

CREDIT OPINION

4 April 2024

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.

Contacts

Sachiko Awano +81.3.5408.4196
Analyst
Moody's Japan K.K.
sachiko.awano@moodys.com

Yuma Taira +81.3.5408.4249
Ratings Associate
Moody's Japan K.K.
yuma.taira@moodys.com

Christian de Guzman +65.6398.8327
Senior Vice President/Manager
christian.deguzman@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 balances its prudent management practices and our expectations that fiscal performance will remain sound against GDP per capita that is weaker than the national average and a high debt burden due to its infrastructure development responsibility.

Exhibit 1
City of Yokohama



The fiscal year starts in April and ends in March of the following year. Our estimates are based on the budgets for fiscal 2023 and 2024.

Source: Moody's Ratings

Credit strengths

- » Strong institutional framework that is supported by its close relationship with the central government
- » Prudent management practices that control expenditure
- » Fiscal performance that will remain sound in fiscals 2023 and 2024

Credit challenges

- » Low GDP per capita relative to other Japanese RLGs

» Still-high debt burden due to 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

	FY2018	FY2019	FY2020	FY2021	FY2022[1]	FY2023E	FY2024F
Net Direct and Indirect Debt / Operating Revenue (%)	180.6	176.6	157.5	141.2	139.9	148.8	147.0
Interest Payments / Operating Revenue (%)	2.1	1.9	1.6	1.3	1.2	1.4	1.4
Gross Operating Balance / Operating Revenue (%)	13.7	13.3	13.1	14.3	14.0	13.2	11.8
Cash Financing Surplus (Requirement) / Total Revenue (%)	5.9	3.7	5.0	4.8	6.9	6.3	5.2
Capital Spending / Total Expenditures (%)	14.9	16.1	14.4	16.7	13.1	13.5	13.2
Unemployment Rate (%) [2]	2.3	2.1	2.8	3.0	2.2	2.4	-
Population ('000s) [3]	3,749	3,762	3,762	3,755	3,756	3,750	-

[1] Fiscal 2022 began on 1 April 2021 and ended on 31 March 2023. [2] Kanagawa prefecture. Fiscal 2023 is as of January 2024. [3] Fiscal 2023 is as of February 2024. FY2020 data excludes the revenue and expenditure related to the central government's special cash transfers to residents during the pandemic. FY = Fiscal year.

Source: Moody's Ratings

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.

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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 issuance has slowed down over the past few years, along with the improvement in local tax revenue, except temporarily during the pandemic, allowing Japanese RLGs to limit such debt issuance to cover shortfalls.

During the pandemic, the central government provided various types of support to RLGs, such as subsidies to cover related expenditure or to support local businesses, which reduced the strain on RLGs' finances.

Disciplined financial policies curb spending

Yokohama has the largest population among cities designated by government ordinance in Japan¹. As an industrial hub and port city neighboring Tokyo, it draws a multitude of global corporations. Its distinctive historical and cultural features, such as Chinatown, contribute to its reputation as an international city.

Yokohama city 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. This discipline is also reflected in its long-term projection to 2065, which lays out plans for future revenue and spending. We believe these plans will ensure that the city can proactively manage its future budget gap resulting from an ageing and decreasing demographic profile.

The city has focused its fiscal strategy on controlling 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 will maintain sound fiscal performance

Yokohama generally benefits from stable revenue trends. Its tax revenue is less volatile than that of most prefectures and other large cities, given the city's higher share of individual income 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 the business sector.

The strain from the pandemic on Yokohama's tax revenue and its broader credit profile was limited. Larger subsidies from the central government to cover pandemic-related costs have also allowed the city to sustain its strong operating surplus.

In fiscal 2022, Yokohama's tax revenue increased by 3.4% from the previous fiscal year to ¥867 billion. The city expects its tax revenue to increase further over the subsequent two fiscal years due to the recovery in individual income tax and corporate tax from the effects of the pandemic. In fiscal 2024, the increase in individual income tax and property tax will continue to drive the growth in overall tax revenue as pent-up demand supports the economic recovery.

The predictability of its stable revenue and its prudent budget planning allow Yokohama to manage its expenditure amid rising social welfare costs. 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. Our social risk assessment takes into account such key constraints from an ageing and declining population.

Yokohama expects growing social welfare costs for the next fiscal years, yet sustained by the recovery of its tax revenue and a lower funding need, the operating margin (measured as gross operating balance as a percentage of operating revenue) will remain the 12%-13% range through the fiscal year ending March 2025 (fiscal 2024).

Inflationary pressure from a weak yen and higher energy prices have had a limited credit impact on the city so far because of government subsidies that support affected local businesses and households.

The city maintained some cash surpluses even during the peak of its capital spending program. An example of a major project was the ring roads (Yokohama Ringed Northwest Line), which started operating in 2020. The city is currently handling other ring road constructions. In the coming few years, we expect its capital spending to stabilize to around ¥200 billion (general account) annually for fiscal 2023 and 2024. Other major projects include new redevelopment projects to host the flower show in fiscal 2027, and infrastructure reinforcements and expansions such as the wharf and railways. We could potentially expect additional infrastructure spending with the redevelopment of its waterfront area, which was the candidate site for hosting the integrated resort until the plan was withdrawn.

Lower GDP per capita reflects role as a residential suburb

Yokohama is a residential suburb of the Tokyo Metropolitan Area, with more than 3.7 million residents, making it the largest local government in Japan in terms of population. Its residents commute to jobs in central business districts. The unquestionable access to infrastructure, including well-developed transportation, underpins the city's positive assessment for access to basic services under our social considerations.

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 87% 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.

In April 2022, Yokohama was designated as one of the 100 model RLGs to promote decarbonization as part of the government's initiatives. Subsidies will be allocated to a project aimed at developing a low-carbon model district in Yokohama's Minato Mirai office and commercial waterfront area. In 2023, three additional facilities newly joined initiatives. This project will use renewable energies, promote resource circulation, and aim to reduce local carbon emissions. In this initiative, Yokohama aims to achieve net-zero carbon-dioxide emissions from the electricity consumption of households and businesses in the model district by fiscal 2030.

Debt burden remains high because of infrastructure development responsibility

Like other ordinance-designated cities with large populations in Japan, Yokohama's debt profile reflects the cost of infrastructure operations, such as water, sewage, mass transport, roads, ports and land redevelopment projects.

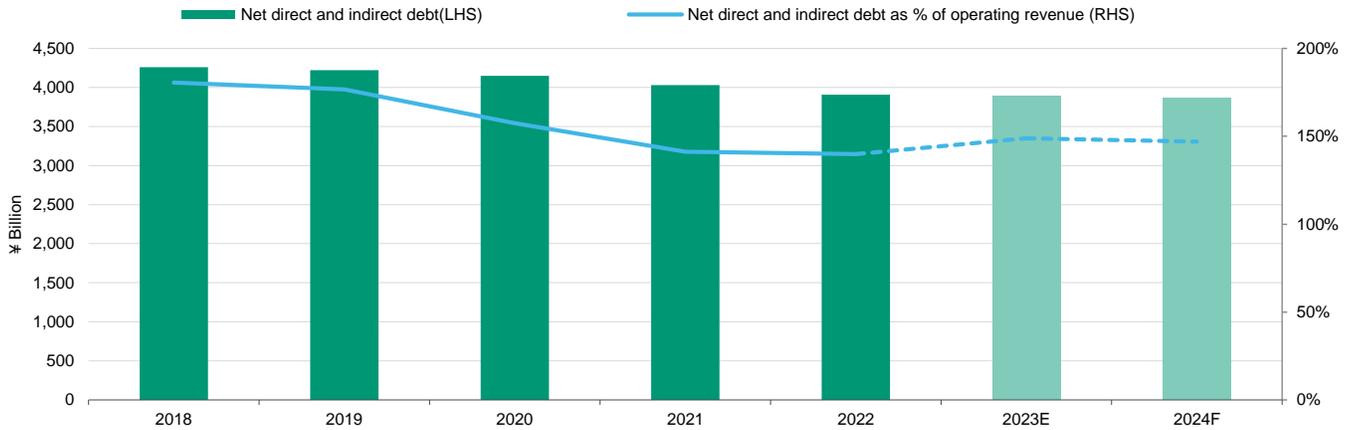
Yokohama's debt burden — net direct and indirect debt in both nominal yen terms and as a share of operating revenue — has significantly declined over the past decade, but remains high and continues to be a key constraint to its credit profile. Total net debt has fallen further to ¥3.8 trillion as of the end of fiscal 2023 from a peak of around ¥5 trillion as of the end of fiscal 2003.

More notably, the corresponding debt ratio relative to operating revenue saw a more rapid improvement to around 180% in fiscal 2019, from around 250% in fiscal 2015, reflecting a progressive decline in indirect debt. It improved to around 140% in fiscal 2022, as a result of the provision of large subsidies by the central government for pandemic-related costs — which boosted operating revenue — during fiscal 2020 to 2022. As subsidies normalize, we estimate the city's debt burden to return to nearly 150% in fiscal 2023.

We expect Yokohama's debt burden to be contained over the next few years in line with the medium-term plan for the four-year period between fiscal 2022 and 2025 that it announced in 2023. The city now plans to limit new debt issuance of its general account to around ¥460 billion over the course of the plan, and reduce the debt of its general account to ¥2.44 trillion from ¥2.55 trillion, which is estimated for the fiscal 2023.

Yokohama has sufficient financial assets to cover its debt service. In addition, the city has short-term bank facilities that can cover its annual debt service. The city estimates that the debt repayment fund will amount to ¥190 billion by the end of fiscal 2023. The fund will be sufficient to cover debt servicing in its general account, including principal payments of ¥74 billion (excluding fund contributions) and interest of ¥22.2 billion, planned for fiscal 2024. The city continues to have strong access to Japan's deep and mature capital markets.

Exhibit 3
Pandemic-related subsidies improved Yokohama's debt ratio; debt burden will rise by subsidy withdrawal, but will stay below pre-pandemic level

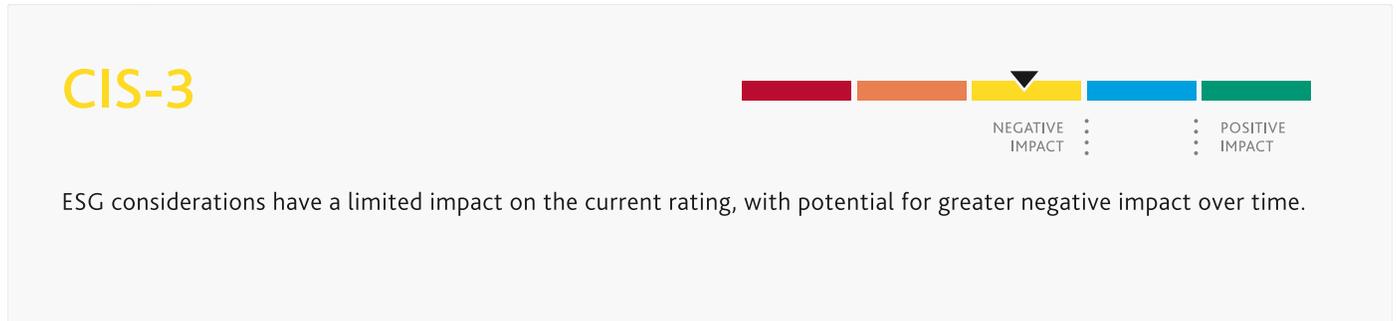


The fiscal year starts in April and ends in March of the following year. Our estimates are based on the budgets for fiscal 2023 and fiscal 2024.
 Source: Moody's Ratings

ESG considerations

Yokohama, City of's ESG credit impact score is CIS-3

Exhibit 4
ESG credit impact score



Source: Moody's Ratings

City of Yokohama's (Yokohama City) ESG Credit Impact Score is **(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 5

ESG issuer profile scores



Source: Moody's Ratings

Environmental

We assess Yokohama City's exposure to environmental risks as (**E-3** issuer profile score), with neutral to low exposures to physical climate risk. 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 (**S-3** issuer profile score), with declining demographics mitigated by 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 governance is (**G-1**) 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 local governments, 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 6

City of Yokohama (fiscal 2022)

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	84.88%	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	14.01%	12.5%			
Interest Burden	3	1.30%	12.5%			
Liquidity	1		25%			
Debt Burden	7	139.86%	25%			
Debt Structure	1	8.75%	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
Suggested BCA						a3
Assigned BCA						a3

Economic strength: Local GDP per capita as a percentage of national GDP per capita.

Operating margin: Gross operating balance/operating revenue.

Debt burden: Net direct and indirect debt/operating revenue.

Source: Moody's Ratings; Fiscal 2022.

Ratings

Exhibit 7

Category	Moody's Rating
YOKOHAMA, CITY OF	
Outlook	Stable
Baseline Credit Assessment	a3
Issuer Rating	A1
Senior Unsecured	A1

Source: Moody's Ratings

Endnotes

¹ Tokyo is considered a metropolitan district, which is a special kind of prefecture in Japan, and not a designated city

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