessions or natural disasters provided they pass respective legislation at the Land level.

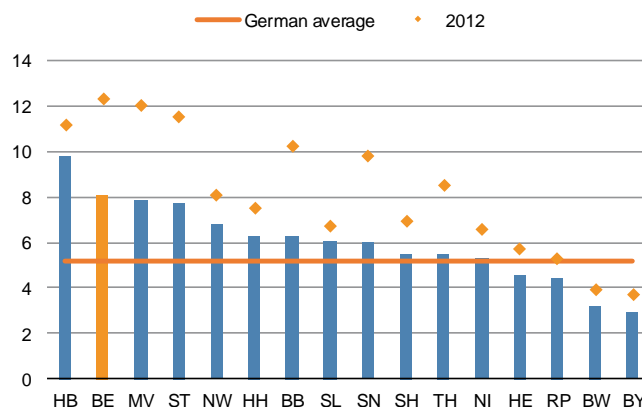
40,000-50,000 inhabitants annually from 2011 to 2018, mainly due to net immigration from other European countries, reflecting Berlin's overall attractiveness compared to other European capitals. Berlin's population is expected to reach more than 3.8m by 2030⁵.

Figure 4: Real GDP growth, 2008-2019



Source: Senatsverwaltung für Wirtschaft, Energie und Betriebe, Scope Ratings GmbH

Figure 5: Unemployment rate, % of total labour force



Source: Regionaldirektion Berlin-Brandenburg der Bundesagentur für Arbeit, Federal Statistical Office, Scope Ratings GmbH

Robust economic growth driven by the service sector

Berlin also benefits from strong economic expansion, with real GDP growth exceeding the German average since 2014 (see **Figure 4**). In 2018, Berlin posted high real GDP growth for the fifth year in a row, at 3.1%. Strong employment growth in the service sector, which accounts for 85% of gross value added (versus 69% nationally), predominantly in the information and communication sector, as well as trade, transport and financial services, has been the main driver of growth. As a result, GDP per capita rose to 99.3% of the German average in 2018 or 119% of the euro-area average. We expect Berlin's economy to continue to grow by 2% in 2019, well above the national average growth rate of around 1%.

Strong employment growth

The unemployment rate declined further to 7.8% in March 2019 (2.7 percentage points above the national average), steadily down from 8.5% one year before and significantly down from 12.3% in 2012 (see **Figure 5**). In 2008, the number of persons employed increased by 47,900 or 2.5%, exceeding the two million mark for the first time. We expect the unemployment rate to continue its declining trend but to remain above average, balancing strong employment growth with the constant flow of jobseekers to the German capital.

Strong investment growth, with a high number of start-ups

The favourable development of Berlin's labour market was underpinned by the high number of start-ups in the capital, reflected by 40,000 registrations for new companies in 2018. Berlin benefits from the highest number of start-ups per capita among the Länder, aided by strong innovation and favourable framework conditions, with a focus on software development. Berlin continues to attract investment, in keeping with its status as a capital city with strong growth. Multinational enterprises have increased their presence steadily. In addition, Berlin has also become a leading tourist destination.

Budgetary performance and flexibility

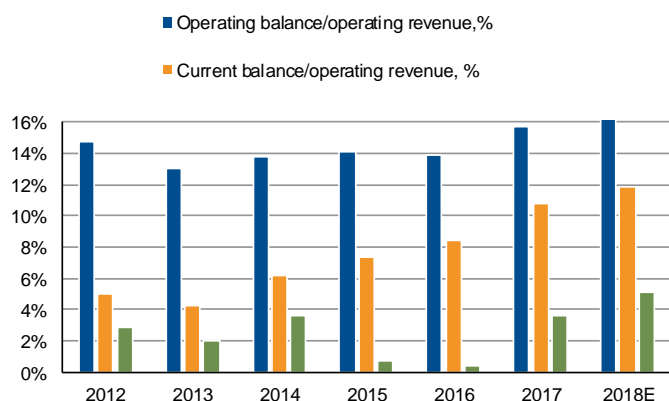
Strict fiscal commitment, successful consolidation efforts

Berlin's sound budgetary performance has been underpinned by controlled expenditure growth since 2012 with high operating surpluses averaging 14.5% of operating revenues. Constantly high operating surpluses enhanced Berlin's ability not only to fund its

⁵ <https://www.stadtentwicklung.berlin.de/planen/bevoelkerungsprognose/>

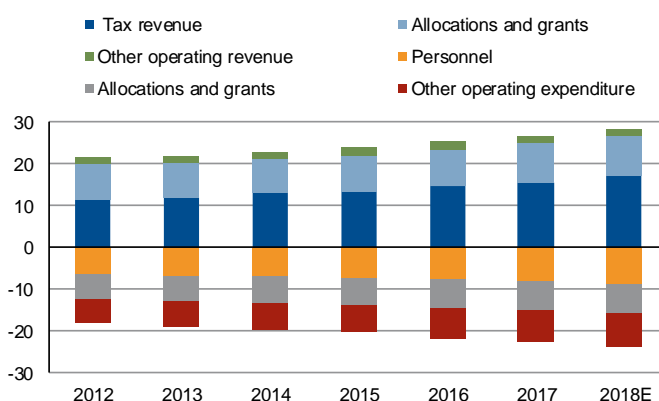
operating expenses with operating revenue but to realise extra revenue to cover interest payments and some capital expenditure. As a result of Berlin's strict commitment to fiscal discipline, the balance after investment activities and interest payments has remained positive since 2012 (averaging a surplus of 2.5% of total revenues), supporting a gradual reduction of the Land's direct debt (see **Figure 6**). The recent Stability Council monitoring report (December 2018) stated that Berlin is (i) compliant with its fiscal consolidation requirements and (ii) not at risk of experiencing budgetary emergencies.

Figure 6: Budgetary performance



Source: Senatsverwaltung für Finanzen Land Berlin, Scope Ratings GmbH

Figure 7: Components of operating balance (EUR bn)



Source: Senatsverwaltung für Finanzen Land Berlin, Scope Ratings GmbH

Further improving budgetary performance in 2018

In 2018, Berlin continued its good budgetary performance and outperformed its budgetary targets despite the rising demand for social services. As a result, Berlin's operating surplus rose to 16.2% of operating revenues in 2018 from 15.7% in 2017 and the budgetary surplus (before debt movement) rose to 5.1% of total revenue in 2018 from 3.6% in 2017, also demonstrating sustainably balanced operating accounts. Berlin has benefitted from higher-than-budgeted tax revenues, a lower interest payment burden and solid expenditure management. For example, interest payments are budgeted for on a conservative basis, social transfers to Berlin's districts regularly include a buffer for contingency purposes and expenditure growth is capped by the growth of revenues to ensure compliance with debt brake rule requirements. In addition, investments were lower than budgeted for in 2018, reflecting capacity constraints in the regional construction sector. The budgetary surplus of EUR 2.4bn was used for net debt redemptions (EUR 766m) and various allocations to reserves for: i) infrastructure investments (EUR 770m); ii) the pension contribution plan (EUR 100m); and iii) the SIWANA⁶ fund (EUR 800, Sondervermögen Infrastruktur der Wachsenden Stadt und Nachhaltigkeitsfonds), resulting in a final financing surplus of EUR 1.5bn in 2018.

Infrastructure bottlenecks despite some leeway

The Senate must balance consolidation requirements with infrastructure investment needs. The Land of Berlin experiences constant net immigration from foreign countries, the extent of which is difficult to anticipate. At the same time, investment in the public transportation network and social housing has been subdued in the past. To cope with the city's population growth and constrained property market, Berlin increased operating and investment expenditure to expand its social infrastructure in 2018. Berlin's government-related entities sector significantly supported the Land in fulfilling these investment duties. In 2018, total investments increased further by EUR 400m to EUR 5.6bn, of which EUR 2.9bn was contributed by Berlin's government-related entities

⁶ In 2014, the Senate established a sustainability fund called SIWANA with annual contributions of around 1% of fiscal revenues to smooth investment expenditures across business cycles.

sector. In addition, Berlin has accumulated reserves which are earmarked for investment purposes, stemming from previous allocations of budgetary surpluses to the SIWANA fund which may be used beyond an accrued fiscal year, thereby providing additional fiscal leeway. In our view, the creation of SIWANA in 2014 has resulted in an effective recourse for the Land of Berlin which may only be used for investments and not for consumptive expenditure. We believe these factors enable the Land of Berlin to cope with rising demand for infrastructure.

Operating revenue is driven by strong national growth

Berlin's operating revenue grew strongly by 6.6% in 2018 (averaging 5.4% since 2012), driven by good performance in taxes and allocations and grants. In line with constitutional arrangements between the Länder and the Bund, Berlin receives shared taxes, largely revenues from personal income taxes, value-added taxes and corporate taxes. These revenues initially flow into Berlin's budget but are later redistributed at a national level in accordance with revenue-sharing agreements and additional transfer mechanisms, essentially weakening their link to the Land's economic performance.

Slowing tax revenue growth expected in 2020 and 2021

Recent national tax growth estimations (May 2019) are signalling slowing tax revenue growth for all of the German Länder compared to previous tax revenue growth projections in 2018. This mainly reflects a weakening national economic environment, as well as changes in the taxation law. As a positive development, Berlin will receive additional revenue of EUR 25m for 2019, contrary to most of the Länder. In addition, Berlin has already anticipated the fiscal impact of changes in taxation laws in its supplementary budget for 2019. However, the Land of Berlin will have to adjust its medium-term financial planning due to negative corrections to tax revenue growth by EUR 381m for 2020 and EUR 495m (which is under 2% of Berlin's operating revenue in 2018) in 2021.

Rigid expenditure structure limits expenditure flexibility

Operating expenditure rose by 5.9% in 2018 (averaging 4.1% since 2012), reflecting the rising demand for social services due to population growth. Moreover, in keeping with the responsibilities of the Land, Berlin's expenditure structure is rigid owing to minimum legislative requirements and the socially-sensitive nature of some expenditure items, making most items difficult to trim. Personnel costs represent the largest single expenditure item at 37% of operating expenditures in 2018; transfers to districts represented 30%. The remainder consists of materials and various administrative costs. We anticipate that operating and investment expenditure will continue to rise, also reflecting the expected population gains. In addition, after a prolonged period of stagnant wages, personnel costs are expected to increase further as wages catch up with the Länder average, also in a bid to retain key administrative personnel.

Pension payments weigh on budgetary flexibility

Going forward, Berlin's budget will be increasingly burdened with rising pension expenditure. Pension payments amounted to 8.1% of total expenditure in 2017, which was below the national average of 11.3%, given the fact that after reunification, civil servants in the new Länder were not included in the pension scheme, but rather treated based on 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 (Sondervermögen 'Versorgungsrücklage des Landes Berlin', required by German law⁷), which are expected to reach around EUR 1.2bn in 2019, resulting in largely unfunded pension liabilities. However, the fund is not designed to cover future liabilities as such, but serves as a buffer, ensuring payments to pensioners are not placed into question during an economic downturn, when revenues would be lower. In 2018, the Land of Berlin assigned an external reviewer to calculate the size of its future pension obligations. The actuarial results conclude that obligations are currently at EUR 57bn, a substantial increase on the previous assumption of EUR 35-40bn.

⁷ Article 5 Nr. 4 of the Pension Reform Law 1998, implemented as §14a BBesG.

**Berlin is likely to outperform
2019 budget targets**

In our opinion, Berlin will continue to surpass initial fiscal targets in 2019, benefitting from higher-than-budgeted tax revenues and resulting in a financing surplus of around EUR 500m.

**Continued budgetary surpluses
over the medium term, but on a
lower level**

According to the conservative financial plan for 2018-2022, Berlin intends to sustain a high level of investments to address the city's rapid growth and keep balances before debt movement solidly positive. Berlin's current balance will cover around 90% of the Land of Berlin's investment expenditure under its medium-term financial plans, which will support the Land in maintaining budgetary surpluses. This underscores the commitment of the Land to avoiding taking on new debt and to creating a solid foundation for coping with the debt brake rule starting in 2020. In our opinion, the expected slowing tax revenue growth in 2020/2021, which mirrors the national economic slow-down, is mitigated by: i) the Land of Berlin's conservative tax revenue growth assumptions; ii) ongoing consolidation efforts; iii) lower interest payments; iv) budgetary adjustment possibilities in view of Berlin's high investment level and capacity constraints in the regional construction sector; as well as v) Berlin's economic and demographic outperformance vis-à-vis national peers. Despite the rising trend in personnel costs, we expect Berlin to continue to keep a grip on its operating expenditure. Over the medium term, we expect budgetary surpluses to decline slightly to around 2% of total revenues over the next few years due to rising operating expenses and investments needed to address the city's rapid growth and migration flows. Consequently, we expect the Land of Berlin to adhere to its consolidation strategy and remain compliant with the debt brake rule.

**High but declining debt stock
and debt service**

At year-end 2018, Berlin reduced its direct debt for the seventh consecutive year to EUR 57.6bn or 196.3% of total revenues, down from 275.9% in 2012 (see **Figure 8**). While this is high in a national and international context, we expect the debt burden to continue to decline, remaining above the average for the Länder. Debt service is also on a declining trend as a result of interest savings, an increase in the average maturity of outstanding debt, and gradual debt reduction. Although debt service remains high (see **Figure 9**), at EUR 7.7bn in 2018 or 27% of operating revenues in 2018, it is significantly down from EUR 9.7bn or 45% of operating revenues in 2013 and mitigated by excellent access to capital markets.

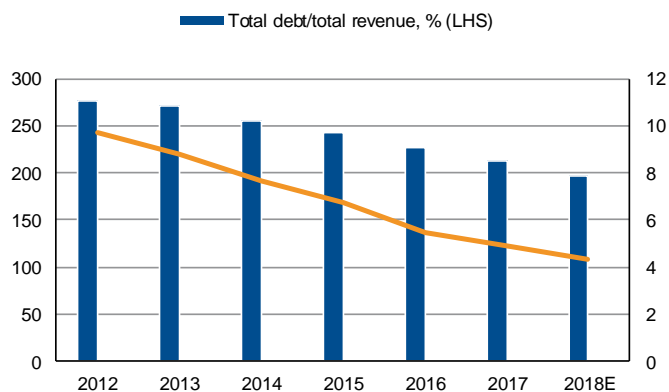
Low interest-payment burden

Berlin's interest expenses are in line with the safe-haven status of the Länder, with the average cost of outstanding debt at 1.76% in 2018, down from 1.82% in 2017. The low and decreasing cost of debt led Berlin's interest payments, relative to operating revenues, to fall to 4.3% in 2017, down from 9.7% in 2012, thereby increasing Berlin's financial leeway.

Favourable debt profile

Berlin's borrowing profile is characterised by a favourable maturity structure which reduces Berlin's exposure to refinancing risk, particularly in a potential scenario of financial stress. Berlin benefits from a conservative refinancing policy, reflected by an increasing average debt maturity length of 7.74 years at the end of 2018, up from 7.62 at the end of 2017 and 7.13 in 2016. Berlin also reduced its annual refinancing volume to around EUR 6bn in 2017 and 2018, down from EUR 11bn in 2009. Berlin has targetted a refinancing volume of around EUR 5bn in 2019, which will further reduce refinancing risks. Moreover, debt is almost entirely euro-denominated (0.2% in yen, 0.1% in Swiss francs). 82% of the stock carries a fixed interest rate before swaps (after swaps, variable debt amounts to 6.9% of the total), while around 66% of the debt was securities at the end of 2018.

Figure 8: Debt and interest burden



Source: Senatsverwaltung für Finanzen Land Berlin, Scope Ratings GmbH

Well-established capital market access and sound liquidity management

The Land of Berlin has a solid track record regarding access to capital markets and also benefits from sound treasury management. During the last financial crisis, access remained excellent, reflecting investor confidence in the German solidarity system. We view the liquidity management of the Land of Berlin as sound due to comprehensive inter-year cash planning and the availability of numerous sources of liquidity. The Land of Berlin pursues a liquidity strategy that limits cash holdings in Berlin's account by lending excess liquidity upon receipt of large tax revenues. In combination with broad access to deep markets, the risk of potential liquidity shortages is negligible. The Land's cash flows, especially inflows, are prone to seasonal variability driven by the tax calendar. Additional continued access to liquidity to bridge 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. Combined with Berlin's own prudent financial planning, this makes the risk of a potential liquidity shortage negligible.

Outstanding guarantees on a significant downward trend

Contingent liabilities

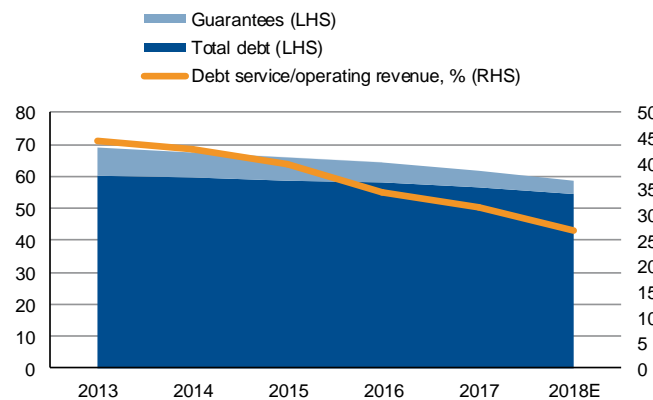
Guarantees

As of 2018, outstanding guarantees issued by the Land of Berlin stood at EUR 4.3bn, down from EUR 5.2bn a year earlier and steadily declining from EUR 26.6bn in 2010. In our opinion, entities and projects guaranteed by the Land of Berlin carry a limited risk that their obligations will crystallise on Berlin's balance sheet. Guarantees are primarily related to three sectors: a third of the outstanding guarantees (EUR 1.2bn in 2018 following redemption versus EUR 1.6bn in 2017) relate to subsidised housing transactions conducted by the Investitionsbank Berlin and KfW. A quarter of the outstanding guarantees (EUR 1.1bn in 2018 following redemption versus EUR 1.6bn in 2017) relate to real estate transactions conducted by the Bankgesellschaft, a wind-down entity, through which real estate assets are divested to repay outstanding liabilities. Another quarter of the outstanding guarantees (EUR 1bn in 2018 versus EUR 1.1bn in 2016) are mainly for Berlin public companies, especially the Berlin water works which has regularly achieved positive financial results in recent years.

Low risk of materialisation for contingent liabilities

The favourable economic outlook, which we anticipate will continue to improve property values, makes it less likely that the Land will have to honour the guarantees related to real estate transactions. In addition, guarantees for debt held by social housing associations are not relevant to the budget, in our opinion, because the associations generate stable rent income. We therefore expect declining guarantee risks over time.

Figure 9: Overall debt risk and debt service
EUR bn (LHS), % (RHS)



Source: Senatsverwaltung für Finanzen Land Berlin, Scope Ratings GmbH

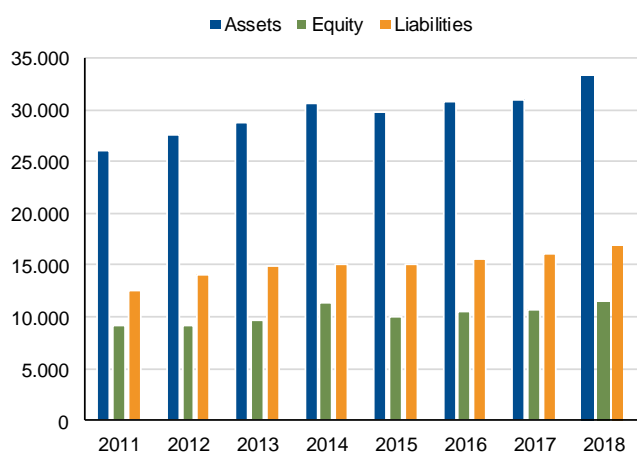
Guarantees for the new Berlin Brandenburg airport amounted to EUR 833m in 2018 versus EUR 824m in 2017. There may be additional financing needs as the airport still faces problems because of a delay in its completion, resulting in a rise in project costs. This is, however, mitigated by two factors. First, the Land owns 37% of the project and shares financial responsibility with the Land of Brandenburg (37%) as well as the Federal Republic of Germany (26%). Second, Berlin has set aside reserves of EUR 104m for potential contingent liabilities related to the airport, thereby reducing the risk of further financing needs appearing suddenly.

Shareholdings in local companies

Berlin's shareholdings play a critical role in the Land of Berlin's investment policy. The companies fulfil a significant public-sector mandate for the Land of Berlin by contributing to the further development of the city's dynamic growth and strengthening the regional economy. Good annual results overall support high and sustained investment volumes.

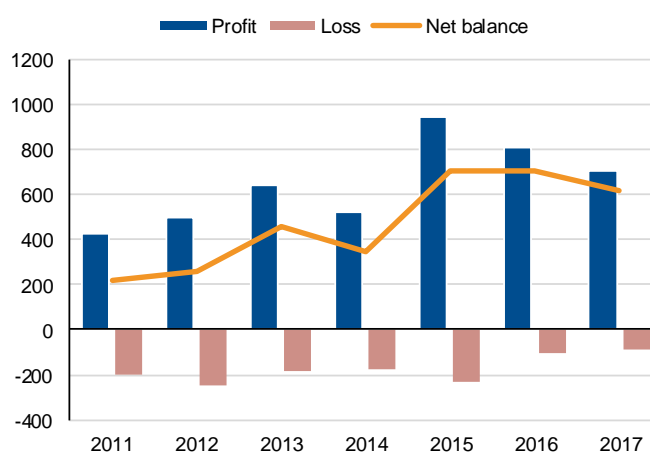
Shareholdings play critical role in investment policy

Figure 10: Assets, liabilities and equity 2011-2017, EUR m



Source: Senatsverwaltung für Finanzen Land Berlin, calculations by Scope Ratings GmbH

Figure 11: Profits and losses of Land of Berlin holdings, EUR m



Source: Senatsverwaltung für Finanzen Land Berlin, calculations by Scope Ratings GmbH

All major units were profitable in 2017

While total liabilities at these companies increased to EUR 16.8bn⁸ in 2018 from EUR 16.2bn in 2017, there is a low degree of leverage with a ratio of total liabilities to assets of 0.51, pointing to greater financial flexibility (see **Figure 10**). The high level of assets is in part due to the Land's participation in the real estate and housing sectors which have experienced a rise in value. Moreover, with the exception of the Berlin Brandenburg airport project, all major units were profitable in 2018 (see **Figure 11**).

Local administration and politics

We view the government and administration of the Land of Berlin as stable. The last regional elections, held in September 2016, resulted in a coalition of three parties (the centre-left Social Democratic Party 38 seats; the Left Party 27 seats; and the Greens 27 seats) gaining 92 of 160 seats in the regional parliament and replacing the two-party coalition of the Social Democratic Party and Christian Democratic Union. The Christian Democratic Union, the Alternative for Germany and the Free Democratic Party are in opposition.

Stable political environment

Long-term commitment to investments and debt reduction

In our view, Berlin's fiscal policy has been successfully balancing investment and consolidation needs since 2016. On the one hand, existing financial leeway is primarily

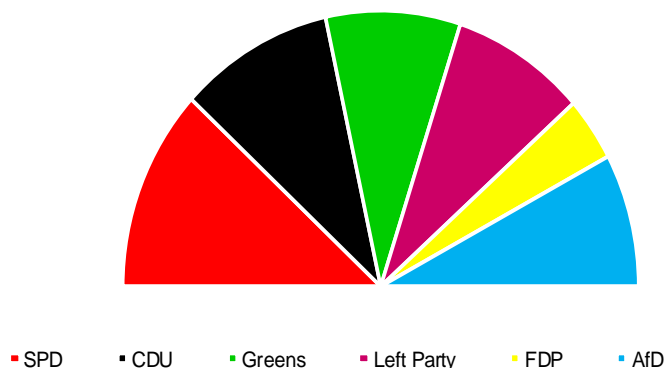
⁸ This figure excludes the debt of fully owned development bank Investitionsbank Berlin which has a conservative lending policy, focusing exclusively on municipalities and social real estate projects, for example.

Unique administrative organisation

used to cover investment needs. On the other hand, the Senate remains committed to the goal of reducing debt, and thus implicitly achieving surpluses before debt variation, thereby gradually reducing the vulnerability of the budget in view of the still-high debt burden.

The Land of Berlin is divided in twelve local districts (Bezirke) with the number of inhabitants ranging from 240,000 (Spandau) to more than 400,000 (Pankow). All of the districts have their own identification with elected local mayors and councils, while their revenues rely mostly on financial assignments ('Globalsumme') from the Land of Berlin. The administrative organisation between the Senate and the districts is unique in Germany: the districts fulfill certain functions while administrative responsibilities are not clearly separated between government levels and financial transfers differ across years and districts. High consolidation needs and the special administrative structure have led administrative services to perform poorly in the past. Following extensive discussions, the district mayors and the Senate agreed on a new legislative proposal (the 'Zukunftspakt') in May 2019 to make administrative processes more efficient. In 2018, all of the districts became debt-free and accumulated a total surplus of EUR 230m. The districts can retain the surpluses they achieve, which acts as an incentive for solid budget management.

Figure 12: Share of seats held by political parties in the Landtag



Source: Abgeordnetenhaus, Scope Ratings GmbH

Methodology

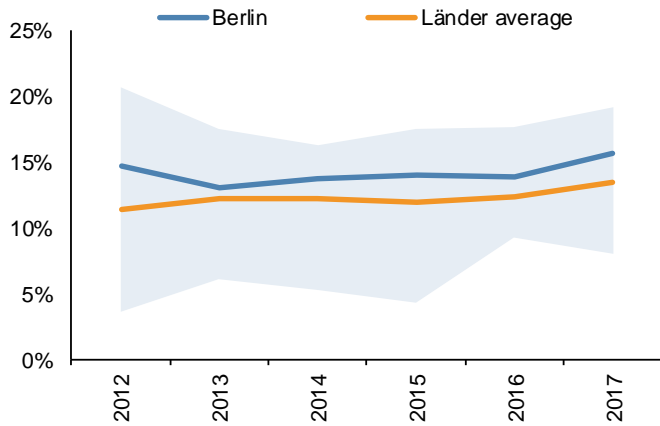
The methodology applicable for this rating and/or rating outlook, 'Sub-Sovereign Credit Rating', published on 15 June 2018, is available on www.scooperatings.com.

Historical default rates of the entities rated by Scope Ratings can be viewed in the rating performance report on <https://www.scooperatings.com/#governance-and-policies/regulatory-ESMA>. Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): <http://cerp.esma.europa.eu/cerepweb/statistics/defaults.xhtml>. A comprehensive clarification of Scope's definition of default as well as definitions of rating notations can be found in Scope's public credit rating methodologies on www.scooperatings.com.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months.

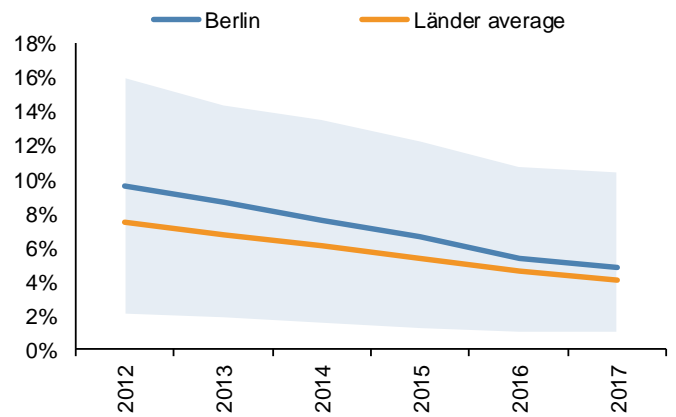
I. Appendix: Peer comparison

Figure 13: Operating balance/operating revenue, %



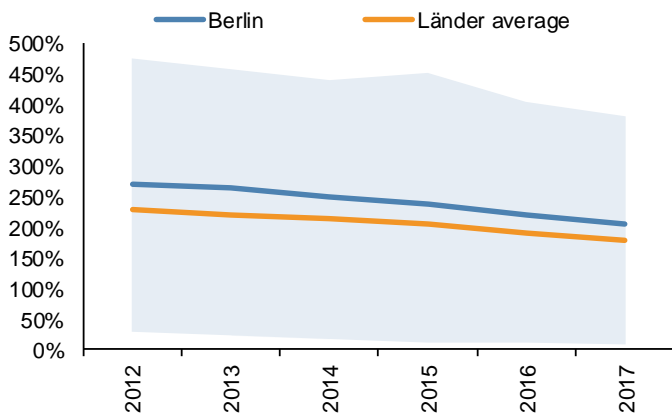
Source: Federal Ministry of Finance, Scope Ratings GmbH

Figure 14: Net interest payments/operating revenue, %



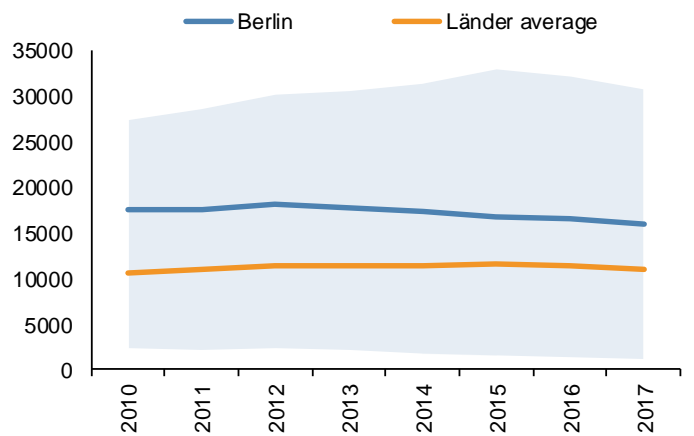
Source: Federal Ministry of Finance, Scope Ratings GmbH

Figure 15: Total debt/overall revenue, %



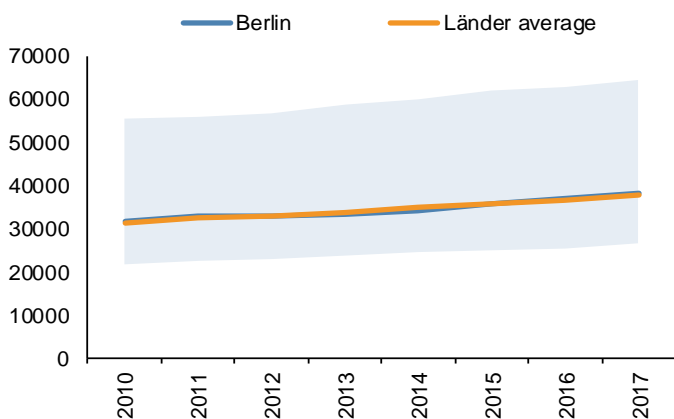
Source: Federal Ministry of Finance, Federal Statistical Office, Scope Ratings GmbH

Figure 16: Debt per inhabitant (EUR)



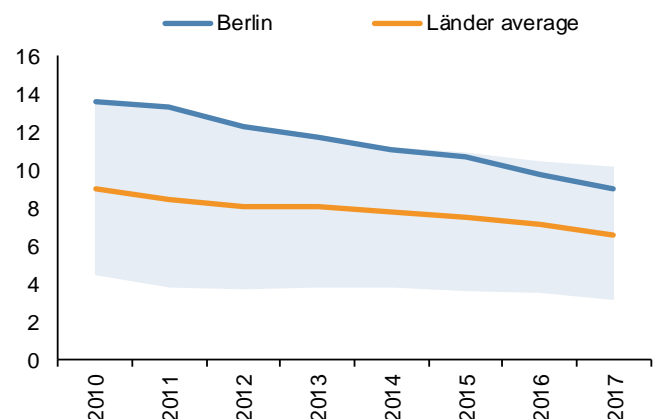
Source: Federal Statistical Office, Scope Ratings GmbH

Figure 17: GDP per capita (EUR)



Source: Federal Statistical Office, Scope Ratings GmbH

Figure 18: Unemployment (% of labour force)



Source: Federal Statistical Office, Scope Ratings GmbH

II. Appendix: Statistical tables

	2012	2013	2014	2015	2016	2017	2018
Financial performance							
<i>Numbers are in million EUR (unless noted otherwise)</i>							
Operating revenue	21.530	21.795	22.909	23.791	25.362	26.724	28.482
<i>Operating revenue growth, %</i>	9,0%	1,2%	5,1%	3,8%	6,6%	5,4%	6,6%
Tax revenue	11.616	11.921	13.127	13.626	14.767	15.399	17.027
Allocations and grants	8.400	8.355	8.182	8.496	8.593	9.600	9.756
Other operating revenue	1.514	1.520	1.601	1.669	2.002	1.725	1.699
Operating expenditure	18.358	18.952	19.747	20.445	21.833	22.536	23.865
<i>Operating expenditure growth, %</i>	1,6%	3,2%	4,2%	3,5%	6,8%	3,2%	5,9%
Personnel	6.759	6.938	7.207	7.487	7.807	8.221	8.854
Allocations and grants	5.879	6.088	6.290	6.452	6.755	6.923	7.215
Other operating expenditure	5.719	5.926	6.251	6.506	7.271	7.392	7.795
Operating balance	3.172	2.843	3.162	3.346	3.528	4.188	4.617
Interest payments	2.097	1.921	1.759	1.607	1.385	1.306	1.229
Current balance	1.075	922	1.403	1.739	2.143	2.882	3.388
Capital balance	-425	-469	-549	-1.553	-2.026	-1.882	-1.879
Balance before debt movement	650	453	854	187	118	1.000	1.509
New borrowing (credit market)	7.820	7.384	8.064	7.136	7.039	5.425	4.511
Debt redemption (credit market)	8.015	7.836	8.405	8.324	7.228	7.381	7.262
Financial ratios							
Balance before debt movement/total revenue, %	2,9%	2,0%	3,6%	0,8%	0,4%	3,6%	5,1%
Operating balance/operating revenue, %	14,7%	13,0%	13,8%	14,1%	13,9%	15,7%	16,2%
Interest payments/operating revenue, % (RHS)	9,7%	8,8%	7,7%	6,8%	5,5%	4,9%	4,3%
Current balance/operating revenue, %	5,0%	4,2%	6,1%	7,3%	8,5%	10,8%	11,9%
Capital expenditure/total expenditure, %	6,6%	6,3%	6,4%	10,0%	11,2%	10,7%	9,8%
Debt							
Direct debt	62.256	61.607	60.804	59.906	59.436	58.994	57.600
Guarantees	8.776	8.890	7.510	6.901	5.928	5.152	4.255
Overall debt risk (incl. guarantees)	71.032	70.497	68.314	66.807	65.364	64.146	61.855
Debt ratios							
Direct debt/total revenue, %	275,9%	270,8%	255,1%	242,4%	226,1%	213,0%	196,3%
Direct debt/operating revenue, %	289,2%	282,7%	265,4%	251,8%	234,4%	220,8%	202,2%
Overall debt risk (incl. guarantees)/operating revenue, %	329,9%	323,5%	298,2%	280,8%	257,7%	240,0%	217,2%
Interest payments/direct debt, %	3,4%	3,1%	2,9%	2,7%	2,3%	2,2%	2,1%
Debt per inhabitant (EUR)	18.213	17.799	17.347	16.831	16.486	15.744	15.008
<i>share in Germany's GDP, %</i>	4,0%	4,0%	4,0%	4,1%	4,2%	4,3%	4,3%
GDP per capita (EUR)	32.803	33.133	34.223	35.837	37.662	38.864	40.568
<i>% of Germany's GDP per capita</i>	95,6%	94,5%	94,3%	96,0%	98,2%	98,0%	99,3%
<i>% of EA average GDP per capita</i>	112,0%	112,3%	113,7%	115,2%	118,4%	118,1%	119,7%
Population (ths)	3.351	3.399	3.446	3.495	3.547	3.594	3.625
Real GDP growth, %	0,0	0,0	2,5	4,1	5,1	3,1	3,1
Unemployment rate (% labour force)	12,3	11,7	11,1	10,7	9,8	9,0	8,1

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



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