

# U.S. Water and Sewer Outlook 2026

## Outlook Revised to Neutral Despite Uncertainty

### Fitch's Sector Outlook: Neutral

Fitch Ratings' 'neutral' outlook for the water and sewer sector reflects an operating environment for the upcoming year that is generally stable and no longer deteriorating. Nonetheless, we expect that much of the uncertainty that emerged in 2025 will carry into 2026. A higher effective tariff rate (ETR) is expected to work its way into utilities' capital programs and contribute to the increased spending trend. To date, most utilities have managed well in the current operating environment by increasing contingency budgets, adapting capital plans and reprioritizing projects, if needed, based on updated cost projections.

### Rating Outlook Distribution

Rating Outlooks for the sector remain overwhelmingly Stable. A narrowing of financial margins could be realized in 2026 as capital programs continue to expand and additional debt is incurred, but Fitch expects limited rating changes in 2026, as most systems maintain adequate headroom to absorb the additional debt.

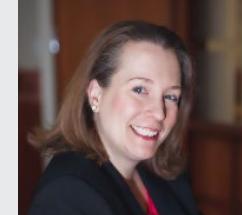
As of November 2025, 92% of water and sewer ratings assigned by Fitch maintained a Stable Rating Outlook. Approximately 5% have a Positive Rating Outlook or are on Rating Watch Positive, and 3% have a Negative Rating Outlook or are on Rating Watch Negative. Ratings trending positive are dominated by utilities with improving leverage profiles, despite incorporating higher capex and operating costs. Conversely, ratings trending negative are predominantly driven by utilities with rising leverage due to increasing capital programs and associated debt issuances without offsetting rate support.

### What to Watch

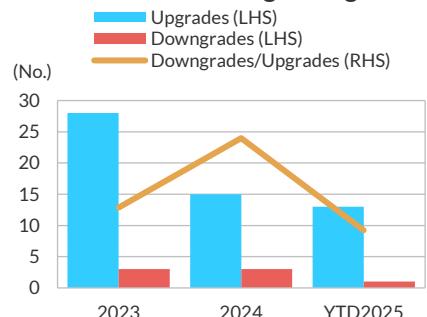
- Capital spending to continue rising.
- Federal actions affecting state revolving fund financing, or the availability and access to disaster aid.
- Utilities managing uncertainty in the operating environment.
- The regulatory environment and effects on capital spending.
- Trends in service affordability.

### Audra Dickinson, Senior Director

"Capital budgets have increased in recent years, driven by inflationary adjustments and labor disruptions. While those cost pressures have generally normalized, utilities are now managing to a higher ETR. In response, many utilities are more frequently reviewing asset management plans and reprioritizing projects when cost projections increase. Across the sector, many capital projects are discretionary and not driven by regulatory mandates, but delayed or canceled investment as a result higher than originally planned costs will exacerbate the sector's deferred maintenance needs."



### Water & Sewer- Rating Changes



Source: Fitch Ratings

### Water & Sewer - Rating Outlooks



Source: Fitch Ratings

### Core Credit Drivers: Water-Sewer

Subsector	Revenues			Expenditures			Financial Profile			
	Personal Income/Affordability	Real-Estate Values	Demand/Volumes	Labor Costs	Labor Availability	Non-Labor Operating Costs	Capital Input Costs	Leverage	Cost of Debt	Financial Reserves & Liquidity
Water-Sewer	↔	N.A.	↔	↔	↔	↔	↓	↓	↑	↔

N.A. – Not a material driver of credit quality in sector. ↑ Improving – High relevance. ↑ Improving – Moderate relevance. ↔ Neutral. ↓ Deteriorating – Moderate relevance. ↓ Deteriorating – High relevance.

Source: Fitch Ratings

## Operating Cost Burden

### Operating Budgets Reflect Higher Cost of Supplies, Personnel

Fitch does not expect acute operating pressures in 2026, which should support continued rating stability for the sector. The upward trend of per unit costs is expected to continue, but the pace of operating cost increases has normalized. Utilities' operating budgets now reflect the recurring costs associated with recent cost-of-living adjustments and the sustained higher cost of chemicals and other supplies. For most utilities, revenue generation is driven by rate adjustments, which are generally coming in near the CPI, supporting higher operating expenses and preserving margins.

### Interest Rate Pressures Continue to Ease

Fitch expects U.S. Fed policy rates to fall to 3.25% through 2026 from 4.0% in 2025, while long-term rates are expected to hold steady. This should result in stable to decreasing financing costs and contribute to moderating revenue requirements, particularly for utilities pursuing new construction. Stable to lower rates would also sustain refunding economics in 2026, continuing the trend of higher refunding issuance that began in 2024.

Debt issuance in 2025 largely kept pace with the record levels of issuance seen in 2024. Fitch expects issuance will likely be sustained in 2026 as utilities move forward with increased capital programs.

### What to Watch – More Challenging Operating Cost Environment

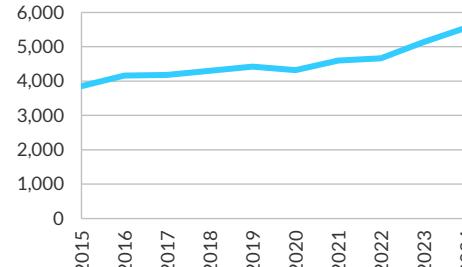
Operating costs have stabilized. However, resurgent inflation, increased supply or labor costs, a severe recession and/or higher long-term interest rates could shift the sector outlook to 'deteriorating'.

### Additional Key Sector Issues

- Increasing climate risk will remain a threat to the sector as utilities work to expand and improve the resiliency of water supply and other infrastructure, and contend with unforeseen expenses that can arise in the aftermath of severe weather events. Increasing concerns related to the availability of, and access to, disaster aid compound this risk.
- While supply availability is not a concern for most water providers, ongoing regional droughts will begin to have more immediate credit impacts if a utility's ability to meet ongoing demand becomes questionable.
- A slowdown in federal funding via state revolving fund (SRF) programs or through the Water Infrastructure Finance and Innovation Act loan program could result in utilities seeking alternate higher-cost funding sources, thereby increasing carrying costs and narrowing margins.
- A breach of critical utility assets from cyberattacks that halts service or requires ransomware payments could negatively affect utility financial performance and potentially result in widespread public and private sector shutdowns.

### Operating Cost Burden

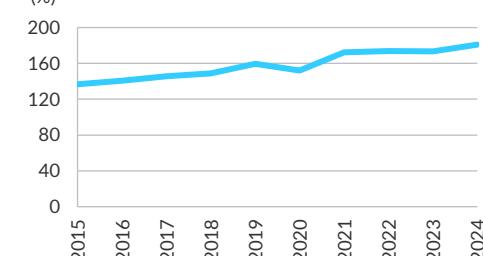
(\$ mil. gallons production)



Source: Fitch Ratings

### Five-Year Average Capex to Depreciation

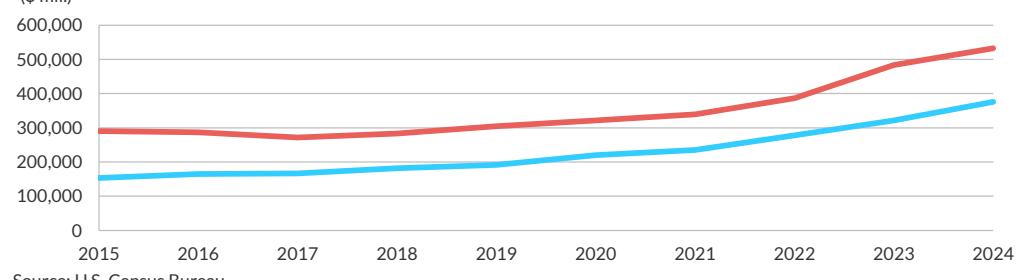
(%)



Source: Fitch Ratings

### National Public-Sector Annual Construction Spending

(\$ mil.)



Source: U.S. Census Bureau

## Capital Investment

### Capital Spending Supported by Rate Adjustments

Capital budgets have increased as the full impact of rebidding and updated cost estimates were incorporated into formal plans, and Fitch expects capital spending to remain robust in 2026. Despite increased spending, median leverage across the sector has declined slightly over the past two years as rate adjustments supported the higher spending and generated increased margins. As such, most utilities are well positioned for sustained levels of higher capital spending. The higher issuance volume in 2025 and expectations for 2026 could suggest an increased debt burden for many utilities in 2026. We expect the recent trend in rate adjustments to continue to offset increased spending, but inadequate support could weigh on credit quality.

While many utilities maintain flexibility within their capital programs to defer projects, this flexibility will be diminishing for those facing regulatory-driven requirements. However, even where project deferral is possible, the need to address aging infrastructure remains a long-term challenge for the sector.

### What to Watch – Cost Increases and Labor Availability

A resurgence in inflationary pressures, a higher ETR than currently contemplated, and/or challenges in labor or contractor availability could shift the sector outlook to 'deteriorating'.

## Federal Regulatory Policy and Financing

### Utilities Implementing Regulatory Compliance Strategies

The evolving regulatory environment and the effect of compliance strategies, particularly for emerging contaminants of concern and service lines, remain a concern for the sector and are considered in the outlook. The U.S. Environmental Protection Agency's (EPA) finalized Lead and Copper Rule Improvements (LCRI) required utilities to inventory all service lines and publicly disclose the composition of service lines by October 2024. With that deadline passed, utilities are now focusing on returning to service lines of "unknown" material for further identification work, which represents an ongoing cost to utilities. Under current guidelines, lead service lines (LSLs) would need to be replaced within 10 years of the LCRI's effective date in 2027. Utilities are now updating capital programs and the accompanying cost estimates to implement replacement strategies.

Operating resources will eventually need to be identified for longer-term compliance. Previously, the EPA estimated LCRI compliance costs to, ultimately, be in the hundreds of millions annually. However, costs should generally remain manageable for the Fitch-rated portfolio, as most utilities have reported finding few to no LSLs in their service areas.

Recent announcements by the EPA suggest the testing and treatment requirements for per- and polyfluoroalkyl substances (PFAS) could change, potentially extending the 2029 deadline by which utilities have to implement solutions to reduce PFAS levels if monitoring shows the maximum contaminant levels (MCLs) or hazard index is exceeded. PFAS have been detected widely across the

country, and the EPA estimates between 3,400 and 6,300 public utilities will need to reduce PFAS levels under the rule.

The EPA estimated the annual cost of compliance at \$1.5 billion. While the cost will be significant for some utilities, the full magnitude of capital plan and cost implications will largely hinge upon a utility's existing treatment capabilities and water supply sources. With the final MCLs set at near non-detectable levels for two specific compounds, those utilities already treating for PFAS may need to upgrade their treatment capabilities further. Compliance strategies vary across utilities. While many are proceeding with treatment upgrades based on existing levels and timelines, others await further EPA guidance on expected deadline extensions. After implementation, those utilities that required new plant construction would be expected to see increased operating budgets to maintain the new treatment facilities over the longer term.

### Uncertainty on Federal Financing Front

Fitch has long noted the importance of ongoing federal support for SRF loan programs, which have been a critical source of financing for utilities nationwide. The federal administration's currently proposed fiscal 2026 budget includes a drastic cut to SRF funding – approximately 90%. Even at historical funding levels, demand outpaced available funding. A final determination on SRF funding levels has yet to be made, but the potential reduction in this funding source would drive utilities to other higher-cost financing options.

While not typically a recurring revenue source for most utilities, reimbursement proceeds from the Federal Emergency Management Agency (FEMA) in the aftermath of natural disasters has helped utilities replenish and retain sound reserves. The restructuring or elimination of disaster aid reimbursements (whether via FEMA or different agencies) would not be expected to have a simultaneous sectorwide impact but, instead, have a more acute impact on a case-by-case basis as individual utilities recover after a natural disaster. Over time, Fitch believes utilities more susceptible to flooding, wildfires or hurricanes would be most at risk for credit deterioration.

### What to Watch – Reversal or Amendment of Finalized Rules

An amendment of either the LCRI or final PFAS rule to extend the timelines for compliance, or a full reversal of the rules, would ease capital pressures on the sector. However, Fitch would not expect it to result in revising the sector's outlook to 'improving', as many utilities are already undertaking compliance strategies, particularly around PFAS. In such a scenario, the majority of costs would still lead to higher rates and/or debt issuance, resulting in delayed costs, but not cost avoidance.

### What to Watch – Cybersecurity Regulations

While no formal regulation has been promulgated in relation to cybersecurity, it remains a topic of discussion – and potential vulnerability – for the sector. As such, Fitch expects that water and sewer utilities will eventually have to comply with certain cybersecurity practices. Shorter-term spending would likely focus on conducting cybersecurity assessments, but any identified vulnerabilities or successful breaches at a utility could result in unforeseen capex.

## Affordability of Service

### Affordability Holds Steady, But Longer-Term Pressures Remain

The Fitch-rated portfolio, as a whole, maintains sound rate flexibility. Utility charges sectorwide rose at a faster pace than CPI growth for many years leading up to the pandemic, and an acceleration in rate adjustments resumed in 2023. Rates adopted in fiscal years 2024 and 2025 were generally closer to the CPI (which itself was higher than in pre-pandemic years), but sufficiently supported higher operating and capital costs. While affordability has not materially eroded to date, stakeholders remain focused on affordability concerns as rate actions continue into 2026, particularly for the most economically vulnerable.

A program to aid lower-income individuals, the Low Income Household Water Assistance Program (LIHWAP), was created as part of federal legislation in 2021, but funding expired at the end of 2023. Although bills were introduced in 2024 in both chambers of the U.S. Congress, neither progressed to the other chamber. Longer-term affordability concerns would only be mitigated by a permanently funded program.

### What to Watch – Trends in Service Affordability

In the longer term, affordability remains a concern as utilities across the country look to increase capital spending to maintain, improve or replace assets. This will necessitate ongoing rate adjustments.

Sector outlooks are a general forward-looking assessment of the underlying operational and business conditions of the sector compared to the previous calendar year. A 'neutral' outlook is an assessment that these conditions will remain mostly unchanged. Sector outlooks are distinct from Rating Outlooks.

## Outlooks and Related Research

### 2026 Outlooks

[Global Economic Outlook - December 2025](#)

[Further Cuts to Colorado River Water Use Could Increase Utility Costs \(November 2025\)](#)

[U.S. Water and Sewer - Peer Credit Analysis \(September 2025\)](#)

[U.S. Water and Sewer Data Comparator: 2025 \(September 2025\)](#)

[California Wildfire Challenges May Test US Public Finance Resilience \(January 2025\)](#)

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