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Coal's Dimming Future Spotlights Public Finance Disclosure Shortcomings.

WASHINGTON — The expected decline of coal production amid growing momentum for climate change action makes it urgent for municipal bond market participants to demand more disclosure, according to a Brookings Institution expert.

Adele C. Morris, a senior fellow and policy director for Climate and Energy Economics at Brookings, said better disclosure is needed to highlight risks certain local economies face from relaying on the increasingly obsolete energy source.

"Local governments — including coal-reliant counties — have yet to grapple with the implications of climate policies for their financial conditions," according to a paper Morris delivered Monday at the Brooking Institution's 8th Annual Municipal Finance Conference. It was co-authored by Noah Kaufman of the Columbia University SIPA Center on Global Energy Policy and Siddhi Doshi of Brookings.

Morris said a "fiscal tsunami" is heading toward coal-backed assets and that "vague and "incomplete" disclosures often seen now in bond documents from issuers heavily reliant on the coal industry create bad governance and may also violate regulatory obligations to bondholders.

"The municipal finance industry can do a better job of determining what the impact of the coal industry means," Morris said in an interview. "If we're going to do something significant on climate change, or even something modest, it's going to have a disruptive impact on the coal industry."

A "moderately stringent" climate policy could create potential declines in U.S. coal production of around 75% in the 2020s, according to Morris. Coal production dipped by one-third between 2007 and 2017 due largely to lower costs for natural gas and renewables coupled with air quality regulations and clean electricity standards, she said.

Morris noted that despite regulations requiring disclosures of financial risk posed to municipalities, a review of outstanding bonds in coal-reliant localities showed "uneven" and in some cases "misleading" by omission information about climate risks. Credit rating agencies have also failed in many cases to highlight risks from dependence on coal revenues, Morris said.

"It is up to municipal bond market participants to determine ways to account for risks from the coal industry," Morris said. "The problem is not going to go away, so we'd best pay attention."

Debt issuance from state governments that top coal-producing rankings made up about 10% of the $388 billion of total bond volume in 2018, according to data from MSRB's Electronic Municipal Market Access website. Morris noted that some of the bond maturities extended to 2039, which would fall nearly a decade after a 2030 date when the U.S. Energy Information Administration projects the nation's coal production will fall 77% below 2016 levels.

The complex nature of tracking coal revenue creates some barriers toward transparency in the municipal market space. Most states have some version of tax levy for severing valuable deposits like coal that can prove to be very volatile. Morris noted that West Virginia's severance taxes garnered $483 million of revenue in 2011 and then just $262 million five years later in 2016, underscoring the fiscal effects of coal's downturn.

S&P Global Ratings credit analyst Timothy Little said that severance taxes such as those levied on coal extraction have greater revenue volatility than more common government revenue sources and can create budgetary pressures for issuers without revenue diversity.

"Broadly speaking, the decline of the coal industry has contributed to our view of more negative economic assessments and demographic changes in parts of the country," Little said.

Little, who is the agency's primary analyst for West Virginia and Kentucky, said S&P has encouraged "broad transparency" about volatile financial performance from declining coal production and will share in credit reports when they see risks. He said they ask coal-reliant issuers about revenue concentration, volatility and changes in large private employers.

"Management's preparedness for the pace and severity of climate change is an important credit consideration, whether the risk comes from rising sea levels and extreme weather events or economic changes to industries that contribute to climate change," Little said. "In coal-reliant communities we would want to know what management is doing to offset the risk of plant or mine closings, the effect it may have on the tax base or regional economy, and if revenue flexibility exists should coal-related revenues decline."

The coal industry's negative projections underscore the need for policymakers to prioritize expanding their economies and revenue systems, Morris said. She said that achieving noticeable changes won't be easy since coal-dependent localities have been intertwined with the industry for generations.

"Coal-reliant communities need to diversify their economies," Morris said, "but that is a challenge since many of these areas are remote and may require major environmental cleanups to attract investment."

By Andrew Coen

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