Municipalities perceive worsened financial situation and higher investment backlog

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The KfW Municipal Panel 2024 shows that the mood among municipal treasurers has deteriorated considerably. Their assessments of the current and future financial position are increasingly pessimistic. The rising social, staff and material costs in particular are a long-term challenge for municipal budgets and reduce municipalities' scope for investment.

Although investment increased again slightly last year, that growth was not sufficient to offset increased needs and higher prices. As a result, the municipalities' perceived investment backlog continues to rise.

Various monetary and non-monetary obstacles hamper the planning, implementation and funding of municipal investment. In order to increase investment in the long term, these barriers must be dismantled, for example by streamlining procurement processes, making building codes more flexible and broadening the financing basis for municipal investment in Germany.

Assessments of financial position have deteriorated again

The cash statistics for 2023 reported a negative annual result for Germany's municipalities for the first time since 2011, posting a funding deficit of -EUR 6.8 billion. Unlike in previous years, municipalities neither received any special financial support from the federal or state governments nor unexpected additional tax revenues, so that the increased revenues were insufficient to offset the rising expenditure in all areas. To be sure, municipal revenues rose by 9% overall on the previous year. At the same time, however, expenditure increased by 12%, with material investment as well as ongoing material expenditure both growing at higher rates of around 16% as a result of higher prices. Expenditure on social services and personnel grew by just under 12% and will weigh on municipal budgets for a long time because of their long-term nature.

These developments are reflected in the assessments of municipal treasurers, who were interviewed by the German Institute for Urban Affairs for the KfW Municipal Panel 2024 during the period between September and November 2023. Only fewer than 20% of municipalities still regard their current financial position as positive, while almost 60% rate it as negative.

This applies all the more to their outlook on the future financial position five years from now. Around 90% of municipalities are now pessimistic, while just 2% have positive expectations.

Investment plans are not keeping up with rising prices

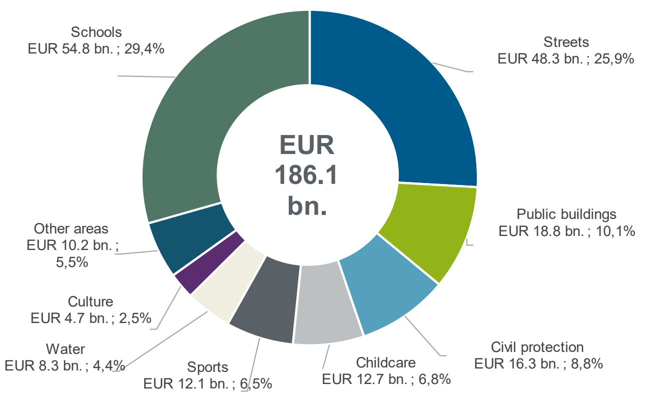
The concern is that sooner or later these negative expectations of municipal treasurers will influence budgetary planning and, for example, will lead to lower investment expenditure. For the current year, however, municipalities expect overall investment of EUR 45.0 billion in their core budgets. Schools remain the main investment priority with around EUR 12.9 billion, followed by roads with approx. EUR 10.8 billion. Child daycare as well as fire safety and disaster management follow at some distance with EUR 3.9 billion each. Only slightly more than EUR 3.1 billion is being budgeted for public administrative buildings. Overall, investment plans increased by 4.1% on the previous year but without offsetting price increases in the construction sector.

Investment backlog grew more strongly than in previous years

Rising prices and further increasing demands on municipal infrastructure have caused the investment backlog perceived by municipalities nationwide to grow to EUR 186.1 billion (Figure 1). That is EUR 20.5 billion or 12.4% more than in the previous year and is essentially driven by the investment areas of roads (+EUR 9.7 billion to EUR 48.3 billion), schools (+EUR 7.3 billion to EUR 54.8 billion) and fire safety and disaster management (+EUR 4.0 billion to EUR 16.3 billion). Only minor changes occurred in the other areas. Further major elements of the investment backlog are administrative buildings with EUR 18.8 billion, child daycare centres with EUR 12.7 billion and sporting facilities with EUR 12.1 billion.

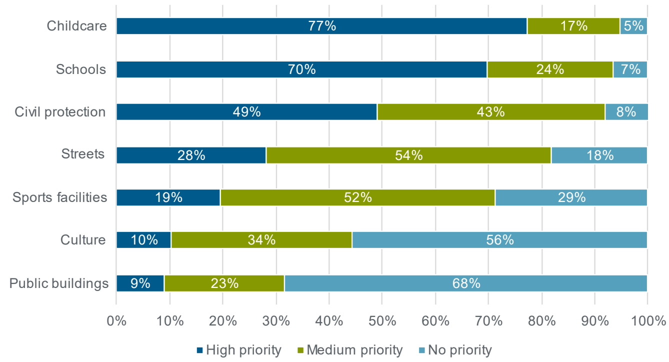
With respect to how the investment backlog will evolve over the coming years, 33% of municipalities expect it to grow and the same proportion expect it to shrink. These expectations, however, differ widely depending on the investment area. Municipal treasurers are relatively optimistic about schools, with 42% expecting a decrease and 28% an increase in the backlog, and are similarly upbeat about child daycare centres, for which 40% expect a drop and 24% a rise. For roads, however, the picture is different, with 53% of the interviewed treasurers predicting that the investment backlog will continue growing, while only 20% anticipate a decrease.

Figure 1: Perceived investment backlog



Source: KfW Municipal Panel 2024, conducted by Difu from September to November 2023

Figure 2: Municipal investment priorities



Source: KfW Municipal Panel 2024, conducted by Difu from September to November 2023

Investment obstacles hamper expansion of municipal investment activity

It has been clear for many years that only around two thirds of planned investment can be realised in the intended timeframe. Various barriers prevent an increase in municipal investment activity and faster realisation.

These barriers operate in very different ways. Lack of funds (in 55% of municipalities) or unsuitable promotional funding schemes (43%), above all, are leading to projects not being completed at all or only in a slimmed-down version. Complex and time-consuming procedures and requirements, for their part, are causing delays of more than one year in around 60% of municipalities. The supply shortages and capacity constraints in the construction sector, too, are leading to delays in around 60% of municipalities and increasing the originally budgeted costs by more than 25% in around half of municipalities. In 56% of affected municipalities, in turn, personnel shortages in development offices are causing severe delays and, in nearly 30% of cases, even preventing projects from being implemented at all.

The multitude of barriers calls for different types of solutions, such as simplifying requirements and reducing red tape, strengthening administrative capacities, particularly by digitalising processes, but also improving the financial basis for municipal investment.

The financing environment has deteriorated

Municipalities have hardly changed how they fund their investments since the previous year. Liquidity from the previous year makes up 23% of the funding mix. General public funds from taxes and non-earmarked allocations amount to 17%, while investment allocations account for a further 10%. Thus, municipal funds make up around half of the funding mix, while the other half is composed primarily of promotional funds (22%) and municipal loans (24%).

Given the municipalities' dwindling budgetary capacity, 56% of them expect debt finance to become increasingly important. They also expect the share of the remaining instruments to either fall or remain the same.

The growing importance of investment loans falls into a period of sharply higher interest rates. Around 40% of municipalities that took up a loan found the borrowing terms last year to be rather unfavourable or very unfavourable, while only 25% saw them as good or very good. For the coming year, 73% of municipalities planning to take up loans expect credit terms to continue deteriorating. Only 4% of these municipalities expect a slight improvement. It is true that these figures are somewhat better than in the previous year, when 87% expected a deterioration and 2% and improvement, but the vast majority of municipalities remains pessimistic about lending conditions.

Administrative buildings are often in need of upgrades but have little priority in municipal policy

Municipal treasurers attach the highest political priority to child daycare centres (77%) and schools (70%). At the other end of the spectrum, only 9% see administrative buildings as a priority, with 23% giving them low priority and 68% no priority whatsoever (Figure 2). This is despite the fact that administrative buildings make up the third largest block of the investment backlog and are therefore addressed in greater detail as a special topic of the KfW Municipal Panel 2024.

After all, there are various reasons that administrative buildings should be modernised. For example, 81% of municipalities see a link between the condition of these buildings and the impression which citizens have of the state. Conversely, this means that where town halls and related buildings are in poor condition, this can create a negative image of the municipalities and the state as a whole. It is one more reason for placing municipal investment on a stronger foundation.
The KfW Municipal Panel

The KfW Municipal Panel is based on an annual survey of treasuries of cities and municipalities with more than 2,000 inhabitants and of all rural districts. The representative nationwide survey is conducted by the German Institute for Urban Affairs (Difu) and supported by the leading municipal associations.

The complete KfW Municipal Panel can be accessed at **www.kfw.de/kommunalpanel**

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