MOODY'S INVESTORS SERVICE

CREDIT OPINION
30 March 2018

Update

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RATINGS

Yokohama, City of

Domicile	Japan
Long Term Rating	A1
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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City of Yokohama (Japan)

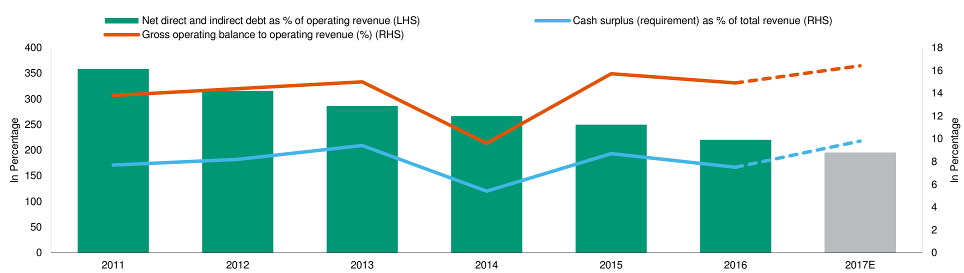
Update to credit analysis

Summary

The City of Yokohama's (Yokohama) A1 rating is at the same level as Japan's (A1 stable) sovereign rating, and reflects our view that the ratings of the central government, and the regional and local governments (RLGs) in Japan should be the same, because of their close links. The considerable level of oversight and supervision exercised by the central government, as well as the well-developed equalization system of transfers through the local allocation tax (LAT) system, ensures that any credit issues at the RLG level are identified and addressed early.

We believe there is a very high likelihood that the Japanese government will step in to provide immediate assistance in the event of an acute liquidity crisis. Yokohama's rating reflects the city's favorable fiscal performance and prudent management practices, but also its weaker economy compared with the national average and higher leverage because of its responsibility for infrastructure development.

Exhibit 1
Yokohama's solid fiscal performance will ease its debt burden



Fiscal year starting from April and ending in March of the following year. Our estimates for 2017 (ending in March 2018).
Source: Moody's Investors Service

Credit strengths

» Strong institutional framework is supported by the close relationship with the central government.

» Yokohama benefits from stable revenues to support favorable fiscal performance.

» Management practices are prudent to control expenditures.

Credit challenges

» The local economy is weaker than the national average.

» The responsibility for infrastructure development elevated its debt burden.

Rating outlook

The rating outlook is stable.

Factors that could lead to an upgrade

» An upgrade of the sovereign rating

Factors that could lead to a downgrade

» A downgrade of the sovereign rating. Furthermore, any policy changes that would materially weaken the highly centralized system or the level of oversight provided by the central government would trigger downward pressure on the rating.

Key indicators

Exhibit 2

City of Yokohama

Yokohama City	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016[1]
Net Direct and Indirect Debt / Operating Revenue (%)	358.6	315.7	286.2	266.3	249.8	220.1
Interest Payments / Operating Revenue (%)	4.2	4.0	3.5	3.3	2.9	2.7
Gross Operating Balance / Operating Revenue (%)	13.8	14.4	15.0	9.6	15.7	14.9
Cash Financing Surplus (Requirement) / Total Revenue (%)	7.7	8.2	9.4	5.4	8.7	7.5
Capital Spending / Total Expenditures (%)	24.7	23.7	21.8	20.8	23.4	20.1
Unemployment Rate (%) [2]	4.5	4.4	3.9	3.4	3.3	3.0
Population ('000s)	3,629	3,708	3,717	3,727	3,734	3,731

[1] Fiscal 2016 from 1 April 2016 through 31 March 2017. [2] Kanagawa Prefecture.
Source: Moody's Investors Service

Detailed credit considerations

Yokohama City's A1 rating combines (1) its Baseline Credit Assessment (BCA) of a3, and (2) the very high likelihood of extraordinary support from the central government in the event that the entity faces acute liquidity stress.

Baseline Credit Assessment

Strong institutional framework is supported by the close relationship with the central government

RLGs in Japan benefit from a highly developed, predictable and stable institutional framework. This protective arrangement contributes notably to their credit strength through the central government's oversight of RLG performance and provision of fiscal transfers that reduce fiscal disparities. Under the New Revival Law, passed in June 2007, RLGs' fiscal operations are overseen by the central government, which uses various fiscal indicators to monitor their performance. If an entity's indicators exceed defined thresholds, it is identified as either an early-correcting entity or a revival entity and must then carry out plans to improve its fiscal situation.

We believe that this law, which covers a wide range of local government activities, reflects the central government's strong resolve to reduce the risk of a financial crisis at the local level and bolster the local sector's credit risk profile. Japanese RLGs have limited flexibility in terms of own-source revenue. The country's Local Tax Law determines the tax base available to RLGs and limits the range of permitted tax rates. For each major local tax, RLGs may apply the standard rate or a higher rate, up to a prescribed maximum.

Depending on the tax, the maximum rate is typically 10%, or 50% higher than the standard rate, although in some cases (for example, the inhabitants tax on individuals and property tax) there is no legal maximum. While an RLG may impose a tax not specified in the Local Tax Law, the Minister of Internal Affairs and Communications (MIC) must first approve it.

Because of declines in national tax revenue (which is used to fund LAT transfers), as well as lower income from local taxes, the central government has allocated the issuance of specific amounts of rinzai-sai debt to the RLGs in place of LAT cash transfers. The larger RLGs, in particular, have been apportioned larger rinzai-sai amounts because the smaller RLGs have limited market access. The repayment of rinzai-sai debt servicing will be included in each RLG's future LAT transfers, which mitigates the impact on the local governments' budgets. However, since the central government has seen large shortfalls in the sources that fund LAT, we are monitoring the sustainability of the LAT transfer model, including the debt-servicing costs for rinzai-sai.

Yokohama benefits from stable revenues to support favorable fiscal performance

Yokohama's financial performance is favorable, as illustrated by its consistent operating margin (gross operating balance as a percentage of operating revenue) of 13%-15% over the past five years, with the exception of a slightly lower balance (of 9.6%) in the fiscal year ended March 2015 (fiscal 2014), owing to a one-time accounting change that hurt revenue. As of fiscal 2016, the city's operating margin recovered to around 15% from its fiscal 2014 level, and the recovery is likely to continue, backed by the city's fiscal discipline. Yokohama benefits from stable trends in revenue, supported by its tax revenue. Yokohama's tax revenue is less volatile than that of the country's prefectures and other large cities, given the city's higher share of property tax revenue and lower reliance on more volatile sources of tax revenue related to corporate businesses.

The largest component of operating spending in core government activities (general account, ippan kaikei) is personnel spending, which has remained flat at around ¥190 billion-¥200 billion over the past decade. In April 2017, the city started paying the salaries of public school teachers in its districts (instead of the regional government, which paid the salaries previously), which increased personnel expenditure to ¥350 billion through fiscal 2017.The regional government transferred an equal amount revenue resource to the city, hence there should be no effect on the city's fiscal balance. Debt service stayed at ¥190 billion over the same period. Social welfare spending (fujo-hi) grew at an annual average of 4.8% for the past five years. So far, the city has offset the rise in fujo-hi by reducing capital spending.

Similarly, constraints on capital spending have underpinned the postings of consecutive cash financial surpluses over the past five years, which in turn have led to a steady reduction in debt. The city has started some new infrastructure projects, such as the ringed networks. The city will accelerate some of these projects, aiming to complete them before the Tokyo 2020 Summer Olympic Games (Yokohama Ringed Northwest Line). Hence, the city's capital spending (at ¥217 billion in fiscal 2016) remained high, compared with the previous seven years. However, the city cut capital spending in fiscal 2017 by 17% compared with fiscal 2016, demonstrating its rigorous control on expenses. Therefore, the city is committed to constraining its new debt to ¥600 billion through the four years of its medium-term plan (2014-17).

Management practices are prudent to control expenditures

Yokohama has an excellent track record of fiscal discipline, controlling both operating and capital spending through strong internal controls and planning, which helps it better contain its spending through the cycles. The city has focused its fiscal strategy on containing spending because of its relatively lower level of tax revenue from the business sector. In some other jurisdictions, faster tax revenue growth tended to drive also faster expenditure growth which could not be curved easily when tax revenue growth muted.

Yokohama has clear and prudent debt management and investment policies, as well as guidelines to ensure that the city minimizes its exposure to investments and debt structures that pose financial risks. The city also provides high-quality information, thereby ensuring transparency and timely delivery and accuracy of disclosures. In addition, the city's audit process is in line with the national legal framework.

The local economy is weaker than the national average

Yokohama is a residential suburb for the Tokyo Metropolitan Area, with many of its 3.7 million residents commuting to jobs in central business districts. The relatively lower level of commercial and manufacturing activities located in Yokohama, along with its large population, results in the city's relatively low GDP per capita (86% of the national average).

However, in our view, this measure of economic performance somewhat understates the city's economic importance because the city benefits from a stable, well-diversified service base and higher-income households. We expect the city to continue to enjoy a broader and more stable tax base (notably, the high market value of taxable properties to support its property taxes) than other municipalities in Japan.

The responsibility for infrastructure development elevated its debt burden

Yokohama has a relatively high debt burden, amounting to 220% of revenue. Similar to other designated cities in Japan, Yokohama's debt profile reflects the cost of infrastructure operations, such as water, sewage, mass transport, roads, ports, as well as land redevelopment projects. The city relies on significant levels of debt financing to provide the needed facilities to a rapidly increasing number of households. Yokohama's debt levels have been falling because the city's gross debt peaked at ¥5,028.2 billion in fiscal 2003 (March 2004) and decreased to ¥4,174 billion in March 2017. Given the current recovery in capital spending, the city's debt will increase slightly to ¥4,192 billion as of March 2018. However, we do not expect the city to reverse the trend of debt reduction because it continues to control capital spending.

We expect Yokohama's debt to decrease faster if its infrastructure projects operated more efficiently and were able to generate higher revenue. The city continues to subsidize mass transportation (subway and bus) for policy purposes, allowing the elderly to travel for free or at a discount. Yokohama will also have to prepare for additional maintenance expenses, which may need to be funded by debt, resulting in the city's debt metrics taking longer to improve. Yokohama has a strong liquidity position, with sufficient financial assets to cover debt servicing for the 12 months ending 31 March 2018. In addition, the city has short-term bank facilities that can cover its annual debt service.

The city's debt repayment fund (totaling an expected ¥98.1 billion for March 2018) and estimated cash surplus will be sufficient to cover debt servicing in its general account, including principal payments of ¥81.8 billion (excluding fund contributions) and interest of ¥29.1 billion, as planned for fiscal 2018. We expect the city to continue to have strong access to the domestic capital markets, which we view as deep and mature. The city does not issue foreign-currency debt. The negative interest rate policy implemented by the Bank of Japan in February 2016 will not lead to a rapid change in the city's funding conditions, given that funding costs are already low and only a fraction of the city's debt will be refinanced at significantly lower rates.

Extraordinary support considerations

We assume a very high likelihood of extraordinary support for the city from the national government, reflecting our assessment of Japan's highly centralized system of local government, as well as the country's unique history of risk socialization.

Output of the Baseline Credit Assessment Scorecard

For Yokohama, the BCA matrix generates an estimated BCA of a3, the same as the BCA of a3 assigned by the Rating Committee. The matrix-generated BCA of a3 reflects (1) an idiosyncratic risk score of 3 (presented below) on a 1-9 scale, where 1 represents the strongest relative credit quality and 9 represents the weakest; and (2) a Systemic Risk score of A1, as reflected in the sovereign bond rating (A1 stable).

Rating methodology and scorecard factors

Exhibit 3

City of Yokohama

Fiscal 2016

Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Scorecard						
Factor 1: Economic Fundamentals						
Economic strength	7	85.74	70%	5.2	20%	1.04
Economic volatility	1		30%			
Factor 2: Institutional Framework						
Legislative background	1		50%	3	20%	0.60
Financial flexibility	5		50%			
Factor 3: Financial Performance and Debt Profile						
Gross operating balance / operating revenue (%)	1	14.37	12.5%	3.25	30%	0.98
Interest payments / operating revenue (%)	3	2.84	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenue (%)	9	220.10	25%			
Short-term direct debt / total direct debt (%)	1	8.10	25%			
Factor 4: Governance and Management - MAX						
Risk controls and financial management	1			1	30%	0.30
Investment and debt management	1					
Transparency and disclosure	1					
Idiosyncratic Risk Assessment						2.92(3)
Systemic Risk Assessment						A1
Suggested BCA						a3

Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
YOKOHAMA, CITY OF	
Outlook	Stable
Issuer Rating	A1
Senior Unsecured -Dom Curr	A1

Source: Moody's Investors Service

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