

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

February 12, 2016

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

PSF: 15HD-177

Hawaii

Approve a 10-Year Term Extension of General Lease No. S-3670, Machida, Inc., Lessee, Pursuant to Act 207, Session Laws of Hawaii 2011 and an Amendment of Terms and Conditions Regarding Allowed Use, Assignment and Sublease Provisions for General Lease No. S-3670; Lot 30, Kanoelehua Industrial Lots, Waiakea, South Hilo, Hawaii, Tax Map Key: (3) 2-2-050:098.

APPLICANT AND REQUEST:

Machida, Inc., lessee, a Hawaii corporation.

Proposed improvements to the leasehold property will be financed by the lessee pursuant to Act 207, Session Laws of Hawaii 2011 and Section 171-36, Hawaii Revised Statutes in an amount of approximately \$30,000.00.

In order for the Lessee to fully amortize its expenditures, Lessee is requesting an extension of General Lease No. S-3670 of 10 years, commencing on March 20, 2016 and expiring on March 19, 2026 for an aggregate term of 65 years (initial 55 year term plus the 10 year extension).

LEGAL REFERENCE:

Sections 171-36, Hawaii Revised Statutes, as amended.

LOCATION:

Portion of Government lands of Kanoelehua Industrial Lots situated at Waiakea, South Hilo, Hawaii, identified by Tax Map Key: (3) 2-2-050:098, as shown on the attached map labeled Exhibit A.

AREA:

15,002 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:

For the first five (5) years of the lease, for the same business use or undertaking in which the Lessee was engaged at the time of the natural disaster; provided that the Lessee may use for uses other than wholesale drugs and sundries in character, with prior written consent of the Board.

TERM OF LEASE:

Original term of 55 years, commencing on March 20, 1961 and expiring on March 19, 2016.

Request for an extension of 10 years commencing on March 20, 2016 and expiring on March 19, 2026.

ANNUAL RENTAL:

Current rent is \$14,750.00, due in semi-annual installments of \$7,375.00.

RENTAL REOPENINGS:

Rental reopenings in the original term were at the end of the 20th, 30th, 40th and 50th years of the term. The last rental reopening occurred on March 20, 2011, therefore, staff is recommending the rent for the extended term be determined by an appraisal that will determine the rent for the extension period of March 20, 2016 through March 19, 2026.

PROPOSED IMPROVEMENTS:

The lessee proposes to replace the existing 60 amp electrical service with a 100 amp service with an external disconnect and new load center. Additional circuits and receptacles will be added to avoid overload and extensive use of extension cords. Replace wiring and structural mounts of overhead lighting fixtures. The cost of the electrical improvements is estimated to be \$29,800.00

DCCA VERIFICATION:

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

APPLICANT REQUIREMENTS:

Applicant shall be required to:

1. Complete approximately \$30,000.00 of proposed improvements to the lease premises by March 19, 2017, and provide the Hawaii District Land Office with copies of receipts for the improvements made prior to April 30, 2017.

BACKGROUND:

General Lease No. S-3670 (GL S-3670) was issued to T. Machida Drug Co., Ltd. pursuant to Act 4, First Special Session Laws of Hawaii 1960, which provided for the direct issuance of leases to natural disaster victims who were affected by the 1960 tsunami that struck Hilo and other areas of the State. The lease was for a term of 55 years commencing on March 20, 1961 and expiring March 19, 2016.

On June 22, 1965, the T. Machida Drug Co., Ltd. changed its name with the Department of Regulatory Agencies to Machida, Inc.

At its meeting of April 28, 1972, under agenda item F-3, the Board approved a waiver of the performance bond requirements for GL S-3670.

The current 55-year lease is set to expire on March 19, 2016 and the lessee is requesting a 10 year extension pursuant to Act 207, Session Laws of Hawaii 2011¹ to amortize the cost of planned improvements to the property at a cost of \$26,800.00.

On May 29, 2015, Hussey Appraisal Group Hawaii, lessee consultant, tendered its report regarding the economic life and value of the proposed improvements to the leasehold premises. The report acknowledged that the building has been maintained in very good condition over the years. The lessee has made consistent improvements over the years such as a new roof in 2001. Given the good maintenance, the estimated economic life of the improvements has been calculated as 35 to 50 years or more.

EXTENSION REMARKS:

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 are also scheduled to expire between 2016 and 2026 (refer to Exhibit B). 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 bay front 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 Kanoiehua. 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.

The East Hawaii economic region is unique in that a majority of the available land suitable for commercial and/or industrial use is under the management of either the Department of Land and Natural Resources (DLNR) or the Department of Hawaiian Home Lands (DHHL). As one of the largest stake holders of commercial/industrial land in East Hawaii, DLNR recognizes the need for a comprehensive analysis of land use in the area in order to develop an economic strategy that will encourage new enterprises in addition to supporting the established businesses.

¹ Act 207, Session Laws of Hawaii 2011 amends Section 171-36(b) of the Hawaii Revised Statutes by allowing the Lessee to: Extend or modify the fixed rental period of the lease: provided that the aggregate of the initial term and any extension granted shall not exceed sixty-five years.

With this concept in mind, DLNR-Land Division retained the services of the consulting firm, Munekiyo & Hiraga, Inc., for the purpose of providing a feasibility study and land use planning analysis for the KIA.

Key elements of the study/analysis will be to:

- Determine the market demand for the KIA properties, particularly the demand for industrial-commercial use or some other use for long-term leasing (30 years or more).
- Determine whether some properties should be consolidated and reconfigured to maximize the utility of the land in view of the results from the above findings.
- Assess the feasibility and desirability of placing management of the leasehold properties under a master lease from the State for industrial, commercial or other uses permitted by the applicable zoning.

The results of the study will be used to assist DLNR in formulating a use strategy for the future of the KIA and create an economic region that will benefit both the public and private sectors. However, good planning does not happen overnight; Departmental reviews, revisions and approvals may extend the timeframe for a well-conceived final plan. Many of the key elements aforementioned require lengthy administrative processes which could take several years to accomplish.

AMENDMENT REMARKS:

Since the lease was issued by direct negotiation instead of public auction, the Board has discretion to amend the lease to change the character of use provision and make other amendments. An amendment to the character of use provision is recommended in this case because the Assignee's use of the premises is inconsistent with the use restriction in the lease. The lease provides in part that:

“use the leased land for the first five (5) years of the term of the lease for the same business use or undertaking in which the Lessee was engaged at the time of the natural disaster or a use designated by the Board; provided, however, that the Lessee may devote or place said demised premises to a use or uses other than wholesale drugs and sundries in character, with the prior written consent of the Board, which consent shall not be unreasonably or arbitrarily withheld; provided, further, that should the Lessor consent to a change in the character of the use, it shall be upon such terms and conditions as set by the Lessor.”

Machida, Inc. maintains an office within the warehouse building, however, the company has changed its nature of operations from wholesale drugs and sundries to property management and development activities. The balance of the warehouse is subleased to a fertilizer & garden supply business. Changing the character of use will resolve any conflict in use and provide clarity to the lease provision regarding the intended use after the first five years.

Also, the lease contains language which allows the Lessee to sublease portions of the property without Board approval, consent or knowledge. Staff believes the better practice is to require prior Board consent for all subleases. Therefore, Staff is

recommending the assignment/sublease provision in the lease be amended to reflect the current language for assignments and subleases.

The Lessee is in compliance with the terms and conditions of the lease. The Lessee is current with rent, insurance and performance bond. A recent inspection showed good maintenance of the property and existing structures.

Staff is recommending that the rent payable for the 10-year extension period commencing March 20, 2016 be determined by immediate appraisal.

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

RECOMMENDATION:

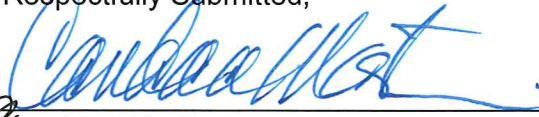
That the Board, subject to the Applicant fulfilling the Applicant requirements listed above:

1. Authorize the extension of General Lease No. S-3670 to Machida, Inc. under the terms and conditions cited above, which are by this reference incorporated herein and further subject to the following:
 - A. The standard terms and conditions of the most current lease extension form, as may be amended from time to time;
 - B. Machida, Inc. shall complete the proposed improvements as described above by March 19, 2017 and submit to the Hawaii District Land Office copies of receipts verifying payment for the improvements by April 30, 2017, or be subject to cancellation.
 - C. Review and approval by the Department of the Attorney General; and
 - D. Such other conditions as may be prescribed by the Chairperson which are in the best interests of the State.

2. Authorize the amendment of General Lease No. S-3670 to change the character of use from “wholesale drugs and sundries” to “uses allowed under the current County of Hawaii Zoning Code, ML-20, limited industrial”, and to update the lease provision titled “Assignments, etc.” (section 22 of the lease) with the current language used by the Department of the Attorney General for assignment and subleasing provisions. The amendment of the lease shall further be subject to the following:
 - A. The standard terms and conditions of the most current consent to change in character of use and amendment of lease document forms, 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.

Respectfully Submitted,



Candace Martin
Land Agent

APPROVED FOR SUBMITTAL:



Suzanne D. Case, Chairperson

EXHIBIT B

