

Oct 30, 2013

R&I Upgrades to A-, Stable: Japan Hotel REIT Investment Corp.

Rating and Investment Information, Inc. (R&I) has announced the following:

ISSUER: Japan Hotel REIT Investment Corp.
Issuer Rating: A-, Previously BBB+
Rating Outlook: Stable

RATIONALE:

Japan Hotel REIT Investment Corp. (JHR), which was formed through the merger of Japan Hotel and Resort, Inc. and Nippon Hotel Fund Investment Corp. in April 2012, is a real estate investment trust (J-REIT) specializing in hotels. The REIT is sponsored by the following three companies: the RECAP group, a foreign real estate investment fund which serves as a main sponsor, Kyoritsu Maintenance Co., Ltd. and ORIX Real Estate Corp.

The rating upgrade for JHR this time reflects the following positive factors: improvements in the portfolio through asset replacements, favorable performance of existing hotels and conservative leverage policies.

After the merger, JHR issued investment units twice through public offerings, and acquired four large hotels, including Hilton Tokyo Bay Hotel, the largest property in the portfolio, and one to be acquired, for a combined total of more than 43 billion yen. Meanwhile, the REIT sold relatively less competitive properties by utilizing negative goodwill generated from the merger. As a result of these asset replacements, the quality and profitability of the portfolio improved significantly. The asset size has reached approximately 160 billion yen, and the REIT is expected to expand it further, capitalizing on its position as one of the few hotel REITs.

According to the interim results announced in August 2013, sales of the major five variable-rent hotels for 1H 2013 were higher than the same term last year and also than the initial forecast. Since full-year sales for 2013 are expected to increase year on year and profit margins are anticipated to rise, JHR revised upward the expected dividend per unit in August. Other hotels are also projected to generate fairly stable rent revenues, supported by long-term leasing contracts. The earnings environment for the hotel industry is improving, as domestic leisure demand recovers and foreign tourists visiting Japan increase on the back of the weaker yen and better business sentiment. Given this, coupled with the strong competitiveness of JHR's major properties and its prudent operations, earnings will continue to recover, in R&I's view.

The earnings environment for hotels is susceptible to economic fluctuations. However, more than 70% of JHR's earnings come from fixed-rate rents generated under long-term leasing contracts, and the NOI yield is high at the 6-7% level, which suggests JHR has a certain level of resilience to economic downturn.

JHR plans to keep its LTV ratio below 50% for some time. Following the two public investment unit offerings, the ratio fell from the level at the time of the merger, standing at a conservative level of 43.8% as of end-June 2013. Furthermore, the portfolio's appraisal value at that point was about 6.6 billion yen higher than its book value.

Its debts are mostly long-term loans, and due dates are comparatively staggered. Given relatively solid relationships with lender financial institutions, there seems no particular problem with funding. That said, JHR's borrowings are all secured at present. Its lender composition and borrowing costs also need to be improved, as compared with those of other REITs.

The Rating Outlook is Stable. JHR will continue to maintain and improve the quality of the portfolio through external growth, and earnings from existing assets will generally show a favorable trend. Its conservative leverage policies will also likely be maintained. As regards debt financing, improvement is needed. In order to obtain higher stability of creditworthiness, further strengthening of the funding base is a challenge that should be addressed.

■Contact : Investors Service Division TEL.+81-(0)3-3276-3511 E-mail. infodept@r-i.co.jp
■Media Contact : Corporate Planning Division (Public Relations) TEL.+81-(0)3-3276-3438

Rating and Investment Information, Inc. Nihonbashi 1-chome Bldg., 1-4-1, Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan <http://www.r-i.co.jp>

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The primary rating methodologies applied to this rating are provided at "Basic Methodologies for R&I's Credit Rating" and "Rating Methodology for J-REIT". The methodologies are available at the web site listed below, together with other rating methodologies that are taken into consideration when assigning the rating.

<http://www.r-i.co.jp/eng/cfp/about/methodology/index.html>

ISSUER: Japan Hotel REIT Investment Corp. (Sec. Code: 8985)

RATING: Issuer Rating
A-, Previously BBB+

RATING OUTLOOK: Stable

Unsec. Str. Bonds No.1	Issue Date	Maturity Date	Issue Amount (mn)
	Dec 28, 2010	Dec 27, 2013	JPY 2,000
RATING:	A-, Previously BBB+		