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*Debt Line* publishes articles on debt financing and public fund investment that may be of interest to our readers; however, these articles do not necessarily reflect the views of the Commission.

Business correspondence and editorial comments are welcome.

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# DATA–CORNER

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

## Credit Rating Activity in California, 2008-2022

*By Jean Shih and Tara Dunn*

In the early stages of the debt issuance process, a public agency will determine whether to obtain a credit rating for its debt. Although a credit rating is not legally required when issuing public debt, issuers often choose to obtain a credit rating to improve the marketability of their bonds and affect lower financing costs. A review of public debt issued and reported to CDIAC from January 1, 2008 through December 31, 2022 (Review Period), shows that 88.3% of long-term debt issued (by volume) had a credit rating.[1] Not only does the data reflect a strong tendency to issue rated debt, but it also shows that over two-thirds of public agency debt (by volume) had more than one rating. This article will address the use of credit ratings in the issuance of debt by public agencies over the Review Period, including trends in the use of multiple ratings by issuance and volume issued.[2]

RATED ISSUES BY NUMBER. The total number of debt issues reported during the Review Period was 24,426, with volume totaling over $909 billion. Of the total number of issues reported, 44.7% had at least one credit rating and unrated transactions totaled 55.3%. While the number of unrated issues exceeds the number of rated issues, more than half of the unrated issues were for private energy conservation improvements (PACE) averaging less than $1 million each.[3] The manner by which PACE issues are reported to CDIAC leads to an artificially inflated count of issues. Therefore, for the purpose of examining ratings by the number of issues, PACE-related debt was excluded.[4] Figure 1 illustrates the percentage of the total number of issues that were in one of five categories based on the number of credit ratings assigned at issuance to the debt over the Review Period.

Debt issuances with no rating represented 36.6% of all issues over the Review Period but have increased from 24.8% of the debt transactions in 2008 to 54% of the debt transactions in 2022, a positive change of 118%. This relative increase of unrated debt has been fueled more recently by debt provided by sources like state and federal loan programs and direct lending by banks which do not include a rating in the classic sense. These forms of debt are reported to CDIAC and included in the total number of issues.

[1] For purposes of this review, long-term refers to debt with long-term credit rating; therefore, notes and commercial paper are not included in this review. In addition, local obligations purchased by a joint powers authority under the Marks-Roos Bond Pooling Act of 1985 are also not included in this review.

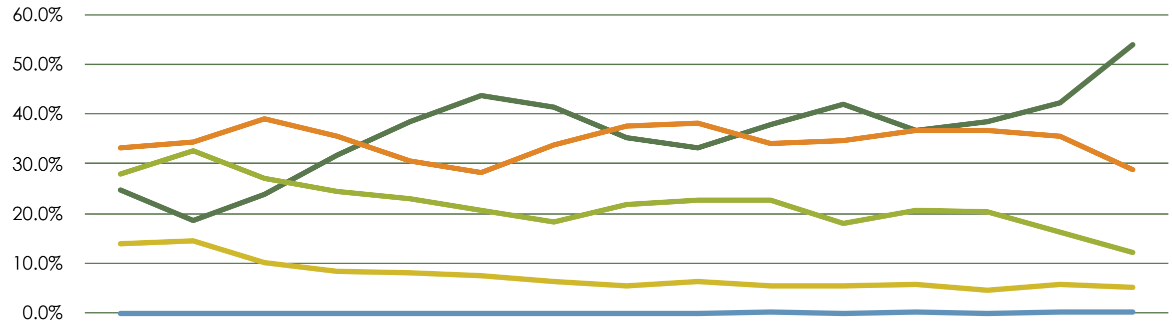
[2] CDIAC DebtWatch Database, https://debtwatch.treasurer.ca.gov/. Data as of October 20, 2023.

[3] Residential and commercial energy conservation improvements, and certain seismic safety improvements consist primarily of loans issued pursuant to a Property Assessed Clean Energy (PACE) program in California.

[4] To analyze the percentage of credit rating use by the number of transactions each year for more typical municipal debt issues, PACE-related debt was excluded in Figure 1.

## Figure 1

PERCENTAGE OF TOTAL DEBT ISSUES BY NUMBER OF CREDIT RATINGS PER ISSUE, JANUARY 1, 2008 – DECEMBER 31, 2022




| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| NO RATING | 24.8% | 18.6% | 23.8% | 31.6% | 38.4% | 43.7% | 41.5% | 35.3% | 33.1% | 37.8% | 42.0% | 36.7% | 38.6% | 42.4% | 54.0% |
| 1 RATING | 33.2% | 34.4% | 39.1% | 35.7% | 30.7% | 28.3% | 33.9% | 37.7% | 38.1% | 34.1% | 34.6% | 36.8% | 36.7% | 35.4% | 28.9% |
| 2 RATINGS | 28.1% | 32.6% | 27.2% | 24.4% | 22.9% | 20.5% | 18.3% | 21.7% | 22.6% | 22.7% | 17.9% | 20.7% | 20.2% | 16.3% | 12.1% |
| 3 RATINGS | 13.9% | 14.3% | 10.0% | 8.4% | 8.1% | 7.5% | 6.3% | 5.2% | 6.3% | 5.2% | 5.5% | 5.7% | 4.4% | 5.7% | 5.0% |
| 4 RATINGS | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.1% | 0.0% | 0.1% | 0.0% | 0.1% | 0.1% |

Source: CDIAC DebtWatch Database, October 20, 2023.

The percentage of debt issues with one rating was relatively consistent over the Review Period, falling within the range of approximately 30-40%. However, different trends appear when examining issues with multiple ratings. Issues assigned two credit ratings decreased from 28.1% in 2008 to 12.1% in 2022, a decline of 57%. The decline in the percentage of issues with three ratings was even greater. Debt issued with three credit ratings fell from 13.9% of issues in 2008 to 8.9% of issues in 2022, a decline of 64%.

RATED ISSUANCE BY VOLUME. An analysis of rated issuance by volume controls for the idiosyncrasies of how certain types of debt are reported to CDIAC, specifically the splitting of issues for reporting purposes. For this reason, this examination of ratings by volume includes all debt issuance during the Review Period, including PACE-related debt.

Issuance with multiple ratings represented 72% of the total volume for the Review Period. Long-term debt with three credit ratings constituted approximately 39% of volume with $354.8 billion. Debt issuance with two credit ratings totaled $305.7 billion or 33.6% of total volume. Debt with one rating totaled $141.5 billion, or 15.6%. Unrated debt represented 11.7% of total volume issued. Public debt with four ratings was issued very infrequently, totaling less than 1% of total volume with approximately $874 million.

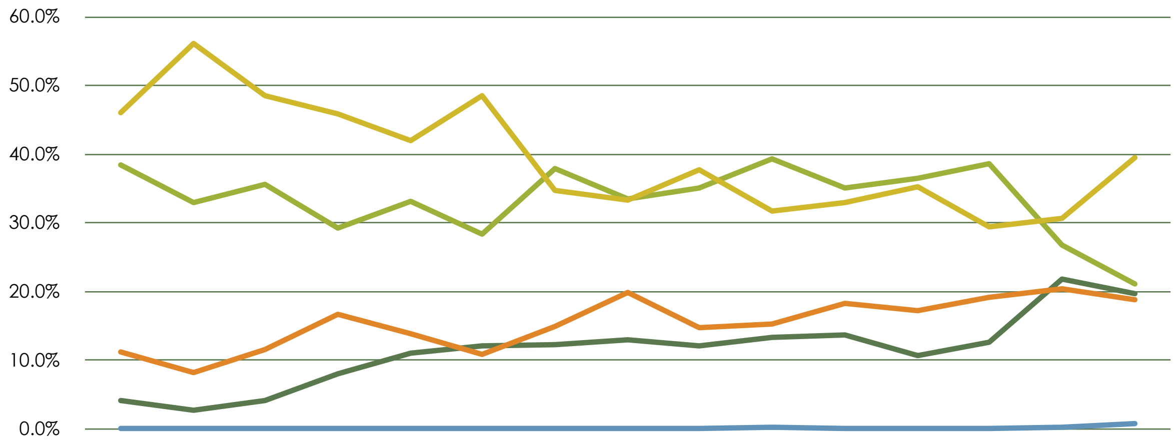
While nearly 73% of total volume during the Review Period was issued with two or three ratings, a review of each year in the Review Period shows trends in ratings practices that are similar to those seen in the per-issue analysis (Figure 2).

Unrated debt has risen from its lowest point of almost 3% in 2009 to nearly 20% in 2022. The relative share of debt with one rating has more than doubled from the low point of nearly 8% in 2009 to almost 19% in 2022. The decline in the issuance of debt with two ratings was not as linear. Issuance volume with two ratings declined from 2008 until 2013, then grew to over 36% on average between 2014 and 2020, only to decline more recently to approximately 21%. Aside from the most recent spike in volume with three ratings, 39% in 2022, the three-rating category has declined rather steadily from its peak in 2009 of 56.2% to around 30% in 2020 and 2021. Examination of the trends seems to indicate a marked shift in rating practices in 2014, with a steep drop in three rating volume met with a countervailing two rating volume increase.

USE OF MULTIPLE RATINGS. A credit rating is an important factor influencing the interest cost on a bond issuance. Generally, it is thought that rated debt has an interest rate advantage to the issuer over unrated debt, but

**Figure 2**

PERCENTAGE OF TOTAL DEBT VOLUME BY NUMBER OF CREDIT RATINGS PER VOLUME ISSUED
JANUARY 1, 2008 – DECEMBER 31, 2022, IN BILLIONS




| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| NO RATING | 4.2% | 2.7% | 4.2% | 8.1% | 11.0% | 12.2% | 12.3% | 13.0% | 12.2% | 13.4% | 13.7% | 10.7% | 12.7% | 21.8% | 19.7% |
| 1 RATING | 11.2% | 8.2% | 11.5% | 16.8% | 13.9% | 10.9% | 15.0% | 20.0% | 14.9% | 15.3% | 18.3% | 17.3% | 19.2% | 20.4% | 18.9% |
| 2 RATINGS | 38.5% | 33.0% | 35.7% | 29.2% | 33.1% | 28.4% | 37.9% | 33.6% | 35.1% | 39.4% | 35.1% | 36.5% | 38.6% | 26.8% | 21.2% |
| 3 RATINGS | 46.2% | 56.2% | 48.6% | 45.9% | 42.0% | 48.5% | 34.7% | 33.4% | 37.9% | 31.7% | 32.9% | 35.4% | 29.5% | 30.6% | 39.5% |
| 4 RATINGS | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.2% | 0.0% | 0.1% | 0.0% | 0.3% | 0.7% |

Source: CDIAC DebtWatch Database, October 20, 2023.

there are a variety of reasons why an issuer may elect to obtain more than one rating. Issuers may obtain multiple ratings in order to improve marketability and demand from certain segments of the municipal market. For example, certain institutional investors require that debt included in their portfolios must meet a threshold credit rating from at least two ratings agencies. It is also commonly thought that secondary market liquidity, a characteristic in demand particularly among institutional investors that trade large lots, is enhanced by having multiple ratings. This market preference tends to be more applicable on large volume issuances. Alternatively, marketability may not be the primary factor in choosing to issue debt with multiple ratings. Some issuers, for example, might choose to issue their debt with multiple ratings because it is a long-standing practice or to maintain engagement with multiple rating agencies.

CONCLUSION. Public debt issuance from January 1, 2008, through December 31, 2022, showed that while the use of credit ratings remained strong with 80.3% of debt issued by volume reporting a rating in 2022, the number of credit ratings used has changed during the Review Period. As the markets evolved from the financial crisis in 2008, endured the changing interest rate environment, and survived a pandemic, structuring practices continue to favor the use of at least one credit rating for the issuance of public debt, but the number of issues reporting no rating or only one credit rating increased in both percentage of total number of transactions as well as annual volume from 2008 to 2022. CDIAC data indicates that the practice of borrowing using two or more credit ratings has declined, 59% on a per issue basis and 27% on a volume basis since 2008.

As interest rates have increased within the last few years, issuers should continue to evaluate the benefits of how they are using credit ratings to obtain the lowest cost of financing. CDIAC will continue to monitor the use of credit ratings and has future plans to examine rating agency fees reported per issue to provide additional analysis in changes in cost for the use of credit ratings.