

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

October 26, 2012

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

Hawai'i

Consent to Merger of Hilo Hawaiian Associates, Lessee, General Lease No. S-3961, into TN Group Hawaii, Inc. (whose name later changed to Hilo-Hawaiian Associates, Inc.); Agreement in Concept for an Extension of Lease Term, Hilo-Hawaiian Associates, Inc., Lessee, Waiakea, South Hilo, Hawaii, Tax Map Key: 3<sup>rd</sup>/2-1-03:05.

APPLICANT AND REQUEST:

Hilo-Hawaiian Associates, Inc. is requesting an extension of General Lease No. S-3961 pursuant to Act 219 SLH 2011 (S.B. 1530) which authorizes the extension of hotel and resort leases along the Banyan Drive area of Hilo Hawaii.

LEGAL REFERENCE:

Section 171- 36(b), Hawaii Revised Statutes, as amended, and Act 219 SLH 2011.

LOCATION:

Portion of Government lands situated at Waiakea, South Hilo, Hawaii, identified by Tax Map Key: 3<sup>rd</sup>/2-1-03:05, as shown on the attached map labeled Exhibit A.

AREA:

5 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

CHARACTER OF USE:

Resort-hotel purposes and uses accessory or incidental thereto and customarily conducted within resort-hotel areas.

TERM OF LEASE:

Original term of 65 years, commencing on April 15, 1966 and expiring on April 14, 2031.

ANNUAL RENTAL:

Current rent is \$133,200.00, due in semi-annual installments of \$66,600.00 on April 15 and October 15 of each year.

RENTAL REOPENINGS:

Reopenings in the original term were at the end of the 20<sup>th</sup>, 35<sup>th</sup>, 45<sup>th</sup>, and 55<sup>th</sup> years of the term, or on April 15. The last rental reopening occurred on April 15, 2006.

DCCA VERIFICATION:

Place of business registration confirmed:	YES <u>X</u>	NO <u>__</u>
Registered business name confirmed:	YES <u>X</u>	NO <u>__</u>
Applicant in good standing confirmed:	YES <u>X</u>	NO <u>__</u>

APPLICANT REQUIREMENTS:

Applicant shall comply with the requirements of Act 219 SLH 2011, negotiate a development agreement with department staff, and return to the Board at a later date for review and approval of the development agreement and requested lease extension.

REMARKS:

At its meeting of February 11, 1966, Item F-8, the Board of Land and Natural Resources authorized the sale of a lease of the subject land at public auction for resort and hotel purposes. The successful bidder for this sixty-five (65) year lease was Melsan Ltd. Due to difficulties in obtaining financing for construction of the hotel structure, the original principals of Melsan Ltd. entered into an agreement with International Management Corporation, whereby the latter assumed full corporate ownership of Melsan, Ltd. At its meeting on September 23, 1973, the Board consented to the extension of construction deadline and consent to mortgage for General Lease No. S-3961.

Construction on the hotel was completed and it opened for business in October 1975. At its meeting of June 13, 1986, Item F-1-c, the Board consented to the assignment of the

lease with assumption of mortgage from Melsan, Ltd, to Hilo Hawaiian Associates, a Hawaii limited partnership.

At its meeting of July 8, 2010, under agenda item D-3, the Board consented to the transfer of 100% stock ownership of parent company of Hilo Hawaiian Associates, Lessee, to HH Associates, LLC, Transferee.

Effective January 1, 2012, Hilo Hawaiian Associates, together with its general partner, HHA Inc., and limited partner, Hijoji Corporation, merged with and into the common parent of these companies, TN Group Hawaii, Inc., with the latter being the surviving entity. The merger did not result in any change in ownership interest in the lessee, Hilo Hawaiian Associates, but was instead intended to consolidate ownership in the parent company. Attached as Exhibit B is a diagram showing the ownership structure before and after the merger. Effective September 10, 2012, TN Group Hawaii, Inc. changed its name to Hilo-Hawaiian Associates, Inc.

Pursuant to Hawaii Revised Statutes Sections 414-316 and 425E-1109, when a company is merged into another company, the real property interests of the merged company vest in the surviving company. While the merger of Hilo Hawaiian Associates into TN Group Hawaii, Inc. may not technically constitute an assignment of the lease under the ownership structure noted above, staff is nevertheless presenting the merger to the Board for consent because the merger changes the lessee from Hilo Hawaiian Associates, a Hawaii limited partnership, to Hilo-Hawaiian Associates, Inc., a Hawaii corporation.<sup>1</sup>

The Lessee, Hilo-Hawaiian Associates, Inc. (Lessee), is requesting a 37-year extension from the end of the current lease set to expire on April 14, 2031 for an aggregate term of 55 years (18 years remaining on lease plus 37-year extension) in order to amortize the cost of the improvements necessary to upgrade the hotel.

Act 219, Session Laws of Hawaii 2011, authorizes the Board of Land and Natural Resources to extend hotel or resort leases (that have not been sold or assigned within the past five years) up to an additional fifty-five (55) years. As a condition to the extension, the Lessee must commit to substantial upgrades to the existing improvements. “Substantial improvements” means any renovation, rehabilitation, reconstruction or construction of the existing improvements, including minimum requirements for off-site and on-site improvements, the cost of which equals or exceeds fifty per cent (50%) of the market value of the existing improvements that the Lessee or the Lessee and developer install, construct, and complete by the date of completion of the total development.”

The act also stipulates that prior to entering into a development agreement, the lessee shall submit to the Board the plans and specifications for the total development being

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<sup>1</sup> The assignment of lease provision in General Lease No. S-3961 does not expressly apply to mergers. By contrast, the assignment provision used in the current lease form for DLNR lands prohibits both voluntary assignments and those that occur “by operation of law”, which would arguably cover mergers.

proposed. The Board shall review the plans and specifications and determine: 1) Whether the development proposed is of sufficient worth and value to justify the extension; 2) The estimated time to complete the improvements and expected date of completion; 3) The minimum revised annual rent based on the fair market value of the lands to be developed, as determined by an appraiser for the Board, and the percentage rent where gross receipts exceed a specified amounts.<sup>2</sup>

Lessee Hilo-Hawaiian Associates, Inc. is estimating improvement costs to be in excess of \$4,283,000 and has submitted a cost proposal (Exhibit C) that includes, elevator modernization, replacing the fire alarm system, new roof coating materials, and renovations to all the hotel guest rooms.<sup>3</sup>

In addition to the improvements to the property, the Lessee is proposing to set aside 3% of the total room revenue each year in a FF&E bank account. This amount will be no less than \$200,000 per year for the length of the lease and will be spent in its entirety to maintain the hotel during the entire lease period.<sup>4</sup> This proposal will be included in the development agreement to be negotiated with the Lessee. Lessee has provided staff with a Summary Appraisal Report dated August 2012 that indicates the value of the existing improvement is \$10,895,000.

Staff is requesting the Board consent to an agreement in concept for the extension of GL S-3961 so that the Lessee can prepare plans and specifications for the improvements and submit said plans and specifications to staff for review and ultimately to the Board for

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<sup>2</sup> The preamble to Act 219 indicates that the purpose of the act is to authorize extensions of hotel or resort leases that have not been sold or assigned within the last five years. Staff does not believe that the 2011 merger amounts to a sale or assignment for the purposes of Act 219 because there was no change in ownership. Further, the intent behind the "no assignment" language was to avoid unfairness in the case where a buyer acquired a lease near the end of its term at a discounted rate, and then turned around and secured a lease extension. In this case, the lease had 21 years remaining on the original term at the time of the 2010 stock transfer. However, if it should later be determined that Lessee is not eligible for a lease extension because of the 2010 stock transfer, Lessee is willing to wait until five years elapse from the 2010 stock transfer before securing a lease extension. The details will need to be addressed in the development agreement.

<sup>3</sup> The cost proposal also reflects an expenditure of \$1,594,000 for new guest room furnishings that the lessee explains are custom-made for the hotel and will remain at the hotel for their useful life. Nevertheless, staff does not believe such furnishings can be considered improvements to the real property and is not including them in the value of the development proposal.

<sup>4</sup> Over a period of ten years, the minimum amount of \$200,000 paid into the FF&E account and invested in hotel improvements would total \$2,000,000. Staff calculates the present value of this amount, factoring in a discount rate of 3.3% (average annual inflation rate for Honolulu), to be \$1,680,215. If this amount is added to the value of improvements listed above, the Lessee may satisfy the requirement concerning the value of proposed improvements established in Act 219.

approval. Additionally, staff is requesting authority to negotiate a development agreement with the Lessee and return to the Board for approval of the development agreement and lease extension.


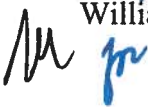
RECOMMENDATION:

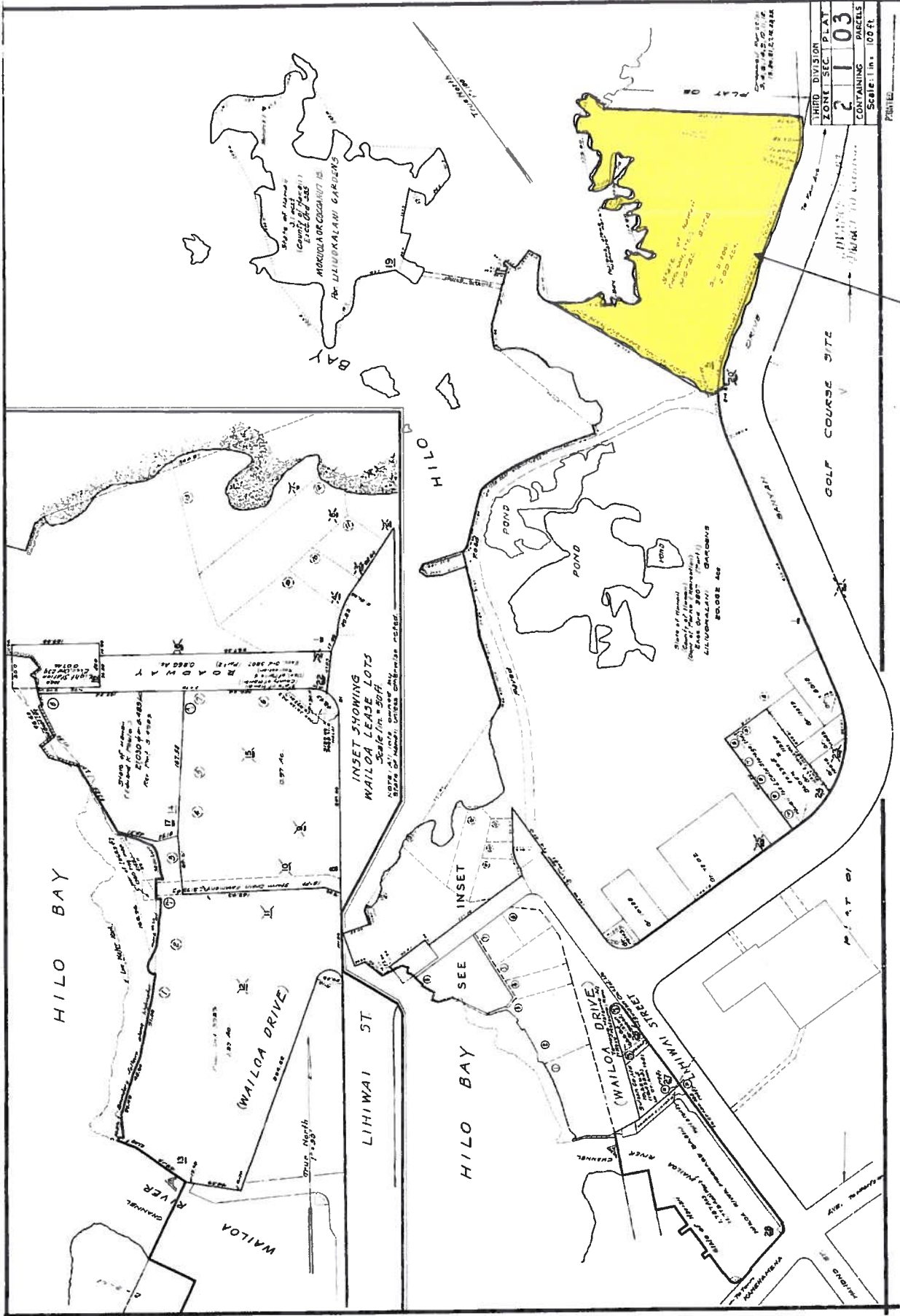
That the Board, subject to the Applicant fulfilling the Applicant requirement listed above, agree in concept the request to extend General Lease No. S-3961, Hilo-Hawaiian Associates, Inc., Lessee, covering the State owned parcel identified by Tax Map Key: 3<sup>rd</sup>/2-1-03:05 pursuant to Act 219 Session Laws of Hawaii 2011 and Section 171- 36(b), Hawaii Revised Statutes, as amended, with the understanding that the approval in concept shall not be deemed to be an approval of the development proposal or lease extension at this time, as staff shall return to the Board at a later date for review and approval of development agreement and lease extension, including plans and specifications for improvements submitted by the Lessee. Land Division staff is authorized to negotiate a development agreement with the Lessee, subject to review and approval by the Board.

Respectfully Submitted,

  
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Gordon C. Heit  
District Land Agent

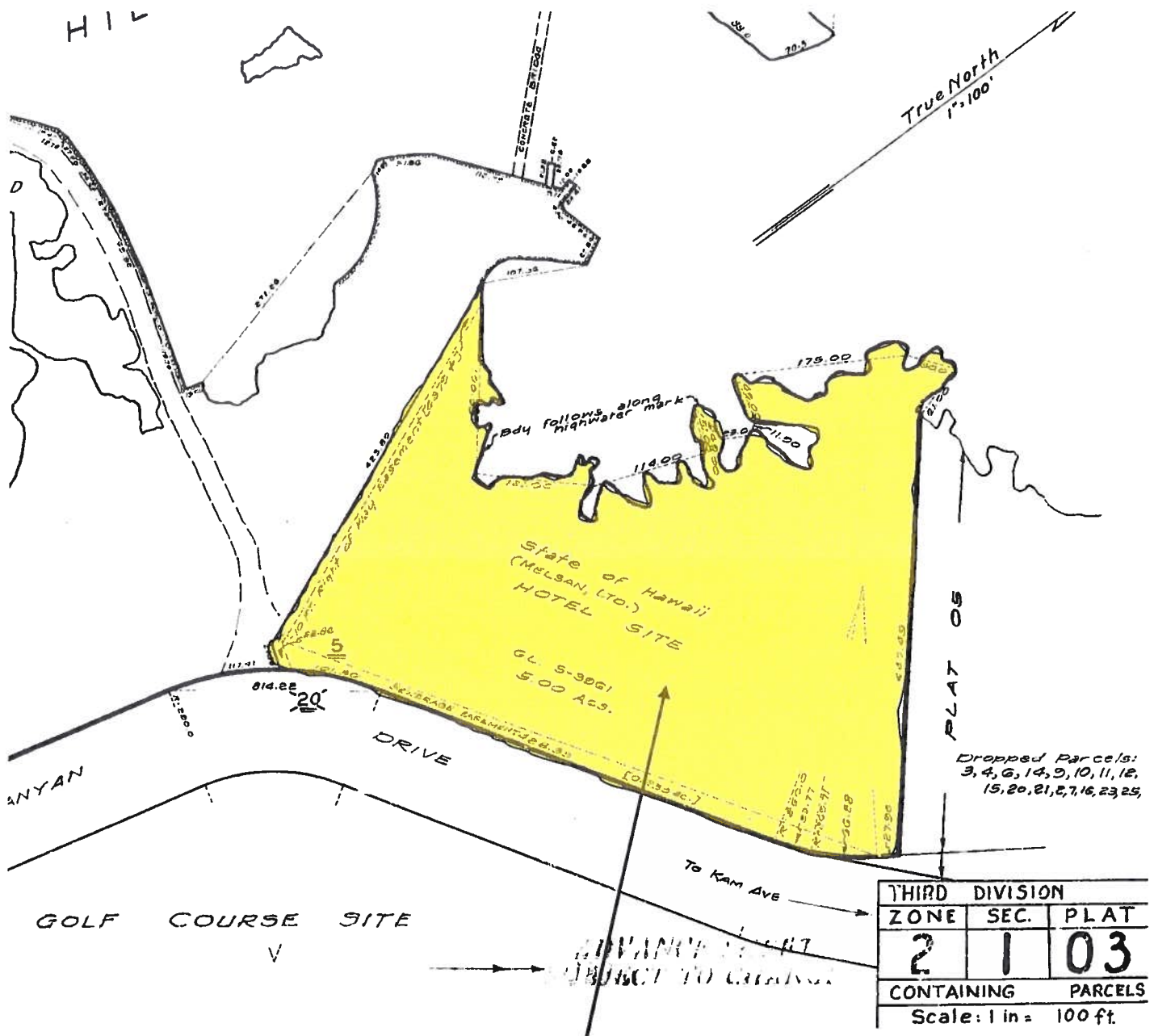
APPROVED FOR SUBMITTAL:

  
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William J. Aila, Jr., Chairperson  




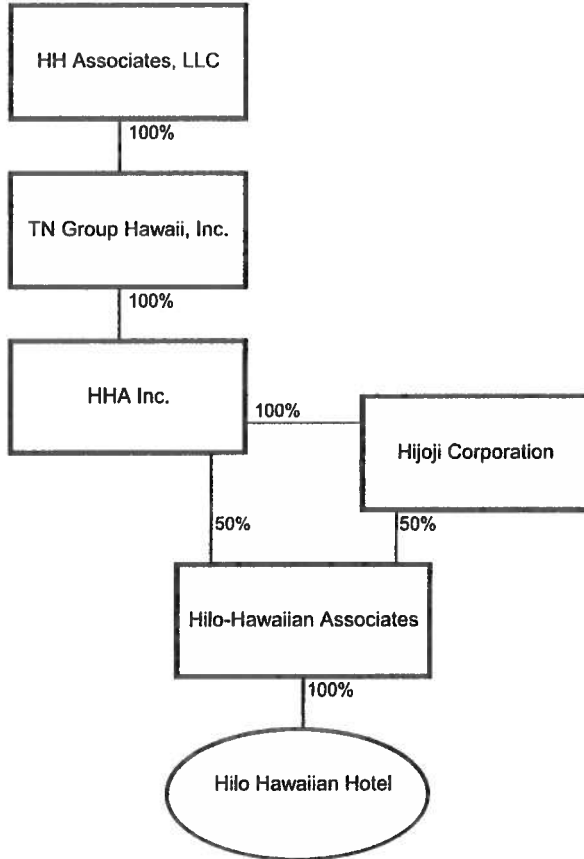
GL S-3961

EXHIBIT A

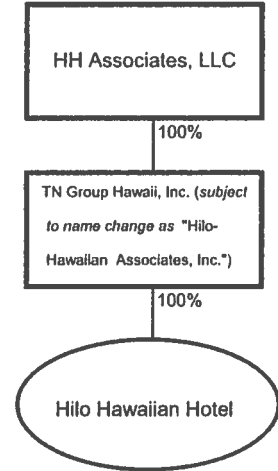


HILO HAWAIIAN HOTEL

**Before Merger**



**Post Merger, effective Jan. 1, 2012**



**EXHIBIT B**



# *Hilo Hawaiian Associates*

*71 Banyan Drive  
Hilo, Hawaii 96720*

October 9, 2012

Mr. Russell Tsuji  
Land Division Administrator  
Department of Land & Natural Resources  
1151 Punchbowl Street, Room 220  
Honolulu, HI 96813

RE: Request for Consent to Lease Extension of General Lease No. S-3961  
Hilo-Hawaiian Associates, Waiakea, South Hilo, Hawaii  
Tax Map Key: 3<sup>rd</sup>/2-1-03:05

Dear Mr. Tsuji:

Thank you very much for your letter of June 20, 2012. As you know, the Hilo Hawaiian Hotel is approximately 50 years old and requires a great deal of improvements in order to upgrade it to the standards that will meet the need of both the tourists and residents planning to stay in Hilo. In that regard, enclosed is Allied Builders System's estimate of \$5,877,000 to do what we believe are the necessary upgrades to make it a first-class hotel.

In order to amortize the money that will need to be spent to upgrade the Hilo Hawaiian Hotel, we are requesting a 37 year lease extension for the property. This extension is pursuant to Act 219 (S.B. 1530) effective July 1, 2011, after the current lease expires in 2031, a total of 55 years. Pursuant to that Act, the value of the improvements must be at least 50% of the market value of the existing improvements.

In addition to the improvements of \$5,877,000, 3% of total room revenue will be set aside each year of the lease in a FF&E bank account. This amount will be no less than \$200,000 per year for all 55 years and will be spent in its entirety to maintain the Hotel during the entire lease period. Please note that the furnishings included in the upgrade proposal is being custom made specifically for the Hilo Hawaiian Hotel and will be considered as a fixture under real property law for its entire useful life. This, as well as the guarantee of the 3% set aside, can be included in the development agreement for the land lease extension.

**EXHIBIT C**

Mr. Russell Tsuji  
Page 2  
October 9, 2012

As contained in our letter of June 20, 2012, the County of Hawaii Real Property Tax Office has assessed the value of the improvements to GL S-3961 (the Hilo Hawaiian Hotel) at \$11,414,400. We have also enclosed a Summary Appraisal Report of the Market Value of the Leasehold Real Property Improvements by Hastings, Conboy, Braig & Associates, Ltd., of the Hilo Hawaiian Hotel as of August 2012 which reflects an appraised value of \$10,895,000.

Please let me know if there is any other information that you require. We are prepared to move ahead quickly in making these improvements, as many people in Hilo have told us that it is critical that the hotel be upgraded in the near future. We are told that these improvements will help greatly with the experience of the guests and will, hopefully, insure the continuation of direct airlift to Hilo and hopefully encourage additional airlift to Hilo. We are also told that this will increase the number of both overseas and Hawaii residents to Hilo.

Sincerely,

Hilo Hawaiian Associates



Gary Oda  
Managing Partner

/ch

Enclosures

cc: Kevin E. Moore  
Gordon C. Heit



ALLIED BUILDERS SYSTEM

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August 7, 2012

Daryle Kitamori  
General Manager  
Hilo Hawaiian Hotel  
71 Banyan Drive  
Hilo, HI 96720

Subject: Hilo Hawaiian Hotel Renovations

Dear Mr. Kitamori:

Allied Builders System hereby proposes to furnish all labor, materials, tools and equipment necessary to complete the work as detailed in the attached schedule, all for the lump sum bid of:

Five Million Eight Hundred Seventy Seven Thousand and 00/100 Dollars  
(\$5,877,000.00)

Please refer to Attachment A for our proposed scope of work.

Please call Justin Izumi at 432-9919 with any questions concerning our proposal.

Sincerely,

Justin Izumi  
Vice-President/Chief Estimator

Encl.: Attachment A – Proposed Scope of Work

## **Attachment A – Proposed Scope of Work**

Renovation of all hotel guest rooms and corridors: \$3,256,000

- Bathroom floor tile and tub surrounds
- Carpet
- Paint
- Wall covering
- Bath accessories (towel racks, robe hooks, tissue dispensers)
- Plumbing fixtures (toilet, tub, faucet, showers)
- HVAC controls
- Lighting

New guestroom furnishings: \$1,594,000

- Headboards
- Nightstands
- Lounge chairs
- Dining sets
- Dressers
- Mirrors
- Desks, tables, chairs
- Artwork
- Sofas
- Lanai sets
- Beds and soft goods
- Drapery
- Lamps

**(Furniture is custom made for the Hilo Hawaiian Hotel and will remain at the Hotel for its useful life.)**

Elevator modernization: \$503,000

- Microprocessor control system
- 35% electricity reduction
- Elevator management system

New fire alarm system: \$304,000

- Guestrooms
- Lobby
- Corridors
- Restaurant

New roof coating system: \$220,000

- 1" closed cell foam
- 32 mils silicone rubber coating
- 15 year warranty