

## CREDIT OPINION

29 August 2023

Update



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### RATINGS

#### Bayerische Landesbodenkreditanstalt

Domicile	Munich, Germany
Long Term CRR	Not Assigned
Long Term Debt	Aaa
Type	Senior Unsecured - Dom Curr
Outlook	Stable
Long Term Deposit	Not Assigned

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

### Contacts

Anna Stark +49.69.86790.2107  
AVP-Analyst  
anna.stark@moodys.com

Alexander Hendricks, +49.69.70730.779  
CFA  
Associate Managing Director  
alexander.hendricks@moodys.com

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Americas	1-212-553-1653
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# Bayerische Landesbodenkreditanstalt

## Update to credit analysis

### Summary

[Bayerische Landesbodenkreditanstalt's](#) (BayernLabo) backed ratings are based on the guarantee framework provided by the [Free State of Bavaria](#) (Bavaria, Aaa stable), and the Aaa/P-1 senior unsecured and issuer ratings are aligned with that of Bavaria. The guarantee framework comprises a guarantee obligation (Gewährträgerhaftung), and a full, explicit and unconditional guarantee for the bank's existing and future obligations in respect of money borrowed, bonds issued and derivative transactions entered into by the bank.

BayernLabo serves Bavaria's public policy objectives with respect to social housing and municipal construction, and also extends loans to the Bavarian state and local authorities.

It is a semi-independent Bavarian regional development bank that is consolidated within [Bayerische Landesbank](#) (BayernLB, Aa3/Aa3 positive, baa2<sup>1</sup>). Although it is a legally dependent part (Anstalt in der Anstalt) of BayernLB, it has its own management board and independent commercial activities, which are, however, directed by Bavaria in the context of the federal state's economic policies for the region. As a subsidiary-like unit of BayernLB, which is 75% owned by Bavaria and 25% owned by the Association of Bavarian savings banks, BayernLabo is included in the resolution perimeter of BayernLB under the European Union's (EU) Bank Recovery and Resolution Directive (BRRD) and its debt is, hence, bail-in-able. However, in the unlikely event of resolution, creditors of BayernLabo would have direct recourse to Bavaria for indemnification, given the explicit refinancing guarantee.

### Credit strengths

- » Strong support from Bavaria and an extensive guarantee framework
- » Minimal asset risk, given its mostly guaranteed lending book
- » Access to funding at very favourable rates because of the guarantee framework

### Credit challenges

- » BayernLabo's participation in BayernLB could result in potential net losses because of the legal structure
- » Reliance on net interest income has strained earnings in a prolonged low-yield environment in the past few years, until mid 2022

## Outlook

- » The stable outlook on BayernLabo's ratings reflects the stable outlook on the rating of the bank's guarantor, the Free State of Bavaria.
- » The outlook on the guarantor reflects our expectation that the regional government will maintain balanced financial accounts over the coming two years and maintain its commitment to reduce its debt.

## Factors that could lead to an upgrade

- » BayernLabo's ratings are at the highest level and, therefore, cannot be upgraded.

## Factors that could lead to a downgrade

- » Negative rating pressure could arise on BayernLabo's ratings if the credit profile of the guarantor, the Free State of Bavaria, were to deteriorate; or the guarantee mechanism were to weaken or be disallowed, which is highly unlikely at present.

## Profile

Bayerische Landesbodenkreditanstalt (BayernLabo) is a development bank operating in the Free State of Bavaria and is headquartered in Munich. The bank is a legally dependent part of BayernLB but independent in organisational and commercial terms. BayernLabo has received an explicit refinancing guarantee from Bavaria.

BayernLabo is one of the two development banks guaranteed and mandated by the state, the other being [LfA Foerderbank Bayern](#) (LfA, Aaa stable/Aaa stable<sup>2</sup>). While LfA focuses on commercial and infrastructure projects, and environmental protection programmes in Bavaria, the remit of BayernLabo is to promote social housing and municipal construction in the region, and to extend loans to the Bavarian state and local authorities.

With total assets of €21.1 billion and 204 full-time equivalent employees as of year-end 2022, BayernLabo is the sixth largest of the 17 state development banks in Germany. For more information, please see the German [Banking System Outlook](#).

## Detailed credit considerations

### BayernLabo's franchise is supported by an extensive guarantee framework

Similar to that of other development banks, BayernLabo's franchise value is incomparable with that of commercially oriented banks. BayernLabo operates under a public policy mandate, as stipulated by [Law on Bayerische Landesbank](#) (Art. 20), which is in line with the [Understanding II](#) agreement reached between the Federal Republic of Germany and the European Commission in 2002.<sup>3</sup> This results in a narrow public mandate, focusing on the fulfilment of public development activities, participation in projects in the interest of the European Community, granting of loans to public legal entities, financing measures with a purely social character and export financing in line with World Trade Organization (WTO) rules. BayernLabo pursues a competition-neutral business model, extending its loans (which have a second-lien status) in conjunction with commercial banks, such as the Bavarian savings or cooperative banks.

The state guarantees in place encompass BayernLabo's guarantor liability (Gewährträgerhaftung) by its ultimate owners, Bavaria and the Association of Bavarian Savings Banks, which jointly, on a pro rata basis of ownership (75% and 25%, respectively), are fully and directly liable for BayernLabo's liabilities. An even more explicit refinancing guarantee is, however, provided by Bavaria on its own, which fully, unconditionally and irrevocably guarantees, upon first demand, all liabilities issued by BayernLabo, and which is the basis for the backed Aaa/P-1 ratings that we assign to BayernLabo.

### Participation in BayernLB can lead to potential net losses

Unlike most other German state development banks, which are legally independent institutions, BayernLabo is a semi-independent institution with the legal structure of Anstalt in der Anstalt (an institution within an institution). Although the bank is a legally

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dependent part of BayernLB and fully consolidated therein, it has its own management board and independent commercial activities, which are, however, directed by Bavaria in the context of the federal state's economic policies for the region.

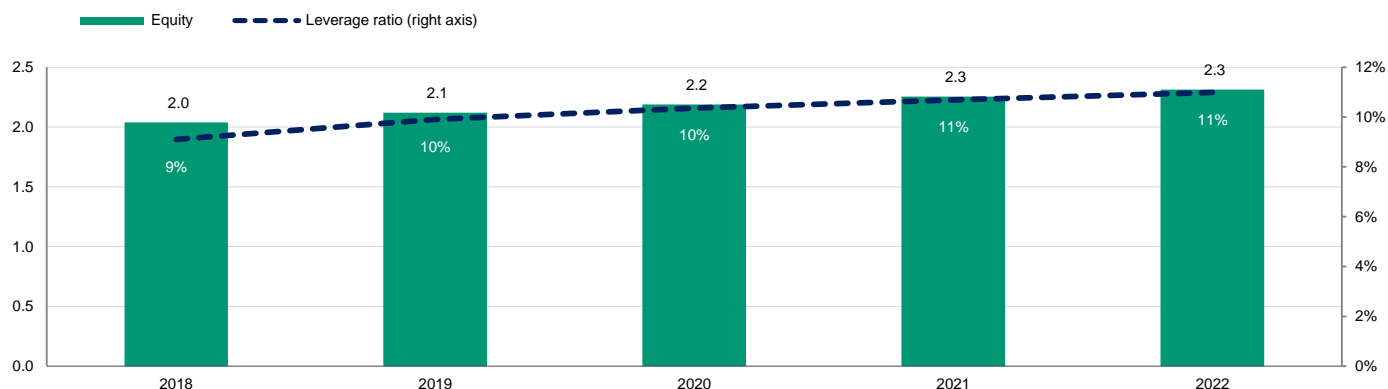
Because BayernLabo is a subsidiary-like unit of BayernLB, the bank's results are reported within the Real Estate and Savings Banks/ Financial Institutions segment of BayernLB. BayernLabo is also included in the resolution perimeter of its parent, BayernLB, under the BRRD and its debt is, hence, bail-in-able. However, in the unlikely event of resolution, creditors of BayernLabo would have direct recourse to Bavaria for indemnification, given the explicit refinancing guarantee.

As part of BayernLB, BayernLabo is supervised by the European Central Bank under its Single Supervisory Mechanism, with its total capital (€2.3 billion as of year-end 2022) being fully reflected in BayernLB's regulatory capital under the EU's Capital Requirements Regulation and Directive (CRR/CRD IV). However, BayernLabo's capital cannot be transferred to the parent bank at management's discretion and is only fungible for BayernLB by absorbing net losses that are created at the parent bank level<sup>4</sup> on a pro rata basis of capital (BayernLabo's local GAAP capital of €2.3 billion accounted for 17% of BayernLB's HGB capital as of year-end 2022). This scenario played out in 2013 and 2014, when BayernLB booked sizeable net losses related to its Heta Asset Resolution AG, ABS portfolio and [Hungary](#) (Baa2 stable) exposures, which were then partly borne by BayernLabo. In return, BayernLabo also benefits if BayernLB generates distributable net profit under German GAAP, which was the case over the period 2016-22. Hence, capital retention will likely remain high at BayernLabo, and only outsized losses at BayernLB could diminish BayernLabo's capital base significantly.

Exhibit 1

### BayernLabo's capital and leverage ratio consistently improved over the past years

Equity in € billion



Leverage ratio = Equity/total assets.

Source: Company data

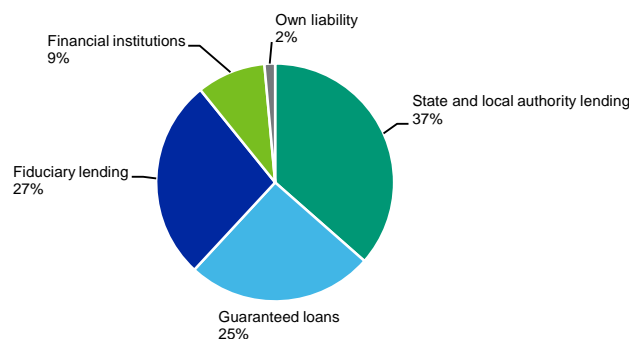
### Minimal asset risk, given BayernLabo's mostly guaranteed lending book

As of year-end 2022, BayernLabo was active in five business areas: state and local authority lending €7.5 billion (2021: €8.3 billion), guaranteed loans €5.2 billion (2021: €5.7 billion), fiduciary lending €5.6 billion (2021: €5.3 billion), interbank lending €1.9 billion (2021: €1.5 billion) and the bank's business at own liability €0.3 billion (2021: €0.3 billion). Overall, the bank's lending volume fell by 3% in 2022, mainly driven by reduced lending volumes to the Free State of Bavaria (state and local authority lending) and lower new business volume in 2022. The total new lending volume reduced in 2022 by around 27% to €1.8 billion (2021: €2.4 billion) largely after the termination of specific temporary support programmes for families and also because of lower demand from nonresidential sectors.

Exhibit 2

**BayernLabo's asset breakdown**

Total assets of €21.1 billion; the share of state and local authority lending has been decreasing since 2015



Source: Company data

BayernLabo took over the state and local authority lending book from BayernLB in 2006. After a period of growth between 2012 and 2015, the volume has decreased continuously since 2015. In 2022, state lending to the Free State of Bavaria decreased by 43% to €1.1 billion from €1.9 billion a year earlier (2020: €2.6 billion). Loans to Bavarian municipalities are funded through capital markets but also represent [Kreditanstalt fuer Wiederaufbau's](#) (KfW; Aaa stable/Aaa stable<sup>5</sup>) programmes to improve local infrastructure, the energy efficiency of municipal buildings and public access for the disabled. Local authority lending volumes remained virtually unchanged at €6.3 billion in 2022.

In fiduciary lending, the Free State of Bavaria channels fiduciary funds through BayernLabo to support residential construction and student housing. Similarly, the Free State of Thuringia extends legacy fiduciary assets through BayernLabo, which relate to business underwritten in Thuringia in the post-reunification period. In Thuringia, no new business has been underwritten since 2002. BayernLabo faces no credit risk from those exposures because credit losses are directly written off against fiduciary liabilities extended by the states.

Business at BayernLabo's own risk of €0.3 billion as of year-end 2022 (1% of total loans) represents follow-up financing for clients who are no longer entitled to benefit from any guaranteed loan programmes. It is the only area where the bank faces any credit risk, but loan loss charges have so far been negligible and are immediately written off, generating no balance-sheet provisions. BayernLabo extends such loans at a maximum 80% loan-to-value ratio.

Guaranteed loans are funded by KfW, [Landwirtschaftliche Rentenbank](#) (Aaa/Aaa stable<sup>6</sup>) and capital market debt to finance residential construction, and the modernisation and construction of rental properties. These loans are further subsidised by BayernLabo, which reduces the interest rate charged below the refinancing rate. No credit risk is associated with these assets as well because they are guaranteed by the Bavarian or Thuringian municipalities or states. Similar to fiduciary lending, the Thuringian-guaranteed lending business is in run-off. The total amount of guaranteed lending of €5.2 billion decreased in 2022 from €5.7 billion in 2021.

Moreover, BayernLabo holds on behalf of Bavaria a 0.26% stake in [Airbus SE](#) (A2 stable), whose market risk is fully hedged.

### Dependence on net interest income in a prolonged low interest environment and the bank's public mission limit BayernLabo's profit generation

In line with BayernLabo's public mandate, profit maximisation is not the bank's primary target. The bank focuses on supporting regional social housing and municipal construction activities with subsidised loans and interest waivers.

In the first half of 2022, low interest rates still prevailed and the bank still had to pass on negative rates or offer other features in its programmes to continue to provide subsidised loans to customers in 2022, while the lending volume contracted. Thus, its net interest income was €51.4 million, or 67% of revenue, down from €59.3 million a year earlier.<sup>7</sup>

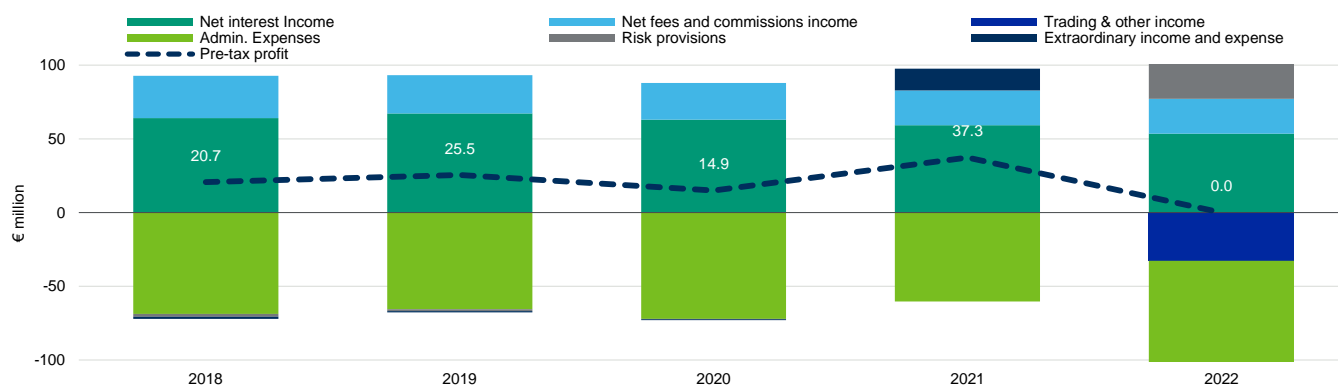
For full-year 2022, BayernLabo's net income was €0 (2021: €37.3 million), weighed down by impairments on the securities in the Contractual Trust agreement (for pension liabilities) amounting to €28.7 million and by higher personnel and material expenses which increased to €69.1 million in 2022 (2021: €64.9 million).

Under IFRS, BayernLabo contributed €25 million in pretax income to its parent BayernLB in 2022 (€38 million in 2021). The decrease in IFRS pretax income mainly stemmed from the termination of specific temporary support programmes for families (Baukindergeld) and thus lower reimbursement and higher administrative expenses.

For 2023, we expect the bank to benefit from an increase in interest rates to support its net interest income and earnings.

Exhibit 3

### BayernLabo's profitability is driven by high prepayments and low provisioning needs



Source: Company reports

### Favourable access to funding supported by the guarantee framework

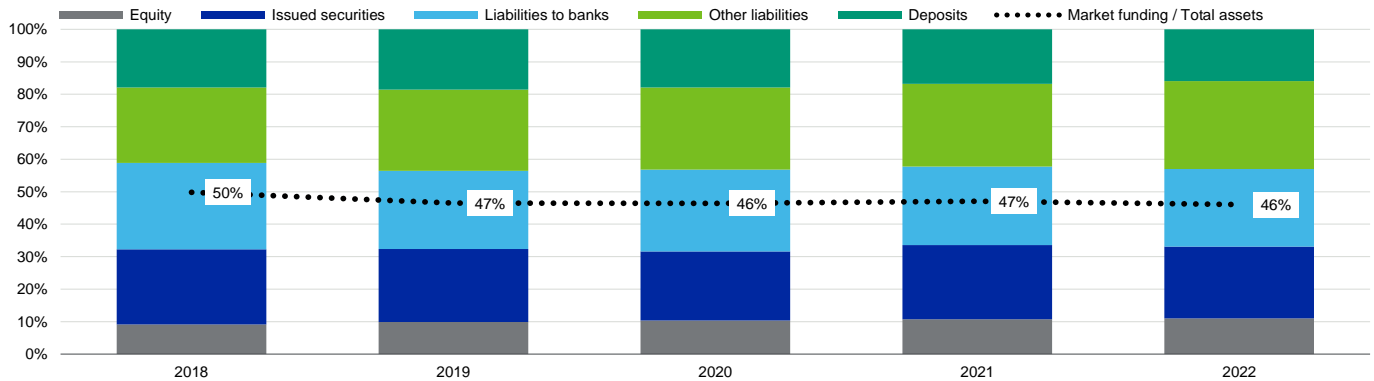
BayernLabo relies highly on market funding and depends on regular market access. However, the bank's status as a quasi-subsovereign prime issuer has ensured uninterrupted access to domestic and international capital markets at very attractive rates.

BayernLabo's funding mix largely consists of confidence-sensitive capital market funding, including bearer bonds, benchmark bonds and structured bonds, whose volume was €4.7 billion as of year-end 2022 (25% of total liabilities). In addition, the bank issues registered bonds, promissory notes and other customer debt, which amounted to €3.4 billion as of year-end 2022 (18% of total liabilities). Besides these issuances, BayernLabo held interbank liabilities of €5.0 billion in 2022, which consist of promotional funding from KfW and Landwirtschaftliche Rentenbank and other banks. Fiduciary liabilities of €5.6 billion (30% of total) constituted the remaining liabilities as of year-end 2022.

BayernLabo's new funding volume amounted to €1.2 billion in 2022, slightly more than €1.1 billion a year earlier. Promotional funding from other development banks amounted to €636 million (55% of total), while bearer bonds (45% of total) totaled €514 million.

Exhibit 4

**BayernLabo's funding is driven by capital market refinancing**



Market funding includes issued securities and liabilities to banks.

Source: Company reports

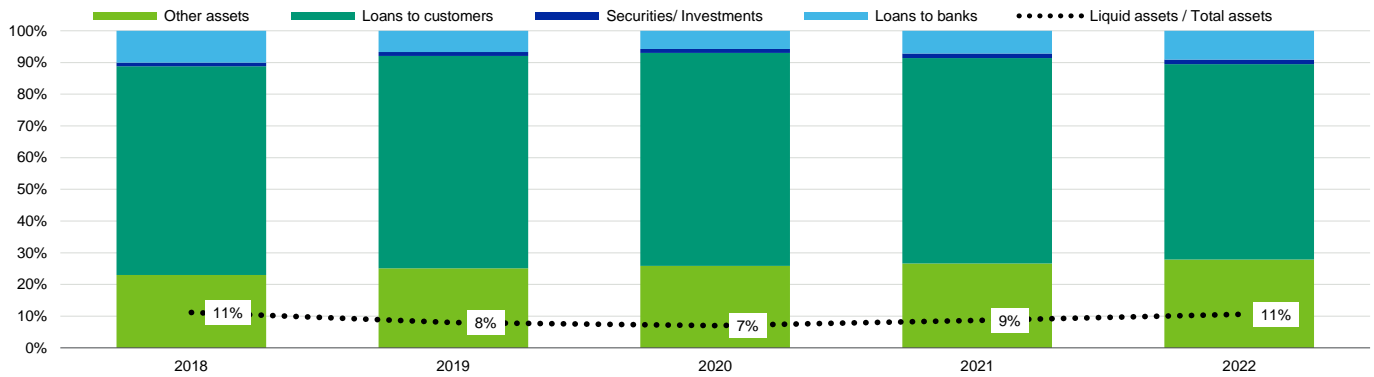
**Adequate liquid resources**

BayernLabo is by and large match funded, and the bank's liquid resources, although low in absolute terms, seem adequate as a result. BayernLabo's liquid assets comprise the bank's liquidity portfolio of German federal and state government bonds, development bank bonds of €0.3 billion and interbank loans of €1.9 billion (mostly BayernLB) as of year-end 2022.

BayernLabo benefits from the so-called Solva-0 status, meaning that banks that purchase BayernLabo's debt are not required to allocate capital against it (zero risk weight) and the bank's debt does not count towards (German) large loan limits. Furthermore, BayernLabo's debt is classified as a Level 1<sup>8</sup> high-quality liquid asset for the calculation of the liquidity coverage ratio.

Exhibit 5

**BayernLabo's liquid resources are adequate and mostly consist of interbank lending**



Liquid assets include securities and loans to banks.

Source: Company data

## ESG considerations

In line with our general view of the banking sector, BayernLabo has low exposure to environmental risks (see our [environmental risk heat map](#)<sup>9</sup> for further information). Given BayernLabo's public mandate and core activities, BayernLabo is particularly involved in financing projects with a positive impact on environmental and climate protection.

For social risks, we also place BayernLabo in line with our general view of the banking sector, which indicates moderate exposure (see our [social risk heat map](#)<sup>10</sup>).

In line with its public mandate and in line with the sustainability strategy of the Free State of Bavaria, BayernLabo has issued [two social bonds](#) of €500 million each, one in 2017 and one in March 2021. Underlying loans result from the bank's promotional programmes for the creation of rental properties, low-interest loans for private housing and modernisation programme totaling €1.564 billion as of December 2022.

Governance<sup>11</sup> is highly relevant to BayernLabo, as it is to all banks. We do not have any particular governance concern for BayernLabo, and we do not apply any corporate behaviour adjustment to the bank. Nonetheless, corporate governance remains a key credit consideration and remains a subject of our ongoing monitoring.

## Methodology and scorecard

The principal methodology used to arrive at BayernLabo's ratings was the [Banks Methodology](#), published in July 2021.

## Ratings

Exhibit 6

Category	Moody's Rating
<b>BAYERISCHE LANDESBODENKREDITANSTALT</b>	
Outlook	Stable
Bkd Bank Deposits	Aaa/P-1
Bkd Issuer Rating	Aaa
Bkd Senior Unsecured -Dom Curr	Aaa
Bkd ST Issuer Rating	P-1
<b>PARENT: BAYERISCHE LANDESBANK</b>	
Outlook	Positive
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	Aa3/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	Aa3
Senior Unsecured	Aa3
Junior Senior Unsecured -Dom Curr	A2
Junior Senior Unsecured MTN -Dom Curr	(P)A2
Subordinate	Baa2
Commercial Paper -Dom Curr	P-1
Other Short Term -Dom Curr	(P)P-1

Source: Moody's Investors Service

## Endnotes

- [1](#) The ratings shown are BayernLB's deposit and senior unsecured ratings, and Baseline Credit Assessment.
- [2](#) The ratings shown are LfA's deposit and senior unsecured ratings.
- [3](#) The Understanding II agreement ensures that German development banks can continue to benefit from public-sector support in the form of state guarantees without breaching the EU state aid rules.
- [4](#) Under German local GAAP or HGB.
- [5](#) The ratings shown are KfW's backed deposit and backed senior unsecured ratings.
- [6](#) The ratings shown are Landwirtschaftliche Rentenbank's backed deposit and backed senior unsecured ratings.
- [7](#) According to German local GAAP.
- [8](#) Level 1 securities are high quality, highly liquid assets
- [9](#) Environmental risks can be defined as environmental hazards encompassing the impact of air pollution, soil/water pollution, water shortages, and natural and human-made hazards (physical risks). Additionally, regulatory or policy risks, such as the impact of carbon regulation or other regulatory restrictions, including the related transition risks such as policy, legal, technology and market shifts, that could impair the evaluation of assets, are an important factor. Certain banks could face a higher risk from concentrated lending to individual sectors or operations exposed to the aforementioned risks.
- [10](#) Social risk considerations represent a broad spectrum, including customer relations, human capital, demographic and social trends, health and safety, and responsible production. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which are mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct are further social risks. Social trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services, increasing information technology costs, ageing population concerns in several countries affecting demand for financial services or socially driven policy agendas translating into regulations that affect banks' revenue bases.
- [11](#) Corporate governance is a well-established key driver for banks, and related risks are typically included in our evaluation of banks' financial profile. Further, factors such as specific corporate behaviour, key-person risk, insider and related-party risk, strategy and management risk factors, and dividend policy may be captured in individual adjustments to the Baseline Credit Assessment, if deemed applicable. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, whereas governance strengths can benefit its credit profile. When credit quality deteriorates because of poor governance, such as a breakdown in controls resulting in financial misconduct, recovery can take a long time. Governance risks are also largely internal rather than externally driven.



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**Contributors**

Vasil Mrachkov  
*Associate Analyst*

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Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454