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Amid Data Center Boom, Public Utilities Push for More Flexibility with IRS Bond Rules.

Public power utilities are pushing for regulatory and legislative changes to allow them to float more tax-exempt bonds to finance the energy-hungry data center boom even as the utilities, and their bondholders, face risks from the large and growing capital plans required to keep pace with the boom.

The industry for years has lobbied Congress and the Treasury Department to make the changes, which would loosen terms on private use rules for tax-exempt financing. The issue now has taken on more urgency amid a data center boom that promises to transform the U.S. energy landscape. The Trump administration has prioritized building out artificial intelligence infrastructure as part of "America's AI Action Plan" and the Department of Energy has launched the "Speed to Power" initiative to "accelerate the speed of large-scale grid infrastructure project development for both transmission and generation."

"Data centers have huge electricity demands and they want it yesterday," said John Godfrey, senior government relations director at American Public Power Association, which represents public power utilities. "We've gotten instructions from the top that we need to accommodate those needs, and we want to, but we need to get unnecessary hurdles out of the way."

Under current IRS private use rules for tax-exempt bonds, public power utilities are restricted to three-year contracts with non-government customers, and less than 10% of a bond issue, or $15 million, that would go to a private use.

Eliminating the three-year contract restriction alone would "unlock billions in grid upgrades, strengthen America's economy, and ensure public power communities aren't left to shoulder the costs alone," the Large Public Power Council said in a July blog post.

Godfrey says industry advocates are talking with the Treasury Department and congressional tax writers and staffers to promote the changes. The hope is that the current AI race will provide a "fresh look at a longstanding problem," he said.

There is no sign the proliferation of data centers, which already numbered 5,426 as of March, according to Statista, is slowing. Investment in electricity infrastructure by electric utilities is projected to be $1.4 trillion from 2025 to 2030, according to Morningstar (MORN). That's double the amount invested in the prior 10 years.

The growth is reflected in the spike of public power municipal bond issuance since 2023 after years of relatively flat issuance. Electric power issuance rose 48% in the first half of 2025, totaling $15.2 billion in the first six months, the fastest-growing sector in the municipal bond market. New-money issuance for the first half was up 104.1%.

In 2024, public power bond issuance totaled $26.8 billion. That's up from a 10-year annual average of $14 billion, Nuveen noted in an April piece on data centers.

“It’s pretty shocking if you look at the numbers,” Godfrey said. “It’s a dramatic increase.”

That issuance would be higher if the industry wins its proposed changes to the private use test.

The scale and cost of the projects, the tech companies’ need for speed, and the lag between a commitment to build and actual construction pose risks to utility credits, the ratepayers and investors that buy the debt, experts said.

Some utilities are being asked to plan for projects that will never get built. Other projects may not materialize after bonds have been sold. Rising electricity bills are increasingly sparking political pushback, as are the water requirements for what Moody’s, in a March report, called among the most “resource-intensive facilities in modern infrastructure.”

Public utilities are “exploring and implementing strategies to help mitigate the risks” associated with the data center boom, said Patricia Taylor, APPA’s director of policy and research. “The scale of the data centers, the speed, the operating profiles – those are some of the big challenges,” she said.

Some utilities, facing a huge number of interconnection requests, are asking tech companies to pay a fee to discourage companies from clogging the queue with speculative projects. Some are imposing specific rates for data centers or other large-load customers. Others are entering into power purchase agreements for new plants to hedge potential risks.

“We’re identifying these risks but also we’re seeing the opportunities,” Taylor said. “They’re bringing load and revenue to the communities but we want to make sure they’re not negatively impacting the communities.”

In a report released Wednesday titled “AI is racing ahead and energy infrastructure needs to catch up,” Tom Kozlik, head of public policy and municipal strategy at Hilltop Securities, said the tech companies driving the boom should shoulder the financial burden and risks.

“It’s important that there is coordination between the public and private side and that the public side isn’t ask or isn’t forced to take on more risk than what they should especially during these individual massive projects,” Kozlik told The Bond Buyer.

The stakes are high, Kozlik said in the report, saying the country’s economy and security depends on a developing a powerful AI sector. Modernizing the outdated IRS rules to allow for more tax-exempt financing would help break the “energy bottleneck” that is endangering the country’s AI sector, Kozlik said.

“Financing matters,” he said. “Modernizing those rules and protecting the municipal-bond tax exemption is not optional. It’s critical.”

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BY SourceMedia | MUNICIPAL | 11/07/25 01:34 PM EST

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