

Green and pleasant land: Decarbonising American electricity

July 2021

Joe Biden's target of zero carbon emissions will increase the challenges for US power companies, and their debt. However, it presents opportunities for European utilities.

Like a driver who realises he has been heading the wrong way down the highway (for four years), Joe Biden has manoeuvred an abrupt U-turn in the US government's climate policy.

On his first day as president, Biden signed the US up to rejoining the international Paris Agreement to limit climate change. He also committed the country to net zero carbon emissions by 2050. President Biden has even said he would ideally like the US to get there by 2035, though we deem this unlikely.

The president's environmental zeal does provide a tailwind for the decarbonisation of US utilities. However, although the US federal government has just performed a U-turn, many state governments and utility companies, never changing their course towards decarbonisation, have been performing their own policy reversals for many years. No fewer than 38 states have carbon reduction goals, which include increasing the share of renewables in electricity generation. This tendency shows up in the national figures. In 2010, 44% of US power came from coal; by 2020, this had slumped to 20%. The proportion that comes from renewables has doubled from 10% to 20%. We think it will reach close to 50% by 2040.

A CHALLENGE TO BOND INVESTORS

As investors, we welcome decarbonisation: global warming will hit the values of an extremely wide range of assets. However, the greening of US power does present a challenge for utilities. If a utility retires a power station early because it burns fossil fuels, that power station will be a "stranded asset" if it is retired before its value has been fully depreciated in the accounts. A stranded asset is an asset whose value must be written down prematurely, because of a change in public and regulatory priorities. In the case of bonds, mothballing assets leaves less cashflow to pay coupons and redemptions.

There are solutions to stranded asset risk. For example, some state regulators allow utilities to securitize undepreciated balances from power plants. Securitization refers to the issuance of off-balance sheet bonds backed by a specific revenue streams from customer bills that have been approved by regulators and/or state legislators. To understand potential problems and permitted solutions, we follow regulatory proceedings for 51 regulators - one for each state, plus the Federal Energy Regulatory Commission.

AUTHORS



Thomas Socha
Credit Analyst

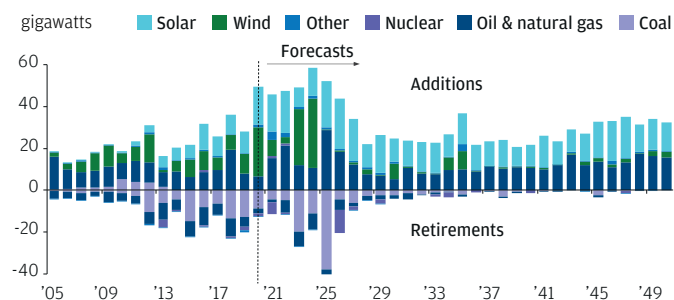


Robert Emes
Credit Analyst

PORTFOLIO INSIGHTS

EXHIBIT 1: WHAT REPERCUSSIONS DOES THE GLOBAL CLIMATE AGENDA HAVE ON HOW WE ASSESS FIXED INCOME SECTORS AND IN PARTICULAR WITH A CONSIDERATION OF STRANDED ASSETS?

U.S. retiring and new generating capacity



Source: EIA, Lazard, Eurostat, METI, BP Statistical, J.P. Morgan Asset Management. 2020 generating capacity is a forecast based off July 2020 data. Data is based on availability as of May 31, 2021.

Greening US electricity also presents investment opportunities. Many European utilities already have particular expertise in green energy, because of an earlier focus on renewables from companies and national governments. Disciplined expansion into markets with supportive energy policies could make the debt of these companies correspondingly more attractive. Take Spain's Iberdrola. It has sizeable assets in solar, wind and green hydrogen – and a large US presence.

CONCLUSION

US utilities have long since started down the green road. While President Biden's mission to turn the US into a net zero country will accelerate this journey, the subsequent increased risk to the debt of US utilities can be managed. European utilities with the expertise needed to help the US reach its carbon reduction targets also look all the more attractive as issuers.

NEXT STEPS

For more information, contact your J.P. Morgan Asset Management representative.

NOT FOR RETAIL DISTRIBUTION: This communication has been prepared exclusively for institutional, wholesale, professional clients and qualified investors only, as defined by local laws and regulations.

The views contained herein are not to be taken as advice or a recommendation to buy or sell any investment in any jurisdiction, nor is it a commitment from J.P. Morgan Asset Management or any of its subsidiaries to participate in any of the transactions mentioned herein. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is considered to be accurate at the time of production. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. In addition, users should make an independent assessment of the legal, regulatory, tax, credit and accounting implications and determine, together with their own financial professional, if any investment mentioned herein is believed to be appropriate to their personal goals. Investors should ensure that they obtain all available relevant information before making any investment. It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yield are not a reliable indicator of current and future results. J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide. To the extent permitted by applicable law, we may record telephone calls and monitor electronic communications to comply with our legal and regulatory obligations and internal policies. Personal data will be collected, stored and processed by J.P. Morgan Asset Management in accordance with our privacy policies at <https://am.jpmorgan.com/global/privacy>. This communication is issued by the following entities: In the United States, by J.P. Morgan Investment Management Inc. or J.P. Morgan Alternative Asset Management, Inc., both regulated by the Securities and Exchange Commission; in Latin America, for intended recipients' use only, by local J.P. Morgan entities, as the case may be; in Canada, for institutional clients' use only, by JPMorgan Asset Management (Canada) Inc., which is a registered Portfolio Manager and Exempt Market Dealer in all Canadian provinces and territories except the Yukon and is also registered as an Investment Fund Manager in British Columbia, Ontario, Quebec and Newfoundland and Labrador. In the United Kingdom, by JPMorgan Asset Management (UK) Limited, which is authorized and regulated by the Financial Conduct Authority; in other European jurisdictions, by JPMorgan Asset Management (Europe) S.à r.l. In Asia Pacific ("APAC"), by the following issuing entities and in the respective jurisdictions in which they are primarily regulated: JPMorgan Asset Management (Asia Pacific) Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited, each of which is regulated by the Securities and Futures Commission of Hong Kong; JPMorgan Asset Management (Singapore) Limited (Co. Reg. No. 197601586K), this advertisement or publication has not been reviewed by the Monetary Authority of Singapore; JPMorgan Asset Management (Taiwan) Limited; JPMorgan Asset Management (Japan) Limited, which is a member of the Investment Trusts Association, Japan, the Japan Investment Advisers Association, Type II Financial Instruments Firms Association and the Japan Securities Dealers Association and is regulated by the Financial Services Agency (registration number "Kanto Local Finance Bureau (Financial Instruments Firm) No. 330"); in Australia, to wholesale clients only as defined in section 761A and 761G of the Corporations Act 2001 (Commonwealth), by JPMorgan Asset Management (Australia) Limited (ABN 55143832080) (AFSL 376919). For U.S. only: If you are a person with a disability and need additional support in viewing the material, please call us at 1-800-343-1113 for assistance. Copyright 2021 JPMorgan Chase & Co. All rights reserved.

LV-JPM53297 | 07/21 | 09dz212007091309