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DATA–CORNER

A Monthly Update From CDIAC's Data Collection and Analysis Unit

Credit Rating Fees in California, 2008-2023

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In the December 2023 edition of *Debt Line*, the California Debt and Investment Advisory Commission (CDIAC) published "Credit Rating Activity in California, 2008-2022," a review of the use of credit ratings for publicly issued state and local government (public agency) debt in California. The article stated that from January 1, 2008 through December 31, 2022, 88.3% of long-term debt issuance (by volume) had obtained at least one credit rating, and that while the use of multiple credit ratings has declined over the review period, over two-thirds of rated public agency debt (by volume) still had more than one rating.[1]

While information on credit rating criteria and rating models is readily available, information relative to how the cost of a credit rating is assessed is not. Each credit rating agency has its own methodology to determine the costs of a rating which is conveyed, in part, through their annual fee schedules, but the schedules establish wide ranges for the cost of a credit rating. Various factors affect where a rating fee will land within the broad ranges established in the schedules. A 2014 credit rating agency disclosure, stated that rating fees are based on sector, par amount, structure, and complexity of the transaction."[2] Additional factors that are widely thought to affect the rating fee are the nature of the repayment revenue source and an issuer's frequency in the market.

A credit rating represents a substantial cost of issuance, but obtaining one or more credit ratings may provide a material net benefit to issuers' cost of borrowing. The Government Finance Officers Association (GFOA) recommends careful evaluation of the need and benefit of obtaining one or more credit ratings for a debt issue.[3] Further, GFOA recommends that issuers negotiate the fee structure before requesting a credit rating. Evidence of general variability among the ratings fees charged provides support for GFOA's recommendations.

This article reviews the credit rating fee information reported to CDIAC for public agency debt issues from January 1, 2008 through December 31, 2023 (Review Period). While the data and analysis that follows does not solve for the method used to determine credit rating fees, it does show the breadth of fees reported to

1 Shih, Jean and Dunn, Tara, "Credit Rating Activity in California, 2008-2022," CDIAC, *Debt Line*, Vol. 42, No. 12, December 2023, www.treasurer.ca.gov/cdiac/debtpubs/2023/202312.pdf.

2 Joffe, Marc, "Doubly Bound, The Cost of Credit Ratings," Haas Institute, Accessed, June 28, 2024, https://belonging.berkeley.edu/sites/default/files/haasinstitute_doublybound_creditratings_april11_publish.pdf.

3 Using Credit Rating Agencies, Government Finance Officers Association, Best Practices, September 30, 2015.

CDIAC and provides some insight into factors that issuers may want to consider in their debt issuance planning and preparation. The data in this article is available through CDIAC's **DebtWatch** website and may be helpful to issuers in their decisions to obtain one or multiple credit ratings or to facilitate the negotiation of the best price for a rating as provided in GFOA's ***Using Credit Rating Agencies*** best practice guidance.

REVIEW OF DATA SET

For this review, the data set was derived from issuance information reported to CDIAC through Reports of Final Sale. The data set consists of 8,791 issues with at least one rating and a maturity greater than 540 days. Approximately 84.7% of all debt issued during the Review Period reported having at least one rating.[4]

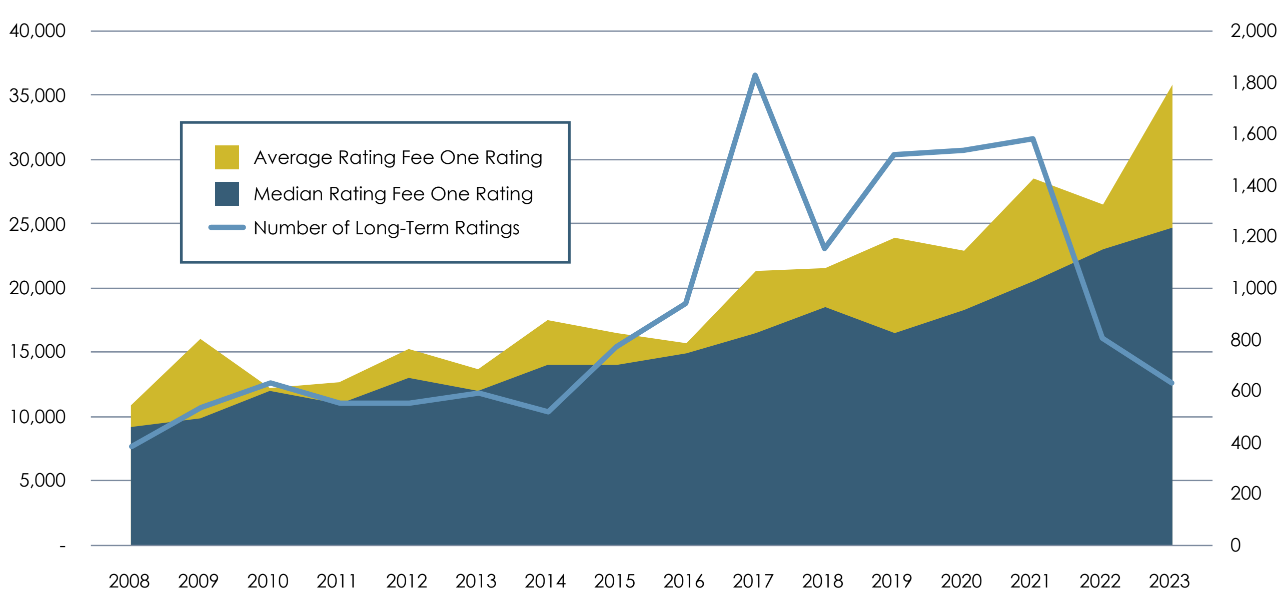
During the Review Period, both the average and median rating fee for debt issuances with one credit rating showed an overall upward trend (Figure 1). The general increase in average and median rating fees annually and the degree of change year-to-year is consistent with the practice of rating agencies updating their fee schedules every year. The greatest period of fee growth was from 2019 through 2023, where the median rating fee went from \$16,500 to \$24,703, an increase of 49.7% over the four-year period or a 10.6% annualized increase.

The number of long-term ratings is included in Figure 1 to illustrate the volume of long-term debt rating activity for California issues during the Review Period and provides context for the trends in credit rating fees. As was discussed in the December 2023 article, the number of long-term issues with one or no rating started to increase while those with two and three ratings showed a downward trend starting in 2009.[5] Evidence of this trend is supported by the decline in the total number of ratings from 2010 through 2014.

Rating activity began a steep increase in 2015 and peaked in the 2017 rush to market created by the pending implementation of the Tax Cuts and Jobs Act of 2017. The record high number

Figure 1

AVERAGE AND MEDIAN CREDIT RATING FEE FOR ISSUANCES WITH ONE RATING
JANUARY 1, 2008 – DECEMBER 31, 2023, AS REPORTED TO CDIAC



4 CDIAC **DebtWatch** Database. Data as of May 28, 2024, includes 8,791 issuances that had at least one rating; 4,503 issuances with one rating, 2,843 issuances with two ratings, 1,439 issuances with three ratings, and 6 issuances with four ratings. Local obligation debt purchased by a joint powers authority under the Marks-Roos Bond Pooling Act of 1985 are not included.

5 Shih, Jean and Dunn, Tara, "Credit Rating Activity in California, 2008-2022," CDIAC, *Debt Line*, Vol. 42, No. 12, December 2023, Figure 1, **www.treasurer.ca.gov/cdiac/debtpubs/2023/202312.pdf**.

of ratings reported to CDIAC in 2017 did not result, however, with a related spike in the average or median rating fees. Fees continued their gradual annual growth rate and pattern during that period of high demand. This may be an indication that issuers were able to negotiate fees even as there was a greater demand for ratings.

CREDIT RATING FEE PER $1,000 OF PRINCIPAL ISSUED

CDIAC analyzed the rating fees reported per $1,000 of principal issued as a method to adjust for the inflation in sectors associated with the expenditures of long-term debt proceeds. During the Review Period, the **median** credit rating fee per $1,000 of principal issued with one credit rating started at $0.95 in 2008 and ended at $1.14 in 2023, representing an annualized growth rate of 1.2% over the 15-year period (Figure 2). The cost of the median credit rating per $1,000 of principal issued gradually increased and did not show large decreases or increases over the Review Period.

The **average** credit rating fee per $1,000 of principal for issues with one credit rating started at $1.24 in 2008 and ended at $2.18 in 2023, representing an annualized growth rate of 3.8% over the 15-year period. The average rating fee per $1,000 did spike when issuance dramatically increased in 2017 and there was an unprecedented demand for ratings.

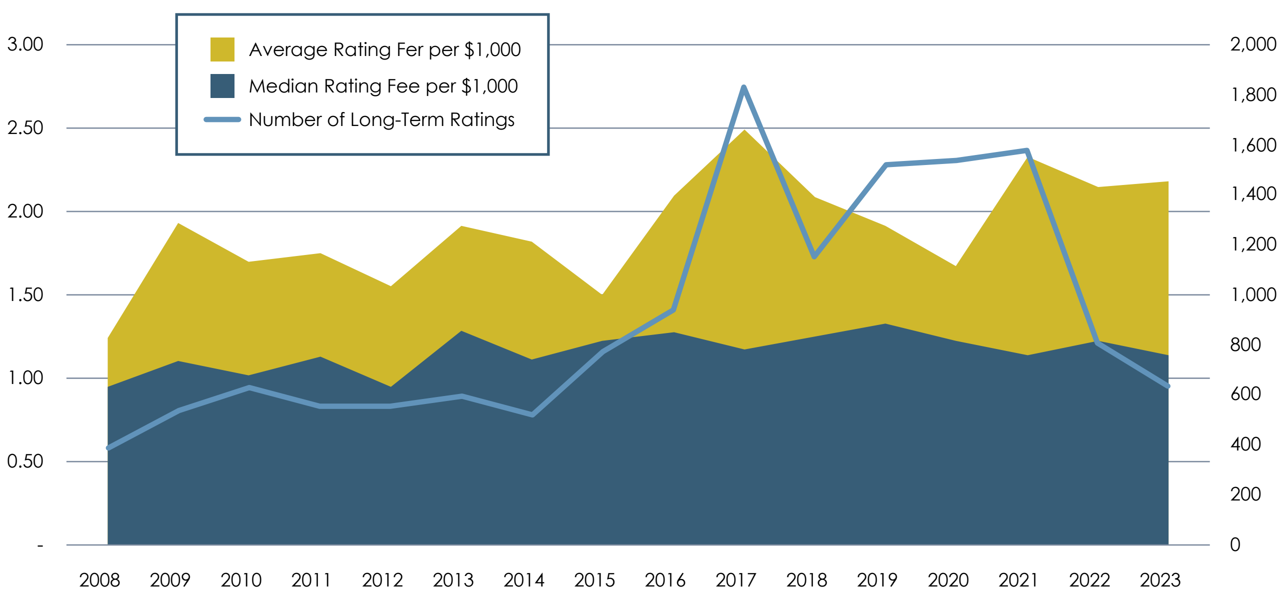
The positive growth rate of both the median and average rating fee per $1,000, suggests that the cost of ratings has outpaced inflation over the review period.

2023 CREDIT RATING FEES PER $1,000 OF PRINCIPAL ISSUED

Reviewing a smaller data set consisting of rating fees per $1,000 of principal issued in CY 2023 with a single rating highlights the variability of fees charged to public agency issuers.[6] A regression analysis revealed a negative correlation between principal amount of the municipal debt issuance and credit rating fee per $1,000 of principal issued.[7] As the principal amount increases, the credit rating fees per $1,000 of principal issued declines (Figure 3). For debt issuance with one credit rating in CY 2023, the range of credit rating fees per $1,000 of prin-

Figure 2

AVERAGE AND MEDIAN CREDIT RATING FEE PER $1,000 OF PRINCIPAL ISSUED FOR ISSUES WITH ONE RATING
JANUARY 1, 2008 – DECEMBER 31, 2023, AS REPORTED TO CDIAC

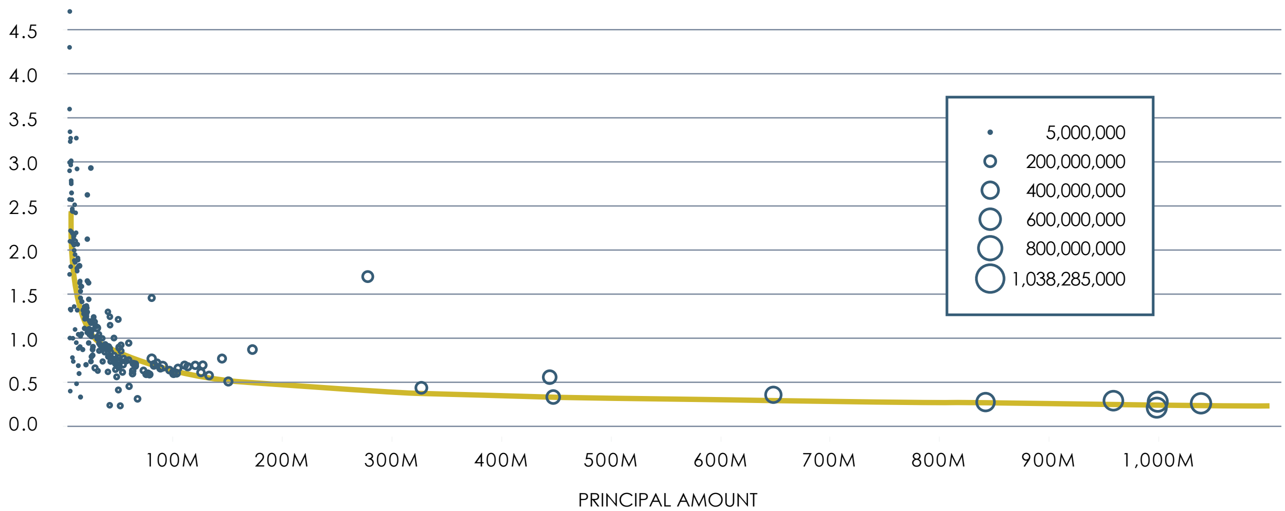


[6] For CY 2023, there were 279 issues with a single rating.

[7] R-Squared: .604, P-value: <0.0001.

Figure 3

CREDIT RATING FEES PER $1,000 FOR ISSUANCES WITH ONE RATING
JANUARY 1, 2023 – DECEMBER 31, 2023, AS REPORTED TO CDIAC



cipal issued varied greatly from above $5 to below $0.4, with the highest fees for issuances less than $50 million. This could mean that there is a certain amount of fixed costs associated with a rating, so the smaller the issue, the fee per $1000 issued increases.

To see the impact that multiple ratings may have on the rates charged to issuers, the review was broadened to include all rated debt issued by volume in CY 2023. This data set of 408 issues includes debt issued with one, two, or three ratings. Debt issuances with a higher principal amount generally carry a higher rating fee per rating, despite the number of credit ratings used on an issuance. However, the analysis indicated average rating fee for issues with multiple ratings increased less rapidly as principal increased when compared with the rating fee for issues with one rating (Figure 4). Debt issued with three ratings, appeared to have the best price per rating as the amount of issuance increased over $100 million, approximately. Beyond the $100 million mark, the spread of average rating fees from the regression line grows, especially on issues with multiple ratings.[8] The variability of rating fees charged to issuers in CY2023, especially on larger multi-rating issues, may also support considerations to negotiate rating fees.

CONCLUSION

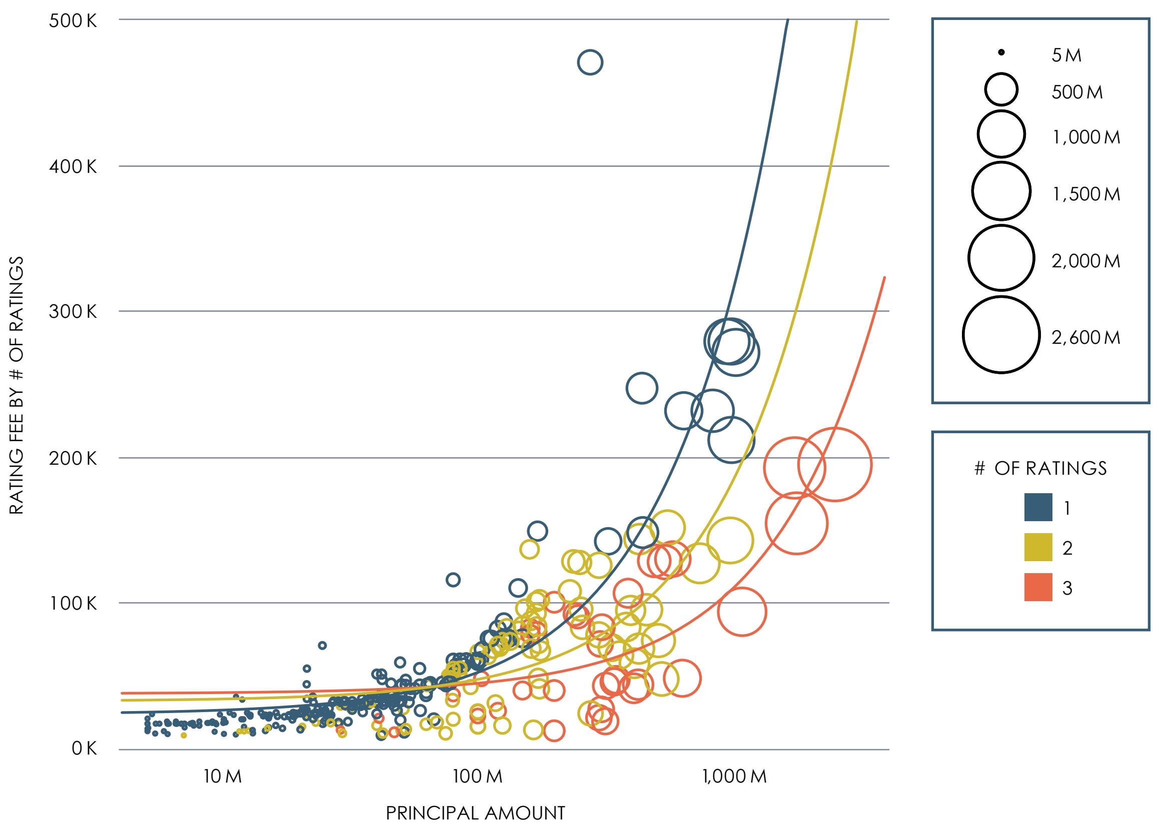
The rating fee data in this article is reported to CDIAC by issuers within 21 days of issuance and is made available on **DebtWatch**. This information can be used to help issuers be informed about the costs of obtaining a rating and generally, the fees that have been charged to other public issuers. Given the variance in rating agency fees charged to public issuers, CDIAC encourages issuers, with the assistance of their municipal advisors, to engage in active communication with potential credit rating agencies to understand and negotiate the credit rating fee amount for a future issuance. Although not the subject of this analysis, it is important for issuers to consider not only the initial cost of obtaining a rating but the cost of ongoing annual surveillance fees or other supplemental fees that may be charged depending on the credit rating agency and applicable base fee schedule.

CDIAC will continue to monitor these debt issuance and rating fee trends and update the analysis as more information is received or if issuance trends change. On November 19, 2024, CDIAC will be presenting **Practical Adaptations to the Evolution of Credit Ratings**, a webinar on the use of credit ratings and how the role of rating agencies has changed over time as market needs and expectations have evolved. Registration for this program is coming soon.

[8] 1 Rating R-Squared: .687, P-value: <0.0001; 2 Ratings R-Squared: .451, P-value: <0.0001; 3 Ratings R-Squared: .608, P-value: <0.0001.

Figure 4

CREDIT RATING FEES BY NUMBER OF RATINGS AND VOLUME
JANUARY 1, 2023 – DECEMBER 31, 2023, AS REPORTED TO CDIAC



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