

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

January 10, 2020

PSF No: 10KD-133
GLS-3832 & S-5578

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

KAUAI

Linda J. Harding Warriner's Request for Reconsideration of the Board's Prior Board Action of October 25, 2019, Item D-1, *After-the-Fact Consent to Assignment of 100% Membership Interest in Lessee Pixar Development, LLC from John Kenneth Purdy to Hotel Coral Reef, LLC; After-the-Fact Consent to Quitclaim Assignment of Membership Interest in Lessee Pixar Development, LLC from Michael F. Harrah to Hotel Coral Reef, LLC; Assess Lease Assignment Premium Against John Kenneth Purdy and Linda J. Harding Warriner (the prior lessee), Jointly and Severally; After-the-fact Consent to Real Property Mortgage and Financing Statement, Pixar Development, LLC, Mortgagor, and First Hawaiian Bank, Mortgagee (2010 Mortgage); General Lease Nos. S-3832 and S-5578, Pixar Development, LLC, Lessee, Kapaa Town Lots, Kapaa, Kawaihau, Kauai, Tax Map Keys: (4) 4-5-011:046 and 4-5-012:005.*

Linda J. Harding Warriner requests reconsideration of that portion of the Board's action of October 25, 2019, Item D-1, that assessed a premium of \$56,470.50 plus interest against her based on an assignment of General Lease No. S-5578 that occurred on March 31, 2005.

BACKGROUND:

At its meeting of October 25, 2019, item D-2, the Board of Land and Natural Resources (Board) approved, as amended,¹ a number of requests relating to the assignment and mortgage of General Lease Nos. S-3832 and S-5578. One of the items the Board approved was the assessment of a lease assignment premium in the amount of \$56,470.50 on General Lease No. S-5578 against two prior lessees, Linda J. Harding Warriner and John Kenneth Purdy,² with interest thereon at the rate of 10% per annum from and after October 25, 2019. Although staff mailed copies of the staff submittal to Ms. Warriner and Mr. Purdy as soon as the matter was confirmed on the Board agenda, neither Ms. Warriner nor Mr. Purdy

¹ The Board's amendment of the staff submittal made a correction to the commencement date for charging interest on the lease assignment premium the Board assessed.

² John Kenneth Purdy was actually a principal of lessee, Pixar Development, LLC.

appeared at the meeting or submitted testimony. A copy of the staff submittal, approved as amended, is attached as Exhibit I.

REMARKS:

After the Board meeting of October 25, 2019, staff mailed copies of the approved-as-amended submittals to Mr. Warriner and Mr. Purdy. Within a week of the meeting, Ms. Warriner contacted staff and explained that she was out of State at the time of the meeting and did not see the correspondence from Land Division relating to this matter until she returned home to Kauai. Ms. Warriner asked if there was any way for the Board to reconsider the matter and give her an opportunity to submit testimony against the assessment of an assignment premium against her. Staff suggested that she write a letter to the Chairperson.

Ms. Warriner wrote a letter to the Chairperson dated November 11, 2019, a copy of which is attached as Exhibit II. In the letter, Ms. Warriner explains that she sold the hotel and assigned the State leases at issue to Mr. Purdy's company, Pixar Development, LLC (Pixar), in 2001. She adds that despite the continuing liability provision in the Board's consent to the assignment of lease, she had no control over whether Mr. Purdy would comply with the lease requirements when he later sold Pixar to Hotel Coral Reef, LLC (HCR) in 2005. Ms. Warriner questions why the lease assignment premium was not assessed against Mr. Purdy in 2005 when he sold Pixar to HCR.³

Further, Ms. Warriner explains that she did not share in any of the profit Mr. Purdy made when he sold the hotel in 2005. She adds that she complied with the lease when she held it and always paid her rent on time. Ms. Warriner states that it is "neither just nor fair" to impose the lease assignment premium against her.

Ms. Warriner additionally states that she is a single senior citizen living on a fixed income who recently had surgery for lung cancer. She explains that "the imposed assignment premium of \$56,470.50 is not only out of bounds of my financial abilities, but it would also result in an unbelievable hardship and would negatively affect the rest of my years." Ms. Warriner requests that she be removed as a responsible party regarding the assignment premium and interest. See Exhibit II.

The imposition of a premium upon assignment of the lease is discretionary with the Board. General Lease No. S-5578 states in part at section 13 that:

prior to the approval of any assignment of lease, the Board shall have the right to review and approve the consideration paid by the Assignee and may condition its consent to the assignment of the lease on payment by the

³ As explained in the staff submittal of October 25, 2019, Neither Mr. Purdy nor HCR notified the State of the transaction at the time. Land Division staff only learned of the sale to HCR many years later when Pixar sought an extension of its leases.

Lessee of a premium based on the amount by which the consideration for the assignment . . . exceeds the straight-line depreciated cost of improvements and trade fixtures being transferred to the Assignee

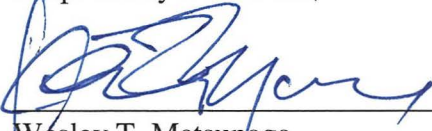
Emphasis added.

Because the assessment of an assignment premium is discretionary, staff believes the Board additionally has the discretion to assess an assignment premium against the lessee responsible for the assignment at issue, and not against a predecessor-in-interest (who remained responsible under the continuing liability language of the Board's consent). Staff believes that in this particular case, the equities weigh in favor of not assessing the assignment premium against Ms. Warriner.

RECOMMENDATION: That the Board:

- I. Amend its Prior Board Action of October 25, 2019, under agenda Item D-1 by deleting recommendation C in its entirety and replacing it with the following:
 - C. Assess a lease assignment premium against John Kenneth Purdy in the principal amount of \$56,470.50, plus interest at the rate of 10% per annum from and after October 25, 2019 until paid in full, subject to the terms and conditions cited above, and further subject to the following:
 1. Receipt of payment of the lease assignment premium and accrued interest shall not be a condition precedent to the consummation of the consents to assignment referenced in recommendations A and B above; and
 2. Authorize the Department of the Attorney General, the Department of Land and Natural Resources, or their agents to collect all monies due the State of Hawaii under for the March 31, 2005 lease assignment premium General Lease No. S-5578 and to pursue all other rights and remedies as appropriate.
- II. Except as amended hereby, all terms and conditions listed in the Board's action of October 25, 2019, agenda Item D-1, as amended, shall remain the same.

Respectfully Submitted,



Wesley T. Matsunaga
District Land Agent

APPROVED FOR SUBMITTAL:



Suzanne D. Case, Chairperson



AMENDED

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

October 25, 2019

Ref. No.: 10KD-133
GLS-3832 & S-5578

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

KAUAI

After-the-Fact Consent to Assignment of 100% Membership Interest in Lessee Pixar Development, LLC from John Kenneth Purdy to Hotel Coral Reef, LLC; After-the-Fact Consent to Quitclaim Assignment of Membership Interest in Lessee Pixar Development, LLC from Michael F. Harrah to Hotel Coral Reef, LLC; Assess Lease Assignment Premium Against John Kenneth Purdy and Linda J. Harding Warriner (the prior lessee), Jointly and Severally; After-the-fact Consent to Real Property Mortgage and Financing Statement, Pixar Development, LLC, Mortgagor, and First Hawaiian Bank, Mortgagee (2010 Mortgage); General Lease Nos. S-3832 and S-5578, Pixar Development, LLC, Lessee, Kapaa Town Lots, Kapaa, Kawaihau, Kauai, Tax Map Keys: (4) 4-5-011:046 and 4-5-012:005.

APPLICANTS:

Pixar Development, LLC, lessee and mortgagor; John Kenneth Purdy, assignor; Michael F. Harrah, assignor; Hotel Coral Reef, LLC, assignee; and First Hawaiian Bank, mortgagee.

LEGAL REFERENCE:

Sections 171-6, -22 and -36, Hawaii Revised Statutes, as amended.

LOCATION:

Portion of Government lands of Kapaa Town Lots, situated at Kapaa, Kawaihau, Kauai, identified by Tax Map Keys: (4) 4-5-011:046 (Parcel 46) and 4-5-012:005 (Parcel 5), as shown on the attached maps labeled Exhibit 1.

as amended
APPROVED BY THE BOARD OF
LAND AND NATURAL RESOURCES
AT ITS MEETING HELD ON
October 25, 2019 Go.

EXHIBIT I

ZONING/AREA:

Lease No.	Tax Map Key: (4)	Area/Use of Land	State Land Use District	County of Kauai CZO
GLS-3832	4-5-011:046	0.5930 acre, improved with hotel structure	Urban	Open
GLS-5578	4-5-012:005	0.2210 acre, improved with parking lot	Urban	C-G (General Commercial District)

Additionally, both parcels are located in the Special Management Area.

TRUST LAND STATUS:

Section 5(b) lands of the Hawaii Admission Act

DHHL 30% entitlement lands pursuant to the Hawaii State Constitution:

YES ____ NO x

CHARACTER OF USE:

GLS-3832: for resort-hotel purposes and uses accessory or incidental thereto and customarily conducted within hotel-resort areas.

GLS-5578: for hotel parking purposes.

TERMS OF LEASES:

General Lease Nos. S-3832 and S-5578, commenced on May 18, 1964 and May 18, 1999, respectively; both were set to expire on May 17, 2019. However, the Board extended both leases pursuant to Act 219 Sessions Laws of Hawaii 2011, until November 12, 2070 in exchange for the lessee making substantial improvements to the premises. The last rental reopening occurred on November 13, 2015; next rental reopening is scheduled for November 13, 2025.

ANNUAL RENTAL:

GLS-3832: Annual rent is \$129,000 and 2% of the annual gross revenue payable in the amount in excess of the annual base rent, with base rent due in semiannual installments of \$64,500 on the 13th Day of November and May of each year.

GLS-5578: Annual rent is \$27,000 and 2% of the annual gross revenue payable in the amount in excess of the annual base rent, with base rent due in semiannual installments of \$13,500 on the 13th Day of November and May of each year.

CONSIDERATION FOR ASSIGNMENTS:

Assignment of 100% Membership Interest in Lessee Pixar Development, LLC from John Kenneth Purdy to Hotel Coral Reef, LLC on March 31, 2005:

GLS-3832: \$1,369,800

GLS-5578: \$249,964

Quitclaim Assignment of Membership Interest in Lessee Pixar Development, LLC from Michael F. Harrah to Hotel Coral Reef, LLC on December 23, 2014, but effective March 31, 2005:

GLS-3832: Nominal consideration – related entity transaction.

GLS-5578: Nominal consideration – related entity transaction.

RECOMMENDED PREMIUM ON ASSIGNMENTS:

Assignment of 100% Membership Interest in Lessee Pixar Development, LLC from John Kenneth Purdy to Hotel Coral Reef, LLC on March 31, 2005:

GLS-3832: Not applicable as the lease did not allow for a premium at the time of the transaction.

GLS-5578: \$56,470.50, plus interest at the rate of 10% per annum from April 1, 2005 until paid in full.

Quitclaim Assignment of Membership Interest in Lessee Pixar Development, LLC from Michael F. Harrah to Hotel Coral Reef, LLC on December 23, 2014, but effective March 31, 2005:

GLS-3832: Not applicable as the lease did not allow for a premium at the time of the transaction.

GLS-5578: None – nominal consideration paid in related entity transaction.

USE OF LOAN PROCEEDS:

The mortgage consent relates to a 2010 loan from First Hawaiian Bank (FHB) to Pixar Development, LLC (Pixar) in the amount of \$4,500,000. The 2010 loan proceeds were used in part to pay off a debt incurred for hotel room renovation, and furniture and fixtures at Hotel Coral Reef located partly on the subject lands.

DCCA VERIFICATION:

PIXAR DEVELOPMENT, LLC

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

HOTEL CORAL REEF, LLC

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

As natural persons, John Kenneth Purdy and Michael F. Harrah are not required to register with the DCCA.

BACKGROUND:

At its meeting of March 9, 2018, under agenda Item D-1, as amended, the Board of Land and Natural Resources (Board) approved a request by lessee Pixar Development, LLC (Pixar) for consent to a new mortgage with First Hawaiian Bank (FHB) with estoppel certificate, and an amendment of a Development Agreement dated August 17, 2016 between the Board and Pixar to extend the time for the construction of improvements required thereunder from 24 to 42 months. However, the Board withheld consent to two requested lease assignments and a 2010 mortgage Pixar had with FHB. The Board directed staff to seek the assistance of the Department of the Attorney General (AG) to determine who is responsible for paying a lease assignment premium when a transaction involves the sale of the membership interest in a lessee as opposed to an outright assignment of the lease to a third party. A copy of the March 9, 2018 Board action under agenda Item D-1, as amended, is attached as Exhibit 2.

The Board was particularly concerned with a March 31, 2005 transaction in which John Kenneth Purdy assigned 100% of the membership interest in Pixar to Hotel Coral Reef, LLC (HCR), which is owned by Michael F. Harrah. The staff recommendation in the March 9, 2018 submittal was not to assess an assignment premium under General Lease No. S-5578¹ against any party to that transaction for a number of reasons, including lack of information on the whereabouts of Mr. Purdy. See Exhibit 2. However, the Board wanted a further analysis of the issue.

After the Board's action on March 9, 2018, Pixar and FHB closed the refinance of their 2010 mortgage. Their Real Property Mortgage and Financing Statement was recorded on April 18, 2018 in the Bureau of Conveyances as Document No. A-66820248. Additionally, by document dated April 26, 2018, the Board and Pixar amended their Development Agreement to extend the time of construction to 42 months.

¹ Of the two leases Pixar has from the State, only General Lease No. S-5578 includes a provision for assessing a premium on the assignment of the lease.

REMARKS:

In accordance with the Board's directive, staff sought advice from the AG as to who is responsible for a potential assignment of lease premium with respect to the March 31, 2005 membership interest transfer from Mr. Purdy to HCR. We understand that both Mr. Purdy and Pixar's immediate predecessor-in-interest, Linda J. Harding Warriner, are liable for the payment of any potential premium the Board assesses. Mr. Harrah and Pixar itself are not liable for the premium.

As explained in the staff submittal of March 9, 2018, Item D-1, the Board consented to the assignment of both leases from Ms. Warriner to Pixar at its meeting of October 26, 2001, Item D-10. The consent instrument for the 2001 assignment contains a standard continuing liability covenant specifying that the assignor (Ms. Warriner) is not released from "any and all responsibilities, obligations, liabilities, and claims respecting or arising under or out of said lease." See Exhibit 3 attached, which is a copy of the consent instrument.

There is a second assignment of membership interest at issue. By instrument dated December 23, 2014, but made effective as of March 31, 2005, Mr. Harrah made a quitclaim assignment of all of his membership interest in Pixar to HCR. However, it does not appear that Mr. Harrah owned a membership interest in Pixar as of March 1, 2005 or December 23, 2014. In any event, a transfer from Mr. Harrah to HCR would be a related entity transaction since Mr. Harrah owns all the membership interest in HCR.

After-the-Fact Consent to Assignments of Membership Interests:

Original General Lease No. S-3832 (the lease on which the hotel is located) was in effect in 2005 at the time Mr. Purdy sold his membership interest in Pixar to HCR and in 2014 when Mr. Harrah transferred 100% of his membership interest in Pixar to HCR.² It is not clear under the original lease whether a stock or membership interest transfer in a lessee requires prior Board consent. At the relevant times, the lease provided in part:

Assignments, etc. That the Lessee shall not transfer or assign any right, privilege or authority herein given or in a any manner transfer or assign this lease for the whole or any part of the term hereof, except by way of devise, bequest or intestate succession; provided, that with the prior written consent of the Lessor, the assignment and transfer of a lease or unit thereof may be made where any one of the following conditions are applicable: (1) the Lessee was required to put in substantial building improvements, (2) the Lessee becomes mentally or physically disabled, or (3) extreme economic hardship is demonstrated to the satisfaction of the Lessor.

² As explained in the staff submittal of March 9, 2018, Item D-1, original General Lease No. S-3832 was superseded as of September 7, 2016 by an Extended, Amended and Restated General Lease No. S-3832 the Board approved as part of the lease extension.

Original General Lease No. S-3832 was an older form lease that did not include any provision about the State receiving a premium upon the assignment of the lease.

Original General Lease No. S-5578 (the lease on which the parking lot is located) was a more modern lease that included the following language in the assignment clause:³

If the Lessee is a partnership, joint venture or corporation, the sale or transfer of 20% or more of ownership interest or stocks by dissolution, merger or any other means shall be deemed an assignment for the purposes of this paragraph and subject to the right of the Lessor to impose the foregoing premium.

Under this provision, Mr. Purdy and Mr. Harrah should have obtained prior Board consent for the two assignments of membership interest in Pixar.⁴ As mentioned above, Mr. Harrah explains that Pixar was not aware of the language in the lease regarding assignments. Pixar now seeks assignment after the fact.

Also as mentioned above, the consent to assignment instruments that the AG prepares typically include a signature block for the assignor and an agreement by the assignor that the assignment does not release it of liability. For the consent instrument the AG prepares for Mr. Purdy's assignment of his membership interest in Pixar to HCR, staff is including a recommendation below that it include language to the effect that the consent be deemed to be valid even without Mr. Purdy's signature on the document. Even if staff is successful in locating him, it seems unlikely that Mr. Purdy would willingly execute a consent instrument for a transaction that occurred over 15 years ago especially when he learns that the State is demanding payment of a large sum of money for the assignment of lease premium for the March 31, 2005 transaction.

Lease Assignment Premium Analysis Under Original General Lease No. S-5578:

Regarding the March 31, 2005 assignment of membership interest in Pixar, a lack of historical financial data makes it difficult to conduct a proper lease assignment premium analysis for General Lease No. S-5578 (the lease for the parking lot). When the Board approved the assignment of the lease from Ms. Warriner to Pixar on October 26, 2001, agenda Item D-10, no assignment premium was assessed based on the recommendation of the staff appraisers at the time. See Exhibit C of Exhibit 1 attached. In the 2001 transaction, a lump sum sales price of \$1,100,000 was paid for the two leases and adjoining

³ Original General Lease No. S-5578 was likewise superseded as of September 7, 2016 by an Extended, Amended and Restated General Lease No. S-5578 the Board approved as part of the lease extension.

⁴ As noted above, it is not clear that Mr. Harrah had any membership interest in Pixar to quitclaim to HCR in 2014 or 2005. Staff is including a recommendation below that the Board consent to this assignment as a precaution. If the Department of the Attorney General finds that Board consent is not required for Mr. Harrah's quitclaim assignment, then the consent document for that part of the transaction can be dispensed with.

parcel of private land, but no allocation was made among the three separate land interests involved in the sale. Because no allocation was made specifically for General Lease No. S-5578, staff is unable to accurately calculate the amount of any profit made on the lease between October 26, 2001 and March 31, 2005, when HCR paid Mr. Purdy \$249,964 for General Lease No. S-5578.

A rough calculation may be possible by working backward from the March 31, 2005 assignment of Mr. Purdy's interest in Pixar to HCR. For the 2005 transaction, HCR purchased the two State leases and private land constituting the hotel for a lump sum of \$2,500,000, and allocated the purchase price as follows:

<u>Land Interest</u>	<u>Allocation</u>	<u>% of Purchase Price</u>
Fee simple land (4) 4-5-012:006:	\$ 880,236	35%
General Lease No. S-3832:	\$1,369,800	55%
General Lease No. S-5578:	\$ 249,964	10%
Totals:	\$2,500,000	100%

If we assume that the same allocations as percentages of the total purchase price were applicable to the 2001 transaction, then the purchase price attributable to General Lease No. S-5578 in 2001 was \$110,000. Adjusted for inflation,⁵ \$110,000 in 2001 was equivalent to \$124,474 in 2005, meaning that Mr. Purdy potentially realized as much as \$125,490 in the sale of his membership interest in Pixar as it related to General Lease No. S-5578 (\$249,964 - \$124,474 = \$125,490). The lease assignment premium is calculated as a percentage of the assignment consideration (less the adjusted depreciated cost of improvements, where applicable).⁶ The assignment of lease premium participation schedule set forth in General Lease No. S-5578 is based on a term of 55 years,⁷ as follows:

For the first 5 years, the premium is 50% of the amount by which the consideration for the assignment, whether by cash, credit, or otherwise, exceeds the depreciated cost of improvements and trade fixtures being transferred to the assignee. The percentage will decrease by 5% after every 5 years of the total term has elapsed.

5 Consumer Price Index, All Items, 1982-84=100, for All Urban Consumers.

6 Once the Board has approved a lease assignment, GLS-5578 states that "the premium on any subsequent assignments shall be based on the difference in the selling and purchase price plus the straight-line depreciated cost of any improvements constructed by the then Assignor" In this case, there is no evidence that Pixar made any improvements to the parking lot on GLS-5578 during the time that Mr. Purdy owned Pixar. As a result, there is no "straight-line depreciated cost of . . . improvements" to factor into the equation.

7 Staff has confirmed with the AG that the 55-year schedule specified in the GLS-5578 is to be used even though the original lease was for a term of only 20 years.

<u>Years</u>	<u>Percentage</u>
1- 5	50%
6 - 10	45%
11 - 15	40%
16 - 20	35%
21 - 25	30%
26 - 30	25%
31 - 35	20%
36 - 40	15%
41 - 45	10%
46 - 50	5%
51 -	0%

The March 31, 2005 assignment of membership interest in Pixar occurred 6 years into the lease term of original General Lease No. S-5578. Under a 55-year premium participation schedule, an assignment in the sixth year of the lease results in a premium participation of 45% as indicated above. Based on 45% participation, the State is arguably owed a premium of \$56,470.50 on \$125,490 by Mr. Purdy and/or Ms. Warriner.

Additionally, the State should receive interest on any unpaid premium assignment. The lease provides for interest on unpaid rent at the rate of 1% per month, or 12% per year. But a question arises whether a lease assignment premium is "rent" as that term is used in the lease. If it is not, then an alternate interest rate needs to be determined. Hawaii Revised Statutes, Section 478-2, provides as follows:

478-2 Legal rate; computation. When there is no express written contract fixing a different rate of interest, interest shall be allowed at the rate of ten per cent a year, except that, with respect to obligations of the State, interest shall be allowed at the prime rate for each calendar quarter but in no event shall exceed ten per cent a year, as follows:

- (1) For money due on any bond, bill, promissory note, or other instrument of writing, or for money lent, after it becomes due;
- (2) For money due on the settlement of accounts, from the day on which the balance is ascertained;
- (3) For money received to the use of another, from the date of a demand made; and
- (4) For money upon an open account, after sixty days from the date of the last item or transaction.

As used in this section, "prime rate" means the prime rate as posted in the Wall Street Journal on the first business day of the month preceding the calendar quarter.

As noted above, General Lease No. S-5578 provides a rate of interest for unpaid rent but not for unpaid assignment premiums. Under this statute, staff believes the Board is within its rights to charge at least 10% per annum on the unpaid lease assignment premium. If interest were applied to this amount from the date of the March 31, 2005 transaction,

accrued interest alone as of October 31, 2019 would be \$82,333.99. See interest calculation table attached as Exhibit 4. Staff believes it would be more equitable to charge interest from the date the Board determines that a lease assignment premium is due to the State.

Accordingly, the Board would appear to be within its rights to assess a lease assignment premium against Mr. Purdy and Ms. Warriner, jointly and severally, in the principal amount of \$56,470.50, with accrued interest at the rate of 10% per annum until paid in full and staff includes a recommendation below to so assess it. Based on Internet research, staff located a potential address for Mr. Purdy at a law office in Edmonton, Alberta, Canada that was apparently valid in 2015. Staff additionally learned that Ms. Warriner lives in Kapaa, Kauai, and located a post office mailing address for her. Staff will send a copy of this Board submittal to Mr. Purdy and Ms. Warriner at these addresses to afford them an opportunity to be heard on this matter. Because Pixar has no control over whether Mr. Purdy or Ms. Warriner will pay the lease assignment premium, staff is recommending that the Board's consent to the lease assignments not be conditioned on receipt of payment of the assignment premium.

Consent to 2010 FHB Mortgage After-the-Fact:

On July 29, 2010, Pixar borrowed \$4,500,000 from First Hawaiian Bank (FHB). FHB recorded a Real Property Mortgage and Financing Statement in the Bureau of Conveyances as partial security for this obligation purporting to encumber the subject leases on August 17, 2010 as Document No. 2010-118887.

Original General Lease Nos. S-3832 and S-5578 both provided at the relevant time that the premises could be mortgaged with the prior consent of the Board.⁸ Among other properties owned by Pixar's affiliates in fee, the subject leases were mortgaged as security for the loan. Neither Pixar nor FHB sought the Board's prior consent to the mortgage. The mortgage was released pursuant to a Release recorded in the Bureau of Conveyances on May 25, 2018 as Document No. A-67190566. Pixar requests the Board's consent to the mortgage after the fact.

Update on Hotel Improvements:

On November 30, 2018, staff conducted an inspection of the portion of the Hotel Coral Reef located on State land. The inspection showed that the construction of a new third floor of the hotel on Parcel 46 was nearly complete, along with the addition of an elevator. The third-floor addition and elevator installation were made in a way that greatly complements the appearance and functionality of the portion of the hotel on State land. See photographs attached as Exhibit 5 (photos include two taken earlier on September 8, 2015 to show contrast between before and after start of construction).

⁸ Original General Lease No. S-5578 goes on to provide that any mortgage placed on the leases premises without such consent "shall be null and void."

However, when staff reviewed the lease files, staff determined there was no completion bond or labor and materialmen's bond on file for the project as required by the parties' Development Agreement. When staff brought this to Pixar's attention, Pixar attempted to secure the bonds but was advised by the bonding company that bonds could not be issued for the project because it was so near completion. In April 2019, Pixar supplied copies of lien releases signed by its contractor on the project and the contractor's subcontractors. Staff additionally requested Pixar to publish a notice of completion for the project as provided for under the State's materialmen's and mechanics lien statute. Pixar published a notice of completion for the work on the hotel on May 3 and May 10, 2019. Staff requested Pixar to publish a notice of completion regarding work on the parking lot, which Pixar did on May 10 and May 17, 2019.⁹ The statutory 45-day periods for claims ran for each publication without any claims or liens being filed.

The Development Agreement provides as follows with respect to the waiver of bonds:

10. Waiver, Modification, Reimposition of Bond and Liability Insurance Provisions. Upon substantial completion of the improvements contemplated herein and after forty-five (45) days after the filing and publication of the Notice of Final or Substantial Completion by Lessee, and upon substantial compliance by the Lessee with the terms, covenants, and conditions contained in this Agreement on its part to be observed or performed, the State at its discretion may in writing, waive or suspend the performance bond or improvement bond requirements or both or may, in writing, modify the particular bond(s) or liability insurance requirements by reducing its amount; provided, however, that except for any bonds terminated by Lessee after the Completion Date pursuant to the terms of Paragraph 8 hereinabove, the State reserves the right to reactivate the bonds or reimpose the bond(s) or liability insurance in and to their original tenor and form at any time throughout the term of this Agreement.

Based on Pixar's payment records on file with Land Division, a final inspection of the hotel work on Parcel 46 conducted by staff on August 29, 2019 (see Exhibit 6), as well as the lien releases and published notices of completion for the project mentioned above, staff has determined that the improvements to the hotel were completed in substantial compliance with the Development Agreement. Accordingly, staff may in the future seek a waiver of the completion bond and labor and materialmen's bond required under the Development Agreement as to the hotel work.

However, upon review of photographs of the parking lot taken between 2012 and 2019, staff is unable to verify that substantial improvements have been made to the parking lot in the value of at least \$19,000 as required by the Development Agreement. Staff continues to work with Pixar to resolve this outstanding item.

⁹ The notice of completion published for the parking lot improvements actually references the wrong tax map key number, so a new publication may be required. However, as discussed below, it is not clear to staff that any substantial improvements have been made to the parking lot in recent years.

With the exception of the matters sought to be resolved by this submittal, Pixar is in compliance with lease terms and conditions regarding rent, insurance and submission of percentage rent reports.

There are no pending issues relating to a rental reopening.

No government agencies or interest groups were solicited for comments as there will be no change in disposition of land use.

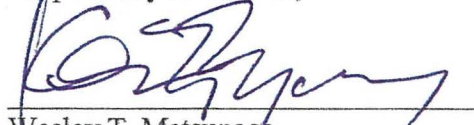
RECOMMENDATION: That the Board:

- A. Consent after the fact to the assignment of a 100% membership interest in Lessee Pixar Development, LLC from John Kenneth Purdy to Hotel Coral Reef, LLC on March 31, 2005, subject to the terms and conditions cited above, and further subject to the following:
 1. The standard terms and conditions of the most current consent to assignment (of membership interest) form, as may be amended from time to time; provided that the consent instrument shall include language to the effect that it be deemed effective even without Mr. Purdy's signature on it;
 2. Review and approval by the Department of the Attorney General; and
 3. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.
- B. Consent after the fact to the quitclaim assignment of membership interest in Lessee Pixar Development, LLC from Michael F. Harrah to Hotel Coral Reef, LLC on December 23, 2014 but effective as of March 31, 2005, subject to the terms and conditions cited above, and further subject to the following:
 1. The standard terms and conditions of the most current consent to assignment (of membership interest) form, as may be amended from time to time; and provided further that if the Department of the Attorney General determines that no consent is legally required for this part of the transaction, such consent may be dispensed with;
 2. Review and approval by the Department of the Attorney General; and
 3. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.
- C. Assess a lease assignment premium against John Kenneth Purdy and Linda J.

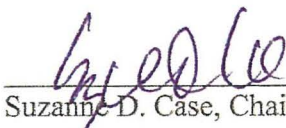
Harding Warriner, jointly and severally, in the principal amount of \$56,470.50, plus interest at the rate of 10% per annum from and after October 25, 2019 until paid in full, subject to the terms and conditions cited above, and further subject to the following:

1. Receipt of payment of the lease assignment premium and accrued interest shall not be a condition precedent to the consummation of the consents to assignment referenced in recommendations A and B above; and
 2. Authorize the Department of the Attorney General, the Department of Land and Natural Resources, or their agents to collect all monies due the State of Hawaii under for the March 31, 2005 lease assignment premium General Lease No. S-5578 and to pursue all other rights and remedies as appropriate.
- D. Consent after the fact to the Real Property Mortgage and Financing Statement dated July 29, 2010 in favor of First Hawaiian Bank, subject to the terms and conditions cited above, and further subject to the following:
1. The standard terms and conditions of the most current consent to mortgage form, as may be amended from time to time;
 2. Review and approval by the Department of the Attorney General; and
 3. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.

Respectfully Submitted,


Wesley T. Matsunaga
District Land Agent

APPROVED FOR SUBMITTAL:


Suzanne D. Case, Chairperson

Land Board Meeting: October 25, 2019; D-1: Approved as amended.

Approved as amended. See attached page.

Land Board Meeting: October 25, 2019; D-1: Approved as amended.

Approved as amended. The Board amended page 3 of the submittal under the heading "RECOMMENDED PREMIUM ON ASSIGNMENTS" to change the date of commencement of the interest charge on the assignment premium from April 1, 2005 to October 25, 2019.

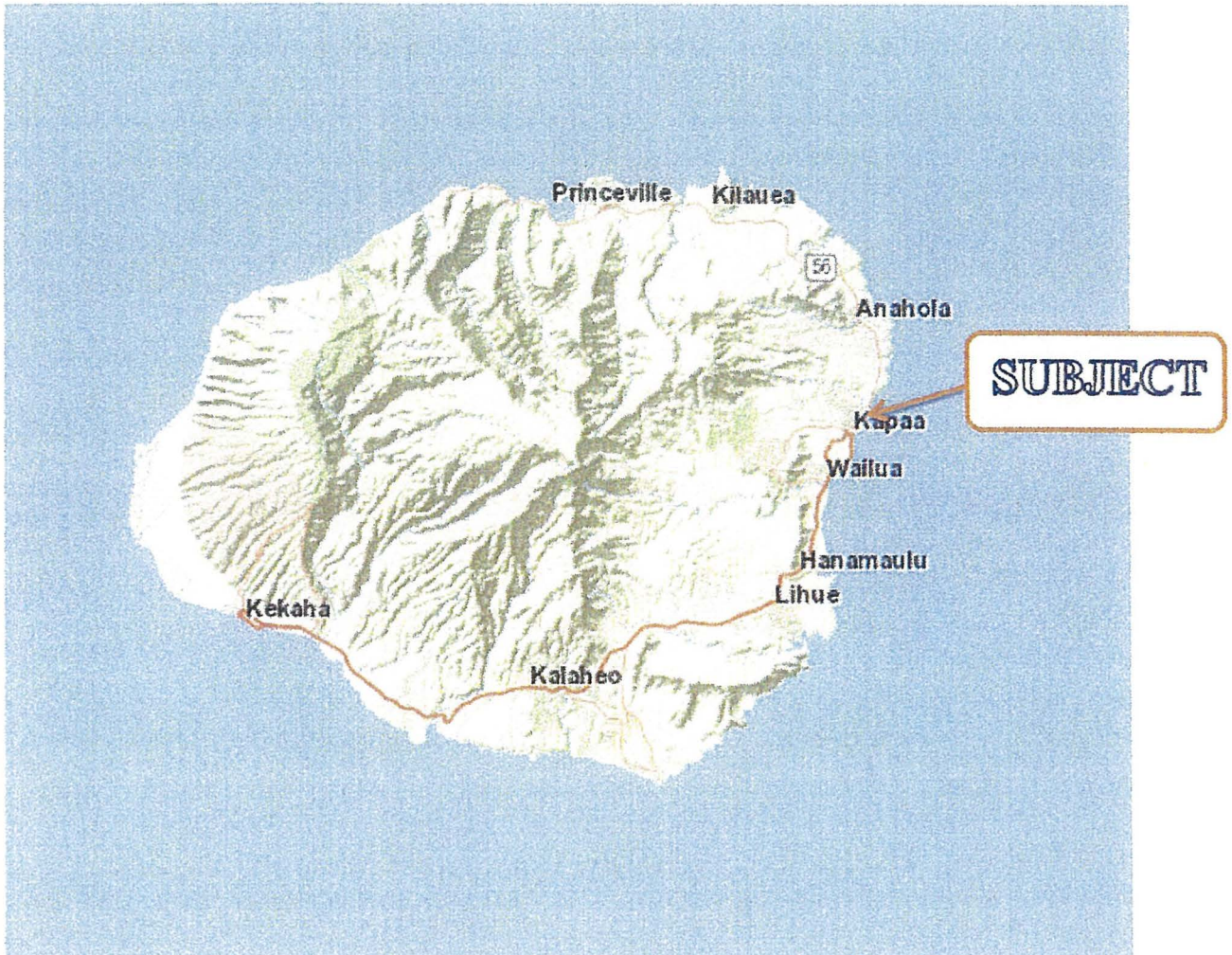


EXHIBIT 1

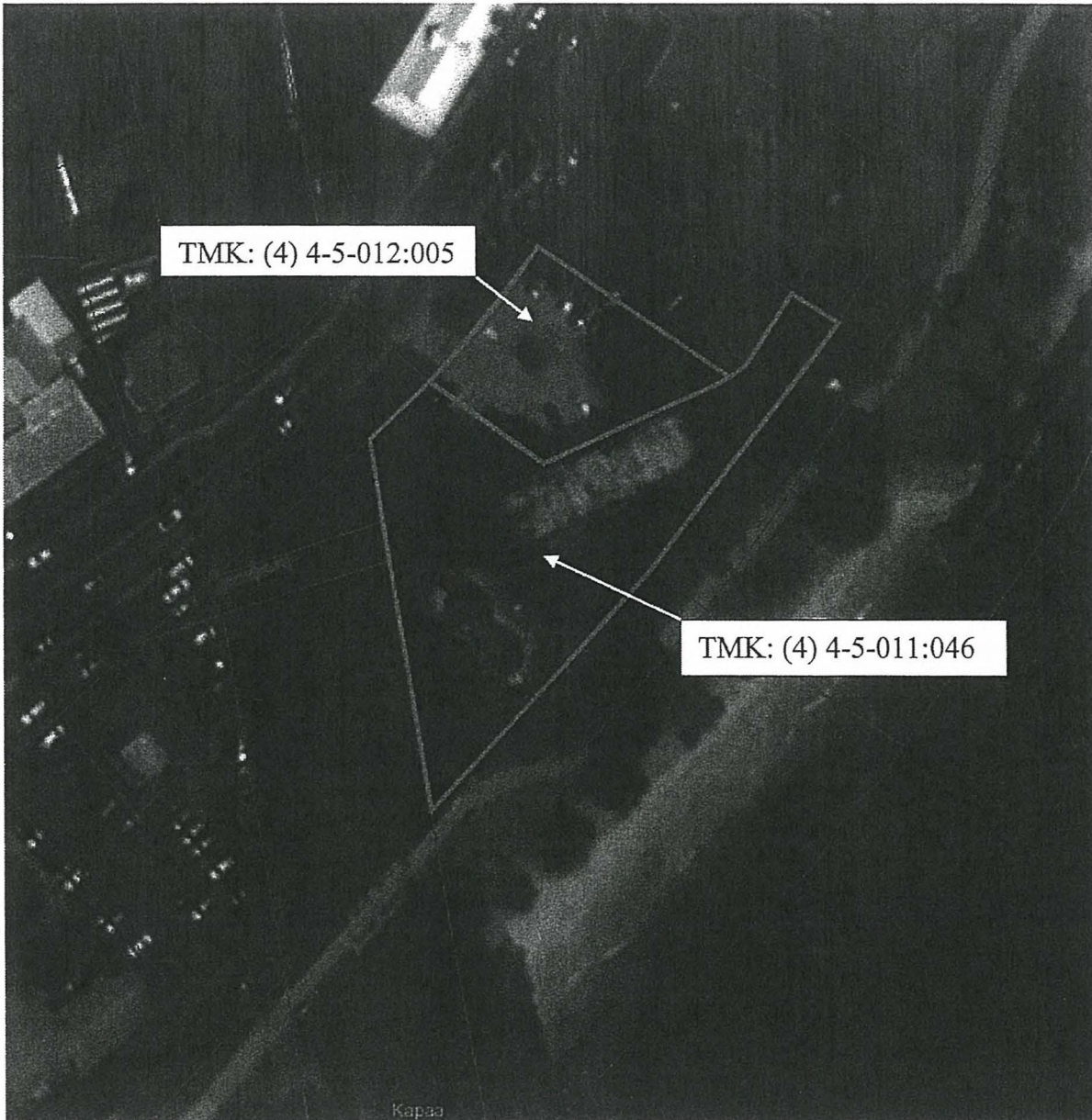


EXHIBIT 1

D-1

AMENDED

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

March 9, 2018

Ref. No.: 10KD-133
GLS-3832 & S-5578

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

KAUAI

After-the-Fact Consent to Assignment of 100% Membership Interest in Lessee Pixar Development, LLC from John Kenneth Purdy to Hotel Coral Reef, LLC; After-the-Fact Consent to Quitclaim Assignment of Membership Interest in Lessee Pixar Development, LLC from Michael F. Harrah to Hotel Coral Reef, LLC; After-the-fact Consent to Real Property Mortgage and Financing Statement, Pixar Development, LLC, Mortgagor, and First Hawaiian Bank, Mortgagee (2010 Mortgage); Consent to Mortgage with Estoppel Certificate, Pixar Development, LLC, Mortgagor, and First Hawaiian Bank, Mortgagee (2018 Refinance); Amendment of Development Agreement dated August 17, 2016 between the Board of Land and Natural Resources and Pixar Development, LLC, Lessee, to Allow an Additional 18 Months over the 24 Months Provided for Construction of Improvements; General Lease Nos. S-3832 and S-5578, Pixar Development, LLC, Lessee, Kapaa Town Lots, Kapaa, Kawaihau, Kauai, Tax Map Keys: (4) 4-5-011:046 and 4-5-012:005.

APPLICANTS:

Pixar Development, LLC, lessee and mortgagor, John Kenneth Purdy, assignor, Michael F. Harrah, assignor, Hotel Coral Reef, LLC, assignee, and First Hawaiian Bank, mortgagee.

LEGAL REFERENCE:

Sections 171-6, -22 and -36, Hawaii Revised Statutes, as amended.

LOCATION:

Portion of Government lands of Kapaa Town Lots, situated at Kapaa, Kawaihau, Kauai, identified by Tax Map Keys: (4) 4-5-011:046 (Parcel 46) and 4-5-012:005 (Parcel 5), as shown on the attached maps labeled Exhibit A.

as amended
APPROVED BY THE BOARD OF
LAND AND NATURAL RESOURCES
AT ITS MEETING HELD ON
March 9, 2018 *Go*

EXHIBIT 2

D-1

ZONING/AREA:

Lease No.	Tax Map Key: (4)	Area/Use of Land	State Land Use District	County of Kauai CZO
GLS-3832	4-5-011:046	0.5930 acre, improved with hotel structure	Urban	Open
GLS-5578	4-5-012:005	0.2210 acre, improved with parking lot	Urban	C-G (General Commercial District)

Additionally, both parcels are located in the Special Management Area.

TRUST LAND STATUS:

Section 5(b) lands of the Hawaii Admission Act

DHHL 30% entitlement lands pursuant to the Hawaii State Constitution:

YES ____ NO x

CHARACTER OF USE:

GLS-3832: for resort-hotel purposes and uses accessory or incidental thereto and customarily conducted within hotel-resort areas.

GLS-5578: for hotel parking purposes.

TERMS OF LEASES:

General Lease No. S-3832 commenced on May 18, 1964 and was set to expire on May 17, 2019. General Lease No. S-5578 commenced on May 18, 1999 and was set to expire on May 17, 2019. However, the Board extended both leases pursuant to Act 219 Sessions Laws of Hawaii 2011, until November 12, 2070 in exchange for the lessee making substantial improvements to the premises. The last rental reopening occurred on November 13, 2015; next rental reopening is scheduled for November 13, 2025.

ANNUAL RENTAL:

GLS-3832: Annual rent is \$129,000 and 2% of the annual gross revenue payable in the amount in excess of the annual base rent, with base rent due in semiannual installments of \$64,500 on the 13th Day of November and May of each year.

GLS-5578: Annual rent is \$27,000 and 2% of the annual gross revenue payable in the amount in excess of the annual base rent, with base rent due in semiannual installments of \$13,500 on the 13th Day of November and May of each

year.

CONSIDERATION FOR ASSIGNMENTS:

Assignment of 100% Membership Interest in Lessee Pixar Development, LLC from John Kenneth Purdy to Hotel Coral Reef, LLC on March 31, 2005:

GLS-3832: \$1,369,800

GLS-5578: \$249,964

Quitclaim Assignment of Membership Interest in Lessee Pixar Development, LLC from Michael F. Harrah to Hotel Coral Reef, LLC on December 23, 2014, but effective March 31, 2005:

GLS-3832: Nominal consideration – related entity transaction.

GLS-5578: Nominal consideration – related entity transaction.

RECOMMENDED PREMIUM ON ASSIGNMENTS:

Assignment of 100% Membership Interest in Lessee Pixar Development, LLC from John Kenneth Purdy to Hotel Coral Reef, LLC on March 31, 2005:

GLS-3832: Not applicable as the lease did not allow for a premium at the time of the transaction.

GLS-5578: None recommended. See discussion in Remarks section below.

Quitclaim Assignment of Membership Interest in Lessee Pixar Development, LLC from Michael F. Harrah to Hotel Coral Reef, LLC on December 23, 2014, but effective March 31, 2005:

GLS-3832: Not applicable as the lease did not allow for a premium at the time of the transaction.

GLS-5578: None – nominal consideration paid in related entity transaction.

USE OF LOAN PROCEEDS:

The mortgage consents relate to the refinancing of a 2010 loan from First Hawaiian Bank (FHB) to Pixar Development, LLC (Pixar) and its affiliates with a current balance of approximately \$3,475,000. Pixar and its affiliates are borrowing \$4,500,000 from FHB to refinance the 2010 loan. A portion of the new loan proceeds will be used to fund capital improvements to the lease premises required under the Development Agreement dated August 17, 2016 between Pixar and the State, including the addition of a third floor

and elevator to an existing two-story hotel structure on Parcel 46, and the replacement of an existing asphalt parking lot on Parcel 5 with a concrete parking lot. The Development Agreement specifies that the upgrades to the improvements on the State parcels will cost approximately \$485,000. Additionally, the loan proceeds will be used to purchase new furniture, fixtures and equipment for the six additional hotel rooms that will result from the construction of the third floor. Loan proceeds will also be used for the maintenance and operations of the Hotel Coral Reef located partly on the premises and partly on the adjoining private land (TMK: (4) 4-5-012:006), owned by Pixar's parent company, Hotel Coral Reef, LLC.

DCCA VERIFICATION:

PIXAR DEVELOPMENT, LLC

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

HOTEL CORAL REEF, LLC

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

As natural persons, John Kenneth Purdy and Michael F. Harrah are not required to register with the DCCA.

BACKGROUND:

In 1962, Ichiji and Masako Matsumura built a small hotel on their private lands at Kapaa, Kauai designated as TMK: (4) 4-5-012:006 (Parcel 6). After acquiring a lease of the adjoining State land designated as TMK: (4) 4-5-011:046 (Parcel 46), they built an additional wing of the hotel of masonry construction containing 16 guest rooms. Abutting Parcel 46 is TMK: (4) 4-5-012:005 (Parcel 5), which is improved with a parking lot for the hotel. Photos of the hotel and parking area are included in Exhibit B.

Land Division's files show the following lease history for the two State parcels:

General Lease No. S-3832 (covering Parcel 46) was sold at public auction on May 18, 1964 to the Matsumuras for a term of fifty-five (55) years expiring on May 17, 2019.

General Lease No. S-4648 (covering Parcel 5) was sold at public auction on May 16, 1980 to Dale M. Matsumura for a term of fifteen (15) years expiring on June 14, 1995.

On September 24, 1985, the Matsumuras notified Land Division that they were in the process of selling the entire hotel operation, which included General Lease No. S-3832 and General Lease No. S-4648. At its meeting of October 11, 1985, Item F-14, the Board of Land and Natural Resources (Board) approved the consent to sale of General Lease

No. S-3832 and General Lease No. S-4648 from the Matsumuras to Michael Wayne Warriner and Linda J. H. Warriner, husband and wife, via agreement of sale. At its meeting of March 13, 1987, Item F-1-c, the Board approved the Consent to Assignment of General Lease No. S-3832 and General Lease No. S-4648 to the Warriners upon satisfaction of the agreement of sale.

In 1997 the Warriners filed for divorce. The decree of divorce specified that Michael Wayne Warriner's interest in General Lease No. S-3832 was awarded to Linda J. H. Warriner.

At its meeting on October 8, 1993, Item F-5, the Board approved a request for extension of General Lease No. S-4648 for a term of five (5) years ending on June 13, 2000. Due to the lack of follow-through, it expired on June 14, 1995.

At its meeting on July 24, 1998, Item D-17, the Board authorized the sale of a lease at public auction for the premises formerly covered by General Lease No. S-4648, and also approved the issuance of an interim revocable permit. Revocable Permit No. S-7145 was thereafter issued to Linda J.H. Warriner for hotel parking lot use only. In May, 1999, Linda J.H. Warriner became the lessee under General Lease No. S-5578 for hotel parking purposes after she bid successfully at auction.

At its meeting on October 26, 2001, Item D-10, the Board consented to the assignment of General Lease No. S-3832 and General Lease No. S-5578, Linda J.H. Warriner, Assignor, to Pixar Development, LLC (Pixar), Assignee.

On April 25, 2014, Item D-2, the Board approved Pixar's request for approval in concept of an extension of the lease terms under General lease No. S-3832 and General Lease No. S-5578, pursuant to Act 219, SLH 2011, which authorized the extension of hotel and resort leases.

On July 25, 2014, Item D-1, the Board approved the negotiated Development Agreement, and proposed plans and specifications for the improvements to the lease premises. The Board additionally authorized the extension, amendment and restatement of the leases for an Aggregate Term of 55 Years.

At its meeting of September 26, 2014, Item D-3, the Board amended its prior action of July 25, 2014, to clarify that the approval of the lease extensions and plans and specifications was in concept only, and that the Pixar was to return to the Board after publication of the anticipated Finding of No Significant Impact (FONSI) in The Environmental Notice for final approval of these items.

At its meeting of November 13, 2015, Item D-3, the Land Board approved, as amended, the extension, amendment and restatement of General Lease Nos. S-3832 and S-5578. The Development Agreement required by the Board approval was executed by Pixar and the State on August 17, 2016. The Development Agreement provides plans and specifications for the addition of a third floor and elevator to an existing two-story

structure on Parcel 46, and the replacement of an existing asphalt parking lot on Parcel 5 with a concrete parking lot. The Development Agreement gives Pixar until August 16, 2018 to complete the improvements. Extended, Amended and Restated General Lease Nos. S-3832 and S-5578 were executed on September 7, 2016.

REMARKS:

Earlier this year staff became aware of a number of past transactions relating to the leases of which Pixar had not previously notified the Department. Michael F. Harrah, the current manager of Pixar and Hotel Coral Reef, LLC, explains that he was not aware the transactions required Board consent. Staff describes those transactions here and, where necessary, seeks Board consent to them after the fact.

On February 12, 2004, Pixar assigned its interest in both leases to its parent company, Hotel Coral Reef, LLC (HCR). The assignment instruments were recorded in the Bureau of Conveyances on February 13, 2004 as Document No. 2004-031847 (GLS-3832), and Document No. 2004-031846 (GLS-5578).

On March 31, 2005, John Kenneth Purdy assigned 100% of the membership interest in Pixar to HCR. Mr. Purdy was the member-manager of Pixar at the time it assigned its interest in the leases to HCR on February 12, 2004.

On July 20, 2005, Pixar and HCR cancelled the assignment of leases executed in 2004. Cancellation of assignment documents were recorded in the Bureau of Conveyances on July 29, 2005 as Document No. 2005-151266 (GLS-3832), and Document No. 2005-151267 (GLS-5578). The documents recite that the parties extinguished and cancelled the assignments. Accordingly, staff believes that there is no reason to seek Board consent for these assignments at the present time. With the recording of the cancellation instruments, it is as if the assignments had not occurred in the first place. The lessee under both leases continues to be Pixar.

On July 29, 2010, Pixar borrowed \$4,500,000 from First Hawaiian Bank (FHB). FHB recorded a Real Property Mortgage and Financing Statement in the Bureau of Conveyances as partial security for this obligation purporting to encumber the subject leases on August 17, 2010 as Document No. 2010-118887.

By instrument dated December 23, 2014, but made effective as of March 31, 2005, Mr. Harrah made a quitclaim assignment of all of his membership interest in Pixar to HCR.

After-the-Fact Consent to Assignments of Membership Interests:

Original General Lease No. S-3832 (the lease on which the hotel is located) was in effect in 2005 at the time Mr. Purdy sold his membership interest in Pixar to HCR and in 2014 when Mr. Harrah transferred 100% of his membership interest in Pixar to HCR. It is not clear under the original lease whether a stock or membership interest transfer in a lessee requires prior Board consent. At the relevant times, the lease provided in part:

Assignments, etc. That the Lessee shall not transfer or assign any right, privilege or authority herein given or in any manner transfer or assign this lease for the whole or any part of the term hereof, except by way of devise, bequest or intestate succession; provided, that with the prior written consent of the Lessor, the assignment and transfer of a lease or unit thereof may be made where any one of the following conditions are applicable: (1) the Lessee was required to put in substantial building improvements, (2) the Lessee becomes mentally or physically disabled, or (3) extreme economic hardship is demonstrated to the satisfaction of the Lessor.

Original General Lease No. S-3832 was an older form lease that did not include any provision about the State receiving a premium upon the assignment of the lease.

Original General Lease No. S-5578 (the lease on which the parking lot is located) was a more modern lease that included the following language in the assignment clause:

If the Lessee is a partnership, joint venture or corporation, the sale or transfer of 20% or more of ownership interest or stocks by dissolution, merger or any other means shall be deemed an assignment for the purposes of this paragraph and subject to the right of the Lessor to impose the foregoing premium.

Under this provision, Mr. Purdy and Mr. Harrah should have obtained prior Board consent for the two assignments of membership interest in Pixar.¹ As mentioned above, Mr. Harrah explains that Pixar was not aware of the language in the lease regarding assignments. Pixar now seeks assignment after the fact. Staff has discussed the lease requirements with Mr. Harrah, who indicates he will be more careful in the future to ensure Pixar complies with the lease terms.

The consent to assignment instruments that the Department of the Attorney General prepares typically include a signature block for the assignor and an agreement by the assignor that the assignment does not release it of liability. Staff is recommending that the consents for the assignment of membership interests discussed above not include signature blocks or continuing liability obligations on the part of the assignor because neither Mr. Purdy² nor Mr. Harrah was the lessee on the lease, or a guarantor of the performance of the lease. Pixar continued to be the lessee during this period and even

1 Based on staff's review, it is not clear that Mr. Harrah had any membership interest in Pixar to quitclaim to HCR in 2014 or 2005. Staff is including a recommendation below that the Board consent to this assignment as a precaution. If the Department of the Attorney General finds that Board consent is not required for Mr. Harrah's quitclaim assignment, then the consent document for that part of the transaction can be dispensed with.

2 In any event, Mr. Purdy's whereabouts are currently unknown. He is included as an applicant in this matter because his signature appears on the assignment of Pixar membership interest to HCR.

after HCR's acquisition of the company, Pixar has continued to be a compliant lessee with regard to rent and insurance.

Lease Assignment Premium Analysis Under Original General Lease No. S-5578:

Regarding the March 31, 2005 assignment of membership interest in Pixar, a lack of historical financial data makes it difficult to conduct a proper lease assignment premium analysis for General Lease No. S-5578 (the lease for the parking lot). When the Board approved the assignment of the lease from Ms. Warriner to Pixar on October 26, 2001, agenda Item D-10, no assignment premium was assessed based on the recommendation of the staff appraisers at the time. See Exhibit C attached. In the 2001 transaction, a lump sum sales price of \$1,100,000 was paid for the two leases and adjoining parcel of private land, but no allocation was made among the three separate land interests involved in the sale. Because no allocation was made specifically for General Lease No. S-5578, staff is unable to accurately calculate the amount of any profit made on the lease between October 26, 2001 and March 31, 2005, when HCR paid Mr. Purdy \$249,964 for General Lease No. S-5578.

A rough calculation may be possible by working backward from the March 31, 2005 assignment of Mr. Purdy's interest in Pixar to HCR. For the 2005 transaction, HCR purchased the two State leases and private land constituting the hotel for a lump sum of \$2,500,000, and allocated the purchase price as follows:

<u>Land Interest</u>	<u>Allocation</u>	<u>% of Purchase Price</u>
Fee simple land (4) 4-5-012:006:	\$ 880,236	35%
General Lease No. S-3832:	\$1,369,800	55%
General Lease No. S-5578:	\$ 249,964	10%
Totals:	\$2,500,000	100%

If we assume that the same allocations as percentages of the total purchase price were applicable to the 2001 transaction, then the purchase price attributable to General Lease No. S-5578 in 2001 was \$110,000. Adjusted for inflation,³ \$110,000 in 2001 was equivalent to \$124,474 in 2005, meaning that Mr. Purdy potentially realized as much as \$125,490 in the sale of his membership interest in Pixar as it related to General Lease No. S-5578. However, one shortcoming with this approach is the uncertainty regarding the accuracy of the allocation of the purchase price in 2001. Furthermore, the lease assignment premium is calculated as a percentage of the assignment consideration (less the adjusted depreciated cost of improvements, where applicable). The assignment of lease premium participation schedule set forth in General Lease No. S-5578 is based on a term of 55 years, as follows:

For the first 5 years, the premium is 50% of the amount by which the consideration for the assignment, whether by cash, credit, or otherwise, exceeds the depreciated cost of improvements and trade fixtures being

³ Consumer Price Index, All Items, 1982-84=100, for All Urban Consumers.

transferred to the assignee. The percentage will decrease by 5% after every 5 years of the total term has elapsed.

<u>Years</u>	<u>Percentage</u>
1- 5	50%
6 - 10	45%
11 - 15	40%
16 - 20	35%
21 - 25	30%
26 - 30	25%
31 - 35	20%
36 - 40	15%
41 - 45	10%
46 - 50	5%
51 -	0%

But original General Lease No. S-5578 was for a term of 20 years, not 55, and arguably the premium participation schedule should have been based on a 20-year term, with the State's share of any assignment premium decreasing proportionately over 20 years, not 55. The March 31, 2005 assignment of membership interest in Pixar occurred 6 years into the lease term of original General Lease No. S-5578. Under a 55-year premium participation schedule, an assignment in the sixth year of the lease results in a premium participation of 45% as indicated above, while under a 20-year schedule, an assignment would result in something closer to a 35% premium.

Additionally, assignment premiums are paid by the assignor, who in this case was Mr. Purdy. Mr. Purdy's whereabouts are unknown. Even if the Board were to assess an assignment premium, the likelihood of collecting it from Mr. Purdy is low. And the fairness of requiring HCR or Mr. Harrah to pay the premium in lieu of Mr. Purdy is questionable, especially in view of Pixar's and HCR's pending investment of approximately \$485,000 in the State leases through hotel renovations/additions.

For the foregoing reasons, staff is not recommending a lease assignment premium for the March 31, 2005 assignment of membership interest in Pixar. General Lease Nos. S-3832 and S-5578 have now been updated with current lease provisions, the lease assignment premiums schedules now correspond to the lease terms, and for any assignments going forward, the lease assignment premium analysis can be conducted on such transactions for both leases. This submittal will provide a baseline to assist in the calculation of future premiums that may be due to the State.

Consent to 2010 FHB Mortgage After-the-Fact:

Original General Lease Nos. S-3832 and S-5578 both provided at the relevant time that the premises could be mortgaged with the prior consent of the Board.⁴ As discussed

4 Original General Lease No. S-5578 goes on to provide that any mortgage placed on the leases premises

above, Pixar and its affiliates borrowed \$4,500,000 from FHB in 2010. Among other properties owned by Pixar's affiliates in fee, the subject leases were mortgaged as security for the loan. Neither Pixar nor FHB sought the Board's prior consent to the mortgage. The mortgage is still of record. Pixar requests the Board's consent to the mortgage after the fact.

Consent to Refinance of 2010 FHB Mortgage with Estoppel Certificate:

Pixar wants to refinance the existing FHB loan. An appraisal report dated August 31, 2017 indicates the combined value of the private fee simple and State leasehold interests will be \$6,460,000 as of January 1, 2019, assuming all County permits for hotel expansion are obtained and the improvements the Board approved to the hotel are completed. Based on an earlier appraisal of the State lease lands only, the value of the improvements on the leased premises as of November 2013 was \$682,000. The total 2018 tax assessed value of the State leased lands and improvements is \$1,825,400. Accordingly, the State leased lands are providing only a portion of the security for the loan amount of \$4,500,000, with the private land portion of the hotel and other assets of Pixar's affiliates providing the balance of the security. FHB is also requesting an estoppel certificate from the State regarding Pixar's compliance with the lease terms. Staff has no objection to these requests.

Amendment of Development Agreement to Extend Time for Construction:

As mentioned above, the Development Agreement the Board executed with Pixar on August 17, 2016 provides that the hotel improvements required thereunder must be completed within 24 months of the Development Agreement, which is August 16, 2018. The Development Agreement states at Section 5:

5. Construction Period. Lessee shall have twenty-four (24) months from the Effective Date to complete the substantial upgrades to the existing improvements on the Subject Property in accordance with the approved Development Plan ("Construction Period").

That deadline was reached through discussions Pixar representatives had with the former Kauai District Land Agent, and was not a legal requirement of the Act 219, SLH 2011, under which the Board approved the lease extension. Twenty-four months turned out to be a very optimistic estimate of the completion time for the project, given that Pixar was required to obtain a number of permits and variances before it secure a building permit. One of the most challenging issues for the project was that the land is not zoned for hotel/resort use (GLS-3832 with the hotel structure on it is zoned Open).

On May 25, 2017 Pixar received the Special Management Area Use Permit, Class IV Zoning Permit, Use Permit and Variance Permit required for the construction of a third story on the hotel. On January 16, 2018, Pixar received its building permit for the

project. To allow sufficient time to complete the improvements required under the Development Agreement, Pixar is requesting an eighteen-month extension of the completion time set forth in the Development Agreement. The total construction period under the Development Agreement would therefore be 42 months. In light of Pixar's diligent pursuit of the necessary permits for the project, staff has no objection to the time extension.

With the exception of the matters sought to be resolved by this submittal, Pixar is in compliance with lease terms and conditions regarding rent, insurance and submission of percentage rent reports.

There are no pending issues relating to a rental reopening.

No government agencies or interest groups were solicited for comments as there will be no change in disposition of land use.

RECOMMENDATION: That the Board:

- A. Consent after the fact to the assignment of a 100% membership interest in Lessee Pixar Development, LLC from John Kenneth Purdy to Hotel Coral Reef, LLC on March 31, 2005, subject to the terms and conditions cited above, and further subject to the following:
 1. The standard terms and conditions of the most current consent to assignment (of membership interest) form, as may be amended from time to time; provided that the consent instrument shall not include a continuing liability covenant by Mr. Purdy or require his signature on the document;
 2. Review and approval by the Department of the Attorney General; and
 3. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.
- B. Consent after the fact to the quitclaim assignment of membership interest in Lessee Pixar Development, LLC from Michael F. Harrah to Hotel Coral Reef, LLC on December 23, 2014 but effective as of March 31, 2005, subject to the terms and conditions cited above, and further subject to the following:
 1. The standard terms and conditions of the most current consent to assignment (of membership interest) form, as may be amended from time to time; provided that the consent instrument shall not include a continuing liability covenant by Mr. Harrah or require his signature on the document; and provided further that if the Department of the Attorney General determines that no consent is legally required for this part of the transaction, such consent may be dispensed with;

2. Review and approval by the Department of the Attorney General; and
 3. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.
- C. Consent after the fact to the Real Property Mortgage and Financing Statement dated July 29, 2010 in favor of First Hawaiian Bank, subject to the terms and conditions cited above, and further subject to the following:
1. The standard terms and conditions of the most current consent to mortgage form, as may be amended from time to time;
 2. Review and approval by the Department of the Attorney General; and
 3. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.
- D. Consent to a new mortgage between Pixar Development, LLC, Mortgagor, and First Hawaiian Bank, Mortgagee, to refinance the 2010 loan, subject to the terms and conditions cited above, and further subject to the following:
1. The loan proceeds shall be used for the purposes as stated in "Use of Loan Proceeds" above. The Pixar shall maintain records of loan expenditures which may be inspected by the Department;
 2. The standard terms and conditions of the most current consent to mortgage form, as may be amended from time to time;
 3. Review and approval by the Department of the Attorney General; and
 4. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.
- E. Authorize the execution of an Estoppel Certificate subject to the following:
1. The standard terms and conditions of the most current estoppel certificate form, as may be amended from time to time;
 2. Review and approval by the Department of the Attorney General; and
 3. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interest of the State.
- F. Authorize an amendment of the parties' Development Agreement dated August 17, 2016 to change the Construction Period as defined in Section 5 of the

Agreement from 24 months to 42 months, subject to the terms and conditions cited above, and further subject to the following:

1. The standard terms and conditions of the most current amendment of development agreement form, as may be amended from time to time;
2. Review and approval by the Department of the Attorney General; and
3. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interest of the State.

Respectfully Submitted,



Wesley T. Matsunaga
District Land Agent

APPROVED FOR SUBMITTAL:



Suzanne D. Case, Chairperson

Land Board Meeting: March 9, 2018; D-1: Approved as amended.

Approved as amended. See attached page.

Land Board Meeting: March 9, 2018; D-1: Approved as amended.

Approved as amended. The Board approved recommendations D, E and F of the submittal with the proviso that any estoppel certificate issued by the State will need to note the unresolved issue of whether a lease assignment premium is due for the 2005 assignment of membership interests in Pixar Development, LLC. Staff was directed to seek the advice of the Department of the Attorney General on who is responsible for paying a lease assignment premium when a transaction involves the sale of the membership interest in a lessee as opposed to an outright assignment of the lease to a third party.

SUBJECT

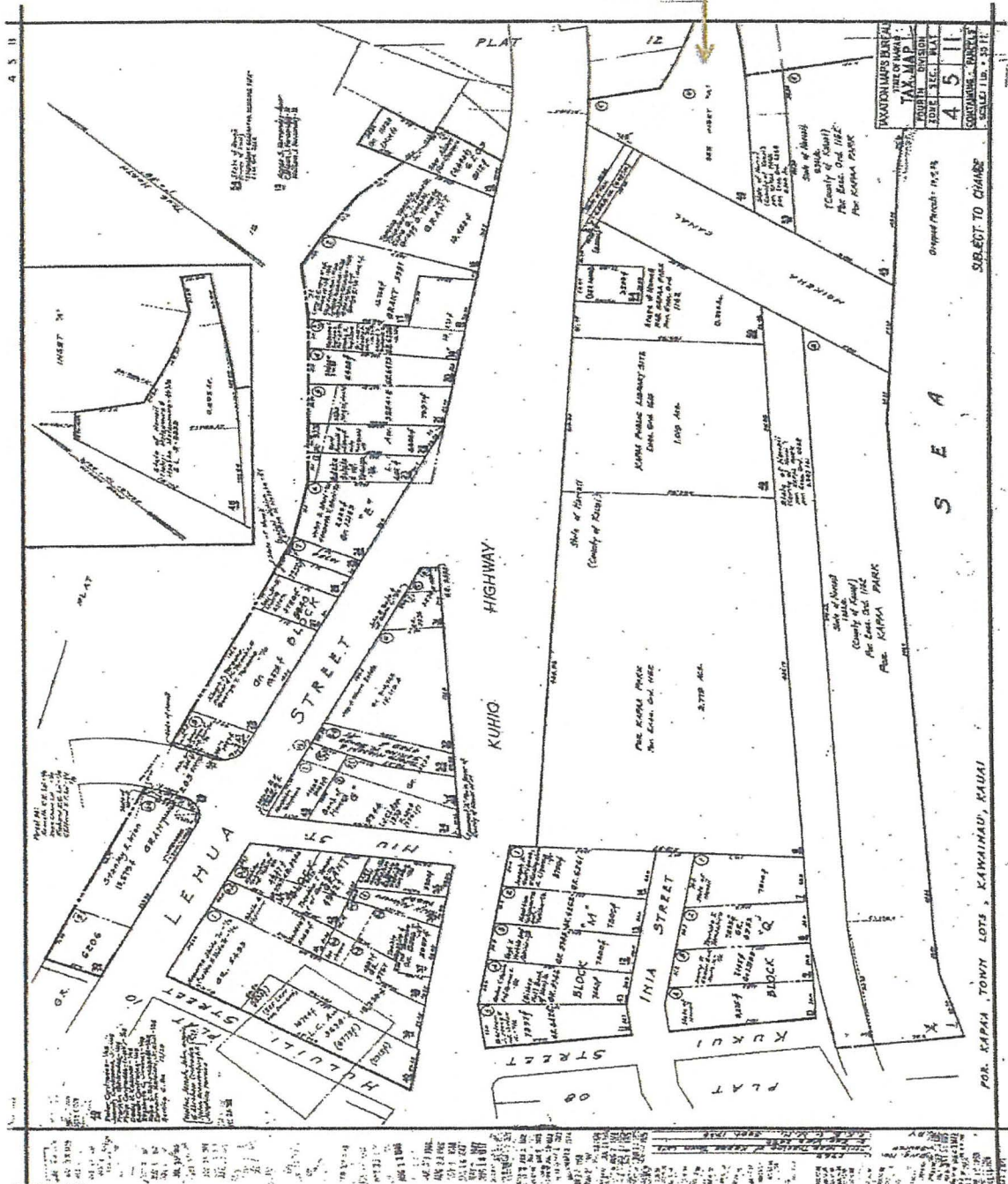
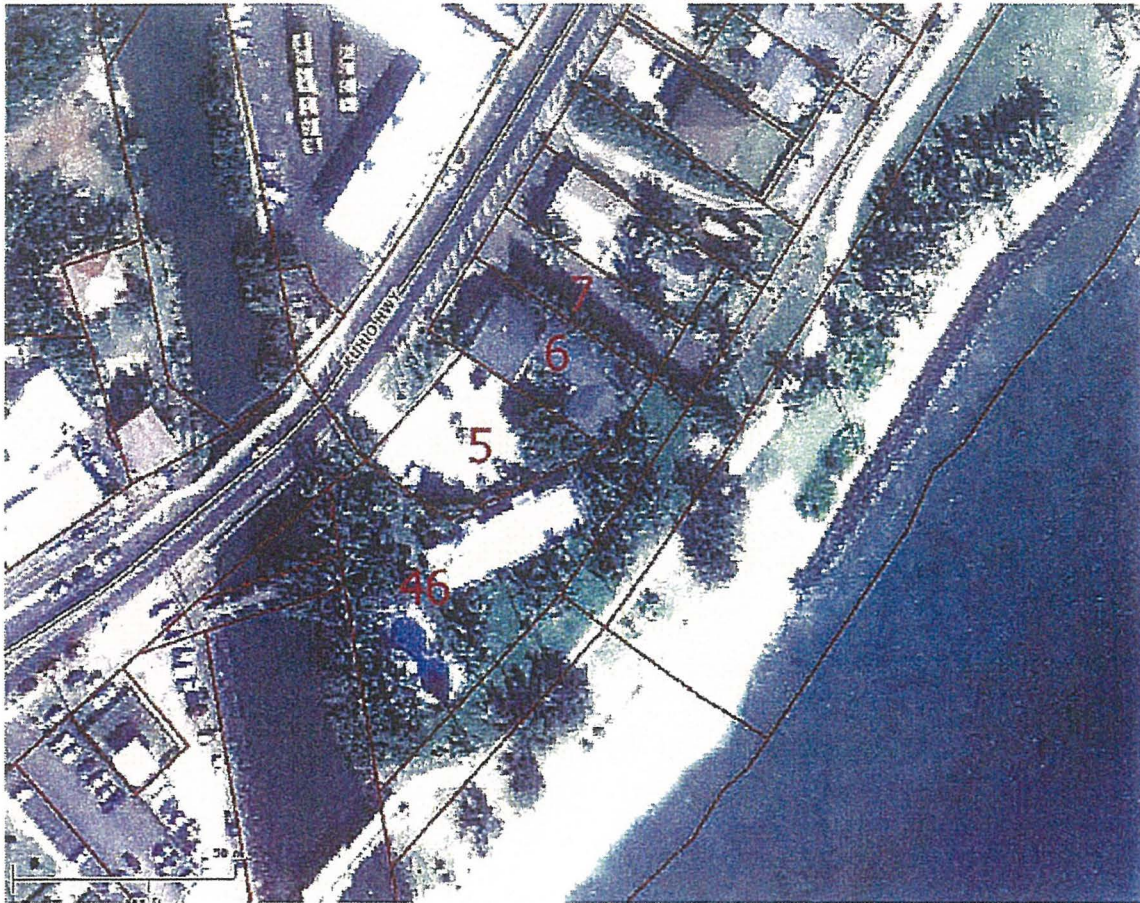


EXHIBIT A





Private parcels (4) 4-5-012: 006 & 007 and

State parcels (4) 4-5-012:005 & 4-5-011:046

EXHIBIT A



EXHIBIT B

**GL S-3832 to Pixar Development, LLC
Swimming pool and portion of hotel on TMK: (4) 4-5-011:046**







GL S-5578 to Pixar Development, LLC
Parking lot on TMK: (4) 4-5-012:005
(Hotel in center background is on TMK: (4) 4-5-011:046)





STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
LAND DIVISION
P.O. BOX 621
HONOLULU, HAWAII 96809

AQUACULTURE DEVELOPMENT
PROGRAM
AQUATIC RESOURCES
BOATING AND OCEAN RECREATION
CONSERVATION AND
RESOURCES ENFORCEMENT
CONVEYANCES
FORESTRY AND WILDLIFE
HABITAT RESTORATION
LAND DIVISION
STATE PARKS
WATER RESOURCE MANAGEMENT

March 16, 2000

MEMORANDUM

TO: Sam Lee, Kauai District Land Agent

FROM: Benjamin Marx, Staff Appraiser *B. Marx*

RE: Hotel Coral Reef, assignment of lease premium
General Lease S-5578, Kapaa, Kauai

A cost schedule provided by Linda Warriner show the parking lot was constructed in 1995 for \$34,027. In April 1997 the hotel was appraised at \$1,300,000. The improvements including the parking lot, were appraised at \$921,200. The proposed 2000 sale is at \$1,110,000. A total of \$591,694 of the sale price was allocated to the improvements by the lessee's accountant. We were unable to obtain an allocated price for the parking lot only; however, it is reasonable to assume the 2000 value of the parking lot is less than \$34,027 once the construction cost index (CCI) and adjustment for depreciation have been applied. We conclude that no premium payment is required.

EXHIBIT C



STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
LAND DIVISION
P.O. BOX 621
HONOLULU, HAWAII 96809

AQUACULTURE DEVELOPMENT
PROGRAM
AQUATIC RESOURCES
BOATING AND OCEAN RECREATION
CONSERVATION AND
RESOURCES ENFORCEMENT
CONVEYANCES
FORESTRY AND WILDLIFE
HISTORIC PRESERVATION
LAND DIVISION
STATE PARKS
WATER RESOURCE MANAGEMENT

September 25, 2001



TO: Sam Lee, Kauai District Land Agent
THROUGH: *Harry M. Yada* Harry M. Yada, Acting Land Division Administrator
FROM: *Mike Nugent* Mike Nugent, Staff Appraiser
RE: Hotel Coral Reef, assignment of lease premium
General Lease S-5578, Kapaa, Kauai

On September 18, 2001 I received a request from you to examine the sale of the above named leasehold for the presence of any assignment premium. During the course of my research I discovered that Ben Marx, on March 16, 2000, had determined that there was no assignment premium involved with this sale. (See attached) Mr. Marx based his determination on the DROA provided to him by you at that time. I compared the full Agreement of Sale provided by you with this request to the DROA provided to Mr. Marx in March of 2000. I could find no discrepancies in the terms and conditions of the sale therefore Mr. Marx's determination of no assignment premium still holds. If you have any questions please feel free to call me at 7-0382.

[Handwritten mark]


and further, that except as provided herein, this consent shall not in any manner be construed as varying in any respect the terms and conditions of the general lease; and also that no further assignment of any interest under the general lease shall be made without the written consent of the Board of Land and Natural Resources being first obtained and endorsed thereon.

FURTHERMORE, Assignor hereby acknowledges that the Lessor's consent to assignment of the general lease, does not release the Assignor from any and all responsibilities, obligations, liabilities, and claims respecting or arising under or out of said general lease.

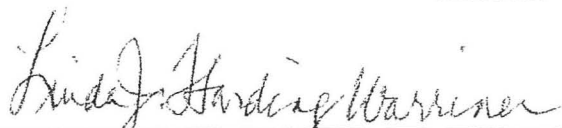
IN WITNESS WHEREOF, the STATE OF HAWAII, by its Board of Land and Natural Resources, has caused the seal of the Department of Land and Natural Resources to be hereunto affixed and these presents to be duly executed this 28th day of January, 2002.

STATE OF HAWAII

Approved by the Board of Land and Natural Resources at its meeting held on October 26, 2001.

By 
Chairperson and Member
Board of Land and
Natural Resources

LESSOR


LINDA J. HARDING WARRINER

ASSIGNOR

APPROVED AS TO FORM:


Deputy Attorney General

Dated: 1/22/02

a:\w\docs2\cagls-5578\warriner\pixar\
tmk(4)4-5-12:5kapaa.1c

STATE OF HAWAII

)

) SS.

COUNTY OF KAUAI

)

On this 9th day of JAN, 2002,
before me personally appeared LINDA J. HARDING WARRINER to me
known to be the person described in and who executed the
foregoing instrument and acknowledged that she executed the same
as her free act and deed.

L.S

Christopher S. Relacion

Notary Public, State of Hawaii

CHRISTOPHER S. RELACION

My commission expires: 7-15-2009

INTEREST CALCULATIONS ON UNPAID ASSIGNMENT PREMIUM OF

\$56,470.50 DUE MARCH 31, 2005

Period	Interest Rate	Calculation	Interest Amount \$
04/01/05-12/31/05	10.0%	$(0.10 \times 56,470.50) \times 0.75$	4,235.29
01/01/06-12/31/06	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/07-12/31/07	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/08-12/31/08	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/09-12/31/09	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/10-12/31/10	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/11-12/31/11	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/12-12/31/12	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/13-12/31/13	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/14-12/31/14	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/15-12/31/15	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/16-12/31/16	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/17-12/31/17	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/18-12/31/18	10.0%	$0.10 \times 56,470.50$	5,647.05
01/01/19-10/31/19	10.0%	$(0.10 \times 56,470.50) \times 0.83$	4,687.05
		Accrued interest thru 10/31/19=	82,333.99



9-8-15: Front of Hotel Coral Reef as it appeared several years ago prior to addition of third story.



9-8-15: Rear of Hotel Coral Reef as it appeared several years ago prior to addition of third story.



11-30-18: Front, left hand side of Hotel Coral Reef with new third floor addition and parking lot in foreground.



11-30-18: Front, right hand side of hotel showing new third floor addition.



11-30-18: Close-up on new elevator tower at front of building.



11-30-18: Rear of hotel with new third floor addition.



11-30-18: New elevator installation as seen from new third floor walkway.



11-30-18: New third floor guest suite, kitchen area.



11-30-18: New third floor guest room.

INSPECTION REPORT
Commercial/Industrial/Resort/Other Business
FINAL INSPECTION

General Information

Document Number: GLS- 3832 & S-5578 Character of Use Hotel/Resort

Inspection Date: 8/29/19 Inspection Time: 1:00pm Land Agent: Wesley Matsunaga

TENANT INFORMATION

Name: PIXAR Development LLC c/o Hotel Coral Reef LLC Home Phone: _____

Address: 1103 N. Braodway, Santa Ana, CA 92701 Business Phone: (808) 822-4481
Fax: _____

Contact Person: William Beaubeaux, Mike Harrah or Shane McGurn
Contact Phone: [REDACTED], William

SITE INFORMATION

TMK: (4) 4-5-011:046 and 4-5-012:005 Area: Parcel 46: .593 acres
Parcel 5: .221 acres

Site Address: 4-1516 Kuhio Hwy
Kapaa, HI 96746

FISCAL INFORMATION

ITEM	N/A	CURRENT= COMPLIANCE	DEFAULT = NON-COMPLIANCE	COMMENTS
Rent		X		
Liability Insurance		X		Expires: 6/14/20
Fire Insurance		X		Expires: 6/14/20
Bond		X		Expires 2/17/20 \$258,000 Surety

FIELD INSPECTION RESULTS (refer to Field Inspection Worksheet)

ITEM	N/A	COMPLIANCE	NONCOMPLIANCE	COMMENTS
Subleases	X			
Improvements		X		Improvements are well maintained.

Premises		X		Premises is clean, neat & orderly.
Character of Use		X		
Phase I Environmental Site Assessment	NA			

State of Hawai'i
DLNR, Land Division

Field Inspection Worksheet
Commercial/Industrial/Resort/Other Business

File Review

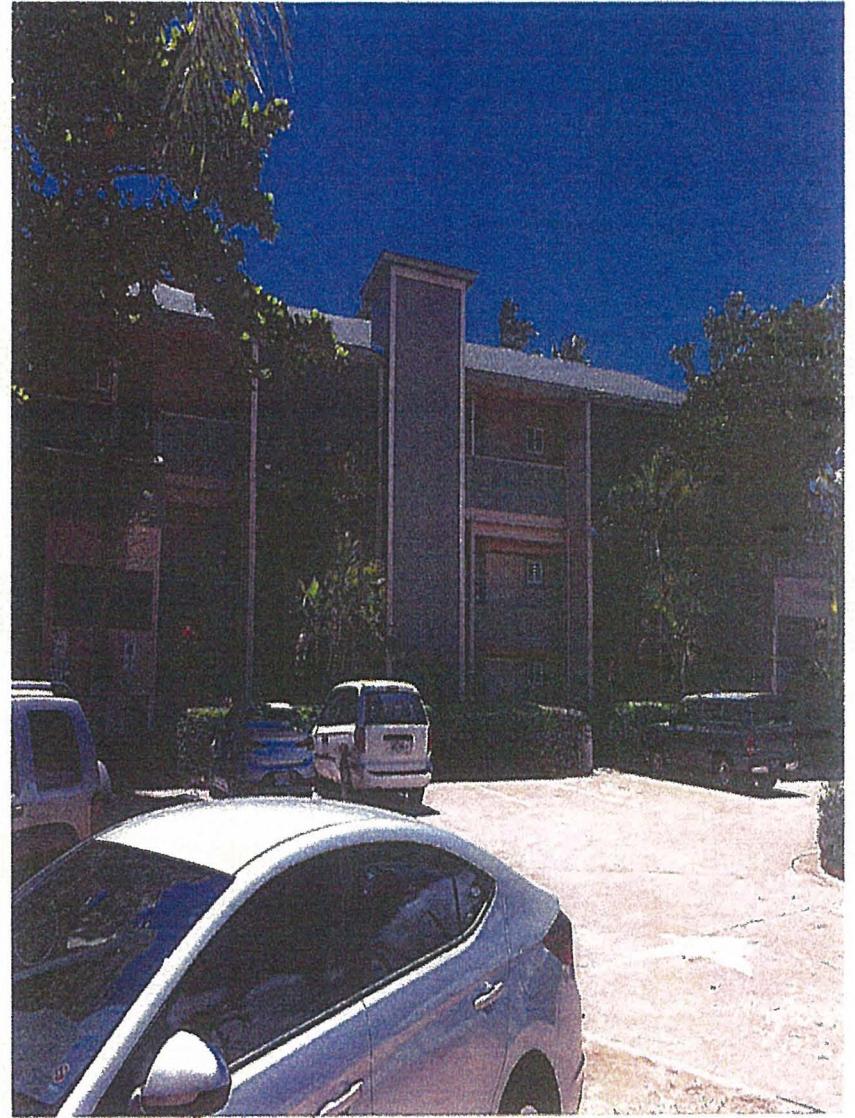
ITEM	DLNR Approval Does in File			COMMENTS/NOTES/LISTS
	N/A	YES	NO	
Subletting	NA			
Improvement Construction Buildings		X		
Improvement Construction Other structures/misc.		X		

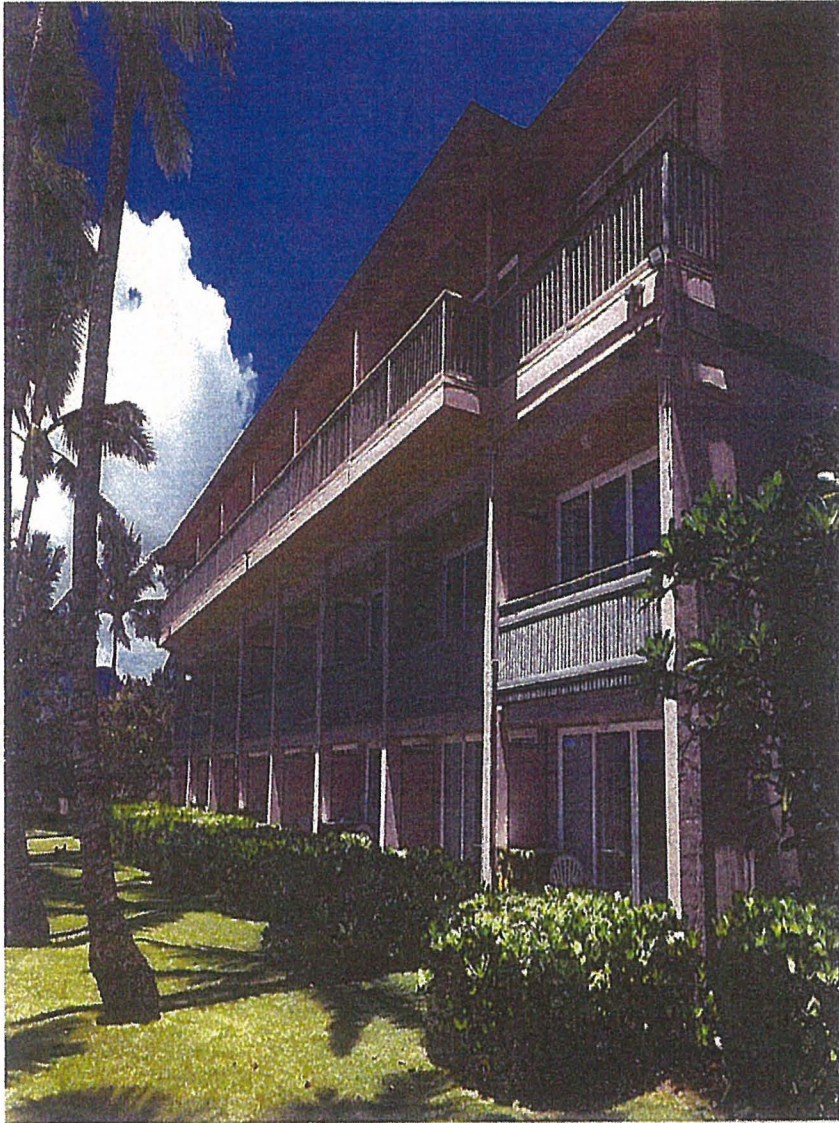
LICENSES/PERMITS/CONSENTS

Field Inspection

ITEM	SATISFACTORY?			COMMENTS/NOTES
	N/A	YES	NO	
SUBLEASES	X			
Consents approved				
Use adheres to lease purpose		X		
IMPROVEMENTS		X		
Buildings/Residences: roof				
paint		X		
exterior		X		
interior		X		
Structures: roads		X		Installation of elevator complete and satisfactory.
walkways		X		
fencelines	X			
others		X		

ITEM	SATISFACTORY?			COMMENTS/NOTES
	N/A	YES	NO	
PREMISES clean, sanitary, orderly		X		Renovation project is completed and all appears satisfactory.
appropriate storage/use of hazardous materials	X			
CHARACTER OF USE adheres to lease purpose		X		Renovation project is completed and all appears satisfactory.
Other:				





5
a. view



7







Kapa'a, HI 96746

November 11, 2019

The Honorable Suzanne D. Case
Chairperson, Board of Land and Natural Resources
1151 Punchbowl St., Room 130
Honolulu, HI 96813

RECEIVED
LAND DIVISION
STATE OF HAWAII
NOV 15 AM 11:03

Re: Assessment of Lease Assignment Premium Under General Lease No. S-5578,
Kapa'a, Kaua'i, Tax Map Key: (4)4-5-012:005

Dear Chairperson Case:

I am writing to ask you to please immediately reconsider the assignment premium of \$56,470.50 plus interest assessed against me as prior lessee and John Kenneth Purdy, the person to whom I sold the Hotel Coral Reef in 2001. Please consider the following. *

My ex-husband and I bought the Hotel Coral Reef in 1985 from the original owners and soon became part of the Kapa'a business community and the State of Hawai'i hospitality community. After Hurricane 'Iniki, we were even able to house *manuahi* many whose homes had been destroyed.

Unfortunately, in the years that followed my marriage fell apart and after the divorce in 1997, I was the sole owner and operator of the Hotel Coral Reef. As I told the Land Board when I appeared before them to request permission to transfer the state leases to a buyer-- "The Hotel Coral Reef started out as a dream, but now it has become my nightmare." I was struggling financially and the only way out was to sell the hotel. Therefore, in January 2002, in spite of the standard continuing liability covenant in the consent to assignment to Pixar Development (aka Mr. Jack Purdy), which stated that I was not released from "...liabilities and claims," I had little choice and was advised by both legal counsel and Mr. Sam Lee, Kaua'i Land Agent at the time, to sign the document even though I had absolutely no control over what Mr. Purdy/Pixar would do at the hotel in the future. Now, almost two decades after the fact, the nightmare continues for me because, out of the blue, a 5-figure premium is being assessed against me by the State of Hawai'i Board of Land and Natural Resources.

I am very confused as to why all of this was allowed to happen. I do not understand why an assignment premium was not imposed by the Board of Land and Natural Resources back in March 2005 when Mr. Purdy assigned 100% of his membership interest in Pixar to Hotel Coral Reef, LLC. That action by Mr. Purdy allowed the Board to impose an assignment premium, yet it was not dealt with at that time. Why didn't the Board act and levy the premium against Mr. Purdy then when his whereabouts were known instead of waiting for 14 years? Why wasn't the lease cancelled when Mr. Purdy failed to comply with the rules and regulations of lease assignments? To make matters more entangled, neither Mr. Purdy nor Mr. Harrah obtained prior consent for the two assignments of membership interest in Pixar. Why? And now, the Board is

11.15.19 ay:KDLO

EXHIBIT II

PM 12:22:24

NOV 21 '19

DLNR KDLO RCU

The Honorable Suzanne D. Case
November 11, 2019
Page 2

also willing to grant a valid after-the-fact consent to this assignment without Mr. Purdy's signature. I obtained Board consent for everything, yet I am the one being dunned years later. This is simply not right.

Furthermore, I sold the Hotel Coral Reef to Jack Purdy for \$1,100,000. He, in turn, sold it a few years later for \$2,500,000—more than twice the price he paid me. I did not reap any of this profit. In addition as mentioned above, it appears that nobody—Mr. Purdy, Michael F. Harrah, or associated LLC members--followed the DLNR rules. In contrast, I worked closely and continually consulted with Mr. Sam Lee to make sure I did everything correctly and lawfully, and I always paid my lease rents on time. I did not break any of the rules and did not need any "after-the-fact" consent, yet I am being penalized. This seems neither just nor fair.

I am not a corporation or an LLC. I am a single senior citizen living on a fixed income who recently had surgery for lung cancer. The assessed amount is slightly less than my annual gross income. Because of my low income status, I am eligible for and have received real property tax relief from the County of Kaua'i continually since 2012. As you can surely see, the imposed assignment premium of \$56,470.50 is not only out of the bounds of my financial abilities, but it would also result in an unbelievable hardship and would negatively affect the rest of my years.

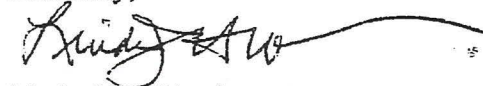
I have not seen or been in contact with Purdy since the sale was finalized. However, after talking to some people who did business with him, I was able to get the following contact information:

Phone: [REDACTED]
Address: [REDACTED], Alberta, Canada TSB3K4
Email: [REDACTED]

I understand that collection of an assignment premium is discretionary and that staff provided multiple reasons against collection of a premium at the March 2018 Board meeting. In light of all this information, I am humbly appealing to you and the Board, Ms. Case, and requesting that there be an equitable re-determination of this assessment to remove me as a responsible party for payment of this assignment premium, thereby forgiving me this assessment of \$56,470.50.

Mahalo for your timely response. I can be reached at [REDACTED] should you have any questions.

Sincerely,


Linda J.H. Warriner

Cc: Russell Y. Tsuji, Administrator, Land Division