››› Municipal investment: Growing needs, limited capacities

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Abstract
The KfW Municipal Panel 2018[1] shows that local governments' investment needs are growing but their planning and implementation capacities are limited. Their investment activity has remained almost steady, so a rise in the perceived investment backlog is the logical consequence. Nevertheless, many surveyed municipalities are cautiously optimistic about their ability to reduce their investment backlog in the long term. The positive economic environment supports this. In regions where rising investment needs are not matched with corresponding investment expenditure, however, a high investment backlog is critical. Looking beyond the current 'fair-weather' period, strengthening municipalities' structural investment capacities therefore remains one of the key tasks for policy-makers to secure equal living conditions and the country's competitiveness.

Investment needs are rising

Germany's economy is growing and so, again, is its population. Contributors are the higher influx of migrants since 2010 and, for several years now, the rising birth rate. As a result, around two million more people live in Germany today than just five years ago, including 400,000 more children up to the age of six. But more inhabitants also require more investment in infrastructure such as housing. And as the share of younger people rises, so, too, does the need for child daycare facilities and schools. Thus, of the surveyed municipalities, 54 % believe the demographic development requires an expansion of child daycare and a sizeable 30 % see the need for more schools.

Municipalities have to respond to these changes by providing commensurate facilities and public services. This applies all the more as demographic change will continue. In addition, demographic trends vary widely from region to region. As some cities, municipalities and districts are shrinking while others are growing, some have to downsize and others need to expand. Both represent a financial challenge.

Capacities are limited

Investment needs are growing but capacities are limited, both in local administration and in the construction sector. Over the past decade, an estimated 10,000 jobs were cut in areas of municipal administration involved with planning. Even if new processes and the contracting of external service providers mean their planning capacities have not necessarily diminished to the same degree, a bottleneck is still emerging in the administrations' capacities to plan and manage investment projects. A shortage of qualified staff in municipal departments involved with planning is becoming a growing obstacle to increasing investment.

At the same time, investments can often not be implemented without delays and significant price rises. Many municipalities have difficulty hiring firms because of high capacity utilisation in the construction sector and competition with private building projects. A majority of 44 % rate the capacities of private construction firms as a serious obstacle to municipal investment activity, even before administrative capacities (31 %). In addition, building land and construction are becoming more costly. Higher investment expenditure does not, therefore, necessarily mean more available infrastructure.

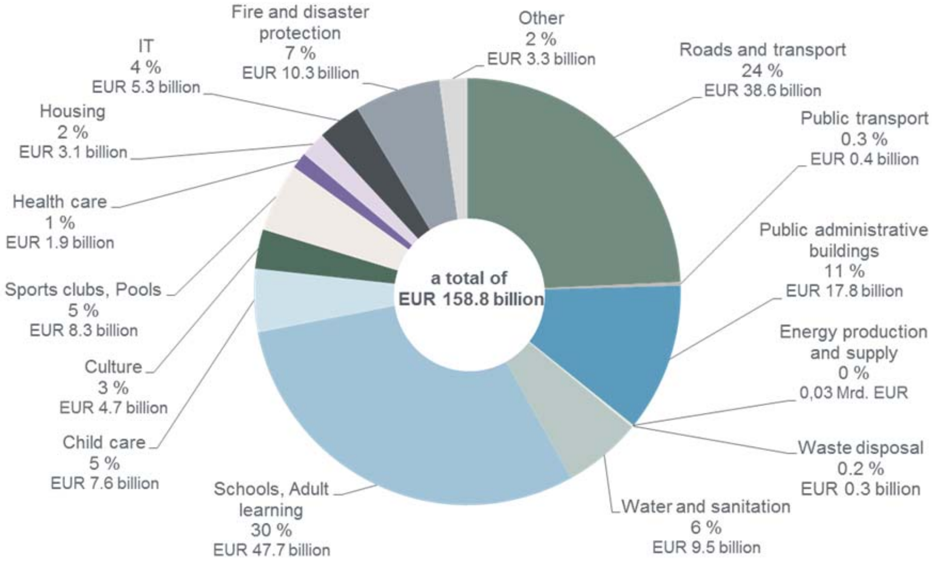
Growing investment backlog

Against the background of rising investment needs and limited capacities, it is hardly surprising that some municipal investments cannot be realised. The treasuries interviewed in the KfW Municipal Panel 2018 thus estimate the investment backlog to have grown to nearly EUR 159 billion. The increase can be observed across almost all classes of population sizes and investment areas, although some of them stand out more. Large cities with more than 50,000 inhabitants account for more than half of this year's increase. At regional level, North Rhine Westphalia and southern Germany record the highest rise. Schools are the infrastructure area with the highest investment needs.

The importance of schools is also illustrated by the distribution of investment backlogs across individual infrastructure areas (see figure on next page). Educational facilities account for the biggest 'slice', with EUR 47.7 billion, followed by roads with EUR 38.6 billion. In the main areas of investment it is also evident that a growing proportion of municipalities see a serious backlog, while the share of municipalities with no or only a minor backlog is diminishing. In other words, in many areas of infrastructure the investment needs are seen as a matter of growing urgency. Moreover, the percentage increases in other areas also reflect current challenges, such as that of providing living space for refugees and househunters under 'housing' and digitalisation of public administration under 'IT'.

[1] Cf. Krone, E., Scheller, H. et al. (2018): KfW Municipal Panel 2018, published by KfW Group, Frankfurt am Main.

Figure: Municipalities' perceived investment backlog in 2017



Source: KfW Municipal Panel 2018, conducted by Difu from August to October 2017.

In addition to demographic change, municipalities' investment restraint of earlier years is also an important factor for the higher investment backlog. While a large proportion of surveyed municipalities see demographic change as the driver of investment in expansion and new construction for schools (23 %) and child daycare (36 %), they mostly blame maintenance neglect (37 %) for the backlog in investment in road infrastructure. This illustrates once again that a sustainable investment policy requires long-term thinking as short-term savings can result in high consequential costs.

Regional differences need to be considered

While high investment backlogs in structurally strong regions are paired with high investment expenditure, this does not apply to financially weak municipalities. The level of investment in municipalities under budgetary supervision is still around one third lower. The higher the perceived investment backlog, the less favourable the ratio of investment to backlog. Although the regional imbalance decreased slightly last year, it remains problematic nevertheless, both with a view to investment and with respect to the backlog, especially for schools and roads. Given the low investment level, it is becoming increasingly difficult for financially weak regions to catch up. This will require targeted political solutions and support.

Expectations are cautiously optimistic

Despite the wide regional differences, the majority of the surveyed municipalities are quite optimistic about the future thanks to the good economic environment. A notable 42 % of the municipalities surveyed expect a reduction in the investment backlog; with regard to schools, almost 50 % are optimistic. Only for roads and transport infrastructure do 37 % expect the investment backlog to increase further – despite the fact that they plan to increase investment in this area. For 2018, municipal treasuries expect overall investment expenditure to increase to EUR 28.2 billion. General public funds and promotional funds have gained in importance as funding instruments and municipalities expect municipal loans to become more significant in the future as well. ■

The KfW Municipal Panel

The KfW Municipal Panel is based on a representative annual survey of treasuries of cities and municipalities with more than 2,000 inhabitants and of all rural districts. The survey is conducted by the German Institute for Urban Affairs (Difu) on behalf of KfW and supported by the leading municipal associations. Representatives of municipalities and municipal researchers are also represented on a panel advisory board.

The full KfW Municipal Panel can be downloaded from www.kfw.de/kommunalpanel (in German only).

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