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CREDIT OPINION
10 February 2020

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RATINGS

hsh portfoliomanagement AoR

Domicile	Germany
Long Term Rating	Aa1
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

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

Contacts

Tamas Fuszenecker **+49.69.70730.971**
Analyst
tamas.fuszenecker@moodys.com

Dina Dexheimer **+49.69.70730.807**
Associate Analyst
dina.dexheimer@moodys.com

Massimo Visconti **+39.02.9148.1124**
VP-Sr Credit Officer/Manager
massimo.visconti@moodys.com

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hsh portfoliomanagement AöR (Germany)

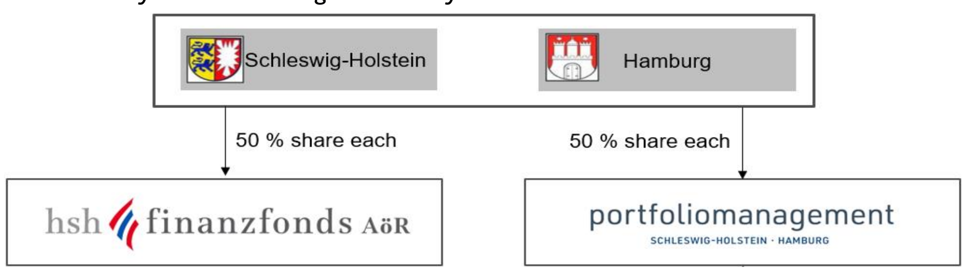
Update following affirmation of Aa1 stable

Summary

The credit profile of hsh portfoliomanagement AöR (PM, Aa1 stable) reflects the full, unconditional and irrevocable guarantee on its outstanding debt provided by its owners, two German Länder — Land of Hamburg and Land of Schleswig-Holstein — that also set up hsh finanzfonds AöR (FinFo, Aa1 stable) (see Exhibit 1).

Exhibit 1

Debt issued by FinFo and PM is guaranteed by the two German Länder



Sources: Issuer, Moody's Investors Service

Credit strengths

- Direct credit link with two German regional governments based on a full, unconditional and irrevocable guarantee on all outstanding debt
- Public-sector legal status, including deficiency guarantee and maintenance obligation under German public law
- Systemic support under the German legal framework regulating wind-down entities and strong supervision by its owners

Credit challenges

- Exposure to asset prices and refinancing risk

Rating outlook

The stable outlook on PM's rating reflects the guarantors' stable credit strength, as well as our assumption that the entity will not issue debt that is not guaranteed.

Factors that could lead to an upgrade

The rating could be upgraded in the event of an improvement in both guarantors' credit strength.

Factors that could lead to a downgrade

The rating could be downgraded in the event of a weakening of one of the guarantors' credit strength, or any weakening of the guarantee or of PM's legal status.

Profile

hsh portfoliomanagement AöR (PM) is a public-sector special-purpose entity established in 2015 under regional law by two German Länder — Land of Hamburg and Land of Schleswig-Holstein — which serve as its owners (50% each, on a pro rata basis). The setup of the entity is in line with federal law (capital market stabilisation fund law, FMStFG) and hence is supervised by Germany's Financial Supervisory Authority.

The entity's purpose is to take over and wind down a portfolio of nonperforming loans (NPLs) from former HSH Nordbank AG — now Hamburg Commercial Bank AG (Baa2 stable, ba2) — as part of the bank's restructuring process. Initially, in 2016, a portfolio of nonperforming shipping loans was taken over at a price of €2.4 billion. To fund the purchase of the bank's nonperforming assets, the entity is entitled to issue fully, unconditionally and irrevocably guaranteed debt (backed by both Länder on a pro rata basis) in the capital markets.

Detailed credit considerations

On 7 February 2020, we affirmed the Aa1 rating for PM and maintained the stable outlook.

The credit profile reflects our view that it is not relevant to distinguish between the entity and the two guarantors. As such, the entity's rating is derived from the credit strength of the support providers.

Direct credit link with two German regional governments based on a full, unconditional and irrevocable guarantee on all outstanding debt

The two German Länder — Land of Hamburg and Land of Schleswig-Holstein — on a pro rata basis (50% each), have set up the entity by law. As described in the law and the state treaty, they provide a full, unconditional and irrevocable guarantee for all debt of the entity. Therefore, we link the credit risk of the entity with that of the two Länder.

In 2017, the entity established a €2 billion debt issuance programme and a €1 billion commercial paper programme to fund itself in capital markets.

Hamburg and Schleswig-Holstein are located in the north of Germany. Hamburg has an exceptionally strong economy and strong demographics, while Schleswig-Holstein's gross domestic product per capita remains somewhat below the German average. Schleswig-Holstein reported a preliminary financial surplus of 1.8% of total revenue in 2019, compared with Hamburg's 4.2%. According to preliminary numbers, Hamburg's direct debt level probably decreased to 147% of operating revenue in 2019 from 156% in 2018, slightly above the sector average, while Schleswig-Holstein's direct debt likely decreased to 217% in 2019 from 227% a year earlier. If we include indirect debt, predominantly other non-self-supporting debt of government-owned entities, both regional governments would have net direct and indirect debt ratios well above the sector averages.

Public-sector legal status, including deficiency guarantee and maintenance obligation under German public law

As a public-sector entity, PM benefits from a maintenance obligation and a deficiency guarantee obligation provided by its public shareholders, as well as explicit guarantees on its debt.

The maintenance obligation is a general principle of German law stipulating that the owner of a public law institution is obliged to secure its economic basis to (1) keep it functioning for the complete duration of its existence, and (2) cover possible financial gaps through subsidies or other appropriate means. Bankruptcy is practically impossible.

The deficiency guarantee obligation is not considered a general principle of law, but it requires an explicit legal basis. It is defined as a direct liability, based on statute or bylaws, on the part of a regional authority or an association under public law with respect to the creditors of a public law institution for all of its obligations. The deficiency guarantee obligation creates the obligation for the guarantor to intervene in the event of insolvency or liquidation of the public law institution. It creates direct claims by the creditors against the guarantor, who can, however, only be called in if the assets of the public law institution are not sufficient to satisfy the creditors. The deficiency guarantee obligation is limited neither in time nor in amount.

The entity benefits from additional liquidity support because the two Länder have taken preventive legislative measures that will allow them to provide liquidity to the entity if required. Hence, liquidity should not be a concern for the entity.

Systemic support under the German legal framework regulating wind-down entities and strong supervision by its owners

PM was established by the two regional governments in 2015 to stabilise the former HSH Nordbank and — by the same token — to stabilise the capital markets. Germany's capital market stabilisation fund act (FMStFG §8b, a federal law) explicitly applies to PM. Therefore, the entity is subject to supervision by Germany's Financial Markets Supervisory Authority as well. However, as the entity is established by the Länder, supervision and governance is predominantly the responsibility of their governments and parliaments.

Exposure to asset prices and refinancing risk

The final cost, which would crystallise on the Länder balance sheets and increase their debt levels, depends on the successful wind down of PM's portfolio. Asset prices will have an impact on the entity's financial situation. Over the wind-down period, the entity will need to refinance itself in the capital markets, which exposes it to refinancing risk. In terms of assets, an NPL portfolio of €4.2 billion was transferred to PM in 2016 at a price of €2.4 billion. This triggered a loss for the bank, which was covered by a guarantee from FinFo. Additional write-downs on this portfolio have resulted in losses for PM in 2017. On the other hand, the wind down of the shipping loan portfolio continued successfully in 2018, with a total amount of €3.7 billion and a book value of €1.5 billion and remained stable trough Q2 2019, while further depreciation pressure looks limited.

ESG considerations

How environmental, social and governance risks inform our credit analysis of PM

We take account of the impact of the ESG factors when assessing sub-sovereign issuers' economic and financial strength. In the case of PM, the significance of ESG factors to the credit profile is as follows:

Environmental considerations are not material to PM's rating. It has some exposure to flood risk, but in this case, the owner regional governments would provide support.

Social risks are not material to the rating either, because the entity's activities are not focused on areas where they would be exposed to these risks and because the entity receives support from its owners.

Governance considerations are material to PM's rating. The governance framework is intrinsically intertwined with the supporting government, which exerts strong oversight and ultimately takes key decisions.

Further details are provided in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks.

Rating methodology

We consider the entity a government-related issuer. From a credit risk profile perspective, it is not significant to distinguish between the entity and the two guarantors. The entity's rating is derived from the credit strength of the support providers, as described in our rating methodology for Government-Related Issuers, published in June 2018. For rating guaranteed debt, we additionally apply the rating methodology for Credit Substitution, Rating Transactions Based on the Credit Substitution Approach: Letter of Credit-backed, Insured and Guaranteed Debts, published in May 2017.

Ratings

Exhibit 2

Category	Moody's Rating
HSH PORTFOLIOMANAGEMENT AOR	
Outlook	Stable
Issuer Rating	Aa1
Bkd Senior Unsecured	Aa1
ST Issuer Rating	P-1

Source: Moody's Investors Service

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