

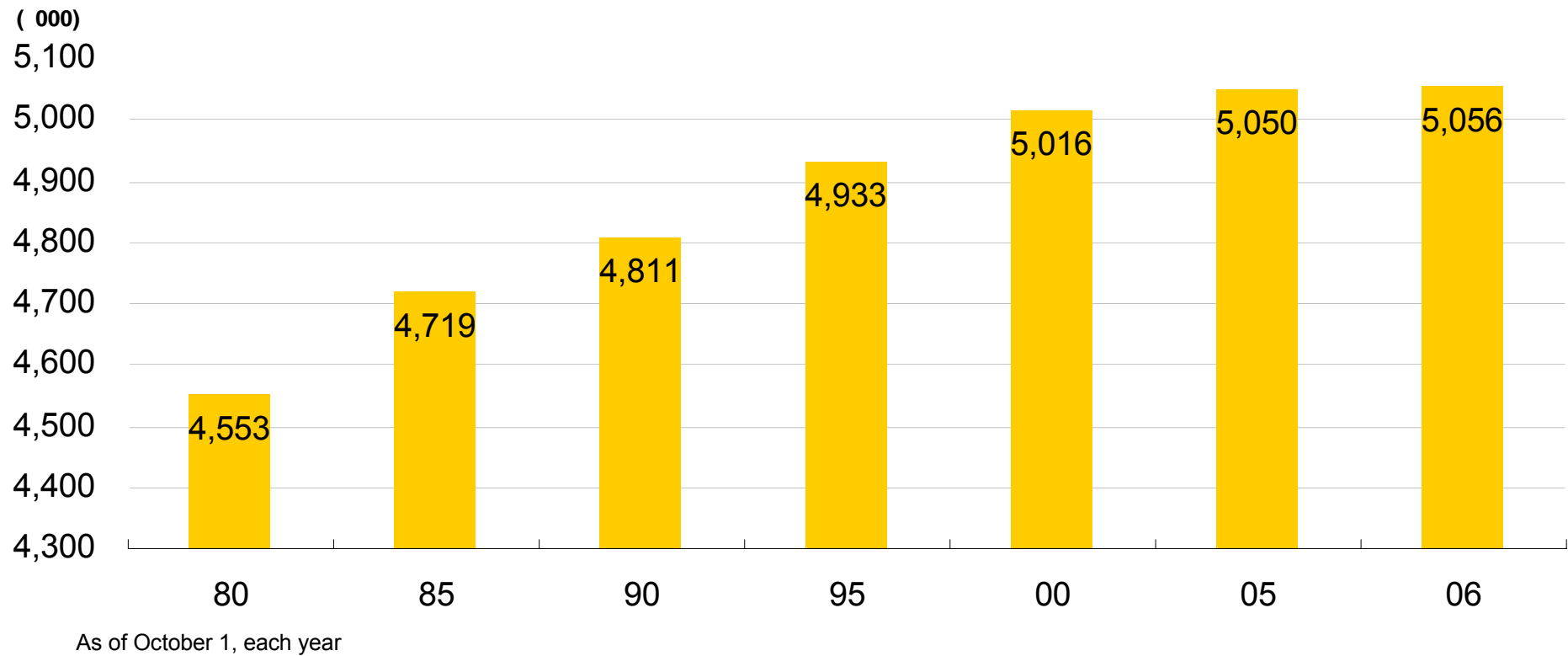
Administrative and Fiscal Reform of Fukuoka Prefecture

Fukuoka Prefecture

January 2008

Overview of Fukuoka Prefecture

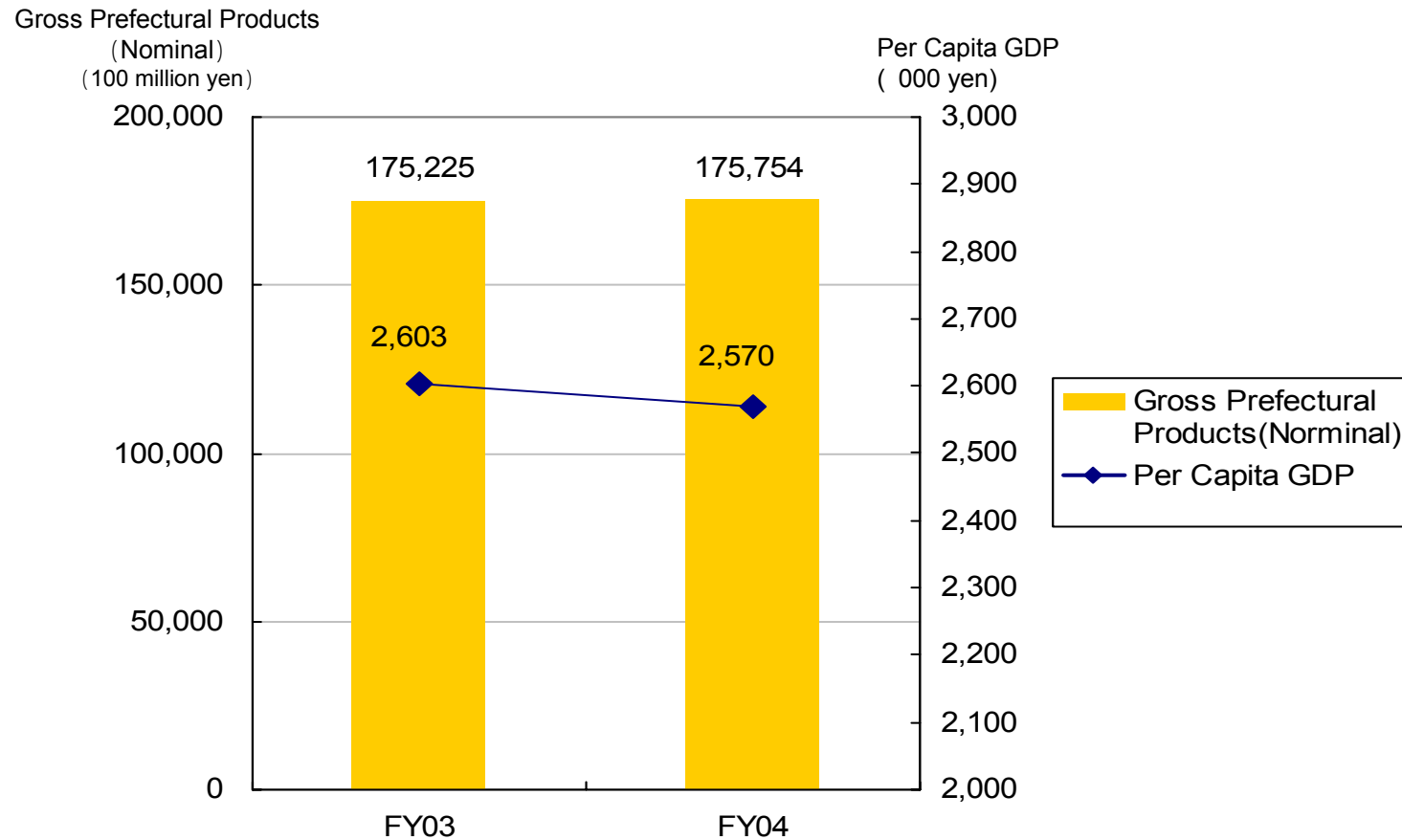
1. Population



Source: “ Population Census” by Statistics Bureau, Ministry of Public Management, Home Affairs, Post and Telecommunications(80-05)
“Annual report of Population and household in Fukuoka Prefecture”by General Affair Department(06)

Overview of Fukuoka Prefecture

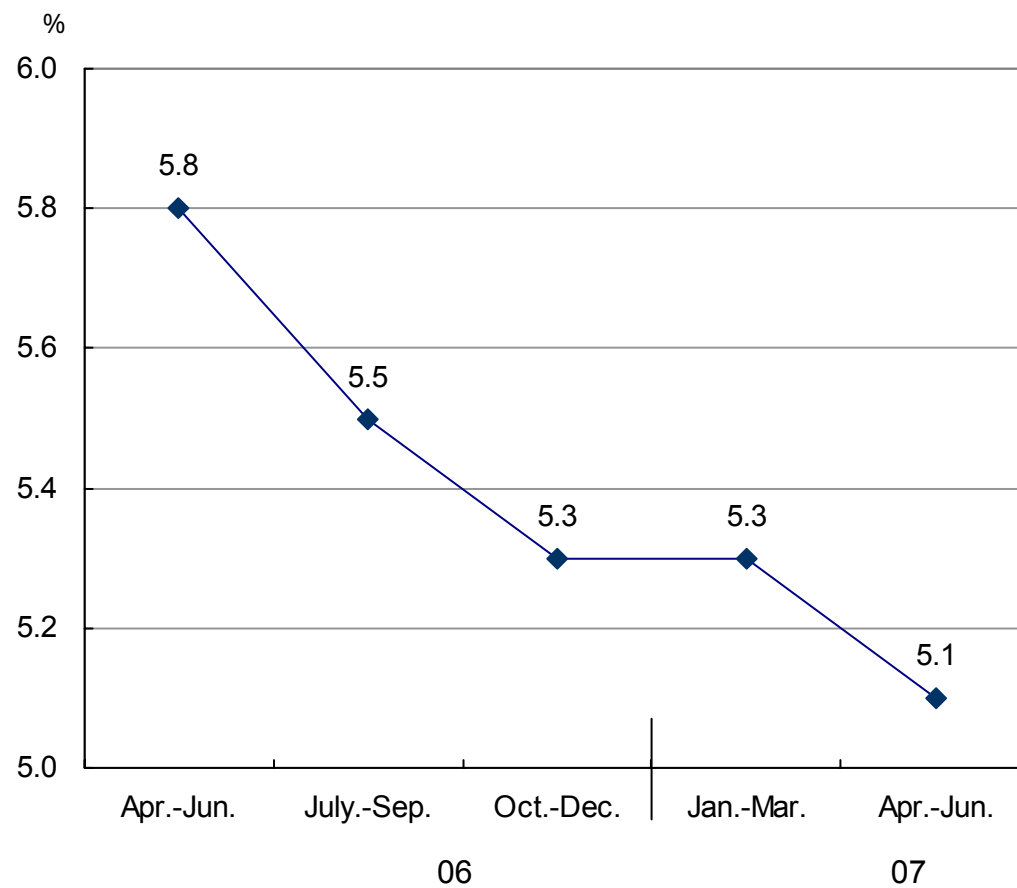
2. GDP



Source: "Annual Report on Prefectural Accounts" by General Affairs Department, Fukuoka Prefecture

Overview of Fukuoka Prefecture

3. Unemployment rate



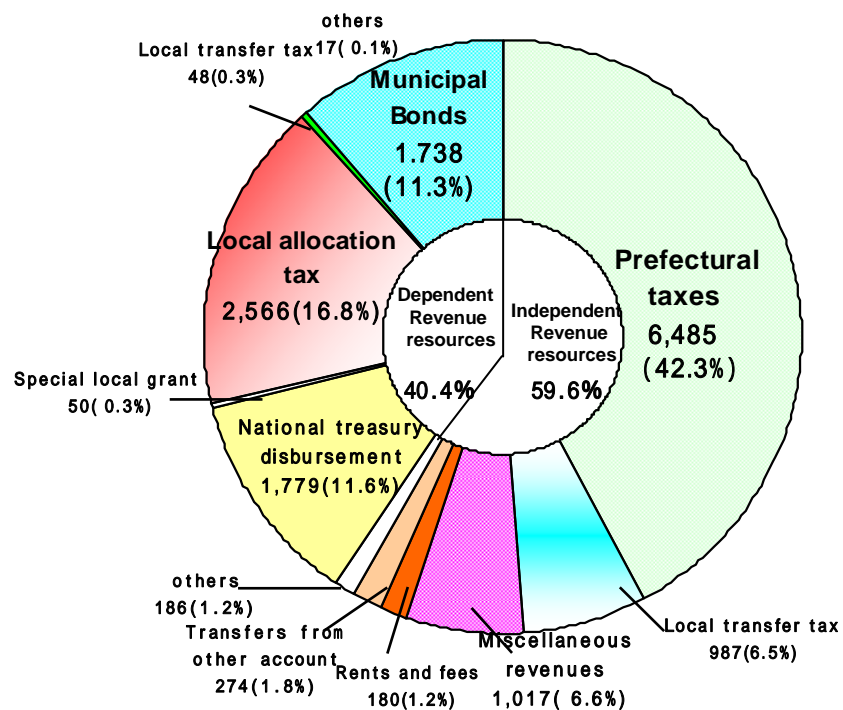
Source. "Labor Force Survey" by Ministry of Internal Affairs and Communications

Financial Conditions of Fukuoka Prefecture

1. FY 2007 Initial General Account Budget

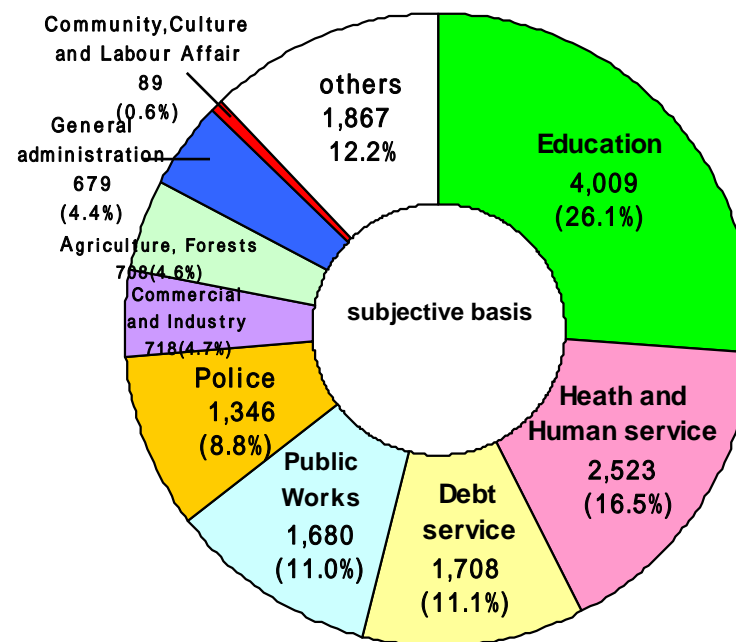
Breakdown of FY2007 Initial General Accounts

Revenue



* Extraordinary financial measures loan is included in Municipal Bonds

Expenditure

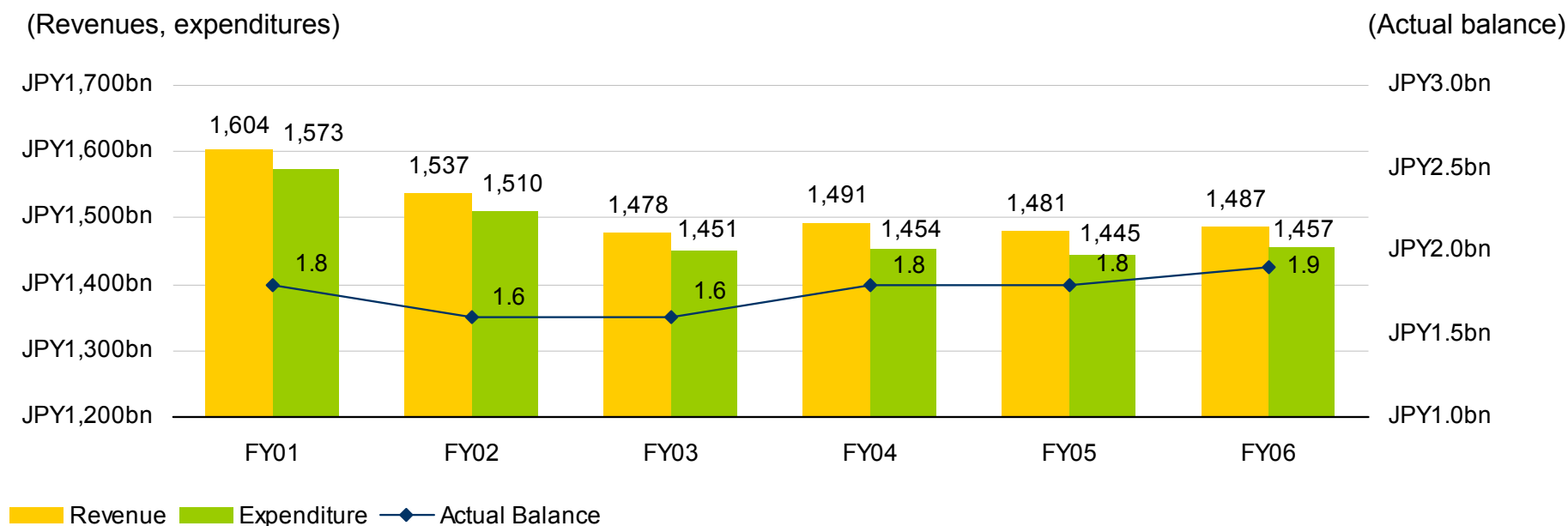


Financial Conditions of Fukuoka Prefecture

2. FY 2006 General Account Results

Both FY06 revenues and expenditures exceeded FY05 results. After its peak in FY01, expenditures have been decreasing along with the streamlining process.

- Actual balance has been constantly surplus for the last 31 years with approximately ¥1.9Bn in FY06
- Local tax revenue has been growing for 3 consecutive years and marked its historical high in FY06 due to an increase in corporate tax revenue backed by the economic recovery despite the lower local allocation tax
- In expenditures, efforts were made to cut labor costs by reducing headcounts and to reduce construction expenses while social insurance costs and allowances for retirement increased



Note: Actual balance = income/expenditure difference minus revenue sources carried forward to the following FY.

General Account Financial Statement

Unit: JPY 100 mil

		FY2006 (a)	FY2005 (b)	+/- (a)-(b)	chg in % (a)/(b)
Revenue		14,873	14,811	62	100.4
	(1) Prefectural Tax	5,532	5,102	430	108.4
	Corporate Tax	1,957	1,711	246	114.4
	Others	3,575	3,391	184	105.4
	(2) Local Transfer Tax	854	312	542	273.5
	(3) Special local grant	25	283	258	8.8
	(4) Local Allocation tax	2,731	2,804	73	97.4
	(5) National treasury disbursement	1,867	2,258	391	82.7
	(6) Municipal Bonds	1,885	1,895	10	99.5
	Temporary Fiscal Expense	466	517	51	90.1
	(7) Others	1,979	2,157	178	91.7
	charge for services, fee	241	268	27	89.9
	sale of property	59	53	6	111.3
	others	1,679	1,836	157	91.4
		14,570	14,445	125	100.9
Expenditure					
	(1) Obligatory Expense	7,431	7,502	71	99.1
	Personnel expense	5,177	5,131	46	100.9
	Allowance for retirement	409	306	103	133.8
	Other	4,768	4,825	57	98.8
	Social Welfare	559	689	130	81.2
	Debt Services	1,695	1,682	13	100.8
	Principal payment	1,295	1,266	29	102.3
	Interest payment	400	416	16	96.2
	(2) Capital Expenditure	2,526	2,607	81	96.9
	General Construction	2,462	2,538	76	97.0
	Other	64	69	5	92.8
	(3) Others	4,613	4,336	277	106.4
	Elderly Medical	786	667	119	117.9
	Health Insurance	362	297	65	121.9
	Child Allowance	90	33	57	272.7
	Tax-related grants	834	802	32	104.0
	Investment Expenditures	27	35	8	77.1
	others	2,514	2,502	12	100.5

Prefectural tax

Increasing for 3 consecutive years to its historical high

Corporate taxes increased by ¥24.6bn through improvement in retail, service and automotive industry earnings

Individual taxes rose by ¥8.7bn through an increase in the percentage tax on dividend of prefectural citizens and the removal of temporary tax cuts
Increase in import boosted regional consumption taxes by ¥7.9bn.

Ongoing reduction of prefectural debt issuances for 3 consecutive years

Labor Costs

Although headcounts and salaries of employees were cut down, the entire labor costs rose due to an increase in allowances for retirement

Capital Expenditure

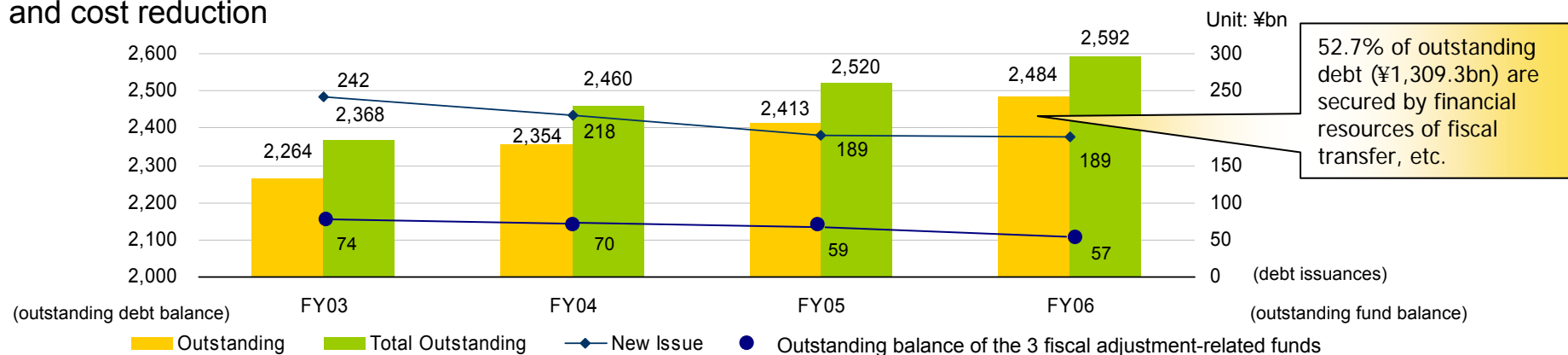
Down for 8 consecutive years due to less public sector investment

Others

Increased by ¥24.1bn due to tax source transfers in conjunction with Koizumi reform and higher social welfare expenses driven by the aging society

3. Debt Issuance and Sinking Fund

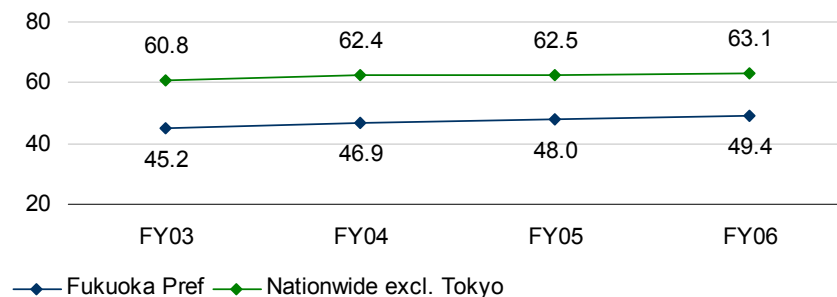
- Debt issuances reduced for 3 consecutive years with ongoing efforts to downsize the total outstanding debt balance
- Outstanding balance of the 3 fiscal adjustment-related funds* decreased as a result of higher local tax revenue and cost reduction



* The 3 funds consists of fiscal adjustment fund, sinking fund (excluding bullet bond redemption) and public construction fund

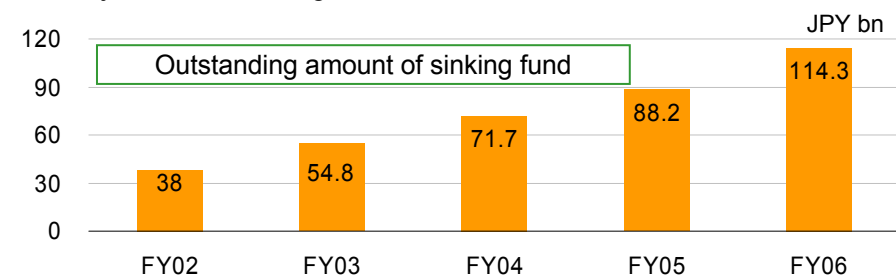
Outstanding debt per capita

The per capita balance is lower than the national average (7th lowest level throughout Japan in FY 06).



Redemption of Fukuoka Prefecture Bullet Bonds

“Public bond administrative special account” is established to accumulate a certain amount of cash every year to secure lump sum redemptions at maturities. The accumulated amount is never used as a revenue source for fiscal adjustment or lending.



4. Financial Statistics – (1) Adjusted Debt Service Ratio

- “Adjusted Debt Service Ratio” indicates the percentage of general revenue source derived from debt issuance in a standard revenue size and is one of the ratios prescribed to indicate fiscal soundness of local authorities
 - 18% or more: Debt issuance requires approval from the central government
 - 25% or more: Debt issuance is controlled by the central government

Fukuoka Prefecture’s Adjusted Debt Service Ratio is 13.8%, below the 18% level which requires the central government approval. (The FY 2005 national average: 14.8%).

Adjusted Debt Service Ratio = 3-year average of $\frac{(A+B)-(C+D)}{(E-D)}$

A: Interest and principal payments of municipal bonds (excluding early redemptions)

B: Any payments pursuant to above (money drawn from general account for interest and principal payments of public corporations and contribution for public debts of PFI and certain unions)

C: Special revenue sources used for interest and principal payments

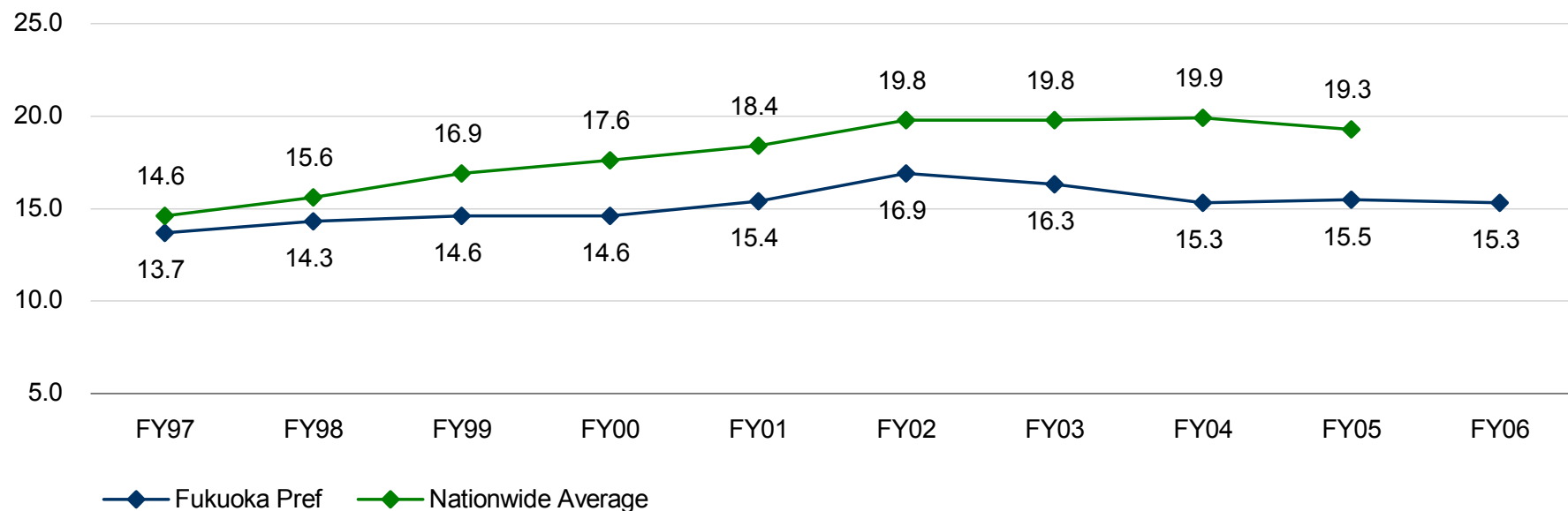
D: Interest and principal payments counted in basic financial needs of ordinary local allocation tax. Ordinary local allocation tax is allocated to local public bodies whose basic financial needs exceed their basic financial revenues, and the amount to be allocated is calculated basically as the difference between those two factors (deficit in financial resources).

E: Standard revenue scale (total of standard financial scale* and extraordinary financial measures loans).

*Standard financial scale is the total general revenue source expected on the standard scale (total of local tax, local transferred tax, ordinary local allocation tax, special district grants and special grants to counter-measures for traffic safety)

4. Financial Statistics – (2) Debt Service Ratio

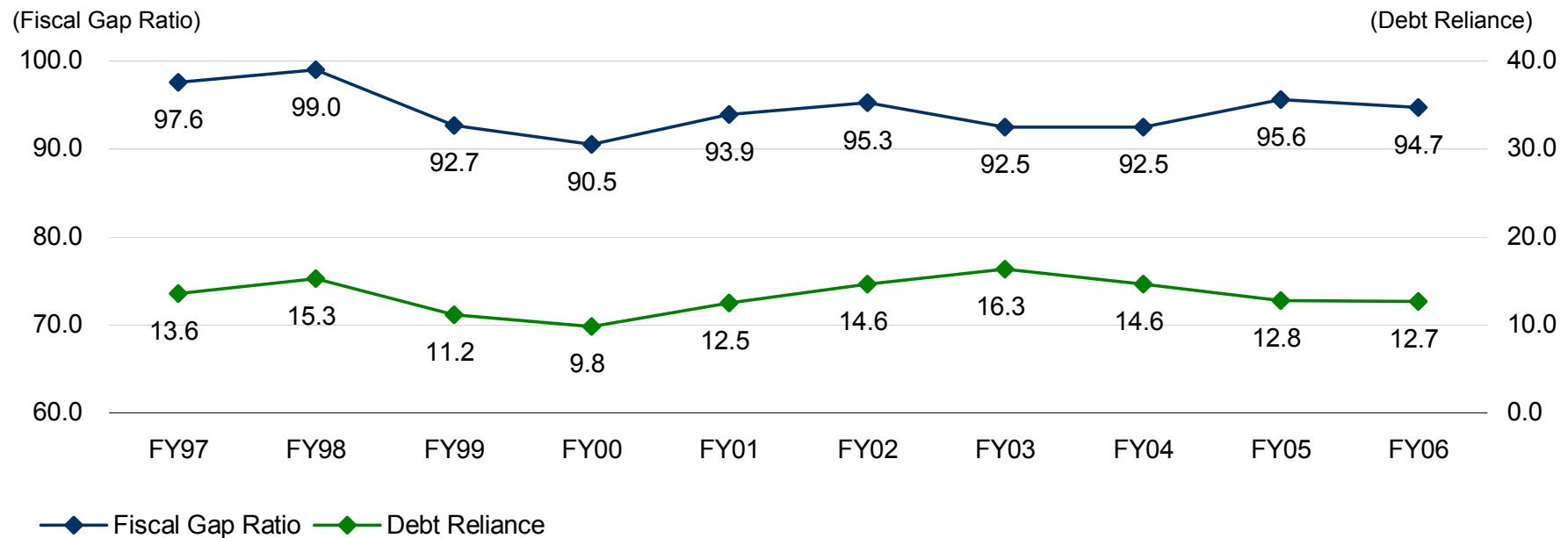
- Debt service ratio declined by 0.2% (YoY) to 15.3% as the general revenue source total amount rose substantially due to large increases in local tax and local transferred tax while fiscal transfers and temporary fiscal expense were curtailed
- Fukuoka Prefecture consistently maintains a low level of debt service ratio relative to the nationwide average



$$\text{Debt Service Ratio} = \frac{\text{Amount of general revenue sources used for bonds redemption}}{\text{Total general revenue source amount}}$$

4. Financial Statistics – (3) Fiscal Gap Ratio / Debt Reliance

- Fiscal gap ratio declined by 0.9% (YoY) to 94.7% due to large increases in local tax and local transferred tax and efforts to cut costs despite an increase in social security and other expenses
- Prefectural bond reliance lowered by 0.1% (YoY) to 12.7% which was led by ongoing efforts to reduce temporary fiscal expense and new debt issuances



$$\text{Fiscal gap ratio} = \frac{\text{Gross Expenditure}}{\text{Gross Revenue}}$$

$$\text{Debt Reliance} = \frac{\text{New Debt Issue}}{\text{Gross Revenues}}$$

5. Fiscal Structure of Fukuoka Prefecture

Reduction in expenditures through fiscal structural reform efforts

As a result of ongoing fiscal structural reform since FY02, total expenditures in FY06 were lower than FY02 despite the rising social security expenses.

Increase in independent revenue sources

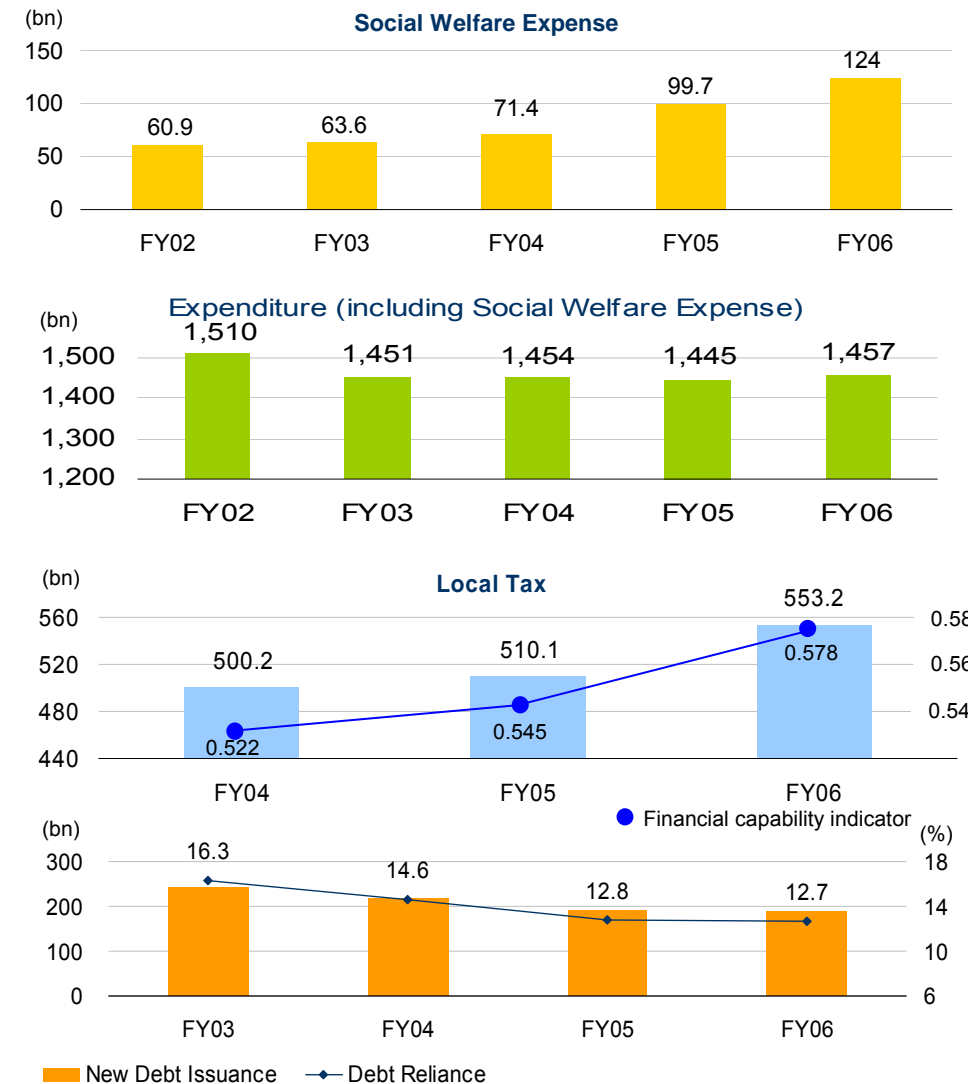
Increases in local taxes and other independent revenue sources improved Fukuoka Prefecture's fiscal capabilities and the degree of freedom in policy implementation even though local allocation tax and extraordinary financial measures bonds were reduced.

<Percentage of Gross revenue>

	FY04	FY05	FY06
local tax	33.5	34.5	37.2
Independent revenue source	47.5	49.0	50.4

Decline in debt reliance

Debt reliance has been declining over the past 3 years due to constant reduction of new debt issuances.



6. Public Enterprise Account

Prefecture-owned hospital reform

Approximately ¥4bn is transferred to hospital business every year. Since this has been a substantial burden on the general account, “Prefecture-owned Hospital Reform Plan” was formulated in FY03 in the aim of privatizing fall prefecture-owned hospitals.

Based on this plan, Asakura Hospital Digestive Organ Treatment Center, Onga Hospital, and Dazaifu Hospital Psychiatric Treatment Center were privatized in April 2005 and Yanagawa Hospital and Kaho Hospital were sold to the private sector in April 2007.

Privatization of all 5 prefecture-owned hospitals are now complete.

Public Enterprise Bureau

Public Enterprise Bureau operates 3 businesses: electricity, industrial water and sewage, and industrial land reclamation.

The first two posted net profits in FY06 and are still in sound business conditions.

Although industrial land reclamation remains unprofitable, the business is managed under the land reclamation reserves (¥3,616mn) that cumulate land sale profits.

FY2006 Result

Unit JPY million

		Electricity	Industrial Sewage	Industrial Land Reclamation	Total
B/S	Asset	3,886	31,521	9,755	45,162
	Liability	274	1,762	65	2,101
	Equity	3,612	29,759	9,690	43,061
	Retained Earning	322	1,125	3,144	4,591
	Total	3,886	31,521	9,755	45,162
P/L	Net Profit	53	219	▲ 336	▲ 64
	Carry-Forward	74	0	▲ 136	▲ 62
	Undivided profit	127	219	▲ 472	▲ 126

7. Affiliated Organization

Major Public Corporation (FY06)

Affiliated organizations are managed solidly. The Land Development Corporation has formulated its administrative improvement plan to eliminate their excessive debt.

Unit JPY million

		Fukuoka Land Development	Fukuoka Highway	Fukuoka-KitaKyushu Highway	Fukuoka Housing
Equity	Equity	30	30,327	204,306	5
	Fukuoka's Equity	30	22,937	102,153	4
	Ratio	100.0	75.6	50.0	76.0
	# of Shareholders	1	2	3	7
B/S	Asset	32,532	112,903	1,186,773	70,789
	Liability	32,665	82,576	981,890	56,654
	Equity	133	30,327	204,883	14,135
	Total	32,532	112,903	1,186,773	70,789
P/L	Net Profit	109	0	59	901
	Carry-Forward	54	0	518	4,137
	Undivided Profit	163	0	577	5,038

Minority-owned Business (FY06)

There are 39 businesses which Fukuoka Prefecture invests 25% or more of their capital, or which Fukuoka Prefecture provides financial support. Only one business is negative in terms of capital or net assets and measures have been taken to eliminate its excessive debt and to improve management.

Unit : JPY million

Equity	Fukuoka's equity	Subsidy from Fukuoka	Loan from Fukuoka	
88,597	38,324	2,855	19,334	38 businesses
▲ 104	280	0	0	1 business
88,493	38,604	2,855	19,334	Total

Fukuoka Prefecture's Administrative and Fiscal Reform

Fukuoka Prefecture's New Fiscal Structural Reform Plan

- In FY04, revenue source shortfalls grew as the central government dramatically reduced local allocation tax, etc. Although local tax revenue recovered in FY05 and FY06, shortfalls have not been covered due to continuous reduction in local allocation tax and increases in social security and other required obligations
- From FY07, the central government will continue to curtail regional general expenditures, thereby further reducing fiscal transfers, etc. and any substantial gains in general revenue sources are hardly expected. With an outlook for higher social security costs and other required expenses going forward, Fukuoka Prefecture will continue to proceed with further reforms

1. Reform Period

5 years from FY07 to FY11

2. Reform Policies

Unify measures aiming at “employment system with small number of capable people” cited in the administrative and fiscal reform framework and implementation of planned reforms across overall expenditures and revenue.

Seek correct responses to new regulatory demands and work to reduce revenue shortfalls foreseen in the future.

Focus on better efficiency of social capital provision, seek reduction of new bond issuances and shift the outstanding bond balance to a declining mode in FY10.

3. Contents of Reform

Personnel expense reduction (about ¥45bn)

Reduce headcount by 2,500, revamp special work allowances, etc.

Reforming administrative business (about ¥84bn)

Revise administrative process including personnel costs.

Reducing construction business expenses (about ¥27bn)

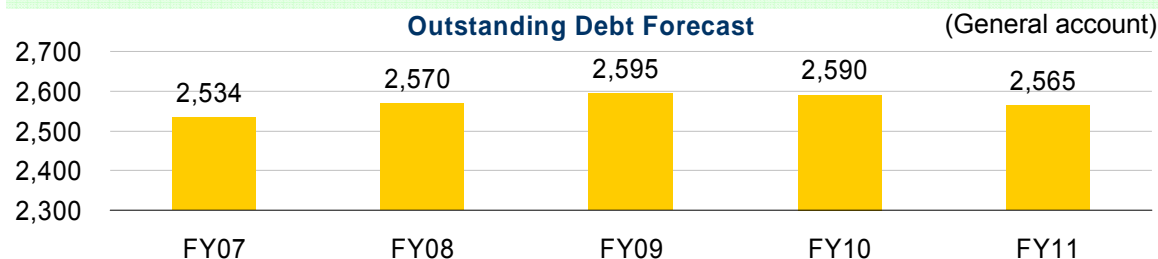
Increase efficiency of construction business, reduce prefecture's burden on its expenses.

Downsizing social security expenses (about ¥26bn)

Implement independent medicare cost containment efforts along with national medical reforms.

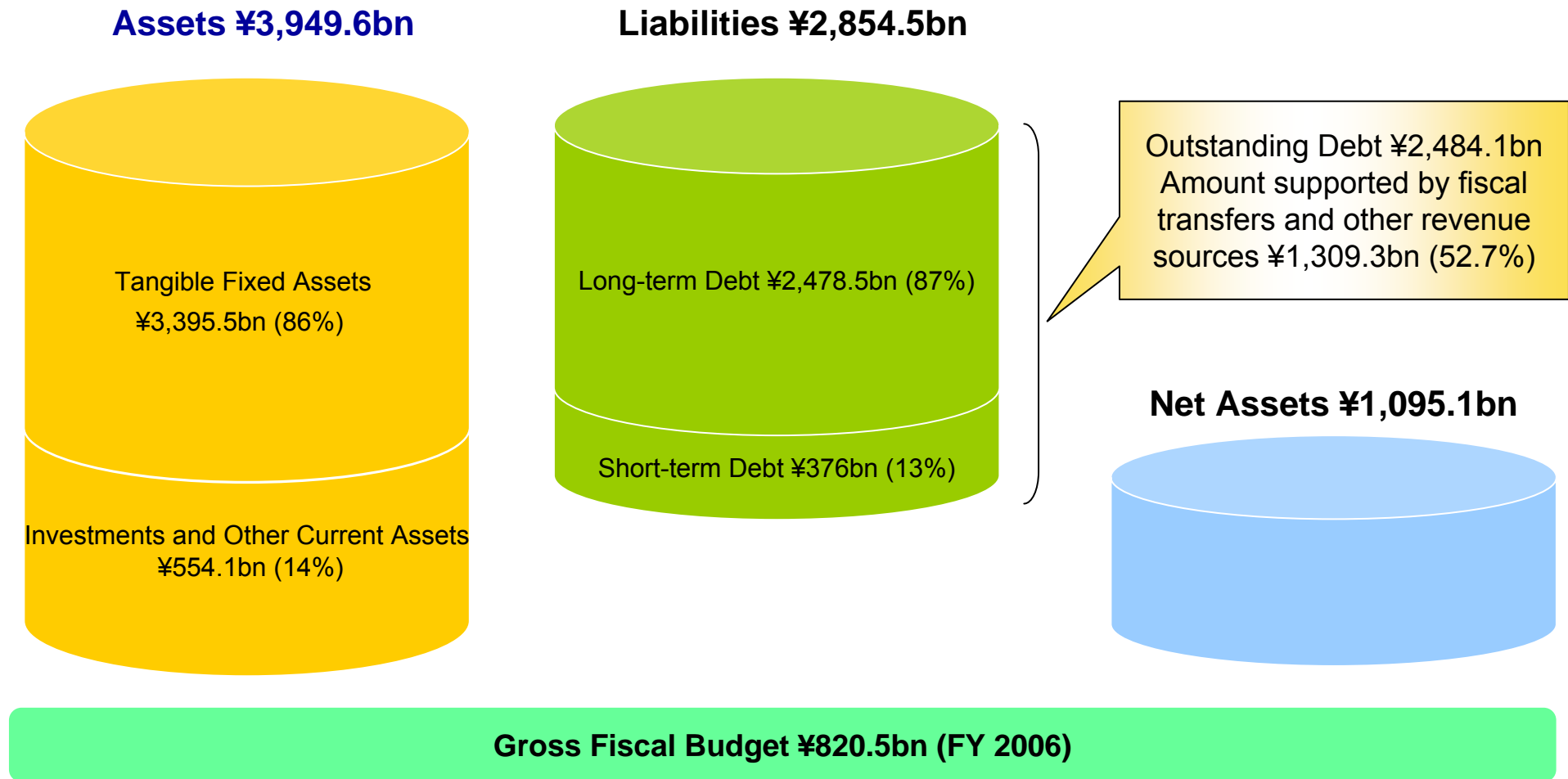
Achieve fiscal revenue (about ¥28bn)

Increase tax revenue, sale of unused land and effective use of funds.



Appendix: Fukuoka Prefecture's Balance Sheet

General account: as of March 31, 2007 (FY06)



Appendix: Funding Strategy

Hold one-on-one IR and group meetings to capture investor demand

Increase issuance frequency to improve liquidity
(From 6 times in FY06 to 11times in FY07 – nearly on a monthly basis)

Diversify the maturity ladder across the curve

- Issue 5-year bonds and 10-year bonds alternately
- Issue super-long maturity bonds in the first half and the second half

FY07 Funding Plan

unit: JPY bn

	June	July	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Total
5-year bonds	10		15		15					15	55
10-year bonds		15		15		15	10		15		70
Super long term			15		20						35
Total	10	15	30	15	15	15	10		15	15	160

Fukuoka Prefecture Rated Aa1 (Domestic currency rating)

Fukuoka Prefecture was rated by Moody's Investors Service on August 1, 2007.

The Aa1 rating is second - highest of Moody's 21 ratings.

Domestic currency rating: Aa1/Stable

Main points of evaluation for Fukuoka Prefecture

New fiscal structure and progress in administrative/fiscal reforms.

Reform plan intended to begin reducing prefectural debt level in FY10; goal appears achievable.

Relatively low per capita debt. Outstanding bonds of 490,000 yen per capita in FY06 – 7th lowest in Japan.

Economic recovery underway with potential for further expansion, especially in auto and other industries.