Record-high municipal deficits and a growing investment backlog

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The KfW Municipal Panel 2026 shows a further marked deterioration in the financial situation of municipalities: The budget deficit has risen to a new record level of EUR 31.9 billion and debt has also increased by 16%. Accordingly, municipal treasuries have a very negative view of both the current and future financial situation.

In nominal terms, municipal investment is stagnating while it is declining in price-adjusted terms. The investment backlog as perceived by municipalities has risen to a new high of EUR 231.2 billion. Substantial backlogs continue to exist in school infrastructure as well as in roads and transport infrastructure. Backlogs in sports facilities, administrative buildings and fire and disaster protection have also grown significantly. For the financial year 2026, one in five municipalities expect additional investment financed through the special fund for infrastructure and climate change (*Sondervermögen Infrastruktur und Klimaschutz*). Planned investment, at EUR 50.3 billion, is therefore significantly higher than in 2025.

This year's focus topic examines the financial situation of municipal shareholdings and outsourced units responsible for providing basic public services. The results show that their financial sustainability differs markedly across areas and that municipalities support their shareholdings primarily by providing guarantees and foregoing profit distributions.

Financial challenges facing municipalities

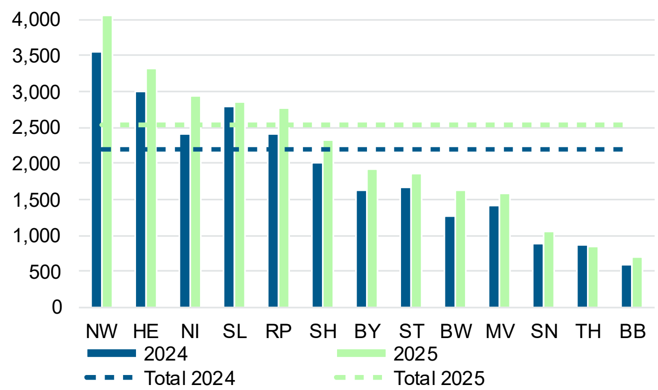
The municipal budgetary situation has become even more acute. Expenditure rose by 5.6% in 2025, while revenue only increased by 4.1%. Social expenditure (+5.9%) and personnel expenses (+6.8%) grew particularly strongly. The financing balance of municipal core and extra budgets was -7.5% of overall expenditure and thus fell further below the record low of -6.8% already reached in 2024.

Accordingly, municipal treasuries assess the municipalities' financial situation very critically. They were surveyed for the KfW Municipal Panel 2026 by the German Institute for Urban Affairs (Difu) between January and March 2026. Only around 30% of municipalities rate their financial situation in the completed 2025 financial year as "satisfactory" or better. By contrast, 44% classify their situation as "poor" and a further 25% as "adequate". The negative assessment is particularly pronounced in larger cities: 73% of municipalities with more than 50,000 inhabitants describe their financial situation as "poor". For the 2026 financial year, four out of five treasuries expect a development of the financial situation that is "rather unfavourable" or "very unfavourable".

Rising debt and increasing cash advances

Parallel to the high deficits, indebtedness is increasing significantly. According to the Federal Statistical Office, the debt of municipalities and municipal associations rose by 16% in 2025 to a total of EUR 196 billion. The largest share is accounted for by investment loans, which grew to EUR 158 billion (+15% compared with the previous year). Of particular concern is the sharp rise in cash advances, which increased by 21.3% to EUR 38.6 billion. Per capita municipal debt at the end of 2025 averaged EUR 2,542 and was thus EUR 351 per inhabitant higher than in the previous year. An increase in per capita debt can be observed in virtually all federal states. Particularly strong increases are evident, among others, in historically fiscally strong states such as Bavaria and Baden-Württemberg (+18 and +28%, respectively).

Figure 1: Per capita municipal debt by federal state in EUR



Source: Federal Statistical Office, debt statistics, own illustration

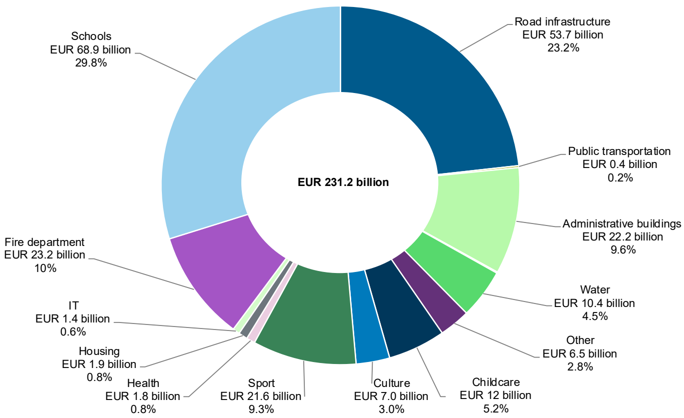
Planned investment increases significantly

According to the extrapolation in the KfW Municipal Panel, investment actually disbursed by municipalities with more than 2,000 inhabitants amounted to EUR 29.3 billion in the 2025 financial year – following around EUR 30 billion in the previous year. Given developments in construction prices, this corresponds to a real decline in investment activity of 6%. By contrast, in the current 2026 financial year planned investment, at EUR 50.3 billion, is significantly higher than in the preceding year. The sharp increase compared with the previous year's figure (+14.8%) is likely to be largely linked to the funds expected from the special fund for infrastructure and climate neutrality. On a rough estimate, municipalities are likely to receive around EUR 60 billion from the special fund over the next twelve years, which, in view of the challenges, is not a large amount. Nevertheless, around one fifth of the municipalities that were able to make a statement on this issue assume that their investment will be higher this year thanks to the special fund. For 2027, this proportion rises to 38%.

The perceived investment backlog continues to rise

By contrast, the perceived investment backlog of municipalities has risen further to EUR 231.2 billion – around EUR 15.5 billion, or 7.2%, more than in the previous year. The largest shares continue to relate to school infrastructure (30% of the total backlog) and roads and transport (23%). These are followed by fire and disaster protection, public administrative buildings and sports facilities, each accounting for around one tenth of the total backlog. In these three areas, a marked increase can be observed compared with the previous year. There are also substantial backlogs in childcare infrastructure and in water supply and wastewater disposal.

Figure 2: Perceived investment backlog 2026



Source: KfW Municipal Panel 2026

Qualitatively, 79% of municipalities assess the investment backlog in relation to the overall infrastructure as at least “significant”, with 13% describing the backlog as “serious”. The situation is particularly problematic in the area of roads and transport: 84% of municipalities report at least a “significant” backlog here, including 28% that even describe a “serious” backlog.

Special fund and financing mix

Municipalities used a similar mix of instruments last year as in previous years to finance investment. However, there was a slight shift away from current budgetary funds, which in 2025 accounted for 19% of the resources used for financing, and liquid funds carried over from the previous year (18%), towards municipal loans (27%). For 2026, many municipalities expect a greater use of funding programmes and earmarked investment grants, combined with fewer own and liquid funds and, overall, less favourable credit conditions.

Focus topic: financial situation of municipal shareholdings

Nine out of ten municipalities have shareholdings in and have outsourced basic public services to enterprises outside the core budget, particularly in the energy and water supply sectors but also, among others, in waste management, local public transport, healthcare, housing, culture and sport. In local public transport, as well as in sport and culture, losses often have to be covered, whereas shareholdings in the energy sector are frequently financially self-sustaining and can in some cases transfer profits to the core budget.

For the next five years, municipalities expect a stable development of their shareholdings overall but with fewer profit transfers from energy, water and waste, as well as higher losses, particularly in local public transport and healthcare. This is partly driven by high investment needs arising from the energy and heat transition and climate change adaptation. To strengthen their shareholdings, municipalities have so far primarily used profit retention and guarantees; in future, they intend to retain profits within the enterprise more frequently. Instruments such as silent partnerships or mezzanine capital continue to play only a very minor role.

Conclusion: investment challenges persist

Despite higher planned investment, municipalities not only have to eliminate an investment backlog that has further increased to more than EUR 230 billion but at the same time must address new challenges – for example in the areas of climate protection and climate change adaptation, digitalisation, transport transition and social infrastructure. In view of high deficits, dynamic expenditure growth and limited scope for increasing tax revenue, it must be assumed that the financial situation of many municipalities will remain strained in the coming years.

The special fund for infrastructure and climate neutrality can make an important contribution to stabilising municipal investment activity but will not remedy the structural imbalance in municipal finances on its own. In addition to financial relief, fundamental reforms of the municipal revenue base and of the allocation of responsibilities and expenditure are required. At the same time, non-monetary obstacles are restricting investment – such as staff shortages in municipal administrations, lengthy approval and procurement procedures or complex funding structures. In order to maximise the impact of the limited funds and avoid placing further burdens on investment activity, support programmes and funding allocation processes that are as lean and low in bureaucracy as possible are crucial.

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.

Further information on the KfW Municipal Panel can be accessed **here**.