Full coffers provide a reprieve but the outlook is clouding over

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The KfW Municipal Panel 2019 paints the picture of a healthy economy and growing municipal investment. Accordingly, the perceived backlog of investment has dropped to the level of the years 2015 and 2016. But with a total of EUR 138 billion, it remains a challenge for investment policy. The municipal treasuries surveyed expect a weaker financial position over the coming years, so it remains to be seen whether the reduction in the backlog of investment can also be continued in the years ahead.

A healthy economic environment

The survey year 2018 was characterised by a good budget position for most German municipalities. Financial statistics show that all municipalities and municipal associations combined generated a positive fiscal balance of EUR 9.8 billion in their core and non-core budgets. The good financial situation is also reflected in the surveyed municipal treasuries' assessments, with 36% rating their financial situation 'good' or 'very good'. Another 31% regard their financial situation as 'satisfactory' and a further 16% consider it at least 'sufficient'. Only 17% of municipalities see their financial situation as 'insufficient', down from 22% in the previous year.

However, financial surpluses and a generally healthy financial position should not conceal the fact that differences still remain between individual municipalities. Even if the number has dropped, 21% of municipalities did not succeed in balancing their budgets in 2018. They include a striking number of large cities. That means a total of around one quarter of Germany's population lives in municipalities that can only manage their budget under budgetary supervision.

Municipal investment activity continues to increase

The encouraging financial situation of many municipalities, along with the various promotional programmes, has led to a further increase in investment activity. The municipal treasurers reported that the investment expenditure planned for 2018 rose to EUR 34.7 billion and is forecast to grow to EUR 35.8 billion this year. The main investment priorities will continue to be roads, with 25% of total investment, and schools with approx. 21%.

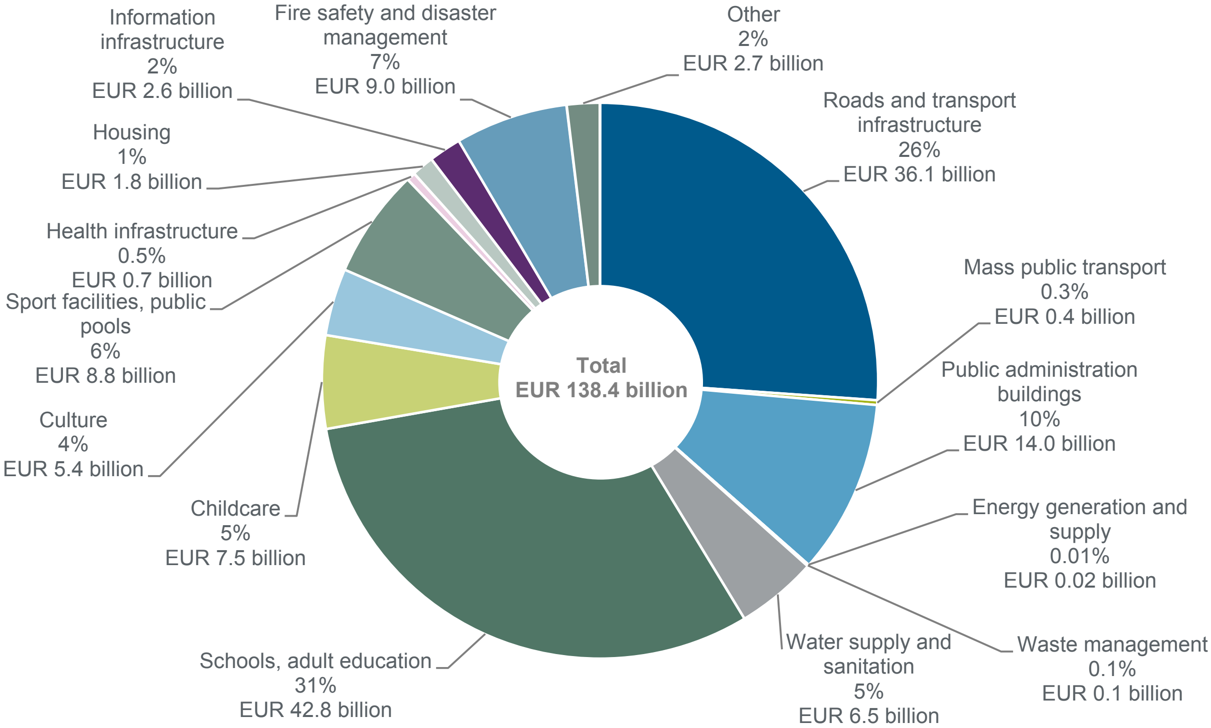
But the municipal treasurers' responses also showed that not all investment expenditure can be realised as planned. In fact, actual investment expenditure in 2018 is estimated to be around one third lower than planned. There are various explanations for this discrepancy. The main causes mentioned by municipalities were capacity bottlenecks in administration and the construction sector, so that investment projects cannot progress within the intended timeframe. It therefore remains to be seen over the coming years to what extent municipalities will effectively be able to implement their planned investments and whether expenditure increases will indeed lead to better infrastructure and not be mainly the result of price rises.

Perceived investment backlog is decreasing

Although not all investment projects can be realised within a budget year, many projects have nonetheless been at least planned or already initiated. At the same time, some uncertainties surrounding investment challenges that were still looming in previous years have now been clarified, so the surveyed treasuries are now more optimistic about their unsatisfied investment needs. As a result, the perceived backlog of investment has dropped to EUR 138.4 billion, roughly the level of the years 2015 and 2016.

The areas with the largest investment gap continue to be schools with EUR 42.8 billion, roads with EUR 36.1 billion and administrative buildings with EUR 14.0 billion. Prominent themes such as housing and digitalisation exhibit a percentage increase but fail to reach the levels of many other areas in absolute figures. This pattern is also due to the differences between municipalities since the backlog of investment between some regions or their population size classes can vary considerably. One reason can be different degrees of externalisation. Specifically, this year's survey also reveals that many areas of responsibility are no longer covered by the municipalities' core administration but have been externalised, for example into municipal or private enterprises. Municipal treasuries can therefore make fewer statements on the investment needs in these areas, which include mass public transport, energy and waste management, for example, but also housing.

Figure: Perceived investment backlog in municipalities in 2018



Source: KfW Municipal Panel 2019, conducted by Difu from September to October 2018

Financing conditions remain adequate

Not much appears to have changed in municipal investment finance. Cities, municipalities and districts finance the largest portion of their investment volume, 41%, from general public funds. Although tax revenues and key allocations have risen in many local government areas, the share has dropped from the previous year. Purpose-tied investment allocations account for 11%. An increase can be seen in promotional funds, which now go to financing more than one quarter of investment volume (27%).

Borrowed funds have also gained importance, with municipal loans increasing to a share of 18%. The remaining approx. 3% are other instruments, including promissory note loans and bonds, but these are at best of relevance to larger cities. Most municipalities reported adequate borrowing conditions. This will probably lead treasuries to expect a growing share of municipal borrowing again in their investment finance for the coming years. Also with a view to the many promotional programmes that have been initiated in the past years, it is not surprising that municipalities expect these funds to gain in importance.

Expectations for future finances are more muted

Experience has shown that, due to their occupation, municipal treasuries are always sceptical with regard to their future financial situation. Yet the current KfW Municipal Panel signals a turning point. Whereas expectations for the development of the financial situation in previous years have always been better than in the preceding surveys, a pronounced slump in sentiment is discernible this year. This view of the treasuries matches the economic forecasts and current tax estimates, which are now more cautious. Against this background, it is intriguing to see whether the majority of municipalities will have their expectations of a further reduction in the investment backlog fulfilled in the coming years despite increased economic risks for most areas of activity. ■

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 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 also participate on a panel advisory board.

The complete KfW Municipal Panel can be accessed at www.kfw.de/kommunalpanel (full version available in German only).