Moody's Investors Service

Global Credit Research
Credit Opinion
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Credit Opinion: Japan Finance Organization for Municipal Ent.

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Tokyo, Japan

Ratings

Category	**Moody's Rating**
Outlook	Stable
Issuer Rating	Aaa
Bkd Senior Secured -Dom Curr	Aaa
Senior Unsecured -Dom Curr	Aaa
Ult Parent: Japan	
Outlook	Stable
Country Ceiling: Fgn Currency Debt	Aaa/P-1
Country Ceiling: Fgn Currency Bank Deposits	Aaa/P-1
Parent: Japan, Government of	
Outlook	Stable
Government Bonds -Fgn Curr	Aaa
Government Bonds -Dom Curr	Aa3

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Key Indicators

Japan Finance Organization for Municipal Ent.

	[1]**FY2007**	**FY2006**	**FY2005**	**FY2004**	**FY2003**	[2]**5-Year Avg**
Total Assets (Tril Yen)	**24.8**	**25.4**	**25.9**	**26.2**	**26.1**	**-0.96**
Total Capital (Bil Yen)	**3,478.8**	**3,137.8**	**2,794.2**	**2,453.6**	**2,136.4**	**13.71**
BIS Tier 1 Ratio/Domestic Tier 1 Ratio	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
BIS Total Capital Ratio/Domestic Capital Ratio	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Problem Loans/Gross Loans (%)	**-**	**-**	**-**	**-**	**-**	**-**
Recurring Earnings Power (%) [3]	**1.36**	**1.33**	**1.30**	**1.25**	**1.15**	**1.28**
Credit Costs % PPP	**-**	**-**	**-**	**-**	**-**	**-**
Net Income (Bil Yen)	**341**	**344**	**341**	**317**	**306**	**330**
ROAA (%)	**1.36**	**1.34**	**1.31**	**1.21**	**1.18**	**1.28**
Overhead (%)	**0.43**	**0.50**	**0.50**	**0.54**	**0.60**	**0.51**
NI Margin (%)	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**

[1] FY2007 started from April 1, 2007 and ended with March 31, 2008 [2] Compound annual growth rate for Total Assets and Total Capital in % [3] Preprovision profits/Average assets

Opinion

SUMMARY RATING RATIONALE

Moody's assigns Aaa foreign and local currency issuer ratings to the Japan Finance Organization for Municipal Enterprises (New JFM). The assigned ratings reflect the important role played by the New JFM in local government (LG) finance, and of the high degree of oversight by the central government. In addition, the ratings are supported by the New JFM's high quality loan portfolio, consisting only of loans to Japanese local governments.

In October of 2008, Japan Finance Corporation for Municipal Enterprises (Former JFM) was converted to a new institution (New JFM) owned jointly by all local governments. Moody's expects that the New JFM will retain its important role in local government finance and will continue to benefit from the involvement of the central government in its operations, despite changes in ownership and oversight procedures.

The ratings also reflect Moody's assessment of the highest likelihood that national institutions would act to prevent a default by the New JFM.

Credit Strengths

Credit strengths of the New JFM include:

Important role played by the New JFM in financing local government capital projects

High quality loan portfolio

Oversight by relevant authorities

Credit Challenges

Credit challenges of the New JFM include:

Challenges are similar to those that could affect the credit position of Government of Japan (GoJ), as owner and guarantor of the majority of the former JFM's debt, and also as the guarantor of the New JFM's "old account" debt.

Rating Outlook

The outlook for the New JFM's ratings is stable.

What Could Change the Rating - Down

In the unlikely event that Japan's local currency bond rating were to be downgraded, the New JFM's rating would also likely be lowered. In addition, should the role of the New JFM in local government financing be diluted, and if the probability of support from national institutions were to decline as a result - also an unlikely event - the ratings would likely be lowered.

Issuer Profile

The former JFM was established in 1957 as the only public specialized institution to provide low-cost, long-term funds to local governments in Japan. At September 30, 2008, the total amount of loans exceeded 22 trillion yen and accounted for more than 10% of total local government debt. The former JFM was categorized as a public fund in the "Local Government Finance Program" and functions as a safety net for local governments. In October 2008, the former JFM was converted to the New JFM, which is owned by Japanese local governments, in accordance with the public financial institution reform. The New JFM is based on a special law ,"The law of Japan Finance Organization for Municipal Enterprises ".

DETAILED RATING CONSIDERATIONS

The ratings assigned to the New JFM reflect the application of Moody's Joint-Default Analysis (JDA) rating methodology for government related issuers (GRIs). In accordance with this methodology, Moody's first establishes the baseline credit assessment (BCA) for the New JFM and then considers the likelihood of support coming from the national government to avoid a default by the entity, should this extreme situation ever occur.

Baseline Credit Assessment

The New JFM's BCA of 4 (on a scale of 1 - 21 where 1 represents the lowest credit risk) reflects the following factors:

Institutional Framework

The former JFM was owned by the central government and was under the control of both the Ministry of Internal Affairs and Communications (MIC) and the Ministry of Finance (MOF). Its business and funding plans required the approval of both Ministers. Its budget was attached to the national budget and was approved by the National Diet. More than half the JFM-issued bonds were guaranteed by the central government, accounting for 55.3% of JFM's bonds (1.4 trillion yen, in FY 2007). The former JFM bonds comprise the largest portion of the Japanese guaranteed bond market.

The New JFM acquired all the assets and liabilities of the former JFM (excluding capital injected by the central government) in October 2008. The new entity is owned by all Japanese local governments, but is required to submit its business and funding plans as well as its budget to the Ministry of Internal Affairs every year. Moreover, the New JFM will be required to submit financial results as well as internal and external audited reports to the MIC within three months following the end of its fiscal year. The New JFM funds will continue to be categorized as public funds in the "New Borrowing Program of RLGs."

The New JFM will operate two accounts: one that includes the New JFM's operations, the other, the former JFM's debt and assets - hence, the "old account." The New JFM is required to create a management plan for the old account that must receive the approval of both MIC and MOF. Bonds to refinance the old account debt will be guaranteed by the central government. It is possible for the New JFM to transfer funds between the old and new accounts. Moreover, there will be no difference between bonds issued from either account, nor will market participants be able to differentiate between them.

Although the New JFM law states that local governments can guarantee its debt, Moody's does not expect this to occur.

Financial Position and Performance

In FY2007, interest income from lending decreased, but so did funding costs, generating a surplus of 341 billion yen. Interest income from cash equivalents increased 1.5 billion yen compared to FY2006.

Total lending has declined for the past three years because local governments have improved their fiscal positions and decreased debt. Lending to prefectures and designated cities accounts for 40% of total debt, while lending to sewage system projects also accounts for 40%.

At the end of FY2007, the former JFM had reserves of 150 billion yen to fund reduced interest loans and 2.96 trillion yen for losses resulting from bond refinancing. The organization also had 899 billion yen for improving the operations of municipal enterprises (used to reduce interest costs for these entities). As indicated, these assets were turned over to the New JFM on October 1, 2008.

Debt & Liquidity

JFM bonds were divided into three categories: (1) guaranteed bonds (in both yen and foreign currency), (2) agency bonds, and (3) private offering bonds. In FY2007, total bonds outstanding came to 1.4 trillion yen, comprising 770 billion yen in guaranteed bonds, 370 billion yen in Zaito agency bonds, and 260 billion yen in private offering bonds. The former JFM and the New JFM issue mainly 10-year bonds to raise funds, but the average loan period is 25 years. To deal with the gap, there are reserves for any losses stemming from bond refinancing. The duration gap between loans and bonds was 2.97 years at the end of FY2007.

At the end of FY2007, JFM had 923 billion yen in cash equivalents and 200 billion yen in JGB, providing a high level of liquidity. In addition, if required, the New JFM has the authority to borrow short-term funds from private banks to meets cash flow needs.

Governance and Management Factors

The New JFM has both a "Convention" and a "Management Committee." The Convention consists of prefecture governors, city mayors, town or village mayors, and experts recommended by three entities (comprising prefectures, cities towns and villages). The Convention appoints a Chairman, an internal auditor, and members of the Management Committee, and chooses the external auditor to audit the New JFM's financial statements. It also discusses budgetary plans and changes to company articles. The Management Committee consists of experts from the private sector. The Convention Chairman must consult with the Management Committee.

The Convention plays an important role in the New JFM's management. A potential moral hazard is that Convention members are the borrowers of the New JFM's funds, although this is unlikely to become a serious issue because the MIC will continue its strong oversight.

The New JFM relies on a consulting system to examine loan applications. To help local governments lower their fund-raising costs, the former JFM had established interest rates lower than its funding costs and low-interest loans accounted for 99% of new lending in FY 2007. This support is likely to continue following the conversion and the interest rate gap will be funded by the reserves mentioned above. The New JFM is a public entity that plays an important role for local government funding under both central and local government policy. Moody's views the BCA as constrained by the rating on Japan Government Bonds (JGB), as are the BCA levels of all Zaito agencies.

Extraordinary Support Considerations

In light of Japan's unique and long history of socializing credit risk, Moody's assigns the New JFM the highest likelihood of receiving extraordinary support from national institutions to prevent default. The strength of that support is represented by Japan's local currency deposit ceiling (LCDC).

Moody's rating committee also assigns a very high default dependence level for the New JFM, as it does for all issuers in Japan supported at the LCDC level.

ABOUT MOODY'S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody's assigns national scale ratings in certain local capital markets in which investors have found the global rating scale provides inadequate differentiation among credits or is inconsistent with a rating scale already in common use in the country. Moody's National Scale Ratings are opinions of the relative creditworthiness of issuers and issues within a particular country. While loss expectation will be an important differentiating factor in the ultimate rating assignment, it should be noted that loss expectation associated with National Scale Ratings can be expected to be significantly higher than apparently similar rating levels on Moody's global scale. Moody's National Scale Ratings rank issuers and issues in order of relative creditworthiness: higher ratings are associated with lower expected credit loss.

National Scale Ratings can be understood as a relative ranking of creditworthiness (including relevant external support) within a particular country. National Scale Ratings are not designed to be compared among countries; rather, they address relative credit risk within a given country. Use of National Scale Ratings by investors is only appropriate within that portion of a portfolio that is exposed to a given country's local market, taking into consideration the various risks implied by that country's foreign and local currency ratings.

The Moody's Global Scale rating for issuers and issues in local currency allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Country Ceilings for Foreign Currency Obligations

Moody's assigns a ceiling for foreign-currency bonds and notes to every country (or separate monetary area) in which there are rated obligors. The ceiling generally indicates the highest rating that can be assigned to a foreign-currency denominated security issued by an entity subject to the monetary sovereignty of that country or area. In most cases, the ceiling will be equivalent to the rating that is (or would be) assigned to foreign-currency denominated bonds of the government. Ratings that pierce the country ceiling may be permitted, however, for foreign-currency denominated securities benefiting from special characteristics that are judged to give them a lower risk of default than is indicated by the ceiling. Such characteristics may be intrinsic to the issuer and/or related to Moody's view regarding the government's likely policy actions during a foreign currency crisis.

Baseline Credit Assessment

Moody's baseline credit assessment incorporates the Government Related Issuer's (GRI) intrinsic credit strength and accounts for all aspects of the entity's existing (or anticipated) activities, including benefits (such as regular subsidies or credit extension) and/or detriments associated with the government relationship. In effect, the baseline credit assessment reflects the likelihood that a GRI would require extraordinary support.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a Government Related Issuer (GRI) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0% - 30%), medium (31% - 70%) or high (71% - 100%).

Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated. Such imperfect correlation, if present, has important diversifying effects which can change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to GRIs, default dependence reflects the tendency of the GRI and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the government to provide extraordinary support and prevent a default by a GRI is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' credit profiles, the lower the benefits achieved from joint support. In most cases, the close economic links and/or close intergovernmental fiscal arrangements between a GRI and its associated government result in a moderate to high degree of default dependence.

Default dependence is described as either low (0% - 30%), medium (31% - 70%) or high (71% - 100%).