

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
Division of Boating and Ocean Recreation
Honolulu, Hawaii 96813

July 24, 2015

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

Statewide

**Continuation of Revocable Permits and Revocable Permit Rent Increases, on
the Islands of Oahu, Maui, Molokai, Hawaii, and Kauai**

REQUEST

Continuation of the revocable permits ("RPs") listed in Exhibit "A" for one additional year and increase rents as indicated in Exhibit "A".

LEGAL AUTHORITY

HRS §171-55. "Notwithstanding any other law to the contrary, the board of land and natural resources may issue permits for the temporary occupancy of state lands or an interest therein on a month-to-month basis by direct negotiation without public auction, under conditions and rent which will serve the best interests of the State, subject, however, to those restrictions as may from time to time be expressly imposed by the board. A permit on a month-to-month basis may continue for a period not to exceed one year from the date of its issuance; provided that the board may allow the permit to continue on a month-to-month basis for additional one year periods."

REMARKS

The Division of Boating and Ocean Recreation ("DOBOR") is responsible for managing the State's recreational boat harbors and facilities, offshore waters, and ocean recreation resources and activities. In managing the fast lands and facilities within the harbors, DOBOR issues long-term leases, concession agreements, and month-to-month RPs. The revenues collected from the leases, concession agreements, and RPs are deposited into DOBOR's boating special fund, which is DOBOR's sole source of funding for its operations, including repair and maintenance of its harbors and facilities, ocean recreation programs, debt-service for capital improvements, and administrative expenses.

DOBOR has one property manager position, which position is responsible for managing DOBOR's leases, concession agreements, and RPs. The property management position however, is currently vacant, and DOBOR will be seeking to fill the position. In the interim, DOBOR solicited the temporary assistance of two Land Division staff members who possess commercial real estate planning, development, and appraisal experience to assist DOBOR with various income generation projects and to help ensure rent revenues to DOBOR's boating special fund represent fair market rents.¹

¹ The two staff members are Land Division's Planning and Development Manager, and a Land Agent with 35 years of experience in commercial real estate appraising (including over 12 years of experience as the staff appraiser for one of the State's largest private landowners). This staff has been assisting DOBOR since October 2014.

The two interim staff members prepared a structured inventory of DOBOR's dispositions including leases, concession agreements, and RPs. Staff observed several concerns regarding the RPs, including the following:

1. DOBOR has a total of 33 RPs, which encumber almost 20 acres of state lands and generate \$277,654 in annual rent. The rent from these RPs equate to only \$0.32 per square foot per year. Many RPs provide for a base rent or a percentage of gross receipts, whichever is greater.
2. The oldest RP was issued in 1981, more than 30 years ago and the most recent RP was issued last year. RPs are valid for up to one (1) year, although the Board may approve the continuation of an RP for additional one year periods. For the past several years, however, DOBOR has inadvertently failed to request the Board's approval to continue the RPs.
3. Staff's research indicates the last time any of the RPs were continued by the Board was on November 10, 2011 (Agenda Item J-3), when 12 RPs were allowed to continue. Staff was unable to determine why only 12 RPs were continued or how the 12 RPs were selected for continuation.
4. The original rents for most, if not all of the 33 RPs were not determined by appraisal. There are 16 RPs (48% of all RPs) with an average land area of 22,000 square feet that are currently at nominal rents equal to or less than \$200 per month, or \$0.01 per square foot per month. Staff was unable to find any records of the RP rents ever being increased since the date of issuance, including the RPs that were issued in the 1980's and 1990's.
5. Several RPs appear to be for areas less than an economic unit (e.g., several RPs are for only 36 square feet of land). The lack of specific tax map key numbers for some RPs indicate the demised premises may not be legally subdivided lots and/or that the respective counties are unaware that the RPs exist.
6. There are 18 RPs (55% of all RPs) that encumber a total of 2.046 acres of state lands that are zoned for commercial, industrial, or residential purposes. The 2.046 acres are portions of larger parcels that the counties assessed in 2015 at \$71.5 million with unit values ranging between \$4 and \$82 per square foot. Applying an 8% rate of return on \$82 per square foot of land indicates the total potential annual rent for these RPs could be in the range of \$585,000.
7. A comprehensive evaluation of the RPs should be conducted, including whether long-term leases would be a more appropriate disposition of the demised premises, whether the RPs are for appropriate economic units, and whether the rents being charged reflect current fair market rents.

A. Continuation of the RPs for an Additional Year

Per HRS §171-55 and the terms of the RPs, the RPs are valid "for a period not to exceed one year from the date of its issuance, provided, that the Board may allow the permit to continue on a month-to-month basis for additional one year periods." DOBOR's RPs, however, have not been authorized by the Board for continuation for the past several years. Staff is recommending the Board authorize continuation of the RPs listed in Exhibit "A" retroactively from July 1, 2015 through June 30, 2016.

It should be noted that although the Board has not authorized continuation of the RPs for the past several years, most, if not all of the RPs, contain the following condition: "Permittee agrees to be bound by the terms and conditions of this Permit and any amendments to this Permit so long as Permittee continues to hold a permit for the Premises or continues to occupy or use the Premises." (emphasis added) Since the permittees have continued to use or occupy the respective premises and pay rent, and DOBOR continued to collect rent, staff believes the RPs remain in effect despite not having been officially continued by the Board on a yearly basis.

B. Rent Increases

The fast and submerged lands within DOBOR's harbors are public lands, which are held in public trust for the benefit of all public trust beneficiaries. As the manager of these public assets, the Board and DOBOR have a fiscal responsibility and fiduciary duty to manage and utilize these lands to their highest and best use and in a manner that will best serve the trust beneficiaries.² Allowing public lands to be leased at below fair market rents would conflict with the Board's and DOBOR's fiscal responsibility and fiduciary duty, and would be detrimental to the general public, the boating public, and the State's taxpayers.

Once DOBOR is able to fill its property manager position, it intends to have the property manager conduct a comprehensive evaluation of the RPs, which will include determining: (i) whether long-term leases should be issued; (ii) whether the RPs are for appropriate economic units; and (iii) fair market rents.

As indicated above, staff has been unable to find any evidence that the RP rents: (i) were initially set at fair market rent as determined by appraisal; and (ii) have ever been increased since the RPs were originally issued, the oldest having been issued more than 30 years ago. Although the RP rents evidently have not increased, DOBOR's operating expenses continue to increase over time (e.g., labor, utilities, fuel, supplies, etc.). Staff believes the current RP rents are well below fair market rents and have not even kept pace with inflation and DOBOR's increasing operating expenses.

With respect to the rents, DOBOR intends to retain an independent appraiser to determine the fair market rents.³ The priority will be on the RPs issued for: (i) lands zoned for industrial, commercial, or resort uses; (ii) industrial and/or commercial uses (including boat storage); (iii) large land areas; (iv) nominal or gratis rents; and (v) lands used as part of a larger facility or operation located on adjacent or nearby lands.⁴

Since rents have remained at below market rates for so long, staff believes interim rent increases would be appropriate until the independent appraisals can be conducted. Staff considered interim rent increases based on an indicator or indicators of market conditions, e.g.,

²Another state agency was previously determined to have breached its fiduciary duties to its trust beneficiaries, see, Kalima v State of Hawaii, 137 P.3d 990 (Haw. 2006). That same agency was also publicly criticized by its beneficiaries for issuing RPs at significantly discounted rents. That agency has since developed recommendations for revising its RP program, which include (a) "[D]etermining appropriate rents, either by fair market appraisal or prudent in-house analysis of the fair market rent"; and (b) "Consult with outside commercial real estate expert to assist in determining whether revenues are being maximized".

³ For the RPs for small areas or nominal rents, it may not be prudent and cost effective to retain an independent appraiser. For these RPs, DOBOR will seek to determine the rents in-house and possibly utilize certain market indicators (e.g., county tax assessed values, etc).

⁴ Rents for RPs for lands that are used as part of a larger facility located on adjacent or nearby lands should reflect the land value of the overall facility and/or the potentially enhanced value contributed to the overall facility by the RP lands.

the Consumer Price Index (“CPI”), asking average office rents, and median sales prices.⁵ While all indices indicate an upward trend in the marketplace and a growing recovery from the recession, staff believes the CPI is the most applicable for purposes of interim increases to the RP rents.

The CPI is computed by the U.S. Bureau of Labor Statistics for the United States as a whole and for selected urban areas. The CPI measures change over time in the prices of various commodities and services typically purchased by urban consumers. The percentage change between years is the rate of inflation, and it is often used to determine lease rent increases.⁶

Staff recommends interim increases to the monthly RP rents based on the CPI as shown in Exhibit “A”. The CPI increases are conservatively based only on the past five (5) years, which staff believes are nominal, and extensively overdue. These interim increases will facilitate DOBOR’s initial efforts to ultimately have the RPs reflect prevailing market conditions. Staff notes the following exceptions:

1. For those RPs that have been in existence for less than five (5) years, Exhibit “A” reflects increases for only the years the RPs were in existence.
2. For RP B-98-03 to Trilogy Corporation, the RP area is used as part of a larger project operated by Trilogy that encompasses both the RP lands and adjacent lands under a long-term lease from DOBOR. As such, the recommended increase is based on the lease rent rate per square foot being charged under the long-term lease.

Should any permittee elect to discontinue its RP due to the proposed rent increase, the permittee may exercise its right to terminate the RP by providing DOBOR written notice in accordance with the terms of the RP.

RECOMMENDATION

That the Board:

1. Approve the continuation of each RP listed in Exhibit “A” on a month-to-month basis for a one-year period, retroactively from July 1, 2015 through June 30, 2016, subject to the following conditions:
 - a. The increase to the new monthly rent as shown on Exhibit “A”;
 - b. Execution of a new revocable permit in the most current revocable permit form approved by the Department of the Attorney General, which will include the permitted uses specified in the existing RP and also allow any other uses permitted under the applicable county zoning, subject to the prior approval of the Chairperson and the Permittee’s compliance with Chapter 343 of the Hawaii Revised Statutes; and
 - c. Permittee shall be in full compliance with all of the RP terms and conditions, including

⁵ Home sales are considered a leading indicator of when the economy is coming out of a recession. Median sales prices peaked in mid-2007, declined, and then were stable until mid-2012 as the market began to demonstrate signs of recovery. The median sales price of single-family homes and condominiums as maintained by the Honolulu Board of Realtors for July 2014 shows year to date median sale prices of single-family homes up 7.5% over the same period in 2013, while median prices for condominium have increased by positive 6.1 percent.

⁶ The Honolulu Consumer Price Index, All Items, 1982-84=100 for All Urban Consumers (CPI-U) annual average of the over the year percent change for 2004 through 2014 were: 3.3% (2004); 3.8% (2005); 5.9% (2006); 4.8% (2007); 4.3% (2008); 0.5% (2009); 2.1% (2010); 3.7% (2011); 2.4% (2012); 1.8% (2013); and 1.4% (2014).

but not limited to:

- i. Payment of all rents, interest, and service charges due under the RP;
- ii. Submittal of a current certificate of insurance evidencing the insurance required under the RP;
- iii. Submittal of the security deposit required under the RP (which amount shall increase in connection with the increased rent); and
- iv. Permittee being duly registered to do business in the State of Hawaii and in good standing with the State Department of Commerce and Consumer Affairs.

Continuation of each RP shall be further subject to Permittee complying with the above terms and conditions by no later than August 10, 2015 (the "**Due Date**"). In the event the permittee fails to comply with such terms and conditions by the Due Date, the RP shall be revoked effective as of the Due Date, and the Chairperson is authorized to issue a Notice to Vacate to the permittee.

2. Delegate to the Chairperson the authority to adjust the rent for any RP in accordance with the terms of the RP; and
3. Authorize DOBOR to procure the services of one or more licensed appraisers to assist in establishing fair market rents as may be necessary or prudent to facilitate recommendation 2 above.

Respectfully Submitted,



Edward R. Underwood
Administrator

Attachment: Exhibit A

APPROVED FOR SUBMITTAL



Suzanne D. Case, Chairperson

LIST OF REVOCABLE PERMITS

	Permittee Name	RP No	Area (Sq Ft)	Effective Date	Current Monthly Rent	CPU-U				
						2010	2011	2012	2013	2014
1	Cates International, Inc.	B-01-02	3500 (fast), 1,800 (sub)	12/1/2001	\$540.00	2.1%	\$571.74	2.4%	1.8%	1.4% (NEW RENT)
2	DLNR, Division of Aquatic Resources	B-05-01	7,500	2/1/2005	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
3	Dolphin Excursions Hawaii, Inc	BO-13040	6,655	5/1/2013	\$732.00	---	---	---	\$745.18	\$755.61
4	Dolphin Excursions Hawaii, Inc	BO-14100	39,640	12/1/2014	\$2,000.00	---	---	---	---	\$2,028.00
5	GKM, Inc.	BH-010-07	392,040	10/1/2012	\$6,917.00	---	---	\$7,083.01	\$7,210.50	\$7,311.45
6	Hawaii Big Game Fishing Club, Inc.	BH-1202	9,975	7/1/2012	\$200.00	\$0.00	\$0.00	\$204.80	\$208.49	\$211.41
7	Hawaii Island Paddlesport Association	BH-010-06	6,000	9/1/2010	\$250.00	\$255.25	\$264.69	\$271.05	\$275.93	\$279.79
8	Hawaii Petroleum, Inc	BH-12013	Fuel Truck Delivery	1/1/2014	\$100.00	---	---	---	---	\$101.40
9	Hawaii Water Ski Association	BO-12010	800	7/1/2012	\$100.00	---	---	\$102.40	\$104.24	\$105.70
10	Hawaiian Parasail, Inc.	BO-12090	36	11/1/2012	\$250.00	---	---	\$256.00	\$260.61	\$264.26
11	Honolulu Transpac, Ltd	BO-13060	699	7/1/2007	\$283.00	\$288.94	\$299.63	\$306.83	\$312.35	\$316.72
12	Island Ice Company L.L.C.	BM-09-51	200	6/1/2010	\$225.00	\$229.73	\$238.22	\$243.94	\$248.33	\$251.81
13	Kaneohe Cultural Foundation	BO-12021	2,600	10/1/2012	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
14	Keahole Point Fish LLC	BH-010-05	20,000	7/1/2010	\$1,150.00	\$1,174.15	\$1,217.59	\$1,246.82	\$1,269.26	\$1,287.03
15	Kona Sailing Club	B-97-02	14,196	10/1/1997	\$860.00	\$878.06	\$910.55	\$932.40	\$949.18	\$962.47
16	Lahaina Yacht Club	BM-07-36	785	7/1/2007	\$130.00	\$132.73	\$137.64	\$140.94	\$143.48	\$145.49
17	Maalaea Boat & Fishing Club	B-10-01	4,731 + 250	10/1/2010	\$658.33	\$672.15	\$697.02	\$713.75	\$726.60	\$736.77
18	Maalaea Charters, Inc.	BM-12051	144	10/1/2012	\$250.00	---	---	\$256.00	\$260.61	\$264.26
19	Maui Oil Company, Inc.	RP 12015	Fuel Truck Delivery	10/1/2012	\$100.00	---	---	\$102.40	\$104.24	\$105.70

LIST OF REVOCABLE PERMITS

										CPU-U				
										2010	2011	2012	2013	2014
Permittee Name	RP No	Area (Sq Ft)	Effective Date	Current Monthly Rent	2.1%	3.7%	2.4%	1.8%	1.4% (NEW RENT)					
20 Maui Petroleum, Inc.	BM-12016	Fuel Truck Delivery	1/1/2014	\$100.00	--	--	--	--	\$101.40					
21 Na Alii Water Ski Club	BO-12011	10,000	7/1/2012	\$100.00	--	--	\$102.40	\$104.24	\$105.70					
22 Na Kalai Wa'a	BH-13081	22,216	11/1/2013	\$200.00	--	--	--	\$203.60	\$206.45					
23 Oahu Water Ski Club	BO-12012	10,000	7/1/2012	\$100.00	--	--	\$102.40	\$104.24	\$105.70					
24 Ocean Wings Hawaii, Inc.	BH-13011	300	4/1/2013	\$500.00	--	--	\$0.00	\$509.00	\$516.13					
25 Outfitters Kauai, Ltd.	BO-1171	3171	10/1/2011	\$850.00	--	\$881.45	\$902.60	\$918.85	\$931.72					
26 Pacific Biodiesel Logistics, LLC	BM-14070	Fuel Truck Delivery	9/1/2014	\$100.00	--	--	--	--	\$101.40					
27 South Pacific Ocean Tours, Inc.	B-96-74	36	11/19/1996	\$40.00	\$40.84	\$42.35	\$43.37	\$44.15	\$44.77					
28 Surf N' Sea, Inc	BO-1170	5227	10/1/2011	\$5,010.00	--	\$5,195.37	\$5,320.06	\$5,415.82	\$5,491.64					
29 The Island of Hawaii YMCA	BH-13082	6,098	10/1/2013	\$100.00	--	--	--	\$101.80	\$103.23					
30 Trilogy Corporation	B-98-03	6,100	2/1/1998	\$152.50	--	--	--	--	\$330.87 ¹					
31 True Blue, Inc.	BO-1172	1742	10/1/2011	\$506.00	--	\$524.72	\$537.32	\$546.99	\$554.64					
32 U.S. Dept of the Interior, National Park Service	RP 6783	273,992	9/1/1991	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00					
33 Wilson Keahi	S-5867	18,644	9/1/1981	\$634.00	\$647.31	\$671.26	\$687.37	\$699.75	\$709.54					
TOTALS:				\$23,137.83 ²					\$25,035.40 ³					

¹ The RP area is used as part of a larger facility operated by the permittee on adjacent lands leased from DOBOR under Lease B-93-02. The new rent is based on the lease rent rate per square foot for Lease B-93-02.

² Total current annual rent = \$277,653.96

³ Total new annual rent = \$300,424.80 (a 7.5% increase from the total current annual rent)