



ENHANCING MUNICIPAL BORROWING IN UKRAINE: RECOMMENDATIONS FROM THE FOCUS GROUP MEETING



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Authors of the publication: Rafal Stanek, Investment Expert, Polaris Programme; Olena Nykyforuk, Doctor of Economic Sciences, Institute for Economics and Forecasting, National Academy of Sciences of Ukraine; Yevhen Bublyk, Doctor of Economic Sciences, Institute for Economics and Forecasting, National Academy of Sciences of Ukraine.

MUNICIPAL BORROWING IN UKRAINE – PROBLEM OVERVIEW

Past studies and recent stakeholder consultations indicate that municipal borrowing in Ukraine remains at an early stage of development. Despite access to bank loans, municipalities rarely use capital markets and municipal bonds to finance infrastructure projects.

One study found that from 2003-2015, the local debt market – comprising municipal securities (bonds), loans from banking and non-banking institutions, and local market guarantees – generated 67 bond issues totalling just over UAH 11 billion. The distribution of these bonds, however, was uneven – both temporally and spatially – with over half of the total (UAH 5.68 billion) issued in 2012, UAH 2.62 billion in 2014, and 74% (UAH 8.19 billion) issued in Kyiv. Further, during this period, bonds accounted for an average of just 1.4% of local governments' revenue bases and were equivalent to just 0.7% of GDP in 2014. For comparison, during the same period, other Central and Eastern European countries – the Czech Republic, Estonia, Poland, and Slovakia – had bond issues of 2-3% of GDP.

According to the Ukrainian Ministry of Finance¹, municipalities took 42 different loans in 2024. The same source reports 28 different loans by municipalities in the period of January – September 2025.

There is a notable increase in both borrowing and guarantee activity in 2024 and 2025 in compare to previous years, with several large loans secured for key cities, including Dnipro, Lviv, and Ternopil.

Interest rates on loans in UAH generally vary between 14% and 16% in the first year, with several loans using the EURIBOR benchmark for variable rates in subsequent years. The term for most loans is 5 to 7 years, with grace periods of 12 to 24 months. The longest-maturity loans are from the EIB (up to 20 years with a 5-year grace period). Few EBRD loans for municipalities were issued for 5 years with a 2-year grace period.

Larger municipalities like Dnipro, Lviv, Kryvyi Rih, and Mykolaiv continue to dominate the borrowing market.

Guarantees are primarily provided for external loans to municipal utilities (e.g., Lvivvodokanal, Dnipro Municipal Energy Service). The municipalities act as guarantors for these loans, with terms typically extending up to 13 years, including grace periods, and EBRD dominates as lender.

As for the source of the loan, the external (IFIs) borrowing dominates however EIB loan is reported as internal one as it is on-lending by the Ministry of Finance.

¹ <https://mof.gov.ua/uk/miscevij-borg-ta-miscevij-garantovanij-borg>

The table below summarises the local borrowing in Ukraine in 2021 - 2025

Source of the loan	2021		2022		2023		2024		Jan- Sept 2025	
	UAH M	%	UAH M	%	UAH M	%	UAH M	%	UAH M	%
External	7 084	29,6	1 074	34,3	1 074	29,8	6 129	68,1	470	9,7
Internal	15 760	65,8	2 060	65,7	2 529	70,2	2 876	31,9	4 377	90,3
Total (including bonds in 2021)	23 944	100,0	3 133	100,0	3 603	100,0	9 005	100,0	4 847	100,0

The positive increase in municipal borrowing has to be weighed against the number of Ukrainian municipalities and the fact that the same large city keeps repeating as a borrower.

Recent stakeholder consultations revealed that this situation persists. A focus group organised by the POLARIS and Institute for Economics and Forecasting of the National Academy of Sciences of Ukraine (IEF NASU) found that banks – Oschadbank, Ukreximbank, Ukrgasbank and Tascombank – while increasing activity in municipal lending, still find their operations constrained by regulatory ceilings, risk-mitigation requirements, and the weak financial capacity of many municipalities.²

At the same time, local budget revenues remain dependent on transfers from the central government and a limited 'own revenue' base. It is true that tax revenues accounted for 67.2% of local budget revenues however majority came from the PIT share. This context limits municipalities' creditworthiness and their capacity to service debt.

Finally, the ongoing war and reconstruction needs heighten both urgency and risk in the municipal borrowing landscape. Because Ukraine's revenues are essentially fully allocated to financing its defence, it continues to seek external financing for social and other expenditures. Recent estimates of reconstruction needs of over USD 500 billion over 10 years bring the need to mobilise significant resources into sharp relief.³

Given ongoing budget deficits exceeding 20% of GDP, it has been proposed that external financing include front-loading macro-financial and reconstruction assistance, primarily through grants.⁴ This approach aims to alleviate immediate fiscal pressures and lay the foundation for long-term recovery.

On the other hand, despite the relatively small share of municipal debt in the overall public debt, municipal borrowing could play a crucial role in Ukraine's reconstruction. By tapping additional financing, local governments could raise significant funds, particularly when combined with grants and their own revenue sources. This could not only enhance municipalities' financial capacity but also support the rebuilding of infrastructure and services at the local level.

² Polaris programme, "Ukrainian Banks and Authorities Seek Solutions for Developing Local Borrowing," 30 September 2025, <https://www.polaris.org.ua/en/news-events/news/novyny/ukrainski-banky-ta-orhany-vlady-shukaiut-rishennia-dlia-rozvytku-mistsevykh-zapozychen-2?utm>. Accessed 5 November 2025.

³ Pindyuk, Olga, "Front-loading financial support to Ukraine – It's now or never," Policy Notes and Reports 85, The Vienna Institutes for International Economic Studies (WIIW), November 2024.

⁴ Ibid.

INSTITUTIONAL AND REGULATORY BARRIERS

The regulatory framework in Ukraine allows local governments to incur debt (and issue municipal bonds) under certain conditions. Local governments, however, seldom avail themselves of this opportunity. Local government bonds were concentrated chiefly in Kyiv and a few other cities, while smaller towns lacked access or capacity to issue bonds.

The POLARIS and IEF NASU's recent focus group emphasised that institutional capacity at the municipal level remains weak for many hromadas, particularly in project preparation, financial planning, and creditworthiness assessment. The focus group participants noted that strengthening municipal creditworthiness through improved local budgeting, diversifying the local government revenue base, and developing building project management capacity are critical for scaling up borrowing.

International financial institutions confirmed these concerns, emphasising their willingness to provide both funding and technical assistance, while stressing the need for transparent project pipelines, creditworthiness enhancement mechanisms, and transparency in municipal finances.

Interviews with lenders also indicated other barriers to municipal debt financing, including: borrowing limits, multiple approvals (central and local bodies), and the lack of standardised credit risk frameworks for municipalities. These regulatory barriers both increase transaction costs and lengthen the financing process.

FINANCIAL MARKET BARRIERS AND RISKS

Financial market barriers and risks arise from both the lender's and the borrower's perspectives. On both the supply and demand sides, these barriers and risks limit the size and growth of the municipal debt market.

Lending institutions face the following barriers and risks:

- **Macro-economic conditions:** above certain levels (90% in the developed world and 60% in emerging markets), public debt to GDP negatively affects economic growth. Ukraine's public debt to GDP is nearing 110%.⁵
- **Market size and limitations:** The small size of the municipal debt market limits secondary trading. As noted, bond issues have been rare and concentrated in a few cities. Weak pricing transparency also reduces potential investor interest. Most borrowing activity involves bank loans rather than market-based instruments such as bonds.
- **Approval requirements:** The requirement for municipalities to obtain multiple approvals (from central and local bodies) slows down loan disbursement processes.
- **Municipal financial statements:** Many municipalities lack reliable financial statements or credible credit ratings that can be used to assess long-term creditworthiness and help qualify for concessional financing.
- **Municipal revenue streams:** many local governments – in particular in war-affected regions – have uncertain revenue streams, making it challenging to assess municipal capacity to repay debt or pay bondholders.
- **Repayment systems:** project repayment systems are weak or untested, raising the risk of non-payment.
- **Interest rates:** high interest rates required under current conditions limit the interest in financial instruments. Donor-back interest rates are necessary to attract municipal demand.

⁵ Ukraine Business News, "Ukraine's debt is nearing 110% of GDP, while global debt is at its highest level since 1948," Thursday, October 16, 2025. <https://ubn.news/ukraines-debt-is-nearing-110-of-gdp-while-global-debt-is-at-its-highest-level-since-1948/> Accessed 5 November 2025.

Borrowers, in turn, face the following barriers and risks:

- **Project preparation:** Many municipalities lack the technical capacity to prepare bankable projects.
- **Financial analysis and management:** municipalities often lack the technical capacity to assess debt service capacity and manage long-term financial obligations.
- **Economies of scale:** smaller municipalities face the disadvantages of scale, combining the previous barriers with higher transaction costs due to smaller project sizes.

INTERNATIONAL EXPERIENCE AND CONTEXT

POLARIS and IEF NASU's focus group stressed that Ukraine can learn a lot from how many EU countries handle municipal borrowing. Several European countries have systems in which local governments routinely borrow for infrastructure and service development — supported by mechanisms such as risk-sharing tools, pooled credit programmes, guarantee funds, and well-developed secondary markets for municipal bonds. These features help reduce capital costs and improve access for smaller jurisdictions.

It's also worth noting that there is not a single universal borrowing-approval system across the EU. Each country has its own set-up. But the standard approach is that the system works fairly quickly, borrowing restrictions are transparent, and automated or online tools often support creditworthiness assessment.

Here are the main lessons and ideas for Ukraine in the long term:

- A national guarantee mechanism or a guarantee fund for local governments, which can act as a backstop and reduce borrowing costs for small and less well-known municipalities (as in Finland).
- Promote a pooled financing model — so smaller local governments can group together (or participate via a dedicated agency) to issue bonds or borrow jointly, thereby gaining better terms than if they borrow alone.
- Develop a market for local government debt: enable municipalities not only to borrow from banks but also to issue bonds, supported by guarantee mechanisms and investor access.
- Ensure approval procedures for municipal borrowing are transparent, fast and rely on clear criteria (including automated creditworthiness checks where feasible).
- Define clear legal rules: what local governments can borrow for, what the limits are, how supervision works, and what happens if they can't meet obligations.
- Make sure local governments have strong capacity: stable revenue sources, good financial management, the ability to assess and monitor investment projects, and a culture of transparency so investors gain confidence.
- Recognise risks: borrowing for infrastructure is good, but only if local governments have the ability to service the debt; there must be strong oversight, and risks like currency mismatch, refinancing risk, or weak project appraisal must be managed.

In short: a framework combining guarantees + pooled borrowing + market access + clear rules + transparency + capacity-building is what many EU systems use, and it offers a blueprint Ukraine could adapt.

The European Investment Bank's (EIB) recent call for project proposals in Ukraine demonstrates IFI interest in supporting municipal investments. Incorporating such funds into municipal borrowing frameworks can accelerate uptake, provided that institutional barriers and risks are addressed.

Also, the Polish Bank BGK, under the Ukraine Facility, is planning a bank guarantees pillar of the facility, together with technical assistance on municipal project preparation.

SUMMARY OF KEY CHALLENGES

From the analysis and consultations with national stakeholders, the main obstacles to scaling municipal borrowing in Ukraine include:

- Weak own-revenues of municipalities with high dependence on central government transfers.
- Limited technical capacity in local governments (including, in particular, in project preparation, debt management, and budgeting).
- Regulatory complexity, borrowing limits, and unclear credit-rating mechanisms.
- Market immaturity: small bond market, limited investor base, weak secondary market for municipal debt.
- Risk-perception by lenders: concerns around war-impact, revenue volatility, and uncertainty of repayments.
- Lack of standardised instruments and guarantee/risk-sharing frameworks tailored for municipalities.
- Uneven capacity across municipalities: large cities may have the capacity to borrow, whilst small hromadas may not, resulting in a widening of development disparities.

RECOMMENDATIONS

Ukraine's municipal borrowing framework needs to be strengthened to ensure that local governments have the necessary resources to finance infrastructure projects, urban development, and reconstruction. The following recommendations aim to enhance municipalities' access to borrowing, streamline the borrowing process, and ensure that municipal companies are sufficiently financially robust to borrow.

Recommendations are grouped into short-term and long-term time horizons and presented below.

Short-term recommendations

DEVELOP AND IMPLEMENT A CAPACITY DEVELOPMENT PROGRAMME IN FINANCIAL MANAGEMENT FOR MUNICIPALITIES.

Problem to be addressed: Many municipalities, especially small communities, have limited knowledge of debt instruments, fear risks, and lack the skills to plan finances and prepare high-quality investment projects. This leads to a reluctance to take on debt, even when it is economically feasible.

Objectives:

- Increase awareness of the benefits of municipal borrowing;
- Increase municipalities' understanding of their debt service capacity, financial planning, project preparation, and borrowing best practices;
- Ensure municipalities are equipped to make informed decisions about debt management and financial planning.

Responsible institutions:

- Ministry of Finance;
- Domestic banks, state-owned and private;
- Municipal associations;
- Local authorities;
- IFIs and donors.

Key actions/activities:

Given that there are 1,469 municipalities in Ukraine, the scale of capacity-building initiatives must be extensive and comprehensive.

- Create a national professional development program for all 1,469 communities that includes modules on budgeting, revenue forecasting, debt capacity calculation, risk management, and investment project preparation.
- Organise a systematic training infrastructure that combines:
 - regular training sessions and seminars;
 - regional training hubs;
 - distance learning courses;
 - special sessions with banks and IFIs on credit requirements and risk assessment.
- Develop a comprehensive package of training resources, including:
 - online courses and methodological materials on debt management;
 - a database of practical tools (project templates, cash flow models, tariff calculators, credit analysis instructions).
- Launch a communication campaign aimed at reducing "debt phobia" among local councils and increasing understanding of the benefits of responsible borrowing for community development.
- Establish systematic cooperation with banks, IFIs, and donors, ensuring:
 - The development of debt capacity assessment tools.
 - joint training programs;
 - Coordination of technical assistance and support to municipalities in project preparation.

SIMPLIFY BORROWING PROCEDURES FOR MUNICIPALITIES.

Problem to be addressed: The borrowing approval process is slow, complex, and not transparent. It takes months to prepare the paperwork, which makes communities less interested and increases transaction costs.

Objective:

- Streamline the borrowing process for municipalities to make it faster and more efficient.

Responsible institutions:

- Ministry of Finance;
- DREAM system (for calculating borrowing capacity).

Key actions/activities:

- Create an online debt capacity calculator in DREAM that automatically generates:
 - the maximum possible debt amount;
 - a forecast assessment of the debt burden;
 - a preliminary conclusion on compliance with the Budget Code;
 - assess municipal eligibility for financial instruments.
- Adopt an electronic office for municipal borrowers, enabling communities to submit documents, track approval status, and receive comments from the Ministry of Finance;
- Reduce the list of documents by standardising financial and project requirements;
- Set maximum deadlines for reviewing applications (for example, 15 days for a preliminary conclusion and 30 days for a final one);

- Automate some checks (e.g., debt limit compliance and financial statement analysis);
- Link borrowing to revenue strengthening, by prioritising loans where municipalities have a proven revenue base (e.g., savings from energy efficiency upgrades, cost-recovery tariffs, etc.) and integrating debt service into local budget planning.

INCREASE THE AVAILABILITY OF SOFT LOANS, SUBSIDISED LOANS, LOAN GUARANTEES, AND MUNICIPAL BONDS.

Problem to be addressed: municipalities in Ukraine find loans and other financial instruments to be too expensive

Objective:

- Provide municipalities with access to affordable credit by offering soft loans, subsidised loan schemes, or loan guarantees.

Responsible institutions:

- Ministry of Finance;
- Domestic banks;
- IFIs.

Key actions/activities:

- Work with commercial banks and IFIs to develop favourable loan conditions for municipalities.
- Leverage EU and international donor funds to subsidise interest rates and reduce the financial burden on municipalities.
- Establish municipal credit enhancement mechanisms by creating guarantee or partial guarantee funds supported by the state and donors to reduce lender risk and enable lower interest rates for hromadas.
- Promote pilot bond issues by working with a few medium-sized municipalities to issue municipal bonds (with IFI support) to build market experience, transparency and investor interest. Possible models: guarantee, underwriting, partial co-financing.
- Develop standardised municipal lending products (standard terms and conditions, document packages, indicative requirements). Possible models: blended sources of funding, interest rate compensation, and guarantee.

STRENGTHEN THE FINANCIAL CAPACITY OF MUNICIPAL COMPANIES

Problem to be addressed: municipal companies cannot borrow independently due to limited borrowing capacity, stemming from poor financial conditions typically resulting from low service tariffs below cost-recovery levels. Increasing the borrowing capacity would free up municipal funds to finance necessary non-revenue-generating projects.

Objective:

- Ensure that municipal companies have the financial capacity to borrow and repay debt.

Responsible institutions:

- Ministry for Development of Communities and Territories of Ukraine.

Key actions/activities:

- Review and revise tariff policies to enable municipal companies to calculate and introduce full cost-recovery tariffs, including in particular, local regulation of tariff-setting;
- Promote increased commercialisation of relationship of municipal companies and municipalities, including by introducing performance-based contracting;
- Establish a mechanism for providing municipal subsidies to municipal companies that are not permitted by the municipality or national legislation (for example, under martial law) to introduce full-cost recovery tariffs for services.

ESTABLISH DEDICATED FUNDING PROGRAMS FOR MUNICIPALITIES

Problem to be addressed: municipal uptake of financial instruments, such as loans and bonds, remains low. Dedicated, targeted programs can help increase municipal interest.

Objective:

- Establish dedicated financial programs that specifically target municipalities, while ensuring they receive necessary support to meet program requirements.

Responsible institutions:

- Ministry of Finance;
- Domestic banks, state-owned and private;
- Municipal associations;
- Ministry for Development of Communities and Territories of Ukraine.

Key actions/activities:

- Create targeted programs within the national budget, donor funds, and IFI funding streams to support municipal investment projects.
- Introduce community support, including:
 - technical assistance,
 - project evaluation,
 - support during document submission.
- Align programs with recovery priorities, including Ukraine Facility, URF, municipal partnerships with EU cities.
- Establish transparency and monitoring requirements to ensure investor and donor confidence.
- Focus on infrastructure rebuilding, local economic development, and urban sustainability projects, with transparent and efficient access to financing.
- Strengthen municipal partnerships with EU cities to learn from best practices and secure technical and financial support.

Long-term recommendations (3-5 years)

INCREASE BORROWING LIMITS

Problem to be addressed: the current borrowing limits for Ukrainian municipalities are too restrictive, hindering their ability to access required financing. Evidence from EU countries suggests that, under certain conditions, these limits can be adjusted, given that municipal debt has small impact on the overall public debt. For instance, some EU countries have excluded loans used for co-financing EU-funded projects from borrowing limits to accelerate the use of EU funds. Additionally, loans taken to pre-finance investments that will later be reimbursed by EU funds were also exempted.

Objective:

- Increase the borrowing capacity of Ukrainian municipalities.

Responsible institutions:

- Ministry of Finance;
- Municipal associations.

Key actions/activities:

By loosening borrowing constraints in the current circumstances, Ukrainian municipalities would be better equipped to secure the funding needed for crucial infrastructure and development projects.

- Analyse borrowing capacity: Conduct a comprehensive review of the borrowing capacity of Ukrainian municipalities and compare it with that of similar municipalities in the EU, with particular focus on budget size and financial structures.
- Evaluate Current Limits: Assess Ukraine's existing borrowing limits and explore options to raise them in line with EU practices. Focus on the flexibility of the borrowing framework based on the specific financial needs of local governments. Investigate EU cases where borrowing limits for municipalities were relaxed or adjusted. Assess the benefits and drawbacks of such measures, with particular emphasis on the exclusion of loans for EU-co-financed projects and the pre-financing of EU-funded investments. Amend the Budget Code to allow municipalities with robust financial governance to adopt higher debt service ratios.
- Establish pooled financing instruments: Create regional or inter-municipal borrowing vehicles (similar to local government banks in other countries) that pool smaller municipalities and collectively access capital markets, reducing costs and risks.
- Integrate borrowing into strategic investment planning: Municipalities should develop multi-year investment plans, align them with national recovery programmes (post-war reconstruction) and link borrowing to tangible infrastructure outcomes and revenue generation.

PROMOTE MUNICIPAL BONDS, INCLUDING GREEN BONDS.

Problem to be addressed: Municipalities lack access to affordable financing for infrastructure projects.

Objective:

- Facilitate municipalities' access to investors interested in infrastructure, in particular green infrastructure projects, making green bonds more affordable and accessible

Responsible institutions:

- Ministry of Finance;
- Domestic banks.

Key actions/activities:

By taking the following steps, municipalities will be better positioned to tap into the growing market for green investments, securing the funding needed for environmentally sustainable infrastructure projects at more competitive rates.

- Develop national standards and a roadmap for municipal bond issuances, including requirements for reporting, credit rating, and disclosure.
- Develop the institutional infrastructure of the market, including:
 - enhancing the capacity of rating agencies to assess municipalities;
 - creating a central portal for municipal investments;
 - developing secondary trading instruments.
- Facilitate the entry of bonds into European markets, including support in completing listing procedures.
- Create a national standard for green municipal bonds that is compatible with the EU Green Bond Standard.
- Provide technical support to communities preparing to issue green or social bonds.
- Develop a municipal debt market: Over a 3-5 year period, establish standardised legal/market frameworks for municipal bonds, enhance rating agencies' ability to assess local government creditworthiness, and support development of secondary trading platforms.
- Enhance transparency and monitoring: Mandate standardised reporting of municipal debt obligations, as well as project financing and outcomes. Publish data to build investor confidence and improve market discipline.



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