

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
Land Division
Honolulu, Hawaii 96813

August 12, 2016

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

Hawaii

Approve (1) Mediated Settlement of Rent Dispute Relating to Ten-Year Extension of General Lease No. S-3599, located in Hilo, Hawaii, TMK No. (3) 2-2-050:090, and (2) Change in the Start Date of the New Rent to the First day of the Ten-Year Extension of the lease.

APPLICANT:

Central Supply, Inc.

LEGAL REFERENCE:

Section 171-17, Hawaii Revised Statutes, as amended.

LOCATION AND AREA:

Portion of Government lands of Lot 22, Kanoiehua Industrial Lots, situated at Waiakea, South Hilo, Hawaii, identified by Tax Map Key no: (3) 2-2-050:090 and shown on the attached Exhibit A (see circled parcel no.). The area of the parcel is 33,750 sq. ft.

TRUST LAND STATUS:

Section 5(b) lands of the Hawaii Admission Act

DHHL 30% entitlement lands pursuant to the Hawaii State Constitution: No

CHARACTER OF USE:

Originally, GL 3599's character of use was jelly processing. At its meeting on March 14, 2014, the Board approved an amendment of the lease to change the character of use to uses allowed under the current County of Hawaii Zoning Code, ML-20, limited industrial.

DCCA VERIFICATION:

Place of business registration confirmed:	YES <u>X</u>	NO <u> </u>
Registered business name confirmed:	YES <u>X</u>	NO <u> </u>
Good standing confirmed:	YES <u>X</u>	NO <u> </u>

TERM OF LEASE:

The original term of the lease was for fifty-five years, expiring on January 15, 2016. At its meeting on March 14, 2014, the Board approved an extension of the lease for ten years (a final extension allowed under section 171-36(b), HRS), from January 16, 2016 through January 15, 2026, for a total of sixty-five years under the lease.

ANNUAL RENTAL:

For the last five years of the original fifty-five years of the lease term, the annual rent was \$22,500. When the Board approved the ten-year extension of GL 3599, it also approved an immediate reopening of rent. Thus, an independent appraiser was hired by DLNR to appraise the new rent as of March 14, 2014. Central Supply, Inc., hired its own appraiser to do an appraisal of the new rent as of the first day of the ten-year extension, January 16, 2016. Subsequently, DLNR and Central Supply, Inc. went into mediation to attempt to settle the rent dispute.

REMARKS:

The parties selected real estate appraiser Esther Price as the mediator. Vince Kimura and Michael Lau, Esq., represented lessee Central Supply, Inc. Russell Tsuji and Pamela Matsukawa from Land Division and deputy attorney general Cindy Young represented the department. Mediation was held on June 16, 2016, in Honolulu with all attending except for Mr. Kimura who was in touch with his attorney Michael Lau by phone. No agreement had been reached by the end of the day. Subsequently, the parties negotiated by email through Ms. Price and reached the Settlement Agreement attached as Exhibit C, which is subject to the Board's approval.

As the parties entered mediation, DLNR agreed to request that the Board approve a change in the start date of the new rent from March 14, 2014 to January 16, 2016, the first day of the ten-year extension. Staff believes that this is appropriate and agreed to recommend January 16, 2016 to the Board as the start date of the new rent for this final extension.

In looking at a value date that is almost two years past the date that staff asked DLNR's appraiser to use, staff found that the fair market rental value as of March 14, 2014 is not readily applicable to the January 1, 2016 value date. Some fair market rental values in the Kanoelehua industrial area have fallen since 2014. For example, out of the three

appraisals of fair market rent for a ten-year extension of the DLNR leases near GL S-3599 with similar start dates and rents accepted by the lessees, two of them - - GL 3622 and GL 3619 -- had appraised fair market rental values that were less than the immediately preceding rents. (Note: The two leases had a provision requiring that the rental for any ensuing rental period shall be the rental for the immediately preceding rental period or the fair market rental at the time of reopening, whichever is higher, so the applicable contract rent was the rent for the immediately preceding period.)

Central Supply, Inc.'s appraiser's final conclusion of value was \$.59 per sq. ft. or \$20,000 per year as of January 16, 2016, which was not convincing to staff in light of the three appraisals done for DLNR industrial leases in close proximity to GL 3599, having similar effective dates, and having been accepted by the lessees. For these three DLNR leases, the rental values were \$.87 per sq. ft. and \$.94 per sq. ft.

The fair market rental values of the three DLNR leases, DLNR's appraiser's rental values for GL 3599, and Central Supply, Inc.'s appraiser's rental value for GL 3599 are compared in the chart below.

GL No.	Size	Fair Market Ground Rent	Fee Simple Land Value & Rate of Return	Zoning	Effective Date
3599 (DLNR)	33,750 sq. ft.	\$35,420/yr. or \$1.05/sq. ft. & \$1.15/ sq. ft for 4 yrs. after initial 3.8 yrs. & \$1.27/ sq. ft. for last 4 yrs.	\$15.00/sq. ft. & 7%	ML-20	3/14/2014
3599 (Central Supply, Inc.)	33,750 sq. ft.	\$.59 per sq. ft. (based on appraiser's final conclusion of \$20,000)	\$12.16/sq. ft. & 4.75% \$12.74/sq. ft. & 4.75% \$11.26/sq. ft. & 3.30%	ML-20	1/16/2016
3622	13,932 sq. ft.	\$13,100/yr. ¹ or \$.94/sq. ft.	\$15.50/sq. ft. & 6%	ML-20	3/20/ 2016
3621	39,000 sq. ft.	\$34,100/yr. or \$.87/sq. ft.	\$14.30/sq. ft. & 6%	ML-20	2/24/ 2016
3619	13,975 sq. ft.	\$13,150/yr. ² or \$.94/sq. ft.	\$15.70/sq. ft. & 6%	ML-20	2/06/ 2016

During the course of mediation the DLNR staff and the mediator emphasized the comparability of industrial leases GL 3622, GL 3621, and GL 3619 because of their

1_/ Based on a lease provision requiring the higher of the preceding rent or the current fair market rent to be paid, the contract rent for a ten-year extension was concluded to be \$15,480, the higher preceding rent. For purposes of analysis at mediation, the current fair market rent of \$13,100 per annum was used.

2_/ Based on a lease provision requiring the higher of the preceding rent or the current fair market rent to be paid, the contract rent for a ten-year extension was concluded to be \$15,120, the higher preceding rent. For purposes of analysis at mediation, the current fair market rent of \$13,150 per annum was used.

proximity to the subject GL 3599 and their similar effective dates. Exhibit B shows their locations with respect to GL 3599. Particular focus was on GL 3621 because GL 3621 is most closely comparable to the subject GL 3599 in size. Appraisers often adjust for size, where a larger parcel is valued less per square foot. GL 3622 and GL 3619 are in the 13,900 sq. ft. range and have a rental value of \$.94 per sq. ft. GL 3621 is 39,000 sq. ft., which is most similar to the subject GL 3599 at 33,750 sq. ft. GL 3621's rental value is \$.87 per sq. ft.

DLNR staff thus concentrated on \$.87 per sq. ft. Central Supply, Inc., raised the fact that the GL 3599 parcel has no sewer line to connect to in its location on Makaala Street, whereas GL 3621 on Holomua Street has a sewer line running along that street that it may connect to. DLNR staff began to discuss with the mediator what discount, if any, may be appropriate to account for the lack of a sewer line for GL 3599's parcel and began to negotiate based on an assumption that an adjustment may be appropriate. However, the June 16, 2016 mediation session ended without an agreement. Subsequently, through the email efforts of Ms. Price, the parties reached an agreement of \$.825 per sq. ft. or \$27,843.75 per year. The Settlement Agreement executed by the parties is attached as Exhibit C.

RECOMMENDATION:

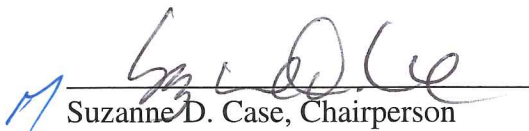
That the Board approve the mediated settlement of \$.825 per sq. ft. or \$27,843.75 per year for the ten-year extension of GL 3599, and approve the start date of the rent to be January 16, 2016, the first day of the ten-year extension period, instead of March 14, 2014.

Respectfully Submitted,



Russell Y. Tsuji
Land Division Administrator

APPROVED FOR SUBMITTAL:



Suzanne D. Case, Chairperson





MEDIATION SETTLEMENT AGREEMENT

July 8, 2016

Russell Y. Tsuji
Land Division Administrator
State of Hawaii
Department of Land and Natural Resources
Land Division
P.O. Box 621
Honolulu, Hawaii 96809

Vince M. Kimura
President
Central Supply Inc.
31 Makaala Street
Hilo, Hawaii 96720

Re: **State of Hawaii General Lease No. S-3599**
31 Makaala Street, Hilo, Hawaii 96720
Third Division Tax Map Key 2-2-50, Parcel 90

PARTIES

The State of Hawaii Department of Land and Natural Resources is the Lessor and Central Supply, Inc. is the Lessee under the above-referenced lease which commenced on January 16, 1961 and was scheduled for termination on January 15, 2016. The Lessee requested a lease extension for the ten-year term commencing January 16, 2016. The Lessor and Lessee, within the body of this document, are referred to as "DLNR" and "Central Supply", and in plural as "Parties".

BACKGROUND INFORMATION

The total term of the original lease was 55 years and the subject land area is 33,750 square feet (0.775 acres). On March 14, 2014, The Board of Land and Natural Resources approved a "Request for Consent to Extension of Lease Term Pursuant to Act 207, Session Laws of Hawaii 2011, General Lease No. S-3599 Central Supply, Inc., Lessee; Amendment of Terms and Conditions Regarding Allowed Use, Assignment and Sublease Provisions for General Lease No. S-3599; Lot 22 Kanoelehua Industrial Lots, Waiakea, South Hilo, Hawaii, Tax Map Key: (3) 2-2-50:90". This consent granted the Lessee a ten-year lease extension, commencing January 16, 2016 and expiring on January 15, 2026 for an aggregate term of (initial 55 year term plus extension) of 65 years.

Exhibit C

The rent for the extended term was to be determined "by an immediate appraisal that will cover the period from the date of the Board action through January 15, 2026". The appraiser shall be selected by the State but paid for by Lessee". According to the terms of Lease No. S-3599, new rentals are to be based "upon the then market value of the land at the then current rate of return for similar properties".

DLNR and Central Supply, Inc. independently commissioned appraisals of the ground rent for the ten-year term commencing January 16, 2016 but, based on the market value estimates of two different appraisers, could not mutually agree on rent for the next ten-year term.

LEGAL REFERENCE

Pursuant to Hawaii Revised Statutes (HRS) Chapter §171-17 subsection (d) (2), which states, in part: "If the board's and the lessee's appraisers do not agree upon the lease rental, the lessee and the board shall in good faith attempt to resolve the dispute by nonbinding mediation by a single mediator mutually agreed upon by the parties".

MEDIATION SETTLEMENT

The initial mediation conference was held on June 16, 2016 at the CBRE office, located at 1003 Bishop Street, Suite 1800, Honolulu, Hawaii 96813. DLNR was represented by Russell Y. Tsuji, DLNR Land Division Administrator; Pamela K. Matsukawa, DLNR Appraisal and Real Estate Specialist; and Cindy Y. Young, Esq., Deputy Attorney General. Central Supply was represented by its legal counsel, Michael H.Q.L. Lau, Esq. Esther H.C. Price served as the mediator. The initial mediation resulted in an impasse. Negotiations subsequently continued via emails between the Parties and Esther H.C. Price from June 22, 2016 to June 30, 2016 with both Parties acknowledging tentative settlement on June 30, 2016. The tentative settlement agreement is subject to review and approval by the State of Hawaii's Board of Land and Natural Resources.

The Parties agreed to the following Fair Market Rent per annum for the ten-year term beginning January 16, 2016.

TWENTY-SEVEN THOUSAND
EIGHT HUNDRED FORTY-THREE DOLLARS AND SEVENTY-FIVE CENTS
(\$27,843.75)

ADDITIONAL AGREEMENTS

The Parties mutually agree that subject to the DLNR review and approval of the rent conceptually but tentatively agreed upon with DLNR staff:

This agreement constitutes the complete understanding between the Lessor and Lessee and is binding on the Parties, their successors, and their representatives. No other terms, promises, or agreements will have any force or effect unless reduced to writing and signed by the individuals signing this agreement.

Russell Y. Tsuji
Vince M. Kimura
July 8, 2016
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All promises, conduct and statements made in the course of reaching this Mediation Settlement Agreement are confidential and are governed by HRS Chapter §626, Hawaii Rules of Evidence, Rule 408 Compromise, offers to compromise and mediation proceedings. The Parties acknowledge as a State agency, DLNR's files are public and that the final mediated fair market rent can be accessed by public request.

This agreement is binding on the signatories upon their signature. Both parties acknowledge that the Mediated Settlement agreement will be presented to the State of Hawaii's Board of Land and Natural Resources.

By signing below, the Parties acknowledge they have read this agreement in its entirety, understand all the terms and conditions of the Agreement, and having done so, knowingly, voluntarily and freely enter into this Agreement without coercion or duress.

It is understood that this Agreement may be executed in counterparts but it will have no force or effect unless and until executed by the mediator and authorized representatives of the Lessor and Lessee. The Parties and mediator will have each executed at least one but not necessarily the same counterparts. Russell Y. Tsuji will serve as the signatory for the Lessor and, Vince M. Kimura as the signatory for the Lessee.



Esther H.C. Price, MAI
Mediator

APPROVED AND ACCEPTED:

Lessor: STATE OF HAWAII
Department of Land & Natural Resources

By _____
Name: Russell Y. Tsuji
Title: Land Division Administrator

Lessee: CENTRAL SUPPLY INC.

By _____
Name: Vince M. Kimura
Title: Lessee

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Mediator

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Department of Land & Natural Resources

By 

Name: Russell Y. Tsuji
Title: Land Division Administrator

Lessee: CENTRAL SUPPLY INC.

By _____
Name: Vince M. Kimura
Title: Lessee

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Esther H.C. Price, MAI
Mediator

APPROVED AND ACCEPTED:

Lessor: STATE OF HAWAII
Department of Land & Natural Resources

By _____
Name: Russell Y. Tsuji
Title: Land Division Administrator

Lessee: CENTRAL SUPPLY INC.

By  7.8.16

Name: Vince M. Kimura
Title: Lessee