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Notice Concerning Revision of Fixed-Term Lease Contracts

This is to inform you that, Japan Hotel REIT Investment Corporation (hereinafter called “JHR”), resolved and concluded Contracts (hereinafter called the “Revised Contracts”) to revise fixed-term lease contracts (hereinafter called the “Contracts”) on 14 hotels in total (hereinafter called the “14 HMJ Hotels”) with Hotel Management Japan Co., Ltd. (hereinafter called “HMJ”) and its subsidiaries (with HMJ, collectively called the “HMJ Group”) as of today, as below.

Each company of the HMJ Group with which JHR concluded the Revised Contracts falls under the category of an interested party, etc. as stipulated in the Act on Investment Trusts and Investment Corporation (Act No. 198 of 1951, as amended; hereinafter called the “Investment Trust Act”). Therefore, with regard to the transactions of the Revised Contracts, the consent of the JHR was obtained based on the approval of the JHR’s board of directors meeting in accordance with the Investment Trust Act and the internal codes for transaction with sponsor-related parties stipulated by the Japan Hotel REIT Advisors Co., Ltd. (hereinafter called the “Asset Management Company”) (please see “4. Transaction with Interested Parties, etc.” below.).

(*) For the revision of fixed-term lease contracts, please also refer to page 8 to 10 in “Financial Result Briefing” announced today.

1. Rationale for the revision

Since February 2020, the hotel market has deteriorated rapidly due to the restraints on economic activities in Japan and overseas, the decline in the number of foreign visitors to Japan as well as the voluntary restraint of events across the nation and the suspension of operations at large theme parks following the state of emergency by the government as a result of the spread of infection of COVID-19.

Under such circumstances, JHR has been communicating closely with the HMJ Group, discussing and examining various measures with the HMJ Group, such as thorough implementation of measures to prevent infections and management of employees’ health at each hotel, reduction of operating costs by thorough review of the operations at each hotel, maintenance of necessary employment, correspondence to financing, etc.

After the discussion and examination with JHR, the HMJ Group has carried out large-scale restructuring of personnel costs and outsourcing costs, etc.. There restructurings are expected to result in cost reduction of at least JPY4.2Bn in the fiscal year 2020 and JPY1.5Bn in the fiscal year 2021 and beyond, compared with the fiscal year 2019, and working for further cost reductions based on the recognition of continuing impact by the spread of infection. Despite these efforts, the GOP (Note 1), which shows revenue before the rent payment of the HMJ Group, is expected to be JPY204MM, since there is a month which monthly sales decline to the JPY200MM level.

Therefore, it is difficult for HMJ Group to pay the full fixed rent (JPY9,530MM/year) from the GOP. Based on such financial conditions of the HMJ Group, JHR decided to review the Contracts and agreed to revise the Contracts with the HMJ Group to reduce the fixed rent for the fiscal year 2020 to the maximum amount that the HMJ Group can pay (JPY794MM/year) after using the internal reserve, and to revise the rent conditions for the fiscal year 2021 and thereafter for the purpose of the described at “2. Summary of the revision” below.

The HMJ Group operates 14 hotels with a total of 4,768 guest rooms. Many of which are large-scale full-service hotels, which require advanced management expertise. Since it is not practical to secure the alternative operators required by JHR in the current market environment from the viewpoint of both the scale of operations and the know-how of operations. Therefore, JHR judged that focusing on reconstructing sustainable relationships with the HMJ Group would contribute to the medium to long term interests of JHR, and JHR reached to agree upon the Revised Contracts.

2. Summary of the revision

The Revised Contracts for each tenant consists of “the Memorandum of Fixed-term Lease Contract” to revise the rent structure for the fiscal year 2020 and “Revised Contract on the Fixed-term Lease Contract” to revise the rent structure for the fiscal year 2021 and beyond.

For the rent structure for the fiscal year 2020, using the funding close to JPY500MM from its shareholders, etc., as its source, the HMJ Group agreed to set the equivalent amount to current monthly fixed rent for January, which was not affected by COVID-19, as fixed rent which amount far exceeds the current year’s forecast of GOP and monthly fixed rent from February onward was waved. On the other hand, when the market environment improves significantly, JHR can receive the variable rent in case the annual GOP exceeds the fixed rent for one month through the generation of the variable rent in the contract.

Although the hotel market is expected to gradually recover in the fiscal year 2021, it is difficult to predict the pace of recovery and downside risks due to the second or third wave of infection. Therefore, considering the possibility that the HMJ Group will not able to generate sufficient GOP for monthly fixed rent payments, the rent for the fiscal year 2021 will be the full variable rent scheme, which is the most flexible rent scheme for such risks was adopted. The rent shall be variable rent only, which is the full amount obtained by multiplying AGOP (Note 2) by a certain rate. The rates for AGOP are set at appropriate rates for each hotel depending on the contracts with each hotel, taking into account the previous rent burden ratio and cost reduction effects resulting from the restructuring.

The rent from the fiscal year 2022 onwards shall be a rent scheme that combines the fixed rent and variable rent like before, assuming the post-COVID-19 market environment. The fixed rent is partially adjusted according to the potential revenue of each hotel, however, the total fixed rent amount of total the 14 HMJ Hotels is the same as before. With the variable rent, JHR and the HMJ Group will share the effects of cost reduction through restructuring and set the base amount for variable rent and AGOP rate so that each hotel’s rent burden ratio will be at an appropriate level. By receiving cost reduction effects of the HMJ Group as the future variable rent, JHR aims to recover the amount of reduction of the fixed rent for the fiscal year 2020 over the medium to long term, while at the same time, the HMJ Group aims to improve their internal reserve, thereby the HMJ Group will improve the capability to pay rents in the event of a similar event occurring in the future.

The rent structure of the 14 HMJ Hotels after revision (fixed rent and variable rent) is shown in the table below.

(1) Fixed rent

No	Name	Lessee	Fixed rent			
			Before	After		
			FY2020 onwards	FY2020	FY2021	From FY2022 onwards
1	Kobe Meriken Park Oriental Hotel	Hotel Management Japan Co., Ltd.	JPY3,221MM/year	January only JPY268MM	Not applicable	JPY3,221MM/year
2	Oriental Hotel tokyo bay					
3	Namba Oriental Hotel					
4	Hotel Nikko Alivila					
5	Oriental Hotel Hiroshima					

6	Okinawa Marriott Resort & Spa	Lagoon resort Nago Co., Ltd.	JPY550MM/year	January only JPY45MM	JPY550MM/year
7	Sheraton Grand Hiroshima Hotel (ACTIVE-INTER CITY HIROSHIMA) (Note 3)	K.K. A.I.C Hiroshima Management	JPY348MM/year	January only JPY29MM	JPY348MM/year
8	Oriental Hotel Fukuoka Hakata Station	Hotel Centraza Co., Ltd.	JPY425MM/year	January only JPY35MM	JPY425MM/year
9	Holiday Inn Osaka Namba	OW Hotel Operations KK	JPY576MM/year	January only JPY48MM	JPY576MM/year
10	Hilton Tokyo Narita Airport	KK NaritaKosuge Operations	JPY444MM/year	January only JPY37MM	JPY444MM/year
11	International Garden Hotel Narita	KK NaritaYoshikura Operations	JPY336MM/year	January only JPY28MM	JPY336MM/year
12	Hotel Nikko Nara	Hotel Management Co., Ltd.	JPY420MM/year	January only JPY35MM	JPY420MM/year
13	Hotel Oriental Express Osaka Shinsaibashi	K.K. HOTEL ORIENTAL EXPRESS	JPY110MM/year	January only JPY9MM	JPY110MM/year
14	Hilton Tokyo Odaiba	Tokyo Humania Enterprise Inc.	JPY3,100MM/year On and after January 1, 2022: JPY1,600MM/year	January only JPY258MM	JPY1,600MM/year

(2) Variable rent

No	Name	Method of calculation of variable rent			
		Before		After	
		FY2020 onwards	FY2020	FY2021	From FY2022 onwards
1	Kobe Meriken Park Oriental Hotel	(The total GOP of The Five HMJ Hotels (Note 4) – base amount (JPY3,351MM/year)) x 85.0%	The total GOP of The Five HMJ Hotels x 89.78% – fixed rent for January	AGOP x 86.0%	(The total AGOP of The Five HMJ Hotels – base amount (JPY4,120MM/year)) x 85.0%
2	Oriental Hotel tokyo bay			AGOP x 79.0%	
3	Namba Oriental Hotel			AGOP x 91.0%	
4	Hotel Nikko Alivila			AGOP x 74.0%	
5	Oriental Hotel Hiroshima			AGOP x 89.0%	
6	Okinawa Marriott Resort & Spa	(GOP – base amount (JPY700MM/year)) x 90.0%	GOP x 82.92% – fixed rent for January	AGOP x 89.0%	(AGOP – base amount (JPY655MM/year)) x 95.0%
7	Sheraton Grand Hiroshima Hotel (ACTIVE-INTER CITY HIROSHIMA) (Note 3)	(GOP – base amount (JPY468MM/year)) x 82.5%	GOP x 79.03% – fixed rent for January	AGOP x 93.0%	(AGOP – base amount (JPY360MM/year)) x 90.0%
8	Oriental Hotel Fukuoka Hakata Station	(GOP – base amount (JPY442MM/year)) x 98.0%	GOP x 96.98% – fixed rent for January	AGOP x 97.0%	(AGOP – base amount (JPY442MM/year)) x 98.0%
9	Holiday Inn Osaka Namba	(GOP – base amount (JPY650MM/year)) x 92.5%	GOP x 90.15% – fixed rent for January	AGOP x 98.0%	(AGOP – base amount (JPY580MM/year)) x 97.0%
10	Hilton Tokyo Narita Airport	(GOP – base amount (JPY550MM/year)) x 86.5%	GOP x 83.59% – fixed rent for January	AGOP x 95.0%	(AGOP – base amount (JPY450MM/year)) x 93.0%
11	International Garden Hotel Narita	(GOP – base amount (JPY360MM/year)) x 98.0%	GOP x 95.35% – fixed rent for January	AGOP x 95.0%	(AGOP – base amount (JPY360MM/year)) x 98.0%

12	Hotel Nikko Nara	(GOP—base amount (JPY470MM/year)) x 91.5%	GOP x 90.05% — fixed rent for January	AGOP x 95.0%	(AGOP—base amount (JPY440MM/year)) x 95.0%
13	Hotel Oriental Express Osaka Shinsaibashi	(GOP—base amount (JPY128MM/year)) x 91.0%	GOP x 87.11% — fixed rent for January	AGOP x 87.0%	(AGOP—base amount (JPY128MM/year)) x 91.0%
14	Hilton Tokyo Odaiba	FY2020 to FY2021: (AGOP—base amount (JPY2,970MM/year)) x 30.0% On and after FY2022: (AGOP—base amount (JPY1,660MM/year)) x 98.0%	GOP x 92.10% — fixed rent for January	AGOP x 97.0%	(AGOP—base amount (JPY1,660MM/year)) x 98.0%

- (*1) GOP (gross operating profit) is the remainder after expenses, such as personnel costs and general and administrative expenses, etc. incurred in hotel operation, are deducted from total sales.
- (*2) AGOP is the amount calculated by subtracting certain fees and other items from hotel GOP.
- (*3) Stating the rent for Sheraton Grand Hiroshima Hotel, the main facility of ACTIVE-INTER CITY HIROSHIMA.
- (*4) The Five HMJ Hotels refers to Kobe Meriken Park Oriental Hotel, Oriental Hotel Tokyo Bay, Namba Oriental Hotel, Hotel Nikko Alivila, and Oriental Hotel Hiroshima, which JHR leases to HMJ.
- (*5) The existing fixed-term lease contracts for Okinawa Marriott Resort & Spa and Hotel Nikko Nara will expire on December 31, 2020. Therefore, the rent structure for FY2021 and beyond is stipulated in the new fixed-term lease contracts with the term of the lease from January 1, 2021 to December 31, 2030.

3. Future Prospects

For the operating forecast and forecast of dividend for the fiscal year ending December 2020 (21st Period) which reflect the impact of the Revised Contracts, please see the “Notice Concerning Difference Between Operating Forecast and Actual Results for the Midterm of the Fiscal Year Ending December 2020 (21st Period), and Operating Forecast and Forecast of Dividend for the Fiscal Year Ending December 2020 (21st Period)” announced today.

4. Transactions with Interested Parties, etc.

Each company of the HMJ Group, which is the lessee of the Revised Contracts, falls under the category of an interested party, etc. as stipulated in Article 201 of the Investment Trust Act as well as Article 123 of the Order for Enforcement of the Act on Investment Trusts and Investment Corporations. Therefore, in accordance with “the Rule for Transaction with the Sponsor-Related Parties” stipulated by the Asset Management Company, appropriate procedures stipulated in the Code for Transactions with Sponsor-Related Parties such as approval of the compliance committee attended by outside experts and of the Board of Directors meeting of JHR have been obtained, prior to the conclusion of the revised Contracts with each company of the HMJ Group.

* Website of Japan Hotel REIT Investment Corporation: <https://www.jhrth.co.jp/en/>