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CREDIT OPINION
6 April 2022

Update

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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.

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City of Yokohama (Japan)

Update to credit analysis

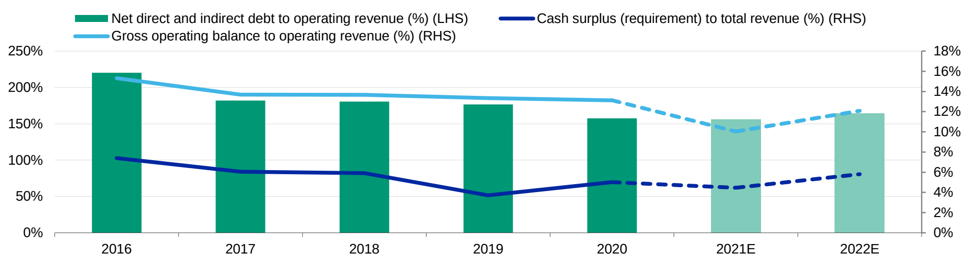
Summary

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; our expectations that its operating margin will recover; its economy, which is weaker than the national average; and its high debt burden because of its infrastructure development responsibility.

Exhibit 1

Yokohama's operating margin will recover from the pandemic



Fiscal year starting from April and ending in March of the following year. Our estimate for fiscal 2021-22.
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.

» Operating margin will recover from the pandemic.

Credit challenges

» The local economy is weaker than the national average.

» Debt burden remains high 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
City of Yokohama

Yokohama City	FY2016	FY2017	FY2018	FY2019	FY2020[1]
Net Direct and Indirect Debt / Operating Revenue (%)	220.1	182.0	180.6	176.6	157.5
Interest Payments / Operating Revenue (%)	2.7	2.2	2.1	1.9	1.6
Gross Operating Balance / Operating Revenue (%)	15.3	13.7	13.7	13.3	13.1
Cash Financing Surplus (Requirement) / Total Revenue (%)	7.4	6.1	5.9	3.7	5.0
Capital Spending / Total Expenditures (%)	14.7	14.1	14.9	16.1	14.4
Unemployment Rate (%) [2]	3.1	2.7	2.3	2.1	2.9
Population ('000s)	3,737	3,740	3,749	3,762	3,762

[1] Fiscal 2020 began on 1 April 2020 and ended on 31 March 2021. [2] Kanagawa prefecture. FY2020 data excludes the revenue and expenditure related to the central government's special cash transfers to the residents during the pandemic.
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 the 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 the 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 the 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 from the pandemic will result in a temporary rise in rinzai-sai debt.

During the pandemic, RLGs have been receiving support from the central government through subsidies to cover pandemic-related costs and to support local businesses, compensation for foregone property tax revenue or measures for tax payment deferrals.

Disciplined financial policies contain spending

Yokohama has a 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.

Yokohama's operating margin will recover from the temporary effects of the pandemic

We expect tax revenues will increase as economic activities grow and earnings of corporations located in the city improve. Higher revenues in turn will increase Yokohama's operating margin (measured as gross operating balance as a percentage of operating revenue) to 12% in the fiscal year ending March 2023 (fiscal 2022) close to the pre-pandemic level, from 10% estimates in fiscal 2021. Furthermore, higher tax revenue will reduce the city's need for funding, which also supports the improvement of its financial profile.

The city expects that its fiscal 2022 tax revenue will increase by 1.5% from fiscal 2021 results estimates. Alternatively, the city budgets to reduce the issuance of rinzai-sai debt.

The adverse effects from the pandemic appear more significantly in fiscal 2021 than in fiscal 2020 based on the previous fiscal year's taxable income. At the same time, the impact will be less than what the city initially budgeted.

Various subsidies and grants from the central government have largely covered pandemic related expenses, limiting the impact on the financial profile. Such subsidies will continue to be budgeted for fiscal 2022.

Yokohama generally benefits from stable revenue trends, 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 (close to 50% of its tax revenue) and property tax revenue (one-third of its tax revenue), and lower reliance on more volatile sources of tax revenue related to corporate businesses.

The predictability from its stable revenue and its prudent budget planning allows Yokohama to manage its expenditure amid rising social welfare cost. This cost is the largest component of its expenditure on core government activities (general account), which continues to increase moderately, similar to that of other RLGs.

The city's disciplined financial policies have allowed it to maintain some cash surpluses even during the peak of its capital spending program. Such spendings have amounted to over ¥230 billion (ordinary account) annually during the peak of the past three years to fiscal 2020. The program included large projects such as ring roads (Yokohama Ringed Northwest Line), which started operating in 2020. In the coming few years, we expect its capital spending to stabilize to around ¥200 billion (general account) annually. Current major projects include new redevelopment projects to host the flower show in fiscal 2027, infrastructure reinforcements and expansions such as wharf and railways as well as the implementation of disaster preventative measures.

Mayor Takeharu Yamanaka, elected in August 2021, has officially withdrawn Yokohama's candidacy to host a casino-featuring integrated resort (IR), a central government initiative. The former mayor led the candidacy, intending for the IR to be an economic growth project for the city to support its revenue by generating new employment opportunities and boost tourism over the long term. The new mayor plans to continue pursue the IR without the casino. Although it is premature to estimate the impact, the city may need to increase capital spending to develop infrastructure to support the IR development. At the same time, the city will need to find other ways to grow revenue instead of the casino.

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 2021) 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) than other municipalities in Japan.

Although improving, debt burden remains high because of infrastructure development responsibility

Yokohama's debt burden ratio (measured as net direct and indirect debt to operating revenue) continues to be high but has been improving from around 250% in fiscal 2015 to 170% levels in fiscal 2019, largely because of the progressive decline of its indirect debt.

The ratio temporarily improved to 157.5% in fiscal 2020, driven by higher operating revenue, as the city received larger subsidies for pandemic-related costs. As subsidies normalize, we expect the debt burden to return to close to 170% in fiscal 2022.

Like other designated cities with large population 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 total debt has fallen from the peak of around ¥5 trillion as of the end of fiscal 2003. As of the end of fiscal 2020, its total net debt amounted to ¥3.974 trillion.

We expect its debt level will be contained over the next few years with its planned fiscal management. In January 2022, the city announced its preliminary financial vision, which guides its medium to long term financial policy, where it aims to follow the current debt management. Through the next four years to fiscal 2025, the city plans to limit new debt issuance of its general account to around ¥530 billion in total over the four year period. This will allow the city to curb its debt by up to around ¥100 billion by the end of fiscal 2025 from ¥2,616 billion estimates for the end of fiscal 2021.

Yokohama has sufficient financial assets to cover debt service in fiscal 2022. In addition, the city has short-term bank facilities that can cover its annual debt service. The city estimates the debt repayment fund will be ¥149.4 billion as of 31 March 2022. The fund will be sufficient to cover debt servicing in its general account, including principal payments of ¥92 billion (excluding fund contributions) and interest of ¥22.8 billion, planned for fiscal 2022. The city continues to have strong access to Japan's deep and mature capital markets.

ESG considerations

CITY OF YOKOHAMA's ESG Credit Impact Score is Moderately Negative CIS-3

Exhibit 3
ESG Credit Impact Score

CIS-3
Moderately Negative

For an issuer scored CIS-3 (Moderately Negative), its ESG attributes are overall considered as having a limited impact on the current rating, with greater potential for future negative impact over time. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-2.

Source: Moody's Investors Service

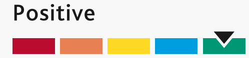
City of Yokohama's (Yokohama City) ESG Credit Impact Score is moderately negative (**CIS-3**). Yokohama City's CIS is constrained by Japan's social risk – mainly ageing, declining demographics – which presents potential weakness over time in the central government's capacity to provide support through its institutional framework, which includes the equalization system. Nevertheless, this strong and predictable institutional framework for Japanese RLGs and the central government's support mechanisms for disaster recovery currently mitigate Yokohama City's ESG risks.

Exhibit 4
ESG Issuer Profile Scores

ENVIRONMENTAL
E-3
Moderately Negative

SOCIAL
S-3
Moderately Negative

GOVERNANCE
G-1
Positive



Source: Moody's Investors Service

Environmental

We assess Yokohama City's exposure to environmental risks as moderately negative (**E-3** issuer profile score), with neutral to low exposures in all environmental categories except on physical climate risk at moderately negative. Our score on physical climate risk reflects Japan's exposure to natural disasters such as typhoons or heavy rains, that could become more frequent and severe from climate change. However, preventative measures, such as infrastructure fortification, diminish the economic and fiscal impact.

Social

Our overall assessment of social risk exposure is moderately negative (**S-3** issuer profile score), with highly negative demographics mitigated by neutral or positive exposures to other social considerations. While Yokohama City's urban characteristics and proximity to Tokyo supports in-migration, its demographic score reflects an ageing, and declining population over time as a nationwide trend. Meanwhile, the city benefits from being part of the large economy in the Tokyo metropolitan area with access to high quality education, basic services from a well-developed infrastructure as well as health and safety.

Governance

Yokohama City's positive governance (**G-1** issuer profile score) reflects a strong institutional structure with regards to the central government, featuring a stable and predictable cash transfer equalization system. Governance is also supported by strong policy credibility and effectiveness, transparency and disclosure and budget management.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

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 5

City of Yokohama (fiscal 2020)

Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				**5.20**	**20%**	**1.04**
Economic Strength	7	84.81%	70%			
Economic Volatility	1		30%			
Factor 2: Institutional Framework				**3**	**20%**	**0.60**
Legislative Background	1		50%			
Financial Flexibility	5		50%			
Factor 3: Financial Position				**2.75**	**30%**	**0.83**
Operating Margin	1	13.27%	12.5%			
Interest Burden	3	1.73%	12.5%			
Liquidity	1		25%			
Debt Burden	7	157.51%	25%			
Debt Structure	1	7.93%	25%			
Factor 4: Governance and Management				**1**	**30%**	**0.30**
Risk Controls and Financial Management	1					
Investment and Debt Management	1					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						**2.77 (3)**
Systemic Risk Assessment						**A1**
Scorecard-Indicated BCA Outcome						**a3**

Economic Strength: Local GDP per capita as a percentage of national GDP per capita.
Operating Margin: Gross operating balance/operating revenue.
Interest Burden: Interest payments/operating revenue.
Debt Burden: Net direct and indirect debt/operating revenue.
Debt Structure: Short-term direct debt/total direct debt.
Source: Moody's Investors Service; Fiscal 2020.

Ratings

Exhibit 6

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

Source: Moody's Investors Service

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