

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

June 28, 2019

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

PSF: 19HD-029

Hawai'i

Authorize the Department of Land and Natural Resources, Land Division, to Negotiate a Development Agreement for a 30-Year Extension of Lease Term, General Lease No. S-3742, JH Moku Ola, LLC, Lessee; Lot 29, Waiakea Industrial Lots, Waiakea, South Hilo, Hawaii, Tax Map Key: (3) 2-2-058:014.

Consent to Sublease, General Lease No. S-3742, JH Moku Ola, LLC, Lessee, to Maui Varieties Investments, Inc. Sublessee, Waiakea Industrial Lots, Waiakea, South Hilo, Hawaii, Tax Map Key: (3) 2-2-058:014

APPLICANT AND REQUEST:

Development Agreement for Lease Extension:

Lessee JH Moku Ola, LLC, a Hawaii limited liability company, is requesting an extension of General Lease No. S-3742 of 30 years, commencing on November 12, 2028 and expiring on November 11, 2058 for an aggregate term (initial term plus all extensions) of 95 years.¹

Sublease:

JH Moku Ola, LLC, a Hawaii limited liability company, as Sublessor, to Maui Varieties Investment, Inc., a Hawaii corporation, as Sublessee.

LEGAL REFERENCE:

Sections 171-36(a)(6), -191 and -192, Hawaii Revised Statutes (HRS), as amended, and Act 149, Session Laws of Hawaii 2018.

¹ Initial term of 55 years commencing on 11/12/1963 and expiring on 11/11/2018. Board previously approved a 10-year extension at its meeting of 9/11/15, Item D-1.

LOCATION:

Portion of Government lands of Lots 8 to 13 inclusive, Waiakea Industrial Lots situated at Waiakea, South Hilo, Hawaii, identified by Tax Map Key: (3) 2-2-058:014, as shown on the attached map labeled Exhibit A.

AREA:

2.165 acres, more or less.

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:

Allowed uses under the County of Hawaii zoning code, ML-20, Limited Industrial.

TERM OF LEASE:

Original term of 55 years, commencing on November 12, 1963 and expiring on November 11, 2018. Board approved extension of 10 years commencing on November 12, 2018 and expiring on November 11, 2028.²

Requested extension of 30 years commencing on November 12, 2028 and expiring on November 11, 2058.

TERM OF SUBLEASE:

9.5 years, commencing on May 12, 2019 and expiring on November 11, 2028.

ANNUAL RENTAL:

Current rent is \$85,260.00, due in quarterly installments of \$21,315.00 on February 12th, May 12th, August 12th and November 12th of each year.

ANNUAL SUBLEASE RENTAL:

\$300,000.00.

RECOMMENDED ADJUSTMENT TO LEASE RENTAL:

\$ 16,105.00 per year. (Refer to attached Exhibit B for analysis of sublease rental income.)

RENTAL REOPENINGS:

Rental reopenings in the original term were at the end of the 20th, 30th, 40th and 50th years of the original term. A rental reopening for the extended term was determined by an appraisal that projected the rent for the extension period of November 12, 2018 through November 11, 2028.

USE OF LOAN PROCEEDS:

The lessee proposes to complete general improvements to both warehouse structures as well as replace and upgrade the existing septic system and install two drywells. A complete list of improvements is attached as Exhibit C.

DCCA VERIFICATION:

SUBLESSOR:

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

SUBLESSEE:

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

APPLICANT REQUIREMENTS:

Applicant shall be required to comply with the requirements of Act 149 Sessions Laws of Hawaii 2018, negotiate a development agreement with department staff, and return to the Board at a later date for review and approval of the development agreement and requested lease extension.

BACKGROUND:

As a result of Act 32, Sessions Laws of Hawaii 1962, the direct lease of public lands to victims of natural disasters, General Lease No. S-3742 was issued to Hilo Trailer Ltd. for a period of 55 years effective November 12, 1963. A condition of the direct lease was that for the first five years, the character of use be consistent with the business being relocated. Hilo Trailer, Ltd. was in the business of manufacturing trailers, truck bodies and un-loaders.

On October 26, 1966 the lease was assigned from Honolulu Iron Works Company, Successor of Hilo Trailers, Ltd., as surviving corporation under merger agreement dated 10/31/1965 as Assignor, to Edward R. Kuwaye, James R. Kuwaye, Yasuo Kuwaye and Yoshinobu Kuwaye, doing business as co-partners under the firm name of Edward R.

Kuwaye & Company. At its meeting of March 10, 1967, under agenda item F-12, the Board consented to the change in character of use to include automotive repair and engine and parts sales.

The Board, at its meeting of January 12, 1979 under agenda item F-1-a, consented to the assignment of lease from Edward R. Kuwaye, James R. Kuwaye, Yasuo Kuwaye and Yoshinobu Kuwaye, dba co-partners under the firm name of Edward R. Kuwaye & Company as Assignors, to Yasuo Kuwaye, husband of Hanako Kuwaye, as Assignee.

At its meeting of April 12, 1990, under agenda item F-1-e, the Board consented to the assignment of lease from Yasuo Kuwaye, husband of Hanako Kuwaye, as Assignor to Yasuo Kuwaye, Trustee under that Revocable Trust Agreement of Yasuo Kuwaye dated April 9, 1986 and American Trust Co. of Hawaii, Inc., Corporate Trustee under that certain Revocable Trust Agreement of Yasuo Kuwaye dated April 9, 1986, as Assignees.

Further, at its meeting of July 8, 1994 under agenda item F-1-d, the Board consented to the assignment of lease from Yasuo Kuwaye, Trustee under that Revocable Trust Agreement of Yasuo Kuwaye dated April 9, 1986 and American Trust Co. of Hawaii, Inc., Corporate Trustee under that certain Revocable Trust Agreement of Yasuo Kuwaye dated April 9, 1986, as Assignor to Yasuo Kuwaye, Trustee under that certain unrecorded Revocable Trust Agreement of Yasuo Kuwaye dated April 9, 1986, as amended by Amended Revocable Trust Agreement of Yasuo Kuwaye (Self-Trusted Trust) dated March 23, 1993, as Assignee.

At its meeting of February 11, 2005 under agenda item D-8, the Board consented to the assignment of lease from Yasuo Kuwaye, Trustee under that certain unrecorded Revocable Trust Agreement of Yasuo Kuwaye dated April 9, 1986, and amended by Amended Revocable Trust Agreement of Yasuo Kuwaye (Self-Trusted Trust) dated March 23, 1993, as Assignor, to JH Moku Ola, LLC, as Assignee, who, at the time of the assignment, was a tenant subleasing a portion of the property.³

As indicated above, the original term of this lease was for 55 years, commencing on November 12, 1963 and expiring on November 11, 2018. At its meeting of September 11, 2015, agenda item D-1, the Board approved an extension of the lease for an additional 10 years to allow the Lessee to amortize the self-financed improvements made to the property.⁴

³ As originally issued, the lease allowed the Lessee to “sublet a part of the leasehold premises without approval of the Board”. However, the Board approved an amendment of the lease at its meeting of September 11, 2015, Item D-1, that changed the subleasing provision to require Board consent.

⁴ Improvements included replacement of existing roof, gutters and downspout, re-siding of exterior walls and electrical improvements.

LEASE EXTENSION:

With the Lessee's current lease set to expire on November 11, 2028, the Lessee is requesting an additional 30-year extension pursuant to Act 149, Session Laws of Hawaii 2018 (Act 149) in order to amortize the cost of additional improvements to the property. Act 149 allows up to a 40-year extension of leases located in the Hilo Community Economic District (HCED) based on "substantial improvements" to the lease premises:

"Substantial improvements" means any renovation, rehabilitation, reconstruction, or construction of the existing improvements, including minimum requirements for off-site and on-site improvements, the cost of which equals or exceeds thirty per cent of the market value of the existing improvements that the lessee or the lessee and developer install, construct, and complete by the date of completion of the total development.

The subject lease is located within the HCED as defined in Act 149. Lessee's proposed improvements include the replacement of the roof on the larger of the two warehouses on the property along with other renovations to the premises at a cost in excess of \$433,000.00 (Exhibit C).⁵ An appraisal evaluation performed by a certified appraiser has determined that the economic life of the proposed improvements will exceed the thirty-five-plus-year period necessary to amortize the refurbishments. The appraiser, contracted by the Lessee, determined the market value of the current improvements to be \$1,185,000.00. Lessee's proposed expenditure of \$433,000.00 represents 36.5% of the value of the existing improvements (\$1,185,000.00), and Lessee is only seeking a 30-year extension of the lease. Accordingly, Lessee's proposed expenditure appears to justify the requested 30-year extension under Act 149.

The subject parcel is located in an area served by aging and/or substandard infrastructure. The area also includes numerous other DLNR parcels currently encumbered by long term leases that have been extended and are scheduled to expire within the next ten years. Most of the DLNR leases in this area were established pursuant to Act 4, First Special Session of 1960 and Act 32, Sessions Laws of Hawaii 1962 resulting from the destruction of the Hilo bay front caused by the 1960 tsunami. Businesses that were severely impacted by the tsunami were given the opportunity to relocate to the newly created industrial area of Kanoelehua. These acts provided the Lessees with an option to purchase the land within two years. Several businesses exercised this option creating an industrial area of mixed DLNR leases and fee simple properties.

Act 149 also stipulates that prior to entering into a development agreement, the lessee shall submit to the Board the plans and specifications for the total development being proposed.

⁵ Once the requested lease extension is granted, Lessee will seek a consent to mortgage from the Board or Chairperson, as appropriate, in order to finance improvements to the property. The Lessee has prequalified for a loan from First Hawaiian Bank of up to \$500,000.00. As a condition of the loan, the bank is requesting the Lessee obtain an extension of the current lease including the known fixed rent for a minimum of 10 years beyond the established amortization period (minimum of 35-years).

The Board shall review the plans and specifications and determine: 1) Whether the development proposed is of sufficient worth and value to justify the extension; 2) The estimated time to complete the improvements and expected date of completion; 3) The minimum revised annual rent based on the fair market value of the lands to be developed, as determined by an appraiser for the Board, and the percentage rent where gross receipts exceed a specified amount.

The Lessee has submitted a proposed development agreement outlining the terms and conditions required in compliance with Act 149 and Section 171-192(a), HRS, as amended. Staff is requesting authority to negotiate the terms and conditions of the development agreement with Lessee and present it to the Board for approval at a later date, along with the improvement plans and specifications.

There are no outstanding rental reopening issues. The Lessee is current with rent, insurance and performance bond.

No agency comments were solicited on the request because it involves a lease extension; not a new disposition.

SUBLEASE:

The Lessee has submitted a proposal to sublease a portion of the lease area to Maui Varieties Investments, Inc. (doing business as Ace Hardware Hawaii). The subleased portion of the property includes 60,000 sq. ft. of open storage area as well as 14,000 sq. ft. of warehouse space. The Sublessee proposes to utilize the property as a distribution center for the company's retail outlets on the island of Hawaii. In addition, Sublessee will have a retail operation in the warehouse.

The Lessee has also indicated that the Sublessee will be making improvements to the facilities in addition to the above-mentioned improvements proposed by the Lessee. Details for these improvements will be provided to the Hawaii District Land Office at a later date.

Staff is recommending that the Board increase the annual lease rent by \$16,105, due to the excess income derived from the sublease.

RECOMMENDATION:

That the Board, subject to the Applicant fulfilling the Applicant requirement listed above:

1. Authorize the Department of Land and Natural Resources, Land Division, to negotiate a development agreement with Lessee JH Moku Ola, LLC for a 30-year extension of General Lease No. S-3742, covering the State-owned parcel identified by Tax Map Key: (3) 2-2-058:014 pursuant to Act 149 Session Laws of Hawaii 2018 and Section 171-192, Hawaii Revised Statutes, as amended, with the

understanding that the authorization shall not be deemed to be an approval of the development proposal or lease extension at this time, as staff shall return to the Board at a later date for review and approval of development agreement and lease extension, including plans and specifications for improvements submitted by the Lessee.

2. Authorize the sublease of General Lease No. S-3742 between JH Moku Ola, LLC., as Sublessor, and Maui Varieties Investment, Inc., as Sublessee, subject to any applicable conditions cited above which are by this reference incorporated herein and further subject to the following terms and conditions:
 - A. The standard terms and conditions of the most current consent to sublease form, as may be amended from time to time;
 - B. Review and approval by the Department of the Attorney General; and
 - C. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.

Respectfully Submitted,



fr Gordon C. Heit
District Land Agent

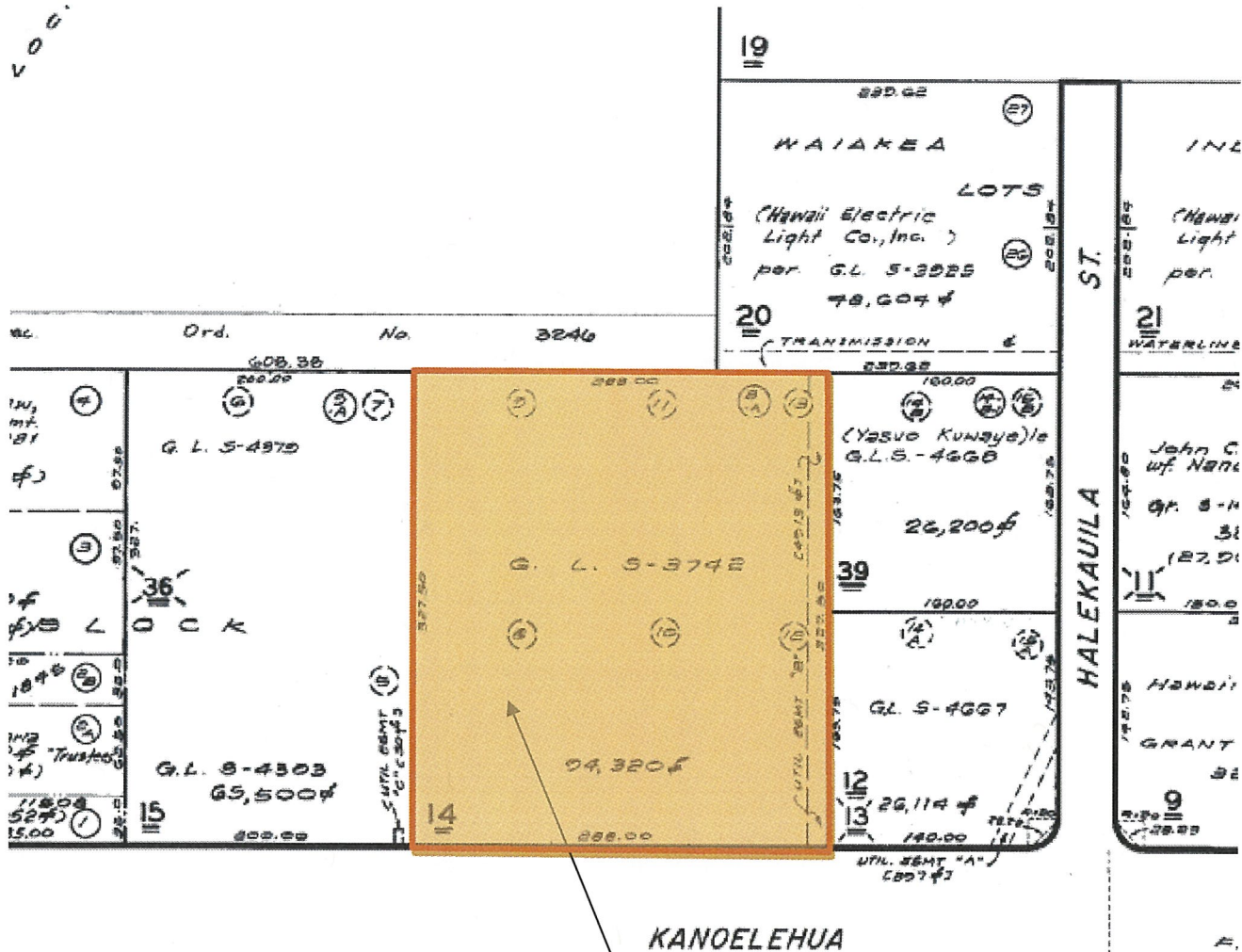
APPROVED FOR SUBMITTAL:



Suzanne D. Case, Chairperson

EXHIBIT A

TMK: (3) 2-2-058:014



SUBJECT PROPERTY



STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
LAND DIVISION

75 Aupuni Street, Room 204
Hilo, Hawaii 96720
PHONE: (808) 961-9590
FAX: (808) 961-9599

June 28, 2019

MEMORANDUM

TO: Suzanne D. Case, Chairperson

THROUGH: Russell Y. Tsuji, Division Administrator

FROM: Gordon C. Heit, District Land Agent

SUBJECT: In-House Recommendation – Sublease Participation Calculation

GL No.:	S-3742
Lessee/Sublessor:	JH Moku Ola, LLC
Sublessee:	Maui Varieties Investment, Inc.
Location:	Waiakea, South Hilo Hawaii
Lease Area:	2.165 acres (94,307 square feet) (Total building area – 22,000 sq. ft.)
Sublease Area:	74,000 square feet (includes 14,000 sq. ft. bldg.)
Tax Map Key:	(3) 2-2-058:014
Char. of Use:	Allowed uses under COH ML-20, Limited Industrial

We have been requested to provide an in-house evaluation of the sublease premium due to the State for the subleasing of a portion of GL S-3742 JH Moku Ola, LLC, Lessee/Sublessor to Maui Varieties Investment, Inc, Sublessee. The sublease documents and information provided by Lessee were analyzed and staff applied the formula approved by the Land Board on January 26, 2001, agenda item D-8, and modified by the Board at its meeting on August 24, 2012, agenda item D-14, comprising of the Sublease Rent Participation Policy.

The original term of this lease was for 55 years, commencing on November 12, 1963 and expiring on November 11, 2018. At its meeting of September 11, 2015, agenda item D-1, the Board approved an extension of the lease for an additional 10 years to allow the Lessee to amortize self-financed improvements in the amount of \$37,000.00.¹ These improvements were completed by September 30, 2016.

¹ Improvements included replacement of existing roof, gutters and downspout, re-siding of exterior walls and electrical improvements.

EXHIBIT B

In addition to the extension, the lease was also amended to provide that the Board shall have the right to review and approve the rent to be charged to the sublessee and shall have the right to revise the rent for the premises based on the rental rate charged to the sublessee.

The Lessee has submitted a proposal to sublease a portion of the lease area to Maui Varieties Investments, Inc. (doing business as Ace Hardware Hawaii). The subleased portion of the property includes 60,000 sq. ft. of open storage area as well as 14,000 sq. ft. of warehouse space. The Sublessee proposes to utilize the property as a distribution center for the company's retail outlets on the island of Hawaii. In addition, Sublessee will have a retail operation in the warehouse.

Staff was guided by the approved Rent Participation Policy item 1(c)(ii) for lessees paying fair market rent which states:

"If the lessee subleases improvements not owned by the State, the Board shall not receive any portion of sublease rents from subleasing improved space unless: (i) that right and method of calculation are specifically stated in the lease, or (ii) participation in sublease rents is warranted considering the age of the improvements (including but not limited to the extent to which the improvements have been depreciated or amortized), lessee's expenditures to maintain the same in relation to sublease revenues, and the extent to which the lessee actually occupies and uses the lease premises for its own business."

The Lessee made improvements to the lease in the amount of \$37,000 as a condition of the 10-year extension and therefore will need to amortize its cost over the remaining term of the lease. The following calculation allows for full amortization of the Lessee's financial improvements along with allowances for property insurance, maintenance costs, General Excise Tax, and Real Property Tax.

CALCULATION:

Annual Ground Rent	\$85,260.00
Annual Sublease Rent	\$300,000.00
Less G. E. Tax	\$ -12,510.00
Less Real Property Tax	\$ -20,531.00
Misc. Allowances ²	\$ -20,652.00
Total Allowances	<u>\$ -41,183.00</u>
Total Sublease Rent	\$161,047.00
Income to Land (less GET)	\$287,490.00
Annual Ground rent	\$ -85,260.00
Total Allowances	<u>\$ -41,183.00</u>
Total Amount	\$161,047.00
DLNR Rent Participation	<u>10%</u>

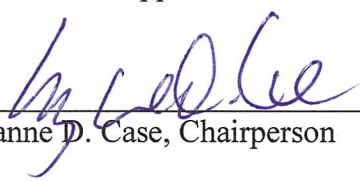
² Amortized financed improvements, insurance and maintenance costs

Additional Annual Rent Due

\$16,105.00

Based on the analysis above, staff is recommending that the Board increase the annual lease rent by \$16,105 due to the excess income derived from the sublease.

Approved/Disapproved:



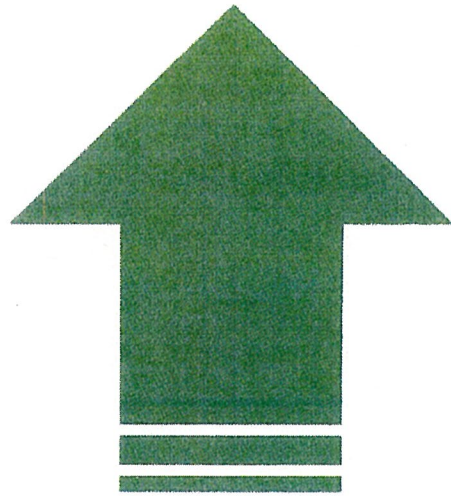
Suzanne D. Case, Chairperson



Date


cc: District Branch Files
Central Files

**TOTAL PROPERTY IMPROVEMENT
COST BY JH MOKU OLA LLC**



\$433,000

EXHIBIT C

EXHIBIT C

REPAINT BUILDING A & B

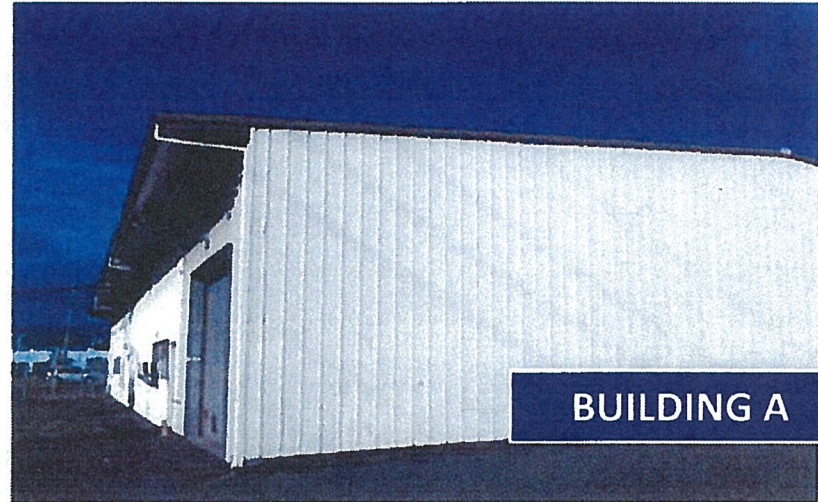
- ✓ ROOF
- ✓ SIDEWALLS

TOTAL COST: \$90,000

REVAMP BUILDING A & B

- ✓ PATCH ROOF (A&B)
- ✓ REMOVE VENTS (A)
- ✓ FLASH OFF SCREENED OPENINGS IN WALL (A)
- ✓ CUT BACK RUSTED RAFTERS/ROOFING (A)
- ✓ INSTALL NEW PURLINS AT EAVE FOR BUILDING A ONLY (A)

TOTAL COST: \$60,000



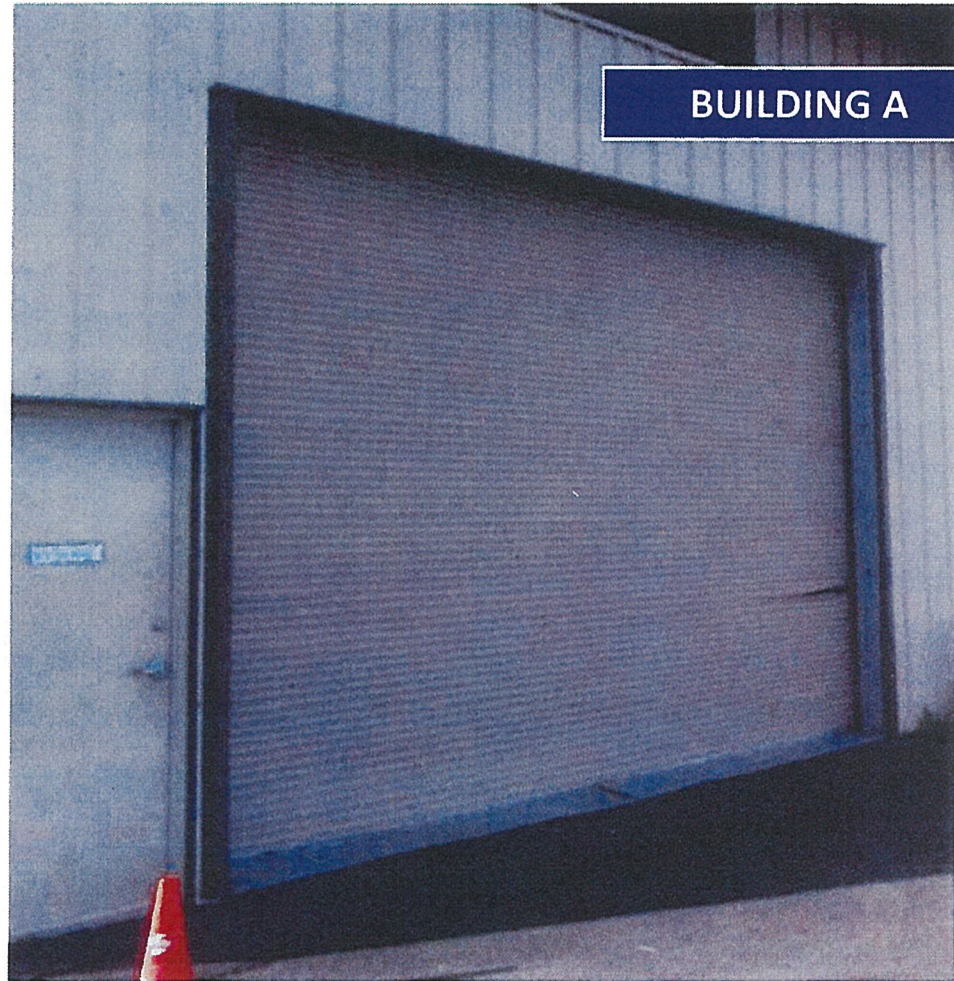
BUILDING A



BUILDING B

**REPLACE DAMAGED
ROLL UP DOOR**

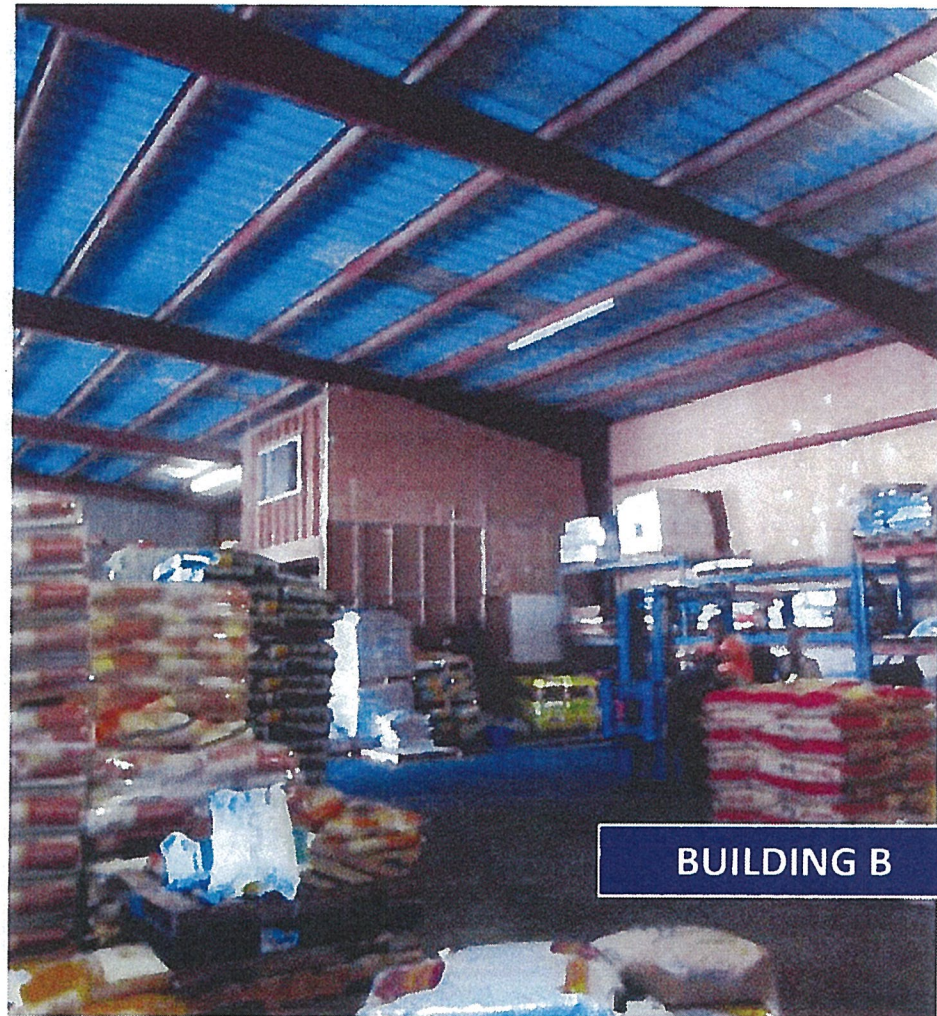
TOTAL COST: \$15,000



INSTALL INTERIOR INSULATION IN BUILDING B

- ✓ WALL (R13)
- ✓ UNDER ROOF FOR BUILDING B (R30)

TOTAL COST: \$75,000



BUILDING B

ADDITIONAL IMPROVEMENT & REPAIRS

1.	REPLACE GUTTERS AND DOWNSPOUTS ON BUILDINGS A & B	\$18,000
2.	INSTALL (2) SHALLOW DRYWELLS 7'-9" DEEP BY 8' IN DIAMETER WITH 10" THICK CONCRETE GRATED INLET COVER	\$28,000
3.	INSTALL (2) 1,250-GALLON JENSEN PRE-CAST CONCRETE SEPTIC TANKS WITH TRAFFIC RATED LEACH FIELD (INFILTRATORS)	\$58,000
4.	ENGINEERING AND DESIGN FOR SEPTIC AND SITE DRAINAGE	\$10,000
5.	ABANDON (3) CESSPOOLS, PUMP OUT AND BACKFILL	\$9,000
6.	REMOVE APPROXIMATELY 13,000 SQ FT OF EXISTING ASPHALT PAVEMENT, REGRADE FOR PROPER DRAINAGE TO SUMPS AND REPAVE WITH 2" THICK ASPHALT PAVEMENT	\$70,000

TOTAL COST: \$193,000

PLAN VIEW OF IMPROVEMENT & REPAIRS

