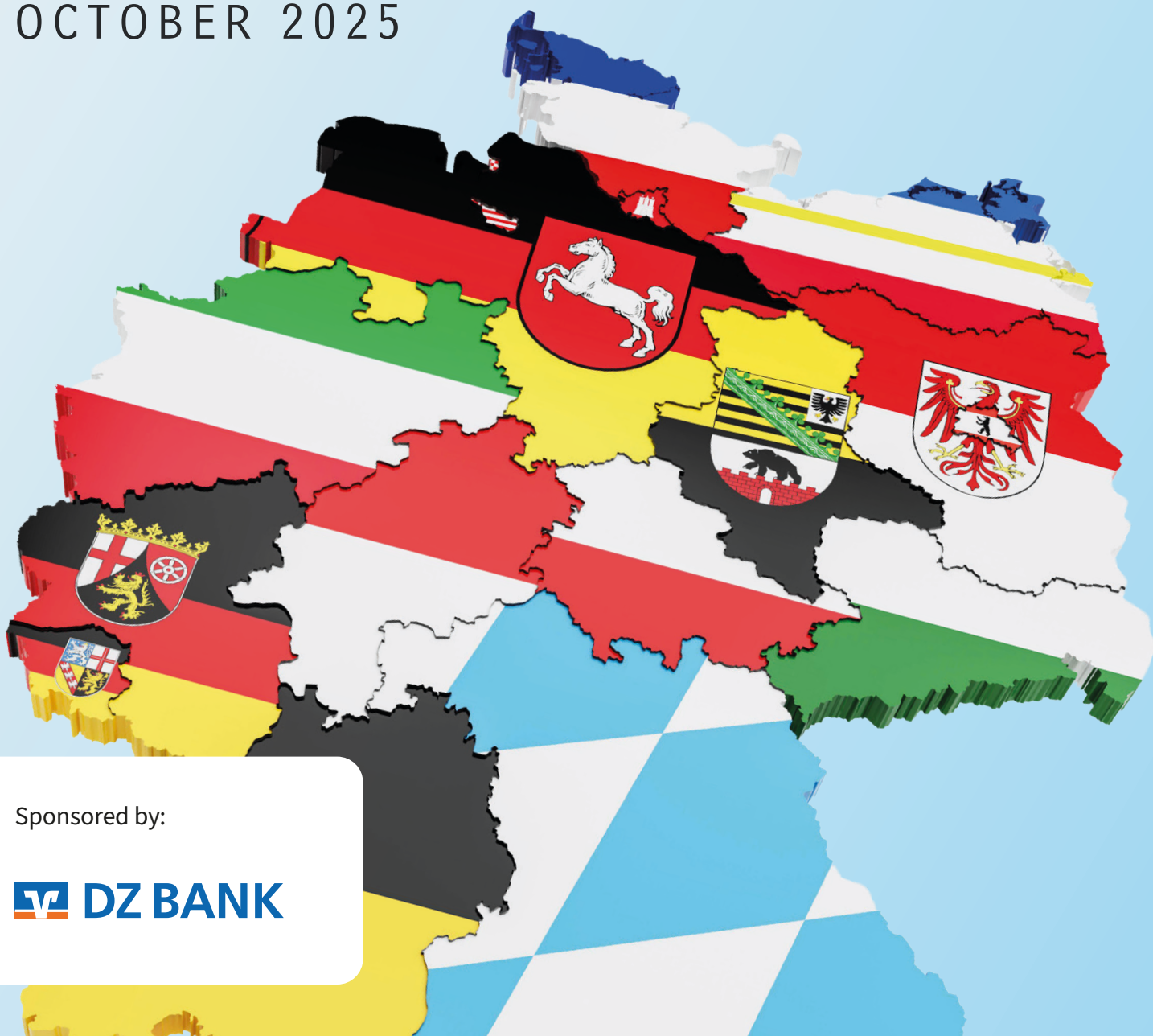


GlobalCapital

German Sub-Sovereign Issuers' Roundtable

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Germany's Länder prepare for life after the debt brake

The U-turn made by Germany's federal government in the spring, to release the grip of the debt brake and engage in a burst of borrowing to finance infrastructure and defence spending, is the biggest change to the country's fiscal trajectory for many years.

The federal states have been running balanced budgets and their prudent fiscal management has made them some of the safest and most respected borrowers in the bond market.

Now they have explicitly been given more leeway to borrow — and there are needs to be met, with growing populations in some areas and social needs such as transport and education everywhere.

At the same time, they will receive grants from the federal government to make investments — although they will not have complete freedom on how to spend the money.

How will the Bundesländer handle the new environment? *GlobalCapital* gathered heads of treasury from five states, together with investment bankers, in Frankfurt in September to discuss how the Länder will use their new freedom and what effects Germany's increased borrowing could have on the country's capital markets.

The treasury officials also explored internationalising their investor bases, the role of sustainable finance and the potential of blockchain in the bond market. And they conclude: with freedom comes responsibility.

Roundtable participants



Bernd Loder, head of supranational, sovereign and agency debt capital markets, DZ BANK

Alexander Labermeier, head of treasury, State of Hesse

Andreas Becker, head of treasury and pension fund, Ministry of Finance, State of North Rhine-Westphalia

Markus Krause, head of treasury, Ministry of Finance, State of Saxony-Anhalt

Elke Badack-Hebig, head of treasury, Senate Department of Finance, State of Berlin

Christoph Hünecken, head of markets, Free and Hanseatic City of Hamburg Financial Services Agency (FSA Hamburg)

Moderator: **Friedrich Luithlen**, global head of debt capital markets, DZ BANK

NEW FISCAL REGIME

Friedrich Luithlen, DZ BANK: Let's start with the elephant in the room — the debt brake, which has now been relaxed. There will be lots of economic growth, at least we hope so.

But the costs of financing the Länder will also rise. So how do you

navigate between more growth, higher costs, perhaps also higher inflation and this relaxed debt brake?

Andreas Becker, State of North Rhine-Westphalia: We need to differentiate between all the changes in the German Basic Law and how we deal with them.

On one hand, we have two major investment packages at federal level, one for infrastructure and one for defence — €500bn and €500bn-€700bn.

The Länder are not directly affected by this for the time being. The federal government does this all by itself and on its own payroll.



Where we could be indirectly affected is if the fiscal basis and rating were to deteriorate due to the creation of new debt. We just saw it on Friday afternoon — France has been hit by a downgrade. I don't see that this is a real peril at the moment, but if Germany were to lose its triple-A rating this would of course have an impact. We can do relatively little to influence this.

But we are even a bit favoured out of the packages, because the Länder get €100bn out of it, of which half or a bit more would flow to the municipalities.

But the money is not necessarily at our free disposal, because the Länder are also responsible for some federal military construction, for example. We in NRW will invest around €300m to €350m in barracks and other infrastructure every year.

A large part of the money we receive — let's say as a present — from the federal government will have to be spent on appropriate infrastructure and defence expenditure in a targeted manner, so this does not increase our financial leeway.

On the other hand, we have a second big change — the amendment to the Basic Law, authorising the Länder to take on 0.35% of GDP as new structural debt. That is a completely different story. This money would be entirely at the disposal of the Länder and it is not targeted to any specific task.

That is also the big risk, in my opinion. NRW, at least, is somewhat ambivalent about this relaxation. We thought about where it came from. In 2008, 2009, when the debt brake was created, the overall deficit target was 0.5% of GDP — 0.35% for the federal government and 0.15% for the Länder.

For various reasons, the Länder have refused this, in order to receive financial support from the federal government and thus have more time to balance their budgets.

We in NRW are actually very grateful for the debt brake up to this point, because it has helped us balance our budgets. Without it, it would have been very difficult to build up the political strength and stamina to save billions and not spend them. So we managed to balance our budget within eight years. This was 2016.

Of course, the situation has now changed. One crisis follows the next. The Länder budgets are under very strong tensions and we ultimately have to take countermeasures.

So we come to the real question — how we deal with this room for manoeuvre. Will we use this money simply to plug holes or are we really striving to finance sustainable investments?

If we succeed in translating this into investments that also spark growth potential, I don't think we will see such a big impact on the financial stability of Germany as a whole or the German Länder.

You have to bear in mind that Germany's debt ratio is by far the lowest. France, USA are around 120% and Italy, Greece far above that. And even there the roads are no better than here.

So we could raise and spend this money without suffering lasting damage. But the task will be to use this wiggle room to make sustainable investments and not simply to plug budget holes and generate a spree of consumption spending.

Luitlén, DZ BANK: The good old distinction between investment-related and consumption expenditure, I believe, is as old as the

Federal Republic of Germany. What is your view of the new fiscal flexibility coming for the state of Hesse?

Alexander Labermeier, State of Hesse: These are always two sides of the coin. Additional federal debt and expenditure will certainly stimulate economic growth and thus tax revenue for the Länder and the federal government.

If economic growth picks up again in Germany and is accompanied by sensible investment spending, that is certainly the positive side of the coin. The Länder will benefit because the federal government will initially bear the larger share of the debt burden for defence and infrastructure.

But the other side of the coin is that taking on additional debt should not be a way to make life easier. All must continue to work hard on reducing bureaucracy and simplifying administrative procedures, because otherwise you simply have more money to spend in the existing structures and procedures. And the impulse is a one-off. You just spend more money. The lasting effect of a more efficient way can only be achieved in the long term.

The art of managing both is to spend the new money sensibly, invest it and at the same time step on the gas when it comes to reducing bureaucracy. Knotty timber, sharp wedge.

I wouldn't be as critical as my colleague just now. All three rating agencies have affirmed Germany's triple-A rating, in light of the debt packages.

I also found their forecasts interesting, which show the same debt to GDP ratio in 2030, with or without fiscal packages, because you have to take higher economic growth into account.

For Bund and Länder, initially, when the debt package was announced, there was a rise in interest rates, which then fell again.

We also have to see how quickly the money is spent. Additional federal debt of up to €1tr is a big increase. With the extra 0.35% of GDP, the Länder will certainly have a much smaller percentage increase. So we assume that our financing conditions will not change significantly.

Of course, we're somehow following the federal conditions. But I would take a positive view, as the agencies as well as investors have a positive view of it as well.

Luithlen, DZ BANK: Against the background of reducing bureaucracy, I am particularly pleased that we have two city states that are perhaps even closer to it, because a lot of bureaucracy takes place at the municipal level.

Berlin has been called 'poor but sexy' — Ms Badack-Hebig, how do you see the temptation that, with added spending flexibility, fiscal discipline will suffer?

Elke Badack-Hebig, State of Berlin: Berlin has indeed made very strong efforts to make savings in consumption. We presented a €3bn consolidation list with the third amendment to the Budget Act 2025 last December.

And we have now passed an administrative reform law, which should help to eliminate some duplication of responsibilities between our districts and the senate departments. Only time will tell whether we will succeed.

As a city state, do we have the opportunity to generate significant domestic growth in the defence area? I think not. Could we generate other domestic growth in the area of investment? Yes.

For the state of Berlin, the share of the federal investment grant from the special fund for infrastructure and climate neutrality is around €435m annually, or €5.22bn over 12 years. This allows us to make allocations to replacement construction of roads and bridges, school construction and digitalisation.

The credit authorisation for regular borrowing under the debt brake reform is much higher — €788m for 2025, according to the draft of the upcoming fourth amendment to the Budget Act.

And the draft of the double budget for 2026 and 2027 has a very strong investment component for both years. The investment volume will amount to around €5.8bn in 2026 and just under €6bn in 2027, so that the investment ratio will be around 13.3% in each year. Investments are planned for transport infrastructure, housing, security and education.

Now we will see how quickly these investments can be put on the road, so that economic growth is triggered.

Considering we will have structurally weak growth in 2025 in Germany as a whole, and Berlin has grown slightly above the national average in previous years, we are quite confident we will also succeed in the next two years.

Luithlen, DZ BANK: So if Berlin is poor but sexy and is now making investment programmes to bring economic growth to the streets, then Hamburg is rich but modest?

Christoph Hünecken, City of Hamburg: I would say perhaps, Hanseatically reserved.

But with legal amendments to the constitution and state budget regulations, we are creating conditions that will enable us to use this new structural debt.

The legal requirements are now in place. But the scope this creates should be used responsibly to invest in science and education, as well as in the infrastructure of a city that has been growing for years and will keep on growing.

The other aspect is — and I believe this will play a much greater role for us in the future — our founding at the beginning of the year of a Financial Services Agency Hamburg.

Hamburg is more or less organised as a corporate group, managed according to accounting and economic criteria — a very business-oriented view of things, with a profit and loss account, depreciations, pensions provisions and commercial balance sheet, in which most of our subsidiaries are consolidated.

The Financial Services Agency Hamburg will increasingly serve as a group financing unit. This means that borrowing by the Free and Hanseatic City of Hamburg will increase, because investments by subsidiaries will be financed through internal loans granted by the City of Hamburg.

We have significant population growth in Hamburg, and we will have to make investments early on, such as in the subway and the construction of schools.

Luithlen, DZ BANK: And the investments are in housing associations, transport companies and municipal utilities?

Hünecken, Hamburg: We have many subsidiaries in mind that are eligible for financing through the City of Hamburg's budget and the Financial Services Agency.

There is no obligation for our subsidiaries to finance themselves through us, but the Financial Services Agency offers an attractive option. And this type of financing will enable us to make significant efficiencies within the group. It is also a logical step, if we are setting ourselves up like a big corporate group, to make a further integration step by financing the group accordingly.

Luithlen, DZ BANK: Ms Badack-Hebig, how do you see this corporate



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Friedrich Luithlen, DZ BANK



approach that Hamburg is taking? Is it written in the stars for Berlin?

Badack-Hebig, Berlin: Finance ministers naturally swap ideas and examine good models for their own application. Berlin has scrutinised this very carefully. We do not have such a large investment portfolio as Hamburg...

Hünecken, Hamburg: We have over 300 corporate investments.

Badack-Hebig, Berlin: Berlin has 61, and some very big players. Our six state-owned housing companies have the largest municipal housing stock in Germany. They have developed their own financing activities. Before the state of Berlin issued sustainability bonds, two of them were already involved in social bonds for housing construction.

So the main question is currently how we can offer more advice. We intend to maintain separate funding activities, as we value the corrective influence of the financial market on funding activities of our state-owned companies.

Luithlen, DZ BANK: Mr Krause — what is Saxony-Anhalt doing with the glut of money?

Markus Krause, State of Saxony-Anhalt: As my colleagues mentioned, we have two different discussions.

On one hand we have now an additional opportunity, in the discussion of new debt. This structural component that is now to change will be an additional component that will continue to be used.

But we already had several exceptions from the debt brake. There has been the option of declaring an emergency and then

financing it with credits. In Saxony-Anhalt, for example, the emergency situation due to the Covid pandemic was still declared in 2025. This means we still have opportunities to service certain expenses under this emergency situation.

We also had the instrument of financial transactions, to increase financial assets.

All in all, what we see is the importance of explaining all the regulations. The debt brake is not simply a debt brake, it means ‘yes but’. You have to explain what this ‘but’ means in figures, again and again.

We have done that for our Land for the last five years. The need for explanation has increased, regardless of the need for capital.

Finally, for Saxony-Anhalt we see a potential of new debt out of the structural component of around €380m. However, the state government is undecided whether these funds should actually be drawn and is waiting for the budget results by the end of the year.

On the other hand, the second topic is funds from the federal infrastructure programme. For Saxony-Anhalt it means potential spending of €2.5bn over 12 years.

Many infrastructure projects and measures are relatively far along in terms of their definition. There has been a cabinet decision in the State that local authorities can plan which projects can be prioritised.

So the additional money will help, but in military construction projects in particular, there are a large number of simplifications implemented in procurement law.

There are still many discussions between the Länder and also within the Federal Ministry of Finance, trying to make this simplification possible and extend them to civil construction.

At the end of the day, it’s about ensuring that this money is utilised and there is not just a big announcement. We need some visible effects and results to measure the efficiency of the spending programmes.

FUNDING PLANS

Luithlen, DZ BANK: Let’s move on to the funding wave being planned. Bernd, perhaps you can give a brief outline of what DZ BANK expects.

Bernd Loder, DZ BANK: This is a highly attractive asset class. On average, Länder bonds trade just 5bp above KfW, a spread that reflects their lower liquidity. Nevertheless, they receive strong demand from asset managers, especially relative to covered bonds.

This year’s issuance has already reached €55bn, surpassing last year’s total by €5bn, partly due to significant frontloading by the segment’s major issuers.

However, there is still a general lack of spread differentiation. Many investors tend to group all the credits together. But over the last few years, we’ve seen that it’s not just supply and demand that moves spreads, but also the respective Land’s individual credit story.

The growing presence of international investors is another positive development. While a strong domestic bid remains crucial — accounting for more than half of allocations — an increasing number of international investors are being drawn in by the attractive yields. Looking ahead, it is likely that supply will continue to increase rather than decrease.

Luithlen, DZ BANK: What do your funding plans look like for the rest of the year? Maybe you already dare to look ahead to next year.

Labermeier, Hesse: The basis of our strategy is liquidity planning. We look at ourselves for an entire year. What is the Land’s income and expenditure?

The tax estimate flows into this, as do the spending programmes. And in this liquidity curve we make the next decision. Do we want to be cash long or not? Since the coronavirus, we have made the decision to be cash long.

There were also years when it was economically interesting because the

curve was inverted at the front. This year it was a bit more expensive. But the position is taken strategically because we have to keep the Land solvent at all times. And be it coronavirus, be it the rating agencies or geopolitical risks, we always have this cash long position — €3bn to €5bn of cash overnight in our accounts.

From this comes the funding strategy. When do I want to finance the year? We have financed €8.5bn this year and are now 100% through, having financed a larger proportion in the first half of the year.

It used to be the other way round. We tended to finance two thirds in the second half of the year because we didn't want to be cash long [for too long].

We expect this strategy to continue next year, raising around the same amount from the markets.

Becker, NRW: We have a similar situation. We always have a daily liquidity plan for an entire year. It is already established until the end of 2026.

The basis for this planning is the budget. At the moment, the draft plan for 2026 still contains the tax estimate from May. That will change in October. But our budget will probably not be greatly affected, because we always make additions or deductions to the tax estimate to anticipate the future developments. The tax estimate is only ever based on current law, and not on what is likely to come. We include that in our calculations.

We are always cash long. That is a very comfortable position. However, our liquidity does not determine the timing of our borrowing.

We look at market opportunities and investor demand and are therefore very flexible and can change our entire programme from one day to the next, because we always have alternative routes up our sleeve.

Our funding programme for this year — slightly above €12bn — is already done. Our latest market appearance was at the end of September with a €2bn seven year bond, which generated great demand in the market.

Next year will be very exciting for us, because in July we passed a new state law that means we will relieve our NRW municipalities of half their liquidity loans — around €10bn — for the long term.



“The task will be to use this wiggle room to make sustainable investments and not simply to plug budget holes and generate a spree of consumption spending”

Andreas Becker, State of North Rhine-Westphalia

We will transfer these to the Land's debt at the beginning of next year. We expect that around half of this will become due next year and we will have to refinance it, plus regular maturities of around €10.1bn, plus any new debt from the cyclical or structural components.

All in all, we expect NRW to have a borrowing requirement of around €18bn in 2026.

Krause, Saxony-Anhalt: Then it might be a good idea to go from €18bn to the other end of the spectrum of the Länder's borrowing requirements!

In Saxony-Anhalt our total debt stock is around €23bn. But we are coming from a time when we used to say our funding requirement was €1bn to €2bn a year. Now it is €3bn to €4bn. That means we can have more flexibility in our capital market approach.

Like the Länder colleagues, we have a liquidity forecast, we keep liquidity in the till, simply to be prepared. Who knows what will happen? This is the major goal of our departments — to ensure the State's liquidity at all times. On the other side, we need to be able to act at any time when the opportunity arises.

We in Saxony-Anhalt are in a much more comfortable situation because we can be very selective about products and timing.

Nevertheless, we have found that the first quarter is a very good window for us, especially at the beginning. It helps us react appropriately to the budget results of the past year and the necessary outcome regarding the use of the debt brake exemption.

Reacting appropriately to this has meant that our major funding activities were also in the first half of the year. That is why we can now focus on credit spreads and demand.

We have issued €3bn this year and are still open to issuing between €500m and €1.2bn.

I have to let myself be surprised, in part, by where the journey takes us and what we see as the liquidity needs of different spending programmes. And the same is planned for next year.

Hünecken, Hamburg: We have a cash pool in which our major holdings participate. Depending on the situation, financing requirements can be covered at short notice from this cash pool. But in principle, we also have large stocks of cash, which we can utilise. In recent years, we've used these to make significant debt repayments. In 2023, the figure was €2.5bn; in total, it has been €3.3bn.

Luithlen, DZ BANK: In other words, if Hamburg Overhead Railway still has lots of cash and the water companies need some, they can use it?

Hünecken, Hamburg: In general, yes. This is done by our liquidity management.

We've done €3bn of funding in this year, and have around €3bn planned for the next three months.

Because we have now started to finance our subsidiaries via our model, we require between €5bn and €7bn in financing over the coming years.

Badack-Hebig, Berlin: Berlin's treasury started 2025 with a base and a maximum funding scenario, to explain to investors what these numerous credit authorisations could imply.

Accounts of the fiscal year are settled at the end of March every year, so front-loading the following year also results from the fact that we only then have detailed accounting.

In this year's scenario, we started [with a funding plan range] between €7bn and €11bn — a very broad spread, since there were few signals from the budget as to how far we would want to use our numerous reserves.

Now, we anticipate borrowing needs of €9bn to €9.5bn for 2025. In the draft for the fourth supplementary budget for 2025, parliament will most likely — this is not the case in all Länder — make use of the 0.35% [borrowing] authorisation this year already. That's €788m. So we still have something we won't know for sure until the end of October.

We have funded €6.5bn so far. Depending on how this authorisation issue turns out, we still have between €2bn and €2.5bn to do this year. We will definitely be carrying out our sustainability bond project in October.

For next year I am counting on about €9bn. Since redemptions are €5bn, you can see that the instrument of financial transactions is very heavily used.

We are significantly strengthening our state-owned companies with capital injections and we have an investment programme in housing loans — both qualifying as financial transactions.

For example, there is a very strong need for investment in energy and heating. Buying the Berlin district heating network from Vattenfall is one thing. But the state-owned company needs to push ahead with the transformation now and say 'How can we decarbonise?' There is a need for deep geothermal boreholes, biomass or power-to-heat systems.

As a result, the equity base of the state-owned companies is being strengthened very significantly. Next year alone, we are planning

€2.5bn in financial transactions in the budget draft. This will result in a total of €9bn of funding for the coming year.

INTERNATIONAL INVESTORS

Luithlen, DZ BANK: You also need international investors for that.

Loder, DZ BANK: Regarding international investors, we have observed significant demand this year, specifically for long maturities, ie. 20 to 30 years.

While certain Länder like NRW and Berlin are active in this maturity segment, the market for such long-dated paper is otherwise small, with only the European Union, International Development Association and Austria being the other regular issuers. Consequently, the market at the ultra-long end is not particularly deep or active.

Is it simply too expensive for issuers due to the yield levels?

Hünecken, Hamburg: Our subsidiaries have longer term financing requirements than we do. They would rather have 20 years. So we are planning a long term transaction this year, financing to pass it on to the companies. Due to the financing requirements of our subsidiaries, I assume that the City of Hamburg will regularly issue bonds with longer maturities in the future.

Labermeier, Hesse: Last year we issued the first 15 year bond from the Länder for a long time — and it was in high demand.

This has now also been increased twice, so we are certainly looking at the long end of the curve as well.

We do get diversification of investors when we issue these long bonds.

We also always look at the steepness of the curve, because we're paying the full interest rate out of the budget. You have to have a strong focus on rising interest rates or be issuing a proportion of the funding that is so small that it almost doesn't matter in the budget to justify this spread.

In the past, we established a long term overlay on the entire debt portfolio, so we had a fixed interest rate of almost 11 years for the entire portfolio. We are actually quite well positioned. But we consider these points of 15 or maybe even 20 years to be helpful for investor diversification.

Becker, NRW: NRW is interested in long maturities at low interest cost, and to achieve this, we catch the opportunities we get. Therefore we issued bonds for up to 100 years during the coronavirus years. Our average term is 20 years.

In this respect, we are very fortunate that our portfolio is not so much affected by all the changes in interest rates. More than half of our bonds will not mature until after 2035, and the sensitivity of the average coupon rate of the entire portfolio is less than 0.15 percentage points per year.

Taking into account the volume we have to cope with, we naturally also have to be flexible and, above all, take investor demand into account.

Yes, the curve is meanwhile very steep. Nonetheless, NRW has always said, especially in euros, we maintain a curve of one to 30 years and keep it alive.

That's why we issue 30 years every year. We did it in January this year. And even if it is a little bit more expensive, you can be sure that NRW will be back in the 30 year segment next year with an issue of at least €1bn, provided the demand is there.

Otherwise, we will keep our curve vital, especially five to 10 years, which will of course always be included, and we will also look at intermediate terms of 15 to 20 years.

In the last few years, the yield peak was around 20 years. That is why we have left them out. Now we have a more or less evenly steep curve, and can perhaps look at 20 years. But we are very flexible, you can talk to us and we listen to what



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Alexander Labermeier, State of Hesse

investors want. That's why we don't want to commit ourselves. However, we are committed to the core terms of five and 30 years.

Luthlen, DZ BANK: Dollar versus euro is always an issue, but under the heading of 'de-dollarisation' now we are seeing, at least at the fringes, moves out of the dollar, by for example Asian or Latin American accounts, from US Treasuries into either dollar SSA names, or even euros, Aussie dollars, Singapore dollars. Do you share that experience?

Becker, NRW: Definitely yes. It is obvious that traditional dollar investors in particular are no longer investing quite so much in US Treasuries, but rather looking for alternatives in Europe, or even switching currencies and investing in euros instead.

It is particularly the major central banks, but also large asset managers which have traditionally only invested in dollars.

We have certainly seen this in the last 12 or 15 months, and the trend is rising. It is quite subtle — dollar portfolios remain, but new investments are being invested in euros or in dollar bonds of European issuers.

About a year ago, we decided to set up a short dollar curve of one to five years. We will complete it next year and then keep it alive accordingly.

It is a way of supplying investors, which are now moving away from US government bonds but not necessarily from dollars, and are looking for alternatives.

Loder, DZ BANK: Adaptability is increasingly important, and as NRW has demonstrated, maintaining a flexible funding toolbox is crucial.

As Andreas has pointed out, diversification is occurring on two levels — there is a dollar diversification, away from US Treasuries into other dollar-denominated assets. And then there is a shift to the euro, but that is quite gradual.

In the medium term, we expect the euro to regain its importance as an investment currency. Furthermore, the current political uncertainty in Europe, particularly in France, is another positive factor for the Länder, as it drives many investors toward less volatile assets.



"It's about ensuring that this money is utilised and there is not just a big announcement. We need some visible effects and results to measure the efficiency of the spending programmes"

Markus Krause, State of Saxony-Anhalt

Labermeier, Hesse: Over the last decade, our order books have become more international, especially following the European Central Bank's withdrawal from its purchase programmes.

Of course, this has been more of an issue for the major issuers, but we are having order books with more than 50% outside Germany.

Responding to this shift, we have decided to regularly meet international investors on site and we do around five roadshows a year in Europe, because, unlike NRW, I don't think we'll be issuing foreign currency bonds any time soon.

But seeing investors on the ground, and answering many questions about the economic situation, the issuer profile, the debt programmes Germany is now undertaking and other issues, including political ones, shows that it makes sense to do this.

You can also see in the order books that we regularly have new names and investors from all over Europe, in addition to those from Asia and north Africa. Outside Europe — for example, Africa and Asia — we are getting up to 10% of our books, depending on the term. In Europe, Benelux is up to 15%, Scandinavia up to 15%, France, Italy also up to 15%. Spain has now been added. So European and worldwide investors are switching to Länder bonds.

Becker, NRW: We have been moving towards internationalisation since 2002 and have regularly approached investors outside Germany since then. And we've felt exactly what Alex said, with a little more emphasis. We've always had a relatively large foreign share in our books, but since the coronavirus pandemic this has increased significantly.

We regularly have a good share from Canada, Asia, north Africa, northern Europe and south America. The central banks there are always very active.

So you could say that we now have the whole world represented in our order books and the German share is really partial, sometimes only 25% to 30%.

As Alex said, you have to be on site regularly to pick up investors and explain things to them. Sometimes you're surprised when you're in your own bubble and think 'OK, everyone knows that', but not everyone does. You really have to go and explain things to people.

At the end of the day, it's only people who decide whether they buy this bond or not. And I have to look them in the eye from time to time and say 'I'm really there and what you're doing is a good thing.'

Badack-Hebig, Berlin: What Alexander and Andreas have described has been observable for us over the past five to seven years. This has enabled us to move away from the €1bn issue volume to €1.5bn, with an important European foreign placement.

Hünecken, Hamburg: We also have international books, perhaps not to the same extent as others round this table, but we have observed up to 50% international participation on occasion in our deals.

Krause, Saxony-Anhalt: We also have around 50% to 60% foreign share in our bonds — partly due to our standardised debt issuance programme, which only NRW and Saxony-Anhalt have.

It really pays off to have documentation in German and English, which reflects the demands

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Bernd Loder, DZ BANK



of international investors in a very clear and broad approach. This was an outcome of our early attempt to approach international investors.

But I have also found that ESG or thematic bonds have led international investors to look at our capital market products. I still remember one book that had over 70% foreign placement — we were very proud of that result.

SUSTAINABLE FINANCE

Luithlen, DZ BANK: That brings us nicely on to the ESG topic. Ms Badack-Hebig, what is your outlook for sustainable issuance?

Badack-Hebig, Berlin: The sustainable issue set for October will be our second sustainability bond after our inaugural deal in 2023.

According to our current framework, this is underpinned by projects which we finance through the budget. In other words, every sustainable project, be it green or social, can be found in one of our budget items.

What we do not currently include — and we still need to check whether this can be changed in any way in the next framework — is the equity injection that was used to purchase the Berlin heating network from Vattenfall. This would give us a large amount of expenditure for sustainable purposes in the future.

In the meantime, we have individual green projects which are included in the budget, mainly clean transportation projects.

Investors often ask: ‘What is the strategy?’ The overall sustainable strategy for Berlin is a two pillar strategy.

We have the activities of the state-owned companies, which are doing their own sustainable financing

and driving the transformation. We support them. That is one pillar.

The other pillar is based on eligible projects in the budget. For the second sustainability bond there will be numerous projects again, based on the projects we identified for the first sustainability bond.

However, we have seen a shift in e-mobility for police and fire brigade emergency vehicles. There was new activity in the ICMA category pollution prevention and control and we are very confident that the 33 eligible green and social projects will bring another good funding result.

Labermeier, Hesse: Adding to the subject of ESG, Hesse is an exclusively green issuer. We have now issued three major green bonds. Our aim is to issue a large liquid benchmark size, ie. at least €1bn every two years. Why only green bonds? We could certainly categorise all the Land’s bonds as sustainability bonds. I issue €8bn in loans every year and in Hesse we spend €10bn on schools and universities alone. So what would be the added value of labelling that ‘social’?

The news, I think, is not our social spending. It’s about showing the projects for environmental protection. And in this regard, we have decided to issue only green bonds.

We also see a good investor base for them, which appreciates this approach. We have also seen a knock-on effect on our normal bonds, with green investors also buying the state’s normal bonds because they have realised that the State of Hesse is a sustainable issuer.

This has now made us the largest green bond issuer among the Länder and also among the European regions.

And now for the first time, investors are asking a public body

‘What impact have you achieved with the money I give you?’

Until now, investors have always bought our bonds because they have a great rating, because they have a spread advantage. With green bonds, we are moving directly to discussing projects with the investors and discussing the impact of them.

Luithlen, DZ BANK: Considering sustainability, what are your thoughts around defence spending? Can it be included?

Becker, NRW: For us, not directly yet, because defence is a task of the federal government. In 2015, we were the first Land to issue a sustainability bond, and since then we have issued at least one a year.

This year, the 12th one we issued was at least €1bn. And we will continue to issue in the future.

The underlying projects in our budget are picked out in regard to a stringent set of rules. We have set numerous exclusion criteria for ourselves. Otherwise, as Alex said, in principle all bonds could be declared green or sustainable, because the corresponding expenditure on education exceeds the amount.

If the defence spending fits into the set rules it can be included. But we won’t amend this set of criteria just to catch the defence spending.

The set of rules has proved its worth over the last 10 years. And it has also worked well with the Wuppertal Institute here in NRW, which prepares an impact analysis for each bond and each individual project, to show exactly how much CO₂ it saves, or how much additional green space has been created.

This is a well rehearsed procedure, and, due to the low volume of defence spending at the moment — €300m to €350m out of the €100bn budget — we do not need to adapt it.

The sustainability bonds have also opened up new groups of investors, who have gradually transferred to regular bonds. These sustainability or green bonds used to achieve financing advantages. We have noticed for about two years that this is no longer the case.

We are at the normal financing level, but we still have the advantage of having a group of investors in our books whom we could not otherwise draw out from the woodwork.

Krause, Saxony-Anhalt: In 2023 we created a framework for social bonds.

We wanted to support a special programme of the State, and included 60 individual projects out of it.

And we wanted to support the ideas and special views of capital market participants, for example by finding the right information and asking the most pertinent questions to grant a success of the programme.

What we learned then was that investors' demands for information are enormous.

And that helps a project manager to ponder what is the overall goal of a project, beside spending money. It is about actually making a difference. Who will benefit from this money?

We made a conscious decision to create a framework focused on social spending, simply to highlight and focus on the special challenges the Land faces.

Of course we are certainly not disconnected from climate change. But in our state, social issues in particular play a greater role, with challenges like age structure, access to education and healthcare and population decrease. So it is these topics that are important and politically relevant to us.

At the same time, our state government has set itself the goal of creating one of the first sustainability budgets. We worked with a project group to sort all the individual items of the Land's budget according to the Sustainable Development Goals.

The preliminary results have already shown how diverse the budget is and how many hidden green activities we have in different projects.

I am incredibly proud and happy that the state is one of five Länder so far that have made progress on this issue. And I'm curious to see which additional facets we can prepare for 2026.

Hünecken, Hamburg: Let's look at the group level again. Since 2017 our state budget reflects the 17 SDGs and the budget items are allocated to these goals.

Beyond that, the corporate objectives for all our subsidiaries include mandatory sustainability targets, and a number of them are active in sustainable finance.

The Hamburg Investment and Development Bank has already issued social bonds. Our Hamburger Hochbahn has issued a green bond. Other companies have issued green promissory notes.

The size of our state budget is currently too small to generate sufficient "green volume" to issue a benchmark green bond.

With our creation of the Financial Services Agency, the idea is to bundle investments at group level, which means we don't just want to use the budget of the City of Hamburg to create a green framework. We also want to use green investments of our subsidiaries. Then we could go into the market regularly and in some volume.

However, we are currently examining the requirements for this and are in dialogue with the companies.

Loder, DZ BANK: On a related note, quantifying the greenium has become quite challenging, although the twin green and conventional bonds issued by the federal government serve as a key benchmark. It is sometimes difficult to recoup the cost of all the work put into sustainable finance projects. This can create a justification challenge for both the investors and issuers.

However, as Alexander has pointed out, there is a clear positive spillover effect on an issuer's conventional bonds. This improves investors' perception of the credit, and our impression is that it results in larger and more granular order books.

Therefore, it remains to be seen how things will develop. We have had the honour of accompanying a number of these projects, and it is always very exciting.

DIGITAL BOND MARKET

Hünecken, Hamburg: One of our aims is also to broaden the investor base.

Luithlen, DZ BANK: What do you think about digitalisation in the bond market, including distributed ledger technology?

Krause, Saxony-Anhalt: Our State issued digital commercial paper under the supervision of the Eurosystem's major phase of DLT tests and trials last year.

We were very happy to get that opportunity and that we successfully used it. We were able to gather a really wide range of experience in terms of organisation, legal framework conditions and requirements. How do you have to restructure the process?

Because it's not just that I now have an input screen. Above all, it's how to restructure myself, to suddenly digitise activities that were done manually.

That was a very big learning experience for us. As a result, we have already restructured many processes.

To be honest and with a smile, we needed one year recovering from this experience. That's why we haven't added a digital bond or anything like that. But we made some progress in the internal preparations.

Germany has created the right framework legal conditions some years ago and Saxony-Anhalt has already updated its legal framework for debt issuance to include electronic ways of issuance last year. That alone was a huge step, which will certainly lead to us being able to deal with this topic even more in the coming years.



"We have seen a knock-on effect [from green issuance] on our normal bonds, with green investors also buying the state's normal bonds because they have realised that the State of Hesse is a sustainable issuer"

Alexander Labermeier, State of Hesse

Becker, NRW: Yes, I think so too. Digital bonds will become a big topic in the future, even if we are still in the early stages at the moment.

Just like Markus said, there are a lot of changes you don't even have on your radar and it's a learning journey.

So as not to be surprised at some point, we in NRW are now also embarking on this journey and examining the legal adjustments we need to make to our state debt system laws and the like, to be able to issue DLT bonds.

Depending on how quickly this happens, we will then follow this path. If it all works out the way we want, you can definitely expect us to try it out next year.

Not from a funding perspective, but to familiarise ourselves, so that when it really does have a significant share of the capital market, we're not just getting started, but are ready.

Labermeier, Hesse: The question with new products is always whether there is a first mover advantage, or whether you should wait until the market has developed a standard — so that you can join the learning journey at some point, but not create five initiatives that have gone in the wrong direction.

The question is, when is the right time to get involved? I think it's getting closer now.

But you also have to say that the Länder already issue efficiently. If necessary I could launch a bond tomorrow. And it would be documented and completed in four days.

The expectation is always that digital will make things faster, easier and better. This idea has to be demolished first, that this can

be done faster, easier and better than the old school way of issuing bonds. You still have to look for these efficiency benefits. That's the point.

But of course, I agree with Andreas. You have to observe, accompany and sometimes go through the hard work.

We saw it with the green bond, which is also a year's work, when a normal bond is three or four days. We do it anyway, also because of the greenium we still see. With digital bonds, the advantage is of course smaller and the work and initial hurdle is greater. But we are also keeping an eye on this.

Badack-Hebig, Berlin: I can only second that. We simply don't have the capacity to spend one year recovering from one bond issue.

Krause, Saxony-Anhalt: To be very clear, we see some real advantages of using DLT, already right now in this stage of development. We made the conscious decision to do commercial paper, because we already have years of experience in this field.

What we experienced is that we were able to reduce the settlement time from T+2, which is normal for CP, to T+1. In theory, we could have reduced it to T+0.

Because CP is really a liquidity instrument, that means it could be a way to organise liquidity incredibly quickly and efficiently. I thought that was one real advantage we saw.

This may not be monetised, but simply from a risk perspective, which should be the focus of all

our attention, in terms of liquidity, the experiment has given us a little more certainty that this possibility exists.

Becker, NRW: And if at some point this should be a functioning market, and you can settle at T+0, then perhaps it could also reduce hedge costs on the bank side, so that it can then really be economically advantageous, not only for the investor, but also for the issuer.

Luithlen, DZ BANK: Thank you very much for your contributions and the open and lively discussion. Before we finish, let me quickly tell you about some of the initiatives we have been working on in the digital space.

At DZ we have worked with partners including KfW, the European Investment Bank, Siemens, NRW.Bank, BayernLB, Union Investment and others, in various functions around DLT-based transactions.

We have acted as crypto-bond custodian, we have been sole adviser on the structure of DLT transactions. We have been bookrunner on syndicated DLT trades and a smart derivative counterparty. In many cases we have had more than one function on the same deal.

We are pushing this development because we believe that among the R&D deals so far, the DLT-based Smart Bond Contract format will represent the future constitution of bonds.

The SBC holds the promise to deliver on the EU's Savings and Investment Union, save significant costs in back offices and opens new ways to work on issuance-specific data use cases.

European legislation and a successful implementation of the Pontes and Appia initiatives at the ECB are two key developments that enable mass adoption.

We believe, further, that there are versions of DLT modality that should allow both high quality liquid assets and ECB collateral eligibility, as well as secondary market liquidity provision.

Once that is achieved, we will see a rapid shift to a new DLT-based issuance standard. That standard will be open, transparent and carried by the industry as a whole. That's why we code everything in the open, are platform-agnostic and publish our white papers on the subject. GC

“Since 2017 our state budget reflects the 17 SDGs and the budget items are allocated to these goals. Beyond that, the corporate objectives for all our subsidiaries include mandatory sustainability targets”

Christoph Hünecken, Free and Hanseatic City of Hamburg

