Summary

1 Recovery in municipal financial situation in 2012 purely due to economic conditions; gap between financially strong and financially weak municipalities widens further

2012 is the first year since 2008 that municipalities have achieved a total budget surplus of EUR 1.8 billion, according to the latest treasury statistics. This surplus is largely due to the increase of just under 7 % in tax revenue and the higher amount of support grants from the German federal states. However, these overall figures hide wide disparities between the regions: the budget surplus of municipalities in eastern Germany (exception: Brandenburg) declined compared with 2011. In Saarland, Hesse, Rhineland-Palatinate and Schleswig-Holstein, expenditures still exceed revenues. The KfW-Kommunalpanel shows that alongside the considerable number of municipalities that generated surpluses in 2012, three in ten municipalities and districts registered hefty budget deficits even in the relatively "good" year 2012. Even municipalities with comparatively high fiscal capacity view their current financial situation as deficient in 40 % of cases. These are often major cities with a high social spending burden, but also increasingly districts that only feel the municipalities' positive revenue trend with a delay. A clear indication of the widening gap between financially strong and weak municipalities is that the stock of cash credits is rising unabated despite the positive total balance in 2012. A good third of municipalities will (have to) further expand their stock of cash credits in 2012 and 2013. In larger towns (with more than 50,000 inhabitants), this proportion rises to more than a half.

2 Unpromising prospects in eastern German states

55 % of the municipalities surveyed rate their prospects for financial growth in 2013 negatively. With regard to medium-term prospects, even two thirds expect their finances to develop unfavourably. The picture becomes even gloomier when considering the appraisal of municipalities in eastern German states. 69 % of the eastern German municipalities surveyed expect their financial situation to deteriorate in 2013. A massive 92 % said that things will likely become (much) worse for them financially over the medium term. Added to this, cash credits are increasingly becoming an issue in eastern German states. Alongside the fact that the Solidarity Pact II is coming to an end, this is primarily attributable to the expected decline in the population. Shrinking municipalities anticipate a smaller contribution from the municipal financial equalisation system. At the same time, they are faced with growing social burdens and need to make significant investments in demolishing and converting their infrastructures. The situation is exacerbated by the fact that the investment backlog in key areas (e. g. municipal road building and housing) is still much higher than in western Germany. In

eastern Germany, 82 % of municipalities consider there to still be a significant or serious backlog in municipal roads construction, and 54 % rate the backlog in municipal housing as significant or serious (western Germany: 63 % and 28 % respectively).

3 Municipalities perceive the investment backlog to be growing sharply

At EUR 24.7 billion, investments from municipalities' core budget declined by about 10 % in 2012 compared with the previous year. The investments planned for 2013 are at around the same level (EUR 25.1 billion). At the same time, the extent of investment in the individual communities and districts differs in line with the very different financial situations of the municipalities. Per capita investment in federal states with a high stock of municipal cash credits was particularly low. However, the decline in investment is not the only reason that the perceived investment backlog has again grown sharply compared with the previous year. According to the municipalities surveyed, the investment backlog now amounts to EUR 128 billion, up by around EUR 20 billion compared with the previous year. The reasons for this big jump are as follows: certain areas are increasingly being given top priority politically in the municipalities. These include childcare, bringing schooling into line with future needs (e. g. reliable all-day childcare and inclusion), and upgrading the energy efficiency of municipal buildings. This is demonstrated by the sharp rise in the investment backlog in power generation, although this is still viewed as low. With those responsible and the public becoming increasingly aware of the implications of demographic change for the healthcare infrastructure, for example, and particularly for the themes of "accessibility" and "inclusion", the perceived investment backlog in this area is also growing.

4 Significant investment need for conversion and demolition

Demographic change in particular – characterised by the key words "fewer, older, more diverse" – as well as structural change, which could result in areas becoming deserted or densely populated, have significant consequences for municipal infrastructure in cities, municipalities and districts. There are wide gaps between supply and demand in some places, and the structure and quality of the infrastructure is no longer adequate. Investments in the demolition and conversion of infrastructure account for around 20 % of total investment from the core budget of the municipalities. The municipalities and districts estimate that around EUR 25 billion will be spent on demolition and conversion over the next five years, with just EUR 6 billion of this amount going to schools. In addition, the requirements applicable to demolition and conversion in the areas of childcare, housing as well as roads and traffic are more stringent than average. There is also increasingly an issue in technical infrastructure, such as water supply and waste water disposal. It is notable that demolition is not only an issue in eastern German states. In particular, there is a considerable requirement to demolish school buildings in western German states, especially in shrinking communities, but also due to the generally declining number of children.

5 However, there is optimism that the investment backlog will be reduced at least in some areas

Despite the negative financial outlook, the municipalities surveyed are surprisingly optimistic about their ability to significantly reduce the investment backlog over the coming years, at least in part. 34 % expect that the investment backlog will be reduced at least to some extent, while just 15 % expect it to increase. There is particular optimism with regard to areas where support is provided by the federal government or states – such as schools, childcare, energy and administrative buildings (energetic rehabilitation) – and those financed through fees, such as water supply and waste water disposal. The apparent contradiction between the uncertain to negative financial outlook and the hope that the investment backlog will be alleviated, at least in part, can be explained to a certain extent. Due to higher revenues and legal requirements, investment can and must be increased. This will initially not improve the fundamentally difficult budget situation of many cities in the medium term, aside from the associated increase in tangible assets. But if successful, the desired positive effects will be felt over the long term.

6 Predominant improvement in credit conditions, interest rate risk apparent

In addition to the hope of reducing the investment backlog at least partially, the situation on the municipal credit market is good, with a further decline in interest rates. This is reducing the debt servicing burden on municipalities and therefore increasing the scope for investment, albeit only marginally. Although larger cities in federal states with a higher than average stock of municipal cash credits especially perceive a slight deterioration in certain aspects of credit conditions (e. g. number of lenders or credit lines for investment loans), this does not change the fact that municipalities generally consider the current situation on the municipal credit market to be positive. However, most municipalities are aware that the historically low interest rates at the moment will rise again. Since municipalities and districts will probably only be able to slightly reduce their debts over the next few years, the loan prolongations that will then be required could lead to significant additional interest charges.