

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

September 23, 2022

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

PSF: 19HD-036

Hawai'i

Amend Prior Board Action of February 11, 2022, Item D-2, Approved as Amended, *Consent to Sublease General Lease No. S-3624, 69 Railroad, LLC, Lessee, to Self Storage Hilo LLC, Covan World-Wide Moving, Incorporated, C.A.R.S.S. LLC, Provision Solar, Inc., Tracey Gapol, Charles Wagner & Erin Wagner, Hawaii Behavioral Health, LLC, Whitney & Arnessa Iranon, Mr. & Mrs. Charles and Erin Wagner, McCully Works, Inc., and Lamar Pacheco, Sublessees, Waiakea, South Hilo, Hawaii, Tax Map Key: (3) 2-1-012:026.*

Authorize the Chairperson to Approve and Execute a Development Agreement for a 30-Year Extension of Lease Term and to Execute the Lease Extension Document, General Lease No. S-3624, 69 Railroad, LLC, Lessee; Waiakea, South Hilo, Hawaii, Tax Map Key: (3) 2 -1-012: 026.

Approve Mediated Settlement of Rent Reopening Dispute Pursuant to Mediation Agreement for the Periods of 2026-2046, General Lease No. S-3624, 69 Railroad, LLC, Lessee; Waiakea, South Hilo, Hawaii, Tax Map Key: (3) 2 -1-012: 026.

The purposes of the amendments are to: (a) provide for the updating of certain lease extension terms and the development agreement for the 30-year extended lease term, and (b) extend the time for completion of improvements required under development agreement and lease extension from approximately 10 ½ months after the Board approval of February 11, 2022 to 18 months after the execution of the development agreement.

BACKGROUND:

At its meeting of February 11, 2022, under agenda Item D-2, the Board of Land and Natural Resources (Board) approved, as amended, a request for: (i) consent to eleven subleases under General Lease No. S-3624 (GLS-3624), 69 Railroad, LLC, Lessee (Lessee); (ii) authorization of the Chairperson to approve and execute a development agreement for a 30-year extension of the lease and the execution of the lease extension

document; and (iii) determination of the mediated rent for the first 20 years of the 30-year lease extension. The Board's amendment related to corrections needed to the terms of two of the eleven subleases listed in the submittal. A copy of the prior Board action is attached as Exhibit AA. The Board approval was expressly subject to "such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State."

With respect to the 30-year lease extension, staff reported in the February 11, 2022 submittal that the subject lease was originally issued at public auction. Based on staff's interpretation of oral advice from the Department of the Attorney General, the February 11, 2022 submittal explained that *State v. Kahua Ranch, Ltd.*, 47 Haw. 28, 384 P.2d 581 (1963), *aff'd on reh'g*, 47 Haw. 466, 390 P.2d 737, *reh'g denied*, 47 Haw. 485, 391 P.2d 872 (1964) (*Kahua Ranch*) meant that, unlike leases issued by direct negotiation, public auction leases could not be amended. As a result, staff reported that GLS-3624 could only be extended on its original terms and conditions. See Exhibit AA at page 5.¹

With respect to the time within which Lessee is required to complete the improvements justifying the lease extension, recommendation 3 of the Board's action gave Lessee 10 ½ months from the date of the Board action on February 11, 2022 to complete the improvements, which include improvements to the warehouse structures, asphalt repavement, installation of new rain gutters, solar panels and wastewater system. See Exhibit AA at pages 3, 6 and 10.

REMARKS:

Upon the Board's approval of February 11, 2022, under agenda Item D-2, as amended, Land Division staff began working with the Department of the Attorney General (ATG), Lessee and its counsel on the terms and conditions of the development agreement.

Separately, on April 28, 2022, the Department of Land and Natural Resources (Department) requested a legal opinion from ATG on lease extensions under Act 149 Session Laws of Hawaii (SLH) 2018, which is the authority for the subject extension, and Act 236 SLH 2021. Since these are relatively recent enactments, the Department sought clarity on whether the *Kahua Ranch* decision actually prohibited the updating of public auction leases to the ATG's current standard lease terms when extended under the acts.

While the Department was awaiting a response from ATG, staff's negotiations with Lessee on the development agreement were completed and execution copies of the Development Agreement and a separate Second Extension of Lease document were prepared and sent to Lessee for signature on July 26, 2022. The Second Extension of Lease document basically carried over the terms, conditions and covenants of GLS-3624

¹ Notwithstanding the oral advice from the Department of the Attorney General, the Department continued to question whether *Kahua Ranch* actually prevented the Department from updating lease forms as a condition of extensions approved; particularly given the intent and language of Acts 149 SLH 2018 and 236 SLH 2021 permitting extended lease terms and lease amendments as a matter of legislative policy.

as originally issued, set forth the extended lease term and the rent to be charged therefor, and contained a covenant regarding the use of Lessee's loan proceeds. In other words, the Second Extension of Lease document did not update the lease to ATG's current lease terms for the lease extension period.

Then later on July 26, 2022, prior to the Chairperson reviewing the documents for either approval and execution, or rejection and revising the documents, the Department received advice from the ATG clarifying the limits and inapplicability of *Kahua Ranch* in the context of Act 149 and Act 236. Staff now understands that the Board may require that public auction leases be updated to the ATG's current lease terms and conditions, to the extent necessary to implement the requirements of Act 149, as a condition of approving the extension.

On August 3, 2022, Land Division received the originals of the development agreement and lease extension signed by Lessee. In light of the ATG response of July 26, 2022, and prior to the Chairperson reviewing the documents for approval or rejection as noted above, staff wrote to Lessee on August 17, 2022 advising Lessee that the Department would hold the development agreement and lease extension until the amendments sought in today's submittal could be presented to the Board for consideration.

Staff now recommends that the development agreement and GLS-3624 be updated to incorporate the following specific current lease terms and conditions for the 30-year extension in order to implement Act 149 and conform the terms of the extension period to current law. Below is a summary of the three substantive provisions that need to be updated in this lease originally issued in 1961:

- Lease Assignments. ATG's current lease form includes an assignment of lease premium analysis that allows the State to share in the consideration paid for an assignment of a lease under some circumstances. This term is consistent with Section 171-36, HRS. GLS-3624 is silent on this provision, and the lease extension period should include this standard assignment of lease premium term.
- Sublease Rents. ATG's current lease form includes language allowing the State to adjust the lease rent based on the sublease rent charged to the sublessee, which is also consistent with Section 171-36, Hawaii Revised Statutes. GLS-3624 is silent on this provision, and the lease extension period should include this standard sublease rent participation language.²
- Ownership of Improvements. ATG's current lease form includes a provision on ownership of improvements at lease expiration giving the State the option of assuming ownership or requiring the lessee to remove them at lessee's expense. State leases have incorporated this provision since about the mid-1960s. GLS-3624 simply provides that at the expiration of the lease, title to the improvements

² As noted above, 69 Railroad reported 11 subleases on the lease premises of GLS-3624.

vests in the State, leaving open the question whether the State is responsible for removing improvements that have outlived their useful lives.³ The lease extension period (and the Development Agreement) should include the current standard terms clarifying the State's options relating to ownership of improvements.

At this time, staff is recommending that these updated lease terms and conditions be limited to the 30-year extension period the Board approved under Act 149 which commences on March 6, 2026. Incorporating these substantive terms for the extension period is consistent with the legislative intent of Chapter 171, HRS, which allows the State to be paid its fair share of ancillary income arising from the tenant's leasehold interest.

Staff is also recommending an amendment to the prior Board action to allow additional time for Lessee to complete the improvements required under the development agreement. In the course of negotiating the terms and conditions of the development agreement with Lessee, staff learned that Lessee would prefer 18 months from the date the development agreement is executed to complete the required improvements to the lease premises. Staff has no objection to providing lessee with 18 months to complete improvements.

RECOMMENDATION:

That the Board:

1. Amend its prior Board action of February 11, 2022, under agenda item D-2, by:
 - a. Striking all statements in the submittal to the effect that the lease terms and conditions for the extension period (running from March 6, 2026 to March 5, 2026) of General Lease No. S-3624 cannot be updated as a condition of consent to the extension under Act 149, and directing that the terms of the lease extension shall be updated to include the three specific and substantive terms and conditions discussed above, consistent with the current lease extension forms used by the Department of the Attorney General;

³ The issue of who is responsible for the potential demolition of improvements at the end of a lease is an important one. In the case of the former Uncle Billy's Hilo Bay Hotel, the leases for the property provided that the improvements belonged to the State at the end of the lease. When the leases expired, the improvements were in such poor condition that the County of Hawaii ordered the closure of the hotel, which has been shuttered since 2017. A February 2018 professional estimate procured by Land Division put the cost of demolition of the improvements in excess of \$8 million, and the current estimate adjusted for inflation and increased contractor costs is about \$13.5 million.

b. Specifically revising recommendations 2 and 4 of the submittal to read as follows:⁴

2. Consent to the sublease under General Lease No. S-3624 between 69 Railroad, LLC, as Sublessor, and the Sublessee listed above, 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; provided, however, that any subleases that continue beyond March 5, 2026 or are entered into after that date shall be subject to Sections 171-36, HRS, as amended, regarding Sublease Rent Participation by the Board through an amendment of lease pursuant to recommendation 4 below;
 - 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.

4. Authorize the Chairperson to approve and execute a development agreement for the 30-year extension of General Lease No. S-3624, 69 Railroad, LLC, Lessee, and thereafter to execute the lease extension document for the lease pursuant to Act 149, Sessions Laws of Hawaii 2018, Section 171-36, and Section 171-192, ~~[Hawaii Revised Statutes]~~ HRS, as amended, under the terms and conditions cited above, and further subject to the following:
 - A. ~~[The standard terms and conditions of the most current development agreement and public auction lease extension document forms conforming with Section 171-192, HRS, and Act 149, as may be amended from time to time]~~ Incorporation of the standard terms and conditions regarding Lease Assignment, Sublease Rent Participation, and Ownership of Improvements used by the Department of the Attorney General with respect to leasing of public lands;
 - 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.

⁴ For the amendments of recommendations 2, 3 (see paragraph 1.d), and 4, deletions of existing language are indicated by bracketed strikethrough and insertions are indicated by underscoring.

- c. Changing all references in the submittal regarding the estimated time of completion of improvements to 18 months from the date the development agreement for the lease extension is fully executed; and
- d. Specifically revising recommendation 3 to read as follows:
 - 3. Determine that: 1) the development proposed is of sufficient worth and value to justify the extension of the lease; 2) the estimated time to complete the improvements is approximately ~~[10 ½]~~ 18 months from ~~[this approval]~~ the date the development agreement for the lease extension is fully executed; and 3) the minimum revised annual rent based on the fair market value of the lands to be developed shall be as set forth in recommendation 5 below.
- 2. Affirm that, except as amended hereby, all terms and conditions listed in its February 11, 2022 approval shall remain the same.

Respectfully Submitted,

Gordon C. Heit

Gordon C. Heit
District Land Agent

APPROVED FOR SUBMITTAL:

RT

Suzanne D. Case

Suzanne D. Case, Chairperson

EXHIBIT AA

AMENDED

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

February 11, 2022

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

PSF: 19HD-036

Hawai'i

Consent to Sublease General Lease No. S-3624, 69 Railroad, LLC, Lessee, to Self Storage Hilo LLC, Covan World-Wide Moving, Incorporated, C.A.R.S.S. LLC, Provision Solar, Inc., Tracey Gapol, Charles Wagner & Erin Wagner, Hawaii Behavioral Health, LLC, Whitney & Arnessa Iranon, Mr. & Mrs. Charles and Erin Wagner, McCully Works, Inc., and Lamar Pacheco, Sublessees, Waiakea, South Hilo, Hawaii, Tax Map Key: (3) 2-1-012:026.

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Approve Mediated Settlement of Rent Reopening Dispute Pursuant to Mediation Agreement for the Periods of 2026-2046, General Lease No. S-3624, 69 Railroad, LLC, Lessee; Waiakea, South Hilo, Hawaii, Tax Map Key: (3) 2-1-012: 026.

APPLICANT AND REQUEST:

Sublease:

69 Railroad, LLC, a Hawaii limited liability company, as Sublessor, to:

1. Self Storage Hilo LLC
2. Covan World Wide Moving
3. C.A.R.S.S. LLC
4. Provision Solar, Inc.
5. Tracey Gapol
6. Charles Wagner & Erin Wagner
7. Hawaii Behavioral Health, LLC
8. Whitney & Arnessa Iranon

as amended

APPROVED BY THE BOARD OF
LAND AND NATURAL RESOURCES
AT ITS MEETING HELD ON
February 11, 2022 *ga*

9. Mr. & Mrs. Charles & Erin Wagner
10. McCully Works, Inc.
11. Lamar Pacheco

As Sublessees.

Development Agreement and Lease Extension:

Lessee 69 Railroad, LLC, a Hawaii limited liability company (Lessee or Applicant), is requesting an extension of General Lease No. S-3624 of 30 years, commencing on March 6, 2026 and expiring on March 5, 2056 for an aggregate term (initial term plus all extensions) of 95 years.¹

LEGAL REFERENCE:

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

LOCATION:

Parcel C, portion of the Government (Crown) Land of Waiakea, situate on the east side of Railroad Avenue at its intersection with Lanikaula Avenue, at Waiakea, South Hilo, County and State of Hawaii, identified by Tax Map Key: (3) 2 -1-012: 026, as shown on the attached map labeled Exhibit I.

AREA:

4.499 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-1A Limited Industrial

TERM OF LEASE:

Original term of 55 years, commencing on March 6, 1961 and expiring on March 5, 2016. Board approved extension of 10 years commencing on March 6, 2016 and expiring on March 5, 2026.²

¹ Initial term of 55 years commencing on March 6, 1961 and expiring on March 5, 2016. BNLR previously approved a 10-year extension at its meeting of September 27, 2013, Item D-3 and June 12, 2015, Item D-1.

² Sept 27, 2013 (Agenda Item D-3) and June 12, 2015 (Agenda Item D-1).

Requested extension of 30 years commencing on March 6, 2026 and expiring on March 5, 2056.

ANNUAL RENTAL:

Current annual rent is \$127,384.40 due in semi-annual installments on March 6th and September 6th, each and every year during the term, from March 6, 2016, up to and including March 5, 2026.

RENTAL REOPENINGS:

Rental reopenings in the original term were at the end of the 15th, 25th, 35th and 45th 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 March 6, 2016 and expiring on March 5, 2026.

By letter dated February 27, 2020, staff apprised Lessee of the State's appraisal dated February 20, 2020 establishing the lease rent amounts for the three 10-year reopening periods to begin March 6, 2026, as follows:

<u>Effective Date</u>	<u>Annual Lease Rent</u>
03/06/2026	\$170,063.00
03/06/2036	\$228,549.00
03/06/2046	\$307,151.00

Lessee rejected the State's proposed annual lease and mediation ensued.

The parties have reached an agreement in principle subject to the Board's approval, of the mediated amount of annual rental for the periods of 2026-2056 as set forth in a Mediation Agreement, attached as Exhibit II, as follows:

<u>Effective Date</u>	<u>Annual Lease Rent</u>
03/06/2026	\$155,000.00
03/06/2036	\$195,000.00
03/06/2046	To be re-opened and negotiated prior to 03/06/2046

Staff recommends the Board confirm the Mediation Agreement signed and approved by the parties and their respective attorneys.

USE OF LOAN PROCEEDS:

The Lessee proposes to complete general improvements to the warehouse structures and lot by asphalt re-pavement, installation of new rain gutters, solar panel and wastewater installation. A complete list of improvements is attached as Exhibit III.

SUBLEASE RENT PARTICIPATION:

There are eleven subleases of the premises to various businesses as discussed below in more detail. Whenever a lease with subleases comes before the Board for an extension request, an issue arises as to whether the State should share in sublease rents collected by the lessee if the State does not already do so. Section 171-36(a)(6), HRS, provides in part as follows:

The lessee shall not sublet the whole or any part of the demised premises, except with the approval of the board; provided that prior to the approval, the board shall have the right to review and approve the rent to be charged to the sublessee; provided further that in the case where the lessee is required to pay rent based on a percentage of its gross receipts, the receipts of the sublessee shall be included as part of the lessee's gross receipts; provided further that the board shall have the right to review and, if necessary, revise the rent of the demised premises based upon the rental rate charged to the sublessee, including the percentage rent, if applicable, and provided that the rent may not be revised downward; . . .

Emphasis added.³

The Board approved a sublease rent participation policy under the foregoing authority on May 26, 2000, Item D-24, as amended on January 26, 2001, Item D-8, and further amended on January 26, 2012, Item D-14. The relevant portion of the policy, as amended, provides as follows.

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.

In the present case, General Lease No. S-3624 provides that the Lessee owns improvements it makes until the expiration or earlier termination of the lease. The lease contains no provision stating a specific right and method of calculation of State participation in sublease rents. Lessee has made substantial improvements to the premises during its tenancy including \$165,000 in approved repairs and renovations to qualify for a 10-year

³ Section 171-36(a)(6), HRS, was not in existence at the time General Lease No. S-3624 was issued by public auction in 1961. Rather, this provision was added to the Public Lands statute four years later by Act 239, Session Laws of Hawaii 1965.

lease extension that commenced in 2016 and will make additional investments in improvements if the Board approves the requested extension. Finally, an affiliate of Lessee, McCully Works, Inc., will continue to occupy a portion of the lease property for its own business.⁴

General Lease No. S-3624 was issued through public auction and, as such, cannot be amended. *State v. Kahua Ranch, Ltd.*, 47 Haw. 28, 384 P.2d 581 (1963), *aff'd on reh'g*, 47 Haw. 466, 390 P.2d 737, *reh'g denied*, 47 Haw. 485, 391 P.2d 872 (1964). The exception to this general rule appears to be where the Legislature includes language in a lease extension act to the effect that, "Any extension of a lease granted pursuant to this section shall be effectuated, documented, and executed using the most current lease form and leasing practices and policies of the board." See Act 219 Session Laws of Hawaii 2011 (Act 219). Act 219 allowed for the extension of hotel/resort leases and the Board approved the extension of leases for three properties under the act before it sunset on December 31, 2015. Act 149, under which Lessee seeks the extension of the subject lease, does not include a similar provision. As a result, the Board has no statutory authority to update the lease form with the most current lease form and leasing practices, even if both the State and Lessee were to agree to such an update.⁵ In light of the foregoing, staff recommends no participation in sublease rents at the present time.⁶

4 In 2012, when Lessee requested consent to two subleases of the premises under General Lease No. S-3624, staff recommended to the Board at its meeting of September 28, 2012, Item D-2, that it increase the lease rent pursuant to Section 171-36(a)(6), HRS, and the Board policy. However, after much discussion including an executive session, the Board amended the staff recommendation and consented to the subleases without increasing the lease rent. The basis for the Board's decision appears to be that the lease agreement does not provide for the State to share in sublease rents. A copy of the Board action of September 28, 2012, Item D-2, approved as amended, is attached as Exhibit IV. A copy of the approved minutes from the meeting for Item D-2 is attached hereto as Exhibit V.

5 For further discussion on issues encountered by Land Division in applying the various lease extension acts, see *Report to the Board of Land and Natural Resources on Issues Encountered by Land Division in Processing Applications for Lease Extensions Statewide* at the Board's meeting of January 14, 2022, Item D-9: <https://dlnr.hawaii.gov/wp-content/uploads/2022/01/D-9.pdf>. The lease covenant regarding ownership of improvements at the end of the lease term is another provision that Land Division typically updates in lease extensions when permitted. Under the subject lease, the improvements default to State ownership at the end of the lease. For new leases, the current lease form gives the State the option to accept ownership of the improvements or require lessee to remove them.

6 The House Investigative Committee Investigating Compliance with Audit Nos. 19-12 and 21-01 (Committee) explored these and other issues relating to lease extensions in the Kanoiehua Industrial Area and issued a number of findings and recommendations in its report. The Committee's recommendations include that the Legislature should make statutory changes to ensure not only that the Department receive fair market rent on lease extensions, but that it share in sublease rents, charge a premium for the extension, and preclude lessees from disputing rents determined by appraisal for the extension period. The full text of the Committee's report can be found here: <https://www.capitol.hawaii.gov/CommitteeFiles/Special/HIC21/Document/HIC21%20Final%20Report.pdf>

CHAPTER 343 - ENVIRONMENTAL ASSESSMENT:

In accordance with Hawaii Administrative Rules (HAR) § 11-200.1-16 and the Exemption List for the Department of Land and Natural Resources reviewed and concurred on by the Environmental Council on November 10, 2020, the subject request is exempt from the preparation of an environmental assessment pursuant to General Exemption Type 1 that states, "Operations, repairs or maintenance of existing structures, facilities, equipment, or topographical features, involving negligible or no expansion or change of use beyond that previously existing," Part 1, Item 40 that states, "Leases of state land involving negligible or no expansion or change of use beyond that previously existing." The proposed extension of a long-term lease is a de minimis action that will probably have minimal or no significant effect on the environment and should be declared exempt from the preparation of an environmental assessment and the requirements of § 11-200.1-17, HAR.

With respect to the improvements proposed by Lessee, which include re-pavement of the parking lot, and installation of new rain gutters, solar panels and a wastewater system along with other renovations to the premises, the improvements are exempt from the preparation of an environmental assessment pursuant to General Exemption Type 3 that states:

"Construction and location of single new, small facilities or structures and the alteration and modification of the facilities or structures and installation of new, small, equipment and facilities and the alteration and modification of the equipment or facilities, including but not limited to: (A) Single family residences less than 3,500 square feet, as measured by the controlling law under which the proposed action is being considered, if not in conjunction with the building of two or more such units; (B) Multi-unit structures, designed for not more than four dwelling units if not in conjunction with the building of two or more such structures; (C) Stores, offices and restaurants designed for total occupant load of twenty individuals or fewer per structure, if not in conjunction with the building of two or more such structures; and (D) Water, sewage, electrical, gas, telephone, and other essential public utility services extensions to serve such structures or facilities; accessory or appurtenant structures including garages, carports, patios, swimming pools, and fences; and acquisition of utility easements."

Part 1, Item 14 that states, "Construction or placement of utilities (telecommunications, electrical, solar panels, drainage, waterlines, sewers) and related equipment (such as transformers, poles, cables, wires, pipes) accessory to existing facilities."

Staff notes that at least one measure, House Bill 2417, has been introduced in the 2022 legislative session as of the date of writing this submittal that contemplates legislative changes to require updating the forms for all leases upon extension, among other recommendations itemized in the bill:

https://www.capitol.hawaii.gov/measure_indiv.aspx?billtype=HB&billnumber=2417&year=2022

Part 1, Item 22 that states, “Interior alterations and renovations to offices, buildings or structures that do not increase the floor area or change the maximum occupancy to include: a. installation of office partitions, utility outlets or connections, air conditioning, lighting, and security systems; b. renovations required to bring existing structures into compliance with current building codes and applicable health, safety, and access regulations; c. renovations that will result in energy or other operational/cost savings; or d. other similar interior alterations.”

The proposed improvements are de minimis actions that will probably have minimal or no significant effect on the environment and should be declared exempt from the preparation of an environmental assessment and the requirements of § 11-200.1-17, HAR.

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 execute the development agreement.

BACKGROUND:

General Lease No. S-3624 was first sold at public auction to Hawaiian Equipment Co., Ltd., as lessee, recorded in the Bureau of Conveyances of the State of Hawaii in Liber 4323 at Page 247, which General Lease, by mesne assignments, was assigned, to the current Lessee, 69 Railroad, LLC, consent given by the Board by unrecorded instrument executed October 23, 2003.⁷ The General Lease was for a period of 55 years effective March 6, 1961. A condition of the auction lease was that the character of use be industrial, unless prior written consent for a different use, subject to any terms and conditions as set forth by the Lessor, was given.

At its meeting of September 27, 2013, under agenda item D-3, the Board consented to the Extension of General Lease S-3624 dated March 29, 2016 for 10 years expiring on March 5, 2026, to amortize the self-financed improvements made to the property.⁸

SUBLEASE INFORMATION:

The original Lessee, Hawaiian Equipment, constructed two large warehouses on the property in 1962 at a cost of approximately \$223,000. The warehouses were used for heavy

⁷ As an auction lease, General Lease No. S-3624 cannot be amended. See *State v. Kahua Ranch, Ltd.*, 47 Haw. 28, 384 P.2d 581 (1963), *aff’d on reh’g*, 47 Haw. 466, 390 P.2d 737, *reh’g denied*, 47 Haw. 485, 391 P.2d 872 (1964).

⁸ Improvements at that time included extensive repairs to the roof along with exterior wall renovations at a cost in excess of \$160,000.00.

construction equipment storage and repairs. After the lease was assigned to Railroad Avenue Partners in 1987, major renovations were done to the structures at a cost of approximately \$140,000 and again in 1989 at a cost of \$76,000. These renovations included the enclosing of the warehouse structures and the creation of several individual bays. The Lessee also created self-storage units in the open base yard area of the lease land.

Lessee, 69 Railroad, LLC, currently is subletting portions of the premises to 11 businesses listed below. The lease does not require Lessee to pay rent based on a percentage of its gross receipts.⁹ Some of the subleases do not have Board consent. However, staff is requesting the Board consent to the sublease for the following subleases within GL S-3624.

	Sublessee	Area	Date	Monthly Rent ¹⁰	Character of Use
1	Self Storage Hilo LLC	77,383sq. ft.	3/01/16-2/29/26	\$8,252.70	Self-storage/office use
2	Covan World-Wide Moving, Incorporated	20,800sq. ft.	3/01/16-2/29/26	\$14,560.00	Warehouse/office space
3	C.A.R.S.S. LLC	3,840 sq. ft.	3/01/16-2/29/26	\$3,625.20	Warehouse/office space
4	Provision Solar, Inc.	3,840 sq. ft.	3/01/19-2/28/22	\$4,608.00	Warehouse/office space
5	Tracey Gapol	2,551 sq. ft.	6/01/19-5/31/21	\$1,447.22	Photography studio
6	Charles & Erin Wagner	2,000 sq. ft.	6/15/21-5/31/26	\$1,160.00 ¹¹	Office/physical therapy ¹²
7	Hawaii Behavioral Health, LLC	2,359 sq. ft.	3/01/17-2/28/22	\$2,594.90*	Office use
8	Whitney & Arnessa Iranon	1,920 sq. ft.	1/01/19-12/31/21	\$1,305.60	Warehouse/office space
9	M/M Charles & Erin Wagner	1,723 sq. ft.	5/01/17-4/30/22	\$2,611.79*	Massage/physical therapy
10	McCully Works, Inc.	1,478 sq. ft.	11/01/19-2/28/26	\$976.32	Warehouse/office space
11	Lamar Pacheco	1,494 sq. ft.	3/15/20-3/31/23	\$1,972.00	Auto detailing/office use

*Monthly rental amount includes CAM fees

All subleases are allowed under County of Hawaii zoning code ML – Limited Industrial Use as either expressly permitted or accessory uses. With respect to the subleases identified as Nos. 6 and 9 above, whose uses include office, physical therapy and massage, Lessee's counsel sent the letter attached as Exhibit VI to the County Planning Director on September 29, 2021 confirming Lessee's understanding that the sublease uses are allowed as accessory uses pursuant to Section

9 This lease is silent with regards to sublease rent participation. It only requires the Lessor's consent to sublet.

10 Monthly rent and fees do not include GET.

11 Annual rent increase of \$0.02 per sf. Additional monthly CAM of \$840.00 adjustable quarterly.

12 §171-41, HRS, requires leases for commercial, industrial and other business uses to be consistent with county zoning requirements.

24-5-142(d) of the County Zoning Code. The Planning Director responded by letter dated September 30, 2021 stating in part that. "This letter will confirm that the use of the physical therapy and wellness operation would be permitted in the ML district on the [subject] property." See Exhibit VII. In light of this, staff is recommending the Board consent to all the foregoing subleases.

DCCA VERIFICATION:

SUBLESSOR: 69 Railroad, LLC

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: Self Storage Hilo LLC.

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: Covan World-Wide Moving, Incorporated.

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: C.A.R.S.S. LLC.

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: Provision Solar, Inc..

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: Charles & Erin Wagner

Individuals are not required to register with the DCCA

SUBLESSEE: Hawaii Behavioral Health, LLC

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: Whitney and Arnessa Iranon

Individuals are not required to register with the DCCA

SUBLESSEE: Mr. & Mrs. Charles and Erin Wagner

Individuals are not required to register with the DCCA

SUBLESSEE: McCully Works, Inc.

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: Lamar Pacheco

Individuals are not required to register with the DCCA

LEASE EXTENSION:

With the Lessee's current lease set to expire on March 5, 2026, 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 re-pavement of the parking lot, and installation of new rain gutters, solar panels and a wastewater system along with other renovations to the premises at a cost in excess of \$536,000.00 (Exhibit III).¹³ 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 \$1,575,000.00. Lessee's proposed expenditure of \$626,838.60¹⁴ represents 40.0% of the value of the existing improvements (\$1,575,000.00), 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.

¹³ 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 \$1,050,000.00. 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).

¹⁴ Revised 1/28/2022.

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 bayfront 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. 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.

Lessee states that it will complete its proposed improvements by December 31, 2022. Staff is requesting authority to negotiate a development agreement outlining the terms and conditions required in compliance with Act 149 and Section 171-192(a), HRS, as amended, with Lessee. Staff is further recommending that the Chairperson be given authority to approve and execute the development agreement and lease extension document. As discussed above, the subject lease cannot be updated because it is a public auction lease.

There are no outstanding rental reopening issues. The Lessee is current with rent, insurance and performance bond. By letter dated June 19, 2020, the Department offered Lessee a two-month rent deferral due to the economic impacts of the COVID-19 pandemic. Lessee accepted the deferral, exercising the option to pay the deferred balance of \$21,655.35 in six equal installments between January 1, 2021 and June 30, 2021. Lessee paid the deferred rent ahead of schedule.

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

RECOMMENDATION:

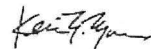
That the Board, subject to the Applicant fulfilling the Applicant requirement listed above:

1. Declare that, after considering the potential effects of the proposed disposition as provided by Chapter 343, HRS, and Chapter 11-200.1, HAR, the extension of a long-term lease is a de minimis action under Section 11-200.1-16, HAR, and Type

- 1, Part 1, Item 40 of the Exemption List for the Department dated November 10, 2020, will probably have minimal or no significant effect on the environment and is therefore exempt from the preparation of an environmental assessment and the requirements of Section 11-200.1-17, HAR. Similarly, the proposed improvements including re-pavement of the parking lot, and installation of new rain gutters, solar panels and a wastewater system along with other renovations to the premises are de minimis actions under Section 11-200.1-16, HAR, and General Exemption Type 3, Part 1, Items 14 and 22 will probably have minimal or no significant effect on the environment and are therefore exempt from the preparation of an environmental assessment and the requirements of Section 11-200.1-17, HAR.
2. Consent to the sublease under General Lease No. S-3624 between 69 Railroad, LLC, as Sublessor, and the Sublessees listed above, 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.
3. Determine that: 1) the development proposed is of sufficient worth and value to justify the extension of the lease; 2) the estimated time to complete the improvements is approximately 10 ½ months from this approval; and 3) the minimum revised annual rent based on the fair market value of the lands to be developed shall be as set forth in recommendation 5 below.
4. Authorize the Chairperson to approve and execute a development agreement for the 30-year extension of General Lease No. S-3624, 69 Railroad, LLC, Lessee, and thereafter to execute lease extension document for the lease pursuant to Act 149 Session Laws of Hawaii 2018 and Section 171-192, Hawaii Revised Statutes, as amended, under the terms and conditions cited above, which by this reference are incorporated herein, and further subject to the following;
 - A. The standard terms and conditions of the most current development agreement and public auction lease extension document forms conforming with Section 171-192, HRS, and Act 149 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.
5. Approve the mediated settlement of the rent reopening dispute pursuant to the Mediation Agreement that sets annual rental for the period of 2026-2036 in the amount of \$155,000.00, and annual rental for the period of 2036-2046 in the amount of \$195,000.00, with the annual rental for the period of 2046-2056 to be reopened and negotiated prior to March 6, 2046, subject to any applicable conditions cited above which are by this reference incorporated herein.

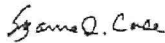
Respectfully Submitted,



for Gordon C. Heit
District Land Agent

APPROVED FOR SUBMITTAL:

RT



Suzanne D. Case, Chairperson

Land Board Meeting: February 11, 2022: D-2: Approved as amended.

Approved as amended. The Board amended the table of subleases on page 8 of the submittal as follows:

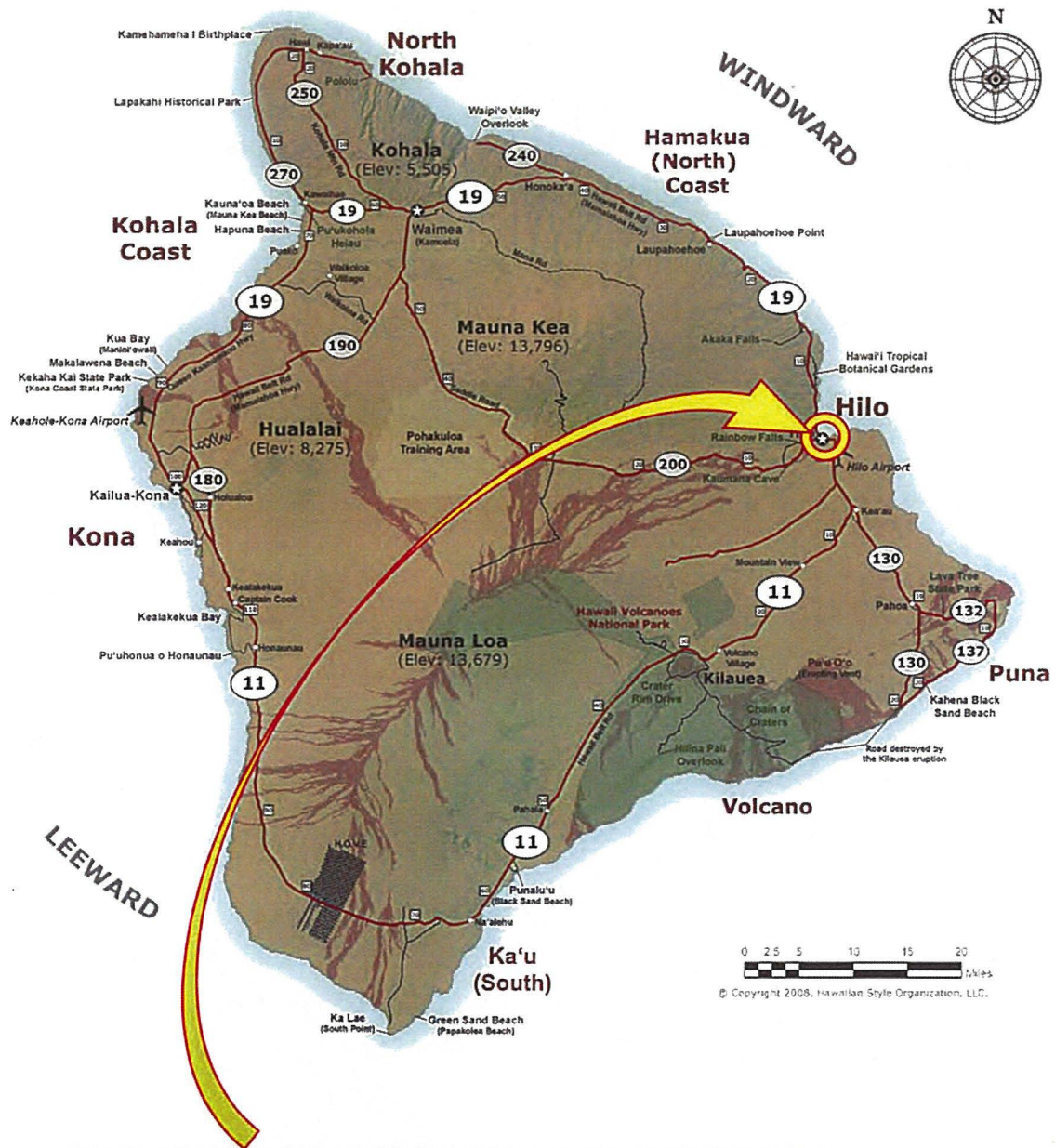
Item 5, Tracey Gapol, Sublessee, the expiration date of the sublease is 5/31/26.

Item 8, Whitney & Arnessa Iranon, Sublessees, the sublease has been on a month-to-month tenancy since the expiration of the sublease term on 12/31/21.

The table relates to the Board's consent to subleases under recommendation 2 of the submittal.

EXHIBIT I

EXHIBIT I



GENERAL LEASE No. S-3624,
South Hilo, Hawaii

TMK: (3) 2-1-012:026

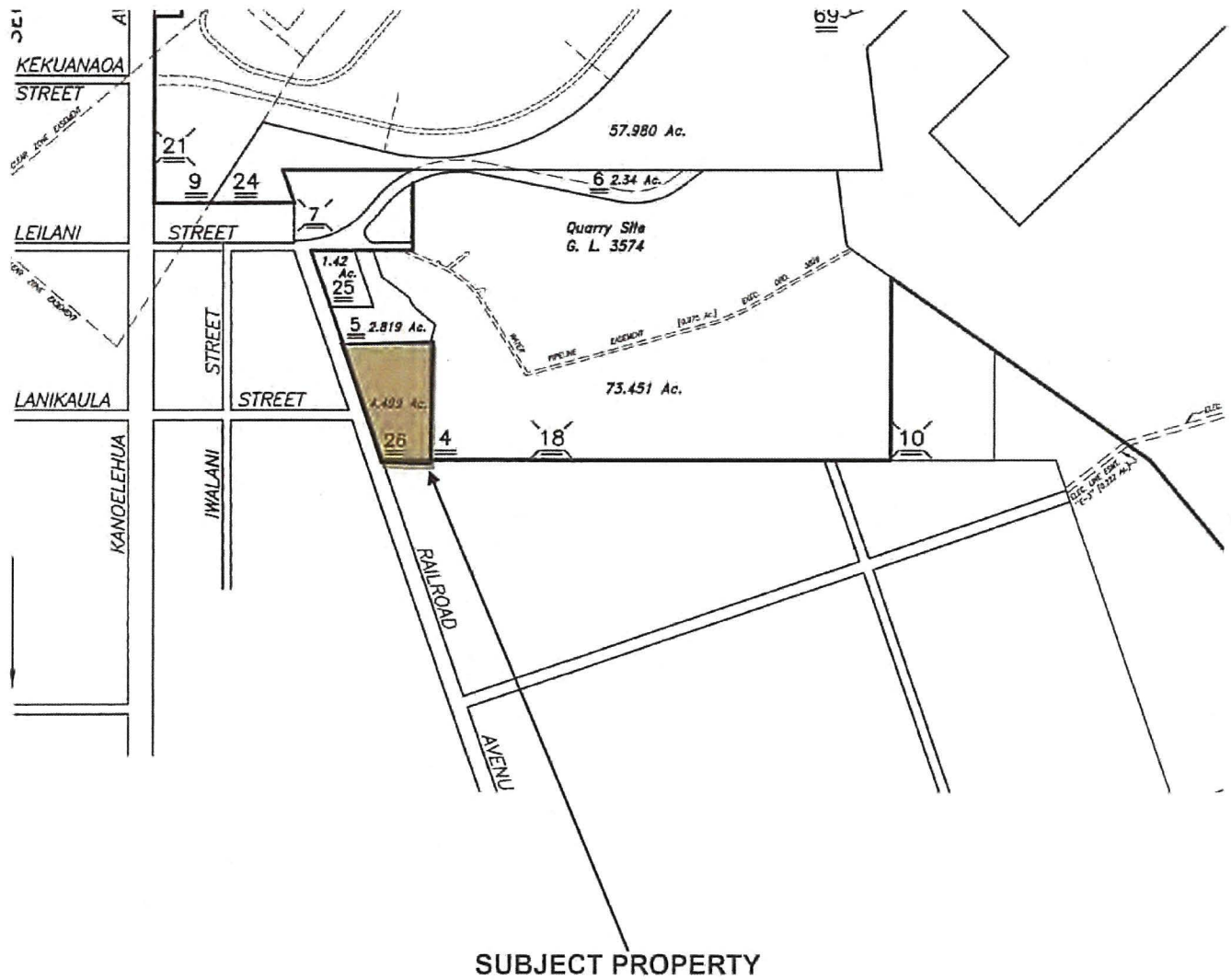


EXHIBIT I

EXHIBIT II

MEDIATION AGREEMENT

On October 30, 2020, the State's Department of Land and Natural Resources (DLNR), represented by Russell Tsuji, Esq., Andrew Tello, Daniel Morris, Esq. and Melissa Goldman, Esq., and 69 Railroad, LLC, represented by Michael Shewmaker, James McCully, and Ronald Kim, Esq. participated in mediation before Andrew Wilson, Esq., regarding the parties' dispute over the fair market value for rent for an extension period from 2026-2056 for the property located at 69 Railroad Ave. 69 Railroad, LLC had requested an extension of its lease pursuant to HRS Sections 171-191 and 192, and the parties had not been able to agree to a fair market rental value for the extension period.

The parties reached an agreement in principle, with the understanding that the Board of Land and Natural Resources (BLNR) will still need to approve the mediated amount of rental value as part of the BLNR's approval of the lease extension and/or development agreement. DLNR will recommend the mediated amount of rental value as part of that approval process.

The parties agreed that annual rent for the period from 2026-2036 would be set at \$155,000, rent for the period from 2036-2046 would be set at \$195,000, and that rent would be re-opened and negotiated for the period from 2046-2056.

The parties agree that the mediated rent amount represents a compromise of disputed issues. The mediated rent amount is only related and applicable to the extension of General Lease No. S-3624, and the parties agree that these mediated settlement amounts may not be used in any other appraisals, mediations or arbitrations involving ground lease rent with DLNR. The parties agree that HRS Sections 171-191 and 171-192 will be followed for the BLNR proceeding to independently authorize or approve an extension of lease term and/or a development agreement.

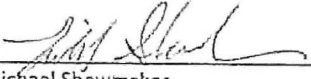
The parties represent and warrant that each signatory below has right and authority to bind the party on whose behalf the document is being signed. The parties agree that this instrument may be executed in counterparts, each of which shall be deemed an original, and the counterparts shall together constitute one and the same instrument, binding all parties notwithstanding that all of the parties are not signatory to the same counterparts. For all purposes, including, without limitation, delivery of this instrument, duplicate unexecuted and unacknowledged pages of the counterparts may be discarded and the remaining pages assembled as one document.

Department of Land and Natural Resources, State of Hawai'i

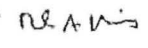
By Russell Tsuji
Russell Tsuji
its DLNR LD - Administrator

EXHIBIT II

69 Railroad, LLC

By 
Michael Shewmaker
Its Manager

APPROVED AS TO FORM AND
LEGALITY:


Daniel A. Morris, Esq.,
Deputy Attorney General
For the State of Hawai'i

APPROVED AS TO FORM
AND LEGALITY:



Ronald Kim, Esq.
Counsel for 69 Railroad, LLC.

EXHIBIT III

Revised 1/28/2022

TO: STATE OF HAWAII/DLNR

FROM: 69 RAILROAD LLC (General Lease #3624)

PROPERTY: 69 RAILROAD AVENUE, HILO, HAWAII

LIST OF SUBSTANTIAL IMPROVEMENT for Ground Lease Extension

			Expected Completion date
Asphalt repave A/F area	Loeffler Construction, Inc.	\$78,281.50	12/31/2022
Asphalt repave Bldg A	Loeffler Construction, Inc.	\$91,040.40	12/31/2022
Asphalt repave Bldg. B - front	Loeffler Construction, Inc.	\$75,612.90	12/31/2022
Asphalt repave Bldg A – end including paving gravel parking area	Loeffler Construction, Inc.	\$26,625.50	12/31/2022
New rain gutters	Big Aina Gutter	\$10,998.00	5/31/2022
Solar Panels	Provision Solar, Inc.	\$35,998.00 (House) \$109,998.00 (Wagner/HBH) \$61,998.00 (Tracey/Lamar) \$40,998.00 (Jim/James)	3/31/2022 3/31/2022 3/31/2022 3/31/2022
Wastewater Improve	Loeffler Construction, Inc	\$62,868.30	12/31/2022
Fencing	Island wide fencing	\$32,420.00	5/31/2022
	Total Improvements	\$626,838.60	

EXHIBIT III

EXHIBIT IV

AMENDED

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

September 28, 2012

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

Hawaii

Resubmittal: Consent to Sublease General Lease No. S-3624, 69 Railroad, LLC, Lessee, to Hui Malama Ola Na OIwi, Kirby Kuoha, Sub-lessees, Subject to State's Participation in Sublease Rent Profits, Waiakea, South Hilo, Hawaii, Tax Map Key:3rd/2-1-12:26.

BACKGROUND:

At its meeting of July 13, 2012, Item D-3, the Board of Land and Natural Resources deferred action on the initial submission of this request for consent to two subleases. The staff recommendation was for the State to participate in the sublease rents. See Exhibit 1 attached. The deferral was granted at the request of the Board's counsel.

REMARKS:

The staff recommendation for sublease rent participation was and is based on the Board's statutory authority and its written sublease rent participation policy. The applicable statute, Hawaii Revised Statutes Section 171-36(a)(6), reads as follows:

The lessee shall not sublet the whole or any part of the demised premises except with the approval of the board; provided that prior to the approval, the board shall have the right to review and approve the rent to be charged to the sublessee; provided further that in the case where the lessee is required to pay rent based on a percentage of its gross receipts, the receipts of the sublessee shall be included as part of the lessee's gross receipts; provided further that the board shall have the right to review and, if necessary, revise the rent of the demised premises based upon the rental rate charged to the sublessee including the percentage rent, if applicable, and provided that the rent may not be revised downward....

Under this authority, the Board adopted its sublease rent participation policy at its meeting of May 26, 2000, Item D-24, as amended at its meeting of January 26, 2001, Item D-8 (and as further described in Exhibit 1).

EXHIBIT IV

APPROVED BY THE BOARD OF
LAND AND NATURAL RESOURCES
AT ITS MEETING HELD ON

As Amended
September 28, 2012 *Don*

D-2

At its meeting of August 24, 2012, under agenda item D-14, the Board approved the modification of the staff recommendation contained in the prior Board sublease rent participation policy by making the staff recommendation consistent with the Board's directives and practice in past years in implementing the policy. The modified staff recommendation now reads as follows:

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.¹

Based on the foregoing, and for the additional reasons given in the initial submittal of the subject sublease requests (see Exhibit 1), staff is recommending that the Board consent to the subleases on the condition that the rent payable under the lease be increased as detailed below.

RECOMMENDATION:

That the Board consent to the sublease under General Lease No. S-3624 between 69 Railroad, LLC, as Sublessor, and Hui Malama Ola Na Oiwi, Kirby Kuoha as Sublessees, subject to any applicable conditions cited above which are by this reference incorporated herein and further subject to the following terms and conditions:

1. The lease rent shall be increased by \$17,588 annually, representing the combined sublease sandwich profits from Hui Malama Ola Na Oiwi and Kirby Kuoha, sublessees;
2. The standard terms and conditions of the most current consent to sublease form, as may be amended from time to time;
3. Review and approval by the Department of the Attorney General; and

¹ New language is underscored.

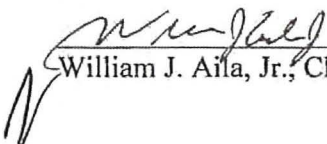
4. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.

Respectfully Submitted,



Gordon C. Heit
District Land Agent

APPROVED FOR SUBMITTAL:



William J. Aila, Jr., Chairperson

Land Board Meeting: September 28, 2012; D-2: Approved as amended:

The Board decided to consent the sublease but not condition the consent on taking a share of the sublease rents; and therefore struck or deleted recommendation number 1.

DEFERRED

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

July 13, 2012

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

Hawaii

Consent to Sublease General Lease No. S-3624, 69 Railroad, LLC, Lessee, to Hui Malama Ola Na Oihi, Kirby Kuoha, Sub-lessees, Subject to State's Participation in Sublease Rent Profits, Waiakea, South Hilo, Hawaii, Tax Map Key: 3rd/2-1-12:26.

APPLICANT:

69 Railroad, LLC, a Hawaii Limited Liability Company, as Sublessor, to:

1. Hui Malama Ola Na Oihi, a Hawaii Non-Profit Agency
2. Kirby Kuoha.

As Sub-lessees.

LEGAL REFERENCE:

Section 171-36(a)(6), Hawaii Revised Statutes, as amended.

"Revision to Sublease Rent Participation Policy" adopted by the Board of Land and Natural Resources (Board) on May 26, 2000, agenda item D-24, and as amended by "Resubmittal: Amendment to the Sublease Rent Participation Policy" approved by the Board on January 26, 2001, under agenda item D-8.

LOCATION AND AREA:

Portion of Government lands of Kanoiehua Industrial Lots situated at Waiakea, South Hilo, Hawaii, identified by Tax Map Key: 3rd/2-1-12:26, consisting of approximately:

- | | | |
|---------------------------|-------------|---------------|
| 1. Hui Malama Ola Na Oihi | Lease area, | 7,253 sq. ft. |
| 2. Kirby Kuoha | Lease area | 1,000 sq. ft. |

As shown on the attached map labeled Exhibit A.

TRUST LAND STATUS:

Section 5(b) lands of the Hawaii Admission Act

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

~~DEFERRED~~
APPROVED BY THE BOARD OF
LAND AND NATURAL RESOURCES
AT ITS MEETING HELD ON
July 13, 2012

EXHIBIT 1

D-3

LEASE CHARACTER OF USE:

Industrial purposes.

SUBLEASE CHARACTER OF USE:

- | | |
|----------------------------|-----------------------------|
| 1. Hui Malama Ola Na Oihi. | Office and warehouse space. |
| 2. Kirby Kuoha | Office and warehouse space |

TERM OF LEASE:

55 years, commencing on March 6, 1961 and expiring on March 5, 2016. Last rental reopening occurred on March 6, 2006; there are no more rental reopenings for this lease.

TERM OF SUBLEASE:

	<u>Begin Date</u>	<u>End Date</u>
1. Hui Malama Ola Na Oihi	03/01/12	02/28/15
2. Kirby Kuoha	07/01/11	06/30/14

ANNUAL RENTAL:

\$74,500.00

ANNUAL SUBLEASE RENTAL:

- | | |
|---------------------------|------------------------------------|
| 1. Hui Malama Ola Na Oihi | \$43,242.36 base rent ¹ |
| 2. Kirby Kuoha | \$13,200.00 base rent |

Sublease Rent Participation Policy

The primary purpose of establishing the Board's Sublease Rent Participation Policy was to avoid lessees from speculating and profiting on fluctuating land values while benefiting from a State lease.

On May 26, 2000, agenda item D-24, the Board approved the "Revision to Sublease Rent Participation Policy" ("Policy"). On January 26, 2001, agenda item D-8, the Board amended the Policy to address the situation in which the lessee is a non-profit making entity and paying less than fair market rent.

In summary, the Policy applies to three types of situations.

- a. If the lessee subleases unimproved lands, the Board shall revise the rent to include as additional rent, 50% of that portion of the sublease rent in excess of the original ground rent paid to the State.
- b. If the lessee subleases improvements owned by the State, the Board shall revise the rent to include as additional rent, 50% of that portion of the sublease rent in excess of the original ground rent paid to the State.

¹ Base rent is for square foot area only and does not include State G. E. Taxes or Common Area Maintenance (CAM) fees.

- c. 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 that right and method of calculation are specifically stated in the lease.

The Board stated on the record that the formulae in the Policy generally reflects the intent of the Board regarding the calculation of sublease sandwich profit and shall serve as guidelines in such calculation. The Board also authorizes the staff to use their discretion in representing the State's interest in applying these formulae to address the varying subleasing arrangements that may not fit neatly into the formulae.

Therefore, notwithstanding the Board adopting the Sublease Rent Participation Policy, the policy was never meant to be followed blindly with rigid adherence but instead, the Board had expected staff to continue to use good land management practices and standards (and common sense) when analyzing a sublease rent proposal and arriving at a reasonable recommendation for the Board to consider that is both fair to both parties and in the best interest of the State.

This lease is silent with regards to sublease rent participation. It only requires the Lessors consent to sublet. The Lessee, 69 Railroad, LLC does not occupy any portion of the property and operates as a landlord/manager for the sublease tenants on the land. Staff is therefore recommending the State participate in the sublease sandwich profits as the Lessee is using the property for purely rental income purposes.

RECOMMENDED ADJUSTMENT TO LEASE RENTAL:

1. Hui Malama Ola Na OIwi
\$13,358 (Refer to Exhibit B attached review by staff on premium/sandwich calculations.)
2. Kirby Kuoha
\$4,230. (Refer to Exhibit C attached review by staff on premium/sandwich calculations.)

DCCA VERIFICATION:

SUBLESSOR:

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

SUBLESSEE: Hui Malama Ola Na OIwi.

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

SUBLESSEE: Kirby Kuoha

Individuals are not required to register with the DCCA

REMARKS:

General Lease No. S-3624 was first sold at public auction to Hawaii Equipment Co., Ltd. on March 6, 1961. The lease was assigned from Hawaii Equipment Co., Ltd. to Castle & Cooke, Inc. on March 25, 1964. The lease was subsequently assigned from Castle & Cooke, Inc. to E. J. Mahoney, III, Leon Stocksdales and Eliot Merk on November 7, 1986. On April 24, 1987, the lease was assigned from E. J. Mahoney, III, Leon Stocksdales and Eliot Merk to Railroad Avenue Partners.

As the result of a rental delinquency, Railroad Avenue Partners entered into a Special Installment Agreement (SIA) on February 3, 1999 in the amount of \$40,755.00 to be paid in 48 monthly-amortized installments of \$1,037.62. This account was paid off on July 15, 2002.

On August 10, 2001, GE Capital Hawaii, Inc. filed a motion for Summary Judgment and for Interlocutory Decree of Foreclosure. The appointed commissioner held a public auction on March 19, 2002. On June 7, 2002 the court approved and confirmed the Order Approving Report of Commissioner, Confirming Commissioner's Sale of Property at Public Sale, Directing Distribution of Proceeds, Granting Writ of Possession, Private Sale of Personal Property and for Deficiency Judgment. The commissioner, as assignor was ordered and directed to make good and sufficient conveyance of the subject property. GE Capital Hawaii, Inc., the Mortgagee, paid \$733,000.00 at auction for the lease.

At its meeting of September 13, 2002, under agenda item D-10, the Board consented to the assignment of lease from Jerel Yamamoto, Commissioner to GE Capital Hawaii, Inc. In a letter dated January 16, 2003 (Exhibit B), GE Capital Hawaii informed HDLO staff that due to an oversight, they had been incorrectly named the Assignee for GL S-3624. The correct name for the lease should have been GECH Holding, Inc., the real estate holding company for GE Capital Hawaii, Inc. To correct this oversight, the Board at its meeting of February 14, 2003, agenda item D-1, consented to the assignment of lease from GE Capitol Hawaii, Inc., as Assignor to GECH Holdings, Inc., as Assignee.

Then at its meeting of July 25, 2003, under agenda item D-4, the Board did consent to an assignment of lease from GECH Holdings, Inc., Assignor to 69 Railroad, LLC, as Assignee.

The original Lessee, Hawaiian Equipment, constructed two large warehouses on the property in 1962 at a cost of approximately \$223,000. The warehouses were used for heavy construction equipment storage and repairs. After the lease was assigned to Railroad Avenue Partners in 1987, major renovations were done to the structures at a cost of approximately \$140,000 and again in 1989 at a cost of \$76,000. These renovations included the enclosing of the warehouse structures and the creation of several individual bays. The Lessee also created self-storage units in the open base yard area of the lease land. Given the age of the structures on the property, staff believes that the construction and renovation costs of the improvements have largely been depreciated over the past decades. The Lessee itself does not occupy a portion of the lease premises, but instead operates as a landlord/manager for the sublease tenants in the property. For these reasons, staff is recommending a sublease rent participation rate of 33%.²

² Staff also notes the current Lessee has included a Common Area Maintenance fee (CAM) to the Sublessee's agreement. The sublease premium is based on the sublease rent exclusive of CAM charges.

The sub-lessees will be occupying areas within the existing structures on the premises. Any alterations to their respective units will be minor.

The Lessee is compliant with all lease terms and conditions including rent, insurance and performance bond. The Lessee has not had a notice of default issued for any lease violation.

Last rental reopening occurred on March 6, 2006; there are no more rental reopenings for this lease. There are no outstanding rental reopening issues.


A site inspection was conducted on April 24, 2012. Premises and improvements are clean, orderly and well maintained. The property is managed in adherence to the designed character of use.

RECOMMENDATION:

That the Board consent to the sublease under General Lease No. S-3624 between 69 Railroad, LLC, as Sublessor, and Hui Malama Ola Na Oiwi, Kirby Kuoha as Sub lessees, subject to any applicable conditions cited above which are by this reference incorporated herein and further subject to the following terms and conditions:

1. The lease rent shall be increased by \$17,588 annually, representing the combined sublease sandwich profits from Hui Malama Ola Na Oiwi and Kirby Kuoha, sub lessees;
2. The standard terms and conditions of the most current consent to sublease 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.

Respectfully Submitted,

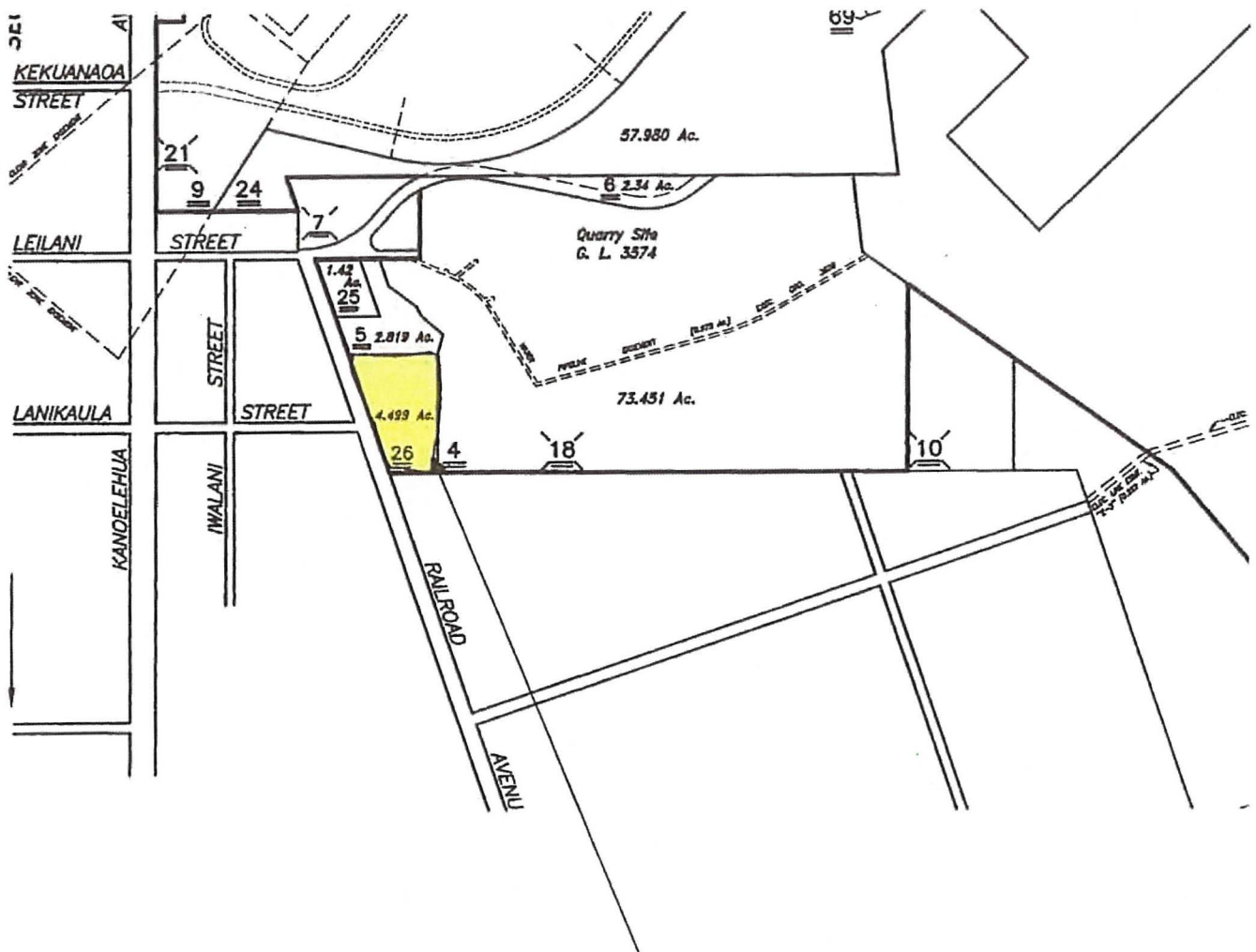

Gordon C. Heit
District Land Agent

APPROVED FOR SUBMITTAL:


William J. Aila, Jr., Chairperson

EXHIBIT A

TMK: 3RD/2-1-12:26



SUBJECT PROPERTY

GL S-3624



0 45 90 180 270 360
Feet





STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
LAND DIVISION

POST OFFICE BOX 621
HONOLULU, HAWAII 96809

May 10, 2012

MEMORANDUM

TO: William J. Aila, Jr., Chairperson

THROUGH: Russell Y. Tsuji, Division Administrator

FROM: Gordon C. Heit, District Land Agent

SUBJECT: In-House Recommendation – Sublease Participation Calculation

GL No.:	S-3624
Lessee/Sublessor:	69 Railroad, LLC
Sublessee:	Hui Malama Ola Na OIwi
Location:	Walakea, South Hilo Hawaii
Lease Area:	4.49 acres (195,584.4 square feet)
Sublease Area:	7,253 square feet
Tax Map Key:	3 rd /2-1-12:26
Char. of Use:	Industrial purposes

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-3624, 69 Railroad, LLC, Lessee/Sublessor to Hui Malama Ola Na OIwi, 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 F-8, comprising of the Sublease Rent Participation Policy.

The original Lessee, Hawaiian Equipment, constructed two large warehouses on the property in 1962 at a cost of approximately \$223,000. The warehouses were used for equipment storage and repairs. After the lease was assigned to Railroad Avenue Partners in 1987, major renovations were done to the structures at a cost of approximately \$140,000 and again in 1989 at a cost of \$76,000. These renovations included the enclosing of the warehouse structures and the creation of individual bays.

The lease is silent regarding sublease rent participation. The Lessee, 69 Railroad, LLC does not occupy any portion of the land and operates as a landlord/manager for the sublease tenants on the property. Staff is therefore recommending the State participate in the sublease sandwich profits as the Lessee is using the property for purely revenue generating purposes.

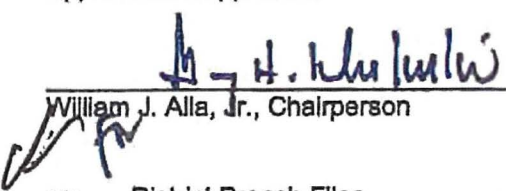
EXHIBIT B

CALCULATION:

Annual Ground Rent		\$74,500
Annual Sublease Rent	\$43,242	
Less G. E. Tax ¹	\$ 0	
Less Real Property Tax	\$ 0	
Misc. Allowances	\$ 0	
Total Allowances	\$ 0	
Total Sublease Rent	\$43,242	
Income to Land:		\$43,242
Annual Ground rent (7,253 sq. ft.)		(\$2,763)
Annual Rent Increase		\$40,479
DLNR Rent Participation		<u>33%</u>
Additional Annual Rent Due		\$13,358

Based on these calculations the additional annual rent due the State is \$13,358.

Approved/Disapproved:



William J. Alla, Jr., Chairperson

5.11.12

Date

cc: District Branch Files
Central Files

¹ GE Tax is not included in the base sublease rent. Real Property Tax, utilities along with maintenance and repairs are included in a Common Area Maintenance (CAM) fee and are in addition to the base sublease rent paid to the Lessee.



STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
LAND DIVISION

POST OFFICE BOX 621
HONOLULU, HAWAII 96809

May 10, 2012

MEMORANDUM

TO: William J. Aila, Jr., Chairperson

THROUGH: Russell Y. Tsuji, Division Administrator

FROM: Gordon C. Helt, District Land Agent

SUBJECT: In-House Recommendation – Sublease Participation Calculation

GL No.:	S-3624
Lessee/Sublessor:	69 Railroad, LLC
Sublessee:	Kirby Kuoha
Location:	Waiakea, South Hilo Hawaii
Lease Area:	4.49 acres (195,584.4 square feet)
Sublease Area:	1,000 square feet
Tax Map Key:	3 rd /2-1-12:26
Char. of Use:	Industrial purposes

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-3624, 69 Railroad, LLC, Lessee/Sublessor to Kirby Kuoha, 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 F-8, comprising of the Sublease Rent Participation Policy.

The original Lessee, Hawaiian Equipment, constructed two large warehouses on the property in 1962 at a cost of approximately \$223,000. The warehouses were used for equipment storage and repairs. After the lease was assigned to Railroad Avenue Partners in 1987, major renovations were done to the structures at a cost of approximately \$140,000 and again in 1989 at a cost of \$76,000. These renovations included the enclosing of the warehouse structures and the creation of individual bays.

The lease is silent regarding sublease rent participation. The Lessee, 69 Railroad, LLC does not occupy any portion of the land and operates as a landlord/manager for the sublease tenants on the property. Staff is therefore recommending the State participate in the sublease sandwich profits as the Lessee is using the property for purely revenue generating purposes.

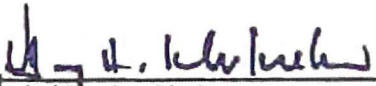
EXHIBIT C

CALCULATION:

Annual Ground Rent		\$74,500
Annual Sublease Rent	\$13,200	
Less G. E. Tax ¹	\$ 0	
Less Real Property Tax	\$ 0	
Misc. Allowances	\$ 0	
Total Allowances	\$ 0	
Total Sublease Rent	\$13,200	
Income to Land:	\$13,200	
Annual Ground rent (1,000 sq. ft.)	(\$380)	
Annual Rent Increase	\$12,820	
DLNR Rent Participation	33%	
Additional Annual Rent Due	\$4,230	

Based on these calculations the additional annual rent due the State is \$4,230.

Approved/Disapproved:



William J. Aila, Jr., Chairperson

5.12.12

Date

cc: District Branch Files
Central Files

¹ GE Tax is not included in the base sublease rent. Real Property Tax, utilities along with maintenance and repairs are included in a Common Area Maintenance (CAM) fee and are in addition to the base sublease rent paid to the Lessee.

EXHIBIT V

**MINUTES FOR THE
MEETING OF THE
BOARD OF LAND OF NATURAL RESOURCES**

DATE: FRIDAY, SEPTEMBER 28, 2012
TIME: 9:00 A.M.
PLACE: KALANIMOKU BUILDING
LAND BOARD CONFERENCE ROOM 132
1151 PUNCHBOWL STREET
HONOLULU, HAWAII 96813

Chairperson William Aila called the meeting of the Board of Land and Natural Resources to order at 9:04 a.m. The following were in attendance:

MEMBERS

William Aila, Jr.
David Goode
John Morgan

Jerry Edlao
Rob Pacheco
Dr. Sam Gon

STAFF

Sam Lemmo/OCCL
David Smith/DOFAW
Alton Miyasaka/DAR

Russell Tsuji/LAND
Roger Imoto/DOFAW
Carty Chang/ENG

OTHER

Bill Wynhoff, Deputy Attorney General (AG)
Linda Chow, Deputy AG
Paul Mancini, K-1
William Yuen, D-2
Laura Thompson, D-6
Ron Terry, C-1
Mark Murakami, D-8

Cindy Young, Deputy AG
Ross Smith: M-1, M-3, M-4, M-5
Diane Schweitzer, K-1
Michael Shoemaker, D-2
Marjorie Ziegler, C-1
Mark Fox, C-1
Emilia Sogin, F-2

{NOTE: Language for deletion is [bracketed], new/added is underlined.}

Item A-1 August 24, 2012 Minutes

Member Pacheco recused from item A-1.

EXHIBIT V

Mancini said if you think its cost effective and time effective and would like the ability to make that call. They had some recent appraisals on the property and have a fairly reasonable idea on the square footage on a 55 year lease. They would like the opportunity to go that route.

Member Edlao asked if we do go forward with the 120 days and would everything else kick in. Mr. Mancini said they will either provide the plan to remove or provide an application of the permit

Member Edlao summarized agreeing with the reduced fine and allowing the 120 days and see what happens. Mr. Mancini noted that they want to get this over with as quick as possible for the client because it is a serious emotional problem and has to be put behind them. If its 60 days they will do it in 60 days, but they have a mountain of problems with the County and isn't something to be taken lightly.

Member Edlao made a motion to reduce the fine to \$5,000.00 with additional \$1,000 for administrative costs and extend the 3 months with another 30 days for a total of 120 days. Member Goode seconded that. All voted in favor.

The Board:

Made a motion to reduce the fine from \$10,000.00 to \$5,000.00 with the additional \$1,000.00 administration fee and add 30 days to the 3 months for a total of 120 days. Otherwise, staff's submittal was approved as submitted.

Unanimously approved as amended (Edlao, Goode)

Item D-2 Resubmittal: Consent to Sublease General Lease No. S-3624, 69 Railroad, LLC, Lessee, to Hui Malama Ola Na Oiwī, Kirby Kuoha, Sub-lessees, Subject to State's Participation in Sublease Rent Profits, Waiakea, South Hilo, Hawaii, Tax Map Key:3rd/2-1-12:26.

Written testimony from William Yee was distributed to the Board.

Russell Tsuji representing Land Division noted that item D-2 is a resubmittal and said there were written objections from Bill Yee that staff had amended their Board policy and Mr. Tsuji disagrees with that. The matter that came before the Board at the last meeting was a housekeeping matter where he read the title "modification of staff recommendation of Board action in January 6, 2001, item D-8 as amended regarding the sublease rent participation policy." The purpose of this modification was to make the staff recommendation in the Board submittal consistent with the Board's directives at that 2001 meeting and practice and participation in the State's rent policies. That is not an amendment of the policy or the Board's policy from 2001. Specifically the Board's own language at the time when they looked at the staff proposal said they are going to approve this, but this is what they added. Furthermore, the following formula that was presented to the Board generally reflects the intent of the Board regarding calculation of sublease sandwich profit and will serve as guidelines in subsequent calculations. The Board authorized its staff to use their discretion in representing the State's interest in applying these formulas to address the valued sublease arrangements that may not fit neatly into the formula.

That was the Board's language in 2001. Staff went back to have that portion in the formula match what was actually directed by the Board and they have done several participation of rent policies in the past. You cannot sublease without the Board's consent. Staff is not recommending a denial of this. The consent is not unreasonably withheld and we think we should be participating in the rent and in this case at least 33% of the sublease rent. There are more than two subleases in this structure and this is for the two that is coming before the Board right now. Based on the facts in the submittal and what was brought to the Board a few months ago goes is why they should be sharing in the sublease rent.

Member Pacheco said he was just confused looking in the submittal, HRS 171-36(a)6, when he reads this it appears to him that they can do the sandwich rents provided further in the case that the Lessee is required to pay a percentage of his gross receipts and that is what triggers our ability to do sandwich rents. He asked whether that was not correct. Mr. Tsuji said no. You're reading it as we can only ask for participation if there is a percentage rent clause in the sublease rent. Member Pacheco confirmed that it's actually in their lease because they have the older leases. Mr. Tsuji said his reading of this is a percentage of the sublease rent. The participation in the context of the landlord, the State's participation is a percentage of the sublease rent only if the Lessee is collecting percentage rent. It is more a participation in the form of the end of sublease rents that the Lessee would be receiving. That is the way it is written. Looking at the last part that provided further the Board has the right to review and if necessary revise the rent of the premises based on the rental rate charged to the sublessee which is the Lessee's tenant including the percentage rent if applicable and the rent may not be revised down. This whole provision only applies to only if there is percentage rent that the Lessee is charging to the subtenant. Looking at it from the landlord, percentage rent is just a method of calculation of what he will get where he cited an example.

Member Pacheco asked are they only able to go after these sandwich rents like this where there are subleases on the property when they come up for approval by our Board. Like in this case the Lessee has other subleases that weren't getting any participation in the sublease rent. Is there a mechanism where the Department can go back and get those sandwich rents or can we look at other properties that have subleases in the State and do that with this authority? Mr. Tsuji said he doesn't recommend we do that because at the time it went through right or wrong they did request the Board's consent in the past and they obtained that without conditions and even without a request for participation. He didn't think it would be fair to go back and try to undo that transaction. The current request for consent is what staff is bringing before the Board and not going back to try and undo the prior consents because that isn't fair.

(Deputy Attorney General (AG) Bill Wynhoff departed and Deputy AG Cindy Young took over.)

Member Goode asked whether they have a prior consent request after the 2001 policy. Mr. Tsuji said they may have. Member Goode asked how many. William Yuen (representing 69 Railroad, LLC) said there were 8. Mr. Tsuji said 10 with today's approval. Mr. Yuen said 8 total. Mr. Tsuji said so 6 so far. He is not disputing those with no consents given. This is why staff tried to make it clearer at this last meeting because my own staff would look at the formula and plug it in

and they figure that is all they got to do. This is to help staff understand as well to make it clearer.

Member Goode asked it's a 55 year lease to 2016 and 4 years from now what happens. Mr. Tsuji said the statute for extensions maybe amended to allow them to -- with original 55 year leases can go up to 65 years if they meet the conditions of the extension. A lot of times they need extensions to hire attorneys or pay back the loans. There is that ability to request that and he doesn't believe they have done that. Member Goode asked if they don't ask for the extension then it goes back out. Mr. Tsuji confirmed that it comes back to the Department and goes back out. Member Goode asked with a new modern lease. Mr. Tsuji acknowledged that and explained this is an old lease since 1961. He related the Kanoelehua area in Hilo industrial having a lot of leases and all expiring at various times where staff was looking at this area anticipating them expire in the near future. They are still evaluating on what to recommend to the Board because a lot of it is non-conforming that a lot of property are small. One idea is whether to consolidate.

Member Pacheco referred to page 2 of the submittal, the underlined second part of that talks about the participation of the subleases pertaining to improvements that were advertised and relationship to sublease rent and the occupier are using the premises for their own business. In this case how does that tie into our policy from the sandwich policy that it hasn't changed and we're arguing that we didn't change that, but changed the recommendation. How does that tie into to our ability on what our policy is? Are you basically saying those improvements are owned by us because they have been there so long? How would you come up to a relationship to the sub-lease rents than the Lessee's expenditures? Mr. Tsuji said and reiterated you are looking at page 2 and that is amending staff's recommendation portion of the submittal that went before the Board in 2001 to take into consideration the Board's directive back in 2001 when they approved and amended staff's proposal referring back to the language he read earlier. He related some situations that fit this scenario where the actual Lessee isn't occupying the property. If they did the auction today you have to qualify/propose you are operating an industrial use. Retail wouldn't necessarily qualify.

Member Pacheco asked whether 69 Railroad stated they were going to do an industrial business when they acquired the lease. Mr. Tsuji said he doesn't know if it went before the Board. Michael Shoemaker (69 Railroad property manager) said they had a consent from the Board and it said they weren't subject to sublease participation which was signed by the AG. Member Morgan asked whether it was for all subleases and Mr. Shoemaker confirmed for all sub-leases. Member Morgan said it would be appropriate to bring that consent here. Mr. Shoemaker reiterated what was stated in Mr. Yuen's letter repeating that they do not participate in sub-lease rents that staff has made this argument in their 3 letters to staff. Mr. Tsuji asked when you signed the document from the State saying it's ok for you to acquire the property and not be subject to sub-lease rent participation and Mr. Shoemaker confirmed that.

Member Pacheco asked to take page 2 and exhibit 1 which summarized that they case participate in sub-lease rent. Under which one A, B or C are we applying to this property? Mr. Tsuji said it's not there. That is what they amended. A, B or C was an excerpt of the staff's recommendation to the Board in 2001 and the Board approved as amended with that language.

Member Pacheco asked these 3 things are current established Board policy on sublease rent participation. Mr. Tsuji said it is the staff recommendation portion of the policy. Staff brought to the Board what they recommend on the policy and to please consider approve. The Board said approve as amended and added the language. These formulas may not fit every situation and staff asks they continue good land management practices. Staff considers the age of the improvements and not limited to depreciate as advertised, etc. Staff has tried to be consistent with the directive since 2001 and made the recommendation to the Board for participation for a portion of the sublease rent.

Member Pacheco asked he understands how they came to what to charge them for the sublease rent, but wouldn't this only apply when our participation set in 2001...he doesn't see the trigger for the Board to come into the lease. Mr. Tsuji said it doesn't say that they will ask for participation and Member Pacheco said right. He feels like they are going back and changing the terms of their legal contract. Mr. Tsuji said that is what they are arguing because the lease doesn't say you can take a share of my sublease rent and therefore you cannot. When you are asking for it would be an amendment and Mr. Tsuji doesn't believe that is true. If that was the case they would allow them to sublease without a consent, why get a consent? Come before the Board to get consent. He related other landlord/tenant situations. The question is what are you consenting to. This situation they want the consent and the State wants a share in the sublease rent and not with holding the lease.

Member Pacheco asked whether anywhere in their lease that requires them to operate an active business on the property. Mr. Tsuji said he doesn't believe it says that and will revise that when they go to auction. It is presumed the Lessee has already qualified and already gone through that process and that is where you usually catch it. What staff has found they are going to recommend to amend for current leases that actually say that because it's usually caught in the auction package when you have to fill out the application. The Chair said this is a usual one and Mr. Tsuji acknowledged that.

Member Pacheco asked what the Department's process is when leases are acquired through foreclosure. What does the State vet that person applying to even qualify to even have that lease? Mr. Tsuji said when he was Deputy AG he went to bankruptcy court and asked the court to go back to the Board to get a formal consent and related the judge wants to get the money. There were more discussions regarding bankruptcy court and another situation.

Member Gon asked on your question that the rent is silent with regard to the sublease rent which flies in the face of 69 Railroad's statement referring to Exhibit B, third paragraph and that suggests to him that there was no indication by the Department one way or the other whether or not 69 Railroad will be exempt or not exempt from the State's participation in sublease rents. Is there any other letter or communication from the Department at the time that gives an indication to 69 Railroad that they would be exempt from sublease rent participation? Mr. Tsuji agreed it doesn't say in the lease and said what he probably read was this sentence or maybe he read the submittal that went back before the Board in July that emphasized that as well. The 1961 lease has an additional paragraph about participation policy and this doesn't have it. As far as direct communication that you are exempt he doesn't know of any and he certainly did not and he doesn't know of any document as described by 69 Railroad that when the Board signed off on

the assignment from foreclosure to 69 Railroad that he would be surprised that they would. Member Gon said the fact that it's silent then it doesn't give any statement. Mr. Tsuji said what they would go back to is Board's consent.

Mr. Yuen said he has a letter from 2003 to Mr. McCully from Gordon Haight the Land Agent and he attaches the submittal that went to the Board for the consent to assignment of lease and it does say in the lease no participation in sublease rents. Mr. Tsuji said the lease does not have a provision for sublease sandwich. Member Gon said that is different from exemption. Mr. Tsuji read the submittal in 2003 and it advises the Board to approve from A to B. Mr. Yuen said the profits refer to the sublease rents.

The Board secretary made copies of the 2003 submittal.

Member Morgan said the lease can be construed as a negative or a positive it means it doesn't allow it or its silent which is always the gray area. Mr. Tsuji said the intent was to allow subleasing or you wouldn't require a consent. Member Morgan said that subleasing is one thing and sandwich profits is completely different thing. Chair Aila said that is different from what he heard in the bankruptcy proceeding that there was a document or order preventing and asked whether he was referring to that type of document. The 69 Railroad representatives said this is a consent.

Member Goode asked whether they came in for subsequent subleases. Mr. Tsuji said they did and approved, but they did not participate.

Mr. Shoemaker introduced himself and testified that since 2003 he managed all the subleases and each time they submit 5 copies to DLNR and in the past they received consents from DLNR and for the past 5 years they did a number of subleases and they never received a consent or a response. The only response was this one in 5 years and his tenants begged him for one because they need to move forward. He had not control and didn't give consents. Mr. Shoemaker has letters documenting all of that.

Member Goode asked in 2006 there was a reopening of the rent that happens every 10 years and he assumed you participated in that. In that process was an appraisal done? Mr. Shoemaker acknowledged that. Member Goode asked they would look at neighboring parcels and State parcels and were the appraisals done looking at what the market rents were for industrial properties in the area. Mr. Shoemaker said yes. Member Goode asked whether they were single users or multiple users. Mr. Shoemaker showed the report and said it was a variation and a lot of the industrial areas are both. Some are operators like us that just sublease, but it's very common for people to operate a portion and sublease the remainder. Member Goode said what he is getting at is it was appraised with the thought that there will be a lot of sublessors which means they are getting the dollar for the parcel. Mr. Shoemaker said that is what the appraisal is meant to do and when the lease rent was adjusted that it went up substantially. They serve an important function by purchasing the property out of foreclosure. If you pass rules that does not allow subleasing of the property that will eliminate mortgages because it depends on market and you cannot have a mortgage without the right to foreclose to put that property on the market. Without a market that includes the right to sublet you diminish the value tremendously because

you restrict it and it will be difficult to make that property function. It's a major issue for the mortgage industry. This is a standard business practice. Member Gon pointed out that there is none of that in this recommendation. Mr. Shoemaker said no, but it's hard for them to sit by that it's just another business. It would be different if they were going for another lease. Our lease does not allow sublease rent and they proceeded on that basis...

Member Morgan said you use the term it does not allow and it says it does not provide for. Mr. Shoemaker said you can argue it, but for them it's pretty solid that the State gave them their word that the sublease does not provide for rent participation. Member Morgan said does not allow is not accurate and it says it does not have a provision for.

Member Pacheco said he has a problem with this because he has leases and they are fortunate to not have a percentage of sales included in their rent while many of the tenants in their complex do. If his landowner came back and wanted to charge a percentage of that is what we are doing to our tenants. He is not against the Department maximizing on our lands, but he is having a hard time seeing the justification and the legal basis for us being able to do it because we are using a Board policy to change a legal contractual contract. Mr. Shoemaker said they retained Mr. Yuen and on his advice what you are doing is in violation of the United States Constitution by re-writing our contract from 1961 which states the rent and cannot charge them more rent.

Member Morgan said he agrees that they have agreements with cell towers and they wrote in there that they want to participate if they sublet to somebody else and is in the contract, but this is a silent contract. If there is money on the table you don't want unfair distribution of the profits, but you have to have that clear in the contract.

Member Pacheco asked from the document you gave us from July 25, 2003 this is the Board submittal for the consent and on page 3 it says and he read it ...the intent of the signee to operate in a similar manner. When 69 Railroad went into this was there any intent to operate a business that fits the industrial zoning outside of managing subletting industrial businesses. Mr. Shoemaker said no. Member Pacheco asked that is what you are in the business and why you bought the foreclosure. Mr. Shoemaker said and the State was fully aware of that. Mr. Tsuji said that the lease did not require it. Member Pacheco said the reasons for the argument are for us to participate.

Mr. Yuen said their feeling was Mr. Tsuji's characterization of the modification to the policy merely stating what the true policy is since 2001 the State was operating with the policy in the addition that you adopted a month ago was the policy with respect to other sandwich leases that come before the Board in the 10 year period the Board has consented to subleases one of the older leases without requiring the sub-lease rent as consideration for the consent. In that regard the policy modification or policy change is an expo facto of law that prepares the contract between the Board and the Lessee contrary to Article 1, Section 10 of the U.S. Constitution. The lease merely requires industrial use and doesn't say the Lessee has to be the industrial user or his tenants have to be industrial user or anybody on the property has to be the industrial user. The rent increase participation has a condition of consent and under that circumstance that general law is construed that a consent should not be unreasonably held. Indication of the proposed sublessee is not an industrial user that would be a reasonable grounds refusing consent, but

unless the lease expressly provides for participation in sublease rents the State cannot use that as a condition for consent. Mr. Yuen cited the Kahua Ranch case in 1963. They also believe if the State is relying on a policy change the State under Chapter 91 would have to go to rule making to implement a policy change otherwise it's a violation and for those reasons they believe that the State should not require payment of a portion of sublease rents as a condition for the consent. Even if you take this policy or the modification to the policy in consideration the State has not obtained any information from the Lessee as to the expenditures and whether the improvements may be old, but the State has not asked what the expenses are to upkeep or whether the Lessee is still depreciating these expenses or not and what the true cost of providing this space is to the tenants. If the State is going implement this policy at least the State should be making that kind of analysis before you arbitrarily say we are going to sublease they want it all proper.

Member Pacheco asked our Board can set policy as long as they can't congregate the rule or law, to set policy we don't have to go out to rule making that there is statute and rules that have processes, but the Board can make policy. Mr. Yuen said the Board can make policy, but what Chapter 91 says is that if you are going to adopt a policy and everyone has to be treated in a certain way because this is our policy you have to follow the Administrative Procedures Act in setting that policy. If you are interpreting the policy you are interpreting on a case by case basis then you don't need rule making. If it's policy this is the rule everybody has to follow then you have to follow the procedures.

Board member Pacheco made a motion for the Board to go into Executive Session pursuant to Section 92-5(a)(4), HRS to consult with our attorney on questions and issues pertaining to the Board's powers, duties, privileges, immunities and liabilities. Member Gon seconded it. All voted in favor.

10:45 AM EXECUTIVE SESSION

11:04 AM RECONVENED

Mr. Tsuji said while the Board was in executive session staff printed the August 24th Board submittal modifying the staff recommendation to match the policy in 2001 and reminded the Board in that submittal staff went over the additions to the varying sublease rents for consent to sublease and asked the Board to consent and participation and in all of those situations they had the exact same lease which did not say we cannot sublease without consent. Referring to Mr. Yuen's argument if you participate in the sublease rents and cannot do it as a matter of law without a rule and he disagrees with that and he would agree with that only if the statute itself 171 did not say anything about subleasing and in our lease form you need the Board's consent before they agree to sublease. Here not only does it say the Lessee shall not sublet the whole or any part except by approval of the Board for sublease rent scenarios here it gives you the expressed statutory authority. He disagrees that a rule is required because the statute authorizes it.

Member Morgan asked you were saying there were other circumstances and they had a sandwich in there and the Board approved it and the attorneys accepted it. Was it prior sandwiches or was

there prior no sandwich? Mr. Tsuji said his recollection they were only approving one sublease and not multiple pointing out some examples – Mt. Ka’ala and HECO as an example.

Member Morgan said he was uncomfortable with the last minute change of practice of getting in a sandwich.

Member Pacheco said he feels the same way that we are applicable to maximize the value of our lands and moved to consent to sublease and strike item #1 from the recommendation. Member Morgan seconded that. All voted in favor.

The Board:

Approved as amended. The Board decided to consent the sublease but not condition the consent on taking a share of the sublease rents; and therefore struck or deleted recommendation number 1.

Unanimously approved as amended (Pacheco, Morgan)

Item D-6 Final Approval of an Exchange Between the State of Hawaii and Tiana Partners and Hawaiian Humane Society for State-Owned Springing Executory Interest in Land at Niu, Honolulu, Oahu, Tax Map Keys: (1) 3-7-04:01, 02, 20 and 21 and Privately-Owned Land at Niu, Honolulu, Oahu, Tax Map Key: (1) 3-7-04:02, for Proposed Addition to the Honolulu Watershed Forest Reserve.

Mr. Tsuji summarized that the property is out in Niu Valley and Tiana and the Hawaiian Humane Society (HHS) each have a percentage interest in it, but there was a restriction to use it for education purposes. HHS doesn’t have that purpose and if you don’t use it for education it will go to the State for a park. State Parks says they do not have an interest or a need for it to be a state park. This has been in the works for years now with Tiana and HHS to work out an exchange for the State to be receiving will be set aside for an addition to the Division of Forestry and Wildlife for Forestry Reserves.

Laura Thompson testified that this is family property, an ahupua’a from King Kamehameha and their family wanted to keep it the way it is not developing it. They wanted to educate the public on the fauna and flora and respect. They have been trying to untangle the various gifts to various organizations and thanked the Board for considering this and asked for the Board’s approval. Member Gon commented that this looks like an extremely important addition to the Forest Reserves and he made the motion to approve that recommendation. Member Morgan seconded it. All voted in favor.

Unanimously approved as submitted (Gon, Morgan)

Item C-1 Request Approval of the Ka’ū Forest Reserve Management Plan, Acceptance of the Final Environmental Assessment for the Subject Plan and Issuance of a Finding of No Significant Impact for the Proposed Project, TMKs (3) 9-7-

EXHIBIT VI

Law Offices of Yeh & Kim
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September 29, 2021

Zendo Kern, Director
Hawai'i County Planning Department
101 Pauahi Street, #3
Hilo, HI 96720
Zendo.kern@hawaiiicounty.gov
Via US Mail and Email

Re: 80/20 Physical Therapy & Wellness Operations on TMK No. (3) 2-1-012:026

Dear Mr. Kern,

The State of Hawaii, Department of Land and Natural Resources is the fee owner of TMK No. (3) 2-1-012:026 ("Property"). My client, 69 Railroad LLC is the Lessee of this property under General Lease S-3624. 80/20 Physical Therapy & Wellness ("80/20 Physical Therapy") is a sub-lessee on the Property, which is zoned ML-1A.

80/20 Physical Therapy provides physical therapy services on the Property to the general public and workers or other users of the industrial area, specializing in rehabilitation including industrial workplace injuries. Our understanding is that these uses are allowed by HCC § 25-5-142(d), which allows for buildings and uses normally considered directly accessory to the uses permitted in the ML district. Please let me know if any of the foregoing is incorrect or should be clarified- we are providing a copy of this letter to the Land Division of the Department of Land and Natural Resources to confirm this mutual understanding.

Very truly yours,

LAW OFFICES OF YEH & KIM



RONALD KIM

Cc: clients, K. Moore, G. Heit

EXHIBIT VI

EXHIBIT VII

Mitchell D. Roth
Mayor

Lee E. Lord
Managing Director

West Hawai'i Office
74-5044 Ane Keohokālole Hwy
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County of Hawai'i
PLANNING DEPARTMENT

Zendo Kern
Director

Jeffrey W. Darrow
Deputy Director

East Hawai'i Office
101 Pauahi Street, Suite 3
Hilo, Hawai'i 96720
Phone (808) 961-8288
Fax (808) 961-8742

September 30, 2021

Ronald N. W. Kim, Esq.
Law Offices of Yeh & Kim
505 Kilauea Avenue, #B
Hilo, HI 96720-2830

Dear Mr. Kim:

Subject: Response to Letter Dated September 29, 2021, Requesting Confirmation of
Physical Therapy & Wellness Operations
Applicant: 80/20 Physical Therapy & Wellness
Tax Map Key: (3) 2-1-012:026

This is to acknowledge receipt of your letter dated September 29, 2021, requesting confirmation of the use of the physical therapy and wellness operations on the above referenced property, which is zoned Limited Industrial (ML-1a).

The subject property is 4.449 acres in size. It is zoned Limited Industrial (ML-1a) by the County and Urban by the State Land Use Commission.

Section 25-5-142 (d) of the Zoning Code states that buildings and uses normally directly accessory to the uses permitted in this section shall also be permitted in the ML district.

The requested use of the physical therapy and wellness operation is similar and would be considered accessory to the uses permitted in the ML district. These uses include 1) indoor amusement and recreation facilities, which partly is defined as including health and fitness establishments; as well as 2) services for persons working in an ML district, which are conducted within an integral part of a main structure....

This letter will confirm that the use of the physical therapy and wellness operation would be permitted in the ML district on the above referenced property.

If you have any questions, please don't hesitate to call me at 961-8125.

Sincerely,

Zendo Kern
Zendo Kern (Sep 30, 2021 10:13:11ST)

ZENDO KERN
Planning Director