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TRENDS IN THE REGIONS

Public utilities would feel pain if muni tax exemption goes

By **Christina Baker** March 31, 2025, 7:46 a.m. EDT 6 Min Read

A municipal worker handles a manhole cover in Chelsea, Massachusetts. Public utilities would face higher capital costs without tax-exempt bonds. *Bloomberg News*

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Higher borrowing costs would force publicly-owned utility providers to raise rates or delay critical infrastructure, advocates say, and may even spur privatization.

Doing away with the tax exemption, as congressional Republicans have suggested, would force local governments to choose between "rate hikes on folks who may not be able to afford it, or forgoing a project that's necessary for safe water," said Mary Grant, campaign director for Food & Water Watch, a nonprofit that advocates for sustainable food, clean water, and a livable climate.

Water and sewer systems have extensive capital needs — the EPA's latest needs surveys predicted America's water and sewer systems will need more than $1.2 trillion to comply with the Clean Water Act and drinking water safety requirements over the next 20 years.

Many water systems have been increasing their borrowing to try to keep up with federal regulations, aging systems and natural disasters. And costs for infrastructure projects will likely increase, Grant said — water equipment manufacturers have told her that just the threat of tariffs has driven up their prices.

Power providers also face mounting capital needs, according to Tom Falcone, president of the Large Public Power Council. Some power authorities need to repair century-old infrastructure; some are trying to expand their capacity for renewable energy; and some are experiencing rapid growth in demand thanks to artificial intelligence and data centers, which consume vast amounts of electricity.

"The utility business is essentially a very high, capital-intensive business, and you're always going to be investing more than your cash flow," Falcone said. "The way that you smooth that is by issuing bonds and paying for those assets over the period of time they're going to be useful."

Public power agencies issued roughly $84 billion of debt for new projects over the last ten years, according to John Godfrey, senior government relations director for the American Public Power Association.

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"All those costs flow through to our customers in the form of higher rates," Godfrey said. "There's no way to hide it."

Utilities have no option but to borrow at those higher costs, Godfrey said. "A road with a pothole is still a road. A power line with a gap is no longer a power line," he said.

However, some utilities would likely scrap some capital projects if borrowing costs increased, Falcone said.

"The way that the world really works is that there's only so much that you want to pass through to your customers," Falcone said. "So I think a natural outcome of that is you would delay investments you otherwise might make."

Followers of the bond market are likely aware of some utility borrowers, like the 29 public power agencies that make up Falcone's organization. Those utilities have capital plans totaling $70 billion over the next five years, he said.

But smaller utilities use the bond market, too. The vast majority of public power utilities serve 50,000 or fewer people, Godfrey said. Those rural utilities make up around half of public power issuances, through increments of $30 million or less.

Smaller utilities may find it harder to cope with the cost of a taxable bond market, said Kristina Surfus, managing director of government affairs for the National Association of Clean Water Agencies.

A smaller system would have to distribute the higher borrowing costs across a smaller customer base, Surfus said. They may also have lower ratings and less experience accessing the market.

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"It's going to be very difficult for smaller issuers to get any kind of long-term financing," Barsky said. "It'll be looking more like shorter-term bank financing that's going to carry with it a lot of repricing risk that a lot of issuers today don't have to face."

Might a local government in these circumstances try to exit the utilities business altogether?

"Absolutely," Surfus said.

"We are really concerned that this might push more public utilities, that might otherwise prefer to stay public, to privatize," Surfus said.

Private companies seeking to buy utilities often use the cost of repairs as a selling point, according to David McMahon, who organized a campaign to stop the sale of the sewer system in Norristown, Pennsylvania. In this pitch, a troubled system can become a one-time source of revenue for a local government instead of a long-term drain.

In Pennsylvania, where the [a 2016 law eased the path for-profit companies] to buy up municipal water and sewer systems, many towns sold their utilities to finance unrelated capital projects, McMahon said. It allows local officials to avoid the political implications of raising taxes or selling bonds.

Grant likened selling a utility to borrowing debt off-balance sheet; instead of raising taxes to cover the interest, the new owner will raise rates to turn a profit. The rate increases that result from a private sale are higher and more regressive than any tax increase would be, she added.

"These budget gimmicks, privatization, it's just going to drive up the cost of water and sacrifice control over an asset that's essential for public health and well-being," Grant said. "It's essential for planning and development. It's an essential function of government."

But even without the tax exemption, there are economic factors that support public ownership of utilities, Falcone noted, which would impede widespread privatization.

"Usually our utilities have a cost of capital that's less than half of their investor-owned utility counterparts," Falcone said.

Grant said higher borrowing costs could spur a push for privatization, but she expects public opposition and examples of negative outcomes will foil many of the deals.

"I've seen it before. [In] the Great Recession, there was a drive toward privatization," Grant said. "A lot of those actually were stopped because they looked at the long-term consequences."

Organizations representing utility groups have been among those lobbying to preserve the municipal tax exemption, trying to communicate what it would cost ratepayers.

"Ninety percent of water projects are financed by local governments, typically through municipal bonds," Grant said. "If you're increasing the cost of 90% of water projects across the country, it's going to lead to higher bills, and people are already struggling."

It's hard to tell if they're breaking through the chaos in Washington, Grant said.

"Congress and the administration will make policy that they think is the right policy," Falcone said, "but you want to make sure that they understand that that isn't just a line item in the budget."

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