

DAVID Y. IGE
GOVERNOR



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DARRELL T. YOUNG

STATE OF HAWAII
DEPARTMENT OF TRANSPORTATION
869 PUNCHBOWL STREET
HONOLULU, HAWAII 96813-5097

IN REPLY REFER TO:

Board of Land and
Natural Resources
State of Hawaii
Honolulu, Hawaii

OAHU

ISSUANCE OF A LEASE TO PACIFIC SHIPYARDS INTERNATIONAL, LLC, AT
PIERS 24 AND 25, HONOLULU HARBOR, HAWAII, TAX MAP KEY NO. (1) 1-5-
038: 1 (POR.) AND 17

LEGAL REFERENCE:

Sections 171-6(7), 171-13, 171-17(b), 171-35, 171-36, and 171-59(b)(2)(A), Hawaii
Revised Statutes ("HRS"), as amended.

APPLICANT:

Pacific Shipyards International, LLC ("PSI"), P.O. Box 31328, Honolulu, Hawaii 96820

CHARACTER OF USE:

The use of a portion or all of Lots, 4, 5, 12, and 15 to support the operation of a marine
engineering, fabrication and repair facility including ship repair, ship building, and
specialty trade operations in support thereof.

LOCATION:

Portion of Government lands, portions of all of Lots 4, 5, 12, and 15, situated at Honolulu
Harbor, Iwilei, Oahu, Hawaii, Tax Map Key No. (1) 1-5-038, portion of 1, and 17, as
shown on the attached map labeled Exhibit "A."

ITEM M-12

AREA:

6.63 acres, more or less

CONSIDERATION:

The annual lease rent is based on appraised values for the two story building, fast lands, and submerged lands. The appraised values were agreed upon by both the Department of Transportation, Harbors Division's ("DOTH"), and PSI's appraisers. The issues for negotiation were related to the amount of the reductions be applied to the appraised values.

DOTH and PSI are in agreement that the annual lease rent for the first year shall be at gratis pursuant to §171-6(7), HRS, which provides that the Board of Land and Natural Resources ("Board") may:

(7) Reduce or waive the lease rental at the beginning of the lease on any lease of public land to be used for any agricultural or pastoral use, or for resort, commercial, industrial, or other business use where the land being leased requires substantial improvements to be placed thereon; provided that such reduction or waiver shall not exceed two years for land to be used for any agricultural or pastoral use, or exceed one year for land to be used for resort, commercial, industrial, or other business use;

DOTH and PSI also agree that the reduction shall include a relocation component since PSI is being forced to relocate, and a regulatory component that reflects the benefits and costs of doing business with government. The components of reduction replace the 50%, undefined use restriction discount that has been applied by appraisers, as a matter of rote practice, and by appraisers who have served as arbitrators in determining market rents pursuant to §171-17, HRS. The relocation reduction starts out at 40% for fast lands and decreases to 15% beginning year 11 to the end of the 35-year term. The regulatory reduction is 25% and remains at that rate for the 35-year term.

DOTH and PSI have agreed, subject to the approval of the Board of Land and Natural Resources, that PSI will sublease the second floor of the two-story building on Lot 4 to Sause Bros., Inc. ("Sause") until Sause, which is being forced to relocate, secures a new location. The sublease would be for a period not to exceed five years at the same rental rate to be paid by PSI.

Annual lease rent for the building, and fast and submerged lands will be as follows:

Years 2-5: \$497,283 to \$641,159
Years 6-10: \$756,264
Years 11-15: \$928,922
Years 16-20: \$952,474
Years 21-25: \$976,932
Years 26-30: \$1,001,717
Years 31-35: \$1,027,453

Three percent (3%) increases occur at years 16, 21, 26, and 31. Lease rent beginning year 36 shall be subject to reopening, and followed by reopenings every 10 years, or at years 46, 56, and 66.

ZONING:

State of Land Use Commission: Urban
City and County of Honolulu: I-3, Waterfront Industrial

TERM OF LEASE:

Seventy (70) years. Thirty-five (years) fixed rent, with rent reopeners at years 36, 46, 56, and 66.

COMMENCEMENT DATE:

To be determined by the Director of Transportation

CURRENT USE STATUS:

Tax Map Parcel 17 is encompassed within Lot 4 and is improved with a masonry and concrete two-story structure used for office space. The structure is currently occupied by the Harbors Police office on the ground floor and Sause Brothers administrative offices on the second floor. The remainder of the lot is improved with a parking lot containing approximately 20 stalls.

The pier extends thirty (30) feet inland from the harbor face, and consists of a concrete bulkhead, concrete piles, concrete apron, bollards, retaining wall and tie backs. A section of the pier area is currently being used to moor the Harbors Police boat.

The open cargo yard is comprised of both concrete and asphalt finished areas.

LAND TITLE STATUS:

Owned by State of Hawaii; management and control of the property was transferred to the Department of Transportation by Executive Order No. 2903.

CHAPTER 343 - ENVIRONMENTAL ASSESSMENT:

PSI's move to Piers 24 and 25 was included in DOTH's Environmental Impact Statement.

APPLICANT REQUIREMENTS:

PSI shall be required to:

- a. Proceed with the settlement of the outstanding issues at Pier 41 on or before June 30, 2016;
- b. Proceed with any and all requirements attendant to the completion of the lease terms and provisions, including but not limited to, providing DOTH with its development plans for the subject property as soon as practicable;
- c. Make permanent improvements to the fast lands, valued at not less than two million dollars and no cents (\$2,000,000.00), within five years from the effective date of the lease.
- d. As having use of piers and wharfs adjacent to its submerged lands, shall be responsible for the maintenance of the piers and wharfs and protected with a surety bond for the duration of the lease.
- e. Shall be subject to lease terms that include cost recovery by DOTH for any improvements that are required by PSI for its operation; and
- f. Comply with any other restrictions and/or conditions that may be imposed by the Board of Land and Natural Resources, as it may deem necessary.

REMARKS:

Applicant's Background

PSI is a commercial shipyard operating in Honolulu Harbor. PSI's primary business is ship repair. It provides vital maintenance and repair services for a wide range of

commercial vessels operating in or visiting the Hawaiian Islands, including: fishing boats, tug boats, inter-island barges, tour boats, specialty vessels, and passenger cruise ships. PSI also provides critical maintenance and repair support to the Navy, Coast Guard, Army, and other governmental owned/operated vessels.

Tracing its corporate roots back to 1920, PSI has almost a century of service and employs a combined workforce of 110 experienced production personnel skilled in steel and aluminum fabrication, welding, pipefitting, mechanical, machining, and preservation and coating services. It offers dry docking, rigging and cranes, and 24-hour mobile marine repair services.

PSI is certified by the American Bureau of Shipping, Navy, Army, and Coast Guard to provide welding, structural, and mechanical repairs. PSI also has government certified and approved programs for contract management and administration, quality, safety, environmental job planning, documentation, and reporting.

For emergency repairs, PSI is available 24 hours a day, 7 days a week, and 365 days a year. Repair specialists and equipment will deploy with a vessel to continue underway repairs so that the operator can maintain critical schedule commitments. Because of its centralized location in Honolulu Harbor, PSI services the entire Pacific Rim.

PSI is presently located at Pier 41, Honolulu Harbor, on about 7-acres of land. The planned Kapalama Container Terminal necessitates that PSI be relocated.

PSI is a current tenant under a revocable permit at Pier 41, on about 7 acres of land situated at the former Kapalama Military Reservation. At that site, it has a machine shop, weld shop, paint shop, a tool room that stocks consumable items, employee locker rooms, and administrative offices. PSI is being relocated to make way for the development of the Kapalama Container Terminal ("KCT"), which is one of the critical modernization projects identified by the Legislature in the enactment of the Harbors Modernization Plan under Act 200, Session Laws of Hawaii 2008). DOTH plans to begin construction of KCT at the end of this year and needs PSI to vacate its current premises at Pier 41. There are outstanding issues related to Pier 41. PSI shall be required to resolve these issues and complete the settlement agreement in the course of vacating Pier 41 no later than June 30, 2016, as a condition of the lease.

Direct Negotiation

Through public participation in the Environmental Impact Statement that relocates PSI to Piers 24 and 25, DOTH did not consider public auction for the subject lands. Also, in consideration of PSI's local history and a need for marine engineering, fabrication, and repair facility including ship repair and ship building in Honolulu Harbors, DOTH entered into lease negotiations with PSI under the direct negotiation provisions of §171-59(b), HRS. In doing so, DOTH intended to promote competition in the maritime and maritime related operations of ship building and ship repair, provide a local alternative to

West Coast ship repairs, preserve and protect the operations and jobs of a long-standing Hawaii company, and help maintain locally-based operators, of which there are a limited number.

Appraisal and Reductions

DOTH's and PSI's appraisers undertook their appraisals and reviews in accordance with the provisions of §171-17(b), HRS. At DOTHs' request, its appraiser provided the highest and best use, market rent valuation, for the property and acknowledged that a reduction is probably applicable, but left the negotiation and establishment of market value rate through such reduction up to the parties. PSI's appraiser, while agreeing with the base values of DOTH's appraiser, believed that a discount should be applied for the restricted use and undetermined environmental impacts upon the subject lands.

DOTH and PSI negotiated the lease terms in accordance with the nonbinding mediation provisions of §171-17(b), HRS. In lieu of the restricted use discount and a discount for any environmental impacts, the parties agreed upon a reduction for PSI's forced relocation and a regulatory reduction for the cost of doing business with government.

Relocation Reduction

DOTH provided a relocation reduction in recognition of the financial burden placed upon PSI in having to move its operations from Pier 41 to Piers 24 and 25.

Regulatory Reduction: Public Goods and Investments

In general, the government provides public benefits to support the community interests such as the safety and protection of our personal and commercial freedoms. Transportation systems and the development of energy and communication systems ensures economic security. The Harbors Division has specific duties as the landlord and monopoly operator to control and manage the commercial harbors, maintain waterfront improvements, ports, docks, wharves, piers, quays, bulkheads, and landings for the safe and efficient reception or disembarking of passengers, or for loading and landing merchandise.

Doing business with government also has burdens from regulatory processes, transparency requirements, and public trust fund reviews, which are not placed on businesses who lease private lands or are private enterprises without public funds. Other burdens arise from open and public processes that promote the public interests in the long-run, but in the short run, they result in additional time and costs such as extensive permitting requirements, minimum wage laws, equal access and environmental requirements. These requirements are for the public good and benefit society as a whole, which in turn supports businesses, and represent investments in sustainable, long-term markets. The regulatory reduction is a balance of the benefits and burdens that doing business with government has on a private entity, on case by case basis.

DOTH believes that the relocation and regulatory reductions better reflect the true nature of its operations on a case by case basis instead of the rote application of the restricted use discount that has been used as appraisal/arbitral precedent, without consideration of the specific circumstances that are attendant to each land disposition transaction.

The regulatory discount may be renegotiated at the end of the known lease rental period, beginning year 36 of the lease period.

Lease Terms

The specific terms and conditions of the lease are under ongoing negotiation in accordance with the direct negotiation provisions of §171-59(b) and the nonbinding mediation provisions of §171-17(b), HRS. DOTH and PSI request the Board's approval of the lease at this time in order to facilitate PSI's capital financing.

PSI requests an extended lease term of seventy (70) years under §171-59(b)(2)(A), which provides in part:

(b) Disposition of public lands for airline, aircraft, airport-related, agricultural processing, cattle feed production, aquaculture, **marine, maritime, and maritime-related operations** may be negotiated without regard to the limitations set forth in subsection (a) and section 171-16(c); provided that:

* * *

(2) The disposition shall not exceed a maximum term of thirty-five years, except in the case of:

(A) **Maritime and maritime-related operations, which may provide for a maximum term of seventy years;**

(Emphasis added.)

PSI agrees to make permanent improvements to the fast lands, valued at not less than two million dollars (\$2,000,000), within five years from the effective date of the lease.

Because ship building and ship repair operations are heavily capitalized, the seventy (70) year lease period is needed financially to provide investors with a sufficient period of security. And for direct negotiation purposes, the extended lease term ensures that at least one locally-based company will continue to operate in Hawaii for a significant period of time.

RECOMMENDATION:


That the Board authorizes the issuance of a Lease to the Applicant covering the subject area for the purposes cited above, subject to the terms and conditions outlined above and incorporated herein by reference, and such terms and conditions as may be prescribed by the Director of Transportation.

Respectfully submitted,

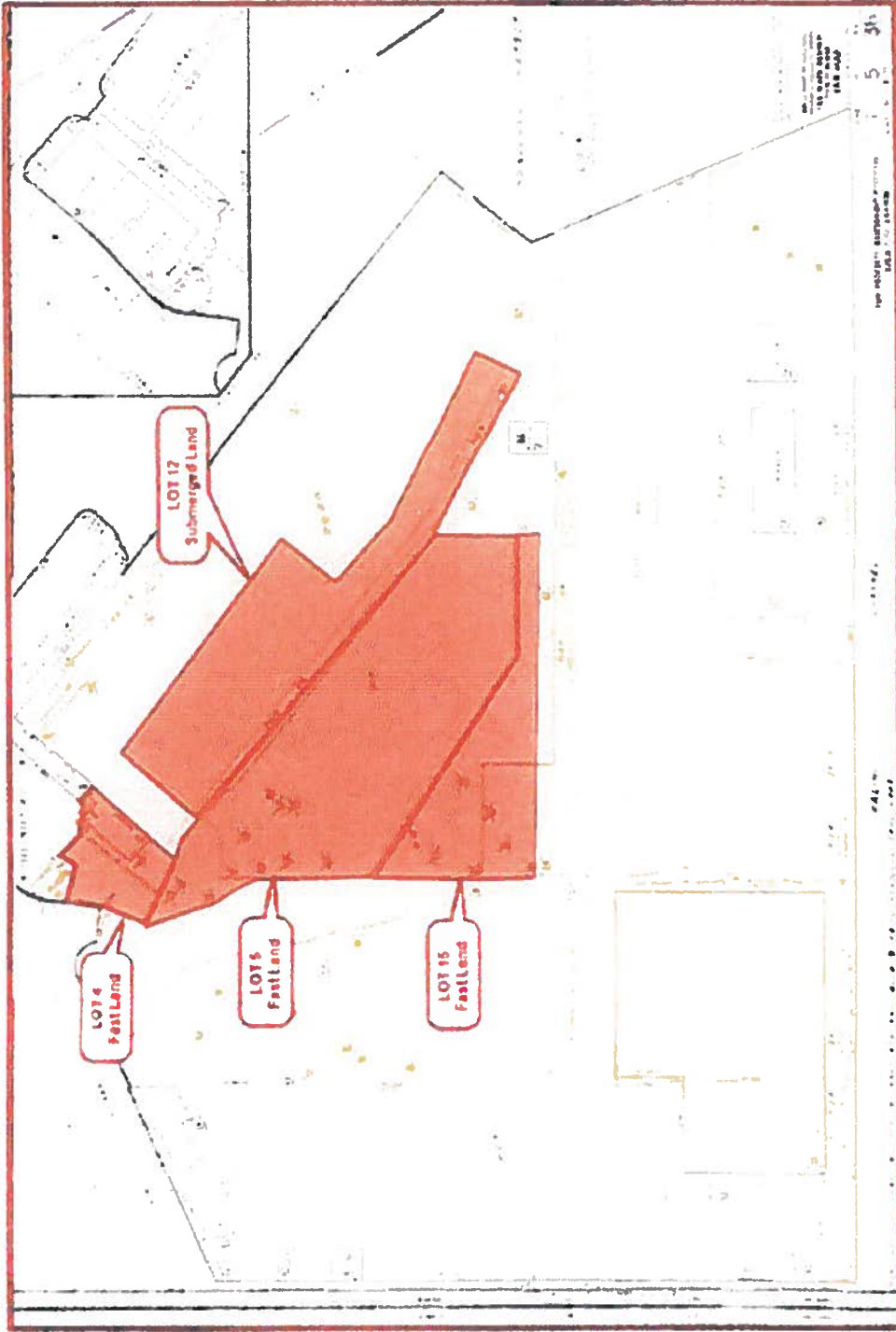


FORD N. FUCHIGAMI
Director of Transportation

APPROVED FOR SUBMITTAL:



SUZANNE CASE
Chairperson and Member
Board of Land and Natural Resources



Tax Map Key Map - Lot boundaries are approximate.