

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

January 23, 2015

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

Hawaii

Consent to Sublease General Lease No. S-6054, Mauna Kea Moo, LLC, Lessee, to The Dutch Hawaiian Cheesery, LLC, Sublessee, Hamakua, Hawaii, Tax Map Keys: (3) 4-1-004:033 (the sublease affects five acres of this parcel), and 4-2-007:002.

APPLICANT:

Mauna Kea Moo, LLC (MKM), a Hawaii limited liability company, as Sublessor, to The Dutch Hawaiian Cheesery, LLC (DHC), a Hawaii limited liability company, as Sublessee.

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 (BLNR) 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.

LEASE LOCATION:

Portion of Government lands of Niupea-Kealakaha Government Tracts, Section 4, and Hoes-Kaao Makai Tract, Section 1, situated at Hamakua, Hawaii, identified by Tax Map Keys: (3) 4-1-004:033 and 4-2-007:002, as shown on the attached map labeled Exhibit A.

LEASE AREA:

TMK: (3) 4-1-004:033 – 337.35 acres
TMK: (3) 4-2-007:002 – 1,066.90 acres

SUBLEASE AREA:

5 acres, more or less, from TMK: (3) 4-1-004:033.

TRUST LAND STATUS:

Section 5(b) lands of the Hawaii Admission Act

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

LEASE CHARACTER OF USE:

Dairying and allied purposes to include the pasturing of dairy-heifers, and also including a milking barn and other accessory uses involved with operating a dairy.

SUBLEASE CHARACTER OF USE:

Dairying and allied purposes including the processing of cheeses, yogurts, butter, and ice cream. The Sublessee is also requesting to use the property for commercial/retail purposes to sell its dairy products along with promotional products to promote the company.

TERM OF LEASE:

35 years, commencing on the 8th day of July, 2014, and expiring on the 7th day of July, 2049. The annual rental reserved shall be reopened and re-determined on the tenth, twentieth, and thirtieth years of the lease term.¹

TERM OF SUBLEASE:

35 years, commencing on July 8, 2014 and expiring on July 7, 2049.

ANNUAL RENTAL:

\$20,500.00 per annum.

ANNUAL SUBLEASE RENTAL:

\$12,000.00 per annum.

RECOMMENDED ADJUSTMENT TO LEASE RENTAL:

Not applicable as the subject lease does not have a provision allowing for sandwich profits. See additional discussion in remarks section.

¹ At its meeting of December 12, 2014, under agenda item D-10, the BLNR approved staff's recommendation to amend the commencement and termination dates and Lessees' request for a waiver of the performance bond requirement for General Lease No. S-6054, as submitted.

DCCA VERIFICATION:

SUBLESSOR:

Place of business registration confirmed: YES X NO ___
Registered business name confirmed: YES X NO ___
Good standing confirmed: YES X NO ___

SUBLESSEE:

Place of business registration confirmed: YES X NO ___
Registered business name confirmed: YES X NO ___
Good standing confirmed: YES X NO ___

CHAPTER 343 – ENVIRONMENTAL ASSESSMENT:

The Final Environmental Assessment for the subject project was published in the OEQC's *Environmental Notice* on March 8, 2011 with a "Finding of No Significant Impact" (FONSI). The cheesery was addressed in the published environmental assessment and is covered by the FONSI.

BACKGROUND:

At its meeting on March 24, 2011, under agenda item D-3, the Board of Land and Natural Resources (BLNR) approved the request from Mauna Kea Moo, LLC (MKM) for a direct lease to use for dairying and allied purposes at Niupea-Kealakaha and Manowai kohau-Kekuaalele, Hamakua, Hawaii, TMKs: (3) 4-2-007:002 and (3) 4-1-004:033. An Environmental Assessment (EA) was published in January 2011 with Findings of No Significant Impact (FONSI). After a lengthy appraisal and arbitration process, on February 20, 2014, the arbitration panel set an annual rental amount of \$20,500.00 as the ground rent for the first ten-year period. The lease commencement date was set at July 8, 2014.

As a condition of the lease agreement, The Board waived the rent requirement for the first two (2) years. The Lessees' request to get the \$41,000.00 performance bond waived was approved on December 12, 2014 BLNR under agenda item D-10 of the BLNR meeting. A request to amend the commencement date of the lease was also approved at this meeting, changing the commencement date from July 8, 2014 to the effective date of the lease, June 1, 2014. The lease is still in its initial ten-year lease period. Therefore, there will be no rental reopening until 2024.

In the 1980's, there were approximately 20 local dairies in Hawaii supplying most of the state with milk. Because of rising costs for feed and shipping, today, there are only 2 dairies left in the entire state and approximately 80% of the milk in Hawaii is imported. MKM will be the third operating commercial dairy in the state, all of which are located on the Island of Hawai'i. Ulupono Initiative² is currently in the process of developing a grass-fed dairy on Kauai, called

² Ulupono Initiative is an impact investment firm which invests in both for-profit and non-profit entities in Hawaii to

Hawaii Dairy Farms, making it the fourth commercial dairy in the state once MKM becomes operational. The Lessee/Sublessor, MKM, will operate as a dairy by raising/milking/breeding cattle and pasteurizing milk. The Sublessee, DHC, will operate as a cheesery by producing various cheeses, yogurts, butter, and ice cream.

REMARKS

Both, MKM (lessee/sublessor) and DHC (sublessee) have a business philosophy that intends to be as environmentally friendly and self-sustainable as possible. These dairy products will be produced using as much local ingredients as possible and will also be growing local produce on its land to produce various flavors to implement into their own dairy products (bananas, strawberries, coffee, etc.). If feasible in the future, MKM will also grow its own feed as well, exercising its philosophy of self-sustainability. All dairy products produced by DHC will utilize milk bought from and processed by MKM, unless demand requires DHC to buy milk from another local supplier.

MKM and DHC will be working in conjunction with each other, as they have the same owner/operator but they are technically two different businesses and will have separate improvements done to their respective properties. MKM will make improvements only pertaining to raising, milking and breeding cattle to produce milk. DHC will make improvements to its demised property only pertaining to producing cheese, yogurt, butter and ice cream.

Prior to beginning any improvements, MKM will submit to the Chairperson, a complete set of plan specifications for approval, as per paragraph 40 under "Special Conditions" of GLS-6054. Upon approval of improvement plan specifications, the Lessee shall also submit an improvement bond of no less than \$900,000.00 as per paragraph 41 under "Special Conditions" of GLS-6054. These improvements include, but are not limited to:

- 3500 square foot portable glass building (the glass greenhouse that used to be next to Tex's Drive Inn in Honokaa). Refer to Exhibit B,³ Exhibit C,⁴ Exhibit D⁵
- Concrete basement to be constructed beneath the location of the glass facility. Refer to Exhibit E⁶ attached
- Cesspool. Refer to Exhibit F⁷ attached
- Parking lot. Refer to Exhibit F attached

positively affect Hawaii's ability to become more self-sufficient in growing its own food, harnessing rich natural resources for renewable energy and improving waste management systems.

3 Exhibit B: Photo of 3500 sq. ft. glass structure

4 Exhibit C: Animated simulation photo of DHC interior

5 Exhibit D: Sketch floor plan of DHC 1st floor

6 Exhibit E: Sketch floor plan of DHC basement

7 Exhibit F: Sketch of prospective location and layout of DHC

- Owner/Manager single family dwelling. Refer to Exhibit F attached.
- Repairs to existing roads on property
- Hook-ups for utilities (i.e., water, electric)

The Board has a sublease rent participation policy of May 26, 2000, Item D-24, as amended January 26, 2001, Item D-8. Initially, staff interpreted the policy to preclude sharing in sublease rents when the improvements were owned by the lessee who paid fair market rent, unless the right to participate in sublease rents and the method of calculation were specifically stated in the lease. However, the Board's approval of the policy always included the caveat that it was not intended to be rigidly applied, and that staff should look at the facts of each case to determine whether participating in sublease rents is warranted. The Board stated:

This policy shall apply to leases under the direct management of the Land Division. Furthermore, the following formulae generally reflect the intent of the Board regarding the calculation of sublease sandwich profit and shall serve as guidelines in such calculation. The board authorizes staff to use their discretion in representing the State's interest in applying these formulae to address the varying sublease arrangements that may not fit neatly into the formulae.

Beginning in 2011, staff began to take a closer look at rent participation in subleases, especially when it appeared the initial costs of the construction of the facility had been largely amortized and the subleases were becoming a revenue generator for the lessee. For example, at its meeting of October 28, 2011, Item D-27, the Board approved staff's recommendation for the State to receive 50% of the sandwich profits generated in a sublease/license situation under General Lease No. S-4223, which was issued in 1969 for microwave station and other radio communication facilities purposes. In that case, the ground rent under General Lease No. S-4223 was \$31,400 per year, and the sublease rent collected by the lessee was \$33,153.57 per year. The staff submittal noted that the improvements constructed by the lessee had largely been depreciated over the course of approximately 40 years since the issuance of the lease. The Board approved the State's participation in sublease rents at the rate of 50% even though the right to participation and method of calculation were not specifically stated in the lease.

At its meeting of August 24, 2012, Item D-14, the Board refined its sublease rent participation policy to encourage staff to continue to evaluate each sublease on its facts. Specifically, the Board directed that:

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.

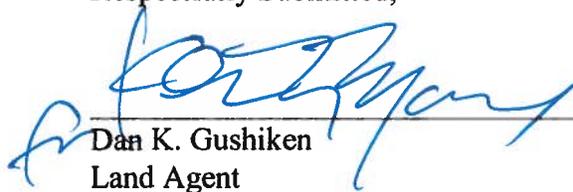
In the present case, staff believes that no sublease rent participation is warranted. The lease does not specifically state a method of sublease rent participation. Further, this is a new lease where MKM and DHC will be making substantial initial investments in improvements and infrastructure. These expenses have not yet been depreciated and amortized. Finally, the MKM will continue to use most of the premises (almost 1,400 acres) for its own related business.

RECOMMENDATION:

That the Board consent to the sublease under General Lease No. S-6054 between Mauna Kea Moo, LLC, as Sublessor, and The Dutch Hawaiian Cheesery, LLC, 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:

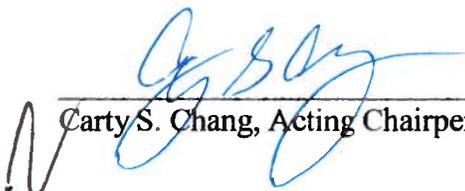
1. The Lessee shall submit construction plans of the Sublessee's improvements to the Land Division for the Chairperson's approval prior to constructing any improvements on the demised premises;
2. Within sixty (60) days upon approval of the construction plans, the Lessee shall submit an improvement bond of no less than \$900,000.00;
3. The standard terms and conditions of the most current consent to sublease form, as may be amended from time to time;
4. Review and approval by the Department of the Attorney General; and
5. Such other terms and conditions as may be prescribed by the Chairperson to best serve the interests of the State.

Respectfully Submitted,



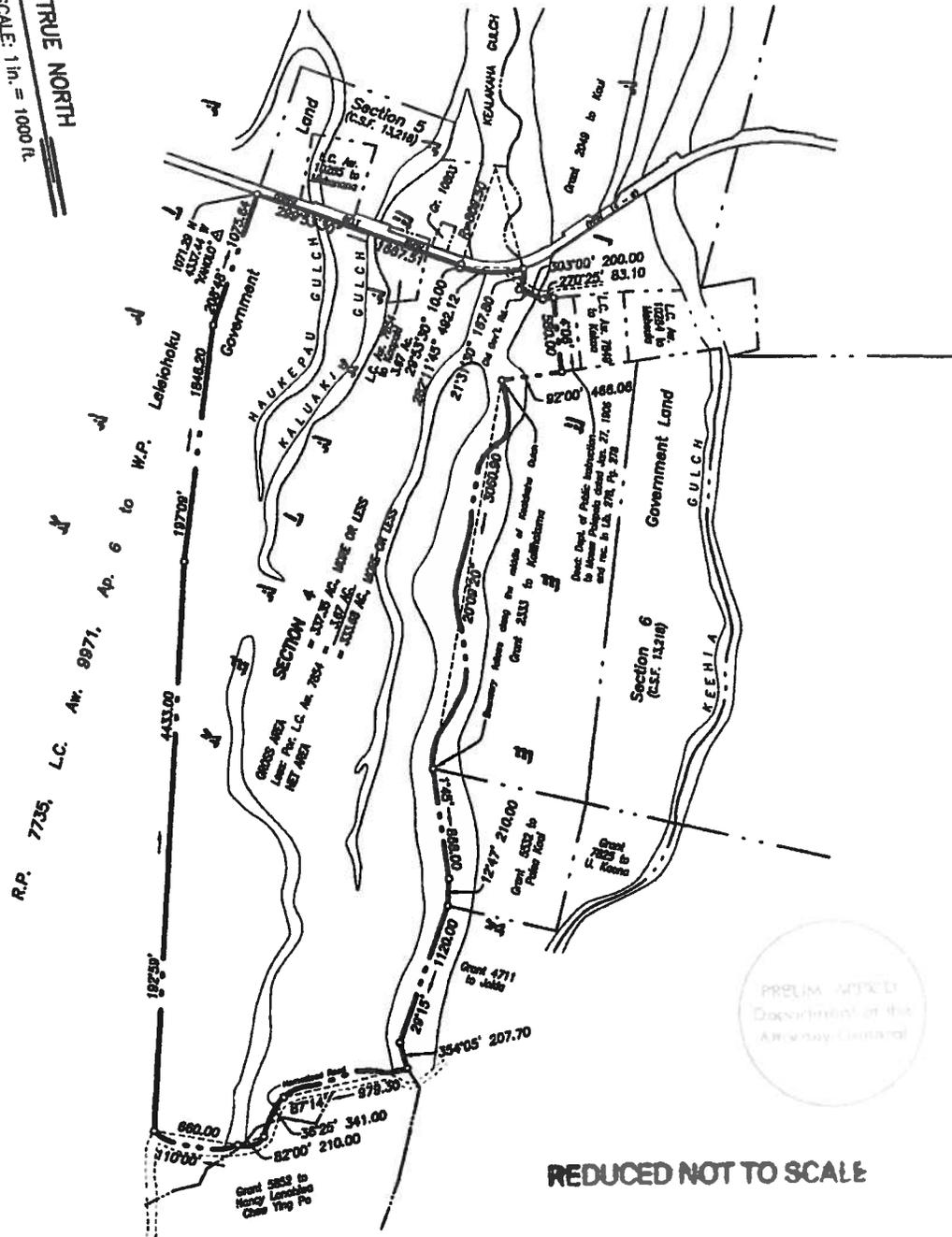
Dan K. Gushiken
Land Agent

APPROVED FOR SUBMITTAL:



Carty S. Chang, Acting Chairperson

TRUE NORTH
SCALE: 1 in. = 1000 ft.



**NIUPEA-KEALAKAHA GOVERNMENT TRACTS
SECTION 4**

Kealakaha, Hamakua, Island of Hawaii, Hawaii
Scale: 1 inch = 1000 feet

JOB H-090(11)
C. BK.

TAX MAP 4-1-04: 33

**SURVEY DIVISION
DEPARTMENT OF ACCOUNTING AND GENERAL SERVICES
STATE OF HAWAII**

C.S.F. NO. 25,088

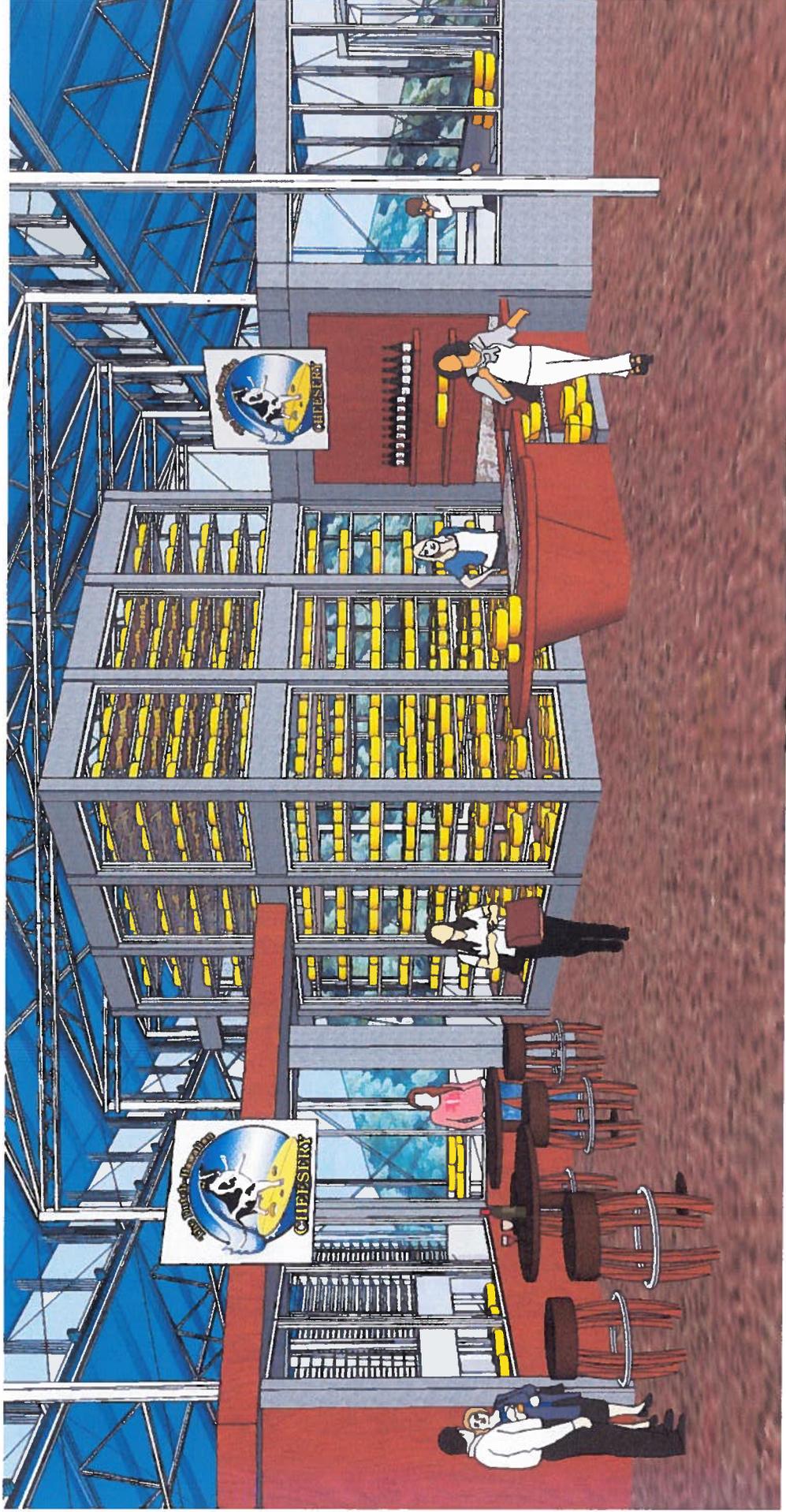
DM June 15, 2011

EXHIBIT B



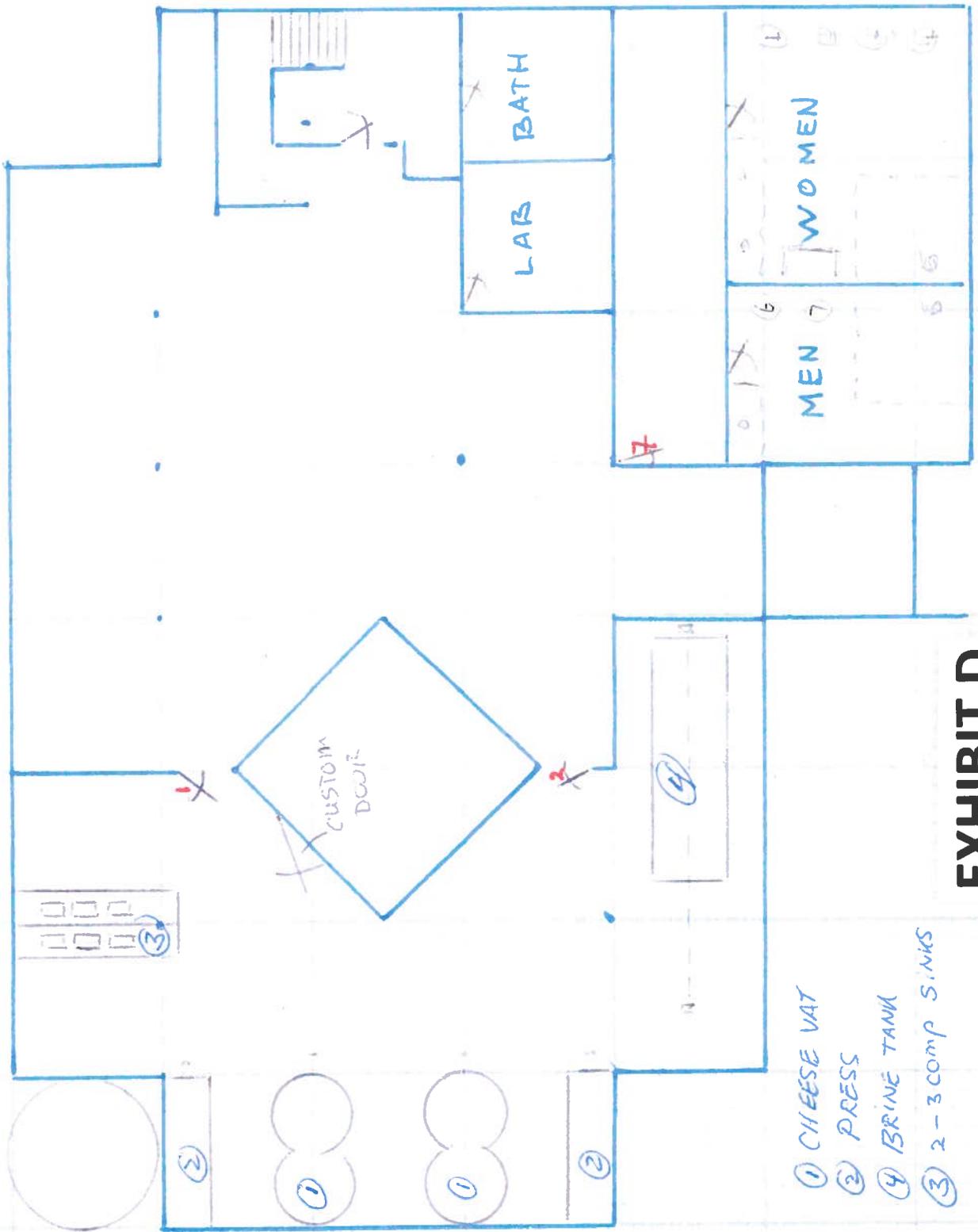
**3500 SQ. FT. PORTABLE GLASS STRUCTURE
(Old greenhouse used to be next to Tex Drive Inn in Honoka`a)**

EXHIBIT C



Animated Simulation of the Dutch Hawaiian Cheesery Interior

12 FLOOR



- ① CHEESE VAT
- ② PRESS
- ④ BRINE TANK
- ③ 2-3 comp S.MKS

EXHIBIT D

BASEMENT

cooling @ 50

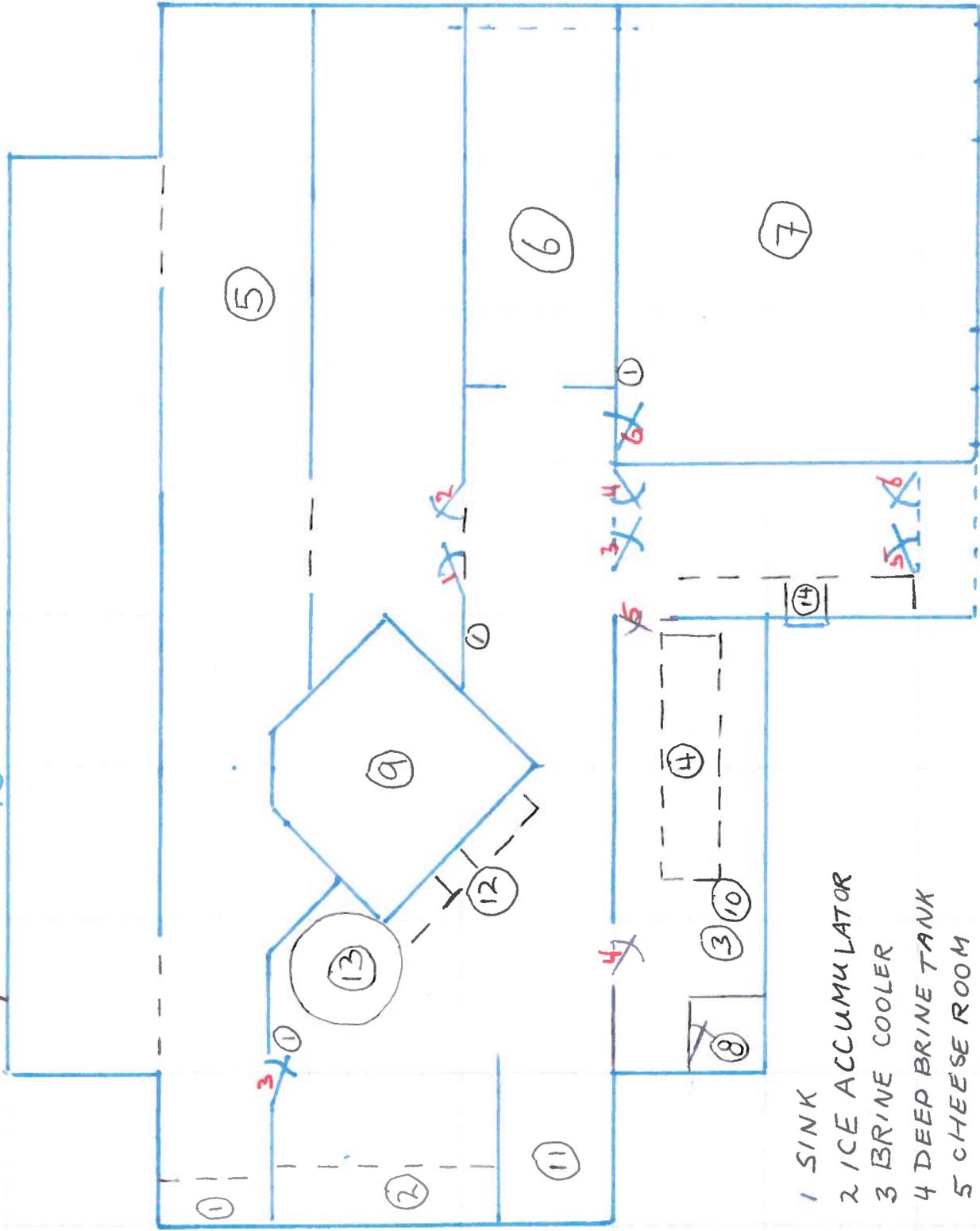
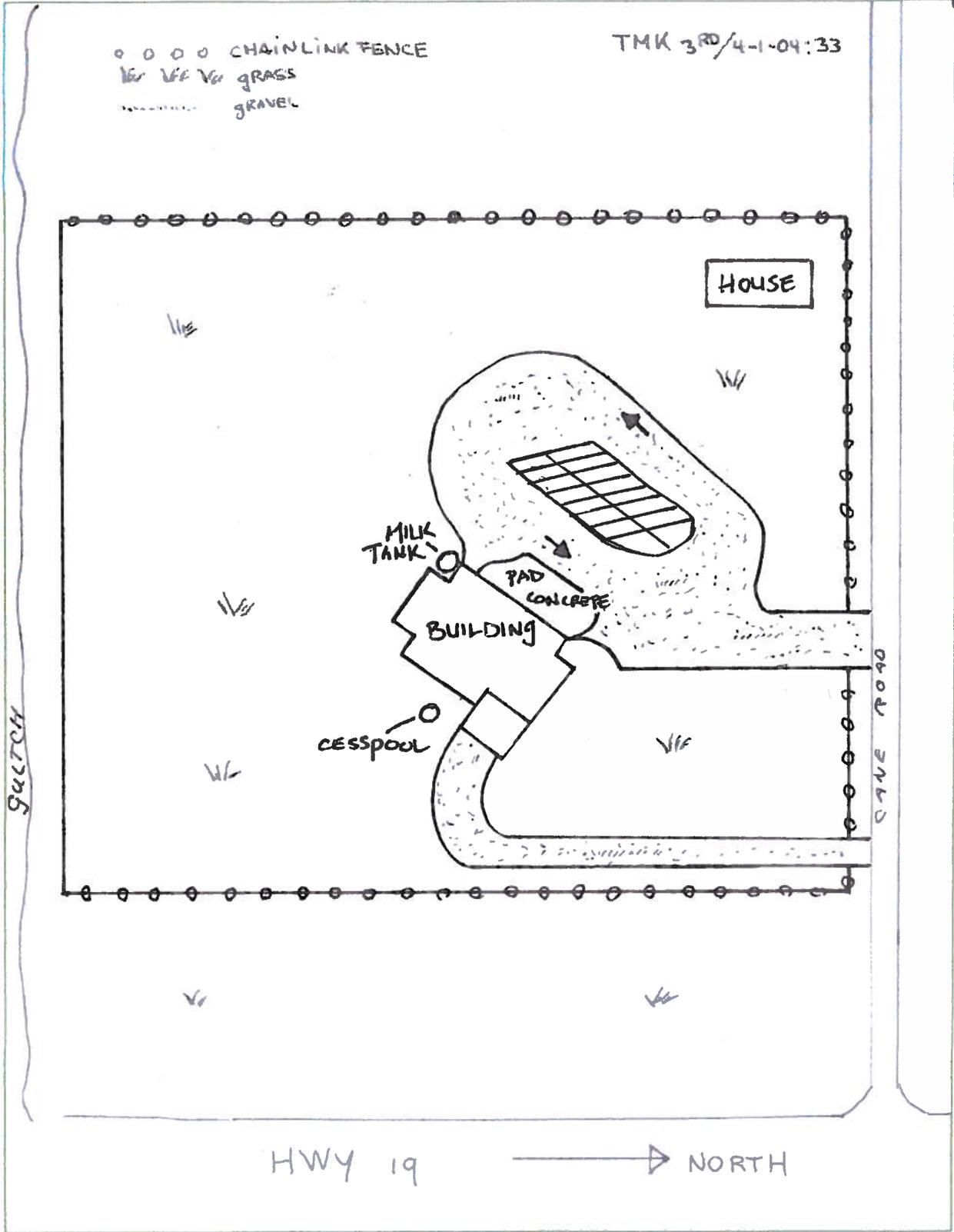


EXHIBIT E

- 1 SINK
- 2 ICE ACCUMULATOR
- 3 BRINE COOLER
- 4 DEEP BRINE TANK
- 5 CHEESE ROOM
- 6 WALK IN COOLER
- 7 CHEESE ROOM
- 8 BATH ROOM
- 9 SCISSOR LIFT TABLE
- 10 AIR COMPRESSOR

- 11 BOTTLE STORAGE
- 12 FILLER CAPPER
- 13 YOGURT VAT
- 14 BOTTLE WASHER + TABLES

EXHIBIT F



Sketch of prospective location and layout of the Dutch Hawaiian Cheesery