

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

July 26, 2013

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

PSF 13HD-080

Hawaii

Consent to Sublease General Lease No. S-5996, First United Protestant Church of Hilo, Lessee, to the Trustees of the Estate of Bernice Pauahi Bishop, Sublessee, Piihonua, South Hilo, Hawaii; Tax Map Key: (3) 2-3-027:016.

APPLICANT:

First United Protestant Church of Hilo, a domestic non-profit corporation, as Sublessor, and the Trustees of the Estate of Bernice Pauahi Bishop, a non-profit organization, as Sublessee.

LEGAL REFERENCE:

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

LOCATION:

Portion of Government lands of Piihonua, South Hilo, Hawaii, identified by Tax Map Key: (3) 2-3-027:016, as shown on the attached map labeled Exhibit A.

AREA:

3.572 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**

LEASE CHARACTER OF USE:

Religious services and educational purposes.

SUBLEASE CHARACTER OF USE:

Preschool purposes.

TERM OF LEASE:

65 years, commencing on August 1, 2011 and expiring on July 31, 2076. Rent reopening is to be every 10 years, with the first reopening scheduled for August 1, 2021.

TERM OF SUBLEASE:

11 years, commencing on February 1, 2012 and expiring on June 30, 2023.

ANNUAL RENTAL:

\$ 480.00

ANNUAL SUBLEASE RENTAL:

02/2012-06/2013	\$26,400.00
07/2013-06/2018	\$36,000.00
07/2018-06/2023	\$37,800.00

RECOMMENDED ADJUSTMENT TO LEASE RENTAL:

02/2012-06/2013	\$ 0.00*
07/2013-06/2018	\$ 2,510.00**
07/2018-06/2023	\$ 2,638.00**

*Per prior Board approval of August 12, 2012, agenda item D-4.

**Refer to Exhibit B attached for review by staff appraiser on sublease profit 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:

The Estate of Bernice Pauahi Bishop is a trust and as such is not required to register with the DCCA.

BACKGROUND:

The lessee, First United Protestant Church of Hilo, obtained the subject property at public auction in 1966 as General Lease No. S-4018 (GL S-4018). The lease term was for 65 years with an annual rent of \$1,396 for the first 15 years. In 1970 they completed construction of a church building and classroom building at a cost of \$150,000 and \$57,000 respectively. Rent reopenings in 1981 and 1996 increased the annual rent to \$4,125.

In 2002, First United Protestant Church experienced some financial challenges and developed a 10-year sublease agreement for the classroom building and an additional playground area with Kamehameha Schools/Bishop Estate for use as a preschool at an annual rent of \$24,000.

On March 4, 2003 the Chairperson consented to the sublease without the State participating in the sublease profits. This was in accordance with the Land Board's Sublease Rent Participation Policy in effect at that time, which did not allow the State to receive sublease profits if the lessee was paying fair market rent, the improvements were owned by the lessee and the lease did not specifically state a method of calculation. At its meeting of August 24, 2012, Item D-14, the Board refined its policy to instruct staff to evaluate the facts of each case to determine whether rent participation is warranted.

In lieu of the scheduled rental reopening, at its meeting of August 12, 2010, under agenda item D-4, the Board approved the mutual cancellation of GL S-4018 and issuance of a new non-profit lease (GL S-5996) at nominal rent. The new lease includes a provision which allows subletting, upon prior approval of the Board, to other non-profit organizations. The Board also consented to the remainder of the sublease term without receiving a portion of the sublease profits. However, it was noted that after the expiration of the sublease in 2013, any new sublease request would require submission of financial statements and would be subject to the Board's right to revise the rent based upon the rental rate charged to the sublessee.

DISCUSSION:

The cancellation of the original lease passed ownership of the improvements to the State and the issuance of a new non-profit lease at nominal rent changed the lease to less than fair market rent, which in accordance with 2b¹ of the current Rent Participation Policy, allows the State to receive 100% of the sublease profits.

¹ For lessees paying any amount less than fair market rent: If the lessee subleases improvements owned by the State, the Board shall revise the rent to include as additional rent, 100% of that portion of the sublease rent in excess of the original ground rent paid to the State less allowances.

When the mutual cancellation was approved, it was not the intention of the State to increase the annual rent by taking the sublease profits, but to provide nominal rent to the non-profit and save the State the costs associated with the appraisal fees. On the other hand, it is evident the intent was to revisit participation in the sublease profits if they were to continue beyond the sublease expiration in 2013.

If the mutual cancellation and issuance of a new lease had not occurred, the State would not participate in the sublease profits, but the annual rent would be substantially greater than the current nominal rent of \$480 per year.

Land Division staff extensively considered the specifics of the sublease arrangement and has sought a reasonable rent participation arrangement that meets the needs of the State, but does not financially over burden the lessee. The following is our recommendation:

For the period 02/01/2012-06/30/2013	a 0% share = \$ 0.00
For the period 07/01/2013-06/30/2018	a 10% share = \$2,510.00
For the period 07/01/2018-06/30/2023	a 10% share = \$2,638.00

Refer to the attached Exhibit B for the calculation details.

Lessee is in compliance with all lease terms and conditions without default.

There are no outstanding rental reopening issues.

RECOMMENDATION:

That the Board;

Consent to sublease under General Lease No. S-5996 between First United Protestant Church of Hilo, as Sublessor, and the Trustees of the Estate of Bernice Pauahi Bishop, as Sublessee, subject to any applicable conditions cited above which are by this reference incorporated herein and further subject to the following terms and conditions:

1. The standard terms and conditions of the most current consent to sublease form, as may be amended from time to time;
2. Lessee shall be required to pay an additional annual rent of \$2,510 during the period from July 1, 2013 through June 30, 2018 and \$2,638 during the period from July 1, 2018 through June 30, 2023;
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,



Candace Martin
Land Agent

APPROVED FOR SUBMITTAL:



William J. Aila, Jr., Chairperson

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EXHIBIT A

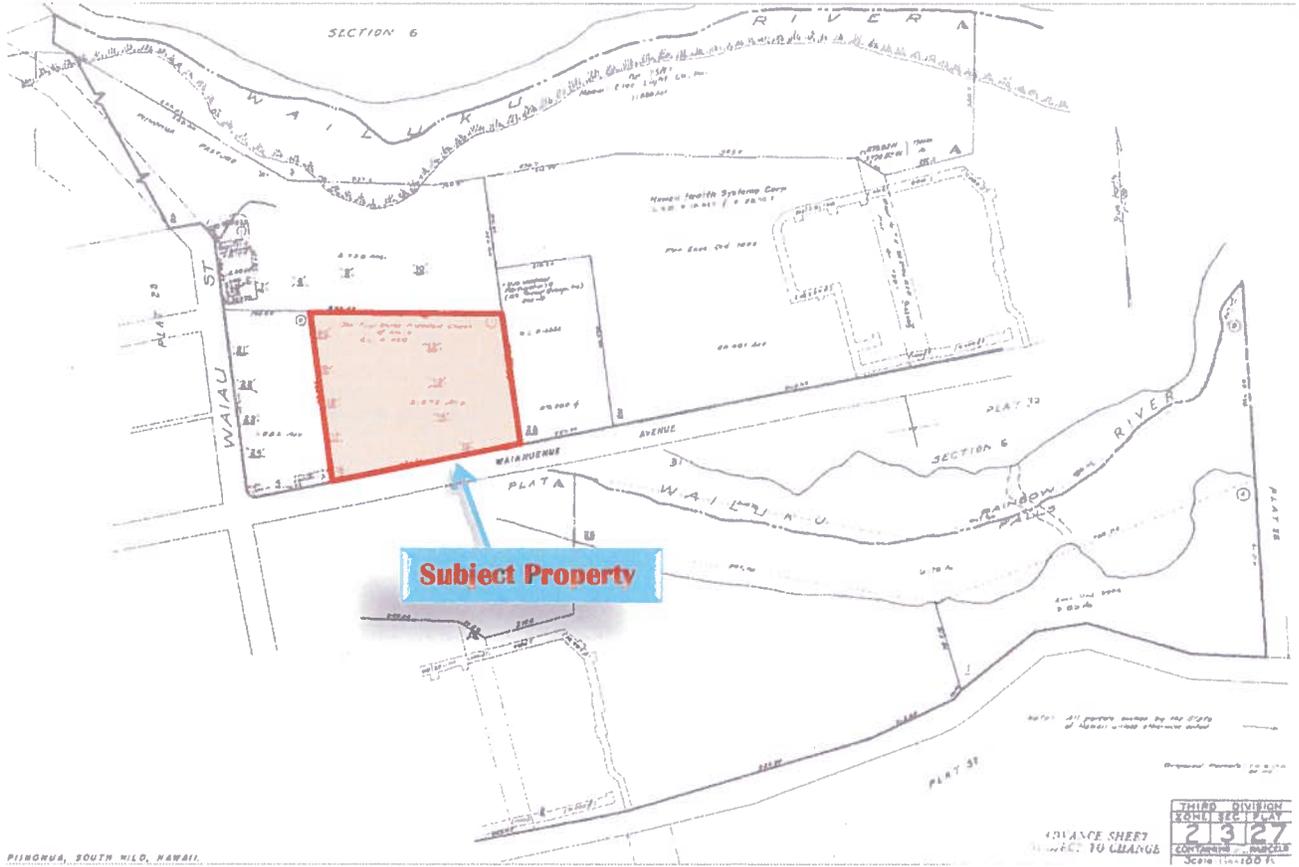




EXHIBIT B



STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
LAND DIVISION

POST OFFICE BOX 621
HONOLULU, HAWAII 96809

June 26, 2013

MEMORANDUM

TO: William J. Aila, Jr., Chairperson

THROUGH: Russell Y. Tsuji, Division Administrator *RYT*

FROM: Candace Martin, Land Agent *CM*

SUBJECT: In-House Recommendation – Sublease Participation Calculation

GL No.:	S-5996
Lessee/Sublessor:	First United Protestant Church of Hilo
Sublessee:	Trustees of the Estate of Bernice Pauahi Bishop
Location:	Piihonua, South Hilo, Hawai'i
Lease area:	3.572 acres
Sublease Area:	24,000 sf. approximately
Tax Map Key:	(3) 2-3-027:016
Character of Use:	Religious services and educational 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-5996, First United Protestant Church of Hilo Lessee/Sublessor to the Trustees of the Estate of Bernice Pauahi Bishop, Sublessee. The sublease documents, financial statements and information provided by Lessee were analyzed and staff applied the formula approved by the Land Board on January 26, 2001, agenda item D-8, and modified by the Board at its meeting on August 24, 2012, agenda item D-14, comprising the Sublease Rent Participation Policy.

The lessee obtained the property at public auction in 1966 as General Lease No. S-4018 (GL S-4018). In 1970 they completed construction of a church building and classroom building at a cost of \$150,000 and \$57,000 respectively. Rent reopenings in 1981 and 1996 increased the annual rent to \$4,125.

In 2003, consent was given to a 10-year sublease of the classroom building and an additional playground area to Kamehameha Schools/Bishop Estate for use as a preschool at an annual rent of \$24,000 without the State receiving a portion of the sublease profits.

In 2010, the Board approved the mutual cancellation of GL S-4018 and issuance of a new non-profit lease (GL S-5996) at nominal rent. The Board also consented to the remainder of the sublease term without receiving a portion of the sublease profits.

The conditions of the original lease did not allow the State to receive a portion of the sublease profits because the lessee paid fair market rent, owned the improvements and the lease did not specifically state the method of calculation.

The cancellation of the original lease passed ownership of the improvements to the State and the issuance of a new non-profit lease at nominal rent changed the lease to less than fair market rent, which in accordance with 2b¹ of the Rent Participation Policy, allows the State to receive 100% of the sublease profits.

When the mutual cancellation was approved it was not the intention of the State to increase the annual rent by taking the sublease profits, but to provide nominal rent to the non-profit and save the State the costs associated with appraisal fees. On the other hand, it is evident the intent was to revisit participation in the sublease profits if they were to continue beyond the sublease expiration in 2013.

Given the above, staff is using the parameters of item 2c² of the Rent Participation Policy with a discounted rent participation percentage of 10% because it approximates the ratio of nominal rent to fair market rent for this property. GE Tax is paid by the sublessee. The real property tax is nominal as both entities are non-profit organizations. The annual insurance premium is \$15,408 of which 50% is being allowed for the subleased area. Building maintenance was determined by averaging the most recent two years costs and allowing 50% for the subleased area. For the third period, the allowances have been increased by the same percentage as the sublease rent; 5%.

SUBLEASE PROFIT CALCULATIONS: GL No. S-5996

For the 1st Sublease Period:

02/01/2012-06/30/2013

At its meeting of August 12, 2010, agenda item D-4, the Board consented to the sublease without a share of the sublease profits through the expiration date of June 30, 2013.

DLNR portion of Rent Participation

\$ 0.00

¹ For lessees paying any amount less than fair market rent: If the lessee subleases improvements owned by the State, the Board shall revise the rent to include as additional rent, 100% of that portion of the sublease rent in excess of the original ground rent paid to the State less allowances.

² For lessees paying any amount less than fair market rent: If the lessee subleases improvements not 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 less allowances.

For the 2nd Sublease Period:

07/01/2013-06/30/2018

Annual Sublease Rent	\$36,000.00
Less Insurance (50%)	-7,704.00
Less Building maintenance	<u>-2,712.00</u>
Net Sublease Rent	\$25,584.00

Annual Net Sublease Income:	\$25,584.00
Less Annual Ground Rent	-480.00
Annual Rental Proceeds to Lessee:	25,104.00
DLNR Rent Participation:	<u>x 10%</u>

DLNR portion of Rent Participation **\$ 2,510.00**

For the 3rd Sublease Period:

07/01/2018-06/30/2023

Annual Sublease Rent	\$37,800.00
Less Insurance (50%)	-8,089.00
Less Building maintenance	<u>-2,848.00</u>
Net Sublease Rent	\$26,863.00

Annual Net Sublease Income:	\$26,863.00
Less Annual Ground Rent	-480.00
Annual Rental Proceeds to Lessee:	26,383.00
DLNR Rent Participation:	<u>10%</u>

DLNR portion of Rent Participation **\$ 2,638.00**

Based on these calculations the additional annual rent due to the State for the period February 1, 2012 through June 30, 2013 is \$0.00; for the period July 1, 2013 through June 30, 2018 is \$2,510.00; and for the period July 1, 2018 through June 30, 2023 is \$2,638.00.

Approved/Disapproved:





William J. Aila, Jr., Chairperson



Date

Cc: District Files
Central Files