

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

August 10, 2012

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

Hawai'i

Consent to Assign General Lease No. S-4308, Hilo Sheet Metal, Inc., Assignor, to Kalawe's Auto Repair, LLC, Assignee, Consent to Mortgage but Deny a Request for an Extension of Lease Term, Waiakea, South Hilo, Hawaii, Tax Map Key: 3rd/2-2-58:02.

APPLICANT:

Assignment:

Hilo Sheet Metal, Inc., as Assignor, to Kalawe's Auto Repair, LLC, a Hawaii Limited Liability Company, as Assignee.

Mortgage and Lease Extension:

Kalawe's Auto Repair, LLC, requesting consent to mortgage from Bank of Hawaii, Mortgagee, in an amount not to exceed \$ 260,000.

LEGAL REFERENCE:

Section 171-36, Hawaii Revised Statutes, as amended.
Section 171-22, Hawaii Revised Statutes, as amended.

LOCATION:

Portion of Government lands of Waiakea situated at Lot 4, Hilo Industrial Development, Pohaku Street Section, Waiakea, South Hilo, Hawaii, identified by Tax Map Key: (3) 2-2-58:02, as shown on the attached map labeled Exhibit A.

AREA:

24,007 square feet, 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:

General industrial purposes.

TERM OF LEASE:

Original term of 40 years, commencing on June 23, 1970 and expiring on June 22, 2010.

Board approved extension of 15 years commencing on June 23, 2010, and expiring on June 22, 2025.

ANNUAL RENTAL:

Current rent is \$21,700.00, due in monthly installments of \$1,808.33.

CONSIDERATION:

\$ 260,000.00.

RECOMMENDED PREMIUM:

Not applicable as the lease does not allow for a premium.

USE OF LOAN PROCEEDS:

The proceeds from a loan from Bank of Hawaii will be used by the Assignee to finance the purchase of General Lease No. S-4308.

DCCA VERIFICATION:

ASSIGNOR:

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>

ASSIGNEE:

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>

REMARKS:

On June 23, 1970, a 40-year lease covering the subject land was sold at public auction to L.H. Nishimoto Plumbing Contractor, Inc. (Nishimoto) as the highest bidder. Nishimoto and the State executed General Lease No. S-4308 in September 1970, and Nishimoto thereafter constructed a warehouse building on the property in accordance with plans approved by the Chairperson of the Board of Land and Natural Resources. Land Division files show that construction of the warehouse was completed as of August 31, 1971.

At its meeting of December 9, 1977, Item F-1-m, the Board approved Nishimoto's request for consent to the assignment of the lease to Hilo Sheet Metal, Inc. (HSM). HSM has leased the property for its sheet metal business since 1977. In 2010, HSM applied for a 15-year extension of the lease to allow it to amortize the cost of self-financed improvements and repairs to the property including: replacement of metal roof, perimeter fencing, and one roll-up door, and exterior painting at an estimated cost of \$36,166.00. The Board approved the 15-year extension at its meeting of May 13, 2010, Item D-5, as amended. The current expiration date for this lease is June 22, 2025.

At the time of the Board action approving the extension, the law only allowed for lease extensions where the initial lease term and any extension totaled an aggregate term of 55 years. The following year, the Legislature passed a measure that increased the aggregate term to 65 years.¹ However, lessees are not entitled to extensions as a matter of right. Rather, the Board has discretion to grant or deny an extension under HRS Section 171-36(b).

HSM is closing its business and selling the lease property to Kalawe's Auto Repair, LLC (Assignee), which is owned by Brian S.K. and Tracy H. Kalawe. In order to secure funding for the purchase of the leasehold property, the Assignee has applied for a loan from Bank of Hawaii and is asking that the lease be extended an additional ten (10) years to qualify for a longer financing term that will allow for a lower loan payment. The bank is requesting the lease be extended to allow for full amortization of the loan agreement.

The applicable statute, HRS Section 171-36(b), provides in relevant part as follows:

The board, from time to time, upon the issuance or during the term of any . . . commercial . . . or industrial lease, may: . . . [e]xtend the term of the lease, to the extent necessary . . . to qualify the lessee for any state or private lending institution loan . . . , such extension being based on the economic life of the improvements as determined by the board or an independent appraiser; provided that the approval of any extension shall be subject to the following:

- (1) The demised premises have been used substantially for the purpose for which they were originally leased;
- (2) The aggregate of the initial term and any extension granted shall not be for more than sixty-five years;
- (3) In the event of a reopening, the rental for any ensuing period shall be the fair market rental at the time of reopening;
- (4) Any federal or private lending institution shall be qualified to do business in the State;
- (5) Proceeds of any mortgage or loan shall be used solely for the operations or improvements on the demised premises; . . .
- (7) The rules of the board, setting forth any additional terms and conditions, which shall ensure and promote the purposes of the demised lands.

In the present case, Assignee's extension request does not meet the requirements of the statute. The statute was not intended to allow a lease extension to finance the purchase of the lease. As there are no new improvements proposed to the property, the loan

¹ The measure became Act 207, Session Laws of Hawaii 2011.

proceeds must be used solely for operations on the demised premises under HRS subsection 171-36(b)(5) above. In staff's view, a purchase money acquisition of the lease is different from the financing of improvements or operations on the premises.

In addition, as stated previously, the term of this lease was recently extended fifteen years at the request of HSM based on repairs and improvements to the property. Most of the DLNR leases in this area of the Kanoelehua Industrial Lots were recently extended and will be coterminous approximately the same time in and around 2025. Staff believes that any future development of the industrial area would be better achieved if all the leases were to expire approximately the same time. Granting an extension of GL S-4308 may adversely impact Land Division's future plans for development of the area.

The Assignee has been in the auto repair business since 1991 and has been operating an auto repair shop in the Hilo industrial area since 2009. Assignee is looking to relocate to the subject property so that it may expand its business. The Assignee has not had a lease, permit, easement or other disposition of State lands terminated within the last five years due to non-compliance with such terms and conditions.

The HSM is compliant with all lease terms and conditions including rent, insurance and performance bond. However, HSM has outstanding tax obligations to the Internal Revenue Service, the State of Hawaii Department of Taxation and the County of Hawaii Department of Finance, Real Property Tax Office. HSM intends to satisfy the obligations out of the proceeds from the sale of the lease. Title Guaranty Escrow of Hawaii, Inc. (TGE) is handling the sale. Staff is including a recommendation below that the executed consent to assignment be delivered to Assignee through TGE, and only after the tax obligations are fully satisfied and releases for any liens are duly recorded.

The extension of lease effective June 23, 2010, determined the new rent for a period of 10 years. The next rental reopening is scheduled for June 23, 2020. There are no outstanding rental reopening issues at this time.

Although the Assignee through its lender is requesting an additional extension to the lease term, staff is recommending against any further extensions for the reasons stated above. In the event the Board decides to allow the additional 10-year extension of General Lease No. S-4308, staff believes Assignee should pay the State a premium for the extension. When the lease expires in 2025, the Board can either redevelop the land with adjoining State parcels in the area, or put the property and the improvements out for a new lease at public auction. An extension of the lease defeats or delays these plans, and staff believes the State should be compensated as a result. An extension would immediately increase the value of the lease without any investment in the improvements on the Assignee's part. Therefore, if the Board is inclined to allow a further extension, then staff is recommending a premium equal to the difference between the value of the lease with and without the 10-year extension.

RECOMMENDATION: That the Board:

- A. Consent to the assignment of General Lease No. S-4308 from Hilo Sheet Metal, Inc., as Assignor, to Kalawe's Auto Repair, LLC, as Assignee, subject to the following:

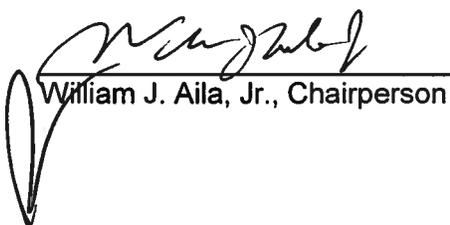
1. The standard terms and conditions of the most current consent to assignment form, as may be amended from time to time;
 2. The executed consent to assignment shall be delivered to the parties through escrow only after all federal, State and County of Hawaii tax obligations have been fully satisfied and all tax liens released;
 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.
- B. Consent to the mortgage between Kalawe's Auto Repair, LLC, Mortgagor, and Bank of Hawaii, Mortgagee, subject to the following:
1. The loan proceeds shall be used for the purposes as stated in "Use of Loan Proceeds" above. The Lessee shall maintain records of loan expenditures, which may be inspected by the Department;
 2. The standard terms and conditions of the most current consent to mortgage form, as may be amended from time to time;
 3. Review and approval by the Department of the Attorney General; and
 4. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.
- C. Deny the request of Kalawe's Auto Repair, LLC, for a ten-year extension of General Lease No. S-4308.
1. Should a ten-year extension be granted, seller would be required to pay a premium equal to the difference between the value of the lease with and without the extension as determined by independent appraisal paid for by Kalawe's Auto Repair, LLC.

Respectfully Submitted,



Gordon C. Heft
District Land Agent

APPROVED FOR SUBMITTAL:



William J. Aila, Jr., Chairperson

