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R&I View: Handling of Municipal Bond op Ratings

Rating and Investment Information, Inc. (R&I) has decided to cancel as of the end of 2008 the op ratings (unsolicited ratings) assigned to 36 entities among the local governments which issue publicly offered municipal bonds. R&I has provided a systematic credit rating information to the municipal bond market for nearly 10 years since March 1999 when the ratings for local governments were assigned for the first time in Japan to meet the strong demand from investors. However, the environment surrounding the municipal bond market has changed dramatically in recent years, and solicited rating has become more prevalent. The initial purpose upon starting to assign op ratings for the municipal bond was to contribute to the development of the municipal bond market by offering credit rating information based on publicly available information. R&I considers that such purpose has been basically achieved.

Progress has been made in decentralizing power and in reforming the government's investment and loan program. Also with the postal privatization, the local government has become financially more dependent on private funds since FY2004. The new system under which the issuance of municipal bonds is authorized after consultation, without obtaining the approval of the Minister of Public Management, Home Affairs, Posts and Telecommunications or governors, was introduced in 2006. Furthermore, the system shifted to a method which allows all municipalities that issue publicly offered municipal bonds to determine their issuance terms independently. The market environment has changed dramatically in recent years. In the wake of the fiscal failure announced by Yubari City in Hokkaido, the concerns of financial institutions over the credit status of local governments widely extend to municipality levels.

Amid such circumstance, the law for restoring fiscal soundness of local governments was enacted in June 2007, and four judgment criteria under the law will be announced this fall. However, it is difficult to assess the creditworthiness of the local government simply by such criteria and the expectation for rating that comprehensively assesses the creditworthiness is mounting than ever.

Responding to such environment change, 12 bodies including Kobe City, Shizuoka and Okayama Prefectures have obtained solicited ratings, out of the 42 bodies which issue publicly offered municipal bonds to which R&I assigned ratings. In the municipal bond market, solicited rating is rapidly becoming the mainstream. Though fiscal conditions of local governments have generally improved on the back of economic recovery, domestic economy remains stagnant since the latter half of 2007. Sluggish or declining tax revenue is expected to decelerate the pace of recovery.

Therefore, how the chief of a local government demonstrates his administrative ability and addresses the administrative and financial reforms will play a more significant role in enhancing the fiscal stability of municipalities. Such qualitative evaluation is increasingly important upon rating the creditworthiness of local governments.

Though based on qualitative analysis, it is essential that R&I which has excellent expertise in the credit rating of local governments provides in-depth credit rating by fully incorporating qualitative evaluation upon solicited rating, in order to promote steady growth of the municipal bond market.

Despite the transition of op ratings to solicited ratings for local governments, R&I will continue to release systematic credit rating of the local governments. As for prefectural and city governments and government-designated cities, new credit rating indicators that consider the

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Ratings are statements of R&I's opinion shown in certain symbols regarding an Issuer's general capacity (credit quality) to repay its financial obligation and individual debts (bonds and loans, etc.) and it is not a statement of recommendations to buy, hold, or sell any securities. Information has been obtained by R&I from sources believed to be reliable, however, its accuracy, adequacy, or completeness is not guaranteed. Therefore, R&I is not responsible for any errors or omissions or the result obtained from the use of the rating. As a general rule, R&I provides the rating services for a rating fee paid by the Issuer.

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profitability and debt level of the third-party corporations will be announced, in addition to the regional economic conditions and various numerical figures of the relevant municipality that reflects its fiscal capability. Furthermore, R&I will continue to provide the financial rankings of cities in Japan and Tokyo's 23 wards.

Unless the rating for a local government is announced upon evaluating structured finance related products backed by the debt of the relevant local government as underlying assets, R&I will assess the creditworthiness of the local government on a non-disclosed basis so as not to interfere with the rating of such structured finance-related products.

(For inquires, please contact Yasuda/Yoshida/Kita, Public Finance Dept., Credit Rating Div. Tel: 03-3276-3424)

R&I RATINGS: (as of March 17, 2008)

(1) Solicited Rating

<u>PREFECTURES/GOVERNMENT-DESIGNATED CITY</u>	<u>R&I Rating</u>
Shizuoka Pref.	AA+ Stable
Okayama Pref.	AA Positive
Kobe City	AA Stable

(2) OP Rating

<u>PREFECTURES</u>	<u>R&I op Rating</u>
Hokkaido	AA- op
Miyagi	AA op
Fukushima	AA op
Ibaraki	AA op
Gunma	AA+ op
Saitama	AA+ op
Chiba	AA+ op
Tokyo	AAA op
Kanagawa	AA+ op
Niigata	AA op
Nagano	AA op
Gifu	AA op
Aichi	AA+ op
Kyoto	AA+ op
Osaka	AA op
Hyogo	AA op
Hiroshima	AA op
Shimane	AA- op
Fukuoka	AA op
Ooita	AA op
Kumamoto	AA op
Kagoshima	AA- op

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<u>GOVERNMENT-DESIGNATED CITIES</u>	<u>R&I op Rating</u>
Sapporo	AA op
Sendai	AA+ op
Chiba	AA+ op
Saitama	AA op
Yokohama	AA+ op
Kawasaki	AA op
Shizuoka	AA op
Nagoya	AA op
Kyoto	AA- op
Osaka	AA- op
Sakai	AA op
Hiroshima	AA op
Kitakyushu	AA op
Fukuoka	AA op

Note) Unsolicited (op) ratings are mainly based on publicly available information.