MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
1 November 2021

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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.

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hsh portfoliomanagement AöR (Germany)

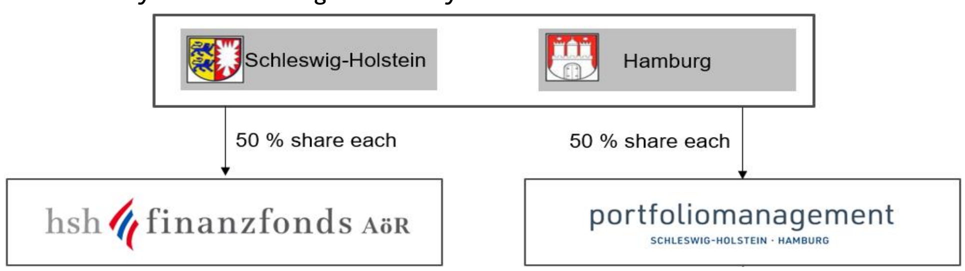
Update to credit analysis

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 two German regional government (Länder) owners — 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 PM and FinFo is guaranteed by two German Länder



Sources: Issuer and Moody's Investors Service

Credit strengths

» Full, unconditional and irrevocable guarantee provided by two German Länder on all outstanding debt

» Public-sector legal status, including maintenance obligation and deficiency guarantee 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 price movements and refinancing risk

Rating outlook

The stable outlook on PM's rating reflects the guarantors' stable credit strength and our assumption that the entity will not issue unguaranteed debt.

Factors that could lead to an upgrade

The rating could be upgraded if there is 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 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). 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 the takeover and wind-down of a portfolio of nonperforming shipping loans from the former HSH Nordbank AG — now Hamburg Commercial Bank AG (Baa1 positive, ba1)[1] — as part of the bank's restructuring process. To fund the purchase of the bank's nonperforming assets, the entity is entitled to issue debt in the capital markets, which is fully, unconditionally and irrevocably guaranteed by the two Länder (on a pro rata basis).

Detailed credit considerations

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

Full, unconditional and irrevocable guarantee provided by two German Länder on all outstanding debt

The two owner Länder have set up the entity by law on a pro rata basis (50% each). 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.

Hamburg and Schleswig-Holstein are located in the north of Germany. Hamburg has an exceptionally strong economy and favourable demographics, while Schleswig-Holstein's GDP per capita remains somewhat below the German average. Like the overall German economy, both Länder's economies were severely impacted by the coronavirus pandemic (with Hamburg's output somewhat more burdened), hurting their budgets: Schleswig-Holstein reported a financial deficit of 3.1% of total revenue in 2020 (versus a 1.8% surplus in the year earlier) and Hamburg reported a 3.9% deficit in the same period (versus a 4.3% surplus in the year earlier).

Hamburg's direct debt burden increased to a relatively high 157% of operating revenue in 2020 from 147% a year earlier, which is above the sector average. While Schleswig-Holstein's nominal debt increased, its direct debt ratio decreased to a still very high 214% in 2020 from 218% in 2019, driven by growth in operating revenue that outpaced debt growth (because of extraordinary federal grants related to the pandemic in 2020). If we include net indirect debt, predominantly other non-self-supporting debt and guarantees to government-owned entities, both regional governments have net direct and indirect debt ratios well above the sector average. The fact that both Länder announced the phasing out of FinFo by end of August 2022, thereby each taking over €1.5 billion of outstanding debt from the entity,[2] does not impact our assessment of the Länder's credit strength because we already took a consolidated view by including it as indirect debt in our credit analysis.

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

As a public-sector entity, PM benefits from a maintenance obligation (Anstaltslast) and a deficiency guarantee (Gewährträgerhaftung) 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 keep it running for the complete duration of its existence, and cover possible financial gaps through subsidies or other appropriate means.

The deficiency guarantee 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 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 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 company if required. Hence, liquidity is not likely to be a concern for the issuer.

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 thus also the capital markets. Germany's financial market stabilisation fund act (FMStFG §8b, a federal law) explicitly applies to PM. Therefore, the entity is subject to supervision by Germany's Financial Market Supervisory Authority as well. However, because the entity is established by the two Länder, supervision and governance are predominantly the responsibility of their governments and parliaments.

Exposure to asset price movements and refinancing risk

As of year-end 2020, PM's remaining loan portfolio comprised a total amount of €2.9 billion and a book value of €1 billion. This is compared with the initial nonperforming loan portfolio of €4.2 billion that was transferred to PM at a price of €2.4 billion in 2016. The wind-down of the shipping loan portfolio over the past five years was mainly burdened by market deterioration, triggering write-downs and resulting in negative equity on PM's balance sheet (minus €775 million as of year-end 2020). During the course of 2021, the charter market for container ships was boosted by the global economic recovery, which allowed PM to accelerate the wind-down process and to realise better sale prices, leading to an improvement in the financial position this year. As of 30 September 2021, PM reduced the portfolio size by 36 ships and improved the negative equity to minus €368 million.

Any additional cost for the two Länder depends on further successful wind-down of PM's loan portfolio because they would finally have to cover any remaining financial gap, mainly reflected by PM's equity position at dissolution of the entity. Due to the dynamic market development, PM is now outpacing its previously anticipated resolution time line and is currently also examining possibilities of a bundled sale of the remaining portfolio.

Over the wind-down period, the entity needs to refinance itself from the capital markets, which exposes it to refinancing risk. In 2017, PM established a €2 billion debt issuance programme and a €1 billion commercial paper programme to ensure its capital market funding.

ESG considerations

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

We take into account 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 material to the rating. We view the pandemic as a social risk under our ESG framework, given the substantial implications for public health and safety. For PM, the shock manifests mainly in the exposure to volatile shipping markets, potentially affecting the successful wind-down of its portfolio.

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 issuer 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 February 2020. For rating guaranteed debt, we additionally apply the rating methodology for 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

Endnotes

1 The bank ratings shown in this report are the long-term bank deposit rating and Baseline Credit Assessment.

2 See hsh finanzfonds AöR or the Länder's press release for further information.

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