Land of Berlin

Rating Report

Rating rationale and Outlook

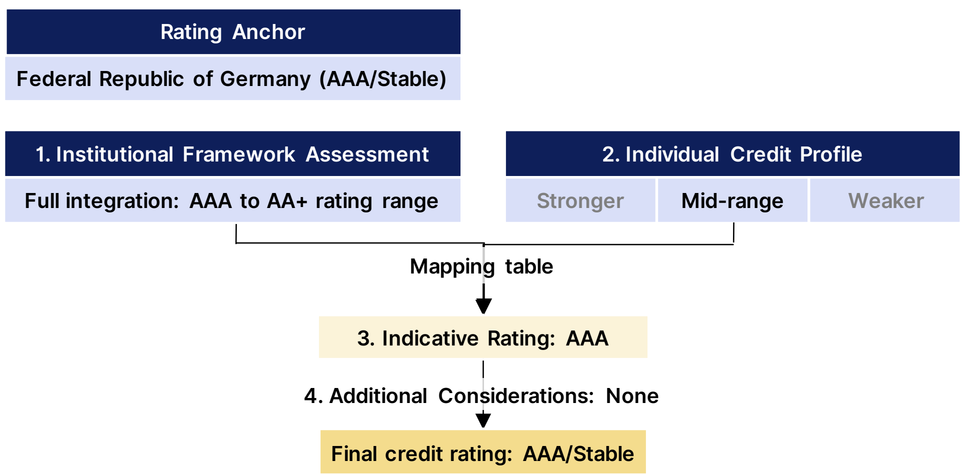
The Land of Berlin's (Berlin) AAA rating is driven by:

A highly integrated Institutional Framework characterised by a strong revenue equalisation system and the federal solidarity principle, which results in a close alignment of the Länder's creditworthiness with the German federal government's AAA/Stable ratings.

A 'mid-range' Individual Credit Profile underpinned by: i) conservative budgetary management and a track record of fiscal consolidation; ii) excellent capital market access and a favourable debt profile; iii) prudent liquidity management; and iv) a strong socio-economic profile.

Credit challenges relate to: i) relatively high direct debt; ii) rising budgetary pressures and moderate budgetary flexibility, in line with other Länder; and iii) largely unfunded pension commitments weighing on long-term expenditure flexibility as well as sizeable, but manageable, contingent liabilities.

Figure 1: Berlin's rating drivers



Note: For further details, please see Scope's Sub-sovereigns Rating Methodology.
Source: Scope Ratings

Foreign currency

Long-term issuer rating/Outlook

AAA/Stable

Senior unsecured debt

AAA/Stable

Short-term issuer rating/Outlook

S-1+/Stable

Local currency

Long-term issuer rating/Outlook

AAA/Stable

Senior unsecured debt

AAA/Stable

Short-term issuer rating/Outlook

S-1+/Stable

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Credit strengths and challenges

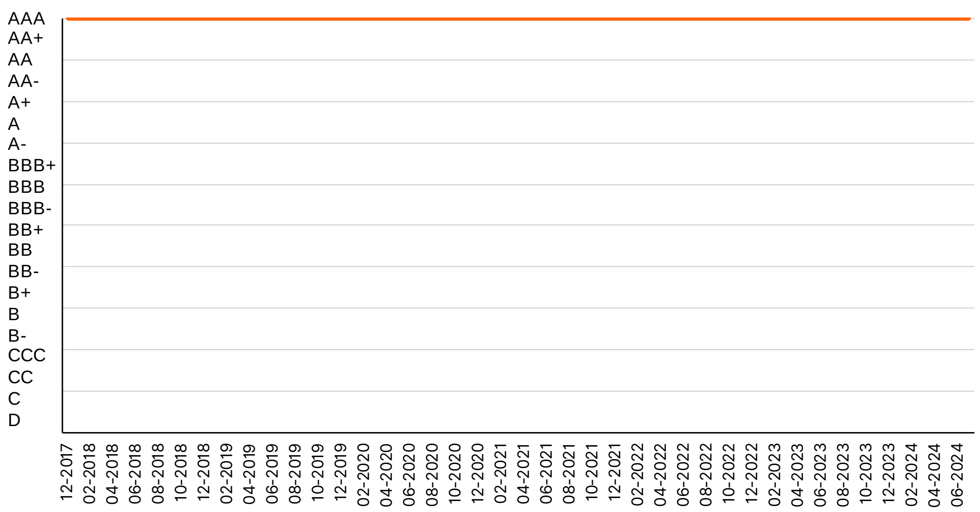
Credit strengths	Credit challenges
• Integrated institutional framework • Conservative budgetary management, track record of fiscal consolidation • Excellent capital market access, favourable debt profile • Prudent liquidity management • Strong socio-economic profile	• High debt levels • Budgetary pressures, moderate budgetary flexibility • Sizeable, though largely low-risk contingent liabilities; unfunded pension commitments

Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced.

Positive rating-change drivers	Negative rating-change drivers
• N/A	• Downgrade of Germany's sovereign rating • Changes in the institutional framework, resulting in notably weaker support • Individual credit profile weakens significantly and structurally

Figure 2: Rating history[1]



Source: Scope Ratings

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[1] Foreign-currency long-term issuer rating. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment

Institutional framework

Federal framework results in close rating alignment…

Berlin, like all German Länder[2] benefits from a mature, highly predictable, and integrated institutional framework. The key elements are: i) a strongly interconnected revenue equalisation mechanism enshrined in the constitution; ii) strict fiscal rules and monitoring, iii) wide-ranging participation and veto-rights of the federal states in the national legislation; iv) equal entitlement of federal states regarding negotiations on federal reforms; and v) a solidarity principle that ensures extraordinary system support during budgetary emergencies.

The federal system under which the Länder operate is the most integrated among the European sub-sovereign systems we cover. This is driven by our assessments of ‘full integration’ for extraordinary support and bailout practices, ordinary budgetary support and fiscal equalisation, fiscal rules and oversight, and revenue and spending powers. We assess funding practices as ‘medium integration’.

…, with distance of up to one notch from the sovereign rating.

The framework assessment results in an **indicative downward rating adjustment of up to one notch** from Germany’s AAA/Stable rating for any of the federal states (see Appendix I for an overview).

Extraordinary support and bail-out practices

Strong solidarity principle ensures extraordinary support

Our framework assessment acknowledges a record of extraordinary financial support. Länder have been granted exceptional financial support from the federal government in five instances: Bremen (1992, 2006), Saarland (1992, 2005) and Berlin (2002). The court approved claims on the grounds of the solidarity principle, or *Bundestreueprinzip*, under which the Länder and the federal government are required to support each other in the event of a budgetary emergency. A claim by Berlin was denied 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 would still be possible as a last resort if the budget and/or debt situation were later assessed as extreme. We consider the *Bundestreueprinzip* to be an implicit bail-out rule, as it requires the provision of federal support in times of budgetary stress.

Federal government as shock absorber during recent crises

More recently, the federal government confirmed its role as a primary countercyclical shock absorber during the Covid-19 and energy crises. Over these years, the federal government financed most anti-crisis measures and provided direct grants to the Länder to mitigate the impact on their finances. Federal budget deficits averaged 3.0% of GDP over 2020-2023, compared 0.15% for the Länder.

Ordinary budgetary support and fiscal equalisation

Comprehensive fiscal equalisation system

The federal financial equalisation system strongly aligns different fiscal capacities across the Länder. 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. The net effect of the system change is positive for all Länder as contributions from the federal government are greater under the reformed system.

Berlin is largest beneficiary of the equalisation system

As in the previous system, Berlin is the largest net beneficiary with total transfers of EUR 5.5bn in 2023, including EUR 3.8bn in redistributed VAT. The net effect of the system change is positive for all Länder as contributions from the federal government are greater under the reformed system.

Funding practices

Autonomous borrowing, access to shared liquidity

Länder governments have broad autonomy in their funding choices. There is no use of sovereign on-lending, and Länder can decide autonomously on their borrowing programmes within the framework of the debt brake. Short-term liquidity is available via access to shared liquidity among the Länder and the federal government, essentially eliminating liquidity risk. Basel III risk-weights for

[2] We use the term ‘Land’ (or collectively ‘Länder’) and ‘state’ interchangeably to refer to German federal states.

Länder debt securities are aligned at 0% with the central government. The Länder have a history of joint bond issuance, having issued such instruments on 64 occasions, although not all of the 16 Länder participated. Berlin has not participated in any of the past issues.

Fiscal rules and oversight

Debt brake anchors borrowing; stability council conducts oversight

Since 2020, the Länder have to comply with debt brakes under which they cannot run structural financing deficits unless, for example, hit by a severe economic downturn or a natural disaster.[3] This is stricter than the rules at the federal level, which cap 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 2020-2023 in response to the Covid-19 and energy crises. Separately, Berlin invoked the safeguard clause of its debt brake for 2020 to implement support measures and credit authorisations to mitigate the impact of Covid-19. Borrowing under safeguard clauses comes with mandatory redemption rules.

Compliance with the debt brake and Länder finances are monitored by the Stability Council. The Council was established in 2010 to monitor restructuring programmes and compliance with budgetary targets and comprises the finance ministers of each Land and the federal ministers of finance and economic affairs. If the Council determines that a Land is threatened with a budgetary emergency, it agrees on a restructuring programme with the affected authority.

2023 federal constitutional court with implications for Länder's financial planning

In late 2023, Germany's constitutional court ruled the Second Supplementary Budget Act 2021 of the federal government as unconstitutional. Crucially, the ruling effectively limits the previously commonly used budgetary practice of using emergency credit authorisations to create budgetary reserves for spending in future years, thus also impacting budgetary practices of the Länder. The ruling also affected Berlin's budgetary strategy, with the state cancelling its plans for a climate fund funded via emergency credit authorisations.

Revenue and spending powers

Shared tax authority with the federal government

The Länder and the federal government share a taxation authority and jointly decide on rates and revenue distribution for high-revenue common taxes (income and VAT). The latest reform of federal financial relations took effect in 2020 and resulted in a higher share of VAT being distributed among the Länder. The VAT distribution fully compensates for the variation in taxing powers, replacing the previous process of horizontal payments between the Länder. Alongside shared taxes, the federal government and the Länder have separate taxation authorities for lower revenue-generating taxes.

Federal reforms strengthen political coherence

Under the reform agreed in 2017, the Länder have assigned limited executive and legislative rights to the central government in certain policy areas, including physical and digital infrastructure and the higher education system, in return for higher payments from the equalisation system. In line with earlier reforms (*Föderalismusreformen II*), we observe that the higher the share of common national legislation (*konkurrierende Gesetzgebung*), the more integrated the system becomes.

Political coherence and multi-level governance

The German federal system is very predictable and supportive. Major reforms are discussed and agreed upon well in advance and in consultation with the Länder, which can directly influence national policymaking via the upper house of parliament.

[3] The debt brake is a legal framework that prohibits structural deficits for the Länder from 2020 onwards; article 109 (3) of the Basic Law stipulates that the Länder may incur deficits in a case of, for example, a recession or a natural disaster provided they pass respective legislation at the state level.

Individual credit profile (ICP)

'Mid-range' ICP, leading to indicative AAA rating

We assess Berlin's ICP as 'mid-range' among German Länder. This places the Land's indicative rating at AAA given our mapping table. For details, see Appendix II and Appendix III.

This is underpinned by the Land's: i) conservative budgetary management and a track record of fiscal consolidation; ii) excellent capital market access and a favourable debt profile; iii) prudent liquidity management; and iv) a strong socio-economic profile.

Credit challenges relate to i) high direct debt levels; ii) budgetary pressures with overall moderate budgetary flexibility, in line with other Länder; and iii) largely unfunded pension liabilities weighing on long-term expenditure flexibility, as well as sizeable, but manageable, contingent liabilities. To balance its budget for 2024/25, we expect the state to use up its remaining, sizeable, budgetary reserves. As a consequence, the state's consolidation efforts are crucial to balancing budgets longer-term.

Debt and liquidity

Debt burden and trajectory

Berlin's debt is relatively high, Covid-19 reversed debt reduction trend

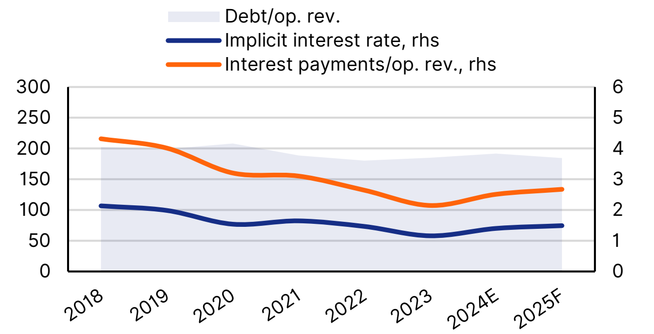
Berlin's debt burden is relatively high in a national and international context. After successful budget consolidation leading up to the Covid-19 shock and a reduction in the debt level to EUR 57.6bn at YE 2019, debt increased to EUR 65.9bn in 2021/22 due to crisis-related borrowing. In 2023, nominal debt declined slightly to EUR 64.2bn. Relative to operating revenue, debt amounted to 185% at YE 2023, slightly up from 180% a year before due to lower operating revenue, but still well-below a peak of 289% in 2012 (**Figure 3**).

Berlin utilised safeguard clause of debt brake for Covid-19

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. Berlin made use of the full envelope of authorisations to issue the corresponding amount of debt. Funds raised but not needed were placed in a pandemic reserve earmarked for tax revenue shortfalls and pandemic-related expenditures. The pandemic reserve was closed at the end of 2023.

Figure 3: Debt and interest burden

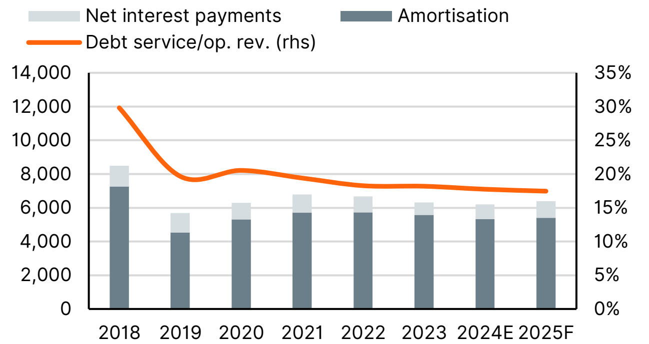
%



Sources: Berlin, Scope Ratings

Figure 4: Debt service

EUR m (lhs), % (rhs)



Sources: Berlin, Scope Ratings

Moderate borrowing expected; debt-funded special fund for climate transition cancelled

In coming years, we expect nominal debt to rise moderately, and to decline very gradually to around 184% as a share of operating revenue by YE 2025 (**Figure 3**).

The government cancelled its plan to set up a multi-year, debt-funded special fund worth EUR 5bn (potentially to be topped up to EUR 10bn in 2024) for the climate transition, due to doubts it would have complied with the rules stipulated for such debt-funded special funds by the German Constitutional Court in its ruling of November 2023. To support the state's climate-related efforts, funds can be unlocked via another debt brake mechanism, namely via borrowing for (net) spending on financial transactions. The Land currently plans with net borrowing of around EUR 1.7bn for 2024 and EUR 440m in 2025. Berlin's financial planning remains committed to fiscal consolidation and the debt brake with its remaining flexibility to manage continued investment needs.

Debt profile and affordability

The risks associated with Berlin's relatively high debt stock are mitigated by a favourable debt profile and excellent market access.

Excellent market access and conservative debt management

Berlin's debt service has been on a declining trend as a result of an increase in the average maturity of outstanding debt and declining interest rates (**Figure 4**). Although redemptions will remain high over the coming years at around EUR 5-6bn, or 15% of operating revenue, it is significantly down from EUR 9.7bn or 45% of operating revenue in 2013. The Land already secured 75% of its required funding for this year, with total planned issuance of EUR 9.2bn - significantly higher than last year's EUR 5.1bn - due to postponed issuances, and increased borrowing for financial transactions.

Berlin employs a conservative debt management strategy with very limited foreign currency and interest rate risks. At YE 2023, the average maturity of outstanding credit market debt was 8.15 years, lengthened from 7.8 years in 2018. Almost all debt is denominated in euro (99.8% at YE 2023), and Berlin hedges interest rate risk, such that after swaps, 98.1% of debt was at fixed coupon rates at YE 2023. Finally, the Land issued a first sustainable bond of EUR 750m in February 2023, which was significantly oversubscribed, highlighting the Land's widening and reliable investor base. A second sustainable bond is planned for 2025.

Low interest payment burden

Berlin's interest expenses are in line with the safe-haven status of the Länder ensuring debt affordability. The average cost of outstanding debt was 1.77% in 2023, up from 1.41% in 2022 and 1.26% in 2021 reflecting the increase in bond yields due to the ECB's monetary tightening. Still, interest payments declined further in 2023 relative to operating revenue to 2.1%, from 9.7% in 2012, raising Berlin's financial flexibility.

Contingent liabilities

Some exposure to contingent liabilities, overall risk low

Berlin is exposed to some contingent liability risks, although we deem the overall impact on its individual credit profile to be low. Main contingent liabilities stem from: i) contractual guarantees mostly for utilities, housing, and the Berlin-Brandenburg airport, ii) strategic shareholdings, and iii) largely unfunded pension liabilities.

Low-risk guarantees

Berlin has a moderate level of contractual guarantees outstanding. As of 2023, outstanding guarantees stood at EUR 4.1bn, down 4.1% compared to 2022 and down from EUR 26.6bn in 2010. There is a limited risk that the obligations of entities and projects guaranteed by Berlin will crystallise onto the Land's balance sheet.

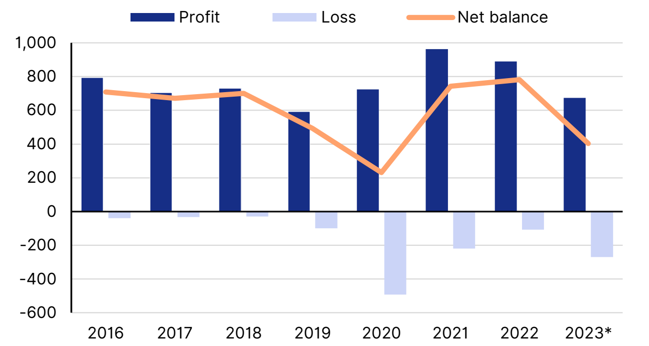
Contractual guarantees are primarily related to three sectors. Half of the outstanding guarantees are for Berlin public companies, especially the Berlin electricity grid (EUR 1.7bn) and the Berlin water works (EUR 897m), whose business models are low-risk, with positive and stable financial results expected in future years. Similarly, outstanding guarantees relating to subsidised housing transactions conducted by Investitionsbank Berlin (IBB) and KfW are assessed as low risk, amounting to EUR 372m. Guarantees for debt held by housing associations also do not pose a material credit concern, because the associations generate stable rental income. Finally, guarantees for Berlin Brandenburg Airport amounted to EUR 718m.

Shareholdings play a critical role in Berlin's 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. These include holdings in the transport, water and waste, hospital, energy, social housing sectors as well as the Land's exhibition centre, a 37%-stake in the Berlin-Brandenburg airport and IBB. On aggregate, the shareholdings record positive annual results, which supported high and sustained investment volumes (**Figure 5**).

Figure 5: Profits and losses of Berlin's holdings

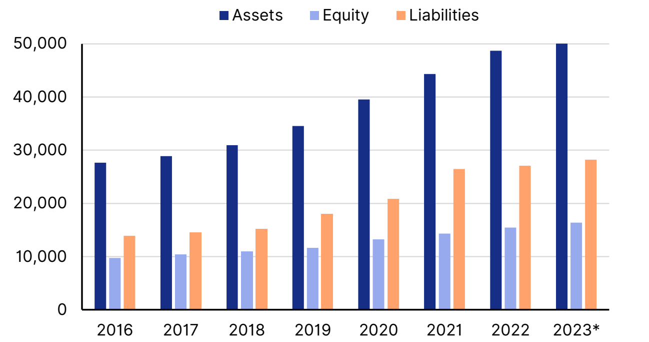
EUR m



*Preliminary and incomplete data for 2023. Sources: Berlin, Scope Ratings

Figure 6: Assets, liabilities, and equity of shareholdings

EUR m



*Preliminary and incomplete data for 2023. Sources: Berlin, Scope Ratings

In 2023, major losses were reported by Berlin-Brandenburg airport and Vivantes, a wholly-owned hospital operator. The Land continues to support both entities, for example via a final tranche of capital planned for the airport in 2026 on the entity's path to self-sustainability, but overall budget impact from these support measures is modest. Total liabilities at Berlin's holdings increased to EUR 28.2bn in 2023, up from EUR 20.9bn in 2020 (**Figure 6**). Correspondingly, assets stood at EUR 50.2bn in 2023. Equity increased to EUR 16.4bn in 2023.

Recent purchases underpin Land's efforts for the energy transition

Further, in May 2024, Berlin acquired a 100%-stake in of BEW Berliner Wärme und Energie, a district heating provider. The Land was also granted an option to purchase a 31.575% stake in GASAG AG, a regional utility. Previously, Berlin had acquired the electricity grid in 2021. These actions highlight the Land's active management in pursuing its energy transition and decarbonisation targets.

Only partial coverage of pension liabilities, in line with other Länder

Finally, and in line with other Länder, Berlin faces significant, unfunded pension liabilities for its civil servants, which are financed via the state's regular budget. Berlin provides mandatory payments to its pension fund of at least EUR 80.5m annually (paused in 2020 and 2021). The fund's assets amounted to around EUR 1.4bn at YE 2023, opposite a net present value of EUR 70bn in future obligations over the next 30 years, according to an external actuary, resulting in largely unfunded pension commitments. The pension fund is not designed to cover all future liabilities but serves as a buffer for pension payment peaks, with withdrawals from the fund possible from 2031. To align with pension regulation for its employees and with the Bund and other Länder, the pension age of the state's civil servants will gradually increase from 65 to 67.

Liquidity position and funding flexibility

Prudent liquidity management and very strong funding flexibility

Liquidity management is 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.

Berlin's cash balance rose significantly over 2020-22, following the allocation of EUR 7.3bn in pandemic-related funding to a reserve. After the liquidity buffer gradually decreased in the second half of 2023 (while remaining very comfortable), it significantly increased again in Q1 2024 given front-loaded refinancing activities benefitting from favourable market conditions. Generally, 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. In combination with excellent market access, the risk of liquidity shortages is negligible.

Budget

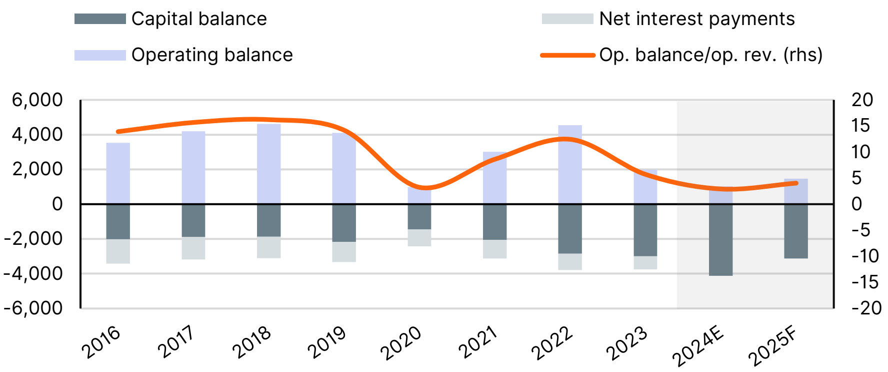
Budgetary performance and outlook

Good budgetary performance before the pandemic

Berlin's track record of solid budgetary performance and management has been underpinned by controlled expenditure growth between 2012 and 2019, with high operating surpluses averaging 14% of operating revenue (**Figure 7**). 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. High operating surpluses also allowed Berlin to post overall surpluses (after (net) expenditure on interest and investments) averaging 2.6% of total revenue between 2012-19, build up budgetary reserves and maintain a gradual reduction in its debt burden.

Figure 7: Budgetary performance

EUR m (lhs); % (rhs)



Sources: Berlin, Scope Ratings

The Covid-19 pandemic impacted 2020/21 fiscal performance

In 2020/21, Berlin's budgetary planning and fiscal outcomes were impacted by the Covid-19 pandemic. Lower-than-budgeted tax revenue, and additional expenditures, led to a reduction in the operating balance to an average 5.9% of operating revenue and overall deficits of an average 2.5% of total revenue.

Significant deficit in 2023 follows strong recovery in 2022

In 2022, Berlin posted a EUR 750m surplus before debt movement, or 2.0% of total revenue, having benefitted from very strong nominal tax revenue. Combined with reserves maintained during the pandemic, the 2022 fiscal outcome allowed the Land to enter 2023 with significant budgetary reserves, which will help absorb expected deficits until end-2025.

In 2023, operating revenue declined by 5.1% due to a challenging economic environment in Germany, which, coupled with a slight increase in operating expenditure, led to a tightening in the operating margin to 5.7% of operating revenue. The reduced operating margin, coupled with elevated capital expenditure, led to a deficit before debt movement of EUR 1.8bn in 2023, or around 5% of total revenue.

High deficits expected for 2024/25

For 2024/25, budgetary pressures will remain, with expected deficits of around EUR 4bn (11% of total revenue) this year and EUR 2.6bn (7%) in 2025, in line with budgeted levels in the 2nd supplementary budget. This is due to only moderate increases in operating revenue (+1%), outpaced by increases in operating expenses (4.7%), mainly driven by spending on personnel. For 2024, the expected deficit also captures the credit-financed, one-off expenditure for the acquisition of BEW Berliner Wärme und Energie.

Berlin anticipated negative impact from 2022 census exercise

Additional pressure stems from latest census results, which adjusted Berlin's population downwards by around 130,000 in 2022. This will negatively impact Berlin's VAT revenue share by EUR 450m annually, and growing to EUR 550m in 2028, through the financial equalisation mechanism. Berlin anticipated a negative impact and correspondingly created a budgetary reserve to partially absorb the impact, and budgeted accordingly. At the same time, since the impact is permanent, this increases the need for budget consolidation. Finally, the timing of the one-off, retro-active adjustment for 2022 (reduced to EUR 150m) and 2023 (EUR 300m) is unclear.

Mandatory redemptions for pandemic borrowing

Further, mandatory redemption expenses of EUR 270m are due annually related to pandemic-related emergency borrowing. To ease the burden on the 2024/25 budget, the Land redeemed EUR 810m in 2023, partly using the remaining pandemic reserve, instead of the mandatory EUR 270m.

Potential one-off impact due to 'A-Besoldung' court decision

Finally, an additional risk arises from the outstanding constitutional court decision regarding the 'A-Besoldung', i.e. salaries paid to certain civil servants. Between 2016 and 2019, salaries were not in line with minimum constitutional requirements, hence some additional expenditures are likely for the Länder, including Berlin, for past entitlements. The extent to which it will weight on budgets will depend on the court's decision, which is expected for this year. The Land plans to build reserves to help absorb the expected impact.

Consolidation efforts needed to balance budgets longer-term

Structurally higher spending will require Berlin to re-balance spending and investment activity. In the financial planning, tight expenditure control will be necessary in view of high spending and investment needs as well as the remaining reserves likely being exhausted by YE 2025. Over the medium term, we expect Berlin to adhere to its long-term fiscal consolidation strategy, supported by a commitment to fiscal consolidation, conservative budget management, low debt service costs, and economic and demographic outperformance of national peers.

Revenue flexibility

Limited revenue flexibility, financial equalisation and central government transfers

As for all German Länder, Berlin's revenue flexibility is generally limited, as a large share of operating revenue stems from shared taxes. In line with constitutional arrangements, the Länder receive 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.

Expenditure flexibility

Moderate expenditure flexibility, persistent spending pressures

In line with other Länder, expenditure flexibility is also generally limited. 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 around 34% of operating expenditure in 2023, broadly in line with its long-term average, while transfers represented 28%. Even with consolidation efforts, including on personnel costs, these expenditures are expected to remain high.

In December 2023, Berlin reached an agreement with its employees for pay rises over 2024 and 2025, which is also applied to its civil servants, together with 14 other Länder. Total additional costs resulting from the agreement over employees and civil servants amount to over EUR 1.6bn over 2024 and 2025. Additional spending was anticipated and already budgeted in in the financial plan.

High level of investment strengthens budgetary flexibility

Berlin's budgetary flexibility benefits from a high share of investment relative to total expenditure at an average 10% between 2018 and 2023. 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. Including investments under SIWA, total investment spending amounted to EUR 4bn in 2023. We expect some priorisation will be necessary to allow for structural consolidation but overall volumes to remain high.

Economy

Wealth levels and economic resilience

Berlin benefits from a strong socio-economic profile underpinned by strong growth dynamics, favourable demographics and a lively start-up and IT sector. Berlin contributed around 4.7% of national GDP in 2023, up from 4.1% in 2015. The state's GDP per capita has exceeded the German average since 2018 and stood at 105% in 2023.

GDP growth exceeding the national average since 2014

Berlin's economy grew by 4.5% in 2022 and 1.6% in 2023, surpassing the national average of 1.8% and -0.3%, respectively, proving resilient throughout the energy shock (**Figure 8**). This relative resilience was supported by 7.9% real growth in the services sector, which contributes a high 80% to total output in Berlin. Additionally, Berlin's industry is well-diversified and not as energy-intensive as in other Länder.

Moreover, the growing relevance of Berlin as a technology center places the capital city to benefit from further growth in technological innovations, such as advancements in artificial intelligence. We expect Berlin's economy to continue to outperform national outcomes and to grow by around 2% in 2024.

Economic sustainability

Stable labour market despite economic uncertainties

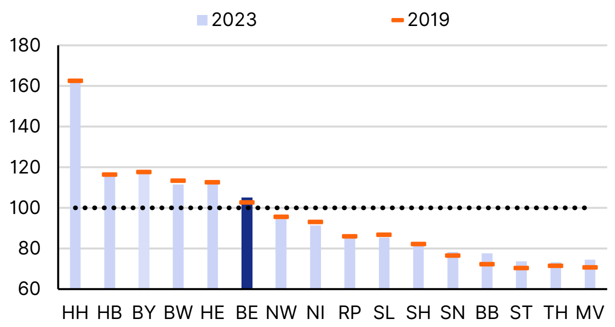
In line with the dynamic economic activity, the labour market in Berlin has performed robustly, but there has been an uptick in the unemployment rate since 2023, which stood at 9.6% in July 2024 (**Figure 9**), well above the national average due to high structural unemployment and many jobseekers entering Berlin. Further, total employment in the Land has been robust during the pandemic and energy shocks, standing at an all-time high of 2.2m at YE 2023. This supports the regional tax base, even though the federal equalisation system delinks to a large extent regional economic and tax revenue performance.

Favourable demographics

Berlin benefits from favourable social and demographic profiles. With around 3.7m inhabitants, 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 and non-European countries, adding an average 31,000 inhabitants each year over 2016-2022. At the same time, shortage of skilled labour is a key constraint to the economy, in line with the rest of Germany.

Figure 8: GDP per capita

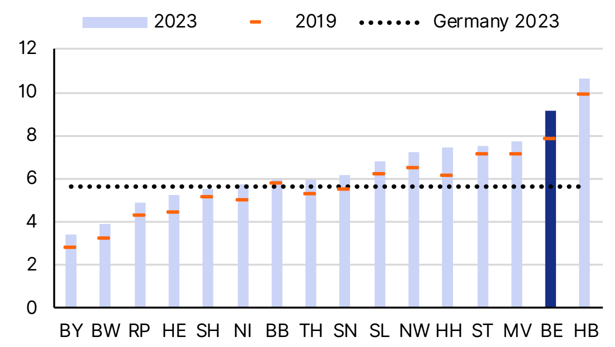
% of national average



Sources: Statistische Ämter des Bundes und der Länder, Scope Ratings

Figure 9: Unemployment rate

%



Sources: Destatis, Scope Ratings

Governance

Governance and financial management

Formation of governing coalition after bumpy election period

After the Berlin constitutional court ruled that the 2021 elections for the Berlin parliament and the district assemblies had to be re-run, elections took place in February 2023. The Christian Democratic Union (CDU) emerged as the winner of the elections with 28.2% of the votes, followed by the Social Democratic Party (SPD) and the Greens with 18.4% each. The CDU and SPD formed a coalition with Kai Wegner (CDU) as Berlin's governing mayor. We expect broad policy-continuity until the next scheduled elections in 2026.

Administration committed to fiscal consolidation and responsive to long-term challenges

Berlin's fiscal policy has been effective at balancing investment and consolidation needs. The state's senate reacted promptly to the Covid-19 shock and the Russia-Ukraine crises, making the necessary adjustments to the budget and ensuring access to liquidity for the regional real economy. The Berlin senate has also been responsive to longer-term social and environmental challenges. The priorities of the new coalition agreement includes ambitious decarbonisation efforts, administrative reforms, improvements in equipment for police and fire departments and advancements in housing construction. At the same time, a goal for structurally balanced budgets has been set only for 2028, signalling challenges in the medium-term to consolidate rising expenditures with the Land's regular revenues.

Environmental and social considerations

Environmental factors and resilience

First issuance of sustainable bond; carbon neutrality by 2045

Berlin has acknowledged the challenges posed by climate change and has developed a comprehensive climate action plan. This plan targets a reduction in greenhouse gas emissions by 70% relative to 1990 levels by 2030 and aims for carbon neutrality (a 95% reduction) by 2045.

Acquisition of energy supply company BEW in May 2024

In May 2024, Berlin acquired 100% of the shares of BEW Berliner Energie und Wärme AG for EUR 1.39bn. This acquisition is pivotal as Berlin's energy mix remains heavily reliant on gas, which constituted 45% of its primary energy consumption in 2022, while renewables only made up 6%. Decarbonising district heating is essential for the Land in reaching its climate goals.

Social factors and resilience

Affordable housing is the main social challenge

The provision of affordable housing remains a critical social challenge for Berlin, particularly as the city continues to grow. In response, the government is implementing several measures to support households during the current cost-of-living crisis. These include a moratorium on evictions for late payments throughout the energy crisis and a rent freeze until the end of 2023.

Further, the Land has set a goal of adding around 20,000 new apartments per year, of which up to 5,000 should be for social housing purposes. Out of the 20,000, the Land's housing associations are to add around 6,500 per year, highlighting the Land's active policy-making through its holdings. In 2022 and 2023, 17,000 and 16,000 new apartments were built, respectively.

Strong demographic development vis-à-vis peers

Berlin outperforms peers in terms of education attainment as reflected by a higher-than-average share of graduates but has the highest share of young people neither in employment nor in education training among the Länder. In terms of demographic related indicators, Berlin similarly outperforms peers with an old-age dependency ratio of 28% versus 35% (national average), the second lowest among peers (after Hamburg). This is also a key driver for Berlin's continued economic outperformance.

Appendix I. Institutional Framework Assessment

To assess the institutional framework, we apply a Qualitative Scorecard (QS1) centred around 6 components. We assess each analytical component on a five-point scale ranging from a score of 0 for 'low' integration to 100 for 'full' integration. The institutional framework score, ranging from 0 to 100, is calculated as a simple average of these assessments. The score is then used to determine a rating range from the rating anchor level, within which the sub-sovereign's rating can be positioned.

Our assessment of intergovernmental integration between the Länder and the Federal Republic of Germany (AAA/Stable) results in an indicative **downward rating range of up to one notch** from the German sovereign, within which the Länder can be positioned according to their individual credit strengths.

Institutional Framework scorecard (QS1)

Analytical component	Full integration (100)	Strong integration (75)	Medium integration (50)	Some integration (25)	Low integration (0)
Extraordinary support and bail-out practices	●				
Ordinary budgetary support and fiscal equalisation	●				
Funding practices			●		
Fiscal rules and oversight	●				
Revenue and spending powers	●				
Political coherence and multilevel governance	●				

Integration score	**92**
Downward rating range	**0-1**

Institutional framework score	100 > x ≥ 90	90 > x ≥ 80	80 > x ≥ 70	70 > x ≥ 60	60 > x ≥ 50	50 > x ≥ 40	40 > x ≥ 30	30 > x ≥ 20	20 > x ≥ 10	10 > x ≥ 0
Indicative rating range	0-1	0-2	0-3	0-4	0-5	0-6	0-7	0-8	0-9	0-10

Appendix II. Individual Credit Profile

Risk pillar	Analytical component	Assessment		
Debt and liquidity	Debt burden & trajectory	Stronger	Mid-range	Weaker
	Debt profile & affordability	Stronger	Mid-range	Weaker
	Contingent liabilities	Stronger	Mid-range	Weaker
	Liquidity position & funding flexibility	Stronger	Mid-range	Weaker
Budget	Budgetary performance & outlook	Stronger	Mid-range	Weaker
	Revenue flexibility	Stronger	Mid-range	Weaker
	Expenditure flexibility	Stronger	Mid-range	Weaker
Economy	Wealth levels and economic resilience	Stronger	Mid-range	Weaker
	Economic sustainability	Stronger	Mid-range	Weaker
Governance	Governance and financial management	Stronger	Mid-range	Weaker

Additional environmental and social factors	Assessment		
Environmental factors and resilience	Positive impact	No impact	Negative impact
Social factors and resilience	Positive impact	No impact	Negative impact

ICP score	50
Indicative notching	0

Appendix III. Mapping table

We derive the indicative rating by mapping the result of the institutional framework assessment to the ICP score. For Berlin, this results in an indicative rating aligned with the sovereign rating of AAA. No additional considerations apply.

Institutional framework assessment		Individual credit profile score							
Score	Downward rating range	100 > x ≥ 80	80 > x ≥ 70	70 > x ≥ 60	60 > x ≥ 50	50 > x ≥ 40	40 > x ≥ 30	30 > x ≥ 20	20 ≥ x > 0
100 > x ≥ 90	0-1	0	0	0	0	0	0	-1	-1
90 > x ≥ 80	0-2	0	0	-1	-1	-1	-1	-2	-2
80 > x ≥ 70	0-3	0	-1	-1	-1	-2	-2	-3	-3
70 > x ≥ 60	0-4	0	-1	-1	-2	-2	-3	-3	-4
60 > x ≥ 50	0-5	0	-1	-1	-2	-2	-3	-4	-5
50 > x ≥ 40	0-6	0	-1	-1/-2	-2/-3	-2/-3	-3/-4	-4/-5	-6
40 > x ≥ 30	0-7	0	-1/-2	-1/-2	-2/-3	-3/-4	-4/-5	-5/-6	-7
30 > x ≥ 20	0-8	0	-1/-2	-2/-3	-3/-4	-4/-5	-5/-6	-6/-7	-8
20 > x ≥ 10	0-9	0	-1/-2	-2/-3	-3/-4	-4/-5	-5/-6	-7/-8	-9
10 > x ≥ 0	0-10	0	-1/-2	-2/-3	-3/-4	-5/-6	-7/-8	-9/-10	-10

Note: Mapping table under section 4 of Scope's Sub-sovereigns Rating Methodology, as applied to the rating anchor's AAA-ratings.

Appendix IV. Statistical table

For 2024/25, the table displays Scope Ratings' estimates and forecasts, which may deviate from the Land's projections.

	2018	2019	2020	2021	2022	2023	2024E	2025F
Budgetary performance (EUR m)								
Operating revenue	28,482	28,925	30,608	34,970	36,540	34,691	34,970	36,597
Operating revenue growth, %	6.6%	1.6%	5.8%	14.3%	4.5%	-5.1%	1.0%	4.7%
Tax revenue	17,027	17,534	20,732	24,653	27,220	26,364	26,949	28,461
Allocations and grants	9,756	9,616	8,302	8,616	7,403	6,461	6,027	6,146
Other operating revenue	1,699	1,775	1,573	1,700	1,917	1,866	1,994	1,990
Operating expenditure	23,865	24,824	29,620	31,959	31,996	32,708	33,951	35,123
Operating expenditure growth, %	5.9%	4.5%	19.3%	7.9%	0.1%	2.2%	4.7%	3.5%
Personnel	8,854	9,310	9,859	10,505	10,941	11,463	12,139	12,722
Allocations and grants	7,215	7,370	9,983	10,713	9,712	9,453	9,845	10,141
Other operating expenditure	7,795	8,144	9,778	10,741	11,343	11,793	11,967	12,260
Operating balance	4,617	4,101	988	3,010	4,544	1,982	1,019	1,475
Interest received	12	13	9	14	11	6	22	22
Interest paid	1,229	1,161	980	1,085	966	745	900	1,000
Net interest paid	1,229	1,148	971	1,071	954	739	878	978
Current balance	3,388	2,953	17	1,939	3,590	1,244	141	497
Capital balance	-1,879	-2,175	-1,450	-2,061	-2,840	-3,004	-4,120	-3,119
Balance before debt movement	1,509	778	-1,432	-122	750	-1,760	-3,980	-2,622
New borrowing (credit market)	4,511	2,967	12,129	3,470	5,390	6,338	7,007	5,849
Debt redemption (credit market)	7,262	4,539	5,315	5,714	5,721	5,572	5,327	5,412
Net borrowing	-2,751	-1,572	6,815	-2,244	-331	766	1,680	437
Debt (EUR m)								
Direct debt	57,600	57,555	63,705	65,923	65,903	64,243	67,098	67,535
Guarantees	4,255	3,016	3,007	4,616	4,283	4,106	4,106	4,106
Overall debt risk (direct debt plus guarantees)	61,855	60,571	66,712	70,539	70,187	68,349	71,204	71,641
Financial ratios								
Debt/operating revenue, %	202.2%	199.0%	208.1%	188.5%	180.4%	185.2%	191.9%	184.5%
Debt/operating balance, years	12.5	14.0	64.5	21.9	14.5	32.4	65.9	45.8
Interest payments/operating revenue, %	4.3%	4.0%	3.2%	3.1%	2.6%	2.1%	2.5%	2.7%
Implicit interest rate, %	2.1%	2.0%	1.5%	1.6%	1.5%	1.2%	1.3%	1.5%
Operating balance/operating revenue, %	16.2%	14.2%	3.2%	8.6%	12.4%	5.7%	2.9%	4.0%
Balance before debt movement/total revenue, %	5.1%	2.6%	-4.6%	-0.3%	2.0%	-5.0%	-11.1%	-7.0%
Transfers and grants/operating revenue, %	34.3%	33.2%	27.1%	24.6%	20.3%	18.6%	17.2%	16.8%
Capital expenditure/total expenditure, %	9.8%	10.9%	7.0%	8.3%	10.1%	10.8%	12.5%	9.3%
Economy and demographics								
Nominal GDP, EUR m	149,391	157,069	156,514	165,929	178,923	193,219		
GDP per capita, EUR	41,164	42,948	42,684	45,203	48,145	51,209		
GDP per capita, % of national GDP per capita	101.4%	102.7%	104.3%	104.0%	104.1%	105.0%		
Real GDP growth, %	3.5%	2.9%	-2.5%	3.3%	4.5%	1.6%		
Population, '000s	3,645	3,669	3,664	3,677	3,755	3,782.2		
Unemployment rate, % labour force	8.1%	7.8%	9.7%	9.8%	8.8%	9.1%		

Source: Berlin, Destatis, Statistische Ämter des Bundes und der Länder, Scope Ratings

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Applied methodologies

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