

Research Update:

Outlook On Germany's Wirtschafts- und Infrastrukturbank Hessen Revised To Negative; 'AA+/A-1+' Ratings Affirmed

October 28, 2020

S&PGR Revises WI Bank Outlook To Negative; 'AA+/A-1+' Affirmed

Overview

- We revised our outlook on the German State of Hesse to negative from stable on Oct. 23, 2020.
- We equalize our ratings on Wirtschafts- und Infrastrukturbank Hessen (WI Bank) with those on the state because we believe the bank enjoys an almost certain likelihood of extraordinary government support if necessary.
- We are therefore revising our outlook on WI Bank to negative from stable, and affirming the ratings at 'AA+/A-1+'.

Rating Action

On Oct. 28, 2020, S&P Global Ratings revised its outlook to negative from stable on Wirtschafts- und Infrastrukturbank Hessen (WI Bank), the German State of Hesse's bank for the promotion of local economic and social development. We also affirmed our 'AA+/A-1+' long- and short-term issuer credit ratings on the bank.

Rationale

The outlook revision follows a similar action on the State of Hesse (see "German State of Hesse Outlook Revised To Negative; 'AA+/A-1+' Ratings Affirmed," published Oct. 23, 2020, on RatingsDirect). COVID-19-related tax revenue shortfalls and a sizable economic support package for the local economy imply significant budget deficits and an increase in Hesse's debt burden over the next two years. Although we expect a rapid decline in deficits from 2021, the negative outlook on the state reflects the risk that Hesse could fail to restore its credit metrics to within the thresholds of our current rating in a timely manner. This could result from adverse macroeconomic conditions persisting or the state having difficulty aligning expenditure volumes to the anticipated,

PRIMARY CREDIT ANALYST

Sabine Daehn
Frankfurt
(49) 69-33-999-244
sabine.daehn
@spglobal.com

SECONDARY CONTACTS

Michael Stroschein
Frankfurt
(49) 69-33-999-251
michael.stroschein
@spglobal.com

Benjamin Heinrich, CFA, FRM

Frankfurt
+ 49 693 399 9167
benjamin.heinrich
@spglobal.com

ADDITIONAL CONTACT

EMEA Sovereign and IPF
SovereignIPF
@spglobal.com

more challenging revenue situation from 2021.

We consider WI Bank to be a government-related entity (GRE) benefitting from an almost certain likelihood of timely and sufficient government support if needed. We base this opinion on WI Bank's "critical role" for, and "integral link" with, Hesse. Accordingly we equalize our ratings on WI Bank with the ratings on Hesse, and we do not derive a stand-alone credit profile (SACP) for WI Bank.

We expect the bank will continue to play a prominent public-policy role as the state's only development bank and dominant economic promotion agency. We therefore do not view government support as subject to transition risk. Accordingly, we do not expect the ownership structure or guarantee mechanism will change in the medium to long term. In addition, the state government mandated WI Bank with administering and disbursing some of its local COVID-19-related loans and grants, further underpinning our view of the close link.

WI Bank is the State of Hesse's only development bank, and it is integrated into Landesbank Hessen-Thüringen (Helaba), a partly state-owned bank. It carries out key government-mandated policies in support of housing, infrastructure, education, urban and business development, as well as social and ecological projects in Hesse. Recently it expanded some of its programs to support small and midsize companies with liquidity provisions during the COVID-19 pandemic and will be involved in managing Hesse's economic support fund, Hessenfond, going forward. We expect WI Bank to retain its flagship role as the sole regional development bank in Hesse and to continue being the vehicle of choice for the state's economic and social development initiatives.

We see WI Bank as having a "critical role" for and an "integral link" with Hesse. We do not consider the likelihood of extraordinary government support as being subject to transition risk, and we do not doubt the state government's general propensity to support its GRE sector. Furthermore, we believe that Hesse's limited (other) contingent liabilities do not constrain its capacity and willingness to support WI Bank in a timely manner, in case the bank were to encounter financial difficulties.

Hesse established WI Bank as a public law institution by an act of the state parliament, which contains the explicit and comprehensive guarantee framework for WI Bank and forms the basis for our assessment of its integral link with Hesse. WI Bank has a special public status, and is legally fully embedded into Helaba, which is 8% owned by the State of Hesse. WI Bank benefits from Helaba's banking license, information technology systems, and (regulatory) reporting structure, but it retains operational independence and produces a separate set of accounts. Our view of an integral link is based on the state's strategy for the bank's lending programs and the reserved majority for state representatives on the supervisory board. The state ministers of economy and minister of finance are appointed members of the board and cannot be outvoted. WI Bank could only be dissolved by an act of the state parliament.

In our view, WI Bank plays a pivotal role in supporting Hesse's economic and social development initiatives and acts in this respect as an arm of the government. In particular, it administers and executes the financial aspects of the vast majority of Hesse's development programs for local enterprises, infrastructure, social housing, urban development, agriculture, education, and employment. Since 2018, the bank has refinanced a voluntary program for short-term municipal debt taken over by a fund, created by Hesse, and is now involved in Hesse's measures to support the local economy throughout the pandemic.

The guarantee framework for WI Bank is twofold and comprises the statutory guarantee of Hesse (Gewährträgerhaftung), which we understand is not timely, and the state's explicit guarantees on liabilities for loans incurred and bonds issued. We understand the guarantee mechanism to be in full compliance with the relevant agreement from 2002 between Germany and the EU on

guarantees for promotional banks (Agreement II), and hence not be under any further scrutiny. The guarantee structure demonstrates the importance of the bank to Hesse, which is reflected in our rating assessment. Furthermore, the organization's business model is distinctly different from that of a commercial bank, since it purely focuses on promotional activities and the execution of government policies, which cannot readily be transferred to a private entity, in our view.

Due to our assessment of an almost certain likelihood of extraordinary government support--and that we do not see this support as subject to a medium-term transition risk--as well as the bank's role in executing strategic government policies, we do not derive an SACP for WI Bank.

In 2019, WI Bank acquired new business volumes of €2 billion under its program framework. Although this appears to be a sharp drop versus 2018 new business volumes of €7 billion, it is mainly attributable to 2018's state-sponsored €5 billion municipal support program, Hessekasse. The largest share (41%) of new business volume in 2019 was attributable to infrastructure development, followed by 22% for housing loans and urban rehabilitation, and 17% for agricultural programs. For 2020, we expect new business to remain stable within WI Bank's standard business segments, with some programs--adjusted for needs during the pandemic--increasing. The latter include WI Bank's formerly called loans--now referenced as liquidity support to micro and midsize enterprises. The State of Hesse covers these measures out of budgetary funds. Similarly WI Bank was responsible for the distribution of federal grants to the hospital sector in Hesse.

WI Bank's total assets increased by €0.8 billion to €24.9 billion in 2019. Although new business increased in all segments, it remains challenging for the bank to compensate repayments--a circumstance generally visible in the sector. Even so, we believe WI Bank's profits will remain stable over the next few years, with the majority distributed to Helaba, as seen previously, and the remainder retained in the bank's balance-sheet reserves.

Funding is primarily taken from banks, including domestic and European development banks (74%), customers (9%), and bond investors (17%), with no major shifts observable. WI Bank expects to have refinancing needs of roughly €1.5 billion in 2020 and a slightly lower amount for 2021.

Outlook

The negative outlook on WI Bank reflects that on the State of Hesse. We believe WI Bank's status as Hesse's key tool for the implementation of economic and social development policies, and its explicit guarantee, will remain unchanged over the medium term.

Downside scenario

Any negative rating action on Hesse would trigger a similar one on WI Bank. In addition, a material weakening of WI Bank's key policy role for, or link to, Hesse could also constrain the rating. For example, changes to the bank's guarantee or ownership structure, or a significant portion of promotional lending being channeled through other institutions in the future could signal a relevant change.

Upside scenario

We could revise the outlook to stable if we took a similar rating action on Hesse.

Key Statistics

Table 1

Wirtschafts- Und Infrastrukturbank Hessen (WI Bank) Selected Indicators

(Mil. €)	2019	2018	2017	2016	2015
Adjusted assets	24,905	24,105	17,627	17,413	16,813
Growth in adjusted assets (%)	3.3	36.8	1.2	3.6	6.0
Customer loans (gross)	13,924	14,023	9,664	9,579	9,444
Loans to banks	10,102	9,292	7,086	7,010	6,670
Loans from refinancing banks	16,337	16,019	11,707	11,668	11,340
Bonds issued	3,746	3,380	2,098	2,053	1,913
Other funding instruments	1,907	1,892	902	826	813
Operating revenues	106	95	93	96	96
Noninterest expenses	83	79	73	64	75
Core earnings	14	14	14	20	21
Net interest income/operating revenues (%)	61.1	57.6	55.6	51.2	55.6
Fee income/operating revenues (%)	37.9	41.3	42.8	40.2	43.6
Cost to income ratio (%)	78.2	83.3	78.5	66.6	78.4

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- German State of Hesse Outlook Revised To Negative; 'AA+/A-1+' Ratings Affirmed, Oct. 23, 2020
- S-Finanzgruppe Hessen-Thueringen Outlook To Negative On Weaker Profitability Prospects Amid COVID-19; Ratings Affirmed April 23, 2020
- Banking Industry Country Risk Assessment: Germany, Oct. 1, 2019

Ratings List

Ratings Affirmed

Wirtschafts- Und Infrastrukturbank Hessen (WIBank)	
Senior Unsecured	AA+

Ratings Affirmed; Outlook Action

	To	From
Wirtschafts- Und Infrastrukturbank Hessen (WIBank)		
Issuer Credit Rating	AA+/Negative/A-1+	AA+/Stable/A-1+

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceld/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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