



# Public Sector Debt Financing in Germany

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## Editorial: Debt is a bet on the future

Climate change, the coronavirus crisis, the war in Ukraine - there is no end to the reasons why the public sector needs to raise large sums of money. These funds cannot be easily raised from the current budgets of the federal government, states, and municipalities. That is why the obvious way forward is to increase the use of borrowed capital.



Following the experience of the financial crisis around 2009, Germany experienced a decade of budget consolidation and debt reduction. Solid economic growth facilitated this path. However, this is likely to come to an end for the time being: a turnaround in fiscal policy is currently underway.

In Germany, the financial requirements for defense, infrastructure and managing the green transformation are driving public borrowing. The beginning of this development was marked by the federal government's special funds for coronavirus aid, for the Bundeswehr and for infrastructure. The latter is part of the March 2025 financial package, which includes exemptions from the debt brake for defense spending and the ability of the states to take on debt. Two to three-digit billion amounts are on the table, which could add up to trillions over the next decade and push the German national debt ratio towards 80% of GDP.

For investors seeking a safe haven, there are new opportunities - but for the federal state, there are risks of rising interest rates and shrinking budgetary leeway in the future. In order for the calculation to work out, the public sector must not "consume" the available funds. Instead, investments must be made where the greatest social and economic returns can be expected. Debt-financed investments then contribute to a better quality of life and improved competitiveness and help to refinance future interest and repayment burdens through higher growth.

However, the public sector still manages primarily according to plan fulfillment and outflow of funds, and not enough according to target achievement and effectiveness. Further reforms are therefore required to ensure the efficient use of funds. This does not guarantee successful, debt-financed investment activities, but it does improve the odds in the public sector's betting game to set the right course.

There will not be one all-encompassing solution. The starting positions of the federal government, states, and municipalities are too different. As we show in this study, the federal levels in Germany use very different financing instruments. It is important to take a differentiated view here. This applies both from the perspective of private investors and public borrowers. The banks play an important role in advising and brokering between the two. Helaba also plays its part: You will find our contacts for all aspects of public sector financing at the end of the study.

Yours,

Dr Gertrud Rosa Traud  
Chief Economist / Managing Director

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# 1 High public investment and financing requirements



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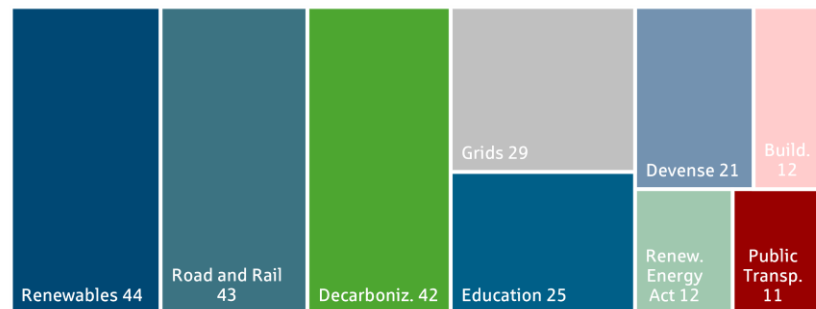
Germany is facing a major **transformative challenge**. Changes are imminent in many social and economic areas that will **require considerable investment**. These challenges can be described using a whole series of “D-words”: decarbonization, demographics, digitalization and derisking - to name just the most prominent ones.

These buzzwords describe concrete needs for change and adaptation, which require large investments for a successful transition. Estimates of these investment requirements vary widely due to methodological differences in relevant studies but generally always lie in **the high billion range**.<sup>1</sup> The public sector accounts for a considerable proportion of the overall economic investment requirements, with a share of around one tenth often cited, for example for upgrading public infrastructure. If government investments and support measures are also considered for businesses and private households to increase their investment activity, the **public investment and financing requirements** increase accordingly.

Usually, **additional requirements** are determined that are necessary over and above the level of investment already made or planned. Overall, the study indicates that the public sector will need to invest **between EUR 20 and 70 billion per year** for the period under review up to the middle of the next decade. Considering interim price increases and a generally increasing investment path over time, investment requirements at the upper end of the estimate are more likely to apply.

## Major public investment needs\* under debate

Additional investment funding needs, billion euros per year



\*selected examples from various studies

Sources: BDEW/VKU/Deloitte, WWF/FÖS, Dezernat Zukunft, Agora Think Tanks, Helaba Research & Advisory

However, such aggregate analyses are subject to great uncertainty due to methodological differences or multiple counting. Instead, demand can be forecasted with greater accuracy with regard to individual sectors or purposes. The clearer allocation then makes it easier to answer open questions **of responsibility and financial viability**.

For the public sector, this means allocating the investment requirements to the sub-state entities. Only on this basis can **financing requirements** and **possible financing methods** be identified. This is because almost all studies agree that the necessary investments can hardly be financed from current revenues but require the **integration of borrowed capital**.

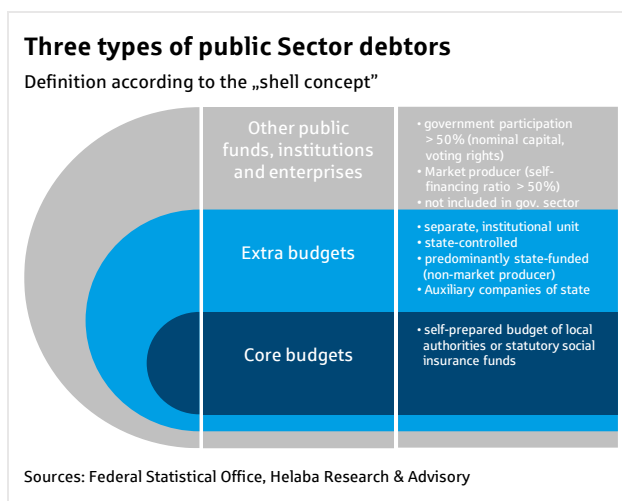
Many economists currently expect a positive effect for Germany from a debt-financed **expansion of investment**. One of the structural reasons cited for the low growth rates in recent years is deficiencies in the infrastructure. Together with weak domestic demand and underutilized construction and production capacities (at least in building construction, less so in civil engineering), additional government investment promises to boost the economy and strengthen Germany's potential growth. With interest rates on capital still quite low in a long-term comparison, higher economic growth contributes to a timely **amortization of investment costs**.

<sup>1</sup> See our Focus: [Wo steht der öffentliche Sektor in der nachhaltigen Transformation?](#) of 4 December 2024 (in German)

## 2 Large number of public-sector debtors in Germany

The state level of the Federal Republic of Germany consists of the **federal government (Bund)** and the 16 **federal states (Länder)**.<sup>2</sup> The federal states are made up of the three city states of Berlin (BE), Hamburg (HH) and Bremen (HB) as well as the 13 territorial states of Baden-Wuerttemberg (BW), Bavaria (BY), Brandenburg (BB), Hesse (HE), Mecklenburg-Western Pomerania (MV), Lower Saxony (NI), North Rhine-Westphalia (NW), Rhineland-Palatinate (RP), Saarland (SL), Saxony (SN), Saxony-Anhalt (ST), Schleswig-Holstein (SH) and Thuringia (TH).

**Municipalities (Kommunen)** form the third administrative level and are part of the federal states under constitutional law.<sup>3</sup> According to the official list of municipalities, the municipal level comprises 106 independent cities, 294 districts and 10,754 municipalities belonging to a district, of which 2,059 have the status of a city. In addition, there are 1,203 municipal associations (depending on the federal state, associations and joint municipalities, offices or administrative associations and communities) in which municipalities belonging to the district are united.



The federal government, federal states and municipalities can perform their tasks in the **core administration**. In addition, public institutions can be entrusted with the fulfillment of certain public tasks. In addition to the core budgets, **the extra budgets** are therefore included in the overall public budget. These are independent parts of the core administration, such as own operations or special-purpose associations, which are allocated to the general government sector according to the criteria of the European System of Accounts.<sup>4</sup>

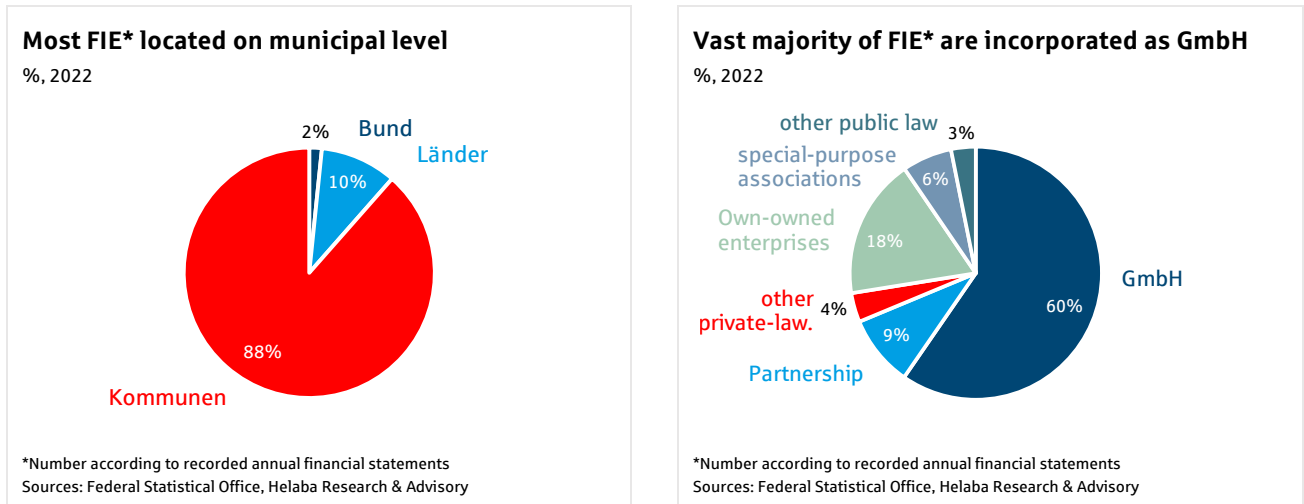
In addition, other **public funds, institutions, and enterprises (FIE)** form the public sector. While the extra budgets often do not act as

debtors but cover their financing requirements via the core budget, the FEUs represent a large group of public debtors. Of the 20,407 FIEs, only 2% are sponsored or owned by the federal government, 10% by the federal states and the majority (88%) have a municipal background. Around 60% are companies in the legal form of a limited liability company. A further 13% are other forms of partnerships and corporations under private law. The remaining 27% are public-law forms of organization. Larger municipalities tend to outsource more tasks to public companies. Such differences in the **degree of outsourcing** between municipalities are only comprehensible with a great deal of research effort and make inter-municipality comparison difficult.

<sup>2</sup> The government sector also includes social security funds, which are not considered further here. Social security funds account for less than 1% of total government debt, as they are mainly financed by contributions and subsidies. Also not considered in more detail here are independent corporations and institutions at federal and state level, which may act as independent debtors on the market.

<sup>3</sup> The municipal level also includes a large number of higher municipal associations and regional associations, as well as special-purpose associations and other forms of inter-municipal cooperation. As a rule, these associations are financed via levies, contributions or their own income, meaning that debt financing only plays a subordinate role.

<sup>4</sup> The government sector includes auxiliary enterprises or units that are predominantly financed by the government and are non-market producers. As a rule, this requires a self-financing ratio of less than 50%. For example, with the introduction of the “Germany Ticket” in May 2024, many transport companies are therefore included in the statistics under extra budgets and no longer under other FIEs.



### 3 Several reasons for public debt

Economic theory usually identifies three central functions of government debt:

1. The **stabilization function** comes into play as an anti-cyclical economic policy and is intended to help stabilize the economy during economic downturns by taking on additional debt or during periods of economic overheating by reducing debt.
2. The **bridging function** serves the purpose of tax smoothing, so that in the event of a cyclical slump in revenue or increased expenditure requirements in the event of a disaster, taxes do not have to be increased directly, but the financing gap can be covered more quickly and cheaply by raising debt.
3. The **burden-shifting function** contributes to the monetary balance between today's decision-makers and future users and involves future beneficiaries and taxpayers in investments made today by stretching the financing burden over time.

In individual cases, each of these functions is controversial because no concrete order of magnitude for an appropriate level of debt can be derived from theory for political practice. The decisive factor in determining the **limits of government debt** is the question of whether government debt is financially sustainable in the long term. The most important indicators for the sustainability of public finances are the **deficit ratio** (current ratio) and the **public debt ratio** (stock ratio), i.e. the respective ratio to gross domestic product (GDP).

As the ratio to economic output is the decisive reference value, the analysis is primarily based on **the ratio of the real interest rate for debt to the economic growth rate**. As long as the interest rate exceeds the growth rate, a primary surplus must be achieved in the budget to finance the interest burden. However, this surplus is only possible in the long term if the real growth rate is higher. **The use of public debt funds to promote growth** is particularly important. The "golden rule" therefore states that public debt should not be used for consumption, but only for investment. What this means in individual cases remains controversial, especially as the benefits of public investment, are often dispersed due to their intermediate nature and only arise at a much later point in time.

How the ratio of interest rate to growth rate will develop in the long term is always uncertain. The assessment of whether public debt is still sustainable therefore remains highly subjective. Soft factors such as **trust and expectations** are at least as important for a country's creditworthiness as hard figures. There are therefore no objective limits for government debt that can be derived according to scientific criteria.

For this reason, **politically defined guidelines** play an important role. First and foremost, deficit rules serve to limit public debt. This follows political-economic considerations, according to which going into debt is the easier way for politicians to finance state services and election promises without having to charge citizens and taxpayers the full costs. This incentive can lead to a steady increase in debt. In order to ensure the long-term financial sustainability of the state, there exist therefore a large number of rules of **political self-commitment** that serve to regulate or limit government borrowing, also in order to avoid unduly restricting the scope for future budgets with debt servicing.

In line with the federal structure, the main **legal sources** for public borrowing are: the European fiscal rules, the Basic Law (especially with the rules on the debt brake), the state constitutions, the federal and state budget regulations and the municipal regulations and their budget bylaws. The rules at state and municipal level in particular can differ from one another, even if certain generally applicable guidelines have emerged nationwide.

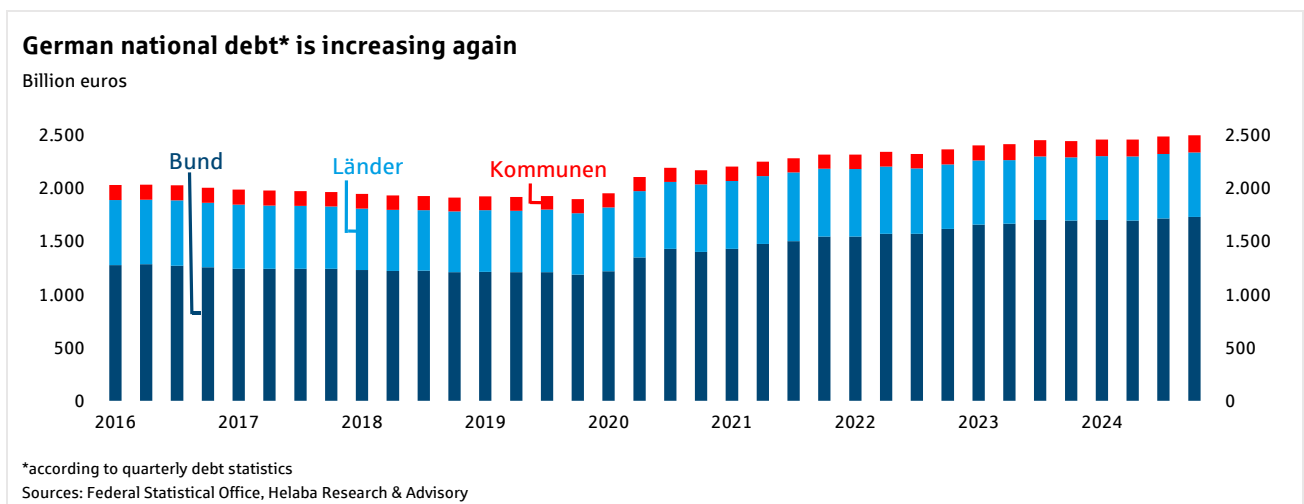
There are **two central statistical data sources** on public sector debt: firstly, the debt statistics, which are kept by the statistical offices of the federal states and the German Federal Statistical Office. These reflect the perspective of debtors. Secondly, the banking statistics of the Deutsche Bundesbank, which reflect the perspective of creditors. Due to methodological differences, the values of the two statistics do not match completely. The debt statistics have been fundamentally changed since 2010 in order to be able to record and report according to harmonized European standards.

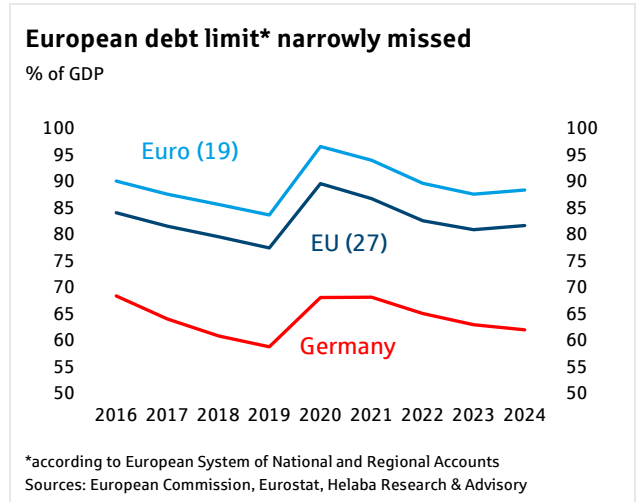
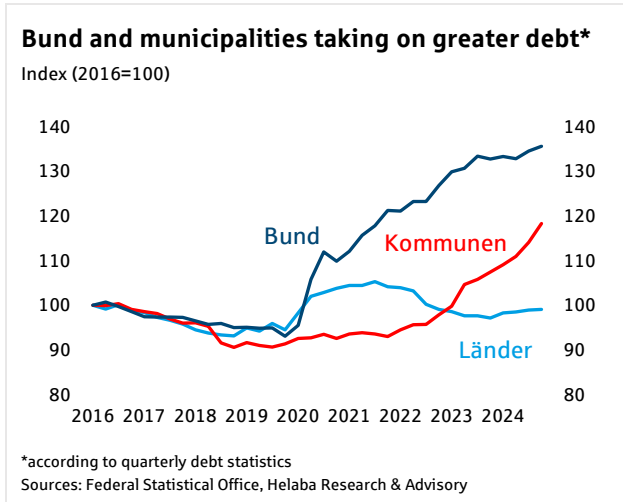
Public **financial obligations** can also arise from public-private partnerships (PPP projects), loan-like legal transactions, guarantees, leasing and trade payables. These are recorded statistically but are not integrated into the official debt level at the national level. The situation is different for debt as defined by the Maastricht criteria. Here, for example, PPP projects, placeholder transactions and government support measures for banks increase public debt.

So-called **implicit liabilities** are not usually recognized. These result from a calculatory underfunding of future financial requirements. A prominent example of this would be the pension gap, i.e. pension commitments for which no reserves have been set aside. The reason for this is that implicit debts can only be roughly estimated and there are no reliable cash flows that can be recorded in the (cash-based) accounts.

## 4 Current public debt is increasing

After a **long period of consolidation**, the level of debt in Germany is rising again. After the so-called debt brake was enshrined in the German Basic Law in 2009, which only allowed the federal government to take on new debt of 0.35% of GDP from 2016 and the federal states to take on no new debt at all from 2020,

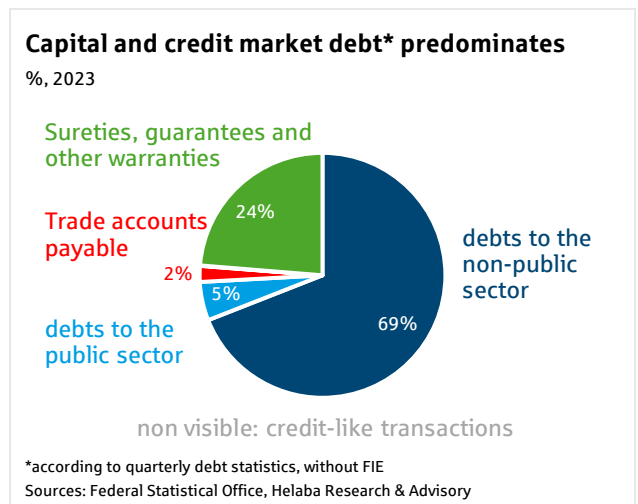
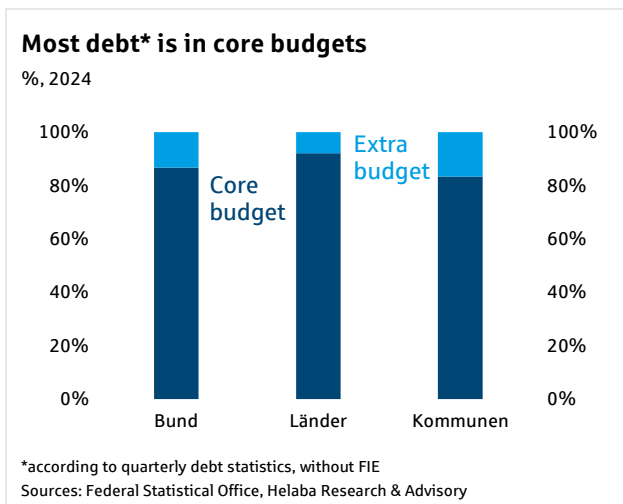




German public debt fell continuously – thanks in part to the good economic conditions. This changed in the course of 2020 with the **coronavirus crisis** and the **launch of large aid packages**, primarily by the federal government (“bazooka”). By mid-2020, the federal government alone had paid out around 130 billion euros for aid measures.

Although the public debt curve flattened again after the coronavirus peak, there was no substantial decline. In addition to the reconstruction aid to cope with the flood disaster in 2021 (30 billion euros), this was mainly due to the Russian invasion of Ukraine, as a result of which the economic and energy crisis led to **renewed federal aid packages** (“double whammy”, 200 billion euros) in 2022. These programs were financed by **special funds**, which were filled by taking on additional debt. The **weak economy** is also putting a strain on current budgets. The German economy has been stagnating since 2023, meaning that government (tax) revenue is growing less strongly than expenditure. This dynamic affects not least the municipal level.

Against this backdrop, the new coalition has agreed on a series of measures after the 2025 federal elections to improve the economic situation and expand public investment in defense and infrastructure. **Tax relief** in particular is likely to affect the revenue base of public authorities for the time being until the hoped-for economic recovery leads to a stronger increase in public revenue. Until then, **budget shortfalls** are likely to be bridged by further borrowing.



The **exceptions to the debt brake** adopted in March 2025 and the newly **created special fund “Infrastructure and Climate Neutrality”** (500 billion euros) are the main factors contributing to a prospective increase in German public debt. By the end of 2024, **total German government debt** will have risen to just over 2.5 trillion euros. With around 1.7 trillion euros, 69% of this is attributable to the federal government. A further 24% or 607 billion euros is attributable to the federal states. At almost 170 billion euros, the remaining almost 7% is attributable to the municipalities.

The **German public debt ratio** according to the Maastricht criteria is 62.4% in 2024. The target of 60% was missed once again. Nevertheless, Germany is still below the European average, which in 2024 is 84% of GDP for the EU and almost exactly 90% of GDP for the eurozone.

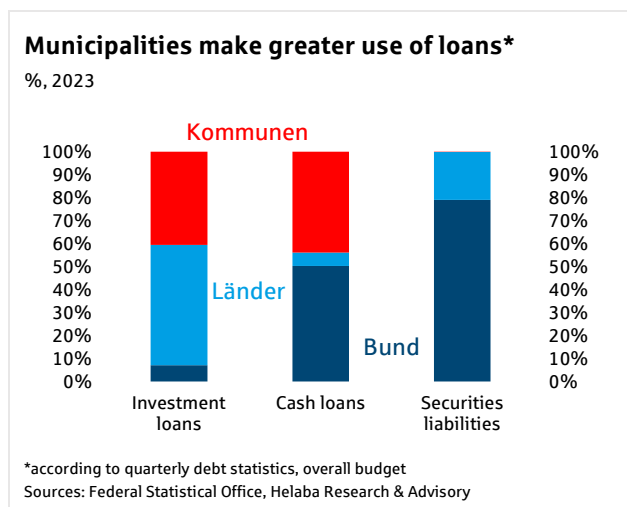
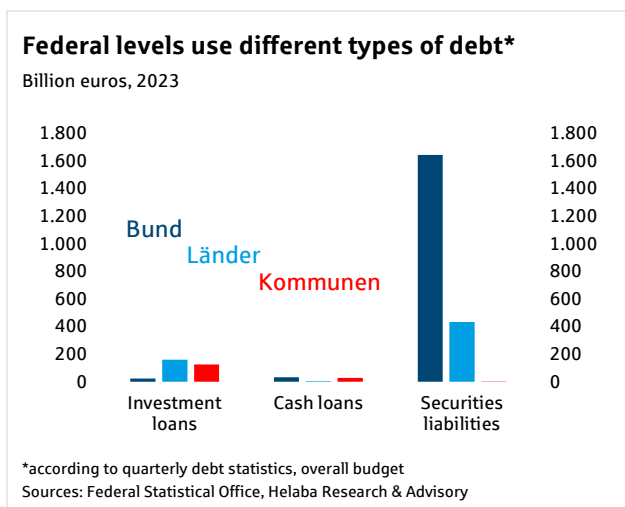
In principle, public debt can take **various forms of liabilities**. With 5% of total debt, the debt of the public sectors to each other hardly plays a role.<sup>5</sup> However, almost a quarter of public debt is in the form of sureties, guarantees and warranties. With 69%, the vast majority of debt is owed to the **non-public sector**, which is usually cited as a reference value for public debt in reporting. Non-public sector creditors include banks and other domestic and foreign lenders such as insurance companies, companies and private individuals. The significance of the creditor groups for the federal levels differs depending on the financing instruments used.

At all federal levels, the majority of debt (over 80%) is recorded in the **core budgets** while **extra budgets** only play a subordinate role. Around one tenth of public debt can be found there. Except for model calculations for the municipalities, there is hardly any data available for the **FIE**.

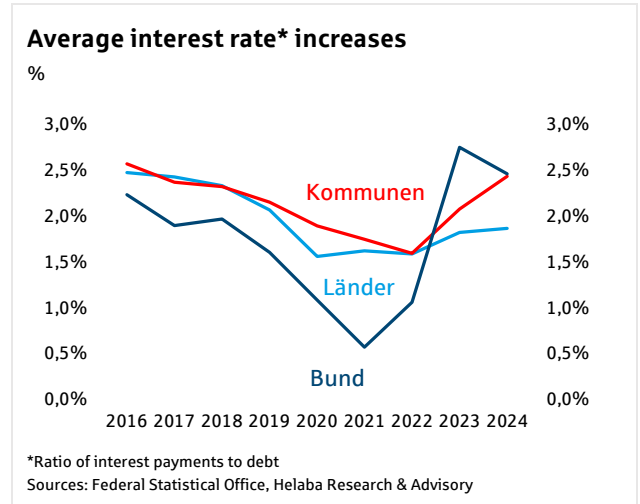
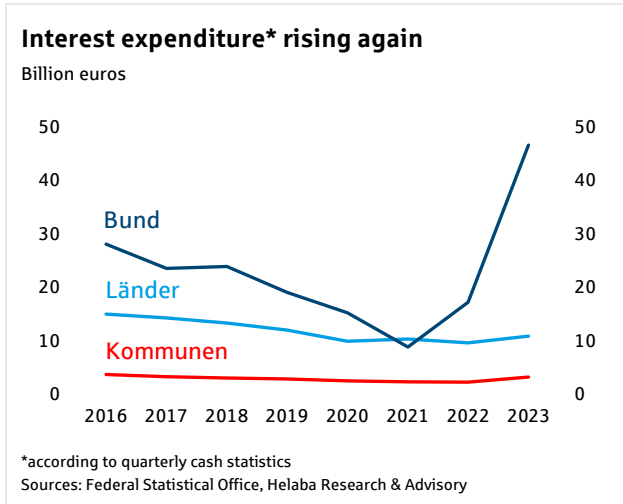
## 5 Federal levels use various financing instruments

The federal levels make use of financing instruments to varying degrees. While the federal government and, by some distance, the federal states issue a high volume of **securities debt**, local authorities hardly use this option. The share of securities debt (e.g. federal bonds, debentures, treasury bills) in total federal debt is 97%. This ratio is 74% for the federal states, but only 2% for the municipalities.

Securities debt primarily includes bonds. These securities, which are in demand on the market and therefore highly liquid, minimize interest and other costs, but are considered comparatively expensive to place on the market and are therefore only profitable for larger volumes, which local authorities usually do not achieve. In contrast, local authorities use **loans** much more frequently. Here, the share of municipal debt is 98%, while the federal states finance 26% and the federal government only 3% via loans.



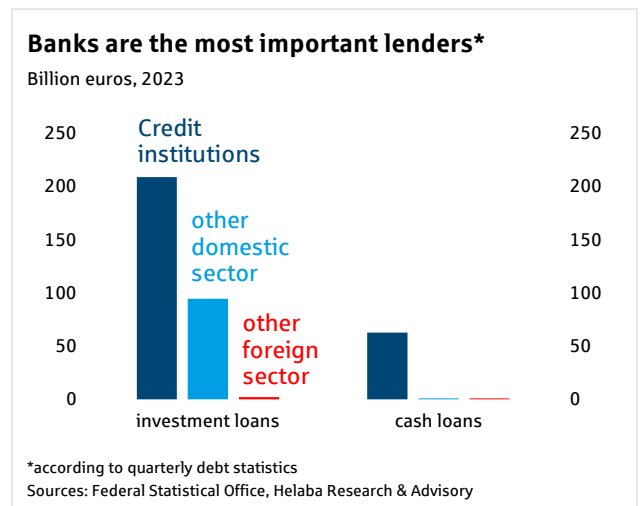
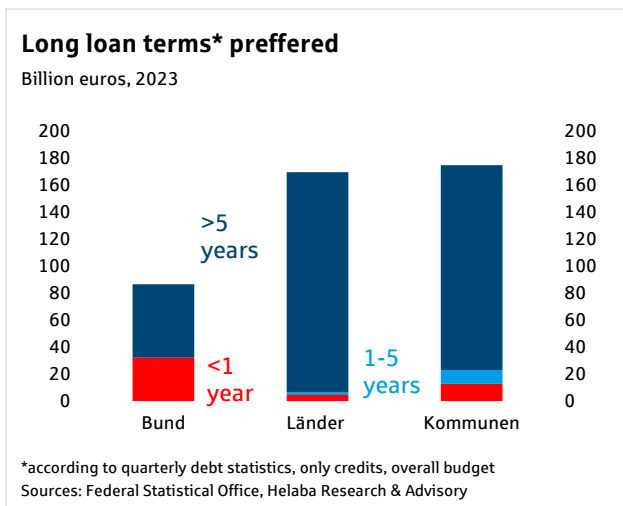
<sup>5</sup> In a comparative analysis, care must be taken to ensure that the data is adjusted to avoid double counting.



Higher debt raises **interest payments**. The federal government which, in particular, has been able to noticeably reduce its interest burden thanks to the low-interest phase and debt reduction, has had to pay significantly more interest again since 2021. The **conditions** also play a role here: after the ECB had raised key interest rates again since 2022 (but has been lowering them again since mid-2024), the federal government has to pay its investors higher yields. In addition, the increase in the debt of other countries, above all the USA (Treasuries), is putting pressure on German government bonds. Together with the foreseeable expansion of federal debt as a result of the fiscal package adopted in March 2025, the financial markets expect interest rates on German government securities to rise.

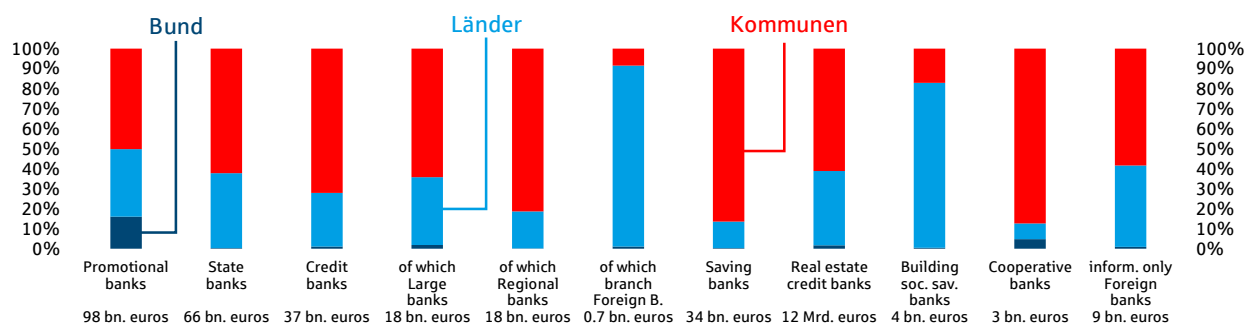
The rise in the general interest rate level from 2022 and the quantitative increase in debt can also be seen in the form of higher interest rates for federal states and municipalities. Increasing **credit financing costs** are particularly noticeable in municipal budgets. Although the burden is manageable with an interest rate of 1% of total expenditure, there is considerable momentum that suggests a further increase in the interest burden for local authorities. The **average interest rate** for both the federal government and the municipalities is 2.5% in 2024.

At the current margin, the conditions for debt financing are likely to be higher. Interest rate indicators point to interest rates of between 2.8% and 3.6% for investment municipal loans with a term of ten years. The state-subsidized promotional loan "Investment Loan Municipality" (IKK) from KfW with a comparable term is currently around 2.6%.



### Banks grant loans\* primarily to municipalities and Länder

% of loans to domestic public budgets by borrower and bank groups, 2023



\*according to banking statistics

Sources: German Federal Bank, Helaba Research & Advisory

The **yield curve** has now “normalized” again. The public sector has to pay more interest for longer-term loans, while shorter-term loans are cheaper (this applies in particular to cash advances). The vast majority of federal states and local authorities are seeking loans with a term of significantly more than five years.<sup>6</sup>

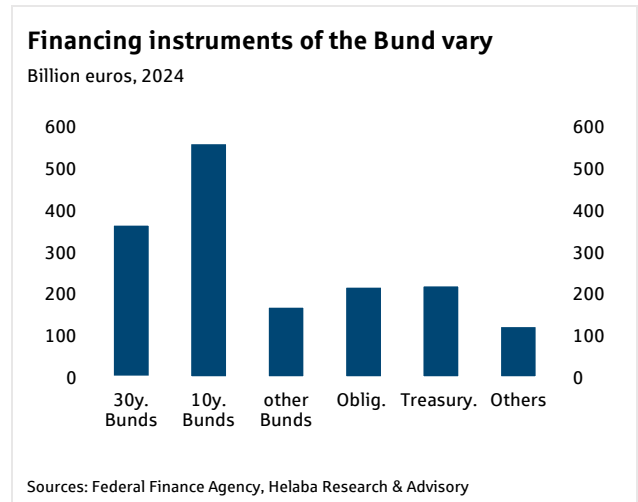
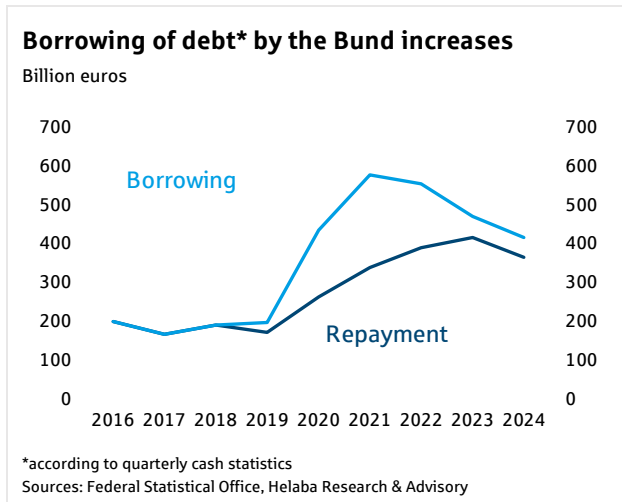
The majority of loans, which are primarily taken out by municipalities and federal states, come from **banks, savings banks and other credit institutions**, which provide 65% of loans to the federal government, 53% to federal states/city states and almost 100% to municipalities. Around 80% of loans to the public sector are granted by credit institutions with a public-law legal form. Domestic banks are particularly important for local authorities, providing 96% of loans, most of which are denominated in euros. Foreign lenders are hardly involved with local authorities and federal states. The federal states receive more than half of their loans from other domestic sources (e.g. insurance companies) beyond the traditional banks. The federal government, on the other hand, has a much broader creditor base, although it is primarily the securities debt that is of interest to institutional investors. Outside the banking sector, only slightly more than one tenth of loans to the federal government are attributable to the other domestic sector.

## 6 Federal debt about to rise

The federal government borrows primarily via **federal bonds (Bunds)**, with maturities of 10 years and 30 years accounting for the largest share at 33% and 22% respectively. Other capital and money market instruments such as federal obligations or treasury bills account for significantly less at around 13% each. At 4%, special financing vehicles such as green securities only account for a small proportion of the **federal debt** of 1.7 trillion euros in 2024. In contrast, promissory bill loans or loans from the federal government are virtually insignificant.

The federal government's securities are traded and held by asset managers, banks, brokers and hedge funds, which hold 88% of the securities. Geographically, almost two thirds of these come from Europe and a quarter from America. Other regions of the world only play a subordinate role. This year, the German government plans to issue bonds with a volume of 380 billion euros. The **exemptions from the debt brake** adopted in March 2025 and the newly created special infrastructure fund are likely to lead to a further increase in federal debt in the foreseeable future. In future, the federal government will be allowed to finance defense spending - defined in an expanded manner - that exceeds 1% of GDP, i.e. currently around 43 billion euros per year, through debt. A further reform of the debt brake has been announced, although the details are not yet known.

<sup>6</sup> The official statistics do not provide a further breakdown of the terms and conditions of loans to the public sector. Further information must therefore be taken from market reports. However, a representative picture of market activity is hardly possible on this basis.



The special fund is intended to ensure an expansion of public investment over the next twelve years. Of the 500 billion euros, 100 billion euros each are earmarked for the climate and transformation fund and for the federal states and municipalities. These funds are to be used to make additional investments, with the draft bill providing for a flat-rate investment share of 10% of the federal budget. However, how exactly the **additionality** is calculated, what the funds are used for in detail and how they are transferred to the project sponsors still needs to be regulated in **the implementing provisions**, so it is likely to be some time before the first funds flow out and debts are actually taken on.

The **infrastructure areas** in question are named in the draft for the Establishment Act: Civil defense and civil protection, transport infrastructure, hospitals, energy infrastructure, education, care and science infrastructure, research and development and digitalization.

As the additional investment funds are clearly defined in terms of amount, the unknown component for future German government debt is primarily defense spending. In addition, the GDP reference figure is variable, meaning that there is a **wide range of estimates** for the development of the debt ratio depending on the assumptions made. The most likely consensus seems to be a figure of around 1 trillion euros over the next ten years with an increase in the annual amounts over time.

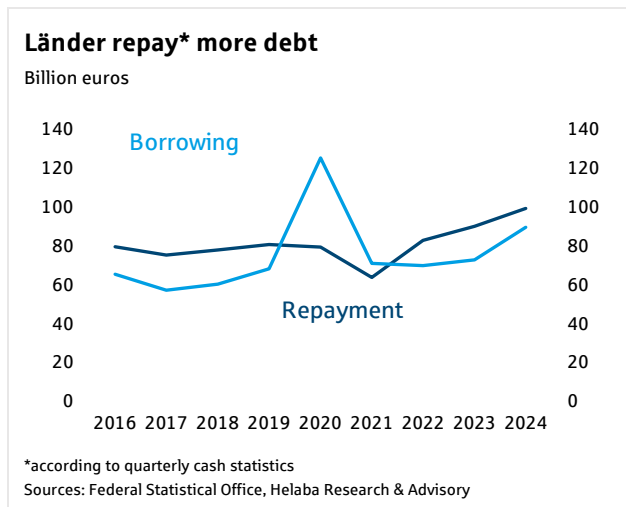
This would put the German **debt ratio** at over 80% of GDP by the middle of the next decade. Such dimensions should not give rise to any initial doubts about debt sustainability. In fact, initial **market reactions** tend to point to a favorable assessment of the debt plans. Yields, spreads and futures on German government bonds show only slight increases in the medium term. For example, the short-term rise in interest rates on 10-year German government bonds of 30 basis points to 2.9% when the fiscal package was announced was not sustained and fell quickly. The interest rate is currently quoted in a range of 2.4% to 2.7%, while long-term forecasts assume a moderate increase to up to 3%.

The actual limit on German government debt is therefore not set by the capital markets, but by **European fiscal rules**. Following the reform of the Stability and Economic Pact in 2024, the rigid Maastricht criteria of 60% of GDP for total debt and 3% of new debt were not abolished but made more flexible. If these orientation values are exceeded - as would be the case if the debt leeway is realized - Germany must agree on a consolidation path with the EU. However, in view of the current geopolitical situation, it remains to be seen what this will look like in detail and how the new rules will be "lived".

## 7 Debt of federal states could increase again

The financial situation and, as a consequence, the level of debt is heterogeneous between the federal states "Länder". This is remarkable insofar as the financial equalization system is intended to safeguard the financial situation of all federal states.

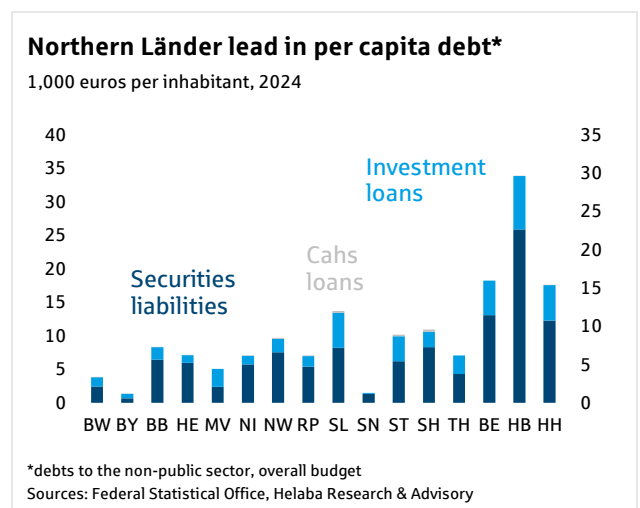
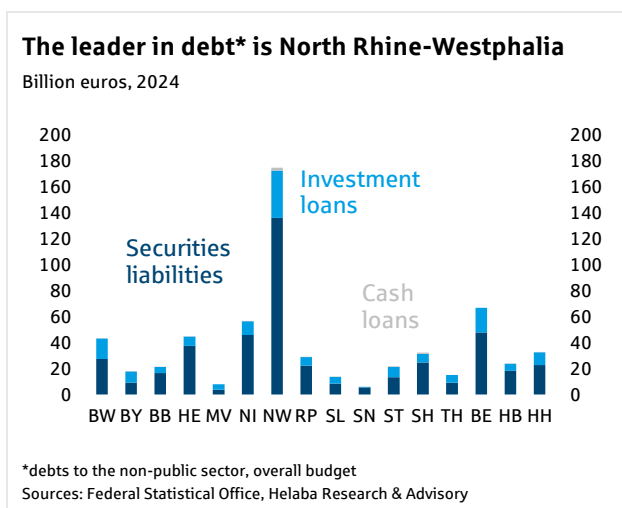
Since the introduction of the debt brake - which took effect for the federal states in the form of a debt ban from 2020 - the financing activities of the federal states have been characterized by a **reduction in debt**. Although the provisions of the debt brake allowed a small amount of debt to be taken on, most of the federal states did not make use of this leeway and at best turned to the financial markets to restructure their debt.



This changed in 2019 in response to the coronavirus crisis. In almost all federal states, the **exemptions for emergencies and disasters** were used to finance relief measures by taking on additional debt. This was most noticeable in Bremen and Saxony. However, not all credit authorizations had to be exhausted, with the result that borrowing decreased and repayments increased from 2020 onwards.

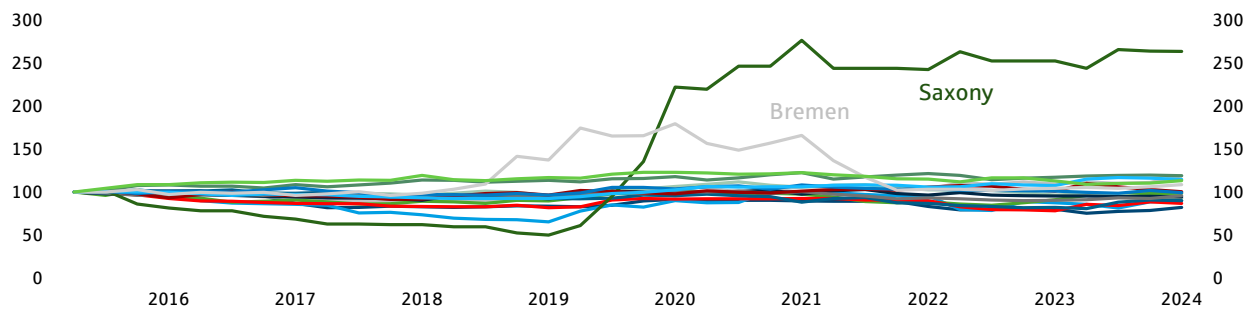
At the end of 2024, North Rhine-Westphalia will be at the top of the **list of German federal states in terms of total debt** with an amount of 174.5 billion euros. If the figures are harmonized on a per capita basis, the picture is put into perspective. At just under 10,000 euros per inhabitant, North Rhine-Westphalia's debt is in the midfield. The most indebted federal state is now Bremen with over 33,000 euros per inhabitant, followed by Berlin and Hamburg with around 18,000 euros per inhabitant. Among the territorial states, Saarland has the highest level of debt at just under EUR 14,000 per inhabitant, while per capita debt in Saxony - despite taking on debt in the meantime - and Baden-Wuerttemberg is significantly lower at less than EUR 1,500 per inhabitant. Bavaria has the lowest level of debt at just over EUR 1,300 per inhabitant.

In the federal states, three quarters of debt is in the form of securities and one quarter as loans, with cash advances accounting for only around 1% of this.



### In terms of debt dynamics\*, special features are only evident in Saxony and Bremen

Index, 2016 = 100



\*debt to the non-public sector, overall budget, each quarterly values  
Sources: Federal Statistical Office, Helaba Research & Advisory

The **amendment to the debt brake** in the Basic Law now also opens up additional scope for the federal states to borrow 0.35% of GDP per year, as was already possible for the federal government. However, it remains to be seen how the amounts will be distributed among the federal states and whether all federal states will make full use of their borrowing options.

## 8 Municipal debt is already rising significantly

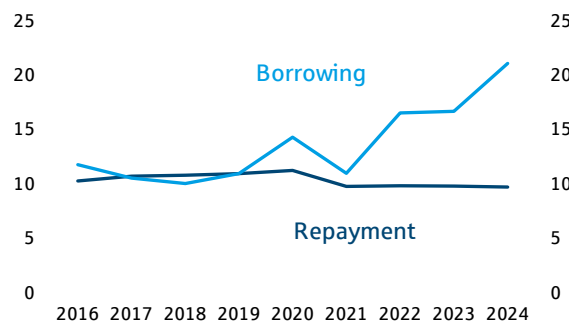
With a total debt of 169.4 billion euros at the end of 2024, the local authorities “Kommunen” accounted for just 7% of general government debt. However, the municipal averages often conceal major regional differences. Because municipalities play an important role in the quality of life of people and the quality of business locations through their public services, there is a particular interest in their financial situation and financing.

Local authority debt varies greatly between the federal states. The municipalities in North Rhine-Westphalia have the highest level of debt with a total of EUR 64.1 billion. With a share of 34%, cash advances account for a considerable proportion of municipal liabilities compared to all federal states. The lowest level of debt can be found in Mecklenburg-Western Pomerania, where local authorities are only indebted to the tune of just over EUR 2.2 billion.

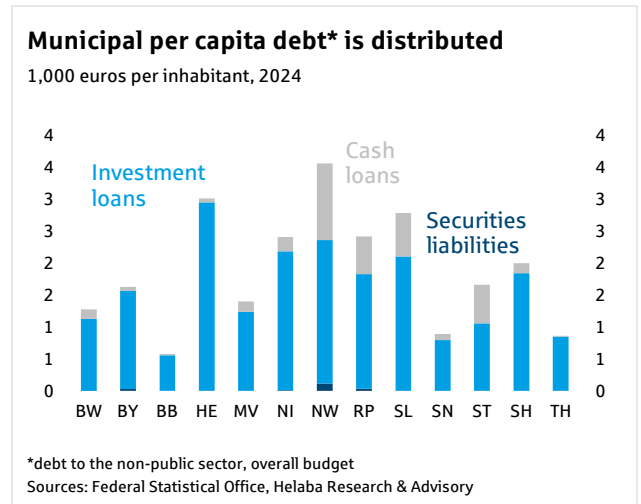
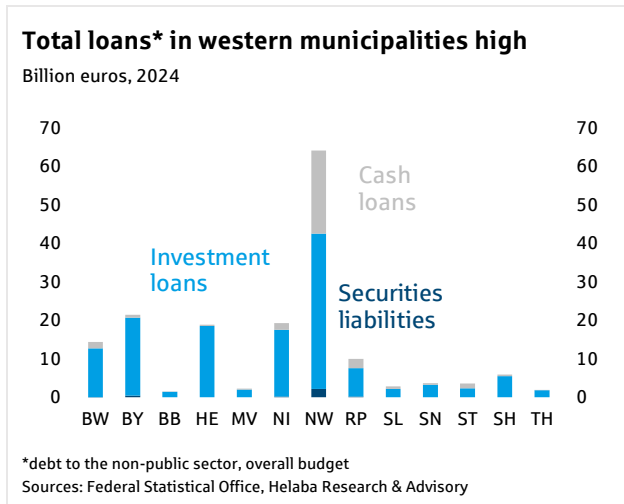
In relation to the population sizes of the federal states, however, the figures are put into perspective. Municipalities in North Rhine-Westphalia still have the highest level of debt at over EUR 3,500 per capita, followed by municipalities in Hesse with just over EUR 3,000 and Saarland with almost EUR 2,800 per inhabitant. In the per capita analysis, the proportion of cash advances is also higher, which is particularly high in North Rhine-Westphalia, Rhineland-Palatinate, Saxony-Anhalt and Saarland. If only the investment-related loans are considered, the Hessian municipalities are at the top.

### Borrowing\* of municipalities increases

Billion euros



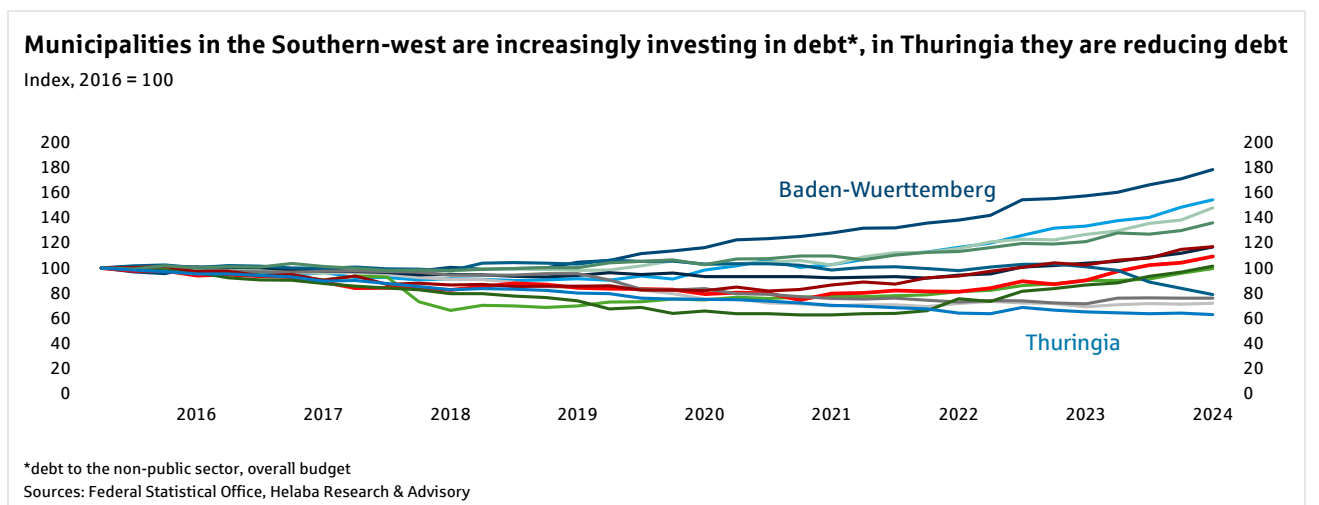
\*according to quarterly cash statistics  
Sources: Federal Statistical Office, Helaba Research & Advisory



The development over a longer period of time shows above all that municipal debt – starting from a low level – was most dynamic in Baden-Wuerttemberg and Bavaria. In contrast, the level of debt in the municipalities in Thuringia and Brandenburg changed only slightly. Similar to the development of debt in the federal states, the municipalities in almost all federal states show a similar trend, albeit with a wider spread.

There has recently been a noticeable decline in the municipalities in Rhineland-Palatinate, which is attributable to the state's **efforts to reduce debt**. Comparable consolidation programs were also previously implemented in other federal states, most clearly in the Hessian municipalities from 2017 onwards in the form of the cash loans (“Hessenkasse”). Now that the federal government has expressed its willingness to provide support in principle, the state of North Rhine-Westphalia is also currently trying to find a solution to the problem of municipal old debts - particularly with regard to cash advances – of its municipalities.

The financing of German municipalities reflects the diversity of the approximately 10,500 municipalities. Population size, financial strength and state law requirements are just some of the **many factors** that determine how a municipality finances itself. Unlike the federal and state governments, local authorities are not directly subject to the debt brake regulations. Instead, there are a number of **other legal norms** that determine their debt options and are specified in particular by the 13 federal states. There can be considerable differences in detail here, even if certain basic rules can be found in all federal states.

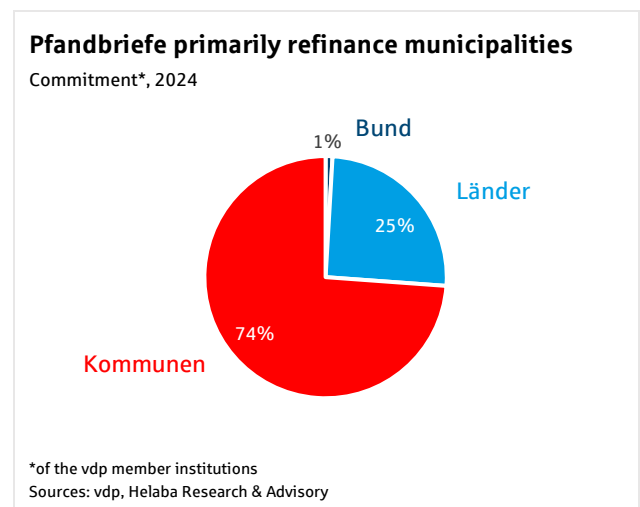
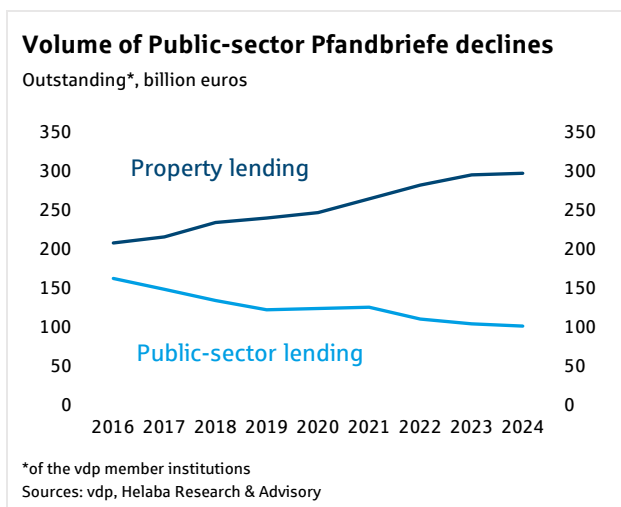


Debt financing is generally only considered by a municipality as a **subsidiary financing instrument** if other options would be uneconomical. The amount of debt is limited by **the long-term economic capacity**, whereby there are different definitions of how this is to be measured. However, the level of debt must be estimated in the budget and therefore approved. In some federal states, each individual borrowing must also be approved or at least reported to the municipal supervisory authority. A debt schedule attached to the budget often provides information on the amount and type of liabilities incurred.

The debt financing of municipalities is primarily in the form of **loans**. Around 80% of municipal debt is in the form of investment loans, with a further 18% in the form of cash loans. Just 2% of municipal liabilities are in the form of securities. This is due to the higher cost of bonds or promissory bills, meaning that these only pay off from larger volumes, which many municipalities do not achieve.

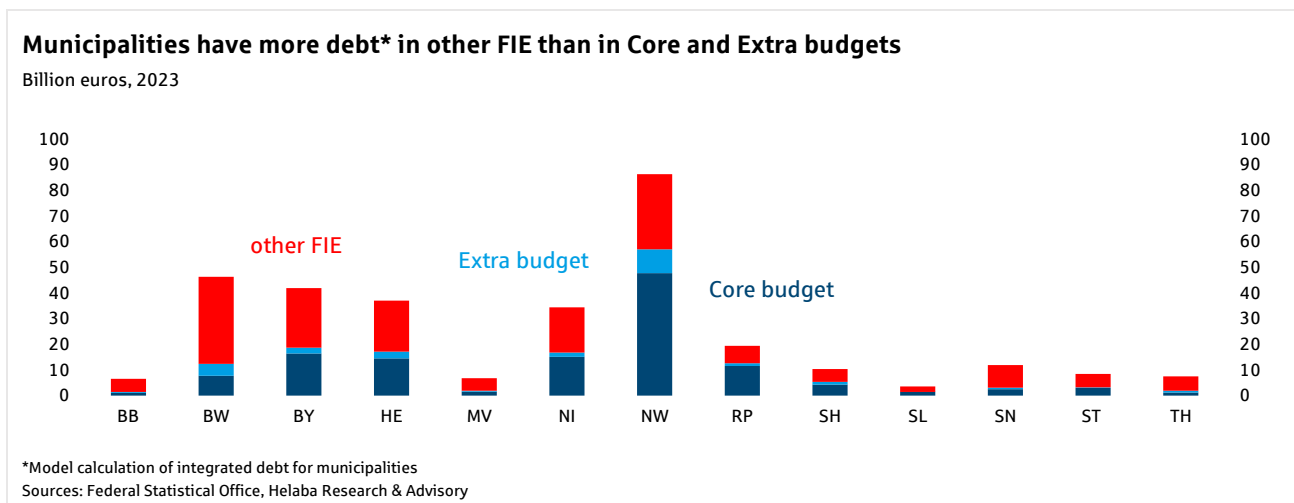
**Alternative financing instruments** can therefore only be found in larger cities, which have a more extensive range of tasks, higher financing requirements and also more personnel resources in financial management. Joint bonds with several participating municipalities are an exception.

In contrast, **municipal loans** have a number of regulatory privileges. Ultimately, it requires little effort to implement and has low margins. It is attractive for local authorities due to its favorable conditions and for banks due to a risk weighting of zero. The loan to a municipality is considered to be fail-safe. Although there is no fixed obligation on the part of the higher federal levels to assume liability, loans to the public sector do not have to be backed by the banks with equity (“partial use”) due to the financial equalization mechanisms, the involvement in municipal supervision and the requirements for sufficient financial resources. Municipal loans may not be collateralized. Instead, the so-called **total cover principle** for the budget applies. Project financing with clearly definable investment projects is therefore rare, even if many (smaller) municipalities generally take out a loan for a specific investment project.



Banks can use loans to local authorities for **refinancing** by backing them with **public covered bond “Pfandbriefe”** (formerly: municipal obligations). This is primarily the link to the capital markets, so that the general interest rate level has an impact on the conditions for municipal financing via the banks' refinancing options (“financing cascade”). Loans to local authorities account for over 70% of the cover for public sector Pfandbriefe. The largest issuers of public sector Pfandbriefe are the State Banks “Landesbanken” (in terms of volume outstanding: Helaba, BayernLB, LBBW and NordLB) as well as DZ Hyp, Commerzbank and pbb Deutsche Pfandbriefbank.

However, the **outstanding volume** of Public-sector Pfandbriefe has decreased over the last few decades, from around 400 billion euros in 2010 to 100 billion euros in 2024. The reasons for this were regulatory changes and more favorable refinancing options during the low-interest phase.



The municipalities perceived this development as a reduction in offers and a deterioration in conditions. This does not apply to all municipal lenders, as the Landesbanken and development banks primarily re-finance themselves via bonds, while the savings banks re-finance themselves via customer deposits. Together, these bank groups account for three quarters of **municipal lending**. In addition, these public-sector banks often have the promotion of municipalities as an objective in their statutes, meaning that the conditions in municipal financing are significantly less market-driven.

Borrowing accounts for an estimated one fifth of municipal investment financing. Municipal borrowing therefore primarily follows the budget situation and investment planning. The close link to investment activity also means that local authorities are interested in the longest possible loan terms. 88% of municipal loans have a term of more than five years and are therefore recorded as long-term in the statistics.

A special feature of the municipal level is the large number of **funds, institutions, and enterprises (FEUs)**, which perform many public functions beyond the core and extra-budgetary budgets. Municipalities hope to achieve efficiency gains through quasi-private management and lower personnel costs. Investment and maintenance costs, which are particularly high for infrastructure, can also be outsourced. Furthermore, spin-offs can facilitate inter-municipal cooperation. These FEUs should actually be taken into account when analyzing municipal financial data, but this is difficult due to the incompleteness of the data base. The Federal Statistical Office sporadically publishes model calculations, at least for public debt.

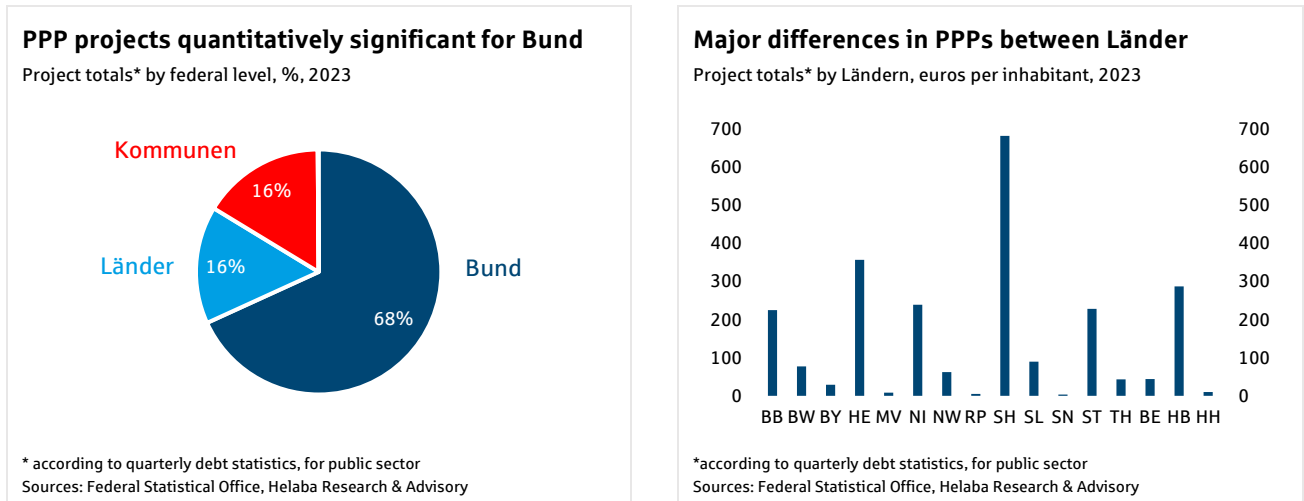
For 2023, an average of approximately 60% of municipal debt will be attributable to the FEU. The **range among the states** ranges from around 35% in North Rhine-Westphalia and Rhineland-Palatinate (states with comparatively high municipal debt, including in their core and extra budgets) to well over 70%, especially in the eastern German states. With a share of 78%, Brandenburg municipalities lead the national comparison. Among the western German states, Baden-Wuerttemberg municipalities rank high with 73%.

## 9 Digression: Public-private partnerships could become more important again

Public bodies are not always able or willing to organize and finance every investment and procurement project entirely on their own. Instead, they seek forms of cooperation with private companies. **Public-private partnerships (PPPs) have become established.**

However, previous experience shows **both positive and negative aspects**. For example, PPP structures have been successful in many municipal school construction projects, but federal and state road construction projects have been criticized extensively. The Courts of Audit, in particular, criticize unplanned cost

increases and one-sided contractual arrangements that disadvantage the public sector. Even if the term has become contaminated after difficult experiences in the 2000s, the **number** of PPP projects and the associated sums remain stable. With a **project sum** of around 22 billion euros, over two-thirds are attributable to the federal government, while the states account for just under 5 billion euros, and municipalities each account for 16% of the project sums, with just over 5 billion euros.



PPP projects are not just about financing, but rather about **procurement**. The advantages of PPP lie primarily in the construction and ongoing operation of a facility or plant, where the public sector leverages the know-how and thus the cost advantages of private providers.

Across all levels, the majority of these amounts accrue in the core budgets, with only a small portion being booked in the extra budgets or in the FEUs. The **large differences** between the states are astonishing: While Schleswig-Holstein leads the national comparison with over 680 euros per inhabitant for state and local governments, in Saxony just 3 euros per inhabitant is handled via PPPs. The reasons for the varying use of PPPs are varied and often result from individual case decisions. Targeted support for PPPs, for example through the establishment of competence centers, helps to disseminate successful project approaches. In these cases, a spatial concentration (cluster) is evident, as can be seen, for example, in the far north.

The **involvement of private capital** is likely to become more important for investments in public infrastructure due to the high investment needs and tight budgets. PPPs have established themselves as a common vehicle for this purpose. However, reservations remain regarding the involvement of private investors in public services. A generally unattractive risk-return profile and the low marketability of many public infrastructure projects make it difficult for private investors to enter the market.

Nevertheless, private investors are showing **increasing interest in expanding** their involvement in infrastructure financing. Opportunities are particularly evident for long-term investors focused on security and sustainability. In the past, various policy measures have been initiated to facilitate such investments. This has led to a market revival, particularly in the energy sector. It remains to be seen whether the further regulatory changes being sought can also contribute to increased private investment in other areas.

## 10 Conclusion

The **high public investment needs** in Germany are leading to a growing **need for public financing**. The federal, state, and local governments will not be able to finance this solely from current budgets, but will increasingly rely on loans and capital market instruments. An increase in public debt in Germany is therefore more than likely.

The difficult experiences with high levels of public debt in the past lead us to view the foreseeable development with **justified skepticism**. Excessive public debt always carries the risk of compromising the sustainability of public finances and the economic flexibility of future generations.

This makes it all the more important to critically examine the **necessity of borrowing** and ensure the most **sensible and economical use** of the funds possible. If the public sector invests the borrowed debt in forward-looking and profitable areas, this can significantly improve the competitiveness of the business location and the quality of life of the people. Future interest and repayment burdens from the debt can then be justified and represent an appropriate price for implementing today's transformation and modernization requirements.

**Societal challenges** such as the path to climate neutrality, the modernization of public infrastructure, or the adaptation to megatrends from digitalization to demographics require the right course of action today. It would be negligent to postpone the underlying decisions simply to avoid taking on debt. However, it is also negligent to take on debt when other financing options are available and would be more economical. The political task remains to set the right priorities and, if necessary, to take the unpopular route of current financing instead of choosing the seemingly easy path of debt.

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