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

May 11, 2012

Ref. No.: GLS-5619

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

Consent to Mortgage of Sublease K-4 with Estoppel Certificate, General Lease No. S-5619, Natural Energy Laboratory of Hawaii Authority, Lessee, Cyanotech Corporation, Sublessee/Mortgagor, Pacific Rim Bank, Mortgagor, Kalaoa 1st-4th, North Kona, Hawaii, Tax Map Key: 3rd/7-3-043: 063.

APPLICANT AND REQUEST:
Cyanotech Corporation, requesting Consent to Mortgage of Sublease K-4 with Estoppel Certificate from Pacific Rim Bank, Mortgagor, in an amount not to exceed $5,500,000.00.

LEGAL REFERENCE:
Section 171-22, Hawaii Revised Statutes, as amended.

LOCATION:
Portion of Government lands situated at Kalaoa 1st-4th, North Kona, Hawaii, identified by Tax Map Key: 3rd/7-3-043: 063 as shown on the attached map labeled Exhibit A.

SUBLEASE AREA:
90.067 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:
YES ____ NO ___X___
SUBLEASE CHARACTER OF USE:

The commercial production of various microalgal products including, but not limited to, spirulina, natural beta-carotene, astaxanthin, natural biopesticides, and Chlorella.

TERM OF LEASE:

45 years, commencing on July 3, 2001 and expiring on July 2, 2046. First rental reopening was scheduled for July 3, 2011.

There is currently a pending submittal to request Amendment of General lease No. S-5619. One of the amendments requested is to extend the lease for another 20-year, which would commence on July 3, 2046. If approved, the total term would then be for 65 years, with an expiration of July 2, 2066.

SUBLEASE TERM:

40-years, commencing on January 1, 1996 and expiring on December 31, 2035.

SUBLEASE RENTAL REOPENING:

Rental reopening shall be every five (5) years, commencing on February 1, 2012. Next rental reopening is scheduled for February 1, 2017.

ANNUAL RENTAL:

Fifty percent (50%) of the net operating income (NOI)\(^1\).

SUBLEASE RENTAL:

$24,932.82 per month

The fixed rental fee is calculated at a rate of $246.78 per acre, per month, for unimproved lands (83.13 acres), $2,200 per pond for two ponds, and $18 per tank for two tanks, for periods covering 2/1/2012 to 1/31/2017.)

\(^1\) NOI is the actual net income remaining after all adjusted operating expenses are deducted from the effective gross income including a reserve for replacement and for major repairs not covered in the operating budget. This does not include federal funds and grants.
USE OF LOAN PROCEEDS:

An itemized breakdown of the loan proceeds will be disbursed as follows:

$ 4,878,000  Machinery & Equipment
$  622,000  Building Improvements (8,400 square foot warehouse)
$  5,500,000  Total loan distribution

Note: Additional building improvements, which include a 2,400 square foot office building ($398,000) six pond expansion ($869,500), refinace of existing mortgage ($545,000) plus anticipated closing costs and fees ($289,500), will be paid by proceeds from a Cyanotech Equity Loan.

REMARKS:

At its meeting of April 26, 1996, the Board of Land and Natural Resources, under Agenda Item D-14, approved the Cancellation of Sublease K-2 and Facilities Use Agreement and Consent to Sublease K-4 of General Lease No. S-4717, NELHA, Sublessor, to Cyanotech Corporation, a Nevada corporation, as Sublessee. Sublease to commence on January 1, 1996 and expire on December 31, 2026, for a term of thirty (30) years.

The NELHA Board approved Supplemental Agreement No. 1 of Sublease K-4, dated November 21, 1996, which modified the Primary Agreement by:

1. Adding Parcels H1 (4.412 acres) and H2 (8.587 acres), which increased the sublease area to 90.067 acres, more or less.

2. Increasing the fixed rental fee from $9,360.00 per month to $12,313.00 per month.

At its meeting of November 19, 1999, the Board of Land and Natural Resources, under Agenda Item D-20, approved as amended, the cancellation of General Lease No. S-4717 and S-5157; Cancellation of Governor’s Executive Order No. 3282; and Direct Issuance of a New Lease (GLS-5619) to the NELHA.

On April 18, 2000, the Chairperson of the Board of Land and Natural Resources approved the Consent to Mortgage of Sublease K-4 and Estoppel Certificate in favor of B & I Lending. Loan proceeds with an aggregate principal amount of Three Million Five Hundred Thousand and 00/100 Dollars ($3,500,000.00) was under the United States Department of Agriculture, Rural Development guaranteed loan program.
At its meeting of May 23, 2008, Agenda Item D-8, the Board of Land and Natural Resources approved consent to mortgage of Sublease K-4 to Bridgeview Capital Solutions, Mortgagee, in an amount not to exceed $1,078,400.00 for working capital.

The NELHA Board, at its meeting of January 31, 2012, approved Supplemental Agreement No. 2 of Sublease K-4, which included the following:

1. Term extension of Sublease K-4 for ten (10) years, commencing on January 1, 1996, and expiring on December 31, 2035.

2. Adjust the fixed monthly rental fee of $12,313.00 (11/21/1996-1/31/2012) to $24,932.82, which is calculated at a rate of $246.78 per acre, per month for 83.13 acres of unimproved land, $2,200 per pond per month for two ponds, and $18 per month for two tanks. The fixed rental fee shall commence on February 1, 2012.

3. Insert the standard Hazardous Waste (Level 1) Evaluation clause.

By letter dated April 10, 2012, Ms. Laurence Sombardier, Contract and Leasing Specialist, NELHA, on behalf of Cyanotech Corporation, requested Consent to Mortgage of Sublease K-4 with Estoppel Certificate\(^2\) of General Lease No. S-5619, NELHA, Lessee, Cyanotech Corporation, Sublessee/Mortgagor, in favor of Pacific Rim Bank, as Mortgagee. The subject consent is for $5,500,000 for the purchase of machinery, equipment, and building improvements. The total project cost is estimated to be $7,482,000, with additional funds being financed through a Cyanotech Equity Loan in the amount of $1,982,000.

NELHA 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.

Staff reviewed the file and can report that for the past two (2) years, Lessee has been in compliance with all lease terms and conditions. The Lessee has never been cited for any illegal or unlawful activity on the State property.

The first rental reopening is scheduled for November 11, 2013.

Staff has no objections to the request.

\(^2\) An Estoppel Certificate, which accompanies the Consent to Mortgage of a Lease, confirms the current status of the Tenant and Landlord rights on the existing lease. In general, it assures the Mortgagee that all terms and conditions of the lease are in compliance at time of financing the mortgage.
No government agencies or interest groups were solicited for comments, as there will be no new disposition or change in land use.

RECOMMENDATION: That the Board:

A. Consent to the Mortgage of Sublease K-4 of General Lease No. S-5619, NELHA, Lessee, between Cyanotech Corporation, Sublessee/Mortgagor, and Pacific Rim Bank, 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.

B. Authorize the execution of an Estoppel Certificate subject to the following:

1. Review and approval by the Department of the Attorney General;

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

Respectfully Submitted,

Wesley T. Matsunaga
Land Agent

APPROVED FOR SUBMITTAL:

William J. Atla, Jr., Chairperson
EXHIBIT A
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