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CREDITWORTHINESS OF MUNICIPALITIES AS A FACTOR IN FINANCING SUSTAINABLE DEVELOPMENT: A COMPARATIVE ANALYSIS OF UKRAINE AND THE EU APPROACHES

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INTRODUCTION

In the context of global challenges and the implementation of the UN Sustainable Development Goals (SDGs) by 2030[1], local self-government bodies play a key role in ensuring balanced economic growth, environmental safety, and social well-being. It is at the municipal level that key responsibilities are concentrated in areas vital to the population, including healthcare, education, energy, utilities, and transport infrastructure. The effective fulfillment of these functions directly depends on the availability of sufficient financial resources and the ability of communities to attract additional sources of funding, particularly through borrowing. However, local budgets are often characterized by a high dependency on state budget transfers, low liquidity, and a lack of trust from external financial institutions and investors. Under such conditions, assessing the financial condition and creditworthiness of municipalities becomes a critical factor in enabling the implementation of long-term investment projects, including those related to sustainable development at the local level. The methodology for assessing the financial condition of communities requires in-depth analysis and the adaptation of best European practices.

The purpose of the study is to conduct a comprehensive analysis and comparison of approaches to assessing the creditworthiness of municipalities in Ukraine and the European Union, considering their role in ensuring the financing of sustainable development. Specifically, the research aims to identify the key factors influencing the creditworthiness of territorial communities, analyze the existing financial diagnostic tools used by Ukrainian banking institutions, and evaluate the effectiveness of integrating international standards – particularly ESG (Environmental, Social, Governance) approaches – into the credit decision-making process. The study focuses on understanding the interrelationship between financial stability, institutional capacity of municipalities, and their potential to implement long-term investment projects. An important component of the goal is to develop

[1] United Nations, Department of Economic and Social Affairs. (2023). *The Sustainable Development Goals Report 2023: Special Edition*. United Nations.

practical recommendations for improving regulatory frameworks, enhancing transparency in local financial management, and creating a methodological basis for assessing municipal credit risk in accordance with European requirements. Achieving this goal will lay the foundation for modernizing the municipal finance system in Ukraine, strengthening the financial autonomy of communities, and enhancing their capacity for sustainable development.

The scientific novelty of the research lies in the comprehensive analysis of the concept of municipal creditworthiness as an integral indicator of the financial, institutional, and managerial capacity of communities. For the first time in Ukrainian academic literature, a comparison is made between the methodologies for assessing municipal financial sustainability used by Ukrainian banks and those employed by EU financial institutions, with a special focus on the integration of ESG indicators into the credit assessment process.

The practical significance of the study lies in the potential application of its findings to improve the financial policies of local self-government bodies, enhance the investment attractiveness of territorial communities, and develop a unified system for assessing creditworthiness based on European standards. The proposed approaches can be implemented in banking practices, local budgeting mechanisms, and strategic governance of communities.

1. Substantive analysis of the research findings

The formation of an effective municipal governance system requires the financial capacity of local self-government bodies. One of the key elements of this capacity is creditworthiness – the ability to fully and timely meet one's obligations under the terms of a loan agreement[2]. This concept is closely related to such categories as financial self-sufficiency, budgetary discipline, solvency, and fiscal autonomy.

A municipality's creditworthiness is determined not only by its current financial condition, but also by its ability to manage resources effectively, make informed managerial decisions, and ensure long-term budgetary stability. In this context, it serves not merely as a technical indicator of solvency but as a reflection of the institutional maturity of municipal governance.

In the context of sustainable development, financial stability plays a critical role. The concept of "financial stability" has a broad range of interpretations depending on the context and field of application. Financial stability refers to a community's ability to fulfill its financial, service, and

[2] Law of Ukraine "On Banks and Banking Activity": Law of Ukraine No. 2121-III of December 7, 2000 // Official Bulletin of the Verkhovna Rada of Ukraine. – 2001. – No. 5–6. – Article 30.

capital obligations using available resources[3]. Financial stability is the ability to meet current needs (infrastructure, healthcare, social services) without jeopardizing future resilience[4]. The financial stability of a municipality is maintained through the following parameters: 1) liquidity for short-term payments; 2) the ability to cover expenditures within the budget framework; 3) the capacity to service long-term debt; 4) the ability to provide an adequate level of services[5].

Based on these definitions, creditworthiness lies at the core of financial stability. Financial stability enables a municipality to maintain a reliable debt portfolio[6]. Creditworthiness, in turn, is the municipality's ability to attract borrowed funds and to service and repay them. Thus, creditworthiness is a derivative concept that is shaped by financial stability and reflects the willingness of creditors to provide resources for municipal development.

Table 1

Logical Connection Between Financial Stability and Creditworthiness of a Municipality

Concept	Components	Leads to
Financial Stability	Budget balance, debt sustainability, adaptability	Level of creditworthiness
Creditworthiness	Willingness of creditors to lend on favorable terms	Access to development finance

Source: the author

The community's ability to attract borrowed capital, implement investment projects, and effectively manage debt obligations directly affects its capacity to modernize infrastructure, implement green technologies, improve social services, and ensure inclusive economic growth. Thus, creditworthiness is not only a financial, but also a strategic resource for sustainable development. It determines the ability of territorial communities

[3] Ritonga, I. T., & Buanaputra, V. G. (2022). Developing rules of thumb for the financial conditions of city livability: a study of municipal governments in Indonesia. Cogent Business & Management, 9(1). https://doi.org/10.1080/23311975.2022.2101327

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[5] Zafra Gómez, J. L., Sánchez Fernández, J., Plata Díaz, A. M., & Pérez López, G. (2014). What elements of financial stress affect contracting out and intermunicipal cooperation in the provision of local public services? The impact of the Great Recession. *European Accounting and Management Review,* 1(1), 143–169.

[6] Padovani, E., Porcelli, F., & Zanardi, A. (2024). The determinants of the financial distress of Italian municipalities: How much is it due to inadequate resources? *International Tax and Public Finance, 31*(4), 1494–1533. https://doi.org/10.1007/s10797-024-09856-7

not only to maintain basic functionality but also to invest in sustainability, innovation, energy transformation, autonomy, and social inclusion. The level of creditworthiness affects not only the volume and structure of potential borrowings but also the cost of capital, the conditions of its provision and servicing, and access to international financial instruments, grants, and co-financing mechanisms.

In the current practices of European financial institutions, municipal creditworthiness assessments include not only financial indicators but also an analysis of non-financial factors. Special emphasis is placed on approaches based on ESG principles (Environmental, Social, Governance), which help provide a comprehensive picture of municipal performance. These approaches are necessary for financial institutions (such as AFD, EIB, EBRD, KfW) to form a complete understanding of municipalities' ability to ensure long-term stability and development under complex economic and social conditions. For sustainable development projects with long investment horizons (10–25 years), non-financial aspects – governance quality, environmental responsibility, social inclusion, and adaptability – are of critical importance. A key list of non-financial KPIs used by European development banks to assess municipalities is provided in Table 2.

Table 2

Set of Non-Financial KPIs for Assessing the Credit Potential of Municipalities

Area	**KPI**	**Impact on Creditworthiness**
1	2	3
Strategic Management	Existence of a long-term development strategy focused on SDGs and climate challenges	Ensures predictability of community development
Environmental Policy	Energy efficiency programs, renewable energy development, water resource management, waste management (circular economy)	Reduces environmental and climate risks, improves access to "green" finance
Institutional Stability	Leadership stability, clarity of decision-making procedures	Reduces political and managerial risks
Governance Transparency	Practices of transparent budgeting (participatory budgeting), data openness	Enhances investor trust, lowers corruption-related risks
Risk Management	Disaster risk reduction systems, climate risk management	Increases community resilience to shocks
Social Policy	Social inclusion, gender aspects	Reduces social risks, fosters social cohesion

End of Table 2

1	2	3
SME Support	Availability of local business support programs	Stimulates local economic development, reduces reliance on external transfers
Infrastructure Resilience	Integration of sustainability principles in the planning and operation of transport, water, and energy infrastructure	Ensures long-term investment efficiency
Accountability	Regular external audits	Increases transparency and creditor trust
Financial Management	Procurement efficiency, resource management quality, timely project execution	Indirectly reduces cost of capital

Source: The author

Thus, non-financial KPIs are not secondary elements – on the contrary, they directly influence the formation of a municipality's credit rating, the lending rate, and access to green, social, or blended financing. External creditors value ESG effectiveness because it shapes perceptions of governance quality and reduces uncertainty in credit risk assessment[7].

In the practice of European development banks such as AFD, KfW, and the EIB, detailed assessment of ESG factors is a mandatory component of the credit decision-making process. In fact, a community's institutional capacity (governance) often becomes the decisive criterion for evaluating long-term projects – even when financial indicators are favorable. Conversely, in the Ukrainian banking sector, the prevailing approach still relies primarily on evaluating financial ratios derived from the Budget Code of Ukraine (budget execution rate, debt burden, tax revenues, etc.). ESG factors have not yet been integrated into formal municipal credit analysis models. This leads to several risks:

1. Absence of a systematic evaluation of community institutional capacity.
2. Insufficient attention to managerial and social risks.
3. Loss of competitiveness of Ukrainian municipalities on the international financial market.
4. Lack of a "green" profile for municipal borrowers — which is exactly what modern investors expect.

[7] Bruno, C. C., & Henisz, W. J. (2024). Environmental, Social, and Governance (ESG) Outcomes and Municipal Credit Risk. *Business & Society*, 63(8), 1709–1756. https://doi.org/10.1177/00076503231220541 (Original work published 2024)

Given the international methodology for assessing sustainable development financing, integrating ESG factors into Ukrainian municipal credit analysis models is a critically important direction for reforming the local finance system. Such approaches would help: increase the volume of external borrowings; boost trust from international creditors and donors; optimize capital costs for municipal projects; ensure a more transparent and predictable development of the municipal sector. Therefore, the inclusion of non-financial indicators in the creditworthiness assessment system should become an essential element in aligning national practice with European standards and enhancing the role of local self-government in achieving sustainable development goals. Assessing municipal creditworthiness is increasingly transforming into a tool for long-term strategic planning. It enables forecasting financial stability, identifying critical risks and proposing mitigation mechanisms, and determining the capacity to implement comprehensive infrastructure and socially significant projects. That is why the methodological approach to such assessment is of paramount importance.

Currently, state-owned banks in Ukraine predominantly apply a simplified approach to evaluating municipal financial stability. This approach focuses on analyzing individual static indicators that primarily reflect the borrower's current solvency and allows for quick assessment of basic budgetary parameters and debt burden. It is based largely on the requirements of the Budget Code of Ukraine. This approach is suitable for short-term financing or in cases of low project complexity.

In contrast, European development banks (in particular AFD, EIB, and EBRD) apply more comprehensive financial analysis models that cover a broader range of indicators and are closer in structure to those used in private sector assessments. These models include not only basic budgetary and debt parameters but also expanded indicators of operational efficiency, liquidity, investment activity, self-financing capacity, and financial resilience to risks. This approach is essential for conducting a well-founded evaluation of long-term investment projects, especially those implemented within the framework of international climate or infrastructure initiatives.

In this context, there is a clear need to compare the existing approaches to assessing the financial capacity of municipalities, with the aim of identifying their strengths, limitations, and potential for integrating more structured models into national practice. The comparative table below summarizes the key indicators used to assess municipal creditworthiness and illustrates the extent to which priorities and analytical depth differ between European and Ukrainian financial institutions.

Table 3

Comparative Characteristics of Financial Capacity Assessment Models for Communities in the Context of Sustainable Development Financing

Financial indicator	**European development banks**	**Ukrainian state-owned banks**
Revenue indicators		
Revenue diversification index	yes	no
Tax collection rate	no	yes
Operating margin rate	yes	no
Intergovernmental revenue share	yes	no
Expenditure indicators		
Operating expense ratio	no	no
Expenditure execution level	no	yes
Expenditure rigidity coefficient	yes	no
Debt and libaility indicators		
Debt-to-revenue ratio	yes	yes
Debt service ratio	no	yes
Current operating margin ratio	yes	no
Net operating margin ratio	yes	no
Self-financing capacity	yes	no
Debt service coverage ratio	yes	no
Working capital (in days of expenditure)	yes	no
Debt service to general fund expenditures	no	yes
Investment effort rate	yes	no

Source: The author

Comparative analysis reveals a significant difference in the analytical depth and systematic approach applied by European development banks and Ukrainian state-owned banks when assessing the financial capacity of municipalities. European development institutions rely on an integrated assessment model that encompasses financial, institutional, and managerial capacity. This model is based on a comprehensive set of indicators that capture both static and dynamic aspects of municipal finances. These include revenue (its diversification and structure), the level of operating margin, the share of intergovernmental transfers, debt burden and coverage, investment activity, self-financing capacity, and liquidity. Particular attention is given to indicators such as working capital, net operating margin, self-financing capacity, debt service coverage ratio, and investment effort rate – all of which are crucial in determining the long-term resilience of a municipality to financial stress.

The advantage of this model lies in its strategic orientation. It enables not only the evaluation of current solvency, but also forecasting a community's potential to implement large-scale infrastructure or social projects with a long investment horizon, based on the assessment of previous performance. At the same time, this approach has limitations. In particular, it assumes a high level of financial and institutional capacity on the part of the municipality. To fully implement such a model, communities must have access to high-quality accounting reports, strategic financial documents, qualified personnel, and a well-developed internal control and analysis system. For smaller communities or those with low levels of digitalization, implementing such a model would require significant methodological and organizational support.

By contrast, the prevailing practice in Ukrainian banking institutions is a simplified analysis model based on a limited set of key indicators, mainly focused on financial metrics derived from the Budget Code of Ukraine. These include: budget execution level, debt-to-revenue ratio, debt service ratio relative to the general fund, and tax discipline (e.g., the tax collection ratio). These indicators are typically calculated based on budget reporting data, which simplifies and expedites the evaluation process.

The main advantage of this approach is its accessibility and operational efficiency. It allows for quick identification of a community's basic level of fiscal discipline and facilitates credit decision-making in the short or medium term. However, this model also has a number of critical limitations: it does not consider the structural specifics of the budget, lacks evaluation of investment capacity or operational efficiency, and does not account for liquidity risk, long-term fiscal endurance, or the ability to attract long-term capital for projects with extended implementation horizons (10 years or more). The Ukrainian approach is poorly aligned with international standards, which significantly reduces the likelihood of municipalities obtaining external funding or participating in multilateral development bank programs. Furthermore, most Ukrainian banks lack a formal internal methodology for analyzing municipal finances that would take into account the specific nature of local government operations, identify real financial needs (which should shape banking products), and regularly adapt to legislative changes in Ukrainian municipal and budgetary law.

Introducing a more comprehensive and standardized model for assessing municipal financial capacity – aligned with European standards – offers several critical benefits for Ukraine's economy in general, and for the local self-government sector in particular:

1. Strengthening financial discipline – the adoption of an expanded set of indicators would incentivize communities to maintain transparent reporting, engage in strategic budget planning, and manage debt responsibly over the long term.
2. Enhancing municipal credit potential – clearly defined indicators such as margin levels, self-financing capacity, and liquidity would enable communities to justify borrowing for large-scale project implementation.
3. Attracting external investment – compliance with international standards increases the investment appeal of communities for the EIB, EBRD, AFD, KfW, and other financial institutions that value transparency, predictability, and financial sustainability in borrowers.
4. Institutional development of the banking sector – banks that adopt modern evaluation methodologies can expand their municipal lending portfolios, attract new clients, increase profitability, improve business unit quality and risk management practices, and establish partnerships with international development banks (joint projects, experience exchange, etc.).

At the same time, implementing a new evaluation model would require a revision of national assessment standards, enhancement of the analytical capacity of local self-government, and integration of standardized procedures into banking decision-making processes.

CONCLUSIONS

The study has established that the creditworthiness of municipalities is not merely a financial indicator, but also a strategic measure of the institutional, managerial, and organizational capacity of territorial communities. It plays a critical role in ensuring long-term budgetary stability, implementing infrastructure and innovation projects, expanding access to international funding sources, and achieving the Sustainable Development Goals (SDGs) at the local level.

The comparative analysis revealed significant differences between Ukrainian and European models of assessing municipal financial capacity. Ukrainian banking practices rely primarily on a narrow set of indicators defined by the Budget Code (such as budget execution, debt burden, and revenues), while European financial institutions (EIB, EBRD, KfW, AFD) employ integrated models that incorporate ESG indicators (environment, social policy, governance quality), operational efficiency, investment activity, self-financing capacity, and resilience to financial risks.

Importantly, in European practice, a community's institutional capacity (governance) is recognized as a decisive factor in evaluating long-term credit applications – even when financial indicators are favorable. Ukrainian models, by contrast, currently overlook this critical dimension, which creates risks of underestimating a community's true potential, lowers investor confidence, and limits access to green or blended financing.

The study has led to the formulation of several practical recommendations:

1. Develop a unified methodology for assessing municipal creditworthiness that integrates financial, non-financial, and institutional dimensions in accordance with international standards.

2. Integrate non-financial KPIs into banking credit analysis models and local financial strategies to enable municipalities to improve their credit ratings, reduce the cost of capital, and secure stable funding for investment programs.

3. Strengthen institutional capacity within communities, particularly analytical and human resources, to support strategic financial planning, reporting, and risk management.

4. Update the legal and regulatory framework and banking procedures to reflect the requirements of a comprehensive municipal sector analysis – including accountability, governance efficiency, gender policy, and sustainable development considerations.

5. Enhance cooperation with international development banks, which expect transparency, predictability, and alignment of municipal financial practices with European standards.

The practical relevance of the study is evident in its potential use by:

1. Financial institutions – to improve credit risk assessment tools and develop new municipal lending products.

2. Local self-government bodies – as a methodological foundation to enhance investment appeal, manage debt, and implement strategic development projects.

3. National regulators – for shaping policies on fiscal decentralization and integrating ESG principles into the system of municipal evaluation.

4. International donors and development partners – as an analytical tool for making informed decisions on financing or providing technical assistance to communities.

Thus, municipal creditworthiness should be viewed as a multidimensional, dynamic, and systemic indicator that reflects not only a community's current solvency but also its long-term potential for sustainable economic growth, institutional development, and financial autonomy in the face of contemporary challenges.

SUMMARY

The section is devoted to the analysis of municipalities' creditworthiness as a key factor in financing sustainable development in Ukraine and the EU. The paper explores current approaches to assessing the financial capacity of territorial communities, particularly through the lens of international standards and practices used by European development banks. Special attention is given to comparing Ukrainian and European assessment models, with an emphasis on integrating non-financial ESG (Environmental, Social, Governance) indicators. It is demonstrated that the level of community creditworthiness directly influences access to long-term financial resources, the cost of capital, and the investment attractiveness of municipalities. It is established that Ukraine's banking system requires reform of its municipal sector assessment approaches in line with European standards. Recommendations are proposed to improve the regulatory and legal framework and financial instruments to increase community investment activity. This work has practical relevance for financial institutions, local authorities, and policy analysts. The study is based on a comprehensive methodological approach that includes comparative, institutional, and case analysis.

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