MOODY'S
INVESTORS SERVICE

CREDIT OPINION
19 March 2021

Update

Rate this Research

RATINGS

Yokohama, City of

Domicile	Yokohama, 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.

Contacts

Hiroe Yamamoto +81.3.5408.4175
Analyst
Moody's Japan K.K.
hiroe.yamamoto@moodys.com

Haruka Saito +81.3.5408.4223
Associate Analyst
Moody's Japan K.K.
haruka.saito@moodys.com

Mihoko Manabe, CFA +81.3.5408.4033
Associate Managing Director
Moody's Japan K.K.
mihoko.manabe@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

City of Yokohama (Japan)

Update to credit analysis

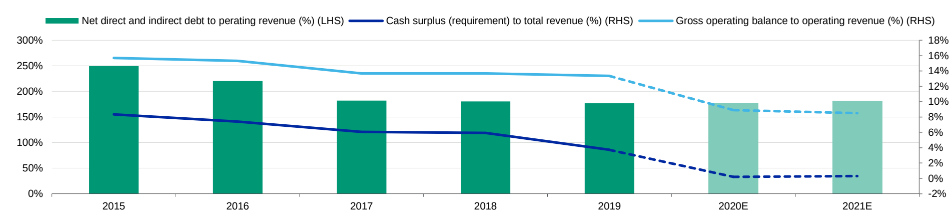
Summary

The credit profile of the City of Yokohama (Yokohama, A1 stable) reflects our view that the rating of the Government of Japan (A1 stable) and those of the regional and local governments (RLGs) in Japan should be the same, given 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 credit issues at the RLG level are identified and addressed early. We also assess that there is a very high likelihood that the Japanese government would step in to provide immediate assistance. Yokohama's rating also reflects its prudent management practices; favorable fiscal metrics which will weaken; its economy, which is weaker than the national average; and its higher leverage because of its infrastructure development responsibility. The coronavirus pandemic is creating overall fiscal pressures for RLGs.

Exhibit 1

Yokohama's fiscal metrics will weaken because of the impact of the coronavirus



Fiscal year starting from April and ending in March of the following year. Our estimate for fiscal 2020-21.
Source: Moody's Investors Service

Credit strengths

» Its strong institutional framework is supported by its close relationship with the central government.

» Prudent management practices control expenditure.

Credit challenges

» Favorable financial metrics to weaken from the pandemic.

» The local economy is weaker than the national average.

» Although improving, high debt burden from the responsibility for infrastructure development.

Rating outlook

The rating outlook is stable, reflecting the outlook on Japan's sovereign rating.

Factors that could lead to an upgrade

An upgrade of the sovereign rating would lead to an upgrade of Yokohama's rating.

Factors that could lead to a downgrade

A downgrade of the sovereign rating would lead to a downgrade of Yokohama's rating. Furthermore, any policy changes that would significantly weaken the highly centralized system or the level of oversight provided by the central government could trigger downward pressure on the rating.

Key indicators

Exhibit 2

Yokohama City	FY2015	FY2016	FY2017	FY2018	FY2019[1]
Net Direct and Indirect Debt / Operating Revenue (%)	249.8	220.1	182.0	180.6	176.6
Interest Payments / Operating Revenue (%)	2.9	2.7	2.2	2.1	1.9
Gross Operating Balance / Operating Revenue (%)	15.7	15.3	13.7	13.7	13.3
Cash Financing Surplus (Requirement) / Total Revenue (%)	8.3	7.4	6.1	5.9	3.7
Capital Spending / Total Expenditures (%)	14.0	14.7	14.1	14.9	16.1
Unemployment Rate (%) [2]	3.3	3.1	2.7	2.3	2.1
Population ('000s)	3,734	3,737	3,740	3,749	3,762

[1] Fiscal 2019 began on 1 April 2019 and ended on 31 March 2020. [2] Kanagawa prefecture.
Source: Moody's Investors Service

Detailed credit considerations

The credit profile of Yokohama, as expressed in its A1 rating, combines its Baseline Credit Assessment (BCA) of a3 and 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 credit strength through the central government's oversight of RLGs' performance, as well as the provision of fiscal transfers that reduce fiscal disparities.

RLGs' fiscal performance is overseen by the central government under the New Revival Law, which relies on various fiscal indicators. 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. This law, which covers a wide range of RLG 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 with respect to 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%-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 Ministry of Internal Affairs and Communications must first approve it.

Because of insufficiency in the central government's tax revenue, which is used to fund LAT, the central government has allocated specific amounts of rinzai-sai debt (an operating debt approved by the Ministry of Internal Affairs and Communications) that are to be issued by the RLGs in place of LAT cash transfers from the central government. The larger RLGs, in particular, have been apportioned larger rinzai-sai amounts because the market access of small RLGs is more limited.

The amounts required for rinzai-sai debt service will be included in each RLG's future LAT subsidy. However, as the central government has seen shortfalls in sources that fund LAT, we are monitoring the sustainability of the LAT transfer model, including the rinzai-sai debt service. The amount of rinzai-sai debt has been contained over the past few years, along with the improvement in local tax revenue, allowing to reduce the fiscal transfers to cover shortfalls. Nevertheless, the decline in local tax revenue because of the pandemic effects will again result in rising rinzai-sai debt.

Amid the pandemic, the central government is providing support to RLGs, such as subsidies to cover costs to contain pandemic and to support local businesses, and a compensation for foregone property tax revenue as well as measures for tax payment deferrals.

Yokohama's favorable fiscal metrics will weaken from the effects of the pandemic

Yokohama's favorable financial performance, as illustrated by its consistent operating margin (gross operating balance as a percentage of operating revenue) of 13%-15% over the past five years, will weaken because of pressures from the pandemic to around 8% toward fiscal year ending 31 March 2022 (fiscal 2021) as a result of lower tax revenue and increasing operating expenditure, in particular the ongoing rise in social welfare cost.

Yokohama generally benefits from stable trends in revenue, supported by its tax revenue that is less volatile than that of the country's prefectures and other large cities, given the city's higher share of residential tax (49% of its tax revenue) and property tax revenue (34%), and lower reliance on more volatile sources of tax revenue related to corporate businesses. Nevertheless, the city budgets its tax revenue to decline by 6.1% in fiscal 2021 relative to the initial budget fiscal 2020 before the pandemic, in particular from weak corporate performance and employment, which weigh on its corporate and residential tax.

The largest component of its operating expenditure on core government activities (general account) is the social welfare cost, which continues to increase moderately, similar to that of other RLGs. The city budgets a 2.4% increase in fiscal 2021 from the fiscal 2020 initial budget.

New infrastructure projects have been carried forward by the city, such as the ring roads (Yokohama Ringed Northwest Line), which have been completed and started operations in March 2020. The city's capital spending will peak in fiscal 2021, with a 12.5% increase from that in the previous year, because of the asset purchase from Yokohama Road Construction. Excluding this, its capital spending would have been flat. The city's disciplined financial policies have allowed it to maintain consecutive cash surpluses which we expect to weaken toward next fiscal year but to remain positive.

Disciplined financial policies contain spending

Yokohama has track record of fiscal discipline, controlling operating and capital spending through strong internal controls and planning, which helps it better contain its spending through the cycles. One recent example is its long-term projection to 2065 that lays out plans for future revenue and spending. The city has focused its fiscal strategy on containing spending because of its relatively lower level of tax revenue from the business sector than other RLGs. In some other jurisdictions, faster tax revenue growth tended to accelerate expenditure growth, which could not be easily curbed when tax revenue growth declined.

Yokohama has clear and prudent debt management and investment policies to minimize the financial risk related to investments and debt. The city also provides high-quality information with disclosures that are transparent, timely and accurate. 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 3.76 million residents (as of March 2020) 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 of around 85% of the national average.

However, this measure of economic performance 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 have a broader and more stable tax base (the high market value of taxable properties will support its property taxes, which are relatively solid compared with corporate taxes, especially amid the pandemic) than other municipalities in Japan.

Although improving, high debt burden from the responsibility for infrastructure development

Yokohama's debt burden ratio (measured by net direct and indirect debt to operating revenue) remains high, amounting to 176.6% in fiscal 2019, although it improved from around 250% in fiscal 2015, largely because of a decline in its indirect debt.

Like other designated cities in Japan, Yokohama's debt profile reflects the cost of infrastructure operations, such as water, sewage, mass transport, roads, ports and land redevelopment projects. The city has relied on debt financing to provide the facilities to service an increasing number of households, but Yokohama's debt has fallen from the peak of ¥5,028.2 billion in fiscal 2003 to ¥4,143 billion in fiscal 2019. Nevertheless we expect the improvement to suspend toward end of fiscal 2021 from the higher financing needs to cover tax revenue shortfalls, including the rise in rinzai-sai debt.

Without the impact of the pandemic, the city would have been close to achieving its plan to limit the new debt issuance to around ¥590 billion for the four years of its medium-term plan (fiscal 2018-21). However, we do not expect the city to largely reverse the debt reduction trend, with its planned fiscal management.

We expect Yokohama’s debt will decrease faster if its infrastructure projects operate more efficiently and are able to generate higher revenue. Yokohama will also have to prepare for additional maintenance expenses, which may need to be funded by debt, resulting in the city's debt burden taking longer to improve.

In 2019, Yokohama officially announced its candidacy to host a casino-featuring integrated resort (IR), a central government initiative. IR is intended to be an economic development project to generate new employment opportunities and boost tourism over the long term. Meanwhile, although it is premature to estimate the impact, the city may need to increase capital spending to develop infrastructure, such as transport infrastructure to support the IR development.

Yokohama has strong liquidity, with sufficient financial assets to cover debt service in fiscal 2021. 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 ¥130.3 billion for end of March 2021) will be sufficient to cover debt servicing in its general account, including principal payments of ¥88.9 billion (excluding fund contributions) and interest of ¥23.7 billion, planned for fiscal 2021. The city continues to have strong access to domestic capital markets, which is deep and mature.

ESG considerations

How environmental, social and governance risks inform our credit analysis of Yokohama

We take into account the impact of environmental, social and governance (ESG) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of Yokohama, we assess the materiality of ESG factors to the credit profile as follows:

Environmental risks are not material to Yokohama’s rating, given its strong links with the central government. Although the country’s exposure to natural disasters has resulted in the requirement for large reconstruction and disaster prevention expenditures, the financial burden is mitigated by the central government’s strong support.

Social risks are not material to Yokohama’s rating, given its strong links with the central government. Although it is exposed to demographic risks, a nationwide phenomena of aging and low birthrate, as well as the pandemic, which is straining social welfare expenditure, the risks are mitigated by the equalization system and the central government's subsidies for pandemic-related costs.

Governance risks are material to Yokohama’s rating, but are mitigated by its strong links with the central government. Its governance is sound, with prudent management policies.

Further details are provided in the “Baseline Credit Assessment” section. Our approach to ESG factors is explained in our cross-sector rating methodology General Principles for Assessing Environmental, Social and Governance Risks Methodology.

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 the local government, as well as the country's unique history of risk socialization.

Rating methodology and scorecard factors

The assigned BCA of a3 is the same as the scorecard-indicated BCA of a3. The scorecard-indicated BCA of a3 reflects an Idiosyncratic Risk score of 3 on a scale of 1-9, where 1 represents the strongest relative credit quality and 9 represents the weakest; and a Systemic Risk score of A1, as reflected by the sovereign bond rating for Japan.

Exhibit 3

City of Yokohama, fiscal 2019

Regional and Local Governments

Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Scorecard						
Factor 1: Economic Fundamentals						
Economic strength	7	84.22	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	13.49	12.5%	2.75	30%	0.83
Interest payments / operating revenue (%)	3	2.00	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenue (%)	7	176.64	25%			
Short-term direct debt / total direct debt (%)	1	9.15	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						2.77(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	A1

Source: Moody's Investors Service

REPORT NUMBER 1257784

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

MOODY'S INVESTORS SERVICE