

Data Centers in Muniland: Watts at Stake

The impact of data center growth is starting to take shape in the municipal market. This electrical demand, primarily stemming from the rising prevalence of artificial intelligence, carries both positive and negative credit implications. And while public power utilities are at the forefront, other sectors — including water utilities, local governments, and state governments — are also poised to feel the effects. The extent and direction of the impact will partly depend on the policy decisions made by municipal management teams, making it imperative for investors to identify the risks and opportunities these actions create.

Where Data Centers Intersect with Public Power

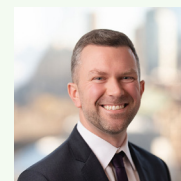
The public power sector could be viewed as a natural fit to accommodate data center demand — which the US Energy Information Administration expects to drive a significant share of long-term electricity consumption growth — since rates are often lower compared to their investor-owned counterparts. But public power utilities have a far smaller nationwide presence, serving 15% of the population and producing 9% of power, and are less incentivized to meet data center needs. As not-for-profit entities, one of their primary goals is to deliver affordable electricity to their constituents. Those that opt to accommodate data centers will need to be selective, ensuring that this objective is not compromised.

The additional leverage required to accommodate load growth is a central concern. Many public power utilities have already embarked on major capital projects for renewable mandates and electrification efforts, and these added infrastructure needs may drive debt levels further. Many that have overseen data center expansions have seen transformative changes to their finances and service areas, including significant revenue growth at the expense of elevated customer concentration.

But prudent rate frameworks targeting these high-usage ratepayers should allow utilities to manage these credit risks. They can include fixed-payment structures, irrespective of energy consumption, and long-term contracts that offer revenue predictability, upfront payments, and termination fees if a data center closes. Utilities may also sell excess power into the wholesale market if anticipated demand fails to materialize.

How Water Utilities Are Impacted by Data Centers

Water utilities could face resource and capacity issues due to server cooling requirements, though credit implications are likely to be less significant than power utilities. Water is one of several cooling methods and demand is usually less intense: according to the International Energy Agency, a 100 megawatt data center uses the



JEFFREY T. DEVINE

*Vice President
Director, Municipal Research*

KEY POINTS:

Public power is at the center: Data centers can drive meaningful load and revenue growth, but issuers must stay selective to avoid compromising affordability.

Key credit risk = leverage + concentration: New infrastructure needs can pressure balance sheets, while a single large customer can quickly raise concentration risk.

Protections are important: Strong rate and contract structures (fixed payments, long-term stipulations, upfront payments, termination fees) can improve predictability and protect credit.

Spillovers extend beyond power: Water systems may face capacity planning needs, local governments may see tax-base gains with limited jobs, and states may face incentive-related revenue drag and policy risk.

equivalent amount of water as 2,600 households annually, compared to roughly 100,000 households for power. Still, water utilities may need to expand their existing resources and consider their existing customer base in rate management decisions.

What Data Centers Mean for Local & State Governments

Local governments stand to benefit from data center development through a near-term influx of construction-related economic activity and long-term tax base growth. And while these facilities usually become major taxpayers, they don't often provide many permanent jobs. That makes it essential for officials to understand a facility's impact on municipal finances. Tax bases that are already large and diverse are better situated to absorb the fiscal risks resulting from taxpayer concentration.

States face uneven credit implications, with at least 38 offering tax incentives to spur data center development. Though designed to promote local economic and tax revenue growth, these exemptions lower state receipts, particularly sales taxes, and have reached as high as 5% of general fund revenues. And unlike traditional tax incentive programs, exemptions are likely to remain elevated after initial construction due to short server lifecycles and aggressive expansion plans. States may need to revisit incentives and sunset periods if the downsides start outweighing the benefits.

Why Issuer Actions Are Important for Investors

Data centers represent both a growth catalyst and a potential credit stressor across the municipal market. Though still an emerging development, our analysis doesn't change: we remain focused on how these entrants affect credit fundamentals and the steps issuers have implemented to reduce downside risk. The signals we watch are mostly at the issuer level, which makes bottom-up analysis essential. We are focused on identifying credits that have not implemented risk-mitigating measures and adjusting our exposure accordingly.

DISCLOSURES:

All material has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy of, nor liability for, decisions based on such information. This represents the views and opinions of GW&K and does not constitute investment advice, nor should it be considered predictive of any future market performance.

ENTREPRENEURIAL DRIVEN, CLIENT FOCUSED

GW&K is a Boston-based investment firm with \$52.6 billion under management and over half a century of creating long-term, trusted client relationships. Learn more about our fixed income capabilities on our website: gwkinvest.com/fixed-income

www.gwkinvest.com

Boston Headquarters
222 Berkeley Street
Boston, Massachusetts 02116
617.236.8900

Other Location
Winter Park, Florida