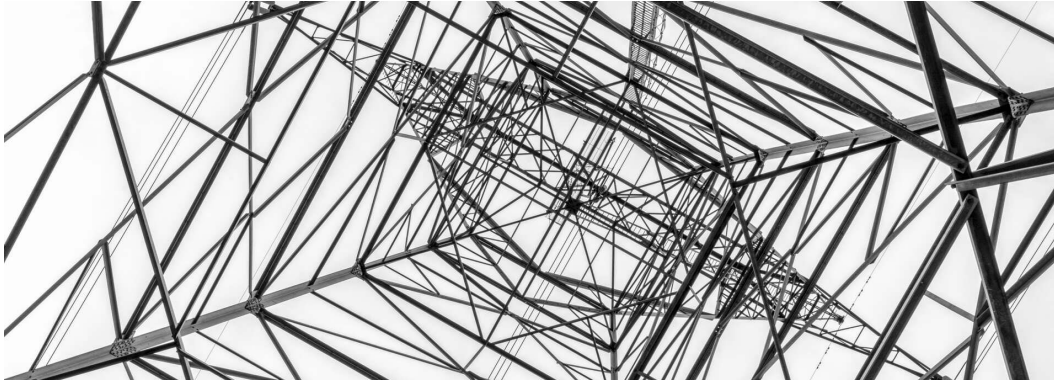


## North America Regulated Utilities

### Capex and climate change pressures credit quality

January 14, 2025

This report does not constitute a rating action.



### What's changed?

**Lower ratings headroom.** A high percentage of companies are operating with only minimal financial cushion from our downgrade threshold.

**Rising capital spending, higher cash flow deficits, and increased wildfire risks** led to downgrades outpacing upgrades for the fifth consecutive year.

**Data centers spur electricity sales growth** at about 1% annually, which will provide modest support to credit quality.

### What are the key assumptions for 2025?

**High cash flow deficits** of about \$100 billion, which could harm financial performance if not funded in a credit-supportive manner.

**Robust dividends** of about \$50 billion for 2025 and at a dividend payout ratio of about 60%.

**Record amount of hybrid securities.** The industry issued \$26 billion of them in 2024, and we expect this trend will persist.

### What are the key risks around the baseline?

**Rising wildfire risks** stemming from climate change.

**Tax legislation could weaken financial measures** if the new Republican administration lowers the corporate tax rate, reduces tax credits, or eliminates their transferability.

**Common equity issuance is below our base-case expectations,** and has been for the last several years, leading to weaker financial measures.

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# Ratings Trends: North America Regulated Utilities

Chart 1  
Ratings distribution

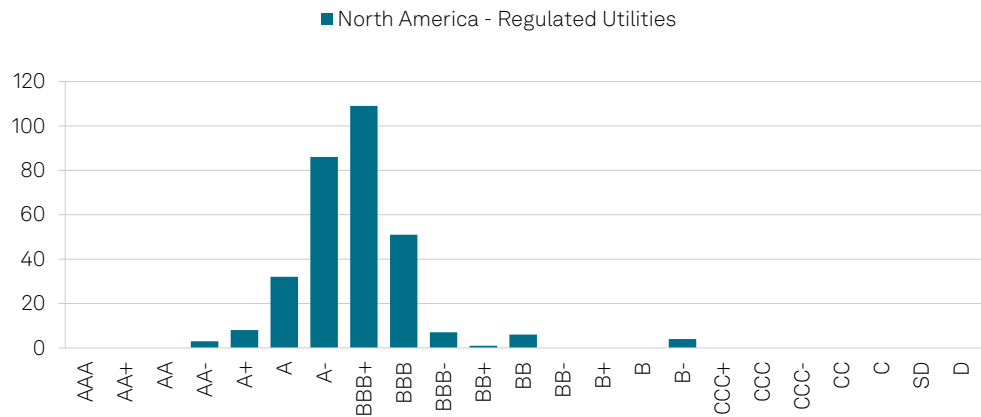


Chart 2  
Ratings outlooks

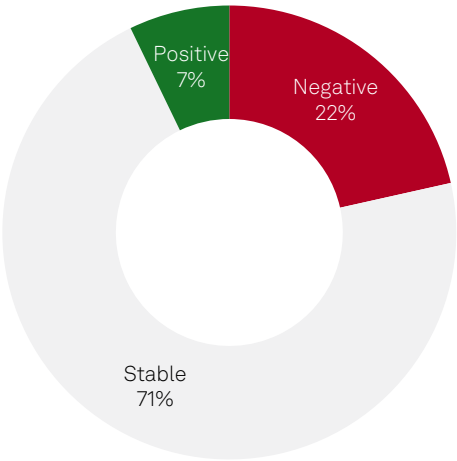
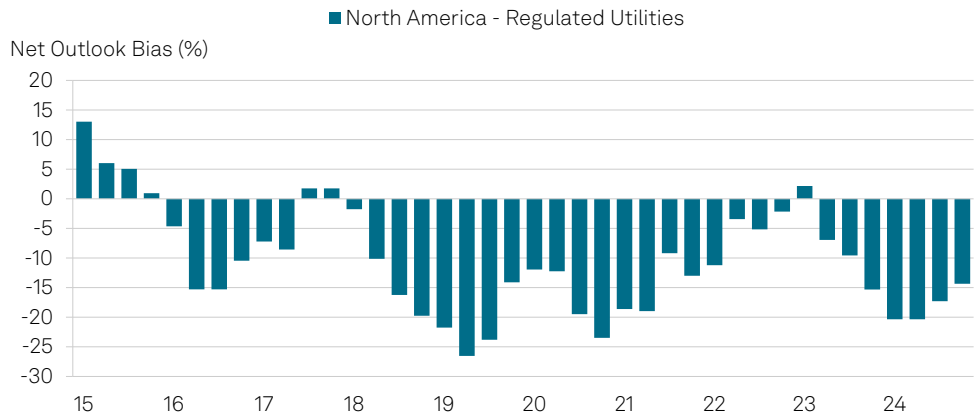


Chart 3  
Ratings outlook net bias



Source: S&P Global Ratings. Ratings data measured at quarter-end.

# Industry Credit Metrics: North America Regulated Utilities

Chart 4  
Debt / EBITDA (median, adjusted)

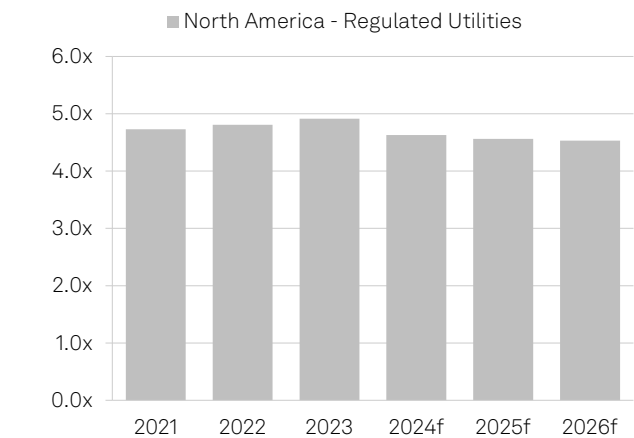


Chart 5  
FFO / Debt (median, adjusted)

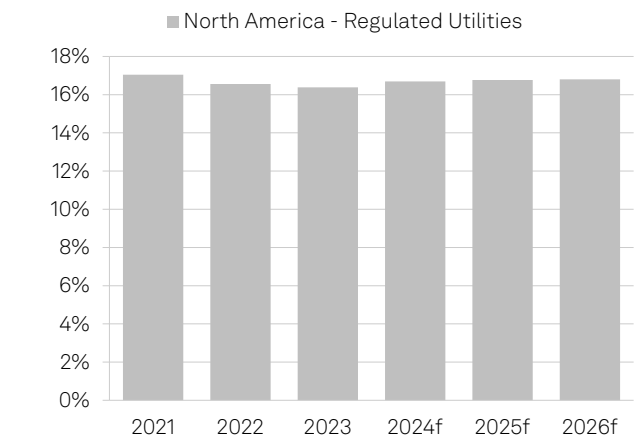


Chart 6  
Cash flow and primary uses

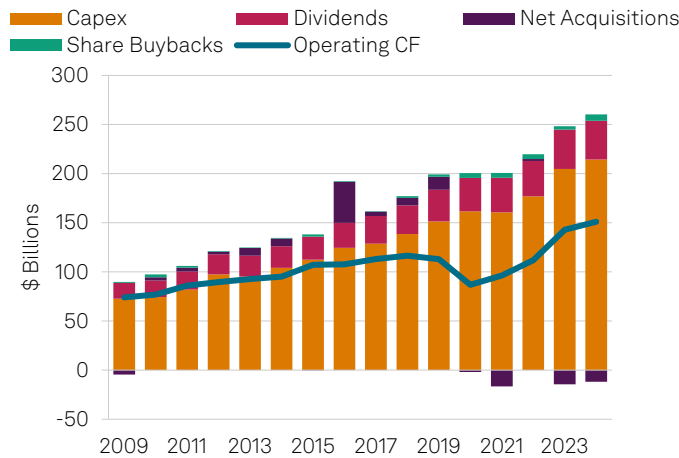
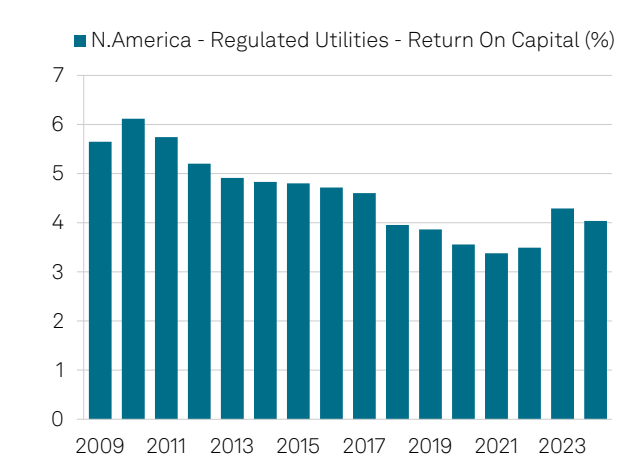


Chart 7  
Return on capital employed



Source: S&P Global Ratings, S&P Capital IQ.  
Revenue growth shows local currency growth weighted by prior-year common-currency revenue share. All other figures are converted into U.S. dollars using historic exchange rates. Forecasts are converted at the last financial year-end spot rate. FFO—Funds from operations. Most recent (2024) figures for cash flow and primary uses and return on capital employed use the last 12 months' data.

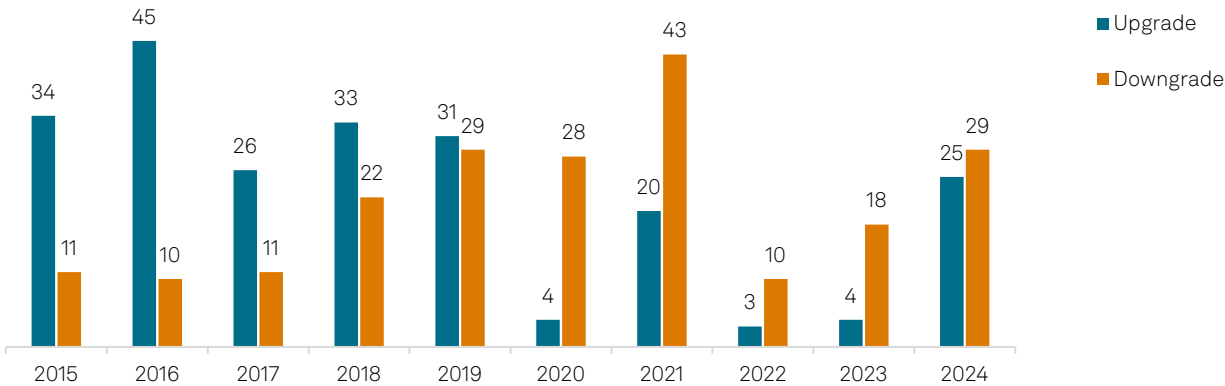
# Industry Outlook

## Ratings trends and outlook

In 2024, downgrades among North America’s investor-owned regulated utilities outpaced upgrades for the fifth consecutive year (see chart 8). Most were directly attributable to rising wildfire risks, robust capital spending, and challenging regulatory constructs. We expect these risks will persist for 2025, further pressuring the industry’s credit quality.

Chart 8

North America regulated utilities’ upgrades and downgrades



Source: S&P Global Ratings.

## Main assumptions about 2025 and beyond

### 1. Record capital spending.

The industry is heavily investing in safety, reliability, energy transition, and data centers. We expect this spending will exceed \$300 billion before the end of the decade.

### 2. Management of regulatory risk.

This includes constructive rate case orders, minimizing regulatory lag, and earning the authorized return on equity (ROE).

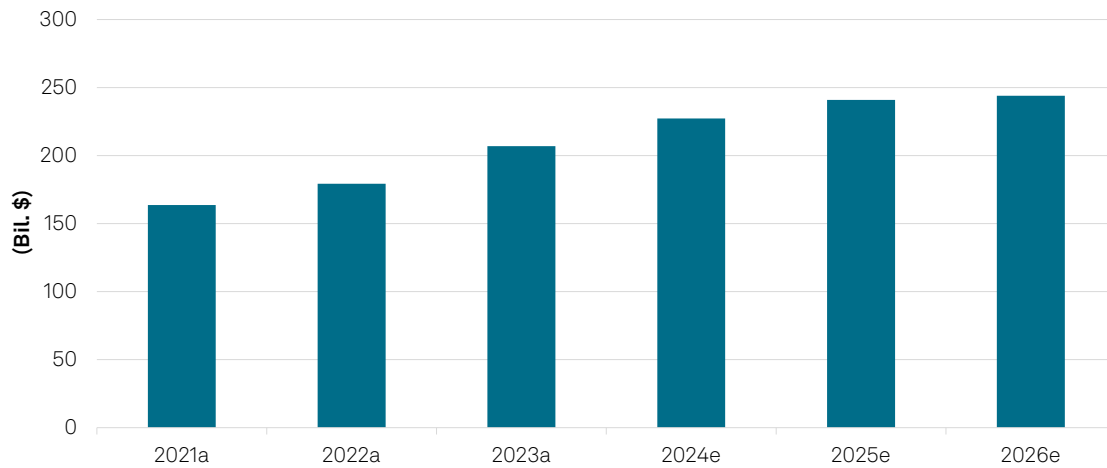
### 3. Climate change increases risks.

The growing frequency of devastating physical events, including hurricanes, storms, and wildfires, is elevating the industry’s credit risks.

**Capital spending continues to break records.** We expect capital spending for North America’s electric, gas, and water utilities will grow by a compound annual growth rate (CAGR) of about 10%. Accordingly, we expect 2025 capital spending to reflect about \$240 billion (see chart 9). To date, the industry’s capital spending has been primarily focused on safety, reliability, and energy transition.

Chart 9

### North America regulated utilities' rising capital expenditures

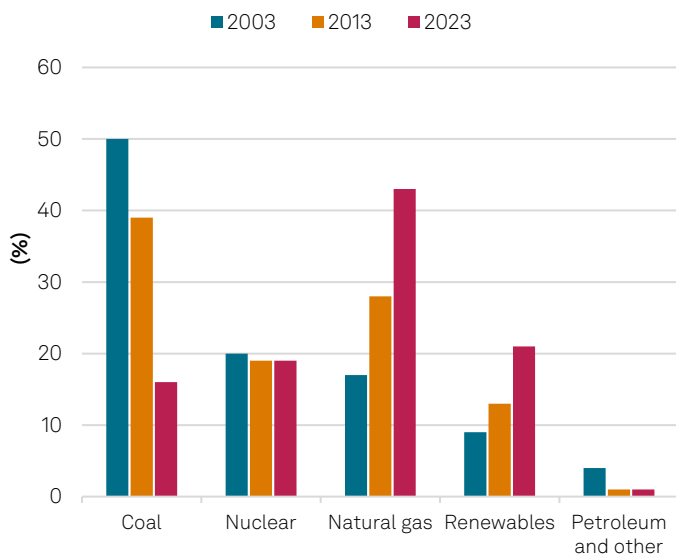


a—Actual. e—Estimate. Capital expenditures represent North American investor-owned electric gas, and water utilities.  
Source: S&P Global Ratings.

**Energy transition remains key.** Over the past decade the industry has invested billions on reducing its reliance on coal-fired generation by about 50% (see chart 10), and today, coal represents only about 15% of total electric generation. Most of the coal was replaced with natural gas, which has about half the carbon emissions. We expect the industry will replace most of its remaining coal-fired generation by about 2030 with renewables and batteries, further reducing its carbon and greenhouse gas (GHG) emissions. The industry has reduced its GHG emissions by nearly 30% over the past decade (see chart 11), and we expect it will reduce them by another 30% by 2035.

Chart 10

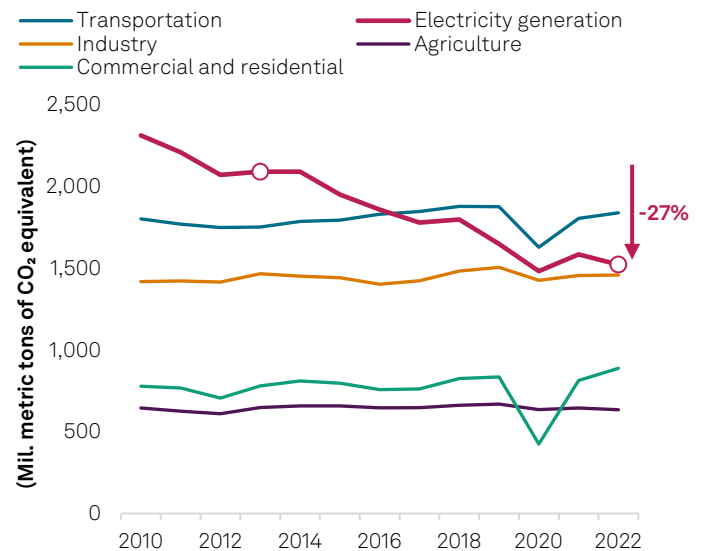
### U.S. generation transformation



Source: U.S. Energy Information Administration.

Chart 11

### GHG emissions by economic sector (2010-2022)

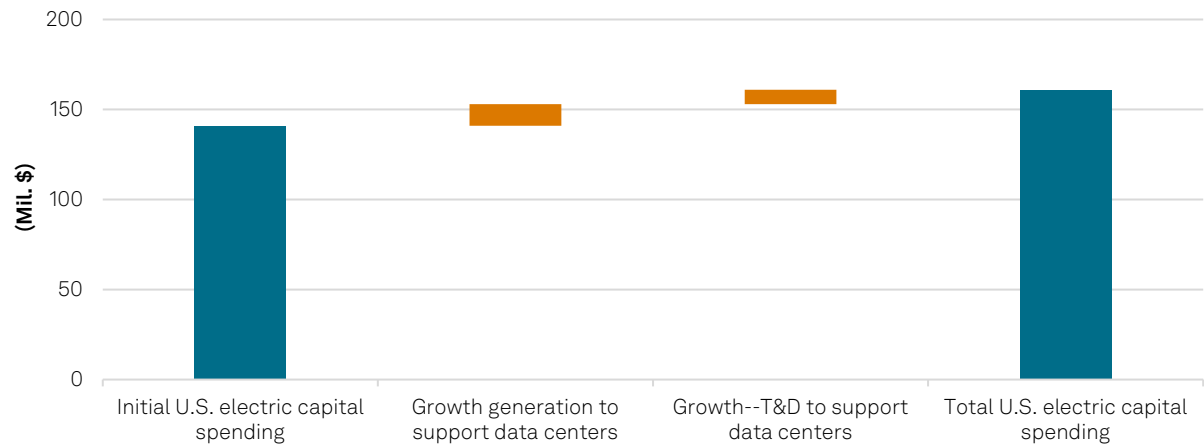


Source: U.S. Environmental Protection Agency.

**Data center growth** is relatively new, and our current base-case assumptions do not fully incorporate the incremental spending necessary for it. The higher spending for data centers is more likely to begin in 2026. Accordingly, 2026 capex could potentially increase by about another 15% above our current base case (see chart 12).

Chart 12

Data center growth will increase U.S. electric utility annual capital spending by about 15%

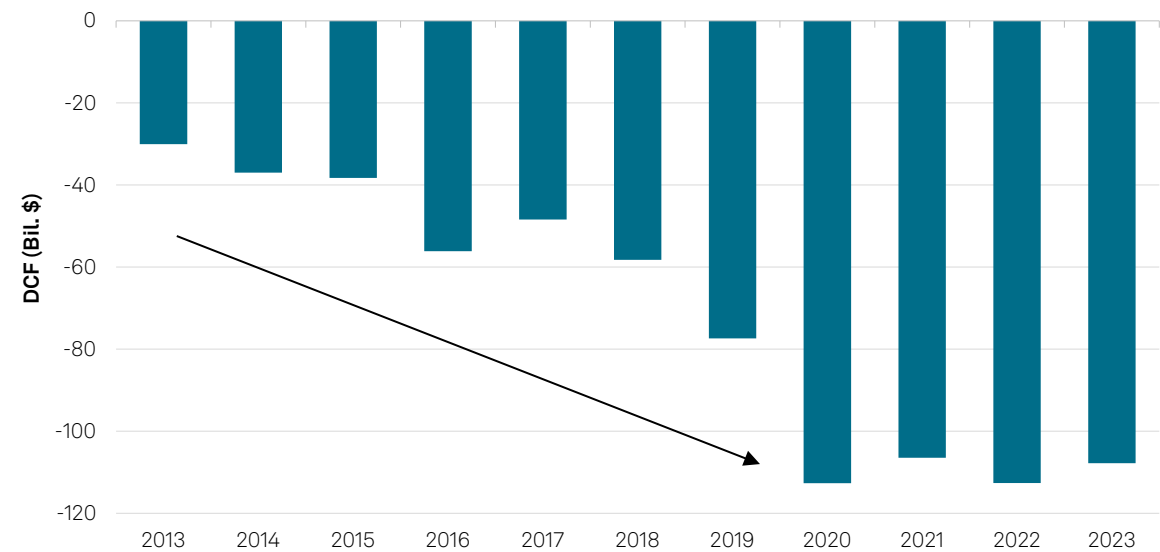


T&D—Transmission and distribution. Source: S&P Global Ratings.

**Cash flow deficits will rise** as a result, increasing the pressure on the industry’s credit quality. Over the past decade the industry’s cash flow deficits have grown from about \$50 billion to consistently over \$100 billion (see chart 13), and we expect this trend will continue.

Chart 13

North America regulated utilities’ cash flow deficits



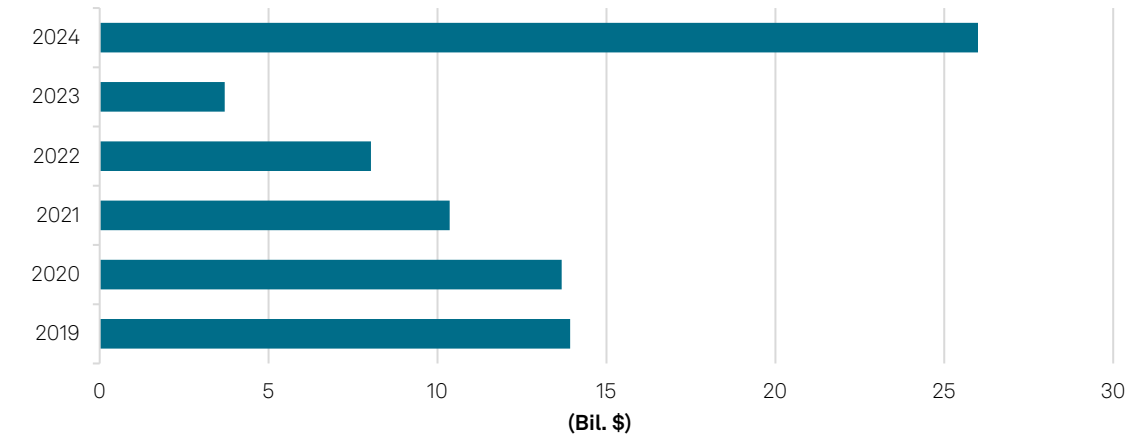
DCF—Discretionary cash flow. Sources: S&P Global Capital IQ, S&P Global Ratings.

**Hybrid security issuance reached an all-time high** of about \$26 billion in 2024, far exceeding the previous record of about \$14 billion in 2019 (see chart 14). We expect the industry will maintain this level of issuance in 2025 given its increased capital spending. This robust issuance supported the industry's 2024 financial measures because we typically assess hybrid securities as more

credit supportive than debt, with most of these securities having intermediate (50%) or high (100%) equity content.

Chart 14

North America regulated utilities’ annual hybrid securities issuance

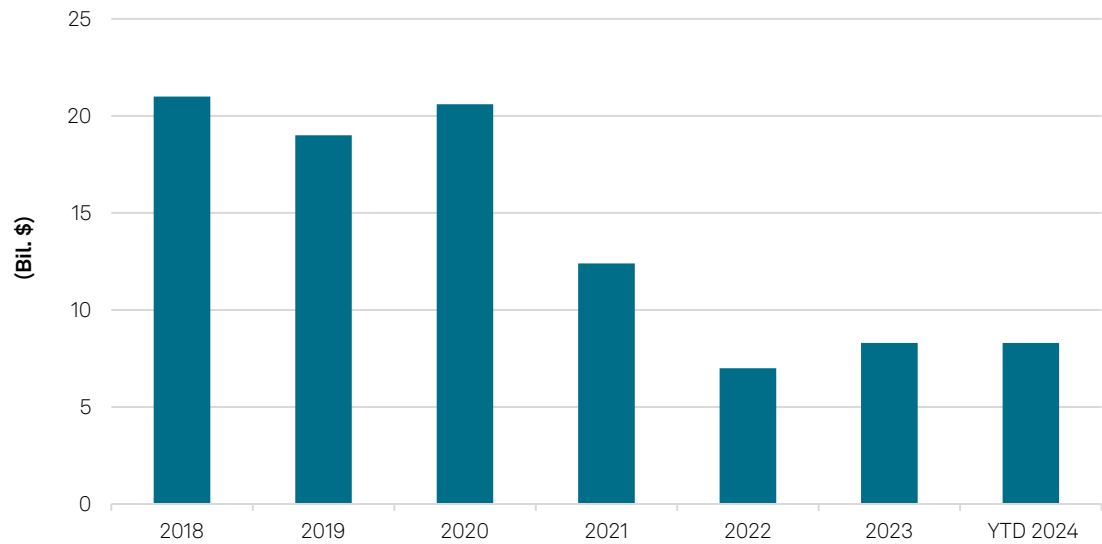


Sources: S&P Global Ratings, S&P Global Market Intelligence.

**Common equity issuance has been weak** and consistently below our expectations since 2021, pressuring the industry’s financial measures. It raised only about \$8 billion in 2024, and we estimate that the full year will reflect only about \$10 billion. This is well below the industry’s average run rate of about \$20 billion annually between 2018-2020 (see chart 15). We expect 2025 common equity issuance will again be relatively weak and more reflective of 2024 levels. Without significantly more common equity issuance, we expect the industry’s financial measures will continue to weaken, albeit gradually, supporting our negative outlook.

Chart 15

North America regulated utilities’ common equity issuance



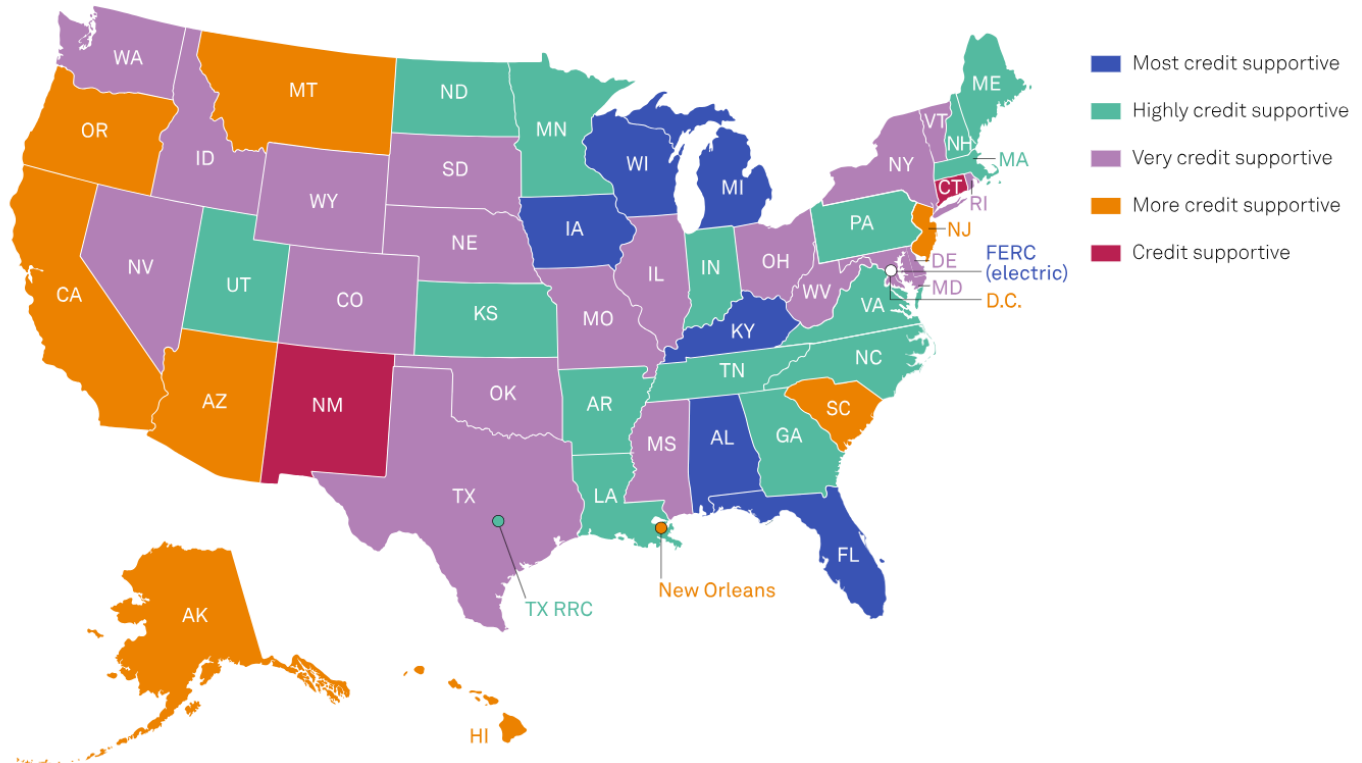
YTD—Year-to-date as of Dec. 15, 2024. Sources: S&P Global Ratings, S&P Global Market Intelligence.

**Effective management of regulatory risk will continue.** We assess all North America's regulatory jurisdictions as credit supportive or better, reflecting the industry's generally stable and predictable cash flows (see chart 16). Over the past decade much of the industry has implemented regulatory mechanisms such as decoupling, interim rates, capital trackers, formula rate plans, forward test years, multi-year rate case filings, and regulatory riders to significantly improve cash flow stability while minimizing regulatory lag (that is, the timing difference between when a utility incurs costs and when it's recovered from ratepayers).

Chart 16

## Regulatory assessment by state

As of November 2024



Source: S&P Global Ratings.

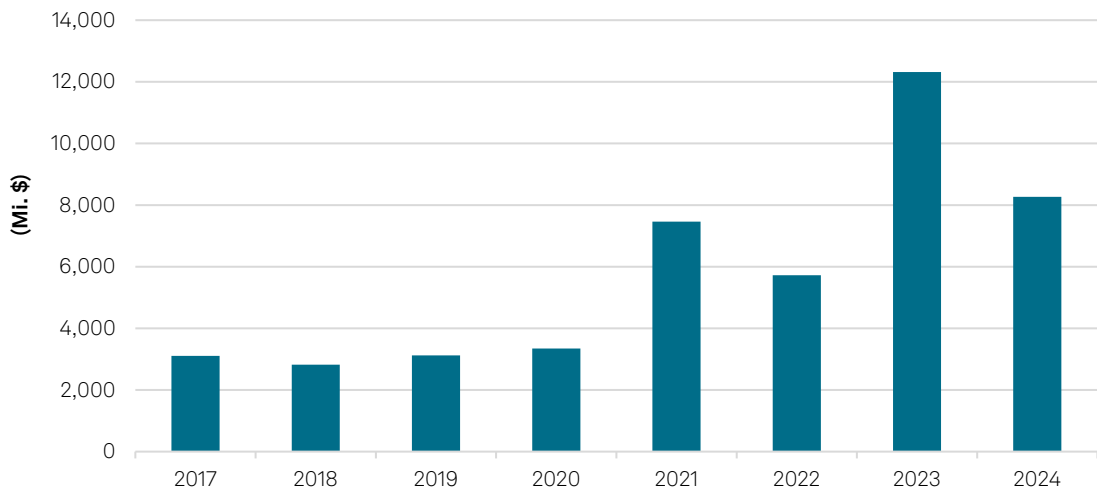
In general, we expect utilities will operate in a regulatory jurisdiction that is supportive of their credit quality by allowing for the full recovery of all their operating and capital costs in a timely manner. We also expect the regulatory jurisdiction will provide a consistent and predictable regulatory framework that results in cash flow stability. Our view of the industry's regulatory constructs supports the industry's mostly investment-grade ratings despite the industry continuing to operate with material cash flow deficits.

Recently, we revised downward our assessment of Connecticut's regulatory construct to credit supportive from more credit supportive. We now expect the state's regulated utilities will be increasingly subject to below-average authorized ROEs, regulatory lag, and an inconsistent ability to earn their lower authorized ROEs. These developments will increase the utilities' cash flow volatility, decrease the stability of their financial performances, and weaken their ability to consistently manage regulatory risk. Other regulatory jurisdictions that we continue to carefully monitor include Arizona, Colorado, District of Columbia, Illinois, Maryland, Michigan, New Mexico, Texas, and West Virginia.

**Regulatory rate case order increases have substantially risen** over the past four years, reflecting the industry’s robust capital spending. Rate case increases for 2021-2024 have increased by more than 2.5x compared to 2017-2020 (see chart 17), and there are more than 100 U.S. rate cases pending, for which utilities are requesting over \$16 billion more in revenue. This is in line with our base case that this year’s rate case orders will again be robust and most likely in the top three years for rate case order increases.

Chart 17

U.S. rate case orders

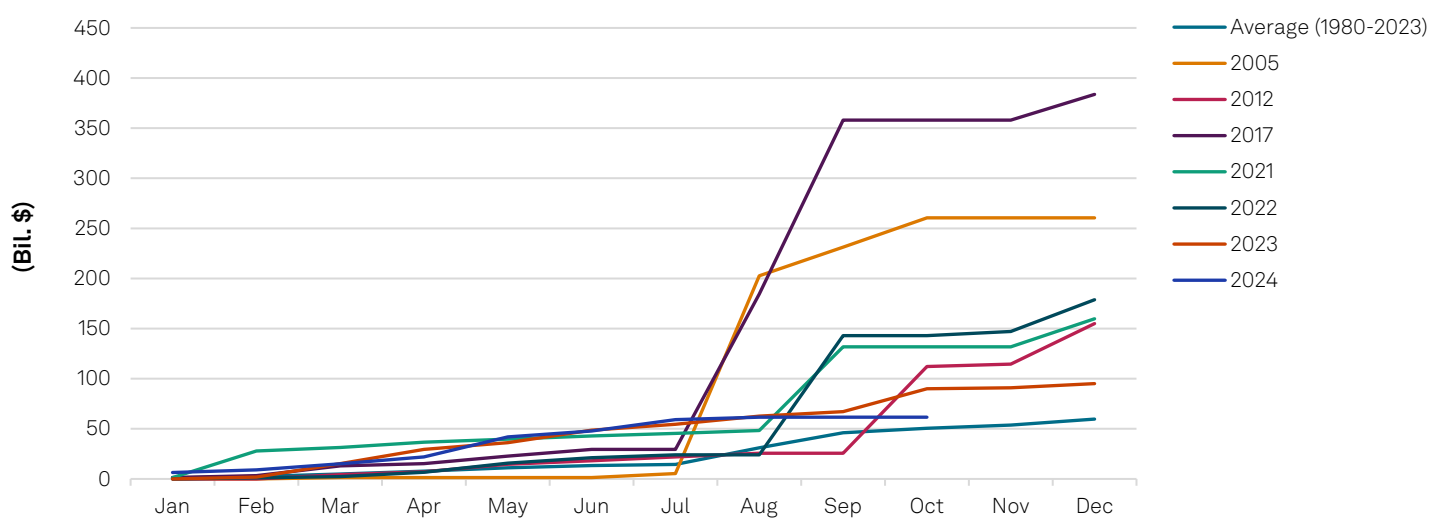


Source: S&P Global Commodity Insights.

**Utilities' exposure to physical risks are increasing.** According to the National Oceanic and Atmospheric Administration (NOAA), on an inflation-adjusted basis, 2021 and 2022 represent two of the most destructive years for extreme weather events since 1980 (see chart 18). We assume these trends will persist, magnifying physical risks for the utility industry.

Chart 18

U.S. billion-dollar weather disaster year-to-date event cost (CPI-adjusted)



Source: National Ocean and Atmospheric Administration.

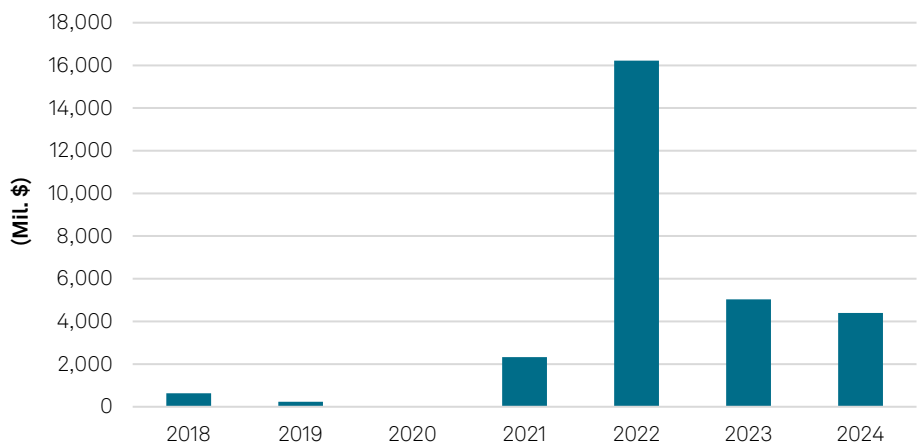
Drier, hotter weather has increased the acreage designated as high-fire-risk across the U.S. This is already taking a toll on credit ratings. For example, in 2024 we downgraded parent Xcel Energy Inc. and subsidiary Southwestern Public Service Co. (SPS) because of the scale and severity of the wildfires in the Texas panhandle, which highlights their increasing wildfire exposure. Overall, because of climate change, we expect the industry’s wildfire risk will increase.

**Securitization increased, which we assess as supportive of credit quality** (see chart 19).

Securitization allows for the issuance of debt secured by a non-bypassable charge to the customer's bill, allowing the utility to fully recover storm-related costs at a lower interest rate for customers. Because the debt is secured by the high likelihood of customers paying their bills, the associated interest costs are typically lower. We often deconsolidate such debt, resulting in stronger credit measures.

Chart 19

S&P Global Ratings-rated utility-related securitization issuance (2018-2024)



Source: S&P Global Ratings.

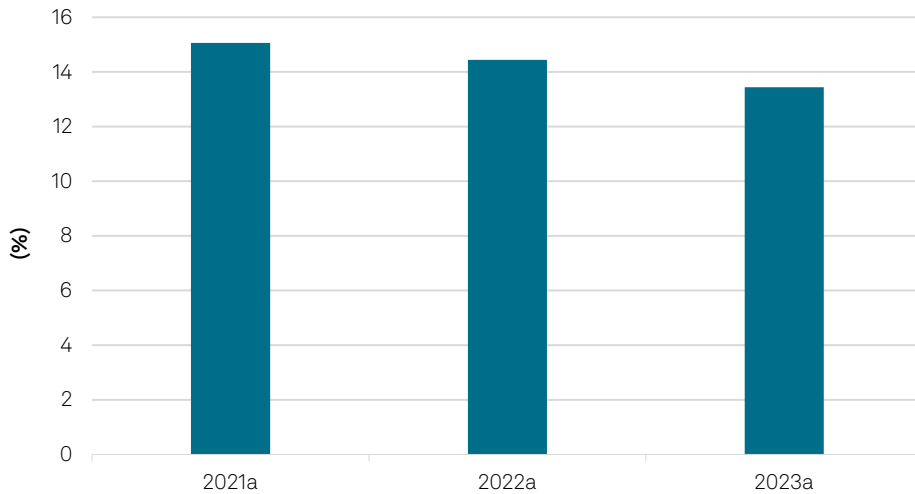
We expect securitization will remain an effective tool that the industry will continue to use. Our base case includes increasing severe natural disasters and weather events as well as continued efforts to decarbonize the energy sector, which sometimes requires securitization to fully recover under-depreciated retiring fossil-fuel generating plants.

**Credit metrics and financial policy**

We expect rising capital spending and increasing cash flow deficits that are not sufficiently funded in a credit-supportive manner will continue to pressure the industry's financial performance. Its average funds from operations (FFO) to debt was about 15% in 2021 and has gradually fallen to about 13.5%, primarily reflecting rising leverage (see chart 20). Given our expectations for continued increasing capital spending over the next decade, we expect financial performance and credit quality will continue to be pressured.

Chart 20

North American regulated utilities' average FFO to debt



a—Actual. Source: S&P Global Ratings.

## Key risks or opportunities around the baseline

### 1. Wildfire mitigation efforts.

Wildfire risk mitigation, while clearly a credit positive, may not fully address the threats associated with extreme weather events.

### 2. Data centers and sales growth.

Data center electricity demand will likely boost revenues at North American investor-owned regulated utilities and provide modest support for the industry's credit quality.

### 3. Managing the customer bill.

The average electric customer bill is about 2% of U.S. median household income, which represents good value for customers relative to other typical household bills. Preserving this value is critical for the industry to maintain credit quality.

**Wildfire risk has expanded.** Recent events in the Northeast U.S. lead us to believe wildfire risk has spread and now potentially affects nearly every utility across North America. (About 15 years ago, it was primarily limited to just Southern California.)

**Wildfire risk is highly negative for credit quality.** The scale of potential liabilities, unpredictable nature of exposures, and frequency of events have materially increased wildfire risk for many utility stakeholders. From a credit standpoint, litigation risk is more problematic than risk of damage to infrastructure because it is difficult to predict or quantify and is so far without sufficient mitigation or containment. Also, wildfire-related litigation payments are typically not recoverable in rates or through other regulatory mechanisms, making them more problematic than physical risk.

Additional wildfire risks to credit quality include:

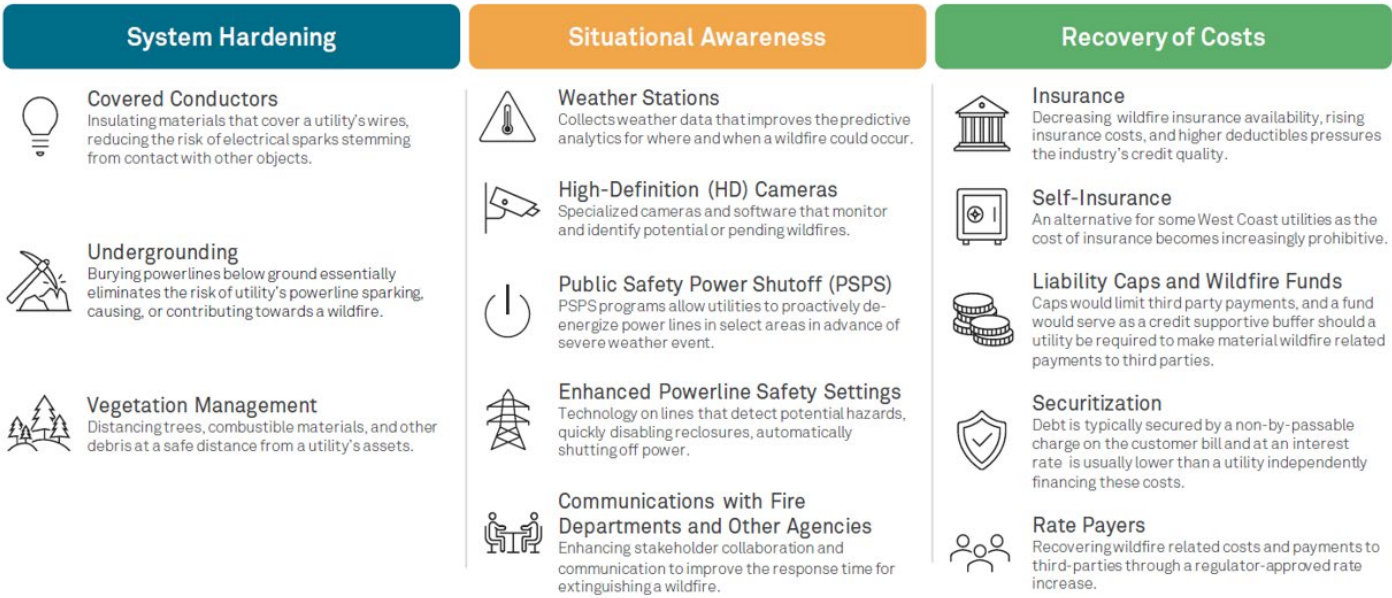
- Insurance is becoming more expensive and less available.
- It only requires a relatively small percentage of damaged or destroyed structures from a wildfire to have a material negative effect on a utility's credit quality.

- The utility industry’s relatively high leveraged balance sheets and modest authorized ROEs are not a backstop for wildfire risk.
- Utilities that are impacted by a catastrophic wildfire and material third-party claims typically cannot implement other strategic initiatives.

**Mitigation strategies.** We expect the industry will develop plans that reduce damages, minimize litigation risk, and expand capabilities for cost recovery from wildfires. We believe the industry will be able to implement much of these strategies over the nearer term because most are not predicated on the development of new technologies or products. That said, because the industry operates in many different service territories and topographies, we expect each utility’s mitigation plan will be customized to its unique exposure. Chart 21 represents an array of wildfire mitigation strategies that either have or are being implemented by many utilities across North America.

Chart 21

North American regulated utilities’ wildfire mitigation efforts



Source: S&P Global Ratings.

**Data centers will likely deliver a return to electricity sales growth.** We expect electricity sales will increase at a CAGR of about 1.1%. This reflects our view that systematic and careful planning across the investor-owned utility sector will likely limit its realistic capability to grow at a substantially faster pace. In general, the expansion of utility infrastructure assets is a long-term planning process that requires permitting, siting, and regulatory approvals.

However, even a 1% CAGR for electricity sales will likely prove transformative for the utility industry, which has experienced flat sales growth over the past two decades. In particular, the growing number of data centers will allow the industry to spread its fixed costs over a wider base. We anticipate this will provide some cushion for the industry to effectively manage regulatory risk and maintain credit quality without necessarily requiring that every rate case order is highly supportive of credit quality.

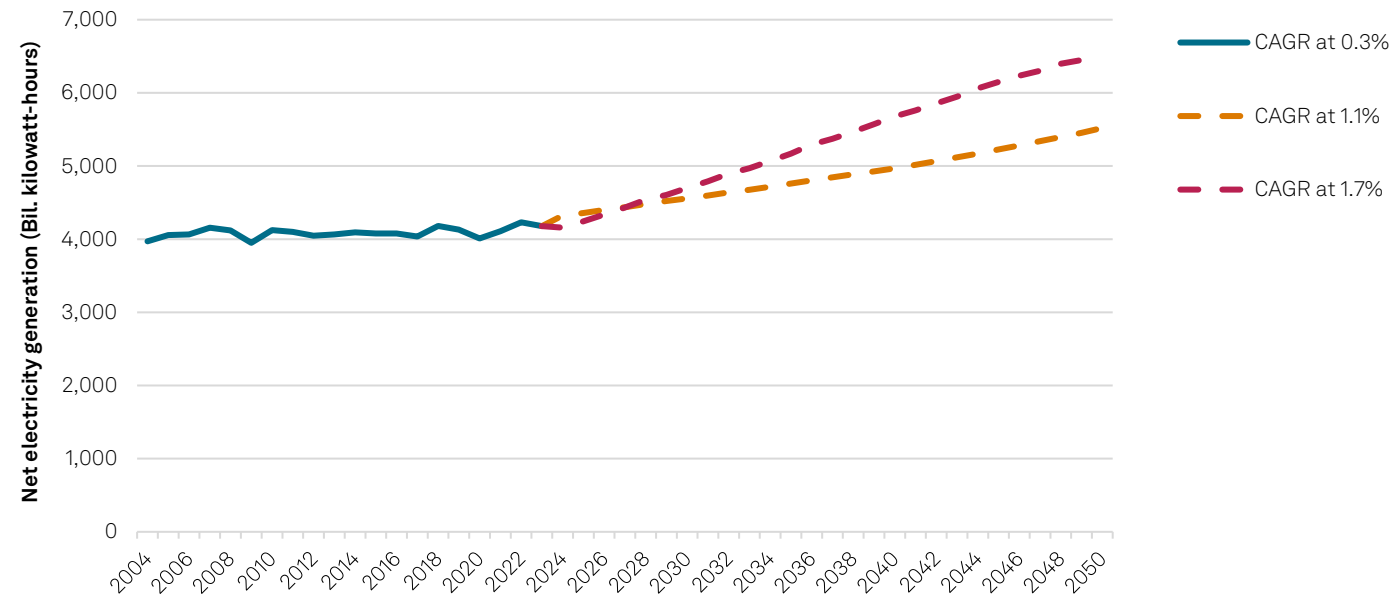
We also expect electric utilities' sales CAGR will be maintained over the longer term (see chart 22), which will support the industry's long-term credit quality. We expect growth in data center numbers will support most of the industry's growth through 2030. In the following decade,

increased onshoring of manufacturing and wider spread adoption of electric vehicles will also support growth.

Chart 22

Growth will be transformative for utilities used to stagnation

Electricity demand: U.S. regulated electric utilities



Data as of June 2024. CAGR—Compound annual growth rate. Sources: U.S. Energy Information Administration (historical and 1.1% CAGR) and S&P Global Commodity Insights (1.7% CAGR).

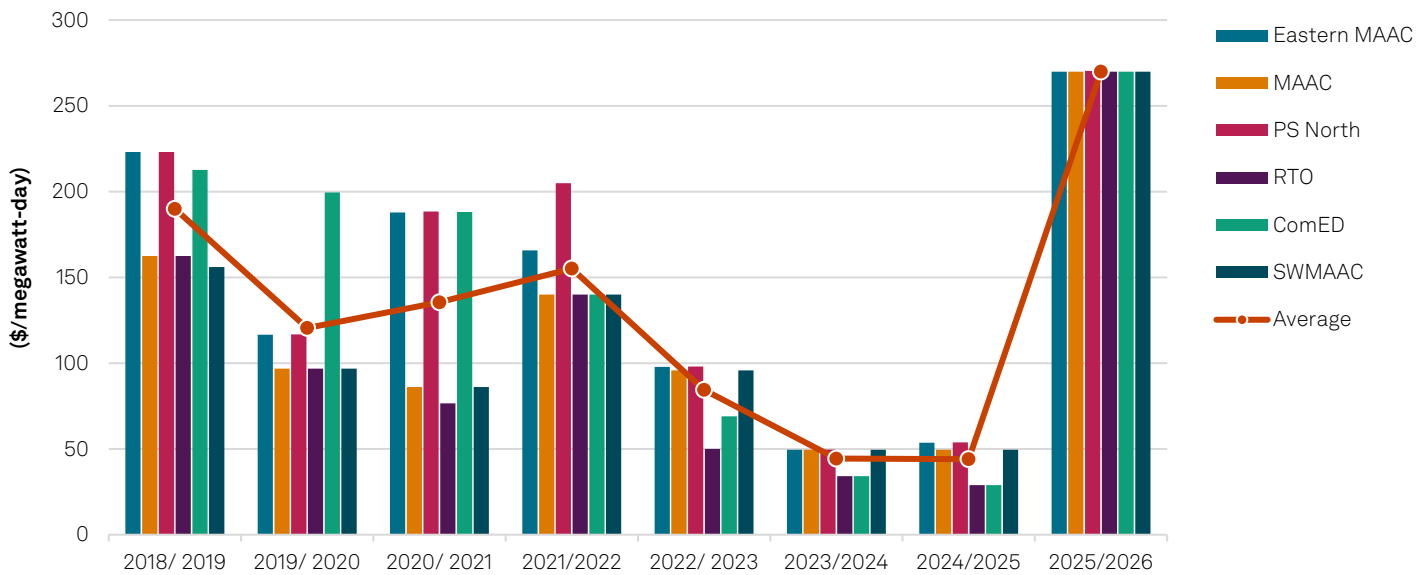
**Data center credit risks.** The industry must structure rates and contracts to ensure that the new data center customers are paying their share of electricity costs. Meeting the demands of relatively few, but very large, data center customers will require significant capital spending and infrastructure investments. If utilities assign a significant portion of data center-related infrastructure costs to existing residential customers, customer bills would increase. This, in turn, pressures regulators to limit rate case increases, which can negatively affect the industry's ability to effectively manage regulatory risk.

Therefore, we expect the increased capital spending needed to accommodate data center growth will be primarily recovered from data center customers over decades. Such a plan comes with risks. For example, a technological breakthrough that reduces or eliminates the need for data centers could shift the recovery of these long-term infrastructure investments onto residential customers.

**Capacity prices.** Pennsylvania-New Jersey-Maryland (PJM) Interconnection capacity prices materially increased during its latest capacity auction (see chart 23). These higher prices are directly passed onto customers, significantly increasing the electric utility bill. If these higher prices persist, it will likely result in higher customer complaints, pressuring regulators to limit increases to other areas of the customer bill that could potentially pressure a utility's ability to effectively manage regulatory risk.

Chart 23

PJM capacity auction results



Source: PJM website.

**U.S. Environmental Protection Agency (EPA).** In 2024 the EPA released final rules aimed at reducing pollution from fossil fuel-fired power plants, which included carbon pollution standards and effluent limitation guidelines and standards for coal-fired power plants. These rules would have increased costs for utilities, specifically regarding the requirement to install carbon capture and sequestration or storage technology on coal-fired power plants intending to operate beyond 2039.

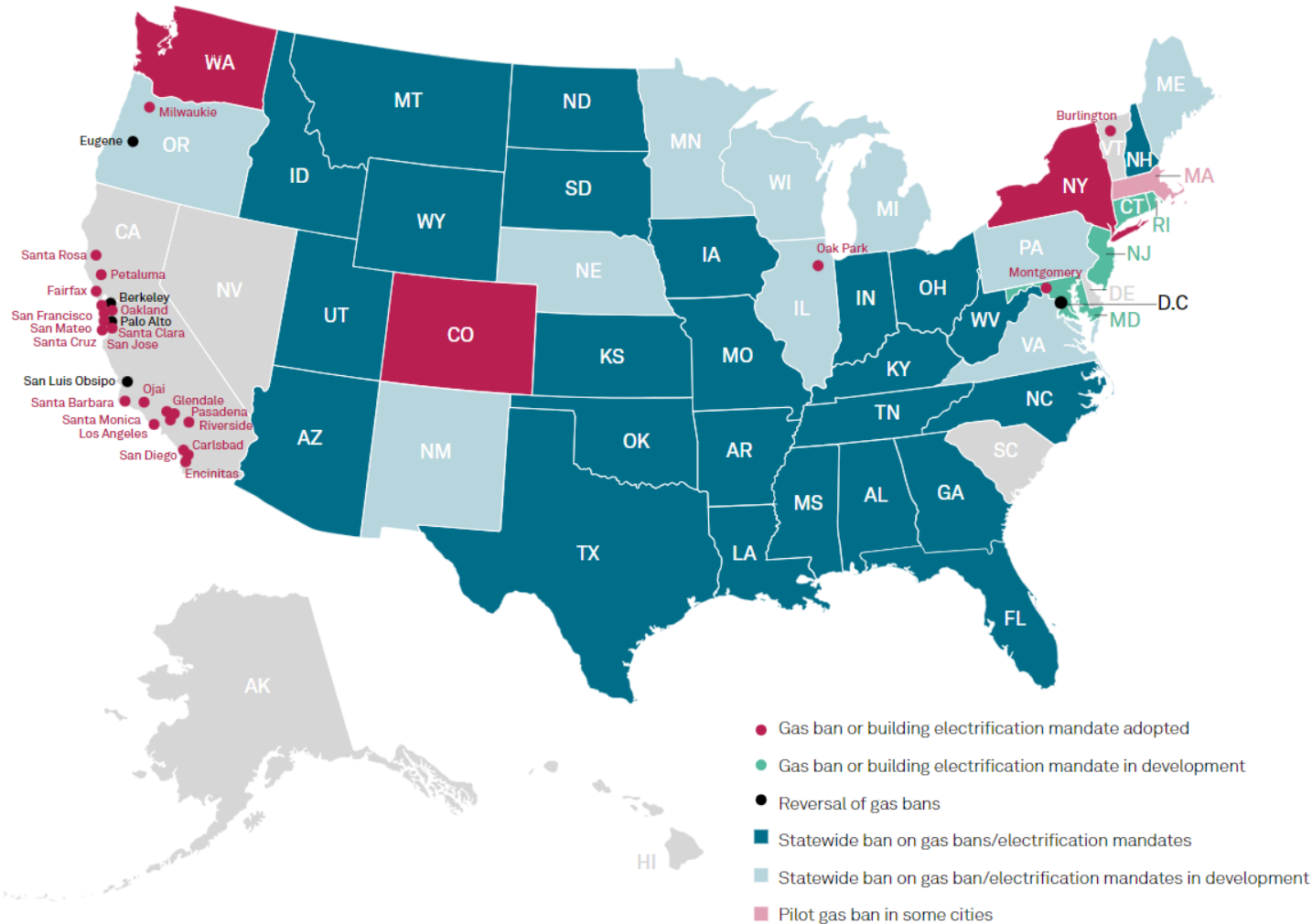
However, we note that the incoming U.S. presidential administration and Republican majority in congress could modify or eliminate these rules. We will monitor executive, legislative, or legal actions that could impact the industry’s credit quality.

**Full electrification.** We expect the longer-term credit quality for some natural gas local distribution companies (LDC) will become increasingly challenging, especially for utilities that operate in warmer climates or whose cities or states have banned new gas connections, severely limiting the growth of natural gas LDCs (see chart 24). We expect this trend will also gradually persist through the passage of local city and town building codes that limit carbon and other emissions.

Offsetting some of this risk is that a majority of states have imposed a ban on the ban of new gas connections. Furthermore, gas LDCs are attempting to reduce their environmental risks by decreasing their carbon footprint through investing in renewable natural gas, blending hydrogen, and initiating various hydrogen infrastructure projects.

Chart 24

Gas bans and electrification mandates



Data as of April 26, 2024. \*Municipalities shown on map are a subset of municipalities in the U.S. that have gas ban policies or electric reach codes in place. §Colorado and Burlington mandates target emissions requirements set out in respective laws or regulations. Source: S&P Global Commodity Insights.

**Cybersecurity.** While cybersecurity breaches against infrastructure assets have been relatively low, we believe the threat of cyberattacks remains high. The 2024 cybersecurity breach against American Water Works Co. Inc. underscores the risks. But the sector has heavily invested to limit this risk. We believe the sector's ongoing vigilance in this area is critical to maintaining credit quality.

## Related Research

- [Wildfire-Exposed U.S. Investor-Owned Utilities Face Increasing Credit Risks Without Comprehensive Solutions](#), Nov. 6, 2024
- [Data Centers: Rapid Growth Creates Opportunities And Issues](#), Oct. 30, 2024
- [Evolving Risks In North American Corporate Ratings: Climate Change](#), Oct. 29, 2024
- [Data Centers: Welcome Electricity Growth Will Fall Short Of U.S. Data Center Demand](#), Oct. 22, 2024
- [Energy Transition: U.S. Investor-Owned Regulated Electric Utilities Face Hurdles With The EPA's Finalized Rules For Fossil-Fueled Power Plants](#), Oct. 17, 2024
- [North American Utility Regulatory Jurisdictions Update: Some Notable Developments](#), Sept. 24, 2024

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